Making better use of trust funds in the Pacific

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There has been a resurgence in the use of trust funds in Pacific island nations. This paper examines two issues arising in their application: their dependence on the whole-of-government fiscal outcome and the role of the donor community in managing such funds. It argues for recognition of the vulnerability of trust funds and the importance of factoring trust funds into the partner-donor relationship.

Trust Funds have been in use in the Pacific for almost 50 years. The Kiribati Revenue Reserve Equalisation Fund (RERF) was established in the 1950s and has set the benchmark for sustainable funds management. Papua New Guinea established its Mineral Resources Stabilisation Fund (MRSF) in the mid 1970s; Tuvalu has its Tuvalu Trust Fund; trust funds are now established in the three ex-US Trust Territories; and in June of this year Timor-Leste established its Petroleum Fund. These trust funds serve different purposes. The trust funds of Kiribati and Timor-Leste are designed to save for future generations proceeds from the exploitation of non-renewable resources. The trust funds of Tuvalu and the ex-US Trust Territories are used to save large injections of donor assistance as long-term replacement of annual assistance. Trust funds are also used to help manage fluctuations in revenue, the primary function of the MRSF.

There are some obvious ‘ingredients’ of sound management of a trust fund. For example, mechanisms to ensure accountability and transparency are critical, as are investment rules to protect funds from inappropriate investment strategies. The Pacific has provided unfortunate illustrations of the cost of missing such ingredients. The demise of the order of US$1 billion held by Nauru from phosphate mining is an extreme illustration of the cost of poor funds management; a further illustration is the loss through bad management of much of the Tonga Trust Fund. IMF guidelines on foreign exchange reserve management are a source of sound advice on how to manage funds (IMF 2001). These guidelines highlight the importance of clear objectives, a clear allocation of management responsibility, a legal and governance framework that provides for accountability and transparency, the prudent management of risk, and the investment of funds in markets that have sufficient depth and liquidity to process transactions in a sound and efficient manner. Duncan, Larmour and Hunt (1995) offered advice on fund management specific to the Pacific funds that remains relevant today.
Trust funds in the Pacific

Trust funds are routinely used as administrative mechanisms to manage donor funds or to hold revenue from mining and petroleum projects for landowners. The trust funds of concern to this paper are those more substantive funds established as permanent mechanisms for holding public financial assets, most usually for the benefit of future generations.

The Revenue Reserve Equalisation Fund

The RERF was established in 1956 to invest Kiribati’s phosphate mining revenue and provide a means of balancing the government’s future recurrent budgets. The fund has been invested offshore, mainly in Australia, and with a growth orientation. The RERF was worth A$68 million (US$75 million) by independence in 1979, and the value doubled between 1994 and 2001 owing to a booming market and a depreciating Australian dollar. Its 2001 value of A$636 million (US$325 million), or A$7,000 (US$3,600) per capita, was the equivalent of seven times annual gross domestic product (GDP) and four times annual gross national income. Market correction led to a fall in value to A$513 million as of the end of 2003 but this fall is likely to have been largely if not fully recovered given the recent strength of the Australian market.

Successive Kiribati governments have generally been reluctant to draw on the RERF since independence, preferring to accumulate funds against an uncertain future. During the 1980s drawings on the RERF funded 20 per cent to 40 per cent of total government expenditure, much as its originators had assumed. Strong growth in fishing licence revenues reduced the need for RERF drawdowns from 1990 and either there has been no withdrawal or the drawdown has been substantially less than earnings. A policy was established to maintain the real value of the fund in domestic currency per head of population at the 1996 level (just over A$4,500 or US$3,500), and to limit the annual drawdown at A$12.6 million (roughly US$10 million or 20 per cent of 1996 GDP). But good capital growth and overall revenue outcomes have meant that these limits have not being binding (Asian Development Bank 2002a:34–9).

The Mineral Revenue Stabilisation Fund

The MRSF was established by Papua New Guinea in 1974 to smooth revenue flows from mineral projects. The national government’s share of earnings from mining projects (taxes, dividends, and so on) were paid into the MRSF and held as a separate kina denominated account at the central bank. Under the original MRSF legislation, funds paid into this account could only be drawn down according to strict guidelines. The intent of the legislation was to ensure that annual drawdowns into consolidated revenue would be sustained in real terms over the following five years. The intention was to save much of any windfall and to provide a pool of savings to insulate expenditure programs from a fall in revenue. The original intent was severely undermined by changes to the MRSF Act and, more importantly, by a wider breakdown in fiscal discipline. The positive account balance, which had reached K567 million (US$200 million) by September 1999 was illusionary, and was written down to zero as part of the 2000 Budget, and thereafter inflows have matched outflows in each period and the balance has remained at zero.

