



مركز البيان للدراسات والتخطيط  
Al-Bayan Center for Planning and Studies

# A Sovereign Wealth Fund for Iraq



Al-Bayan Center Studies Series

## **About**

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## Research Department

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### Introduction

Once used by only a few countries around the world, Sovereign Wealth Funds (SWF) are becoming an increasingly common feature of international finance and state-led economic development. An increasing number of countries, predominantly developing countries, who rely on the export of commodities such as hydrocarbons and minerals are creating SWF portfolios. The exact motivation behind creating an SWF varies between countries. Some SWFs aim to provide funds for an aging or growing population while others invest the funds in development and investment programmes to help diversify revenue generation mechanisms. Others are explicitly designed to cushion a country's economy from price shocks, currency volatility and general international economic instability.

Indeed, the perceived protection from instability afforded to economies through the use of SWFs have been of particular interest for many developing countries. This perception was further strengthened following the 2008 financial crisis which saw many emerging economies with large SWF portfolios emerge relatively unscathed. SWFs have since come to be seen as a means to diversify economies reliant on single commodities, cushion currency shocks and avert the so-called Dutch Disease reliant on a single-commodity economy. The number of countries creating an SWF or otherwise expressing interest in them have expanded significantly since.

As Iraq emerges from the war against the Islamic State (IS), the need to generate revenue to fund reconstruction efforts is pressing, as is the need to ensure that the oil-reliant Iraqi economy can diversify itself while protecting it from the conditions that left the country vulnerable during the collapse of the global oil prices between 2014 and 2018. The present rise of oil prices affords the Government of Iraq (GoI) the opportunity to fund the reconstruction efforts and improve the country's infrastructure. In conjunction, the instability caused by fluctuating oil prices and over-reliance on a single commodity can easily repeat in the next boom-bust cycle. Thus, a robust mechanism is required to ensure that the

revenues generated from oil wealth can be used towards the goal of rebuilding, allowing the Iraqi economy to become more sustainable and resilient against price shocks and ultimately transferring Iraq's oil wealth to its wider population.

This paper looks into the SWF model, exploring the various types of SWFs and analysing how they can relate to the demands and needs of the Iraqi economy. In doing so, this paper also explores the identified best practices for the SWFs as defined by the "Santiago Principles". This paper will also provide comparative analysis on the Norwegian and Qatari SWFs to see what an Iraqi SWF can adopt from this while also exploring the challenges Iraq faces by looking at the Central Bank of Iraq's-Development Fund for Iraq (DFI), which was created in 2003 and has since become emblematic of the country's corruption problem. Although not intended to be an SWF, its model resembles one and is therefore sometimes listed as an SWF<sup>1</sup>, making it an instructive case study.

This paper recommends that an SWF can present itself as a solution to Iraq's issues surrounding over-reliance on a single commodity; diversification; and, a lack of robust economic policy. The paper points out that via effective management and allocation through a technocratic board, the GoI can direct a portion of oil revenues towards reconstruction while using the rest towards revenue generation via investment and capacity-building of local industries and enterprises. The paper recommends that the SWF be gradually directed to infrastructure building and maintenance as the goals of reconstruction are achieved.

However, this paper warns that the creation of an SWF alone will not present a "silver bullet" solution to Iraq's economic ills. This paper points out to numerous instances when SWFs were not managed well or otherwise were used by politicians and governments for their unintended or personal uses.

## **Sovereign Wealth Fund**

### **General Definitions and Remit**

The International Forum of Sovereign Wealth Funds (IFSWF)<sup>2</sup> defines a Sovereign Wealth Fund (SWF) as:

*"Special-purpose investment funds or arrangements that are owned by the*

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1. "Sovereign Wealth Fund Rankings", Sovereign Wealth Fund Institute, August 2018 (Last Updated), <<https://www.swfinstitute.org/sovereign-wealth-fund-rankings/>>, [Accessed 19-October-2018]

2. Also known as the International Working Group of Sovereign Wealth Funds

*general government. Created by the general government for macroeconomic purposes, SWFs hold, manage or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets”<sup>3</sup>*

The investments described above can include both fixed assets such real estate, commodities and precious metals or liquid assets such as stocks and bonds. SWFs may also invest in private equity funds and hedge funds.

Country	Sovereign Wealth Fund Name	Assets USD-Bil	Inception	Origin	Linburg-Maduell Transparency Index
Norway	Government Pension Fund – Global	1058.05	1990	Oil	10
China	China Investment Corporation	941.4	2007	Non-Commodity	8
UAE – Abu Dhabi	Abu Dhabi Investment Authority	683	1976	Oil	6
Kuwait	Kuwait Investment Authority	552	1953	Oil	6
China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	522.6	1993	Non-Commodity	8
Saudi Arabia	SAMA Foreign Holdings	515.6	1952	Oil	4
China	SAFE Investment Company	441**	1997	Non-Commodity	4
Singapore	Government of Singapore Investment Corporation	390	1981	Non-Commodity	6
Singapore	Temasek Holdings	375**	1974	Non-Commodity	10
Saudi Arabia	Public Investment Fund	360	2008	Oil	5
Qatar	Qatar Investment Authority	320	2005	Oil & Gas	5

#### Sovereign Wealth Fund rankings<sup>4</sup>

The IFSWF definition of the SWFs was reached through coordination with international bodies such as the World Bank (WB) and the International Monetary Fund (IMF) in 2008 and has been used since. It therefore represents the most commonly-understood and acknowledged definition of what an SWF is. According to the IFSWF, this definition deliberately excludes foreign currency reserves for central banks (which are used for balance of payments (BoP) or monetary policy purposes). State-owned enterprises, government-employee pension funds and assets managed for the benefit of individuals are also excluded<sup>5</sup>.

3. "Dealing With Disruption: IFSWF Annual Review 2017", International Forum of Sovereign Wealth Funds (IFSWF), 2017, pp. 3-4

4. "Sovereign Wealth Fund Rankings", Sovereign Wealth Fund Institute, August 2018 (Last Updated), <<https://www.swfinstitute.org/sovereign-wealth-fund-rankings/>>, [Accessed 19-October-2018]

5. "Dealing With Disruption: IFSWF Annual Review 2017", International Forum of Sovereign Wealth Funds (IFSWF), 2017, p. 4

However, some divergences on definitions remain. As mentioned above, SWFs are normally associated with the investment and management of foreign assets. However, since 2014, the IFSWF has admitted a number of funds that focused on domestic investment. According to the organisation, these funds were thoroughly assessed and determined to align with the remit and definition of an SWF<sup>6</sup>, however these variances were not agreed universally. As such, entities such as the Saudi Arabian Monetary Agency (SAMA) are treated as an SWF by some while others argue that its remit is more in line with that of a Central Bank whose holdings are mostly in traditional reserve assets<sup>7</sup>.

Despite these minor divergences on exact definitions and remit, SWFs are nevertheless viewed as having an important role and place in macroeconomic management and global economic stability. Due to integrating public finances, monetary policy and external accounts, these funds are perceived as being able to respond to crises more effectively, protecting the economy at large from fluctuations in the international economy and serving as an additional layer of revenue-generating mechanism. Such perception was reinforced in the aftermath of the global financial crisis of 2008. Although sovereign investors, including SWFs, were impacted and suffered large losses due to the decline of equity markets, their subsequent recovery and ability to ride out the worst of the crisis gave confidence to long-term investors<sup>8</sup>.

#### How the SWF can Mitigate the Resource Curse and the Dutch Disease

The Resource Curse Theory claims that economies of the countries that are rich in extractive commodities (oil, gas, minerals, metals) develop slower than those with little to no natural resources. At times, they may even suffer from negative growth. The theory suggests that extractive commodities, especially oil, generate significant revenues from rents but do not employ a large segment of the population or encourage supply chains that facilitate further industrialisation. This is especially the case in countries with weak institutional foundations who are more likely to engage in “rentierism”, using the money obtained from the ownership and taxation of natural resources to sustain themselves without investing in the development of the economy. Some governments may institute

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6. Ibid, p. 4

7. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, p. 35

8. Al-Hassan, Abdullah; Papaionnaou, Michael; Skancke, Martin; Chih Sung, Cheng. “Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management”, International Monetary Fund (IMF), Vol 13, Issue 231, (November 2013), p. 3

generous welfare systems or abolish taxation to keep the population placated while others may take a siege mentality, investing predominantly in the security forces and patronage to keep dissent in check. However, such structures erode the social contract between the rulers and the rest of the population, dis-incentivising the ruling class to look out for the well-being of the populace while encouraging members of the ruling class to engage in corrupt activities.

This results in the now-well-known paradox of the Resource Curse: the resource revenues that should bring prosperity to a country too often do the opposite. In fact, over 60% of the world's poorest people live in resource-rich countries, and their incomes are well below world averages even as their rulers remain some of the wealthiest in the world. Such conditions almost always lead to instability when the foundations the system is built on no longer become tenable due to price shocks, resource depletion or some other unexpected development that the system cannot cope with<sup>9</sup>. Many economists and political experts view Iraq as suffering from the Resource Curse. In particular, the country displays a great number of symptoms associated with the Resource Curse including unsustainably generous welfare spending, low non-oil tax revenues, low capacity (and infrastructure)-building despite high public spending, and high levels of corruption. Public accountability around hydrocarbons is low.

