Highlights of the 2015 MEFMI Central Bank Governors' Forum of 27 June 2015, Basel, Switzerland

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At the

MEFMI Combined Forum

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OUTLINE

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2. **Highlights**
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   - ✓ Rules-Based Framework
   - ✓ Role of Sovereign Wealth Funds
   - ✓ Development Model
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   - ✓ Key Considerations
   - ✓ Asset Managers
   - ✓ Conclusions

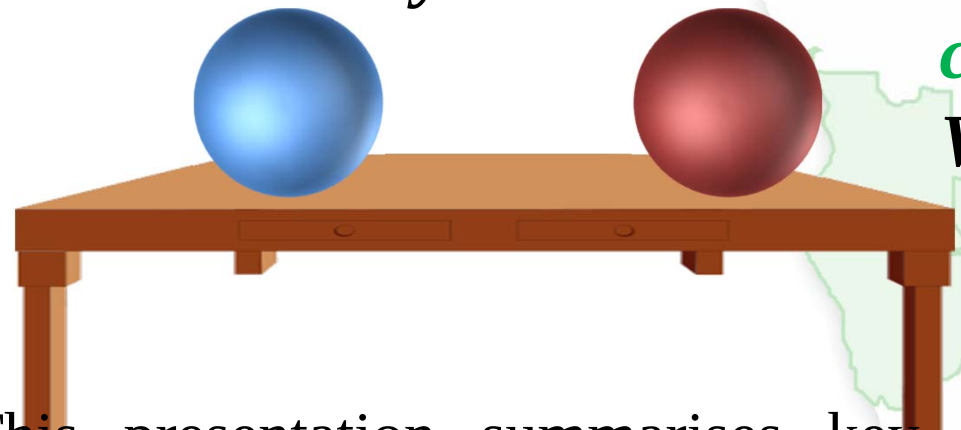
INTRODUCTION

- MEFMI re-launched the Governors’ Forum in 2015, last held in 2005.
- The Theme of the Forum was ***“Leveraging Sovereign Wealth Funds as a Tool for Economic Stabilisation”***.
- Forum opened by Dr. Adelaide Matlanyane, Governor, Central Bank of Lesotho and attended by MEFMI Governors, other invited officials from within and outside the MEFMI region.
- The Forum was jointly funded by MEFMI and Investec Asset Management and supported by World Bank RAMP.

TWO PRESENTATIONS DELIVERED

- *"Why the Recent Slump in Commodity Prices Strengthens the Case for African SWFs, Fiscal Rules and Good Governance"* ***by Investec***

- *"The role of central banks in managing a country's natural resource revenues: investment and institutional considerations"* ***by the World Bank RAMP***



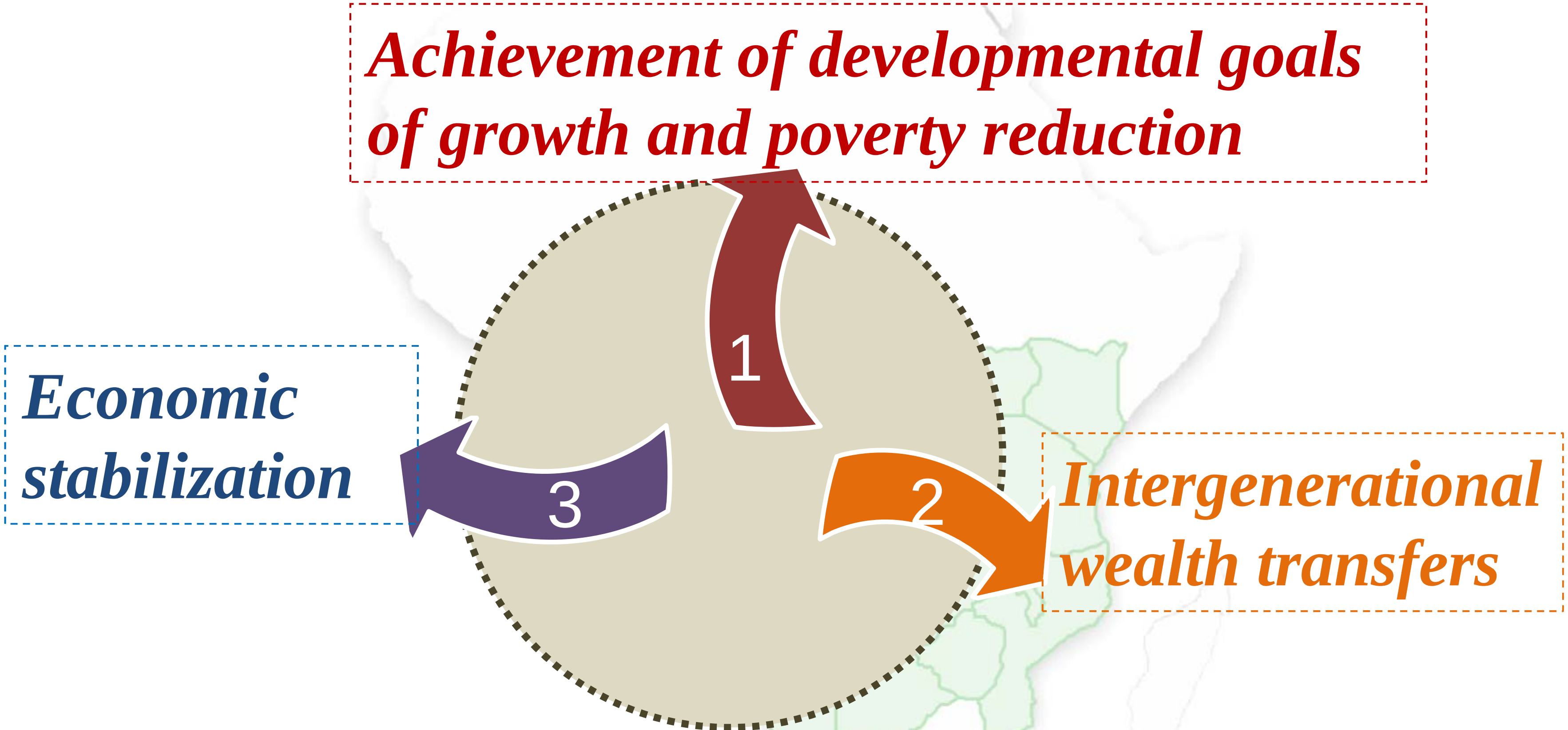
- This presentation summarises key policy takeaways from the Forum. The full Report is available for distribution.

