SOVEREIGN INVESTMENT FUNDS, OPPORTUNITY WITHIN THE CONTEXT OF THE GLOBAL ECONOMIC CRISIS

Doina DRĂNICEANU, PhD Candidate[*]

Abstract

Emergent countries' governments which have at their disposal huge amounts of money from external balances of trade strongly in excess became foreground investors, influential players on the financial markets by means of sovereign funds, often with political component. The economic crisis triggered in 2008 made the sovereign investment funds to adopt an active position in the financial markets, contributing through their massive interventions in the European and American banks, to the rescue of world economy, consolidating their position within the global financial sector. The consequences of the sovereign investment funds' strengthening are both economic and political, influencing the pregnant change within the world power ratios in the new multi-polar world, from political and military point of view, with significant growth of interdependence of national economies.

Keywords: emergent countries, financial markets, economic crisis, sovereign funds, world economy

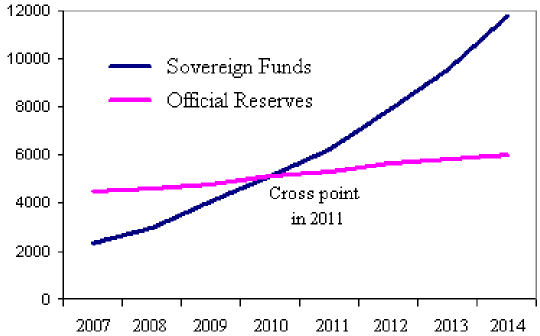
JEL: F33, F59, F65, G24

1. General considerations

At least 25 countries with trade surpluses already have sovereign investment funds, or are in the process of establishing such funds, the estimated total available amounts reaching some 3 trillion USD. It seems that in a few years, the sovereign investment funds will exceed in value to official reserves worldwide (Morris, 2010).

[*] *Head of Training Unit, Romanian Court of Accounts.*

Fig.1 Comparative evolution of the sovereign funds and of the official reserves



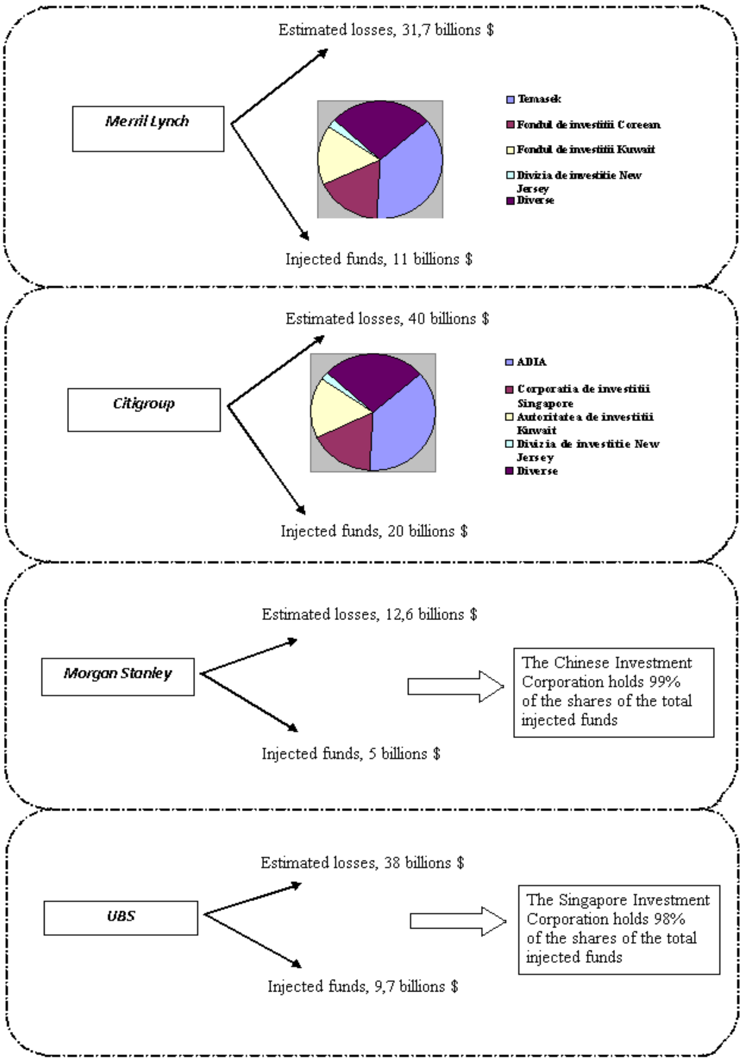
Source: Morgan Stanley investment bank report, May 2007

