



World Bank Group in Mongolia
Conference Note

Effective Sovereign Wealth Fund Management in Mongolia: What Principles Apply?

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9 May 2013



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I. Background

This policy note is motivated by a recent international conference hosted by the Mongolian Ministry of Finance and the World Bank in Ulaanbaatar on 20-21 March 2013. International guests joined Mongolian government officials, Members of Parliament and civil society to discuss what lessons could be gathered from international experience to guide the design of an effective Sovereign Wealth Fund (SWF).

Experiences of natural resource management were shared between practitioners from Mongolia and Norway, Chile, Botswana, Timor-Leste, Trinidad and Tobago and Abu Dhabi. All the presentations are available via the World Bank Mongolia website:

<http://www.worldbank.org/en/news/press-release/2013/03/20/for-effective-sovereign-wealth-fund-management>

II. Six Key Lessons from the Conference

A key lesson from the conference is that even countries successful with avoiding the resource curse have evolved their instruments (including SWF) for managing natural resources in an incremental and iterative manner. Norway –the prime example of extractives prudence- enjoyed over 25 years of oil revenues before accumulating savings in a SWF. Country experiences are not constant across time and good performance apparent in one period is not necessarily maintained. An honest assessment suggests most countries muddle through the challenges of natural resource management. This bolsters the argument that there is no best practice and instead only general principles that can be extracted from international experience to help design a SWF in Mongolia.

The following principles –garnered from international experience- can help guide Mongolia towards the design of an effective SWF that is right for the Mongolian context.

1. **Make objectives clear and design the SWF accordingly.** Different types of SWF have been developed for different reasons (for example economic stability, to meet pension liabilities; and inter-generational savings). A SWF is not a silver bullet and should not be over-burdened with too many objectives.
2. **Keep it simple and evolve over time.** Managing fiscal instruments and enhancing institutions is an iterative and incremental process and a lot will be learnt along the way. Start with something straight forward (for example keep investments simple and low risk at first) and increase sophistication as financial skills and lessons are gained). Some SWF do invest domestically –the merits of which are currently being debated- but this should be approached carefully as there are significant risks.
3. **Integrate the SWF with a disciplined fiscal policy.** A SWF is not sufficient on its own to stabilize an economy; it must importantly be combined with a commitment to fiscal discipline. All expenditures should also be kept on-budget and the recent proliferation of off-budget expenditures should be reversed. A country like Mongolia should of course invest domestically, but it should occur through the budget and fiscal surplus should be accumulated in the SWF.
4. **Build political and public support for saving.** Public debates and consultations on the topic should be encouraged to ensure sufficient buy-in for the SWF over-time.

5. **Transparency and accountability are key factors for success.** The rules for and operations of the SWF must be made clear to stakeholders through regular and widely available reporting. Both the legislature and the public should be able to view and understand the SWFs business, to ensure widespread support. Ideas from other countries include: a Citizen’s guide to the budget, quarterly reports published on websites in local language and English, brochures, websites, public lectures (in schools and universities), and regular press statements.
6. **Invest in the SWF only in times of fiscal surplus.** It does not make sense to borrow in order to accumulate financial assets in the SWF as returns from the saving may be lower than the cost of the borrowing.

III. The Status-Quo in Mongolia

Mongolia is experiencing a major economic transformation thanks to its vast mineral resources. It has been one of the fastest growing economies in the world registering economic growth of 17.5 percent in 2011 and 12.3 percent in 2012. Estimated to have the potential to provide at least a third of national GDP, the development of the Oyu Tolgoi copper and gold mine—along with other mineral discoveries—promises to transform this nation’s economy. The natural resource revenues provide a great opportunity to significantly enhance national wealth and share prosperity across all Mongolians.

Large revenue windfalls from minerals do not come without significant challenge. Increasing reliance on mineral resources —given their highly volatile nature— makes the Mongolian economy more vulnerable to mineral market downturn. This was clearly evident during the 2008-2009 crisis when collapsing prices led to a rapid depletion of fiscal space and severe contraction of the economy. Efforts have been since made to manage such volatility and Mongolia has a Fiscal Stability Law limiting budget deficits and a stabilization account. But it requires saving into the account and some improvements to the design. There is also no merit in bypassing the stability laws and procedures by spending money off-budget, as witnessed in 2012 and now in 2013, as it prevents the above mentioned challenges from being met. None of the saving or smoothing mechanisms will work unless there is a disciplined fiscal policy.