A separate but related phenomenon for the Resource Curse is the “Dutch Disease”. The term refers to the strengthening of a national currency due to the export of natural resources at high prices. The high value of the national currency decreases the profitability and competitiveness of other industries. This leads to a gradual shift away from manufacturing and processing sectors to the extractive sector, diminishing the diversity of an economy. The gradual erosion of non-extractive sectors increases unemployment. In economies that were not diverse to begin with, the Dutch Disease manifests itself in the form of chronic failure to diversify<sup>10</sup>.

The Dutch Disease also leads to price distortions in economies. Prices of goods and services that are produced domestically often grow sharply, especially

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9. Peck, Sarah; Chayes, Sarah. "The Oil Curse: A Remedial Role for the Oil Industry", Carnegie Endowment For International Peace, 30-September-2015, <<https://carnegieendowment.org/2015/09/30/oil-curse-remedial-role-for-oil-industry-pub-61445>>, [Accessed 25-August-2018]

10. Chirkova, Elena. "How Institutions Affect Development in Resource-Based Economies", Carnegie Endowment for International Peace, 19-April-2017, <[carnegieendowment.org/publications/68715](https://carnegieendowment.org/publications/68715)>, [Accessed 26-August-2018]

when competition is lacking, resulting in a preference for imports over domestic production<sup>11</sup>. The growing prevalence of imports can hinder what little domestic production there remains. In extreme cases (or in conjunction with other factors that damage domestic industries), the entire economy can end up reliant on imports for the most basic of commodities. In the event of a price shock, the ability to import goods diminishes severely, resulting in shortages. The Dutch Disease highlights not only the importance of maintaining a diverse and competitive economy but also the reasons why avoiding the negative impacts are so difficult.

SWFs are viewed as being capable of mitigating the impacts of the Resource Curse and the Dutch Disease because they focus on strengthening a country's net external asset structure in a manner that is consistent with the wider socio-economic context, allowing for the maintenance of long-term socio-economic stability<sup>12</sup>. As will be detailed below, Norway's SWF is one such example, converting the non-renewable funds generated from hydrocarbons into a diverse portfolio of equities and investments that will generate long-term revenues<sup>13</sup>. SWFs are also viewed as mitigating macroeconomic risks caused from the appreciation of the real exchange rate, especially under a fixed exchange rate regime and the degeneration and non-competitiveness of non-hydrocarbon sectors of the economy<sup>14</sup>. Indeed, this is the main reason why the remit of SWF investment is predominantly restricted to external, rather than domestic, investment.

Ideally, an SWF will serve as a buffer between the revenue-generating sector (such as the hydrocarbons sector) and the wider economy, allowing the latter to remain diverse without the influx of money that could devalue non-hydrocarbon sectors. SWFs also serve as a barrier between the national economy and the global economy, serving to limit the direct and immediate impacts of currency shocks, revenue dips and global economic crises. Furthermore, a well-managed SWF will prevent the state or the appointees of the state from using the reserves in the fund for their own purposes.

### Types of Sovereign Wealth Funds

Not every SWF follows the same structure or objective. Characteristics of an SWF can vary on the broad macroeconomic objectives of the state and the

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11. Ibid

12. Al-Hassan, Abdullah; Papaionnaou, Michael; Skancke, Martin; Chih Sung, Cheng. "Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management", International Monetary Fund (IMF), Vol 13, Issue 231, (November 2013), p. 8

13. Ibid, p. 8

14. Ibid, p. 8

availability of the assets. Furthermore, some SWFs can address multiple issues or have separate goals and objectives. Most of the literature surrounding SWFs identify two main types of funds: Stabilisation Funds and Savings funds<sup>15</sup>. Other literature identifies additional types of funds such as Reserve Investment Corporations, Development Funds and Pension Reserve Funds<sup>16</sup>.

### Savings Funds (Long-Term Savings Funds)

It is common for commodity-rich countries to choose to save a portion of their resource wealth for the future. Countries who deal with lucrative but finite commodities such as extractive resources (oil, gas, metals) are aware that they will run out of these resources in the future. Even without the risk of depletion, changing industrial or commercial trends can shift the demand and, ultimately, the lucrateness of a commodity. For example, falling costs of electric vehicles and rising availability of cobalt (which is vital for the production of batteries for such vehicles), in conjunction with a growing drive to move away from fossil fuels, will likely leave oil and gas less lucrative in the long-term (despite the short-and-medium term rises they may experience), regardless of whether oil-and-gas producers continue to hold significant reserves<sup>17</sup>.

The goal of the Savings Funds, alternatively known as the Long-Term Savings Funds, therefore is to convert the wealth from finite resources into renewable financial assets, generating revenues for future generations who may no longer have access to (or benefit from) the primary finite resource<sup>18</sup>. In doing so, countries both aim to avert the Dutch Disease caused by the rapid influx of revenues into the economy in the short-term that results in the degradation of non-hydrocarbon sectors as well as the Resource Curse that damages the long-term viability of the economy while leaving vulnerable to depletion or price shocks. The Kuwait Investment Authority (KIA), which is the world's oldest SWF, is one such example<sup>19</sup>. Such SWFs are particularly popular in oil-producing Arab

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15. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, pp. 35-36

16. Allen, Mark; Caruana, Jaime. "Sovereign Wealth Funds - A Work Agenda", International Monetary Fund (IMF), 29-November-2008, p. 5

17. "How Renewable Energy Will Change Geopolitics", Stratfor, 27-June-2018, <<https://worldview.stratfor.com/article/how-renewable-energy-will-change-geopolitics>>, [Accessed 27-September-2018]

18. "Dealing With Disruption: IFSWF Annual Review 2017", International Forum of Sovereign Wealth Funds (IFSWF), 2017, p. 5

19. Ibid, p. 5

states and may be a feasible SWF option for Iraq, especially if applied alongside a development-focused fund.

Countries with persistent trade surpluses may also create funds to diversify their foreign exchange reserves. By investing in a wide range of asset classes, such funds can help generate longer-term returns<sup>20</sup>. Other than the source, such savings funds are functionally identical to the conventional savings funds.

Savings funds represent one of the best options for long-term wealth creation and the associated policy objectives. However, the operational rules for accumulation and withdrawal, as well as the overall success and viability of the fund, is highly dependent on the government's willingness to respect the original purpose of the fund<sup>21</sup>. Institutional fail-safes and control mechanisms may restrict or limit the government's temptation to dip into savings whenever convenient. However, such mechanisms are unlikely to succeed where corruption is high and accountability, transparency or oversight is low.

#### Pension Reserve Funds

Pensions Reserve Funds function similarly to Savings Funds to the point that some entities, including the IFSWF consider them one and the same. Indeed, just as the Savings Funds, Pension Reserve Funds focus on long-term value creation with a focus on building capital that will help the state meet up to its future pension obligations and mitigate identified future outflows related to pensions-related contingent-type liabilities on the government balance sheet<sup>22</sup>. According to the IFSWF, such funds differ from orthodox pension funds which must continually pay out to their members. Pension Reserve Funds have no such liabilities and can put their capital to work in long-term investments<sup>23</sup>. Pension Reserve Funds are particularly attractive for countries where the number of aged citizens are expected to rise significantly, potentially surpassing the working population (and thus the relative taxes generated) in the process<sup>24</sup>.

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20. Ibid, p. 5

21. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, p. 36

22. Al-Hassan, Abdullah; Papaionnaou, Michael; Skancke, Martin; Chih Sung, Cheng. "Wealth Funds: Aspects of Governance Structures and Investment Management", International Monetary Fund (IMF), Vol 13, Issue 231, (November 2013), pp. 5-6

23. "Dealing With Disruption: IFSWF Annual Review 2017", International Forum of Sovereign Wealth Funds (IFSWF), 2017, p. 5

24. Ibid, p. 5

The New Zealand Superannuation Fund (NZSF) is one such example. Since 2001, it has developed a large portfolio of private market assets, taking advantage of the liquidity offered by such investments. The fund invests in global forestry, transport, infrastructure and real estate. A reference portfolio is used by the NZSF's managing board of "Guardians" to benchmark and measure the performance of the NZSF<sup>25</sup>.

With a significantly high youth population, such a fund is outside Iraq's demands and needs at the moment. However, it stands to reason that with such a population, Iraq will, in some 50 years, face challenges similar to what many European countries (and Japan) are facing today. The creation of such a fund today, in conjunction with a revised tax system and the creation of a national insurance scheme (which is not in the remit of this paper) would help the GoI be ahead of the curve, maximising the opportunities presented by its youthful population in the process.

### Stabilisation Funds

Stabilisation Funds represent the second primary type of SWF. The main purpose of such funds is to serve as a protection for the economy by insulating the budget from commodity price volatility and external price shocks<sup>26</sup>. As such, funds like these serve to mitigate some of the short-term impacts of the Resource Curse by smoothing out the differences between peaks and dips of commodity prices and providing macroeconomic stability.

