



## **The Challenges of Setting Up a SWF: Why, How & How Large?**

**Government's appetite, OSF failure and establishment of NDFI**

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**Sovereign Investment Workshop**  
**In Quest for Stability: The Global Governance of Sovereign Wealth Funds**  
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# Answering the questions by case of Iran?

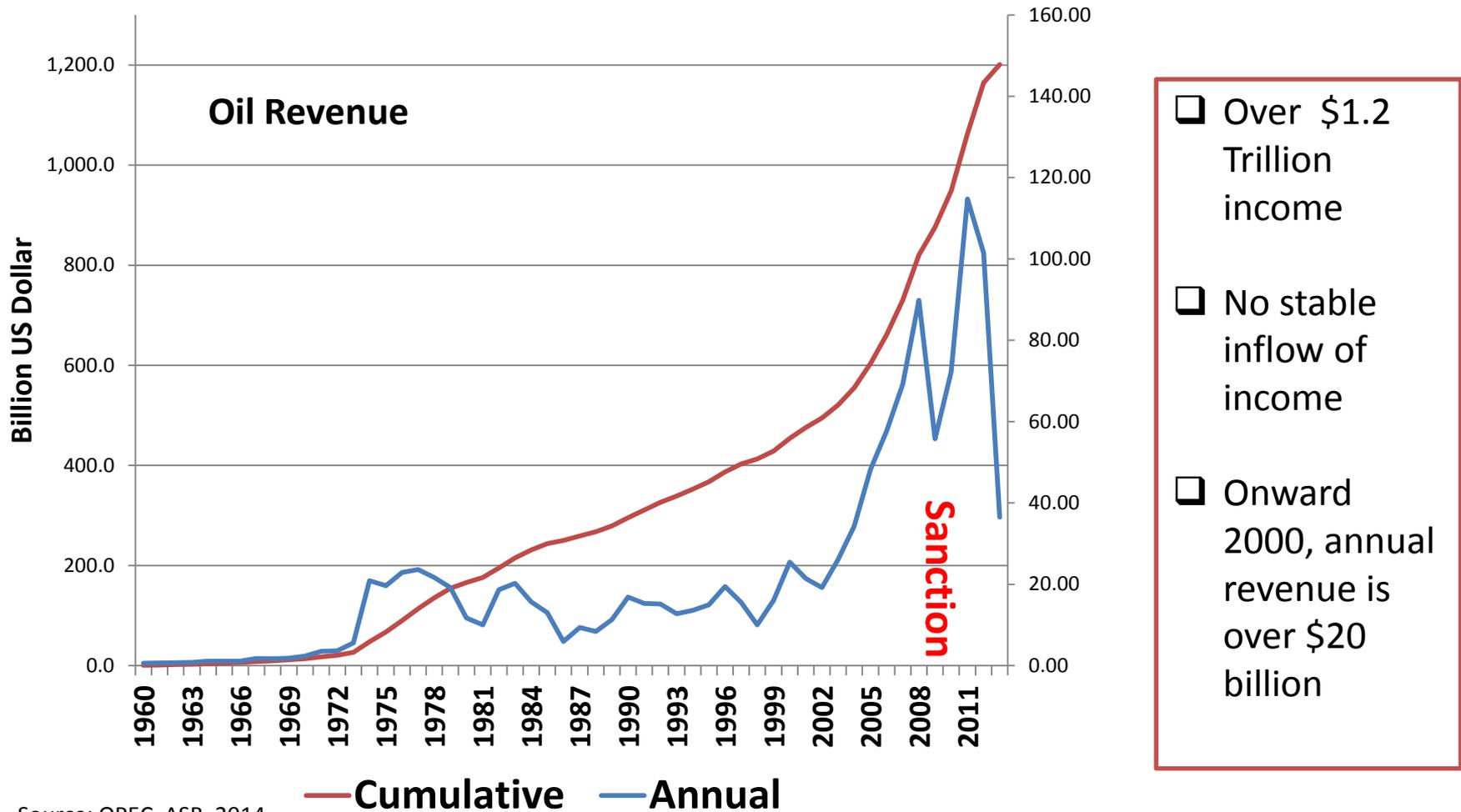
**Why?** Fluctuations, future generations and etc.

