

Critical Perspectives on Guyana's Sovereign Wealth Fund

An Introduction to the Natural Resources Fund, Macroeconomic Stability and Public Financial Management in Guyana

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Abstract

Guyana has discovered significant quantities of commercially viable oil offshore the coast of Guyana. In anticipation of this, the Government of Guyana has sought to implement a Sovereign Wealth Fund, which is intended to capture revenues from the oil and gas sector. This Fund, known in Guyana as the Natural Resources Fund, also intends to have, deposited into it, revenues from other extractive industries in Guyana. A number of issues must be examined within the context of Guyana's macroeconomic stability and the public financial management framework in Guyana. This paper seeks to address these matters. It is divided into three (3) sections: 1. An overview of Sovereign Wealth Funds and Guyana's proposed Fund; 2. The Fiscal Rule and the Management of the Fund; 3. Critical Perspectives of the Fund. This paper is based on the widely circulated 'Green Paper' published by the Ministry of Finance, Government of Guyana.

1. Introduction

The year 2020 will be remembered as a watershed moment in the history of Guyana. However, these years in the build-up to 2020 are pivotal in ensuring that the development path which is charted for the country is one which is sustainable as well as allows maximum benefits to be assimilated to Guyanese. At present, the country is expected to, at current discoveries, benefit from in excess of 500,000 barrels per day – a respectable nominal figure which transforms into an impressive per capita production amount given the small size of Guyana's population. Inevitably, this will provide a new revenue stream for the Government and increase the amount of monies available to do development work of the country.

The dynamics of the landscape will transform in an unprecedented manner. One action of pivotal importance is the integration of the oil and gas sector into the macroeconomic framework in a form that does not cause disruption to the stability which prevails. The injection of large amounts of money into an economy is dangerous and, if not managed properly, can be the perfect recipe to a disaster.

Typically, in these scenarios of resource-rich endowments injecting large amounts of revenue into a country, Governments utilize the Sovereign Wealth Fund as one of its principal tools in preserving a stable macroeconomic environment. Therefore, naturally, a Sovereign Wealth Fund (SWF) tends to exist in situations where there is a fiscal surplus.

It is this tool that helps to protect a country against the volatility of the international price market for oil and the risks encountered when opening a significant component of a country's export portfolio to the shocks of an international market. These risks are of course exaggerated in a small open economy which is a price-taker on the international market as opposed to a large open economy which wields significant geo-political and economic influence, and has the ability to manipulate world market prices.

General Issues which arise from Oil & Gas Dependence

In a general sense, there are some specific issues which arise from a dependence on natural resource revenue, particularly in the extractive industries which follow international prices. In a more concrete sense, the following are issues which may arise from a dependence on oil and gas:

- i. **The Natural Resource 'Curse' or the 'Dutch Disease'** – The infamous macroeconomic situation where increased domestic demand, stemming from injections of large amounts of money into the system results in increased inflation and significant exchange rate appreciation.
- ii. **Unfair Inter-generational Wealth Sharing** – The undesirable situation where there are massive increases in consumption and unfair benefit-sharing between generations.
- iii. **Budgetary Programming Issues** – with unstable revenues arising from persistently fluctuating oil prices, programming forecasted revenue becomes problematic in the budgetary process. This, by logical extension, creates an environment for unstable government spending.
- iv. **'Presource' curse** – The situation where a government begins to borrow riskily and heavily against overly optimistic revenue projections based on favourable international prices at the time.

Section 1 - Guyana's Sovereign Wealth Fund – The Natural Resource Fund¹

3.1 Structuring the Natural Resource Fund

In August 2018, the Government of Guyana advanced a green paper to the National Assembly entitled 'Managing Future Petroleum Revenues and Establishment of a Fiscal Rule and A Sovereign Wealth Fund' which outlined the Government's intention to establish its version of a Sovereign Wealth Fund to manage the expected inflow of resources from the oil and gas industry.

