

Experiences with Oil Funds: Institutional and Financial Aspects



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June 2006

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Energy Sector Management Assistance Program (ESMAP)

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Abbreviations and Acronyms

\$A	Australian dollar(s)
ACG	Azeri-Chirag-Gunashli (oil fields in Azerbaijan)
AHSTF	Alberta Heritage Savings Trust Fund
AID	Alberta Investment Division
APF	Alaska Permanent Fund
APFC	Alaska Permanent Fund Corporation
BEAC	Banque des Etats de l’Afrique Centrale
BTC	Baku-Tbilisi-Ceyhan (oil pipeline of SOCAR)
Can\$	Canadian dollar(s)
CBRF	Constitutional Budget Reserve Fund
CCF	Chilean Copper Fund
CCSRP	Collège de Contrôle et de Surveillance des Ressources Pétrolières (Chad)
CEMAC	Communauté Economique et Monétaire de l’Afrique Centrale
CID	Canada Investments Division
CO2	Carbon Dioxide
COBAC	Commission Bancaire de l’Afrique Centrale
CPD	Capital Projects Division
CPI	consumer price index
EAFE	Europe, Australasia, and the Far East
EID	Energy Investment Division
EPD	Economic Policy Department
ESMAP	Energy Sector Management Assistance Program
FGF	Future Generations Fund
FIEM	Investment Fund for Macroeconomic Stabilization [Fondo de Inversión Para la Estabilización Macroeconómica] (República Bolivariana de Venezuela)

FMS	Fund for Macroeconomic Stabilization (República Bolivariana de Venezuela)
FTSE	Financial Times Stock Exchange
GDP	Gross Domestic Product
GRF	General Revenue Fund
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
KIA	Kuwait Investment Authority
KIO	Kuwait Investment Office
LIBOR	London interbank offered rate
MDRC	Mineral Resources Development Corporation (Papua New Guinea)
MRSF	Mineral Resource Stabilization Fund (Papua New Guinea)
MSCI	Morgan Stanley Capital International
NBIM	Norges Bank Investment Management (Norway)
NFRK	National Fund of the Republic of Kazakhstan
NGO	Nongovernmental Organization
NGPF	Norwegian Government Petroleum Fund
Nkr	Norwegian krone
NPRTF	Nauru Phosphate Royalty Trust Fund
OECD	Organisation for Economic Co-operation and Development
OSF	Oil Stabilization Fund (Russian Federation)
OSGRF	Oman State General Reserve Fund
POMV	Percentage of Market Value
PRSP	Poverty Reduction Strategy Paper
RFFG	Reserve Fund for Future Generations (Kuwait)
Rub	ruble(s)
SOCAR	State Oil Company of the Azerbaijan Republic
SOFAZ	State Oil Fund of the Azerbaijan Republic

STPPF	São Tomé and Príncipe Permanent Fund
SWGB	Salomon World Government Bonds Index
TLPF	Timor-Leste Petroleum Fund
UN	United Nations
VAT	Value Added Tax

Executive Summary

1. In the last 30 years, a number of countries have adopted the use of oil funds, in which a portion of government revenues from oil (and gas) is deposited, for various purposes. Recently, interest in the reasons for the creation of such funds, and the mechanics of doing so, has greatly increased, in part as a result of the emergence of several new oil-producing nations, and in part because current high oil prices give an opportunity to governments to save now in order to provide for future spending if oil revenues decline.

2. This study brings together detailed information on the creation, operation, and financial performance of 12 oil funds and 3 other resource funds. The purpose of the study is to provide comparative information on the backgrounds of the creation of these funds, the legislation used to do so, the details of the organization and management of the funds, and of their financial performance. By bringing together in one study comparative information of different funds and their approaches to saving oil revenues, it is hoped to provide policy makers in countries considering the establishment of an oil fund with a reference document on the various approaches that might be used. A particular feature of the study is the inclusion of legislation setting up some of these funds, because countries wishing to do so will need to consider a number of detailed issues that can be treated in various ways through the legislation adopted.

3. However, the report does not take the additional step of analyzing the historical interactions between the government's budgetary policy and the operation of the fund. To make an assessment of the performance of a fund in a macroeconomic context would require a detailed investigation of fiscal policy and economic performance, and their likely outcomes in the absence of the fund and resource revenues. For many countries the experience with resource revenues and funds has been too short to permit such assessments to be made. The relationship between the structure and operations of a fund and the country's political system would also need to be further investigated. This is a somewhat broader accent than that of concern to this paper. Subsequent studies on the performance of resource funds are likely to pick up these themes.

4. The report opens with a brief review of the reasons for establishing an oil fund and the principal issues in doing so. This topic has been covered extensively in a number of other publications, and accordingly the review serves only as a guide to these issues. References are provided for readers who wish to obtain more information on these aspects.

5. The report then provides detailed coverage of four oil funds where there is substantial public information about the operation and performance of the funds (Alaska, Alberta, Azerbaijan, and Norway). The next chapter gives more limited information on funds in another 11 countries. For three of these countries (Chad, São Tomé and Príncipe, and Timor-Leste) the legislation is available and included, but because they have either not started to accumulate yet, or have made only first payments into the fund, there are no data yet on their performance. For another three countries (Chile, Nauru, and Papua New Guinea), the funds are concerned with revenues from minerals rather than from oil, but

they are included because their operation and performance are of especial relevance to oil funds. For Kazakhstan, Kuwait, Oman, the República Bolivariana de Venezuela, and Russia, details of the establishment, operation, and performance are to various extents much more limited, but these cases have been included as background information.

6. A final chapter provides some comparative material on the different funds and explores the construction of a set of indicators for good practice in the design of the funds. The appendixes contain the legislation creating and governing the funds, where this is available

1

The Use and Nature of Oil Funds

Oil and economic performance

1.1 The presence of substantial amounts of oil and gas reserves has been identified by many authors as potentially a mixed blessing for the country concerned (Gary and Karl 2003, Tsalik 2003, Stevens 2003, Katz and others 2004, B. Smith 2004). The performance of economies that receive a large proportion of government revenue and export earnings from the ownership and taxation of natural resources is often poor when compared with similar countries without such resources. Even though the initial development of the resource brings a jump in government revenues and national income, subsequent non-resource income growth may be disappointing, the economy may experience structural shifts away from traditional export sectors, and there may be resulting unemployment. In addition, the performance of the public sector, financed in large part from resource-based taxes, may be poor, and the economy may gradually experience increasing levels of corruption. This concatenation of outcomes has been termed “the resource curse” or “the paradox of plenty.”

1.2 These potentially negative impacts on the economy come through a number of channels:

- **The appreciation of the real exchange rate.** The so called “Dutch disease” effects created by an appreciation of the currency caused by the net inflows from the export receipts of the natural resource have been widely discussed (Gelb and associates 1988). The export and production of the non-oil sector falls, which may lead to sectoral unemployment (oil employing relatively few workers), while the price of non-traded goods increases. This leads to a loss of economic diversity and the loss of whole sectors of the economy that may find it difficult to reestablish themselves once the natural resource boom has ceased.
- **Lack of domestic absorption capacity.** Substantially increased spending on domestically produced items, made possible by the extra revenues from the taxation or ownership of the natural resource, may encounter rising supply curves. The effect of the increased spending is then largely to force up the prices of such goods.

- **Weak governance of public spending.** Where a substantial amount of the new resource revenue enters the government budget in the form of increased expenditure, the ability of the civil service to manage large increases can be very limited. Poor choice of projects, lax contracting procedures, and weak project oversight can lead to a poor performance in terms of the social output obtained from the expenditures undertaken. The notion that there is sudden “easy money” may lead the government to a choice of projects with very low payoffs, but which appeal to popular sentiment.
- **Increased corruption.** The large increases in public spending accompanying the development of a natural resource sector, which correspond in large part to a rent on the resource and are therefore not the direct result of the efforts of any individuals in the society, can lead to various corrupt practices. These can occur in the contracting for projects or even in the siphoning off of resource payments due to the treasury. As corruption becomes more widespread and more egregious, there can be a tendency for it to become endemic and affect other sectors of the economy. This weakens the investment climate and can result in steady erosion of the country’s economic performance.
- There are, however, examples of countries that appear to have avoided some, if not all, of these problems—in both the 19th and early 20th centuries, when taxation of the resource was much lower, and more recently, in cases such as Botswana (diamond production) Chile (copper production), and Malaysia (oil). One important feature of economies that have used the resource revenues well is the nature of the political system itself (Eifert and others 2003).

1.3 The balance of opinion appears to be that, although natural resource revenues can lead to deteriorating economic performance, this is not inevitable, and there are important measures that can be taken to guard against the onset of such problems, or to start to reverse them once they have occurred (Stevens 2006). In particular, it appears that attempts to increase government spending by the whole amount of the extra revenue received in each year may exacerbate these problems. If governments instead saved some of the revenue and sterilized it by investing it abroad, exchange rate pressures would be reduced, and absorption capacity would not be so severely tested. Accordingly, one policy adopted by many oil-producing countries is to follow a more rational expenditure pattern for government oil revenues by spreading out expenditures to benefit future as well as current generations and smoothing out government expenditures caused by fluctuations in the oil price. These objectives can be met by the use of oil funds dedicated to these purposes, which tend to be transparent and also help to sterilize some of the inflow of foreign exchange, thus leading to less pressure on the domestic economy.

1.4 A key point is that meeting these objectives depends on the stance of overall fiscal policy. Placing resource revenues in a special oil fund, while the government increases spending through increased borrowing, could result in a decrease in net saving. In addition, this increase in net spending may possibly introduce the macroeconomic problems (such as Dutch disease) that the creation of the fund was designed to avoid.

Policy issues raised by the presence of oil and gas

1.5 The sudden discovery and exploitation of large amounts of exhaustible natural resources, primarily hydrocarbons and mined products, faces governments of the host countries with a number of management problems both for the macro economy and for the sector itself. These include:

- Choice between current and future welfare benefits;
- Design of policies that will be sustainable against fluctuations in the price of the resource and the eventual depletion of the resource;
- Improvement of domestic capacity to use the funds so received in an efficient manner;
- Pursuit of policies for the use of resource revenues for public benefit that have general support, and not for private or factional interests through various illicit practices.

1.6 These issues revolve largely around the decision on how much of the resource revenue to spend each year, what to spend it on, and how to ensure accountability and public support for these decisions. A well-designed macroeconomic strategy will take into account choices between present and future consumption, sector allocation, the efficiency of spending, and the desirability of this allocation. To minimize suboptimal decision making, these steps should all be taken in a transparent manner so that accountability to all interested parties is guaranteed.

1.7 Three aspects related to the existence of revenues from the exhaustible natural resource pose special problems for decision makers. First, the resource revenues may be very large in relation to the rest of the economy, but will not be permanent, the resource being exhaustible; second, the size of the revenues may be so large in relation to the economy itself that it would be difficult to identify productive uses for all of it, were it to be immediately spent; and third, the volatility of resource prices and the variability of volumes can result in substantial changes in government resource revenues from year to year. These features can result in a desire not to spend immediately all of the resource revenues arising during the period, which in turn raises problems of where to place these revenues, how to obtain the best financial returns from these unspent revenues, and how to do so in a transparent manner.

1.8 Various solutions to accumulating financial assets, arising from decisions not to spend all resource revenues immediately, have been followed by different countries:

- Net payment into the general treasury account, which is treated as an increase in financial reserves of the government held at the central bank and is not shown separately;
- Reduction in government debt as more debt is retired than issued;
- Net payment into a special line item in the treasury accounts, identified as “the oil fund” but held and managed with all other government assets (the so called “virtual fund”);
- Net payment into a separately held fund(s) accounted and managed separately from the government’s general financial assets.

1.9 The experience of the oil shocks of the 1970s and 1980s, when oil prices rose very sharply, persuaded a number of governments to establish oil funds. Different approaches were followed in these earlier experiences, reflecting different objectives and different political systems, and the lessons learned from these have been incorporated into more recent oil funds being established by countries that have recently begun oil production.

1.10 The establishment of an oil fund involves a number of practical issues (Timor Leste Government 2004), which include:

- Formalization of the objectives of the fund in the context of overall fiscal policy;
- Legal foundation of the fund;
- Rules determining the payments into and out of the fund;
- Arrangements for the financial management of the fund;
- Nature of the oversight of the fund.

These issues are discussed in the following sections.

The objectives of fiscal policy and the role of oil funds

1.11 Oil funds are best created after the discovery of the resource but before revenues from it have started to arise, but sometimes they have been created during the period in which revenues are being received. The initial round of exploration for oil, with the possibility of future revenues, especially where these may be large in relation to the size of the economy, inevitably stimulates internal discussions on the size and impact of the revenues. This in turn leads to questions about spending levels and recipients, both nationally and regionally. This is the natural time for the government to make decisions about the broad strategy for spending or saving (Takizama and others 2004) and the method by which any saving should be effected. A similar opportunity may occur when there is a very large increase in the magnitude of expected oil revenues, as has recently been the case for a number of oil-producing economies.

- **Expenditure on current consumption.** A policy of devoting all the revenues to current consumption, whether public or private, or to a reduction in non-oil taxes, will fail to provide for future generations but is likely to be politically popular because all the benefits are felt immediately by agents who can influence political outcomes. Private individuals can make decisions about saving for their own future needs (including those of their descendants) and may therefore be attracted to schemes whereby the oil revenues are immediately distributed to citizens. This policy can also be achieved by cutting tax rates, thus leaving households with more spending power.
- **Investment in non-financial assets.** A policy of spending the revenues on non-financial investments expected to yield further benefits will raise the future level of income that in turn will benefit individuals. Such a policy is constrained by the ability to find domestic investment opportunities that yield a return greater than the alternative of saving the revenues and investing in financial assets. Developing countries often face an “absorption” problem, where the benefits from such investments decline when various supply bottlenecks result in higher prices rather than higher output. Also, inexperienced civil services may find it difficult to identify which public sector projects will yield a satisfactory social and economic return. Furthermore, experience from earlier oil booms suggests that this can open the way for dubious investments, without real screening of investors (Gelb and associates 1988).
- **Saving oil revenues.** There are several reasons to save all or part of oil revenues and use them to purchase financial assets (or reduce public debt) that will make a return for the economy.
 - ***Exhaustibility and future generations.*** The resource revenues from the production of oil are only temporary, with their duration dependent on the size of reserves, the rate of extraction, and future prices of oil. If the government wishes to achieve intergenerational equity and ensure that benefits accrue to all citizens of the country, both present and future, the revenues themselves should generate future earnings streams. Saving part of the revenues and obtaining a return from their investment in financial instruments, or from reducing gross public debt, can be the most effective way of providing benefits for future generations and future needs of current generations, such as pension payments.
 - ***Revenue volatility and stabilization.*** The potential volatility of oil revenues, relative to the expected path determined by projected production levels and oil prices, can be very large. Governments have to face the possibility that their planned spending programs may have to be suddenly changed. Because it is difficult and costly to suddenly cut back spending on current items, or to halt a public investment project, there is a strong incentive to adopt a strategy

that can provide a fairly smooth government expenditure scheme. This requires a stabilization approach in which a share of revenues is set aside at times of higher than average expected receipts, which can be used to supplement current revenues in times of below average receipts.

- ***Precautionary saving.*** As well as the “normal” volatility of revenues, there can be extraordinary shifts in the fiscal situation of a country. Unexpectedly large needs for current expenditures (for example, following a natural disaster) or unexpected loss of revenue of a magnitude beyond that normally experienced in volatile markets (for example, following a blow-out, civil disturbance requiring shutdown of facilities, or war) face the government with an urgent need for extra financing. Accumulated resources, possibly held in an oil fund, can provide a precautionary cushion against such incidents.
- ***Lack of absorption capacity.*** Economies may lack sufficient current opportunities for domestic investment or consumption expenditure that provide the same current benefits as financial investment. Too high a level of domestic spending, relative to available capacity to produce, will result in an increase in prices of non-tradable goods. In such a case, it may be better to partially restrict public spending until the capacity of the economy to respond has improved. This decision is often particularly difficult for newly oil-producing developing countries that have great needs for public spending, but very little capacity to produce that extra output in the short run. Popular sentiment may push the government to be seen to spend the newly acquired revenue, even though its benefits may be rather limited.

1.12 The choice between the various uses of oil revenues then depends on a number of factors, both economic and political, which partly explains why the oil funds established in different countries (as explained below) have very different characteristics.

1.13 The integration of accumulation into the oil fund decisions and overall fiscal policy requires the harmonization of two objectives. Fiscal policy, usually set in a medium-term framework, will articulate policies about expenditure and the level of debt that can be accumulated, within the constraint of expected fiscal revenue. The presence of exhaustible sources of fiscal revenue may encourage the government to take a longer view of the use of the oil revenues, to ensure that they provide a stream of benefits after the resource is depleted. This requires forecasts of oil production, oil prices, and population growth, as well as a decision on the discount rate to apply to future benefits.¹ Budgetary plans should therefore take into account the path of expected oil revenues, the desired stream of future benefits, and the current levels of public debt.

¹ It should be noted that the social discount rate should be used to value benefits for future generations. However, generally, the discount rate is based on the return on financial assets.

The legal foundation of an oil fund

1.14 Many countries have established oil funds (Fasano 2000, Davis and others 2001)—not all successfully. The establishment of a resource fund can follow one of two routes, depending on whether the fund is “virtual” and within the budget envelope where the resources are fully commingled with other government financial resources, or whether it is “real” and held separately from the rest of government assets.

- A *virtual fund*, as part of the normal budgetary process, needs no special approval to establish it or to manage it—the creation of another line item in the budget and treasury accounts gives no new responsibilities. Money can be paid into this fund or drawn out of it purely as for any other expenditure in the budgetary process and is covered by whatever legislation, regulations, and tradition are used in drawing up and executing budgetary decisions. Of course, target principles for adding or withdrawing from the virtual fund can be created, but these can be as for other items of policy, similar to those determining how much to spend on education and so forth. What might need to be additional is some public explanation of the principles guiding the overall accumulation of public savings and of the use of the additional revenues to the government that make the creation of such a fund possible. The financial management of money accumulated in a “virtual” fund can also be identical to that for all government financial assets, because they are commingled.
- A *real fund*, such as a future generations fund or a stabilization fund, where the accumulated assets are held in a separately managed and audited account, needs a legal framework for its establishment, control, oversight, management, use, and dissolution. Depending on the legal system, this can be done by a constitutional amendment or by the creation of a law or regulation. Because countries with newly developed natural resources will typically need to pass a general law dealing with ownership, production, and so on of the resource, it is possible to include in such a law provisions for the establishment of any special funds required, as well as rules that relate to payments to the fund and the use of accumulated reserves. Where the fund is established subsequent to the onset of production and the establishment of a resource law, it may be simpler to deal with the establishment of a separate fund by a purpose-designed law.

1.15 The same fiscal and long-term objectives can be obtained through the use of either a virtual or real fund. The preference for one or the other may depend on the overall transparency of fiscal reporting to both the legislature and the public. The creation of a real fund may highlight the link between resource generation and resource utilization, thus becoming a useful political tool.

1.16 The advantages and disadvantages of using a constitutional amendment, or the amendment of a resource extraction law, to establish a real oil fund are symmetric. On the one hand, the existence of such a fund is more firmly entrenched by a constitutional amendment, because this typically requires a larger majority to overturn it. On the other hand, constitutional amendments are slower to be passed and need greater

support. In particular, where the rules on the operation of any such fund (payments in, withdrawals, and their uses) are specified in a constitutional amendment, the inflexibility of this approach will ensure the financial integrity of the scheme, but will also make it difficult to respond to unforeseen circumstances, such as a natural disaster or war, where governments might suddenly wish to draw more heavily on accumulated assets but be unable to do so. Funds where operations may be determined by the executive (for example, the cabinet), not needing formal parliamentary approval, are more flexible in responding to changed circumstances, but their whole purpose is correspondingly easier to reverse or pervert by a subsequent administration.

Payments into and out of the fund

1.17 The size and growth of the oil fund should be determined on the basis of the overall fiscal policy. However, in some countries, the rules for paying in and withdrawal determine the size of the fund. Where countries have created an oil fund as an instrument of saving for future generations, the desired size of the fund is usually determined by reference to a policy of attempting to keep the wealth of the fund constant, by spending on average only the “permanent” income from the oil wealth, (Hannesson 2001, Budina and Radzvill 2001) as part of its overall fiscal stance. Where the fund is created for stabilization purposes, the magnitude of the fund depends on the expected volatility of the revenues and the average spending needs of the government.

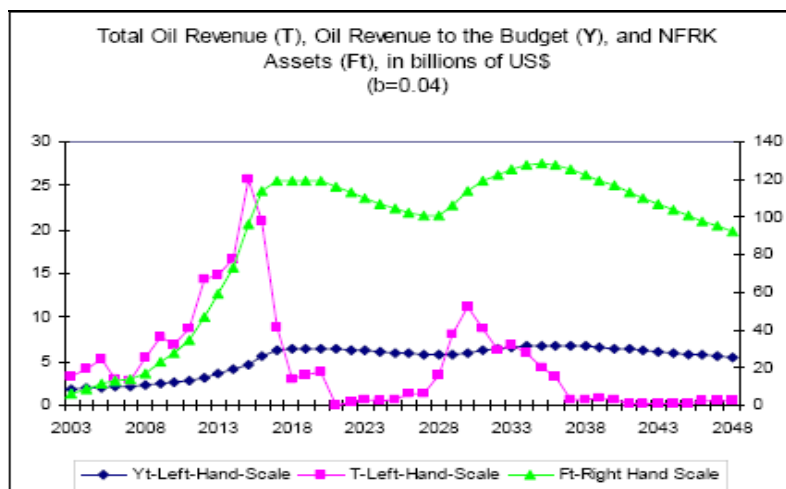
- ***Savings funds and permanent income.*** This principle aims to spend each period an amount of oil revenue of a magnitude such that the value of the wealth from oil—below the ground, invested in the oil fund, or both—remains constant, thus permitting the same level of incremental total government expenditure to be continued indefinitely. To calculate the wealth of the country from oil, the discounted present value of all future expected revenues has to be estimated (Hannesson 2001, Budina and Radzvill 2001). Multiplying this total by the expected real rate of return (nominal rate less the rate of inflation) provides the value of permanent income. Two considerations may modify the desire to keep a constant level of incremental expenditure (possibly calculated on an expected per capita basis) made possible by the resource revenue. First, in the early years of oil revenues, the permanent income can be greater than the revenue itself, so that the country would have to borrow to finance expenditures equal to permanent income; and second, immediate needs for spending are so high that governments would wish to spend more than the permanent income in the early stages of oil revenues, even if the revenues were larger than permanent income. These overall considerations may require the modification of rules designed to maintain a constant flow of income from the fund.
- ***Stabilization funds and revenue volatility.*** The size of a stabilization fund depends on the magnitude of expected oil revenues, their relative importance in the budget, and the possible volatility of the revenues. The larger the possible variation in revenues relative to total budget

expenditure, the greater should be the amount of precautionary assets, possibly held in a fund. Again, in the early days of oil revenues, it may be difficult to accumulate enough for the fund to provide a buffer effect because immediate spending priorities are likely to dominate. If revenues are peaking at a time of high oil prices, as would be the current situation for some oil producers, there is a good reason for trying to accumulate some of the exceptionally large revenue because they are likely to face revenue declines that would make smoothing expenditure difficult in the absence of a fund to draw upon.

1.18 Although the reasons for the accumulation of assets may address different issues in terms of stabilization, savings, or both, there is no reason to establish separate funds, or even separate accounts within a single fund, to meet these objectives. A stabilization fund is of necessity also a savings fund because the average amount held in the fund earns a return that can be used to provide future welfare benefits. However, the amount retained solely to stabilize the budget against possible swings in the oil revenue would generally not be adequate to provide a financial return that keeps permanent income constant. Savings funds, when they are integrated with the budget process, may also exhibit a stabilization function because the amounts paid into the fund will normally vary according to the current price and the expected future revenues, which have to be recalculated as expected prices and production change.

1.19 Once the target size of the fund has been determined in the context of planned overall government saving, the rules for adding to it follow. The most prescriptive approach has been to legislate that a given proportion of oil revenues be paid into the fund (either directly or through the treasury) and that all income and capital must remain in the fund and may not be withdrawn until legislation provides otherwise. This approach is seen as one to give the maximum emphasis on the use of the fund for saving for future generations, because it cannot be easily utilized for budget stabilization. A slightly more flexible approach has been to allow some or all of the income of the fund, but none of the capital, to be withdrawn into the budget process at the determination of the executive or legislature. In some cases, this has been relaxed further to allow withdrawal of part of the capital. It should be noted that, although many funds prohibit borrowing against the fund's resources, governments may still be able to increase debt. Where the cost of the debt is above the return on government investment, this policy should be avoided.

1.20 Simulations of alternative savings and expenditure rules have been carried out for some recently established funds. An interesting example is provided by an analysis of a possible revision to the Kazakhstan fund rules (Hausmann and others 2004). The analysis proposed a compromise between a "permanent income approach" in which only the permanent income of the expected oil wealth could be spent each period, and a "bird in hand" approach where only the income from the fund could be spent each period. Figure 1.1 below illustrates the revenue flows to the budget and to the fund in the case of Kazakhstan.

Figure 1.1: Revenue Flows

1.21 For stabilization funds, rules are needed to determine when additions should be made to the funds and when there should be withdrawals. These amounts are linked to the budgetary process and revenue forecasting, because the sums involved are intended to allow expenditure smoothing. Generally, parliamentary or presidential approval is used to authorize such transfers. In certain cases, countries have actually formalized the rules governing the use of stabilization funds so that amounts added or withdrawn are automatic. Such rules require that long-term revenue forecasts, which are used to plan budget expenditures, be made, and then unanticipated revenues are adjusted through the use of the fund. Even in this approach, the parliament or president needs to authorize the planned budget expenditures around which the stabilization has to work.

1.22 A different approach has been to make payments into the fund, and withdrawals from the fund, discretionary. Guiding principles for payments and withdrawals, especially for budget stabilization and sterilization purposes, can be formulated, but need not be adhered to in times of need. This approach gives the greatest room for maneuver in times of varying need (such as that caused by sudden large changes in the oil price) and also gives the greatest opportunity to the executive or legislature to change the purposes of the fund. A fund whose original purpose was to provide some resources for future generations could be more easily extinguished in the case where all resources can be withdrawn without any legislative change. Stronger political discipline, and adherence to long-term objectives, is required to operate such a scheme. The weakest form of control is one in which the executive alone makes decisions on payments and withdrawals, with no ex ante reference to the legislature. The submission of ex post accounts for the fund to the legislature allows comments to be made on these decisions, but does not easily permit them to be reversed.

1.23 The choice of a rules-based or a discretionary-based approach raises a difficult tradeoff. In the end, all rules can be changed, so that the issue is less one of rules per se, but rather of the political cost of changing the rules. The problem with pure discretion is that no alarm bells will go off when policies are imprudent—rules can create these alarm bells. However, pure and rigid rules can at some stage cease to be credible, and without some organized process of exception, the cost of modifying or voiding or evading them can be very high.

The financial management of an oil fund

1.24 Where governments have established a separate (real) oil fund for the purposes of saving or stabilization, the accumulated sums must be invested to preserve or enhance its value over time. The choice of asset classes, the choice of asset managers, and the oversight of the performance of the fund are then the key issues in obtaining the best return from the country's resources.

1.25 The strategic asset allocation depends on policy objectives and risk constraints. Several countries, particularly in the first years of the existence of the fund, have followed a low-risk strategy and invested only high-grade fixed income securities. As the fund has grown, and the government has come to have confidence in its investment advisers and managers, a wider range of assets has been permitted. Real estate investment is particularly problematical, because it can be both very volatile and rather illiquid, and it is not permitted in some cases. In an attempt to decrease the risk of their investment portfolio, some countries have limited investment by sector. Others have prohibited investing in the oil sector so as to diversify away from the source of the country's revenue risk.

1.26 As well as broadening to equities and alternative investments, governments have been concerned with the location of the assets. Some developed countries have placed limits on how much of the portfolio is to be invested domestically or abroad. Domestic investment might be expected to increase support to local firms, but it depends on the strength and absorption capacity of the local bond and stock market, as well as the absorption capacity of the economy. Furthermore, by investing locally, the government is likely to bring about Dutch disease, and investing abroad will sterilize the economy. Matching the distribution of investments by currency to the distribution of imports by currency has been considered, but may prove impractical—for example, when the target market is not developed or large enough.

1.27 Most countries that have established oil funds have been concerned to limit the total risk carried by the fund. This has been achieved through a number of restrictions on the portfolio management. Limits have been specified on the rating of admissible investments, the maximum percentage of equity holdings, the type and maximum duration of securities, and the geographical spread. In addition, benchmarks have been specified for each component of the portfolio as defined by the performance of some well established financial market index. Managers may be given freedom to diverge from the benchmark performance by a small amount in order to improve the yield through active management.

1.28 An alternative approach to investment strategy in some countries has been to use the fund as a surrogate budget—that is, to spend on development projects or current outlays that would normally be undertaken as part of the country’s central expenditure strategy, and as part of the standard budget process. Investing in local companies, to support new ideas or technologies, or in areas where social benefits are expected (for example, in the health sector or national parks) requires particular competence of the investment managers, because these are not the type of investment decisions usually made by experienced financial fund managers. This approach also risks duplication with the normal budgetary expenditures, with resulting loss of efficiency. Where the operation of the fund is not open to ex ante parliamentary scrutiny and approval, this route experiences less control and oversight than does the main budgetary process, and indeed it can undermine the integrity of the budget process.

1.29 The government also has to decide who will manage the investments of the fund. Generally, the government sets up a body comprising fund trustees but delegates responsibility for the management of the fund to the central bank, which would then have the discretion to engage third-party custodians and specialist asset managers for the safekeeping and investment of the assets. Asset management mandates may be structured based on global total return objectives or based on a benchmark representing a specific investment universe. In the latter case, manager performance is based on excess returns versus the benchmark adjusted for the amount of risk assumed. Fund trustees, or their delegates, are responsible for hiring, performance review, and subsequent fund allocation decisions. All of these steps should be transparent, so that reasons for hiring and changing managers are known generally, and the performance of the fund against the benchmarks should be publicly available. Many countries with revenue funds publish annual reports, which are submitted to parliament for approval.

The oversight of an oil fund

1.30 The creation of a separate, legally established oil fund requires oversight at a number of levels:

- Oversight of payments into the fund and certification that withdrawals from the fund comply with governing policies;
- A global custodian for the safekeeping and reporting of negotiable financial assets;
- Auditing of the accounts of the oil fund;
- Clear accountability for management decisions concerning the investment of the fund’s resources (investment policy, strategic asset allocation, tactical asset allocation, investment guidelines, and risk limits);
- Monitoring of compliance with investment policies and guidelines;
- Stringent standards for transparency and regular reporting to the legislature and public on the operation of the fund.

1.31 Because some aspects of these have the possibility of conflict of interest (for example, if the financial adviser to the trustees is also an asset manager), the various oversight arrangements need to be carefully structured, and all should be ultimately accountable to the executive and legislature.

1.32 The rules for establishing the various oversight mechanisms are usually spelled out in the legislation establishing the fund, so that oversight itself is stable and cannot be easily changed to reflect the interests of any group within the country. Some legislatures have not only formulated the principles under which oversight bodies should be selected and, if necessary, dismissed, but have also mandated criteria for selection (for example, previous business experience).

1.33 A good governance principle (Petersen and Budina 2003, Heilbrunn 2002) is that there should be simultaneous vertical and horizontal accountability. Vertical accountability is present in the reporting line of the management of the fund that continues up the hierarchy until it meets a minister. Horizontal accountability operates through two mechanisms: (1) elected officials independent of government receive regular reports on portfolio performance, and (2) readily available information is published through press releases, publications, and audits and on the Internet. The presence of watchdog nongovernmental organizations (NGOs) strengthens horizontal accountability.

1.34 A central issue in the management of large resource revenue flows, whether through a separate fund or not, is that of transparency. The public at large is likely to be aware that the government receives large amounts of revenue, and there is a corresponding expectation that they will benefit from it. Transparency concerning the oil fund is often connected to and reinforces attitudes toward a wider transparency concerning a country's oil sector. Some oil funds, from their inception, have been established in an environment where published information on total oil revenue flows to the government is an integral part of the budget process, but in other cases, total oil revenues are not transparent. One way to provide such information is through the Extractive Industries Transparency Initiative (www.eitransparency.org), in which governments, companies, and civil society form a voluntary partnership to collect and publish information about all resource revenues made to and received by the government. It may also be valuable to ensure that basic information is made available to the widest possible part of the population through information campaigns that provide a simple account of the revenues to be received and their planned use by the government.

1.35 Certain countries have taken a paternalistic approach and deliberately concealed information about resource revenue flows, and the size and performance of their oil funds, to avoid popular demands for increased current spending that the authorities may feel is unjustified in terms of longer-term strategic interest. However, this approach runs the risk of concealing self-interested behavior by policy makers and poor fund performance.

2

The Alberta Heritage Savings Trust Fund (AHSTF)²

Overview

2.1 Some two-thirds of the land in Alberta is government owned “Crown land,” and 80 percent of the province’s oil and gas production occurs on Crown land (Warrack and Keddie 2002), which has resulted in the provincial government receiving an important source of revenue from royalties on the production of oil and gas (the federal government receives corporate taxes). As oil production increased, so did the importance of this royalty income. The ratio of oil and gas sales to provincial gross domestic product (GDP) climbed steadily, from 14 percent in 1961 to 23 percent in 1973, just before the first oil shock. However, government receipts from other sources increased even faster, so that by 1973, the share of revenue from royalty receipts had fallen from 38 percent in 1961 to 20 percent (Roger S. Smith 1992).

2.2 During this period, the abundance of taxation from oil and other natural resources allowed the provincial government to reduce taxes on items such as gasoline and personal income, so that households were implicitly receiving part of the resource rents and were able to make their own savings versus consumption decisions on this extra disposable income. An incident that foreshadows later experience in Alaska, and the current debate on the use of oil revenues in countries such as Iraq, occurred in the 1950s, when the government, prior to an election, issued an oil dividend of Can\$25 to every adult in the province.

2.3 The very large increase in the world oil price of 1973–74 coupled with increasing production led, as in Alaska, to a sharp increase in the importance of the oil sector—in 1975, the ratio of the sales of oil to GDP reached 29 percent, and royalties accounted for 41 percent of total government receipts. In late 1974, a savings fund was proposed and, following vigorous debate during the 1975 election, the AHSTF was established by an act of parliament in 1976.

2.4 Before the creation of this fund, there had been no explicit policy with respect to the use of oil revenues, but government spending had largely focused on social and economic development. Premier Peter Lougheed articulated the new focus of the

² Official information on the AHSTF is taken from www.finance.gov.ab.ca/business/ahstf/.

fund (Mumey and Ostermann 1990): “Are we prepared as a province to put aside substantial sums of current revenues from the sale of non-replaceable crude oil production, put it aside for our children and for our grandchildren and not make it available for current revenue needs; to use it for that day...when some of the wells may have gone dry?” There were to be four objectives:

1. ...a future source of revenue, either through the income flowing from the fund or from the fund itself, as resource revenue declines in the years and decades ahead;
2. ...to reduce the debt load that may at some future time, perhaps not too far away, be required by the citizens of this province for capital projects of a budgetary nature;
3. ...to improve the quality of life in this province, to do some special things that no other province is able to do, so the quality of life here becomes even better and certainly compares well with other parts of Canada;
4. ...to strengthen and diversify the economy of the province.... It is fairly clear to forecast that for Alberta in the mid 1980s, oil and gas as both a source of revenue and as a job-creating part of our economy in a conventional sense will have passed its peak.

2.5 These distinct aims were to be met by creating separate divisions within the fund’s operational structure, each with distinct goals and responsibilities. There was no mandate to maintain financial capital in either real (via inflation proofing) or even nominal terms, because expenditures could draw down capital as well as income. The fund was set up with an initial endowment of Can\$1.5 billion, plus 30 percent of royalty income, and all yields from the fund’s investments. However, in 1983, the yields from the fund were diverted to the general budget of the province, and for the period 1984–87, only 15 percent of royalties were added to the fund while yields were remitted to the General Revenue Fund (GRF). From 1987 onwards, there were no further resource inflows into the fund, and yields went back to the general budget. The decreased resource flow into the fund reflected the increasing spending needs of the government together with the effects of slowly declining oil production and lower oil prices in the mid-1980s. Reflecting these changes, which were brought about by increasing budgetary demands, the fund reached its peak value of Can\$12.7 billion in 1987 and has declined slightly in nominal terms and substantially in real terms since then (a historical summary of flows into and out of the AHSTF is given in table 2.5).

2.6 By the mid-1990s, the province’s net debt was well on the way to being eliminated, and as a result of this, and also of increasing questioning of the effectiveness of the spending policies made by the fund itself, a wide-ranging review of the fund’s objectives and operations was undertaken, starting with a survey of public opinion in 1995. There was overwhelming support for retaining the fund (rather than dissolving it with an effective payout to current citizens) but for changing it into purely an ordinary financial investment fund whose goal was to maximize return subject to acceptable risk. In 1996, a new act was passed, which restructured it into two separate portfolios. A transition portfolio was to hold all the old “heritage” assets, and an endowment portfolio

was to hold the long-term investment in all forms of assets. The transition portfolio was to transfer at least 10 percent of its assets each year to the endowment portfolio until it had evaporated completely. Sufficient income was to be held in the fund to cover its costs and for inflation proofing, but the rest was to be transferred to the government budget. Inflation proofing was achieved by ad hoc retention of some yields of the fund in 1996–97, 1997–98, and 1999–2000, and after 2000, this would become an automatic feature once government debt was paid off. The investment aims of both portfolios were purely commercial, and so the earlier goals of economic diversification and social improvement were abolished. Interestingly, the new act still maintained the flexibility to pay oil revenues into the fund from the GRF, using a special act, but to date, this provision has not been used.

2.7 By November 2005, the series of budget surpluses run by the government during the previous decade had led to the complete retirement of public debt. The government announced that Can\$226 million would be paid to the AHSTF to ensure its inflation proofing for the year. In addition, the treasury would pay every resident of Alberta a rebate of Can\$400. This was to be paid directly from government revenues, rather than indirectly from the dividends or capital of the oil fund.

2.8 Hence, the AHSTF has evolved in two striking ways. First, its claim on oil and gas revenues, initially from their flows and from the yields on their investment by the fund, has been steadily reduced, until the present day when (a) no new transfers into the fund are made, (b) it is managed to maximize income, and (c) all of this income (less that for inflation proofing) is returned to the government budget. Second, the investment strategy of the fund itself has been changed from one in which it could support industrial diversification and social projects, as well as purely financial investments, to one in which only financial investments are carried out. These changes reflect the flexibility of arrangements with which the fund was set up and the relative ease with which changes in these policy parameters could be made.

2.9 In effect, the AHSTF has been de facto completely decoupled from the oil economy and is now purely a portfolio of financial assets, whose returns are being used largely to pay down provincial debt. However, the eradication of the province's debt and the rapid increase in royalties, from higher oil prices and from any increased production encouraged by these prices, is providing a new stimulus to Alberta to consider not only the future role of the existing fund, but also how to use the next generation of oil revenues.

2.10 From its inception in 1976 until 2005, the AHSTF has received Can\$12.0 billion from the GRF as its share of royalties, and it has earned (net of costs) Can\$26.9 billion. Of this, Can\$27.6 billion have been transferred back to the GRF, of which Can\$3.5 billion was spent on capital projects, leaving the fund's portfolio at Can\$11.4 billion (at cost). The detailed flows shown in table 2.5 show that one of the important effects of the fund was to transfer revenues and interest earned in the 1970s and early 1980s to government expenditures spread out from the mid-1980s to the present.

The establishment of the AHSTF

2.11 Before the foundation of the AHSTF, there was active political debate about the desirability and need for establishing a form of savings available for future generations, as well as providing a mechanism to diversify the provincial economy and improve social infrastructure, as the quotation above from Premier Loughheed illustrates. The initial form of the AHSTF then supported an “Alberta first” policy (McMillan and Norrie 1980) that effectively was prepared to forgo immediate financial returns in exchange for building a stronger and more desirable society, as well as provide some benefits for future generations rather than for just the current generation. There was no formal consultation of the public over the establishment of the fund, its investment policies, and spending policies, but the democratic process with the election of 1975 ensured that there was active representation of the population in making these decisions. One important way in which public opinion was informed of the likely operation of the fund was by the tabling of a preliminary draft of the AHSTF Act in parliament, which was allowed to die on the order paper, to give a view of the likely final bill. One crucial change was made as a result, which was the substitution of a provision for an automatic transfer of 30 percent of royalties to the fund by a requirement to legislate each year for the approval and authorization of how much should be transferred to it (Pratt and Tupper 1980). This requirement that parliament would legislate the transfer each year allowed the fund to be more fully integrated with budgetary requirements, while reducing the primacy of the savings role of the fund. Thus, after the parliamentary debate of 1975, the AHSTF was established by provincial statute in 1976 by the Alberta Heritage Savings Trust Fund Act. The final version of the initial act is given in appendix 1A.

2.12 In the late 1970s and early 1980s, the investment policy of the fund gradually shifted: Loans to other provinces (which had totaled Can\$1.9 billion between 1977 and 1982) ceased, but capital project spending started. The ability of parliament to determine transfers to the fund was demonstrated by the fact that the share of resource revenue directed to the AHSTF from the GRF decreased in 1983 and ceased in 1987. In neither of these decisions was there a formal public consultation, although they clearly would have large impacts on the Alberta economy. These decisions were made by parliament through the special acts passed each year, which determined the share of resource revenues to be transferred to the AHSTF, and through the mechanisms for strategizing and managing the investments of the fund, which needed to be reported to the legislative assembly but which did not even require a formal parliamentary decision.

2.13 Nevertheless, there was debate within Alberta, and in Canada generally, on the aims and performance of the AHSTF. In 1980, a special issue of Canadian Public Policy was devoted to discussing many aspects of the fund, ensuring that many criticisms were publicly aired. Important aspects raised included the optimal savings decision on how much of the resource rent should be saved for future generations, whether an effective diversification policy could be achieved by interventionist policies, and what should be the degree of accountability of the operation of the fund to the legislative assembly itself and to the public more generally.

2.14 In the late 1990s, a series of public consultations about the future of the fund and its purpose were held. In 1995, the government carried out a survey entitled “Can We Interest You in an \$11 Billion Decision?” to which there were more than 50,000 replies. The responses emphasized retaining the fund but focusing it on generating better returns on longer-term investments. As a result, the AHSTF Act was amended in 1996 to reflect these opinions, and the fund itself was restructured in 1997 (the revised version of the act is given in appendix 1B). A further survey in 1998, “Talk It Up. Talk It Out,” asked about fiscal priorities, including increasing savings in the fund, reducing provincial debt, reducing taxes, and increasing spending. Of these, increasing the savings in the fund as first priority attracted support of only 19 percent of the responses. A further survey in 2000, “It’s Your Money,” confirmed these priorities. In 2002, a commission reported on Alberta’s fiscal framework (“Moving from Good to Great—Enhancing Alberta’s Fiscal Framework”) and made a number of recommendations that included allowing the AHSTF to grow through further transfers into the fund, and that the fund be partially used for stabilization purposes. These proposals have not been accepted. Yet another survey (“Looking Forward: Planning for the Future with the Alberta Heritage Savings Trust Fund”) was carried out by the government in 2003, in which some 77,000 Albertans replied to questions asking specifically about the purposes of the fund itself. The priority was to maintain the fund at its existing level and use the earnings to support the budget. However, the fact that all debt has now been retired, and that oil revenues are increasing sharply, is likely to reopen questions about the long-term strategy for using these revenues and whether the fund should start to receive a share of them to increase its benefits for future generations.

The flow of money into and out of the fund

2.15 The flows of money into the Fund were defined in the original act and modified in the 1996 revision. All royalties and bonus payments received by the Crown were first paid to the provincial treasury. Annual transfers from the GRF to the AHSTF, which were to be 30 percent of such revenues, would be paid to the fund on the passing of an annual special act, the Alberta Heritage Trust Fund Special Appropriation Act. Actual payments would be made monthly during that year, and could be based on estimates for revenue to be received. A reverse transfer from the AHSTF to the GRF would be made at the end of the year if too much had been transferred during the year. In the initial version of the act, there was no provision to transfer money back from the AHSTF to the GRF except to balance out the requirement that 30 percent of revenues received by the province would be placed in the AHSTF. In addition, there was a one-time payment on the establishment in the AHSTF of Can\$1.5 billion. All AHSTF income was reinvested in the fund.

2.16 However, from 1983, all of the earnings of the fund were transferred back from the AHSTF to the GRF, while the share of revenues paid into the fund were steadily reduced until 1987, when payments into it ceased. Capital project expenditures ceased in 1995.

2.17 After the fund became decoupled from the oil economy, efforts were made to preserve its real value by a series of ad hoc inflation-proofing adjustments that reduced the payments back to the GRF, and these are intended to become automatic once the entire province's debt has been repaid.

The management and investment policy of the fund

2.18 Under the 1976 act, the AHSTF, which was technically a Crown corporation, was directly managed by the Investment Management Division of Alberta Revenue (Treasury). The act also specified the purposes for which investments could be made and specified limits on the shares of the total fund that could be used for each of these purposes. Decisions on acquiring and disposing of such assets had to be approved by a specially created investment committee, which consisted of all members of the Executive Council (the premier and cabinet ministers).

2.19 The act did not provide any performance benchmarks for investments except that they should yield a reasonable return to the fund, and they should tend to strengthen and diversify the economy of Alberta. The only part of the act that gave more detailed instructions was for that sum of money was not invested in any of the principal objectives and which was to be managed by the provincial treasurer. This could be invested in any bond or debenture guaranteed by the government of Canada, or another country, or in bonds guaranteed by corporations listed in the Canadian and British Insurance Companies Act (ratings were not used to limit the choice within these asset classes).

2.20 The provincial treasurer has to provide quarterly reports summarizing investments made to the legislature and to the public. The provincial auditor has to provide to the legislative assembly and the public an annual report of payments made and income received.

2.21 The initial structure of the AHSTF was made up of three investment divisions with different remits: The Alberta Investment Division (AID), the Canada Investments Division (CID), and the Capital Projects Division (CPD). All other resources of the fund not used by these divisions were held as cash and marketable securities. In 1980, two extra investment divisions were created: the Commercial Investment Division and the Energy Investment Division (EID). All these divisions were abolished after the 1996 act was passed, and all assets were placed into the transition and endowment portfolios.

2.22 The AID provided loans to Alberta corporations with the aim of encouraging diversification, and it was required to make a "reasonable but not necessarily commercial return. There was no limit placed on the share of the fund that could be held by this division. Initially, this was the most important division, with more than 50 percent of loans, but this gradually reduced until in 1996, it accounted for only 20 percent of the total. The bulk of the loans went to Crown corporations (the Alberta Mortgage and Housing Corporation, Alberta Agricultural Development Corporation, Alberta Government Telephones Commission, Alberta Municipal Financing Corporation, Alberta Opportunity Company). These corporations were not generally financially successful, so their "competitive" interest paid to the fund had to be financed in part by

grants from the provincial government. In addition, the fund was allowed to price its services below cost. The AID did invest Can\$500 million in the Syncrude project, Can\$400 million in a heavy oil upgrader project, Can\$400 million in forestry projects, Can\$100 million in a grain terminal, and Can\$200 million in a new Alberta-based oil company. Because of the weak constraints on financial performance, the real rate of return of this division averaged about 2 percent, as opposed to 10 percent achieved by the commercial division. The control and management of this division was exercised by the investment committee of the executive council (cabinet).

2.23 The CID made loans to other provincial governments at preferential rates, because Alberta had the lowest risk of any Canadian government entity. However, these loans were made at a time when interest rates were high, thus they were financially successful. No new loans were made after 1982, and all such loans were due to be repaid by 2005. This division was initially constrained to account for 15 percent of the fund at a maximum. Management of this division was under the control of the investment committee of the executive council.

2.24 The CPD invested in parks, hospitals, and other nonfinancial return investments (Alberta Heritage Foundation for Medical Research, Alberta Heritage Scholarship Fund, Reforestation Nursery Enhancement Program, Alberta Oil Sands Technology and Research Authority). No cost-benefit analysis was carried out for these projects, which could account for up to 20 percent of the fund. These were kept on the books of the fund as “deemed” assets despite their lack of return (contrary to recommendations of the government auditor). Spending on such projects ceased in 1995. Management of this division’s investment was under the control of the executive council.

2.25 In 1980, the Commercial Investment Division was established to invest in Canadian stocks and money markets, but this accounted for only a small part of the fund until the restructuring in 1997, when the whole fund was organized so as to optimize financial returns. Current assets were under the management and control of the provincial treasurer.

2.26 Also in 1980, the EID was established to invest in debt or equity that would facilitate further development of Canada’s energy sector. This was inconsequential in size and was curtailed after the start of a national energy program.

2.27 In 1997, the investment policy of the fund was changed completely to maximize returns subject to the “prudent investor rule” (that is, to restrict itself to investments that would be made by a prudent person). According to the act, it was “to provide prudent stewardship of the savings from Alberta’s non-renewable resources by providing the greatest financial returns on those savings for current and future generations.” The portfolio was initially split into two parts—the transition portfolio that was to be managed to support the province’s immediate fiscal needs and the endowment portfolio that was to optimize long-term returns. Over time, assets would be transferred from the transition fund to the endowment fund, and in fact, the transition portfolio was wound up in 2002, when all its assets had been transferred to the endowment portfolio. The aim was that in the long run, 60 percent of the endowment fund would consist of equities, of which half would be non-Canadian. There were thus no restrictions on the classes of assets that could be held, so that both Canadian and non-Canadian equities and

bonds could be held as well as real estate. A benchmark portfolio was established, which on historical grounds could be expected to achieve a 5 percent real rate of return, and it was expected that active management would add 0.5 percent above the benchmark.

2.28 External managers were hired to cover specific investment mandates, and following the restructuring of the AHSTF, the annual business plans, which are required to be published, formulated a numbers of goals, which could be changed if circumstances warranted. For example, the business plan for 2004–07, reviewed and approved by the Treasury Board in January 2004, and by the legislature’s Standing Committee on the AHSTF in February 2004, articulated the following goals:

- Maintain the nominal value of assets at a 5-year planning horizon,
- Achieve budgeted cumulative income forecasts during a 5-year planning horizon,
- Preserve the real value of assets over a 20-year horizon.

2.29 These were to be achieved through:

- Increasing investment in absolute return strategies and private equity,
- Reducing Canadian fixed income investments,
- Reducing public equity investments,
- Rebalancing the assets portfolio mix within guidelines set by Alberta investment management’s guidelines,
- Reducing investment in project loans,
- Retaining, as affordable, sufficient income to ensure that the AHSTF grows with inflation.

2.30 This asset portfolio mix was then expected to generate a total real rate of return of 4.5 percent at an acceptable level of risk over a five-year period, and to be 0.5 percent higher (after deduction of fees) than a passively invested benchmark portfolio. Specific shares in the portfolio of each asset class and the benchmark index for these classes are published in the annual reports.

2.31 From 2000, the annual reports and auditor’s report on the AHSTF have been published on the Internet, which allows an assessment of the composition and performance of the fund, both in total and by asset class. It does not provide separate details of the external fund managers and their performance, except for the percentage of the portfolio they manage.

The governance of the fund

2.32 The initial debate on the establishment of the fund raised the issue of its overall control. Premier Loughheed insisted that control would indeed be by the legislature (the provincial parliament), rather than by the executive (the cabinet). The first way in which the legislature would exercise control over the fund was by the annual special act of parliament required to transfer monies to and from the AHSTF during the

year—in particular, the share of royalties to be transferred. A second control on this transfer was to be exercised by a Select Standing Committee established by the AHSTF Act. This 15-member “watchdog” committee, made up of members of the legislative assembly, had as its duty to review the annual reports of the fund and make recommendations to the government. The act for transferring monies be authorized only when the Select Standing Committee’s report had been received. This gave a delaying or veto power to the committee on increasing the size of the fund, but could not directly control investment policy decisions. The political composition of the committee reflected that of the parliament, thus it is not surprising that the committee did not generally make recommendations that were contrary to the government’s views. On occasion there have been minority reports, but the government did not have to act according to the recommendations of the committee or respond to them.

2.33 With respect to the governance of the fund’s investment decisions, the initial act treated the different investment divisions distinctly. For projects put forward by the CPD, the procedure was the same as for other government expenditures. Estimates of expenditures were introduced in parliament and a full debate by the Committee of Supply was followed by the passage in the house of an appropriation bill. This ex ante control could apply to at most 20 percent of the fund’s assets (the maximum allowed under the act for capital projects). Projects under the AID or the CID had to be made in accordance with the directions contained in any resolution of the legislative assembly, but this provision was scarcely used. The cabinet had a subcommittee, the AHSTF Investment Committee, which determined the investments by these divisions without prior legislative debate or approval, but which could seek investment advice from outside. It is the performance of these investments that is subject to ex post review by the Select Standing Committee of the house. The residual pool of current assets was placed under the management of the provincial treasurer and his staff. These arrangements were the subject of intense debate at the time of setting up the fund. The Conservative Party of the time saw the role of the government as that of an entrepreneur, and argued that its investment intentions could not be divulged ahead of time because this would place it at a competitive disadvantage. Hence, decisions were left to the executive, with weak oversight by the legislature after the event. This set of arrangements is summarized in table 2.1.

2.34 The revised act of 1996 reviewed the governance provisions of the now single-goal fund. The provincial treasurer³ was given authority “...to hold, manage, invest and dispose of the assets of the Fund...” The treasurer has to report quarterly on the performance of the fund, within 60 days of the end of the quarter, and make public the annual report within 90 days of the end of the fiscal year. The treasurer is also responsible for the preparation of a three-year business plan published as part of the annual provincial budget.

³ The government of Alberta made a series of changes to its organization that determined who had oversight and control of the AHSTF. In 2001, the treasury was split into revenue and finance divisions with separate ministers, and the minister of revenue had responsibility for the AHSTF; in 2004, these were recombined into the ministry of finance headed by the finance minister, who then took over responsibility.

Table 2.1: The Organization and Administration of the Original AHSTF*

<i>Division</i>	<i>Objectives</i>	<i>Investment criteria</i>	<i>Maximum share of fund's Assets</i>	<i>Executive control and management</i>	<i>Legislative control and review</i>
Capital projects	To undertake projects to provide long-term social or economic benefits to Albertans	Projects that will by their nature not yield a return of capital or income to the fund	20%	Executive council and operating departments	(a) Tabling of estimates, votes on appropriations by full committee of supply; (b) post facto review by Select Standing Committee
CID	Provisions of loans to federal government or other provinces	Loans at market rates of interest	15%	Executive council (investment committee)	(a) Investments made or approved by investment committee in accordance with directions of any resolution by legislative assembly, (b) post facto review by Select Standing Committee
AID	Investments for purposes of strengthening and diversifying the Albertan economy	Investments must strengthen and diversify the Albertan economy and yield a reasonable financial return to the fund	No limit	Executive council (investment committee)	(a) Investments made or approved by investment committee in accordance with directions of any resolution by legislative assembly; (b) post facto review by Select Standing Committee
Current assets	Investments in government and high-quality corporate bonds, treasury bills, and other marketable securities	Quality, term, yield, risk, diversification, and liquidity	Residual	Provincial treasurer	Post facto review by Select Standing Committee

* Source: (Pratt and Tupper 1980)

2.35 The revised act established the Standing Committee on the Alberta Heritage Savings Trust Fund, which comprised nine members of the legislative assembly appointed at the beginning of each session in the same way that members of other standing committees are appointed. Three of these could not be members of the ruling party, unless nobody in this category is willing to serve. The statutory functions of the standing committee are to:

- Review and approve annually the business plan for the AHSTF,
- Receive and review quarterly reports on the operation and results of the operation of the AHSTF,
- Approve the fund's annual report,
- Review after each fiscal year the performance of the AHSTF and report to the legislature whether the fund's mission is being fulfilled and hold public meetings with Albertans on the investment activities and results of the fund.

2.36 Each year, the treasurer prepares a business plan for the operation of the fund, which first has to be approved by the treasury board, consisting of the minister of finance and at least four other elected members appointed by the lieutenant governor in council, before being submitted to the standing committee for its approval, after which it is incorporated into the annual budget plan for consideration by the legislative assembly.

2.37 In 2003, further formal oversight provisions were introduced by the creation of the endowment fund policy committee, which provides advice to the treasurer on the investment policies of the fund. This committee reviews and makes recommendations with respect to the business plan, annual report, and investment policy statements for the fund. External members of this committee provide financial and business expertise. The committee meets at least quarterly to review fund performance and provide general oversight.

2.38 In addition, the investment operations committee, chaired by the deputy minister of revenue and including private sector representatives (nominated by the minister of revenue), is charged with the responsibility of providing oversight of the actual management of the fund (by Alberta Revenue's investment management division) and of investment performance at the subfund level.

2.39 The new organization and administration arrangements are summarized in table 2.2.

2.40 Since the fund's inception, auditing has been provided by the auditor general, but in terms of providing a check on overall policies, this sometimes proved to be of limited value, as reflected in the debate over the treatment of the investments of the CPD. These investments were not expected to provide a financial return (for example, parks) but were recorded as "deemed" assets in the balance sheets. The auditor general and the standing committee on the AHSTF both consistently recommended that they should be excluded from the statement of the fund's net worth, and in 1987, the auditor general explicitly dissented, but the practice continued until the nature of the AHSTF was changed by the 1996 revision.

Table 2.2: Administration and Oversight of the Revised AHSTF

<i>Responsible entity</i>	<i>Function</i>
Legislature	Passes law to establish fund Passes special act for transfers into fund Approves business plan Sets mandate
Standing committee of members of the legislature	Reviews annual and quarterly reports and business plan
Treasury board	Approves investment policy and business plan
Minister of revenue	Recommends investment policy Established endowment fund policy committee
Endowment fund policy committee	Advises minister on investment policy and reviews performance
Investment operations committee	Provides oversight of management of investments
Department of Revenue: Alberta Investment Management Division	Manages the portfolio
Internal and external investment managers	Make investments
Auditor general	Audits financial reports

The financial performance of the fund

2.41 The performance of the AHSTF covers two separate periods, before and after the 1996 act, which entirely altered the goals of the fund's investment policy. Performance figures for the earlier period are difficult to interpret, because they include investments in nonfinancially performing assets. Values of the real rate of return for the period 1978 to 1989 (Peter J. Smith 1991) indicate that year by year, there was considerable fluctuation, with an average for the period of 4.8 percent (slightly lower than the 5.3 percent achieved by the Alaska Permanent Fund during the same period). The official recorded composition of the fund's investments in 1988, which can be taken as a fairly representative year during the first phase of the AHSTF's existence, is shown in table 2.3 (Mumey and Ostermann 1990).

2.42 The entries make clear how much funding was being provided to entities that might conventionally be funded through the general government budget, especially the investments of the AID. The distinctive feature of these investments was that, unlike budget expenditures, they were not subject to rigorous ex ante debate in the legislature or control, and they were undertaken outside the standard budget process. The fund's expenditures did not have to compete for scarce public resources as ordinary budget expenditures do. The fund was therefore executing the wishes of the executive rather than the legislature, and the grounds for choice could be largely concealed, although the democratic process and the need for reelection placed limits on the degree, nature, and extent of such choices. Without an analysis of the value of the outputs of the various corporations, the loans to them could be valued solely by the interest paid by them to the AHSTF, which in fact was a financial transfer between two parts of the government. The

assets of the AHSTF at this time were entirely Canadian, and this lack of diversification is in strong contrast to most other funds, which have been largely invested abroad.

Table 2.3: Composition of the AHSTF, March 31, 1988 (current Can\$ million)

<i>AID</i>	
Alberta Mortgage and Housing Corporation	3,279
Alberta Government Telephones Commission	1,099
Alberta Agricultural Development Corporation	1,017
Alberta Municipal Financing Corporation	825
Alberta Opportunity Company	165
Participation in Syncrude project	509
Alberta Energy common shares	237
Government of Alberta promissory notes	200
Other investments (primarily Ridley Grain and Millar Western Pulp debentures)	190
Total	7,520
<i>CID</i>	
Loans to Atlantic provinces	982
Hydro Quebec	303
Manitoba	185
Total	1,470
<i>Commercial Investment Division</i>	
Securities	263
<i>CPD</i>	
Loan to Vencap Equities Alberta Ltd.	200
<i>EID</i>	
	1
<i>Cash and marketable securities</i>	
Banker's acceptances, deposits, notes, and money	1,430
Government of Canada treasury bills	1,014
Government of Alberta promissory notes	353
Total	2,798
Accrued interest and receivable due from the GRF	310
Total financial Investments of the fund	12,562
<i>CPD (deemed assets)</i>	
Walter C. McKenzie Health Services Center	388
Alberta Heritage Foundation for Medical Research Endowment	300
Other medical or hospital	199
Irrigation: headworks, main systems improvement, rehabilitation, and improvement	600
	404
Alberta Oil Sands Technology and Research Authority	225
Kananaskis Country Recreation Development	100
Alberta Heritage Scholarship Fund	544
Other deemed assets	
Total	2,759
Total financial and deemed assets	15,321

2.43 Following the restructuring of the portfolio in 1997 and the change of its mandates, with the winding up of loans to Crown corporations and other Canadian provinces, a more conventional savings fund was created. The annual reports from 2000 to 2005 provide substantial detail on the assets held in each asset class, the performance

of each asset class, and returns compared to the benchmark. All performance measures are given in Canadian dollars. By 2005, the revised act had been in operation for several years, and the initial separation of the endowment and transition portfolios terminated with the winding up of the transition portfolio.

2.44 To achieve a satisfactory long-run performance that balances return and risk, a benchmark portfolio was determined that indicates for each class of assets the long-term target weight in the portfolio and an index of returns for each class of assets. The actual portfolio performance is then measured against the performance of the benchmark portfolio. Table 2.4 shows the performance of the actual and benchmark portfolios for 2005. Administrative expenses were 0.169 percent of the fair market value of the fund in 2005.

Table 2.4: Actual and Benchmark Portfolio Performance of the AHSTF for Year Ended March⁴ (returns measured in Can\$)

<i>Asset</i>	<i>2005 actual (%)</i>	<i>2005 target (%)</i>	<i>2005 return</i>	<i>2004 return</i>	<i>2003 return</i>	<i>2002 return</i>	<i>2001 return</i>	<i>Five- year return</i>
Short-term fixed income	0.8	32.5	2.3	2.9	3.0	3.8	5.7	3.5
Long-term fixed income	31.9		2.2	3.0	2.7	3.7	5.7	3.5
			5.5	11.6	9.5	5.9	9.5	8.4
			5.0	10.8	9.2	5.1	8.7	7.7
Canadian public equities	18.5	15.0	15.4	36.6	-16.6	4.2	-16.0	2.9
			13.9	37.7	-17.6	4.9	-18.6	2.0
U.S. public equities	16.2	15.0	-1.6	22.1	-30.6	1.4	-14.4	-6.3
			-1.0	20.5	-30.7	1.6	-15.1	-6.5

Not Applicable (NA).

a. Inflation measured by all items' CPI for Canada.

Note: Figures in italics are benchmark returns. The separation of the portfolio into endowment and transition subportfolios in earlier years means that no overall benchmark returns were published.

2.45 During the period 2001–05, the AHSTF was expected to achieve a 4.5 percent real return, and during the five-year period, the rate of inflation was 2.4 percent. Hence, the required nominal return of 6.9 percent was not achieved by the fund, largely because world equity markets during that period underperformed historical long-term average rates of return. The nominal rate of return for this five-year period is similar to

⁴ The benchmark funds against which performance are measured are short-term fixed interest = Scotia Capital 91 day treasury bill index; long-term fixed interest = Scotia Capital Universe Bond Index; Canadian equity investment = Toronto Stock Exchange Standard & Poor (S&P) Composite Index; private equities = consumer price index (CPI) plus 8 percent; U.S. equities = S&P 1500 Index; non-North American equities = Morgan Stanley Capital International Index for Europe, Australia and the Far East (EAFE); CPI plus 5 percent; absolute return strategies = CPI plus 6 percent.

the return made in the period up to 1990 (4.8 percent net). The value of the portfolio at cost during the most recent period was kept more or less constant by the rules for operating the fund (appendix 1), but operating costs steadily increased during the most recent five-year period.

2.46 The detailed breakdown of the performance of the fund by asset class reveals some interesting features of performance valued in domestic currency. Even over a five-year period, the returns from U.S. and EAFE equities were negative, while Canadian assets returned substantial positive returns. Exchange rate movements have been an important feature of the performance of the AHSTF, as illustrated by the experience of 2005. The benchmark equity index rose 7.2 percent in U.S. dollars, but fell by 1 percent in local currency. For Alberta, where there was a substantial domestic market for fixed interest and equities, as well as real estate, the decision to invest the majority of the portfolio locally ensured that the performance of the fund in 2005 was satisfactory. The performance of domestic and foreign equities was highly variable over the period, while fixed interest securities delivered a much less variable return.

2.47 The experience of the AHSTF highlights a number of issues:

- Should returns be measured in local currency or a basket of foreign currencies?
- Should substantial investment in real estate be undertaken?
- Should the portfolio be invested locally, and if so, to what extent?
- Should the portfolio include equities?

2.48 In Alberta, where the income from the fund is returned yearly to the budget for general use, it is clearly important to consider returns in local currency, although providing information on the returns in the currency of the assets is also important in that it allows an assessment of the performance against the benchmark, and also provides evidence on which class of foreign assets performed best. To reduce the risk from exchange rate variations and a reliance on equities, more than 60 percent of the AHSTF was invested locally, of which more than half was in high-grade income securities. Such a strategy may not be possible in developing countries, where the markets for bonds and equities may be thin or nonexistent.

2.49 Equities, although they may provide the best returns over the long run, can be much more volatile than interest-bearing investment, and domestic bonds (mainly long-term securities) made up about one-third of the AHSTF. Indeed, in the period considered by this analysis, the return on investment provided by low-risk, interest-bearing, securities was higher than the average return of the whole portfolio.

2.50 The AHSTF has benefited from real estate investment, but this may be particular to the case of a highly developed economy experiencing growth and possessing a large stock of real estate assets. In developing countries, the real estate market may be extremely volatile, and its assets may be highly illiquid.

Assessment

2.51 The experience of the AHSTF illustrates many of the issues that have been raised in general discussions of the desirability of establishing oil revenue management funds, in particular whether the aims of the fund should be distinct and separate from those of the general budget, how the fund was to be governed, and its relation to the population of Alberta.

2.52 The initial goals for fiscal policy and the creation of the AHSTF with its spending priorities corresponded to aspirations exhibited in many oil-producing countries, both developed and developing:

- Some of the revenue should be saved for future generations against a time when the oil would run out, and this should be done in a way that is visible by keeping the money separate in a fund and by managing this money prudently.
- There should also be spending on diversification to strengthen the economy for a time when the importance of oil and gas production declines.
- There should be spending on social projects that would not yield a direct economic return but would either yield long-term gains (for example, education) or else would contribute to noneconomic forms of welfare (parks and so on).

