Journal of Positive School Psychology http://journalppw.com
2022, Vol. 6, No. 6, 3077-3084

The Effect Of Sovereignty Funds In Iraq On The Sustainable Development

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Abstract

Sustainable development is a process in which the exploitation of resources, investment directives, technological development and institutional change harmonize in a way that enhances both the present and future capabilities for the purpose of fulfilling human needs, which is compatible with the Iraqi society, especially the effects of the conditions that swept Iraq after 2003 and the resulting military operations. And the many events that followed, which prevented the continuity of the sustainable development approach. These conditions had a direct impact on the indicators of development in Iraq, through the destruction of technical infrastructure services, including them and communities, such as educational, health and cultural services, in addition to the widespread devastation caused in various areas of life. The economic and social ones, and the manifestations of deterioration and slackness deepened to the extent that the Iraqi society lost the characteristics of a civilized and cohesive society. Since Iraq is one of the oil-exporting countries that has large financial surpluses, which makes those in charge of developing development plans for the economy face the inevitability of finding solutions and mechanisms to exploit these surpluses in a way that contributes to achieving sustainable development in the economic field in particular, due to the effects that sovereign funds exercise on the state From many aspects, this overall effect comes through its effects on economic variables and macro policies in the local economy.

Keywords (sovereign funds, oil, investment, salary financing, legislation of legal rules, the effects of operating the fund)

INTRODUCTION

The Sovereign Fund is a government-owned investment fund that is funded by the financial surpluses of the government, such as the balance of payments surplus, and export income, particularly oil profits, because Iraq is an oil-producing country. It is invested in achieving sustainable development, especially investment projects and financing loans and infrastructure. This means that sovereign wealth funds have a major role in financing sustainable development, since the purpose of their establishment is to manage financial surpluses and invest them at the local or external level. Sovereign funds often differ in terms of their sizes, the investment strategies within which they move, their special nature and the reasons for which they arose. However, in general, all sovereign funds reflect the interests of their countries and aim at developing their capital, achieving the best returns on their investments for the benefit of future generations, diversifying their sources of income, achieving stability in the budget and the economy in general and protecting state revenues from any fluctuations. As a result, Iraq shifted its focus to establishing oil funds, or so-called sovereign funds, to better manage its oil resources and achieve a variety of objectives. Most oil funds were established in response to rising oil prices, which led to the investing of those returns in a way that benefits future generations and protects national economies when oil prices vary, particularly during years of decline. As a result, the fund is used to augment government spending and deal with various emergencies.

The First Topic

The Concept of Sovereign Funds

Many countries, particularly those in the third world, suffer from economic instability despite having local resources, particularly oil, due to a failure to save financial surpluses in specific funds to deal with economic crises and employ them in various sectors and marketplaces. Therefore, some of the oil-producing countries have tended to diversify their sources of financing by introducing new and sustainable financing mechanisms, starting with external sources of financing such as sovereign wealth funds, where it has established special funds in order to get out of economic crises during the high prices of oil and other natural resources that they produce. Historically, sovereign funds began to appear in the past, but they witnessed rapid growth in the twentieth century. In the fifties of the previous century, for example, specifically in 1953, the State of Kuwait established the Kuwait Investment Council, which had a mandate to invest surplus oil revenues, with the aim of reducing the state's dependence on black gold as the only source of its revenue. Later, other sovereign funds began to appear in the world, as their number increased from three sovereign funds in 1969 to nearly 82 funds in 2014. As for the year 2020, according to the data of the Sovereign Wealth Funds Institute (SWF Institute), the assets of 89 sovereign funds around the world amounted to nearly eight trillion dollars. Norway's state pension fund is the world largest sovereign fund, with assets of $1.12 trillion. The idea of establishing sovereign funds is mainly due to the desire of countries, especially those that have one source of income (such as oil, for example) to face the constant changes and fluctuations in the prices of their exports. Therefore, considering these funds as a new source of income helped them diversify their sources of income, which was a new way to reduce the risks of the idea of low prices for the only source of income. As for the social aspect, the idea of depletable material revenues has always been an important concern among thinkers, which prompted them to encourage the idea of building sovereign portfolios and funds whose ownership is transferred from one generation to another as permanent investment for future generations. (Bu-Flaieh:2017).