The Natural Resource Fund paper can be divided into seven (7) components. These are set out as follow:

1. Why establish a single fund to achieve multiple objectives?
2. What is the purpose of the Natural Resource Fund;

¹ Elements of this section are derived in part from the Ministry of Finance's Green Paper on the Establishment of a Natural Resources Fund for the Management of the Petroleum Industry

3. How does the Natural Resource Fund integrate with the National Budget?
4. What is the fiscal rule associated with the Fund?
5. What are the structures for managing the Fund?
6. How are investments to be made by the Fund; and
7. How is the Fund to be reported, audited and transparency measures to safeguard the Fund?

In a general sense, the aforementioned seven (7) questions constitute the key components of a Sovereign Wealth Fund. The section below answers the Government of Guyana's position on these questions. Therefore, understanding each of these sections provides a clear understanding of the general direction of the Natural Resource Fund. This following will advance the government's position on these questions.

3.2 How is the Natural Resource Fund organized?

1. Why establish a single fund to achieve multiple objectives?

The question of establishing a single fund is answered strictly on a cost-basis. The overall cost, when considered, of managing a single fund is lower than managing more than one fund. The Government highlights that establishing an SWF is complex and there can be substantial administrative costs.

If multiple funds are established, then this implies that multiple administrations must exist. There must be multiple governance structures, investment policies and mandates, accounting and external auditing. This can prove to be extremely complex and burdensome on the resources, especially human resources, which are limited in a country with a small labour market. The government cites Timor-Leste and Norway as examples of successful single funds whilst Nigeria is cited as unsuccessful case of multiple funds.

2. What is the purpose of the Natural Resource Fund?

The Natural Resource Fund, according the Green Paper, has three (3) primary objectives:

- a. **Economic Stabilisation:** The Fund should contribute to economic stabilization and ensure that volatility in natural resource revenues does not lead to volatile public spending and ensuring that natural resource revenues do not lead to a loss of economic competitiveness (to guard against the Dutch Disease)
- b. **Intergenerational Wealth Transfer:** The Fund should ensure that there is a fair transfer of natural resource wealth across generations, to ensure that future generations benefit from these resources and the benefits of the proceeds of the Fund do not accrue to a specific generation; and

- c. **Financing Development Gaps:** The intent is to use the natural resource wealth to finance development priorities, via the National Budget, as identified in the national development strategy. This, the government says, should go towards the creation of an inclusive, green economy.

3. How does the Fund integrate with the National Budget?

Natural Resource revenues from the extractive industries, specifically petroleum, mining and forestry will be deposited into the Natural Resource Fund which will be held as a US dollar bank at the Bank of Guyana. It is from this account that withdrawals will be made, based on a rule known as the 'fiscal rule.' These withdrawals from the Fund will be deposited into the Consolidated Fund to form part of the revenue for the annual budget, along with other traditional streams of government revenue, including loans, tax and non-tax revenues.

Government will then determine its development priorities, through its national plan, known as the Green State Development Strategy (GSDS), and the available income. The Government has stated that priority will be placed on catalytic investments to transform Guyana within the context of the measureable targets, identified within the GSDS.

Withdrawals from the Natural Resource Fund cannot exceed the amount approved by Parliament. This amount, after Parliamentary approval, will be placed into the Consolidated Fund for utilization according to the priorities identified in the year's national budget, which draws its inspiration from the GSDS. It is important to note that, according to the Green Paper, the only further drawdowns that can be made would be for Petroleum Tax Refunds, when necessary. Figure 1 attempts to capture the Public Financial Management constructs associated with the Natural Resource Fund.

