

Trust Funds in the Pacific

Their Role and Future

Presentation by

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ADB

Overview

1. Why Trust Funds and Why Now?
2. Trust Fund Basics
3. Trust Funds and Development
4. Case Analysis: Trust Funds in the PDMCs
5. Good Practices
6. Conclusion

1. Why Trust Funds and Why Now?

Introduction

- Development in Pacific remains a great *challenge*
- *Pacific Paradox*, self-reliance attainable?
- Renewed *commitments* need *new approaches*
- Trust funds presenting *potential* opportunities

1. Why Trust Funds and Why Now? (continued)

Some Guiding Questions

- How do they *work* and *differ*?
- How do they fit into *development* and *PDMCs*?
- Existing Pacific funds and *lessons learned*?
- The *future* and *ADB's role*?

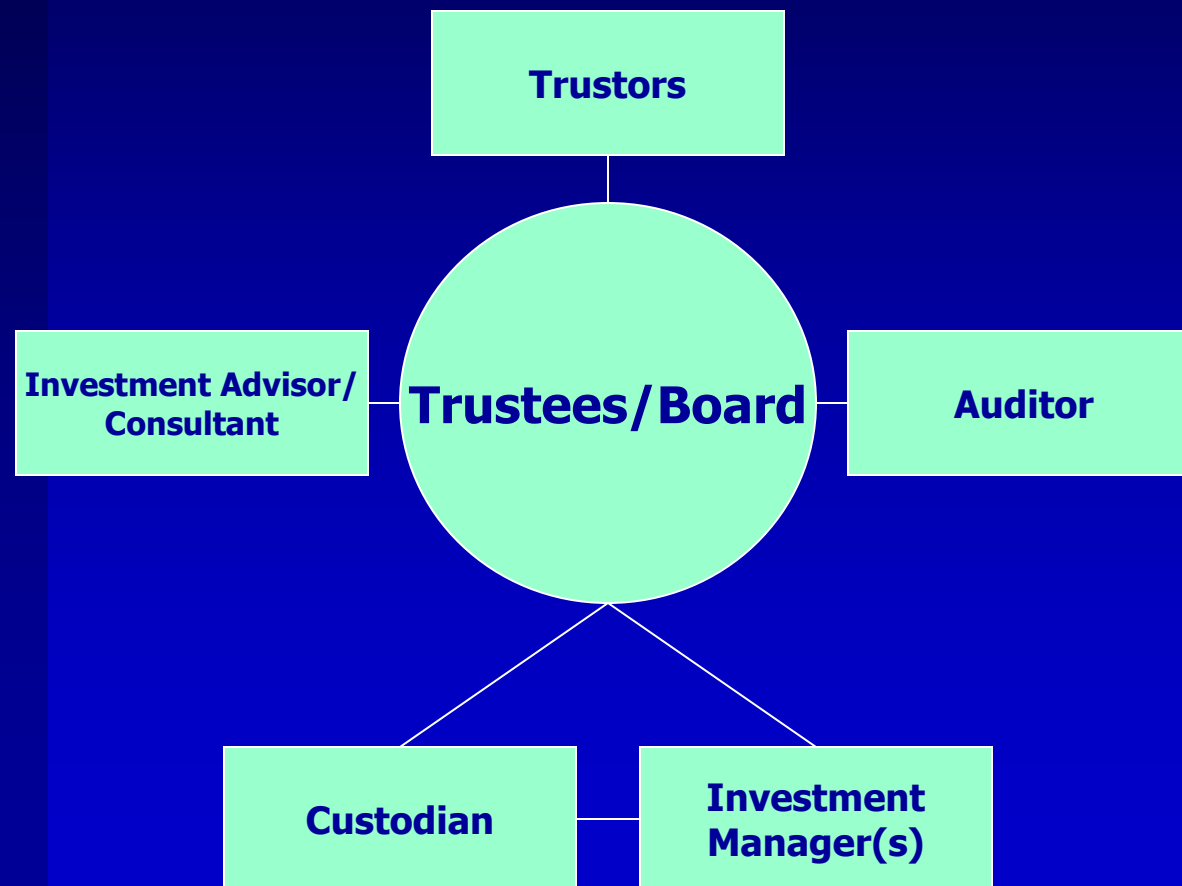
2. Trust Fund Basics

Definitions

- *Trust* – a legal arrangement wherein one party (trustor) gives control of assets to another party (trustee) to be administered on behalf of a third party (beneficiary)