Going forward, counter-cyclical fiscal policy and proper management of mineral revenues will be critical to ensuring stable and sustainable economic growth and to turning the expected mineral revenue streams into a strong foundation of prosperity for future generations. In this context, the Ministry of Finance has been working to develop a comprehensive framework for SWF management. As the Government defines a set of concrete actions including drafting a new legislation that will stipulate guidelines of sovereign wealth management, it will need to develop public and political consensus around the design and management of a SWF.

IV. Why does Mongolia need a Sovereign Wealth Fund?

So why should Mongolia save? The main reason being reliance on non-renewable natural resources (which Mongolia’s geology provides in plenty) poses significant challenges to policymakers. These challenges were clearly set out during the conference by Rolando Ossowski (former Assistant Director at the Fiscal affairs Department of the IMF) and are fourfold. First, natural resource revenues are volatile

and uncertain. Global prices can change to great extent, without warning and are almost impossible to project reliably. Second, natural resources run out; they are exhaustible. The benefits must be made to last by transferring some (and not all) for future generations. Third, Mongolia will be selling most of its copper, coal, oil and other minerals abroad. This has implications for the domestic economy in terms of how the non-mining sector competes and in terms of macroeconomic stability. Fourth, the exploitation of natural resources can be a source of corruption and inefficiency. Mongolia needs to deliver value for money when investing and spending tax payers' and mining revenues.

V. Ideas for Next Steps

Eric Parrado, former head of the Chilean 'Economic and Social Stabilization Fund', has been working with the government to design a mechanism to save natural resource revenues to first smooth the economy and second provide for future generations of Mongolians. In his presentation '*A Review of Options for Managing Wealth and Opportunities in Mongolia*' he provided some guidance for the next steps. Eric Parrado's proposal involves the move towards two SWFs and a pension fund, each with clear objectives:

- i. The Fiscal Stability Fund (FSF), a SWF which has been established already the Fiscal Stability Law (2010), to act as a truly countercyclical policy device that will help Mongolia weather the cyclicity of the commodity markets.
- ii. The Future Generations Fund (FGF), a SWF to establish a ring-fenced diversified portfolio of appropriate investments for the benefit of future generations of Mongolian citizens.
- iii. The Pension Reserve Fund (PRF) to establish a ring-fenced portfolio of investments specifically related to and with the object of financing future fiscal obligations that stem from guarantees of minimum pensions.

To move towards this framework, Eric Parrado suggested some next steps for the government to consider¹:

- Hold **public debate and consultation** to devise clear objectives for the SWFs and Pension fund.
- Develop revised **legislation** for the SWF. One option is a SWF law. (And it is likely that several corresponding amendments will need to be made to the FSL). This should include clear accumulation rules (ensuring funds are not borrowed in order to accumulate savings in the SWF).
- Develop **institutional arrangements**. There are two options. First, build a new independent institution from the governments (examples include South Korea, China and Kuwait). Second, use the Ministry of Finance to manage the SWFs or the Central Bank as in Chile, Botswana, Norway and Trinidad and Tobago.
- The **investment policy** should start simple and be 'safe' at first. There is a need to learn how to accept risk. There is a need to think of newspaper headline risk as well as financial risk. All resources should be invested abroad.

¹ These build on a recent report Eric Parrado drafted following consultation with the Ministry of Finance in 2012 as part of a World Bank financed project.

Annex A: Country SWF Snap-Shots from the Conference

Country: Timor-Leste	
Country Information:	
Population: 1.2 million. GDP per capita: USD 9,500 (2012) Area: 14,874 sq km. Oil provides 80% of GDP.	Natural resources types: petroleum, natural gas, gold, manganese and marble. Petroleum revenues as % of total gov't: 95%
Selected Information on Sovereign Wealth Fund from Conference presentation:	
<ul style="list-style-type: none"> — Timor-Leste Petroleum Fund (TLPF) has been active since August 2005 and is guided by a Petroleum Fund Law. The objective of the Fund is that it contributes to both the current and future generations. It is a tool to contribute to sound fiscal policy, where appropriate consideration and weight is given to long-term interests of Timor-Leste's citizens. — The Central Bank is the operational manager and they report on a quarterly basis to the Ministry of Finance and the public. There is Consultative council with church members, former presidents, former prime ministers; civil society is a key member. — The Petroleum Fund Law limits maximum risk of the fund (no more than half in equities). — There are other mechanisms to invest domestically including human capital and infrastructure funds. They have a multi-year structure but all expenditures must on budget. Money cannot go directly from oil and all funds to these funds and must instead go through the budget each year that is approved by parliament. 	
Website links:	
Ministry of Finance: http://www.mof.gov.tl/about-the-ministry/ Central Bank: http://www.bancocentral.tl/en/ SWF institute ranking: http://www.swfinstitute.org/swfs/timor-leste-petroleum-fund/ Accessed 29 March 2013.	