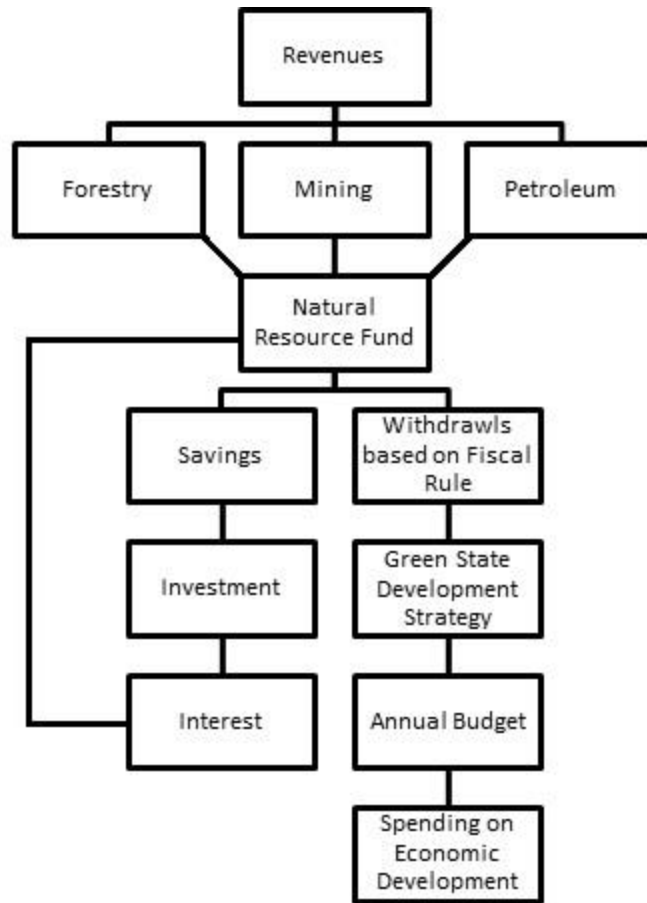


Figure 1 - Intended Operation of the Natural Resource Fund

4. What is the 'fiscal rule' associated with the Fund?

The 'Fiscal Rule' is an important instrument as it is this mechanism which will determine the amount of money which can be withdrawn from the Natural Resource Fund. As Figure 1 depicts, it is the Fiscal Rule which acts as the intermediary between the Natural Resource Fund and spending on economic development.

The Government envisages an initial **frontloading of spending** to address critical development gaps, in the earlier years, and subsequent progression to higher savings ratios in later years. The **Fiscal Rule** (Economically & Fiscally Sustainable Amount), shall be the least of:

- i. the Economically Sustainable Amount for that Fiscal Year which shall be determined through a macroeconomic committee;
- ii. the Fiscally Sustainable Amount for that Fiscal Year which shall be a mathematically derived amount; and

- iii. the balance of the Natural Resource Fund which shall also be a mathematically derived amount.