The First Requirement

Introducing Sovereign Funds

The fund "sunduk" where the "s and d" letters are by "Damma case" and the letter "n" is by "sukkun case" which means without diacritics. The plural of the word "sunduk" fund" is "sanadeek" funds". The "sunduk "fund" means the "money cabinet", the place where cash is received, taken and kept. As for sovereignty "siyadiya", it means sovereignty: authority, domination, freedom of action, or the sovereignty of the country: its elevation, its authority, its glory. (Ibn-Manzur).

Terminologically, sovereign funds are defined by several definitions by jurisprudence and international institutions, as part of jurisprudence defines them as "a mechanism or tool established by a country that has a realized financial surplus as a result of a surplus in the trade balance or due to the rise in the state's general revenues with the aim of saving or investing this surplus internally or externally in the global markets finance or international banks and financial institutions", while the Organization for Economic Cooperation and Development defines it as "a group of financial assets owned and managed directly or indirectly by the government to achieve national goals and financed either by foreign exchange reserves, exports of natural resources, public revenues of the state or any other incomes (Mark Allen and Jaime Caruana:2008).

The Sovereign Wealth Funds Institute defines it as "a government investment fund consisting of financial assets such as stocks, bonds and other financial instruments, where the fund resources consist of the balance of payments surplus, the general budget, the outcomes of privatization processes, or commodity export revenues (Fearnley.T:2012). International Monetary Fund defined them as “investment funds with specific purposes owned by the general government and established for macroeconomic purposes, and they are funds that retain assets, employ them or manage them to achieve financial objectives used in those investment strategies that include investing in foreign financial assets, and sovereign wealth funds are characterized by a diversification of their structures that organize the legal, institutional parts and government practices, which are a group of heterogeneous characteristics, including public financial stability funds, savings funds, reserve investment institutions, development funds, and reserve funds that are not associated with explicit pension obligations (Norges Bank Investment Management:2016).

As a result of the preceding definitions, it is evident that sovereign wealth funds are investment funds controlled by governments, but they are not associated with finance ministries or central banks. The majority of their resources come from raw material income, particularly oil. The purpose is to manage and invest part of the state financial surpluses according to a commercial plan of profitability in long-term investment operations outside the countries of origin. The fields in which these funds are invested are diverse, most notably real estate, hedge funds, investment funds in the financial markets, bonds, stocks, futures contracts and raw materials. That is, the idea of establishing this fund is linked to the nature of the raw materials produced by countries interested in sovereign wealth funds, as resources such as oil and natural gas are subject to depletion in the future, therefore, the purpose of achieving justice in the distribution of wealth among generations requires investing parts of the main export proceeds of the country producing raw materials, so that they bring income to future generations when they are depleted. However, we notice here on the level of international reality that the idea of funds has developed in such a way that it is not limited to the producers of raw materials. There is a number of countries, led by China, that are working to establish sovereign wealth funds to invest their surpluses from foreign trade transactions, for the purpose of maximizing the economic return of the state and sometimes to exercise political influence in important areas, which could make such funds an effective arm for exercising soft economic power on the global scene. Of the mentioned earlier, we find that sovereign wealth funds can be defined as “saving tools established by the state for the purpose of benefiting from the financial surpluses of the budgets by reinvesting them in various assets with the aim of achieving additional returns and profits and encouraging investment.”

The Second Requirement

Justifications for Establishing Sovereign Funds

The majority of oil-exporting countries have large financial surpluses, putting those in charge of developing these economies of countries in front of the inevitability of finding solutions and mechanisms to exploit these surpluses in a way that contributes to long-term economic development in particular. Sovereign funds exert influence on the mother country in many ways. The overall impact through its effects on economic variables and macro policies in the local economy (Pilbeam: 2010). The most prominent justifications for its emergence are:

First: Achieving Economic Diversification

Iraq is one of the countries that relies on oil earnings to pay its budget, necessitating the creation of this fund with the goal of diversifying national income or government revenue sources through developing industries and non-oil incomes. This is done by using part of the oil revenues to develop the necessary infrastructure for the development of production and service sectors on the one hand, as well as saving a part of the immediate oil revenues, and developing them through internal or external investment to form an alternative income from oil when it is depleted in the long run (Mabrook:2014).