**How?** A Managed account, Through central bank, or a Fund

**How large?** Small, medium or large

# Iran's oil revenue and economic growth

## Is there a sign of Dutch disease & resource curse

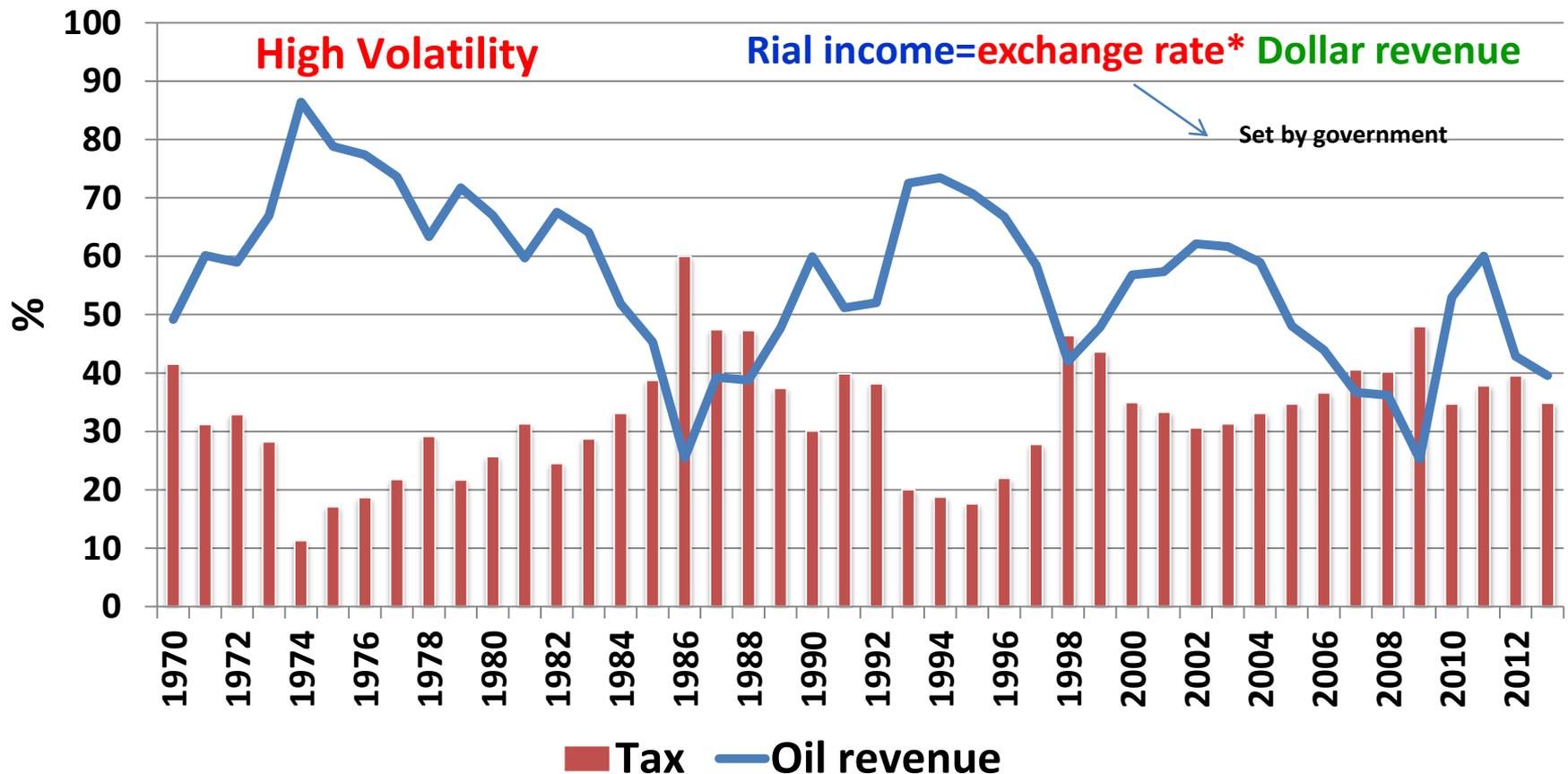


Source: OPEC, ASB, 2014

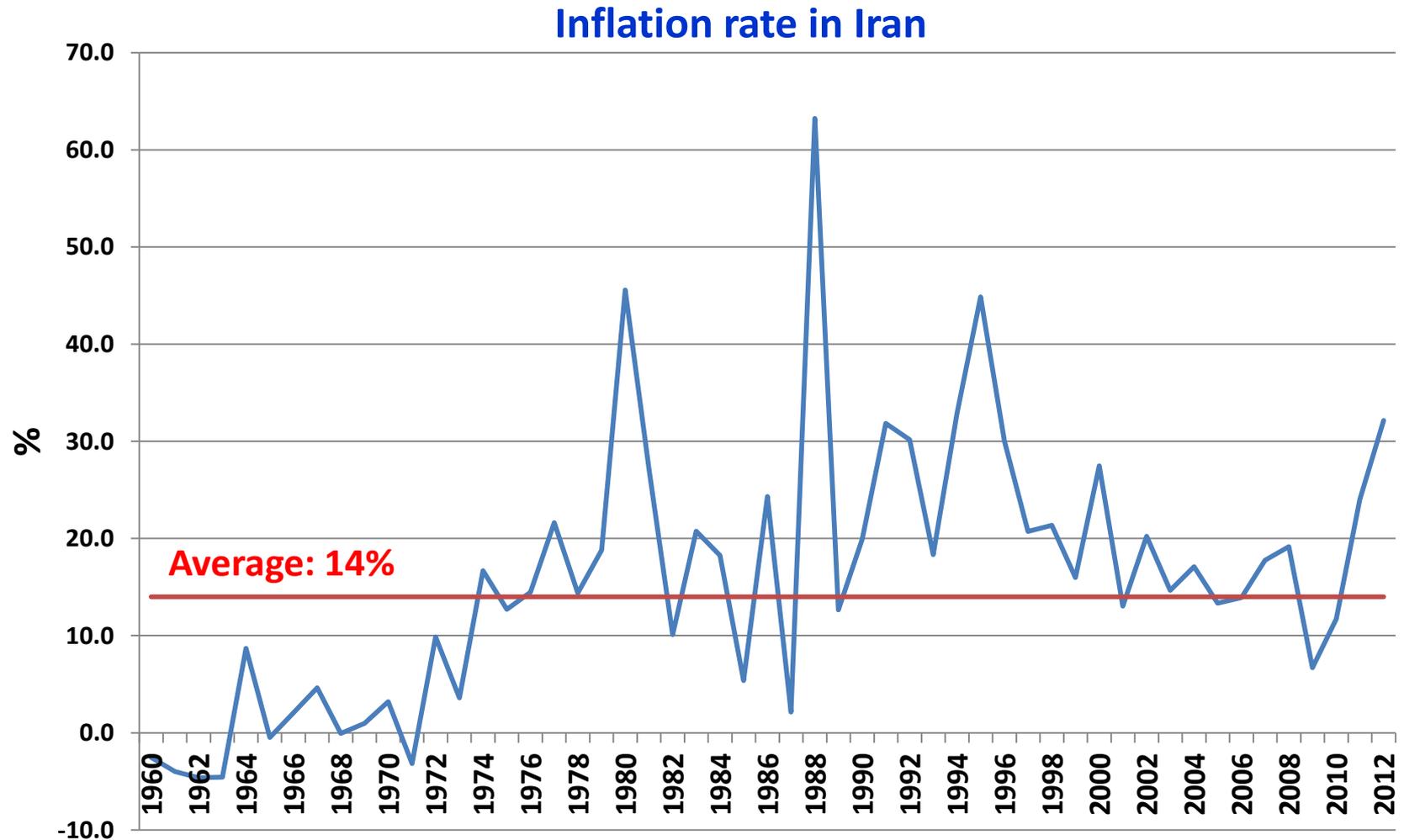
# Iran's oil revenue and economic growth