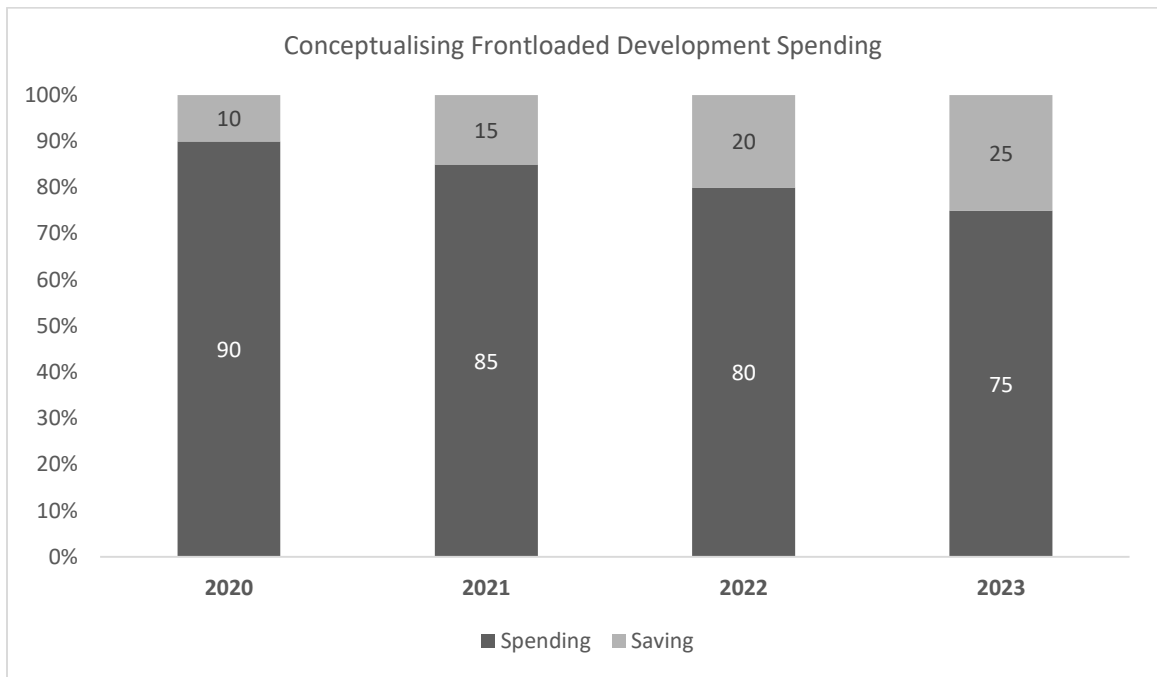


Figure 2 - An Example of Frontloaded Development Spending proposed in the Natural Resources Fund Green Paper

Section 2 – The Fund’s Fiscal Rule

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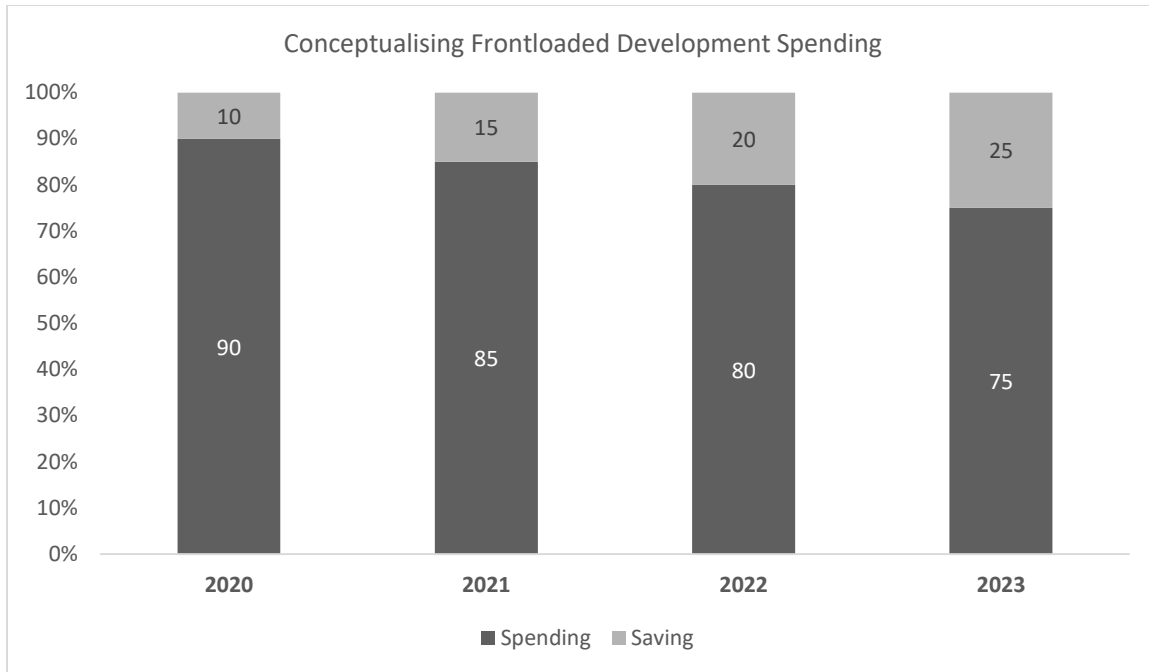


Figure 3 - An Example of Frontloaded Development Spending proposed in the Natural Resources Fund Green Paper

