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## ARGUMENTS FOR THE ESTABLISHMENT OF A SOVEREIGN INVESTMENT FUND IN ROMANIA

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**Abstract:**

*The creation of the national development fund was approved in 2006 through the specific legislation. The main argument in supporting the idea of creating this fund was the fact that Romania still had to privatize some more governmental ownership companies and the sums that would be obtained were going to be used according to some very precise rules. Another argument was that the executive power had to assure the financing of some major infrastructure investment projects, to assure the local contribution of the project financed by structural funds and to assure de necessary funds for solving the problems caused by the retrocession of some buildings.*

**Key words:** *state assets, privatization, legal, regularity, inter-ministerial body*

### **1. The Formation and the Use of the National Development Fund (NDF) Mechanism**

The reasons for establishment of the National Development Fund of Romania in 2006, that has elements that can classify it as a sovereign investment fund, were given by the need to ensure a transparent mechanism for the use of revenues collected from the privatization of state assets.

The basic sources for the Fund were proceeds from the privatization of the public sector, which offers the advantage of no additional costs associated and that they can be used quickly on the basis of national mechanisms that were rigorously regulated.

The mounts forming this fund would provide (G.D. no. 113 from 21<sup>st</sup> December 2006 concerning the creation of the National development Fund, art.1): funding, starting with 2007, for large investment projects in infrastructure; co-financing the projects with European funds; ensure the necessary amounts to cover expenses related to property retrocession process;

The legal document mentioned, stipulates a series of clear rules that had to be respected in order to ensure the function of the used fund, which are:

- ✓ The financings from the fund are distributed according to the proposals of the main authorizing officers of the local and state budgets, based on Governmental decisions, and according to the public finance law.
- ✓ The budgets of the main authorizing officers, which are supplemented with the approved sums, will be distinctively and will only be used for the approved targets.
- ✓ hiring, authorizing and payments of the allocated amounts have to be made under the provisions of the governing legislation.
- ✓ The main authorizing officers report monthly to the Ministry of Public Finances the manner that the allotted sums are used.
- ✓ The yearly state budget deficit can be covered from the payments made from the National Development Fund allotments, that are defrayed from the following sources: incomes resulted from the privatizing process, after the deduction of the expenses established in the budget of each institution; sums collected from the sale of the stocks resulted from the conversion of the state budget debts; existing sums from the current account of the State Treasury and from the currency account of the Ministry of Public Finances, from privatizing revenues.

## **2. Analysis of the Use of Allocations of the National Development Fund**

The use of the money that fueled the National Development Fund has to be analyzed under two aspects. On one hand, it has to analyze the evolution of budget allocations to this fund and, on the other hand, it has to check if the operating mechanism rules were respected.

Regarding the first aspect, contrary to the estimations, the level of the NDF foreseen in the state budget, after the annual budgetary rectifications, had a descended trend, from 600 million lei (179,8 mil. euro) in 2007, to 101,7 million lei (27,7 mil. euro) in 2008. Through the annual budgetary laws some relatively small amounts were set for the NDF, insignificant towards the total value "equivalent in lei" of the liabilities provided by the privatization from the beginning of the year: 5,1% in 2007; 0,9% in 2008 and from the end of the year: 5,5,% in 2007 and 0,9% in 2008.

Regarding the second aspect, for the realization of the mission, at central level, six institutions were verified: the General Secretariat of the Government, the Ministry of the Public Finances, and four other ministries. At local level, the verification was made in 38 counties, including the municipality of Bucharest. The audit sample was built up of 94 entities selected from 140 other entities financed by the NDF in 2007 and 2008.

The findings and conclusions of the report of the Romanian Court of Accounts may be a real case study that can be generalized to the whole budget process, which is relevant to have a picture of how poor are managed the allocation and spending of public funds in general, and of the Fund in particular.

The findings of the report, customized on central public authorities have highlighted that: Fund establishment was followed by restricted, delayed and hesitant allocations of the amounts collected, that were rather pre-bookings of the privatization

amounts instead of amounts to be entered in the investment circuit; there have been failures in the use of the amounts by the beneficiaries even if there were not found obvious forms of waste or political interests; no identified evidence to certify that projects that were financed from the Fund were considered priority, because a unitary procedure concerning the allotment criteria of the sums has not been legally regulated; No allotment proposals from the NDF were asked from the authorizing officers in order to include them in the state budget project, the allotments being distributed on subjective basis; There were financed mostly projects that had as target local communities regarding cultural settlements in the rural and small urban environment, water sources and protection against floods, the rehabilitation of the water supply and sewerage systems and the construction of social houses that were implemented by the Ministry of Culture, the Ministry of Environment and the Ministry of Development, Public Works and Housing.