## Is there a sign of Dutch Disease & resource curse

### Share of oil revenues in government budget

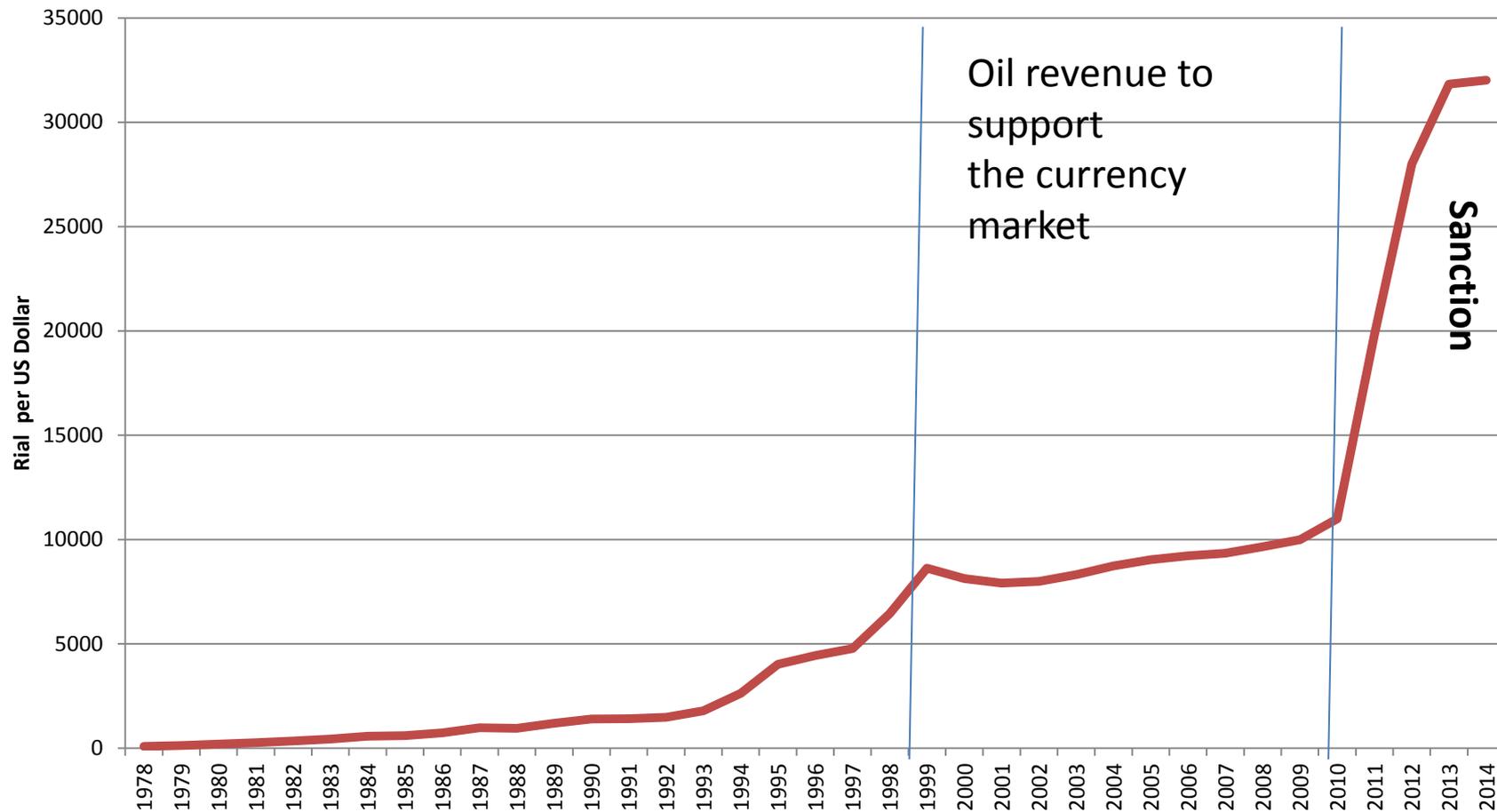


# Economic growth, Inflation, Exchange rate: Is there a sign of Dutch Disease & Resource Curse?



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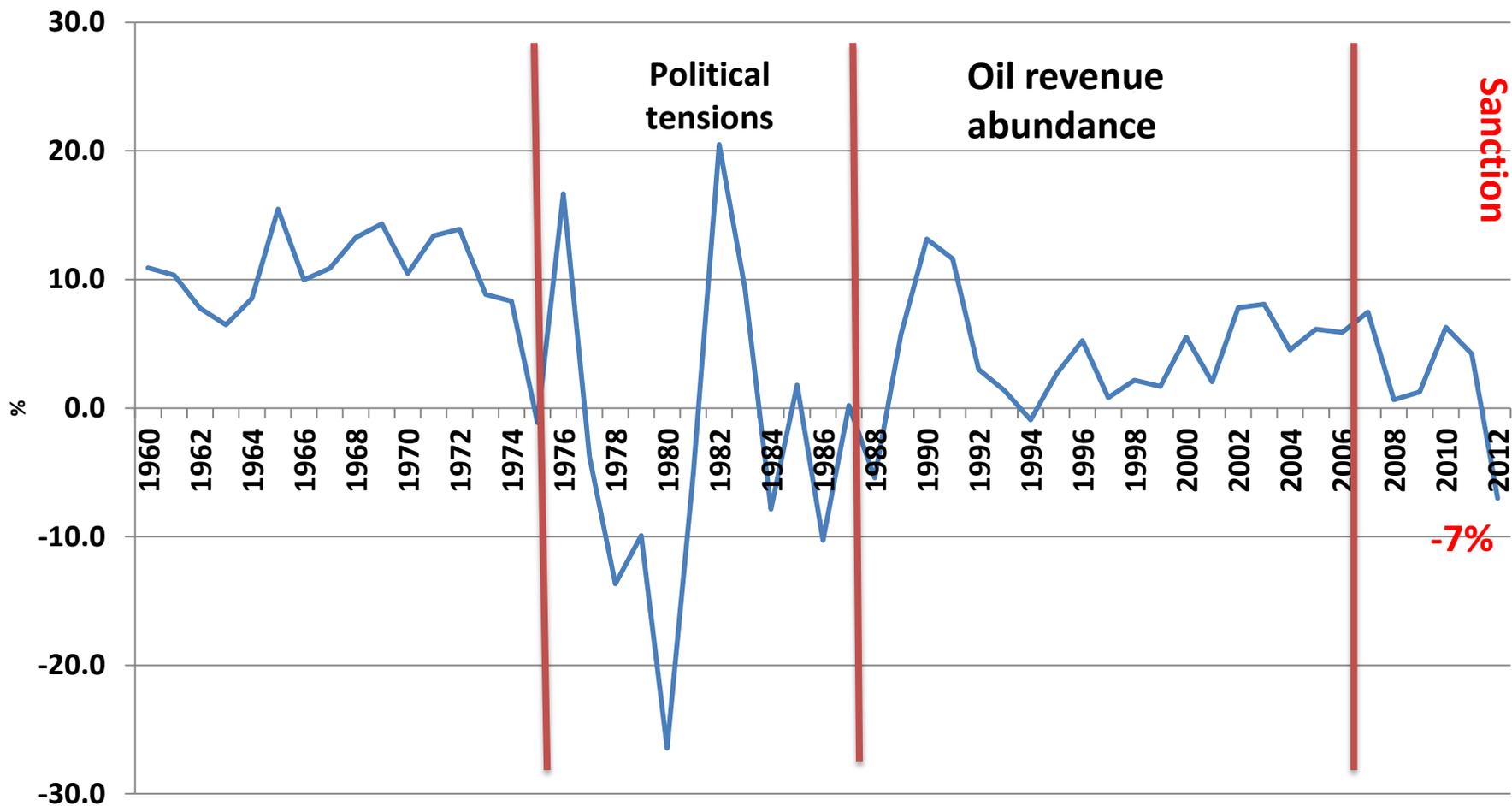
## Depreciation of Iranian Rial vis-à-vis US dollar



