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UT-030908

OIL

(4)

EXECUTIVE SECRETARIAT COALITION PROVISIONAL AUTHORITY	
FOR Jessica LeCroy JM	DATE: 8-Sep-03

INFO MEMO

CoS
Mil
Exec. JM 9/8

FOR: Amb. Bremer

ORIGINATION: PSEC – Tom Foley

RE: Iraq's Oil Trust Fund

Attached is Foley's paper on the Oil Trust Fund as promised in his memo this morning.

Also attached for your reference are:

1. Governance, August 24 memo to the GC on Iraqi Oil Trust (TAB A)
2. McPherson, August 18 memo on Oil Heritage Trust (TAB B)

Attachment(s): As stated

(Prepared by: Jeb Mason)

Tom
Thanks. Let's
discuss.
W 9/10

PSEC - Foley
CHRON

Revenues vs. Taxes

PM Proposal 95% Bdgt
5% – 1) 30 – Stabilization Fund
2) 30 – ~~Divd~~ Payment
3) 40 – Corpus/Pension
– Block/Wolfe

(1) Does not work
(2) Politically unrealistic

Foley – 10% – Operating
10% – Divds
80% – Reconstn/5 yrs
– then: corpus/pension/general benefit.

Crane
1) Fee Per Barrell → Fund
2) Fund → Food Subsidy
3) → Energy
3) Rest-Operations.

02971

COALITION PROVISIONAL AUTHORITY

BAGHDAD

CoS		
Mil Asst		
Exec. Sec	GM	9/8 1700

INFO MEMO

September 8, 2003 1600L

FOR: THE ADMINISTRATOR

FROM: Tom Foley, Director of Private Sector Development

SUBJECT: Iraq's Oil Trust Fund

Introduction

Iraq's oil wealth belongs to its people and this wealth should be equitably, permanently and directly held by them. The establishment of an Oil Trust for the People of Iraq ("OTPI") that serves this purpose should be a high priority for the CPA. An oil fund that permanently and broadly distributes Iraq's oil wealth among its citizens will help prevent inappropriate expansion of the state or the opportunity for a tyrant to seize and concentrate the wealth of Iraq as Saddam did. Furthermore, an oil fund should build a capital asset to replace the oil resources as they are consumed, in order to provide a perpetual source of income to the Iraqi people.

Major Objectives

The Office of Private Sector Development recommends that the structure of an Iraqi oil fund satisfy the following objectives:

1) Irrevocably put Iraq's oil wealth directly in the hands of the Iraqi people;
2) Cap the amount of oil income available directly to the government at a level significantly below the government's total need, thus requiring the government to collect taxes from the people to fund a major portion of their expenditures;
3) Create an efficient and professionally managed oil operation;
4) Provide for a high level of transparency; and
5) Operate independently from direct control of the government.

Proposed Structure

All of Iraq's oil production assets, including its oil reserves, should be donated to the OTPI. All other oil-related businesses, including refining and oil field services, should be privatized. An operating subsidiary of the OTPI should manage oil production operations with a management team appointed by the OTPI Board of Directors. The OTPI Board of Directors should include at least ten directors and be elected by the public or appointed by the Prime Minister or President. In either case, directors should have staggered seven year terms. All of Iraq's operating income from oil (revenues net of production costs, including appropriate reserves for exploration and

other development costs) should be captured directly by the OTPI without any ability for the government to intercept funds or pad the oil production company with patronage jobs. The OTPI should distribute annually the following percentages of average annual operating income over the previous five years:

1) 10 percent to the government as general revenue;
2) 10 percent in the form of a dividend distributed to all Iraqi citizens over the age of 18 who have lived in the country for at least five years; and
3) The remainder into a reconstruction fund for the first five years of the OTPI and thereafter into a capital fund to be invested in perpetuity for the benefit of future generations of Iraqis.

Lessons Learned

This proposal has features that have proven successful in other venues. First, it is generally accepted that representative governments are more stable and more durable when a nation's wealth is broadly held and difficult to reconcentrate. Second, a government's size and power is held in balance when it must directly tax its citizens for its funding needs. Third, we recommend the capital fund have a structure similar to the Norwegian Government Petroleum Fund ("NGPF"). In the NGPF, the Norwegian government provides general oversight of the fund and is responsible for making strategic investment decisions such as choosing the benchmark portfolio and selecting the risk limits. However, a money management firm handles to day-to-day investment operations of the NGPF. The money manager's specific tasks include implementing the investment strategy (as well as accounting and reporting functions), managing risk and providing investment advice. In addition, the NGPF has geographical, company and asset class restrictions that require the asset managers to remain properly diversified. Fourth, the OTPI shares three fundamental principles with the Alaska Permanent Fund ("APF") including: recognizing that the oil resources belong to the people; establishing an irrevocable trust and specifying that its principal should be invested in perpetuity; and requiring that information operations and investment activities be transparent and readily available to the public.

Comparison to the Iraqi Heritage Fund Proposed by the Ministry of Finance

The staff of the Ministry of Finance ("Finance") has proposed the Iraqi Heritage Fund ("IHF"). Their proposal properly recognizes the importance of setting aside Iraq's oil in a trust. The IHF differs from OTPI in that the IHF does not place Iraq's oil assets and the right to Iraq's oil income directly into the hands of the Iraqi people, and therefore does not provide irrevocable protection that these assets and income will be reconcentrated in the future by an individual or an overly expansive government. Second, the IHF does not provide for a vertical decoupling and privatization of the non-production assets of the state-owned oil businesses.

Timing

The OTPI should be introduced soon. The first dividend payment from the fund should coincide with a one-time removal of all subsidies on all energy.

