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POST EVENT REPORT

The Challenges & Opportunity Facing Sovereign Wealth Funds In MENA

The Future of Banking, Finance & Monterey Policy Program (FBM)

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Overview: *A discussion on The Challenges & Opportunity Facing Sovereign Wealth Funds in MENA was held recently. Experts addressed MENA region's sovereign wealth funds seek to diversify their investment portfolios, and the geopolitical context between China and the US will impact their investment strategies. It is emphasized that most economic engagement between entities in the Middle East and Chinese counterparts is expected and permissible and doesn't fall into the very controversial category of ties and relations. Sovereign wealth funds can collaborate and contribute to the broader foreign policy picture that seems to be emerging within the region. Therefore, MENA's sovereign wealth funds must continue diversifying their investment portfolios while considering the geopolitical context in which they operate.*

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1. INTRODUCTION

DUBAI, April 10, 2023 – The Center for the Study of Global Economic Future hosted an interview with Dr. Robert Mogielnicki, Senior Resident Scholar at Arab Gulf State Institute Washington and author /editor of the Book 'The Political Economy of Sovereign Wealth Fund in the Arab Gulf (under edition) . Dr Robert was interviewed as a part of CSGEF Interview with Author series and an initiative of The Future of Banking, Finance & Monterey Policy Program (FBM). The event aimed to congregate 'the challenges and opportunities facing sovereign wealth fund in MENA region'. Dr. Robert Mogielnicki, interviewed by Renny Castaneda, Professor at the College of Security and Global Studies, American University of the Emirates. Mr. Mahmood Sharif, the Managing Director of CSGEF, attended the interview. The event provided high-quality content to suit a diverse range of audiences. It was a perfect platform to discuss the developments in MENA's Sovereign Wealth Fund industry.

2. Introductory Remark

In his welcoming address, Mr. Mahmood Sharif, the Managing Director of CSGEF opined that the impact of the financial sector on economic growth is significant, and the opposite is equal. The financial service industries constitute at least 20% of the global economy GDP, around 23 trillion in 2023. With a compound annual growth rate CAGR of 9.9%, the prospect for global investment and finance may be undermined due to various challenges, such as poor governance, food and fuel crisis, financial crisis, post-COVID-19 pandemic, and climate disruptions, weakening economic output, and rising inflation, among others.

However, the International Forum of Sovereign Wealth Funds reported a 50% increase year-on-year in 2021, and a 60% increase in the number of direct investments made by sovereign wealth funds in the previous five years. However, 2022 was a bad year for most sovereign wealth funds, with losses of around $1 trillion due to interest rate hikes and central bank responses to cool down inflationary pressures. The upcoming recession of 2023 is also a driving force in the industry. The regional focus of SWFs differs depending on the preferences of the top 10 investors, with most funds focused on investments in North America, followed by Europe and emerging markets. He also mentions concerns about national security implications for SWF investments, as some concerns have been raised about how SWF investments could affect the national security of the recipient economies.

The interview addressed the regional focus of SWFs, which differs depending on the total investor's preference. Most funds focus their investment in North America, Europe, and emerging markets. The future of SWFs in the MENA region was also discussed, highlighting the challenges and opportunities in the region.

The interview identified the challenges facing SWFs in the MENA region, including the impact of rising interest rates, the central bank's role in cooling down inflationary pressures, and the impact of the upcoming recession. The interview also highlighted the opportunities for SWFs in the region, including investing in basic infrastructure, human capital, institutions, and supporting the country's economic strategies and development plans. U.S. companies.

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Geo-economics & Sovereign Wealth Funds

Dr. Robert explains that we live in a volatile world, which has created extreme volatility, risks, and opportunities for sovereign wealth funds. The challenge is to manage the volatility within the region and internationally so that the funds can take advantage of opportunities and not snuff out. Dr. Robert commented on the risks and rewards associated with investing in emerging markets, such as India, and the importance of transparency and access to information for investors. He also touched on sovereign wealth funds, primarily those in oil and gas-exporting countries, and the correlation between their size and oil and gas resources. Additionally, He addressed the organic growth of sovereign wealth funds and the importance of realized return on investments and capital influxes. However, Dr. Robert said that it's unlikely for sovereign wealth funds to become a fully sustainable funding mechanism for countries, and used Norway's sovereign wealth fund as an example, which contributes only 25% to the country's budget despite being one of the largest sovereign wealth funds in the world.

Moreover, Saudi Arabia is strongly promoting domestic development and its sovereign wealth fund, the Public Investment Fund, is a key player in this effort. The UAE has multiple sovereign wealth funds, which allows some funds to be more conservative in their investments, while others can be more experimental. On the international level, the big risk for sovereign wealth funds is their exposure, and the traditional safe, conservative approach was to diversify away from oil and gas.