Source: [www.energyseec.com](http://www.energyseec.com)

# Economic growth, Inflation, Exchange rate: Is there a sign of Dutch Disease & Resource Curse?

## Iran's real economic growth (1960- 2012)



# Resource Curse or Blessing?

- It is a curse if it is mismanaged: Witnessing of economic fluctuations, high inflation, unstable exchange market etc. like the Persian disease
- It is a blessing if it channelized correctly into the economy



**“The Curse of Oil: The Paradox of Plenty,” *The Economist*, December 20, 2005**

*An unusual meeting took place in October at St Matthew’s church in Baltimore. After the sermon, somebody stayed behind to hear two others from Africa explain the harm that America’s gasoline guzzling does to the poor in faraway lands. An elderly parishioner raised his hand: “I know Africa is very rich in diamonds, gold, and oil, but the people are very poor. Why are your governments so bad at **managing that wealth?**” Austin Onuoha, a human-rights activist from Nigeria, smiled and conceded, “**You hit the nail right on the head.**”*



It is all about “**wealth Management**”? So how to do it?

# Saving vs. Stabilization Funds

## ➤ **The rationale behind a saving Fund:**

- Oil and gas resources are exhaustible
- Oil wealth (not revenues) needs to be converted to financial wealth
- Preserving the share of future generation
- Sustainable development and economic stability