The Fiscal Rule and its determination

The Macroeconomic Committee shall determine the Economically Sustainable Amount for a Fiscal Year. In assessing the Economically Sustainable Amount, the committee shall observe the following indices to make a determination of that amount:

- inflation;
- the real effective exchange rate;
- the balance of payments;
- economic growth, particularly in the agriculture and manufacturing sectors;
- the composition of public spending; and
- external debt

The **Fiscally Sustainable Amount** for that Fiscal Year; and the **balance of the Natural Resource Fund** are mathematically derived amounts which are calculated on petroleum production figures and the prices associated with oil, amongst other indices of oil production.

The Macroeconomic Committee is therefore critical in the management of the Natural Resource Fund. According to the Green Paper, the following shall comprise the Macroeconomic committee, the appointments which shall be made by the Minister of Finance:

1. A representative of the Minister of Finance (who shall be the Chairperson);

2. A member from academia or the private sector nominated by the Institute of Chartered Accountants of Guyana;
3. A representative of the Bank of Guyana nominated by the Governor of the Bank of Guyana;
4. A member from academia or the private sector nominated by the Leader of Opposition in Parliament; and
5. A leading expert in macroeconomics appointed by the Minister with the approval of Cabinet.

B. Management of the Fund

There are six (6) primary players involved in the management of the Fund which are given responsibility of the Natural Resource Fund in different form. The players are:

- i. Parliament
- ii. Ministry of Finance
- iii. Sovereign Investment Committee
- iv. Senior Investment Adviser and Analyst
- v. Bank of Guyana
- vi. Private Managers

Table 1 below highlights the responsibility of each player associated with the Natural Resource Fund, according to the Green Paper of the Government

Table 1 - Responsibility of Players involved in Natural Resource Fund Management

Player	Responsibility
Parliament	<ol style="list-style-type: none"> 1. passing the Natural Resource Fund Act 2. approving the Annual Budget which would include the annual withdrawal from the Natural Resource Fund, and; 3. reviewing the Annual Report.
Ministry of Finance	<ol style="list-style-type: none"> 1. overall management of the NRF, including requested withdrawal in the Annual Budget Proposal; 2. calculating the Fiscally Sustainable Amount; 3. drafting the Investment Mandate; 4. entering into the Operational Agreement with the Bank of Guyana and; 5. drafting the Annual Report and reporting on the NRF through the Annual Budget
Sovereign Investment Committee	A Sovereign Investment Committee would be responsible for advising the Minister of Finance on the Investment Mandate and would consist of the following seven members appointed by the Minister:

	<ul style="list-style-type: none"> i. A representative of the Minister of Finance; ii. an ex-officio representative nominated by the Minister of Natural Resources; iii. an ex-officio representative nominated by the Governor of the Bank of Guyana; iv. a representative nominated by the Institute of Chartered Accountants of Guyana; v. a representative nominated by the Guyana Association of Bankers; vi. a representative nominated by the Leader of the Opposition; and vii. the Senior Investment Adviser and Analyst.
Senior Investment Adviser and Analyst	<p>The Senior Investment Adviser and Analyst would be recruited would be responsible for:</p> <ul style="list-style-type: none"> i. assisting the Minister draft the Investment Mandate; ii. assisting the Minister report and monitor the financial performance of the Natural Resource Fund iii. supporting the Sovereign Investment Committee undertake its functions; iv. undertaking financial modelling among other technical support <p>This Adviser would be recruited via open international tender.</p>
Bank of Guyana	<p>The Bank of Guyana (BOG) would be the Operational Manager of the Fund and manage it in accordance with the Operational Agreement and Investment Mandate.</p> <p>The BOG would:</p> <ul style="list-style-type: none"> i. draft quarterly reports and annual accounts, ii. procure Private Managers; and iii. draft Management Agreements and Investment Instructions
Private Managers	<p>Private Managers would manage the overall investment portfolio in accordance with Management Agreement and Investment Instructions and submit reports to Bank of Guyana</p>

Source: Managing Future Petroleum Revenues and the Establishment of a Natural Resource Fund Green Paper, Ministry of Finance

Investments of the Fund

The Economically and Fiscally Sustainable Amount as highlighted in Section 2 above would determine how much funds are transferred to the National Budget for the purposes of development spending. The balance

would then be invested in overseas markets so as to avoid injecting too much money into the local economy which has the potential to destabilize the domestic economy.