2.53 The latter two goals for the fund are particularly striking because they cover activities that are conventionally undertaken by the general budget. However, in the case of Alberta, the governance structure that was set up for these activities (as opposed to general capital projects) was such that the level of control was different from and less stringent than what it would have been had this money been left in the general budget. Indeed, by transferring money to the fund for this loosely defined set of objectives, the executive (through the cabinet) determined spending priorities in a very autonomous fashion. This was defended at the time on “business” grounds, under the need to conceal from potential rivals the nature of the deals the AHSTF would be making, thereby also concealing from parliament and the public the intentions of the executive until after decisions had been implemented.

2.54 Although there were ex post considerations of these decisions, which could have led to refusal by the legislature to approve further transfers into the fund, these were rather weak and could not easily reverse a spending decision once it had been made. Moreover, although transactions were subject to scrutiny by the auditor general, no social or economic cost-benefit analysis was carried out, so the success of these decisions was difficult to assess.

2.55 Although there had been substantial initial debate about the creation of such a fund and its goals, once the initial act had been passed, the involvement of the population at large was rather indirect. Annual accounts were published, but these initially were in the form of government papers and were rather inaccessible to the average citizen. Later commentators noted that few people knew much about the fund,

how it worked and what its resources were. At the same time, much of its spending was in forms that yielded rather indirect results (for example, loans to Crown corporations), so its current benefits were somewhat intangible, and the accumulated savings aspect was not widely publicized. The lack of formal benchmarks against which the fund performance could be evaluated, as well as the initial limitation of investment to within Canada, also distinguish its operation from that of other funds during the period before 1997.

2.56 The distancing of the fund from both the legislature and the public made it possible to gradually shift its nature during the 1980s, when the government's aggressive spending policies, coupled with the fall in oil revenues linked to the drop in the world oil price, necessitated the gradual elimination of transfers into the fund and the withdrawal of all the proceeds it had earned. In fact, the failure to even inflation-proof the fund at this time resulted in its decline in value in real terms. Ignoring the social spending aspects of the fund, and treating this part of its history as an exercise in optimal savings, it could be argued that the government saved too much early on, and too little later, leading to the possibility of a rather uneven flow of expenditure. Some of this was in fact smoothed out by increasing the province's debt, but then this had to be repaid, putting pressure on other government spending.

2.57 By the mid-1990s, the government of Alberta was willing to engage the public in a debate over the future of the fund, reflecting unease over the performance of the nonfinancial assets and the impact of the democratic process. A series of surveys resulted in a major formal change in the act and the fund, restricting its role to that of a savings fund with financial objectives tied to "prudent" investing. Although the possibility of increasing total savings by making further transfers into the fund was left open, this has not happened during the past seven years, indicating the higher priority of paying off the province's debt. The crucial aspect of the fund that emerged from a series of decisions is that it no longer reflects changes in the oil price and oil revenues and so has no stabilization function. Even following the enormous rises in oil prices in 2004, the general budget of the province benefited but the fund did not. Its contribution to the province's finances is presently limited by movements in stock exchange values and by financial management policies of the portfolio.

2.58 The other major change that was made was to improve the governance of the fund by introducing a number of checks and balances and improved transparency. The publication of quarterly and annual reports (now available on the Internet) and a business plan, together with the need for legislative approval and the establishment of a formal committee of external advisers on investment policy, have removed control from the executive. Ironically, the restriction of the fund to a financial investment instrument, managed by the finance ministry through internal and external investment specialists, has made relatively little difference in this aspect of the fund's performance. Previously, the current assets, which were a substantial part of the fund, were all managed by the Investment Management Division of Alberta Revenue and appeared to perform well, but this was without a specific business plan with published goals and targets. The use of benchmarks to check on progress is one form of control on performance, but control could be further enhanced by the introduction of some competition between managers of subfunds with similar goals.

2.59 Several of the possible criticisms of the AHSTF can also be seen as positive aspects, even though they may be owed to the strong democratic nature of the province. The ability to change the remit of the fund, to adjust payments into it and the use of earnings each year, by executive council (cabinet) decision with the sole check that the previous year's annual report had been received by the legislature allowed a flexible response to changing external or internal circumstances. As oil prices first fell, then later rose, changes in the province's budgetary strength were reflected in the attitude to the use of the fund in a way that could not have been achieved if the fund had been established outside executive control, or by a constitutional instrument that required major legislation for change. Even the revised act of 1996, which changed the fundamental objectives of the fund, required only a simple majority in the legislative assembly.

2.60 There is little direct evidence that the initial goals of the fund to diversify the economy and improve social infrastructure were very successful. This lack of evidence comes from the failure of the government to carry out cost-benefit studies, or even consumer satisfaction surveys, so that although the policies may have achieved their goals, the evidence was not collected. The responses of the citizens to the surveys of the 1990s on the possible uses of the fund, which showed that the overwhelming support was for a savings function alone, suggest that there was no public perception that the other goals had been achieved and were worthwhile. Again, this may have been due to a lack of information and publicity, but it illustrates the dangers of this approach.

2.61 The investment strategy of the post-1997 fund and its performance illustrate the differences between operating a resource fund in a highly developed economy and doing so in a developing economy. The AHSTF experienced solid performance from its high-grade income securities, all of which were domestic, and from domestic real estate, while equity performance (measured in domestic currency) from foreign and domestic markets was highly variable. Developing countries may be able to avoid the risks associated with equity investment by limiting themselves to longer-term fixed interest securities, but they are likely to be more vulnerable to foreign exchange risks because virtually the whole portfolio may need to be held in foreign currency. Hedging could provide some insurance against exchange rate risks, but this can be difficult to achieve.

Table 2.5: Summary of Operations of the AHSTF 1976–2004*

(Current Can\$ million)					
<i>Year</i>	<i>Net income</i>	<i>Transfers from the GRF</i>	<i>Transfers to the GRF</i>	<i>Capital project expenditures</i>	<i>Fund equity at cost</i>
1976–77	88	2,120	—	36	2,172
1977–78	194	931	—	87	3,210
1978–79	294	1,059	—	132	4,431
1979–80	343	1,332	—	478	5,628
1980–81	724	1,445	—	227	7,570
1981–82	1,007	1,433	—	349	9,661
1982–83	1,482	1,370	866	296	11,351
1983–84	1,467	720	1,469	330	11,739
1984–85	1,575	736	1,575	228	12,247
1985–86	1,667	685	1,667	240	12,692
1986–87	1,445	216	1,445	227	12,681
1987–88	1,353	—	1,353	129	12,552
1988–89	1,252	—	1,252	155	12,397
1989–90	1,244	—	1,244	134	12,263
1990–91	1,337	—	1,337	150	12,113
1991–92	1,382	—	1,382	84	12,029
1992–93	785	—	785	84	11,945
1993–94	1,103	—	1,103	71	11,874
1994–95	914	—	914	49	11,825
1995–96	1,046	—	1,046	—	11,825
1996–97	932	—	756	—	12,001
1997–98	947	—	922	—	12,026
1998–99	932	—	932	—	12,026
1999–2000	1,169	—	939	—	12,256
2000–01	706	—	706	—	12,256
2001–02	206	—	206	—	12,256
2002–03	–894	—	—	—	11,362
2003–04	1,133	—	1,133	—	11,362
2004–05	1,092	—	1,092	—	11,362
Total	26,925	12,047	24,124	3,486	11,362

—“0”

* Source: Annual Report 2005: Alberta Heritage Savings Trust Fund.

3

The Alaska Permanent Fund (APF)⁵

Overview

3.1 Alaska became the 49th state of the United States in 1959. It was then very sparsely populated (fewer than 300,000) and had a low per capita income, high unemployment, and in some respects faced the development issues of low-income countries that suddenly become oil-rich. At that time, very little oil was being produced. This altered dramatically with the exploration and development of the Prudhoe Bay lease, which yielded US\$900 million to the state treasury in 1969 through its share of the lease payments, because most of the land involved belonged to the state. This initial payment was huge in relation to the then state budget of US\$112 million (Warrack and Keddie 2002). Oil production climbed from 160,000 barrels a day in 1969 until it reached 2 million barrels a day in 1998 and then slowly declined, falling to about 1 million barrels a day in 2004. Currently, the population is 650,000, and oil accounts for about 40 percent of government revenues.

3.2 The initial oil lease revenue was used for general development projects approved by the legislature and funded by the treasury, including water systems, schools, roads, a student loan scheme, and a longevity bonus, as well as projects to cut down trees, plant barley, and establish dairy farms, which collapsed (Hannesson 2001). The whole of this sum was quickly spent, and concerns that some of the money had been wasted, and that future revenues would not last for long, generated an intense debate over the use of future oil revenues. Public hearings were held, and internationally well-known economists were invited to give advice. In both 1970 and 1975, bills were introduced into the state legislature to create a permanent fund, in which part of the oil revenues would be saved for future generations. These were not passed (the second being vetoed by the governor) because of a clash with the state constitution that forbade the creation of any mechanism for earmarking the use of state revenues for specific purposes. Accordingly, a constitutional amendment was introduced by the governor, and amended by the legislature, on which all citizens of Alaska were entitled to vote, for the creation of a permanent fund. This amendment was easily passed (75,588 in favor and 38,518 against).

⁵ Official information on the APF is taken from www.pfc.org.

3.3 The amendment stated that at least 25 percent of all mineral lease rentals, royalties, royalty sales proceeds, federal mineral-sharing proceeds, and bonuses received by the state should be placed in a permanent fund, the principal of which should be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. Revenue from severance (production) taxes was not paid into the fund, so that the fund received about 10 percent of total state revenue from oil (Peter J. Smith 1991); about 80 percent of the total of Alaska's fiscal revenues came from oil at that time. The first revenues were deposited in the APF in 1977, from receipts related to oil flowing through the trans-Alaska pipeline. This set off four years of debate about whether the fund should be managed as a public trust or an economic development bank, and in 1980, the fund was established by legislation as a public trust. In addition, the legislature increased to 50 percent the share of the designated state revenues that would be passed to the fund from leases granted after 1979 (taking the fund's share of all oil revenues to about 15 percent) and made a special appropriation to it of US\$900 million from the general fund.

3.4 The key feature of the trust was that the principal of the fund was to be invested permanently and could not be spent without a further vote of the people. Fund income could be spent, decisions on its use being made each year by the legislature. To manage the assets of the fund, the Alaska Permanent Fund Corporation (APFC) was established in 1980, and initially investment was restricted to high-grade income securities. At the same time, the legislature created the Permanent Fund Dividend Program (managed by the state treasury) backdated to January 1, 1979, to distribute each year to eligible Alaskans a portion of the income of the fund as a dividend payment. The original proposal was to distribute larger sums to those who had been living longer in the state, but this was struck down as unconstitutional discrimination by the Alaskan Supreme Court. The final residence test was merely that all residents (including minors) who had resided for at least the previous 12 months in the state would be given an equal dividend.

3.5 The APF was set up in two parts: principal and earnings reserve. Oil revenues are transferred to the principal, and once money is allocated to the principal, it cannot be removed without a vote by the majority of voters in a statewide plebiscite. All investment income earned during the year is placed in the earnings reserve. At the end of the fiscal year, decisions are made by the legislature on the use to which the earnings reserve is to be put. The earnings reserve has been used to transfer money back to the principal, to provide for inflation-proofing (since 1982), and to the dividend account of the treasury, from whence payments to all citizens are made. Withdrawals for general government spending can also be made, but this has not yet happened. The balance is either paid back into the principal (as in 1986) or retained in the earnings reserve to allow some smoothing of future dividends in years when the income of the fund is lower because of variations in stock market performance. Formulae for inflation-proofing and for the sum paid into the dividend account are specified by a legislative act.

3.6 The APFC is a public corporation and is guided in its investment decisions by an independent board of trustees composed of six members appointed by the governor. Two must be heads of departments of the state government (one of whom is the commissioner of revenue); the other four must be members of the public who do not hold

any state office, who must have recognized competence in finance, investment, or other business management–related activities.

3.7 The APFC has to manage the investments of the APF according to the “prudent investor” rule, but the means to do so have evolved. Initially, the target for the trustees was to achieve a 3 percent real rate of return. Over time, the APFC has been authorized to invest in a wider range of securities: In 1982, investment in U.S. common stocks and real estate began, and in 1989, investments in non-U.S. securities were authorized by the legislature, with investments in emerging markets beginning in 1989. Alternative investments of up to 5 percent were authorized in 1999, and private equities and absolute return strategies were added in 2004.

3.8 During this whole period, dividends were paid annually from the fund, starting with a special dividend paid from the general state budget in 1982 of \$1,000 per eligible person. Since then, dividends have varied between a low of \$331 in 1984 and a high of \$1,964 in 2000, which was followed by a substantial decline back to \$845 in 2005, reflecting movements in the stock markets in which the APF was invested. It is important to note that dividends relate to current stock market performance rather than the current oil prices, although high oil prices will certainly affect the value of the fund and hence future income and dividends. Dividends, which are paid out just before Christmas and have become an established and “permanent” feature of Alaskans’ sources of income; their cessation would be a major blow to lower-income households, so that suggestions to reduce or abolish these payouts have been fiercely resisted by the voters (Goldsmith 2002).

3.9 A further source of oil revenues to the state has been from the settlement of legal disputes with oil companies, of which some 60 cases have earned more than \$6.8 billion in direct payments (Tsalik 2003). Since 1990, these payments have been placed in a separate Constitutional Budget Reserve Fund (CBRF), which is used to help balance the budget. Loans, which are interest free, from the CBRF to the budget need the approval of three-quarters of the legislature. If there is a budget surplus, it must be transferred back to the CBRF. However, because of state spending policies, the CBRF has been largely depleted, and most disputes with the companies have been settled, so that this is unlikely to provide a future source of revenue for the budget. The liquidity required by such a fund necessitates short-term investment policies and lower returns than earned by the APF, and the capital of the fund can be depleted by action of the legislature. Some critics have even argued that these monies should also have been transferred to the APF, placing even more stress on the budget.

3.10 The capital of the APF, receiving 50 percent of certain oil payments, some of the income of the fund, and some special appropriations, and being inflation-proofed almost since its inception, has grown very rapidly and was worth \$30 billion in June 2005. At the same time, the “lock box” strategy adopted by Alaska, during a period when its population almost doubled and demands for public spending increased, while there was no state income tax and there were low excise taxes on fuel, started to generate fiscal deficits in the 1990s. Following a statewide debate, there was an advisory vote in September 1999 in which, with a 95 percent voter turnout, some 83 percent of these voted against a suggestion to use the earnings of the fund to balance the budget. After

further state deficits (\$400 million in 2002), lawmakers have debated possible solutions to this dilemma, and in 2004, legislation was filed in the Alaska Fair Share Bill to increase the payments of the oil companies to the state. A particular point of focus was the economic limit factor, which gives lower tax rates on wells producing lower amounts. As fields mature and decline, the average tax payment per barrel is declining. From an average production tax rate of 13.5 percent in 1993 to 7.5 percent currently, the rate is predicted to fall as low as 4 percent by 2013 if no change is made to the legislation (Hartzok 2004).

3.11 Currently, the trustees are proposing an alteration to the way in which earnings from the fund, which define the dividend payout, are calculated. Unrealized gains are counted as part of the principal and so cannot be spent, but once the gains are realized from the sale of assets, all of these are available for appropriation by the legislature, being deemed to be income and paid into the earnings reserve account. When the realized gain is very large, this results in a high proportion of the fund being “unprotected.” The alternative is based on a percentage of market value (POMV) approach in which total withdrawals from the fund are limited to a maximum of 5 percent of market value averaged over five years.⁶

3.12 Up to June 2004, the fund had reserved assets (principal) of \$26.5 billion, which has come from dedicated mineral revenues (mainly oil) of \$8.1 billion, special legislative appropriations from the fund’s unreserved assets (earnings reserve) of \$4.1 billion, the state’s general fund of \$2.7 billion, and \$8.4 billion from the earnings reserve fund for inflation-proofing, as well as unrealized gains or losses. Unreserved assets in the earnings reserve were \$859 million in June 2004. Total dividends paid out since 1982 amount to \$13.1 billion.

3.13 The APF has remained remarkably constant in both its purpose and operation—indeed, the main thrust of public opinion has been to reinforce its sole effective purpose of paying out dividends to every citizen. This has come to be seen as an entitlement, thus efforts to broaden the purposes to which the fund income (or capital) may be put have been constantly defeated. Other changes reflect the investment policy of the fund and allow it, by broadening the class of assets that may be acquired, to obtain even higher returns with the hope of higher dividends. Changes in governance have been made, but these are minor, and in any case, the public hostility to the legislature changing the practice of using income only for present or future dividends has reduced the active area of governance to that of following good financial investment strategies. In 2004, an amendment was introduced that the governor could remove a member of the APFC board only with a letter indicating cause, in contrast to the previous situation where cause did not have to be shown.

⁶ *Permanent Fund* 101.www.apfc.org.

The establishment of the fund

3.14 In Alaska, the nature and uses of the oil revenues have generated continuing debate, some in the legislature and some more generally. Several amendments to legislation have been introduced, not all successfully, and there have been two periods of intense consultation before changes to the law were attempted.

3.15 In the initial constitution of Alaska, delegates enacted article VIII, section 2: “The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people.” In addition, the constitution forbade the dedication of state revenues to any spending theme. These two themes were shown to be possibly inconsistent by the experience following the signing of the Prudhoe Bay lease in 1969, which netted \$900 million for the state from the sale of the leases (Kasson 1993). The spending of this very large and sudden state revenue provoked debate on what spending pattern would be for the benefit of the people, especially in the future. In particular, Robert Krantz of Kidder Peabody, at the 10th Annual Convention of the Alaska State Chamber of Commerce in 1969, called for the establishment of a permanent fund, whose income would be available for appropriation by the legislature.

3.16 The history of the efforts of the next few years, in which there were several attempts to set up some form of oil revenue fund, has to be seen in the context of the Alaskan political system. The state has both a house of representatives and a senate, so that any bill has to be approved by both. Also, the governor has the ability to veto bills. In addition, there are provisions for constitutional changes by virtue of a referendum of all eligible voters. The first attempt to introduce a bill creating an oil fund was made in 1970, when Governor Keith Miller introduced legislation to create a permanent resource fund. This was passed in the senate, but died in the house. One of the issues that this first attempt highlighted was the issue of dedication—Governor Miller’s bill allowed the legislature to appropriate money to the fund as it deemed necessary. The next five years saw the state gradually increase annual budgets and incur debt based on expectations of future revenues from the oil fields.

3.17 In 1975, the legislature passed a bill to establish the Alaska Mineral Lease Bonus Permanent Fund, whose purpose was expressed: “The Legislature finds and declares that it is essential to preserve a portion of the revenue derived from mineral lease bonus sales, a nonrenewable resource, for future generations of Alaskans, and further, that this purpose best can be served by preserving this income in a permanent fund to be used for investment capital by Alaska residents.” The bill dedicated 50 percent of bonuses to the fund, whose principal was to be invested as with other state surplus funds. The income could be reinvested or appropriated for operating or capital expenses of the government as provided by law. Although this legislation created a permanent fund and limited expenditures from it to income earned, the bill was vetoed by Governor Jay Hammond. The purpose of the governor’s veto was not to oppose the principle of the fund, but rather its establishment and dedication of revenues by a bill. The governor argued that this required a constitutional amendment instead. Accordingly, in 1976, the governor introduced such an amendment to the legislature, who made some further

amendments and then placed a version before voters at the 1976 election. The amendment read:

ALASKA PERMANENT FUND. At least twenty five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state shall be placed in a permanent fund, the principal of which shall be used only for those income producing investments designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the General Fund unless otherwise provided by law.

3.18 This constitutional amendment of 1977 established the payment of revenues into a permanent fund, but left the definition of income-producing investments and the use of such income to separate legislation. It also remained silent on the governance and management of any such fund.

3.19 During 1976, debate started on what the investment aims should be, and whether these should include social (for example, income redistribution-type policies), economic (for example, subsidizing small businesses), or fiscal (for example, use of the fund to stabilize budget expenditures against fluctuating oil revenues) approaches. The state investment advisory committee was expanded and charged with looking into organizational structures and investment options for the APF. This committee consisted of members of the business community, consumer groups, the executive branch, the legislature, and the general public. A number of hearings were held that produced calls for a variety of uses. A first bill was introduced in 1977 as a holding measure, in which the commissioner of revenue was instructed to invest the fund in conservative investments. This bill was easily passed. A second bill was introduced that contained plans for the long-term management structure. It suggested increasing the share of revenues from at least 25 percent to 50 percent and that investments should be 40 percent investment-grade securities, 30 percent in private Alaskan industry, and 30 percent in community development. This bill was not passed, nor was another bill introduced by the governor, which suggested a cash distribution of income to registered voters of one share per each five years of residency.

3.20 In the period leading up to the 1978 legislative session, the House Special Committee on the Permanent Fund took its hearings on the road around the state. A number of consultants were also hired to analyze the various options being considered. The house and senate introduced their own bills, which differed in important respects. The senate wanted the department of revenue to manage the fund and its investments and focus the use of income to provide capital to the rural population to close a perceived capital gap for small enterprises. The house wanted the management of the fund to be independent from the state government, but accountable to the public, through the creation of a public corporation. The house did not specify particular uses for income, suggesting that this be left to the legislature though its transfer into the general fund. The governor, meanwhile, continued to press for his scheme of giving income to Alaskans in the form of dividends. This would keep income within the state and reduce the possibility of allowing pork barrel politics, whereby legislators tied spending schemes to local interest groups. It would also make it easier to control public spending after the oil ran

out. In 1980, a bill was introduced that, among other things, gave residents \$50 for each year of residency since the establishment of statehood in 1959. The bill, which was passed in 1980, also established the APFC and raised the payment to the fund to 50 percent of the designated revenues. On appeal, the clause on the dividend-sharing rule was struck down as unconstitutional by the Alaskan Supreme Court because it did not treat all citizens equally.

3.21 In 1982, the legislature introduced an alternative dividend plan that gave equal payments to all those who had been resident in the state for the previous 12 months. The first payment was to be \$1,000, and subsequent annual payments were to be based on the annual earnings of the fund. A second important piece of legislation was introduced at the request of the trustees, which enacted inflation-proofing to protect the principal of the fund and broadened the list of permissible investments to include U.S. common stocks and equity real estate.

3.22 The drop in oil revenues and the rise in budgetary spending during the 1990s produced further consideration of how the fund should operate. In 1995, a nonpartisan, legislatively sponsored committee reviewed the state's fiscal picture and suggested that there should be a cap on dividends to citizens, but no action was taken. Further growth in fund income and declining oil revenues led to the establishment of the Principles and Interests Project in 1997. This culminated in a two-day workshop, town hall meetings across the state (80 meetings in 41 settlements), and a statewide call-in during 1998. These focused on the future of the income from the fund (especially the dividend program) and the capital. The papers from the workshop were then published by the APC trustees (Alaska Permanent Fund Corporation 1993a). The culmination of this activity was a statewide advisory vote on whether the earnings from the fund could be used to balance the budget, to which 83 percent of the 90 percent voter turnout were opposed, demonstrating the importance of the dividend as seen by those receiving it.

3.23 Despite further fiscal pressures brought about by increased demand for spending, the fund continued as before. However, complete and mandatory inflation-proofing of the fund, in a way that was less conservative than the previous model, was then proposed by the trustees. This was to be achieved through applying a formula based on the POMV that is the limit to what can be safely paid out each year. Currently, the proposal is that appropriations from the earnings reserve account would be limited to 5 percent of market value averaged over the previous five years (similar to that for several other public endowment funds), the rest being retained in the earnings reserve for inflation-proofing. This appropriation is currently greater than the legislation requires for transfer to the dividend account so it would be available for transfer to the general fund to help with the budgetary position. Calculations in 2004 indicated that something in the range of \$175–\$300 million could be transferred to the budget this way (Alaska Permanent Fund Corporation 1993b). The size of these figures indicates just how much the previous rules had overprovided for inflation. This proposed constitutional amendment has not yet been put to voters.

3.24 The fund is covered by the original constitutional amendment, cited above, and by the law on the APF that is given in full in appendix 2, plus some other amending legislation.

3.25 The principal provisions of the law have already been explained, and sections of the law cover:

- Payments into the fund from revenues and special appropriations and management of the fund by the APFC;
- The goal of fund to maximize revenue and act as a savings fund while maintaining safety of the principal;
- Establishment of APFC and its board of trustees (number, qualification, and appointment of trustees by the governor);
- Term of office for four years, staggered for the four public members and removal of Trustees;
- Quorum and voting of the board and compensation, staff of the APFC, and conflict of interest provision for the board and staff;
- Application of the prudent investor rule by the board and general conditions on investments that may be obtained;
- Definition of net income of the fund to include income from the earnings reserve account, definition of income available for distribution;
- Disposition of income via transfer from the earnings reserve account to the dividend account according to formula; transfer to principal an amount determined by the formula for inflation-proofing;
- Provisions for audits and reports.

3.26 There is also state law pertaining to the permanent fund dividend. This covers:

- Eligibility criteria for receipt of an annual payment,
- The process of application for the dividend and proof of eligibility,
- The formula determining amount of the dividend,
- Establishment of the dividend fund within the treasury and duties of the dividend fund division.

The flow of money into and out of the fund

3.27 The way in which payments flow into and out of the APF is largely determined by legislation, with little room for even legislative discretion, and this rests upon the primary requirement that the real value of capital be maintained.

3.28 At the opening of each year, the APF is holding a portfolio of assets, determined in accordance with its long-term investment strategy, while the earnings reserve account is holding whatever amount was left after paying dividends to eligible citizens, inflation-proofing, and any special appropriations back to the APF. In addition, the legislature can transfer resources from the earnings reserve account to the budget, but this option has not been used so far. The assets of the earnings reserve account are kept

liquid. During the year, both the APF and the earnings reserve account earn income from their assets, and all of this income is placed in the earnings reserve account. The payments due from the 50 percent of oil revenues are transferred monthly from the treasury to the APF, from where they can be invested. The legislature can also make special appropriations from the budget to be paid into the APF to add to the principal of that fund.

3.29 At the end of the financial year, the income available for distribution is calculated from the earnings reserve account (excluding unrealized gains and losses). It is set at 21 percent of the net income of the fund over the previous five years (including the current year), but may not exceed the income of the fund for the fiscal year just ended plus the balance in the earnings reserve account. At this stage, 50 percent of the income available for distribution is transferred to the dividend account of the treasury, which distributes the dividend to citizens as explained below.

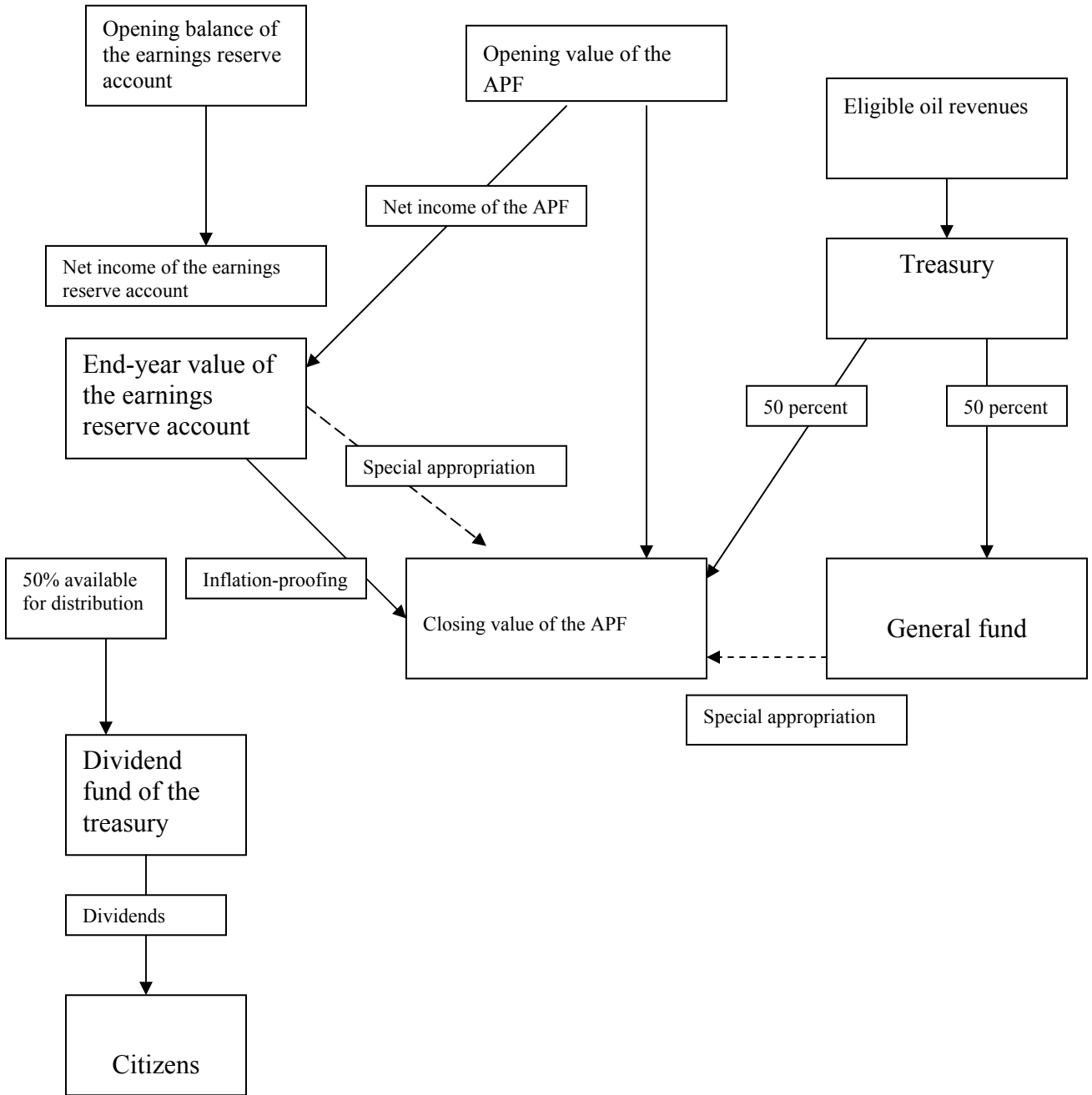
3.30 From the earnings reserve account, a sum sufficient to offset the impact of inflation on the principal of the APF is then transferred back to the APF. This inflation-proofing sum is calculated by computing the percentage change in the U.S. CPI between the two previous calendar years and applying this to the value of the APF on the last day of the current financial year.

3.31 The legislature can then decide whether to return the remaining balance of the earnings reserve account to the APF, maintain it in the earnings reserve account as a cushion against future low incomes from the assets of the APF, or transfer it to the budget. This system to date has effectively had only one outflow, the amount distributed to dividends.

3.32 For the last few years, the trustees have advised that the rules on payments out of the earnings reserve account be altered. They have argued that the present rules allow the available income of the earnings reserve account to be transferred to the budget, and in certain circumstances, this could result in a large withdrawal from the value of the fund. This is because all realized capital gains are treated as income and placed in the earnings reserve account in the year that they occur. The trustees' recommendation is to limit the total of all payments out of the fund to 5 percent of its total market value (averaged over a five-year period). Where the difference between this amount and the sums for inflation-proofing and dividends transfer is positive, then the balance can be transferred to the budget.

3.33 The formula for the determination of the individual dividends is fully specified in a separate act. The total available for dividend payments equals the amount transferred into the dividend account during the current year, plus any unspent balances, less any obligations to pay dividends from previous years (late applicants and so on), less costs of administration. This amount is divided by the number of eligible individuals as defined by law to calculate the individual dividends, which are shown in table 3.3. The schematic flows in and out of the various funds are shown in figure 3.1.

Figure 3.1: Schematic Inflows and Outflows of the APF



3.34 An important feature of the dividend scheme is that payments do not reflect current oil prices, but are instead based on a five-year average of the earnings on a number of securities. Hence, despite the very large oil price increase, the 2005 dividend was lower than in 2004 because earnings on the assets in 2005 were lower than those in 2000 (in the five-year averages) and because more qualified applicants are expected than in the previous year.

The management and investment policy of the fund

3.35 Since 1980, the APF has been managed by the APFC, which is a special body created for the purpose. The six trustees, appointed by the governor subject to the criteria explained above, form the board of the corporation, and they appoint an executive director and other staff. Detailed practices of the APFC are given in The Corporate Policy Manual: Investment Policy and Practice.⁷

3.36 The long-term investment goal of the fund is now to achieve an average 5 percent real rate of return, and asset allocation is adjusted with this in mind. At the beginning of each year, the board's investment consultant and board staff assist in reviewing asset allocation policy for the coming year, and the board adopts the policy by resolution. The investment consultant, chosen as an independent third party with experience of the oversight and management of large funds, has duties to:

- Advise the board on asset allocation policy;
- Establish the appropriate array and size of individual asset portfolios;
- Compare total fund returns to the board's long-term investment goal;
- Analyze the performance of each asset class against appropriate benchmark returns;
- Evaluate the performance of each of the fund's investment managers against the benchmark return established for that manager;
- Assist in the evaluation and selection of new managers.

3.37 A second layer of advice is provided by a three-person investment advisory council, appointed for staggered terms of three years. One must have direct portfolio management experience, one must have worked as a chief investment officer of a large fund, and the third must have experience working with an endowment or foundation. The advisers attend the board meeting when the investment consultant reviews the capital market assumptions for the coming year, as well as two other meetings a year. The duties of the advisers are to:

- Review the investments made by the board;
- Make recommendations concerning investment policies and procedures;
- Advise on the selection of performance consultants;
- Advise on the form and content of the annual reports.

⁷ www.media.apfc.org/iceimages/homeobjects/INVMAN.pdf.

3.38 The management of the portfolio is split between internal and external managers. Staff of the APFC manage a substantial portion of the fixed income portfolio, as well as a unitized fund of the APF's short-term and cash assets. The internally managed fixed income is reviewed by the board. The investment consultant monitors and evaluates the performance of the internal managers in the same way that external managers are evaluated.

3.39 External managers are selected after an extensive search process in which the investment consultant helps in identifying a long list (at least 10) of potential managers qualified to provide the services needed. A manager search committee then identifies between 3 and 5 candidates for consideration by the board. All managers are evaluated quarterly by the investment consultant through written reports to the board, comparing performance against benchmarks established for the appropriate class of assets.

3.40 In 2004, the shares of the total portfolio in the classes of approved assets (target shares in brackets) were:

- U.S. fixed income, 30.7 percent (28 ± 5 percent);
- International fixed income, 4.4 percent (4 ± 2 percent);
- Active managed U.S. stocks, 23 percent; active managed international stocks, 12 percent; passive managed stocks, 22.1 percent (total stocks, 55 ± 5 percent);
- Real estate, 7.8 percent (10 ± 2 percent);
- Private equity, 0.0 percent (2 ± 2 percent);
- Absolute return, 0.0 percent (1 ± 1 percent).

3.41 The benchmarks for the various classes of assets are specified by the APFC, so that performance of managers and the fund as a whole can be measured against these external checks. The asset classes are even divided into subclasses, such as large cap and small cap equities, each with its own benchmark, and a total of 37 managers were used to cover all the asset classes in 2004, giving opportunities for comparisons among the asset managers.

The governance of the fund

3.42 The active governance of the APF is exercised by the board of the APFC, which in turn is overseen by the governor, who has power to change the board and alter policies. However, this power has recently been limited by requiring the governor to show cause before removing a board member.

3.43 Much transparent behavior is also required by legislation, including publishing both quarterly and annual reports (the latter audited by an external auditor) on a Web site, in the local press, and through direct submission to the governor and the legislature. The overall structure of governance is shown in table 3.1.

Table 3.1: Administration and Oversight of the APF

<i>Responsible entity</i>	<i>Function</i>
Governor	Initiates or vetoes legislation Appoints and fires APFC board members Receives annual report
Legislature	Passes legislation Receives quarterly and annual reports Can initiate audit Votes special appropriations to be added to APF principal
APFC board	Determines investment policy Hires staff and appoints advisers
Audit committee of the board	Recommends external audit firms and receives audit
Investment consultant	Advises the board on investment policy and monitors performance of fund and managers
Investment advisers	Advises the board on policy Performance oversight
Internal APFC managers	Manage some fixed income and short-term assets
External managers	Manage other fixed income, equities, and real estate investments
Treasury dividend account division	Receives allocation from the earnings reserve account Oversees payment of dividends

The financial performance of the fund

3.44 Financial performance figures for the APF can be obtained from the annual reports, which are available on the Web site⁸ from 1995 onwards; a detailed breakdown is given for the last five years in table 3.2.

3.45 The APF relies heavily on equities, and both domestic and foreign have shown highly variable performance. Real estate was consistently strong during the period, and high-grade income securities also performed well. The variability of the equity performance coupled with its large share in the portfolio was reflected in the variability of the nominal and real returns from the fund. The portfolio's real rate of return for the most recent five-year period was well below the 5 percent real rate of return, which is the current target.

⁸ www.apfc.org/publications/AnRptArch.cfm.

Table 3.2: Actual and Benchmark Portfolio Performance of the APF for Year Ended June (returns measured in US\$)

<i>Asset</i>	<i>2005 return</i>	<i>2004 actual (%)</i>	<i>2004 target (%)</i>	<i>2004 return</i>	<i>2003 return</i>	<i>2002 return</i>	<i>2001 return</i>	<i>Five- year return^a</i>
U.S. fixed income	6.8	27	28.0	0.8	10.2	8.0	11.4	NA
	6.8			0.3	10.4	8.6	11.2	
Overseas fixed income	10.1	4	4.0	4.3	15.3	10.2	0.8	NA
	8.8			3.7	12.7	15.7	-7.4	
U.S. public equities	7.2	39	55.0	21.1	-0.3	-15.4	-13.1	NA
	7.5			20.5	0.8	-17.2	-14.3	
Overseas public equities	15.4	19		28.4	-5.0	-8.6	-22.9	NA
	15.8			32.4	-6.5	-9.5	-23.8	
Real estate	27.2	10	10.0	16.5	9.1	10.3	14.8	NA
	22.7			13.9	7.0	7.2	14.1	
Private equity	0.0	0	2.0	0.0	0.0	0.0	0.0	NA
Absolute return strategies	0.0	0	1.0	0.0	0.0	0.0	0.0	NA
Total nominal return	10.4	100.0	100.0	14.2	4.5	-2.2	-3.3	4.5
	10.5			14.1	4.8	-3.7	-4.5	4.0
Inflation (%)	2.7			2.3	1.6	2.8	3.4	2.5
Total real return	7.1			11.9	2.9	-5.0	-6.7	2.0

Not Available (NA).

a. Five-year return figures for the period 2001–05 are available only for the total fund.

Note: Figures in italics are benchmark returns.⁹

3.46 The longer-run performance of the fund is provided by rolling 10-year average returns as shown in table 3.3, and this indicates that, taking a longer view (as would be consistent with the asset composition of the fund's portfolio), a 5 percent average real return was consistently achieved. The two tables together suggest that a policy of heavily weighting the portfolio toward equities will produce good returns over the long run, but over the shorter run, this can even lead to negative nominal returns. Over the 21-year history of the fund, the annualized nominal return is 10.1 percent and the real return is 7 percent.

⁹ The benchmark indexes are U.S. equities, the Russell 3000 index; international equities, the Morgan Stanley International Equities Index for EAFE; U.S. fixed interest, the Lehmann Index; real estate, the National Council of Real State Investment Fiduciaries Classic Index. For international bonds, an amalgam of indexes is used, but their individual details are not given in the annual reports.

**Table 3.3: Rolling 10-Year Nominal and Real Returns of the APF
(measured in US\$)**

<i>Period</i>	<i>Nominal return</i>	<i>Inflation</i>	<i>Real return</i>
1985–94	11.6	3.8	7.8
1986–95	10.5	3.6	6.9
1987–96	9.6	3.5	6.1
1988–97	10.6	3.7	6.9
1989–98	11.7	3.5	8.2
1990–99	11.4	3.3	8.1
1991–2000	11.4	3.0	8.4
1992–2001	10.1	2.8	7.3
1993–2002	8.6	2.6	6.0
1994–2003	7.8	2.5	5.3
1995–2004	9.1	2.5	6.6
1996–2005	8.7	2.5	6.2

3.47 Comparisons with the performance of the benchmark portfolio also show the fund tracking the benchmark extremely closely—in 2005, the fund was 0.1 percent below the benchmark return, and for the recent 10-year average, the fund return was 0.1 percent above that of the benchmark portfolio. Costs of administration were about 0.16 percent of the value of assets managed.

Assessment

3.48 The Alaskan experience of setting up a dedicated fund to receive part of the very substantial oil revenues due to the state illustrates two features not presently found elsewhere. First, as far as is legally possible, the principal of the fund has been entrenched so that it is not able to be spent short of a constitutional amendment, which would require a vote of all citizens of the state. Second, the income of the fund is used solely for inflation-proofing the capital and paying a dividend to the citizens of the state. Although it is legally possible to transfer some income from the fund to the general budget, this has not yet happened. The operation of the fund can then be seen to ensure that the fund's principal increases with the dedicated share of revenues, and that these are held constant in real terms. The balance is devoted to whatever citizens decide to spend their dividend on. Of course, the oil revenues dedicated to the fund can be indirectly spent if the government runs a deficit and borrows. At present, the total debt of the state of Alaska is about \$8 billion, compared to the fund's market value of \$30 billion. State debt has been slowly increasing since the mid-1990s, indicating that the net saving of the state has not increased as fast as the value of the fund.¹⁰

¹⁰Data taken from www.census.gov and www.revenue.state.ak.us/treasury/debtbook/PublicDebtBook2004-2005.pdf

3.49 The operation of the APF has been successful seen from the perspective of accumulating resources in a separately managed account, whose income effectively is earmarked for providing dividends to the population of the state. Not only have mandatory oil-related payments been accumulated into the fund, but also the state has itself appropriated to the fund about another 10 percent of its value from the general fund, as well as returning to the principal another 15 percent of its total value from the earnings reserve account that could have been used for other purposes. In short, the strategy has been to accumulate as much as possible from oil revenues into an untouchable reserve. Hence, although the share of oil revenues payable into the fund has been quite low (at most about 15 percent), the fund presently has such a large principal that the income earned from the APF in the late 1990s was larger than total state revenue from oil, which itself was the largest single source of revenue for the budget.

3.50 The obverse of the success of the Alaska model is that its rigidity, which protects it from unwise or politically motivated spending decisions by the legislature, threatens to be a handicap as oil production declines and the state continues to face budget deficits. The inability to respond to changing state needs is related to the inviolability of the principal plus the lengthy tradition of distributing earnings in the form of dividends to all citizens of the state. The direct benefits of the citizens from such a program, and the effectively “permanent” nature of this arrangement, mean that citizens have an enormous interest in the operation and use of the fund. They have overwhelmingly resisted suggestions that some of the income should be used to balance the budget, thus reducing present or future dividends, and would no doubt equally strongly resist constitutional amendments that would allow the principal of the fund to be spent. In short, the Alaska model is set up to work entirely for the benefit of all the individuals in the state and not to support any form of collective or nonmarket benefit. Public goods and merit goods are entirely excluded, and the decisions on expenditure are left entirely to the individual. Remarkably, even though the legislature has the power, without a constitutional amendment, to transfer part of the income of the fund to support the general fund, popular resistance to this has so far blocked this option. This raises the possibility that the state of Alaska, unable to print money, reluctant to increase local taxes because of public opposition, and constrained on how much debt it can accumulate, will have to cut social spending. In the long run, the effects of this may force a reconsideration of the original purpose of the fund, but this correction is likely to be slow to come into being, as current experience in Alaska has demonstrated.

3.51 The model set up in Alaska has resulted in net public saving, but the only use to date for these savings is to distribute them directly to individuals, thus intergenerational transfers are made at a rate dependent on the share of total oil revenues paid into the fund. Alaskans receiving dividends each year have the option to spend or save their share of the fund earnings. There has been little formal investigation of household use of the dividend payments (Goldsmith 2002), so it is not possible to conclude that households have a pro-consumption bias, or that they treat the dividend as equivalent to any other form of income and save a similar fraction.

3.52 The APF is very highly structured by law and custom: all tax receipts must be paid to capital, and no capital may be spent; dividends are based on a formula; inflation-proofing is based on a formula; and the residual earnings are traditionally returned to capital if they become large. Although the legislature could alter the dividend or inflation-proofing formulae (the latter being currently under consideration through the use of a POMV approach), this could be politically dangerous and so far has been resisted. This has in fact left very little discretion on the operation of the fund, and accordingly there has been little need for governance outside the actual investment policies of the fund itself. This contrasts strongly with the situation in Alberta, where the discretion on spending targets meant that governance with respect to performance was very important, but *ex ante* information was concealed by the cabinet for the sake of business confidentiality.

3.53 Since its inception, the APF has exhibited a very considerable degree of transparency. The APFC has produced annual and quarterly reports for the public, the legislature, and the governor. It has maintained a Web site, published in newspapers, and commissioned special papers to discuss the history and problems of the fund.

3.54 The actual management of APF investments has also been tightly circumscribed by the law, as shown in appendix 2, where the classes of allowable assets are indicated with great precision. Over time, these classes have been broadened to permit a very deliberate policy of allowing an increased risk to be balanced by increased return. The use of performance benchmarks and an elaborate system of investment advisers and specialists, which is certainly necessary for what is one of the largest funds in the world,¹¹ has ensured a performance that matches the benchmarks chosen across a wide spectrum of asset classes and produced an average long-run real rate of return around 5 percent.

3.55 One feature of the governance of the APFC, and hence of the APF, is very striking. The governor has the sole power to appoint and dismiss the APFC board, which in turn has complete direct control of the investment policy and strategy. The legislature must approve the APFC annual reports, but their direct power to influence the board appears limited. The governor's power over the APF is therefore potentially very great and, until the recent legal amendment whereby he had to give written cause for dismissal, could have been used to pack the board to follow investment policies that might have been unwise. Overuse of Alaskan-based investment managers, or restrictions on investing in local bonds and equities, could have been used for political rather financial ends. In other circumstances, the model adopted for control in Alaska could have produced very poor outcomes for the citizens. However, the requirement that the governor be democratically elected provides a check on actions the governor might take that would result in lowering dividends to the citizens.

¹¹ The fund is among the top 100 investment funds in the world and is larger than any single endowment fund, private foundation, or union pension trust in the United States.

3.56 The objective of the dividend payout scheme, which is currently unique to the Alaskan experience with resource funds, was to create an active citizen counterweight to government in a strongly individualistic society. In this respect, it has indeed worked well.

Table 3.4: The APF Dividends 1982–2004 (current US\$)

<i>Year</i>	<i>Amount</i>
1982	1,000.00
1983	386.15
1984	331.29
1985	404.00
1986	556.26
1987	708.19
1988	826.93
1989	873.16
1990	952.63
1991	931.34
1992	915.84
1993	949.46
1994	983.90
1995	990.30
1996	1,130.68
1997	1,296.54
1998	1,540.88
1999	1,769.84
2000	1,963.86
2001	1,850.28
2002	1,540.76
2003	1,107.56
2004	919.84

4

The Norwegian Government Petroleum Fund¹² (NGPF)

Overview

4.1 Oil production began in Norway at the beginning of the 1970s. By the time of the first oil shock, production was only 32,000 barrels a day, but, stimulated by the impact of both oil shocks, it climbed to about 1 million barrels a day by 1987 and 3 million barrels a day by 1996. Because Norway has a population of only 4.5 million, domestic demand for oil is limited, making it one of the leading oil export countries.

4.2 Although Norway already had a well-developed economy before the production of oil, the scale of the discovery was large in relation to the total size of the economy. Over the last decade, oil and gas have accounted for about 17 percent of GDP and 40 percent of exports, and oil revenues from the sector accounted for 23 percent of total government revenue in 2004. In 2004, per capita income was about US\$55,000.

4.3 The initial discovery of oil (following earlier skepticism that any oil would be found) triggered a debate on how to use the revenues without distorting the nature of the economy and society. In particular, there were widespread fears of Dutch disease effects whereby increased domestic spending would drive up the exchange rate, making existing export sectors uncompetitive and creating inflation and unemployment. The major concern was that the economy would not be able to absorb sudden large injections of spending (Hannesson 2001). However, there was no debate about how to make the income from the oil revenues “permanent” through some form of savings fund. In the early 1980s, the spending of the oil revenues was accompanied by a rise in inflation, an increase in public sector employment, and an increase in public debt. The sharp fall in oil prices of 1986 reduced revenues abruptly, so that there was no discussion of a savings fund at that time. Because the government was also a passive partner in some North Sea developments, it needed to provide cash to finance its share of investments, and this resulted in virtually no net cash flow from the sector to other activities during the latter part of the 1980s.

¹² Official information on the NGPF is taken from the Web site of Norges Bank; www.norgest-bank.no/english/petroleum_fund/reports/.

4.4 At this time, an important long-run concern of budgeting was the funding of the increased pension requirements that the aging population would require (Skancke 2002), and accordingly the government eventually decided to establish a petroleum fund that would contribute to the goal of accumulating sufficient resources to be able to fund the increased pension payments. Studies by the ministry of finance indicated a scenario in which the fund would reach a peak value around 2020 and would then decline, vanishing around 2040. The NGPF was established by Act 36 of the Storting (parliament) in June 1990. The broad objectives of the fund were to safeguard the long-term use of oil revenues, manage the government's net cash flow from oil, and transfer money to the fiscal budget to cover the nonoil deficit. A report to parliament in 1998 on the future of the fund also stressed the role of the fund in financing future pension claims, but did not address a permanent savings objective.

4.5 The operation and use of the petroleum fund in Norway is markedly different from the cases of Alberta and Alaska, and indeed has a parallel only in the case of the newly established fund in Timor-Leste. All oil-related revenues are paid into the NGPF, as are any interest or dividends earned on assets already held, but then the deficit on the government non-oil budget, determined by parliament, is paid out of the fund (while surpluses remain in the fund). This means that neither income nor capital of the fund is safeguarded, because parliament could authorize a budget deficit large enough to use all current oil revenues and some of the accumulated past revenues. This arrangement completely addresses fungibility of resources, because transfers into or out of the fund take place according to the non-oil deficit of the central government, which itself is determined through normal parliamentary budgetary processes. The central government debt is small and a stable fraction of GDP (about 19 percent in 2004) and the fund has already reached a value of 60 percent of GDP, thus its assets correspond approximately to the net financial position of the central government. This allows a fundamental transparency principle to be observed: the assets of the fund and their trajectory correspond to government savings, and people are thus well informed of the net position of the government through the fund's highly publicized annual reports, even if they are less well informed on the magnitude of overall government debt.

4.6 The dominance of the budgetary process over the savings function of an intergenerational fund was well illustrated in the early 1990s when, although petroleum revenues were more than 10 percent of total government revenue, no net additions were made to the fund because of the domestic recession then being experienced, which decreased non-oil revenues and increased claims for spending. The first net additions to the fund were made in 1996, and the fund has since accumulated resources steadily, with on average 75 percent of all petroleum revenues being added to the fund during this nine-year period. In some years, virtually all the oil revenue has been kept in the fund, unlike in Alberta and Alaska, where only a fraction was saved. This change in behavior indicates the strong fiscal discipline exercised by the Storting. Recently, with increasing oil revenues and a steady increase in the total value of the fund, there have been questions about the long-term purpose of this accumulation and whether spending should be encouraged (Listhaug 2004).

4.7 In 2001 the administration presented a White Paper to the Storting outlining a further principle for the use of oil revenues. It was agreed that there should be a gradual phasing in of petroleum revenues into the economy roughly in step with the expected real return on the Government Petroleum Fund. This has acted as an anchor for budgetary policy.

4.8 Because net withdrawals from the NGPF are determined through the annual budgetary process, which was already long established before the advent of the fund, the main focus of concern has been on the management structure of the fund and the investment policy it should follow. Changes to these have been made almost every year, although some have been relatively minor. Management of the fund has been entrusted to the ministry of finance, which has since 1996 delegated responsibility for management to the central bank (Norges Bank). In turn, Norges Bank has contracted some external managers for part of the portfolio but has also managed a large part of the portfolio itself. The actual arrangements within Norges Bank to establish an effective management team, while keeping it separate from the rest of the bank's operations, have evolved over time as experience has been gained.

4.9 The overall guidelines for managing the fund, in terms of which classes of assets may be held, from which countries, and in which proportions, is regulated by the ministry of finance, which also has a formal management mandate with the Norges Bank. From the beginning, all the investments of the fund have been made outside Norway for fear of distorting the relatively small economy by the injection of large sums of financing.

4.10 The ministry of finance and the government have also issued instructions to Norges Bank about investing in socially responsible activities. In 2001, a sub-portfolio of the fund, the environmental fund, was established to hold equities based on sound environmental criteria, and in 2004, following debate in the budget and the report of the Committee on Ethical Issues for the Petroleum Fund (Graver Committee), the ministry of finance approved new guidelines for ethical investment. The following mechanisms were agreed:

- Corporate governance is based on the UN Global Compact and the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance and the OECD Guidelines for Multinational Enterprises to promote long-term financial returns.
- There is negative screening from the investment universe of companies that, either themselves or through entities they control, produce weapons that, with normal use, violate fundamental humanitarian principles.
- Companies are excluded from the investment universe where there is deemed to exist an unacceptable risk of contributing to:
 - Gross or systematic violation of human rights, such as murder, torture, deprivation of liberty, forced labor, the worst forms of child labor, and other child exploitation;
 - Gross violation of individual rights in war or conflict situations;

- Severe environmental degradation;
- Gross corruption;
- Other particularly serious violations of fundamental ethical norms.

4.11 The government appointed an advisory council on ethics to advise the ministry of finance on negative screening and exclusion, and the ministry makes decisions and informs Norges Bank of its decisions. As a result of these changes, the environmental fund became redundant, so it was wound up and its assets transferred back into the main portfolio.

4.12 In January 2006 the government established the Government Pension Fund, which is comprised of the Government Petroleum Fund and the National Insurance Scheme Fund. There will continue to be two portfolios, and that corresponding to the former Petroleum Fund will be known as the “Government Pension Fund – Global.” Payments into the global portfolio will be equal to the budget surpluses (including oil revenues) and will be managed and invested as before. The new fund will not assume the role of a formal pension fund in attempting to match assets to future pension liabilities. It will, however, provide the government with resources which will contribute to the management of its future obligations.

The legal status of the NGPF

4.13 The NGPF was established by an act of parliament in 1990 and was amended by Act 2 of 2004. The act (see appendix 3A) is very concise and defines the existence of the fund, payments into it, and the use of the fund only for transfers to the central government budget following an annual resolution by the Storting. It is forbidden to provide credit to the central government or private sector entities, and it cannot be used to raise loans. Investment of the fund is carried out in the same manner as for the government’s other assets, and it is managed by the ministry of finance.

4.14 The act allows the ministry of finance to issue regulations on the governance and management of the fund. The most recent version of the management regulations was issued in 2004 (appendix 3B), replacing the version of 1997, and is coupled with a management agreement between the ministry of finance and Norges Bank (appendix 3C). A separate guideline for the NGPF’s environmental portfolio was issued in 2001 (appendix 3D), and ethical guidelines were issued in 2004 (appendix 3E).

4.15 The regulation on the management of the NGPF sets out the following basic principles:

- Norges Bank will manage the Fund and may use other managers.
- There shall be reports made to the ministry of finance on the performance of the fund.
- The highest return shall be sought subject to any limits set by the ministry or elsewhere in the regulation.

- There will be a benchmark portfolio established and there will be a maximum limit for the expected differential between the benchmark return and the fund return.
- There will be specified limits on asset mix (equities versus fixed interest), and country limits on the equity portfolio and the fixed interest portfolio.
- There will be a specified interest rate risk limit for high-grade income securities.
- There will be ethical guidelines for investment.
- There will be a risk control system.
- There will be a specified limit on ownership of equity capital in any single company.

4.16 One important provision concerns the placement of the fund. The NGPF is placed in a separate account in the form of Norwegian krone (Nkr) deposits at Norges Bank. The bank invests this capital separately in its own name in financial instruments and cash deposits denominated in foreign currency. Although the performance of the fund is thus calculated in foreign currencies, exchange rate movements could produce major changes in overall fund value in local currency, which could be important if or when parliament decides to withdraw substantial amounts from the fund for the purpose of domestic expenditure. The requirement that all equity and bond investment be abroad comes from the annual mandates issued by the ministry of finance that specify the investment universe.

4.17 The management agreement provides broad guidance on the management structure, reporting responsibilities, and auditing functions to be followed. Detailed procedures have emerged and been modified over time.

4.18 In terms of the political system, Norway is a parliamentary democracy; the NGPF is technically an account of the ministry of finance and as such is controlled by the ministry, as answerable to parliament. Day-to-day decisions are delegated by the ministry of finance to the central bank, which is responsible for managing the portfolio, subject to a management agreement between the two institutions. Acts of parliament have been used to create the fund and state its purposes, as well as place constraints on its operation beyond the initial purpose of obtaining the maximum revenue for the nation.

Flows of money into and out of the fund

4.19 As determined by the foundation act, all (upstream) petroleum sector revenues are first paid into the fund:

- Total tax revenues and royalties deriving from petroleum activities collected pursuant to Act 35 of June 13, 1975, relating to taxation of offshore petroleum resources and Act 11 of March 22, 1985, relating to petroleum activities;

- Revenues deriving from tax on carbon dioxide (CO₂) emissions due to petroleum activities on the continental shelf;
- Revenues deriving from the state's direct financial interest in petroleum activities, defined as operating income and other income less operating expenses and other direct expenses;
- Central government revenues from net surplus agreements associated with certain production licenses;
- Dividends from Statoil ASA;
- Transfers from the petroleum insurance fund;
- Central government revenues deriving from the removal or alternative use of installations on the continental shelf;
- Any government sale of stakes representing the state's direct financial interest in petroleum activities;

less

- Central government direct investment in petroleum activities;
- Central government expenses in connection with the petroleum insurance fund;
- Central government expenses in connection with the removal or alternative use of installations on the continental shelf;
- Any government purchase of stakes as part of the state's direct financial interest in petroleum activities.

4.20 Net financial transactions associated with petroleum activities are the sum of:

- Gross revenues from government sale of shares in Statoil ASA;

less

- Government capital contributions to Statoil ASA and the company or companies promoting the state's interests in petroleum activities.

4.21 Flows into the fund also include all interest and dividends earned from the assets of the fund.

4.22 Flows out of or into the fund to the treasury are equal to the nonoil budget deficit (surplus) authorized by the Storting. Adjustments take place after the end of the fiscal year to account for deviations from the planned deficit or surplus, so that the actual outflow or inflow exactly matches the actual budget deficit or surplus. The foundation act gives no indication of the target size of the fund or the principles that should determine the long-term gross assets of the central government. Hence, decisions on the size of the nonoil deficit (which help to determine the fund's total financial accumulation) are not formally related to the total oil wealth of the country.

Table 4.1: Net Transfers to the NGPF and the Accumulated Fund in Current Billions of Nkr (US\$1 = Nkr 6.08, Dec 31, 2004)

<i>Year</i>	<i>GDP</i>	<i>Central government debt</i>	<i>Net transfers to the fund</i>	<i>Share of petroleum revenues transferred (%)</i>	<i>Size of fund</i>
1996	1,026	284	47.5	63	47.8
1997	1,111	276	60.9	71	113.4
1998	1,132	253	32.8	62	171.8
1999	1,233	258	24.4	59	222.4
2000	1,469	285	149.8	94	386.4
2001	1,526	278	251.2	99	613.7
2002	1,519	291	125.3	68	609.0
2003	1,576	339	103.9	64	845.3
2004	1,710	321	138.2	61	1,016.4

Sources: www.norges-bank.no/english/petroleum_fund/reports/ and: www.ssb.no/english/subjects/.

4.23 Table 4.1 presents the net flows retained by the fund since deposits began in 1996. The shares of total petroleum revenues retained also indicate the magnitude of the net inflow to the fund. The very high proportion of oil revenues saved since 1996 indicates that the fund is presently being treated as a savings fund, although the variations in the proportion of oil revenue being saved do point to a de facto stabilization function as well. A marked difference from other oil funds has been the very large share of total oil revenue retained in the fund, which explains why the total size of the fund has increased so rapidly and, as pointed out in the 2004 annual report, is now equivalent in size to the largest global pension funds. The fall in the value of the fund in 2002, despite the presence of a net transfer into the fund, reflects a strong decline in the value of the equity portfolio in that year.

The management and investment policy of the fund

4.24 Although the NGPF was established in 1990 under the direct management responsibility of the ministry of finance, it was only in 1996 that responsibility for its management was delegated to Norges Bank, which was the date at which the first accumulation in the fund occurred. In 1998, Norges Bank created a special division, Norges Bank Investment Management (NBIM) to manage the NGPF. In addition, the NBIM was responsible for managing the assets of the government petroleum insurance fund (established in 1986 to cover liabilities from the government's own involvement in production) and foreign exchange reserves not required for short-term liquidity. By 2004, these two activities had increased the total portfolio managed by 20 percent. The executive director of the NBIM reports to the governor of the Norges Bank but is not a regular member of the bank's investment group. Procedures were put in place to establish "Chinese walls" with other parts of Norges Bank so that the NBIM does not have access to confidential information received from other central banks and international organizations.

4.25 The market operations department of the bank has the responsibility for formulating recommendations submitted by Norges Bank to the ministry of finance concerning the guidelines for the operation of the NGPF. In addition, it is responsible for settlement functions of internally managed subportfolios of the fund, and it makes the final calculations of the return required for comparison with that of the benchmark portfolio.

4.26 Initially, all equity investment was farmed out, but in 1999, the NBIM started to manage some equity investment, leaving the more actively managed part to the external managers, who were hired after Internet tendering. Because external management is more expensive, a balance is sought to contain the costs of the total portfolio. To retain top quality staff, there is also concern to ensure that salaries within the NBIM are competitive with those of equivalent positions in the private sector, and to this end, an element of performance-related pay is used.

4.27 Subsequently, the back office functions handled by the operations management division were merged into the NBIM, because it was the main consumer of these services. However, the investment support department of the NBIM was kept separate from the investment department itself, and the investment support department maintains responsibility for settlement, risk and return measurement, and accounting.

4.28 As the mandate for investment broadened, allowing a wider range of countries and markets into the portfolio, an increasing number of external managers has been utilized. By the time of the 2004 annual report, there were 35 external managers covering a total of 65 mandates.

4.29 As well as external fund managers for both interest-bearing and equity portfolios, the NBIM also outsources a number of other activities:

- Custody and clearing of securities (two global custodian institutions),
- Transaction settlements with counterparties for the internally managed equity portfolio,
- Accounting,
- Portfolio benchmarking (one company for equities and one for interest-bearing),
- Voting (the NBIM makes its own voting decisions but purchases information on voting agendas),
- Market risk for the equity and interest-bearing portfolios, which is measured using a model from a commercial company,
- Credit ratings on the NGPF interest-bearing portfolio and unsecured counterparty exposures, which are based on deliveries from three ratings agencies.

4.30 In 2002, the ministry of finance contracted an external consulting firm to evaluate Norges Bank's management of the NGPF. The consultant's reports for 2003 and 2004 are published on the ministry's Web site (Mercer Investment Consulting 2004). The main task of the report was to check on the internal performance measurements of Norges Bank, of both portfolio and benchmark, and explain any differences that were identified.

4.31 From the fund's inception, the policy has been to invest the entire fund abroad, whether in high-grade income securities or (later) in equities. Initially, investment was restricted to low-risk, high-grade income securities in a limited number of countries, with limits also on geographical weighting. Also, from the beginning, a key management tool has been the benchmark portfolio, which indicates what a passive investment policy of matching this portfolio choice would yield. In 1998, several important changes were made to investment policy on the instructions of the ministry of finance. First, equities were added to the portfolio in five monthly steps of 8 percent, so that investment in high-grade income securities was reduced to 60 percent, the proportion that continues to be the target. Second, the weights for individual countries in the benchmark portfolio were changed and the investment universe was expanded from 10 to 17 countries. The benchmark for equities was the FTSE index for the countries in which investment was permitted, while that for high-grade income securities was based on a world bond index. Finally, the ministry of finance gave some latitude to the NBIM to deviate from the benchmark portfolio, by allowing a tracking error of at most 1.5 percent, which allowed for more active management to achieve higher returns and not constrain the portfolio to exactly matching the benchmark all the time, which could prove costly.

4.32 In addition to stipulating the limit to the expected tracking error, the ministry of finance set limits for the risk profile of the high-grade income securities portfolio by limiting the duration of the investments to three to seven years and imposing regional investment limits (Europe, 40–60 percent; the Americas, 20–40 percent; Asia, 10–30 percent). Finally, the fund was not to hold more than 1 percent of the equity in any single company. Initial ideas of limiting market shares to match those of Norway's imports proved too restrictive because its trade was very strongly linked to the other Scandinavian economies, where the limited size of the financial market did not permit sufficient diversification of the investment.

4.33 By 2000, the portfolio had been extended to cover the 21 countries of the Financial Times Stock Exchange (FTSE) country indexes (including emerging-market countries). The regional equity index weights were 50 percent for Europe, 30 percent for the Americas, and 20 percent for Asia and Oceania. In each region, the market capitalization weights of the individual countries were used to weight countries in the portfolio. The weights of the high-grade income securities were based on Salomon Smith Barney's World Government Bond Index for 18 countries, with the same regional weightings as for equities. Country weights were based on relative GDP weighting. Each quarter, the benchmark portfolio was rebalanced at the same time that new capital was transferred to the fund from the ministry of finance. The limit on holdings in any one company was raised from 1 to 3 percent.

4.34 In 2001, a subportfolio of equity holdings, the environmental fund, was established to be invested in companies on the basis of environmental criteria. The benchmark was the same as for the equities of the total fund, except for the provision that specific requirements for environmental reporting or management (as determined by the ministry of finance) were included and companies in five emerging markets were excluded.

4.35 In 2003, a further change was made to the constraints on geographical distribution when the two regions “the Americas” and “Asia and Oceania” were pooled into one region that was to make up between 40 and 60 percent of the portfolio. At the same time, the equity benchmark portfolio was changed to allow for both large and medium-size companies, thus increasing the number of companies covered in the benchmark. For the first time non-government-guaranteed bonds were added to the portfolio.

4.36 In 2004, the management mandate of the NGPF was changed again when a further list of countries was added to the investment universe. Following a report of the government-appointed Graver Committee and debate on the revised national budget for 2004, the ministry of finance approved new ethical guidelines for the fund’s investments. An advisory council on ethics was appointed to advise the ministry of finance on negative screening and exclusion of companies. Because the ethical guidelines included environmental aspects, the need for a separate environmental sub-portfolio was reduced, and it was abolished, with assets being transferred back to the other sub-portfolios, in December 2004. The risk exposure limits stipulated by the petroleum fund regulation are shown in table 4.2.

Table 4.2: Risk Exposure Limits Stipulated by the Petroleum Fund Regulation

<i>Risk</i>	<i>Limits</i>	<i>Actual at 31 December 2004</i>
Market risk	Maximum 1.5 percentage point tracking error	0.19
Asset mix	High-grade income 50–70 %	59.0
	Equities 30–50%	41.0
Market distribution equities	Europe 40–60%	49.0
	Other 40–60%	51.0
Emerging markets	< 5% of equities	3.0
Currency distribution of fixed income instruments	Europe 45–65%	56.0
	America 25–45%	34.2
	Asia/Oceania 0–20%	9.8
Interest rate risk	Modified duration 3–7	5.6
Ownership interest	Maximum 3% of a company	2.7

Governance of the fund

4.37 The governance of the NGPF has been entirely determined by the regulations and instructions of the ministry of finance, following the passing of the Act of 1990, which stated only that “[t]he Ministry of Finance shall manage the Fund.” The guidelines and regulations for the operation and governance of the fund were produced by the economic policy department (EPD) of the ministry of finance, without reference to the Storting. The EPD also supervised and drafted reports on the fund for the minister of finance and the Storting.