Second: Its Contribution to Achieving Economic Stability

Sovereign funds are created with the goal of absorbing price swings in basic commodities resulting from oil, and then stabilizing income from those exports of commodities. Sharp price volatility characterizes the commodity market, particularly the oil markets. Iraq bears in the development of its economy on oil exports, so the fluctuations in oil prices and its exposure to decline make the state budget unbalanced. Just like to what happened in the 2019 budget, where there was a significant drop in oil prices, in addition to the crisis of the Corona epidemic, which caused a major economic crisis, forcing Iraq to lend for the purpose of bridge the financial shortfall. The top ten investment funds are China, with investment funds amounting to $2.244 trillion and annual profits estimated in 2019 at $197 billion. This constitutes approximately 10 percent of the fund size. Followed by the UAE, with investment funds amounting to 1.363 trillion dollars and annual returns of 8.4 percent of its value in the last 30 years, an amount of 110 billion dollars annually in light of its current size. Then came the Norwegian sovereign fund, with a size of 1.108 trillion dollars, and its profits in 2020 were about 90 billion pounds, despite the global economic collapse. Before 2019, its profits were 180 billion dollars, which means that its annual profits are approximately 15 percent of its total value. Saudi Arabia will then come up with a sovereign fund of $899 billion in 2021 after its value in 2015 was $150 billion, and with future plans to increase its size to be more than a trillion dollars. After Saudi Arabia, Singapore is a small country with a sovereign fund of $703 billion, and then the Kuwaiti sovereign fund. The Kuwaiti sovereign fund is the oldest in the world, with a volume of $533 billion. Then the funds of Qatar, Australia, the United States of America and Russia, with a total sum of these countries amounting to more than one trillion dollars. (Al-Munif: 2010).

Third: Creating Savings for Future Generations

It means to achieve justice in the distribution of wealth among generations which is done by maximizing saving directed to future generations, by preserving the returns from non-renewable natural resources, and then creating savings for future generations, by converting assets from non-renewable assets to permanent financial assets. This serves as a mechanism to achieve financial savings and benefit from today wealth to build tomorrow on the one hand (Dahshan: 2015). It also contributes to achieving sustainable development by providing work opportunities, as the funds are affected by investing in local assets. This will lead to an increase in the demand for these assets and their prices will inflate, resulting in problems that force the monetary authorities to inject funds that lead to the distribution of those surpluses and returns from their investment to many sectors of the national economy (Saleh:2007).

Fourth: Pension Funding

If implemented in Iraq, sovereign funds contribute to the financing of pension obligations, with the goal of addressing the future deficit in paying pensions for the elderly as a result of population increase and the ability to fulfill the financing requirements associated with them in the future. When financial reserves accumulate and the demographic environment is favorable, these conditions can be exploited and these surpluses invested to benefit from them, especially if the need for them increases as a result of the effect of aging (Swapan. 2011). This is the simplest thing that can be mentioned about the benefits of the sovereign fund, but why can the sovereign fund be considered an experiment and a successful means? The sovereign fund can be considered a successful experiment for no more than two reasons, the first of which is that the experience of Sovereign Fund is the special framework related to financing government spending in all major economies despite the fact that the experience of the sovereign fund is an old one, but now it has become the best means of government financing. Currently, there are more than forty-five sovereign funds in the world, and in the Arab world itself there are about ten investment funds with a total asset of nearly ten trillion dollars, that is 1.5 percent of the total global economy.

The Second Topic

Requirements for Establishing the Sovereign Wealth Fund in Iraq

The Sovereign Fund is a vital economic emergency plan for the state because of the material value it holds in the form of money and assets, as well as the resources it generates for the state in the form of profits from investments in major companies and large and medium-sized projects, as well as investments in other international investment funds. Determining the mechanism of the fund work is an important issue for all countries that work with this system to maximize their profits, but the importance of establishing a fund for the Iraqi state is the most important among all countries because Iraq is its greatest and primary resource is the oil industry and oil export sector (Qadi:2009). So, we will divide this topic into two demands, which we will show in the first requirement the legislation of legal rules regulating the mechanism of operating the fund, and we will address in the second requirement.

