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# Sovereign wealth fund and Kenya's development aspirations

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## Executive Summary

The Global South is awash with precious minerals and natural resources, though their prudent management presents a mixed bag of fortunes. Hindsights are indicative of vast discoveries especially hydrocarbons and rare earth. Years between 2011 and 2018 witnessed a surge in major gas discoveries along the Indian Ocean coastline (Mozambique and Tanzania), Egypt, West Africa (Senegal and Mauritania), and South Africa. The International Energy Agency estimates that these findings in Africa account for over 40% of new global gas discoveries. Challenges in the management of these natural resources are predominantly manifested by the "resource curse" phenomena prevailing in many low-income states. Conflict over monopolization and misappropriation of the resulting revenues are ubiquitous in the Democratic Republic of Congo, South Sudan, Angola, and Ecuador. With the oil discovery in the East African region and the potential offshore natural gas resources in the Kenyan maritime area, concerns around resource-instigated conflicts are extant. This paper presents ideas that could be utilized to manage this wealth, and avert or assuage the emergent resource-based threats to the development agenda in Kenya. Contextual analysis of Sovereign Wealth Funds (SWFs) provides insightful lessons and best practices for Kenya's prospective SWF laws and policies that will advance the development agenda and mitigate resource conflict.

## Context

The history of SWFs is intertwined with the dawn of huge hydrocarbon discoveries in Scandinavia and Gulf states. The funds though managed by the government, remain the sovereign wealth of its citizens. The pioneer SWF was the Kuwaiti Future Generations Fund established in 1976. Subsequent funds include Norway's Government Pension Fund- Global (1990), Algeria's Revenue Regulation Fund (2000), Iran's Oil Stabilization Fund (2000), Kazakhstan's National Oil Fund (2000), Russia's Stabilization Fund (2004), Libya's Oil Reserve Fund (2005), Qatar's Investment Authority (2005) and Venezuela's Macroeconomic Stabilization Fund (2005). Their establishment is premised on the need to shrewdly manage the enormous revenues from gas and other minerals and advance socio-economic welfare.

Progressiveness in the establishment and management of these funds largely explains the economic progress in these regions. Through accountable and professional management of these funds, the Gulf states quickly transitioned from being amongst the world's poorest to now possessing some of the highest per capita incomes globally. Their development orientations and investment climate are robust and conducive to spurring sustained progress. Conversely, developing African states allowed rent-seeking tendencies to guide their management of natural wealth. Blinkered policies, institutions, and management approaches are responsible for a small subset of the population controlling the wealth and revenues. This dogmatic stance has proved inimical. It advanced the Dutch disease


*President Uhuru Kenyatta during the flagging off ceremony for petroleum from Kenya oil fields in Turkana*


*Exploration well in deep-water Kenya*

phenomena where greater dependence on revenues from the newfound resources informed their predilection of neglecting other sectors of the economy. Thus, these states are exposed to political and economic volatility.

The aforementioned context dissuades the notion that these states end up poor due to their copious natural resources. Though poverty rates in these sub-Saharan African states doubled after the advent of natural wealth, the primary causal factor remains the defeatist rent-seeking behavior coupled with the plunder of oil wealth. The fondness to concentrate this wealth around political elites precipitated political and state fragility and predictably led to political change. To varying extents, resultant civil strife has been witnessed in the Democratic Republic of Congo, Sao Tome and Principe, Nigeria, Ecuador, Angola, and South Sudan.

This paper advances the credence that countries including Kenya need to plan how to manage the windfall from these resources. These resources belong to the people. The decision-making process around SWFs should be inclusive, transparent, and ethical. When these are present and anchored in the prerequisite legal, policy, and institutional frameworks and practices, states and citizens jointly benefit from these resources for posterity.

