Sovereign Wealth Funds and Long-Term Development Finance: Risks and Opportunities

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Rapid growth of SWF assets

Aggregate Sovereign Wealth Fund Assets Under Management ($ tn), 2008-2015

Source: The 2015 Preqin Sovereign Wealth Fund Review
**SWFs: Strong growth during high oil prices**

- SWF holdings total about $6.35 trillion
  - Over 3 times Africa’s GDP
  - $3.8t from oil, gas, $2.5t from other
  - Only $500 billion in 1990: 20% annual growth
  - Major funds include China/HK ($1.7t), UAE ($1t), Norway ($893 bill.), Saudi (773 bill.), Singapore, Kuwait, Qatar…

- In Africa:
  - Algeria ($77 bill.), Libya ($66 bill.), Botswana ($6.9 bill.), Angola ($5 bill.) Nigeria ($1.5 bill → 5 bill.), Senegal (non-commodity), Gabon, Ghana, Eq. Guinea…
SWFs: Original Purpose

- Saving oil, gas, mining revenues abroad
- Stabilization, isolate economy from price shocks
- Reduce risks of inflating asset bubbles and exchange rate appreciation (Dutch disease)

- Traditionally, domestic spending of oil/mineral revenues only through government budget

- SWF direct domestic investment can exacerbate risks of Dutch disease, asset bubbles, volatility. How to address this?
* Traditional: Invest in liquid high-quality foreign financial assets

* Shift to wider range of investments: emerging markets
  * Infrastructure investment by SWFs: 56 percent of funds invest in infrastructure (Prequin, 2012). Mostly foreign infrastructure, brownfield, low-risk, high-return, Europe, Asia

* Motivation for investments: commercial
  * SWF’s portfolio optimization strategies like private funds
  * Yet are public investors: can be subject to pressures
At least 14 existing SWFs include domestic development objectives:

- several established since 2005, mostly resource-based:
  - Abu Dhabi, Angola, Bahrain, Kazakhstan, Malaysia, Nigeria, Russia, United Arab Emirates

* Discussed by several other resource-rich countries:
  - Tanzania, Uganda, Zambia, Colombia, Sierra Leone, Republic of Congo
  - These may not be the largest funds but they open up new possibilities for investments in Africa, and also raise some new questions.
Abu Dhabi Investment Council (est. 2007):
- “To increasingly participate in and support the sustainable growth of the Abu Dhabi economy”.

Kazakhstan, Samruk Kazynah (est. 2008):
- “To develop and ensure implementation of regional, national, and international investment projects”.
- “To support regional development and implementation of social projects”.

Nigeria Infrastructure Fund (est. 2011):
- “To invest in projects that contribute to the development of essential infrastructure in Nigeria”.

Macro-fiscal risks

- Unlike pension funds, revenues are generated from exports, potential effect on exchange rate, Dutch disease (same effect if expenditure through gvt. budget)

- Procyclical investments may exacerbate macroeconomic volatility

- Risk of inflating asset bubbles (real estate)
Opportunity Fraught with Risks: Government Budget

Potential duplication of national budget

- Relationship of SWF to the national budget process and procurement systems of sector ministries
- Could be used to bypass parliamentary scrutiny of spending
- May undermine quality of public investment and wealth (savings) objectives of the SWF
Opportunity Fraught with Risks: Accountability

- Basic conflict of interest: fund owner (government) is also investment promoter
- No direct accountability outside government

- Funded by resource revenues, does not need to raise funds in financial markets
- Unlike pension funds, not accountable to contributors
- Not funded by tax revenue, not directly accountable to taxpayers
- Vulnerable to political interference
- Risk of low-productivity, “white elephant” projects
Why Invest Domestically through a SWF?

* If SWF is able to operate as an expert investor can function as anchor investor to share risk and crowd in other investors to critical infrastructure and other productivity-enhancing investments

* Some argue: should never invest at home

* But its happening anyway........

* And other strategies are not risk-free either
  - Savings funds can be raided,
  - Budget spending might have little oversight
As an expert investor
- Sharing of risk with private investors
- May crowd in private investment to projects that would otherwise not be bankable but have an important development impact

Innovative PPP arrangements (infrastructure)

Bring in external specialized capacity
- Where necessary may boost its capacity by involving foreign majority investors to strengthen investment discipline
Dual trigger: commercial financial return and development impact
  ➢ Otherwise fund management unaccountable - development impact hard to measure. Non-commercial investments through gvt. budget

Competitive investments
  ➢ Domestic allocations should compete with return on foreign assets, rather than fixed portfolio share for domestic investment

Pooled Investments
  ➢ With private investors, other SWFs, IFIs
  ➢ To bring additional expertise and integrity
  ➢ Only minority stakes by domestic SWF

Strong corporate governance
  ➢ Independent board, professional staff, transparent reporting, independent audit
Thank You!

Link to paper:


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