Country: Botswana	
Country Information:	
Population: 2.1 million. GDP per capita: USD 16,800 (2012) Area: 581,730 sq km.	Natural resources types: diamonds, but also copper, nickel, salt, soda ash, potash, coal, iron ore, silver Mining: 27% of GDP (2001-11 average) Natural resources: 86% exports & 44% gov't revenues.
Selected Information on Sovereign Wealth Fund from Conference presentation:	
<ul style="list-style-type: none"> — Mines and Mineral Act and Income Tax Act lay out framework. — They invest mining revenues in physical assets (infrastructure), human capital (skills) and financial assets. — Financial investments are for stabilization and long-term annuity (for future generations) and take place through the Pula Fund (although lack of clarity on the balance). — Fiscal surplus is accumulated through the Pula Fund and most Pula Fund assets are held off-shore. — A mixture of in-house (Central Bank) and contracted managers invests financial assets. — Fiscal rules guide spending and saving decisions (for example public debt limited to 40% of GDP). — Very little off-budget expenditure and policies supported by fiscal discipline and good macroeconomic management. — The Bank of Botswana is responsible for managing the fund. 	

- Key elements of success are very little corruption and good negotiation skills (Botswana gets 81% share of diamond profits).

Website links:

Ministry of Finance: http://www.finance.gov.bw/index.php?option=com_content1&id=297
 Central Bank: <http://www.bankofbotswana.bw/>
 SWF institute ranking: <http://www.swfinstitute.org/swfs/pula-fund/>
 Sovereign Wealth Fund: <http://www.bankofbotswana.bw/content/2009103013033-pula-fund>
Accessed 29 March 2013.

Country: Norway

Country Information:

Population: 4.7 million. GDP per capita: USD 55,300 (2012) Area: 323,802 sq km.	Natural resources types: petroleum, natural gas, iron ore, copper, lead, zinc, titanium, pyrites, nickel, fish, timber, hydropower. Petroleum % of GDP: 23% Petroleum % of exports: 49%
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Selected Information on Sovereign Wealth Fund from Conference presentation:

- The Government Pension Fund Global (GPF), Norway’s SWF, helps separate spending from current revenues. It is one for the largest funds in the world. A long-term investment horizon is taken.
- The GPF helps turn volatile petroleum revenues into long-term benefits.
- The framework developed over a long period and Norway utilized petroleum revenues for 25 years before savings in the GPF.
- The fund is managed by Norges Bank Investment Management (NBIM) a branch of the Norges Bank (Norway’s Central Bank).
- The Fund is fully integrated with fiscal policy and underpinned by fiscal discipline.
- Fiscal rule introduced in 2001 to phase petroleum revenues into the economy in line with the expected real return of the fund (estimated at 4%). Considerable emphasis on stabilizing the economy.
- High degree of transparency with the fund helps maintain public and cross-political support for saving.

Website links:

Ministry of Finance: <http://www.regjeringen.no/en/dep/fin.html?id=216>
 Central Bank: <http://www.norges-bank.no/en/>
 SWF institute ranking: <http://www.swfinstitute.org/swfs/norway-government-pension-fund-global/>
 Sovereign Wealth Fund: http://www.norges-bank.no/default___25991.aspx
Accessed 29 March 2013.

Country: Chile

Country Information:

Population: 17.2 million. GDP per capita: USD 18,400 (2012) Area: 756,102 sq km.	Natural resources types: copper, timber, iron ore, nitrates, precious metals, molybdenum, hydropower Copper as % of total GDP: 13% Copper as % gov’t revenues: 15%.
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Selected Information on Sovereign Wealth Fund from Conference presentation:

- The Fiscal Responsibility Law provides for two SWFs: (i) the Pension Reserve fund (USD 5.9 bn as of January 2013) and (ii) the Economic and Social Stabilization Fund (ESSF) (USD 15 bn as of January 2013).
- The Minister of Finance delegated management of the funds to the Central Bank of Chile (given the Bank's experience and reputation in managing Chile's international reserves).
- A Financial Committee advises the Minister of Finance on the design of an investment policy for the funds.
- The Pension fund will help meet contingent liabilities of the government.
- The ESSF is there to finance potential fiscal deficits and amortize public det.
- The ESSF helps Chile with a counter-cyclical fiscal policy and protect government spending from the volatility of global copper prices.
- Transparency has been maintained since the SWFs establishment in 2006. Public information is made available.