Photo Credit: The Media line

## Sovereign wealth funds and diversified development

Sovereign Wealth Funds (SWFs) have proved pivotal to the social and economic progress of states with newfound natural wealth. Their popularity is premised on the need for finance divesture. SWFs are most appropriate as the resultant wealth exceeds the capacity of local economies to absorb it without breeding inflationary tendencies. To this end, SWFs play a dual role as stabilization funds and savings vehicles. To yield more returns, strategic global investments of the funds have proved increasingly pragmatic.

Lessons from Scandinavia and Gulf Cooperation Council states of Bahrain, Kuwait, Oman, Saudi Arabia, and the United Arab Emirates portend that the SWF approach is an enabler to cultivating benefit to both current and future generations. Moreover, the funds have been essential to bolstering local economies from fiscal shocks and uncertainty. During the periods when global prices are high, these states make more allocations to the fund. For instance, Kuwait annually allocates 50% of its annual gas and oil revenue to the SWFs. 10% is apportioned to the national budget and spread across various local economic sectors. Importantly, most of the funds remain in the Gulf states' home economies. Oppositely, during periods of economic change, it is the finance reserves inbuilt in SWF investments that provide the cushion.

Two states provide a lucid illustration of the SWF feat where broad and transparent management of the funds was pursued. The Norwegian Pension Fund which is valued at over US$ 1.3 trillion averages annual returns on investment of 4.6%. As of May 2021, each Norwegian citizen was entitled to around $250,000 of the fund. Currently, interest revenue from the investments largely pays for the Norwegian pension and health schemes. In the Gulf states like Kuwait, responsible fiscal decisions have presented these nations with alternative revenue streams. During Iraq's invasion of Kuwait, Kuwait's SWF financed government operations and later reconstruction. Experts opine that some of the gulf states earn more revenue from SWF investments than from oil and gas.

It would be imperative to note that the successes currently being enjoyed by the aforementioned Nordic and Gulf states arise from ethical and transparent fund management. These principles are jointly pursued with responsible and professional decision-making. In the highlighted examples, these governments appreciate that they are stewards of the wealth on behalf of their citizens. Norway often considered the archetype of SWF management, regularly publishes data on its accounts and operations. This is key in fomenting public trust and support in the management of the fund. Additionally, it curtails the corrupting effect of oil and natural resource wealth and a burgeoning of the Dutch disease.

When juxtaposed along with jurisdictions where the principles of ethics, professionalism, and transparency are overlooked, the destabilization of economic and political systems is evident. Moreover, lessons from most resource-poor Eastern Asian economies that uphold these principles show that they outstripped resource-rich counterparts like Nigeria, Angola, Russia, Argentina, Venezuela, Equatorial Guinea, and Gabon. Most of the later states are susceptible to recurrent political and economic upheavals. Even in situations where these states attempt at appeasing their citizenry by alleviating tax obligations or subsidized services, the implications are equally grave. The Dutch disease viewpoint decimated other sectors of the economy which are increasingly neglected due to the new wealth. Nations are left vulnerable to risks especially when the oil revenues are threatened by depressed global


Photo Credit: Kenyareporter-wordpress

*Ngamia One oil exploration site in South Lokichar basin*


prices, economic sanctions, or local sabotage of supply lines. Motivation for economic productivity plummets thus the predicament of "oil poison". Thus, the perpetual cycle of an unaccountable government, misappropriation, and conflicts are rife.

The above-mentioned principles are therefore the anchor for SWFs as an apt avenue for socio-economic development. Development experts opine that it is much preferable to stimulate accountability structures before the discovery and exploitation of natural wealth. Norway and Botswana provide evidence in this regard. Equally, states can start as developmentally, democratically, or institutionally weak but purposefully strive to substantially improve their accountability structures. As such, they perch on a much more sure footing in averting the oil curse and mitigating malignant dependence on resource wealth. Chile and Malaysia are laudable examples.