The sources of the sovereign investment funds consist in the reserves of the central banks (case of China), in the reserves for pensions (Norway), or the income from raw materials (Norway, Russia, Qatar); these sovereign investment funds are private funds under the control of the government, with the purpose to invest the surplus of reserves of the state. They are almost always located outside the official financial institutions, free from the investment limitations enforced on the official reserves.

2. The sovereign investment funds within the context of the global economic crisis

The sovereign investment funds used the opportunity of the global economic crisis to inject liquidity in some banks, companies and economies. Of these, one may notice the funds of the countries obtaining substantial incomes from oil, or of the large exporters, such China. As significant amounts of capital build up in these countries due to the favourable international trade flows, it was only natural for them to establish sovereign investment funds.

Fig. 2 Sovereign funds injected in the largest investment banks in 2008



Source: O'Brien, J., 2008, "Barriers to entry: Foreign direct investment and the regulation of sovereign wealth funds", 42 International Law, 1231

Previously to the global economic crisis, the activity of the sovereign investment funds was worrying the targeted countries, which feared of the political influence of the investment funds. The sovereign funds persist in a low transparency in terms of the amount of investment and losses, of their investment strategy, or their institutional mandate.

This attitude persisted throughout the economic crisis, but the sovereign investment funds have sizeable amounts of liquidities available for the targeted countries, and this is very desirable for these countries (Georgescu, 2012), more so as the sovereign investment funds usually invest on the long term and also display a tendency to overpay.

Relying on the national government, the sovereign funds have been outstandingly resilient to the effects of the crisis and to the significant losses incurred during it, assisting banks such as Citigroup, Morgan Stanley and Merrill Lynch, even if they sustained major losses, including for some of the corporatist acquisitions.

Owning larger assets than the private equity companies, financial funds larger than all the hedging funds worldwide and growth perspectives for their funds due to the increasing prices for commodities and energy and due to the larger trade imbalances between the West and East, the sovereign investment funds represent an increasing segment of the global financial sector.

The first sovereign investment fund was the Kuwait Investment Authority, established in 1953, to develop the local economy with the surplus from the oil trade. It belongs to the type of investment fund oriented towards the development of the national economy. Before the crisis it was worth 300 billion USD. Later, in 1956, the Revenue Equalization Reserve Fund was established, in which Kiribati deposited 400 million USD (450% of the GDP), obtained from the trade in guano (sedimentary bat excrements). The largest sovereign investment fund worldwide is the Abu Dhabi Investment Authority, established in 1976, with a value of 850 billion USD when the crisis started.

Using their trade surpluses, oil exporting countries such as Kazakhstan, Bolivia, Nigeria, Azerbaijan and Angola, are in different stages of establishing sovereign investment funds. In 2008, Saudi Arabia established the Public Investment Fund, with independent management, after it had previously administered 450 billion USD worth of surpluses from oil trade through a division of the central bank.

China has several hundred billion USD in several sovereign funds, the most known ones being SAFE Investment Corporation and China Investment Corporation, which invested in companies and assets considered critical by other states.

The western states too developed sovereign investment funds; however, they are fewer in numbers and have lower values because of the lower trade surpluses of those countries and to the more profitable internal investment opportunities. One of the outstanding sovereign funds is Norway's Government Pension Fund, Worthing 400 billion USD, third fund worldwide in terms of size. It was established in 1990 under the authority of the Parliament, for the profit of the state-owned oil company Statoil. The purpose of the fund is to ensure the future expenditure with the pensions; it is noted for its transparency and efficiency, while Norway is just on the 13th position in terms of crude oil reserves.

Of the funds characterised by transparency and which have a favourable political image, the Alaska Permanent Fund and the Alberta Savings Heritage Trust, stand out, their areas of operation having large crude oil extraction operations. In Asia, the Government Investment Corporation (established in 1981) and Temasek Holdings (established 1974) from Singapore, although they are not noticed for their transparency and governance, are highly efficient.