Despite their prominence, Stabilisation Funds are relatively basic and straightforward. They consist of pools of capital drawn from commodities that the national economy is reliant on but experience cycles of volatility. Such pools often hold large proportions of their assets in liquid investments in order to have access to capital at a short notice<sup>27</sup>. In addition to mitigating the short-term impacts of the Resource Curse, Stabilisation Funds can also help mitigate some effects of the Dutch Disease by holding out excess revenues from the wider economy, balancing the economic contributions of the commodity sector (such as hydrocarbons) against the rest of the economy. Examples of such funds include the Economic and Social Stabilisation Fund of Chile (ESSF), which was

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25. Ibid, p. 5

26. Al-Hassan, Abdullah; Papaionnaou, Michael; Skancke, Martin; Chih Sung, Cheng. "Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management", International Monetary Fund (IMF), Vol 13, Issue 231, (November 2013), p. 5

27. "Dealing With Disruption: IFSWF Annual Review 2017", International Forum of Sovereign Wealth Funds (IFSWF), 2017, p. 6

established in 2007. Pegged against the country's copper exports, the fund's creation was timely and allowed Chile to ride out the worst of the 2008 Global Economic Crisis.

A Stabilisation Fund could help the Iraqi economy, which has a significant reliance on oil. In 2017, the sector accounted for 65% of the Gross Domestic Production (GDP), 90% of GoI revenue and 100% of exports<sup>28</sup>. Although this is an improvement from years such as 2014 where oil made up 90% of the GDP<sup>29</sup>, it nevertheless highlights the reliance the country's economy has on hydrocarbons. Indeed, the global oil price crash between 2014 and 2018 and the resulting lack of revenues needed to address the needs of Iraqis and maintaining infrastructure all the while fighting the IS should be an effective demonstration why the current model is unsustainable and harmful to Iraqi well-being. The creation of a Stabilisation Fund would go some way towards relieving some of the impacts, should oil prices crash again or otherwise start a slow but steady descent due to ongoing long-term trends. However, without fixing some of the underlying issues in the Iraqi economy (such as the oversized public sector), such a fund will only provide a temporary reprieve and may not save the economy from a prolonged crisis.

### Reserve Investment Corporations

Reserve Investment Corporations are somewhat contentious in the sense that they are not recognised as an SWF by major institutions including the IFSWF. The main goal of a Reserve Investment Corporation is to reduce the negative carry costs of holding reserves or to earn higher return on ample reserves while the assets in the funds are still counted as reserves. Reserve Investment Corporations pursue higher returns by high allocations in equities and alternative investments<sup>30</sup>. Therefore, they have a more complementary role, either another SWF (likely a Savings or Stabilisation Fund) or to reserve funds and other similar entities. Reserve Investment Corporations may allow the state to engage in riskier (but higher reward) investment behaviour with an earmarked reserve without endangering the wider reserves.

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28. "Iraq Economic Monitor: From War To Reconstruction to Economic Recovery", World Bank, Spring 2018, p. 5

29. Feher, Csaba; Mansour, Mario; Aslam, Aqib; Hegazy, Amgad; Basile, Gregory; De Mets, Patrick. "Iraq: Selected Issues", International Monetary Fund, Vol 17, No 252, (2017), p. 16

30. Al-Hassan, Abdullah; Papaionnaou, Michael; Skancke, Martin; Chih Sung, Cheng. "Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management", International Monetary Fund (IMF), Vol 13, Issue 231, (November 2013), p. 6

At present, a Reserve Investment Corporation is not within the demands and needs of Iraq. Although investments can bring some windfall, the GoI lacks the economic expertise and experience to engage in such investments without incurring unnecessary losses. Furthermore, such funds are usually recommended for when a government has ample reserves, something that the Iraqi economy, at present, lacks.

### Development Funds

Development Funds were created and became popularised in the light of the global financial crisis in 2008 and the subsequent bout of low growth and investment returns. Instead of investing in foreign assets, Development Funds have a decidedly domestic purpose. The goal of these funds is to allocate resources and revenues (usually from commodities) into domestic investment, usually infrastructure. The goal is to acquire stakes in private domestic companies, especially in strategic industries, and help nurture their growth and development as part of the wider economy, with the dividends realised in financial returns<sup>31</sup>. Singapore's Temasek and Malaysia's Khazanah Nasional have also used the dividends of domestic investments to build foreign investment portfolios<sup>32</sup>.

Development Funds may blur the lines between what is a state-owned corporation and what isn't. The principal difference is that the corporations invested by the Development Fund are private corporations. The state (through the Development Fund) is merely an investor and may get the financial returns like any other investor. Thus, a state may use Development Funds to invest in assets that suit its macroeconomic goals (such as domestic industries it wishes to develop) but it does not acquire direct control of these assets like it would if these were state-owned. An asset invested by the Development Fund is therefore still beholden to economic goals and targets (e.g. making a profit) whereas a state-owned enterprise may be beholden purely to political goals of the state.

Regardless, out of all the SWFs, the Development Fund may be the one that is most closely linked to the macroeconomic goals of the state. Indeed, Temasek and Khazanah Nasional, as well as the Irish Strategic Investment Fund (ISIF), the United Arab Emirates' Mubadala and the Russian Direct Investment Fund (RDIF) have all used their capacities to such ends<sup>33</sup>. Some analysts have raised

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31. "Dealing With Disruption: IFSWF Annual Review 2017", International Forum of Sovereign Wealth Funds (IFSWF), 2017, p. 7

32. Ibid, p. 7

33. Ibid, pp. 7-8

concerns that the SWFs such as RDIF and Mubadala have since expanded their focus beyond the macroeconomic goals and towards geopolitical goals, turning these SWFs into instruments of foreign policy<sup>34</sup>.

As a country in need of reconstruction, as well as development of domestic industries for diversification needs, a Development Fund is well suited to the needs of Iraq. Such an Iraqi SWF could invest in companies engaged in reconstruction or those industries that are struggling in the wake of the IS (mostly linked to agriculture). Investment that could target the development of decayed and degraded infrastructure, especially in southern Iraqi provinces such as Basra would also be pertinent. Investing in emergent technologies such as desalination and geoengineering to help mitigate the impacts of droughts and water shortages could also be an appropriate sector for a Development Fund, as investment in such sectors would create employment, improve local skills and help remove wider developmental barriers.

It should be kept in mind that the scope and remit of an SWF can change as the priorities of a government shifts. Similarly, governments may create multiple SWFs, each with their own goals or they can create an SWF with multiple objectives.

### SWF Governance and Good Practice

Once implemented, SWFs can become deeply linked to the macroeconomic management of the economy. The assets they manage and the returns they provide can have significant impacts on public finances, fiscal and monetary policies, external accounts and balance sheet linkages. Therefore, it is important for an SWF to have sound and transparent management, robust legal frameworks, clear objectives and effective checks and balances. Lacking these, the SWF will be far from the solution to the economic ills of a country and may instead incur significant losses and worsen corruption. The example of Qatar is instructive on this. As will be detailed further, the heavy involvement of the Al-Thani Royal family in Qatar's SWF has created a conflict of interest between the fund's national objectives and those of the royal family. In an opaque and corrupt system, the mechanisms intended to ring-fence and separate the SWF revenues from the wider economy

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34. Karasik, Theodore; Erel, Adam. "Nations Are Wielding Their Sovereign Wealth Funds as Tools of Power", Foreign Policy Magazine, 11-January-2018, <<https://foreignpolicy.com/2018/01/11/nations-are-wielding-their-sovereign-wealth-funds-as-tools-of-power/>>, [Accessed 29-September-2018]

can end up restricting ordinary citizens from holding the state into account<sup>35</sup>. The risk is even greater if embezzlement and other corrupt practices is common within a government. In Russia, the deputy finance minister was arrested in 2007 for embezzling \$43 million, leaving some analysts to question how a state can prevent its SWF from falling prey to similar practices.

Indeed, as early as 2008, there were concerns among both investors and regulators that the governance around SWFs are neither transparent nor accountable to investors or international financial organisations such as the IMF or the WB. It is with this in mind that the IFSWF, known back then as the International Working Group of Sovereign Wealth Funds, set up a series of “Generally Accepted Principles and Practices” commonly referred to as the “Santiago Principles”<sup>36</sup>.

#### The Santiago Principles

The Generally Accepted Principles and Practices were formulated out of recognition of such concerns relating to the rapid growth of SWFs in quantity and size. The Group cited the importance of demonstrating to home and recipient markets and to the international financial markets that SWF arrangements are properly set up and investments are made on sound economic and financial logic<sup>37</sup>. These principles and practices are underpinned by the following guiding objectives for the SWFs:

- To help maintain a stable global financial system and free flow of capital and investment;
- To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;
- To invest on the basis of economic and financial risk and return-related considerations;
- To have in place transparent and sound governance structure that provides for adequate operational controls, risk management and accountability<sup>38</sup>.

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35. Anders. "The Truth About Sovereign Wealth Funds", Foreign Policy Magazine, 3-December-2007, <<https://foreignpolicy.com/2007/12/03/the-truth-about-sovereign-wealth-funds/>>, [Accessed 19-October-2018]

36. “Sovereign Wealth Funds: Generally Accepted Principles and Practices ‘Santiago Principles’”, International Working Group of Sovereign Wealth Funds, October 2008, p. 1

37. Ibid, pp. 3-4

38. Ibid, p. 4

According to the Group, these principles were distilled from pre-existing SWF practices and subsequently balanced with accepted international norms and practices on governance and transparency while ensuring that these funds remain a financial success. As a collaborative effort between the Group members and international institutions, these principles appear to be highly pragmatic. Indeed, the document detailing the Santiago Principles, the Group acknowledged that some of the principles would be difficult to implement, especially by newer, less experienced members and noted that there may be need for a transitional phase or a multi-speed timeframe<sup>39</sup>.