The First Requirement

Legislation of Legal Rules Regulating the Mechanism of Operating the Sovereign Wealth Fund

Originally, the Sovereign Wealth Fund was created to aid in the resolution of financial crises, with laws enacted by most oil-producing countries to save or invest the financial surpluses generated as a result of high oil prices, and to benefit from them in a variety of sectors both within and outside the state. Sovereign funds are created to ensure that the assets of the state are protected and invested. The Sovereign Fund represents a remedy for the crises sweeping the state, and it is an urgent need for the state that relies on a single source to finance its budget, especially if this exporting country is subject to price fluctuations, especially the sovereign wealth fund has effects on the general price by investing in shares, bonds and securities, and providing support to projects, institutions and government companies that produce goods and services that the state sells to its citizens for a sum of money. Therefore, the Iraqi government moved towards adopting the idea of establishing the first sovereign wealth fund to be financed from surplus financial budgets with the aim of building a coherent financial barrier that prevents economic collapse, as well as the possibility of investing these funds in reviving the local economy, and addressing crises that may arise as a result of the drop in oil prices. This project is incomplete because it has not been legislated and has been moved to the next parliamentary session (Saleh: 2007).

Therefore, the effective management of sovereign wealth funds requires a solid legal framework based on solid foundations and rules in order to strengthen the institutional framework and governance structure when managing external sovereign assets, by clarifying the legal nature of the fund, whether it is independent or affiliated with the Ministry of Finance, specifying its goals and assets for the purpose of ensuring the soundness of the legal status of the fund when investing abroad, especially enjoying some tax privileges, determining the entity that will manage and supervise it, especially since it contains two sub-funds: a savings portfolio and a development portfolio. The purpose of the savings portfolio is to invest oil revenues for the benefit of future generations, while the development portfolio aims to reduce the level of public debt, provided that state stock revenues (and perhaps its rights, although this is not clear) are deposited in the savings portfolio. The government may use part of the interest collected to finance its expenditures. As for the revenues from tax fees on oil companies, they are deposited in the development portfolio and can be used to pay off the public debt (Burnett: 2008).

The proposed law should also clarify that the fund will publish a list of the assets it owns, along with a list of the managers of these assets. In addition, the law should emphasize the obligation of the fund to disclose the amounts paid by the directors. The managers must affirm their independence from any of the sovereign fund departments. In addition to the above, a clear goal must be set for the sovereign fund based on an integrated macroeconomic strategy for the oil sector in addition to a financial strategy. Since the oil industry and its derivatives are an extractive industry, its resources are inevitably finite. Therefore, it is necessary to study the method of its use because it is not renewable. Natural resources should be treated as assets for current and future generations and not be spent as normal incomes are spent (Hashad: 2008).

Clear controls and restrictions should be established on investment in addition to specifying how to dispose of the assets owned by the fund or funds owned entirely by it, as well as defining an effective institutional structure for governance that clarifies the distribution of responsibilities and imposes ethical controls and conflict of interest standards. Additionally, informing the public of citizens of extensive information about the operations of the sovereign fund. Transparency does not mean just regular, accurate and detailed reports on the fund activities in an accessible format for the readers' audience, but rather clarifying and announcing the laws governing the fund. Independent supervisory bodies must also be identified that follow the fund actions to ensure the implementation of the legal, legislative and disclosure requirements in which the sovereign fund invests (Al-Khaiyat: 2020).

It's also worth noting that the law should mention the need to exempt all transactions involving the fund and the firms it owns from any taxes, fees, and the like. Dividends are not exempt from these exemptions. The controls for executing this are defined in the Fund Articles of Association. Exemptions do not apply to subsidiary funds and companies in which the fund contributes. It is also necessary to stipulate in the budget law for the year 2022 the inclusion of a legal paragraph stipulating that oil revenues and other derivatives must be transferred to a sovereign fund, in order to prevent political and nepotistic appropriation of this wealth. However, a question remains for posing the researchers: Will a draft law be drawn up for the sovereign wealth funds in Iraq, and will it be approved in light of the differences of parliament members and the sharing of sovereign positions, and will it be implemented if it is approved and published?

The Second Requirement

The Effects of Operating a Sovereign Wealth Fund

Undoubtedly, Iraqi economy is dependent on the global oil price, indicating that the presence of a sovereign fund will provide the oil sector with a major and basic alternative in the event of the collapse of global oil prices. This is what we have witnessed in more than one era, either early and later. The simplest and largest of the two examples is the collapse of oil prices after the occupation of the terrorist organization ISIS for large parts of Iraq and Syria, and we witnessed it again in the crisis of the Corona pandemic, as oil prices collapsed globally (Martellini & Milhau, 2011).