Dr. Renny Castaneda described the BRICS (Brazil, Russia, India, China, and South Africa) countries as emerging economies with high growth rates and large populations, making them attractive destinations for investors willing to tolerate a level of risk. Dr. Robert emphasized that while these countries may not offer traditional investment mechanisms, looking beyond the traditional asset in the West is worth considering on a conceptual level.

It is believed that having a policy coordination center that focuses on spending policies and allocating government resources, particularly in the case of Saudi Arabia, makes sense to ensure coordination and collaboration among different entities and projects. Dr. Robert highlights the importance of clear demarcation between the Saudi government's official budget and the sovereign wealth fund portfolio to reduce uncertainty for investors and make it easier to determine how spending is allocated across the country.

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Moreover, it is crucial to have clear guidelines on the relationship between the state and sovereign wealth funds and to ensure that investment committees' advice is followed without undue political influence. Additionally, the importance of measuring the returns on investment and being transparent about the sources of growth in sovereign wealth funds should emphasized. Overall, support the idea of a spending efficiency center that creates better coordination and alignment between different entities and activities in the Saudi government.

Dr. Robert brought Asian case studies alongside Middle Eastern cases because of the different models of sovereign wealth funds that allowed those funds to grow. As such, China has very lucrative trade exports that they deposit into their sovereign wealth fund from trade surpluses with global partners. Meanwhile, Middle Eastern countries have grown their sovereign wealth funds from hydrocarbons. While the geopolitical contest between China and the U.S. could impact Middle East sovereign wealth funds, most economic engagement between entities in the Middle East and China is expected and permissible. It does not fall into the controversial category of ties and relations. Economic engagement between the Middle East and China is not a serious concern for government officials in the U.S. Additionally, Middle Eastern sovereign wealth funds are expected to have a diversified portfolio. Diversifying investments in Asian markets is part of a broader foreign policy picture that acknowledges the Middle East region as an increasingly multipolar.

Dr. Renny Castaneda acknowledged the accuracy of this distinction, particularly in the GCC region, and highlighted the difference between political economies and investment returns behind the figures of sovereign wealth funds. He also discussed the outlook for upcoming commodity versus non-commodity-based sovereign wealth funds in the MENA region and how the region should focus more, considering how the market sector is reconfiguring in the coming years.

The Speakers discussed the MENA region's sovereign wealth fund strategies in the context of the China-US tensions. They noted that while most economic engagement between entities in the Middle East and Chinese counterparts is expected and permissible, the geopolitical situation affects the investment strategies of the region's sovereign wealth funds. The discussion highlighted the opportunities provided by non-commodity special bond funds, such as China's sovereign wealth funds, which could help diversify the MENA region's sovereign wealth fund investments.

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Additionally, the conversation touched on the MENA region's efforts to diversify its relationships and give due credence to various partners. The speakers noted that the region is not leaving or moving away from the US but ensuring that they have a diversified portfolio. Sovereign wealth funds can make a compelling case for diversification and collaborate, contributing to the broader foreign policy picture that seems to be emerging within the region.

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Economics, Market, & Corporate Dimension of SWF

Dr. Robert opined that sovereign wealth funds in the MENA region should primarily focus on oil and gas exports. Although these funds have financialized assets, most are built with the proceeds from hydrocarbon exports. They discussed the challenges investors face in emerging economies such as India, where there may not be enough safeguards or access to information and transparency to underpin their investments. However, the potential of these markets cannot be ignored, and sovereign wealth funds must carefully weigh the risks and rewards of investing in these markets.

Dr. Renny Castaneda's question about the role of sovereign wealth funds in an integrated fiscal and monetary policy framework, taking into account the strategic role of state-owned investment vehicles in the future of the region. Dr. Robert mentions that the most obvious link between sovereign wealth funds and fiscal policy is on the fiscal side. The big question is to what degree sovereign wealth funds are expected to support short-term fiscal needs and emerging fiscal dynamics in countries when economic times are tough. Dr. Robert points out that the pressure on sovereign wealth funds increases during tough economic times, putting officials in a tough spot. Suppose their mandate is to diversify their holdings away from the region as a hedge against commodity-based sovereign wealth funds and asset holdings. In that case, investing in the region or plug a budget shortfall becomes challenging.

Dr. Robert further states that the ultimate objective of sovereign wealth funds differs from country to country and depends on the type of fund. Some funds are established for specific purposes, such as a Future Generations Fund or a General Reserve Fund. However, the big question arises when a General Reserve Fund runs dry, and officials must address budget shortfalls. Some officials will argue that they have access to financial resources, so they should utilize them, while others will say that is not the purpose of the fund.