The following simple arithmetical outlay gives insight into the operation of the Petroleum revenue as it passes through the Fund.

1. Income = Spending + Savings
 - a. Spending = Budgetary Appropriations
 - b. Savings = Investment
 - i. Investment = Very Safe Investments + Passive Investment Management

As the Green Paper highlights “Very Safe Investments would be mandatory such that the first US\$500 million and at least three times the expected annual withdrawal would be invested in Very Safe Investments (Eligible Bank Deposits and Eligible Treasury Bills). This would ensure that the Fund meets short term stabilisation and cash management objectives.”

These investments will yield minimal returns but will guarantee a rate of return in a short period of time to ensure that is sufficient flow into the Natural Resource Fund. Other Investments by the Fund would be made following a Passive Investment Management strategy to maximise returns over the long run. These are invested in all ‘eligible investment asset classes’ by the Fund.

Reporting and Auditing

Figure 2 below highlights the Reporting and Auditing which are necessary for the Natural Resources Fund. Figure 2 is lifted directly from the Green Paper and provides succinctly the reporting and auditing requirement of the Natural Resource Fund.

Figure 4: Reporting and Audit Requirements of the Natural Resource Fund

Report	Responsible	Content
Annual Budget	Ministry of Finance	<ul style="list-style-type: none"> • Explanation of Economically and Fiscally Sustainable Amount. • Explanation of governance of the Fund and summary of its financial performance.
Annual Report	Ministry of Finance	Detailed report including: <ul style="list-style-type: none"> • all deposits, withdrawals and investments; • analysis of performance of investments; and • audited financial statements and external auditor's report.
Quarterly Reports, Accounts and Internal Audit	Bank of Guyana	<ul style="list-style-type: none"> • Quarterly reports and financial statements. • Accounts. • Drafted in accordance with International Financial Reporting Standards. • Internal Audit at least annually.
External Audit	Auditor-General	<ul style="list-style-type: none"> • An external audit of the accounts, records and other documents relating to the Natural Resource Fund shall be undertaken annually by the Auditor General. • Auditor-General may engage an internationally recognised auditing firm.
Financial Reports	Private Managers	<ul style="list-style-type: none"> • Summary of investment performance. • Drafted when requested/as agreed with Bank of Guyana.

Source: Managing Future Petroleum Revenues and the Establishment of a Natural Resource Fund Green Paper, Ministry of Finance

Section 3 - Critical Perspectives on the Natural Resources Fund

1. The Importance of Development Planning

Development Planning is of paramount importance in ensuring that the mechanism of the Fund works. Spending on economic development by way of the public financial mechanism must be well planned, costed and sequenced in their implementation. The critical questions to be asked in this regard are:

- i. What are we spending on?
- ii. How much are we spending?
- iii. What are our priorities in spending?

This will ensure that the current system of ad-hoc public budgeting does not continue to curtail the effectiveness of development expenditure as it has been; and, that maximum impact can be realized

through synchronous, complimentary spending. This development plan must be multi-dimensional, encompassing methods to spur economic growth, social development, cultural preservation and promotion, all within an environmentally friendly framework.

2. **Whether the proceeds of Gold Mining should be deposited into the Natural Resource Fund?**

When the international market is in an economic downturn, our other five (5) sectors (commonly agriculture, forestry, fishing) tend to dip in the prices which are being offered on the world market and tend to shrink the value of proceeds from those sectors for that fiscal year.

