

Natural Resources Wealth Management

Resource funds. Resource-dependent could choose among a range of alternative mechanisms to manage resource flows, ranging from an account at the central bank to independently managed sovereign wealth funds. *How do you see the role of resource funds in resource revenue management? What type(s) of funds make sense and what are the principles for fund inflow-outflow rules and asset composition?*

There exists a variety of the welfare funds in the West and East. The most attractive are the models of Norway and Alaska (USA). The wealth of these countries (a European kingdom and a US state) is based on their petroleum revenues plus transparent and ethical management of oil reserves. We learned that the state bank of Norway (Norges Bank) is responsible for the publication of quarterly and annual reports on the Norwegian welfare fund, which are made public. These reports include lists of all companies and commodities, in which the fund has invested, rates of return, absolute and relative risks, and a strategic plan for the future. The fund's board of directors consists of nine members, who are appointed by the King of Norway to four-year terms. The corporate governance principles adopted by the Norwegian fund are based on the Norwegian Code of Practice for Corporate Governance and the OECD Principles of Corporate Governance. It would be premature to say the same about another northern model – stabilization fund and the fund for future generations of the Russian Federation (also based on huge oil revenues). These structures are not transparent, and it is hard to say whether there exists a model of accountability. Our close neighbour, Kazakhstan, also has a welfare fund of the kind – “Samruk-Kazyna”. It is entirely under command of the ruling elite, so we can hardly borrow any examples or draw any lessons.

There are other East Asian models, with Northern Asian countries such as Japan, South Korea and Taiwan adopting social insurance models. A sovereign wealth fund established by the government of Brazil began with at least \$10 billion in assets and it had intended to invest in securities issued by the Brazilian National Development Bank, among others.

Now the coalition government of Kyrgyz Republic decided to follow the trend and announced its plans to establish a National Development Bank (NDB). So far Kyrgyz capital markets, insurance and pension sectors have been very small. The development of these sectors should remain a long-term objective for many years lying ahead. Meanwhile, according to Temir Sariev, Kyrgyz Minister of Economics and Counter-Monopoly Policy, the new financial institution with the initial capital stock of over \$ 43 million (kgs 2 billion) will be founded under the auspice of the National Fund of State Property. The Kyrgyz cabinet of ministers (Sariev in particular) is voicing contradictory statements: the NDB will be not for the profits but rather a political institution, then – the NDB will be the instrument of economic development, then – the NDB will be the welfare institution, etc. So far the launching of NDB, its purpose, its composition and functions are not discussed in detail and publicly. And the general public in Kyrgyz Republic is very much concerned that the political and economic elite of the country is going to reconstruct the scheme of the previous deposed regime. The notorious Kyrgyz Republic Development Fund (KRDF) had been created by Maksim Bakiev, son of the deposed president Bakiev, with the purpose of withdrawal of state finances via this institution.

On 2 June 2011, the Kyrgyz Government sent to IMF the Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding. There was a section concerning the KRDF:

“Governance issues related to the financial activities and reporting procedures of the Kyrgyz Republic Development Fund (KRDF), currently undergoing liquidation, prevented the previous government from completing reviews under the program supported by the Exogenous Shocks Facility (ESF). We recognize the Fund’s constructive role in helping to safeguard bilateral assistance received from Russia in 2009. We believe that there are still many unknowns in KRDF’s operations... We will provide all the necessary information to the external auditor. Once finalized, we will publish the forensic audit report (structural benchmark). Mindful of the implications for the Fund-supported program, we will not create any other extra budgetary fund throughout the duration of the ECF arrangement and will ensure that all public finances are channeled through the budget”.

In the text of the Memorandum the government repeatedly stated its intentions:

“We will not create any development/investment vehicle without prior consultation with IMF staff to ensure consistency with our program commitments”.¹

But all that has been changing. Another question arises: the source of that capital stock, where is the money for NDB (over \$ 43 million)? There are suggestions to capitalize the Kumtor Project shares belonging to Kyrgyz government - thus making the pretence of sound resource revenue management. Through a jurisprudence developed from out of their “golden share” cases we can see the dangerous light-mindedness of the government:

“In March 2011, Centerra was served by a Turkish company, Sistem Muhenkislik Insaat Sanayi Ticaret SA (“Sistem”), with a notice of enforcement to seize any shares and dividends in Centerra held in the name of the Kyrgyz Republic, followed by a notice of garnishment in April 2011 for any debts owed by Centerra to the Kyrgyz Republic (the “Republic”). These notices were served by Sistem through the Sheriff in Toronto as part of the enforcement proceedings brought by Sistem in the Ontario Superior Court to collect approximately \$11 million with additional interest, owed to Sistem by the Republic in accordance with a judgment of the Ontario Superior Court enforcing an international arbitration award against the Republic. In these Ontario proceedings, Sistem alleges that the shares in Centerra owned by Kyrgyzaltyn JSC, and any dividends paid in respect of those shares, are in fact legally and beneficially owned by the Republic and are therefore subject to execution to pay the judgment. Based on legal advice received, Centerra disputes those allegations and maintains that Kyrgyzaltyn JSC alone is the legal and beneficial owner of the shares and any dividends in respect of those shares, based on the applicable legal principles and the binding agreements with Kyrgyzaltyn JSC. As a result, and notwithstanding such notices of enforcement and garnishment, Centerra paid its May 18, 2011 dividend in the total amount of approximately Cdn\$31 million to Kyrgyzaltyn JSC. Sistem is continuing with its claim regarding the Centerra shares owned by Kyrgyzaltyn JSC. If this claim is successful in the Ontario court proceedings, Sistem may have a right to execute its judgment against those shares and may assert a claim against Centerra in respect of the payment of the dividends to Kyrgyzaltyn JSC. However, Centerra believes it has a strong defense to that claim based on the facts and the law. At a motion in September 2011, Kyrgyzaltyn JSC was formally added as a party to the proceeding.” ²

We see that transparent governance of EI revenues is a winding path in many countries. Governments cannot reserve this difficult job for themselves, excluding civil society and companies from the process. Even when their property was subject to seizure, the state (like in our case) tends to behave irresponsibly. IMF should be keeping a watchful eye over sovereign wealth funds that have become popular with emerging-market governments, who seek to manage their newfound wealth. In this undertaking civil society organizations already found its place.

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¹ Site www.donors.kg

² (<http://www.centerragold.com/sites/default/files/news-releases-en/cg-11032011-en.pdf>)