4.38 The EPD determines the benchmark portfolio, which has been changed several times, and supervises the performance of the fund against the benchmark. It also reviews reports and external audits and generally monitors performance of the sub-funds.

4.39 Internal audits of the fund by Norges Bank are carried out quarterly, and the office of the auditor general carries out an annual external audit that is submitted to the Norges Bank supervisory council, which is appointed by the Storting. The quarterly and annual reports from Norges Bank, and the auditor general’s report, are published on the Internet. These reports detail all flows into and out of the fund; all of the fund’s holdings and values; the returns, risks, methodology of calculations; and administrative costs.

4.40 Finally, as a check on internal calculations of performance, the ministry of finance appointed an independent consultant in 2002 to carry out an evaluation of the returns and risks for the benchmark and for the actual portfolio. These reports confirmed that the calculations of benchmark and actual returns made by the NBIM were accurate. The 2004 report also confirmed that the fund also performed better than the benchmark portfolio—in 14 of the quarters since 2000, the fund outperformed the benchmark.

Financial performance of the NGPF

4.41 Extensive details of the performance of the NGPF are contained in the annual and quarterly reports all of which are available on the Norges Bank Web site. The main features of performance since the fund began to accumulate in 1997 are given in table 4.3.

4.42 Table 4.3 illustrates several important features of a fund that has been run with the sole aim of maximizing returns subject to a cap on risk. The international return on equities was highly variable and produced a lower average return than on bonds over the seven-year period. Only countries that can afford to take a long view and can sustain temporary large losses, such as occurred in 2001 and 2002, can afford to have such a large portion of the portfolio in equities. The active management strategy for the fund as a whole (of both external and internal managers), which permitted managers to deviate within each asset class from the exact securities identified in the benchmarks, produced an average excess return over the benchmark of 0.38 percent, which is about 10 percent of the total return. After allowing for costs and inflation, the real return in international currency, for the eight years of the NGPF’s existence, was 4 percent.

Table 4.3: Annual Nominal and Real Return Measured in Terms of the Fund's Currency Basket 1997–2004 (percent)

	1997	1998	1999	2000	2001	2002	2003	2004	1997– 2004
Nominal return									
Equities	NA	12.86	34.81	−5.82	−14.5 9	−24.3 7	22.83	13.00	3.64
Bonds	9.07	9.31	−0.99	8.41	5.04	9.90	5.26	6.10	6.46
Total return	9.07	9.25	12.44	2.50	−2.47	−4.74	12.59	8.94	5.76
(Total return NKr)	10.83	19.75	13.85	6.53	−5.31	−19.0 9	19.96	3.93	6.14
Excess over benchmark	0.23	0.20	1.25	0.20	0.02	0.13	0.47	0.53	0.38
Inflation	1.75	0.92	1.28	2.02	1.18	1.89	1.36	2.43	1.60
Real return	7.19	8.25	11.02	0.47	−3.61	−6.51	11.08	6.35	4.09
Costs	0.04	0.06	0.09	0.11	0.07	0.09	0.10	0.11	0.08
Net real return	7.15	8.19	10.93	0.36	−3.68	−6.60	10.98	6.24	4.01

Not Applicable (NA).

4.43 The ultimate purpose of the fund appears to be to support domestic spending, possibly on pensions, thus the performance of the fund in domestic terms is of considerable importance. However, for a fund of the size of the NGPF, there is little alternative to investing abroad because the domestic market would not be able to support such large financial investments. This contrasts with the case of Alaska, where it was possible to be heavily invested in the U.S. market without running any exchange rate risk, but invest outside the state and avoid domestic problems caused by high levels of expenditure. Over the period considered, the return in domestic currency was similar to that in the international currency basket, so that the effect of exchange rate movements over this period was largely neutral.

4.44 In 2004, the NBIM managed 78 percent of the total portfolio, including 57 percent of equities, and accounted for 38 percent of total costs. External managers, who are more expensive, were allowed to take a more active management approach to their mandates, but the NBIM is also permitted a certain amount of active management on its part of the portfolio. The annual reports indicate the extent to which the internal management was able to improve returns by this means, and this is shown in table 4.4, which gives the value added through active management, taking into account the associated costs.

Table 4.4: Norges Bank's Contribution to the Return on the NGPF (percentage points)

1998	1999	2000	2001	2002	2003	2004	1998–2004
0.19	1.18	0.20	0.11	0.21	0.54	0.49	0.40

4.45 The extra net return due to active management of the NBIM, compared to the total net real return on the fund, which averaged 4.09 percent for the whole period, is substantial. However, if a less sophisticated domestic financial institution were charged with the management of the fund's investments, a policy of maintaining the benchmark portfolio would produce the majority of the benefits to be obtained, without the risks attached to permitting an inexperienced team to actively manage portfolio selection.

Assessment

4.46 The distinctive feature of the NGPF is that it is, de jure, part of the general budget process, because the only explicit use of the fund is to support nonoil budget deficits, and the status of the fund is such that at any time the parliament can withdraw as much as it wishes from the fund to support the nonoil budget deficit. This flexibility is due to the fact that there are no rigid accumulation or withdrawal rules. In practice, during its short operational life since 1996, it has de facto been used largely as a savings fund, although there have been substantial year-to-year variations in the proportion of oil revenues saved.

4.47 This contrast between what might be done with the fund, and what has actually happened, points to the strong discipline of the Storting in not spending the money on short-term benefits or for political advantage. Such a structure could be particularly vulnerable to a political election cycle, and over longer periods, this may prove to be an important factor in the use of the fund.

4.48 The other key feature of the NGPF arrangement is linked to the limitations on the investment universe—the almost absolute control of the policies for the management of the fund by the ministry of finance, determined by the foundation act. Because the single overarching constraint of the fund is to maximize its return subject to a risk cap, the management focuses on delegation to a competent authority and the establishment of adequate auditing procedures, which are particularly straightforward for the classes of assets permitted by the ministry.

4.49 The Norwegian approach to the investment management of the fund was to make this the primary concern of the central bank and encourage the bank to undertake much of this itself through the creation of specialized divisions. The bank was already managing the investment of the petroleum insurance fund and some of the foreign exchange reserves, initially all held in foreign government bonds, so that the decision in 1999 to allow the NBIM to start to manage some of the equity portfolio itself, and oversee external managers pursuing an active policy of trying to improve on a benchmark portfolio, was an important departure. Establishing adequate staffing to take on these new responsibilities has been an ongoing concern for the central bank.

4.50 The investment universe permitted by the ministry of finance has evolved in a slow but steady fashion. Initially, only government bonds in a narrow range of developed country markets were allowed, but this has been widened to permit emerging-market securities and equities, as well as some non-government fixed interest securities. More volatile assets, such as real estate, have not yet been permitted. Over its eight-year lifetime, the performance of the fund does not make an overwhelming case for the

inclusion of equities in the portfolio, and such a decision has to be based on long-term market performance. A particular difficulty for a fund of this nature, where parliament may suddenly call for a large withdrawal, is that an equity-dominated portfolio could find that sufficient funds could be liquidated at short notice only at a loss. Because borrowing against the fund is not permitted, and increasing debt outside the Fund is not encouraged, the liquidity of the fund is a factor that should also be borne in mind. This risk is also compounded by the fact that the whole portfolio is invested abroad, making it vulnerable to sudden exchange rate movements when a withdrawal for domestic use is required.

4.51 The strategy of defining a benchmark portfolio that could be purchased at relatively low management cost, against which the more actively managed portfolio can be assessed, is a very important auditing tool for both the external managers (mandate by mandate) and the NBIM as a whole.

4.52 For a fund of the size of the NGPF, especially in relation to the size of the domestic economy, the decision to invest the entire fund abroad is an effective method of sterilizing the impacts of the oil boom. If there is a need to support domestic investment, then the non-oil deficit can be increased and transfers to the fund decreased.

4.53 The role of parliament and bodies outside the ministry of finance is also limited. The Storting does directly control the size of the fund, through its decisions regarding the non-oil budget deficit, and takes a limited active role in oversight through the approval of the annual and quarterly reports and the auditor general's annual report. The wide publicity given to the performance and management of the fund, through the widespread publication of the reports, acts as a source of public information, which could influence the activities of the fund through the democratic process. The 2004 decision to impose ethical standards on investments illustrates how political considerations may be superimposed on traditional investment constraints.

4.54 Overall, the operation and management of the NGPF has proved very successful in accumulating funds for the Norwegian state. It remains to be seen whether the aggressive saving of oil funds and sophisticated investment policies followed by the government will be able to accumulate sufficient funds to finance future spending needs at a time when oil production will be in decline.

5

The State Oil Fund of the Azerbaijan Republic (SOFAZ)¹³

Overview

5.1 Azerbaijan has been an oil-producing region since the late 19th century, and production subsequently grew to substantial levels. However, starting in the mid-1960s, production gradually declined because of lack of investment when the Soviet Union directed its attention to other producing regions. By the time of independence and the creation of the Republic of Azerbaijan, production was about 200,000 barrels a day. The country was effectively an old oil producer facing the impacts of steadily declining revenues. The economy at the time of independence, and in the first years thereafter, was in very poor shape. Government revenues were less than 15 percent of GDP in 1995, and the deficit was as high as 10 percent of GDP. The resulting monetary expansion drove down the value of the currency and increased the rate of inflation. Despite the decline of the oil sector from earlier levels, it was still a major provider of foreign exchange: in the mid-1990s, oil accounted for 61 percent of total exports, and the large swings in oil prices hit the balance of payments very hard (as in 1999). Domestically the economy was weak and suffered from high rates of unemployment—an estimate from the census of 1999 indicates that it was at least 16 percent.

5.2 However, in 1994, the government signed the US\$10 billion “deal of the century” for the development of the Azeri-Chirag-Gunashli (ACG) oil fields, which produced immediate revenue in the form of signing bonuses in 1995, with oil production commencing in 1997. Since that time, there has been further investment in oil and gas, leading to what has been termed a “second oil boom” for Azerbaijan (Bagirov and others 2003, Petersen and Budina 2003). This has resulted in a dramatic turnaround in the financial and fiscal strength of the economy. Oil revenues accounted for 30 percent of total government revenue by 2001, and signing bonuses from 1995 onward have been used to finance a large part of the nonoil deficit, with an average of 62 percent between 1995 and 2000—even by 1999, the share of oil in total exports had risen to 91 percent. GDP has also increased steadily, and by 2004, per capita GDP was estimated at US\$1,029.

¹³ Official statistics on the oil fund are taken from <http://www.oilfund.az/>.

5.3 The ACG is making possible a very rapid acceleration in oil output so that, from a current level of about 300,000 barrels a day, output is now expected to peak in 2010 at approximately 1.4 million barrels a day, making it about the 15th largest oil producer in the world, at a level similar to that of Brazil or Libya. However, this very sharp increase is expected to be immediately followed by a period of decline, with output falling to about 700,000 barrels a day in 2020 and a further steady decline thereafter. This extremely peaked pattern of production will have major impacts on the magnitude and path of government revenues from oil. Because the contract for the ACG is on a profit-sharing basis, in the early years of production, during the cost recovery phase, revenues will be limited, but will then accelerate extremely rapidly after full cost recovery. Production will increase roughly fivefold between the present and the peak; in 2004, it has been forecasted (World Bank 2004) that government revenues will increase almost 10-fold, under the assumption that the oil price will steadily decline from around US\$40 in 2004 to US\$26 a barrel in 2010. In its study, the World Bank projected fiscal revenues to rise from about US\$0.5 billion in 2004 to approximately US\$5 billion in 2010, with a decline to US\$3 billion by 2020. Over a 20-year horizon, total oil revenues were projected to be about US\$70 billion. If oil prices remain higher than in these assumptions, not only will revenues be higher, but large revenues will occur earlier.

5.4 The special characteristics of the oil revenue flow in Azerbaijan make its situation akin to that of new oil-producing countries. The flows will accelerate quickly to an extremely large level (relative to the size of the country) but then immediately start to decline. This generates a need to presently save some of the revenues, both for future generations, when the revenues will have declined, and because of the problems of absorbing so much money if it were all spent as it is earned. In addition, because of the volatility of oil prices, and the dominance of the oil sector for the budget, a policy for the stabilization of government expenditures is needed.

5.5 The system of public finance within the economy has shaped the treatment of oil revenues. Parliament exercises limited control over spending because it neither drafts nor amends the budget submitted by the ministry of finance, but can only approve or reject, with the latter being effectively a vote of no confidence. In addition, early budgets were very brief, giving little line-item detail, thus there could be no debate on planned specific uses of revenues. Hence, when the SOFAZ was established by presidential decree in 1999, it was founded as a legally independent entity, answerable to the president, and with powers to propose spending plans from the resources of the fund. Before this, a special account at the national bank had been opened to sterilize some of the bonus payments by keeping foreign exchange earnings out of the monetary system.

5.6 The oil fund, with explicit operating, investment, and expenditure rules, was launched in July 2001, by presidential decree (appendix 4A). The fund was designed explicitly to take account of the problems of managing a large and temporary inflow, and the rules of operation were designed to be sufficiently flexible for use as either a savings or stabilization function, as well as supplying budget-type support for specific projects. Subsequently, the International Monetary Fund (IMF) and World Bank have supported a program to improve the design of the fund through technical assistance and program conditionality.

5.7 The basic principles of SOFAZ suggested that expenditures from it would be used for human development and the promotion of the nonoil sector, as well as for budget support. In particular, it has been used also for assistance to refugees and funding the share in the Baku-Tbilisi-Ceyhan (BTC) oil pipeline of the State Oil Company of the Azerbaijan Republic (SOCAR).

5.8 Revenues from bonuses, the sale of profit oil from the production-sharing agreements, rental fees, and acreage fees, as well as revenues from the investments of its own assets, are all paid into SOFAZ; profit tax payments from SOCAR and the ACG partners are all paid directly into the budget. At the end of 2004, the net assets of SOFAZ were US\$964 million, and over the period 2004 to 2024, about US\$50 billion is estimated as being paid to SOFAZ, with another US\$20 billion being paid directly to the budget. Currently, use of the fund's resources in any year are limited to an amount equal to the revenues of the fund in the same year, ensuring that the nominal value of the fund does not decrease over time. Expenditures from the fund itself, whether as budget support or project-specific outlays, have to be approved by the president.

5.9 Since 2003, oil revenues paid directly to the budget, which have been inflated beyond expectations by high oil prices, have created an excess for the budget and so have been placed into a separate stabilization account created by the ministry of finance. These are held in domestic banks and can be drawn down when required, according to a principle that they are to be used for stabilization only if the price of oil drops below that in the current budget estimate. By mid-2004, another US\$82 million had been accumulated in this way, which reduces the need for SOFAZ to be regarded as providing a stabilization role and lessens the need for its assets to be held in the short term. This arrangement is rather informal and raises a number of questions about its operation and use—in particular, whether the stabilization account should be amalgamated with SOFAZ, which is acquiring investment management expertise in both short-term and longer-term securities.

The establishment of SOFAZ ¹⁴

5.10 All legislation relating to the fund has been accomplished by presidential decree, which is the quickest way to implement policy but is also the simplest to reverse (by a countermanding decree). The operation of the fund, as explained below, is also under the direct control of the president, with certain formal checks and balances to this process (annual audits, parliamentary involvement in expenditure decisions, supervisory board) as well as advisory inputs. Overall, SOFAZ is a version of a model in which the establishment and operation of the fund are harmonized through the actions of a single political agent.

5.11 Decree 240 of 1999 established the existence of an oil fund, and this was subsequently amended by Decree 849 of 2003. This legislation indicated which revenues would be payable into the fund and that the primary purpose of the fund would be to direct revenues toward the socioeconomic progress of the country. It also indicated that

¹⁴ Key documents are taken from the SOFAZ Web site, www.oilfund.az/ and are reproduced in appendix 4.

the cabinet would draw up regulations for the operation of the fund. At this stage, there was no indication that the fund would be used either for savings for future generations or for stabilization; instead it appeared to be more in the spirit of the early stages of the AHSTF. Until the fund was formally created, the relevant oil revenues were to be held in a special account at the national bank. Decree 240 was extremely short compared to the founding legislation for other funds, but it was designed to give time for the planning of what the fund should do, and how assets should be invested, through later decrees.

5.12 The key legislation was embodied in Decree 434 of 2000 (amended by Decree 849 of 2003), which created the regulations for the state oil fund. The regulations indicated principles of the use of the assets of the fund and importantly limited total expenditures from the fund in any one year to a maximum equal to its revenues in that year. The objects of expenditures were stated in broad terms to be for the most important nationwide problems, strategically significant infrastructure, and the purpose of the country's socioeconomic progress. These are clearly open to interpretation and give flexibility, but they also impart the possibility of shifting priorities to meet short-term political expediencies, rather than longer-term planned goals. One important provision was that the fund's assets could not be used for lending to government bodies or public enterprises, nor as collateral for debts.

5.13 The SOFAZ management structure was also described in the regulations decree (appendix 4B). There was to be an executive director, appointed and dismissible by the president, whose duties were defined, and a supervisory board for giving opinions to the director, but without any powers to vary policies. The composition of and appointment to the board were not defined in detail in the initial regulations, except that it would be appointed by the president and it had to meet at least once a quarter. Reestablishment and liquidation of the fund would be carried out by presidential decree. There was to be an external audit of the fund each year by an auditor appointed by the president.

5.14 In 2001, two important decrees covered the investment and withdrawal policies of the fund, making it fully operational. The rules for asset management were issued in Decree 511, which limited the types of asset and currency that could be held and specified the duties of the executive director and supervisory board in preparing an investment plan. The rules appeared to envisage that all assets would be held abroad and the majority of the investment would be in government securities and debt, with little scope for equities. Decree 579 (amended by Decree 849 of 2003) is largely concerned with the procedures for preparing the budgeted expenditures, which have to be presented to the president for approval. Withdrawals were to be of two types: expenditures on specific projects, in line with the broad policies adopted for the use of the fund, or a transfer to the budget to be used for general budget support and not earmarked to particular items. In line with these decrees, specific expenditures on displaced persons were approved by further decrees in 2001 and 2002.

5.15 In 2004, the fund was given a more explicit requirement for saving for the future by Decree 128, which ruled that once revenues reached their peak (around 2009), at least 25 percent of each year's revenue must be retained by SOFAZ. The decree indicated that in the medium term, expenditures from the fund would be determined on

the basis of the nonoil budget deficit, which was not to be sharply changed; in the long term, a constant real expenditure pattern should form the basis of policy. A partial list of objectives for spending was provided, which included developing the nonoil sector, large-scale infrastructure, and poverty reduction. The requirement to save at least 25 percent of inflows once the estimated peak revenue has been reached should be seen in the light of recent experience—35 percent was retained in the fund in 2003 and 50 percent was retained in 2004, indicating that a rapid accumulation is taking place during the upswing of oil revenues.

5.16 The creation of SOFAZ and the further decrees have been accompanied by lively press discussion. Not all of the press supported the creation of an oil fund. Worries about the use of an off-budget fund were important, and some of those in favor wished to subordinate it to parliament. The ad hoc decisions to spend fund resources on building homes for refugees, and for financing the state's share of the BTC pipeline, were debated, and some critics questioned why the regular budget should not do this. International NGOs opposed these moves, arguing for direct links to poverty reduction, but this was countered by a group of domestic NGOs supporting the decisions.

The flow of money into and out of the fund

5.17 The initial principle of establishing a fund was to sterilize foreign currency from oil and gas revenues, which were in excess of the government's needs, and to manage the assets "in the interests of the citizens of Azerbaijan and their future generations." Revenue flows from oil are divided between those that go directly to SOFAZ and those that go directly to the state budget.

5.18 The sources of revenue for SOFAZ include:

- Revenues from the sale of the state's share of production under the Petroleum Sharing Agreements (PSAs) (excluding SOCAR's participating interests),
- Bonus payments (from 2000),
- Dividends and the government's share of profit oil,
- Surface fees beginning in 2001,
- Government earnings from transport of oil and gas through the BTC and Baku-Tbilisi-Erzurum (BTE) pipelines,
- Revenues from sale of project assets by foreign companies to the government of Azerbaijan,
- Revenues from other sources permitted by legislation,
- Revenues from grants,
- Earnings from SOFAZ investment activity, including interest payments, dividends, and income from rebalancing of foreign exchange portfolios.

5.19 Foreign companies deposit payments to SOFAZ into the fund's special account at the national bank, where it is absorbed into the investment program.

5.20 Taxes paid by SOCAR and foreign oil companies go directly to the budget.

5.21 In 2001, the audit firm found some ambiguities in revenue rules, including whether termination and abandonment payments, revenues from onshore fields, and pipeline transit fees should be paid to SOFAZ or to the budget because of the phrasing of the presidential decrees of 1999 and 2000: "other revenues obtained as a result of joint activities with foreign companies." This illustrates well the point that the complexity of fiscal arrangement typical of the oil sector necessitates careful drafting of the legislation if a split of revenues between a fund and the state budget is envisaged.

5.22 Withdrawal rules cover flows out of the fund. The legislation is clear as to the maximum amount that can be withdrawn in any given year. Presently, this is equal to the revenue inflow during the year (or expected during the year at the time of the budget process), but it will fall to 75 percent of the revenue expected once revenues have peaked, which is currently expected to be in 2009 or 2010. This regulation means that, short of an enabling presidential decree, there is no mechanism for directing extra money from SOFAZ back to the budget to meet a large unforeseen expenditure requirement or a sudden inadequacy of the permitted transfer due to a very large fall in the oil price and revenues.

5.23 The actual outflow from the fund is determined by the nonoil budget deficit, as debated in parliament, plus special expenditures from the fund determined by presidential decree, subject to the overall constraint that total expenditure must not exceed the expected revenue of the fund in the same year. As noted, the rules governing permitted expenditure from the Fund are broad, defined in terms of "the socio economic progress of the country; for solving the most important national problems; and for the construction and reconstruction of strategically significant infrastructure facilities" (appendix 4D). Rules for the preparation of the SOFAZ annual budget also state that the plans should take into account the "necessity to promote the development and increase the competitiveness of the non-oil sector of the national economy

5.24 Three presidential decrees have authorized SOFAZ to spend on internally displaced persons, and another decree in 2002 permitted SOFAZ to allocate expenditures in support of SOCAR's share of financing the BTC pipeline (US\$118 million). This was a controversial decision for a number of reasons. First, there was a question of whether it went against the provision of the regulatory decree that forbade lending to state enterprises, and second, the goals of the use of the fund explicitly state supporting the nonoil sector and socioeconomic development. Despite initial IMF objections, it was finally agreed that some pre-2000 bonus payments held on deposit at the national bank (and therefore not directly in the fund) would be used for this purpose, and the government agreed to transfer ownership of its stake in the BTC pipeline from SOFAZ to the ministry of economic development so that oil fund expenditures remained consistent with the regulations.

5.25 Revenues directly from the oil sector have been dominated by the sale of profit oil (estimated to be 86 percent of total revenues in 2004), with bonus payments, transit fees, and acreage fees each making minor contributions. Revenues from asset management come from two sources: the investment of the fund's assets and income (or losses) generated by revaluation of its foreign exchange assets. The revenues from managing the assets of the fund amounted to about 7 percent of revenues from oil in 2004; currently, the dominant source of revenue is the payments from the oil sector, and it is any unspent amount of this that gives substantial potential for the fund to continue to grow.

The management and investment policy of the fund

5.26 SOFAZ is an independent legal entity and an off-budget institution with its own administrative structure. The executive director, who is appointed and can be dismissed by the president, operates the fund.

5.27 The executive director chooses an investment strategy in line with the rules spelled out in: "On Storage, Placement and Management of the State Oil Fund's Foreign Currency Reserves" (Presidential Decree 511). The strategy outlines portfolio structure and volumes, asset liquidity, acceptable credit risks, and portfolio management efficiency requirements. The strategy and comments on it by a supervisory board must be annually submitted to the president for approval.

5.28 Management of a portion of the fund's assets may be contracted out to external portfolio managers (the number of managers and conditions on this are not spelled out).

5.29 Within SOFAZ, an investment board reviews developments in financial markets and provides guidance on investment opportunities. The board consists of the executive director and senior officials of various SOFAZ departments. Local and foreign consultants may be invited to attend board meetings.

5.30 The executive director is also responsible for preparing the budget in collaboration with the ministry of finance. They predict earnings based on the medium-term outlook and propose expenditures in line with the fund's mandate. This budget, with comments by the supervisory board, must be submitted to the president in September of the preceding year for approval. Other oil funds are not usually given this duty, which could place a large burden on the staff of the fund.

5.31 At its inception, SOFAZ had only 6 full time staff, compared to Alaska's 32 and Alberta's 18, but this has steadily increased and reached 19 in 2003. Although there is a provision to use external portfolio managers, this was not exercised initially. In 2002, two external managers were each allocated US\$40 million to manage in accordance with the investment criteria set out in the regulations, and by 2004, external managers were responsible for 12 percent of the fund's assets. In the 2004 annual report, the performance of the two external managers was presented separately from that of the rest of the portfolio.

5.32 The investment policy of the fund is based on an annual plan prepared by the executive director, which is submitted, with the opinion of the supervisory board, to the president for approval.

5.33 The asset management rules were set out in Decree 511 of 2001. The main guidelines were on the currency in which assets could be held and the class of assets that could be held. Foreign currency assets could be currency or investment assets denominated in euros, U.S. dollars, yen, or pounds sterling, with other currencies with a long-term country rating not less than S&P' A (Moody's A2) up to a limit of 5 percent of the portfolio. Permitted assets included:

- Bonds and other securities issued by governments of countries that have long-term country (sovereign debt) ratings of at least A (S&P, Fitch) or A2 (Moody's);
- Securities issued by financial institutions with state guarantees or by state agencies and governments of countries with long-term country (sovereign debt) ratings of at least A (S&P, Fitch) or A2 (Moody's);
- Securities and bonds issued by international (supranational) financial institutions (including but not restricted to the International Bank for Reconstruction and Development (IBRD), the European Bank for Reconstruction and Development, and the Asian Development Bank);
- Debt issued in the form of securities by commercial banks and other financial institutions that have long-term credit ratings of at least A (S&P, Fitch) or A2 (Moody's);

5.34 When a portion of the oil fund's foreign currency assets is managed by an external manager, such an investment portfolio may comprise other investment assets, including corporate debt and equities in addition to those listed above. External managers shall have a credit rating of not less than AA- (S&P, Fitch) and Aa3 (Moody's).

5.35 In addition, there are specific prohibitions that the oil fund's investment portfolio shall not be invested in:

- Currency arbitrage, swaps, forwards, and futures (except for the purpose of hedging or optimizing the currency composition of the investment portfolio and structure of the oil fund's assets);
- Precious metals and stones;
- Real estate.

5.36 These rules permit the fund, but only through its external managers, to hold equities, but this has not yet been exercised, nor is the proportion of the portfolio that can be so held specified.

5.37 A benchmark for the performance of the fund was set through the annual investment policy of the three-month U.S. dollar London interbank offered rate (LIBOR), and a similar benchmark was applied to the external fund managers.

5.38 In 2003, the portfolio was divided into an investment portfolio and an expenditure portfolio. The latter kept funds earmarked for expenditures to ensure an adequate liquidity profile and ensure that some income was generated on those funds before they are called. Not surprisingly, the return on the expenditure portfolio (which was about one-sixth of the investment portfolio) was modest, at about 1 percent. This distinction was not maintained in the 2004 annual report.

Governance of the fund

5.39 The governance of SOFAZ is a three-tiered model. All the ultimate control of the fund is exercised by the president—at present, even the decision to liquidate would be made by the president. The role for parliament is first through the approval or disapproval of the main budget, which would include a transfer from the fund for budget support. In December 2002, the IMF suspended a tranche of its Poverty Reduction and Growth Facility of US\$17 million because of ad hoc decisions made on use of the fund’s assets. A suggestion for strengthening parliamentary oversight through a law was rejected, but it was agreed to change the budget systems law so that expenditures from the fund would be reported in the budget. However, parliament still does not possess line-item amendment power. A second level of control is through the annual external audit, carried out by an international specialist company and published as part of the SOFAZ annual report.

5.40 Below the president is the supervisory board, whose members are appointed (and terminated) by the president according to Decree 855 of 2001. Two members of the Milli Majlis (Parliament) are nominated by the speaker of parliament. The stated powers and composition of the board are very general. It must contain “representatives from relevant state bodies and public organization, as well as other persons,” but the numbers and bodies are not specified in the decrees. Procedural rules for the board were agreed in 2002 but were not published (voting and quorum issues). At present, the board comprises the:

- Prime minister,
- First vice speaker of parliament,
- Economic adviser to the president,
- Minister of finance,
- Minister for economic development,
- Chairman of the state committee for securities,
- Chairman of the board of the national bank,
- Minister of communications and information technologies,
- President of the national academy of sciences.

5.41 The current makeup of the board is heavily weighted toward members of the government, and the absence of any business interests is notable, because most other funds involve some experienced business persons in an advisory capacity.

5.42 The duties of the board are to review the fund's draft annual budget, which includes the important expenditure plans, review the annual report and financial statements, and provide comments on these to the president.

5.43 The executive director of SOFAZ consults with and provides information to the board, but is ultimately responsible to president, to whom he reports directly and who approves the investment strategy. The board is expected to provide feedback on the annual budget prepared by the executive director. It is supposed to meet at least once a quarter, but initially met less than once a year.

5.44 The duties of the executive director, who is appointed by the president, are to be vested with the powers to be legal representative of the fund; organize and conduct the business of the fund, including appointment and dismissal of employees; manage and disburse the assets of the fund in conformity with the regulations; be responsible for the preparation of the SOFAZ annual budget, incorporating an annual program of the use of assets; and submit this for presidential approval.

5.45 Outside auditors provide oversight in a report, which has been published separately for financial years 2002, 2003, and 2004, and annual reports have been published for all the years of the fund's operation—as well as, more recently, quarterly statements. In addition, parliament's chamber of accounts is entitled to audit SOFAZ at its discretion, but there is no provision of the publication of any such audit.

5.46 Azerbaijan has a transparent disclosure policy on oil revenues. The annual reports and the regulations on the fund are publicized on the Web site (www.oilfund.az). The reports give extensive detail on the sources of revenue from each stream being paid into the fund and the banks in which deposits have been made. Latterly, brief quarterly reports have also been published. Recently, Azerbaijan opted to join the Extractive Industries Transparency Initiative and published initial reports on oil revenue flows received for 2003 and the first six months of 2004.

The financial performance of the fund

5.47 SOFAZ was initially endowed with revenues from bonus payments received prior to 2001. Table 5.1 summarizes flows into and out of the fund as given in the annual reports, with the returns measured in both U.S. dollars and local currency.

5.48 The fund has steadily accumulated assets, and in 2004 was equal to about 12 percent of GDP. Preliminary estimates indicate that by the end of September 2005, the assets of SOFAZ had reached manat 5.8 billion (US\$1.3 billion), reflecting the impact of the large oil price rise during the year. In 2005, a small transfer was made to SOFAZ from the special stabilization account created to accumulate surplus oil tax revenue. Operating costs of the fund are approximately 0.1 percent of its value.

Table 5.1: Flows into and out of State Oil Funds in Current Billion Manats and Annual Returns at December 31^a

	<i>Contribution received</i> (manat)	<i>Net surplus on fund</i> (manat)	<i>Transfers to budget & other spending</i> (manat)	<i>End-year total</i> (manat)l	<i>Nominal return</i> (manat)	<i>Nominal return</i> (US\$)	<i>Real return</i> (US\$)
Initial transfer	1243.70						
2001	963.60	146.2	-3.6	2,349.90	8.51	3.87	2.25
2002	1,089.70	122.9	-188.7	3,373.90	4.41	2.15	1.25
2003	1,361.70	136	-903.5	3,968.10	5.08	4.42	1.99
2004	1,522.60	34.9	-791	4,734.70	1.46	1.88	1.54
2001–04	6181.30	440	-1886.8	4,734.70	4.93	3.08	1.76

a. 4,593 Manats = US\$1, December 2004.

5.49 In foreign currency terms, the return on the fund's assets was modest, and below the return on foreign assets obtained during the same period by Alberta, Alaska, and Norway, in large part because of the conservative investment policy that has been adopted so far. For the first three years of the fund's operation, the return, which was largely from high-grade income securities, was 3.5 percent in U.S. dollar terms and 6.0 percent in local currency, but in 2004, local returns did not exceed dollar value returns. For 2004, the breakdown of the fund by asset type is shown in table 5.2.

5.50 The annual reports also show the breakdown of total withdrawals. In 2002, a transfer of manat 189 billion was made to the refugees committee, but no other transfer was made to the budget; in 2003, manat 533 billion was transferred to the budget, manat 281 billion was paid out in respect of the BTC company, and manat 90 billion was paid to the refugees committee. In 2004, manat 650 billion was transferred to the budget, manat 89 billion to financing the BTC pipeline, and manat 75 billion to refugees, and expenses were manat 3.6 billion.

Assessment

5.51 SOFAZ has only a short history, but its role in the management of the economy is becoming clearer as successive legislation, through presidential decrees, has defined the investment and expenditure strategies more precisely.

Table 5.2: SOFAZ Assets, December 31, 2004 (current US\$ million)

<i>Investment type</i>	<i>Amount</i>	<i>Share (%)</i>
Bank deposits	296	30.7
Money market funds	146	15.2
Correspondent accounts	27	2.9
Sovereign debt	5	0.6
Securities of U.S. federal agencies	55.1	5.7
Bank securities	309	32.0
Corporate debt	10	1.0
Funds externally managed	115	11.9

5.52 From its inception, the fund has received an unusually high fraction of total oil receipts, and the long-term prediction is that about 70 percent of all oil revenues of the government will first be passed to the fund. This makes the rules and decisions on expenditures from the fund of special importance. The constraint that spending from the fund is limited to an amount equal to current revenues (yearly transfer to the fund plus investment earnings) has the potential to allow it to accumulate assets very rapidly, especially at a time when high oil prices are generating a budget surplus through the receipts of revenues not paid into the fund. The tightening of the spending constraint to permit only 75 percent of current revenues to be spent in any year (once peak revenues are reached) implies that at least almost 20 percent of total oil revenues will then be saved.

5.53 The recent decision to use fund revenues to cover the non-oil budget deficit, plus any spending on special projects approved by the president, and a restriction on total withdrawals from the fund, is moving toward a fuller integration of fiscal policy. Budgetary plans have to take into account the likely oil revenue flows and adjust expenditure and taxation plans to respect the overall savings decision implied by this rule. The restriction to save at least 25 percent of revenues of the fund will provide a tighter constraint, although at present, more than 25 percent is being retained in the fund.

5.54 Decisions on the size of the non-oil deficit are made by parliament through its budgetary process; spending on special projects, such as the support for internal refugees or the BTC pipeline, is determined by presidential decree. The bulk of the withdrawals from the fund are made to cover the expected non-oil budget deficit, thus the arrangement is also improving public accountability through the involvement of parliament.

5.55 The distinctive feature of SOFAZ is its ultimate subordination to a single agent, in the person of the president, in that the establishment, regulatory, and asset management decrees were all determined by the president. Also, the president appoints the executive director of the fund and approves the membership of the supervisory board. This arrangement had the advantage of allowing rapid establishment of the fund and giving time to understand what legislation would be needed for the best long-run interest

of the country. Currently, discussions are under way with respect to passing a parliamentary act concerning the nature and operations of the fund because, as with other funds where the laws concerning them have not been entrenched in the constitution, thus requiring a major political debate on any changes to be made, changes of direction could easily be made and short-term needs could come to dominate the longer-term purposes of the original ideas behind the creation of a savings-type fund.

5.56 The SOFAZ investment management strategy has to date been very conservative, but this mirrors the experience of other funds, whereby all investments are made in foreign-denominated assets and the class of assets is initially confined largely to low-risk securities. With such a constrained investment scheme, the use of benchmarks has been very simple, and the management of a large part of the portfolio by SOFAZ itself has been relatively uncontroversial. If a more aggressive investment strategy becomes desirable, then the guidelines on investments by market and assets, as well as the definition of performance benchmarks, will become more important. In addition, a technical advisory board could be established.

5.57 The actual control of the fund and oversight are more limited than in the case of the funds in Norway, Alberta, and Alaska. The executive director is aided by an investment committee drawn from senior staff within SOFAZ. Outsiders and technical experts can be invited to attend, but this is discretionary, and actual use made of this provision is unclear. In contrast to other funds, there is no formal role within SOFAZ for external investment advisers with specialist knowledge of financial markets. The supervisory board, which comments on the current investment strategy presented to the president, consists almost entirely of ministers and also has no current representative from the business community.

5.58 The transparency of the fund itself is well established, with a very detailed Web site and the publication of all relevant legal material, as well as the annual reports and the external audit. As the investment strategy becomes more complex, these will need to provide more detail on the actual holdings of the fund to permit debate on whether appropriate investment decisions are being made.

6

Some Other Resource Funds

6.1 In the last 30 years, several other resource-dependent economies have established funds for either stabilization or saving or both. Details of most of these experiences are sparse, and for several countries, almost nothing exists in the public domain to describe the operation and magnitude of such funds.

6.2 For three countries, Kazakhstan, Nauru, and Papua New Guinea, there is a certain amount of detail available, and the particularities of each case are very instructive, so sections of this chapter are devoted to describing and analyzing what is generally known about them.

6.3 Three countries (Chad, São Tomé and Príncipe, and Timor-Leste) have recently passed legislation setting up resource funds just as the first payments for oil and gas have started to be made to the governments. Because in these cases there has been considerable international discussion and advice on the best approach to setting up such funds, their legislation appears in appendixes 5–7.

6.4 Finally, there are other countries where only the outline of the funds and their existence is publicly documented, and a short section is included on each to act as an initial reference for more detailed within-country investigation. These countries are Chile, Kuwait, Oman, Russia, and Venezuela.

6.5 The Chilean (copper), Nauru (phosphate), and Papua New Guinean (copper) funds were financed by nonoil mineral revenues, but the principles underpinning their working and their individual histories are particularly relevant to oil funds and thus have been included.

6.6 Other countries that have previously experimented with some form of fund, or have made some steps toward establishing a stabilization or savings fund, include Kiribati, Trinidad and Tobago (Williams 2004), Turkmenistan (Kalyuzhnova and Kaser 2005), and Iran (Amuzegar 2005) but these have been omitted for lack of detail.

A. The National Fund of the Republic of Kazakhstan (NFRK)¹⁵

6.7 In the early 1990s, after the creation of the Republic of Kazakhstan in 1990, oil production was about 500,000 barrels a day. A series of large investments took this to 1.1 million barrels a day by 2003. Domestic demand for oil declined throughout the 1990s, so that net exports were able to rise even faster than production. Further investment in the sector indicates that production may reach 2 million barrels a day by 2010 and even 3 million barrels a day by 2015 (Tsalik 2003, International Monetary Fund 2004c), making Kazakhstan one of the world's largest producers and exporters of oil. In the five years following independence, per capita income halved as the economy struggled to adjust to its new circumstances. However, in the mid-1990s growth resumed and, spurred by revenues from the increasingly important oil and gas sector, reached around US\$1,500 per capita in 2003 (a year of 20 percent growth).

6.8 Oil is the dominant export of Kazakhstan, and fluctuations in its price have a very large impact on the budget. Earnings from oil exports accounted for 5 percent of government revenues in 1999, 20 percent in 2002, and reached more than 50 percent in 2004 (United States Energy Information Agency 2004).

6.9 Faced with this very rapid change in oil revenues and the need to construct a sustainable fiscal strategy, there was a proposal in the later 1990s to create a budget for the development of Kazakhstan, managed by the central bank and responsible to the president, that would have sterilized income from oil exports, invested the resources of the budget, and provided credit for private sector development. Although the idea was temporarily dropped during the period of low oil prices following the Asian financial crisis, money was put aside in a Swiss bank account by the president.

6.10 The recovery of oil prices in 2000 gave renewed impetus to the problem of revenue management, and the NFRK was created by presidential decree to prevent overspending on low-priority projects. The NFRK is not a separate entity but rather an account of the government held at the national bank. Oil and mining revenues due to the government are first paid to the ministry of finance, which then pays a portion into the fund according to a strict formula.

6.11 The fund is designed to have both a savings and a stabilization function, and payments are made into two separate portfolios to reflect this (International Monetary Fund 2004c).¹⁶ A reference price for oil is determined for a five-year period (currently US\$19 a barrel) and this determines baseline budgeted oil revenues. Of these revenues, 10 percent are paid quarterly into the savings account, and 90 percent are retained for the budget. Excess revenues above the budgeted amount are paid into the stabilization account, and deficits (when the actual price is below US\$19 a barrel) are withdrawn from the stabilization account. Mining payments had a separate reference price. This scheme has a number of weaknesses, and the IMF has argued for a simplification that would bring the rules nearer to those of the Norwegian model, where flows into and withdrawals from the fund depend on the budget approved by parliament.

¹⁵ www.nationalfund.kz/.

¹⁶ www.nationalbank.kz..

The stabilization mechanism depends on a reliable forecast for the oil price—too high a forecast could deplete the fund, and then the sanctity of the savings fund could be questioned. If the price stays at the reference price, all revenue goes to the budget: however, this revenue, which would be expected to increase with the anticipated increases in production, might be inadequate for a number of reasons—for example, production might fail to keep up with the forecast, or needs might accelerate more rapidly as a result of some unforeseen circumstance.

6.12 Government revenues from the oil, gas, and mining sectors eligible to be paid in part into the NFRK are based on a specified number of companies' returns. Originally these included some 11 hydrocarbon and 3 mining companies, but later these were reduced to just 6 hydrocarbon companies. Payments of corporate income tax, excess profits tax, royalties, value added tax (VAT), bonuses, and PSAs are included. In addition, the earnings from the fund are paid into the savings account. Finally, there can be discretionary payments, determined by the president, such as proceeds from privatizations that are paid into the savings account.

6.13 The first payment into the Fund was from the sale of the government's share in the TengizChevroil consortium and a related bonus payment. In 2001, contributions from the companies to the government were US\$1.1 billion, of which US\$576 million went to the NFRK and US\$500 million went to national and local budgets (accounting for about 40 percent of government revenues).

6.14 The investment strategy is based on that of the NGPF in respect of the standard portfolios, their duration, and principles for selecting external managers. Management of the NFRK's assets is undertaken and overseen by the central bank. As well as directly managing part of the assets of the fund, the bank has retained several Western portfolio managers to provide diversity in investment styles (they also provide training to the national bank's personnel to help them carry out in-house investment) while managing a portion of the portfolio. There is also a separate custodian of the fund, selected by international competitive bidding.

6.15 The plan is to hold about 75 percent of assets in the savings portfolio and 25 percent in the stabilization portfolio. Both portfolios are invested entirely abroad to sterilize the economy against appreciation of the real exchange rate, and the stabilization portfolio has no equity assets—it is instead held in short-term liquid assets. About 60 percent of portfolio is held in the United States, with most of the rest in Europe and Japan.

6.16 The ministry of finance sets benchmarks for the fund, and the central bank reports to the ministry on the performance of the fund relative to the benchmarks. The savings portfolio is based on a benchmark of the Merrill Lynch six-month U.S. Treasury Bill Index. The benchmarks for the stabilization portfolio are 75 percent based on the Salomon World Government Bonds (SWGB) Index (80 percent U.S.-dollar-hedged) and 25 percent based on the Morgan Stanley Capital International (MSCI) world index, excluding the energy sector. The class of assets for permitted investment in the savings portfolio includes:

- Government bonds included in the SWGB,
- Corporate bonds with an A– credit rating or higher,
- Mortgage-backed securities and asset-backed securities with a credit rating above AA
- Those stocks included in the MSCI world index,
- Derivatives for tactical asset allocation and hedging.

6.17 The duties of the custodian of the NFRK include:

- Custody of the fund;
- Income collection;
- Portfolio accounting, including daily valuation and monthly reconciliation;
- Performance measurement;
- Compliance monitoring;
- Securities lending;
- Representing the NFRK as a shareholder in companies where it has equity;
- Paying taxes due to foreign governments.

6.18 Table 6.1 presents data on the NFRK.

**Table 6.1: Budget Revenues from Oil and the NFRK at December 31
(current US\$ millions)**

	1999	2000	2001	2002	2003	2004	2001– 04
Budget revenue from oil ^a	158	604	1,430	1,075	1,900	NA	NA
NFRK assets	0	0	1,240	1,915	3,663	5,131	5,131
Return	—	—	2.86	–0.43	8.69	7.61	5.16

Not Available (NA),

^a. *Excludes bonuses, privatization receipts, and other exceptional payments.*

6.19 Net payments into the NFRK have rapidly increased its size, and the latest figures for 2005 reveal that by December, the fund's had increased to US\$8.0 billion. The fund currently has a value equal to about 5 percent of GDP.

6.20 The NFRK is managed as two separate portfolios with separate benchmarks and, until 2004, 57 percent of the combined portfolios was managed by external mandates. In 2004, the stabilization fund had a value of US\$1.3 billion and

obtained a return of 1.42 percent against the benchmark of 1.22 percent, while the savings portfolio had a value of US\$3.8 billion and obtained a return of 9.33 percent against the benchmark of 9.46 percent. The savings portfolio performed worse than its benchmark, and this resulted in the government deciding to conclude the investment management agreement with the U.S. money market mandate external manager and place this part of the portfolios entirely under the management of the national bank.

6.21 In respect of its accountability, the NFRK has fewer checks than other major oil funds, and all checks are directly overseen by the president. Parliament has only a peripheral role—the creation of the fund involved neither parliament nor the public. Figure 6.1 shows the principal lines of control. The main feature is that the president alone can make changes to the NFRK, and parliament receives reports on the performance of the fund, but cannot approve, reject, or amend them. Only the president can propose spending from the NFRK, and there are no guidelines on permissible expenditures, although these do have to be approved by parliament. Moreover, the fund is not integrated with the budgetary process, a point that has been highlighted by the IMF.

6.22 The powers of the president in relation to the Fund are wide-ranging and include (Tsalik 2003):

- Exclusive rule making for the fund;
- Authority to designate transfers from the fund;
- Authority to issue binding regulations concerning the fund to the oversight council, government, and national bank;
- Authority to approve the annual report submitted by the ministry of finance
- Authority to approve the external audit;
- Power to control activities concerning the management of the fund;
- Ability to dissolve the fund, because it was created by presidential decree.

6.23 The oversight council, which has rather limited powers, consists largely of presidential appointees, including the prime minister, the head of the presidential administration, the chairman of the national bank, the deputy prime minister, the finance minister, the two speakers of parliament, and the chairman of the state budget control committee. Two members of the committee, the chairman of the national bank and the finance minister, are responsible for managing the fund and thus exhibit potential conflict of interest.

6.24 The national bank produces daily, monthly, quarterly, and annual reports for the finance ministry on the investments, but these are not made public. Periodic statements on accumulation in the fund are published in the press. The annual report and audit are not published in full, but a truncated summary is publicly available.

Assessment

6.25 The NFRK has clearly articulated rules for accumulation or withdrawal, but these rules are not presently formally linked to overall fiscal policy. The procedures for managing the investments mirror those used in other well-established funds.

6.26 Several aspects of the NFRK have attracted criticism:

- Excessive control exercised by the president,
- Rigidity of the rules for accumulation,
- Lack of full public disclosure of the fund's performance,
- Lack of integration with the overall fiscal policy.

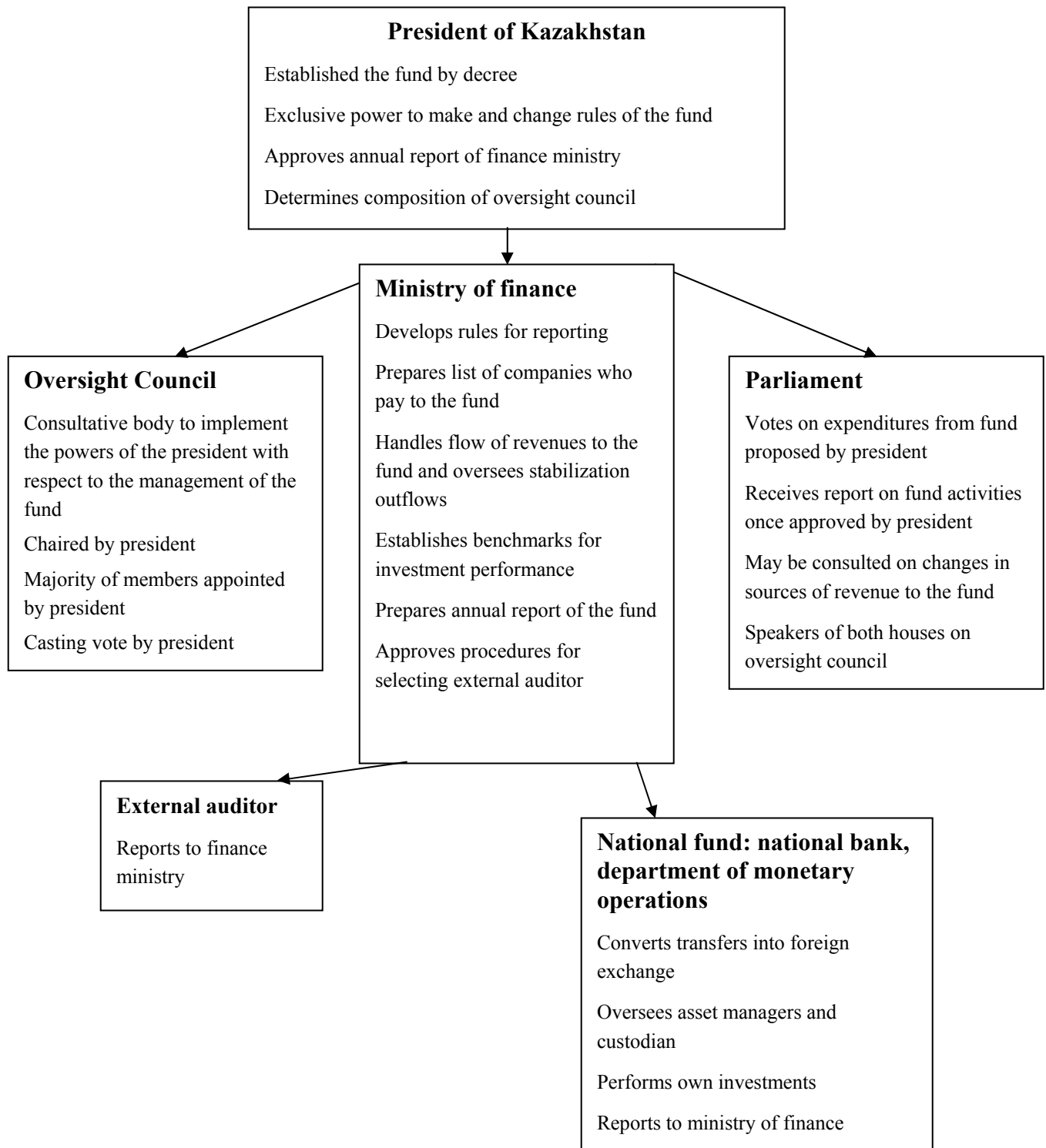
6.27 Although on a daily basis the fund is organized to work without recourse to presidential approval, all major decisions, including accepting the audits, controlling the management of the fund, and altering rules on the payments into and out of the fund, have to be made by the president. Although these powers do not currently appear to have acted to the detriment of the operation of the fund itself, there is certainly the possibility of diverting it to a more political agenda.

6.28 As an operational detail, the rigidity of the stabilization rules, and the linking of the amount saved to a fraction of projected receipts, based on a price forecast that is made only every five years and is presently much too low, can lead to great imbalances in the fund. There could be too much devoted to stabilization, caused by the excess revenues received, and too little to savings, with no adjustment made according to increased current expenditures that might be justified by either higher revenues or increased needs of the economy. However, a presidential order could be used to correct an obvious imbalance in the fund.

6.29 The lack of full transparency for the fund prevents informed public discussion on its performance and use. The partial and occasional release of data on the size of the fund through the Kazakhstan News Bulletin and the summary of the audit and annual report give some information on its workings, but the lack of detail and regular publication is in sharp contrast to the situation for other large oil funds. The central bank report for 2004 provides the basic data on the performance of the NFRK and its constituent portfolios, but as yet this information source gives only limited material.

6.30 The rules for payments into the savings and stabilization accounts of the fund indicate a lack of formal integration with the budget process and failure to make explicit the consideration of maintaining long-run wealth. The rule for saving 10 percent of budgeted revenues based on a projected oil price has already been shown to be inadequate. Unless future savings decisions take into account the under-prediction of the oil price during the past several years, the amount saved is likely to be inadequate for the preservation of real wealth. At the same time, the rules could have led to over-accumulation in the stabilization account because the oil price is unlikely to return to US\$19 a barrel in the foreseeable future.

Figure 6.1: Lines of Accountability in Oversight of the NFRK ¹⁷



¹⁷ Source: Tsalik (2003)

B. The Petroleum Revenue Management Framework of the Republic of Chad: Sterilization, Stabilization, and Savings Mechanisms

6.31 As one of the 10 poorest countries in the world, Chad's economic development has been challenged by its landlocked geography, high energy costs, and the desert climate in the northern half of the country. Since its independence from France in 1962, Chad has been politically unstable and has only recently achieved relative peace. In the past, Chad's economy has been dominated by the primary sector (32.7 percent of GDP in 2002) (International Monetary Fund 2004b). More than 80 percent of Chad's population relies on subsistence farming and raising livestock for its livelihood. Cotton, cattle, and gum arabic provide the bulk of Chad's nonoil export earnings. However, the country has experienced consistently high economic growth rates over the last five years, largely due to foreign investments surrounding the development of the Doba Basin oil fields and the construction of the Chad-Cameroon oil pipeline. As a result, petroleum production has been and is expected to remain the major driver of economic growth within the country.

6.32 Oil exploration in Chad began in the 1960s. The presence of oil in commercial quantities was confirmed in 1975. However, oil exploration was halted by the civil war and could resume only in 1981. Oil is currently produced from four fields in the Doba Basin. These are situated 300 miles southwest of the capital, N'Djamena. The legal foundation for the current project was put into effect in 1988, when a convention agreement was signed between Chad and a group of oil companies comprising two U.S. oil majors (Exxon Mobil and Chevron Texaco) and the Malaysian national oil company (Petronas Carigali). Doba's oil production began in July 2003 as the export system (pipeline and floating storage and offloading facility) was completed and the first of three oilfields, the Miandoum, were put into service. The combined proven and probable reserves were estimated¹⁸ at approximately 900 million barrels of oil to be produced over a 20-year horizon. The net present value discounted at 10 percent of Chad's share of revenues from the upstream (extraction) and downstream (transportation) parts of the project was projected at US\$ 463 million, of which approximately 40 percent would have accrued to Chad in the first five years of the project.¹⁹

6.33 By the end of the third quarter 2005, almost 118 million barrels of oil had been shipped to international markets. As a result, Chad received approximately US\$354 million in upstream royalties.²⁰ In 2004, the first full year of production, the petroleum sector accounted for about 30 percent of GDP.

¹⁸ Reserves estimates are made using a combination of geological and engineering data. Initial estimates normally vary when production data are obtained to provide a more reliable reservoir model. Reserves were estimated for three fields declared commercial by the operator.

¹⁹ Projections were based on an average Brent price level of US\$18 per barrel.

²⁰ Chad currently uses a tax and royalty regime for hydrocarbon exploration, development, and production. The new hydrocarbon code currently under preparation contemplates the introduction of production-sharing contracts. To date, the bulk of the revenue going to Chad has come from royalties levied on net sales of crude oil from the producing fields, signing bonuses, and share premia from its share capital in the oil transportation companies. In fact, the revenues generated by the upstream activities have not yet been sufficient to cover the costs of these activities (operating costs, noncapitalizable investments, and asset

6.34 In January 1999, Chad promulgated Petroleum Revenue Management Law 001, which provided for most of the direct revenues (royalties and dividends) from the fields of Miandoum, Kome, and Bolobo (the “Three Fields”) to be used for priority poverty reduction and development purposes²¹. The law also established the Collège de Contrôle et de Surveillance des Ressources Pétrolières (CCSRP), a joint government–civil society body whose task is to oversee and monitor the spending of the government revenues generated by the Three Fields. In accordance with the provisions of the law and related decree laws,²² all direct revenues (royalties and dividends, net of the repayment of IBRD and European Investment Bank (EIB) loans directly related to the Doba project, and of applicable offshore account management fees) from the exploitation of the Three Fields were to be allocated as follows:

- Ten percent of revenues is to be deposited in a future generations fund (FGF) held offshore and invested in long-term external assets.
- Of the remaining 90 percent of direct revenues:
 - Five percent of royalties is allocated to the Doba oil-producing region, to be disbursed by local authorities in accordance with the regional development plan and under the supervision of a regional oversight committee.
 - Fifteen percent is allocated to the country’s general budget for the financing of recurrent government expenditure for a period of five years from the date of production.²³ After that time, it is to be added to priority sector spending.
 - The residual is earmarked to finance additional²⁴ expenditure in priority sectors.²⁵

depreciation). Consequently, no corporate income tax has yet been paid to the government of Chad to date on account of upstream activities. However, mainly on account of high oil prices, revenues from corporate taxes are expected to become significant starting from 2007.

²¹ Laws and decrees for Chad are set out in appendix 5.

²² Decree 238/PR/MEF/03 creating a mechanism for sterilization of the revenues derived from the exploitation of the fields of Kome, Miandoum, and Bologo.

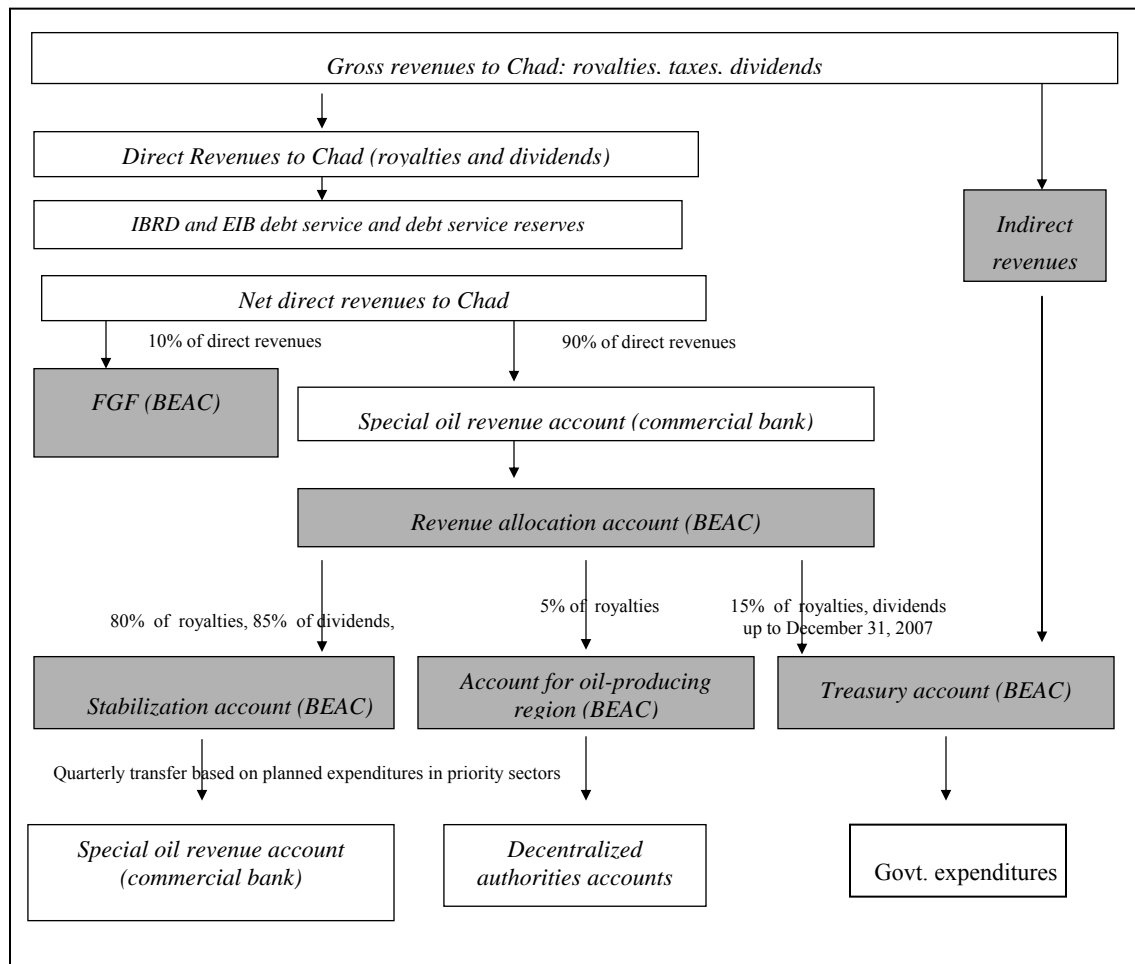
²³ Although Law 001/PR/99 provides for the 15 percent to be allocated to general budget needs for five years from the date of production (that is, until October 2008), Decree Law 238/PR/MEF/03 specifies that the Banque des Etats de l’Afrique Centrale (BEAC) shall transfer this amount into the current account of the treasury—with the BEAC—December 2007. It is unclear what the payment modality will be after that date.

²⁴ Additionality is defined with reference to the 2002 expenditure level.

²⁵ For budget preparation and expenditure monitoring purposes, the priority sector criteria under Law 001 were translated into institutional criteria for determining the eligibility to receive earmarked direct oil revenues. Several ministries were identified as priority ministries: health, social action, education, youth and sports, agriculture, livestock, environment and water, infrastructures, and urban development.

6.35 It is not clear what factors influenced the choice of these percentages. A simplified diagram of the revenue flows is set out in Figure 6.2.

Figure 6.2: Simplified Diagram of Oil Revenue Flows in Chad as Provided for in Law 001/PR/99, as amended, Decree 238/PR/MEF/03, and Decree 239/PR/MEF/03



6.36 To avoid the creation of excessive liquidity, Decree 238/PR/MEF/04 established a mechanism for the sterilization of the funds earmarked for expenditure in priority sectors, which were to be transferred quarterly on the basis of the government's spending plans from the BEAC, the regional central bank, to the special accounts of the treasury with two Chadian banks for budget execution.

6.37 Decree 239/PR/MEF/04 established a mechanism to stabilize expenditures financed by the revenues derived from the Three Fields with the objectives of:

- Ensuring the stable and sustainable financing of poverty reduction expenditures;
- Avoiding pro-cyclical expenditures;
- Ensuring the effectiveness of expenditures;

- Strengthening budget discipline and reducing the vulnerability of public finances to external shocks;
- Ensuring the application of the additionality principle.

6.38 Both the direct revenues earmarked for expenditure in priority sectors and the non-earmarked direct revenues were affected by the decree. Any positive difference between actual earmarked and non-earmarked resources and actual expenditures financed by these resources was to be deposited in the stabilization account. Should expenditures be higher than the revenues, the difference would be withdrawn from the stabilization account. An automatic rule was established to adjust the expenditure patterns: if the actual direct revenues were more than 20 percent lower than the estimated direct revenues for a consecutive period of three months, the government had to reassess the macroeconomic framework and adjust medium- and short-term expenditure accordingly. There was no limitation on the size of the withdrawals, and there were no specific rules to determine the sustainability or effectiveness of expenditures financed by these revenue flows. To ensure the application of the principle of additionality, the decree provided that priority expenditures financed by means of non-earmarked revenues be no less than 42.6 percent (its level in 2002).²⁶

6.39 The FGF was regulated by Decree 96/PR/MEF/04. In accordance with the provision of Law 001/PR/99, 10 percent of net direct revenues as well as earnings on the fund were to be set aside for future use. Funds could be withdrawn from the FGF only if the total government revenues from the Three Fields were less than 10 percent of the total government revenues in the preceding year, up to the limit of the previous year's inflows into the FGF (revenues and interest). Funds withdrawn from the FGF could be used only in accordance with Law 001/PR/99 and under the supervision of the CCSRP. An investment committee, presided over by the prime minister, was responsible for defining the investment strategy, selecting portfolio managers, monitoring investment results, and preparing monthly performance reports. Audit and performance reports were then to be published by the government. The minister of economy and finance was tasked with the presentation of a report on the performance of the FGF to the parliament upon presentation of the budget law. The management of the FGF was entrusted to the BEAC²⁷ through one or more international portfolio managers, whose selection was to be approved by the investment committee. The management contract between the BEAC and the portfolio managers, also to be approved by the investment committee, defined the investment strategy, oversight, audit, and disclosure mechanisms. The FGF was created in June 2004, and by September 2005 had accumulated US\$27 million. To that date, the government had not formulated its investment strategy and oversight procedures. Therefore, no tender for the selection of the portfolio managers had been launched.

²⁶ It is important to note that the additionality principle has been observed only at budget preparation and not at the budget execution level.

²⁷ The BEAC and the government of Chad negotiated a protocol of agreement that sets out the procedures for managing the FGF and the remuneration of BEAC for its services

6.40 In respect of the existing agreements related to the monetary cooperation among the member states of the regional central bank (BEAC), several agreements were established between the government and the BEAC for the implementation of the revenue management framework established by the authorities. These agreements set forth the procedures for the management of various accounts: (a) the direct revenues allocation account, (b) the stabilization account, (c) the oil-producing region's account, and (d) the FGF.

6.41 Oversight and transparency were guaranteed through a series of supervisory bodies and the publication of various reports and audit reports, as summarized in table 6.2.

Table 6.2: Oversight and Disclosure Arrangements in Chad

<i>What</i>	<i>Who</i>	<i>Responsibility</i>	<i>Disclosures</i>
Special accounts (commercial banks)	CCSRP	<ul style="list-style-type: none"> • Verifies consistency between expenditure commitments and the finance law • Authorizes payments 	Reports published periodically by the CCSRП and yearly by the government
	COBAC (CEMAC region's banking oversight board)	Certifies commercial banks	Annual audit published by COBAC
FGF (offshore)	CCSRP	Verifies revenue allocation, verifies and certifies utilization	Periodic reports published by the CCSRП 15 days after their presentation to government
	CdC	Verifies account balance	Annual audit conducted by the CdC and published by the government
	Supreme Court	Verifies correct application of the laws	Annual report produced by the Supreme Court and published by the government
Account for the allocation of direct revenues (BEAC)	COBAC	Verifies management of account	Annual audit (no public disclosure obligation)
Treasury account (BEAC)	Parliament	Controls allocation of petroleum revenues	Budget and budget amendment laws
	CdC	Verifies account balances	Annual audit conducted by the CdC and published by the government

<i>What</i>	<i>Who</i>	<i>Responsibility</i>	<i>Disclosures</i>
	Supreme Court	Verifies correct application of the laws	Annual report produced by the Supreme Court and published by the government
Stabilization account (BEAC)	CdC and Supreme Court	Verify the legality of account management and utilization	Annual audit published by the government
	CCSRP	Oversees the application of the stabilization mechanism detailed in Decree 239/PR/MEF/03	Annual report published by the government
Producing region account (BEAC)	CdC	Verifies account balances	Annual audit conducted by the CdC and published by the government
	Supreme Court	Verifies correct application of the laws	Annual report produced by the Supreme Court and published by the government
	CCSRP	Verifies revenue allocation, verifies and certifies utilization	Reports and audits made public 15 days after their presentation to the government
	Producing region committee	<ul style="list-style-type: none"> • Identifies, selects, and approves (subject to the approval of the CCSRP) all regional projects in respect of the PRSP • Oversees project execution 	<ul style="list-style-type: none"> • Quarterly, semiannual, and annual reports • Project audits (no specific public disclosure obligations)

CdC Chambre des Comptes; *CEMAC* Communauté Economique et Monétaire de l’Afrique Centrale; *COBAC* Commission Bancaire de l’Afrique Centrale ; *PRSP* Poverty Reduction Strategy Paper

6.42 The creation of two government–civil society supervisory bodies, the CCSRP²⁸ and the Producing Region Committee²⁹, was of particular interest. The mandate of the CCSRP focused on the verification of the correct allocation of revenues

²⁸ See Law 001/PR/99, Decree 240/PR/MEF/0E.