On the whole, the Santiago Principles are made up of 24 points. These consist of:

1. The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

A. Subprinciples also state that the legal framework should ensure legal soundness and that the legal relations between the SWF and other state bodies should be publicly disclosed.

2. The policy purpose of the SWF should be clearly defined and publicly disclosed.
3. Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.
4. There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.

A. Subprinciples also state that the source of SWF funding as well as the general approach to withdrawals from the SWF and spending on behalf of the government should all be publicly disclosed.

5. The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

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39. Ibid, pp. 4-5

6. The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.
7. The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.
8. The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.
9. The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.
10. The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.
11. An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.
12. The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.
13. Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.
14. Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.
15. SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

16. The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.
17. The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.
18. The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.
  - A. Subprinciples here highlight that the investment policy should guide the SWF's financial risk exposures and the possible use of leverage.
  - B. They also note that the investment policies should address the extent to which internal and/or external investment managers are used, the range of activities and authority and the process by which they are selected and their performance monitored.
  - C. They add that all these should be publicly disclosed.
19. The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.
  - A. Subprinciples here add that if investment decisions are subject to considerations beyond economic and financial (such as macroeconomic or geopolitical goals), these should be set out and publicly disclosed.
  - B. It also adds that the management of SWF assets should be consistent with what is generally accepted as sound asset management principles.
20. The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

21. SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.
22. The SWF should have a framework that identifies, assesses, and manages the risks of its operations.
  - A. Subprinciples state that the risk management framework should include reliable information and timely reporting systems which should enable adequate monitoring and management of relevant risks within acceptable parameters and levels, control incentive mechanisms, codes of conduct, business continuity planning and an independent audit function. They also mention that this framework should all be publicly disclosed.
23. The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.
24. A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.<sup>40</sup>

It is evident that much of what is prescribed by the Santiago Principles are related to matters of governance such as setting up clear institutional boundaries, robust institutional structures, a clear legal framework, exact definition of duties or responsibilities and a clear separation of powers.

As the document for the Santiago Principles itself explains in the subsequent commentaries, much of these principles are intended to provide checks-and-balances on the temptation that a government may have to use the funds outside the remit of the SWF or otherwise use it to offset the damage due to bad governance<sup>41</sup> or populist policies. Indeed, this is especially pertinent given the guiding purpose of SWFs as vehicles for protecting the national economy from the caprices of the global economy and providing a steady and predictable revenue stream that is resilient to such shifts. Where an SWF engages in risky investment behaviour, the fund's risks by such behaviour need to be tightly ring-fenced so that losses are left at a tolerable level.

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40. Ibid, pp. 7-9

41. Such as Tax Deficits due to lack of a robust tax code or enforcement

Furthermore, the sheer scale of the funds involved in SWFs may present a tempting target for individuals looking to enrich themselves or foster patronage. A robust institutional framework, a technocratic basis of governance, a separation of powers and a system of checks and balances may not fully stop such acts but will restrict them.

Indeed, there is a broad agreement that strong, transparent and technocratic institutions hold the key towards averting the Resource Curse, whether it involves an SWF or not. While SWFs have their attraction, they will not be able to confer sustainable economic development on their own if sound fiscal management is lacking<sup>42</sup>

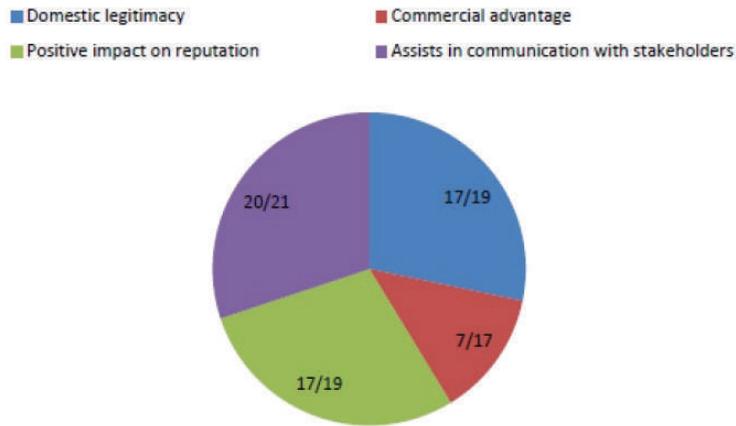
In her research for the United Nations, Dr Carole Nakhle notes that many SWFs in the Arab World (Middle East, North Africa and the Gulf) are “are so opaque that there is no way to know how much may be lost to mismanagement—or who benefits from these funds’ investments”, even though most of their owners have voluntarily agreed to uphold the Santiago Principles “in all material respects”<sup>43</sup>. Such funds may confer the impression of stability and may even ride out financial crises due to their sheer volume but such success stories are best described as “mirages” by analysts who note that there rarely is any real investment or capacity-building<sup>44</sup>. The sheer bulk of their portfolio may be impressive at first. But as the nature of gains, losses and spending remains opaque, investors will gradually lose confidence. The IFSWF notes that transparency, both internal and external confers some very real benefits to practitioners.

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42. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, p. 34

43. Ibid, p. 38

44. Behrendt, Sven (ed); Kodmani, Bassma. "Managing Arab Sovereign Wealth in Turbulent Times - and Beyond", Carnegie Endowment for International Peace, April 2009, pp. 15-16



SWFs: Aspects of governance structures and investment management<sup>45</sup>

### Case Studies

For the purposes of this research paper, two countries will be held as case studies: Norway and Qatar. Both countries have extremely strong hydrocarbons sectors that have conferred great wealth upon them. Furthermore, both countries have relatively little else in terms of non-hydrocarbon resources (such as arable land), most of which come from their seas. Additionally, both countries have leveraged their hydrocarbons wealth into SWFs. However, whereas the Norwegian economy has diversified relatively well and the country boasts a robust record of development and transparency, the Qatari economy has in general, failed to leverage its hydrocarbons wealth into other sectors. Most of the population remains reliant on money from its hydrocarbons sector and its SWF is among the lowest-ranked in terms of transparency.

#### Norway

Norway is notable among oil-producing states in that it is usually viewed as having avoided the worst impacts of the Resource Curse and the Dutch Disease and the country remains in the top five global exporters of oil and gas. Despite the sheer volume and the importance of oil in Norwegian economy, hydrocarbons constitutes only 67% of Norwegian exports and 22% of Norwegian GDP. Indeed,

45. Al-Hassan, Abdullah; Papaionnaou, Michael; Skancke, Martin; Chih Sung, Cheng. “Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management”, International Monetary Fund (IMF), Vol 13, Issue 231, (November 2013), p. 326

the country has a very robust fishing and shipping sector and is also strong in the production of ferro-alloys<sup>46</sup>. As a result, the Norwegian economy is considered fairly diverse despite the significant revenues brought in by hydrocarbons.

The most distinguishing feature of Norway's management of its hydrocarbons (and indeed its overall economic system) is taxation with some of the highest taxes in the world. The hydrocarbons sector is particularly heavily taxed, with the 2018 tax rate standing at 55%<sup>47</sup>. The state owns all natural resources and extraction is not done through the sale or rent of these fields to companies but through a licensing process in which the state keeps a majority stake. Most often, this is handled through the state-owned Statoil corporation. Norway allocates its licenses for hydrocarbons exploration and extraction through an administrative process<sup>48</sup>. While this is not viewed as the most transparent system, applicants for a license in Norway must meet specific minimum criteria including technological expertise and safe-guards for emergencies such as oil spills, which improves the transparency of the system. The pre-qualification criteria, which is also required by Algeria, Iraq and Libya, is one of the areas where Norwegian and Iraqi policies are broadly synchronised<sup>49</sup>. In conjunction, the country has a guiding document referred to as the "The Ten Oil Commandments" which have informed and underpinned Norwegian hydrocarbons policies since the 1970s<sup>50</sup>. These guiding set of principles have allowed the Norwegian Government to retain administrative focus and institutional continuity over the years, allowing for a relatively stable decision-making process with regards to oil spending. This stands in contrast to Arab oil exporters, none of whom have a comprehensive code for their country's demands and needs regarding its oil wealth. In Iraq's case, the country does not even have a codified hydrocarbons law despite such being required constitutionally<sup>51</sup>.

The presence of a strongly codified and continuous regulation and taxation regime gives Norway not only the means to support a comprehensive welfare state but also the vision to create mechanisms that builds resilience against unexpected

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46. "Norway", The European Commission, 16-April-2018 (Last Updated), <[ec.europa.eu/trade/policy/countries-and-regions/countries/norway/index\\_en.htm](http://ec.europa.eu/trade/policy/countries-and-regions/countries/norway/index_en.htm)>, [Accessed 29-September-2018]

47. "Main Tax Features 2017-2018", Norwegian Ministry of Finance, 2017, p. 16

48. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, pp. 12-13

49. Ibid, p. 20

50. Ibid, pp. 20-21

51. Ibid, p. 20

developments and remain accountable to its citizens in tax spending. The country uses its tax earnings to support infrastructure programmes and generous welfare programmes that are specifically aimed at capacity building (such as education and skills training).

In addition to the adjustment of the budget on an annual basis to adapt to changing economic realities, the system has allowed Norway to build the largest SWF in the world: The State Global Pension Fund. It is valued at over \$1 trillion in assets including 1.3% of global oil stocks and shares<sup>52</sup>.