- *Trust fund* – a fund with financial assets managed under a legal trust
- *Trustors* (grantors, donors, or settlors) – create trust, legal terms, provide capital
- Trustees – manage, carry out the terms of the trust, hire and monitor service providers
- *Beneficiaries* – entitled to trust income or principle, currently or in the future
- *Service providers* – advisors, custodians, managers, auditors, etc.

2. Trust Fund Basics (continued)

Management Structure of Generic Trust Fund



2. Trust Fund Basics (continued)

True, Revolving and Sinking Funds

- *True trust fund* (endowment) – principal capital preserved, kept in perpetuity, real value maintained
- *Revolving fund* – principal capital consumed but replenished
- *Sinking fund* – principal capital consumed over a fixed period

“Trust” often attached to all because of fiduciary responsibilities transferred to trustees

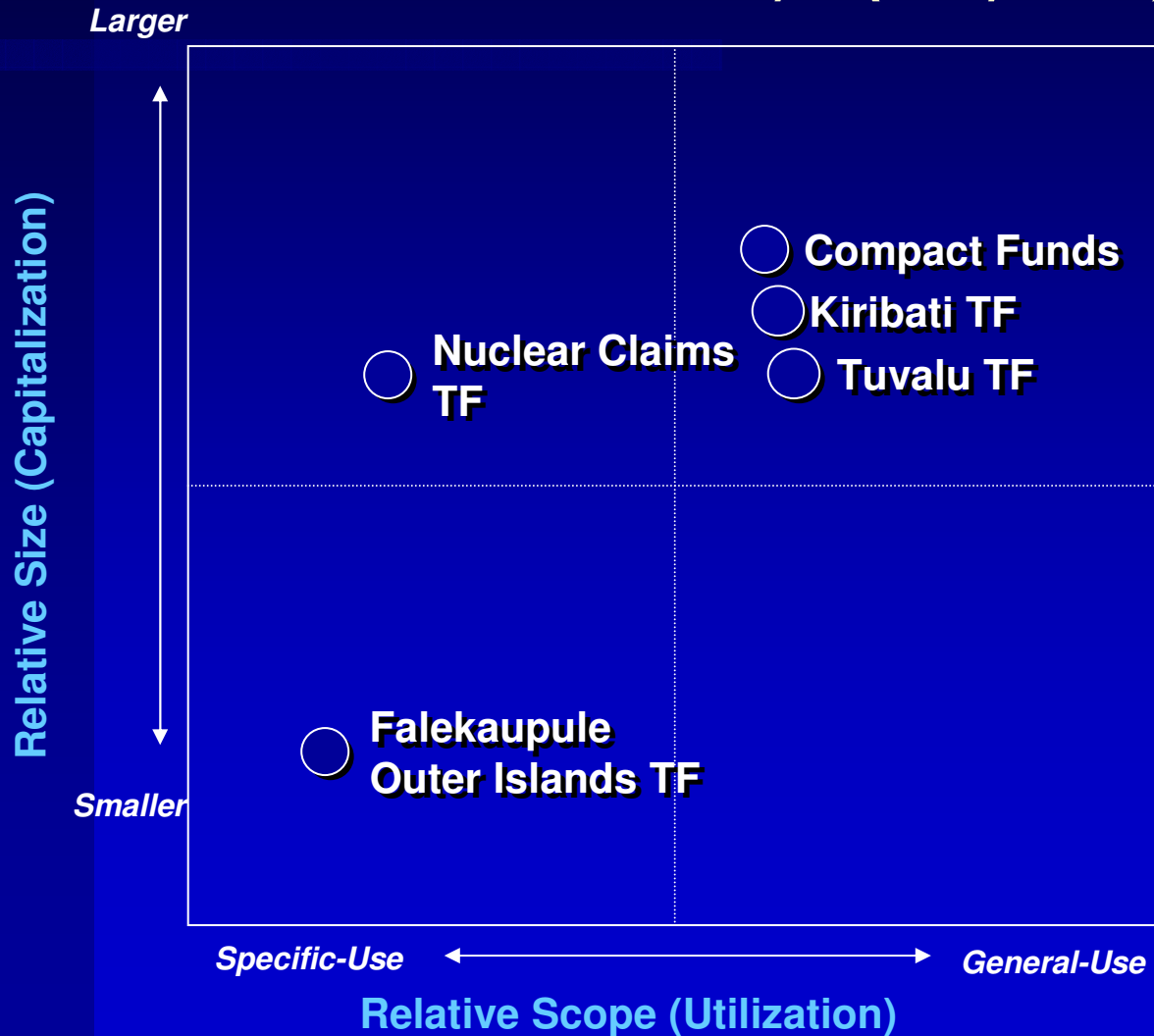
2. Trust Fund Basics (continued)