Website links:

Ministry of Finance: <http://www.hacienda.cl/english.html>

Central Bank: <http://www.bcentral.cl/eng/index.asp>

SWF institute ranking: <http://www.swfinstitute.org/swfs/social-and-economic-stabilization-fund/>

Sovereign Wealth Fund: <http://www.hacienda.cl/english/sovereign-wealth-funds/economic-and-social-stabilization-fund.html>

Accessed 29 March 2013.

Country: Abu Dhabi (UAE)**Country Information:**

UAE Population: 5.4 million (NB Abu Dhabi is one of the seven Emirates).

GDP per capita: USD 49,500 (2012)

Area UAE: 83,600 sq km.

Natural resources types: petroleum (7% of global reserves) , natural gas.

Natural resource revenues as % of total:

Natural resources as % exports:

Selected Information on Sovereign Wealth Fund from Conference presentation:

- The Abu Dhabi Investment Authority (ADIA) was set-up in 1976 and aims to secure and maintain the future welfare of the Emirate.
- The fund is owned 100 percent by the government but remains an independent legal identity with full capacity to act in fulfilling its objectives and statutory mandate.
- The ADIA has a goal of long-term financial returns.
- The ADIA has a professional workforce of 1,200 well trained in financial management and investment.
- A diversified strategy is maintained for risk management purposes.

Website links:

Ministry of Finance: <http://www.mof.gov.ae/en/Pages/default.aspx>

Central Bank: <http://www.centralbank.ae/en/index.php>

SWF institute ranking: <http://www.swfinstitute.org/swfs/abu-dhabi-investment-authority/> and

<http://www.swfinstitute.org/swfs/abu-dhabi-investment-council/>

Accessed 29 March 2013.

Country: Trinidad and Tobago

Country Information:

Population: 1.3 million.

GDP per capita: USD 20,400 (2012)

Area: 5,128 sq km.

Energy sector: 40% GDP.

Natural resources types: petroleum, natural gas and asphalt.

Energy sector revenues as % of total gov't: 58%

Energy Sector as % total exports: 83%

Selected Information on Sovereign Wealth Fund from Conference presentation:

- Trinidad and Tobago has a 'Heritage and Stabilization Fund' (HSF) that is both a stabilization and savings fund. It was established in 2000 as part of the Interim Revenue Stabilization Fund (IRSF) but formalized in March 2007 following Parliament passing the HSF Act. These efforts followed experience of two oil booms in the 1970's when government spending went unchecked and the non-energy deficit climbed from under 10% to over 40% in the 1980s. There was consensus that the same mistake should not happen again in the 2000s.
- The objective of the HSF is twofold. First, to insulate fiscal policy and the economy from adverse swings in international oil and gas prices (the stabilization objective). Second, to accumulate savings from the country's exhaustible assets of oil and gas for future generations (the heritage element).
- The Central Bank is the fund manager, but it outsources functions to external fund managers. There is quarterly reporting to the Minister of Finance who in turn reports to Parliament. An annual audit of the fund is carried out by the Auditor General's Office.
- There is a savings rule, withdrawal rule and clearly defined governance and disclosure/ reporting regimes. The withdrawal rule allows draw-downs only when energy revenues are at least 10% budgeted revenues. Withdrawals can be up to 60% of the shortfall but cannot exceed 25% of the fund and there's a capital floor on USD 1 billion.
- The fund does not invest in assets directly related to oil and gas, cannot be used as collateral for government borrowing and has a medium-to-long horizon.

Website links:

Ministry of Finance: <http://www.finance.gov.tt/>

Central Bank: <http://www.central-bank.org.tt/>

HSF Act: <http://www.finance.gov.tt/legislation.php?mid=20>

SWF institute ranking: <http://www.swfinstitute.org/swfs/heritage-and-stabilization-fund/>

Accessed 29 March 2013.