### The State Global Pension Fund

The State Global Pension Fund, also semi-formally known as the Oil Fund (Oljefondet) is Norway's main vehicle for investing surplus revenues of the Norwegian petroleum sector. The fund's main purpose is to achieve inter-generational equity, converting the non-renewable resource into a diversified portfolio of financial assets that will generate income flows from interest payments, dividends and appreciating asset values for future generations. It therefore is both a Pension and a Savings fund.

The fund also invests in a wide range of securities outside Norway, effectively shielding the fund from the fluctuations within the Norwegian economy. The ring-fenced structure of the fund means that the Norwegian economy is, in turn, shielded from any instability or bad investments that could damage the fund<sup>53</sup>.

The fund has been managed and supervised by a board of trustees since 2004. The board oversees a number of issues including investment ethics and risks. It does not invest in shares and debts of companies and also refrains from investing in companies involved in (or facilitating) torture, restrictions of liberty and other human rights violations<sup>54</sup>. The fund has grown 3.8% annually since 1999. Although its increase has been lower than other global equity indices, it has been more stable compared to other indices<sup>55</sup>.

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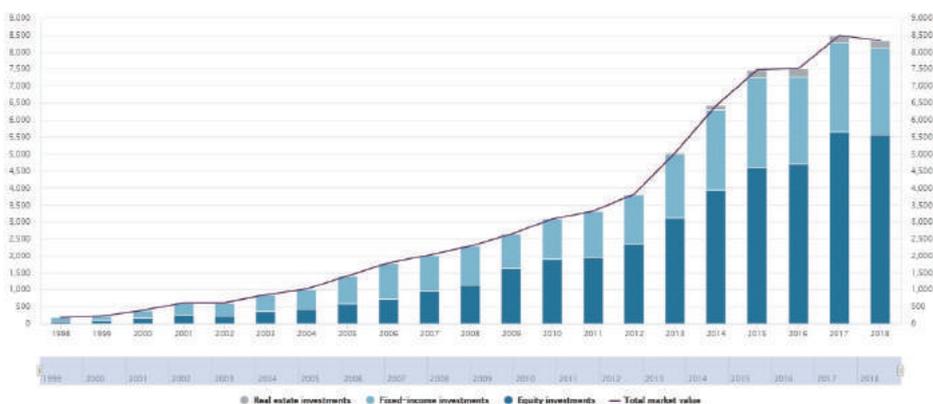
52. "Norway's Sovereign Wealth Fund Passes the \$1trn Mark", *The Economist*, 21-September-2017, < <https://www.economist.com/finance-and-economics/2017/09/23/norways-sovereign-wealth-fund-passes-the-1trn-mark>>, [Accessed 29-September-2018]

53. Grigoryev, Vladimir; Movchan, Andrey; Zotin, Alexander. "Managing the Resource Curse", *Carnegie Endowment for International Peace*, p. 104

54. *Ibid*, p. 104

55. *Ibid*, p. 104

In billions of kroner, 2018 values as at 30 June



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The Fund, in conjunction with a comprehensive tax code, nationally-oriented hydrocarbons policies and a transparent bureaucratic framework with clear objectives, has granted significant benefits to Norway. Notably, the country is significantly less oil-reliant than many comparable oil-producing states. Even as the GDP per person exceeded \$60,000 a year in 2016, only about \$20,000 of this was linked to the hydrocarbons market. The country has a very high purchasing parity and scores well on equality levels. Although high wages and high costs of consumer products (not just restricted to taxed items like alcohol and tobacco but also food items) has reduced Norwegian competitiveness, this has often been compensated by the high prosperity and education levels<sup>57</sup>.

The Fund adheres to the Santiago Principles in both letter and spirit. Experts in transparency and governance state that the country is especially strong with regards to having:

- A strong structure with clearly defined roles, responsibilities, oversight and accountability,
- Clearly defined roles, goals and objectives,
- Integration with the budget system,

56. "Market Value", Norges Bank Investment Management, 21-August-2018 (Last Updated), <<https://www.nbim.no/en/the-fund/market-value/>>, [Accessed 19-October-2018]

57. Grigoryev, Vladimir; Movchan, Andrey; Zotin, Alexander. "Managing the Resource Curse", Carnegie Endowment for International Peace, pp. 104-105

- Integration with the budget system,
- Sound assets management strategy,
- Clear operational rules<sup>58</sup>.

Adherence to these principles is cited for the success of Norway's SWF and its general ability to avoid the Resource Curse and the Dutch Disease.

There remain some fears for the long-term viability of the Norwegian economy. On the whole, foreign investment remains lower in Norway than in its competitors and has shown a trend of falling in recent years. Industrialisation is also showing a similar trend, with spending for research and development for new technologies ranking at 1.4% of the GDP, an amount significantly lower than its regional comparators. Norway's overall GDP growth has been at an average rate of 1.73%. While stable, it has also shown signs of stagnating. Furthermore, although the oil and gas production continue to show good numbers, Norwegian hydrocarbons reserves are expected to diminish over the coming decades. The growing prevalence of renewable energy and the shift away from oil will present another complication<sup>59</sup>.

Regardless, the current model of the Norwegian economy, with its tax-to-welfare model that is backed by oil revenues, has been cited as the reason why the country has remained resilient against numerous oil price fluctuations over the years. The model has not only allowed successive Norwegian governments to transfer their earnings into infrastructure, but the strong institutional mechanisms and accountability through taxes have also created a series of checks and balances that have kept corruption and tax avoidance low. While Iraq does have a number of key differences to Norway that would make the exact application of a Norwegian model unviable, the country nevertheless offers key lessons for Iraq.

### Qatar

As a country with a relatively small population (less than 2.5 million) and size (around 11,500 square-kilometres), Qatar nevertheless boasts a significant

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58. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, pp. 37-38

59. Grigoryev, Vladimir; Movchan, Andrey; Zotin, Alexander. "Managing the Resource Curse", Carnegie Endowment for International Peace, pp. 104-107

wealth, having recorded a GDP of \$167.61 billion in 2017<sup>60</sup>. The wealth comes from Qatar's substantial oil and gas reserves. However, Qatari GDP is almost entirely reliant on hydrocarbons. Indeed, the country's peak GDP of \$206.22 billion in 2014 suffered significantly since oil prices crashed the same year, recording a GDP of \$164.64 billion in 2015 and \$152.45 billion in 2016. The country imports nearly all its goods including a heavy reliance on food supplies. In addition to issues relating to susceptibility to price shocks, the vulnerability of the Qatari economy to shocks was highlighted in 2017 when Saudi Arabia, Bahrain and the United Arab Emirates (UAE) launched a blockade on Qatar. The country, which exported much of its consumer goods, survived mainly due to political acumen, rerouting much of its imports via Oman and India and replacing the sources of its Gulf imports with those from Iran and Turkey<sup>61</sup>.

Even before the blockade, the country was aware of the risk presented by its single-commodity economy. As early as 2008, the country announced its "Qatar National Vision 2030" in which the aim is to "transform Qatar into an advanced society capable of achieving sustainable development" by the year 2030<sup>62</sup>. Its four pillars entail Economic, Social, Environmental and Human Development<sup>63</sup>.

The economic aspect is particularly relevant. The Qatari Government identifies its economic goals as:

- Sound economic management that ensures reasonable and sustainable economic growth that secures a high standard of living and financial and economic stability with low inflation rates;
- Reasonable exploitation of oil and gas, establishing balance between reserves and production;
- Sustainable economic diversification that gradually reduces dependence on

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60. "Qatar GDP", Trading Economics, 2018, <<https://tradingeconomics.com/qatar/gdp>>, [Accessed 2-October-2018]

61. "Turkey, Iran Help Qatar Thrive, One Year Into Saudi-led Blockade", Haaretz, 18-June-2018, <<https://www.haaretz.com/middle-east-news/turkey/qatar-crisis-turkey-iran-help-tiny-emirate-thrive-one-year-into-saudi-led-blockade-1.6177992>>, [Accessed 2-October-2018]

62. "Development Pillars", Ministry of Development Planning and Statistics, 2018, <<https://www.mdps.gov.qa/en/qnv/Pages/default.aspx>>, [Accessed 02-October-2018]

63. Ibid.

hydrocarbon industries and enhances competitiveness<sup>64</sup>.

The Qatar Investment Authority (QIA) plays an important part in this. Although the QIA, founded in 2004, predates the Qatar National Vision 2030, it nevertheless is an integral part of the Kingdom's efforts to diversify its economy and build sustainable revenue-generating mechanisms. As of 2017, the QIA boasted assets estimated to be worth \$335 billion<sup>65</sup>. Although not the biggest SWF in the world or even the Gulf, in comparison to the country's small population, it is substantial.

#### The Qatar Investment Authority

The Qatari SWF known as the QIA was founded in 2005 to manage the oil and gas surpluses of the country. Its main mission is defined as managing and growing Qatar's reserves to create long-term value for the State and future generations<sup>66</sup>. It is therefore classified as a Long-Term Savings Fund.

The long-term goal of the QIA is to support the development of a competitive Qatari economy, facilitate economic diversification and developing local talent, ultimately being classified as a world-class investment institution and a preferred partner of choice for investors, financiers and stakeholders<sup>67</sup>. The main focus of its investments are the banking and real estate sectors in across the West, particularly in the United Kingdom where it holds a significant real estate portfolio<sup>68</sup>. It is a major investor in banks such as Barclays and Credit Suisse and has continued its investments there even after other banks withdrew from it<sup>69</sup>.