## ➤ **The rationale behind a stabilization Fund:**

- Volatility in oil and gas prices and pertinent revenues

# Oil Stabilization Fund (OSF) Establishment and failure

**□ OSF as the first step for independence from oil and gas revenue was established in 2000**

**Why?**

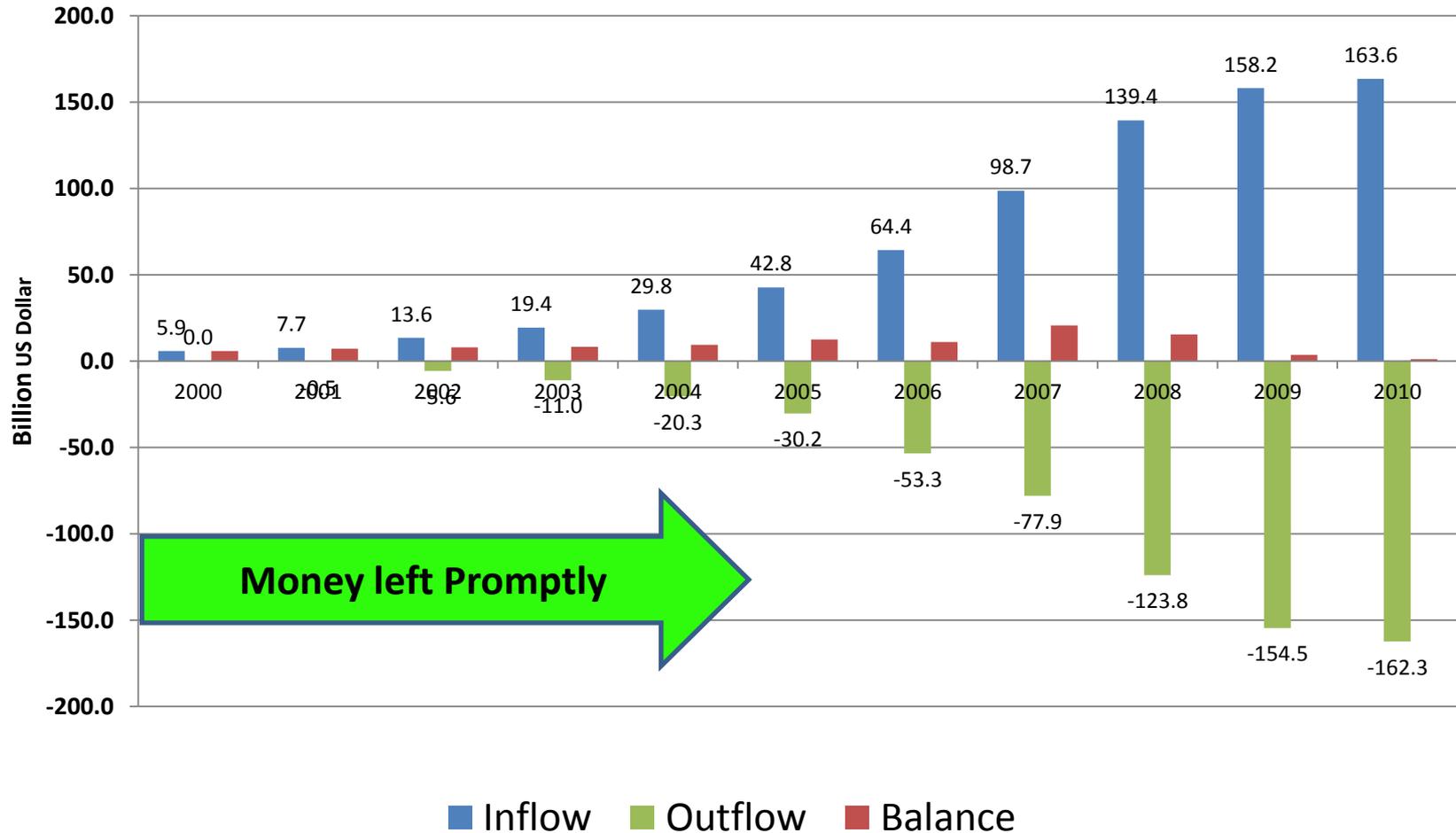