Gold as a commodity is unique when juxtaposed against that of the international market. When the international market is in an uptick, the price of gold tends to reduce as countries, specifically Central Banks internationally are purchasing less gold. However, when the international market begins to slum, Central Banks tend to purchase more gold to hedge against speculative falls in the value of their currency.

As such, in the context of Guyana, when the other sectors are in a decline based on the international price market, the gold sector buoys the economy for both the private and public sector. Depositing these proceeds from the mining sector into a fund and treating like another ordinary commodity will defray the impact which gold will have as regards buoyancy of the economy. Therefore, when considering this, there is need to reexamine whether we should be depositing the proceeds of mining into the Natural Resources Fund.

3. **A suitable macroeconomic framework and strong Public Financial Management**

Since the realization of the expenditure from the Natural Resource Fund is dependent on the mechanism of public financial management, a suitable macroeconomic framework must be in place to ensure stability in the macroeconomic framework of Guyana. As such, improvements to the current Public Financial Management system must be made. (Khadan & Baxter, 2018, pp. 19-20) identifies, Guyana currently has none of the following key features which should be enacted for strong public financial management in anticipation of oil revenues.

Some of these features are:

- a. **balanced budget rules** - Budget balance rules focus on an overall budget balance, structural or cyclically adjusted balances, or an average balance over the cycle of the economy. This rule helps reduce the budget deficit and supports the convergence of the debt – to GDP ratio to a desired level
- b. **public debt rules** – The public debt rules in Guyana are on nominal limits and, require amendments. They are not pegged to a specific index (e.g. GDP). Debt rules set a specific numerical target for public debt as a percentage of GDP. This rule is useful when monitoring and measuring economic performance. Debt rules are capable of directly tackling debt sustainability,

can be transparent and simple, and can accommodate large shocks if debt is well below a defined ceiling

- c. **non-resource primary fiscal balance** - Overall fiscal balance excluding resource revenues, spending associated with the development of the resource sector, and interest payments, (i.e., total non-resource revenues minus total non-resource expenditures). Useful to measure whether fiscal policy is being pro-cyclical or counter-cyclical.
- d. **revenue rule** - Revenue rules impose limits on revenues with a view to containing the size of the public sector/tax burden and allocating ex-ante revenue windfalls (e.g., due to surprisingly high growth).
- e. **expenditure growth rule** - Sets a limit on the growth of government spending. Useful to limit the procyclicality of fiscal spending especially in cases of absorptive capacity constraints and where the volatility of resource windfalls requires precautionary savings
- f. **budgeting in a fiscal sustainability environment** using the Debt Sustainability Analysis and a Medium-Term Debt Strategy.

4. **Complex Fiscal Rule**

The Fiscal Rule is extremely complex for the layman and complex even for the financial analyst. For this Rule, the principle of parsimony, also commonly known as Occam's Razor should be applied to this critical mechanism. Public edification on the fiscal rule is important for every Guyanese to be able to understand the mechanism and how it works. This has facilitated some of the most successful Sovereign Wealth Funds in the world becoming successful.

5. **The Establishment of an Economic Commission**

If Parliament is approving the withdrawal, then Parliamentary Majority will control the withdrawal. Given Guyana's Parliamentary structure, there is a possibility that over the time horizon period, the problem identified by John Stuart Mill in his 1859 treatise 'On Liberty' regarding the 'tyranny of majority' will result. There should be the establishment of an Economic Commission or Council, instituted as a Constitutional Agency who will act as the sentinel for the SWF pool. The macroeconomic committee can be a sub-committee of the same Commission.

6. **Composition of the Macroeconomic Committee**

The macroeconomic committee is critical to the management of the Natural Resources Fund and withdrawals from the fund for spending on national development. The composition of the macroeconomic committee in the landscape of Guyana's political economy must be considered. The terms of reference of this committee should be established and each representative should reach a minimum level of qualification and experience.

