Sovereign Development Funds and the Shifting Wealth of Nations

Salzburg Global Seminar

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A fundamental shift

- Emerging economies are returning to their historical position in the global economy - a rebalancing of the wealth of nations.

- “Decoupling” is no longer an appropriate concept, since the Centre is no longer the Centre, and the Periphery no longer Periphery.

- Sovereign Wealth Funds are at the heart of this process.

Joaquín Torres García
América Invertida, 1943
<table>
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<th>Sovereign Wealth Funds in the global shifting of wealth</th>
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<tbody>
<tr>
<td>2</td>
<td>New investment drivers in the emerging world</td>
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<tr>
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<td>Sovereign Development Funds?</td>
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Emerging economies have enhanced growth over recent years...

Emerging and developing countries’ contribution to global GDP growth

U.S. Dollar and Commodity Price

Source: OECD Development Centre, 2008.
...the trend is likely to continue in the short run

World Growth Prospects – 2008

Emerging Markets

OECD

Source: OECD Development Centre, based on IMF and Economist Intelligence Unit
Emerging markets continue to accumulate foreign reserves...

Source: OECD Development Centre, based on Economist Intelligence Unit
.. creating significant surpluses...

Source: OECD Development Centre, based on IMF and Central Banks
## Sovereign Wealth Funds (SWFs) by origin, 2008

<table>
<thead>
<tr>
<th>Region</th>
<th>Number</th>
<th>Total assets (USD bn)</th>
</tr>
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<tbody>
<tr>
<td>Middle East</td>
<td>7</td>
<td>1,533</td>
</tr>
<tr>
<td>Asia</td>
<td>9</td>
<td>867</td>
</tr>
<tr>
<td>OECD</td>
<td>10</td>
<td>489</td>
</tr>
<tr>
<td>Russia &amp; Central Asia</td>
<td>4</td>
<td>177</td>
</tr>
<tr>
<td>Africa</td>
<td>7</td>
<td>109</td>
</tr>
<tr>
<td>Latin America</td>
<td>4</td>
<td>23</td>
</tr>
<tr>
<td>Pacific islands</td>
<td>6</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>47</td>
<td><strong>3,194</strong></td>
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Source: OECD Development Centre, estimation based on Deutsche Bank
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Emerging economies have become major actors in mobilising capital.

Outward Foreign Investment from Emerging Countries

Outward Foreign Investment by country 1999-2007

Note: Emerging countries refer to Latin American and Asian only.

Source: OECD Development Centre 2007, based on Thomson Datastream (Economist Intelligence Unit).
Sovereign funds' assets in perspective: small in one respect....

Source: OECD, Deutsche Bank, 2008.
... yet fast becoming heavyweights as an asset class

Financial institutions’ total assets, 2007

Source: OECD, Deutsche Bank, 2008.
Sovereign fund investment is shooting up

- Currently, global equity funds invest 7-10% of their equity investments in Emerging Markets.

- If SWFs invested along a similar allocation, they would already account for a large part of the inflows to emerging economies.

- SWFs, themselves based in emerging countries, might be more willing to invest in other emerging countries.
with the potential to reach USD 1.4 trillion to emerging markets over the coming decade

Emerging market investment potential by SWFs

- SWFs total assets
- Potential 2018 SWF flows to EM
- United Arab Emirates: ADIA
- Norway: Pension Fund Global
- Potential current SWF flows to EM
- Singapore: GIC
- Kuwait: KIA
- China: CIC
- Russia: Stabilisation Fund
- Singapore: Temasek
- Development Aid DAC donors

- Allocations from Sovereign Development Funds to emerging and developing countries could generate inflows of over $100 billion/year over the next 10 years
- With such huge potential flows, it is critical to address SWF impact on developing world early on.
- SWFs sheer size has the potential to dwarf ODA flows to developing world

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Emerging markets have proven resilient to shocks more than ever before

Three key differences:

1. Real wage rigidities have decreased

2. Monetary policy: Stronger commitment of central banks to control inflation (i.e. inflation targeting)

3. Share of oil in the economy has decreased substantially

SWFs are well adapted to investing in emerging regions

• Sovereign funds seeking higher returns will find fast growing emerging markets attractive

• Emerging market SWFs seem like ideal investors for developing countries: long-term (not short-term speculators),

• Geographical, language and “familiarity effects” could mean lower information asymmetries for emerging market investors.

• If Developed country protectionist urges solidify, this may drive EM SWFs further into developing regions.

• Timing is felicitous: many African / Emerging Market countries have considerably improved governance & investment climate over recent years (16 functioning stock markets in Africa today – 5 in 1980’s)
SWFs investments are becoming increasingly present.

Major FDI location of Sovereign Wealth funds

...their investments start to diversify by industry and location

FDI location of Sovereign Wealth funds – An Estimation

Geographical estimation of M&A by SWFs
2007

United Kingdom
United States
Germany
Taiwan
Tunisia
Other Developing
Other Developed


Industry Investments of SWFs

- Transport, communications
- Finance
- Hotels and restaurants
- Business activities
- Vehicles and transport eq
- Chemical
- Primary
- Others

Note: Data based on cumulative investments (M&A) only. See UNCTAD (WIR), 2008.
Information Asymmetries

• What information? Accounting practices, corporate culture, political events, the structure of asset markets and their institutions.

• Market participants do not share the same information. Emerging SWFs have experience, firsthand knowledge of emerging countries institutional and infrastructure shortcomings.

• → they are themselves from an emerging investor universe and have historical informational/network advantages (Gulf states in North Africa, Indians in East Africa, Chinese in South-East Asia, Russian in Central Asia)
Sovereign Wealth Funds signal a major reshaping of the world’s economy. They may grow to become key actors of development finance: Sovereign Development Funds.

If SWFs were to allocate 10% of their portfolio to other emerging and developing economies over the next decade, this could generate inflows of USD 1 400 billion.

The international investment of sovereign funds is already increasing. Domestically, they are development finance institutions. Abroad, they seek performance and returns.

Collaboration and peer-learning between different actors can be promoted.
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ANNEX
Case Studies: what’s going on in Asia and the Middle East?

Increasing regional exposure for Asian and Middle Eastern funds

- **Temasek (Singapore)** → Asia represents 40% of its portfolio, including ICICI Bank, Tata Sky, Tata Teleservices, Mahindra & Mahindra.
- **Gulf SWFs are increasing their exposure to Asia**: targeting 10-30% of total portfolio towards Asia
- **Kuwait Investment Authority** → $750 billion stake in Industrial and Commercial Bank of China.
- **Qatar Investment Authority** → Stake in Industrial and Commercial Bank of China
- **Dubai International Capital** → 30% of portfolio to allocated to Emerging Asia. Early 2008 announced that will invest $ 5 billion in China, India and Japan. Also
- **MENA Infrastructure Fund** (‘MENA IF’), a US$500 million sector-specific fund targeting investment opportunities in infrastructure projects in the MENA region