There is now a question as to whether Papua New Guinea should be seeking to resurrect its MRSF. Papua New Guinea now faces a potential resources boom as the petroleum and mining industry responds to favourable prices, a revised tax regime and a generally improved business climate. Existing projects are being expanded and
over the June quarter the proposed gas pipeline secured conditional sales agreements sufficient to meet the level previously reported as required for the project to proceed. The government’s current intention appears to spend mining and oil revenue as it is earned. The wisdom of this approach is questioned by the speed with which the wage and salary bill has increased as fiscal conditions have improved. It is reasonable to question whether the public sector, built up on the previous resources boom, is appropriate. Action to re-establish the MRSF, or a new trust fund arrangement that places more emphasis on saving for the future, may be one way to re-orient the PNG public sector to a sustainable one.

Tuvalu Trust Fund
The Tuvalu Trust Fund was established in 1987 with contributions from the governments of Australia, New Zealand, the United Kingdom (these three being the main contributors), and Tuvalu and South Korea. The Government of Tuvalu has subsequently contributed additional funds as did (in smaller amounts) the governments of Australia, Japan and South Korea. A requirement of the Tuvalu Trust Fund is that the real value of contributions is maintained by the reinvestment of the inflationary premium (as measured by the Australian CPI). Distributions to the government’s Consolidated Investment Fund (CIF) are only allowable to the extent that the Fund’s current market value exceeds what is termed its ‘maintained’ capital value, being the real value of contributions (Asian Development Bank 1998:24). The Fund’s Board, currently comprising representatives of the governments of Australia, New Zealand and Tuvalu are responsible for overseeing and administering the Fund in accordance with the terms of the international agreement which created the trust. An accompanying Tuvalu Trust Fund Advisory Committee provides independent economic and financial advice to the Board and Government of Tuvalu, with members appointed by those countries represented on the Board. The value of the Tuvalu Trust Fund stood at A$74 million (US$55 million) as of June 2004, of the order of three times annual GDP.

Falekaupule Trust Fund
The Falekaupule Trust Fund was established by Tuvalu in 1999 with contributions from the government, island communities, and ADB loan funds. Investment and distribution rules are similar to the Tuvalu Trust Fund: in particular, funds are invested offshore, overseen by a board, and the real value of contributions must be maintained. (Issues arising from the management of the fund are discussed in Asian Development Bank 2002b:184–87.) The value of funds invested was A$18 million (US$13 million) as of June 2004.

Tonga Trust Fund
The Tonga Trust Fund was established in 1989 with proceeds from the sale of Tongan passports and subsequently from the lease of Tonga’s satellite space. The fund was managed separately from the budget and official international reserves and invested almost entirely offshore. It reached a book value of US$37 million as of June 2000 but bad management, including the investment in high-risk life insurance policies in the United States, saw the value of the fund decline to US$3 million by June 2002. Legal action was initiated to recover some of the lost funds (see ADB 2002c:24–5; IMF 2003:16–9).

The Palau Compact Trust Fund
Palau’s Compact Trust Fund was provided as part of the Compact of Free Association between Palau and the United States. The Compact provided for total financial assistance of approximately US$600 million
from October 1994 to September 2009. US$70 million of this was provided for the establishment of the Compact Trust Fund. The aim was to accumulate, by the end of the first 15 years of the Compact, sufficient cash reserves and interest income to replace US financial assistance over the final 35 years of the Compact. The value of the Compact Trust Fund peaked in FY2000 at US$161 million before falling as the US market weakened. The estimated value as of April 2005 was US$141 million, the equivalent of approximately 120 per cent of GDP.

A schedule of drawdowns from the Compact Trust Fund was prepared at the inception of the Compact Trust Fund on the assumption that a 12.5 per cent per annum rate of return would be earned. Returns have averaged only 8 per cent per annum, and if returns remain at this rate, planned annual drawdowns of US$15 million beyond FY2008–09 could only be sustained to 2033.

If the Compact Trust Fund is to meet the objective of providing a constant annual source of deficit financing over the final 35 years of the Compact (to 2044), it appears that either the size of the annual drawdown will have to be reduced or additional funds will have to be injected.