**Objectives**

**Stabilize government's annual budget**

**provide financial means to commercial banks for lending to private and cooperative entities for certain investment projects**

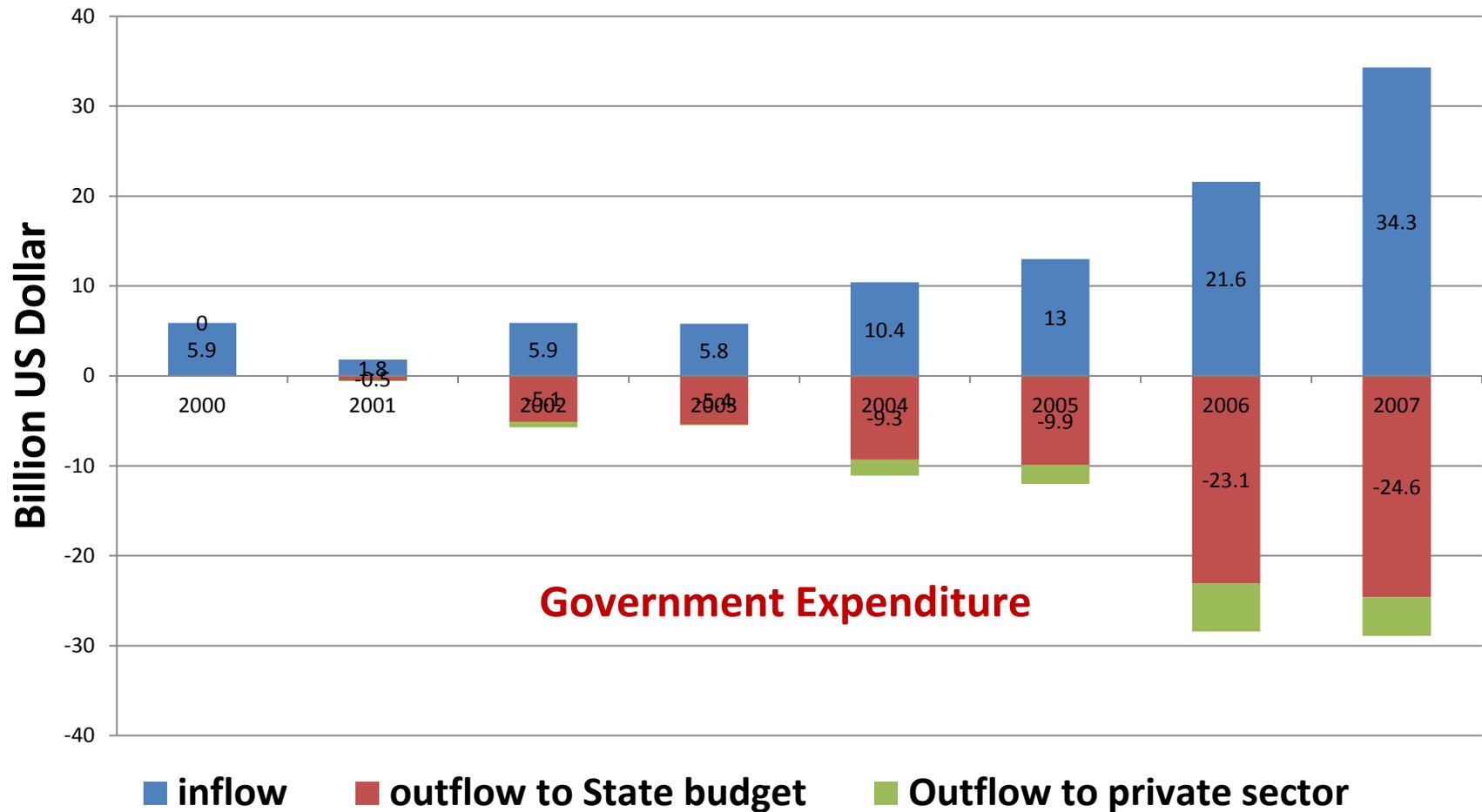
# Oil Stabilization Fund (OSF):