Dr. Robert uses the example of Kuwait, which had a General Reserve Fund and a Future Generations Fund. Kuwait was able to tap into the General Reserve Fund to support fiscal needs for some time. However, eventually, that fund ran dry, and the government had to work with the parliament to alter how the Kuwait Investment Authority conducted its business. The officials at the Kuwait Investment Authority did not want to do a big, massive U-turn and address needs that they believed were the government's responsibility to prepare and manage.

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This conversation sheds light on the importance of considering emerging economies and alternative investment opportunities beyond traditional assets in the West. Sovereign wealth funds must navigate the risks associated with investing in these markets, but the potential rewards cannot be overlooked. The MENA region should continue focusing on their primary commodities while considering other investment opportunities in emerging economies.

Furthermore, the speakers highlighted the different growth models for sovereign wealth funds. Investment capital in sovereign wealth funds originating from lucrative trade exports or trade surpluses with partners around the globe indicate different growth models

Furthermore, the speakers highlighted the different growth models for sovereign wealth funds. Investment capital in sovereign wealth funds originating from lucrative trade exports or trade surpluses with partners around the globe indicate different growth models In recent years, there has been a trend for sovereign wealth funds, particularly in the Middle East, to incorporate ESG frameworks. However, some argue that this trend has ebbed due to the perception that it is more of a box-ticking exercise than a genuine commitment to sustainability. While the principles of ESG are important and should be supported, it is crucial to be realistic about what sovereign wealth funds can accomplish. These funds cannot do everything, and it is essential to clarify their primary objectives. Sovereign wealth funds primarily derive their proceeds from hydrocarbon exports, which will eventually have diminishing returns. Financializing these proceeds and using them to create non-oil economies that are more sustainable in the long term is a good approach. However, it is important to recognize that sovereign wealth funds cannot accomplish every goal, and Dr. Robert commented that we should be realistic about what they can achieve.

He also added that a country's sustainable development should involve the sovereign wealth fund's returns from investments playing an increasingly important role in public sector revenues that are not primarily dependent on oil and gas exports. These funds should also support non-oil revenue streams, even indirectly, and play a vital role in supporting other non-oil industries. If sovereign wealth funds can accomplish these goals over the next two decades, they can make significant progress towards sustainability. However, it is essential to be realistic about their limitations and not make unrealistic claims about their abilities to achieve net-zero investments from hydrocarbon exports.

This interview can guide investors and financial institutions considering sovereign wealth funds and investment opportunities in emerging economies. By carefully weighing the risks and rewards, investors can make informed decisions leading to successful investments in these markets. The interview also highlights the need for transparency and safeguards in emerging economies to protect the interests of investors and promote sustainable economic growth. The interview concluded with Dr. Roberts advice on the strategies that should be implemented at the level of the United Arab community to better assess the challenges and opportunities facing SWFs in the region. Moreover, the interview provided valuable insights into the future of SWFs in the MENA region and their challenges and opportunities in light of the current economic and geopolitical climate.

The primary concern with sovereign wealth funds is their role in supporting short-term fiscal needs during economic hardship. When times are good, the expectation is that the funds will receive surplus funds from the government. However, the pressure on the funds to support the government's needs can be significant when times are tough. In some cases, countries have set up multiple funds with specific purposes, such as Future Generations or General Reserve funds. However, when these funds run dry, officials may be tempted to use the sovereign wealth fund to address budget shortfalls. The Public Investment Fund in Saudi Arabia is an example of a sovereign wealth fund attempting to do many things, but this may become more challenging during difficult economic times. Clarifying a sovereign wealth fund's primary objective may be necessary for its professionalization and to ensure it can effectively perform its duties.

The author concludes that the region's main challenge for sovereign wealth funds is finding the right balance between investing locally and internationally. Investing locally can directly impact the domestic economy, but investing internationally may offer more promising returns. The risk with investing locally is that decisions may be based on optimistic assessments of government visions and plans, which may not necessarily align with the interests of international investors. Ultimately, international investors are primarily interested in making a profit and will only invest if they see a viable and clear path to profits. So, the challenge for sovereign wealth funds is creating investment opportunities that can attract international investors while benefiting the local economy.

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About Us

Established in Dubai, UAE, in 2021, the Center for the Study of Global Economic Future (CSGEF) is a multidisciplinary policy research organization scrutinizing the economic, geoeconomics, socio-economic, and systemic forces that bear upon the future of the economic system worldwide. The aim is to offer an extraordinary methodical perspective on the socio-economic and systemic forces that sustain the global economy's future.

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