According to the QIA, it is an adherent of the Santiago Principles and describes its values in terms of five guiding principles:

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64. "Economic Development", Ministry of Development Planning and Statistics, 2018, <<https://www.mdps.gov.qa/en/qnv/Pages/default.aspx>>, [Accessed 02-October-2018]

65. Sergie, Mohammed. "The Tiny Gulf Country With a \$335 Billion Global Empire", Bloomberg, 12-January-2017, <<https://www.bloomberg.com/news/articles/2017-01-11/qatar-sovereign-wealth-fund-s-335-global-empire>>, [Accessed 2-October-2018]

66. "About", Qatar Investment Authority, 2018, <<https://www.qia.qa/About/OurMission.aspx>>, [Accessed 2-October-2018]

67. Ibid

68. McSparren, Jason; Besada, Hany; Saravade, Vasundhara. "Qatar's Global Investment Strategy for Diversification and Security in the Post-Financial Crisis Era", Centre of Governance, May 2017, p. 11

69. Setser, Brad; Ziemba, Rachel. "GCC Sovereign Funds: Reversal of Fortune", Council of Foreign Relations, January 2009, pp. 23-24

- Integrity to apply the highest ethical, moral and professional standards of conduct in each of their undertakings;
- Mission focus to fulfil its “noble mission” on behalf of the Qatari people;
- Entrepreneurialism, encouraging a flexible approach even as the QIA grows and institutionalises;
- Excellence in all aspects of its undertakings;
- Respect for people which it recognises as a valuable asset, thus creating a respectful workplace environment<sup>70</sup>.

The Chairman of the Board is the Deputy Emir of the State of Qatar, Abdullah bin Hamad bin Khalifa Al-Thani who is the brother of the current Emir, Sheikh Tamim bin Hamad Al-Thani. The Vice Chairman is another member of the Al-Thani royal family, Ahmed bin Jassim Al Thani. A number of other members of the Al-Thani family occupy positions including the position of the CEO.

Further information is provided about its organisational structure, which is led by a Board of Directors, Board Investment Committee and Board Audit Committee, all linked to the CEO of the QIA. The QIA offers relatively little details on the exact distribution of duties for these officials, with only relatively basic guidelines provided for responsibilities involved in the management of the fund<sup>71</sup>. Highlighting the bare-bones nature of its information-communication, the QIA does not publish clear figures or breakdowns of its portfolio or assets, forcing analysts to estimate the exact numbers involved.

The Fund is similarly scarce in details when it comes to disclosing how it avoids the conflict of interests borne out of numerous members of the board belonging to the same royal family. Indeed, a number of assets invested by the QIA were also invested by the former Emir of Qatar, Sheikh Hamad bin Khalifa Al-Thani, calling it into question how private family interests are separated from the interests of the QIA<sup>72</sup>. It is therefore unsurprising that Nakhle refers to QIA as “failing” when it comes to transparency, suggesting that it follows the Santiago

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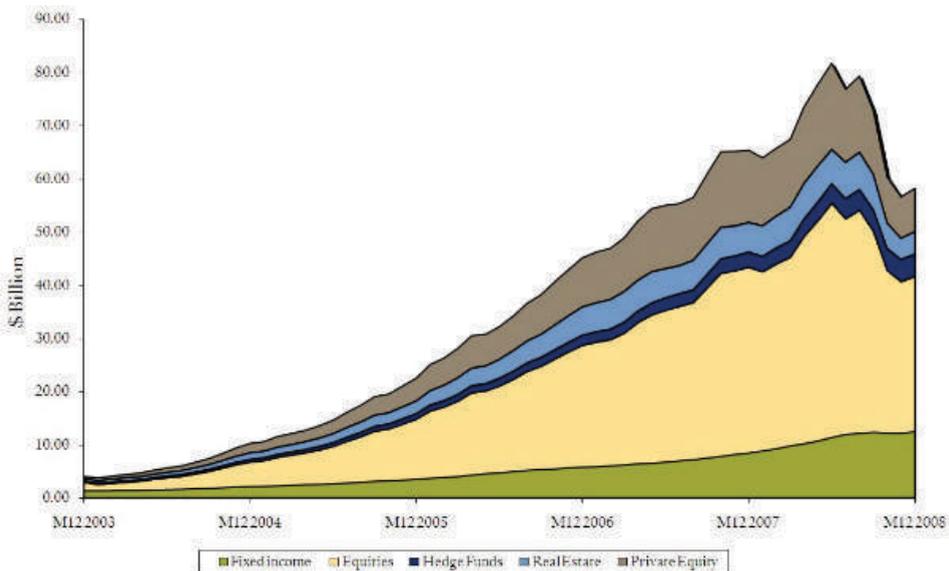
70."About", Qatar Investment Authority, 2018, <<https://www.qia.qa/About/OurMission.aspx>>, [Accessed 2-October-2018]

71. Ibid

72. Setser, Brad; Ziemba, Rachel. “GCC Sovereign Funds: Reversal of Fortune”, Council of Foreign Relations, January 2009, p. 24

Principles only in name<sup>73</sup>.

The impacts of such policies are self-evident. In particular, in an attempt to scale its assets quickly, the QIA has been willing to take risks and invest in concentrated portfolios. The fact that much of its investments were in the United Kingdom or in markets heavily integrated to the system London was part of, it was hit by the 2008 financial crisis harder than many other Gulf SWFs. Its eventual recovery was not due to prudent investments but due to rising oil and gas prices, effectively meaning that rather than protecting the Qatari economy from international financial crises, the QIA left itself vulnerable to the same forces it was meant to provide protection from<sup>74</sup>.



QIA, Estimated Portfolio<sup>75</sup>

Unfortunately for the QIA, things have not changed much in the decade since. The QIA has begun cultivating its Asian portfolio only recently despite Asia

73. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, pp. 37-38

74. Setser, Brad; Ziemba, Rachel. "GCC Sovereign Funds: Reversal of Fortune", Council of Foreign Relations, January 2009, p. 24

75. Ibid, p. 24

being stated as a target market a decade ago<sup>76</sup>. It also appears to be unrecognising of emerging market trends and investment opportunities in northern and eastern Africa despite the country having long-standing relations with a number of countries such as Sudan, Djibouti, Ethiopia, Nigeria, Kenya and Somalia<sup>77</sup>. This is especially pertinent, given that Qatar's allies, such as Turkey, and former allies, such as the UAE, are racing to build up their economic and political influences in the region<sup>78</sup>.

Furthermore, despite the QIA's (and the wider Qatari National Vision 2030's) stated objective to diversify the economy, improve conditions and increase sustainability, Qatar continues to lag behind in all of these aspects. Although it boasts a GDP per capita comparable to Luxembourg, Switzerland and Norway, Qatar's human development levels remain closer to the UAE and Saudi Arabia which have far lower GDP per capita, leading Nakhle to refer to Qatar as "richer than developed"<sup>79</sup>.

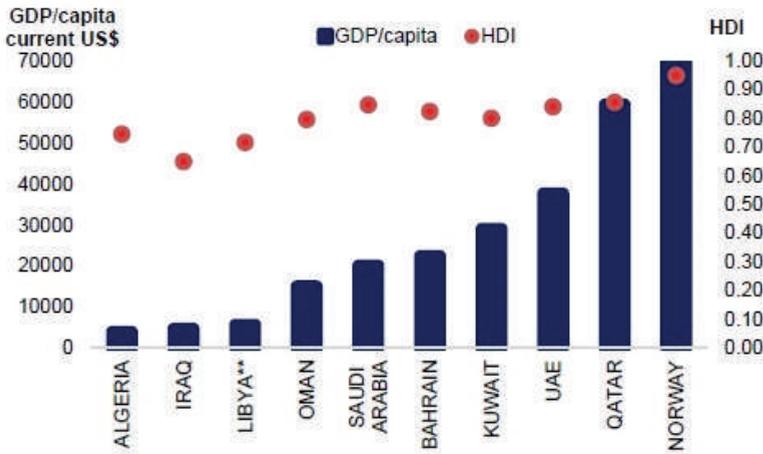
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76. McSparren, Jason; Besada, Hany; Saravade, Vasundhara. "Qatar's Global Investment Strategy for Diversification and Security in the Post-Financial Crisis Era", Centre of Governance, May 2017, P. 10

77. Ibid, pp. 10-11

78. "In the Race Between Turkey and the UAE, Somalia Wins", Stratfor, 14-August-2017, <<https://worldview.stratfor.com/article/race-between-turkey-and-uae-somalia-wins>>, [Accessed 4-October-2018]

79. Nakhle, Carole. "Towards Good Governance Of the Oil and Gas Sector in the MENA", Economic and Social Commission for Western Asia (ESCWA), 1-December-2017, pp. 43-44



Data Sources: The World Bank, 2017a & 2017e  
 \*\*The latest available data for Libya is 2011

Income per capita & HDI<sup>80</sup>

Other signs reflect this trend. Despite nearly a decade’s worth of effort to diversify, the country remains reliant on hydrocarbons. Gulf countries including Qatar also rank higher in electric consumption, energy intensity and wasteful practices such as gas flaring (in which Iraq ranks highest)<sup>81</sup>, signalling that hydrocarbons are not being used as effectively, efficiently or sustainably as they could be.