Iraq, by finishing the war against ISIS, needs to generate revenue to fund reconstruction efforts is urgent, as is the need to ensure that the oil-dependent Iraqi economy can diversify its economy. The current rise in oil prices provides the Iraqi government with the opportunity to finance reconstruction efforts and improve the country infrastructure, but the Iraqi economy dependence on the unstable commodity, as a result of oil price volatility, may lead to a sudden collapse in the economy. Therefore, a strong mechanism must be in place to ensure that the revenues generated from the oil wealth are used in the direction of reconstruction. This allows the Iraqi economy to become more sustainable and resilient to price shocks, and ultimately transfers Iraqi oil wealth to its population (Jordon and Al-Hiti: 2006).

It is worth noting that the establishment of a similar sovereign fund does not necessarily have to be financed if it is established from Iraqi oil imports only. On the contrary, it can be financed through the surplus of Iraqi budgets in addition to a small percentage of oil. So, Iraq's budget surpluses after 2003 amounted to more than fifty billion dollars, which was for the year 2018. Only a surplus of more than $18 billion, which is an important factor for investment development, and has greater economic benefits in the short, medium and long term. It contributes to eliminating unemployment, as well as increasing the gross domestic product and bringing in large imports to the governmental public sector and the capitalist private sector. Now, it is the appropriate time to establish a sovereign fund for Iraq, especially after the Iraqi government intend to reform and modernize the economy and maximize the financial resources of Iraq. It would be appropriate to develop a plan to establish Sovereign Fund in the current parliamentary session (Ibrihi: 2009). Such a trend will lead to strengthening the links of the economies currently dependent on oil with the global economy, and diversifying the relationship between them, so that it is not limited to providing hydrocarbon energy, and investing in instruments such as foreign government debts. However, it is expected to extend, in light of the current trend, to invest in productive assets and major companies covering diverse and globally influential fields of economic activities, which will benefit both the countries that own the funds, and the countries in which these funds invest their money. Therefore, the necessity of establishing the fund appears, especially after the end of the compensation paid by Iraq to Kuwait, which is estimated at 3-5 percent of the Iraqi oil resources, the remaining now is about one and a half billion dollars. Therefore, the sovereign wealth fund is supposed to start with 5 % of the oil revenues in addition to finance the deficit in its general budgets.

It also highlights its effects in times of crises facing the country, and here the fund can be one of the basic financing tools, as an alternative to resorting to borrowing from international financing organizations. It is expected that the fund will come to light after the meeting of the House of Representatives.

Conclusions

First: The Results

Sovereign wealth funds are known as "saving tools established by the state for benefiting from the financial surpluses of the budgets by reinvesting them in various assets with the aim of achieving additional returns and profits and encouraging investment."

It becomes evident that sovereign wealth funds are investment funds controlled by governments, but they are not linked to finance ministries or central banks. The majority of their resources come from raw material income, particularly oil, and its goal is to manage and invest a portion of the state financial surpluses in successful long-term investment operations outside of their countries of origin.

It became clear to us that the fields in which these funds invest are diverse, most notably real estate, hedge funds, investment funds in the financial markets, bonds, stocks, futures contracts and raw materials. That is, the idea of establishing this fund is linked to the nature of the raw materials produced by countries interested in sovereign wealth funds.

We found that after Iraq ended its war against ISIS, the need to generate revenues to finance reconstruction efforts became urgent, as well as the need to ensure that the Iraqi economy that depends on oil can diversify its economy. The current rise in oil prices provides the Iraqi government with the opportunity to finance reconstruction efforts and improve the country infrastructure. However, the Iraqi economy dependence on the unstable commodity, as a result of oil price volatility, may lead to a sudden collapse in the economy. Therefore, a strong mechanism must be in place to ensure that the revenues generated from the oil wealth are used in the direction of reconstruction. This allows the Iraqi economy to become more sustainable and resilient to price shocks, and ultimately transfers the Iraqi oil wealth to its population.

Second: Recommendations

We propose to legislate a law for the establishment of the Sovereign Wealth Fund in Iraq that clarifies the legal framework of the fund and defines its objectives and sources of funding.

When legislating the law, the text should be on defining the legal nature of this fund in a clear and explicit manner that does not carry interpretation as it is independent and is not affiliated with either the Central Bank or the Ministry of Finance.

The budget law for 2022 must include a legal paragraph stipulating that oil revenues and other derivatives must be transferred to a sovereign fund, in order to prevent political and nepotistic appropriation of this wealth.

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