Advantages and Disadvantages

Fund Type	Comparative Advantage	Comparative Disadvantage
<i>True Trust Fund</i>	<ul style="list-style-type: none">• Most sustainable• Long-term planning• Less costly to donors• Can earn investment income	<ul style="list-style-type: none">• More capital upfront• More sophisticated set up• Higher recipient costs• Can incur investment losses
<i>Revolving Fund</i>	<ul style="list-style-type: none">• Flexible• Quicker set up, dissolution• More closely match resources to needs	<ul style="list-style-type: none">• Less sustainable• More frequent consultation• Disruption of resource flows
<i>Sinking Fund</i>	<ul style="list-style-type: none">• Short-term initiatives• Usually less capital• Targeting	<ul style="list-style-type: none">• All capital upfront• Least sustainable• Not as flexible

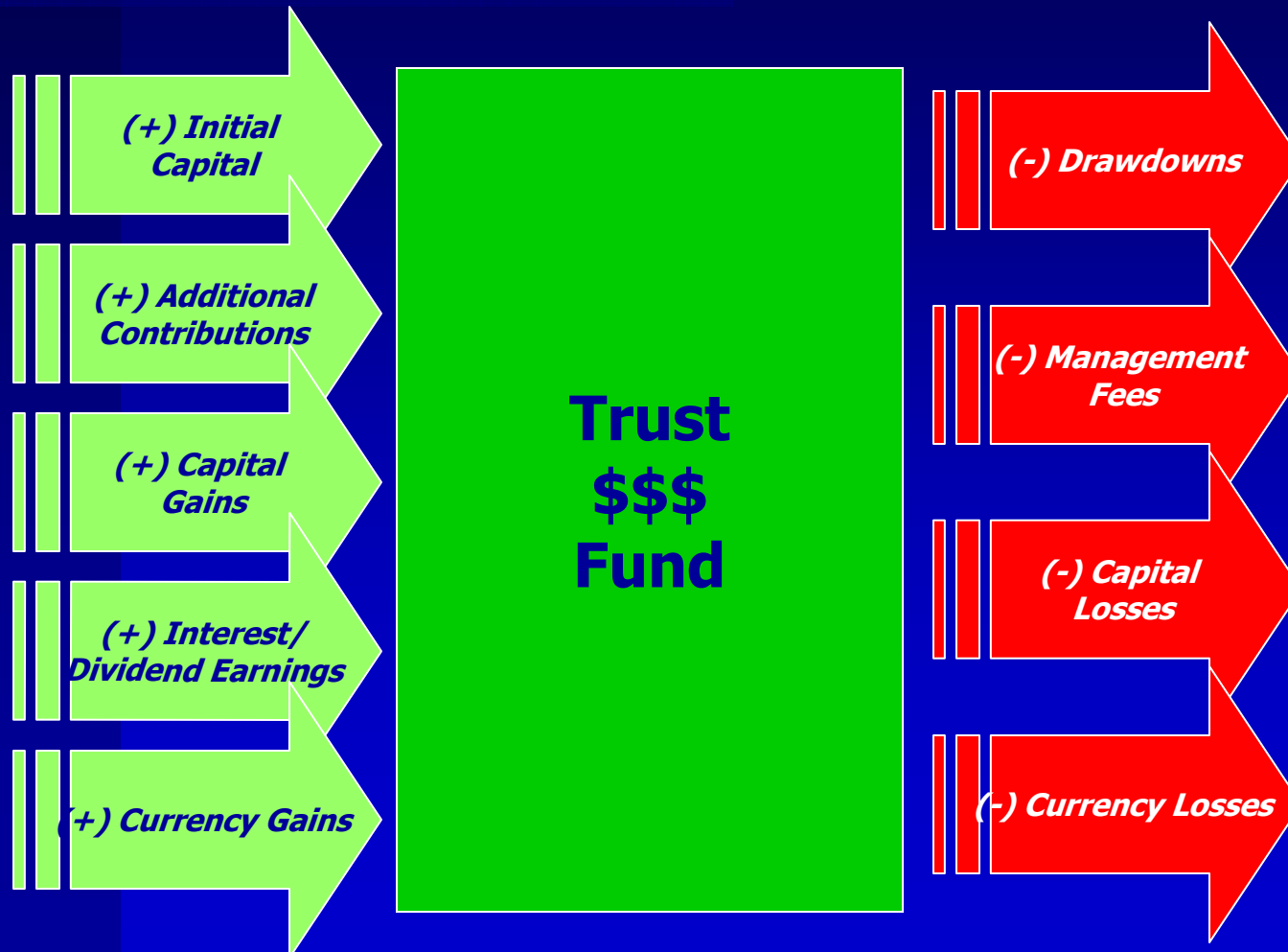
2. Trust Fund Basics (continued)