Marshall Islands Intergenerational Trust Fund

The Marshall Islands Intergenerational Trust Fund arose from the renegotiation of US financial support provided under the Marshall Islands’ Compact of Free Association. The amended Compact of Free Association financial assistance package, as formally agreed in 2003, led to a major change in financial relations between the two countries. It affected the level of US funding, the allocation of public funds (grants and internal revenue) and internal systems for managing public funds (for example, audit procedures, planning requirements, and procurement). As part of the renegotiation of US assistance, budget surpluses were achieved in FY2002 (year ended September) and FY2003 to enable the government to save a temporary ‘bump-up’ in US funding. These savings were invested in the Marshall Islands Intergenerational Trust Fund, which is intended to ultimately provide a source of revenue sufficient to replace US grants. US$7 million is to be provided annually by the United States to the Trust Fund until FY2023 and ongoing contributions are also to be made by the national government. The Trust Fund had a balance of slightly more than US$30 million as of end FY2004, the equivalent of approximately 30 per cent of GDP.

The FSM Compact Trust Fund

As for the Marshall Islands, the financial support arrangements that came into effect in FY2004 (year ended September) with the amended Compact provided for a substantial change in the way US support is to be provided to the Federated States of Micronesia. Under the amended Compact, the United States is to provide US$92 million in grants annually until FY2023. A portion of the grant is to be saved each year in the FSM Compact Trust Fund. Initially, US$16 million is to be saved each year, but from FY2006 the amount saved will increase by US$0.8 million a year. The consequence is that grants available for general government expenditure will decline and be re-directed to savings. Rules on the use of public funds also apply. The government also saved in the Trust Fund the ‘bump-up’ in funds provided by the US for the final two years of the previous assistance package, which required budget surpluses in FY2002 and FY2003.

The PNG Sustainable Development Fund

The PNG Sustainable Development Fund was established as a vehicle to hold the share of Papua New Guinea’s Ok Tedi mine, previously owned by BHP (now BHP Billiton). The fund is to be used for the benefit
of current and future generations, with funds to be spent both within the mine area and throughout Papua New Guinea. The fund is, for example, partnering in road construction and maintenance projects outside the mine’s province.

The Timor-Leste Petroleum Fund

The Timor-Leste Government initially indicated an intention to spend petroleum taxes and save only what was termed the First Tranche Petroleum (which is ade facto royalty payment) from current oil projects. The Petroleum Fund, established in June 2005, is designed to pursue an alternative policy of achieving intergenerational equity by maintaining the real value of petroleum wealth. This is to be achieved by limiting expenditure of petroleum revenue to what is termed the sustainable income; being the amount of petroleum revenue that could be spent every year indefinitely. The Bayu Undan field is initially to provide the main source of revenue, which is projected to peak in FY2011 (year ended June) at US$380 million and over the life of the project to total US$3.8 billion (US$2.2 billion in net present value terms). In comparison, non-oil, non-United Nations GDP was estimated at US$300 million for 2003. By the March quarter 2005, reserves had already risen to US$284 million. The government has based the Petroleum Fund on a Norwegian model, which requires funds to be largely invested abroad in low risk assets and be subject to accountability and transparency measures. (The Petroleum Fund proposal is outlined in Timor-Leste, Ministry of Planning and Finance 2004.)

The importance of the whole-of-government fiscal outcome

Whether a country is saving financial resources depends on its net holdings of financial assets, defined as the total of all holdings of financial holdings less total debt (inclusive of contingent liabilities). A trust fund represents holdings in only one public account (although it is noted that in practice a group of associated accounts may collectively constitute a trust fund). The balance in such an account can be important or it can also be meaningless, as what matters is the net position for the government as a whole and not the holdings in any individual account. All trust funds operating in the Pacific islands suffer from the limitation of a focus on holdings in the trust account without factoring in the whole-of-government position. Transactions outside the trust fund can thus undermine the fiscal standing of a trust fund.