RESOURCE ABUNDANCE

- Africa has an abundance of barely harnessed natural resources:
  - Angola, Nigeria, Egypt, Cameroon, etc. are oil producers;
  - Kenya, Mozambique, Uganda and Tanzania will be first time oil and gas producers going forward;
  - Copper in Zambia and the Katanga region in the DRC;
  - Diamonds in Botswana, Angola, Namibia and Lesotho;
  - Gold in Zimbabwe, South Africa and Swaziland.
- These natural resources are finite and will be depleted at some point.

REVENUE MANAGEMENT MODEL

- Revenues from natural resources require prudent management to ensure 3 things:



- A special purpose vehicle (SPV) or Sovereign Wealth Fund (SWF) can be used to achieve these objectives. However, SWFs are not a panacea for growth and development.

RULES-BASED SWF FRAMEWORK

- It is useful to establish **a rule-based SWF framework** for natural resources management.
  - Countries should start with a simple rule-based framework which can be effective in terms of the fiscal decisions in the short to medium term.
  - In the medium to long term, countries should then adopt a co-integrated, fully-fledged, rule-based framework.
  - The rules should be enshrined in the law to be clearly understood and to protect all stakeholders.
  - Countries should note that SWFs are a **work in progress** and their mandates and structures evolve over time as they get clarified and strengthened.

ROLE OF SOVEREIGN WEALTH FUNDS

- Rule-based SWFs:
  - o Stabilise volatile revenues: **stabilisation rules**;
  - o Support domestic infrastructure development, which is a massive priority in Africa: **spending rules**; and
  - o Transform a depleting volatile natural resource into a more stable permanent financial one: **savings rules**.

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Support domestic infrastructure development, which is a massive priority in Africa: **spending rules**

Transform a depleting volatile natural resource into a more stable permanent financial one: **savings rules.**

DEVELOPMENT MODEL

- African countries have massive infrastructure and other development needs. They can consider a model where specific priority investment needs have specific funds such as:
  - Hospital fund, public education fund, highways fund, etc.
  - Thereafter, resources are specifically earmarked in the budget to these priority areas.