²⁹ The producing region committee is a temporary body created to manage the utilization of direct revenues from the Three Fields allocated to the producing region in application of the provisions of Law 001/PR/99. This was done while waiting for the creation of the “decentralized communities,” subregional bodies created to implement the decentralization process provided for in the constitution.

from the Three Fields, their application to the various accounts created by the government to implement the revenue management framework, approval of expenditures financed by direct revenues from the Three Fields, and, if it so chose, the audit and follow-up of the implementation of projects financed by these direct revenues. The mandate of the producing region committee also included the selection, planning, and implementation of projects of regional interest. Therefore, there was no separation among planning, approval, execution, and spending authority. To attenuate the potential conflict of interest that such an extended mandate might have created, all projects selected by the producing region committee were to be in line with the PRSP and receive the prior approval of the CCSRP. Notwithstanding this, room for improvement remained in the transparency, governance, and accountability of this committee.

6.43 Although accounts created to implement the revenue management framework were integrated into the state budget and were subject to all applicable public finance rules and procedures, there were, de facto, four different budgets (the ordinary budget, the oil budget, the Heavily Indebted Poor Countries Initiative budget, and the donors' budget), each with its own formulation, execution, budget classification, and cash management mechanisms.

6.44 Seeking greater flexibility in the short term to address their financing problems, in December 2005, the authorities promulgated an amendment to Law 001/99. Although the amendment extended the application of the law to all oil and gas fields, it also breached the government undertaking not to amend Law 001/99 in a way that would materially and adversely affect the implementation of the poverty reduction program³⁰. As a result, the government's decision triggered the suspension of all disbursements by the World Bank.³¹ Discussions to reach a mutually acceptable solution are ongoing.

Assessment

6.45 Perhaps the most remarkable feature of this framework is the support to civil direct involvement in the debate over the use of extractive resources to alleviate poverty and foster economic development through enhanced transparency of government revenues and spending plans, and to strengthen governance and accountability by means of the creation of mixed government–civil society oversight and control committees at the national and regional levels. However, the lack of capacity and resources of these committees, compounded by the overall situation of the public finance management system, poses a serious challenge to their ability to carry out their very wide mandate in the short term (Gary and Reisch 2005).

6.46 It is difficult to assess the effectiveness and efficiency of the revenue management framework created by the government of Chad: the system had been in place for only 18 months, and some of its elements had not been finalized (for example,

30 In particular, the abolition of the FGF; the substantial modification of the earmarking scheme; the inclusion of security, justice, and territorial administration among the priority sectors; and the changes in the composition and governing rules of the CCRSP were judged to substantially weaken the poverty focus of the revenue management program.

31 See press statement released on January 6, 2006, by the World Bank, www.worldbank.org.

the investment strategy of the FGF and the portfolio managers, the regional development plan). However, experience has highlighted a number of shortcomings and practical difficulties in implementing the framework, with particular reference to budget fragmentation resulting from the earmarking scheme that had undermined the government's ability to identify, monitor, and implement its policies. The severe capacity constraints of the administration have compounded the difficulties of managing a complex set of rules. Chad has had chronic problems with project planning, implementation, and oversight. This reflects large and serious problems in the government sector as a whole: the civil service is badly paid and has often been on strike over irregular payment in the recent past, thus the administration is disrupted. There are no good records of the size, qualifications, skills, and location of the civil service. As a consequence, the government's ability to deploy the civil service to plan, implement, and oversee its policies and programs has been hindered. These problems have been emphasized by the increase in the volume of projects made possible by the availability of oil revenues. Although reforms of the civil service and of the court system are under way, the effects of these reforms are not likely to be seen in the short term.

6.47 Even though the revenue management framework envisaged by the various laws and decrees allows for a certain flexibility in its implementation, the law is prescriptive with regard to the additionality principle and the percentage allocations between priority and nonpriority sectors. Setting rules is an attempt to avoid some of the problems that governments face with large natural resource-based revenues. To some extent, they succeed by limiting consumption and making provisions for stabilizing expenditure. However, Chad's case clearly illustrates how difficult it is to formulate a comprehensive set of rules that correspond to the full range of challenges posed by large, resource-based government revenues, especially in the presence of weak fiscal discipline.³² Governments end up using essentially arbitrary rules. Opinion is divided on whether the formulation of fixed rules to determine government revenues is beneficial or not. Experience shows that it is difficult to constrain the action of sovereign governments by setting up rules. However, the decision to deviate from the rule tends to require justification, which should help promote careful thinking about the decision.

6.48 In the design of a revenue management system, consideration should also be given to the expected magnitude, profile, and type of resource revenues³³. In Chad, the high level of oil prices over the past 15 months has allowed the consortium of oil companies to recover a considerable part of its upstream investment. Oil prices are expected to remain high over the next three years, thus cost recovery of the considerable capital investment made by the consortium will be achieved in a shorter time than originally anticipated, bringing forward the generation of sizable amounts of taxable revenues. Given the limited absorption capacity of the Chadian economy, consumption of

32 The country has been facing a liquidity crisis, with accumulation of arrears, notably on the payment of pensions and wages. However, these problems have several causes, particularly cash management issues, and they cannot be explained solely by the restrictions imposed by the revenue management framework.

33 Normally, direct revenues tend to be more important at the beginning of production, and indirect revenues increase after cost recovery is reached.

this revenue should be spread over time in an attempt to generate higher financial income from the investment of the unused revenue while generating net savings.

C. The Timor-Leste Petroleum Fund (TLPF)³⁴

6.49 Timor-Leste was recognized as an independent state in 2002. At that time, as a result of extensive destruction prior to independence, per capita income was estimated to be about US\$300, and most development indicators were extremely low. After the international contributions to aid and reconstruction, incomes rose to about US\$430 per capita in 2003. There are still substantial needs for infrastructure and social development investment for the population of approximately 1 million.

6.50 However, in the Timor Sea between Australia and Timor-Leste, three separate oil or gas fields have been identified, of which the Bayu-Undan field started production in 2004. This field is located in the Joint Petroleum Development Area, shared with Australia, from which 90 percent of revenues accrue to Timor-Leste and 10 percent to Australia. It has been estimated (international Monetary Fund 2004a) that the government's revenues from this field might amount to US\$3.2 billion in real terms over a 20-year period. Already in fiscal year 2004/05, revenues from oil and gas were US\$129 million, compared to spending from the central government account of US\$75 million and GDP of less than US\$350 million.

6.51 Although there were pressing needs for government spending, it was recognized that there would be problems of absorbing too expansionary an approach, and also that needs would continue well into the future, when oil and gas revenues might be expected to decline. Accordingly, the government decided to establish a petroleum fund on the Norwegian model to ensure transparency and accountability while preserving the primacy of fiscal budget decision making in a situation where oil and gas revenues were particularly uncertain.

6.52 Facing the need to involve the whole population in the debate over its nature and use, the prime minister issued a public consultation paper in October 2004 (Timor Lest Government 2004) supported by an extensive public education campaign, whereby comments were solicited. This paper outlined the broad principles that the government recommended to be adopted for the design and implementation of the fund. In February 2005, a draft act was published (appendix 6A) and comments were invited, which were made public on the ministry of finance's Web site. The World Bank, IMF, several major NGOs, and individuals made extensive comments on the draft, and the final version was approved by parliament in July 2005. The first quarterly report of the fund was produced in September 2005.

6.53 The main features of the proposed act, based on the so called "Norway plus" model, are presented in the executive summary of the act:

³⁴ www.transparency.gov.tl/.

- There will be a separate petroleum fund, where the government has overall responsibility for management. The minister of planning and finance will have direct responsibility for oversight. The fund itself will be managed by the central bank, subject to a management contract, and the bank can contract out the management of a portion of the fund to independent managers. The minister will submit an annual report on all aspects of the fund (payments in and out and returns) to parliament.
- There will be an independent investment advisory board advising the minister on any matter relating to the management of the fund. It would recommend benchmarks for fund performance, advise on the performance of managers, and make recommendations on the appointment or removal of managers. The board will be made up of the director of the treasury, the head of the central bank, two persons with significant investment management experience, and one other person.
- There will be a consultative council appointed by parliament comprising:
 - Former presidents,
 - Former speakers of the house with at least three years experience,
 - Former ministers of finance with at least three years experience,
 - Former heads of the central bank with at least three years experience,
 - A person appointed by the president,
 - A person appointed by parliament,
 - A person appointed by the government,
 - A person representing civil society nonprofit organizations,
 - A person representing private business,
 - A person representing religious organizations.

6.54 The council will advise parliament on all matters relating to the fund and on appropriations from the fund when they are greater than the calculated sustainable income of the fund.

- There will be external audits of the fund by an internationally recognized accounting firm, which will also certify estimates of sustainable income and prepare a report on payments made by companies to the fund.
- There will be transparency of all aspects of the fund's operation, and reports will be made public.
- All investments of the fund will initially be made in low-risk foreign securities, and they must be U.S. dollar denominated with a minimum credit risk rating and maximum duration as specified in the act. The investment strategy will be reviewed after five years of operation.

- All revenues from the petroleum sector, and earnings from the fund itself, will flow directly into the fund. There will be a first tranche payment based on revenues received by the government before the creation of the fund.
- Payments out of the fund are specified by two principles:
 - All payments out are made to the state budget and cannot normally exceed a ceiling set by parliament at the time of budget approval. They will generally be equal to that amount needed to cover the nonoil deficit in the planned budget. The residue will then remain in the fund.
 - The fund will pay out over its lifetime an amount that will be sustainable indefinitely, as shown in a formula in the act.

6.55 These two principles can be inconsistent, because the sustainable income from all revenue payments from petroleum need not be equal to the nonoil budget deficit. The law specifies that if the proposed nonoil budget deficit is larger than sustainable income, then the consultative council will report on the issue to parliament, who will make the final decision.

6.56 The rules governing payments out of the fund permit a compromise between ensuring that the real wealth of the country stays intact and using the revenue from oil for immediate budgetary support. The sustainable income from hydrocarbon revenues is related to the discounted sum of expected future hydrocarbon revenues. The act makes no mention of how the price assumptions concerning future expected revenues from oil and gas are to be calculated, unlike the cases of Chile or São Tomé and Príncipe. The consultative council has to rule on whether planned withdrawals would be in excess of what would be sustainable, thus they have a primary duty to see that this calculation is made. Without guidance on the principles to be followed, this could prove controversial, especially because it must involve assessments of the future oil price, as well as allowances for any quality discounts.

6.57 In addition to the Petroleum Fund Act itself, the government also published the management agreement between the minister of planning and finance and the central bank governing the operational details of the fund (appendix 6B). The first payments into the TLPF occurred in September 2005, and the first annual report of the fund is planned for 2006.

6.58 The first quarterly report contained more details on the principles by which the fund will be managed. The bank and payments authority of Timor-Leste, which took on the responsibility for the operational management of the fund when the act was passed, transferred US\$80 million from the first tranche petroleum account accumulated since 2000 into the fund. It also transferred US\$125 million from the consolidated fund. These sums were invested in U.S. securities and passively managed to track the benchmark Merrill Lynch zero- to five-year government bond index. A separate department to manage the fund was established within the bank and payments authority, and a training program for staff was implemented. The IMF provided an adviser to help with the establishment of the operation framework of the fund.

Assessment

6.59 The act is designed so that all aspects relating to the collection and use of oil and gas revenues are highly transparent and society and parliament are given enough information to react to their use and the performance of the TLPF. There are numerous checks and balances built in for oversight and reporting. This should ensure proper use of the fund in accordance with both the act and the wishes of parliament, which will make the crucial decisions on withdrawals from the fund. The act governing the use of fund revenues is notable in that, although the only use of revenues is to cover the nonoil budget deficit, there is an explicit constraint that withdrawals should not decrease the permanent income derivable from the fund. Where the proposed nonoil budget deficit would do so, then the consultative council will report on the issue to parliament, which will make the final decision on whether the proposed budget deficit should stand or the real value of the fund should be maintained. In Norway, the requirement to explicitly refer to a long-run goal is not embedded in the legislation describing the operation of the NGPF. Although in both cases parliament makes the final decision, the Timorese version, whereby there must be a formal debate on this issue (following a report by a body of experienced members of society, several of whom have no formal political role), is an attempt to give the opportunity for a mature reflection on the impact of current budgetary proposals where these would result in the reduction of the permanent income generated by the fund.

D. The National Oil Account and Permanent Fund of São Tomé and Príncipe (STPPF)

6.60 The West African island group of São Tomé and Príncipe achieved independence in 1975. It has been a predominantly agricultural economy, which suffered when the international price of cocoa fell. Despite a substantial economic reform program, its per capita GDP in 2004 was still only US\$388.

6.61 In 2001, Nigeria and São Tomé and Príncipe reached agreement on joint exploration for oil in waters claimed by the two countries, and in 2003, the joint development zone was opened for bids. The imminence of signing bonuses, to be followed later by royalties, which would be very substantial in relation to the size of the economy, and the examples from neighboring West African countries of the difficulties of managing such large flows for the benefit of the country, persuaded the government to pursue a strategy of planned management of the revenues. A number of institutions, including Columbia University and the World Bank, combined to provide assistance in designing this strategy and drafting a law to implement it. Parliament passed such a law in December 2004.

6.62 An unofficial English translation of the draft law (Columbia University) as presented to the national assembly is given in annex 7. The fund is designed to have primarily a savings role (Bell and Faria 2005), help control expenditure so as to avoid Dutch disease effects, and exhibit high standards of transparency and accountability.

6.63 All state oil revenue is first paid into the national oil account, which is held by a custodian bank selected by the central bank with the approval of the investment committee. Each year, the government proposes in the state budget an annual funding

amount that is transferred to the treasury from the national oil account after parliamentary approval. A limit is placed on the annual funding amount with the purpose of keeping the real wealth of the fund intact. Once production commences, all unspent money will then be transferred to a subaccount of the STPPF. To take account of the sequence of payments, which begins with bonus payments, and then, after an uncertain period, royalty and other payments attached to actual production, the following process is to be used:

- In the first year (2005) the first bonus payments is to be paid into the national oil account, and withdrawals will be equal to the annual funding amount as set out in the state budget.
- Starting in 2006, until the first year after production commencement, the withdrawal will be limited to the lesser of (a) 20 percent of the balance of the account in the current year, (b) 20 percent of the balance of the account in the previous year, or (c) an amount equal to the account balance divided by the number of years remaining until the first year after production commencement.
- One year after production commencement, the annual funding amount should be not more than the lesser of (a) the sum of the existing balance of the permanent fund and the present value of expected future oil receipts, multiplied by the long-term real rate of return, or (b) the sum of the balance of the permanent fund multiplied by the long-term real rate of return and the balance of the unrestricted part of the national oil account at the end of the previous year.

6.64 These rules, which place a cap on withdrawals from the national oil account, are designed to ensure that once production starts and estimates of future revenues can be made with some certainty, the real wealth of the fund is preserved. To ensure that these rules also guarantee that the real wealth of the country is maintained, fiscal policy would need to constrain the size of the budget deficit to be no greater than the annual funding amount. There is no procedure, as in Timor-Leste, to ensure a debate on the relationship of the annual funding amount to the size of the proposed budget deficit. This implies that parliament, without reference to any other body, could propose a budget that would increase its borrowing while maintaining the real value of the fund, thus decreasing overall government saving.

6.65 Until oil production begins, the rules ensure that the bonus payments are spent in a smooth fashion, avoiding sharp discontinuities in the budget. The choice of a 20 percent limit on spending the balance in the fund, until production begins, recognizes that this period might be as long as five years. The purpose of the alternative constraints, once production has started, is to protect capital and prevent borrowing against future revenues.

6.66 To make this process operational, the act then defines how expected future oil receipts are to be calculated. Amounts (estimated by block operators) only from producing fields are to be taken into account, and these are valued at the average Brent price for the previous 10 years less a discount for the quality of the oil produced. This rule faces two problems: first, as very recent experience illustrates, oil prices are not

obviously mean reverting, so that the future prices cannot be expected to average out near the past 10 years' prices, and the forecast price will only slowly move toward the newer level of prices established, resulting in too much saving in the fund relative to the goal of keeping its real wealth constant; second, given that the discount for different qualities of crude oil is sensitive to a number of factors, including the general oil price level and refinery configurations and capacities for markets where the crude is sold, the expected monetary value of oil revenues may prove difficult to estimate accurately.

6.67 The long-term real rate of return, used to calculate the permanent income value of the oil to be produced, is to be based on the expected real rate of return of the assets held in the permanent fund, which is not to exceed 5 percent.

6.68 In addition to calculating a cap on the amount that can be transferred to the budget, the law also specifies restrictions on how this money is to be spent, which includes an allocation of at least 10 percent of the total annual funding amount to local budgets and 7 percent for public expenditure in the autonomous region of Príncipe.

6.69 The management and investments of the oil revenues in the oil accounts is the responsibility of a management and investment committee, which has to act in accordance with the prudent investor rule. The committee consists of five members, including the minister of planning and finance as chairman, the governor of the central bank, one member appointed by the president, and two appointed by the national assembly (one of whom will represent the opposition parties). The latter three persons serve for two years, renewable once, and must have experience of managing international investment portfolios. In addition, there is a petroleum oversight commission of 11 members, appointed by different bodies, including business, unions, and NGOs. The commission oversees compliance with the law of expenditures of the annual funding amount, the management of oil revenues, enforcement of transparency rules, and the audits.

6.70 All investments are to be outside the country, and a list of permitted instruments is provided in the act. The fund itself cannot be used as collateral for government borrowing. The management and activity of the fund are audited annually by the auditor general and also by an international auditing firm. The audit reports are sent to the president, the national assembly, the government, the petroleum oversight commission, the principal solicitor's office, and the public registration and information office.

6.71 A transparency principle is included in the law to ensure that all payments into the accounts and all transactions and balances are made public, as are the agreements with fund managers, oil revenue forecasts, and all contracts entered into by the state where these directly or indirectly concern activities related to oil revenues.

Assessment

6.72 The São Tomé and Príncipe Oil Revenue Law reflects the primacy of a target size of the oil fund, rather than a broader fiscal criterion, in that the transfer to the permanent fund could be greater than that required to maintain the country's permanent wealth. An innovation in the law is a set of provisions for the treatment of initial bonuses spread over a period until the oil is actually produced. The oversight arrangement and

transparency provisions also reflect the best practices that have evolved in other countries, and they go beyond these insofar as they require that oil contract details will be published (except for information on proprietary industrial property rights). The legislators have preferred a very prescriptive approach to the definition of permanent revenues and spending rules that may prove too rigid if unexpected expenditures are higher than the annual transfer, because the government may then be forced to borrow.

E. The Nauru Phosphate Royalty Trust Fund (NPRTF)

6.73 Nauru is an atoll of 21 square kilometers in the Pacific with a population of about 11,000, making it one of the smallest sovereign states in the world. The island was rich in phosphate, and before independence, this was extracted by the British Phosphate Company (jointly owned by the British, Australian, and New Zealand governments). Only a small royalty found its way back to the local population until 1963, when Nauru obtained the world price for phosphate. Nauru obtained independence in 1968 and took over the phosphate industry, creating the Nauru Phosphate Commission. At that time, the state had already accumulated a very substantial sum per person from the royalties.

6.74 Output rose to a peak of about 1.5 million tonnes in the 1980s, but declined steadily thereafter to 0.5 million tonnes at the end of the 1990s. The transfer of the ownership of the resource made it apparent that the business was highly profitable, and the islanders came to enjoy an extraordinarily high level of GDP per capita, with a peak in 1975 when phosphate prices reached US\$52 a ton—annual income per capita was estimated to be about US\$50,000 (1998 prices). In the late 1980s, per capita income was estimated to be about US\$7,000, which was about 10 times that of neighboring islands that lacked the natural resource. However, between 1988 and 1998, per capita income halved. The dividend stream paid to the government by the Nauru Phosphate Company averaged US\$22 million a year between 1971 and 1990 (US\$2,000 per person per year), but dropped to US\$5 million in 1991 and ceased in 1993.

6.75 The ownership of the natural resource by the state, and the management of an extremely large (relatively speaking) rent that by its nature was rapidly depletable, posed an extreme version of the resource revenue management problem. The money was distributed by the government in four principal ways:

1. The major distribution mechanism was by employment. By the end of the 1990s, 96 percent of the workforce was employed by the government or government corporations.
2. There was large government spending on luxury items, such as a presidential aircraft and ships and expensive cars for senior government employees; in addition, spending on such items as a London West End musical (designed to be a financial investment) were complete failures.
3. There was a very extensive welfare state (especially for health), with a wide range of items provided free, even down to bandages and aspirins, free housing, and free education (Hannesson 2001).
4. There was investment in trust funds to generate future incomes.

6.76 Each of these mechanisms generated serious problems, and it is possible that it would have been better to save more “under the ground” and extract less quickly, thus putting less pressure on the inter-temporal spending and savings mechanisms.

6.77 Facing the very large expenditures of money into the domestic economy, Nauru was faced with classic Dutch disease problems. With the currency tied to the Australian dollar, excessive domestic expenditures were highly inflationary, so that no other exporting sector could hope to survive, and even domestic production was threatened by importables made possible by the high level of income. Traditional activities, such as fishing and agriculture, largely disappeared, thus posing problems for the reentry of the economy into a normal production pattern if and when the resource rents dried up. The spending on health and education, which might have been expected to provide a better-qualified labor force, did not provide motivation to build new activities based on these aspects. With such an abundance of support, and the lack of any need to struggle to find jobs, no service industries appeared, with the exception of offshore banking, which was largely tied to the use of Nauru by foreigners wishing to hide certain financial activities.

6.78 Some of the revenues were placed in trust funds. A principal trust fund was established, the NPRTF, which oversaw seven sub-funds, some of which were in effect owned by landowners on whose land the phosphate was mined, and others were owned directly by the government. Reports suggest that at their peak in the 1990s, the total value of the NPRTF was 1.3 billion Australian dollars (\$A), but the value fell to \$A 225 million by the end of that decade. This precipitate decline was attributable to two factors. First, the investment was in riskier assets than other trust funds tended to use, including substantial amounts of real estate (Hughes and Gosarevski 2004). Second, the government ran a very expansionary fiscal policy, even at the time that resource revenues were drying up, spending far beyond its current sources of income. This resulted in drawing down the fund and using it as collateral for borrowing. The result of this policy was that in 2004 the NPRTF was placed into receivership by its principal creditor (Four Corners 2004), and the eventual sale of properties to cover the debts left virtually nothing in the fund.

6.79 The upshot of this history is that, within a generation, Nauru passed from being one of the richest countries in the world (on a per capita GDP basis) to one facing implosion of the economy. Faced with falling resource rents, and being unwilling to cut public spending in a society that had become accustomed to guaranteed jobs and free public services, the government got ever deeper into debt and started activities for alternative revenue raising that were highly questionable. Concerns about the 450 offshore bank “shells” that were registered in Nauru, with virtually no supervision, and which could facilitate money laundering, led the United States to declare it the first “rogue state” under the 2001 Patriot Act.

6.80 The public spending and savings decisions were so poorly executed and open to so much fraud, it has been suggested that the Alaska solution of the distribution of most of the phosphate revenues annually to the citizens would have produced a better outcome. Many would have saved for the future or invested in or consumed items that would have benefited them directly. At the same time, the reduction of such an extensive

welfare state and guaranteed employment would have maintained a greater level of entrepreneurship in the economy, which has by now almost vanished. The very sharp peak in resource rent flows, followed by its rapid decline, also suggests that a less aggressive extraction policy should have been followed, particularly because, given the nature of the resource and the size of the island, further supplies would not be found.

6.81 The role of the NRPTF has been unclear. Its accounts have not been available, thus information on payments in and out, and on capital gains and losses, has not been publicly disseminated. Even multilateral development institutions, such as the Asian Development Bank, which have been working with the government to rescue the situation, have been hampered by an almost complete lack of economic statistics (Asian Development Bank 2005). However, certain remarks can be made:

- The rules for payments into and out of the NRPTF are not clear, but judging by the government's actions, they were free to withdraw both interest and capital.
- The fund was able to be used as collateral for government borrowing, which is expressly forbidden in most countries with savings funds of this type.
- There appears to have been no published investment policy guide (for example, limiting the class of assets chosen or providing benchmarks on returns required).
- The arrangement for oversight of the fund in terms of its investment performance is also not transparent.
- The details of the size of the fund and transfers into and out of it do not appear to be published, and the auditing arrangements are also unclear.
- There was little public discussion of the strategic uses of the fund and the likely course of phosphate revenues, leading possibly to overoptimistic expectations by the public of the size and duration of government spending from this source of income, which in turn resulted in a low level of public pressure to alter spending policies.

Assessment

6.82 The Nauru experience illustrates all the problems of the "resource curse":

- Spending was concentrated on creating public sector jobs, which would not be sustainable once the resource was depleted, or on luxury items that did not enhance the economy's ability to reengage once the resource was depleted and the fund was used up.
- The investments made by the fund were very risky and did not ensure long-term growth of the portfolio.
- The fund was used as collateral for government debts, which encouraged further spending in excess of what was sustainable.

- The failure to educate and involve the population in a discussion of the likely course of resource revenues and the purposes and amounts of the fund encouraged excess consumption and lack of interest in acquiring new skills that would be needed when the fund was depleted.
- The lack of transparency concerning the size and performance of the fund allowed poor investment decisions to go unquestioned.

6.83 The failure to make a realistic long-term projection of resource revenues, and the possibility of exhaustion within a relatively short period, led to a policy of rapid extraction, which in turn gave a temporary appearance of greater long-term wealth than was justified and led to general overspending and undersaving.

F. The Papua New Guinea Mineral Resource Stabilization Fund (MRSF)

6.84 At the time of independence in 1975, Papua New Guinea was a bisectoral economy. Employment was dominated by subsistence agriculture, but it also had a very substantial minerals-exporting industry. Income per capita was fairly low at about US\$500, and it ranked very low on social indicators, with great needs for physical and social infrastructure (May 1998).

6.85 For many years before independence, there had been mining activity, especially for gold where the country had large reserves, and in 1967, an agreement was negotiated under the trustee state (Australia) for the new Bougainville mine, which would produce copper and gold. The terms of the agreement were renegotiated in 1974 to be more favorable to the government. This mine was extremely large by world standards, and in its early years it produced about 180,000 tonnes of copper and 20,000 tonnes of gold. Further exploration and development led to the opening of the Ok Tedi mine after lengthy negotiations in the mid-1980s, in which the government had to finance part of the start-up infrastructure costs. In addition, oil and gas were produced toward the end of the 1990s. By the early 1990s, the export value of minerals accounted for a quarter of GDP and two-thirds of total exports.

6.86 Because of the volatility of metals prices, revenues were also highly volatile, and the government developed a plan to stabilize economic activity: this required that only a small budget deficit could be tolerated and that foreign exchange reserves should be accumulated. After the renegotiated Bougainville settlement, the MRSF was established in 1974. It received all direct revenue in taxes and dividends from major minerals projects and paid out to the budget only those amounts judged to be sustainable over a five-year horizon (Daniel 1985, Lum and others 1995, Allan C. Clark 2001).

6.87 However, there was a major change in late 1988, when strikes and sabotage at the Bougainville mine led to its closure in May 1989. These actions were related to issues concerned with land ownership and secession. The closure of the mine had a significant impact on exports (losing about 20 percent of the total) and on the government's revenue from mining. Since 1972, the mine had contributed about 17 percent of Papua New Guinea's internal revenues, 12 percent of GDP, and 45 percent of export earnings. Moreover, the government then spent a large amount to quell the Bougainville uprising. The unanticipated closure of the Bougainville mine in 1989

changed the country's revenue and expenditure plans completely. Revenue fell precipitously and expenditure rose, and withdrawals from the fund started to accelerate. In addition, the government changed the rules concerning payments into the fund, and from 1988, some receipts from government equity were directed instead to a new destination, the Mineral Resources Development Corporation (MDRC), which was a state-owned enterprise intended to take up state equity in mining as the government tried to further develop the value of its natural resources. The MDRC is the parent company of Petroleum Resources Kutubu, which manages the country's 22.6 percent share in the Kutubu oil project. Even after the Bougainville mine closed, government spending continued to rise, and the government started borrowing. By 1994, debt repayment and service accounted for one-third of budget, and the government then negotiated a loan from overseas private investors on the condition that interest and repayment would have first call on mining and petroleum revenues that otherwise would have gone to MRSF.

6.88 Further losses of minerals revenues were felt in 1988, when the Ok Tedi mine ceased to produce gold and produced only copper. Also, from 1998, a period of drought affected agriculture and mining, which, coupled with the Asian financial crisis and poor fiscal management, led to a significant shortfall in government revenues. The MRSF accordingly was completely depleted in 1999 by withdrawals to the budget. Finally, in 2000, an act of parliament was passed that repealed the act creating the MRSF, and it was thus wound up both legally and financially.

6.89 The MRSF was managed by a board of senior public servants, and the balances were invested by the central bank and held as local currency and not invested abroad. The managers made an 8-year projection of the copper price each year; until 1983, this was to vary by not more than 10 percent from the 20-year average historical real copper price in U.S. dollars. In 1983, this was amended to allow the projection to fall more than 10 percent below this average. The same procedure applied for gold, except that the historical average covered only the single preceding year. Only revenues from already producing mines could be included in the revenue forecast. The managers' recommendations about how much could be paid out to the budget was expected to vary by not more than 20 percent in real terms from that of the previous year, but the minister of finance had the discretion to vary this by a further 10 percent (32 percent in real terms). An amendment in 1983 allowed the managers to reduce proposed payments by more than 20 percent. Withdrawals from the fund were subject to parliamentary approval.

6.90 Until the late 1980s, the fund was successful in accumulating resources, and flows to the budget were by and large more steady than revenue flows into the fund. The increasing inflows from the new mines also permitted increased government spending as well as a steady increase in fund value, as shown in table 6.3. However, an assessment by the government itself in 2000 concluded that fiscal stabilization had not been achieved through the use of the fund because of the willingness of the government to increase the amount of debt (Morauta 2000).

6.91 However, the loss of revenue from Bougainville and the continued increase in government spending, coupled with the creation of the MRDC, signaled a switch in government policy to active investment in the sector to boost future minerals

revenues, which looked to be in decline. As a result, the MRSF was depleted in a single year and terminated in the following year.

Table 6.3: Flows into and out of the MRSF (current million kina)

<i>Year</i>	<i>Total MRSF receipts</i>	<i>Withdrawals to budget</i>	<i>Fund balance</i>
1973–74	28.0	28.0	0.0
1975–74	34.7	34.7	0.0
1975–76	62.9	45.0	17.9
1976–77	24.6	35.0	7.5
July–Dec 1977	23.8	17.0	14.3
1978	21.1	32.0	3.4
1979	39.4	38.5	4.3
1980	108.7	56.6	56.4
1981	71.4	81.4	46.4
1982	25.4	40.0	31.8
1983	25.0	21.0	35.8
1984	55.5	29.7	61.7
1985	23.7	32.1	53.3
1986	36.0	14.0	75.3
1987	26.8	36.4	65.7
1988	91.4	57.1	100.0
1989	119.7	84.7	135.0
1995	282.0	170.0	302.0
1996	424.0	195.0	531.0
1997	452.0	165.0	696.0
1998	311.0	330.0	677.0
1999	309.0	986.0	0.0
2000	20.0	20.0	0.0

Note: From 1976 to 1994, the kina was pegged to a basket of Papua New Guinea's trading partners. From 1994, the kina has been floated and was at US\$0.30 in 2003.

Sources: *Annual Reports of Ministry of Finance* quoted by: Lum, and others (1995) with 1987 corrected; Clark (2001); Daniel (1985).

Assessment

6.92 The MRSF was designed as a stabilization fund to give some smoothing of government expenditures against fluctuating commodity prices. It achieved its purpose in accumulating assets at times of high resource revenues and indeed lasted for almost 30 years. The closure of the Bougainville mine in 1998, despite the increase of revenues from other sources, was a major blow to the government's fiscal policy. It had accounted for about 20 percent of export earnings and a large share of the government's revenues. At the same time, the needs for government spending continued to rise, so that a more aggressive stance on encouraging further investment into the extractive sector was pursued by use of funds diverted from the MRSF to the MRDC.

6.93 The fund was treated as part of the government's assets and was not a true investment fund, because the policy of allowing the central bank to manage its assets and hold them only in domestic currency limited the variety of investments and its returns. Governance was exercised by the group of senior public servants charged with the management of the fund, and its accounts were audited as for other parts of the budget.

6.94 The rules of payments out and in were an attempt to find a compromise between smoothing government revenues and ensuring that a change in the Fund's assets would not be too violent, by limiting payments out to at the maximum 20 percent more (or less) than the previous payment. In fact, this rule proved to be unworkable at certain times, and ministerial discretion had to be used to make larger withdrawals. Furthermore, the need to define a sustainable level of payments by taking a revenue forecast that depended on the future prices of the minerals, while also constrained to be not too far from the historical average price, demanded a degree of specialist knowledge from the managers of the fund.

6.95 At the time of the establishment of the MRSF in 1974, there was much less concern globally about transparency and less awareness of the dangers for resource-dependent economies of nontransparent payments and expenditures. Little information about the fund and its performance appeared, except for the bare summaries of flows in and out and the total fund value, but its strong links to the budget suggest that it was subject to adequate parliamentary oversight. The weakest aspect of management appears to have been the constraints on investment policy and the lack of published details on performance, which might have given more impetus to improving the returns on the fund and the debate regarding its best use.

G. The Chilean Copper Fund (CCF)

6.96 Chile is a well-developed economy, with per capita income of more than US\$10,000. It has a long history of copper production, and the economy is still dominated by this sector, which accounts for about one-third of exports, although the share in exports and GDP has slowly fallen in recent years as the economy has diversified. Chile is the world's largest copper producer, with about 30 percent of proven and probable reserves.

6.97 Copper prices, like oil prices, have proved highly volatile. Following a period of high prices in the late 1960s and 1970s, there was a period of lower prices. These swings, which produced large fluctuations in government revenue, encouraged the government in 1981 to introduce rules governing the treatment of "excess" revenue from copper. When the current price was above a reference price, the additional revenues were placed in a special account with the treasury and used to buy back debt (Tsalik 2003, Larrain and others 2000, Organisation for Economic Cooperation and Development 2004, Basch and Miller 1993). The reference price was determined by the ministry of finance, with a cap based on the London Metal Exchange price average over the previous six years, adjusted by the U.S. wholesale price index.

6.98 In 1985, the government formalized this arrangement by creating the CCF, which started accumulation in 1987. This fund had the sole purpose of partial stabilization of the budget revenue against variations in the world copper price. The trigger mechanisms for payments into and out of the fund were determined in agreement with the World Bank. The source of revenues for the fund is the payments from its exports by the state-owned copper company, Cooperación del Cobre SA (CODELCO). A reference long-term copper price was established at each budget cycle, again based on the historical average of six years' past copper prices.

6.99 Each quarter thereafter, the actual price is compared to the reference price, and an allocation of the excess (or deficit) revenue is made between the central budget and the fund, according to the following rules:

- If the price is less than US\$0.04 above the reference price, all the excess revenue is paid into the budget (the difference between the reference price and actual price times the volume of sales in that quarter).
- If the price is less than US\$0.10 above and more than US\$0.04 above, then this part of excess revenue (the difference between the reference price plus US\$0.04 and the actual price) is shared equally between the government and the fund, and the first US\$0.04 excess is paid to the budget.
- If the price is more than US\$0.10 above the reference price, then the first two conditions apply to revenues up to the level of the reference price plus US\$0.10, and the revenues corresponding to the difference between the reference price plus US\$0.10 and the actual price are all paid into the fund.
- If the price is below the reference price, the same rules apply symmetrically for withdrawals from the fund (up to the point where it is exhausted).

6.100 This set of rules for the operation of the fund has been criticized on two grounds. First, the long-term forecast price was entirely backward looking and would not, for example, take into account a sharp drop expected in the near future. Second, the payments into or out of the fund took no account of the size of the fund itself. There was no minimum balance for the fund to ensure its durability.

6.101 More recently, the forecasting exercise has been delegated to the copper price panel, which consists of 14 individuals appointed by the minister of finance for one year at a time and a balance of members related to the governing and opposition parties, employees of mining companies, and financial analysts of the sector. Each panel member estimates the long-term (10-year) price of copper and, at one of the two panel meetings held during the budget season, submits a forecast that is published anonymously. The 2 extreme forecasts are discarded, and a simple average of the remaining 12 is used as a reference price without attempting to reach a consensus view.

6.102 The fund, for which few details of value or performance are available, is an account held in trust and managed by the central bank. The bank is obliged to obtain a specified return on assets (LIBOR less 0.125 percent), and does so as part of its normal liquidity operations. The fund is overseen by a board, which includes representatives of the national copper company.

6.103 Withdrawals from the fund, following the above rules, have been made to cover budget expenditure other than debt repayment on several occasions. In 1988–89, payments were made in the form of a subsidy to grape exporters, after a temporary ban on exports to the United States, and to prepay debt that the treasury had contracted with the central bank. In 1990, payments were made to cover the larger than planned imports

after an overexpansionary fiscal policy implemented during the run-up to an election. Exceptions to the withdrawal rules have also occurred. A special transfer of US\$460 million to the oil stabilization fund (created to cover the costs of imports of oil) was made, but this was done following public debate and the issuance of a parliamentary law to establish the conditions for repayment to the CCF, which has indeed since occurred. In 2001, the government even borrowed to replenish the fund. It has been estimated that the size of the fund is of the order of US\$2 billion.

6.104 Several attempts have been made to assess the effectiveness of the CCF in helping to stabilize the government's budget. Except in 1999, the government has been able to avoid budget deficits in the face of continuing low copper prices. However, this is due in part to the recent adoption of a structural budget balance fiscal rule that takes copper revenues as one of the ingredients, but also plans for other variable factors. In addition, the importance of copper revenues to the budget has declined, so that it now accounts for only 4 percent of the government's budget. It appears that the stabilization role of the fund has largely become redundant, so that it may transform itself into a de facto savings fund.

Assessment

6.105 The CCF is an example of a pure stabilization fund, with clear rules determining payments in and out, but with the possibility that parliament can override these rules. The distinctive features of the rules are the mechanism for forecasting the reference price, which is required especially if transfers are not to be determined by parliamentary decisions, and the withdrawals rule, which is determined by a nonlinear relationship between the reference and actual prices. The latter has the effect that only large fluctuations from the reference price bring the fund fully into play, while small deviations leave it untouched.

6.106 The payments into and out of the fund, being part of the budgetary process, are known only ex post, because no accumulations or withdrawals are planned for in the budget, which is based on the reference price itself. These, plus any special allocations determined by parliament, ensure some transparency in the management of the fund. However, the lack of statements about the fund's assets reduces the accountability to the citizenry and relies on the oversight committee, which does not publish a report. The return on assets managed by the central bank is low, even allowing for the fact that the CCF must remain fairly liquid to cope with unforeseen fluctuations in copper prices.

H. The Investment Fund for Macroeconomic Stabilization of the República Bolivariana de Venezuela (FIEM)

6.107 The República Bolivariana de Venezuela has been a major oil producer for a long time. In 1980, it produced 2.2 million barrels a day, and currently produces about 3 million barrels a day. The population of 25 million currently has GDP per capita of approximately US\$6,000 after a very sharp decline since 2000. It has remained an oil-dependent economy, with oil accounting for about one-quarter of GDP, three-quarters of export earnings, and half of government revenue.

6.108 Given the dependence of the economy on oil for such a lengthy period, it is not surprising that the government, faced with the usual problems of revenue volatility in the face of big oil price swings, has on more than one occasion established oil funds. In 1997, following the decline of oil prices after the Asian financial crisis, it created a new stabilization investment fund (FIEM). This was established in 1998. Accumulation was to be based on a reference price of crude oil, which was a five-year moving average of past prices. All oil-derived income above the reference price was to be placed in the fund, and if prices fell below the reference price, the fund would be drawn down by an amount equal to the difference in the reference price and the actual price multiplied by the volume of oil sold. Further, if the fund's holding exceeded 80 percent of the average of the previous five years' oil export revenues, this excess could be used, with congressional approval, to pay down government debt. To prevent instant depletion of the fund, the balance was required to be at least one-third of the balance of the fund in the previous year.

6.109 The election of President Chavez in 1999 led to changes in the fund's rules, allowing the president more discretion over its uses and reducing the level of transfers to it by depositing only 50 percent of the excess revenues above the reference price.³⁵ The president was also allowed to authorize withdrawals from the fund by decree. Despite the reduced requirements for payments into the fund, even these were not made in full in 1999; in 2000, despite a rise in oil prices, the government needed to borrow to meet its accumulation obligations because it had increased spending by more than 40 percent. In fact, rather than stabilizing the economy through steady fiscal policy and swings in deposits to the fund, the government followed a pro-cyclical fiscal policy. In 2001, the rules of the FIEM were changed again, diminishing its holdings. There were to be no deposits to the fund for one year, and in 2003, the it was to receive 5 percent of oil revenues, followed by annual increments of 1 percent up to 10 percent in 2007. After that date, the original accumulation rules of 2008 were to be restored. These rules, based on an automatic formula, removed any stabilization aspect for inflows, and outflows could be determined by presidential decree. In 2000, the FIEM had a net balance of US\$4.5 billion but, as a result of the freeze on receipts to the fund and the use of large transfers from it, its 2002 assets were reduced from US\$2.6 billion to US\$700 million in the one year.

6.110 In 2003, the government established the Fund for Macroeconomic Stabilization (FMS) to replace the FIEM, transferring the remaining assets to it. Future contributions to the FMS would come from contributions from the state-owned oil company (Petróleos de Venezuela, S.A.), proceeds from privatization, special contributions from the executive branch, and proceeds from the administration of the FMS.

6.111 Reports on the flows into and out of the FMS were published by the ministry of finance, but there was little public information on the investment management or performance of the assets held by the central bank as custodian of the fund.

³⁵ The English text of the 1999 version of the Law of the Investment Fund for Macroeconomic Stabilization is given in appendix 8 (www.bcv.org.ve/ifms/ifmmslaw2.htm).

Assessment

6.112 The FIEM was set up as a conventional stabilization fund, but almost immediately its role was weakened by the change of regime and the new law. Furthermore, the rigid rules for transfers into the fund succumbed to spending pressures—the government even had to borrow at expensive interest rates to place resources into the FIEM according to the rules. The oil fund was not integrated with overall fiscal policies, hence the government reduced transfers into the fund and enabled transfers out of it to be made on a much more discretionary basis, using presidential decrees. The further weakening of the law effectively negated its original purpose, and its short existence was finally terminated six years after its inception. The pressures to make these changes came from the fiscal policies followed by the government, due in part to domestic circumstances and in part to the decline in oil prices. The experience of the República Bolivariana de Venezuela serves to illustrate that no fund can be entrenched against an overwhelming political aversion to using it for its stated purposes or rules that are too rigid to allow for changing circumstances.

I. The Oman State General Reserve Fund (OSGRF)

6.113 Oman is another small country that has enjoyed the benefits of substantial oil reserves. It has a population of about 2.5 million citizens, and currently per capita income is around US\$13,000. Oil production began in 1967 and steadily climbed to a peak in 2001 of 960,000 barrels a day. By 2004, this had already declined to 785,000 barrels a day, and estimates suggest that oil will continue to steadily deplete from now on.

6.114 Oil production currently accounts for about 40 percent of GDP, about 90 percent of total exports (Central Bank of Oman 2002), and about 75 percent of total government revenues, so that the economy has been heavily dependent on oil for its development.

6.115 To cope with the need to save some of the oil wealth for future generations, in 1980, the government established the OSGRF, which originally received 5 percent of total oil revenues. In 1990, this ratio was raised to 15 percent, and a contingency fund was also established for the purposes of stabilization. It received 7.5 percent of revenues when the oil price was between US\$18 and US\$20 a barrel, and 10 percent when the price was higher than US\$20 a barrel. In 1993, an oil fund was established that received the value of a fixed volume of oil production (about 2 percent during the late 1990s). The oil fund is used to finance investments in the oil sector.

6.116 Currently, the SGRF is used as a stabilization fund, where revenues are paid in when the oil price exceeds a reference price. Withdrawals from the fund are normally limited to an amount equal to the budget deficit, so that there is net accumulation only when the budget deficit is less than the excess revenue plus investment revenue. In addition, there are special procedures for further withdrawals. In the recent past, Oman has persistently run a nonoil deficit, thus the fund has regularly contributed to the budget.

6.117 There is little information on the magnitude of the fund, because there is no annual report or Web site, and the government does not share information with the public. The assets are largely held abroad, and there are monthly internal audits and investment performance reviews, quarterly external audits, and six-monthly portfolio reviews, none of which are published.

Assessment

6.118 Despite the not too distant prospect of severe depletion of oil resources, the country appears to have concentrated on the stabilization aspects of the oil fund. Given that Oman has persistently run a financial deficit, it could be possible that a long period of low oil prices would considerably reduce the fund. The success of reentry into a postoil economy will depend on whether government spending has laid out the conditions necessary for the economy to diversify and become competitive in some sectors.

6.119 The complete lack of transparency of the fund makes it difficult for the population to assess the long-term strategy being followed by the government, or the success of the management of the fund's resources.

J. Oil Stabilization Fund (OSF) of the Russian Federation

6.120 Russia is the world's second largest oil producer, currently at about 9 million barrels a day, which marks a steady recovery from about 6 million barrels a day in the mid-1990s. This country of 140 million people has a per capita income of about US\$10,000, but it is still heavily dependent on oil and gas. It is estimated that these accounted for 25 percent of GDP, at least 40 percent of budget revenues, and 50 percent of exports in 2003. The rapid increase in oil prices since then will have increased these ratios further.

6.121 As oil revenues recovered in the late 1990s, there was debate within Russia on the need to set up a formal oil fund to help stabilize budgetary revenues. Initially, the Duma proposed its version of a stabilization fund law in 2002, and this was countered by the government proposing its own version of the law, which came into effect at the beginning of 2004 (The Moscow News 2003). There were to be three sources of revenues for the OSF: first, any end-year surplus from the budget; second, if world oil prices exceed a benchmark price for Russian export oil, export duties and tax on oil beyond the benchmark price will be paid monthly into the fund; and third, yields on the assets of the OSF will be paid back into the fund. The assets of the fund may be placed only in foreign debt instruments from a government list of approved items. Withdrawals from the fund will take place if the actual price falls below the benchmark price (then US\$20 a barrel), because the budget is prepared on the basis of this price. In addition, once the fund has accumulated 500 billion rubles (Rub), it may be used to finance certain strategic objectives. The ministry of finance had proposed a higher threshold of 9 percent of GDP before non-stabilization withdrawals could occur, but in the event, the lower threshold of about 3.8 percent of GDP was implemented.

6.122 The designers of the OSF had expected that it might take three to four years before such disbursements would occur, but the steep rise in oil prices has already taken the fund to more than Rub 1.46 trillion by November 2005 (which is almost equal

to the estimate of GDP for the year), so that calls for disbursement on a range of projects are occurring (such as reducing the rate of VAT or granting development loans to businesses) that could create risks of Dutch disease effects. Early plans for uses of the fund's revenues included paying back external debt and financing the pension deficit. The cautious estimate of the oil reference price has in fact meant that the OSF has very rapidly accumulated reserves, and this has put the government in a strong position to stabilize budget revenues if and when oil prices turn down. Faced with the unexpected developments in the world oil market, the authorities raised the benchmark price to US\$40 a barrel for the 2006 budget.

6.123 The OSF is held as a sub-account of the treasury at the central bank, and the bank is responsible for investing these sums. Each month, the press publishes details of the balance of the fund, transfers into it, and its uses. At present, the balance of the fund is entirely invested in U.S. high-grade income securities. There is at present no official dedicated source of information for the fund, and its investment performance is at present not published. Also, if an external audit of the fund has been carried out, this has not been made public.

Assessment

6.124 Russia chose a particularly fortuitous time to establish the OSF, just as the world oil price rise started its rapid climb. This meant that its modest accumulation target was achieved within one year, so that the country has some time to consider the long-term use of the funds before they become essential for budget revenue stabilization. The fund as yet does not conform to international best practice for transparency in terms of information.

K. The Reserve Fund for Future Generations (RFFG) of Kuwait

6.125 Although geographically small, Kuwait is one of the world's major oil producers. Oil production is currently about 2.4 million barrels a day, and its reserves are the fourth largest in the world, giving it an extraordinarily high reserve to production ratio (British Petroleum 2005). With a population of 2.3 million, of which only 1 million are Kuwaiti, GDP per capita is high at more than US\$20,000. Oil accounts for nearly 50 percent of GDP, 80 percent of government revenue, and 95 percent of exports.

6.126 Faced with oil revenues that are huge in relation to the size of the country, and which will last for an extremely long period, there is only a weak case at present for a substantial intergenerational fund. A fund for future generations has to be interpreted not in terms of intergenerational preferences, but more in terms of precautionary saving against falls in the world oil price (caused by technological and demand shifts over the longer run) and against geopolitical uncertainties. In addition, concerns about the effects of excessive domestic spending have led to the withdrawal of some funds from circulation and their sterilization through being invested abroad. Kuwait, unlike some other oil producers, does not face the immediate reentry problem of how to restructure the economy for when the oil runs out, but by the same token, it needs to avoid embedding the creation of negative incentives for entrepreneurship and employment that have occurred elsewhere with the presence of huge revenue flows.

6.127 Faced with the extreme dominance of the oil sector, the government has for a long time sought to diversify through investing some of the oil revenues abroad. In 1952, the Kuwait Investment Board, based in London, was established to manage the portfolio of foreign investments, and in 1958, this became the Kuwait Investment Office (KIO).

6.128 In 1960, the government created the General Reserve Fund, financed from budget surpluses; in 1976, it also created the RFFG, allocating to it 50 percent of the General Reserve Fund at that time, plus 10 percent of future budgetary revenues and the profits on the assets of the RFFG. The Kuwait Investment Authority (KIA) was created in 1982 to take over from ministry of finance the management of both of these funds. The minister of finance is the chair of the KIA board of directors, and other board members include the minister for oil, the governor of the central bank, the undersecretary for the ministry of finance, and five other members who are experienced in the field of investment and finance. These members are appointed for terms of four years, and three of them must not hold any other public office. The KIA board has as its main tasks to draw up strategy, supervise implementation, and set up rules and regulations for the operation of the KIA. The board reviews and authorizes the annual budget and financial accounts before they are submitted to the council of ministers. The KIA also encourages the local private sector by participating in financing of the establishment of companies, and it has provided liquidity to the treasury. The KIO is technically an arm of the KIA, but it acts independently. Provision of public information on the fund's assets is prohibited by law, partly in an attempt to insulate the fund from pressures for it to be spent. The rules for payments into the RFFG are clear, but conditions for withdrawals are not made public. However, all withdrawals from the fund must be approved by the national assembly.

6.129 Before the Gulf War, the RFFG had accumulated assets steadily and managed these so well that investment income had become larger than direct oil income (Country Studies). This gave an enormous stabilization effect to the country, because it greatly reduced the importance of swings in the world oil price for the total budget (Chalk and others 1997). At the outbreak of the Gulf War, the fund was estimated to be worth between US\$90 and \$100 billion, equivalent to a multiple of approximately five times per capita income for each citizen.

6.130 The Gulf War did a great deal of damage to the Kuwaiti economy, not least in shutting down its oil production completely. Even with very rapid reconstruction, oil revenues in 1990–91 were down by two-thirds from before the war, and government expenditure was 25 percent higher, thus resulting in a very substantial budget deficit. However, by 1993, oil production and GDP had largely recovered. The deficits were met out of the assets of the RFFG, although the exact amount drawn down has not been published. Estimates range from between one-third to one-half of the then assets of the fund. One result of this drawdown was that investment income declined, reducing the ability of the fund to provide stabilization so that the economy became more vulnerable to swings in the world oil price.

6.131 The lack of transparency concerning the fund in terms of its value, portfolio performance, asset composition and diversification, and audits makes it difficult to assess its potential benefits to the economy.

Assessment

6.132 Kuwait has very large oil revenues in relation to the size of the budget and has also been able to run fiscal surpluses, so that the rule of depositing 10 percent of revenues into the RFFG has been easier than it is in some other economies. The accumulated saving of the RFFG was apparently valuable in providing the short-term financing required by the heavy strain placed on the economy by the Gulf War.

6.133 The deliberate lack of transparency concerning the fund, in terms of revenue and expenditure flows, assets held, and investment performance, has been justified by the authorities in terms of preventing calls for the immediate spending of the fund, with its likely consequences of further distorting the economy. However, this lack of transparency, in a situation where all citizens have an interest in the management of the economy, is not a model that is to be recommended, and indeed it may not be sustainable under increasing pressure for accountability.

7

A Comparison of Oil Funds

Introduction

7.1 The preceding chapters have given details of individual oil funds, and this chapter builds on that material to present a comparative picture of the funds and their operations. The discussion of individual funds has highlighted their strengths and weaknesses, so that a list of indicators is provided to allow cross-country comparisons of some key aspects of performance and design.

7.2 To make a full evaluation of the success of the various funds in achieving the objectives for the government, in terms of saving for the future as opposed to immediate consumption while maintaining a healthy fiscal position, in providing stabilization of government expenditures against fluctuations in revenues from oil due to price and production variations, and in providing the maximum financial return subject to an acceptable risk profile, extensive information would be required. However, only four funds provide a full history of their performance, and for all but Alaska this is based on only a few years' experience (Alberta having changed its policies in the late 1990s). Furthermore, to evaluate fiscal policy against the counterfactual of there being no oil fund would require formal economic modeling beyond the scope of this study.

7.3 The objectives of this chapter are more modest. Certain features which should lead to well designed and operating funds can be identified, and the experiences of the 15 funds described in the study are categorized with respect to these indicators. Again, the actual contribution of these indicators to the overall performance of a particular fund cannot be quantified. For example, it is widely accepted that transparency over a fund's inflows, outflows and financial performance is desirable, but it is not generally possible to evaluate whether the existence of mechanisms for ensuring such transparency actually made any difference to the operation of the fund or overall fiscal policy.

7.4 The chapter begins by providing some basic information on the size of the oil funds, and their importance relative to the size of the economy. This is followed by a comparative table of the financial performance of the four funds for which detailed

information is published. Turning to the actual way in which the funds were created, are operated, managed, and provide public information on their performance, some twenty indicators are suggested. The fifteen funds are then described with respect to these indicators. Each indicator is discussed with respect to the desirability or not that a fund should adopt the practice referred to by the indicator.

7.5 At this stage of the experience of oil funds, and given the limited amount of information publicly available, the study does not attempt to come to formal evaluations of the general performance of each fund; nor does it attempt to suggest that there are rigid codes of best practice that should be followed. The situations of each of the countries studied are so different that the goals and constraints facing each country have led to very different approaches to setting up and operating the funds. What the study does provide is an insight into the approaches to good practice that need to be considered in any particular case, and it points out where the failure to follow such practices has led to a need to redesign the fund, or face unsuccessful outcomes from the creation of the fund.

Oil funds in the context of the economy

7.6 The importance of oil to an economy and the size and relevance of an oil fund are determined in part by the current level of oil production and the known size of reserves. These have to be evaluated against the level of income in a number of ways. The ratio of the government's oil-related revenues to its total revenues, and the ratio of oil production to GDP and to exports, are indicators of the dependence of the economy on oil.

7.7 Table 7.1 presents indicators for the oil economies discussed in the text. Although there is some uncertainty regarding some of the figures, the overall picture is clear. In all cases, the governments of countries that have adopted oil funds are heavily dependent on oil revenues for the budget and for a source of export earnings. Azerbaijan, Chad, Kuwait, and Oman, are especially dependent on oil revenue. In addition, Oman, with a relatively low R/P ratio, needs to find a balance between using current revenues to strengthen the economy and accumulating some savings in preparation for the time when oil revenues will be exhausted. Chad, with high current spending needs relative to current resource revenue, may be able to devote little to future uses.

7.8 Table 7.1 confirms that, for the group of countries that have established oil funds, oil production is most important for the lower-income countries (Azerbaijan, Chad, Kazakhstan). Countries with high ratios of oil production to GDP are likely to be the most vulnerable to swings in the world oil price and have the most need of a stabilization mechanism, whether it be through the formal operation of their oil fund or prudent expenditure-planning decisions that allow for some smoothing against revenue fluctuations. The reserves to production ratio, which is a static indicator of how much saving is "below the ground," suggests that Alberta, Azerbaijan, Kazakhstan, Kuwait, and the República Bolivariana de Venezuela appear to be least in need of the savings

aspect of an oil fund, but even these countries should have an intergenerational approach to expenditure and saving decisions.

Table 7.1: Indicators of the Relation of the Oil Sector to the Economy, 2004

	<i>Production (1,000 barrels a day)</i>	<i>Proved reserves (billion barrels)</i>	<i>R/P (years)</i>	<i>GDP per capita (current US\$)</i>	<i>Oil production/ GDP per capita (000 barrels per day/\$)</i>	<i>Oil exports/tot al exports (%)</i>	<i>Government oil revenues/ total revenue</i>
Alaska	1,086	4.45	11	51,685	0.02	NA	42
Alberta	1,720	175.6	280	44,128	0.04	56	33
Azerbaijan	318	7.0	60	1,029	0.31	77	56
Chad	168	0.60	10	486	0.35	NA	58
Kazakhstan	1,295	39.6	83	2,724	0.48	55	42
Kuwait	2,424	99.0	112	16,974a	0.14	86	77
Norway	3,188	9.7	8	54,598	0.06	39	23
Oman	785	5.6	19	8,160a	0.10	76	73
RB of Venezuela	2,980	77.2	71	4,184	0.71	83	46
Russia	9,285	72.3	21	4,078	2.28	41	NA
São Tomé and Príncipe	0	NA	NA	388	NA	NA	NA
Timor- Leste	NA	NA	NA	366	NA	NA	NA

Not Applicable (NA).

a. In 2003.

Sources: various World Bank and IMF estimates, *BP Statistical Review of World Energy*.

7.9 The 15 resource funds described here vary considerably with respect to size and functions. In trying to evaluate the success of the various models and their operation in different countries, it is necessary to return to the underlying purposes of the funds—saving or stabilization. In practice, many funds combine both aspects, sometimes in separate treasury accounts, and any stabilization fund is also likely to be a de facto savings fund, because it must on average hold enough resources to withstand shocks to

the system. Therefore, judging performance by the size and use of the funds is unlikely to be straightforward and is not attempted here.

Financial indicators of fund experience

7.10 Because funds are to be managed for the benefit of the economy, their own financial performance is an important indicator of success. Good management can increase the total value of the fund or the amount that can be paid out. This study contains some comparative evidence, although with respect to only the four funds that have been in operation for long enough to give an indication of their performance and that publish enough data. The basic information of the size and returns of the well-documented funds is presented in table 7.2.

7.11 The Norwegian fund appears to have been the most successful despite its avoidance of real estate investments, which were highly successful in Alberta and Alaska. Part of this superior average performance is attributable to the very rapid growth of the fund in the last two years, when it was able to obtain a very good return on investment; in the earlier part of the observed period, when all funds had poor performance, the size of the Norwegian fund was much smaller.

7.12 Alaska and Norway were able to achieve excess returns versus their benchmarks through active management. All funds experienced periods when returns measured in the currency basket of the assets and measured in local currency diverged somewhat.

7.13 The year-by-year performance of the different components of the portfolios also indicated that in some years, a portfolio with a large equity component can experience substantial negative returns. This is an important issue for citizens of the country, who need to understand how funds take a long view of asset markets to achieve higher returns without too much risk.

Non-financial indicators of fund design and operation

7.14 In addition to assessing funds by their financial performance, they can be judged in terms of the institutional arrangements made to ensure that their purposes are fulfilled. These arrangements should:

- Provide a stable existence for the fund through the procedures for establishing the fund;
- Give a clear mandate for the functions of the fund through rules for determining flows into and out of the fund;
- Use the most appropriate management structure for the fund and ensure an appropriate investment policy;
- Provide adequate oversight and control of the management of the fund.

Table 7.2: Basic Financial Statistics for Certain Oil Funds

<i>Fund</i>	<i>Alberta</i> (<i>March 2005</i>)	<i>Alaska</i> (<i>June 2005</i>)	<i>Norway</i> ^a (<i>December 2004</i>)	<i>Azerbaijan</i> ^b (<i>December 2004</i>)
Effective start	1976	1976	1996	2001
Latest value (current US\$ billion)	12.2	30.0	167	1.03
Nominal return over previous 5 years (local currency)	4.1 (NA)	4.5 (3.0)	6.1 (5.7)	4.9 (NA)
Net real return over previous 5 years (international currency)	1.6	1.8	4.0	1.7
% held in equities	58	57	41	0
% held in real estate	10	8	0	0

Notes: NA = Not Available.

^a Based on the most recent eight years. ^b Based on four years.

For Alberta real returns are in Canadian dollars.

Figures within parentheses are benchmark returns.

7.15 Twenty indicators related to the funds in the 15 countries are presented in table 7.3. In a few cases, the secrecy surrounding a particular fund does not permit an evaluation of the status of certain indicators. The indicators are grouped under these four aspects (A–D) covering: the establishment of the fund; transfers into and out of the fund; the management of the fund; and the governance of the fund.

A. The establishment of oil funds

7.16 Four aspects of the establishment of an oil fund are included: the prior information campaign, the legal method of establishment, the purpose of the fund, and the status of the fund. These four aspects together help to ensure that the fund is established in a way that reflects public support and understanding, and that the rules governing the fund strike a good balance between being flexible enough to adjust to changing circumstances, but are not so flexible that they can be varied according to short-term political priorities, which may not have general support.

1. The prior information campaign

7.17 In establishing an oil fund, attention should be given to creating public understanding of its purposes. A public information campaign, explaining the reasons for creating the fund (Alaska, Timor-Leste, Chad, São Tomé and Príncipe) and the rules or principles for transfers in and out of the fund, is needed to establish confidence in the government's motives for creating the fund and its judgment on how much can be deposited in the fund from current oil revenues. To accomplish this, a draft of the law and accompanying regulations governing the operation of the fund should be widely circulated, and there should be a mechanism for interested parties to make their comments known publicly (Alberta, Timor-Leste, São Tomé and Príncipe). Although the growth of the Internet has facilitated such a process, countries with low rates of literacy, difficulties in accessing the Internet, or a number of indigenous languages apart from the official language, require special dissemination programs to reach a broad cross-section of the population.

Table 7.3: Indicators for Oil and Resource Funds

	<i>Oil Funds</i>										<i>Mineral Funds</i>				
	<i>Alaska</i>	<i>Alberta</i>	<i>Azerbaijan</i>	<i>Chad</i>	<i>Kazakhstan</i>	<i>Kuwait</i>	<i>Norway</i>	<i>Oman</i>	<i>RB Venezuela</i>	<i>Russia</i>	<i>São Tomé and Príncipe</i>	<i>Timor-Leste</i>	<i>Chile</i>	<i>Nauru</i>	<i>Papua New Guinea</i>
A. Establishment of fund															
1. Prior information campaign	Y	Y	Y	Y	N	N	N	N	N	N	Y	Y	N	N	N
2. Legal method of establishment ^a	C	A	D	D	D	A	A	A	D	A	A	A	A	A	A
3. Purpose of the fund ^b	F	F	B	B	B	F	B	T	T	T	F	F	T	F	T
4. Status of the fund ^c	A	A	A	M	M	M	M	A	M	M	M	M	M	M	M
B. Flows into and out of fund															
1. Determination of net payments to fund ^d	R	R	D	na	R	D	D	R	D	D	R	R	R	D	D
2. Formula for price calculation	N	N	N	na	Y	N	N	Y	Y	Y	Y	Y	Y	N	Y
C. Management and investment															
1. Special fund strategy body	Y	Y	Y	na	Y	Y	N	?	N	N	Y	Y	N	?	N
2. Investment advisers	Y	Y	N	na	N	?	N	?	N	N	Y	Y	N	?	N
3. External managers	Y	N	Y	na	Y	Y	Y	?	N	N	Y	Y	N	Y	N
4. Overall target return published	Y	Y	Y	na	Y	N	Y	N	N	N	N	Y	Y	N	N
5. Benchmarks established and published	Y	Y	Y	na	Y	N	Y	N	N	N	N	Y	Y	N	N
6. Domestic investment permitted	Y	Y	N	na	N	?	N	?	Y	N	N	N	Y	?	Y
7. Equities permitted	Y	Y	Y	na	Y	Y	Y	Y	N	N	N	N	N	Y	N
8. Real estate investment permitted	Y	Y	N	na	N	?	N	?	N	N	N	N	N	Y	N
9. International geographical spread limited	Y	Y	Y	na	N	?	Y	?	na	?	N	Y	na	N	na
D. Governance															
1. Multilevel oversight	Y	Y	Y	Y	N	N	Y	N	N	N	Y	Y	N	N	N

	<i>Oil Funds</i>										<i>Mineral Funds</i>				
	<i>Alaska</i>	<i>Alberta</i>	<i>Azerbaijan</i>	<i>Chad</i>	<i>Kazakhstan</i>	<i>Kuwait</i>	<i>Norway</i>	<i>Oman</i>	<i>RB Venezuela</i>	<i>Russia</i>	<i>São Tomé and Príncipe</i>	<i>Timor-Leste</i>	<i>Chile</i>	<i>Nauru</i>	<i>Papua New Guinea</i>
2. Annual report published	Y	Y	Y	na	N	N	Y	N	N	N	Y	Y	N	N	Y
3. Performance published	Y	Y	Y	na	N	N	Y	N	N	N	Y	Y	N	N	Y
4. Audit Publisher	Y	Y	Y	na	N	N	Y	N	N	N	Y	Y	N	N	N
5. Web site for fund performance	Y	Y	Y	na	N	N	Y	N	N	N	Y	Y	N	N	Y

Notes to table.