This issue is well illustrated by Papua New Guinea’s experience with the MRSF. From 1984 to 1999 Papua New Guinea recorded positive balances in the MRSF, but for most of this time the funds were actually being spent elsewhere. The illusory nature of the MRSF stemmed from the fact that it was only one component of the government’s overall balance sheet and the balance in the MRSF failed to represent the overall budget position. Over the course of the 1990s the increase in ‘savings’ in the MRSF was more than offset (and substantially so) by government borrowings from the domestic banking system. From 1990 to 1998 the MRSF balance grew to K57 million (US$275 million). But over this period the government borrowed K1,099 million (US$520 million) from the central bank, the Bank of Papua New Guinea, and K704 million from the commercial banks. The net asset position as of 1998 was a domestic debt of K1,216 million (US$570 million) and not the saving of K587 million (US$275 million) recorded in the MRSF. It is not too harsh a criticism to say that for much of the 1990s the MRSF undermined the quality of macroeconomic management. This is so because it contributed to a false sense of security about the true value of the...
government’s financial assets (savings) by obscuring the true nature of the government’s fiscal position.2

Papua New Guinea’s 2000 Budget proposed to re-establish the MRSF as a foreign currency denominated account and to change the means by which the funds were drawn down. The holding of the MRSF as a kina deposit with the central bank probably aggravated the weakness of the MRSF as it made it easier for the government to finance budget deficits. Thus the proposed changes had the potential to improve the design of the MRSF, but nonetheless the underlying weakness of an exposure to a lack of fiscal discipline would remain.

The weakness in the MRSF was recognised long before its suspension with the 2000 Budget. For example, Duncan et al. noted that

\[ \text{[w]ith the fund held as a deposit with the Bank of Papua New Guinea, there has been no guarantee of saving or sterilisation since there is no constraint on government borrowing. Rules on retaining balances in the Fund are meaningless if the government can borrow from the Bank of Papua New Guinea to finance budget deficits. The underlying problem is, of course, one of fiscal discipline. Changes to Fund management will be of little use without a greater commitment in Papua New Guinea to fiscal discipline (1994:46).} \]

The potential pitfall of a focus on one account can also be illustrated by Tuvalu’s CIF, which holds drawdowns from the Tuvalu Trust Fund and acts as the government’s financial buffer. With the aim of ensuring sustainability, fiscal rules have been established as to when funds can be drawn down from the buffer and how much can be drawn down. But these rules do not take into account the government’s growing overdraft with the National Bank of Tuvalu. Such a short-term debt has the same effect as a drawdown of the CIF as it reduces the fiscal capacity of the government to manage fluctuations in revenue. In effect the government has borrowed to retain funds in the CIF. As of late 2004 the government only held net cash holdings sufficient to fund the planned 2005 deficit. The balance on the CIF was almost three times this level. But that does not mean the government could readily fund a deficit three times larger than planned. Responsible fiscal management would be to use the CIF to clear the overdraft and to record the government’s buffer as the current net debt position and not the fiscally meaningless balance in the CIF.3

The designers of Timor-Leste’s Petroleum Fund appear to recognise the exposure of the fund to the overall fiscal position. The public discussion paper on the trust fund notes that

\[ \text{[t]he Petroleum Fund does not guarantee a wise management of the petroleum wealth, but it can be a useful tool—provided it goes hand in hand with a fiscal policy framework that strikes the right balance between current consumption, investing in physical assets (infrastructure and human development), and saving in financial assets.} \]

Further, it was noted that

\[ \text{[b]oth theory and experience teach us that a Petroleum Fund is no guarantee that the petroleum wealth will be well managed. A Petroleum Fund cannot be a substitute for good fiscal policy. A poorly designed fund will do more harm than good, but a well-designed fund can help the government achieve its sound fiscal policy objectives (Timor-Leste, Ministry of Finance and Planning 2004a:4, 9).} \]

But ultimately the Petroleum Act that established the fund placed no constraints to ensure consistency between the overall fiscal position and the fund balance.4

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From a policy perspective it is important to recognise that the benefits of compliance with investment rules, accountability mechanisms, and so on, of a trust fund, even when sensibly designed, can be readily undone by laxness elsewhere in the public sector. As the experience of the MRSF emphasised, trust fund rules can be changed and this can undermine the original intent of a trust fund. For these reasons, trust funds should be seen as vulnerable. Policy actions that address this vulnerability will help maximise the development contribution of trust funds.

The role of donors in trust funds

Within the region, donors have an explicit management position only in the Tuvalu Trust Fund, which is through representation on the Board and an Advisory Committee. The United States has an indirect role in the trust funds of Marshall Islands and the Federated States of Micronesia. This is provided through requirements for the government to meet certain saving requirements; through controls on how public funds are used (for example, the sectoral allocation of funds); and through mechanisms to help ensure accountability and transparency. Such a minor role for donors in the region’s trust funds appears to downplay their position as sources of the finance for trust funds and as ‘insurers’ of the risks of mismanagement of trust funds.