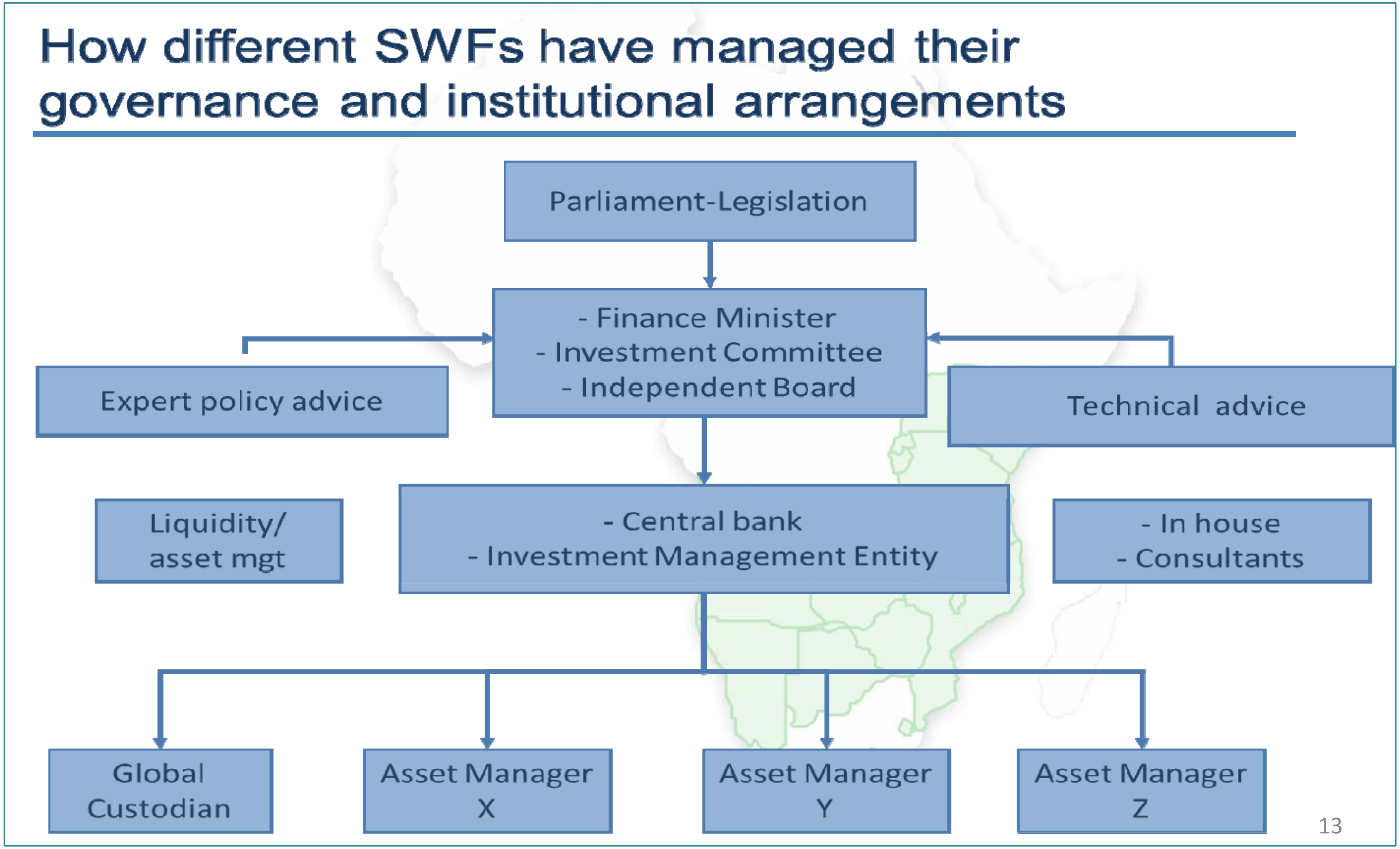
CUSTOMISED SOLUTIONS

- **No one size fits all**
  - The right mix of stabilisation, spending and savings depends on a country's overall economic and developmental needs.
- For African countries developing a savings fund, savings of approximately 25% may be considered.
  - This fund should go hand in hand with an appropriate institutional capacity for spending.

KEY CONSIDERATIONS

- **Segregation of duties and institutional autonomy** are important *(Chart1)*, between the principal and the agent.
- **Control and oversight roles** are key - in cases of difficult investment decisions and challenges to governance.
- **Transparency and communication –** especially with different interested bodies and stakeholders required to buy into the country's concept of having a sovereign wealth fund.
- **Human resource policies** must be strengthened to allow for attraction and retention of skilled staff in SWFs.
- It is critical to generate **political buy-in** and **consensus** from the citizens.

Chart 1: Segregation of roles and Governance Structure



ASSET MANAGERS: CASE FOR THE CENTRAL BANK

- There are **pros and cons** of having either the central bank or an independent entity as asset mangers for the SWFs.

- **Central banks** have the advantage of:
  - Being independent from government;
  - Having technical capacity in investment management;
  - Having a predominant culture of capital preservation;
  - Having special privileges and immunities; and
  - Legitimacy in international financial markets.

