



**NATIONAL RESEARCH INSTITUTE (NRI)  
NATIONAL BUDGET FORUM**

PRESENTATION PAPER ON SOVEREIGN WEALTH FUND

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**INTRODUCTION**

Good morning Heads and senior management of relevant government agencies; Heads of diplomatic missions and donor agencies; participants from academic institutions and all other interested participants.

I would like to thank the NRI together with the Development Centre at Australia National University for convening this National Budget Forum and also for the invitation to present to this forum on the Sovereign Wealth Fund framework endorsed by the Government of Papua New Guinea.

**BACKGROUND**

I would like to provide you a little bit of a background how this work came about. In March 2010, the NEC established a joint Department of Treasury-Bank of Papua New Guinea Working Group mainly to examining options to manage windfall revenue, including the possible creation of an offshore Sovereign Wealth Fund.

In undertaking this work, the Working Group consulted with, and sought input from key government agencies and relevant domestic and international stakeholders. Domestic stakeholders from Government organisations, private sector organisations, and NGOs and international stakeholders were consulted, attended the workshops, as well as provided unsolicited submissions. The Working Group then developed a final report incorporating inputs from two stakeholder workshops and unsolicited submissions and was structured broadly around two central themes – economic matters and design issues. A submission with this final report was provided to NEC recommending the establishment of an offshore Sovereign Wealth Fund as an appropriate mechanism to manage future LNG and other mineral and petroleum revenues.

The 2011 budget, approved in November 2010, provided for the establishment of the PNG Sovereign Wealth Fund and its key design elements. Since February 2011, the

government has been developing the Sovereign Wealth Fund framework and its legislation. In October 2011, the government endorsed the policy and legislative framework of the PNG Sovereign Wealth Fund to support the management of historic wild fluctuations in mineral and petroleum revenues to underpin the long-term social and economic development in PNG. The Organic Law was introduced in the December sitting of Parliament in 2011 and was subsequently passed in February this year 2012.

The Organic Law allows for close monitoring of the Funds and to prevent the PNG Sovereign Wealth Fund drawdown rules from being changed regularly to limit exposure of the PNG Sovereign Wealth Fund to misuse and corruption. But this does not necessarily mean that all elements of the PNG Sovereign Wealth Fund design and operation are locked in under the Organic Law as some operational flexibility is required. Basically, the Organic Law incorporates only the essential high level policy issues. Other aspects of the policy issues will be established through Acts of Parliament which are currently being worked on by the SWF Secretaries Committee through their technical working group and an Implementation Secretariat.

## **THE PNG SOVEREIGN WEALTH FUND**

The scale of PNG LNG project is a major development for PNG. Many people have described it as transformative. However, the expected level of gains from the PNG LNG must be placed in perspective. The impact on the rest of the economy from simply turning on the gas is much more limited. Relatively few on-going jobs will be created. The main positive impact on the rest of the economy will be through the taxation of the project and the dividend stream that the Government and landowners will receive. These revenue flows will be significant, but they are projected to be well below the mineral revenues we have received in the last few years. Indeed, much of this revenue will simply replace expected declines from other mines such as Ok Tedi and declining oil production.

Despite these modest revenue flows, the economic size of the project means that we must manage major macroeconomic pressures such as exchange rate appreciation (Dutch disease), increased liquidity and higher overall demand within the economy. This could undermine the competitiveness of the non-mineral sectors of the economy, such as agriculture, potentially having a severe impact on activity, employment and incomes in labour sensitive sectors of the economy.

Past experience from the emergence of new resource sectors and earlier commodity booms indicates that PNG has not successfully translated these revenues into improved socio-economic indicators and sustained development outcomes to the extent that might be expected – we cannot afford to squander this opportunity by dismissing the macroeconomic risks that need to be managed.

It is also important to recognise that over recent years, the shortage of funds has not been our problem in terms of effective development spending on infrastructure projects. It has been the poor ability of the public sector to establish and deliver credible project plans that has seen funds languish rather than being put to effective use. The availability of expected revenues from LNG will not see this problem disappear and it may intensify. This strongly argues against allocating excessive funds that cannot be

effectively used. Our recent experience indicates a poor track record of successfully translating development funds into effective infrastructure programs.

The PNG Sovereign Wealth Fund is designed to manage public mining and petroleum resource revenues. The overall objectives of the PNG SWF are to support:

- i) macroeconomic stabilization;
- ii) the development objectives of the Government including long-term economic and social development; and
- iii) asset management in relation to financial assets accrued from natural resource revenue.