The sovereign investment funds are extremely different; they have different sizes and cannot be assigned to any particular typology, the classifications being vague and relying merely on the stated or perceived purpose of activity.

As types of sovereign funds, the most simple are the stabilization funds, whose purpose is to support the anti-cyclic economic policies. They store surpluses during the periods of growth, as state bonds, which are very liquid, and which can be sold instantly if necessary, during periods of crisis. Thus, in the oil producing countries, the sovereign funds gather assets during the periods when the energy prices are higher and supplement the revenues to the state when the prices for energy are lower. Such funds are easy to run and easy to liquidate, which is an advantage under conditions of maximum lack of transparency. Such examples are the sovereign fund of Kiribati Republic, the Russian sovereign fund Oil Stabilisation Fund, the sovereign Economic and Social Stabilization Fund from Chile, and the Investment fund for macroeconomic stability from Venezuela. The operating rules of the sovereign investment funds are very heterogeneous: some observe transparency and responsibility, while others have a lower responsibility and a higher opacity.

Fig. 3 ***Classification of the sovereign investment funds***

1. ***Stabilization funds***, whose role is to protect the budget and the economy against fluctuations in the price of commodities;
2. ***Savings for the next generations***, to stimulate the conversion of goods that cannot be renewed within a diversified portfolio of commodities;
3. ***Corporations for investments in reserves***, in which the goods are treated as belonging to the reserves and are established with the purpose to enhance their profitability, although they run higher risks;
4. ***Development funds***, established with the purpose to finance the socio-economic and infrastructure projects;
5. ***Contingent pension reserves***, established in order to finance the social security and to cover the health care expenditure.

Another type of sovereign funds is represented by the saving funds which invest in the national wealth, with the purpose to distribute it subsequently (such as Norway).

The purpose of most numerous sovereign funds is strategic development. They buy companies from key-industries, open branches in the country of the sovereign fund and/or make know-how and technology transfer, encouraging sometimes the development of the local industry by transfer of production capacity. China does such operations. Thus, the disastrous investment in the Blackstone investment fund (2 billion USD losses shortly after 3 billion USD investments) aimed not only to make profit, but also to make know-how transfer in assets management, risk management and in other categories of financial expertise. Singapore is another state that uses sovereign funds for strategic development purposes. It invested aggressively in telecommunications and banking through the Temasek sovereign fund. Saudi Arabia and Qatar invested in agricultural land and in food industry, with the purpose to ensure their food security. China directed its investments towards the supply of raw materials (in Africa and South America) or in controversial commodities (arms, military technology, nuclear fuel). The states have several sovereign funds, diversified according to their purpose. Thus, Abu Dhabi Investment Council invests in high-tech industry which it brings to the emirate, the Government Investment Corporation from Singapore invests in financial assets, Temasek sovereign fund from Singapore invests in strategic industries, while the Kuwait Investment Authority is a passive holder of portfolios.

Another type of sovereign funds develop sovereign wealth enterprises which act towards a particular purpose in a particular field, in order to avoid publicity and the limitations imposed to the sovereign investment funds by their initial mandate. Such example is the Qatar Investment Authority which owns Hassad Food, which makes strategic acquisitions in the food industry.

3. The continuous ascension of the sovereign investment funds

The proportion of the sovereign investment funds within the global finances is likely to increase. By their value, they are significant for the system as a whole because they are fuelled by the high commodity prices and by the long-term disequilibrium of the trade balances, by their goal of national development and of getting maximal political, social and economic benefits for the whole country. Thus, despite the major losses due to the crisis, the holder states continued their support, the cumulated economic influence of the profits leading to the development of political power within the context of the global need for investments.

The rise of the sovereign investment funds highlights the institutional and absorption deficit of the domestic economies of those countries. Thus, the Abu Dhabi Investment Authority stated that no accomplished investment will be used as instrument of foreign policy. In order to alleviate the adverse publicity, some sovereign funds associate in investments with other sovereign funds that have a better reputation (for instance, CIC invested in natural gas in America, next to investment funds from South Korea and Singapore).

Concerns were noticed for the reform of the system to make it more transparent. Thus, the Santiago Principles adopted in 2008, under IMF aegis, by 26 sovereign investment funds, include 24 recommendations among which observation of the transparency rules of the host country where the investment funds do business. However, the observance of these principles is voluntary and there are no penalties in case of breach of the principles. Under these circumstances, there are sovereign funds with assets worth of hundred billion USD which publish no kind of information, not even annual reports. These faults are presently overlooked because these investment funds are necessary to the global community.