Significantly, the establishment of SWFs by themselves does not advance a nation's development agenda. They have to be supported by sound principles and practices that are anchored on robust legal and policy frameworks. The alternative would be the privatization of natural resources. This, however, disappointingly leads to wealth concentration, a rise of oligarchs, and erosion of public trust as prevalent in most resource-rich states. Patronage, rent-seeking behaviors, and weak institutions are pronounced in these economies. Combined, they corrode equitable and sustainable development which should be the derivative of the natural wealth.

## Conclusion

Kenya should initiate discussion on the ethical, transparent, and prudent management of wealth funds from her hydrocarbon and other natural resources to safeguard and maximize long-term gains. This process should be addressed through prerequisite laws and policies before her hydrocarbon resources are commercialized. The solidification of the necessary thought and institutional structures is necessary for the clear planning and investment of the resultant surplus funds. Moreover, there should be clear programs for the diversification of the local economic sectors. SWF provides this platform that safeguards the current and future well-being of states. It is through the prudent management of this wealth that countries like Kenya can be able to fortify their international clout in regional and global spaces.

*Photo Credit: The Eastern Africa*

## Recommendations

1. The Ministry of Finance and the Ministry of Petroleum and Mining should initiate stakeholders' forums on the development of law and policy framework on Kenya's Sovereign Wealth Fund that guides investment from the anticipated hydrocarbon revenues.

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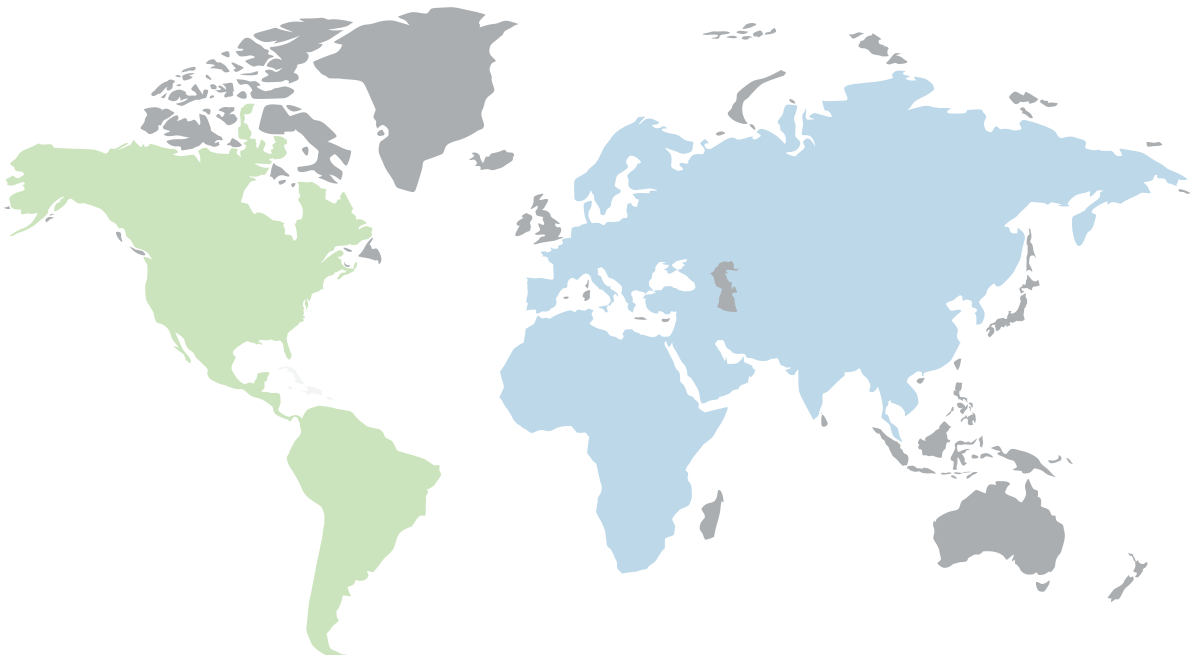

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