Currently, the macroeconomic committee comprises:

- a. A representative of the Minister of Finance (who shall be the Chairperson);
- b. A member from academia or the private sector nominated by the Institute of Chartered Accountants of Guyana;
- c. A representative of the Bank of Guyana nominated by the Governor of the Bank of Guyana;
- d. A member from academia or the private sector nominated by the Leader of Opposition in Parliament; and
- e. A leading expert in macroeconomics appointed by the Minister with the approval of Cabinet.

Clearly, the currently suggested composition of this committee is heavily biased towards the instrument of the Government and as such, towards whichever party is in power at the point. Three (3) of the five (5) committee members are appointed via the instrument of the government. Taking into consideration the political economy landscape of Guyana, the nature of the resource and the idea of intergenerational wealth transfer, below would be the alternative suggestion for the formation of the critical macroeconomic committee:

- f. Representative of the Minister of Finance nominated by the Minister of Finance
- g. Representative of the Parliamentary Opposition nominated by the Leader of the Opposition
- h. Representative of Academia nominated by the University of Guyana Council and Academic Board
- i. Representative of the Private Sector sought through the mechanism of the Private Sector Commission which reaches to all sectoral bodies
- j. Internationally renowned expert in macroeconomics who reaches certain criteria sourced through an interview process by the preceding four representatives and a professional recruitment firm

7. Composition of the Sovereign Investment Committee

The composition of the Sovereign Investment Committee needs to be looked at. The structure of this committee is important and the investments of the SWF have bearing on macroeconomic stability. Currently, the Green paper highlights that the Sovereign Investment Committee would be responsible for advising the Minister of Finance on the Investment Mandate and would consist of the following seven (7) members appointed by the Minister:

- a. A representative of the Minister of Finance;
- b. an ex-officio representative nominated by the Minister of Natural Resources;
- c. an ex-officio representative nominated by the Governor of the Bank of Guyana;
- d. a representative nominated by the Institute of Chartered Accountants of Guyana;
- e. a representative nominated by the Guyana Association of Bankers;
- f. a representative nominated by the Leader of the Opposition; and
- g. the Senior Investment Adviser and Analyst.

The same advice rendered regarding the macroeconomic committee can be repeated here as the responsibility of this investment should be spread across the different factions of institutions.

8. Private Managers

The intent of 'Private Managers' needs to be clearer and made pellucid in the paper. This is extreme importance as the decisions of the 'private managers' of the Sovereign Investment Committee will have the overarching responsibility of ensure macroeconomic stability with their investment decisions. Macroeconomic stability is a public good and as such, these private managers are private agents who will have a task pertaining to a public good. This is in diametric opposition to the nature of a private investor who seeks to balance cost and risk for maximum returns as opposed to the public good of macroeconomic stability.

9. The Nature of Annual Reporting of the Ministry of Finance

Currently, one measure to ensure accountability of the Natural Resources Fund is via the Annual Reporting of the Ministry of Finance. Currently, the Ministry of Finance does not produce an Annual Report, nor, is the Ministry legislatively charged with producing an Annual Report. The legislatively mandated Economic Commission/Council as suggested above can absorb this function

Conclusion

It is commendable that the Government of Guyana is going the route of a Sovereign Wealth Fund. This bodes well for the development prospects and the maintenance of macroeconomic stability of Guyana. The Green Paper has issues which need to be addressed, not from an idealistic, theoretical perspective, but with consideration for the fact that Guyana has unique circumstances in polity and economy. The benefits of the oil and gas industry should assimilate to all citizens of Guyana and the Sovereign Wealth Fund should be part of the machinery which facilitates this.

There are major considerations which need to be made within the architecture of the public financial management framework if Guyana is to successfully integrate the oil and gas sector into the economy. It is within this context that an updating of the public financial management laws of Guyana is strongly recommended. This will ensure that upward pressure is not placed on commodity prices and overheating of the economy does not occur. Additionally, it may of consideration for the Government to keep the other elements of the extractive industries in a separate fund and do not allow for co-mingling of the funds. Separation of oil revenues and non-oil revenues, in anticipation for management for macroeconomic stability is key for Guyana.