ATTACHMENTS: [NONE]

COORDINATION: ?

CIJ-030407-27

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COALITION PROVISIONAL AUTHORITY

BAGHDAD

INFO MEMO

August 24, 2003

FOR: THE GOVERNING COUNCIL

FROM: THE ADMINISTRATOR, Coalition Provisional Authority

SUBJECT: IRAQI OIL TRUST

The natural wealth of Iraq has for far too long been abused and squandered by its leaders. It is high time that the riches of Iraq were used solely for the benefit of the Iraqi people. In order to achieve this, the new Iraqi Oil Minister could announce the creation of an Oil Trust. The establishment of an Iraqi Oil Trust, into which a portion of oil revenues would be paid, would have a number of advantages:

- It would enable oil revenues to be saved and used directly for the benefit of the Iraqi people. This can be done through direct payments to citizens in the form of dividends, or by managing long term needs of the state, such as by paying for pensions.

- It would protect the state against volatility in the global oil market. Saving a portion of oil revenues would mean that the state could draw upon financial reserves to meet fiscal deficits caused by a drop in oil prices.

- It would create a transparent and accountable means of managing oil revenues and would be designed and managed according to international "best practice".

- It would enable the state to plan and implement economic goals for the near-term, medium-term, and long-term thereby allowing it to address the diverse economic needs of the country.

- It would cultivate broad popular and social support among Iraq's population, through the provision of much needed social benefits.

In the near term, due to the massive demands for reconstruction expenditure not much oil revenue will be routed through the Trust. The only feasible payments to the trust will be pension's payments. But sourcing oil revenue into the Trust, which will produce clear benefits to Iraqis in terms of direct payments, will be a good means of demonstrating to the people that their livelihood is directly linked to oil production. Damaging oil production will harm their future prospects.

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COALITION PROVISIONAL AUTHORITY

BAGHDAD

August 24, 2003

THE GOVERNING COUNCIL

THE ADMINISTRATOR, Ambassador L. Paul Bremer

CT: Proposed Agenda for August 27 Meeting

l, I submit to the Governing Council the following agenda for the August 27 meeting
am. As I mentioned to the Council on August 23, Ambassador David Richmond
ress the GC in my absence until September 4th.

or the August 27 meeting include:

Iraqi Oil Trust

Establishment of a Ministry of Science and Technology

ador Richmond would of course also welcome discussion of any GC proposals.

d over papers on these two topics to the Governing Council on Tuesday.

o: Ambassaddr Kennedy
Colonel Norwood
om: Peter McPherson
ate: August 18, 2003
ubject: Executive Summary of Iraqi Oil Heritage Trust

ll Block and I were asked by Ambassador Bremer to provide a two page summary scription of the Iraqi Heritage Trust for translation. Please see below. This document ntains modest revisions compared to a version submitted last month.

iqi Heritage Trust – Executive Summary Version

- Iraq is an oil-dominated economy and must manage its oil resources carefully.
- The early establishment of an "Iraqi Heritage Trust" is an important step toward ensuring that the entire country benefits from its oil resources – a major break from past policies, when only the Baath Party largely benefited from Iraq's oil resources.
- Financing for the Trust will be provided through foreign oil sales. Iraq's national budget will be paid from the Trust, thereby assuring long-term fiscal discipline and providing transparency to the people of the country. In addition, the Trust would put revenues from oil sales into three funds described below pursuant to a pre-determined formula and sliding scale.
- Although initial financing for the Trust may be very small, some upfront "seed money" may be prudent to establish the institutional structure and operations for the Trust.
- For the next two year period of time, and possibly longer, Iraqi pensions should be paid directly through the Trust Fund (the "Savings Fund" -- see below) to help establish this institutional structure.
- The Trust should, in time, be legally established in the Iraqi Constitution, while its exact operational structure should be codified by statute.
- The Trust will have a number of important objectives:

  1) Full transparency, accountability, and high performance standards.

2) Near-term, medium-term, and long-term economic objectives that will address the various economic needs of the country (see below).

3) The cultivation of broad popular and social support among Iraq's population.

4) Incorporation of international "best practices" in the Trust's design, management, and accountability.

- The Trust will be comprised of three distinct funds:

1) A "Dividend Fund" that makes annual payments directly to all Iraqis.

This fund will to ensure that Iraqis benefit directly from oil revenues, will help to create hope among the Iraqi population, and will help to ensure that oil management decisions benefit the entire country.

2) A "Savings Fund" that will help to meet long-term needs of the country.

This fund will help to ensure that some portion of oil revenues are saved for future generations and will be available to meet key long-term needs of the country – for instance, pensions and education.

3) A "Stabilization Fund" that will improve macroeconomic policies.

This fund will provide room for countercyclical fiscal policies and will help to provide Iraq with a "cushion" against volatility in global oil prices that has caused hardships for other oil-dominated economies.

- Each fund will be separately managed and evaluated in order to strengthen incentives for strong financial performance. The funds will invest in different types of assets (defined by law) and will also have a distinguished international advisory board.

- The amount of financing provided to each fund is an important decision for Iraq. A large number of combinations are possible depending on the priority assigned to near-term versus long-term priorities.

- However, to ensure that each of the funds receives some support, a clearly defined minimal amount of financing, or "floor," for each of the funds should be legally established. In addition, the amount paid into the funds should be determined in part by oil revenues during a calendar period.

- Changes in allocations among the funds should be permissible only through a legislative "super-majority" (e.g., three-fourths) and Presidential concurrence in

order to limit the room available to manipulate the funds for short-term political purposes.

- Clear expenditure rules and guidelines for each of the funds should be established clearly defining the conditions under which spending is to be permitted, the amount of spending that is to be permitted.