

Investing oil and gas revenue for future generations: how to improve KWAN

1. What is the paper about?

- The paper discusses the Kumpulan Wang Amanah Negara (KWAN), Malaysia's natural resource fund, evaluates the strengths and weaknesses of the KWAN and suggests several improvements.

2. What is the Kumpulan Wang Amanah Negara (KWAN)?

- The Kumpulan Wang Amanah Negara (KWAN) is a Government Trust Fund that was established under Section 10 of the Financial Procedures Act 1957 to ensure Malaysia has some savings from its depleting natural resources.
- These savings can be used as an alternative source of income for development expenditures of both federal and state governments.

3. Why do we need to improve the KWAN?

- There has been much discussion on the need to set up a Special Petroleum Fund, in which all or part of Malaysia's petroleum revenue will be kept, to make the Malaysian government more fiscally prudent and less reliant on unsustainable petroleum revenue.
- The paper argues that instead of creating new trust fund, the current KWAN should be kept as Malaysia's petroleum fund and be improved.
- The KWAN has potential to be a petroleum fund that can save Malaysia's petroleum revenue and encourage the government to be more fiscally prudent and disciplined. However, it has not reached its potential.
- The fund is 26 years old this year and the amount of money accumulated over the years is only RM9 billion. This represents only 1.5 percent of the total petroleum revenue accumulated over the last 26 years, amounting to RM 600 billion.
- If we compare KWAN's wealth to other countries' Natural Resource Funds established later, this amount is fairly small (see Table 1)

Table 1: KWAN's wealth in comparison with the NRFs on Norway, Chile and Timor Leste

	KWAN	Norway's Global Pension Fund	Chile's Pension Reserve Fund	Chile's Economic and Social Stabilisation Fund	Timor Leste's Petroleum Fund
Year established	1988	1990	2006	2006	2005

Total Wealth	USD 3.1 Billion (December 2013)	USD 670 Billion (July 2013)	USD 7.01 Billion (August 2013)	USD 15.21 Billion (August 2013)	USD 13.5 billion (August 2013)
Natural Resource Governance Index (NRGI) Score	46	100	87	87	

4. How do we improve the KWAN?

- We can improve its governance mechanism that regulates who manages the funding, the way deposits and withdrawal processes are done and the way it is accountable to taxpayers.
- A study by the Natural Resource Governance Institute (NRGI) and the Columbia Center for Sustainable Institute (CCSI) on Natural Resource Funds around the world found that good governance is very important in ensuring funds achieve their objectives.

5. So, what are the principles of good governance for natural resources fund then?

- Based on the study of the National Resource Governance Institute and the Columbia Center on Sustainable Investment, a well-governed Natural Resource Fund has the following six elements:
 1. Clear objective
 2. Clear, appropriate, and well-enforced fiscal rules.
 3. Clear, appropriate, and well-enforced investment rules.
 4. Clear division of responsibilities between the ultimate authority over the fund, the fund manager, the day-to-day operational manager and set as well as enforce ethical and conflict of interest standards
 5. Regular, and extensive disclosure of key information and audits to the public
 6. Independent oversight bodies that monitors that fund behavior and enforces the rules.

6. Based on these principles, what is the KWAN lacking?

- The KWAN 's objective is clear, but it is stated in its Annual Report, which is not easily accessible to the general public.
- Deposit and withdrawal rules are too general.
- Division between various holders of responsibilities is clear, but can be improved to allow for better oversight.
- Public disclosure of the fund's information is still minimal.

7. How do we improve it?

- State the objective of saving for future generations, stabilising the budget and financing development expenditures clearly in the policy documents, preferably in the KWAN Act
- Deposit to the KWAN should only be made from the consolidated fund.
- Implement expenditure rules for saving and accountability. The expenditure rule that can be applied is a limit of 2% of the growth operating expenditures.
- Revise withdrawal rule to ensure that the amount withdrawn does not exceed the guaranteed return of the KWAN's investment and this withdrawal should be part of the budgetary process.
- Revise withdrawal rule to ensure the withdrawal of the remaining balance of the fund must be approved by parliament and used for earmarked purposes agreed by various stakeholders.
- Revise the oversight mechanism and the management structure of the fund by the following means:
 - The MOF will be the owner and the manager of the fund, but the day-to-day operations will remain the responsibility of the Bank Negara Malaysia.
 - As a result, the KWAN Panel should no longer be the manager of the fund. They should act instead as supervisory or advisory council to the manager of the fund (the MOF) and report directly to the parliament.
 - Membership of the KWAN Panel however should be revised. The private sector can be invited to the panel and the elements from the MOF should no longer be there.
 - An external auditor can be invited to audit the management of the fund by the BNM.
- Improve public disclosure by:
 - Making the KWAN Report downloadable on the MOF, BNM and parliament website
 - Having a dedicated website page managed by the BNM as the operational manager of the fund. The website can feature key information about the KWAN.