Donors are clearly a direct source of finance for trust funds in Tuvalu and the ex-US Trust Territories. What is probably less obvious is that donors are also an indirect source of finance for trust funds. The indirect role is well illustrated by the case of Timor-Leste. For Timor-Leste to achieve the objective of maintaining the real value of petroleum wealth, the overall fiscal surplus must be large enough to allow sufficient savings to be made. This in turn rests on the financial

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*This table follows the format of the Timor-Leste budget papers. To be consistent with the conventions of the International Monetary Fund’s Government Finance Statistics, this item should be included as a revenue and expenditure item and in the calculation of the overall balance.

support of the international donor community. For example, from FY2005 to FY2008 the government is expected to achieve a budget surplus sufficient to cover 75 per cent of off-budget bilateral and multilateral expenditure (see Table 1). This means that petroleum revenue could be used to substitute for much of the planned donor support. But doing so would prevent savings in the Petroleum Fund. Savings can only be made if donors continue to provide substantial financial support such that budget funds are freed up to save. It is thus unclear to what extent the government and donors are funding the Petroleum Fund. Certainly the argument that the Petroleum Fund is fully internally funded is difficult to support. This is a reflection of the fungibility of aid funds.

The position of donors as providers of insurance for the mismanagement of funds is illustrated by Nauru. Nauru had sufficient resources to sustain a high standard of living. Instead it has become a nation heavily dependent on donor support to meet its basic equipment, material and service needs. Papua New Guinea is another illustration. The mineral boom provided Papua New Guinea the opportunity to substantially raise living standards and to reduce dependence on foreign aid. But the opportunity was largely lost and recognition of the fragility of Papua New Guinea has seen a substantial increase in aid, notably from Australia. Australian support is now provided for such basic functions as road maintenance, pharmaceutical supplies, and the provision of education materials. For humanitarian and political reasons, it is impractical to expect donors to punish countries by withholding assistance because they had previously mismanaged their opportunities.

Donors have a further role to play as de facto custodians of trust funds with responsibilities for conserving the savings made in trust funds. Extending the argument above regarding the importance of the net financial position, it can be seen that the actions of donors can amount to the drawdown of a trust fund. Specifically, any debt that is not self-financing is most meaningfully represented as a drawdown on that trust. In future periods what matters is the net financial holdings available to finance expenditure and not the individual components of a portfolio. When a trust fund country borrows for an activity, it is in effect borrowing to save in the trust fund. For this reason, the presence of a trust fund places lending agencies such as the multilateral banks in the position of de facto custodians of trust funds. Their lending practices have a bearing on the sustainability of a trust fund even though they may not be directly involved in its operation. Debt sustainability is generally not a concern for those countries that operate a substantial trust fund, but the sustainability of trust funds is.

Policy options

A case can be made for a more active role for donors in the region’s trust funds, given their position as either direct or indirect sources of trust fund savings and as insurance policies in the event of mismanagement. How should such a role be managed? It could be along the lines of the Tuvalu Trust Fund where donors are joint-trustees. Or it could be along the lines of the recent US approach.

Applying the US approach would see fiscal rules established in trust fund countries. Enforcement is an obvious problem, as it can be difficult to put in place. But fiscal rules can even be helpful in the absence of strong enforcement. The Cook Islands government adopted fiscal rules relating to the overall debt position and the budget balance as part of its mid 1990s public sector reform. Additional rules relating to the composition of expenditure were adopted as
part of its 1998 debt restructuring. The government has not always complied with its fiscal rules, notably in terms of the wage and salary bill. But budget and semi-annual budget updates have reported on compliance and the consequences of any non-compliance. The government’s approach of setting fiscal rules has helped Cook Islands to move to one of the strongest fiscal positions in the Pacific even though there was no real enforcement agency.

Donors could establish penalties for non-compliance with any fiscal rules, such as the withholding of grant assistance or loan funds. The proposition that aid be subject to previous performance is a variant of the aid conditionality argument. Conditions are often specified at a project level, but only infrequently at an economy-wide level. However, the more extensive use of trust funds in the region and the cost to the region’s trust funds of poor policy environments appear to be raising the need for an explicit stance on the link between aid flows and overall fiscal performance.