The matter of lagging human development links into an issue that is present in not only Qatar but much of the Gulf: the nature of the investments. Analysts note that many Gulf SWF investments go into financial assets that do not add to productive capacity or capital goods but are merely cycled around existing assets. This means that despite investment worth billions of dollars, there is little to no actual development taking place. In effect, these investments and the protection they provide are a “mirage”. Once they are extricated from the investment portfolios, the resulting numbers are rather sobering<sup>82</sup>.

Other issues of the QIA highlight the dangers of letting different interests

80. Ibid, p. 44

81. Ibid, pp. 40-42

82. Behrendt, Sven (ed); Kodmani, Bassma. "Managing Arab Sovereign Wealth in Turbulent Times - and Beyond", Carnegie Endowment for International Peace, April 2009, pp. 15-16

hijack the purpose of the SWF. The QIA (and wider Qatari investments) received condemnation in the United Kingdom due to Qatar's alleged funding of the IS and the Syrian group Jabhat al-Nusra (now known as Hayy'at Tahrir al-Sham)<sup>83</sup>. Subsequently, speculation emerged that these allegations were motivated by a property dispute between the billionaire Barclay family and the Al-Thani family<sup>84</sup>. Both allegations are equally damning for the QIA, with one linking the Fund to terrorist groups and other suggesting that the Fund can be held hostage to a so-called family feud.

Ultimately, the examples of both Norway and Qatar are instructive for Iraq in what to do and avoid. Although Iraq's circumstances (such as population or development level) are different than these two case countries, they nevertheless offer insight to the direction an Iraqi SWF should take. These lessons should be remembered alongside the lessons to be learned from Development Fund for Iraq.

### **Iraq: Background, Needs and Recommendations**

#### **Background**

The Iraqi economy suffers from a number of major issues that causes it to run a high deficit against its GDP. The 2018 budget estimates that the country will make a revenue of 91,643 billion IQD against expenses amounting to 104,158 billion IQD. The resulting deficit amounts to 12,514 billion IQD<sup>85</sup>. Many of the expenses and the resultant deficit can be linked to the war against the IS and the reconstruction needs in major cities such as Mosul, Fallujah and Ramadi, which have been left devastated in the wake of the group's occupation.

These issues are further compounded by the reliance of the Iraqi economy on hydrocarbons. The 2018 budget cites the estimated oil and gas revenue as 77,160 billion IQD and the non-oil revenue as 14,483 IQD, highlighting how

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83. "No Ally of Britain Should Allow the Funding of Terror", The Telegraph, 2-November-2014, <<https://www.telegraph.co.uk/news/worldnews/middleeast/qatar/11202656/No-ally-of-Britain-should-allow-the-funding-of-terror.html>>, [Accessed 4-October 2018]

84. Donaghy, Rori. "Was a London property dispute behind a Telegraph campaign against Qatar?", Middle East Eye, 15-June-2015, <<https://www.middleeasteye.net/news/barclay-brothers-telegraph-campaign-against-qatar-and-battle-three-london-hotels-367590621>>, [Accessed 4-October-2018]

85. "Text of the General Budget of the Federal Republic of Iraq for fiscal year (2018)", Iraqi Ministry of Finance, 2017, p. 3

reliant the Iraqi economy is on oil production<sup>86</sup>. The 2018 figures are actually an improvement from 2014 during which high oil prices represented some 90% of the country's GDP<sup>87</sup>. The IMF estimates that the non-hydrocarbons sector will grow in the coming years on account of the reconstruction and the resultant internal consumption. However, it estimates that these gains can be threatened by sustained political or economic instability<sup>88</sup>. The fact that Iraq has little to no concrete tax system and what little there is has eroded over the years of high oil income only restricts revenue sources further.

Beyond lacking a robust tax system, corruption is another major issue that Iraq faces. The country ranks 169 out of 180 in the Corruption Perception Index<sup>89</sup> and 168 out of 190 in the 2018 Doing Business ranking<sup>90</sup>. The corruption levels not only deter investor confidence and make the delivery of services and governance more challenging, they often result in the squandering of revenues better used elsewhere. This is best highlighted in the fate of the Development Fund for Iraq.

### Development Fund for Iraq

The DFI, was created by the Coalition Provisional Authority (CPA) in the wake of the 2003 Invasion of Iraq by the United States and its allies. The fund was technically an SWF but was different in that its sources were the assets seized and vested from the accounts of Saddam Hussein and his family as well as funds linked to the oil-for-food programme. Despite the CPA citing the importance of transparency and accountability over the use of the money for the good of the Iraqi people, much of the money was squandered in what was referred as a "black hole of unaccountability". Out of \$23 billion held, some \$8.8 billion was unaccounted for<sup>91</sup>. By all accounts, including eyewitnesses, the money was used

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86. Ibid, p. 3

87. Feher, Csaba; Mansour, Mario; Aslam, Aqib; Hegazy, Amgad; Basile, Gregory; De Mets, Patrick. "Iraq: Selected Issues", International Monetary Fund, Vol 17, No 252, (2017), p. 16

88. "Iraq Economic Monitor: From War to Reconstruction and Economic Recovery", The World Bank, Spring 2018, pp 19-20

89. "Iraq", Transparency International, 2018, <https://www.transparency.org/country/IRQ>, [Accessed 5-October-2018]

90. "Iraq Economic Monitor: From War to Reconstruction and Economic Recovery", The World Bank, Spring 2018, p. 9

91. "Development Fund for Iraq", Global Policy Forum, <<https://www.globalpolicy.org/humanitarian-issues-in-iraq/development-fund-for-iraq.html>>, [Accessed 5-October-2018]

by American and Iraqi officials for their own purposes<sup>92</sup>.

A 2014 statement of clarification from the Iraqi Embassy in the United States confirms that the fund still existed by then<sup>93</sup>. Similarly, a 2017 IMF document on balance of payments contains references to the “Development Fund for Iraq and its successor accounts”. According to the document no payments have been made into the DFI and all numbers are null. This suggests that the DFI, if it still exists, is inactive<sup>94</sup>. Most other queries for a Development Fund for Iraq lead to sources related to the “Iraq Social Fund for Development”. This, however, is a WB aid programme and not an SWF<sup>95</sup>.

The fate of the DFI is instructive on why the existence of an SWF is not a solution to a country’s problems where many other structural problems such as corruption remain. Any new attempts at creating an Iraqi SWF will fall prey to the same issues unless appropriate anti-corruption measures, such as ring-fencing the funds and enforcing accountability, are implemented.

### Needs

In order to identify the scope, mission and remit of an Iraqi SWF, the first thing needed is to identify what Iraq is looking to obtain from such an initiative.

The first and most immediate needs Iraq has is reconstruction and redevelopment. Much of western and northern Iraq has been devastated by the IS, with many cities in the region in need of widespread reconstruction. However, the southern and eastern parts of Iraq which have not been touched by recent wars, have nevertheless witnessed steady decay in their infrastructure since the Gulf War in 1991, when the country was placed under embargo. The Basra Water Crisis and the subsequent protests are just a facet of infrastructure problems Iraq faces. Many sectors of Iraq ranging from healthcare to agriculture are in desperate need of redevelopment. Thus, an Iraqi SWF should keep reconstruction and development concerns in mind.

92. "So, Mr Bremer, Where did all the money go?", The Guardian, 7-July-2005, <<https://www.theguardian.com/world/2005/jul/07/iraq.features11>>, [Accessed 5-October-2018]

93. "Clarification on status of the Development Fund for Iraq", Embassy of the Republic of Iraq, 5-June-2014, <[www.iraqiembassy.us/article/clarification-on-status-of-the-development-fund-for-iraq](http://www.iraqiembassy.us/article/clarification-on-status-of-the-development-fund-for-iraq)>, [Accessed 5-October-2018]

94. "Iraq: Letter of Intent, Memorandum of Economic Financial Policies, and Technical Memorandum of Understanding", International Monetary Fund, 23-July-2017, P. 37

95. "What is the Iraq Social Fund for Development?", The World Bank, 6-February-2018, <<https://www.worldbank.org/en/news/factsheet/2018/02/06/what-is-the-iraq-social-fund-for-development>>, [Accessed 5-October-2018]

Another significant challenge Iraq faces is diversity of its economy. As mentioned above, governments can use SWFs to invest in sectors of the economy that suit the macroeconomic needs of the country. Within such a context, an Iraqi SWF should be aimed at “capacity building” of local industries. As mentioned above, the WB estimates that reconstruction related consumption will allow the non-hydrocarbon sector to grow in the coming years. Such sectors, such as construction, can help kick-start native Iraqi manufacturing capabilities to gradually expand as the base of skilled workers grow. Another such sector is agriculture which has suffered massively due to the IS in the north and west as well as drought conditions across the country<sup>96</sup>.

Another long-term consideration is the country’s high youth population. As mentioned above, Iraq has a very high youth population, with a median age of 20<sup>97</sup>. The country, however, faces high unemployment due to lack of development. Meanwhile, the high median age means that Iraq’s aged population will balloon in the coming decades. Thus, Iraq faces a two-pronged macroeconomic and demographic challenge: Providing jobs and development for the youth of today; and providing care and pension for the elderly of the future. Although the issue of an aging population is not urgent, it is nevertheless important to keep in mind and plan for accordingly.

