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PNG's 2015 Sovereign Wealth Fund Bill: Key Weaknesses and Proposals for Improvement

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Introduction

The PNG Government published the *Organic Law on Sovereign Wealth Fund* in the National Gazette on 27 October 2014. The Bill was passed 76-4 in Parliament on 30 July 2015.

The *Organic Law* provides the deposit and withdrawal rules of the two sub-funds of the Sovereign Wealth Fund (SWF), namely the Stabilisation Fund and the Savings Fund. It also sets out the functions and membership of the board, and the appointment procedures.

The National Research Institute (NRI) has closely followed the process and kept a strong interest in the SWF Legislation since 2010 when the plans for the establishment of a SWF were first discussed until the passing of the Bill five

years later, as evidenced by several publications and submissions on the issues.

In this article, we highlight the key events thus far on the progress towards the establishment of the Fund including a snapshot of some key issues relating to the current legislation. For more on this see NRI Issues Paper #09, authored by David Osborne and published in October 2014, titled, 'An analysis of the Papua New Guinea Sovereign Wealth Fund's process of formulation and progress towards establishment'.

We then recommend some areas for improvement, such as via subordinate legislation.

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Background

A chronology of events regarding the PNG SWF

The chronology of events can be summarised as follows:

- **March 2010:** The NEC established a joint Department of Treasury-Bank of PNG Working Group. Consultation meetings were organised and discussions were undertaken with input from international and local experts and various interest groups. The final report of the Working Group is contained in a Discussion Paper published in 2010 by the Department of Treasury.
- **November 2010:** The 2011 Budget was passed (under the Somare Government) which outlined the first SWF structure. It included three sub-funds, namely a Stabilisation Fund; an Infrastructure Fund; and a Savings (Futures) Fund.
- **November 2011:** The 2012 Budget (passed under the O'Neill Government) made a proposal for the establishment of a SWF as an organic law. The structure was altered to include only two funds: a Stabilisation Fund and a Development Fund.
- **November 2011:** The SWF Organic Law was published in the National Gazette.
- **December 2011:** The SWF Organic Law was tabled in Parliament.
- **February 2012:** The SWF Organic Law was passed after its second tabling in Parliament.
- **March 2012:** The SWF Organic Law was certified by Parliament. However, this was later suspected to be defective because of a procedural error. Questions about the validity of the Organic Law were raised and discussed.
- **2012–2014:** In attempts to rectify the procedural error, the Government proposed significant changes to the SWF. There have been some statements and media reports of changes, but there was no open consultation process.

- **October 2014:** The PNG Government published the *Organic Law on Sovereign Wealth Fund* in the National Gazette on 27 October 2014. This law sought to implement Section 212A of the Constitution and to repeal and replace the prevailing Organic Law on Sovereign Wealth Fund that was enacted in 2012 but not operationalised, and to establish the Sovereign Wealth Fund.
- **February 2015:** Prime Minister Peter O'Neill introduced the Organic Law to set up the Sovereign Wealth Fund. The first reading was passed by 82–0 votes.
- **March–April 2015:** The Organic Law was before the Constitutional Laws and Subordinate Legislation Parliamentary Committee (CLASLPC) for deliberations. Public briefings were held and written and oral submissions invited on the Organic Law on Sovereign Wealth Fund bill.
- **July 2015:** *The Organic Law on Sovereign Wealth Fund* was passed in Parliament by 76–4 votes. No changes have been made to the Legislation as gazetted in October 2014.

Chronology of NRI contributions

NRI has made the following contributions:

- **July 2010:** NRI made a Submission to the Department of Treasury and the Bank of Papua New Guinea Joint Sovereign Wealth Fund Working Group.
- **2014:** NRI conducted research and released two publications with the aim of stimulating public debate on the SWF:
 - ♦ Osborne, D. (2014), *An analysis of the Papua New Guinea Sovereign Wealth Fund's process of formulation, and progress towards establishment*, Issues Paper, October 2014, Port Moresby, the National Research Institute.
 - ♦ Sanida, O., Yala, C. and T. Webster (2014), *PNG's Sovereign Wealth Fund: The Critical Elements*, Spotlight with NRI, October 2014, Port Moresby, the National Research Institute.
- **April 2015:** NRI made both oral and written submissions to CLASLPC:

- ◆ A written submission was made on 7 April 2015 (Submission on the Organic Law on Sovereign Wealth Fund).
- ◆ An oral submission was done on 21 April 2015 at B2 Conference Room, Parliament House.
- **July 2015:** Concerns raised and suggestions made (by NRI) during the March-April 2015 consultations have not been incorporated. Hence, NRI worked on a response.
- **December 2015:** NRI released three publications on the SWF Legislation including this Spotlight, with a view to stimulating a renewed public debate on the SWF and the need for future subordinate legislation to deal with the shortcomings in the current Legislation:
 - ◆ Osborne, D. (2015), Review of the Legislation establishing the Sovereign Wealth Fund in Papua New Guinea. Issues Paper, 2015, Port Moresby, National Research Institute.
 - ◆ Chand, S. (2015), The mathematics, economics, and financial soundness of the withdrawal formula. Issues Paper, 2015, Port Moresby, National Research Institute.

An analysis of the 2014 Legislation: Some concerns

The changes made in the 2014 legislation are not simple amendments to the 2012 legislation, but constitute a redesign of the policy and the proposed SWF model. There have been several noteworthy changes including changes to the sub-funds and their deposit and withdrawal rules, the governance arrangements, the Investment Mandate, and the role of the responsible Minister.

In its submission to CLASLPC, NRI identified the major shortcomings and potential implementation problems of the 2014 Legislation and made recommendations for changes. In this Spotlight, two far-reaching changes are discussed in some detail: changes to the sub-funds and the withdrawal rules.

Under the 2012 Organic Law, the SWF was to contain a Stabilisation Fund and a

Development Fund. The rationale of the Development Fund was to establish a dedicated source of funding for investment in high priority infrastructure development in PNG to set the foundation for sustained broad-based economic growth. At the time, it was believed that PNG's immediate development needs were too great to lock money away for future generations, and current and ongoing investments in social and physical infrastructure would pay a higher rate of returns than investing in long term financial assets could.

Under the 2014 Organic Law, the Development Fund has been abolished, and replaced by a Savings Fund in order to deal with issues of intergenerational equity. However, the Development Fund would have provided benefits for both the present and future generations.

The Savings Fund, as outlined in the 2014 Organic Law, is to provide a means of preserving the real [inflation adjusted] value of extracted mineral and petroleum resources through long-term investment for the benefit of current and future generations of citizens of Papua New Guinea. In other words, current income is locked away in long-term financial assets in order to achieve intergenerational equity, which however, is likely to be better achieved through investing now in PNG's development.

The deposit and withdrawal rules of the Stabilisation Fund are much more complex in the 2014 Organic Law compared to the 2012 Law which could lead to implementation problems and which makes forecasting the balance of the fund much harder. By reducing the period for calculating the moving average from 15 years to five years (with a two year lag), the rule will more closely reflect the actual volatility in receipts, reducing the revenue 'smoothing' purpose of the Stabilisation Fund.

As shown in Chand's 2015 paper, the withdrawal formula does not target stabilisation, as withdrawals from the Stabilisation Fund on the basis of the formula can be destabilising, and withdrawals via the proposed formula can lead

to depletion of the Stabilisation Fund. Furthermore, the opaqueness of the formula for withdrawals from the SWF is to the cost of transparency that is necessary for public scrutiny and critical to the mitigation of the risks of mismanagement of the SWF. On the positive side, the Legislation allows subordinate legislation to make changes to the withdrawal rules.

Conclusions and Recommendations

Following from the analysis above, it is strongly recommended that two areas of concern should be addressed through subordinate legislation:

1. The Development Fund which was part of the 2012 Legislation should be re-introduced. It was created to set aside funds for key infrastructure development. While intergenerational equity is an important consideration which is addressed through establishing the Savings Fund, the present generation in PNG suffers from poor infrastructure and its needs have to be equally met. In other words, PNG's immediate development needs are too great to lock money away for future

generations only, and current and ongoing investments in social and physical infrastructure would pay higher returns than financial investments could. Indeed, the economic growth stimulus created by the Development Fund will provide opportunities and benefits for both the present and future generations.

2. The withdrawal formula should be re-designed in order to align the goals of stabilisation with the preservation of the fund for continued use. This is because transparency, in terms of flows into and out of the SWF, and the release of real-time information together with the maintenance of a vested interest of the wider population in the financial health of the Fund are critical to containing the risks of mismanaging the SWF.

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