Relative Size and Scope (Simplified)



2. Trust Fund Basics (continued)

Debits and Credits on True Trust Fund Value



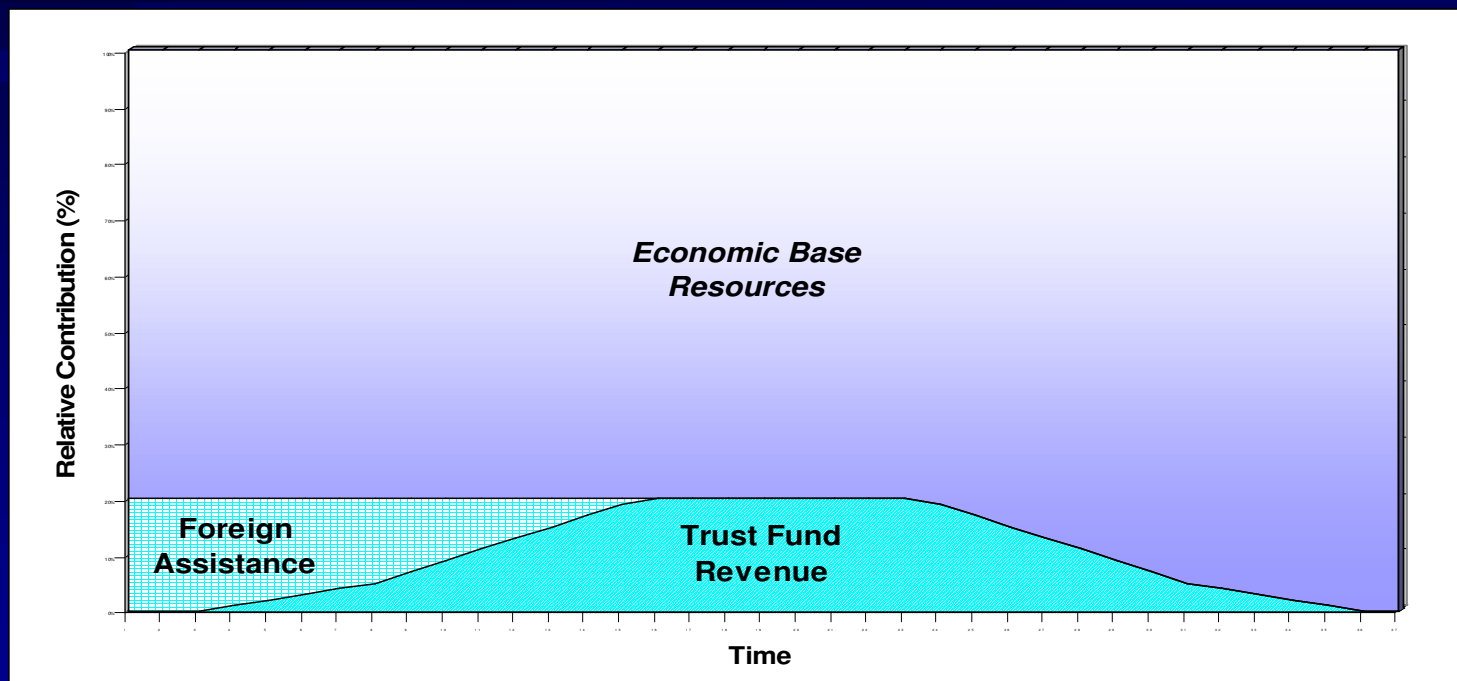
3. Trust Funds and Development

Trends

- Relatively *new*
- New development *consensus*: focus on policies and institutions, poverty
- *Capital* no longer central focus but still *critical*
- Trust funds *pool, grow, focus and spread out* use of capital
- Trust funds (especially true) redirect capital: *forego current* for future spending
- Enhance *security* and *sustainability* of development resource flows
- Foster *long-term planning* – key weakness among PDMCs

3. Trust Funds and Development (continued)

Ideal Life-Cycle



- However, trust funds *not a panacea* – can spur growth only when used correctly (among other cons)
- At best, provide *steady base* of supplementary resources while economy grows
- Basis for *ideal life-cycle* principle of trust funds in development

3. Trust Funds and Development (continued)

General Trends at ADB, WB, USAID, UNDP

- True trust funds still *uncommon* (mostly sinking and revolving)
- *USAID* uses true trust funds most