Within the context of the crisis, some sovereign investment funds acted with caution. For instance, Temasek, with an excellent reputation, invested in two companies of mobile phones in Indonesia, during the Asian crisis, using a local partner, buying minor packages, staying out of management and avoiding flame up the local nationalist feelings.

4. Future evolutions in the perspective of 2030

Due to the heterogeneous character of the sovereign investment funds, their future evolution displays different priorities, methods and levels of transparency. Owning assets worth of trillion USD, the sovereign investment funds accumulate interests in purely private companies by transborder investments; this will probably cause protectionist bursts of the states within the context in which, for the first time since the 15th century, the western states are likely to yield their power challenged by the ascension of the emerging powers.

Having as main finding the decline of the West (Anghel, 2013), the January 2013 strategic report of the National Intelligence Council (NIC), the American bureau of geopolitical and economic forecasting, „Global trends 2030 – alternative worlds”, shows that although the USA will remain one of the main world powers, they will give up the economic hegemony in favour of China. Within the new, multipolar world, in which the regional poles will be China, India, Brazil, Russia and South Africa, China will dispute its international supremacy with the USA and its historical allies – United Kingdom, France, Germany and Japan. In 2030, the proportion of the western states within the world economy will shrink from the currently 56% to just 25%. Therefore, the West will lose its economic dominance, and one of the main consequences will be the lack of financial means for the world military supremacy, structural change that will be worsened by the deep present economic crisis. During the Asian era, a strong China will lead the triumph of Asia, stronger than the USA and Europe together in terms of the population and GDP, of the military expenditure and technological investments. The report shows the prominent place of the USA, which has energy independence due to the schist gas and oil. In 2020, the USA might become the number one world producer of crude oil, outdoing the current world leader, Saudi Arabia, and this might shatter the power relations.

The mentioned CIA report considers that the crisis will last at least one more decade in Europe, until 2023, showing uncertainty about EU cohesion.

The report confirms the emergence of China as the second world power and its soon ascension to the top position. The report also states the simultaneous rise of the BRIC countries (Brazil, Russia, India and South Africa) on the second position and their direct competition with the former dominant JAFRU countries (Japan, Germany, France and the United Kingdom).

It also shows the emergence of several intermediary powers on the third position. These are countries that display demographic and economic growth and which will become regional hegemonic poles that will likely cluster in a group with world influence – CINETV (Columbia, Indonesia, Nigeria, Ethiopia, Turkey and Vietnam).

It seems that by 2030, when the most populated countries will be India and China, with Russia on the 10th position, within the new international system, the largest communities will no longer be states, but reunited communities interconnected by the internet and social networks, having a decisive influence in the world policy.

5. Conclusions

The foreign trade balances of the emergent countries (huge surpluses) turned the sovereign investment funds into first grade investors; the governments that have at hand huge amounts of money became influential players on the financial markets through these sovereign funds, and the political component is often there too. The strong ascension of China and of other emerging economies has a decisive contribution to the revival of the world economy, according to OECD.

The economic crisis which started in 2008 prompted the sovereign investment funds to take active position on the financial markets, contributing by their massive interventions in support of the European and American banks, to the relief of the world economy, according to the data centralised by the Sovereign Wealth Fund Institute, independent organisation which monitors the activity of the sovereign investment funds.

There are both economic and political consequences of the consolidation of the sovereign investment funds; they influence the substantial change of the world power balance within the emerging new political and military multipolar world, with a significant increase of the interdependence between the national economies. Drive of the global economy growth, China will outgo the USA by 2030, while by 2050, the GDP of China will amount to 70,000 billion USD, twice the American GDP of that time.

Standing out as the new extremely competitive pole of the world economy, with an irresistible growth of the economic, financial and military power (by 2049 it will be the main military power in the Asia-Pacific region) (Beech, 2013), with an active diplomacy and displaying the will to grasp all available resources, emerging superpower, China fascinates, worries and disturbs, while exerting an increasing influence on the phenomenon of globalization towards the great convergence, as fundamental change of the world whose balance of power shifts towards the East.

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