Donors could also explore the wider application of trust funds as a means of encouraging fiscal independence and eventually finding a US-style exit strategy from the region. In the case of the ex-US Trust Territories, trust funds have been established to provide the United States with a clear exit strategy as they are intended to ultimately replace annual US grants. The US approach is also notable for establishing controls that extend beyond the trust fund and address the potential for transactions outside the trust fund to undermine the fund. The approach seeks to encourage fiscal discipline and to improve resource management, where achieving this will require behavioural change offering broader benefits than just sensible trust management.

One way to approach this issue of fiscal independence is for donors to request that partner governments contribute to trust funds an amount equal to a set proportion of grants. The share could be set low initially and rise over time to provide for a gradual build-up in the fund. Such commitments could be limited to any increase in grants above current levels so as to reduce adjustment costs, or involve the reallocation of existing grants. An obvious candidate for reallocation is the support provided to tertiary education. Funding for tertiary education is a candidate given its large share of aid to the region and because the ratio of private to social gain appears to be substantially higher than the ratio of private to public funding.

It is probably impractical to devise a trust fund that could be completely protected from inappropriate transactions outside the fund. But more could be done in this regard. For example, rules can be established to limit deficit financing to certain sources, such as the trust fund and the multilateral lending agencies, in an effort to control the overall net asset position. Controls that make it hard to access funds for purposes outside the original intent are sensible. The Sustainable Development Fund has, for example, established a complex system of controls built around offshore company structures that has so far protected the fund. Trust funds may need to be established under the constitution rather than normal legislation, as is normally the case, so as to reduce the ease with which Parliament can move away from the original intent. In the case of the RERF, there is considerable potential to improve controls as the Minister of Finance and not Parliament has discretion as to the use of the Fund (see Asian Development Bank 2002a:Appendix C). And it is essential that action is taken to prevent trust funds or their revenue flows being used as security, guarantees and so on, along the lines of the constraints on Timor-Leste’s Petroleum Fund.

One of the lessons from the Pacific experience is that it is very important to record trust income and drawdowns on-
budget so that the overall fiscal position is clear. The practice has been to record such funds off-budget or not to report on trust fund activities at all. Such practices can reduce transparency and accountability and thus hinder the potential contribution from trust funds. This reporting issue can be addressed by the adoption of a convention of recording all transactions associated with trust funds on-budget. There is a sound basis for such an approach. The International Monetary Fund’s Government Financial Statistics define revenue as a transaction that increases the net worth of the government. Application of these conventions, which are now applied widely in the Pacific, would suggest recording all income from trust funds as the property income item of revenue. Under this approach whether a government plans to or has saved in a year would be readily evident from the bottom line of the budget, the overall balance. Public release of such information and parliamentary endorsement of the overall budget outcome would be a significant step.

Conclusions

The role of trust funds is gaining prominence in fiscal management in the Pacific region. This raises a number of important policy issues, notably how best to achieve accountability and transparency and whether donor programs can help safeguard the investment made in trust funds. The recent US approach to the ex-Trust Territories is a reminder of the potential for trust funds to be used to build fiscal independence and to provide an exit strategy for donors. The policy issues raised by trust funds warrant discussion and greater recognition in government and donor strategies. The need is obvious for a country such as Timor-Leste that is embarking on the use of a trust fund; but the need applies elsewhere in the region.

Notes

2 This interpretation of the MRSF is attributable to Robert Harden.
3 It is noted that as the government owns the National Bank of Tuvalu, much of the high interest payments on the overdraft could be recovered by the government via dividends.
4 There is only a constraint on the ability to use the Petroleum Fund as guarantee, security, and so on for loans.
5 A self-financing debt is interpreted as one that generates sufficient additional revenue to meet all debt-servicing costs.
6 Countries with substantial trust funds will generally not need to borrow from donors as they are not capital constrained. However, borrowing from donors can make sense if countries are prevented from making sound drawdowns of a trust fund (loans relax this constraint); if they can invest at a higher rate of return than the concessional cost of donor debt; or if donor loans are supported by valuable technical assistance provided on a grant basis.
7 Although the potential to adopt such an approach is probably unique to the Sustainable Development Fund.
8 It has been argued that for net savers such an approach of full disclosure would encourage spending as it would show the budget as in surplus. This is a possible adverse effect of the full recording of trust fund transactions, but it is considered a price worth paying if full disclosure helps prevent the mis-use of trust fund assets and/or the emergence of lax fiscal policy.
References