Y = yes; N = no; na = either not applicable or no decision yet.

a. C = constitutional amendment; A = parliamentary act; D = presidential decree.

b. T = stabilization fund; F = savings fund; B = savings and stabilization fund.

c. A = autonomous body; M = within ministry of finance or other ministry or central bank.

d. R = rules-based; D = discretionary

2. *The legal method of establishment*

7.18 The legal instrument for creating a fund (and for disestablishing an existing fund) depends on the legal traditions and political economy of the country in which the fund is to be created. The establishment of the oil fund itself can be by one of three routes:

- *A constitutional amendment.* This typically requires the greatest political support to be accepted, and equally would require similar support to subsequently undo any such legislation. Only Alaska has found it appropriate to choose this route, in large part because of an existing constitutional clause banning any expenditure earmarking of natural resource revenues.
- *An act of parliament.* Several countries have established oil funds by an act of parliament, which usually provides the opportunity for public discussion of the aims of the fund and the broad outlines of its operation. Details of the management of the fund have sometimes been delegated to a management agreement between the responsible authority (for example, the ministry of finance) and the executing agency. This arrangement combines a degree of stability with the possibility of flexibility. Major changes to the act will require subsequent legislation, but desired changes in the management of the fund can be instituted without recourse to parliament. One important issue is the change in purpose of the fund, or its termination, both of which will typically require a new act of parliament, which provides the opportunity for informed debate on these major decisions (Alberta, Papua New Guinea).
- *An executive decree.* The most expeditious way to establish an oil fund is by decree, which in most cases does not require the approval of any other government body (Azerbaijan, República Bolivariana de Venezuela). By the same token, decrees can be used to rapidly reverse or alter the decision, as in the case of the República Bolivariana de Venezuela.

7.19 In general, a constitutional amendment would be favored only when there is substantial fear of the fund being cancelled or subverted by subsequent administrations. The use of executive decrees is expedient and gives the most flexibility for subsequent emendations to the rules and purposes of the fund, which can suit an evolving situation. However, the downside of this approach is the possibility of subsequent change where there are few checks on the wishes of the executive. Ultimately, anchoring the existence and operation of a fund in a parliamentary act appears to give the best balance between rigidity and flexibility.

3. *The purpose of the fund*

7.20 Oil funds may be set up to fulfill a variety of purposes:

- *Savings fund.* Most oil funds have been set up with at least part of their aim being to help the government to save now to provide future expenditure. This can be done for three distinct reasons:
- To provide income for future generations who should benefit from the country's natural endowment—policies of rapid depletion, often driven by urgent needs for current expenditure, as well as economies of scale in exploration and production, may mean that, in particular for countries whose reserves are not likely to last into the distant future, some of the revenues should be saved now to smooth out future expenditures (São Tomé and Príncipe, Timor-Leste).
- To obtain the best social return over time by limiting current government expenditures to those projects that yield an adequate return—where the absorption capacity of the economy is low, too rapid an injection of current government expenditure will exacerbate Dutch disease symptoms and not benefit the economy as much as would the delaying of some expenditure until capacity has increased.
- To provide precautionary saving against large and unexpected shocks to the domestic or world economy that would generate either abnormal demands for expenditures or else unexpectedly large falls in revenue.

7.21 One of the decisions concerning a savings fund is its planned eventual size. Several funds are based on the principle of maintaining the real value of the fund intact. The Timor-Leste act provides detail on how this could be done: it values expected future revenues by discounting them to the present at the nominal rate of interest on U.S. treasury securities. Of this expected present value, a fraction equal to the real rate of interest can be spent each period, and the unspent part will then earn just sufficient to restore the value to its previous level. All revenues from oil are then paid into the fund, which gradually builds up to a permanent level after depletion and can provide a constant stream of income indefinitely. Basing savings decisions on a calculation of permanent income, which provides an important philosophical underpinning to the spending and savings decisions, does have a number of shortcomings. These are listed below:

- Because oil revenues may have a very sharp peaked profile (gas tends to be less peaked) with low revenues early on, often followed by a rapid increase and then a decline, spending according to a permanent income approach could require the state to borrow in early years, before the revenue levels move toward their peak. Depending on the degree of solvency of the government, borrowing against future oil revenues is risky and usually involves higher interest rates than the average return on

investment in the financial market. In this case, a net contribution to savings is unlikely to be made.

- Even when there is ample revenue accruing to the fund to cover permanent consumption, expenditure needs may appear to be larger than the amount calculated as permanent consumption. In this case, parliament or the president, depending on local laws, has to decide between adhering to the principle of maintaining real value intact or undertaking additional expenditure now, perhaps with the idea of saving more in the future to offset this (Timor-Leste).
- To calculate permanent income, it is necessary to obtain estimates of future oil revenues. These are likely to be subject to a good deal of uncertainty concerning the resource price, the production profile, and the cost of production. Because future discoveries are not normally taken into account, the calculation will need to be adjusted over time. With respect to prices, some countries approach this by taking the current price of oil as the long-term reference price and then revisiting the issue after a few years (Kazakhstan, Russia); others use a moving average of historic prices to give constantly updated forecasts of the long-term oil price. In the case of Chile, poor experience with this type of approach led to the use of an expert panel to make the annual forecasts of the future resource price. In general, a cautious approach to forecasting should be used, or else countries may lock themselves into spending amounts that are too high for the long-term preservation of real wealth, but difficult to reverse in the short term because of political commitments.
- Often the calculation does not explicitly allow for population growth (Timor-Leste). If the numbers at each point in time are expected to increase substantially, then trying to equalize benefits per person over time requires a higher allocation to future generations than calculated using an equal total consumption figure for every year.
- **Stabilization fund.** For economies where oil revenues contribute a large part of the government's total revenue, the volatility of world oil prices and uncertainties about future oil production levels mean that budget planners are faced with the prospect of large swings in the total finance available for the budget. In this case, policy makers in some countries have implemented or considered the use of a fund for the stabilization of budget revenues (Azerbaijan, Chile). There are then two dimensions to the decision:

- The size of the fund depends on the expected swings in revenues. Too small a fund would be inadequate to smooth out expenditures when oil prices take a substantial decline, and too large a fund would not be used and would in fact largely have a savings function. Simulations of possible oil price paths and expenditures can be made to arrive at a reasonable target size for a stabilization fund.
- The rules for additions and withdrawals to a pure stabilization fund can be determined budget by budget, when the planned nonoil deficit in the budget is to be covered by the fund, with any residual revenue being added or deficit being withdrawn (Norway), or it can be determined according to fixed rules depending on the deviation of the actual oil price from the expected oil price, on which the expenditure plan has been predicated (Azerbaijan, Chile, Russia).

7.22 The purposes for which a fund is established need to be clearly articulated both in the prior campaign and in the legislation. This enables the use of the fund to be meshed with a successful fiscal policy, and to provide information to the public on the strategy the government is following with respect to the use of the oil revenues.

7.23 A rules based approach to the fund has the advantage that attempts by the parliament to diverge from the original principles used in establishing the fund will require some legislative action to alter the rules, thus alerting concerned parties to the implicit change in policy. A discretionary system (Norway) is more flexible but this flexibility is most advantageous when there is a strong democratic tradition, and the parliament is concerned to represent the wishes of the electorate.

4. *The status of the fund*

7.24 The establishment of the fund as an autonomous body provides some degree of shelter from the interventions of politicians in that it requires a justification for changes, but it is likely to make it more difficult to integrate the use of the fund with the budgetary process.

7.25 Oil funds have been established in two separate forms. In some cases, the fund is a legally separate entity (Alaska, Alberta, Azerbaijan, Kuwait, and Oman), an autonomous government agency. In this form, the direct control and management of the fund's assets are under the control of the agency. In other cases, the fund is a division of the ministry of finance, sometimes managed on its behalf by the central bank (Norway, Timor-Leste). The second route is more appropriate when the payments into and out of the fund are determined by decisions of parliament, often through the budgetary process, which is an integral part of the functions of the ministry of finance.

7.26 In general, where the fund is to be used for stabilization, or where all revenues are first paid to the fund, with payments out being made to treasury, then it is likely to be most effective to keep the fund within the ministry of finance (treasury).

B. Transfers into and out of the fund

7.27 Two aspects concerning flows into and out of the fund should be considered: the principles by which net payments to the fund are determined and the existence of a reference price.

1. Principles for transfers

7.28 Two approaches have been used for determining transfers into an oil fund.

- The direct transfer. This requires that certain categories of oil revenues (possibly all) as defined in the legislation are to be paid into the fund account (either directly or via the treasury), which is held by the treasury or central bank (Alaska, Azerbaijan, *Kazakhstan*). In this approach, precise details of which categories of payments are to be made to the fund become important. Certain legislations are ambiguous, or omit categories of payments that might be expected to be grouped with other payments in light of the purposes of the fund. This approach then determines the expected size and use of the fund through the rules concerning withdrawals from the fund.
- The indirect transfer. In this approach, all oil revenues are first paid to the treasury and, following a decision by the authorities (parliament or president) that *determines* the expenditures from oil revenues that will be made through the budget, the balance is transferred into the fund for investment.

7.29 There are three different approaches to determining withdrawals from the fund:

- Fully specified mechanism. In cases where only the dividends of a fund can be distributed (Alaska), or where net payments into the fund are rigidly determined by a formula (Chad, Chile, *Kazakhstan*), the evolution of the fund depends on the course of the resource price, production volumes, and investment performance of the fund. The case of Alberta, where no payments are made into the fund and all earnings less those required for inflation-proofing are returned to the budget, is also a fully specified mechanism.
- Budget needs take preference with an expenditure capping mechanism. In funds with long-term goals for saving, particularly related to keeping the income *earned* from natural resources constant (Timor-Leste) while trying to meet immediate expenditure needs, which may be larger than current

oil revenues can meet, the law can refer all proposed withdrawals, in excess of what can be afforded to keep estimated permanent income constant, to parliament for consideration and approval. This requires a deliberation on the balance between the long-term and short-term needs of the country.

- Budget needs are taken as dominant. In some countries, there is no formal reference in the foundation act to maintaining the real value of the fund constant (permanent income), so that parliament or the executive are unfettered in their decision on how much to withdraw from the oil fund (Norway). The accumulation of the *fund* is then left to parliament or the executive to ensure that the fund accumulates an appropriate sum for its long-term purposes.

7.30 The existence of formal rules for payments into and out of the fund may facilitate public scrutiny to ensure that the laws are being obeyed. Discretionary systems, especially where the decision is to be made by parliament through the budgetary process, can work well. The danger of the discretionary process is that, in the presence of liquidity constraints, a parliament where there is a solid majority, particularly before an election, may decide to tap the resources of the fund to enhance the chance of success for the incumbent government.

2. The existence of a formula to determine the reference price

7.31 In systems where the fund is designed to maintain real value of its assets intact, or to help stabilize current government revenues, the calculation of future oil revenues becomes very important. The procedures for making this calculation are highly dependent on forecasts of the oil price. A formula to determine the reference price (Chile, São Tomé and Príncipe) is advisable in that it avoids arbitrary decisions designed to favor the current spending plans of the parliamentary majority.

C. The management of the fund

7.32 In managing an oil fund, similar considerations apply as in managing any portfolio. The objective is to maximize long-term return subject to an acceptable amount of risk, which will be determined by the investment horizon, liquidity, and minimum income constraints.

7.33 Arrangements for the management and investment policy of the fund can be described by nine categories: use of an investment strategy body, use of investment advisers, use of external managers, publication of overall target return, use of benchmarks, domestic investment policy, equity investment policy, real estate investment policy, and geographical spread.

1. Investment strategy body

7.34 Some countries have created a special body to define the overall investment strategy (choice of equities, bonds, real estate, and so forth) of the fund (Alaska, Alberta, and Azerbaijan); others, such as Chile, Norway, and Russia, use prescriptive rules set in the foundation act or implementing regulation. The overall flexibility of either arrangement depends on the legal status of the fund: when the operation of the fund is set forth in the country's law, there is less scope for adapting the investment strategy over time. The expertise and independence of the members of the investment body are important features in guaranteeing its effectiveness.

7.35 A flexible strategy should intuitively provide better returns on investment. However, there is not sufficient empirical evidence to support this argument (length of the evaluation period and number of funds).

7.36 In Norway, the ministry of finance has issued further guidelines on the composition of the portfolio. A first step was to set up a subportfolio limited to assets that fulfilled certain requirements on environmental reporting and management. This was superseded by a restriction of the whole portfolio to assets that passed certain ethical standards (including environmental standards). Other funds have not adopted this approach.

7.37 In some cases, the legislation explicitly invokes the prudent investor principle (Alaska, Alberta, São Tomé and Príncipe, Timor-Leste) in which fund managers have to take the same attitude to risk as would an individual prudent investor. The management contracts with the executing managers also typically specify the benchmark, eligible asset classes, and how much market risk is to be tolerated with respect to the benchmark.

2. Investment advisers

7.38 Although broad investment principles may be spelled out in the founding act or decree, and in the management contract, if any, there is still a need to make investment policy decisions on the general direction of the fund at a level above the individual executing managers. Several countries have engaged an investment advisory consultant or group. This group reports upward to the minister of finance (if appropriate) or to the board of the fund itself (Alaska, Alberta). Investment advisers are normally entrusted with the definition of criteria for selecting external managers, evaluating their performance, allocating assets, comparing fund returns to total goals and benchmarks, and so forth. Investment advisers provide additional guidance and feedback to the management of the fund.

3. External managers

7.39 For both types of fund (autonomous or within the treasury or central bank), there is the option to manage the fund entirely internally or engage external managers for all or part of the fund.

- **Internal management.** In the early days of a fund's history, its investments may be limited to high-grade income securities (Azerbaijan, Chile, Norway), and the expertise for this may already exist within the central bank that manages the rest of the government's assets. In the case of internal management, it is important to maintain "Chinese walls" with the rest of the bank's operations, which may be privy to confidential information from other agencies (Alberta). Where the fund is entirely managed internally, there is no opportunity to compare performance with a second group of managers, although the use of a benchmark portfolio does provide a check on the management performance of the fund (Alberta).
- **External management.** As experience has been gained, funds' management arrangements have evolved, and diversification to equities and even to alternative investments (private equity, real estate) has occurred. To undertake the *management* of these assets, funds have usually engaged external managers for part or even the whole of the portfolio. This is especially important because central banks rarely have experience in managing a portfolio of equities or other non-high-grade income securities. As well as assigning specific mandates to separate specialist managers, a specific mandate may be divided among several managers. This allows comparisons of performance among the different managers and the different asset classes (Alaska, Azerbaijan, Norway).

7.40 The procedure for the appointment of external managers is commonly spelled out in the act of the regulations governing the fund. Two principal approaches have been used:

- Direct appointment by some authorized body. In Alaska, the governor appoints all members of the board of the fund, with restrictions on their constituency. *Duration* of appointment and grounds for dismissal are also specified. A similar approach is used in Alberta.
- Appointment by the ministry of finance. Where the ministry of finance has direct responsibility for the fund, it can be empowered to hire external managers, *and* nonrenewal is at the discretion of the ministry of finance.

4. Publication of overall target return

7.41 The foundation act or the management contract may specify target returns for the fund as a whole. Several funds have as a principal performance goal an overall target real rate of return (Alaska, Alberta, Chile). This is publicized, and actual returns are compared against it. In most cases, the aggregate return is expressed not only in the international basket of currencies (or U.S. dollars) in which the fund is held, as a primary check on performance, but also in local currency to provide a check on the strategy of investing abroad.

5. Use of benchmarks

7.42 Some funds (Alaska, Alberta, Chile, Norway) identify benchmark indexes for each class of assets and, where applicable, each active management mandate. The actual return for each asset class is then compared to the benchmark for that class. Target allocations between asset classes are also specified, so that the overall return depends partly on the shares actually held in the different asset classes, as well as the asset selection within each class. The excess (or deficit) over the return on the benchmark portfolio is then attributed to the active management of the portfolio.

6. Domestic investment policy

7.43 One of the important decisions about asset allocation is that relating to the geographical location of the assets. Some funds (Norway, Timor-Leste, São Tomé and Príncipe) from the beginning held almost all assets overseas; others (Alaska, Alberta, Chile, and Papua New Guinea) were initially invested entirely domestically.

7.44 Small economies, especially with undeveloped asset markets, can find it difficult to domestically absorb the large sums that could accrue in the oil fund, and much better risk-adjusted performance may be obtainable from overseas assets. In other cases, the injection of finance into the economy might provide a stimulus to the domestic economy, as was the hope during the first period of the AHSTF, when investment in a wide range of domestic activities was undertaken.

7.45 Domestic investment policies should take into consideration the need for sterilizing the economy against exchange rate appreciation by largely investing abroad.

7. Equity investment policy

7.46 Certain funds, especially in their early days, limit assets that can be held to high-grade income securities (Alaska, Azerbaijan, Chile, São Tomé and Príncipe, Timor-Leste), and some limit the maximum duration of these securities (Norway, Timor-Leste). This is one way of limiting the overall investment risk. The liquidity profile of the fund is also an important consideration, because it should match the expected withdrawals profile (Azerbaijan, São Tomé and Príncipe). More mature funds have permitted investment in equities (Alaska, Alberta, Norway).

8. Real estate

7.47 Some funds permit the holding of real estate (Alaska, Alberta), usually in the home country, and others explicitly ban it (Azerbaijan). In the cases of Alaska and Alberta, this turned out to be one of the strongest parts of the portfolio, with annual rates of return of more than 10 percent. However, it is also one of the most difficult to manage, as the experience of Nauru suggests, and is particularly inappropriate for domestic real estate in developing countries, where markets may be thin and highly volatile. An additional consideration is the need to ensure that the investment policy maintains its return on investment objectives and is not subverted toward public investments that do not provide an adequate return.

9. Geographical spread

7.48 In addition to the considerations made under the heading of domestic investment policy above, the diversification among various nondomestic investments is important. Once the decision to permit overseas investment has been made, geographical split has also been mandated in some cases. Two principles of geographical coverage have been considered. The predominant approach is to assign market shares on a basis related to market capitalization, so that the United States, the European Union, and Japan are assigned most of the assets. An alternative approach is to match the geographical coverage of the country's trade to face the same exchange rate risk on the portfolio as on trade. However, as in the case of Norway, trade patterns may be so different from international market capitalization as to make such a scheme very restrictive.

D. The governance of the fund

7.49 Most funds have adopted a three-tier strategy for the direct management and oversight of their oil fund, in addition to the ultimate control exercised by the ministry of finance when the fund is not an autonomous body.

7.50 At the top level is a supervisory body looking into strategy and the general performance and management of the fund. Members of this board should be different from both any investment advisory board and the actual management of the fund because of potential conflict of interest. This body typically reports downward to the fund in making its recommendations known and upward to the ministry of finance.

7.51 Governance of a fund can be described by five indicators: multilevel oversight of the fund, publication of annual reports, publication of the fund's performance, publication of audit, and use of Web sites.

1. Multilevel oversight

7.52 The separation of an oil fund from the rest of the treasury accounts, and its (often) distinct investment management mandate, require a high standard of oversight and transparency. In some cases, where the fund is an autonomous agency, as in Alaska or Alberta, a multilevel and formal approach to administration and oversight has evolved (investment advisers, external auditors, and so on). For funds within the ministry of finance, the normal checks and balances that apply to the budget process can be used, but may need to be supplemented by specific governance mechanisms.

2. Annual reports

7.53 One of the most important tools for the evaluation and control of an oil fund is its annual report, which should be a public document. In the cases of Alaska, Alberta, Azerbaijan, and Norway enough detail is contained to give a full assessment of the overall performance of the fund and the main categories of investment assets. The fair value of the fund, returns in domestic and international currency, in nominal and real terms and net of costs, serves to give information to the government and to society as a

whole of the value of “above the ground” savings and the returns from them. In the case of Norway, details are also given of the value of all individual stock holdings. However, not every country publishes annual reports (Kuwait, Oman) partly on the grounds that their revelation would increase pressures for current spending. Some countries do not publish a full annual report but do publish occasional statements about the total value of the fund and additions to the Fund (Kazakhstan, Russia).

3. Publication of the fund's performance

7.54 To evaluate the performance of the fund managers in achieving target returns, it is important that the annual reports include sufficient details of performance and classes of assets held. This enables observers to judge whether the fund may be adopting a very cautious approach (Chile) or a very risky approach (Nauru). The use of published benchmarks, against which performance of each class of assets is to be judged, provides information on the degree of success of the fund managers and the gains from active management (Norway).

4. Publication of audit

7.55 All funds are likely to have an internal mechanism for their audit through the government's auditor (Alberta, Norway), but for the most secretive funds, even this aspect is not made public. The auditors' report certifies the accuracy of the returns, portfolio valuation, and transactions presented in the annual report of the fund (whether or not this report is made public). The use of benchmark portfolios and the requirement for performance monitoring extends the need for audit to a comparison of actual returns with those expected from a benchmark portfolio. To give more confidence to the auditing process, a separate external audit should be carried out and published (Alaska, Azerbaijan). In the case of Norway, an entirely separate external performance audit has also been carried out and published for the last two years, which checks the internal audit of performance, as well as the actual performance against the benchmark.

5. Use of Web sites

7.56 The publication of annual reports and audit reports is an essential tool to ensure that good use is being made of the fund's resources. Before the advent of the Internet, reports to parliament were the sole source of information, and these could be difficult for the public at large to obtain. The creation of a Web site on which all reports, as well as related news items about the fund, are regularly published is a powerful mechanism for keeping a wide range of parties informed about the progress of the fund.

Appendix 1

The Alberta Heritage Savings Trust Fund

1.A: The Alberta Heritage Savings Trust Fund Act (1976)

WHEREAS substantial revenues are being received by the Province from the sale of non-renewable resources owned by the people of Alberta; and

WHEREAS there is a limited supply of non-renewable resources and therefore revenues from the sale of these resources will ultimately be reduced; and

WHEREAS it would be improvident to spend all such revenues as they are received; and

WHEREAS the Legislature of Alberta considers it appropriate that a substantial portion of those revenues be set aside and invested for the benefit of the people of Alberta in future years:

THEREFORE HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Alberta, enacts as follows:

1. In this Act,
 - (a) “Investment Committee” means the Heritage Savings Trust Fund Investment Committee established under section 3;
 - (b) “non-renewable resource revenue” means
 - (i) moneys received by the Crown pursuant to agreements as defined in the *Mines and Minerals Act*,
 - (ii) moneys received by the Crown as bonuses to acquire agreements as defined in the *Mines and Minerals Act*,
 - (iii) moneys received under and agreement between the Crown in the right of Alberta and the holder of a bituminous sands lease under which the crown agrees to accept money payments in lieu of royalty under the lease;

- (c) “Special Act” with reference to any fiscal year after the 1976-77 fiscal year means an Act of the Legislature authorizing the transfer from the General Revenue Fund to the Trust Fund of 30 per cent of the non-renewable resource revenue received in that fiscal year;
 - (d) “Trust Fund”: means the Alberta Heritage Savings Trust Fund established under section 2.

- 2.
 - (1) There is hereby established a fund to be known as the “Alberta Heritage Savings Trust Fund”.
 - (2) The Provincial Treasurer shall hold and administer the Trust Fund in accordance with this Act.
 - (3) The Provincial Treasurer shall establish and maintain a separate accounting record of the Trust Fund.

- 3.
 - (1) There is hereby established a committee called the “Heritage Savings Trust Fund Investment Committee” consisting of all members of the Executive Council.
 - (2) The Investment Committee shall designate one of its members as chairman and another as vice-chairman.
 - (3) The Lieutenant Governor in council may make rules governing the calling of meetings of the Investment Committee, the quorum required at its meetings and, generally, the conduct of the Committee’s business and affairs.

- 4.
 - (1) As soon as practicable after the commencement of this Act, there shall be transferred from the General Revenue fund to the Trust Fund \$1,500,000,000.
 - (2) The amount transferred pursuant to subsection (1) may be transferred in cash or other assets, but where assets other than cash are to be transferred, the Investment Committee shall, before any transfer is made, approve
 - (a) the assets to be transferred;
 - (b) the manner in which and the time or times at which the transfer is to be made, and
 - (c) the valuation of the assets or the method by which the assets are to be valued,and may impose such conditions relating to the transfer as the Investment Committee considers necessary.
 - (3) Where the Investment Committee is of the opinion that any asset to be transferred under subsection (1)
 - (a) will yield a reasonable return or profit to the Trust Fund, and
 - (b) will tend to strengthen and diversify the economy of Alberta,the Investment Committee may direct that the asset upon its transfer shall form part of the Alberta Investment Division of the Trust Fund as if the asset were the subject of an investment made pursuant to section 6, subsection (1), clause (c).
 - (4) Assets other than cash that are transferred pursuant to subsection (1) and that do not form part of the Alberta Investment Division of the Trust Fund by virtue of a direction under subsection (3) shall consist only of assets within the classes enumerated in section 9, subsection (1) and upon being transferred shall be deemed to be investments made under that section.
 - (5) The income of the Trust Fund accrues to and forms part of the Trust Fund.

- 5.
 - (1) After the commencement of the Act,
 - (a) 30 per cent of the non-renewable resource revenue received in the 1976-77 fiscal year shall be transferred from the General Revenue Fund to the Trust Fund in accordance with this Act;

- (b) 30 per cent of the non-renewable resource revenue received in the 1977-78 fiscal year shall be transferred from the General Revenue Fund to the Trust Fund in accordance with this Act but only if the transfer is authorized by a Special Act enacted in that fiscal year;
 - (c) 30 percent of the non-renewable resource revenue received in the 1978-79 fiscal year and in each fiscal year thereafter shall be transferred from the General Revenue Fund to the Trust Fund in accordance with this Act but only if, in the case of each fiscal year, the transfer is authorized by a Special Act enacted in the preceding fiscal year.
 - (2) The title of a Special Act shall be "The Alberta Heritage Savings Trust Fund Special Appropriation Act" followed by a reference to the fiscal year to which it relates.
 - (3) The President of the Executive Council or a member of the Executive Council designated by him for the purpose shall, with the leave of the Assembly,
 - (a) introduce during the 1977-78 fiscal year a Bill for a Special Act relating to the 1977-78 fiscal year, and
 - (b) introduce during the 1977-78 fiscal year and during each fiscal year thereafter a Bill for a Special Act relating to the next succeeding fiscal year.
 - (4) The Provincial treasurer shall, with respect to each month in
 - (a) the 1976-77 fiscal year, and
 - (b) each succeeding fiscal year in respect of which a Special Act is enacted,transfer 30 per cent of the non-renewable resource revenue received in the month from the General Revenue Fund to the Trust Fund as soon as practicable after the end of the month in which it is received.
 - (5) Notwithstanding subsection (4), the Provincial Treasurer may, with respect to any month to which that subsection applies, estimate 30 percent of the non-renewable resource revenue to be received in that month and transfer that sum from the General Revenue Fund to the Trust Fund during that month or as soon as practicable after the end of the month in respect of which the estimate is made.
 - (6) With respect to the 1976-77 fiscal year and each succeeding fiscal year in respect of which a Special Act is enacted, the Provincial Treasurer, depending upon whether the total of the sums transferred pursuant to subsections (4) and (5) is greater or less than 30 percent of the non-renewable resource revenue received in that fiscal year as shown in the public accounts for that fiscal year, shall
 - (a) transfer moneys from the General Revenue Fund to the Trust Fund, or
 - (b) transfer moneys from the Trust Fund to the General Revenue Fund,so that the amount of the non-renewable resource revenue in the Trust Fund for that fiscal year is equal to 30 percent of the non-renewable resource revenue received in that fiscal year.
 - (7) No interest is payable with respect to any money transferred pursuant to this section to or from the General Revenue fund or to or from the Trust Fund.
- 6.
 - (1) The assets of the Trust Fund shall be used for the following purposes:
 - (a) the making of investments in projects which will provide long term economic or social benefits to the people of Alberta but which will not by their nature yield a return to the Trust Fund;
 - (b) the making of investments by way of loans to
 - (i) the Crown in right of Canada, or
 - (ii) the Crown in right of any other province of Canada, or
 - (iii) any other person if the repayment of the loan and the payment of interest thereon by that person is guaranteed by the Crown in right of Canada or the crown in right of any other province of Canada;
 - (c) the making of investments which, in the opinion of the Investment Committee or in the opinion of the Legislative Assembly as expressed in a resolution of the Assembly,
 - (i) will yield a reasonable return or profit to the Trust Fund, and
 - (ii) will tend to strengthen and diversify the economy of Alberta.
 - (2) Investments referred to in subsection (1), clause (a)
 - (a) shall only be made if the moneys are first appropriated from the Trust Fund by an Act of the Legislature specifically for a purpose described in subsection (1), clause (a),

- (b) shall not exceed 20 per cent of the assets of the Trust Fund, and
 - (c) shall form the Capital Projects Division of the Trust Fund.
 - (3) Investments referred to in subsection (1), clause (b)
 - (a) shall be made or approved by the Investment Committee in accordance with the directions contained in any resolution of the Legislative Assembly,
 - (b) in the absence of any such directions, shall be made only with the approval of the Investment Committee,
 - (c) shall not exceed 15 per cent of the assets of the Trust Fund, and
 - (d) shall form the Canada Investment Division of the Trust Fund.
 - (4) Investments referred to in subsection (1), clause (c)
 - (a) shall be made or approved by the Investment Committee in accordance with the directions contained in any resolution of the Legislative Assembly,
 - (b) in the absence of any such directions, shall be made with the approval of the Investment Committee, and
 - (c) shall form the Alberta Investment Division of the Fund.
 - (5) For the purposes of this section,
 - (a) investments in the Capital Projects Division shall be deemed to be assets of the Trust Fund with a value equal to the amounts expended pursuant to Acts of the Legislature referred to in subsection (2), clause (a);
 - (b) investments in the Canada Investment Division and the Alberta Investment Division and all other assets of the Trust Fund shall be valued at book value;
 - (c) the percentage limitations referred to in subsection (2), clause (b) and subsection (3), clause (b) shall be determined at the end of each fiscal year.
- 7.
 - (1) Where any investment is made under section 6 with the approval of the Investment Committee, no disposition shall be made of that investment except with the approval of the Investment Committee.
 - (2) Where a resolution of the Legislative Assembly directs the making of any investment pursuant to section 6, no disposition shall be made of that investment except pursuant to a resolution of the Legislative Assembly.
 - (3) Where a resolution of the Legislative Assembly directs the disposition of any investment then, notwithstanding subsection (1), the investment shall be disposed of in accordance with the directions contained in any resolution of the Legislative Assembly.
- 8. Any approval given by the Investment Committee under section 6 or 7 may be made subject to such terms and conditions as the Committee considers necessary.
- 9. (1) Notwithstanding section 6, where any moneys in the Trust Fund have not been or are not being invested pursuant to that section, the Provincial Treasurer may invest or may re-invest those moneys in any or all of the following:
 - (a) the bonds, debentures or other evidences of indebtedness of, or guaranteed as to the repayment of principal and interest by, the government of Canada, the government of any province of Canada or any municipal corporation in Canada;
 - (b) the bonds, debentures or other evidences of indebtedness of or guaranteed as to the repayment of principal and interest by the government of a country other than Canada;
 - (c) the bonds, debentures or other evidences of indebtedness of any agent of the Crown in right of Alberta;
 - (d) certificates of deposit, deposit receipts or other evidences of indebtedness given by a chartered bank or treasury branch in consideration of a deposit or deposits made with the bank or treasury branch;
 - (e) certificates of deposit, deposit receipts or other evidences of indebtedness which are unconditionally guaranteed by a chartered bank;

- (f) the bonds, debentures or other evidences of indebtedness of or guaranteed by any corporation, if those bonds, debentures or other evidences of indebtedness are authorized investments under section 63, subsection (1) of the *Canadian and British Insurance Companies Act*;
 - (g) mortgages or hypothecs of real estate or leaseholds in Canada if the amount paid for the mortgage or hypothec together with the amount of indebtedness under any mortgage or hypothec on the real estate or leasehold ranking equally with or superior to the mortgage or hypothec in which the investment is made does not exceed three-quarters of the value of the real estate or leasehold covered thereby;
 - (h) mortgages or hypothecs of real estate or leaseholds in Canada notwithstanding that the mortgage or hypothec exceeds the amount authorized under clause (g) if the excess is guaranteed or insured by, or through and agency of, the Government of Canada or a province of Canada, or by an insurance company approved by the Treasury Board.
 - (2) The Provincial Treasurer may dispose of any investments made or deemed to be made under this section.
 - (3) Notwithstanding section 28.4, subsection (1) of *The Financial Administration Act*, the Provincial Treasurer shall transfer moneys from the Trust Fund to the Consolidated Cash Investment Trust Fund only where the moneys have not been invested or re-invested under subsection (1) or where the moneys have not been invested pursuant to section 6.
10. (1) Where any costs, expenses or other payments are directly attributable to the administration of the Trust Fund, the Provincial Treasurer may charge the cost, expense or payment to the Trust Fund.
- (2) After the end of each fiscal year the Investment Committee shall
- (a) estimate an amount consisting of the fees, wages, salaries, costs, expenses or other payments incurred in connection with the administration of the Trust Fund and paid out of the General Revenue Fund in the preceding year, and
 - (b) authorize the Provincial Treasurer to transfer the amount estimated under clause (a) from the Trust Fund to the General Revenue Fund.
11. (1) The Provincial Treasurer shall, as soon as practicable after the end of each quarter of the 1977-78 and succeeding fiscal years, prepare a report summarizing the investments made under section 9 and listing the investments made under section 6 during the preceding quarter.
- (2) When a quarterly report is prepared under subsection (1), the Provincial Treasurer shall forthwith furnish copies of the report to all members of the Legislative Assembly and to the Clerk of the Legislative Assembly and upon doing so shall make the report public.
12. (1) The Provincial Auditor shall from time to time and at least once each year audit the accounts and financial transactions of the Trust Fund.
- (2) The Provincial Treasurer shall, as soon as practicable after the end of each fiscal year, prepare a report summarizing the operation of the Trust Fund during the preceding fiscal year and containing a financial statement, audited by the Provincial Auditor, showing
- (a) transfers of cash and other assets to the Trust Fund during the preceding fiscal year,
 - (b) payments made from and income accrued to the Trust Fund for the preceding fiscal year,
- and

(c) the total moneys expended under Acts of the Legislature referred to in section 6, subsection (2), clause (a) in respect of investments in the Capital Projects Division of the Trust Fund.

- (3) When an annual report is prepared under subsection (2), the Provincial Treasurer shall forthwith furnish copies of it to all members of the Legislative assembly and to the clerk of the Legislative Assembly and upon doing so shall make the report public.
13. (1) There is hereby established a select standing committee of the Legislative Assembly called the “Select Standing Committee on The Alberta Heritage Savings Trust Fund Act” consisting of 15 members.
- (2) The members of the Select Standing Committee shall be appointed at the commencement of each session in the same way that members are appointed to other select standing committees of the Legislative Assembly.
- (3) When a copy of the annual report is furnished to the Clerk of the Legislative Assembly pursuant to section 12, subsection (3) the annual report shall be deemed to be referred to the Select Standing Committee for review and a report concerning the investments of the Trust Fund which may contain any recommendations of the Committee concerning these investments.
- (4) Where a motion is made in the Legislative Assembly for second reading of a Bill for a Special Act relating to the 1978-79 or any succeeding fiscal year, then, unless the Assembly by resolution otherwise directs, the debate on the motion shall be proceeded with only if the report of the Select Standing Committee relating to the preceding fiscal year has been tabled in the Assembly.
- (5) The Select Standing Committee may, without leave of the Assembly, sit during any period when the Assembly is adjourned or after prorogation of a session of the Legislature.
14. *The Financial Administration Act is amended*
- (a) *as to section 16.1 by adding the word “or” at the end of clause (e) and by adding the following clauses after clause (e):*
- (f) between accounts in the General Revenue Fund and the Alberta Heritage Savings Trust Fund, or
- (g) between accounts in the Consolidated Cash Investment Trust Fund and the Alberta Heritage Savings Trust Fund, or
- (h) for the purpose of making investments under section 9 of *The Alberta Heritage Savings Trust Fund Act*,
- (b) *by adding the following section after section 40.1:*
- 40.2 The Provincial Treasurer shall, upon the direction of the Treasury Board, advance from the General Revenue Fund to the Alberta Heritage Savings Trust Fund such sums as may be required upon such terms and conditions as the Treasury Board may impose.

(c) *as to item 1 of the schedule, by adding to the list of designated funds of the Provincial Treasurer the following:*

(a.1) Alberta Heritage Savings Trust Fund.

15. This Act comes into force on the day upon which it is assented to.

1.B: Alberta Heritage Savings Trust Fund Act as of 2005

WHEREAS the mission of the Heritage Fund is to provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans;

THEREFORE HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Alberta, enacts as follows:

1 In this Act,

- (a) "endowment portfolio" means the endowment portfolio referred to in section 3;
 - (b) "Heritage Fund" means the Alberta Heritage Savings Trust Fund referred to in section 2;
 - (c) "mineral agreement" means an agreement as defined in the Mines and Minerals Act;
 - (d) "non-renewable resource revenue" means
 - (i) money received by the Crown under a mineral agreement or a contract under section 9 of the Mines and Minerals Act or under a reservation of royalty in letters patent conveying title to a mineral,
 - (ii) money received by the Crown from or in connection with the disposition of the Crown's royalty share of a mineral,
 - (iii) fees paid to the Crown in connection with the issuance of a mineral agreement,
 - (iv) money received by the Crown as a bonus to acquire a mineral agreement,
- and
- (v) money received by the Crown pursuant to a contract under which the Crown agrees to accept that money instead of royalty otherwise payable under one or more leases of oil sands rights issued under the Mines and Minerals Act;

- (e) "Special Act" with reference to any fiscal year means an Act of the Legislature authorizing the transfer from the General Revenue Fund to the Heritage Fund of a percentage of the non-renewable resource revenue received in that fiscal year;
 - (f) "Standing Committee" means the Standing Committee established under section 6;
 - (g) "transition portfolio" means the transition portfolio referred to in section 3.
- 2
- (1) There is hereby continued the Alberta Heritage Savings Trust Fund established under the Alberta Heritage Savings Trust Fund Act, RSA 1980 cA-27.
 - (2) The Provincial Treasurer shall hold, manage, invest and dispose of the assets of the Heritage Fund in accordance with this Act.
 - (3) The Provincial Treasurer shall establish and maintain a separate accounting record of the Heritage Fund.
- 3
- (1) The investments and other assets of the Heritage Fund shall be contained
 - (a) in an endowment portfolio, and
 - (b) until no later than December 31, 2005, in a transition portfolio.
 - (2) Investments made under the endowment portfolio must be made with the objective of maximizing long-term financial returns.
 - (3) Investments made under the transition portfolio must be made with the objective of supporting the Government's short-term to medium-term income needs as reflected in the Government's consolidated fiscal plan.
 - (4) Subject to the regulations, when making investments the Provincial Treasurer shall adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss and obtain a reasonable return that will enable the endowment portfolio and the transition portfolio to meet their respective objectives.
- 4
- (1) The Provincial Treasurer may enter into agreements providing for
 - (a) the lending of securities acquired or held pursuant to this Act, and
 - (b) the delivery to the Provincial Treasurer of collateral consisting of securities or classes of securities or of letters of credit.
 - (2) The Provincial Treasurer may enter into agreements or engage in other activities of a financial nature respecting investment under this Act, including, without limiting the generality of the foregoing, exchange agreements, futures agreements, option agreements, rate agreements, any other financial agreements or any combination of the agreements or activities referred to in this subsection.

5 The endowment portfolio and the transition portfolio are designated as depositors in the Consolidated Cash Investment Trust Fund under the Financial Administration Act.

6 (1) There is hereby established a standing committee of the Legislative Assembly called the "Standing Committee on the Alberta Heritage Savings Trust Fund" consisting of 9 members of the Legislative Assembly.

(2) The membership of the Standing Committee shall include 3 members of the Legislative Assembly who are not members of the governing party, but if there is

(a) an insufficient number of non-government members to fill the 3 positions on the Standing Committee, or

(b) an insufficient number of non-government members who are willing to fill the 3 positions on the Standing Committee,

the resulting vacant positions on the Standing Committee may be filled by members of the Legislative Assembly who are members of the governing party.

(3) The members of the Standing Committee shall be appointed at the commencement of each session in the same way that members are appointed to other standing committees of the Legislative Assembly.

(4) The functions of the Standing Committee are

(a) to review and approve annually the business plan for the Heritage Fund;

(b) to receive and review quarterly reports on the operation and results of the operation of the Heritage Fund;

(c) to approve the annual report of the Heritage Fund;

(d) to review after each fiscal year end the performance of the Heritage Fund and report to the Legislature as to whether the mission of the Heritage Fund is being fulfilled;

(e) to hold public meetings with Albertans on the investment activities and results of the Heritage Fund.

(5) The Standing Committee may, without leave of the Assembly, sit during any period when the Assembly is sitting or when it is adjourned or after prorogation of a session of the Legislature.

7 (1) The Provincial Treasurer shall for each fiscal year prepare and provide to the Treasury Board a business plan for the Heritage Fund.

(2) Once the Treasury Board has advised the Provincial Treasurer that the Treasury Board has approved the business plan, the Provincial Treasurer shall provide a copy of the approved business plan to the Standing Committee for the Standing Committee's approval.

(3) On the Standing Committee's giving its approval of the business plan, the Provincial Treasurer shall incorporate the business plan into the business plan prepared by the Provincial Treasurer under section 13 of the Government Accountability Act.

- 8 (1) The income of the Heritage Fund accrues to and forms part of the Heritage Fund.
- (2) The net income of the Heritage Fund less the amount allocated to the Heritage Fund under section 11 shall be transferred by the Provincial Treasurer from the Heritage Fund to the General Revenue Fund annually in a manner determined by the Provincial Treasurer.
- 9 (1) A percentage of the non-renewable resource revenue received in each fiscal year shall be transferred from the General Revenue Fund to the Heritage Fund in accordance with this Act, but only if the transfer is authorized by a Special Act.
- (2) The title of a Special Act shall be the "Alberta Heritage Savings Trust Fund Special Appropriation Act" followed by a reference to the fiscal year to which it relates.
- (3) The President of the Executive Council or a member of the Executive Council designated by the President of the Executive Council for the purpose shall, with leave of the Assembly, introduce a Bill for a Special Act in respect of each fiscal year.
- (4) The Provincial Treasurer shall, with respect to each fiscal year in respect of which a Special Act is enacted, transfer the percentage authorized in accordance with subsection (1) of the non-renewable resource revenue received from the General Revenue Fund to the Heritage Fund in a manner determined by the Provincial Treasurer.
- 10 (1) In this section, "previous Act" means the Alberta Heritage Savings Trust Fund Act, RSA 1980 cA-27.
- (2) Notwithstanding section 14 of the Financial Administration Act, money invested pursuant to section 6(1)(a) of the previous Act that is recovered through the disposition of assets owned by the Crown shall be included in and forms part of the Heritage Fund.
- 11 (1) Subject to subsections (2) and (3), for the fiscal year 1999-2000 and subsequent fiscal years, the Provincial Treasurer shall retain from the income of the Heritage Fund and allocate to the endowment portfolio as soon as convenient after the end of each fiscal year an amount equal to the value of the total equity of the Heritage Fund as recorded in the financial statements of the Heritage Fund for March 31 of the fiscal year multiplied by the percentage increase, if any, for that fiscal year in the Canadian gross domestic product price index specified by the Provincial Treasurer.
- (2) If the income of the Heritage Fund in a fiscal year is less than that required to be allocated to the endowment portfolio under subsection (1), the Provincial Treasurer shall allocate that income, if any, to the endowment portfolio as soon as convenient after the end of that fiscal year.
- (3) For the purposes of subsection (1), if the percentage increase in the gross domestic product price index specified by the Provincial Treasurer is a negative number, that negative number shall be treated as if it were zero.
- (4) Notwithstanding subsections (1), (2) and (3), until the accumulated debt is eliminated in accordance with the Fiscal Responsibility Act, the Provincial Treasurer is not required to retain the amounts required

- under subsections (1), (2) and (3), but may retain any amounts that the Provincial Treasurer considers advisable.
- 12 (1) The Lieutenant Governor in Council shall in each fiscal year direct the Provincial Treasurer to allocate assets with a book value of \$1 200 000 000, or any greater amount that is authorized by the Lieutenant Governor in Council, from the transition portfolio to the endowment portfolio.
- (2) Notwithstanding subsection (1), by December 31, 2005 all the assets of the Heritage Fund that remain allocated to the transition portfolio shall be removed from the transition portfolio and allocated to the endowment portfolio.
- 13 The Provincial Treasurer may charge a cost, expense or other payment to the Heritage Fund if in the opinion of the Provincial Treasurer the cost, expense or other payment was incurred or paid in respect of the Heritage Fund.
- 14 The Auditor General is the auditor of the Heritage Fund.
- 15 (1) The Provincial Treasurer shall, as soon as practicable after the end of each of the first 3 quarters of every fiscal year, prepare and provide to the Standing Committee a report on the activities of the Heritage Fund and financial statements for the preceding quarter.
- (2) When the Standing Committee is provided with a quarterly report under subsection (1), the Standing Committee shall furnish copies of the report to all members of the Legislative Assembly and to the Clerk of the Legislative Assembly within 2 months after the conclusion of the quarter for which the quarterly report was prepared and on doing so shall make the report public.
- 16 (1) The Provincial Treasurer shall, as soon as practicable after the end of each fiscal year, prepare and provide to the Standing Committee an annual report of the Heritage Fund, including a financial statement audited by the Auditor General.
- (2) Once the Standing Committee has approved the annual report provided to the Standing Committee under subsection (1), the Standing Committee shall, on or before June 30 following the conclusion of the fiscal year for which the annual report was made, furnish copies of it to all members of the Legislative Assembly and to the Clerk of the Legislative Assembly and on doing so shall make the report public.
- 17 The Lieutenant Governor in Council may make regulations respecting the investments that may be made under this Act.

Appendix 2

Alaska's Constitution and Law Pertaining to the Permanent Fund

ALASKA CONSTITUTION Article IX, Section 15

Section 15. Alaska Permanent Fund.

At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law [Effective February 21, 1977].

ALASKA LAW Article 01. ALASKA PERMANENT FUND.

Sec. 37.13.010. Alaska permanent fund.

(a) Under art. IX, sec. 15, of the state constitution, there is established as a separate fund the Alaska permanent fund. The Alaska permanent fund consists of

(1) 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, net profit shares under AS 38.05.180 (f) and (g), 25 percent of federal mineral revenue sharing payments received by the state from mineral leases, and 25 percent of all bonuses received by the state from mineral leases; and

(2) any other money appropriated to or otherwise allocated by law or former law to the Alaska permanent fund.

(b) Payments due the Alaska permanent fund under (a) of this section shall be made to the fund within three banking days after the day the amount due to the fund reaches at least \$3,000,000 and at least once each month.

(c) The Alaska Permanent Fund shall be managed by the Alaska Permanent Fund Corporation established in this chapter.

Sec. 37.13.020. Findings.

The people of the state, by constitutional amendment, have required the placement of at least 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments and bonuses received by the state into a permanent fund. The legislature finds with respect to the fund that

the fund should provide a means of conserving a portion of the state's revenue from mineral resources to benefit all generations of Alaskans;

the fund's goal should be to maintain safety of principal while maximizing total return;

the fund should be used as a savings device managed to allow the maximum use of disposable income from the fund for purposes designated by law.

Sec. 37.13.030. Purpose.

It is the purpose of AS 37.13.010 - 37.13.190 to provide a mechanism for the management and investment of those fund assets by the Alaska Permanent Fund Corporation in a manner consistent with the findings in AS 37.13.020.

Sec. 37.13.040. Alaska Permanent Fund Corporation.

There is established the Alaska Permanent Fund Corporation. The corporation is a public corporation and government instrumentality in the Department of Revenue managed by the board of trustees. The purpose of the corporation is to manage and invest the assets of the permanent fund and other funds designated by law in accordance with AS 37.13.010 - 37.13.190.

Sec. 37.13.050. Composition and qualifications of board of trustees.

(a) The Board of Trustees of the Alaska Permanent Fund Corporation consists of six members appointed by the governor. Two of the members must be heads of principal departments of state government, one of whom shall be the commissioner of revenue. Four members shall be appointed by the governor from the public and may not hold any other state or federal office, position or employment, either elective or appointive, except as a member of the armed forces of either the United States or of this state.

(b) The four public members of the board must have recognized competence and wide experience in finance, investments, or other business management-related fields.

(c) The board shall annually elect a chairman from among its members.

Sec. 37.13.060. Term of office.

The public members of the board shall be appointed for terms of four years, and they may be reappointed. The terms of the public members shall be staggered so that no more than one term of a public member expires each year.

Sec. 37.13.070. Removal and vacancies.

(a) The governor may remove a public member of the board from office only for cause. A removal by the governor must be in writing and must state the reason for the removal. A member who is removed by the governor may not participate in board business and may not be counted for purposes of establishing a quorum after the member receives written notice of removal from the governor.

(b) A vacancy on the board shall be promptly filled by appointment by the governor. An appointee to a vacancy shall hold office for the balance of the term for which the appointee's predecessor on the board was appointed.

(c) A vacancy on the board does not impair the authority of a quorum of the board to exercise all the powers and perform all the duties of the board.

Sec. 37.13.080. Quorum and voting.

Four members of the board constitute a quorum for the transaction of business and the exercise of the powers and duties of the board. Action may be taken only upon affirmative vote of a majority of the full membership of the board.

Sec. 37.13.090. Compensation of board members.

Public members of the board receive an honorarium of \$400 for each day spent at a meeting of the board or at a meeting of a subcommittee of the board or at a public meeting as a representative of the board. Members of the board are entitled to per diem and travel allowances as provided by law for members of state boards and commissions.

Sec. 37.13.100. Corporation staff.

The board may employ and determine the salary of an executive director. The executive director may, with the approval of the board, select and employ additional staff as necessary. An employee of the corporation, including the executive director, may not be a member of the board. The executive director and the other employees of the board are in the exempt service under AS 39.25.

Sec. 37.13.110. Conflicts of interest.

(a) Members of the board, the executive director, and investment officers of the corporation are subject to the provisions of AS 39.50.

(b) If a member of the board or an employee of the corporation acquires, owns, or controls an interest, direct or indirect, in an entity or project in which fund assets are invested, the member shall immediately disclose the interest to the board. The disclosure is a matter of public record and shall be included in the minutes of the board meeting next following the disclosure.

Sec. 37.13.120. Investment responsibilities of the board.

(a) The prudent-investor rule shall be applied by the board in the management and investment of fund assets. The prudent-investor rule as applied to investments of the fund means that in making investments the board shall exercise the judgement and care under the circumstances then prevailing that an

institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

(b) The fund assets shall only be used for income-producing investments.

(c) The board shall maintain a reasonable diversification among investments unless under the circumstances it is clearly prudent not to do so.

(d) The board shall submit long-range and quarterly investment reports to the Legislative Budget and Audit Committee.

(e) The corporation may not borrow money or guarantee from principal of the fund the obligations of others except as provided in this subsection. With respect to real property investments of the fund, the corporation may, through an entity in which the investment is made, borrow money if the borrowing is without recourse to the corporation and the fund.

(f) The board may enter into and enforce all contracts necessary, convenient or desirable for purposes of the corporation.

(g) Subject to the limitations contained in this section, the board may invest fund assets at the competitive national market rates or prices that are applicable to each investment only in

(1) obligations of, or obligations insured by or guaranteed by, the United States or agencies or instrumentalities of the United States;

(2) obligations secured by reserves paid in by the United States or agencies or instrumentalities of the United States or obligations of corporations in which the United States is a shareholder or member;

(3) certificates of deposit and term deposits of United States domestic banks that are members of the Federal Deposit Insurance Corporation and that may be readily sold in a secondary market at prices reflecting fair value or that are fully secured at all times as to payment of principal and interest as described in (m) of this section;

(4) certificates of deposit and term deposits of federally chartered savings and loan associations in Alaska that are fully secured at all times as to payments of principal and interest as described in (m) of this section;

5) certificates of deposit and term deposits of mutual savings banks in Alaska that are fully secured at all times as to payments of principal and interest as described in (m) of this section;

(6) fixed-term certificates of indebtedness of federally insured credit unions in Alaska that are fully secured at all times as to payments of principal and interest as described in (m) of this section;

(7) Debt instruments that have been issued by domestic entities and that are rated investment grade, or debt instruments of comparable quality issued by nondomestic entities;

(8) short-term

(A) promissory notes that have been issued by domestic entities and that are rated investment grade; or (B) promissory notes of comparable quality issued by nondomestic entities, the interest on which may be payable in either United States dollars or nondomestic currencies;

(9) bankers' acceptances drawn on and accepted by United States banks each of which has a combined capital and surplus aggregating at least \$200,000,000;

(10) repurchase agreements, the securities underlying the agreements being any of the items in (1) - (6) of this subsection;

(11) the portions of business and industrial loans made under the Rural Development Act of 1972 that are guaranteed by the Farmers Home Administration;

(12) the guaranteed portion of Farmers Home Administration loans;

(13) notes secured by mortgages granting a first lien on residential real estate improved by completed buildings if the mortgages are insured by a private mortgage insurance corporation that is authorized to do business in this state and has combined capital and surplus aggregating at least \$20,000,000, and if loan-to-value ratios do not exceed 90 percent; however, mortgage insurance is not necessary for residential loans having a loan-to-value ratio of less than 70 percent and the minimum coverage of other residential loans shall be 10 percent for those having a loan-to-value ratio greater than 70 percent but less than 90 percent and 20 percent for those having a loan-to-value ratio of 90 percent;

(14) preferred and common stock and other equity interests in entities organized in the United States;

(15) certificates of deposit, term deposits, or bankers' acceptances, that are issued by a United States or non-domestic bank or trust company located outside of the United States and are denominated in United States or non-domestic currency, if either

(A) they may be readily sold in a secondary market at prices reflecting fair value, or

(B) the issuing bank or trust company has capital, surplus, and retained earnings at the date of issue equaling at least \$500,000,000; investments made under this paragraph are not subject to the collateral requirements for domestic certificates under (m) of this section;

(16) equity interests in, and debt obligations secured by mortgages granting a first lien on, real estate if the real estate is located in the United States, is professionally managed, and is

(A) improved by completed and substantially rented buildings ; or

(B) located within the market area of real property in which the fund holds an existing interest and is acquired

(i) for the purpose of creating or adding to a portfolio of similar properties; or

(ii) to retain or service the needs of existing tenants;

(17) securities of nondomestic governments and nondomestic government agencies, the principal of, or interest on, which is payable in either United States dollars or nondomestic currencies;

(18) securities of other nondomestic entities whose dividends, if any, may be payable in either United States dollars or nondomestic currencies;

(19) taxable municipal or state debt instruments that are rated investment grade;

(20) shares in a money market or short-term investment fund that has either collateral securities of a type authorized elsewhere in this section as acceptable collateral or securities of similar quality to those authorized elsewhere in this section as acceptable collateral:

(21) interests in a titleholding entity, real estate investment trust, real estate operating company, or other entity whose assets consist predominantly of

(A) equity interests in real property or debt obligations secured by mortgages granting a lien on real property, so long as the property is of a type in which the corporation is otherwise permitted to invest fund assets under this subsection; or

(B) interests in other entities in which the corporation is permitted to invest fund assets under this paragraph.

(h) The board may enter into future contracts for the sale of investments purchased under (g) of this section, or for the sale of nondomestic currencies, only for the purpose of hedging an existing equivalent ownership position in these investments or as a means of implementing asset allocation strategies.

(i) The fund may at no time own more than five percent of the voting stock of a corporation unless the issuing corporation is an entity in which the Alaska Permanent Fund Corporation is permitted to invest fund assets under (g)(21) of this section. Domestic stocks, except for bank and insurance company stocks and stocks of corporations in which the Alaska Permanent Fund Corporation is permitted to invest fund assets under (g)(21) of this section, must be listed at the date of purchase on an exchange registered with the Securities and Exchange Commission. Except as otherwise permitted under (k) of this section, at the time of each investment, the aggregate investment of the fund in each stated category of investment may not exceed the following stated percentage of the total investments of the fund:

(1) mortgages under (g)(13) of this section - 15 percent;

(2) real estate investments under (g)(16) and (21) of this section - 15 percent;

(3) certificates of deposit, term deposit, or bankers' acceptances under (g)(15) of this section - 20 percent;

(4) interests in domestic and nondomestic entities under (g)(14) and (18) of this section - 55 percent.

(j) The assets of the fund may not be used for the purchase of debt instruments of a corporation or other entity upon which any regular interest payment has been defaulted within five years before purchase, except debt instruments never in default but which have been outstanding for less than five years.

(k) The board shall establish and from time to time as necessary modify guidelines for the investment of the assets of the fund. Before adoption of any guidelines, the guidelines shall be reported to the Legislative Budget and Audit Committee for review and comment. Notwithstanding (g), (h) and (j) of this section or the percentage investment limitations under (i) of this section and so long as doing so satisfies the prudent-investor rule under (a) of this section, the board may invest up to ten percent of the total assets of the fund in either or a combination of the following:

(1) other types of investments not specifically listed in (g) of this section;

(2) categories of investment subject to the percentage investment limitations established in (i) of this section, even though investing additional assets in a category will cause the aggregate investment in the category to exceed the applicable percentage limitation.

(l) The board shall invest the assets of the fund in in-state investments to the extent in-state investments are available if the in-state investments

(1) have a risk level and expected yield comparable to alternate investment opportunities; and

(2) are included in the list of permissible investments in (g) of this section.

(m) Certificates of deposit or the equivalent instruments that are not of a quality that may be readily sold in a secondary market at prices reflecting fair value must be secured by a pledge as collateral of

(1) investments authorized for the fund under (g)(1), (2), (4), or (8) - (10) of this section;

(2) obligations of the state or instrumentalities of the state that are rated at least "A" by a major bond rating service and have a demonstrated secondary market;

(3) the guaranteed portion of Federal Small Business Administration loans;

(4) the portion of first lien real estate mortgages guaranteed by the federal Department of Veterans Affairs;
or

(5) notes secured by mortgages granting a first lien on commercial or residential real estate improved by completed buildings if the originating financial institution retains at least 25 percent of the mortgage until maturity.

(n) Investments or obligations pledged as collateral under (m) of this section must have value at least equal to the face value of the certificates of deposit being secured. The board may require substitution of collateral in order to ensure continued satisfaction of the requirements set out in (m) of this section.

(o) For purposes of (g) of this section, "investment grade" means a Standard & Poor's Corporation rating BBB or better, or Moody's Investors Service, Inc., rating of Baa or better, including a rating with a "+" or "-" designation or other variations that occur within these ratings, or a comparable rating by another nationally recognized rating organization.

(p) For purposes of applying the percentage investment limitations established in (i) of this section, if the board determines that a particular form of investment authorized under (g) of this section may appropriately be classified in more than one category of investment, it may elect the category to which that form of investment is assigned.

Sec. 37.13.140. Income.

Net income of the fund includes income of the earnings reserve account established under AS 37.13.145. Net income of the fund shall be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains or losses. Income available for distribution equals 21 percent of the net income of the fund for the last five fiscal years, including the fiscal year just ended, but may not exceed net income of the fund for the fiscal year just ended plus the balance in the earnings reserve account described in AS 37.13.145.

Sec. 37.13.145. Disposition of income.

(a) The earnings reserve account is established as a separate account in the fund. Income from the fund shall be deposited by the corporation into the account as soon as it is received. Money in the account shall be invested in investments authorized under AS 37.13.120.

(b) At the end of each fiscal year, the corporation shall transfer from the earnings reserve account to the dividend fund established under AS 43.23.045, 50 percent of the income available for distribution under AS 37.13.140.

(c) After the transfer under (b) of this section, the corporation shall transfer from the earnings reserve account to the principal of the fund an amount sufficient to offset the effect of inflation on principal of the fund during that fiscal year. The corporation shall calculate the amount to transfer to the principal under this subsection by

(1) computing the average of the monthly United States Consumer Price Index for all urban consumers for each of the two previous calendar years;

(2) computing the percentage change between the first and second calendar year average; and

(3) applying that rate to the value of the principal of the fund on the last day of the fiscal year just ended.

(d) Notwithstanding (b) of this section, income earned on money awarded in or received as a result of *State v. Amerada Hess, et al.*, 1JU-77-847 Civ. (Superior Court, First Judicial District), including settlement, summary judgment, or adjustment to a royalty-in-kind contract that is tied to the outcome of this case, or interest earned on the money, or on the earnings of the money shall be treated in the same manner as other income of the Alaska permanent fund, except that it is not available for distribution to the dividend fund, and shall be annually deposited into the principal of the Alaska permanent fund.

Sec. 37.13.150. Corporation budget.

The revenue generated by the fund's investments must be identified as the source of the operating budget of the corporation in the state's operating budget under AS 37.07 (Executive Budget Act). The unexpended balance of the corporation's annual operating budget does not lapse at the end of the fiscal year but shall be treated as income under AS 37.13.140.

Sec. 37.13.160. Audits.

The Legislative Budget and Audit Committee may provide for an annual post audit and annual operational and performance evaluations of the fund's investments and investment programs.

Sec. 37.13.170. Reports and publications.

By September 30 of each year, the board shall publish a report of the fund for distribution to the governor and the public. The board shall notify the legislature that the report is available. The report shall be written in easily understandable language. The report must include financial statements audited by independent outside auditors, a statement of the amount of money received by the fund from each investment during the period covered, a statement of investments of the fund including an appraisal at market value, a description of fund investment activity during the period covered by the report, a comparison of the fund performance with the intended goals contained in AS 37.13.020, an examination of the effect of the investment criteria of this chapter on the fund portfolio with recommendations of any needed changes, and any other information the board believes would be of interest to the governor, the legislature, and the public. The annual income statement and balance sheet of the fund shall be published in at least one newspaper in each judicial district. The income statement and balance sheet for the two fiscal years preceding the publication of the election pamphlet under AS 15.58 shall be included in that pamphlet.

Sec. 37.13.180. Tax exemption.

The corporation and the fund are exempt from all taxes and assessments in the state. All security instruments issued by the corporation or the fund, their transfer, and their income are exempt from all taxes and assessments in the state.

Sec. 37.13.190. Political activities.

The resources of the corporation or the fund may not be used to finance or influence political activities.

Sec. 37.13.200. Public access to information.

Information in the possession of the corporation is a public record, except that information that discloses the particulars of the business or affairs of a private enterprise or investor is confidential and is not a public record. Confidential information may be disclosed only for the purposes of an official law enforcement investigation or when its production is required in a court proceeding. These restrictions do not prohibit the publication of statistics presented in a manner that prevents the identification of particular reports, items, persons, or enterprises.

Sec. 37.13.205. Regulations.

The board may adopt regulations under AS 44.62 (Administrative Procedure Act) to interpret and implement this chapter.

Appendix 3

Documents on the Norwegian Government Petroleum Fund

3.A: Act Relating to the Government Petroleum Fund

Adopted on 22 June 1990. Amended by Act no. 2 of 16 January 2004

§ 1. The Act shall regulate the deployment and investment of a fund intended to safeguard long-term interests through the use of petroleum revenues.

§ 2. The Fund's income consists of the cash flow from petroleum activities, which is transferred from the central government budget, the return on the Fund's capital and net financial transactions associated with petroleum activities.

The cash flow is the sum of:

- total tax revenues and royalty deriving from petroleum activities collected pursuant to Act no. 35 of 13 June 1975 relating to Taxation of Offshore Petroleum Resources and Act no. 11 of 22 March 1985 relating to Petroleum Activities
- revenues deriving from tax on CO₂ emissions due to petroleum activities on the continental shelf
- revenues deriving from the State's direct financial interest in petroleum activities, defined as operating income and other income less operating expenses and other direct expenses
- central government revenues from net surplus agreements associated with certain production licenses
- dividends from Statoil ASA
- transfers from the Petroleum Insurance Fund
- central government revenues deriving from the removal or alternative use of installations on the continental shelf
- any government sale of stakes representing the State's direct financial interest in petroleum activities

less

- central government direct investment in petroleum activities
- central government expenses in connection with the Petroleum Insurance Fund
- central government expenses in connection with the removal or alternative use of installations on the continental shelf
- any government purchase of stakes as part of the State's direct financial interest in petroleum activities

Net financial transactions associated with petroleum activities are the sum of:

- gross revenues from government sale of shares in Statoil ASA

less

- government capital contributions to Statoil ASA and the company/companies promoting the State's interests in petroleum activities

§ 3. The Fund's capital may only be used for transfers to the central government budget pursuant to a resolution by the Storting (Norwegian Parliament). The Fund's capital may not be used in any other way, nor may it be used to provide credit to the central government or to private sector entities.

§ 4. The Fund's capital shall be invested in the same manner as the central government's other assets.

§ 5. The Fund may not raise loans. The Fund itself has no rights or obligations vis-à-vis private sector entities or public authorities. The Fund cannot be subjected to legal proceedings and may not institute legal proceedings.

§ 6. The Ministry of Finance shall manage the Fund.

§ 7. The King may issue provisions to supplement this Act and concerning its implementation, including provisions relating to the establishment of the Fund, its management, etc.

§ 8. This Act comes into force on the date decided by the King.

3.B: Regulation on the Management of the Government Petroleum Fund

Issued on 19 November 2004 by the Ministry of Finance.

§ 1. Management of the Government Petroleum Fund

Norges Bank manages the Government Petroleum Fund on behalf of the Ministry of Finance. The Bank may use other managers. Such managers must have adequate internal ethical guidelines for their own activity.

Norges Bank shall submit reports on the management of the Government Petroleum Fund in accordance with the guidelines set out by the Ministry of Finance.

§ 2. Placement of the Government Petroleum Fund

The Government Petroleum Fund shall be placed in a separate account in the form of NOK deposits in Norges Bank. Norges Bank shall invest this capital separately in its own name in financial instruments and cash deposits denominated in foreign currency.

Norges Bank shall seek to achieve the highest possible return on investments denominated in foreign currency within the limits set out in the regulation and the guidelines issued pursuant to this regulation.

§ 3. Accounting return on the Government Petroleum Fund

The value of the Petroleum Fund's krone account is set at the value of the portfolio of financial instruments and cash deposits. Norges Bank's book return on the portfolio, less remuneration to Norges Bank, shall be added to the Petroleum Fund's krone account on 31 December every year.

§ 4. Benchmark portfolio and relative risk

Following consultation with Norges Bank, the Ministry of Finance shall establish a benchmark portfolio for the Government Petroleum Fund. The Ministry shall set a maximum limit for the expected return differential between investments in the Petroleum Fund and the benchmark portfolio, measured in the form of tracking error.

§ 5. Asset mix

The Government Petroleum Fund shall be invested in accordance with the following asset distribution:

Interest bearing instruments 50-70%

Equity instruments 30-50%

When calculating the asset distribution in accordance with the first paragraph, equity derivatives shall be treated as though investment had taken place directly in the underlying equity instrument. In accordance with the first paragraph, the asset distribution must be calculated on the basis of the whole of the ordinary portfolio excluding derivatives.