- *Environmental* funds most popular (50 established, 40 in the pipeline)
- *Targeting* and *multi-donor* contribution on the rise
- Trust funds effective with *right conditions*

4. Case Analysis: Trust Funds in the PDMCs

COUNTRY	TRUST FUND	MARKET VALUE (millions)	AS OF	US \$ MARKET VALUE (millions)
Kiribati	RERF	US \$460	31-Dec-05	460.0
RMI	Compact TF	US \$65.2	31-Aug-06	65.2
FSM	Compact TF	US \$63.5	2005 (est.)	63.5
Niue	Niue TF	NZ \$23.5	Oct-06	15.5
Palau	Palau TF	US \$153	end FY 05	153.0
Tonga	Tonga TF	US \$3	end June 2002	3.0
Nauru	PRT	AUS \$138	2002	104.5
Tuvalu	Falekaupule	AUS \$24	Sep-05	18.2
Tuvalu	Tuvalu TF	AUS \$98	31-Dec-05	74.2

TOTAL \$ 957.2

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4. Case Analysis: Trust Funds in the PDMCs (continued)

Trust Funds Analyzed

- Analysis covered nine PDMC trust funds:
 - *Kiribati Revenue Equalization Reserve Fund*
 - *Tuvalu Trust Fund*
 - Compact of Free Association Trust Funds (Palau, RMI, FSM)
 - *Nauru Phosphate Royalties Trust*
 - Tonga Trust Fund
 - Tuvalu Falekaupule Trust Fund
 - Marshall Islands Nuclear Claims Fund

4. Case Analysis: Trust Funds in the PDMCs (continued)

Kiribati Revenue Equalization Reserve Fund (RERF)