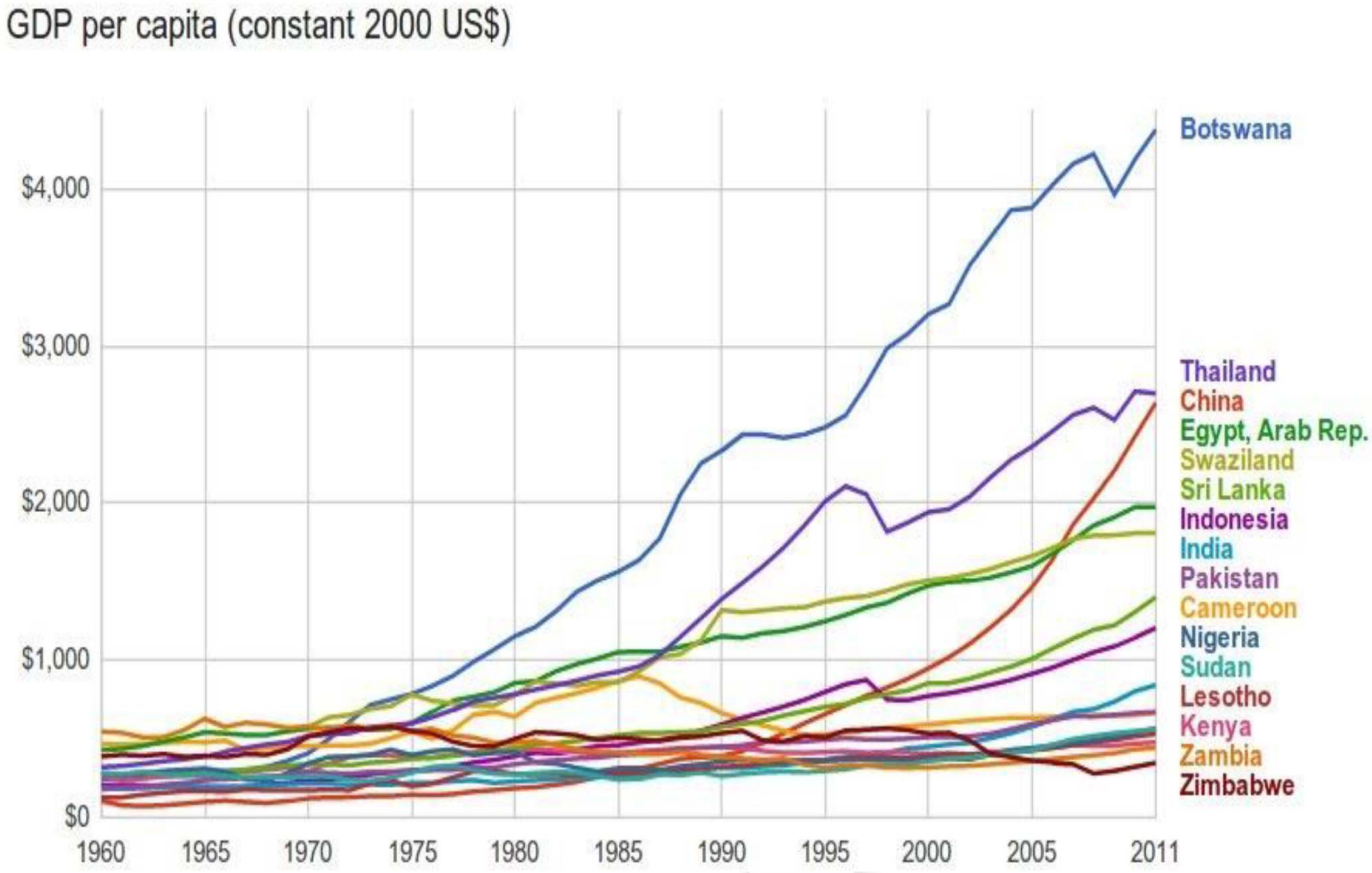
ASSET MANAGERS: CASE FOR INDEPENDENT ASSET MANAGERS

- **Independent external asset managers** however provide a clean slate to implement the best and most contemporary best practices.
  - o An independent entity is not subject to public sector regulation, thus the human resource policies would not be constrained and would be able to offer competitive packages.
  - o However, legal issues may be challenging particularly with regard to immunity and succession for these institutions.

NEED FOR EARLY REFORMS

- **The cost of delayed reforms** - there are costs to delayed set-up and implementation of SWFs.
  - Not just institutional adjustment costs, but also the cost of depleting reserves which is associated with loss of earning power which would have been generated by those assets.
  - Botswana is a good example where growth in per capita GDP has outperformed China, Indonesia, India, Thailand and other economies in the world *(Chart 2)*, following prudent natural resource wealth management.

An Example of Success Case: Botswana



CONCLUDING REMARKS

- The strong economic performance even when commodity prices have slumped are signs that Africa is making progress on growth and poverty reduction through:
  - Economic diversification from single or few commodities; and
  - A number of countries are redirecting a huge portion of resources for inclusive and equitable growth.
- The slump in international commodity prices is an opportunity for countries to lay the foundation for establishment and management of SWFs as they prepare to take advantage of the expected future rise in commodity prices and the resultant boom.

Discussions