At the level of local authorities, the report has highlighted that: some deviation from the legal path were noticed, the total prejudice amount is estimated to 20.386 thousand lei (representing 3,9% of the allotted amounts); the sums asked by the municipalities were uncertain, because they were not based on clear data and they were not distributed on time in order to be used as co-financing sources; in some cases the sums received from the NDF were also used for some other project related expenses, which should have been paid from other funds; the town halls did not always keep a distinct financial evidence of the received and used sums from the NDF.

The conclusion of the audit mission was that the NDF was created in an unsystematic manner towards the level of expectations generated by the actuality, necessity and importance of the proposed objectives. The importance of establishing this Fund was diluted also towards the importance and purpose of establishing it, as the establishment procedures did not prove to be particularly transparent and rigorous, the causes of inefficiency being in the public management approach.

The evolution of the National Development Fund was stopped in the second part of 2008, when in Romania appeared the first signs of economic crisis and when we consolidated incomes that had declined, the budget deficit reached the end of 2008 with 5.5% of GDP compared to 2.4% at the end of 2007, the interest on Lombard credit reached in October 2008 14.25%, while the expenditure had not been restructured due to subjective reasons. Under these conditions, the amounts of NDF were allocated to cover expenses (wages and pensions) to counteract the effects of the crisis, and what was worse, due the legislative elections campaign the amounts were focused strictly to political purposes. The justification that as interest rates fall, they will issue government bonds in order to reintegrate the fund, it never happened even if interest rates decreased thereafter.

### **3. Actuality and Perspectives of Establishing a Sovereign Investment Fund**

The establishment, that is conditioned to ensuring the optimal functioning of a sovereign investment fund, is primarily justified by the need to continue the

privatization of the state sector in order to improve the state companies and to obtain additional revenue for public investment.

Concerns for ensuring the operation of a sovereign investment fund has become an actual issue in 2013, the invoked model being the one of Norway. The Government intends to establish a special fund where all amounts received to be collected as a result of higher fees charged for new oil producers and gas exploitation of energy resources sooner than 2015 (companies that produce oil and natural gas currently pay royalties contained 3.5% and 13.5% of production, depending on the type of hydrocarbon deposits. These levels of royalties were fixed in 2004 and are valid until December 2014, inclusive, being established by the privatization contract with OMV Petrom). The amounts collected would be used for politically decided goals, but in our view, based on economic fundamentals, such as the construction of highways.

In the Senate there exists a bill, that in our view is overly subjective and excessive by entrusting several competences to one ministry, that provides for the establishment of a fund called "Romanian Investment Strategic Fund in Energy and Energetic Resources SA", which is comprised of state-owned shares at energy companies and at other companies, and that will take over the current Office of State Ownership and Privatization in Industry. The stakes will be the ones owned by the state at companies such as: Petrom, Rompetrol and E.On, at other profitable state companies such as: Electrica, Hidroelectrica, Nuclear electrica and Romgaz, but also at inefficient companies like: Coal Plantor Termoelectrica.

The main provisions of the project that appear to be excessive in some cases are: The Fund will operate as a joint stock company, such as closed investment company owned by the state; The legal framework will be approved by the Government. The fund will be registered at the National Securities Commission (NSC) as a special collective investment body, that has as purpose financing the investment projects; From the date of establishing the Fund and the date of entry into force of the contract with an administrative company, selected via international auctions, all management operations will be performed by a Supervisory Board; The investment policy will be determined by the board or by the management of the company, as the case. The Fund may not hold more than 20% of its assets in securities and money market instruments, admitted to trading, except for government securities and bonds issued by the Ministry of Finance; The current accounts value and the cash held by the Fund shall not exceed 20% of its assets. This limit can be extended up to a maximum of 50% under the condition that those amounts come from investments reaching the term or from selling financial instruments from the portfolio, and that the overcoming do not lie on a period longer than 90 days; The Fund will invest at least 20% of its assets in securities registered for trading on a regulated market or traded in an alternative system in Romania or in another EU Member State; Investment limits may be amended by decision of the Government and NSC opinion. The Minister for Energy will be empowered with the Fund on the basis of a protocol to decide on further actions/state assets under the administration of the Ministry, other than those specified in the Annex, in order to strengthen the Fund's portfolio; Ministry