- Background:
 - Established 1956
 - Primary objective *fiscal support*
 - Capitalization with *phosphate mining tax revenue*
 - Governed entirely by Kiribati
 - *Conservative* investment policy (A\$1m in 1956 to A\$600m today)
 - Maintaining 1996 real per capita value of fund
- Key Issues and Takeaways:
 - Prudence laudable, but perhaps *too prudent*
 - Contributions *economically significant*: A\$114m already injected into budget, declining budgetary aid (absolute and % revenue), declining current account official credits (as % GDP)
 - But contributions *too erratic* (move with markets)
 - RERF governance relatively *thin*

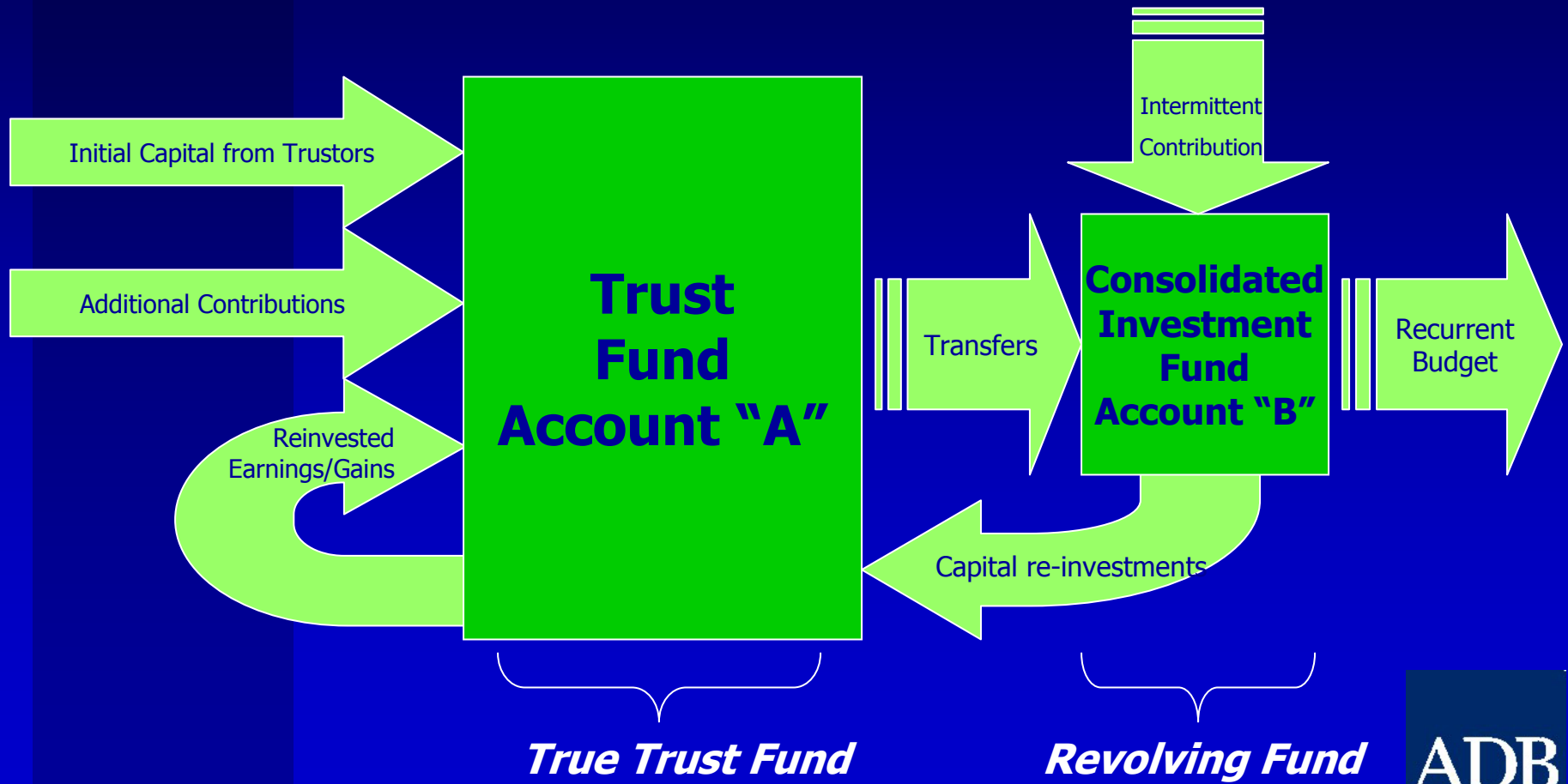
4. Case Analysis: Trust Funds in the PDMCs (continued)