Annex B: International SWF Conference Agenda

International Conference on Effective Sovereign Wealth Fund Management March 20-21, 2013 Parliament House, Ulaanbaatar Agenda	
WEDNESDAY, MARCH 20, 2013	
8:00-9:00	Registration
Morning Session: "A Vision of Shared Prosperity"	
9:00-9:30	"A vision for Sovereign Wealth Fund Management in Mongolia" <i>Opening remarks by the Prime Minister of Mongolia (20 minutes) and Ms. Coralie Gevers, Country Manager, The World Bank (5-10 minutes)</i>
9:30-10:00	"Norway's Sovereign Wealth Fund and the Management of Natural Resource Wealth" <i>Keynote speech by Mr. Roger Schjerva, Deputy Minister of Finance, Norway</i>
10:00-10:45	"Setting the stage: An Overview of Fiscal Management and Resource Funds in Resource-Rich Countries" <i>Mr. Rolando Ossowski, Former Assistant Director, IMF (40 minutes for presentation, followed by 5 minutes of clarifications/questions)</i>
10:45-11:15	<i>Coffee break (30 minutes)</i>
11:15-12:00	"Setting the stage: Governance and Operational Issues in Managing Sovereign Wealth Funds" <i>Mr. Roberto De Beaufort Camargo, Lead Financial Officer, The World Bank (40 minutes for presentation, followed by 5 minutes of clarifications/questions)</i>
12:00-13:00	Panel Conversation with the Presenters <i>Moderator: Dolgion, Bloomberg TV Mongolia All international speakers are introduced and give 5 minute comments to presentations</i>
13:00-14:00	Lunch
Afternoon Session: "How to agree on why, when and how much to save? International practices on sound fiscal management"	
<i>Moderator: Mr. Chuluunbat O., Vice-Minister of Economic Development</i>	
14:15-14:45	Norway's Experience <i>Mr. Vidar Ovesen, Senior Consultant to ADB, Former Deputy Finance Minister, Norway</i>
14:45-15:15	The Chilean Sovereign Wealth Fund <i>Mr. Eric Parrado, Former Head of the Chilean Economic and Social Stabilization and Pension Reserve Fund</i>
15:15-15:45	The Pula Fund, Botswana <i>Mr. Keith Jefferis, Former Deputy Governor of the Central Bank, Botswana</i>
15:45-16:10	<i>Coffee Break (25 minutes)</i>
16:10-16:40	The Petroleum Fund, Timor-Leste <i>Presenter: TBD</i>
16:40-17:40	Panel Conversation with: <i>Mr. Garamgaibaatar B., Chairman, Economic Policy Standing Committee Mr. Amarjargal P., Member of Parliament</i>

	<p><i>Mr. Jargalsaikhan, Journalist and Economist</i> <i>Mr. Enkbold, Chairman of Mongolian People's Party</i></p>
<p>THURSDAY, MARCH 21, 2013</p>	
<p>Morning Session: "How to manage and invest transparently? International practices on institutional arrangements"</p>	
<p>Moderator: <i>Patrick O'Connell, Resident Debt Advisor for Mongolia, U.S. Department of the Treasury</i></p>	
9:30-10:00	<p>Heritage and Stabilization Fund, Trinidad and Tobago <i>Mr. Ewart Williams, Former Governor of the Central Bank, Trinidad and Tobago</i></p>
10:00-10:30	<p>Abu Dhabi Investment Authority, Abu Dhabi <i>Mr. Georges Sudarskis, Former Senior Investment Controller (Chief Investment Officer), Private Equities, Abu Dhabi Investment Authority</i></p>
10:30-11:00	<p><i>Coffee break (30 minutes)</i></p>
11:00-12:30	<p>Panel conversation with: <i>S. Purev, Vice Minister, Ministry of Finance</i> <i>Ch, Khashchuluun, Professor, Mongolian National University</i> <i>L. Dashdorj, Advisor to the Economic Policy to the President</i> <i>D. Erdenebat, Chairman of the Democratic Party</i></p>
12:30-14:30	<p>Lunch with Peer-to-Peer Roundtables <i>5 roundtables (each table with two international guests and 5-6 Mongolian participants)</i></p>
<p>Afternoon Session: "Discussing Options for Mongolia"</p>	
<p>Moderator: <i>H.E. Ulaan Ch., Minister of Finance</i></p>	
14:30-15:15	<p>"A Review of Options for Managing Wealth and Opportunities in Mongolia" <i>Mr. Eric Parrado, Former Head of the Chilean Economic and Social Stabilization and Pension Reserve Fund</i></p>
15:15-16:45	<p>Panel Conversation on Key objectives and Characteristics of a Future Mongolia's Sovereign Wealth Fund with: <i>H.E. Batbayar N., Minister of Economic Development</i> <i>L. Zoljargal, Governor, Bank of Mongolia</i> <i>Ts. Davaasuren, Chairman, Budget Standing Committee</i> <i>N. Battserereg, Member of Parliament, Head of "Justice Coalition" group</i></p>
16:45-17:00	<p>Closing remarks <i>H.E. Ulaan Ch., Minister of Finance</i></p>