§ 6. Currency and market distribution

The equity portfolio shall be invested according to the following currency and market distribution:

1. Europe 40-60%
2. the Americas, Middle East/Africa, Asia and Oceania 40-60%

The portfolio may be invested in equity instruments listed on stock exchanges in the following countries and regions:

Europe: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden, Switzerland, Turkey, the UK, Iceland, Cyprus, Poland, Czech Republic and Hungary

Americas: Brazil, Canada, Mexico, the US and Chile

Asia and Oceania: Australia, Hong Kong, Japan, New Zealand, Singapore, South Korea, Taiwan, Thailand, the Philippines, India, Indonesia, China and Malaysia

Middle-East and Africa: Israel and South Africa

Total investments in equity instruments in Turkey, Brazil, Mexico, South Korea, Taiwan, Thailand, Poland, Czech Republic, Hungary, Chile, the Philippines, India, Indonesia, China, Malaysia, Israel and South Africa shall not exceed 5 per cent of the combined investments in equity instruments, measured by currency or market share.

The interest bearing portfolio shall be invested according to the following currency and market distribution:

1. Europe 45-65%
2. The Americas and Middle East/Africa 25-45%
3. Asia and Oceania 0-20%

The portfolio may be invested in interest bearing instruments issued in the currency of one of the following countries or regions:

Europe: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden, Switzerland, the UK, Iceland, Cyprus, Poland, Czech Republic and Hungary

Americas: Canada, the US and Mexico

Africa: South Africa

Asia and Oceania: Australia, Hong Kong, Japan, New Zealand, Singapore and South Korea

§ 7. Interest rate risk

Modified duration for the total portfolio of interest-bearing instruments and associated derivatives shall be between 3 and 7.

§ 8. Credit risk

The Ministry of Finance shall establish limits for credit risk in the Government Petroleum Fund.

§ 9. Screening and withdrawal

The Ministry of Finance issues ethical guidelines for the Government Petroleum Fund and decides on whether specific issuers should be excluded from the investment universe. An Advisory Council on Ethics provides an evaluation of whether potential investments in financial instruments issued by specified issuers are inconsistent with the ethical guidelines.

The Ministry of Finance may issue detailed rules for the Council, its activities and its organisation.

§ 10. Risk systems and risk management

Norges Bank shall ensure that satisfactory risk systems and control routines exist for the instruments to be used in the management of the Government Petroleum Fund. Derivatives may be used provided that the financial exposure does not exceed the exposure that would have resulted from investing directly in the underlying instruments.

§ 11. Equity ownership

Investments may not be made in such a way that the Government Petroleum Fund exceeds 3 per cent of the equity capital in a single company or 3 per cent of the voting shares in a single company.

Norges Bank shall exercise ownership rights for the Government Petroleum Fund. The primary objective of the exercise of ownership rights is to safeguard the Fund's financial interests. The Ministry of Finance may issue supplementary guidelines for Norges Bank's exercise of ownership rights.

§ 12. Entry into force

The regulation enters into force on 1 December 2004. The regulation of 3 October 1997 nr 1078 on the management of the Government Petroleum Fund shall be revoked the same date.

3.C: Management Agreement between the Ministry of Finance and Norges Bank

The Ministry of Finance and Norges Bank entered into the following Management Agreement on 12 February 2002

2.1.1.1 1. The contents of the agreement, etc.

The State, represented by the Ministry of Finance, has delegated to Norges Bank the responsibility for the operational management of the Government Petroleum Fund. The management of the Fund is subject to Act no. 36 of 22 June 1990 on the Government Petroleum Fund with the appurtenant regulations, as well as other decisions and guidelines that have been or may be adopted by the Ministry of Finance. This agreement, together with the regulations and decisions mentioned, governs the relationship between the Ministry of Finance and Norges Bank in connection with the management of the Fund.

All notifications that affect this agreement shall be in writing and signed. Such notifications shall be communicated to Norges Bank Investment Management and to the Economic Policy Department of the Ministry of Finance.

2.1.1.2 2. Obligations of Norges Bank

2.1 Norges Bank's responsibilities

Norges Bank shall manage the Fund in accordance with the law, the financial management regulation for the central government, regulations and other decisions and guidelines that apply to the Fund (cf Clauses 1 and 3.1). Matters of special importance shall be submitted to the Ministry of Finance.

Quarterly and annual reports on the management of the Fund, to be drawn up by Norges Bank in accordance with guidelines laid down by the Ministry (cf Section 1 of the regulation), shall be approved by Central Bank Audit. Norges Bank shall without undue delay notify the Ministry of significant changes or expected significant changes in the Fund's assets. Norges Bank shall provide the Ministry of Finance with information as requested by the Ministry, including information in machine-readable form to companies that assist the Ministry in evaluating Norges Bank's management of the Government Petroleum Fund.

Norges Bank is liable for paying damages to the State for losses arising as a result of negligence or intent on the part of the Bank, external managers or external service providers operating under an agreement with the Bank (cf Clause 2.2, first paragraph of the agreement).

2.2 Management of the Fund

Norges Bank may use external managers and external service providers in the management of the Fund. Norges Bank is party to agreements with such service providers, and shall supervise their activity on behalf of the Fund.

The Ministry of Finance shall be informed of the choice of external service providers of major importance to management and the basis for the selection. The Ministry shall receive copies of the annexes relating to remuneration in new management agreements entered into by Norges Bank with external managers in connection with the management of the Fund. Remuneration to external managers shall be such that the Petroleum Fund retains the major part of increases in the excess return. The Ministry of Finance may require Norges Bank to submit to the Ministry all contracts entered into in connection with the management of the Fund.

2.3 Amendments to regulations, guidelines etc

At the request of the Ministry of Finance, Norges Bank shall provide the Ministry with advice regarding amendments to the framework conditions for management, including regulations, decisions and guidelines laid down by the Ministry. Norges Bank may also submit its own proposals for such changes in the framework conditions as the Bank considers advisable.

2.4 Withdrawal of financial instruments

At the request of the Ministry of Finance or the commission, as specified in Section 9 of Regulation no. 1078 of 3 October 1997, Norges Bank shall secure information about specified issuers, and supply the commission with this information.

If the Ministry of Finance makes decisions to exclude particular financial instruments from the Government Petroleum Fund's investment universe, Norges Bank shall be given a period of at least four weeks in which to unwind any such positions the Fund might have.

Norges Bank shall notify the Ministry of Finance when a position has been unwound. The Ministry of Finance shall consider whether to announce the assessments of the commission and the Ministry of Finance on a case-to-case basis (cf. the Royal Decree of 30 November 2001). If management considerations

indicate the necessity, the Ministry shall endeavour to postpone announcement until it has been notified that a position has been unwound.

2.5 Information

Norges Bank shall provide information concerning the Fund's management to the public, in accordance with the Public Information Act and the Public Administration Act and detailed guidelines issued by the Ministry of Finance.

2.1.1.3 3. The obligations of the Ministry of Finance

3.1 Regulations, guidelines, etc

Norges Bank shall have the opportunity to express its view before any changes are made to regulations, decisions or guidelines on management, and shall be notified in due time for changes to be made in the portfolio.

3.2 Remuneration

Remuneration shall be subject to Annex 1 to this agreement. Changes in the method for calculating remuneration for the following calendar year may be requested by either party before 1 December of each year.

Remuneration is drawn from the Fund's gross return before the net return is transferred to the Fund's krone account on 31 December of each year. Norges Bank shall submit its remuneration calculations to the Ministry of Finance as early as possible and no later than one week before finalising the accounts.

3.3 Crediting

If relevant, the Ministry of Finance transfers capital from the Treasury to the Fund's krone account in Norges Bank. The deadline for notifying Norges Bank and the final amount credited in NOK shall be in accordance with the prevailing "Guidelines for rebalancing the Petroleum Fund".

3.4 Amounts debited

The Ministry of Finance shall inform Norges Bank of any drawings on the Fund in due time for the Bank to make any portfolio adjustments. The Ministry of Finance will inform Norges Bank of the account to which the transfer is to be credited.

3.5 Taxation

The Ministry of Finance shall contribute to providing the documentation necessary to clarify the tax position of capital from the Fund that has been invested abroad.

2.1.1.4 4. Amendments and entry into force, etc.

4.1 Amendments

The agreement shall be revised when changes to laws or regulations, decisions or guidelines so require. This agreement and the annex thereto may not otherwise be amended without the written approval of both parties.

4.2 Entry into force and termination, etc

This agreement enters into force on 1 January 2002. If neither of the parties has given written notification by 31 December in a given year that the agreement is to be terminated as from 31 December of the following year, the agreement will continue to apply one year at a time until such notification is given.

The Ministry of Finance issues further specified rules and instructions in connection with the termination of the management assignment, including severance pay and other remuneration to Norges Bank in connection with the termination. Clause 3.1 applies accordingly.

Annex 1: Remuneration for management of the Government Petroleum Fund in 2003

The remuneration shall cover the costs incurred by Norges Bank in connection with the management of the Fund. However, costs in excess of 10.0 basis points of the Fund's average market value shall not be covered. Calculation of the average amount shall be based on the market value of the Petroleum Fund's portfolio measured in NOK at the beginning of each month in 2003. In addition to recovering costs up to the upper limit, Norges Bank shall receive remuneration for the portion of the fee to external managers that is due to the excess returns achieved.

3.D: Guidelines for the Government Petroleum Fund's Environmental Portfolio

Laid down by the Ministry of Finance on 21 August 2003 with effect from 19 September 2003 pursuant to section 2 of the Regulation of 3 October 1997 relating to the Management of the Government Petroleum Fund.

1. The environmental portfolio is to be established on 31 January 2001, with capital of NOK 1 billion. Changes in the amount invested may be made pursuant to specific decisions. The portfolio forms part of the Government Petroleum Fund and is to be managed by Norges Bank.
2. The environmental portfolio is to be invested exclusively in equity instruments listed on stock exchanges in the following countries and regions:

Europe: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden, Switzerland and the UK

The Americas: Canada and the US

Asia and Oceania: Australia, Hong Kong, Japan, New Zealand and Singapore
3. The benchmark portfolio for the Environmental Portfolio consists of those companies in the FTSE indices for the countries listed above which fulfill specific requirements regarding environmental reporting or environmental management systems. Companies that are considered to have little negative impact on the environment are also included, even if they do not comply with the reporting and certification requirements. The British consulting company Ethical Investment Research Service (EIRIS) has been commissioned by the Ministry of Finance to identify these companies.
4. At the time of establishment, the regional distribution of the benchmark portfolio for the environmental portfolio is set at 50 per cent in Europe, 30 per cent in North America and 20 per cent in Asia/Oceania. The country weights within each region are determined by the market value of the companies that fulfill the

criteria. Within each country, the approved companies are weighted in proportion to their market value. The regional weights in the environmental portfolio will not be rebalanced, but will vary with developments in market value in the regions.

5. The environmental portfolio's investment universe and the benchmark portfolio are identical with two exceptions: First, companies that are removed from the benchmark portfolio may remain in the environmental portfolio for a further three months. Second, investments may be made in companies that EIRIS or FTSE has decided to include before the companies are actually added to the benchmark portfolio.

6. The upper limit for the expected tracking error for the environmental portfolio in relation to its benchmark portfolio is 1 percentage point.

7. Norges Bank is to report on the management of the environmental portfolio at the same time as it reports on the management of the Petroleum Fund in general. The Bank shall assist in gathering and processing data for use in evaluating the environmental portfolio after three years of operations.

8. The benchmark portfolio is to be constructed on the basis of the FTSE GEIS (Global Equity Index Series) with sub-indices for large and medium-sized companies, but excluding sub-indices for small companies, and a list from EIRIS of companies that fulfill the environmental criteria. On behalf of the Ministry of Finance, EIRIS is responsible for sending the list of companies that fulfill the environmental criteria to Norges Bank and the index providers simultaneously.

3.E: Ethical Guidelines for the Government Petroleum Fund Issued 19 November 2004

1 Basis

The ethical guidelines for the Government Petroleum Fund are based on two premises:

The Government Petroleum Fund is an instrument for ensuring that a reasonable portion of the country's petroleum wealth benefits future generations. The financial wealth must be managed with a view to generating a sound return in the long term, which is contingent on sustainable development in the economic, environmental and social sense. The Fund's financial interests should be consolidated by using the Fund's ownership interests to promote sustainable development.

The Government Petroleum Fund should not make investments that entail an unacceptable risk that the Fund is contributing to unethical actions or omissions, such as violations of fundamental humanitarian principles, gross violations of human rights, gross corruption or severe environmental degradation.

2 Mechanisms

The ethical basis for the Government Petroleum Fund shall be promoted using the following three mechanisms:

Exercise of ownership rights to promote long-term financial returns based on the UN's Global Compact and the OECD Guidelines for Corporate Governance and for Multinational Enterprises.

Negative screening from the investment universe of companies that either themselves or through entities they control produce weapons whose normal use violates fundamental humanitarian principles.

Exclusion of companies from the investment universe where there is deemed to exist a considerable risk of contributing to:

Gross or systematic violation of human rights, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other child exploitation

Gross violations of individual rights in war or conflict situations

Severe environmental degradation

Gross corruption

Other particularly serious violations of fundamental ethical norms

3 The exercise of ownership rights

3.1

The primary objective of Norges Bank's exercise of ownership rights for the Government Petroleum Fund is to safeguard the Fund's financial interests. The exercise of ownership rights shall be based on a long-term horizon for the Fund's investments, and broad investment diversification in the markets that are included in the investment universe. The exercise of ownership rights shall primarily be based on the UN's Global Compact and the OECD Guidelines for Corporate Governance and for Multinational Enterprises. Norges Bank's internal guidelines for the exercise of ownership rights shall stipulate how these principles are to be integrated into the exercise of ownership rights.

3.2

Norges Bank shall report on its exercise of ownership rights in connection with its ordinary annual reporting. An account shall be provided of how the Bank has acted as owner representative – including a description of the work to promote special interests relating to the long-term horizon and diversification of investments in accordance with Sections 3.1 and 3.2.

3.3

Norges Bank may delegate the exercise of ownership rights to external managers in accordance with these guidelines.

4 Negative screening and exclusion

4.1

The Ministry of Finance shall make decisions on negative screening and exclusion of companies from the investment universe based on the recommendations of the Government Petroleum Fund's Council on Ethics.

The recommendations and decisions are to be made public. The Ministry can in certain cases postpone the time of public disclosure if this is deemed necessary in order to ensure a financially sound implementation of the exclusion of the company concerned.

4.2

The Government Petroleum Fund's Council on Ethics shall be composed of five members. The Council shall have its own secretariat. The Council shall submit an annual report on its activities to the Ministry of Finance.

4.3

The Council is to issue recommendations at the request of the Ministry of Finance on whether an investment may be in violation of Norway's obligations under international law.

4.4

The Council is to issue recommendations on negative screening of one or several companies on the basis of the production of weapons whose normal use is in violation of fundamental humanitarian principles. The Council is to issue recommendations on the exclusion of one or more companies from the investment universe where there is deemed to exist a considerable risk of contributing to actions or omissions that involve:

- Gross or systematic violation of human rights, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other forms of child exploitation

- Gross violations of individual rights in war or conflict situations

- Severe environmental degradation

- Gross corruption

- Other particularly serious violations of fundamental ethical norms

The Council is to raise matters under this section on its own initiative or at the request of the Ministry of Finance.

Appendix 4

The State Oil Fund of Azerbaijan (SOFAZ)

4.A: A Decree of the President of the Republic of Azerbaijan on Establishment of the State Oil Fund of the Republic of Azerbaijan (#240)

(including amendments according to the Presidential Decree #849 dated February 7, 2003)

Business co-operation between the State Oil Company of the Republic of Azerbaijan and leading international oil companies, which had been commenced with the signing of the Contract of the Century in 1994, is about to give its first real results. To direct expected revenues towards social-economic progress of the Republic of Azerbaijan is a primary purpose of the state policy.

Taking the aforementioned into account, and for the purposes of securing accumulation and efficient management of currency and other revenues generated from sale of profit oil produced as a result of joint development of oil fields with foreign companies, application of such proceeds to development of primary areas and performance of projects of social-economic significance, it is hereby decreed:

1. To establish the State Oil Fund of the Republic of Azerbaijan.
2. To accumulate resources of the State Oil Fund of the Republic of Azerbaijan on the account of the following sources:
 - 2.1. Revenues generated from implementing agreements on exploration, development and production sharing for oil and gas fields in the territory of the Republic of Azerbaijan including the Azerbaijani sector of the Caspian Sea (Lake), as well as other agreements on oil and gas exploration, development and transportation entered into between the State Oil Company of the Republic of Azerbaijan or other authorized state body and investors:
 - 2.1.1. Net revenues from the sale of hydrocarbons falling on the share of the Republic of Azerbaijan (to deduct expenditures incurred for hydrocarbons transportation, customs clearance and bank costs, marketing, insurance and independent surveyor fees and not to include revenues falling on a participating interest or investment of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);
 - 2.1.2. Oil and gas agreements signature and/or performance bonuses paid by investors to the State Oil Company of the Republic of Azerbaijan or an authorized state body;
 - 2.1.3. Acreage payments due to the State Oil Company and/or an authorized state body of the Republic of Azerbaijan from investors for the use of contract area in connection with oil and gas exploration and development;

2.1.4. Dividends and profit participation revenues falling on the share of the Republic of Azerbaijan in connection with oil and gas agreements implementation (not to include revenues falling on a participating interest or investment of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);

2.1.5. Revenues generated from oil and gas pass over the territory of the Republic of Azerbaijan with the use of Baku-Supsa, Baku-Tbilisi-Ceyhan and Baku-Tbilisi-Erzurum export pipelines;

2.1.6. Revenues generated from transfer of assets from investors to the State Oil Company and/or an authorized state body within the framework of oil and gas agreements;

2.2. Revenues generated from placement and management of the Fund's assets, including interest, dividend, asset revaluation and other revenues;

2.3. Grant and other free aid;

2.4. Other revenues and receipts in accordance with the legislation.

3. Sale of the Republic of Azerbaijan's share of crude oil and gas shall be carried out by the State Oil Company of the Republic of Azerbaijan.

4. The Cabinet of Ministers of the Republic of Azerbaijan shall prepare within two (2) months proposals on Regulations of the State Oil Fund of the Republic of Azerbaijan and composition of supreme management authorities thereof and submit the same to the President of the Republic of Azerbaijan.

5. To order the National Bank of the Republic of Azerbaijan to secure, prior to commencement of activities by the State Oil Fund of the Republic of Azerbaijan, accumulation of assets of the latter on a special account.

4.B: Regulations of the State Oil Fund of the Republic of Azerbaijan

1. General Provisions

1.1. The State Oil Fund of the Republic of Azerbaijan (hereinafter referred to as "Fund") has been established in accordance with the Presidential Decree #240 dated December 29, 1999 "On Establishment of the State Oil Fund of the Republic of Azerbaijan" to ensure effective management of the country's assets, which are generated from implementation of agreements signed between the State Oil Company (or Authorized Government Body) and investors in regards to oil/gas exploration, development and production sharing, including those generated from the implementation of other agreements concerning exploration and development of the oil/gas reserves in the Azeri sector of the Caspian.

1.2. The Fund shall be accountable and responsible to the President of the Republic of Azerbaijan.

1.3. The Fund is an extra-budgetary institution. The Fund is a legal entity and shall have settlement account and other accounts at banking institutions. The Fund shall have a seal with the State Emblem and its name engraved on it, as well as appropriate stamp and paper forms.

1.4. A Supervisory Board shall exercise general control over establishment and spending of the Fund's assets.

1.5. In the implementation of its activities, the Fund shall cooperate with government bodies, individuals and legal entities of the Republic of Azerbaijan, as well as with international organizations.

1.6. Except for rights and responsibilities assigned by Presidential Decrees and by these Regulations, the Fund:

a) shall not have any rights, responsibilities and shall not bear any commitments in relationships with the Government of the Republic of Azerbaijan, other government bodies, including ministries, state committees, public institutions, enterprises and organizations and financial institutions, as well as in relationships with any social funds, public and other non-governmental organizations under jurisdiction of the Republic of Azerbaijan or of another country;

b) shall not bear any responsibility related with commitments or guarantees of the Government of the Republic of Azerbaijan, other government bodies, public enterprises, institutions and organizations.

1.7. The Fund's operation shall be guided by the Constitution and laws of the Republic of Azerbaijan, Presidential Decrees and Resolutions, as well as by these Regulations.

1.8. The Fund shall locate in Baku.

2. Main Responsibilities of the Fund

Main responsibility of the Fund is to ensure collection and effective management of foreign currency and other assets that are generated from the implementation of agreements signed in the field of oil/gas exploration and development, as well as from the Fund's own activities, in the interest of citizens of the Republic of Azerbaijan and their future generations.

3. Revenue sources of the State Oil Fund

3.1. The Fund shall be formed on the account of the following sources:

3.1.1. Revenues generated from implementing agreements on exploration, development and production sharing for oil and gas fields in the territory of the Republic of Azerbaijan including the Azerbaijani sector of the Caspian Sea (Lake), as well as other agreements on oil and gas exploration, development and transportation entered into between the State Oil Company of the Republic of Azerbaijan or other authorized state body and investors:

3.1.1.1. Net revenues from the sale of hydrocarbons falling on the share of the Republic of Azerbaijan (to deduct expenditures incurred for hydrocarbons transportation, customs clearance and bank costs, marketing, insurance and independent surveyor fees and not to include revenues falling on a participating interest or investment of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);

3.1.1.2. Oil and gas agreements signature and/or performance bonuses paid by investors to the State Oil Company of the Republic of Azerbaijan or an authorized state body;

3.1.1.3. Acreage payments due to the State Oil Company and/or an authorized state body of the Republic of Azerbaijan from investors for the use of contract area in connection with oil and gas exploration and development;

3.1.1.4. Dividends and profit participation revenues falling on the share of the Republic of Azerbaijan in connection with oil and gas agreements implementation (not to include revenues falling on a participating interest or investment of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);

3.1.1.5. Revenues generated from oil and gas pass over the territory of the Republic of Azerbaijan with the use of Baku-Supsa, Baku-Tbilisi-Ceyhan and Baku-Tbilisi-Erzurum export pipelines;

3.1.1.6. Revenues generated from transfer of assets from investors to the State Oil Company and/or an authorized state body within the framework of oil and gas agreements;

3.1.2. Revenues generated from placement and management of the Fund's assets, including interest, dividend, asset revaluation and other revenues;

3.1.3. Grant and other free aid;

3.1.4. Other revenues and receipts in accordance with the legislation.

3.2. The Fund's assets under management shall be placed in investment grade rated banks and instruments.

3.3. The Supervisory Board of the Fund determines rules for accounting and reporting the use of the Fund's assets.

4. Utilization of the Fund's Assets

4.1. Utilization (spending) of the Fund's resources shall be based on the principle of limiting Fund's expenditures in any financial year to its revenues in the same year.

4.2. Utilization of the Fund's assets shall be carried out in accordance with main directions (program) to be approved each year through Presidential Resolutions.

4.3. The Fund's assets may be used for solving the most important nation-wide problems, and for construction and reconstruction of strategically significant infrastructure facilities, for the purpose of the country's socio-economic progress.

4.4. Information about approved directions for utilization of the Fund's assets for each year, as well as annual report about their actual disbursement shall be published in press.

4.5. The Fund's assets may neither be used for lending to government bodies, public and non-public enterprises (organizations), nor as collateral for debts (commitments, guarantees) or other liabilities of any entity under jurisdiction of the Republic of Azerbaijan.

4.6. The Fund's revenues shall be exempt from tax, duties and other charges in accordance with the legislation.

5. Management of the Fund

5.1. Executive Director shall carry out operational management of the Fund's activities.

5.2. The Executive Director shall be appointed to and dismissed from this position by the President of the Republic of Azerbaijan.

5.3. The Fund's Executive Director shall:

- organize and manage current work of the Fund;

- prepare proposals regarding main directions (program) for utilization of the Fund's assets and submit them for approval to the President of the Republic of Azerbaijan together with opinion of the Supervisory Board;
- prepare annual report on the Fund's operations and submit it to the President of the Republic of Azerbaijan together with opinion of the Supervisory Board;
- prepare cost estimates for managing the Fund (including maintenance costs of the central office) and submit them to the President of the Republic of Azerbaijan for approval;
- organize preparation of necessary materials based on assignments of the President of the Republic of Azerbaijan;
- appoint and dismiss employees of the Fund's central office in a manner determined by the legislation, and apply encouragement and punishment measures to them;
- ensure the creation of necessary conditions for revision by auditor to be appointed by the President of the Republic of Azerbaijan;
- publish in the press the auditor's opinion, which reflects results of the Fund's annual operations;
- prepare analytical information regarding the Fund's activities, and submit it to the President of the Republic of Azerbaijan and to the Supervisory Board;
- exercise other powers in accordance with the legislation of the Republic of Azerbaijan and these Regulations.

5.4. For the purpose of general supervision over the Fund's activities, the Supervisory Board shall be established comprised of representatives from relevant state bodies and public organizations, as well as of other persons.

5.5. Members of the Supervisory Board shall be approved by the President of the Republic of Azerbaijan.

5.6. The Supervisory Board shall review and give its opinion on the main directions (program) for utilization of the Fund's assets, the Fund's annual report (together with the auditor's opinion attached to it) and balance, as well as on the Fund's draft annual cost estimates to be presented to it by the Executive Director.

5.7. The Supervisory Board shall meet when necessary but not less than once a quarter. Ad hoc meetings may be held upon initiative by the executive director or by half of the Supervisory Board's members.

5.8. Members of the Supervisory Board shall carry out their work on social grounds (i.e. without remuneration).

6. Accounting and Reporting

The Fund shall maintain accounting and statistical reporting in a manner determined by the legislation. The Fund's annual operations report must be examined and approved by an independent auditor to be appointed by the President of the Republic of Azerbaijan.

7. Making Changes to the Fund's Regulations

Any change or addition to the Fund's Regulations shall be approved by the President of the Republic of Azerbaijan.

8. Reestablishment and Liquidation of the Fund

Reestablishment and liquidation of the Fund shall be carried out through decree by the President of the Republic of Azerbaijan.

4.C: Asset Management Rules (Guidelines) for the State Oil Fund of the Republic of Azerbaijan

The goals of these Rules:

- to specify the Fund's authority limits
- establishment of control mechanism of and reporting system on the Fund's activity
- to ensure transparency of the Fund's activity

Scope of the Rules

These Rules shall apply only to the Fund's assets comprising the investment portfolio of the Fund that is the total Fund's assets denominated in foreign currency less the amount to cover expenditures of the Fund as per its budget.

Management arrangements

The authority to hold, place and manage the foreign currency assets of the Oil Fund in compliance with its investment policy and these Rules as well as to determine the relevant internal procedures of the Oil Fund is vested with the Executive Director of the Oil Fund.

Management of the Oil Fund's foreign currency assets shall be carried out in accordance with the Oil Fund's investment policy.

Financial institutions specialized in investment portfolio management (external managers) may be invited to manage some portion of the Oil Fund's investment portfolio. External managers shall have a credit rating of not less than AA- (Standard & Poor, Fitch) and Aa3 (Moody's).

Bank accounts of the Oil Fund

In the Republic of Azerbaijan, the Oil Fund's clearing accounts shall be opened only at the National Bank of Azerbaijan (NBA).

Outside the Republic of Azerbaijan, the clearing accounts of the Oil Fund shall be opened at banks rated by reputable international rating agencies such as Standard & Poor's, Moody's and Fitch with a long-term credit rating not lower than: "AA-" - as defined by Standard & Poor's, Fitch or "Aa3" - as defined by Moody's.

The counterparts of the Oil Fund in international financial markets shall be commercial banks and other financial institutions with a long term credit rating of at least A (Standard & Poor, Fitch) or A2 (Moody's). The opening and maintenance of bank or other accounts (securities depository accounts) for the Oil Fund shall be based on an appropriate contract (agreement). Contracts (agreements) on the holding, placement and management of the foreign currency assets shall be signed by the Oil Fund's Executive Director on behalf of the Oil Fund.

Custodians of the Oil Fund

Custodian (depository) services on securities shall be provided to the Oil Fund by:

- Central (National) banks
- Commercial banks and other financial institutions which have a rating of at least AA- (Standard & Poor, Fitch) or Aa3 (Moody's);

Foreign currency composition of investment portfolio

The Oil Fund's foreign currency assets shall comprise currencies and /or investment assets denominated in the following currencies:

- Euro
- US Dollar
- Japanese Yen
- Pound sterling

Other currencies of countries which have a long-term country rating which is not less than A (Standard & Poor, Fitch) or A2 (Moody's), provided that such assets shall not exceed 5% of the total investment portfolio and shall be fully hedged back into US dollars

The Oil Fund's investment policy

The Oil fund's investment policy:

- Shall be prepared annually
- Shall be prepared by its Executive Director within the framework of the draft program for the utilization of the Oil Fund's assets
- Shall be submitted jointly with the opinion of the Oil Fund's Supervisory Board on the proposed investment policy to the President of the Republic of Azerbaijan
- Shall be approved by the President of the Republic of Azerbaijan

In line with the generally accepted principles of foreign currency asset management, the Oil Fund's investment policy shall specify:

The forecast volume of the investment portfolio

Liquidity requirements and maximum investment horizon of the investment portfolio

- Credit risk limits
- The forecast return
- The portion of the investment portfolio assigned to external managers for management, its investment horizon

Permitted investments

The following assets may comprise the Oil Fund's investment portfolio:

- State Securities (bonds) issued by governments of countries which have long-term country (sovereign debt) ratings of at least A (Standard & Poor, Fitch) or A2 (Moody's);
- Securities issued by financial institutions that have state guarantees or by state agencies and governments of countries which have long-term country (sovereign debt) ratings of at least A (Standard & Poor, Fitch) or A2 (Moody's);
- Securities and bonds issued by international (supranational) financial institutions (including but not restricted to World Bank, European Bank for Reconstruction and Development, Asian Development Bank);
- Debt issued in the form of securities by commercial banks and other financial institutions which have long-term credit ratings of at least A (Standard & Poor, Fitch) or A2 (Moody's).
- In the case that a portion of the Oil Fund's foreign currency assets is managed by an external manager, such an investment portfolio may comprise other investment assets, including corporate debt and equities in addition to those listed above. External managers shall have a credit rating of not less than AA- (Standard & Poor, Fitch) and Aa3 (Moody's).

Restrictions on investments

The Oil Fund's investment portfolio shall not be invested in:

- currency arbitrage, swaps, forwards and futures (except for the purpose of hedging or optimizing the currency composition of the investment portfolio and structure of the Oil Fund assets)
- precious metals and stones
- real estate

The Oil Fund's officials and officers' professional behavior

The Oil Fund's officials and officers' professional behavior in the process of Fund assets management shall comply with ethical norms and rules of conduct established by the ACI Code of Conduct issued by the Financial Markets Association (Paris), and avoid any conflict between personal interests and their duties as the Fund staff.

4.D: Rules on the Preparation and Execution of the Annual Budget for the State Oil Fund of the Republic of Azerbaijan

These Rules have been prepared in accordance with the "Regulations (Statute) on the State Oil Fund of the Republic of Azerbaijan" approved by the Decree of the President of the Republic of Azerbaijan No. 434 dated December 29, 2000 and determine the arrangements for the preparation, approval and execution of the annual program of revenues and expenditures (hereinafter referred to as a budget) of the State Oil Fund of the Republic of Azerbaijan (hereinafter referred to as the Oil Fund).

1. GENERAL PROVISIONS

1.1. The Oil Fund's budget means an annual financial program that is prepared to ensure the implementation of the Oil Fund's objectives and functions in compliance with the legislation of the Republic of Azerbaijan, and reflects the Oil Fund's revenues and expenditures.

1.2. The Oil Fund budget shall be prepared for each financial year and shall cover the period starting on the first of January and ending on the thirty-first of December.

1.3. The preparation and execution of the Oil Fund's budget shall be based on development and implementation of a coherent macroeconomic policy and on the principle of the consolidation of revenues and expenditures of the consolidated government.

1.4. No expenditures from the Oil Fund shall be allowed unless the expenditures are in accordance with the Oil Fund's budget.

2. THE STRUCTURE OF THE OIL FUND'S BUDGET

2.1. The Oil Fund's budget consists of revenue items and expenditure items.

2.2. Disaggregation of the Oil Fund's budget into items shall be effected in compliance with the state budget account classification of the Republic of Azerbaijan and shall be consistent with international standards.

2.3. The revenue items of the Oil Fund's budget shall comprise the following:

2.3.1. Revenues generated from implementing agreements on exploration, development and production sharing for oil and gas fields in the territory of the Republic of Azerbaijan including the Azerbaijani sector of the Caspian Sea (Lake), as well as other agreements on oil and gas exploration, development and transportation entered into between the State Oil Company of the Republic of Azerbaijan or other authorized state body and investors:

2.3.1.1. Net revenues from the sale of hydrocarbons falling on the share of the Republic of Azerbaijan (to deduct expenditures incurred for hydrocarbons transportation, customs clearance and bank costs, marketing, insurance and independent surveyor fees and not to include revenues falling on a participating interest or investment of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);

2.3.1.2. Oil and gas agreements signature and/or performance bonuses paid by investors to the State Oil Company of the Republic of Azerbaijan or an authorized state body;

2.3.1.3. Acreage payments due to the State Oil Company and/or an authorized state body of the Republic of Azerbaijan from investors for the use of contract area in connection with oil and gas exploration and development;

2.3.1.4. Dividends and profit participation revenues falling on the share of the Republic of Azerbaijan in connection with oil and gas agreements implementation (not to include revenues falling on a participating interest or investment of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);

2.3.1.5. Revenues generated from oil and gas pass over the territory of the Republic of Azerbaijan with the use of Baku-Supsa, Baku-Tbilisi-Ceyhan and Baku-Tbilisi-Erzurum export pipelines;

2.3.1.6. Revenues generated from transfer of assets from investors to the State Oil Company and/or an authorized state body within the framework of oil and gas agreements;

2.3.2. Revenues generated from placement and management of the Fund's assets, including interest, dividend, asset revaluation and other revenues;

2.3.3. Grant and other free aid;

2.3.4. Other revenues and receipts in accordance with the legislation.

2.4. The expenditure items of the budget shall comprise the following:

- expenditures to finance the projects and social programs in compliance with the main directions (program) of the Oil Fund's assets utilization;
- expenditures to finance the Oil Fund's operational expenses, including administrative (staffing) expenditure, expenditure on employment of external consultants, assets revaluation expenses and other expenses.

3. PREPARATION OF THE OIL FUND'S BUDGET

3.1. The process of preparation of the Oil Fund's budget

3.1.1. The process of preparation of the draft Oil Fund's budget shall commence simultaneously with the preparation of the State Budget of the Republic of Azerbaijan 11 months ahead of the next calendar year and shall cover the period until the day of presentation of the draft to the President of the Republic of Azerbaijan for approval.

3.1.2. With a view to ensuring consolidation of the revenues and expenditures of the consolidated government, the Oil Fund's budget and the State Budget of the Republic of Azerbaijan shall be prepared on a consistent basis through close cooperation and coordination between the Ministry of Finance and the Oil Fund.

3.1.3. While preparing the Oil Fund's budget the Oil Fund shall provide its Supervisory Board with the basic principles and take the Supervisory Board's comments on the Oil Fund's budget into consideration.

3.1.4. The preparation of an annual the Oil Fund's budget shall assume medium term (3 years) projections of revenues and expenditures of the Oil Fund. These projections shall be developed by the Oil Fund in close coordination with the Ministry of Finance to ensure consistency with the Medium Term Expenditure Framework that is prepared by the latter.

3.1.5. While preparing the draft Oil Fund's revenues and expenditures and Oil Fund's budget on the basis of paragraph 1.3 of these Rules, the effects of the Oil Fund's expenditure of foreign currency to finance domestic projects on the macroeconomic situation and the competitiveness of the national economy shall be carefully considered. To this end the Oil Fund shall consult with the state bodies of the Republic of Azerbaijan in charge of financial, monetary, economic, energy and statistical policy, and shall take their opinion into consideration.

3.1.6. In order to enable preparation of the Oil Fund's budget, as stipulated in paragraph 3.1.4 medium term projections of revenues and expenditures of the Oil Fund, the Oil Fund shall have the right to require provision of information from the relevant executive authorities of the Republic of Azerbaijan, from companies holding Oil Agreements with the State bodies and from the Oil Agreements' contractors.

3.2. Preparation of a forecast for revenue items of the Oil Fund's budget

3.2.1. The forecast of revenue items of the Oil Fund's budget which are generated from the implementation of the Oil Agreements shall be prepared based upon analysis of global hydrocarbon markets, research, forecasts and estimates of reputable specialized local and international organizations and scientific-research centers, as well as reports and other data to be submitted to the Oil Fund by the state bodies of the Republic of Azerbaijan in charge of energy and economy. To this end the basic oil price indicators shall be coordinated between the Oil Fund and the Ministry of Finance and while preparing the Oil Fund's budget the same figures stipulated in the state budget shall be applied.

3.2.2. The forecast of revenue items of the Oil Fund's budget which are generated from the Oil Fund's asset management shall be prepared based upon the provisions of the Oil Fund's asset investment policy adopted within the framework of the Fund's assets utilization program.

3.2.3 The investment policy of the Oil Fund shall be prepared in compliance with its asset management rules and be based upon financial market analysis and reports of reputable international rating agencies, and, if necessary, making use of reputable foreign consultants. It shall establish optimum economic return, low risk and conformity to the Oil Fund's constitutional goals as the major guidelines and principles for the Fund's asset management.

3.3 Preparation of expenditures items of the Oil Fund's budget

3.3.1 The expenditures items of the Oil Fund's budget predominantly shall be limited to an amount not exceeding the volume of projected revenues from managing the Fund's assets.

3.3.2. The expenditures items of the Oil Fund's budget within the Fund's assets utilization program shall envisage only financing of the most important nation-wide projects, construction and reconstruction of strategically significant infrastructure facilities for the purpose of the socio-economic progress of the Republic of Azerbaijan.

3.3.3. The forecast of expenditures items to finance the Oil Fund's assets utilization program shall take into account the necessity to promote the development and increase the competitiveness of the non-oil sector of the national economy and shall be based on a macroeconomic forecast of the socio-economic development of the Republic of Azerbaijan, an analysis of the performance of different sectors of the economy and the evaluation of project proposals, which shall be submitted within the framework of the State Investment Policy and priorities specified by the President of the Republic of Azerbaijan.

3.3.4. The Oil Fund shall coordinate with the President of the Republic of Azerbaijan the list of projects for consideration within the Oil Fund's assets utilization program not later than April 1 of each year, it shall carry out expert examination of the projects and include approved projects to the draft budget of the Oil Fund for the next year. The Oil Fund shall establish criteria for project evaluation and the format for project submissions, including volume of investment, duration of the project and an assessment of the availability of co-financing or other investment sources.

3.3.5. The forecast of expenditures items relating to the Oil Fund's operations shall be prepared based on estimates (calculations) of workload, staffing and other requirements for the next year as well as on the amount of expenditures actually spent in the preceding financial year.

3.4 Use of any difference between the revenues and expenditures

3.4.1 In the preparation of the Oil Fund's budget expenditure items shall not exceed revenue items.

3.4.2 The Oil Fund's budget preparation shall envisage the transfer of the full amount of the difference between forecasted revenues and expenditures, if any, to the Oil Fund's asset management portfolio (investment portfolio).

4. APPROVAL OF THE OIL FUND'S BUDGET

4.1. Every year at the latest by September 5 the draft Oil Fund's budget having been prepared in coordination and on a consistent basis with the preparation of the draft State Budget of the Republic of Azerbaijan shall be submitted by the Oil Fund's Executive Director to the OF Supervisory Board for comments along with the following documents:

- the Oil Fund's assets utilization program;
- the Oil Fund's investment policy;
- an estimate of Oil Fund operational expenditures.

4.2. Every year at the latest by September 20 the draft Oil Fund's budget and the documents stipulated in paragraph 4.1 above together with the Supervisory Board's opinion shall be submitted to the President of the Republic of Azerbaijan for consideration.

4.3. Final coordination of the Oil Fund's budget with the State Budget and the approval of the Oil Fund's budget shall take place after both documents comprising draft consolidated government's revenues and expenditures have been considered by the President of the Republic of Azerbaijan preceding the submission of the draft State Budget submission to the Milli Majlis (Parliament).

4.4. The Oil Fund's budget shall be approved not later than December 1 of each year.

4.5. If the draft Oil Fund's budget is not approved, for whatever reason, by December 31, the Oil Fund is authorized to execute expenditures to cover expenditures of the Fund in the amount of 1/12 (one-twelfth) of actual expenditure for this purpose of the previous financial year for each month.

4.6. The Oil Fund's budget shall be published immediately upon approval.

5. EXECUTION OF THE OIL FUND'S BUDGET

5.1. General provisions on the execution of the budget

5.1.1 The Oil Fund's budget shall be executed so as to ensure collection of revenues and their spending in compliance with Oil Fund's budget.

5.1.2 To finance the expenditures according to the Oil Fund's budget the revenues received by the Oil Fund through the financial year shall be accumulated on special highly liquid Oil Fund accounts. Revenues accumulated in excess of the amount of forecasted annual expenditures of the Oil Fund net of actually incurred expenditures shall be transferred to the Oil Fund's investment portfolio on a quarterly basis.

5.1.3 The Oil Fund shall publish reports on its revenues and expenditures on a quarterly basis.

5.1.4 In case the revenues in the beginning of the financial year are not sufficient to finance the expenditures of the Fund an amount not exceeding the approved quarterly expenditures of the Oil Fund shall be made available from the Oil Fund's investment portfolio. The above amount shall be transferred back to the investment portfolio as soon as the corresponding revenues have been received.

5.1.5 All expenditures shall be executed in accordance with the purpose for which they were approved.

5.1.6 If during the execution of the Oil Fund's budget revenues actually received exceed forecast revenues or expenditures have not been executed in full for whatever reason, the resulting excess amount shall not be spent but transferred in full to the Fund's investment portfolio on a quarterly basis.

5.2 Execution of expenditure items relating to the Oil Fund's assets utilization program.

5.2.1. Expenditure items relating to the Oil Fund's assets utilization program shall be executed through the State Treasury in compliance with the legislation in force and allowing for certain provisions stipulated in these Rules.

5.2.2 The amounts transferred by the Oil Fund to the State Treasury shall not be used to finance expenditures other than the expenditures for which they were originally allocated.

5.2.3 Procurement of goods (works and services) under the projects financed by the Oil Fund shall be regulated by the legislation of the Republic of Azerbaijan.

5.2.4 The Oil Fund shall be authorized to exercise supervision over the use of the Oil Fund's project finance related expenditures executed through the State Treasury, including the right to request and receive the requisite data.

5.2.5 In order to enable the Oil Fund to produce quarterly and annual reports, the Ministry of Finance shall submit reports on the execution of the Oil Fund's expenditures through the State Treasury to the Oil Fund.

5.3. Execution of expenditures relating to the Oil Fund's operational expenditures

5.3.1 Within the budget for the Oil Fund's operational expenditures up to 30% of unexecuted expenditures (saving) may be reallocated among items of expenditures at the discretion of the Oil Fund's Executive Director, any reallocation in excess of 30% of unexecuted expenditures (saving) shall be approved by the President of the Republic of Azerbaijan

5.3.2. The Oil Fund's operational expenditures shall not exceed the quarterly allocation for operational expenditures.

5.3.3. Information on the Oil Fund's expenditures executed through the State Treasury shall be provided to the Ministry of Finance to enable the latter to incorporate all expenditures of the Oil Fund in its quarterly report published on the expenditures of the consolidated government.

5.4 Amendments to the Oil Fund's budget

5.4.1 In case of a pressing necessity upon the decision of the President of the Republic of Azerbaijan the Oil Fund's budget may be amended subject to having allowed for such an amendment in the consolidated government revenues and expenditures.

5.4.2 To make an amendment to the Oil Fund's budget the Executive Director of the Oil Fund shall pursue coordination procedures set forth in paragraph 3.1 hereof and submit to the President of the Republic of Azerbaijan an application for the approval of the amendments prepared.

6. REPORTING ON THE OIL FUND'S BUDGET EXECUTION

6.1 The Oil Fund shall produce quarterly reports on the Oil Fund's budget execution and submit them to the Supervisory Board and the President of the Republic of Azerbaijan.

6.2 The Oil Fund shall produce an annual report on the Oil Fund's budget execution and coordination with the Ministry of Finance and submit it to the President of the Republic of Azerbaijan along with the comments of the Supervisory Board at the latest by April 30 of the next financial year.

6.3 The approval by the President of the Republic of Azerbaijan of the Oil Fund's annual report on the Oil Fund's budget execution shall take into account the opinion of a reputable international audit firm on the Oil Fund's budget execution within the framework of the annual audit of the Oil Fund.

Appendix 5

Laws and Decrees Concerning Oil Revenue Management in Chad

LOI N° 001/PR/99

PORTANT GESTION DES REVENUS PETROLIERS

Vu la Constitution,

L'Assemblée Nationale a délibéré et adopté en sa séance du 30 Décembre 1998 ;

Le Président de la République promulgue la Loi dont la teneur suit:

CHAPITRE I : DES DISPOSITIONS GENERALES.

Article 1 : La présente Loi a pour objet de déterminer les modalités de gestion des revenus pétroliers provenant de l'exploitation des trois (3) **champs de KOME, MIANDOUM et BOLOBO.**

Article 2: Les revenus pétroliers sont constitués par des ressources directes et des ressources indirectes ;

Les ressources directes comprennent les dividendes et les redevances;

Les ressources indirectes comprennent les impôts, taxes et droits de Douanes liés à l'exploitation pétrolière.

Article 3 : Les ressources directes citées à l'alinéa 2 de l'article 2 sont déposées sur le compte d'une institution financière internationale spécialement ouvert pour l'Etat Tchadien et appelé compte séquestre offshore.

Elles sont réparties selon les modalités ci-après :

- 90% sont versées sur des comptes spéciaux du trésor logés dans une ou deux banques primaires de la place ;
- Le reliquat de 10% est déposé dans un compte d'Epargne ouvert dans les conditions prévues à l'article 9 de la présente Loi.

Article 4 : Les ressources indirectes, impôts, taxes et droit de Douanes, sont déposées directement sur les comptes du Trésor Public.

Article 5 : Les différentes ressources citées à l'article 2 de la présente Loi sont intégralement inscrites au Budget Général de l'Etat.

Article 6 : L'affectation des revenus est effectuée selon les critères définis au Chapitre II de la présente Loi.

CHAPITRE II : DE L'AFFECTION DES REVENUS.

SECTION 1 : DES SECTEURS PRIORITAIRES ET DE LA REPARTITION REGIONALE.

Article 7 : Les ressources directes sont principalement affectées aux secteurs prioritaires. Sont considérés comme prioritaires, les secteurs de la Santé Publique et des Affaires Sociales ; de l'Enseignement des Infrastructures ; du Développement Rural (Agriculture et Elevage) de l'Environnement et des ressources en eau.

Article 8 : Les ressources directes, constituées des dividendes et des redevances déposées sur les comptes spéciaux prévus à l'alinéa 2 de l'article 3 ci-dessus sont affectées de la manière suivante :

- a) Quatre vingt pour cent (80%) sont destinés aux dépenses relatives aux secteurs prioritaires énumérés à l'alinéa 2 de l'article 7 ;
- b) Quinze pour cent (15%) sont destinées à couvrir les dépenses de fonctionnement et d'investissement courants de l'Etat, pour une période de cinq ans à compter de la date de production.;
- c) Cinq pour cent (5%) des redevances sont destinés aux collectivités décentralisées de la région productrice conformément aux dispositions de l'article 212 de la Constitution;

Ce montant peut être révisé par décret tous les cinq ans en fonction des ressources disponibles, des besoins et de la capacité d'absorption de la région;

La gestion de ce fonds ainsi que les modalités de contrôle se feront conformément aux textes en vigueur en matière de comptabilité publique.

SECTION 2 : DE L'EPARGNE.

Article 9 : Le reliquat de dix pour cent (10%) des ressources directes : redevances et dividendes mentionnées à l'article 3 de la présente Loi est déposé sur un Compte d'Epargne ouvert dans une institution financière internationale au profit des générations futures, conformément à la réglementation de la Banque des Etats de l'Afrique Centrale (BEAC).

CHAPITRE III : DES MECANISMES DE GESTION DES COMPTES SPECIAUX.

SECTION 1 : DU FONCTIONNEMENT.

Article 10 : Le mécanisme de gestion des comptes spéciaux, obéit à l'orthodoxie budgétaire de l'Etat à savoir le respect des procédures d'approbation, de décaissement de suivi et de contrôle du budget général de l'Etat.

Article 11 : Les comptes spéciaux sont logés dans une ou deux Banques Commerciales primaires de la place certifiées par la COBAC. Ils sont directement alimentés par le compte séquestre prévu à l'article 3 alinéa 1 de la présente Loi.

SECTION 2 : DES CRITERES DE DECAISSEMENT.

Article 12 : Les fonds déposés sur les comptes spéciaux en vue du financement des dépenses dans les secteurs prioritaires sont engagés conformément au programme de dépenses publiques élaboré chaque année par le Gouvernement.

Le programme s'inscrit dans un cadre triennal de développement et sert de référence à la Loi des Finances. Il fait l'objet d'une revue annuelle par le Gouvernement.

Les dépenses sur les recettes pétrolières dans les secteurs prioritaires viendront en sus du budget général de l'année fiscale précédent les premières recettes pétrolières selon le principe d'additionnalité.

Article 13 : Les demandes de décaissement de l'Ordonnateur du Budget Général de l'Etat doivent être effectuées conformément aux procédures prévues par la Loi des Finances et être soumises à l'autorisation expresse du Collège de Contrôle et de Surveillance des Ressources Pétrolières.

CHAPITRE IV : DES INSTITUTIONS DE CONTROLE.

Article 14 : Le contrôle de la mobilisation et de l'utilisation des revenus pétroliers est effectué séparément ou conjointement par le Contrôleur Financier du Ministère des Finances et de l'Economie, le CCSRP, la Chambre des Comptes de la Cour Suprême et le Parlement.

SECTION 1 : DU COLLEGE DE CONTROLE ET DE SURVEILLANCE DES RESSOURCES PETROLIERES (CCSRP).

Article 15 : Il est institué un Collège de Contrôle et de Surveillance des Ressources Pétrolières (CCSRP).

Article 16: Le CCSRP est composé de la manière suivante :

- un Magistrat membre de la Cour Suprême
- un Député
- un Sénateur
- le Directeur Nationale de la BEAC
- le Directeur du Trésor
- le Directeur du Pétrole
- le Directeur de la Planification et du Développement
- un Représentant des ONG locales
- un Représentant des Syndicats.

Article 17 : Les membres du **CCSRP** représentant le Parlement, la Cour Suprême, les ONG nationales et les Syndicats sont désignés et nommés pour un mandat de trois (3) ans renouvelable une seule fois.

Article 18 : Le CCSRP a pour mission de :

- a) vérifier la conformité des engagements sur les comptes spéciaux avec la Loi des Finances.
- b) d'autoriser et de contrôler les décaissements des comptes spéciaux et l'affectation des fonds.

Article 19: Un Décret déterminera les modalités de fonctionnement, d'organisation et les conditions de contrôle et de surveillance exercés par le CCSRP.

SECTION 2 : DES AUTRES INSTITUTIONS DE CONTROLE.

Article 20 : Il est effectuée par le Parlement un contrôle des affectations des revenus pétroliers à travers l'adoption et le suivi de l'exécution du Budget Général de l'Etat.

Article 21 : La Chambre des Comptes de la Cour Suprême exerce un contrôle de légalité des dépenses de l'Etat par l'arrêt officiel des comptes des recettes et par le contrôle des dispositions légales sur la répartition des ressources entre le Budget général de l'Etat et les collectivités décentralisées ainsi que des dispositions régissant la Constitution des réserves ou le placement à l'étranger des ressources excédentaires.

SECTION 3 : DES MODALITES DE SUIVI.

Article 22 : Le suivi de la mobilisation, de l'affectation et de l'utilisation des revenus pétroliers est assuré grâce à des audits et rapports produits périodiquement à l'attention du Gouvernement et notamment :

- les audits annuels des comptes spéciaux et du Compte d'Epargne au profit des générations futures ;
- les rapports périodiques de gestion du Compte d'Epargne pour les générations futures et des comptes d'épargne des éventuels surplus de financement ;
- les rapports périodiques du CCSRP ;
- les rapports et audits de la COBAC sur les banques primaires assurant la gestion des comptes spéciaux spécifiques ;
- les audits annuels des comptes d'exécution du Budget Général de l'Etat établis par la Chambre des Comptes.

Ces différents rapports et audits feront l'objet d'une publication annuelle par le Gouvernement.

CHAPITRE V : DES DISPOSITIONS FINALES:

Article 23 : La présente Loi sera enregistrée, publiée au Journal Officiel de la République et exécutée comme Loi de l'Etat.

LOI N° 016/PR/2000

Portant modification de la Loi n° 001/PR/99 du

11 Janvier 1999 portant Gestion des Revenus Pétroliers

Vu la Constitution ;

L'Assemblée Nationale a délibéré et adopté en sa séance du 26 Juillet 2000 ;

Le Président de la République promulgue la Loi dont la teneur suit:

Article 1 : La Loi n° 001PR/99 du 11 Janvier 1999 portant gestion des revenus pétroliers est modifiée comme suit :

Au, lieu de

Article 16 (ancien) : Le CCSTP est composé de la manière suivante :

- Un magistrat membre de la Cour Suprême
- Un Député
- Un Sénateur
- Le Directeur National de la BEAC

- Le Directeur du Trésor
- Le Directeur du Pétrole
- Le Directeur de la Planification et du Développement
- Un représentant des ONG locales
- Un représentant des Syndicats.

Lire :

Article 16 (nouveau) : Le Collège de Contrôle et de Surveillance des Ressources Pétrolières (CCRSP) est un organe indépendant composé de la manière suivante :

- un magistrat membre de la Cour Suprême ;
- un Député ;
- un Sénateur ;
- le Directeur National de la BEAC ;
- le Directeur du Trésor
- quatre (4) représentants de la société civile.

Le reste du texte sans changement.

Article 2 : La présente Loi sera enregistrée, publiée au journal Officiel de la République et exécutée comme Loi de l'Etat.

Décret N° 238/PR/MEF/03

portant mise en place du mécanisme de stérilisation des revenus pétroliers provenant de l'exploitation des trois champs de Komé, Miandoum et Bolobo.

Vu la Constitution ;

Vu la Loi n° 001/PR/99 du 11 Janvier 1999 portant Gestion des Revenus Pétroliers ;

Vu la Loi n° 016/PR/2000 du 18 août 2000 portant modification de la Loi n° 001/PR/99 du 11 Janvier 1999 portant Gestion des Revenus Pétroliers;

Vu la Loi n° 006/PR/2001 du 20 avril 2001 portant ratification de l'accord de prêt en date du 29 mars 2001 entre la République du Tchad et la Banque Internationale pour la Reconstruction et le Développement pour le projet d'Exploitation Pétrolière et d'Oléoduc ;

Vu les Accords de Coopération Monétaire signés entre les Etats membres de la BEAC et la République Française du 23 novembre 1972 ;

Vu le Décret n° 230/PR/2003 du 24 Juin 2003 portant nomination du Premier Ministre, Chef du Gouvernement ;

Vu le Décret n° 231/PR/PM/2003 du 25 Juin 2003 portant nomination des membres du Gouvernement ;

Vu le Décret n° 331/PR/PM/02 du 26 Juillet 2002 portant structure générale du Gouvernement et attributions de ses membres ;

Vu le Décret n° 141/PR/MEF/03 du 8 mai 2003 portant organigramme du Ministère de l'Economie et des Finances ;

Sur proposition du Ministre de l'Economie et des Finances

Le Conseil des Ministres entendu en sa séance du 19 Juin 2003.

DECRETE

TITRE I : DES DISPOSITIONS GENERALES

Article 1 : Le présent Décret met en place un mécanisme de stérilisation des revenus pétroliers provenant de l'exploitation des trois champs de Komé, Miandoum et Bolobo.

Article 2 : Le mécanisme de stérilisation a pour objet d'éviter toute situation susceptible de créer une liquidité excessive dans l'économie et de mettre en péril la stabilité macroéconomique du pays.

TITRE II : DU FONCTIONNEMENT DU MECANISME DE STERILISATION DES REVENUS PETROLIERS

Chapitre I : Des Revenus Pétroliers Directs

Article 3 : Le rapatriement au Tchad des Revenus Pétroliers, à l'exclusion de ceux affectés au Fonds pour les Générations Futures (10 pour cent des Revenus Pétroliers Directs) qui font l'objet d'une gestion spécifique, à partir du compte séquestre offshore vers le compte spécial du Trésor auprès de la Banque Commerciale, se fait à travers la BEAC, conformément à la réglementation des changes en vigueur dans la Communauté Economique et Monétaire de l'Afrique Centrale (CEMAC).

Article 4 : Aux termes d'un contrat passé avec l'Etat, la Banque commerciale reverse dans un second temps sur le Compte de répartition des revenus directs à la BEAC l'ensemble des montants reçus du compte séquestre offshore. Le contrat liant la Banque commerciale à l'Etat pour deux années renouvelables prévoit le montant de la commission versée à la Banque commerciale pour cette opération, et la rémunération des dépôts sur le compte spécial du Trésor. Le contrat précise également que seuls les Revenus Pétroliers directs pourront alimenter le Compte spécial du Trésor.

Article 5 : Aux termes d'un contrat passé avec l'Etat, la BEAC répartit les montants des Revenus pétroliers directs que la Banque commerciale a reversés dans le Compte de répartition des revenus directs de la manière suivante:

* 5% des redevances seront versées sur le Compte de la région productrice ;

* jusqu'au 31 décembre 2007, 15% du montant total reçu sera versé dans le compte courant du Trésor ouvert à la BEAC ;

* le solde restant est versé sur le compte de stabilisation à partir duquel la BEAC reverse à la Banque commerciale tous les trimestres les montants nécessaires à l'exécution du budget, selon la programmation financière de l'Etat.

Article 6 : Le contrat liant l'Etat à la BEAC prévoit :

- les montants à transférer du compte de stabilisation vers le compte spécial du Trésor sont communiqués par l'Ordonnateur du Budget Général de l'Etat à la BEAC chaque trimestre ;
- que seuls les transferts vers le compte spécial du Trésor sont autorisés à partir du compte de stabilisation ;
- la rémunération accordée aux dépôts du compte de stabilisation.

Chapitre II. Des Revenus Pétroliers Indirects

Article 7 : Les Revenus Pétroliers Indirects rapatriés au Tchad depuis le compte séquestre offshore seront directement logés dans le compte courant du Trésor ouvert à la BEAC afin d'assurer la stérilisation automatique de tous les revenus excédant les montants de dépenses financées sur Ressources budgétaires non pré-affectées, programmées par l'Etat dans le cadre de l'exécution du budget.

TITRE III: DES DISPOSITIONS DIVERSES ET FINALES

Article 8 : Les définitions portées en annexe font partie intégrante du présent décret.

Article 9 : Le Ministre de l'Economie et des Finances est chargé de l'application du présent Décret qui prend effet pour compter de la date de sa signature ; sera enregistré et publié au journal officiel de la République.

ANNEXE AU DECRET N° 238/PR/MEF/03

Dans le présent Décret, il faut entendre par :

Banque commerciale : la banque commerciale retenue, après consultation avec la Banque Mondiale conformément aux dispositions de l'Accord de prêt en date du 29 mars 2001 entre la République du Tchad et la Banque Internationale pour la Reconstruction et le Développement pour le projet d'Exploitation Pétrolière et d'Oléoduc, ratifié par la Loi n° 006/PR/2001 du 20 avril 2001, sur la base d'un appel d'offres restreint auprès des trois banques primaires les mieux cotées par la Commission Bancaire de l'Afrique Centrale (COBAC) permettant d'obtenir le meilleur contrat, suivant les caractéristiques décrites à l'article 4 du présent Décret ;

Compte séquestre offshore : le compte ouvert auprès d'une institution financière internationale au nom de l'Etat tchadien pour recevoir les revenus pétroliers, conformément à l'article 3 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de Gestion des Recettes Pétrolières ;

Compte de stabilisation : le compte ouvert à la Banque des Etats de l'Afrique Centrale (BEAC) au nom de l'Ordonnateur du Budget Général aux fins de stabilisation des dépenses dans les secteurs prioritaires, conformément à l'article 5 du présent Décret ;

Compte spécial du Trésor : le compte ouvert dans la Banque commerciale au nom de l'Ordonnateur du Budget Général pour loger les recettes pétrolières directes destinées au financement du Budget Général de l'Etat ;

Compte de la région productrice : le compte ouvert à la Banque des Etats de l'Afrique Centrale (BEAC) pour recevoir les revenus pétroliers directs alloués à la région productrice ;

Compte de répartition des revenus directs : le compte ouvert au nom de l'Ordonnateur du Budget Général de l'Etat auprès de la Banque des Etats de l'Afrique Centrale (BEAC) pour recevoir l'ensemble des revenus directs reversés par la Banque commerciale, et à partir duquel seuls les transferts vers le compte de la région productrice, le compte de stabilisation et le compte courant du Trésor à la BEAC sont autorisés ;

Fonds pour les Générations Futures : le compte d'épargne dans lequel sont déposés au profit des générations futures 10% des Revenus Pétroliers Directs, conformément à l'article 9 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières ;

Revenus Pétroliers Directs : l'ensemble des redevances et dividendes, conformément à l'article 2 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières ;

Revenus Pétroliers Indirects : l'ensemble des impôts, taxes et droits de douanes liés à l'exploitation pétrolière, conformément à l'article 2 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et à l'Accord de prêt en date du 29 mars 2001 entre la République du Tchad et la Banque Internationale pour la Reconstruction et Développement pour le Projet de l'Exploitation Pétrolière et d'Oléoduc ;

Revenus Pétroliers Directs pré-affectés : l'ensemble des Revenus Pétroliers Directs pré-affectés aux dépenses additionnelles dans les secteurs prioritaires, conformément à la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières, soit quatre vingt pour cent des redevances et quatre vingt cinq pour cent des dividendes, après déduction des montants destinés au Fonds pour les générations futures, auxquels s'ajoutent après le 31 décembre 2007 quinze pour cent des redevances et dividendes, après déduction des montants destinés au Fonds pour les générations futures ;

Revenus Pétroliers Directs alloués à la région productrice : cinq pour cent des redevances, après déduction des montants destinés au Fonds pour les générations futures, conformément à la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières ;

Ressources budgétaires non pré-affectées : l'ensemble des ressources budgétaires à l'exclusion des Revenus Pétroliers Directs pré-affectés et des Revenus pétroliers directs alloués à la région productrice.

Dans le présent Décret, il faut entendre par :

Banque commerciale : la Banque commerciale retenue, après consultation avec la Banque Mondiale conformément aux dispositions de l'Accord de prêt en date du 29 mars 2001 entre la République du Tchad et la Banque Internationale pour la Reconstruction et le Développement pour le projet d'Exploitation Pétrolière et d'Oléoduc, ratifié par la Loi n° 006/PR/2001 du 20 avril 2001, sur la base d'un appel d'offres restreint auprès des trois banques primaires les mieux cotées par la Commission Bancaire de l'Afrique Centrale (COBAC) permettant d'obtenir le meilleur contrat, suivant les caractéristiques décrites à l'article 4 du présent Décret ;

Compte spécial du Trésor : le compte ouvert dans la Banque commerciale au nom de l'Ordonnateur du Budget général pour loger les recettes pétrolières directes destinées au financement du Budget général de l'Etat;

Compte de stabilisation : le compte ouvert à la Banque des Etats de l'Afrique Centrale (BEAC) au nom de l'Ordonnateur du Budget Général aux fins de stabilisation des dépenses dans les secteurs prioritaires, conformément à l'article 5 du présent Décret ;

Consortium : le Consortium constitué des sociétés *ESSO EXPLORATION AND PRODUCTION CHAD, Inc., Petronas Carigali (Chad EP), Inc., et Chevron Petroleum Chad Company Ltd*, qui sont parties à la convention de Recherche, d'Exploitation et de Transport des Hydrocarbures signée avec la République du Tchad le 19 décembre 1988 ;

Fonds pour les générations futures : le compte d'épargne dans lequel sont déposés au profit des générations futures 10% des Revenus Pétroliers Directs, conformément à l'article 9 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières ;

Prix effectif: le prix du pétrole brut tchadien provenant des trois champs de Komé, Miandoum et Bolobo, en francs CFA, utilisé pour valoriser la redevance sur la production versée en espèce par le Consortium ; il est égal "au prix du marché départ champ" tel que défini à l'article 21.3 de la Convention de Recherche, d'Exploitation et de Transport des Hydrocarbures entre la République du Tchad et le Consortium en date du 19 décembre 1988 ;

Prix de référence : le prix du tchadien provenant des trois champs de Komé, Miandoum et Bolobo, en francs CFA, utilisé dans les prévisions des revenus pétroliers du Budget Général de l'Etat. Ce prix est estimé à partir des prévisions des Perspectives Economiques Mondiales du Fonds Monétaire International, les plus récentes au moment de l'élaboration budgétaire, du prix du baril du brut de référence de Brent, du cours du dollar américain par rapport à l'euro, et d'une estimation de la valorisation du pétrole de Doba et du coût du transport. La valorisation est estimée par le Ministère en charge des affaires pétrolières en application de son modèle de valorisation; le coût du transport est celui fixé dans le contrat le plus récent conclu entre le Consortium, la Tchad Oil Transportation Company et la Cameroon Oil Transportation Company, et approuvé par le Ministre en charge des affaires pétrolières, conformément aux dispositions de l'article 14.9 de la Convention de Recherche, d'Exploitation et de Transport des Hydrocarbures entre la République du Tchad et le Consortium en date du 19 décembre 1988 ;

Revenus pétroliers effectifs : les revenus pétroliers versés à l'Etat tchadien, valorisés au prix effectif .

Décret N° 239/PR/MEF/03

portant mise en place du mécanisme de stabilisation

des dépenses financées au moyen des revenus pétroliers.

Vu la Constitution ;

Vu la Loi n° 001/PR/99 du 11 Janvier 1999 portant Gestion des Revenus Pétroliers ;

Vu la Loi n° 016/PR/2000 du 18 août 2000 portant modification de la Loi n° 001/PR/99 du 11 Janvier 1999 portant Gestion des Revenus Pétroliers ;

Vu la Loi n° 006/PR/2001 du 20 avril 2001 portant ratification de l'accord de prêt en date du 29 mars 2001 entre la République du Tchad et la Banque Internationale pour la Reconstruction et le Développement pour le projet d'Exploitation Pétrolière et d'Oléoduc ;

Vu le Décret n° 230/PR/2003 du 24 Juin 2003 portant nomination du Premier Ministre, Chef du Gouvernement ;

Vu le Décret n° 231/PR/PM/2003 du 25 Juin 2003 portant nomination des membres du Gouvernement ;

Vu le Décret n° 331/PR/PM/02 du 26 Juillet 2002 portant structure générale du Gouvernement et attributions de ses membres ;

Vu le Décret n° 141/PR/MEF/03 du 8 mai 2003 portant organigramme du Ministère de l'Economie et des Finances ;

Vu le Décret n° 238/PR/MEF/03 du 1er Juillet 2003 portant mise en place du mécanisme de stérilisation des Revenus Pétroliers ;

Sur proposition du Ministre de l'Economie et des Finances.

Le Conseil des Ministres entendu en sa séance du 19 Juin 2003.