Tuvalu Trust Fund (TTF)

- Background:
 - Established 1987, *model* for use of trust funds in development
 - *Multilateral capitalization/governance*: UK, NZ, Australia, Tuvalu, Japan, Republic of Korea
 - Independent *advisory committee* extra *accountability and expertise*
 - Also very *conservative*, A\$27.1m to over \$80m today (\$100m target)
 - Developed *buffer account* to smooth out contributions
 - Maintaining real per capita value of fund
- Key Issues and Takeaways:
 - Prudence has paid, but also some criticism of being *too conservative*
 - *Governance effective* - transparency and collective management
 - Contributions *economically significant*: around 20% budget revenues, diminishing budgetary aid (absolute and % revenue), evidence of falling current account transfers
 - *Innovative and efficient* binary fund structure (A and B accounts)

4. Case Analysis: Trust Funds in the PDMCs (continued)

Tuvalu Trust Fund (TTF)



4. Case Analysis: Trust Funds in the PDMCs (continued)

Nauru Phosphate Royalties Trust (NPRT)

- Background:
 - Established 1968 with *phosphate mining tax revenue* (four separate funds)
 - Governed entirely by Nauru
 - Fall in *phosphate demand* and higher extraction *costs* reduced competitive advantage, *revenues fell* precipitously beginning late 1980s
 - Falling revenue, poor investments, fiscal expansion – *intense fiscal stress*
 - Government *borrowed heavily*, collateralized NPRT (or drew directly from it)
 - Market value: A\$1.3b in 1991, estimated A\$300m today
- Key Issues and Takeaways:
 - Almost *every rule* in the book *broken*
 - *Convoluted/weak* governance structure, *little transparency*, poor investments, *unchecked fiscal expansion*, collateralization, raiding of fund corpus, etc.

5. A Summary of Good Practices

Why and When a Fund Should be Established

- Unanticipated *excess revenue* available (windfalls, rents) and *no immediate use*
- Critical *long-term resource shortage forecasted* and no cheaper, more efficient means of financing available
- As *hedge against economic volatility*, an “anchor to windward” in public sector asset management

5. A Summary of Good Practices (continued)

Criteria for Consideration

- Trust funds *gaining popularity* – three in last three years, more in pipeline
- ADB will become *more involved* in trust funds
- Some key criteria for PDMC establishment of trust funds:
 - Trust fund idea and impetus *locally owned*, concept *well understood*
 - Issue/problem to be addressed *not short-term* (if true trust fund)
 - Trust fund must fit into *larger picture* of public finance and development
 - Trust fund in line with *country and ADB strategy*
 - *Sound fiscal management* system in place
 - *Governance robust*, multi-layer oversight, collective management

6. Conclusion

The Future, ADB's Role

- Ensuring *effective development* processes a priority of *ADB's Pacific Strategy*
- Trust funds *potential means* to do this
- PDMCs *populations to double by 2050* (8 million to 16 million)
- *Low economic growth* likely to remain
- Critical *resource gaps* at local, national, regional levels

- Help *identify and prioritize* resource gaps, determine whether and where trust funds appropriate (if at all)
- Continue fiscal strengthening
- Sharpen trust fund *skill set*, provide guidance
- PDMCs already heading down *trust fund path*, so keep ahead of the game
- *Leverage* other donors, serve as *liaison* between PDMCs and donors with increasing trust fund interest

For More Information

See *Trust Funds in the Pacific: Their Role and Future*

Available: <http://www.adb.org/Documents/Reports/Trust-Funds-Pacific/default.asp>

The logo for the Asian Development Bank (ADB), consisting of the letters "ADB" in a white serif font on a dark blue square background.

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Thank You

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