## OSF Inflow and outflow of funds



# Oil Stabilization Fund (OSF):

Distribution of OSF outflow



# Failure of OSF and establishment of NDFI in 2011

Due to Failure of OSF, National Development Fund of Iran was established in 2011

Major differences between OSF and NDFI:

	Structure	Cash Inflow	Cash outflow
<b>OSF</b>	Managed Account with CBI	Oil revenue surpluses	Financing projects and covering the government's budget deficits



Government



<b>NDFI</b>	Established by Constitution	Fixed portion of oil revenue	Financing domestic projects and investment in international financial markets
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# How Large: Distribution of oil revenues in Iran

How large:

- How much **excess revenue** is really available?
- What is the level of **domestic economy absorption**? (e.g. Norway and Kuwait)
- What pace of long term and **stable economic growth** is deemed?



Government Budget  
54.5%

NDFI (minimum 20%) now  
 $\%29+2\%= 31\%$

National Iranian oil  
Company 14.5%

Revenues  
generated  
form export  
of oil, gas and  
condensate



## How Large: 32% is a big cut!

- ❑ **32 %** cut from the government budget is a big cut
- ❑ A wise method to make independency from oil-based economy is a **gradual** departure
- ❑ huge amount of asset under management of NDFI would lead **government** to find ways and means to grab a portion of the funds
- ❑ The **big challenge** is prevention of government in reaching NDFI resources.

# NDFI Objectives

- Reduce **dependency** on oil & gas revenues
- Transfer a portion of oil and gas export revenues to **wealth** then to productive investments
- Save the **future generation's** share of hydrocarbon resources
- **Economic stability** and sustainable development

# NDFI's Steering Boards

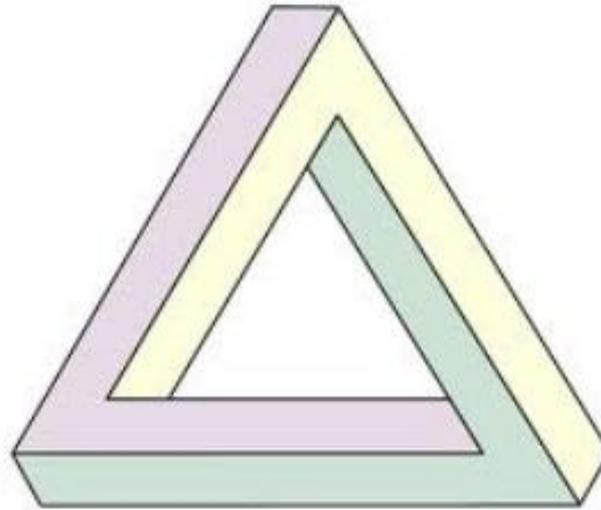
## **Board of Trustees,**

headed by the president, consists of representatives of Administration, Legislative, Central Bank and Private sector,

## **Board of Executive Directors**

consists of 5 lucid, experienced and renowned persons to run NDFI.

**Supervisory Board** consists of the heads of State Audit Organization, State inspectorate organization and Supreme Audit Court.



**Transparency**

**Efficiency**

**Accountability**

# NDFI Main Stream of Activities

**Domestic**



?