DECRETE

TITRE I : DES DISPOSITIONS GENERALES

Article 1 : Le présent Décret met en place un mécanisme de stabilisation des dépenses financées au moyen des revenus pétroliers provenant de l'exploitation des trois champs de Komé, Miandoum et Bolobo.

Article 2 : Le mécanisme de stabilisation a pour objet :

- d'assurer un financement stable aux dépenses de réduction de la pauvreté, et d'assurer leur soutenabilité à long terme ;
- d'éviter la procyclicité des dépenses ;
- d'assurer l'efficacité des dépenses financées par les revenus pétroliers ;
- de promouvoir la discipline budgétaire et réduire la vulnérabilité des finances publiques aux chocs extérieurs ;
- d'assurer le caractère additionnel des dépenses dans les secteurs prioritaires financées par les revenus pétroliers directs pré-affectés.

TITRE II : DU MECANISME DE STABILISATION DES DEPENSES

FINANCEES AU MOYEN DES REVENUS PETROLIERS.

Chapitre I : Du Fonctionnement du Mécanisme

Article 3 : Le principe de stabilisation repose sur l'utilisation de l'écart entre les ressources budgétaires effectives et les dépenses inscrites au Budget Général de l'Etat.

Article 4 : La stabilisation des dépenses financées par les revenus pétroliers directs pré-affectés se fait par l'utilisation d'un compte de stabilisation ouvert à la BEAC, dont l'alimentation se fait par l'excédent de ces revenus sur les dépenses qu'ils financent suivant les dispositions de l'article 5 du décret n° 238/PR/MEF/03 portant mise en place du mécanisme de stérilisation des revenus pétroliers.

Article 5 : Tout excédent des ressources budgétaires non pré-affectées, sur les prévisions de dépenses financées par ces mêmes ressources, est également épargné dans le compte courant du Trésor ouvert à la BEAC.

Article 6 : Le montant prévisionnel versé au compte de stabilisation chaque année fait l'objet d'une inscription à la Loi de finances au titre des transferts.

Chapitre II : La Programmation Des Dépenses

Article 7 : La programmation des dépenses est fonction :

- du cadre macroéconomique à long terme du Document de Réduction de la Pauvreté (DSRP), régulièrement mis à jour.
- du cadre des dépenses à moyen terme, mis à jour chaque année, notamment à partir des conclusions des revues des dépenses publiques.

Les prévisions des dépenses dans les secteurs prioritaires se feront de surcroît en fonction des budgets de programmes mis à jour chaque année.

Les dépenses dans les secteurs prioritaires ne peuvent faire l'objet de mesures de gel ou de plafonnement en cours d'exercice budgétaire.

Article 8 : L'existence d'un écart positif entre les revenus pétroliers directs pré-affectés effectifs et revenus pétroliers directs pré-affectés de référence ne donne pas lieu à une révision du programme des dépenses.

Revenus pétroliers de référence : les revenus pétroliers, valorisés au prix de référence. Ces revenus sont calculés à l'aide du modèle de projection utilisé par une équipe conjointe du Ministère de l'Economie et des Finances et du Ministère du Pétrole, la responsabilité de la détermination des recettes revenant en dernier ressort au Ministère de l'Economie et des Finances. Dans un premier temps, dans l'attente de la spécification d'un modèle de prévision tchadien, le modèle utilisé sera celui développé par le Consortium ;

Revenus Pétroliers Directs : l'ensemble des redevances et dividendes, conformément à l'article 2 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières ;

Revenus pétroliers directs pré-affectés : l'ensemble des revenus pétroliers directs pré-affectés aux dépenses additionnelles dans les secteurs prioritaires, conformément à la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières, soit quatre vingt pour cent des redevances et quatre vingt cinq pour cent des dividendes, après déduction des montants destinés au Fonds pour les Générations Futures, auxquels s'ajoutent après le 31 décembre 2007 quinze pour cent des redevances et dividendes, après déduction des montants destinés au Fonds pour les générations futures ;

Revenus pétroliers directs alloués à la région productrice : cinq pour cent des redevances, après déduction des montants destinés au Fonds pour les générations futures, conformément à la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières ;

Revenus Pétroliers Indirects : l'ensemble des impôts, taxes et droits de douanes liés à l'exploitation pétrolière, conformément à l'article 2 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et à l'Accord de prêt en date du 29 mars 2001 entre la République du Tchad et la Banque Internationale pour la Reconstruction et Développement pour le Projet de l'Exploitation Pétrolière et d'Oléoduc ;

Ressources budgétaires non pré-affectées : l'ensemble des ressources budgétaires à l'exclusion des Revenus pétroliers directs pré-affectés et des Revenus pétroliers directs alloués à la région productrice ;

Secteurs prioritaires : secteurs définis à l'article 7 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et dans le programme de gestion des recettes pétrolières.

Tout surplus est systématiquement épargné dans le compte de stabilisation, en sus de l'épargne éventuelle initialement prévue au budget.

Article 9 : Au cas où les revenus pétroliers directs pré-affectés effectifs sont inférieurs aux dépenses qu'ils doivent financer, l'écart est compensé par le recours à l'épargne constituée dans le compte de stabilisation.

Article 10 : Au cas où les revenus pétroliers directs effectifs sont inférieurs de plus de 20 pour cent aux revenus pétroliers directs de référence pendant plus de trois mois consécutifs, le cadrage macroéconomique et le cadre des dépenses à moyen terme sont révisés, et le programme de dépenses ajusté en conséquence.

Article 11 : La part, en terme d'allocation, des dépenses prioritaires financées par les ressources budgétaires non pré-affectées dans l'ensemble des dépenses financées par ces mêmes ressources est au moins égal à son niveau de 2002, soit 42,6 pour cent.

Article 12 : Le montant des dépenses dans les secteurs prioritaires financées par les ressources budgétaires non pré-affectées qui ne seraient pas exécutées au cours d'un exercice budgétaire donné est systématiquement rajouté au programme des dépenses établi suivant les principes définis ci-dessus de l'exercice suivant.

TITRE III : DES DISPOSITIONS DIVERSES ET FINALES

Article 13 : Les définitions portées en annexe font partie intégrante du présent Décret.

Article 14 : La Chambre des Comptes de la Cour Suprême exerce un contrôle de légalité sur le fonctionnement du compte de stabilisation des revenus pétroliers. Le Collège de Contrôle et de Surveillance des Revenus Pétroliers (CCSRP) exerce un contrôle sur le fonctionnement du mécanisme de stabilisation.

Article 15 : Le Ministre de l'Economie et des Finances est chargé de l'application du présent Décret qui prend effet pour compter de la date de sa signature; sera enregistré et publié au Journal Officiel de la République.

ANNEXE AU DECRET N° 239/PR/MEF/03

Dans le présent Décret, il faut entendre par :

Banque commerciale : la banque commerciale retenue, après consultation avec la Banque Mondiale conformément aux dispositions de l'Accord de prêt en date du 29 mars 2001 entre la République du Tchad et la Banque Internationale pour la Reconstruction et le Développement pour le projet d'Exploitation Pétrolière et d'Oléoduc, ratifié par la Loi n° 006/PR/2001 du 20 avril 2001, sur la base d'un appel d'offres restreint auprès des trois banques primaires les mieux cotées par la Commission Bancaire de l'Afrique Centrale (COBAC) permettant d'obtenir le meilleur contrat, suivant les caractéristiques décrites à l'article 4 du présent Décret ;

Compte spécial du Trésor : le compte ouvert dans la Banque commerciale au nom de l'Ordonnateur du Budget Général pour loger les recettes pétrolières directes destinées au financement du Budget général de l'Etat ;

Compte de stabilisation : le compte ouvert à la Banque des Etats de l'Afrique Centrale (BEAC) au nom de l'Ordonnateur du Budget Général aux fins de stabilisation des dépenses dans les secteurs prioritaires, conformément à l'article 5 du présent Décret ;

Consortium : le Consortium constitué des sociétés *ESSO EXPLORATION AND PRODUCTION CHAD, Inc., Petronas Carigali (Chad EP), Inc., et Chevron Petroleum Chad Company Ltd*, qui sont parties à la

convention de Recherche, d'Exploitation et de Transport des Hydrocarbures signée avec la République du Tchad le 19 décembre 1988 ;

Fonds pour les Générations Futures : le compte d'épargne dans lequel sont déposés au profit des générations futures 10% des revenus pétroliers directs, conformément à l'article 9 de la Loi n° 001/PR/99 modifiée par la Loi n° 016/PR/2000, et au programme de gestion des recettes pétrolières ;

Prix effectif : le prix du pétrole brut tchadien provenant des trois champs de Komé, Miandoum et Bolobo, en francs CFA, utilisé pour valoriser la redevance sur la production versée en espèce par le Consortium; il est égal "au prix du marché départ champ" tel que défini à l'article 21.3 de la Convention de Recherche, d'Exploitation et de Transport des Hydrocarbures entre la République du Tchad et le Consortium en date du 19 décembre 1988 ;

Prix de référence : le prix du tchadien provenant des trois champs de Komé, Miandoum et Bolobo, en francs CFA, utilisé dans les prévisions des revenus pétroliers du budget général de l'Etat. Ce prix est estimé à partir des prévisions des Perspectives Economiques Mondiales du Fonds Monétaire International, les plus récentes au moment de l'élaboration budgétaire, du prix du baril du brut de référence de Brent, du cours du dollar américain par rapport à l'euro, et d'une estimation de la valorisation du pétrole de Doba et du coût du transport. La valorisation est estimée par le Ministère en charge des affaires pétrolières en application de son modèle de valorisation; le coût du transport est celui fixé dans le contrat le plus récent conclu entre le Consortium, la Tchad Oil Transportation Company et la Cameroon Oil Transportation Company, et approuvé par le Ministre en charge des affaires pétrolières, conformément aux dispositions de l'article 14.9 de la Convention de Recherche, d'Exploitation et de Transport des Hydrocarbures entre la République du Tchad et le Consortium en date du 19 décembre 1988 ;

Revenus pétroliers effectifs : les revenus pétroliers versés à l'Etat tchadien, valorisés au prix effectif.

Appendix 6

Timor Leste Petroleum Fund

6.A: Timor-Leste Petroleum Fund Act

Preamble

This Act establishes a Petroleum Fund which seeks to meet with the constitutional requirement laid down in Article 139 in the Constitution of the Republic. Pursuant to this provision, petroleum resources shall be owned by the State, be used in a fair and equitable manner in accordance with national interests, and the income derived therefrom should lead to the establishment of mandatory financial reserves.

The Petroleum Fund shall contribute to a wise management of the petroleum resources for the benefit of both current and future generations. The Petroleum Fund shall be a tool that contributes to sound fiscal policy, where appropriate consideration and weight is given to the long-term interests of Timor-Leste's citizens.

Efficient planning and proper execution of public sector budgets are key components of a sound management of the petroleum wealth. The Petroleum Fund is to be coherently integrated into the State Budget, and shall give a good representation of the development of public finances. The Petroleum Fund shall be prudently managed and shall operate in an open and transparent fashion, within the constitutional framework.

This Act lays down the key parameters for the operation and management of the Petroleum Fund. The Act governs the collection of and management of receipts associated with the petroleum wealth, regulates transfers to the State Budget, and provides for Government accountability and oversight of these activities.

Therefore, pursuant to Article 139 of the Constitution and for the purpose of establishing a fund of income from the exploitation of non-renewable petroleum resources for the needs of both current and future generations,

The Government presents to the National Parliament, pursuant to paragraph c), item 1, Article 97, and paragraph a), item 2, Article 115, of the Constitution of the Republic, the following draft law:

Chapter I – General Provisions

Article 1

Citation

This Act may be cited as the Petroleum Fund Act.

Article 2

Definitions

2.1 In this Act, unless the context requires otherwise:

- (a) “Central Bank” means the authority to be established under Section 143 of the Constitution of the Republic or, until such authority is established, the Banking and Payments Authority;
- (b) “Code” means the Petroleum Mining Code and the Interim Petroleum Mining Code agreed and adopted by Timor-Leste and Australia under Article 7 of the Treaty, as amended, varied, modified or replaced from time to time, and regulations made and directions given under it;
- (c) “estimated sustainable income” for a fiscal year means the amount determined in accordance with the formula set out in Schedule 1;
- (d) “Exchange of Notes” means:
 - (i) Exchange of Notes Constituting an Agreement between the Government of Australia and the United Nations Transitional Administration in East Timor, of 10 February 2000; or
 - (ii) Exchange of Notes Constituting an Agreement between the Government of Timor-Leste and the Government of Australia, of 20 May 2002.
- (e) “fiscal year” means the period of twelve (12) months from 1st July to 30th June;
- (f) “independent auditor” means an internationally recognised accounting firm appointed for the purpose of auditing the Government accounts as set out in the Timor-Leste law until the administrative, tax and audit courts is established, or thereafter an internationally recognised accounting firm appointed pursuant to Article 34;

- (g) “investment manager” means the Central Bank and any person appointed as external investment manager under Article 12;
- (h) “Minister” means the Minister in charge of finances;
- (i) “Parliament” means the National Parliament of Timor-Leste;
- (j) “payer” means any entity on whom there is an obligation pursuant to this present Act to make a payment into the Petroleum Fund;
- (k) “petroleum” has the same meaning given to it in the Petroleum Act;
- (l) “Petroleum Act” means the Petroleum Act, 2005, as amended, varied, modified or replaced from time to time, and regulations made and directions given under it;
- (m) “petroleum authorisation” means:
 - (i) an access authorisation, a petroleum contract, a prospecting authorisation or a seepage use authorisation, or any agreement made in respect of such an authorisation or contract, granted or entered into under the Petroleum Act; or
 - (ii) an authorisation or production sharing contract, or any agreement made in respect of such an authorisation or contract, granted or entered into under the Code;
- (n) “Petroleum Fund” means the Petroleum Fund for Timor-Leste established under Article 5;
- (o) “Petroleum Fund receipts” has the meaning given to it in Article 6;
- (p) “petroleum operations” means authorised activities under a petroleum authorisation;
- (q) “State Budget” means the State Budget referred to under Section 145 of the Constitution of the Republic;
- (r) “tax revenue” means any tax or duty imposed under Timor-Leste law;
- (s) “Timor-Leste” means the Democratic Republic of Timor-Leste; and
- (t) “Treaty” means the Timor Sea Treaty between the Government of Timor-Leste and the Government of Australia signed on 20th May 2002, as amended, varied, modified or replaced from time to time.

2.2 All terms in the present Act that are defined in the Timor-Leste law on budget and financial management have the same meaning given to it in that law.

Article 3

Scope of the Act

This Act shall provide for the establishment and management of the Petroleum Fund, and the procedural rules relating thereto.

Article 4

Inconsistencies

For the purposes of this present Act, in the event of any inconsistency between the provisions of the Act and the provisions in the law of Timor-Leste on budget and financial management, or between the provisions of the Act and the terms of a petroleum authorization, the provisions of the present Act shall prevail.

Chapter II – The Petroleum Fund for Timor-Leste

Article 5

Petroleum Fund for Timor-Leste

5.1 There is hereby established a fund known as the Petroleum Fund for Timor-Leste.

5.2 The Petroleum Fund shall have an earmarked receipts account, held by the Central Bank in compliance with Articles 14 and 15, into which the Petroleum Fund receipts set out in Article 6 are credited.

5.3 Transfers from the Petroleum Fund shall be made only in accordance with Articles 7 to 10.

5.4 The details concerning the account referred to in Article 5.2, and the State Budget account referred to in Article 7.1, shall be made public through the publication of the operational management agreement to which Article 11.3 refers.

Article 6

Petroleum Fund Receipts

6.1 The following amounts are Petroleum Fund gross receipts:

- (a) the gross revenue, including tax revenue, of Timor-Leste from any petroleum operations, including prospecting or exploration for, and development, exploitation, transportation, sale or export of petroleum, and other activities relating thereto;
- (b) any amount received by Timor-Leste from the Designated Authority pursuant to the Treaty;
- (c) any amount received by Timor-Leste from the investment of Petroleum Fund receipts;
- (d) any amount received from direct or indirect participation of Timor-Leste in petroleum operations; and
- (e) any amount received by Timor-Leste relating, directly or indirectly, to petroleum resources not covered in paragraphs (a) to (d) above.

6.2 In the event that Timor-Leste participates in petroleum operations indirectly, as provided for in paragraph (d) of Article 6.1, through a national oil company, the receipts of the Petroleum Fund shall include the following:

- (a) any amount payable by the national oil company as tax, royalty or any other due in accordance with Timor-Leste law; and
- (b) any amount paid by the national oil company as dividend.

6.3. From the amount received in accordance with Article 6.1, the Central Bank shall be entitled to deduct, by direct debit of the Petroleum Fund account, any reasonable management expenses, as provided for in the operational management agreement referred to in Article 11.3.

Article 7

Transfers

7.1 Subject to Article 6.3, the only debits permitted to the Petroleum Fund are electronic transfers made in accordance with this present article, as well as Articles 8 to 10, to the credit of a single State Budget account.

7.2 The total amount transferred from the Petroleum Fund for a fiscal year shall not exceed the appropriation amount approved by Parliament for the fiscal year.

7.3. Subject to Article 8 to 10, transfers from the Petroleum Fund by the Central Bank in the fiscal year, shall only take place after publication of the budget law, or any subsequent changes thereto, in the *Jornal da República*, confirming the appropriation amount approved by Parliament for that fiscal year.

Article 8

Requirements for Transfers

No transfer shall be made from the Petroleum Fund in the fiscal year unless the Government has first provided Parliament with reports:

- (a) specifying the estimated sustainable income for the fiscal year for which the transfer is made;
- (b) specifying the estimated sustainable income for the preceding fiscal year; and
- (c) from the independent auditor certifying the amount of the estimated sustainable income in paragraphs (a) and (b).

Article 9

Transfers Exceeding the Estimated Sustainable Income

No transfer shall be made from the Petroleum Fund in a fiscal year in excess of the estimated sustainable income for the fiscal year unless the Government has first provided Parliament with:

- (a) the reports described in paragraphs (a) and (b) of Article 8;
- (b) a report estimating the amount by which the estimated sustainable income for fiscal years commencing after the fiscal year for which the transfer is made will be reduced as a result of the transfer from the Petroleum Fund of an amount in excess of the estimated sustainable income of the fiscal year for which the transfer is made;
- (c) a report from the independent auditor certifying the estimates of the reduction in estimated sustainable income in paragraph (b); and
- (d) a detailed explanation of why it is in the long-term interests of Timor-Leste to transfer from the Petroleum Fund an amount in excess of the estimated sustainable income.

Article 10

Transfers for Purposes of Refund of Tax

If required under the law of Timor-Leste, transfers from the Petroleum Fund are exceptionally permitted for purposes of refund of tax, in the event of overpayment of tax under paragraph (a) of Article 6.1. This amount represents a reduction of the Petroleum Fund receipts, and shall not be considered as part of the appropriation approved under Article 7.2.

Chapter III – Petroleum Fund Investment and Protection

Article 11

Management of the Petroleum Fund

11.1 The Government is responsible for the overall management of the Petroleum Fund.

11.2 The Minister shall not make any decisions in relation to the investment strategy or management of the Petroleum Fund without first seeking the advice of the Investment Advisory Board in accordance with Article 16.

11.3 The Minister shall enter into an agreement with the Central Bank for the operational management of the Petroleum Fund and the Central Bank shall be responsible for the operational management of the Petroleum Fund.

11.4 The Petroleum Fund shall be managed prudently in accordance with the principle of good governance for the benefit of current and future generations.

Article 12

External Investment Managers

12.1 The Central Bank may propose to the Minister, either of its own motion or at the request of the Minister, the appointment of one or more external investment managers to be responsible for managing the investment of amounts in the Petroleum Fund.

12.2 The Central Bank may select and appoint an external investment manager proposed under Article 12.1 only if the Minister is satisfied that:

- (a) the external investment manager is a legal person with sufficient equity capital and adequate guarantees and insurances against operational risks;
- (b) the external investment manager has a sound record of operational and financial performance; and
- (c) the references and reputation of the external investment manager in the field of fund management are of the highest standard.

12.3 The Central Bank shall be responsible for the tendering procedures required for any appointment made pursuant to Article 12.1, as well as for the contracting of any other professional services under the operational management agreement referred to in Article 11.3, and shall in doing so comply with the substantive provisions of Timor-Leste law.

12.4 The procedures for terminating a contract with an external investment manager shall be laid down in the operational management agreement referred to in Article 11.3.

12.5 The duty of the investment manager is to maximise the return on the Petroleum Fund investments having regard to appropriate risk as indicated by the investments permitted under Articles 14 and 15, any subsidiary legislation under this Act, any instructions by the Minister and the operational management agreement referred to in Article 11.3.

Article 13

Quarterly Reports on the Petroleum Fund

13.1 The Central Bank shall present to the Minister quarterly reports on the performance and activities of the Petroleum Fund no later than twenty (20) days after the end of each quarter.

13.2 The Central Bank shall provide for the publication of its reports no later than forty (40) days after the end of the quarter.

13.3 The Central Bank shall ensure that in releasing, or allowing access to, such reports measures are taken to prevent the disclosure of confidential information.

Article 14

Investment Rules

14.1 Not less than ninety per cent (90%) of the amounts in the Petroleum Fund shall be invested only in qualifying instruments described in Article 15.

14.2 Not more than ten per cent (10%) of the amounts in the Petroleum Fund may be, in accordance with all procedures laid down in this present Act, invested in financial instruments other than those mentioned in Article 15.1, provided that such instruments are:

- (a) issued abroad;
- (b) liquid and transparent;
- (c) traded in a financial market of the highest regulatory standard.

14.3 The range of instruments included as qualifying instruments in Article 15.1 shall be reviewed by the Government, and approved by Parliament, at the end of the first five (5) years of the Petroleum Fund existence, having regard to the size of the Petroleum Fund and the level of institutional capacity.

Article 15

Qualifying Instruments

15.1 Subject other provisions of this present article, a qualifying instrument is:

- (a) a debt instrument denominated in United States Dollars that bears interest or a fixed amount equivalent to interest, that is:
 - (i) rated Aa3 or higher by the Moody's rating agency or rated AA– or higher by Standard & Poor's rating agency; and
 - (ii) issued by or guaranteed by the World Bank or by a sovereign State, other than Timor-Leste, provided the issuer or guarantor is rated Aa3 or higher by the Moody's rating agency or rated AA– or higher by Standard & Poor's rating agency; or
- (b) a United States Dollars deposit with, or a debt instrument denominated in United States Dollars that bears interest or a fixed amount equivalent to interest issued by:
 - (i) the Bank for International Settlements;
 - (ii) the European Central Bank; or
 - (iii) the Central Bank of a sovereign State, other than Timor-Leste, with a long-term foreign currency rating of Aa3 or higher by the Moody's rating agency or AA– or higher by the Standard & Poor's rating agency;
 - (iv) a bank designated by Moody's rating agency with a long-term foreign currency rating of Aa3 or higher or designated by Standard & Poor's rating agency with a long-term foreign currency rating of AA– or higher.

15.2 The investment manager shall dispose of an instrument if it ceases to be a qualifying instrument because of a change in the rating of the instrument or the issuer of the instrument within one month of the instrument ceasing to be a qualifying instrument.

15.3 The average interest rate duration of Petroleum Fund qualifying instruments under Article 15.1 shall be less than six (6) years.

15.4 A derivative instrument is a qualifying instrument only if:

- (a) it is solely based on instruments that satisfy the requirements of Article 15.1; and
- (b) its acquisition reduces the financial exposure to the risks associated with the underlying instrument or instruments.

Article 16

Investment Advisory Board

16.1 There is hereby established an Investment Advisory Board that is responsible for:

- (a) developing for the Minister performance benchmarks of desired returns from, and appropriate risks of, the investments of the Petroleum Fund;
- (b) advising the Minister on the investment instructions that the Minister shall provide to the investment managers of the Petroleum Fund appointed pursuant to Article 12;
- (c) advising the Minister on the performance of the external investment managers and making recommendations to the Minister on the appointment or removal of external investment managers; and
- (d) advising the Minister on the need for changes in the overall investment strategy or management of the Petroleum Fund, including the making of recommendations as to such changes.

16.2 Subject to Article 18, the Minister shall seek the advice of the Investment Advisory Board before making a decision on any matter relating to the investment strategy or management of the Petroleum Fund.

16.3 Any advice given by the Investment Advisory Board on investment strategy or management of the Petroleum Fund shall take into account:

- (a) the overall objective that the Petroleum Fund be a fund of income from the exploitation of non-renewable petroleum resources for the benefit of current and future generations;
- (b) the current conditions, opportunities and constraints in investment markets, and the constraints under which the Central Bank and other key institutions in Timor-Leste operate; and
- (c) the need to ensure that sufficient amounts are available when needed for transfers referred to in Article 7.

16.4 The Investment Advisory Board shall determine the rules of procedure under which it operates.

Article 17

Organisation of the Investment Advisory Board

17.1 The members of the Investment Advisory Board shall be:

- (a) the Director of Treasury;
- (b) the Head of the Central Bank;
- (c) two persons appointed by the Minister with significant experience in investment management; and
- (d) one other person appointed by the Minister.

17.2 The Central Bank shall provide the secretariat for the Investment Advisory Board and any support required by the board to carry out its functions.

17.3 The Minister shall provide, in accordance with Timor-Leste law:

- (a) a person to sit on the secretariat of the Investment Advisory Board; and
- (b) appropriate remuneration for the members of the Investment Advisory Board appointed under paragraphs (c) and (d) Article 17.1.

Article 18

Absence of Advice from the Investment Advisory Board

18.1 The non-provision of advice by the Investment Advisory Board, within fifteen (15) days of the request, or within such longer time period as may be determined by the Minister having regard to the nature of the advice sought, shall not constitute an impediment for the Minister to make a decision.

18.2 If, having regard to the nature and urgency of the decision to be taken, there is insufficient time to seek the advice of the Investment Advisory Board, in relation to a particular decision, the Minister shall make a decision without first seeking the advice of the Investment Advisory Board.

18.3 If the Minister makes a decision under Article 18.1 or 18.2, the Minister shall immediately report the making of the decision to the Investment Advisory Board.

18.4 The Minister shall reexamine the decision having regard to any subsequent advice provided by the Investment Advisory Board.

Article 19

Release of Advices of the Investment Advisory Board

19.1 When required by Parliament, the Government shall without delay provide Parliament with all advices given thereto by the Investment Advisory Board.

19.2 The Minister shall ensure that in releasing, or allowing access to, advices given thereto, measures are taken to prevent the disclosure of confidential information.

Article 20

No Encumbrances on the Assets of the Petroleum Fund

20.1 Any amount that is invested pursuant to Articles 14 and 15 shall, at all times, remain the property of Timor-Leste.

20.2 Any contract, agreement or arrangement, to the extent that it purports to encumber the assets of the Petroleum Fund, whether by way of guarantee, security, mortgage or any other form of encumbrance, is null and void.

Chapter IV – Supervision of the Petroleum Fund

Article 21

Maintenance of Petroleum Fund Accounts and Records

21.1 The Director of Treasury is responsible for maintaining the Petroleum Fund accounts and records in accordance with the International Accounting Standards in force, to reflect the operations and financial condition of the Petroleum Fund.

21.2 The Director of Treasury shall submit to the Minister quarterly management information reports and analyses on the performance and activities of the Petroleum Fund no later than twenty (20) days after the end of each quarter.

21.3 The Director of Treasury is responsible for reporting on the performance and activities of the Petroleum Fund for the purpose of the annual financial statements of Timor-Leste.

Article 22Internal Audit

The accounts, records and other documents relating to the Petroleum Fund shall be audited every six months by the bodies responsible for internal audits of each of the entities involved.

Article 23Annual Report

23.1 The Government shall submit an Annual Report for the Petroleum Fund for a fiscal year to Parliament, at the same time as the annual financial statements of that year are submitted to Parliament.

23.2 The Annual Report referred to in Article 23.1 shall be published by Government within fifteen (15) days of its submission to Parliament.

Article 24Information Contained in the Annual Report

24.1 The Annual Report for the Petroleum Fund shall be prepared in a manner that makes it readily adaptable for public information, and shall contain in particular the following information for the fiscal year for which the Report is prepared:

- (a) audited financial statements certified by the independent auditor, comprising:
 - (i) an income and expenditure statement;
 - (ii) a balance sheet, including a note listing the qualifying instruments of the Petroleum Fund, valued at market value;
 - (iii) details of all appropriations and transfers from the Petroleum Fund; and
 - (iv) notes to the financial statements, as appropriate;
- (b) a report signed by the Minister describing the activities of the Petroleum Fund in the year, including all advice provided by the Investment Advisory Board, any reports prepared by the independent auditor under Article 35 and drawing attention to particular issues or matters that may be of concern or interest to Parliament;
- (c) a statement by the Director of Treasury drawing attention to any accounting issues or practices arising from the Report that may materially affect the interpretation of amounts or activities shown within it;
- (d) the income derived from the investment of Petroleum Fund assets during the fiscal year compared with the income of the previous three fiscal years;
- (e) a comparison of the nominal income on the investment of Petroleum Fund assets with the real return after adjusting for inflation;
- (f) a comparison of the income derived from the investment of Petroleum Fund assets with the benchmark performance indices provided to the Minister pursuant to Article 16.1;

- (g) a comparison of the estimated sustainable income for the fiscal year with the sum of transfers from the Petroleum Fund for the year;
- (h) in the event of Government borrowings, the liabilities shall be reflected in the presentation of Petroleum Fund accounts so as to give a true representation of the past and expected future development of the Government's net financial assets and rate of savings; and
- (i) a list of persons holding positions relevant for the operation and performance of the Petroleum Fund, including:
 - (i) the Minister;
 - (ii) the Director of Treasury;
 - (iii) the members of the Investment Advisory Board;
 - (iv) the external investment managers;
 - (v) the Head of the Central Bank; and
 - (vi) the members of the Petroleum Fund Consultative Council.

24.2 The sources of the information described in Article 24.1, whatever their form, and including all reports and statements, shall be annexed to the Annual Report in unedited form.

Chapter V – Petroleum Fund Consultative Council

Article 25

Petroleum Fund Consultative Council

25.1 There is hereby established a Petroleum Fund Consultative Council.

25.2 The Petroleum Fund Consultative Council shall, of its own motion or at the request of Parliament:

- (a) advise Parliament on matters relating to the performance and operation of the Petroleum Fund;
- (b) advise Parliament on appropriations from the Petroleum Fund as set out in Article 30.2; and
- (c) in the context of the budgetary process, advise Parliament on whether the appropriations of the Petroleum Fund are being used effectively to the benefit of current and future generations.

Article 26

Composition of the Petroleum Fund Consultative Council

The Petroleum Fund Consultative Council shall comprise the following members, all of whom are nationals of Timor-Leste:

- (a) former Presidents of the Republic;
- (b) former Speakers of the Parliament who have effectively been in office for at least three (3) years;
- (c) former Prime Ministers who have effectively been in office for at least three (3) years;

- (d) former Ministers in charge of finances who have effectively been in office for at least three (3) years;
- (e) former Heads of the Central Bank who have effectively been in office for at least three (3) years;
- (f) two members appointed by Parliament, elected in accordance with the rules laid down by Parliament;
- (g) two members appointed to represent civil society non-profit organisations;
- (h) a member appointed to represent the private business sector; and
- (i) a member appointed to represent religious organisations.

Article 27

Appointment, Tenure and Reeligibility of Members

27.1 The members of the Petroleum Fund Consultative Council referred to in paragraphs (a), (b) and (c) of Article 26 are appointed, in accordance with procedures laid down by Parliament, from the end of their term in office for a period of ten (10) years. These members are not eligible for reappointment.

27.2 The members of the Petroleum Fund Consultative Council referred to in paragraphs (d) and (e) of Article 26 are appointed, in accordance with procedures laid down by Parliament, from the end of their term in office for a period of five (5) years. These members are not eligible for reappointment.

27.3 The members of the Petroleum Fund Consultative Council referred to in paragraphs (f), (g), (h), and (i) of Article 26 are appointed for a period of four (4) years. These members are eligible for reappointment for a second term.

27.4 The members of the Petroleum Fund Consultative Council referred to in paragraphs (g), (h), and (i) of Article 26 shall be freely appointed by the concerned organisations, duly registered in accordance with Timor-Leste law, under procedures to be laid down by Parliament.

27.5 If no appointment can be made to the Petroleum Fund Consultative Council pursuant to paragraphs (a), (b) or (c) of Article 26, the President of the Republic, the President of Parliament, and the Prime Minister, respectively, shall appoint one member to fill such a vacancy.

Article 28

Limitations

28.1 A person shall not be appointed as a member of the Petroleum Fund Consultative Council if the person:

- (a) has been removed from office;
- (b) has been declared bankrupt or insolvent; or
- (c) has been convicted of a criminal offence.

28.2 Members of the Petroleum Fund Consultative Council have security of tenure and, unless otherwise provided for by law, may not be suspended, retired or removed from office.

28.3 The appointment of a member of the Petroleum Fund Consultative Council ceases if the member:

- (a) is declared bankrupt or insolvent;
- (b) is convicted of a criminal offence; or
- (c) is unfit for office.

28.4 Until such time as specific procedures for the removal of a member under paragraph (c) of Article 28.3 are established under the general law, the procedures applicable for the removal of judges shall apply.

Article 29

Economic Advisor to the Petroleum Fund Consultative Council

Subject to approval by Parliament, the Petroleum Fund Consultative Council may select and appoint as its international adviser for economic and financial matters, for a period of two (2) years, an academic or professional of the highest reputation and competence.

Article 30

Functioning of the Petroleum Fund Consultative Council

30.1 In conducting its activities, the Petroleum Fund Consultative Council shall take into account:

- (a) the overall objective that the Petroleum Fund be a fund of income from the exploitation of non-renewable petroleum resources for the benefit of current and future generations; and
- (b) the principles for the operation of the Petroleum Fund as outlined in this present Act.

30.2 When:

- (a) the Government introduces legislation to Parliament to appropriate an amount from the Petroleum Fund, and
- (b) the amount the legislation would appropriate in the fiscal year is greater than the estimated sustainable income of the Petroleum Fund for the fiscal year,

the Petroleum Fund Consultative Council shall submit, in a timely manner, as decided by Parliament on a case by case basis, an advice to Parliament on the Government's proposed appropriation.

30.3 The non-provision of advice by the Petroleum Fund Consultative Council, within the time period decided by Parliament, shall not constitute an impediment for Parliament to make a decision.

30.4 For purposes of advising Parliament, the Petroleum Fund Consultative Council shall consult widely in the community and, to this end, shall hold an annual forum on issues relating to the Petroleum Fund.

30.5 The Petroleum Fund Consultative Council shall determine the rules of procedure under which it will operate, and its decisions shall not be binding unless taken by majority, with a quorum of six (6) members.

30.6 Parliament shall provide adequate funding for the operations of the Petroleum Fund Consultative Council, including appropriate remuneration for members of the Petroleum Fund Consultative Council, through the budgetary appropriation for the operation of Parliament.

Article 31

Release of Information

31.1 Parliament shall provide for the publication of the advices of the Petroleum Fund Consultative Council, including minority opinions, within thirty (30) days of having been provided.

31.2 Parliament shall ensure that in releasing, or allowing access to, advices of the Petroleum Fund Consultative Council, measures are taken to prevent the disclosure of confidential information.

31.3 The Minister and/or the Head of the Central Bank shall furnish the Petroleum Fund Consultative Council with information it requests on any aspect of the operation or performance of the Petroleum Fund for the purpose of its monitoring of the Petroleum Fund.

31.4 In dealing with the information furnished under Article 31.3, the Petroleum Fund Consultative Council shall ensure that measures are taken to prevent the disclosure of confidential information.

Chapter VI – Transparency

Article 32

Transparency as a Fundamental Principle

32.1 The management of the Petroleum Fund shall always be carried out, and the related duties of all relevant parties shall be discharged, with the highest standard of transparency.

32.2 Information or data whose disclosure to the public could, in particular:

- (a) prejudice significantly the performance of the Petroleum Fund;
- (b) be misleading, as it relates to:
 - (i) incomplete analysis, research or statistics;
 - (ii) to frankness and candour of internal discussion;
 - (iii) the exchange of views for the purposes of deliberation; or
 - (iv) the provision of confidential advice;
- (c) significantly affect the functioning of the Government;
- (d) amount to the disclosure of confidential communications;
- (e) substantially prejudice the management of the economy;
- (f) substantially prejudice the conduct of official market operations; or
- (g) result in or lead to improper gains or advantages;

may be declared as confidential. The declaration of confidentiality shall, taking into account the principle of transparency and the right of the public as regards to access to information, provide a clear reasoning on the motives for treating such information or data as confidential.

32.3 Any information that is kept confidential at the time at which it could have been published, as well as the reasoning for having been treated as confidential, shall be made available to the public, upon request, when the reasons for confidentiality are no longer valid, and in any case after five (5) years from the date at which it could have been published.

32.4 In the exercise of its functions and competences, and as provided for in this present Act, Parliament, the Government, the Minister, Central Bank, Investment Advisory Board and the Petroleum Fund Consultative Council shall take all necessary measures to ensure transparency mechanisms and free access to public information.

32.5 The Minister shall ensure that this present Act, any subsidiary legislation made thereunder, any instructions relating to the Petroleum Fund, the operational management agreement referred to in Article 11.3 and the reports referred to in Articles 8 and 9 are readily available to the public within thirty (30) days of having been finalised.

Article 33

Payments into the Petroleum Fund Account

For all purposes of Timor-Leste law, an obligation to make a payment into the Petroleum Fund shall not be treated as discharged until the amounts have been deposited, integrally and unconditionally, into the Petroleum Fund earmarked receipts account.

Article 34

Independent Auditor

34.1 Without prejudice to the jurisdiction of any court, there shall at all times be appointed an independent auditor, which shall be an internationally recognised accounting firm, selected and appointed by the Government.

34.2 The selection and appointment of the independent auditor shall be made in accordance with the procurement procedures established under Timor-Leste law.

34.3 The independent auditor appointed under this present Act shall remain in function for the contracted period, unless the contract is terminated for serious misconduct or serious breach of contract, or if the independent auditor's conduct otherwise prejudices the performance of the Petroleum Fund.

Article 35

Payments made as Petroleum Fund Receipts

35.1 The independent auditor shall prepare a report for the Minister of all payments made, or that should under this present Act have been made, as Petroleum Fund receipts for each fiscal year.

35.2 The independent auditor may require any payer to provide any information, and to deliver proof of any facts which may be necessary for the full discharge and performance of the independent auditor's duties under this present Act.

35.3 The independent auditor's report shall state the aggregate amounts of payments made as Petroleum Fund receipts for each payer for the fiscal year.

35.4 If the independent auditor concludes that there is a discrepancy between payments made and those which should have been made, and which cannot be explained, the independent auditor shall refer the matter to the Minister. In referring the matter to the Minister, the independent auditor shall provide all information that the independent auditor possesses regarding the discrepancy in question.

Article 36

Reports of the Independent Auditor

36.1 The Minister shall provide for the publication of the independent auditor's report, in particular through the Annual Report.

36.2 The independent auditor shall ensure that in preparing the report measures are taken to prevent the disclosure of confidential information.

Chapter VII – Penalties

Article 37

Scope of the Chapter

The provisions included in this Chapter are without prejudice of criminal and civil liability under general law.

Article 38Non-Compliance with an Obligation to Publicise Information

Whoever fails to comply with any obligation to publicise information, provided for in this present Act, or leads someone else to fail to comply with, or in any manner hinders or leads someone else to hinder the compliance with, such an obligation, shall be punished by imprisonment for a period up to two (2) years or fine of not less than fifty (50) days.

Article 39Misleading Information

39.1 Whoever gives information that is materially false or misleading, or knowingly includes or permits to be included, in any report or document, information that is materially false or misleading, shall be punished by imprisonment for a period up to three (3) years or fine of no less than seventy five (75) days.

39.2 An attempt is punishable.

Article 40Hindering the Exercise of Powers by an Auditor

40.1 Whoever, directly or indirectly, in any measure or by any means, hinders or leads someone else to hinder the exercise of powers by an auditor under this present Act, shall be punished by imprisonment for a period from three (3) months to four (4) years or fine of not less than one hundred (100) days.

40.2 An attempt is punishable.

Article 41Accessory Penalties

In relation to the crimes provided for in this present Act, the following accessory penalties may be applied:

- (a) Termination of contracts;

- (b) Publication of the conviction and sentence; and/or
- (c) Other injunctive relief as may be necessary taking into account the circumstances of the case in question.

Article 42

Liability of Legal Persons, Corporations and Other Legal Entities

42.1 Legal persons, corporations or any other legal entities, including those without juridical personality, are liable for contraventions provided for in this Part when committed by its organs or representatives in its name and in the collective interest.

42.2 The liability is excluded where the agent has acted against express orders or instructions properly issued.

42.3 The liability of the entities mentioned in Article 42.1 does not exclude the individual liability of the respective agents.

42.4 The entities mentioned in Article 42.1 are jointly and severally liable, as provided for in civil law, for the payment of any fines or compensations, or for the fulfillment of any obligations, derived from the facts or with incidence on matters covered by the scope of this Act.

Article 43

Fines to Legal Persons, Corporations and Other Legal Entities

43.1 In the case of legal persons, corporations or any other legal entities, including those without juridical personality, the daily rate for fines corresponds to an amount between one United States Dollars (USD \$1.00) and two thousand United States Dollars (USD \$2,000.00), as determined by the court, taking into account the economic and financial circumstances of the legal person, corporation or other legal entity.

43.2 If the fine is applied to an entity without juridical personality, its payment will be guaranteed by the entity's assets and, in the event of non-existence of such assets or under-capitalisation, jointly and severally, the assets of each of the partners or shareholders of the entity.

Article 44

Complaints to the Ombudsman for Human Rights and Justice

44.1 Any person, legal and natural, may lodge a complaint with the Ombudsman for Human Rights and Justice, on any matters covered by the scope of this present Act, in accordance with general law.

44.2 Any recommendations forwarded by the Ombudsman for Human Rights and Justice to the competent authorities, on any matters covered by the scope of this present Act, shall be treated as a matter of urgency.

Article 45

Subsidiary Legislation

General criminal law, both substantive and adjective, as well as the relevant administrative legislation, are applicable in a subsidiary manner, with the required adaptations, to the extent necessary to give effect to the provisions of this Chapter.

Chapter VIII – Transitional and Final Provisions

Article 46

Implementation of Organizational Structure

46.1 All appointments necessary for the effective functioning of the Investment Advisory Board shall be made within three (3) months of the entry into force of this present Act.

46.2 All appointments necessary for the effective functioning of the Petroleum Fund Consultative Council shall be made within six (6) months of the entry into force of this present Act.

Article 47

Subsidiary Laws and Regulations

The Government and the Minister may make regulations for the effective carrying out of the provisions of this present Act, including regulations of a transitional nature consequent upon the making of this present Act.

Article 48

Opening Balance of the Petroleum Fund

48.1 The opening balance of the Petroleum Fund is the total amount of the payments received by Timor-Leste, up to the commencement of the present Act, as *First Tranche Petroleum*, from the Joint Authority pursuant to the terms of the Exchange of Notes, or from the Designated Authority pursuant to the terms of the Treaty, increased by such amount, if any, as determined by the Government.

48.2 A report on the determination of the opening balance of the Petroleum Fund shall be provided with the first quarterly report presented under Article 13.

Article 49

Entry into force and application

49.1 This present Act enters into force on the day following its publication in the *Jornal da República*.

49.2 This present Act applies to fiscal years commencing on or after 1 July 2005.

49.3 Until the implementation of the organizational structure under this present Act is fully completed, and in no case for a period of more than six (6) months starting from the date of entry into force of this present Act, only the provisions that do not require the intervention of the organic structure to be constituted shall apply.

Schedule 1

Calculating estimated sustainable income for a fiscal year

I. Estimated sustainable income for a fiscal year is the maximum amount that can be appropriated from the Petroleum Fund in that fiscal year and leave sufficient resources in the Petroleum Fund for an amount of the equal real value to be appropriated in all later fiscal years as determined in accordance with the formula in paragraphs II and III below.

II. Estimated sustainable income for a fiscal year is calculated according to the following formula:

$$r \times \textit{petroleum wealth}$$

where:

r is the estimated average real rate of return, or real interest rate, on Petroleum Fund investments in the future and, for the purposes of these calculations, shall be 3.0%.

III. In this Schedule, “petroleum wealth” is calculated according to the following formula:

$$V + \textit{present value} (R_0, R_1, \dots, R_n) = V + \sum_{t=1}^n \frac{R_t}{(1+i)^t}$$

where:

V is the estimated value of the Petroleum Fund at the end of the prior fiscal year

*R*₀, *R*₁, etc. are the published budget projections for expected annual Petroleum Fund receipts minus investment returns for that fiscal year (*R*₀) and future fiscal years (*R*₁, etc.)

i is the estimated nominal yield on a U.S. government security, averaged over the years in which Petroleum Fund receipts are expected

n is the number of years until no further Petroleum Fund receipts are projected to be received.

IV. All assumptions upon which the calculations made pursuant to paragraphs II and III above are based shall be clearly identified and explained, and any changes made in these assumptions in subsequent calculations shall be clearly pointed out.

V. All assumptions made shall be prudent, reflect international best practice and be based upon internationally recognized standards.

VI. The amount determined in accordance with the formula in paragraphs II and III above shall be certified by the independent auditor.

6.B: Petroleum Fund of Timor-Leste—Operational Management Agreement

This Agreement is made on [date] between the Minister for Planning and Finance (“Minister”) representing the government and the Banking & Payments Authority (“Central Bank”), hereinto referred to as the “Parties”, pursuant to Articles 11.3 and 12.4 of Law No. __/2005 on the Petroleum Fund (“Law”).

Whereas the Minister will exercise the key functions and competencies of the Government, which has been assigned overall responsibility for the management of the Petroleum Fund (“Fund”) and the Banking and Payments Authority has been assigned the responsibility of the operational management of the Fund;

Whereas the requirement established by law that the Minister shall enter into an agreement with the Central Bank for the operational management of the Fund;

It is therefore agreed between the parties

1. The Central Bank shall undertake the operational management of the Fund and shall be accountable for its operational management of the Fund to the Minister.
2. The Government shall be responsible for the overall management of the Fund, which shall include the following functions to be exercised by the Minister:
 - a. To establish the overall policies and guidelines for the investment of the capital of the Fund, and to issue such instructions to the Central Bank as may be required to allow the Central Bank to implement the operational management of the Fund;
 - b. No less than fifteen (15) days prior to the commencement of each calendar quarter, to provide a forecast of the monthly cash requirements of government for that quarter, including the projected timings and amounts to be transferred from the Fund;
 - c. To provide the regulatory framework for the management of the Fund, and to consult with the Central Bank concerning proposed changes to this framework;
 - d. To provide documentation as necessary to clarify the tax position of capital from the Fund that has been invested abroad;

- e. To ensure that requests by the Central Bank for guidance on ad hoc policy decisions to enable it to implement the operational management of the Fund are responded to clearly and in a timely manner;
 - f. To consult with the Central Bank concerning information to be released to the public;
 - g. To appoint the independent auditors of the Fund and to arrange for their remuneration from the State budget.
3. The Central Bank shall be responsible for the operational management of the Fund, which shall include the following functions:
- a. The investment of the capital of the Fund in financial instruments as set out in this Agreement, including exercising all the rights and complying with all obligations associated with the ownership of the Fund's assets;
 - b. Receiving and accounting for the investment income and other revenues of the Fund;
 - c. Without prejudice to the responsibilities of the proper authorities for administering tax and royalty payments, maintaining a register of all payments made as Petroleum Fund receipts;
 - d. Maintaining the books of account for the Fund on behalf of the Director of Treasury;
 - e. Appointing and dismissing banking correspondents, dealers, brokers, custodians and other financial intermediaries necessary for the proper management of the Fund;
 - f. Acquiring and maintaining the information necessary to construct benchmark indices and construct notional portfolios for policy development and reporting purposes;
 - g. Evaluating the performance of external fund managers;
 - h. Supplying information to the Minister and the Director of Treasury necessary for the drafting of reports and statements relevant to the management of the Fund, including all reports relating to the management of the Fund required by law, with all such information being available to the recipients at least ten working days prior to any legislated publication date unless otherwise agreed between the parties;
 - i. Meeting all the operational expenses relating to the management of the Fund, which shall be compensated for from the annual management fee;
 - j. Implementing systems, procedures, risk management practices, and development of human resources to minimise the risk of operational loss to the Fund;
 - k. Advising the Minister of all significant events affecting the value of the Fund and other matters considered to be urgent or of importance relating to the management of the Fund;
 - l. Providing the members of the public with such information concerning the Fund as may be determined by the Minister;
 - m. Assisting the Minister in the preparation of the Annual Report of the Fund;

4. The Central Bank shall maintain the Secretariat of the Investment Advisory Board (“the Board”), which shall include the following functions:
 - a. Preparation of notices of meeting to the members of the Board;
 - b. Preparation, in consultation with the Minister, of reports, financial accounts, recommendations, background papers and other information to be submitted to meetings of the members of the Board;
 - c. Preparation, in consultation with the Minister, of technical advice and recommendations to the Board, including special reports on the operations of the Fund as may be requested by the Board;
 - d. Arrangement of facilities to hold the meetings of the Board;
 - e. Preparation and distribution of minutes of meetings of the Board;
 - f. Administering the meeting expenses of the Board, including remuneration of the members, the cost of which unless otherwise agreed shall be met from the State budget.
5. The Minister and the Central Bank shall jointly undertake the following functions with respect to the Consultative Council (“the Council”):
 - a. Preparation of such technical advice and reports as may be requested by the Council in the course of performing its duties;
 - b. Preparation of such commentaries on the operations and performance of the Fund as may be requested from time to time by the Council.
6. The Central Bank shall implement the operational management of the Fund through the adoption of the following principles:
 - a. The assets of the Fund shall be maintained in the name of the Central Bank, but shall at all times be segregated from the assets of the Central Bank in such a manner as shall allow the beneficial ownership of the assets and the income associated with those assets to be clearly determined at any time;
 - b. The books and records of the Fund shall be maintained separately from the books and records of the Central Bank to the maximum extent practicable;
 - c. The Central Bank shall make the books and records relating to the operational management of the Fund available at any time on request to the Minister, staff authorised by the Minister, and the auditors of the Fund.
 - d. The Central Bank shall ensure that all staff associated with the management of the Fund shall be bound by a code of ethics and rules to avoid conflicts of interest.
7. The Central Bank shall be permitted to invest only in the qualifying instruments described in Article 15.1 of the Law.

8. The Minister shall determine the mandate set out in Annex 1 to this Agreement, and the Central Bank accepts the mandate and shall undertake it to the best of its ability.
9. The performance of the Fund shall be measured periodically against the benchmark set out in Annex 1, and will be the subject of periodic reports.
10. The Minister shall give the Central Bank at least four weeks' notice before implementing any change to the mandate or benchmark as set out in Annex 1, and the Central Bank shall advise the Minister as to the anticipated length of time it will take to effect the new requirements.
11. The remuneration of the Central Bank shall be subject to Annex 2 to this Agreement, and shall be payable in monthly instalments from the assets of the Fund.
12. The earmarked receipts account of the Fund required by Article 5.2 of the Law shall be account number 021080973 held by the Central Bank at the Federal Reserve Bank of New York, with further details as set out in Annex 3 to this Agreement.
13. The single state budget account referred to in Article 7.1 of the Law shall be account 2-3711 held by the Ministry of Planning and Finance at the Central Bank.
14. The Central Bank shall undertake the appointment of external portfolio managers, under the following conditions:
 - e. The Central Bank shall undertake the procurement process in a fair and transparent manner according to its internal procedures;
 - f. The Central Bank shall make a written recommendation of the appointment to the Board, including but not limited to information about the services to be provided, the proposed level of fees, the proposed benchmark, the levels of insurance cover maintained against negligent losses, and such information concerning the procurement process as is necessary to inform the Board that the process was undertaken in accordance with the law;
 - g. The Minister shall issue a written decision to the Central Bank concerning the recommendation to appoint the proposed portfolio manager;
 - h. The Central Bank shall enter into a contract with the portfolio manager in its own name.
15. Should the Central Bank wish to terminate the contract of an external portfolio manager, the Central Bank shall consult with the Minister as follows:
 - a. The Central Bank shall provide a written recommendation to the Minister concerning the termination of the portfolio manager's contract, and send a copy to the President of the Board;
 - b. The Minister may, within five working days of receiving the recommendation, seek the advice of the Board concerning the proposed termination of the portfolio management contract;
 - c. The Minister shall confirm in writing the decision within 30 working days of receiving the Central Bank's recommendation, failing which the Central Bank's recommendation shall be deemed to be approved.

16. The Central Bank shall not be liable for losses arising from the operations of the Fund unless such losses arise from the negligence of the Central Bank or its employees.
17. The Minister shall provide with at least five working days' notice written payment instructions to transfer amounts from the Fund to the government's account referred in Article 13, that shall include the following information:
 - a. The amount or amounts to be transferred;
 - b. The date or dates on which the transfer(s) are to take place;
 - c. The parliamentary appropriation under which the transfer is authorised;
 - d. A statement that the provisions of Articles 8 to 10 of the Law have been complied with, including such supporting documentary evidence as may be relevant;
 - e. The signature of the Minister;
 - f. The signature of the Director of Treasury.
18. All formal communications between the Minister and the Central Bank required under this agreement shall be in writing, and the communications shall be delivered as follows:
 - a. To the Minister: Minister for Planning and Finance,
Building 5
Palácio do Governo,
Dili
 - b. To the Central Bank: The General Manager
Banking & Payments Authority of Timor-Leste
Avenida Bispo Medeiros
Dili

Either party may at its discretion provide copies of formal communications to the Board.
19. This agreement may be amended by the parties at any time, provided that such amendments shall not be effective except in writing and signed by both parties. The Minister shall at the Central Bank's request delay the publication of amendments to this agreement concerning changes in portfolio allocations, benchmarks or other aspects that may affect the value of the Fund until the Central Bank has substantially completed the related market operations.
20. The Minister may propose changes to this Agreement on the basis of advice received from the Board after this body is established.

Annex 1: Qualifying Instruments and Benchmarks**1. QUALIFYING INSTRUMENTS**

The assets of the Fund shall be invested in the classes of instruments as described below. The indices indicated with each asset class shall be used to measure the performance of the Fund.

Debt instruments issued by the United States and other qualifying sovereign governments:

Index: Merrill Lynch 0-5 year government bond index

Short-term liquidity instruments maintained by the Fund limited to budgeted monthly appropriations from the Fund to the state budget account described in Article 13 based on cash projections supplied to the Central Bank by the Minister shall be excluded from the Fund for the purpose of benchmark comparison, but the Central Bank shall otherwise be accountable for the return on these instruments.

2. MANDATE

1. The nature of the mandate established by the Minister shall be to passively manage the Fund close to the benchmark, so that in normal circumstances the objective shall be to achieve a return within 25 basis points¹ of the benchmark.
2. The difference in the modified duration² between the portfolio and the benchmark shall be less than 0.2 year.

To enable the orderly acquisition of suitable investments, the parameters in this Annex 1 shall apply only from thirty (30) days after the date of entering into force of this Management Agreement.

Notes:

1. 100 basis points is the same as 1 percentage point.

² By “modified duration” is meant a measure of the percentage decline (increase) in the market value of the Petroleum Fund due to a 100 basis point increase (decline) in the level of interest rates.

Annex 2: Remuneration of the Central Bank

1. The remuneration of the Central Bank shall be calculated on the basis of the costs incurred with the management of the Fund.
2. The upper limit for the remuneration thus calculated, for the 2005/06 fiscal year, shall be two hundred and seventy thousand United States dollars (USD \$270,000).
3. The remuneration may be drawn in monthly instalments from the assets of the Fund.
4. In addition to recovering costs limited to the value of remuneration set forth in paragraph 2 of this Annex, the Central Bank shall receive remuneration for the portion of the fee to external investment managers that is due to excess returns received.

Appendix 7

The São Tomé and Príncipe Oil Revenue Law

Preamble

The Democratic Republic of São Tomé and Príncipe shall soon be starting to receive oil revenues resulting from the exploitation of its oil resources. Related to this reality are complex strategic matters that must be anticipated, resolved and regulated so that such revenues can foster progress and sustainable social and economic development in São Tomé and Príncipe.

Based on these principles, this law is adopted, guided by two fundamental ideas. The first idea is centered on the payment and management of oil revenues. An attempt was made to address the concerns shown by the international experience taking into account the national reality and the need for the Saotomean] people to make strategic decisions regarding their future.

For that purpose an account is established – the National Oil Account – in which all oil revenues shall be deposited directly, and mechanisms are introduced which are intended to ensure that such revenues will not be used indiscriminately. Thus, limits are set forth for the use of the oil revenues, such limits not excluding, however, the need to make decisions about spending on priority sectors on which expenditures will focus and the respective revenue allocation.

Similarly, this law introduces mechanisms to prevent the revenues being channeled to other accounts. Revenues may only be deposited in the State Treasury Accounts or in accounts established for that specific purpose in the name of the State, as authorized by the National Assembly.

This law establishes quantitative and qualitative limits on the amount of oil revenues that shall be used for annual budgetary expenditures. The quantitative limits define, in certain breadth, the maximum amount of annual expenditures to be financed by oil revenues. The qualitative limits determine the basic principles for the calculation of the annual expenditures within the maximum fixed limits, as follows: (I) planned and forecasts of future revenues; and (II) absence of distortions in the economy.

The finite nature of oil resources was also taken into account, as well as the need to introduce mechanisms that will allow São Tomé and Príncipe to face the post-petroleum era with minimum economic distress. For that purpose, a reserve sub-account was established – the Permanent Fund of São Tomé and Príncipe – in which part of the oil revenues shall be deposited, and whose use shall be strictly conditioned, except for the earnings generated from investments of its funds. Thus, it is intended for the Saotomean people to continue to benefit from the yields generated by the investments of the reserve sub-account even after the oil resources come to an end.

The management and investment of the oil revenues are assigned to an Investment and Management Committee, which is the institution with the authority ascribed by law for that purpose. The Investment and Management Committee shall act pursuant to the prudent investor rule, the principles established by this law and by the management and investment policy.

This law introduces mechanisms to ensure the effective management and investment of oil revenues, and establishes different priorities according to their allocation. All revenues allocated to finance public expenditure shall be managed for immediate liquidity, while the revenues deposited in the permanent fund shall be managed for medium- and long-term profitability. The management and investment policy, which will guide revenue management and investment, shall reflect these principles.

The second fundamental idea of the law is centered on oil revenue management auditing, transparency and oversight mechanisms, which are considered to be of great importance to ensure that this law be enforced according to its objectives.

Two annual audits of the oil accounts, in which the oil revenues shall be deposited, shall be carried out: one by the Auditor General and the other by an internationally recognized international auditing firm.

The law establishes clear transparency and publicity rules with respect to all acts and documents related to the oil activity. On one hand, mechanisms are introduced that limit the confidentiality of contracts concerning oil resources or oil revenues, mandatory registration and disclosure are introduced for all documents and information related to the oil sector. On the other hand, all people have the ample rights to access the information.

The law also creates a Petroleum Oversight Commission, with independence and administrative and financial autonomy to ensure its effectiveness, with oversight, investigative and sanctioning powers.

Finally, this law clarifies that its dispositions apply to the Joint Development Zone; it establishes a range of irreconcilable conflicts with regard to the exercise and placement in positions in the bodies created by the law; and it aggravates by one third, in their minimums, the penalties established by the general law to punish behaviors that violate the provisions of this law.

In these terms, the National Assembly sets forth, pursuant to Article 97(b) of the Constitution, the following:

Chapter I

Definitions and Scope of Application

Article 1

(Definitions)

1. For the purpose of this law:

- a) “Administration” or “State Administration” – shall mean the direct, indirect, autonomous or independent administration of São Tomé and Príncipe, including all ministries, entities, agencies, departments, offices, institutes, services, support services to the sovereignty bodies, as well as local and regional branches of the state and all their services, departments and all entities, companies and production unities controlled, in whole or in part, directly or indirectly, by the central, regional or local administration;
- b) “National Petroleum Agency” – shall mean the governmental legal entity with authority to regulate the national petroleum industry;
- c) “Official” or “State Administration Official” – shall mean any individual occupying any position in, employed by, contracted by or otherwise acting on behalf of or representing the State Administration, including ministers, directors, administrators, managers, attorneys-in-fact, commissioners or concessionaires of any entities controlled by the Public Administration;
- d) “Year” – shall mean the period between January 1st and December 31st;
- e) “Business Association” – shall mean any permanent association of entrepreneurs or professionals created in order to defend and promote their business or professional interests;
- f) “Joint Development Authority” – shall mean the collective body established for the purposes described in the Treaty;
- g) “Central Bank” – shall mean the Central Bank of São Tomé and Príncipe, as established by Law No.8/92, dated as of August 3, 1992;
- h) “Custody Bank” – shall mean any financial institution, or its branches or agencies, in an international foreign center, which is rated the highest by two internationally recognized risk analysis agencies, able to receive and hold cash balances in an internationally convertible currency, act as the custodian itself or by an Official, keep operation records of the National Oil Account, and provide to the public, directly or through competent entities, the information subject to the transparency principle under the terms of this law;
- i) “Approved Bank” – shall mean any foreign commercial bank, or its branches or agencies, in an international financial center, which is rated the highest by two internationally recognized risk analysis agencies;
- j) “Management and Investment Committee” – shall mean the committee organized to ensure the management of the Oil Accounts and the investment of the oil revenues deposited in such accounts;
- k) “Petroleum Oversight Commission” – shall mean the independent organization that ensures the oversight of all the activities related to the national oil resources and revenues;

- l) “Oil Accounts” – shall mean the National Oil Account and the Permanent Fund of São Tomé and Príncipe, when collectively referenced;
- m) “Treasury Account” – shall mean any account or sub-account referred to as Public Treasury Account, established by the Treasury with the Central Bank, pursuant to Decree No. 51/96, dated as of October 29, 1996;
- n) “National Oil Account” – shall mean the account established and held by the Central Bank with the Custody Bank, pursuant to this law;
- o) “Oil Contracts” – shall mean transaction instruments having Oil Resources or Oil Revenues as an object;
- p) “Abuja Joint Declaration” – shall mean the declaration regarding transparency and good governance signed on June 26, 2004 by the Presidents of the Federal Republic of Nigeria and the Democratic Republic of São Tomé and Príncipe;
- q) “State” or “Saotomean State” – shall mean the Democratic Republic of São Tomé and Príncipe, as defined in article 1 of the Constitution;
- r) “Permanent Fund” or “Permanent Fund of São Tomé and Príncipe” – shall mean the subaccount established with the Custody Bank, with the purpose of establishing a permanent savings reserve, pursuant to paragraph 1 of Article 3, and to Article 10 of this Law;
- s) “Public Registration and Information Office” – shall mean the public registration and information service, as defined in Article 18 of this law;
- t) “Natural gas” – shall mean all hydrocarbons that are gaseous at atmospheric pressure and temperature;
- u) “Approved Foreign Government” – shall mean the government of any foreign country or any agency or instrumentality of such foreign government, which is rated the highest by two internationally recognized risk analysis agencies;
- v) “Production Commencement” – shall mean the date on which the commercial production of hydrocarbons shall commence in any block of the national territory, including the Exclusive Economic Zone and the Joint Development Zone;
- w) “Hydrocarbons” – shall mean the hydrocarbons as defined in the Treaty, the Treaty Regulations, and sub-paragraph (m) of Article 1 of the Oil Activities Law;
- x) “Oil Activities Law” – shall mean Law No. 4/2000, dated as of August 23, 2000, and all amendments thereto;
- y) “State General Budget” – shall mean the State General Budget as defined in Law No. 1/86, dated as of December 31, 1986;
- z) “Non-Governmental Organizations” – shall mean any association, organization, legal entity, foundation, institution or company and other bodies deemed as legal entities represented in São Tomé and Príncipe, non-for-profit, that predominantly pursue scientific, cultural, charitable, aid, social solidarity, social and economic development, human rights protection, environmental protection goals, and other related goals;
- aa) “Unrestricted Part of the National Oil Account” – shall mean the balance of the National Oil Account, excluding the Permanent Fund of São Tomé and Príncipe;

- bb) “Person” – shall mean any individual or legal entity, whether national or foreign, resident or non-resident of São Tomé and Príncipe;
- cc) “Petroleum” or “oil” – shall mean all hydrocarbons that are liquid at atmospheric pressure and temperature;
- dd) “Management and Investment Policy” – shall mean the document containing the management and investment rules for the Oil Revenues deposited in the Oil Accounts, pursuant to the principles set forth in this Law;
- ee) “Expected Average Prices” – shall mean the price calculated according to paragraph 1(a) of Article 7 of this law;
- ff) “International Reference Prices” – shall mean, for the period of ten years as from the Production Commencement Year, the official price of hydrocarbons publicly rated by the Brent FOB Sullom Voe, and, and for the seventh year after Production Commencement and subsequent years, the actual sale price of crude oil in São Tomé and Príncipe, including the sales of hydrocarbons of the Joint Development Zone;
- gg) “Oil Production” – shall mean the commercial production of oil or any other hydrocarbon in the Exclusive Economic Zone or in the Joint Development Zone;
- hh) “Field Development Program” – shall mean the detailed document, which, pursuant to the Treaty, the Treaty Regulations or Oil Revenue Law, as the case may be, is submitted by an oil operator for the establishment, construction and operation of facilities and services for the recuperation, processing, storage and transportation of hydrocarbons in the contracted operator’s block;
- ii) “Oil Revenue” – shall mean any payment or payment obligation owed by any Person to the State, directly or indirectly, with respect to the oil resources of São Tomé and Príncipe, including, but not limited to:
- I) Any and all payments from the Joint Development Authority arising out of hydrocarbon-related activities developed in, or in connection with, the Joint Development Zone;
 - II) All payments arising out of activities related to Exclusive Economic Zone Oil Resources, namely, but not limited to São Tomé and Príncipe’s share of crude oil and gas sales; signature bonuses and production bonuses; *royalties*; rents; proceeds from sale of assets; taxes; fees; duties and customs taxes; public service fees; net profits of state-owned oil companies; revenues from State share rights in oil contracts; crude oil sales; commercial activity resulting from transaction of oil, gas, or refined products; return on investments of the oil revenues; any and all payments generated in connection with the commercial production of hydrocarbons;
 - III) Other revenues of analogous nature or revenues deemed as having an analogous nature by law.
- jj) “Extraordinary Oil Revenue” – shall mean, for the period after the Oil Production Commencement, any signature bonus or any other payment, including the payments received from the Joint Development Zone related to an area that is not yet in production;
- kk) “Oil Resource” – shall mean any deposit, block or area where hydrocarbons can be found, regardless of its commercial potential, within the national territory, including the Exclusive Economic Zone, and pursuant to the terms of the Treaty, in the Joint Development Zone;

ll) “Prudent Investor Rule” – shall mean that in performing any investment transactions or services, the agent shall ensure high quality and efficiency standards, and shall discharge his or her duties protecting the legitimate interests of the State with the diligence of a discerning and orderly manager, pursuant to the risk sharing principle and the safety of the investments, in accordance with the investment rules approved by the Management and Investment Committee pursuant to this Law;

mm) “Operation Rules” – shall mean the document containing the operation rules for the Oil Accounts;

nn) “Treaty Regulations” – shall mean the regulations approved by the competent authorities in accordance with the Treaty;

oo) “Royalties” – shall mean the liquidated revenues from the sale or disposition of crude oil or natural gas, as defined in the Treaty, in the Treaty Regulations and in the Oil Activities Law;

pp) “Long Term Real Rate of Return” – shall mean the rate calculated pursuant to paragraph 4 of Article 8 of this law;

qq) “Service Fee” – shall mean any charges for Oil Accounts administration, management and maintenance services, as well as by the investments of the Oil Revenues deposited in such accounts;

rr) “Treaty” – shall mean the treaty dated as of February 21, 2001, between the Federaral Republic of Nigeria and the Democratic Republic of São Tomé and Príncipe concerning the Joint Development Zone for petroleum and other resources;

ss) “Union” – shall mean any permanent workers’ association formed to defend and promote their social-professional interests;

tt) “Expected Present Value of Future Oil Revenues” – shall mean, for any period, the amount calculated pursuant to paragraph 1(c) of Article 7 of this law;

uu) “Annual Funding Amount” – shall mean the amount to be transferred to the Treasury Account pursuant to this Law;

vv) “Joint Development Zone” – shall mean the area defined for the purposes of the Treaty;

ww) “Exclusive Economic Zone” – shall mean the maritime area as defined by Law No. 1/98, dated as of March 31, 1998.