The PNG SWF consists of a **Development Fund** and a **Stabilisation Fund**. The purpose of the Stabilisation Fund is to manage the impact of fluctuating mineral and petroleum revenues on the PNG Economy and on the Budget; and while the purpose of the Development Fund is to provide a definite and ongoing funding source for the provision of development in key economic and social priorities in accordance with the development plans as determined by the Government, from time to time.

The key features of the PNG SWF include:

- A single governance framework to manage the Development Fund and the Stabilisation Fund;
- Onshore management, offshore investment and onshore expenditure of the funds;
- Full integration with the budget and fiscal framework;
- Governance, transparency, disclosure, accountability and asset management rules based on international best practice and the PNG SWF's own internal principles and practices;
- Development of deposit and withdrawal rules to ensure prudent macroeconomic management;
- Deposit and withdrawals from the Development Fund made in compliance with the Organic Law;
- Oversight by an independent board located within Papua New Guinea mandated to act in the best interests of the PNG SWF;
- Investments policies and guidelines that achieve an acceptable risk return trade-off and are consistent with the objectives and investment mandate provided by the Government; and
- Investment primarily in foreign assets and restrictions on purchasing Papua New Guinea Government debt or investing or direct lending domestically.

The PNG Sovereign Wealth Fund will be onshore managed, offshore invested and onshore spent. In short, the PNG Sovereign Wealth Fund will operate and be governed within PNG with an independent Board (7 members: 6 private sector and 1 ex-officio) that will invest the assets predominantly overseas to help macroeconomic management and seek the best returns for PNG, but all spending will be in PNG through the Budget.

The Stabilization Fund can help everyone in PNG. It will ensure a steady stream of revenues to the government budget for social and development spending. It will help protect PNG's economy from the volatility and uncertainty in global markets that we continue to see. Without it PNG risks repeating the cycles of boom then bust, and not making the most from our resource wealth.

Looking ahead, our mining and petroleum resources will one day be exhausted. We cannot forget that they are limited and non renewable. The Development Fund will safeguard a portion of revenues to provide a dedicated stream of funds for urgently needed nation-building infrastructure maintenance, the re-capitalization of our State Owned Entities, and for future development priorities. This work is critical to improving the lives of everyone now and will provide a significant benefit for future generations.

One of the key features of PNG Sovereign Wealth Fund is that while investments are undertaken by an independent Board the State will retain full ownership and control over its assets. Lessons from the past will lead to the PNG Sovereign Wealth Fund being fully integrated into the budget to manage government spending and the economy. This is to ensure that all revenues (including dividends) from the PNG LNG project as well as from other mineral and petroleum projects and the timing of all expenditures can be most effectively used to advance PNG's social and economic development. These processes can also help ensure funds are accounted for and managed in a transparent and coordinated manner.

Any investments carry risks, therefore mechanisms have been put in place in the Organic Law to minimize this. Firstly, the majority of the members of the independent Board will be selected for their skill and experience in working in financial and investment markets. The Government will provide the Board with an Investment Mandate specifying the acceptable risk profile which will be based on expert portfolio analysis recognizing the need to maintain the capital while achieving a return. The Board must also invest through external fund managers with expertise in particular investment portfolios. Finally, the establishment of an Independent Probity Auditor, amongst other things, will provide a robust governance and oversight framework.

The importance of the PNG Sovereign Wealth Fund cannot be understated. It aims to ensure PNG's natural resource revenues are well managed and used, and support the economy and future development of our nation as envisaged in the PNG development strategies – the PNG Vision 2050, DSP and the MTDP. Nearly 40 nations around the world have Sovereign Wealth Funds and it is time for Papua New Guinea to also benefit from this well established practice of managing resource wealth.

## **CONCLUSION**

I would like to conclude by stating that although PNG continues to enjoy solid economic growth, we need to be mindful of the number of key risks that confronts us. The Government is cautious about these risks and particularly inflation and will need to carefully design and implement policies that will address or reduce these challenges.

The Sovereign Wealth Fund is one of the key policies that the Government is driving to manage the fluctuations in our mineral and petroleum revenues to help ensure that the potential adverse risks from the mineral boom (the so-called Dutch Disease) can be

best managed in ways consistent with macro-economic stability and lower inflation. And at the same time, ensuring meeting our development needs.

I would also like to take this opportunity to acknowledge and thank all participants and I trust that this presentation provided the importance behind the development of a PNG Sovereign Wealth Fund and its key design elements.

Thank you.