**Domestic  
currency  
loan  
(Preferred  
interest  
rates for  
specific  
sectors)**

**Hard  
currency  
loans for all  
sectors and  
regions**

**Developmental role & return on capital**

**International**



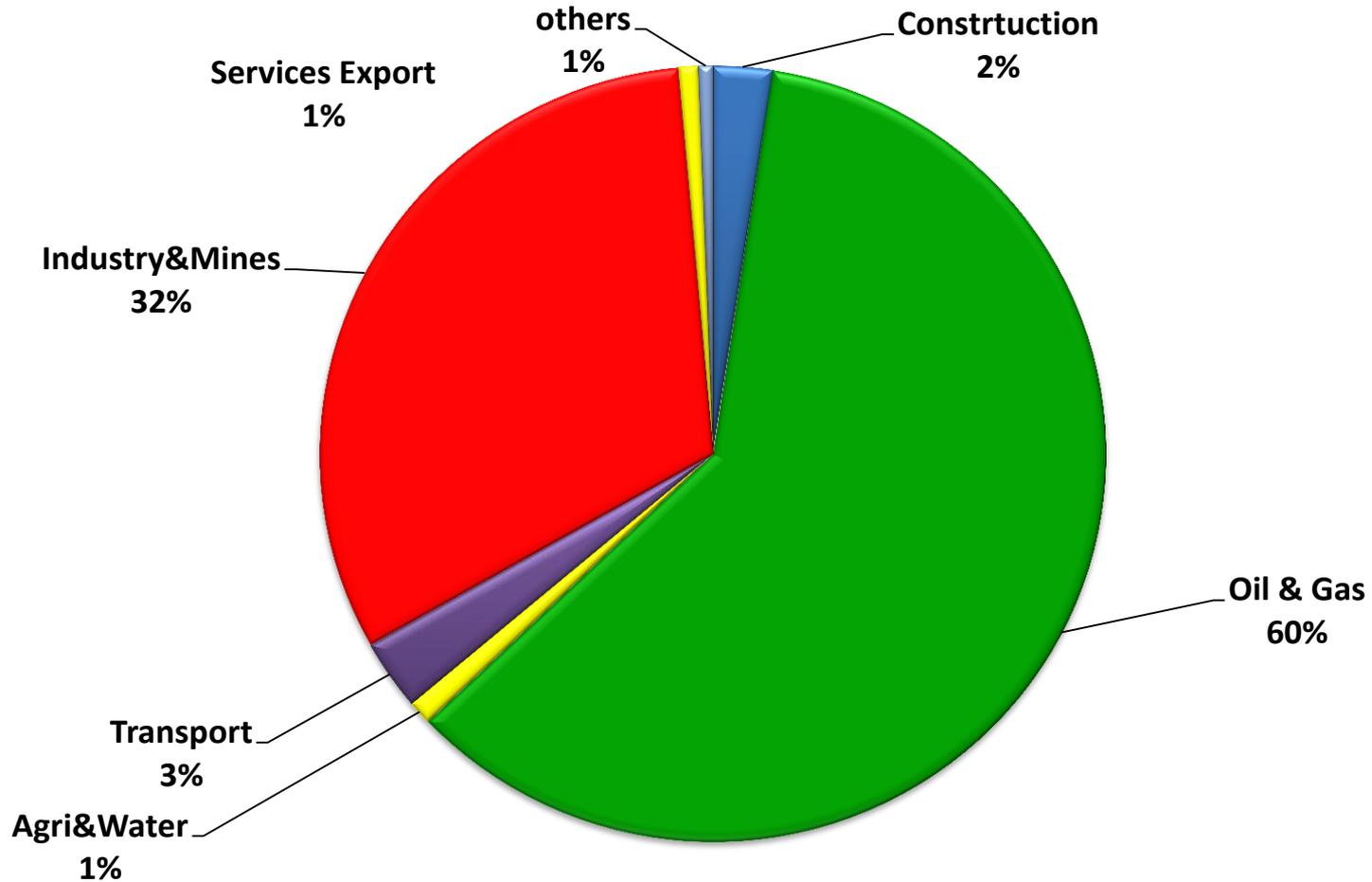
**Financial  
assets in  
international  
markets**

**Return on Capital**

# NDFI Loan Entitlement

- **NDFI defines the priority for investments**
- **NDFI agent banks : due diligences and feasibility studies, taking the project risks**
- **Entitlement to receive a loan?**
  - Any **non governmental** entities ( Companies with share of State ownership less than 20%) and foreign investors who provide 50% of the investment needs

# Hard Currency Allocation by Economic Sectors



As of September 2013

# Concluding Remarks

## Why establishing a SWF:

**Objectives:** Multi purposes including saving, stabilization, steady economic growth, avoiding overheating etc.

**Challenges:** Proper establishment, good governance , design and compliance to rules and regulations

**OSF Failure:** lack of good structure, governance and compliance

## How to establish a SWF:

**Structure:** Constitution with clear Article of Association, management mandates, and guarantee of good governance

**Challenges:** regular changes in AOA due to political motivations

**NDFI:** is under annual government's budget pressure for allocation

**How Large:** it should consider the capacity of the pertinent economy. A very large inception leads to lack of compliance. It should be very well balanced with the facts and figures of the relevant economy.



صندوق توسعه ملی

Thank you very much  
for your kind attention

**You are all cordially invited to the second NDFI International Conference (NIC 2015)  
To be held in Tehran in 2015**

[www.ndfic.com](http://www.ndfic.com)