Lastly, corruption, as mentioned above, is a critical structural factor that must be addressed. As highlighted above, creating an SWF alone is not a solution for corruption. However, an SWF can be built to be resilient against corruption by restricting access to its reserves and holding every withdrawal into strict account. In doing so, the SWF can “lead by example”, allowing anti-corruption policies to be implemented in other sectors.

### Recommendations

This paper recommends that an SWF be created only if it can address the aforementioned demands and needs. As referenced repeatedly over the course of this paper, attempting to create an SWF just because this is what other oil-producers have done will make the SWF part of the problem, not the solution.

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96. "With ISIS Gone, Farmers Struggle to Revive What Was Once Iraq's Breadbasket", Haaretz, 29-June-2018, <<https://www.haaretz.com/middle-east-news/iraq/with-isis-gone-farmers-try-to-revive-what-was-once-iraq-s-breadbasket-1.6318202>>, [Accessed 5-October-2018]

97. "Iraq Demographics Profile 2018", IndexMundi, 20-January-2018, <[https://www.indexmundi.com/iraq/demographics\\_profile.html](https://www.indexmundi.com/iraq/demographics_profile.html)>, [Accessed 5-October 2018]

The author recommends that the GoI create an SWF that is either multi-purpose or multiple SWFs with different purposes. Having multiple SWFs may create an additional layer of insurance in the event of an investment going wrong but may increase management overhead.

As diversification of the economy, reconstruction and restoration of the infrastructure represent the main needs for Iraq, the fund should primarily be a Development Fund. In this way, not only can funds be directed towards reconstruction and redevelopment projects, but the fund can help domestic industrial capacities grow by investing in them. As the foundation of skilled workers emerges, the investments can target more sophisticated industries in line with the macroeconomic goals of the GoI. In doing so, Iraq may even become a pioneer of emergent technologies such as desalination, which has been cited as a potential solution for the water crisis in Basra and wider Iraq<sup>98</sup>.

The Development Fund can be synergised with a Long-Term Savings Fund and a Pension Reserve Fund. Both of these funds are gravitated towards creating long-term value and supporting subsequent generations and pension-holders. The long-term value creation aspect of the Savings Fund can be used to invest in assets and sectors that can generate revenues. Some of these revenues can be used to then invest domestically in industries that either suit the macroeconomic goals of the GoI or which will not become profitable until time has passed. A portion of these funds can also be used towards building a portfolio specifically aimed at supporting the aging population.

Implementing these funds and seeing the changes that confer will be a medium-to-long term endeavour. In the interim, however, the Iraqi economy will remain reliant on hydrocarbons and susceptible to price shocks in the event of an oil crash. To avert the impacts of such a crash, the author recommends the creation of a Stabilisation Fund. Such a fund would ideally be separate from the development/long-term-value oriented funds and its main goal would be to shield the Iraqi economy from crashes as it moves to accomplish its long-term objectives.

Through it all, the example of Norway and how it manages its hydrocarbons riches should be kept in mind. In particular, Norway is a robust example of compliance to the Santiago Principles not only in letter but also in spirit. The way

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98. MacDonald, Alex. "How locals are turning Basra's poisoned rivers into drinking water", Middle East Eye, 1-October-2018, <<https://www.middleeasteye.net/news/water-basra-1860957290>>, [5-October-2018]

Norway makes its hydrocarbons revenues, from taxes and licensing rather than rents, should also be considered. Such an approach will require wholesale reform of the Iraqi economic system, which will be a long-term endeavour. Thus, in the short term, the SWFs may need to source themselves from the present system. Regardless, creating a roadmap of transition from rentierism to a tax-and-licence-oriented system will increase confidence.

Lessons should also be learned from both Norway and Qatar regarding clear delineation of roles, mission, and the avoidance of conflicts of interest. In Norway's Oil Fund, the roles of officials are clear, as are its objectives. The creation of an institutional memory and the formulation of a specific set of values and principles with clear perimeters has allowed Norway to retain its institutional focus in wealth creation. Qatar, on the other hand, has objectives and principles but these are vaguely stated, often referring to ideals or using buzz-words as opposed to providing a clear set of guiding principles. Furthermore, the conflict of interests emerging from the heavy involvement of Al-Thani family in the fund's management means that family interests and other state interests can intrude on the interests and goals of the SWF, often to its detriment. Given the levels of corruption in Iraq, as well as the importance of sect, ethnicity, tribe and party affiliation, similar issues will likely crop up in an Iraqi SWF. As highlighted above, addressing these issues without wider reforms will be difficult.

An Iraqi approach will therefore need to be wholly technocratic in nature. This paper recommends that Iraq follow the example of Norway in having its SWF managed by a bank created for and dedicated to that purpose alone. By being a fresh institution rather than a pre-existing one, this proverbial "Iraqi Investment Bank" can look towards hiring the best possible options for its board of directors. Such a board should be made of technocrats with expertise in banking in both an Iraqi context and a global context. Having the board's experience skewed towards one sector will leave it unable to deal with the demands and needs of the other. For instance, a board wholly experienced in global finance will find it difficult to navigate Iraq's own financial landscape. Appealing to expat Iraqis may be a viable option.

One of the most distinguishing features of the Norwegian Oil Fund is its Ethics Board. The Board is in charge of ensuring that the fund invests its money on companies that do not violate human rights, engage in destructive environmental

practices or otherwise violates the principles of corporate social responsibility<sup>99</sup>. While such issues may not immediately resonate with an Iraqi context, it should be noted that many of these issues tend to be closely linked with corruption. As such, an Ethics Board (perhaps with a focus on anti-corruption) would be a vital part of the governing board of an SWF. Staff for such a board would be best sourced from institutions such as the Iraqi Integrity Commission due the commission having experience on such matters already. However, care must be taken to ensure the SWF does not become politicised. Achieving these goals can ensure that not only is the money spent where it is truly needed, without doing more damage, but Iraq can avoid the accusations that dogged Qatar relating to how its funds were used towards supporting terrorists. On the whole, transparency, accountability and proper bookkeeping should be preconditions for domestic investment from the SWF, serving as an incentive for wider anti-corruption. If the SWF becomes a success story in accountability, it can also garner the political capital and will to reform the wider economic system.

Norway also exemplifies how funds in an SWF are invested. As Iraq starts to build its SWF portfolio, it will no doubt attract many businesses looking for investments. As the Qatari example highlights, toxic or concentrated investments can damage the credibility of even the strongest SWF. The risk is even higher in Iraq where the skills baseline for investing in the global market is still low.

This paper recommends that the focus be kept on domestic investments for the time being. As mentioned above, Iraq's domestic sectors are in the biggest need of development. Furthermore, the aforementioned unfamiliarity of many Iraqis with the global investment system means that domestic investment will allow for a more informed policy-making. That said, since maintaining financial diversity is vital for an SWF to avoid getting hit by crises, investing all the funds in domestic markets should be avoided from the beginning. Instead, the board of technocrats should assess which investments are safe and invest in them. In the short-term, such cautious investments will bring less revenue; however, predictability and steady revenues are a boon for long-term value. A small amount (no more than 15% of the amount earmarked to foreign investments) can be ring-fenced to experiment with riskier investments, helping build local knowledge, expertise and institutional memory. How long this takes is entirely dependent on how the process develops. In Norway, which followed such a path,

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99. "Responsibility", Norges Bank Investment Management, <<https://www.nbim.no/en/responsibility/>>, [Accessed 19-October-2018]

the fund did not invest outside public markets for more than 12 years. Even then, the Norwegian Parliament had to approve a 5% allocation to the global real estate market<sup>100</sup>. Furthermore, the exact capital earmarked for such an SWF would need to be assessed by expert Iraqi financiers with solid knowledge of government budgets and requirements. This assessment would also need to be made in conjunction with an analysis of Iraq's contemporary context, given the volatility of the political and security situations in Iraq, as well as the volatility of global oil prices.

### **Conclusion**

The past ten years have seen a rapid growth of SWFs in both size and quantity. However, many of these SWFs only project success due to the sheer size of the assets that back them, such as hydrocarbons. Although this grants them the ability to withstand economic crises and increase the economic profiles of their home-countries, a closer look at them shows that many SWFs fail in achieving their stated goals of diversifying their economies, building local capacities and, ultimately, averting issues such as the Resource Curse and the Dutch Disease. The case studies of Norway and Qatar show that it is not an SWF that cures a country of such problems, it is institutionalisation, transparency, accountability and, ultimately, a clear mission and focus.

This paper has looked into the notion of whether Iraq can benefit from having its own SWF as it moves to post-war reconstruction of its infrastructure and the diversification of its economy away from over-reliance on hydrocarbons. This paper concluded that Iraq can indeed benefit from an SWF, particularly one that prioritises development and capacity-building while protecting the Iraqi economy from its current vulnerabilities.

This paper reiterates the point that the creation of an SWF is not sufficient enough to move Iraq past its vulnerabilities. Failure to recognise that will turn the fund from a solution to a problem. Rather, the fund is a tool that can help protect Iraq's economy, serve as a vehicle of reconstruction and redevelopment, diversification and even anti-corruption.

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100. Al-Hassan, Abdullah; Papaionnaou, Michael; Skancke, Martin; Chih Sung, Cheng. "Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management", International Monetary Fund (IMF), Vol 13, Issue 231, (November 2013), p. 19