2. The terms listed above may be used in the singular or in the plural, provided the adequate alteration, unless the context clearly indicates otherwise.

Article 2

(Scope of Application)

This law shall regulate the payments, management, use and oversight of oil revenues resulting from oil operations in the entire national territory, including its terrestrial and maritime areas, including the Exclusive Economic Zone and the Joint Development Zone created by the Treaty.

Chapter II

Oil Accounts

Section I

General Provisions

Article 3

(Establishment of Oil Accounts)

1. The Central Bank, acting in the name of the State, shall establish and hold the Oil Accounts with a Custody Bank selected by the Government pursuant to this law.
2. The Central Bank shall deliver to the Custody Bank upon execution of the Oil Accounts opening and management agreement the Operation Rules, which shall be an integral part of such agreement, and the Treasury Account number into which the Annual Funding Amount shall be transferred.

Article 4

(Prohibition on Liens or Encumbrances)

1. Any and all acts are prohibited by the State or its Officials if such acts directly or indirectly create, permit, assume, or promise the existence of public loans, public bonds, security interests or any other liens or encumbrances relating to the Oil Accounts or any other Oil Resources, whether existing or future, or related thereto.
2. The prohibition contained in paragraph 1 above shall not apply to financial charges in connection with the maintenance and management of the Oil Accounts maturing no more than one year after the date on which such lien is initially incurred.
3. Any attempt to violate paragraphs 1 and 2 above shall be null and void.

Article 5

(Operation Rules)

1. All transfers out of and in to the Oil Accounts shall be effected electronically.
2. The Central Bank shall prepare and present to the Government, who will submit to the National Assembly for approval by statute the Operation Rules of the Oil Accounts, which shall include:
 - a) Authorization for transactions and transfers between the National Oil Account and the Permanent Fund;
 - b) Deadlines for transfers to the Oil Accounts;
 - c) Certification, registration and proof of transactions;
 - d) Authorizations for Oil Accounts investment transactions;
 - e) Payment of fees, commissions, emoluments, and other Service Fees for bank services and operations;
 - f) Other rules regarding deposits and remittance of oil revenues to the State.
3. Oil Accounts debt transactions will require signature of the following persons:

- a) President of the Republic;
- b) Prime-Minister;
- c) Director of the Treasury and Patrimony;
- d) Director of International Transactions of the Central Bank.

4. The contract referred to in paragraph 2 of Article 3 above shall provide that no transfer of the Oil Revenues deposited in the Oil Accounts may be effected to any bank account that is not held in the name of the Saotomean State, or any other account not authorized by a law approved for that purpose by the National Assembly.

Section II

National Oil Account

Article 6

(Deposits)

1. All monies owed to the State as Oil Revenue shall be deposited directly into the National Oil Account by the Persons liable to pay such monies. The Central Bank and other institutions that are currently or in the future in charge of the matter shall approve all necessary regulations and instructions.
2. Any Oil Revenue shall be considered paid by the Persons when fully and effectively deposited in the National Oil Account.

(Forecast of the Oil Revenues)

1. No later than June 30 of each Year, the National Petroleum Agency shall calculate and make public:
 - a) The expected average price of the oil barrel which shall be the average international reference price of Brent FOB Sullom Voe publicly quoted in the 10 prior years, which reference price shall be adjusted by a price differential resulting from the difference in quality between Brent and the different types of São Tomé and Príncipe oil. The expected future average price for natural gas shall be the reference future average price adopted in natural gas contracts and adjusted pursuant to the terms set forth for oil.
 - b) The expected future sales of hydrocarbons by or on behalf of the State, based solely in the production in the blocks under production or commercial development and consistent with the production estimates updated by the block operators.
 - c) The Expected Present Value of Future Oil Revenues, as estimated by the sum of the revenues deposited in the National Oil Account during the previous twelve months ending on June 30 of such Year, plus the expected revenues for all future Years, with the proper discounts. Expected future revenues shall be estimated using the expected average future price of oil and natural gas, as defined in paragraph (a) and the expected future hydrocarbons sales, as defined in paragraph (b) of this Article. A rate of not less than 7% shall be used to discount expected future revenues.
2. The National Petroleum Agency shall submit the calculations in writing to the President of the Republic, the National Assembly, the Government, the Governor of the Central Bank, the Petroleum Oversight Commission, and shall effect the respective registry.

3. Within 30 days from the date of submission of the calculations by the National Petroleum Agency pursuant to this Article, the Petroleum Oversight Commission shall check if the calculations were done according to the provisions of this law.

Article 8

(Determination of and Limits on the Annual Funding Amount)

1. The Government shall include in the proposed State General Budget an Annual Funding Amount that shall be transferred out of the National Oil Account for the expenditures set forth in Article 9 of this law, and which shall only be transferred out of the National Oil Account to the Treasury Account after the definitive approval of the State General Budget.

2. The Annual Funding Amount for 2005 will be as set forth in the National State Budget as approved by the National Assembly.

3. In the following years, the Annual Funding Amount shall be subject to the following limits:

a) Starting in 2006, for each Calendar Year until the end of the first Year after the Production Commencement, the Annual Funding Amount shall not exceed the greater of the following amounts:

I) 20% of the balance of the National Oil Account on December 31, 2005, as estimated by the Central Bank;

II) 20% of the total estimated balance of the National Oil Account at the end of previous Year, as estimated by the Central Bank;

III) Each Year, after the date of announcement of commercial hydrocarbon discovery and after the assurance of production, the amount equal to the total forecast balance for the National Oil Account at the end of the immediately preceding Year, as estimated by the Central Bank, *divided* by the number of remaining years until the end of the first Year after the expected Production Commencement Year.

b) For each Year starting with the second Year after the Production Commencement, the Annual Funding Amount shall not exceed the lesser of the following amounts:

I) An amount equivalent to the sum of:

A) The Long Term Real Rate of Return multiplied by the balance of the Permanent Fund on June 30 of the previous Year, and

B) The Long Term Real Rate of Return multiplied by the Expected Present Value of Future Oil Revenues on June 30 of the previous Year.

II) An amount equivalent to the sum of:

A) The Long Term Real Rate of Return multiplied by the balance of the Permanent Fund on June 30 of the previous Year, and

B) The balance of the unrestricted part of the National Oil Account on June 30 of the previous Year.

4. For the purpose of this Article, the Long Term Real Rate of Return shall be the Real Rate of Return expected on a portfolio composed of assets proportionate to the assets held in the Permanent Fund during the same period. The Long Term Real Rate of Return shall never exceed 5%. The inflation adjustment shall use the variation rates of the official price indexes of the currencies in which the Permanent Fund asset portfolio is invested.

Article 9**(Allocation of the Annual Funding Amount)**

1. The allocation of the Annual Funding Amount shall be decentralized with respect to sectors and territory, and aimed at the elimination of poverty and the improvement of the quality of life of the Saotomean people, the promotion of good governance, and social and economic development. In addition, such allocation shall be used, namely, to strengthen the efficiency and effectiveness of the State Administration, to ensure a harmonious and integrated development of the Country, a fair sharing of the national wealth, the coordination between economic policy and social, educational and cultural policies, rural development, preservation of the ecological balance, environmental protection, the protection of human rights, and equality among citizens before the law.
2. The Annual Funding Amount may only be used pursuant to the policies and actions defined in a national, regional or local development plan and a national poverty reduction strategy.
3. Should the policies, plans and strategies referred to in paragraph 2 above not be in place, the Annual Funding Amount shall be allocated essentially and in first priority for the education, health, infrastructure and rural development sectors, as well as in the strengthening of the State's institutional capacity, as proposed by the Government and approved by the National Assembly.
4. An amount not less than 7% of the Annual Funding Amount shall be annually reserved to the public expenditures of the Autonomous Region of Príncipe.
5. An amount not less than 10% of the Annual Funding Amount shall be annually reserved for the State share of local budgets, and shall be distributed pursuant to the Local Finance Law.
6. The allocation of the reserves provided in this article shall be part of the State General Budget. The National Assembly shall approve budgetary and accounting procedures and mechanisms that are sufficient to ensure efficient monitoring of such use.
7. The proposals for the allocation of the Annual Funding Amount shall be accompanied by explanatory reports.

Section III**Permanent Fund of São Tomé and Príncipe****Article 10****(Permanent Fund)**

1. No later than the first Production Commencement Year, the Central Bank shall establish a sub-account of the National Oil Account that shall constitute the Permanent Fund, and whose transactions may only be effected pursuant to the following paragraphs.
2. No later than January 31 of each year starting in the second Year after the Production Commencement, and after the transfer from the National Oil Account of the Annual Funding Amount and the Service Fees owed, the balance of the National Oil Account on June 30 of the previous Year shall be transferred to the Permanent Fund.

3. After the Production Commencement, any Extraordinary Oil Revenue deposited in the National Oil Account shall be transferred to the Permanent Fund within 30 days from the date of such deposit.

4. No later than January 31, as from the second Year after the Production Commencement, an amount not greater than the amount set forth in subparagraphs (b)(I)(A) and (b)(II)(A) of paragraph 3 of Article 8 of this law may, if necessary, be transferred from the Permanent Fund to the National Oil Account for the payment of the Annual Funding Amount.

5. Any and all transfers of Oil Revenues deposited in the Permanent Fund in violation of paragraph 4 above shall be prohibited and shall be null and void, without prejudice to the transfers explicitly and exclusively authorized for investments pursuant to the Operation Rules and the Management and Investment Policy.

Section IV

Management and Investment of the Oil Accounts

Article 11

(Management principles and rules)

The management and investments of the Oil Revenues deposited in the Oil Accounts shall be the responsibility of a Management and Investment Committee, which shall act according to the Prudent Investor Rule, following the principles and rules set forth in this law and in the Management and Investment Policy.

Article 12

(Management and Investment Committee)

1. A Management and Investment Committee shall be established, chaired by the Minister of Planning and Finance and also including the Governor of the Central Bank as the deputy chair, and three other members, one appointed by the President of the Republic and the other two appointed by the National Assembly, one of the latter appointed by the opposition parties.

2. The Persons appointed by the President of the Republic and the National Assembly shall be nationals, individuals or legal entities, resident or legally represented in São Tomé and Príncipe, and shall have proven previous experience in managing international investment portfolios.

3. Each one of the members appointed by the President of the Republic and the National Assembly shall serve a two-year term commencing on the date of the respective appointment, renewable only once for an identical period.

4. In case of vacancy, the new member shall commence a new term.

5. The Management and Investment Committee may only meet if the majority of its members is present, and decisions shall depend upon the affirmative vote of at least three of its members.

6. The members of the Management and Investment Committee, with the exception of the Minister of Planning and Finance and the Governor of the Central Bank, shall be paid a fee to be fixed by the Government, and shall receive no other remuneration other than reimbursement of previously authorized expenses.

7. The Management and Investment Committee shall establish its internal operating rules, subject to the approval of the National Assembly.

8. The State General Budget shall include an allocation for the annual budget of the Management and Investment Committee.

Article 13

(Management and Investment Policy)

1. The Management and Investment Committee shall design and propose to the Government, which shall submit it for approval by the National Assembly, the Management and Investment Policy which shall meet the following objectives:

- a) Sufficient investment liquidity to ensure the availability of cash for the Annual Funding Amount;
- b) Maximum profitability of the Permanent Fund of São Tomé and Príncipe, subject to specified levels of acceptable risk for the investment horizon;
- c) Transparent, modern and diversified management of the financial assets that are part of the investment portfolio of the Oil Accounts.

2. The Management and Investment Policy shall apply to each one of the Oil Accounts and shall include, at a minimum:

- a) The types of permitted investments, including categories of assets and instruments;
- b) Minimum required ratings and classifications for permitted high-risk investments, based on classifications proposed by expert firms of international reputation;
- c) The rules relating to asset diversification by sector and issuer;
- d) The rules to determine and monitor market risks, notably currency risks and interest rates risks;
- e) The acceptable level of market value fluctuation during the term of the investment;
- f) The rules established to ensure sufficient liquidity according to the Annual Funding Amount requirements.

3. The National Oil Account investments shall be held only in internationally convertible currency, in the form of the following instruments:

- a) Cash bank deposits with an Approved Bank;
- b) Negotiable direct obligations issued by any Approved Foreign Government;
- c) Securities issued or directly guaranteed or insured by any Approved Foreign Government, maturing no later than two years after the date of acquisition, provided that the full faith and credit of such Approved Foreign Government is pledged in support thereof;
- d) Bankers' acceptances, and floating rate certificates of deposit issued by the Approved Bank, maturing no later than two years after the date of acquisition;
- e) Investment funds, the assets of which shall comprise securities of the type described in sub-paragraphs (a) and (c) above, regardless of the maturity date of such assets;

f) Other financial instruments of similar risk, profitability and liquidity to the ones referred to in the preceding sub-paragraphs, as approved by the Management and Investment Committee.

4. The Management and Investment Committee may delegate to managers specialized in investments the operational aspects of their powers and duties.

5. It is prohibited to invest the Oil Revenues deposited in the Oil Accounts in investments domiciled in São Tomé and Príncipe, or in any investments controlled directly or indirectly, totally or partially, by any national Person, whether or not resident of São Tomé and Príncipe, or who falls within the circumstances described in paragraph 1 of Article 30 of this law.

Chapter III

Auditing

Article 14

(Annual Audits)

1. The management and activity of the National Oil Account, including all investments, deposits, withdrawals and transfers, shall be subject to two annual audits, one by the Auditor General and the other, external and independent, by an international auditing firm, and such audits shall be concluded within six months of the end of each audited Year.

2. The audits referred to in paragraph 1 above shall assess compliance with this law and with other laws relating to the financial administration of the State, the Investment Policy, the Operation Rules, as well as all other rules relating to the Oil Accounts management and operation in the previous Year, namely, any investments, deposits, withdrawals and transfers.

3. Audit reports shall be simultaneously sent to the President of the Republic, to the National Assembly, to the Government, to the Petroleum Oversight Committee, to the São Tomé and Príncipe's Solicitor's Office and to the Public Registration and Information Office, within 30 days upon completion, under the terms of this Article.

4. The reports mentioned in paragraph 3 of this Article shall include, necessarily, all documents, notes and observations that contribute to the full understanding of such reports.

Article 15

(Selection of the Auditing Firm)

1. The auditing firm shall be selected by the Petroleum Oversight Commission pursuant to competitive public procurement open to internationally recognized accounting firms with international experience.

2. Without prejudice to the requirements of paragraph 1 above, the competing audit firms shall present proof of their technical competence to audit corporations listed in official stock markets, according to international auditing and accounting standards.

3. The provisions of Article 22 shall be applicable accordingly.

Article 16

(Public Debate)

1. After the beginning of each legislative session, the National Assembly shall schedule and debate, in separate plenary sessions, according to its internal organization:
 - a) General policy concerning hydrocarbons, to which members of the Government shall be present to answer the Deputies' questions and clarification requests;
 - b) The Oil Accounts audit reports, to which the ministries in charge of finance and hydrocarbons matters, the members of the Management and Investment Committee, the Governor of the Central Bank, the Auditor General, the President and the members of the Petroleum Oversight Commission, one administrator from the external auditing firm that should have participated in the audit, the Executive-Director of the National Petroleum Agency shall all be present and shall have the right to address the floor.
2. The topics mentioned in paragraph 1 above shall be discussed with civil society in public sessions organized by the Petroleum Oversight Commission prior to the debates at the National Assembly.

Chapter IV

Public Integrity

Section I

Transparency and Publicity

Article 17

(Transparency)

1. All payments, management, use and investment of Oil Revenues or Oil Resources shall be subject to the transparency principle.
2. The transparency principle implies disclosure of, and public access to, namely:
 - a) Payments and respective receipts, management, and debit and credit transactions, as well as balances of the Oil Accounts;
 - b) The agreement for the opening and management the Oil Accounts entered into between the Central Bank and the Custody Bank;
 - c) The distribution of revenues arising out of the oil activity carried out in the Joint Development Zone;
 - d) The Operation Rules of the Oil Accounts and any amendments thereto;
 - e) The forecast of Oil Revenues prepared by the National Oil Agency;
 - f) All liens and encumbrances levying on the Oil Accounts, as permitted under paragraph 2 of Article 4;
 - g) Reports and other audit-related documents prepared by the Auditor General and the auditing firm with respect to the management and execution of the Oil Accounts;
 - h) The Investment Policy concerning the Oil Accounts;

- i) The annual report of the Petroleum Oversight Commission;
 - j) All budgets that benefit from transfers from the Annual Funding Amount, including the State General Budget and the Joint Development Authority Budget;
 - k) All contracts relating to the participation of the State or any enterprise or entity owned or controlled in whole or in part by the State, the scope of which directly or indirectly concerns activities related to Oil Resources or Oil Revenues;
 - l) Conflict matters as described in Article 30, as well as related lawsuits and sanctions.
3. All activities subject to the transparency principle shall be made public through a website in the Internet for inquiry purposes.

Article 18

(Public Registration and Information Office)

1. A Public Registration and Information Office shall be established, where all documents and information about activities related to Oil Resources and to the management of the Oil Revenues mentioned in the previous Article shall be filed, compiled, kept and made available to the public.
2. The documents and information referred to above shall be submitted for filing purposes to the entity in charge of the organization and maintenance of the Public Registration and Information Office, by the entities of the State Administration or Persons responsible for the elaboration, submission, receipt or approval of such documents and information, within ten business days of the occurrence of the event subject to registration.
3. The organization and maintenance of the Public Registration and Information Office shall be under the responsibility of the National Assembly.
4. A special law shall regulate the establishment and operation of the Public Registration and Information Office.

Article 19

(Publicity and Access to Information)

1. Information subject to transparency shall be conveyed in such a way that an addressee with basic comprehension and knowledge can apprehend its meaning and scope, and such information shall:
 - a) Be presented in the Portuguese language;
 - b) Be complete, whole, clear, objective, truthful and current;
 - c) Be of universal and free access.
2. Without prejudice to the universal and free access to information, the Government shall regulate the forms of public disclosure and access, and shall establish the fees for the provision of certificates, shipping or copies, as well as the time for the information to be obtained and the guarantees of the public access to information.

Section II

Oil Contracts

Article 20

(Confidentiality Clauses)

1. Confidentiality clauses or other mechanisms included in Oil Contracts or in any other transaction instrument concerning any Oil Revenue or Oil Resource that prevent or attempt to prevent access to documents and information pursuant to Article 17 of this law shall be null and void, and contrary to public policy.
2. Information concerning proprietary industrial property rights shall be exempted from the scope of mandatory disclosure to the extent that confidentiality in such cases is protected by a national law, by the Treaty, by the Treaty Regulations or by an international law.
3. In no case shall the provision of the above paragraph apply to any financial information.
4. Any Person intending to avail itself of the protection granted in the above paragraph shall have the burden to prove its right to confidentiality protection pursuant to the rules of evidence applicable to documents contained in the Civil Code.

Article 21

(Implicit contract clauses)

1. All Oil Contracts or other transaction instruments concerning Oil Resources or Oil Revenues shall contain, and in the absence thereof shall be construed to imply, the following provisions:
 - a) “No loan, reward, advantage or benefit of any kind has been given to any Official or to any person for the benefit of such Official or person or third parties, as consideration for an act or omission by such Official in connection with the performance of such person’s duties or functions or to induce such Official to use his or her position to influence any acts or decisions of the Administration with respect to this Agreement. Any breach of this representation shall cause this Agreement to be invalid and voidable by the State Administration”;
 - b) “The validity and effectiveness of this agreement shall be subject to the full compliance with all applicable administrative procurement rules relating to State contracting.”;
 - c) “This Agreement is elaborated and filed in the Portuguese and English languages, in case of non-conformity, the Portuguese language version shall prevail.”;
 - d) “This Agreement shall be made public and a copy hereof shall be provided to the Public Registration and Information Office within 10 days from its execution.”

Article 22**(Public Competition)**

1. All Oil Contracts or other transaction instruments to be entered into with the State Administration concerning Oil Resources or Oil Revenues, services relating to Oil Resources or in any way related to the oil sector or related activities, shall be preceded by public competitive tender pursuant to general law.
2. In the absence of legislation applicable to public tender, Oil Contracts or any other instruments mentioned in paragraph 1 above shall be approved by the Petroleum Oversight Commission prior to execution.
3. All Oil Contracts or other transaction instruments mentioned in paragraphs 1 and 2 above shall be made public by the State or by any Person, no less than ten days prior to execution, without prejudice to the terms of paragraphs 2, 3 and 4 of Article 20.
4. Oil Contracts and other transaction instruments entered into in violation of this Article shall be considered void and without any effect, without prejudice to the liability of Officials and Persons perpetrating such violation.
5. The provisions of this Article shall not exempt any Person or State Administration Official of any legal obligation, except those obligations that are not consistent with this Article.

Chapter V**Ensuring Public Oversight and Enforcement****Section I****Petroleum Oversight Commission****Article 23****(Establishment of the Petroleum Oversight Commission)**

1. A Petroleum Oversight Commission having legal entity status and administrative and financial autonomy shall be established to ensure the permanent oversight of all payment, management and use of the Oil Revenues and Oil Resources.
2. The Petroleum Oversight Commission shall be composed of eleven members, appointed or elected as follows:
 - a) One member appointed by the President of the Republic;
 - b) Three representatives of the National Assembly, one necessarily appointed by the parliamentary groups from the opposition;
 - c) One counselor judge with at no less than five years of professional experience, appointed by the Superior Judiciary Council;
 - d) One representative from the Autonomous Region of Príncipe;
 - e) Two representatives from local governments;

- f) One representative from Business Associations;
- g) One representative from the Unions;
- h) One representative from Non-Governmental Organizations.

3. The decisions of the Petroleum Oversight Commission shall require the affirmative vote of at least six of its members.

4. The organic law regulating the Petroleum Oversight Commission shall regulate the form of appointment and dismissal of the members of the Petroleum Oversight Commission, the duration of their terms, their compensation, and internal rules and conflicts of interests, as well as the organization and operation of the Petroleum Oversight Commission.

Article 24

(Authority and Powers of the Petroleum Oversight Commission)

1. Without prejudice to the oversight powers provided by the law to other government bodies, the Petroleum Oversight Commission shall have the authority to oversee the compliance of all activities with this law, namely:

- a) The verification and regularity of the expenditures of the Annual Funding Amount;
- b) Management and investment of Oil Revenues, including the exchange operations to the credit and debit of the Oil Accounts and their respective flow of funds in accordance with the Operation Rules and the criteria defined in the Investment Policy;
- c) The enforcement of the transparency rules;
- d) The external auditing firm's audit;
- e) The certification of the Production Commencement date.

2. To carry out its duties, the Petroleum Oversight Commission shall have the power to:

- a) Request relevant information and documents from any Person;
- b) Inquire about violations of any nature related to Oil Resources or Oil Revenues;
- c) Initiate investigations and inquiries based on its own knowledge or on third parties' complaints of irregularities or violations of the requirements of this law;
- d) Carry out searches, inspections, and seizure of any documents or personal property that are the object, tool, product of any infraction, or that are necessary to the opening of the respective process;
- e) Present reports that may include detailed description of any act subject to oversight, the investigation process, and inquiries initiated and closed, as well as recommendations as to the appropriateness of the adoption of new procedures;
- f) Hear, judge and enforce administrative proceedings and minor infractions consisting of violations of this law;
- g) Report to the competent authorities any irregularities or apparent violations of the provisions of this law that are subject to disciplinary, civil or criminal sanctions;
- h) Act as a party to judicial actions.

Section II

Ensuring the Enforcement of the Law

Article 25

(Mechanisms for law enforcement)

The mechanisms to ensure the enforcement of this law shall be defined by a special law, which shall regulate, in particular, the civil, criminal, and administrative responsibilities for acts performed in violation of the requirements of this law.

Article 26

(Public Prosecutor's Office and Police Authority)

1. Upon knowledge of violation of this law, the Public Prosecutor's Office shall on its own motion initiate judicial action to enforce the responsibilities of Officials or Persons pursuant to the Public Prosecutor's Office's organic law, as well as criminal, civil, and other applicable law.
2. Police authorities shall cooperate as may be requested by the Petroleum Oversight Commission in the exercise of its oversight functions.

Article 27

(Injunctions)

1. At any time prior to the issuance of a final decision, a governmental body with decisionmaking authority shall on its own motion, or upon request, issue any necessary injunction in case of a justifiable fear of grave injury to the public interest which would be difficult to repair.
2. Any decision to issue or amend any injunction shall set out the grounds therefor and the term of any injunction shall be fixed.
3. The grounds for the revocation of any injunction shall also set out the grounds therefor.
4. The appeal of injunctions shall stay the effectiveness of the appealed decisions, except when the appellate body shall determine otherwise.
5. Except as expressly provided otherwise, any injunction shall expire:
 - a) When a definitive decision is made;
 - b) If the fixed term of the injunction or its extension has expired;
 - c) If the deadline for a definitive decision has elapsed;
 - d) If the injunction is revoked by a judicial decision that becomes *res judicata*.

Article 28

(Court actions)

1. Any Person whose rights are protected under this law may appeal final decisions made by any Administration body to judicial courts with jurisdiction.
2. Any appeal filed pursuant to paragraph 1 above shall stay the appealed decision unless such stay results in grave injury to public interest and the court so declares in a reasoned decision.
3. In the case of appeal of decision made by the Petroleum Oversight Commission in the exercise of its oversight power, it is presumed that any stay of any Petroleum Oversight Commission's decision constitutes grave injury to public interest.

Chapter VI

Final Dispositions

Article 29

(Joint Development Authority)

1. Without prejudice to the provisions of the Treaty, the provisions of this law shall apply to all Oil Revenues of the State arising out of the Joint Development Zone and all State Administration Officials or any other Person employed, hired, or otherwise acting on behalf of or representing the Saotomean State Administration in the Joint Ministerial Council or in the Joint Development Authority.
2. In particular, such Persons and Officials mentioned in paragraph 1 above shall act so as to implement, jointly with the Federal Republic of Nigeria, the Abuja Joint Declaration as applicable to the Joint Development Authority.
3. All information that shall be made public pursuant to the Abuja Joint Declaration shall also be made public in accordance with paragraph 3 of Article 17 and paragraph 2 of Article 18 of this law.
4. In no case shall the State make any financial contribution to the budget of the Joint Development Authority or carry out any other obligation under the terms of the Treaty, without the approval of the National Assembly.

Article 30

(Conflicts)

1. No Person may be appointed or stay in office if such Person holds, directly or indirectly, on its own or through a third party, any economic, financial, participatory or other interest in activity related to Oil Revenues, or if such Person serves on boards, or is a representative, attorney-in-fact, agent or commissioner of, or otherwise represents any Person in which the Oil Revenues deposited into the Oil Accounts are held or invested.
2. Any Person in a situation described in paragraph 1 of this Article shall refuse his or her nomination, or shall resign from the position he or she has been appointed to, as the case may be.

3. Any person or entity who nominates, appoints, accepts or serves terms with the State Administration having knowledge of a conflict as described in paragraph 1 of this Article shall be punished with a fine equivalent to three times the amount such Person earned as compensation from the time he or she engaged in such activity until the time the conflict was uncovered.

4. Any Official who, due to the interest or resulting from his or her appointment, receives directly or through a third party, by any way or nature, an economic advantage from the violation of the provisions of this Article, will be punished with a fine equivalent to three times the economic advantage received.

5. In addition to the fines prescribed in this Article, the Official shall disgorge to the State the amount equivalent to the economic benefit including all proceeds earned by him or her or by a third party in connection with the violation.

6. Attempted violations shall always be punishable with a fine equivalent to half of the fine established for the consummated illegal act.

Article 31

(Violation of the law)

1. Until the law defined in Article 25 is approved, and without any prejudice to the penalties explicitly prescribed by this law, any violations of this law that constitute either a crime or a misdemeanor shall have their minimum terms increased by one third if related to Oil Resources or Oil Revenues.

2. For the purposes of this law, the daily fine is equivalent to the amount of three national minimum wages in effect at the time when the action or omission occurs.

3. Any violations of the mandatory provisions of this law shall be void and shall not bind or produce any legal effect against the State, except for the rights of bona fide third parties, as provided for and protected under applicable law, and the liability of Officials.

Article 32

(Secondary Application)

Matters not specifically addressed in this law or in regulations pursuant to this law shall be subject to the rules applicable to analogous matters specifically subject to this law and regulations pursuant to this law. In the absence or insufficiency of rules in this law and in regulations pursuant to this law, such matters shall be subject, by secondary application, to the provisions of the Oil Activities Law.

Article 33

(Effectiveness)

This law shall become effective five days after its publication in the Official Gazette.

Appendix 8

Venezuelan Law of the Investment Fund for Macroeconomic Stabilization (1999)

Article 1: An investment fund is created without legal personality attached to the Central Bank of Venezuela, which shall be known as the Investment Fund for Macroeconomic Stabilization, whose purpose shall be to ensure that fluctuations in oil income do not affect the necessary fiscal, exchange and monetary equilibrium of the country. The organization and operation of the Fund shall be governed by the provisions of this Decree and its Regulations.

Article 2: The Board of the Central Bank of Venezuela shall act as the Board of the Investment Fund for Macroeconomic Stabilization. The Board of the Fund shall exercise the highest level of control of the Fund; in particular its powers shall be the following:

- 1) Oversee compliance with the purpose of the Fund.
- 2) Approve the annual operating budget of the Fund.
- 3) Approve the annual report of results of the Fund. Copy of said report shall be sent to the Congress of the Republic within the fifteen days of approval.
- 4) Issue the internal operating rules of the Fund.
- 5) Approve disbursements from the Fund in the cases established in this Decree.
- 6) Establish the investment policies and criteria for the resources of the Fund.
- 7) Others powers necessary to ensure the proper operating functions of the Fund and compliance with its purpose.

Article 3: The resources of the Investment Fund for Macroeconomic Stabilization shall be constituted by:

- a) Contributions that, in accordance with the provisions of Articles 4, 5 and 6 of this Decree, shall be made by the Republic, the state entities and Petróleos de Venezuela, S.A.
- b) Net income obtained as proceeds from the operations made with the contributions referred to in the preceding letter.
- c) Net income resulting from disposal of its assets.
- d) Contributions by the National Executive other than those established in this Decree.

Article 4: The National Executive shall transfer to the Investment Fund for Macroeconomic Stabilization the following revenues, after deducting the amount corresponding to the constitutional appropriation [to state and local governments], the share to be transferred to the state entities in accordance with the Law on Special Economic Transfers to State Entities Derived from Mining and Hydrocarbons, and the portion of revenue which, pursuant to the Organic Law for Creation of the Public Debt Retirement Fund, shall be used for this latter fund:

- a) Revenues from income tax incurred by taxpayers engaged in the activities specified in Article 9 of the Income Tax Law, received in excess of the average of said income collected in the last five calendar years.
- b) Revenues from the production tax on oil and gas received in excess of the average of said income collected in last five calendar years.
- c) Income from dividends declared and paid by *Petróleos de Venezuela, S.A.* received in excess of the average of said income collected in the last five calendar years.
- d) Revenues from income tax incurred on the income received by *Petróleos de Venezuela, S.A.* and its subsidiaries incorporated or domiciled in Venezuela, arising from the participation shares paid by private pre-qualified companies to participate in bidding processes for the oil opening, from the runoff bonds offered and paid by the winning companies, from the net profitability bonds on projects (known as "PEG") paid on the basis of the percentage offered by the investors and from any other similar items.

For purposes of this article, the National Executive shall acquire foreign exchange currency from the Central Bank of Venezuela and shall transfer the resulting amount to the Investment Fund for Macroeconomic Stabilization.

Article 5: The state entities shall transfer to the Investment Fund for Macroeconomic Stabilization the resources received from the constitutional appropriation and from the special economic transfers, arising from the revenue received by the Republic for the items and cases referred to in the preceding article.

For purposes of this article, the National Executive, with the portion of revenue applicable to each state, shall acquire, for the account of each state, foreign exchange currency from the Central Bank of Venezuela and shall transfer it to the Investment Fund for Macroeconomic Stabilization and shall inform the state entities of the amount applicable to each of them transferred to the Fund.

Article 6: *Petróleos de Venezuela, S.A.* shall maintain in the Investment Fund for Macroeconomic Stabilization the income from export of hydrocarbons and its products, after deducting only the related taxes, arising from the increase in the export price of hydrocarbons and its products with respect to the average export price of the last five calendar years. Similarly, *Petróleos de Venezuela, S.A.* shall maintain in the Fund the extraordinary income received from the cases listed in letter d) of Article 4° of this Decree, after deducting the related income tax. *Petróleos de Venezuela, S.A.* shall maintain ownership of these funds.

For purposes of this article, *Petróleos de Venezuela, S.A.* shall transfer foreign exchange currency to the Investment Fund for Macroeconomic Stabilization.

Article 7: The Investment Fund for Macroeconomic Stabilization shall maintain in separate accounts the funds contributed by the Republic, the state entities and *Petróleos de Venezuela, S.A.*, as well as the proportional share of the income obtained from the investments made.

Article 8: After reaching the average level of income used as reference for determining the surplus income that the National Executive shall transfer to the Investment Fund for Macroeconomic Stabilization, as well as the resources that shall be maintained by Petróleos de Venezuela, S.A. in the Fund in accordance with Articles 4, 5 and 6 of this Decree, the National Executive and Petróleos de Venezuela, S.A. shall evaluate, during the first 30 calendar days of each quarter, if the income received during the immediately preceding quarter corresponds to the cases specified in this Decree and if it is a consequence of a price increase in the terms established therein, as the case may be, in which case the amounts applicable to the Fund shall be transferred during the 60 calendar days following the expiration of the time limit indicated in this Article.

In the case of the funds referred to in letter d) of Article 4 of this Decree, the transfer to the Investment Fund for Macroeconomic Stabilization shall be made during the 60 calendar days following their entry.

Article 9: The Investment Fund for Macroeconomic Stabilization shall sell foreign exchange currency to the Central Bank of Venezuela and shall make the transfer of the resulting bolivares to the National Treasury which, in turn, shall allocate up to 40% of said transfer to the Single Social Fund, when in accordance with the relevant legal procedures, the revenue to be collected by the Republic is re-estimated as a consequence of the following cases:

- a) Reduction in revenue from income tax incurred by taxpayers engaged in the activities specified in Article 9 of the Income Tax Law, with respect to the average of said income collected in the last five calendar years.
- b) Reduction in revenue from production taxes on oil and gas, with respect to the average of said income collected in the last five calendar years.

Article 10: The Investment Fund for Macroeconomic Stabilization shall sell foreign exchange currency to the Central Bank of Venezuela and shall make the transfer of the resulting bolivares to the respective state entity, when in accordance with the relevant legal procedures the revenue to be received by the respective state is re-estimated as a consequence of the following cases:

- a) Reduction of revenue from the constitutional appropriation arising from the reduction in revenue received by the Republic from income tax from taxpayers engaged in the activities specified in Article 9 of the Income Tax Law with respect to the average of said income received in the last five calendar years.
- b) Reduction in revenue from the constitutional appropriation arising from the reduction in revenue received by the Republic from the production tax on oil and gas with respect to the average of said income received in the last five calendar years.
- c) Reduction in income from the special economic transfers with respect to the average of said income received in the last five calendar years.

The Investment Fund for Macroeconomic Stabilization shall transfer directly to the municipalities, in accordance with the distribution indicated by the National Executive, the share that applies to them for the constitutional appropriation arising from the funds mentioned in this Article.

Article 11: The Investment Fund for Macroeconomic Stabilization shall transfer foreign exchange currency to Petróleos de Venezuela, S.A., when, in accordance with the decision of its Shareholders' Meeting, export income from hydrocarbons and its products is re-estimated, as a consequence of the reduction in the export price of said products with respect to the average export price of the last five calendar years.

Article 12: The transfer of funds by the Investment Fund for Macroeconomic Stabilization to the Republic, the state entities and *Petróleos de Venezuela, S.A.* requires the prior opinion of the Finance Committee of the Senate and the Chamber of Deputies of the Congress of the Republic acting jointly.

The opinion referred to in this Article shall be reported to the National Executive during the 20 business days following the date of receipt of the request for opinion. If not sent by said time limit, the opinion shall be considered favorable.

Article 13: The Board of the Investment Fund for Macroeconomic Stabilization shall approve the disbursement of funds from the Fund after the National Executive reports on compliance with the cases and conditions established in this Decree. Within one month from the decision adopted by the Board of the Fund, the timetable for the transfer by the Fund shall be agreed with the respective entity.

Article 14: In all the cases stipulated in Articles 9, 10 and 11, the respective adjustments based on the income actually received shall be made at the end of the respective fiscal year. In such case, the surplus funds contributed by the Fund shall be returned to the Investment Fund for Macroeconomic Stabilization. The refund shall occur within the three months following the date of determination by the Fund of its origin.

Article 15: In the cases stipulated in Articles 9, 10 and 11, the contribution that the Investment Fund for Macroeconomic Stabilization shall make to the respective entity shall not exceed the amount necessary to cover the difference in revenue, on the understanding that the contributions made by the Fund during a determined fiscal period may not be higher than two thirds of the balance of said Fund at the end of the immediately preceding fiscal year.

Article 16: When the amount of the funds destined for the Investment Fund for Macroeconomic Stabilization exceeds 80% of the amount equivalent to the average of the proceeds of the oil exports of the last five calendar years, the surplus shall be distributed as follows:

- a) The share applicable to the Republic shall be distributed as follows:
 1. A portion equivalent to 40% shall be allocated to the Single Social Fund.
 2. A portion equivalent to 25% shall be allocated to the Fund for Retirement of Venezuelan Public Debt.
 3. A portion equivalent to 35% shall be allocated to the Venezuelan Investment Fund.
- b) The share applicable to the state entities shall be transferred to them exclusively for investment spending.
- c) The share applicable to *Petróleos de Venezuela, S.A.* shall be transferred to that company in the terms established by the President of the Republic, in the Council of Ministers.

Article 17: For purposes of estimating the revenue of the National Executive in the Budget Law from the production tax on oil and gas, from income tax levied on said activities and from dividends of *Petróleos de Venezuela, S.A.*, the National Executive shall establish as estimated revenue from these items the average of the same for the last five calendar years.

Exceptionally, when the information available and the circumstances existing at the time of preparation of the annual budget are such that it is desirable to establish as estimated revenue for the items referred to in this Article a lower amount than the average for the last five calendar years, the National Executive shall establish a lower amount as estimated revenue for such items in the Budget Law. The adjustment of the estimate of revenue referred to in this Article shall consider, for purposes of determining its size, the availability of funds in the Investment Fund for Macroeconomic Stabilization during the period of the budget under consideration.

Article 18: The funds of the Investment Fund for Macroeconomic Stabilization shall be administered by the Central Bank of Venezuela in accordance with the policies and criteria determined by the latter for the management of the international reserves pursuant to the Central Bank Law. The resources of the Fund shall not form part of the international reserves or of the net worth of the Central Bank of Venezuela.

Article 19: The Central Bank of Venezuela, against the respective payment, shall provide the services, goods, personnel and other facilities necessary for the operation of the Investment Fund for Macroeconomic Stabilization.

Article 20: The Investment Fund for Macroeconomic Stabilization shall not give guarantees, issue debt instruments or undertake financial operations that represent indebtedness for the Fund. The Fund shall not make direct loans to the Republic, state entities or Petróleos de Venezuela, S.A.

Article 21: For purposes of interpretation and calculation of all the provisions contained in this Decree, the dollar of the United States of America is established as the unit of account.

Article 22: The operations of the Investment Fund for Macroeconomic Stabilization are exempt from payment of all taxes, fees or contributions. The Fund shall enjoy all the privileges and prerogatives enjoyed by the National Treasury.

Article 23: The provisions of other laws that conflict with this Decree shall not apply to the matters regulated herein.

Article 24: For purposes of the application of Articles 4, 5, first part of 6, 9, 10 and 11 of this Decree, from the entry into effect of the same until the 2004 fiscal year inclusive, instead of the parameter of the average of the last five calendar years, the following bases shall be applied:

- a) The amount of US\$420 million as the average revenue referred to in letter a) of Articles 4 and 9.
- b) The amount of US\$967 million as the average of revenue referred to in letter b) of Articles 4 and 9.
- c) The amount of US\$1,254 million as the average of revenue referred to in letter c) of Article 4.
- d) The amount of US\$9 as the average referred to in Articles 6 and 11, considering the income from export of hydrocarbons and its products.
- e) The amount of US\$105 million as the average referred to in letter a) of Article 10.
- f) The amount of US\$323 million as the average referred to in letters b) and c) of Article 10.

Article 25: For purposes of the application of Articles 4 and 5, the revenue from export of hydrocarbons and its products, referred to in Article 6, during the fiscal years relative to the period from 1999 to 2004, the parameters established in the preceding article shall also be used, but only an amount equivalent to 50% of the total that exceeds said parameters shall be transferred or maintained in the Investment Fund for Macroeconomic Stabilization.

Article 26: For the sole purpose of the application of Article 16 of this Decree, during the first five years of its operation, the President of the Republic, in the Council of Ministers, may authorize use of the revenue constituting the surplus alluded to in the first paragraph of said article, in accordance with the use established in all the letters, even before they reach the level mentioned in said provision, in accordance with the provisions of Article 12 of this Decree.

Article 27: For purposes of application of Article 15 of this Decree, from its effective date until fiscal year 2004, the contribution that the Investment Fund for Macroeconomic Stabilization shall make to the respective entity shall not exceed the parameters established in Article 24 of this Decree.

Article 28: Until the Single Social Fund referred to in Articles 9 and 16 of this Decree is created, the funds allocated to the same shall remain in the Investment Fund for Macroeconomic Stabilization, in the account of the Republic.

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Joint UNDP/World Bank
ENERGY SECTOR MANAGEMENT ASSISTANCE PROGRAMME (ESMAP)

LIST OF REPORTS ON COMPLETED ACTIVITIES

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	Francophone Household Energy Workshop (French)	08/89	--
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	Énergies modernes et réduction de la pauvreté: Un atelier multi-sectoriel. Actes de l'atelier régional. Douala, Cameroun du 16-18 juillet 2003. (French Only)	09/04	286/04
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Zaire	Energy Assessment (English)	05/86	5837-ZR
	Energy Assessment (English)	01/83	4110-ZA
Zambia	Status Report (English)	08/85	039/85
	Energy Sector Institutional Review (English)	11/86	060/86
	Power Subsector Efficiency Study (English)	02/89	093/88
	Energy Strategy Study (English)	02/89	094/88
	Urban Household Energy Strategy Study (English)	08/90	121/90
	Energy Assessment (English)	06/82	3765-ZIM
	Power System Efficiency Study (English)	06/83	005/83
Zimbabwe	Status Report (English)	08/84	019/84

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Zimbabwe	Power Sector Management Assistance Project (English)	04/85	034/85	
	Power Sector Management Institution Building (English)	09/89	--	
	Petroleum Management Assistance (English)	12/89	109/89	
	Charcoal Utilization Pre-feasibility Study (English)	06/90	119/90	
	Integrated Energy Strategy Evaluation (English)	01/92	8768-ZIM	
	Energy Efficiency Technical Assistance Project: Strategic Framework for a National Energy Efficiency Improvement Program (English)	04/94	--	
	Capacity Building for the National Energy Efficiency Improvement Programme (NEEIP) (English)	12/94	--	
	Rural Electrification Study	03/00	228/00	
EAST ASIA AND PACIFIC (EAP)				
Asia Regional China	Pacific Household and Rural Energy Seminar (English)	11/90	--	
	County-Level Rural Energy Assessments (English)	05/89	101/89	
	Fuelwood Forestry Preinvestment Study (English)	12/89	105/89	
	Strategic Options for Power Sector Reform in China (English)	07/93	156/93	
	Energy Efficiency and Pollution Control in Township and Village Enterprises (TVE) Industry (English)	11/94	168/94	
	Energy for Rural Development in China: An Assessment Based on a Joint Chinese/ESMAP Study in Six Counties (English)	06/96	183/96	
	Improving the Technical Efficiency of Decentralized Power Companies	09/99	222/99	
	Air Pollution and Acid Rain Control: The Case of Shijiazhuang City and the Changsha Triangle Area	10/03	267/03	
	Toward a Sustainable Coal Sector In China	07/04	287/04	
	Demand Side Management in a Restructured Industry: How Regulation and Policy Can Deliver Demand-Side Management Benefits to a Growing Economy and a Changing Power System	12/05	314/05	
Fiji	Energy Assessment (English)	06/83	4462-FIJ	
	Indonesia	11/81	3543-IND	
Indonesia	Status Report (English)	09/84	022/84	
	Power Generation Efficiency Study (English)	02/86	050/86	
	Energy Efficiency in the Brick, Tile and Lime Industries (English)	04/87	067/87	
	Diesel Generating Plant Efficiency Study (English)	12/88	095/88	
	Urban Household Energy Strategy Study (English)	02/90	107/90	
	Biomass Gasifier Preinvestment Study Vols. I & II (English)	12/90	124/90	
	Prospects for Biomass Power Generation with Emphasis on Palm Oil, Sugar, Rubberwood and Plywood Residues (English)	11/94	167/94	
	Lao PDR	Urban Electricity Demand Assessment Study (English)	03/93	154/93
		Institutional Development for Off-Grid Electrification	06/99	215/99
	Malaysia	Sabah Power System Efficiency Study (English)	03/87	068/87
Mongolia	Gas Utilization Study (English)	09/91	9645-MA	
	Energy Efficiency in the Electricity and District Heating Sectors	10/01	247/01	
	Improved Space Heating Stoves for Ulaanbaatar	03/02	254/02	
	Impact of Improved Stoves on Indoor Air Quality in Ulaanbaatar, Mongolia	11/05	313/05	
Myanmar	Energy Assessment (English)	06/85	5416-BA	

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Papua New Guinea	Energy Assessment (English)	06/82	3882-PNG
	Status Report (English)	07/83	006/83
	Institutional Review in the Energy Sector (English)	10/84	023/84
	Power Tariff Study (English)	10/84	024/84
Philippines	Commercial Potential for Power Production from Agricultural Residues (English)	12/93	157/93
	Energy Conservation Study (English)	08/94	--
	Strengthening the Non-Conventional and Rural Energy Development Program in the Philippines: A Policy Framework and Action Plan	08/01	243/01
	Rural Electrification and Development in the Philippines: Measuring the Social and Economic Benefits	05/02	255/02
Solomon Islands	Energy Assessment (English)	06/83	4404-SOL
	Energy Assessment (English)	01/92	979-SOL
South Pacific	Petroleum Transport in the South Pacific (English)	05/86	--
Thailand	Energy Assessment (English)	09/85	5793-TH
	Rural Energy Issues and Options (English)	09/85	044/85
	Accelerated Dissemination of Improved Stoves and Charcoal Kilns (English)	09/87	079/87
	Northeast Region Village Forestry and Woodfuels Preinvestment Study (English)	02/88	083/88
	Impact of Lower Oil Prices (English)	08/88	--
	Coal Development and Utilization Study (English)	10/89	--
	Why Liberalization May Stall in a Mature Power Market: A Review of the Technical and Political Economy Factors that Constrained the Electricity Sector Reform in Thailand 1998-2002	12/03	270/03
	Reducing Emissions from Motorcycles in Bangkok	10/03	275/03
Tonga	Energy Assessment (English)	06/85	5498-TON
Vanuatu	Energy Assessment (English)	06/85	5577-VA
Vietnam	Rural and Household Energy-Issues and Options (English)	01/94	161/94
	Power Sector Reform and Restructuring in Vietnam: Final Report to the Steering Committee (English and Vietnamese)	09/95	174/95
	Household Energy Technical Assistance: Improved Coal Briquetting and Commercialized Dissemination of Higher Efficiency Biomass and Coal Stoves (English)	01/96	178/96
	Petroleum Fiscal Issues and Policies for Fluctuating Oil Prices In Vietnam	02/01	236/01
	An Overnight Success: Vietnam's Switch to Unleaded Gasoline	08/02	257/02
	The Electricity Law for Vietnam—Status and Policy Issues—The Socialist Republic of Vietnam	08/02	259/02
	Petroleum Sector Technical Assistance for the Revision of the Existing Legal and Regulatory Framework	12/03	269/03
Western Samoa	Energy Assessment (English)	06/85	5497-WSO
SOUTH ASIA (SAS)			
Bangladesh	Energy Assessment (English)	10/82	3873-BD
	Priority Investment Program (English)	05/83	002/83
	Status Report (English)	04/84	015/84
	Power System Efficiency Study (English)	02/85	031/85
	Small Scale Uses of Gas Pre-feasibility Study (English)	12/88	--
	Reducing Emissions from Baby-Taxis in Dhaka	01/02	253/02

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India	Opportunities for Commercialization of Non-conventional Energy Systems (English)	11/88	091/88	
	Maharashtra Bagasse Energy Efficiency Project (English)	07/90	120/90	
	Mini-Hydro Development on Irrigation Dams and Canal Drops Vols. I, II and III (English)	07/91	139/91	
	WindFarm Pre-Investment Study (English)	12/92	150/92	
	Power Sector Reform Seminar (English)	04/94	166/94	
	Environmental Issues in the Power Sector (English)	06/98	205/98	
	Environmental Issues in the Power Sector: Manual for Environmental Decision Making (English)	06/99	213/99	
	Household Energy Strategies for Urban India: The Case of Hyderabad	06/99	214/99	
	Greenhouse Gas Mitigation In the Power Sector: Case Studies From India	02/01	237/01	
	Energy Strategies for Rural India: Evidence from Six States	08/02	258/02	
	Household Energy, Indoor Air Pollution, and Health	11/02	261/02	
	Access of the Poor to Clean Household Fuels	07/03	263/03	
	The Impact of Energy on Women's Lives in Rural India	01/04	276/04	
	Environmental Issues in the Power Sector: Long-Term Impacts And Policy Options for Rajasthan	10/04	292/04	
	Environmental Issues in the Power Sector: Long-Term Impacts And Policy Options for Karnataka	10/04	293/04	
	Nepal	Energy Assessment (English)	08/83	4474-NEP
		Status Report (English)	01/85	028/84
		Energy Efficiency & Fuel Substitution in Industries (English)	06/93	158/93
	Pakistan	Household Energy Assessment (English)	05/88	--
Assessment of Photovoltaic Programs, Applications, and Markets (English)		10/89	103/89	
Pakistan	National Household Energy Survey and Strategy Formulation Study: Project Terminal Report (English)	03/94	--	
	Managing the Energy Transition (English)	10/94	--	
	Lighting Efficiency Improvement Program Phase 1: Commercial Buildings Five Year Plan (English)	10/94	--	
	Clean Fuels	10/01	246/01	
	Household Use of Commercial Energy	05/06	320/06	
Regional	Toward Cleaner Urban Air in South Asia: Tackling Transport Pollution, Understanding Sources.	03/04	281/04	
Sri Lanka	Energy Assessment (English)	05/82	3792-CE	
	Power System Loss Reduction Study (English)	07/83	007/83	
	Status Report (English)	01/84	010/84	
	Industrial Energy Conservation Study (English)	03/86	054/86	
	Sustainable Transport Options for Sri Lanka: Vol. I	02/03	262/03	
	Greenhouse Gas Mitigation Options in the Sri Lanka Power Sector: Vol. II	02/03	262/03	
	Sri Lanka Electric Power Technology Assessment (SLEPTA): Vol. III	02/03	262/03	
	Energy and Poverty Reduction: Proceedings from South Asia Practitioners Workshop How Can Modern Energy Services Contribute to Poverty Reduction? Colombo, Sri Lanka, June 2-4, 2003	11/03	268/03	

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EUROPE AND CENTRAL ASIA (ECA)			
Armenia	Development of Heat Strategies for Urban Areas of Low-income Transition Economies. Urban Heating Strategy for the Republic Of Armenia. <i>Including a Summary of a Heating Strategy for the Kyrgyz Republic</i>	04/04	282/04
Bulgaria	Natural Gas Policies and Issues (English)	10/96	188/96
	Energy Environment Review	10/02	260/02
Central Asia and The Caucasus	Cleaner Transport Fuels in Central Asia and the Caucasus	08/01	242/01
Central and Eastern Europe	Power Sector Reform in Selected Countries	07/97	196/97
Central and Eastern Europe	Increasing the Efficiency of Heating Systems in Central and Eastern Europe and the Former Soviet Union (English and Russian)	08/00	234/00
	The Future of Natural Gas in Eastern Europe (English)	08/92	149/92
Kazakhstan	Natural Gas Investment Study, Volumes 1, 2 & 3	12/97	199/97
Kazakhstan & Kyrgyzstan	Opportunities for Renewable Energy Development	11/97	16855-KAZ
Poland	Energy Sector Restructuring Program Vols. I-V (English)	01/93	153/93
	Natural Gas Upstream Policy (English and Polish)	08/98	206/98
	Energy Sector Restructuring Program: Establishing the Energy Regulation Authority	10/98	208/98
Portugal	Energy Assessment (English)	04/84	4824-PO
Romania	Natural Gas Development Strategy (English)	12/96	192/96
	Private Sector Participation in Market-Based Energy-Efficiency Financing Schemes: Lessons Learned from Romania and International Experiences.	11/03	274/03
Slovenia	Workshop on Private Participation in the Power Sector (English)	02/99	211/99
Turkey	Energy Assessment (English)	03/83	3877-TU
	Energy and the Environment: Issues and Options Paper	04/00	229/00
	Energy and Environment Review: Synthesis Report	12/03	273/03
MIDDLE EAST AND NORTH AFRICA (MNA)			
Arab Republic of Egypt	Energy Assessment (English)	10/96	189/96
	Energy Assessment (English and French)	03/84	4157-MOR
	Status Report (English and French)	01/86	048/86
Morocco	Energy Sector Institutional Development Study (English and French)	07/95	173/95
	Natural Gas Pricing Study (French)	10/98	209/98
	Gas Development Plan Phase II (French)	02/99	210/99
Syria	Energy Assessment (English)	05/86	5822-SYR
	Electric Power Efficiency Study (English)	09/88	089/88
	Energy Efficiency Improvement in the Cement Sector (English)	04/89	099/89
	Energy Efficiency Improvement in the Fertilizer Sector (English)	06/90	115/90
Tunisia	Fuel Substitution (English and French)	03/90	--
	Power Efficiency Study (English and French)	02/92	136/91
	Energy Management Strategy in the Residential and Tertiary Sectors (English)	04/92	146/92
	Renewable Energy Strategy Study, Volume I (French)	11/96	190A/96
	Renewable Energy Strategy Study, Volume II (French)	11/96	190B/96

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Tunisia	Rural Electrification in Tunisia: National Commitment, Efficient Implementation and Sound Finances	08/05	307/05
Yemen	Energy Assessment (English)	12/84	4892-YAR
	Energy Investment Priorities (English)	02/87	6376-YAR
	Household Energy Strategy Study Phase I (English)	03/91	126/91
	Household Energy Supply and Use in Yemen. Volume I: Main Report and Volume II: Annexes	12/05	315/05
LATIN AMERICA AND THE CARIBBEAN REGION (LCR)			
LCR Regional	Regional Seminar on Electric Power System Loss Reduction in the Caribbean (English)	07/89	--
	Elimination of Lead in Gasoline in Latin America and the Caribbean (English and Spanish)	04/97	194/97
	Elimination of Lead in Gasoline in Latin America and the Caribbean - Status Report (English and Spanish)	12/97	200/97
	Harmonization of Fuels Specifications in Latin America and the Caribbean (English and Spanish)	06/98	203/98
	Energy and Poverty Reduction: Proceedings from the Global Village Energy Partnership (GVEP) Workshop held in Bolivia	06/05	202/05
	Power Sector Reform and the Rural Poor in Central America	12/04	297/04
	Estudio Comparativo Sobre la Distribución de la Renta Petrolera en Bolivia, Colombia, Ecuador y Perú	08/05	304/05
	OECS Energy Sector Reform and Renewable Energy/Energy Efficiency Options	02/06	317/06
	The Landfill Gas-to-Energy Initiative for Latin America and the Caribbean	02/06	318/06
Bolivia	Energy Assessment (English)	04/83	4213-BO
	National Energy Plan (English)	12/87	--
	La Paz Private Power Technical Assistance (English)	11/90	111/90
	Pre-feasibility Evaluation Rural Electrification and Demand Assessment (English and Spanish)	04/91	129/91
	National Energy Plan (Spanish)	08/91	131/91
	Private Power Generation and Transmission (English)	01/92	137/91
	Natural Gas Distribution: Economics and Regulation (English)	03/92	125/92
	Natural Gas Sector Policies and Issues (English and Spanish)	12/93	164/93
	Household Rural Energy Strategy (English and Spanish)	01/94	162/94
	Preparation of Capitalization of the Hydrocarbon Sector	12/96	191/96
	Introducing Competition into the Electricity Supply Industry in Developing Countries: Lessons from Bolivia	08/00	233/00
	Final Report on Operational Activities Rural Energy and Energy Efficiency	08/00	235/00
	Oil Industry Training for Indigenous People: The Bolivian Experience (English and Spanish)	09/01	244/01
	Capacitación de Pueblos Indígenas en la Actividad Petrolera. Fase II	07/04	290/04
	Estudio Sobre Aplicaciones en Pequeña Escala de Gas Natural	07/04	291/04
Brazil	Energy Efficiency & Conservation: Strategic Partnership for Energy Efficiency in Brazil (English)	01/95	170/95
	Hydro and Thermal Power Sector Study	09/97	197/97
	Rural Electrification with Renewable Energy Systems in the Northeast: A Preinvestment Study	07/00	232/00
	Reducing Energy Costs in Municipal Water Supply Operations "Learning-while-doing" Energy M&T on the Brazilian Frontlines	07/03	265/03

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Chile	Energy Sector Review (English)	08/88	7129-CH
Colombia	Energy Strategy Paper (English)	12/86	--
	Power Sector Restructuring (English)	11/94	169/94
Colombia	Energy Efficiency Report for the Commercial and Public Sector (English)	06/96	184/96
Costa Rica	Energy Assessment (English and Spanish)	01/84	4655-CR
	Recommended Technical Assistance Projects (English)	11/84	027/84
	Forest Residues Utilization Study (English and Spanish)	02/90	108/90
Dominican Republic	Energy Assessment (English)	05/91	8234-DO
Ecuador	Energy Assessment (Spanish)	12/85	5865-EC
	Energy Strategy Phase I (Spanish)	07/88	--
	Energy Strategy (English)	04/91	--
	Private Mini-hydropower Development Study (English)	11/92	--
	Energy Pricing Subsidies and Interfuel Substitution (English)	08/94	11798-EC
	Energy Pricing, Poverty and Social Mitigation (English)	08/94	12831-EC
Guatemala	Issues and Options in the Energy Sector (English)	09/93	12160-GU
	Health Impacts of Traditional Fuel Use	08/04	284/04
Haiti	Energy Assessment (English and French)	06/82	3672-HA
	Status Report (English and French)	08/85	041/85
	Household Energy Strategy (English and French)	12/91	143/91
Honduras	Energy Assessment (English)	08/87	6476-HO
	Petroleum Supply Management (English)	03/91	128/91
Jamaica	Energy Assessment (English)	04/85	5466-JM
	Petroleum Procurement, Refining, and Distribution Study (English)	11/86	061/86
	Energy Efficiency Building Code Phase I (English)	03/88	--
	Energy Efficiency Standards and Labels Phase I (English)	03/88	--
Jamaica	Management Information System Phase I (English)	03/88	--
	Charcoal Production Project (English)	09/88	090/88
	FIDCO Sawmill Residues Utilization Study (English)	09/88	088/88
	Energy Sector Strategy and Investment Planning Study (English)	07/92	135/92
Mexico	Improved Charcoal Production Within Forest Management for the State of Veracruz (English and Spanish)	08/91	138/91
	Energy Efficiency Management Technical Assistance to the Comisión Nacional para el Ahorro de Energía (CONAE) (English)	04/96	180/96
	Energy Environment Review	05/01	241/01
Nicaragua	Modernizing the Fuelwood Sector in Managua and León	12/01	252/01
	Policy & Strategy for the Promotion of RE Policies in Nicaragua. (Contains CD with 3 complementary reports)	01/06	316/06
Panama	Power System Efficiency Study (English)	06/83	004/83
Paraguay	Energy Assessment (English)	10/84	5145-PA
	Recommended Technical Assistance Projects (English)	09/85	--
	Status Report (English and Spanish)	09/85	043/85
	Reforma del Sector Hidrocarburos (Spanish Only)	03/06	319/06
Peru	Energy Assessment (English)	01/84	4677-PE
	Status Report (English)	08/85	040/85
	Proposal for a Stove Dissemination Program in the Sierra (English and Spanish)	02/87	064/87
	Energy Strategy (English and Spanish)	12/90	--

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Peru	Study of Energy Taxation and Liberalization of the Hydrocarbons Sector (English and Spanish)	120/93	159/93
	Reform and Privatization in the Hydrocarbon Sector (English and Spanish)	07/99	216/99
	Rural Electrification	02/01	238/01
Saint Lucia	Energy Assessment (English)	09/84	5111-SLU
St. Vincent and the Grenadines	Energy Assessment (English)	09/84	5103-STV
Sub Andean	Environmental and Social Regulation of Oil and Gas Operations in Sensitive Areas of the Sub-Andean Basin (English and Spanish)	07/99	217/99
Trinidad and Tobago	Energy Assessment (English)	12/85	5930-TR

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	Energy End Use Efficiency: Research and Strategy (English)	11/89	--
	Women and Energy--A Resource Guide		
	The International Network: Policies and Experience (English)	04/90	--
	Guidelines for Utility Customer Management and Metering (English and Spanish)	07/91	--
	Assessment of Personal Computer Models for Energy Planning in Developing Countries (English)	10/91	--
	Long-Term Gas Contracts Principles and Applications (English)	02/93	152/93
	Comparative Behavior of Firms Under Public and Private Ownership (English)	05/93	155/93
	Development of Regional Electric Power Networks (English)	10/94	--
	Roundtable on Energy Efficiency (English)	02/95	171/95
	Assessing Pollution Abatement Policies with a Case Study of Ankara (English)	11/95	177/95
	A Synopsis of the Third Annual Roundtable on Independent Power Projects: Rhetoric and Reality (English)	08/96	187/96
	Rural Energy and Development Roundtable (English)	05/98	202/98
	A Synopsis of the Second Roundtable on Energy Efficiency: Institutional and Financial Delivery Mechanisms (English)	09/98	207/98
	The Effect of a Shadow Price on Carbon Emission in the Energy Portfolio of the World Bank: A Carbon Backcasting Exercise (English)	02/99	212/99
	Increasing the Efficiency of Gas Distribution Phase 1: Case Studies and Thematic Data Sheets	07/99	218/99
	Global Energy Sector Reform in Developing Countries: A Scorecard	07/99	219/99
	Global Lighting Services for the Poor Phase II: Text Marketing of Small "Solar" Batteries for Rural Electrification Purposes	08/99	220/99
	A Review of the Renewable Energy Activities of the UNDP/ World Bank Energy Sector Management Assistance Programme 1993 to 1998	11/99	223/99
	Energy, Transportation and Environment: Policy Options for Environmental Improvement	12/99	224/99

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	Privatization, Competition and Regulation in the British Electricity Industry, With Implications for Developing Countries	02/00	226/00
	Reducing the Cost of Grid Extension for Rural Electrification	02/00	227/00
	Undeveloped Oil and Gas Fields in the Industrializing World	02/01	239/01
	Best Practice Manual: Promoting Decentralized Electrification Investment	10/01	248/01
	Peri-Urban Electricity Consumers—A Forgotten but Important Group: What Can We Do to Electrify Them?	10/01	249/01
	Village Power 2000: Empowering People and Transforming Markets	10/01	251/01
	Private Financing for Community Infrastructure	05/02	256/02
	Stakeholder Involvement in Options Assessment: Promoting Dialogue in Meeting Water and Energy Needs: A Sourcebook	07/03	264/03
	A Review of ESMAP's Energy Efficiency Portfolio	11/03	271/03
	A Review of ESMAP's Rural Energy and Renewable Energy Portfolio	04/04	280/04
	ESMAP Renewable Energy and Energy Efficiency Reports 1998-2004 (CD Only)	05/04	283/04
	Regulation of Associated Gas Flaring and Venting: <i>A Global Overview and Lessons Learned from International Experience</i>	08/04	285/04
	ESMAP Gender in Energy Reports and Other related Information (CD Only)	11/04	288/04
	ESMAP Indoor Air Pollution Reports and Other related Information (CD Only)	11/04	289/04
	Energy and Poverty Reduction: Proceedings from the Global Village Energy Partnership (GVEP) Workshop on the Pre-Investment Funding. Berlin, Germany, April 23-24, 2003.	11/04	294/04
	Global Village Energy Partnership (GVEP) Annual Report 2003	12/04	295/04
	Energy and Poverty Reduction: Proceedings from the Global Village Energy Partnership (GVEP) Workshop on Consumer Lending and Microfinance to Expand Access to Energy Services, Manila, Philippines, May 19-21, 2004	12/04	296/04
	The Impact of Higher Oil Prices on Low Income Countries And on the Poor	03/05	299/05
	Advancing Bioenergy for Sustainable Development: Guideline For Policymakers and Investors	04/05	300/05
	ESMAP Rural Energy Reports 1999-2005	03/05	301/05
	Renewable Energy and Energy Efficiency Financing and Policy Network: Options Study and Proceedings of the International Forum	07/05	303/05
	Implementing Power Rationing in a Sensible Way: Lessons Learned and International Best Practices	08/05	305/05
	The Urban Household Energy Transition. Joint Report with RFF Press/ESMAP. ISBN 1-933115-07-6	08/05	309/05
	Pioneering New Approaches in Support of Sustainable Development In the Extractive Sector: Community Development Toolkit, also Includes a CD containing Supporting Reports	10/05	310/05
	Analysis of Power Projects with Private Participation Under Stress	10/05	311/05
	Potential for Biofuels for Transport in Developing Countries	10/05	312/05
	Experiences with Oil Funds: Institutional and Financial Aspects	06/06	321/06

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