of Economy can provide the Fund, based on the protocol, the ownership of some block of shares; The funding for investments in energy will come from own funds of the Fund, from the own funds of the economic entities that are part of the portfolio, from exploiting the green certificates, from sources made available through national programs and European fund used in order to reduce emissions and funds raised by some potential investors; The Fund will participate in financing investment projects for economic operators from the portfolio and will participate in financing investments, inclusively participation in the establishment of public-private partnerships; The Fund will conduct activities as privatization agent of the holdings of public shares, others than the Ministry of Economy.

Another alternative refers to some opinions that say that the Fund can be a starting point for a sovereign investment fund. However, as it is structured and managed, the fund is merely a form of passive management of various minority stakes of the state in various privatized assets or to be privatized having a modest liquidity. The experience of Property Fund and its difficult operation, where the delay of taking simple decisions remains disabled, proves that it can be a starting point for such an approach.

A sovereign fund is an investment instrument that has as assets: stocks, bonds, securities, commodities or cash, respectively the whole spectrum of possible assets. A sovereign fund invests globally (meaning on-shore and off-shore) and it is managed separately from monetary and non-monetary reserves of the State.

According to the operation model, there are four types of sovereign funds, as follows: Funds whose destination is the inter-generational transfer of wellbeing (Norway, Singapore, Kuwait); Defensive Funds, for the protection of national financial systems from failure (France, Russia), where there is a risk of unwanted mergers and acquisitions at national level or where the exit and the local listings are modestly compared to the potential of the market; Funds, whose purpose is to increase the economic growth through reaching some international strategic objectives, on economic or political basis (China, Qatar); Funds, whose destination is the outsourcing of assets that might be exposed to political risk in the event of unforeseen political changes (Saudi Arabia).

A sovereign investment fund in Romania in the first stage could be built in the same pattern as Russian or French sovereign fund, to protect the national financial system weaknesses and then take the characteristics from the Norwegian model by creating the capacity of inter-generational transfer of liquidity for pension funds, which are the most exposed in the future.

This fund may consist of revenues from privatization, taxes from exploiting the natural energetic resources and it can be devoted to co-finance European projects, in order to finance major investment projects to discourage acquisitions, hostile mergers or to finance banks in case of any difficulty or to support the local entrepreneurs to "export" as co-investors, following the advanced amounts to be recovered from the funded entities so that they provide insight and effective self-management of the fund.

The arguments for creating in Romania a sovereign investment fund are: Public credibility on the financial system; Increased access to European funds by increasing the capacity of financing; Financing investment projects with low equity or reduced access to the international market of private equity or reduced access to the stock exchange funding in areas of interest such as alternative energy or agriculture, where there are prospects for development by ensuring secure financing; as an emergency solution to support the financial system that remains exposed to the Euro zone crisis, without direct access to the protection offered by the European Central Bank, given that Romania might need a "bad bank" (not a bank-bridge) to cushion a possible Euro crisis; development of regional infrastructure projects, financed from the EU budget to speed up the efforts of integration in the European Union.

#### **4. Conclusions**

The Sovereign (or national) investment fund issue is a timeless problem that supports various approaches. Of the countries that have sovereign investment funds, always a positive example cited is that of Norway, which has been responsible, cautiously and fairly approached between generations. In this context, it should be noted that most of these funds were established in the surplus created from the exploitation of natural resources or favorable trade conditions for economic growth. Fortunately these perspectives are foreseen in Romania and it can find resources for such a fund by making use of the incomes from privatization revenues, from exploiting resources in the Black Sea or from the energy revenues, etc.

In our opinion, the major problem is the answer to the question whether the state has capacity to administer such a fund, given that the Romanian Court of Accounts' findings reveal that the state did not prove to rigorously use the public funds. There are documented opinions that such a fund should have rules and standards of profitability and profitability similar to a private fund, meaning that after the return on investment and after it will generate profit, the share holdings should be sold, given the example of private investment funds that deliver value 8 to10 times of the initial investment.

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