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Sovereign Wealth Funds: Between the State and Markets

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Sovereign Wealth Funds: Between the State and Markets is one of a series of books authored by three highly trained academics with professorial degrees in finance and economics: Adam D. Dixon (Heriot-Watt University), Patrick J. Schena (Tufts University), and Javier Capapé (Universidad Instituto de Empresa, or IE University). It is a free electronic book and available for download in OAPEN Library, sponsored under government grant from the European Union's Horizon 2020 research and innovation program. Readers can also buy the printed version at current market price provided by booksellers online.

Written in the style of a university-level academic textbook, there is no preface, but Acknowledgement and Introduction sections are featured.

The Introduction chapter offered an overview of topics – what, where, why, and how SWFs are being accepted as legitimate participants in global financial markets; their function as capital providers in these markets; and their contribution to both domestic and international economic growth.

The book's six chapters go in-depth into fundamental aspects of SWFs with debate about definitions; background of the establishment; the legitimization of state involvement in investment and global markets; the revelation of the reality of global financial giants; exposure of the purposes of SWFs as strategic development of the state; and the argument about the normalization of the state as a capitalist.

Readers who prefer just the key points can use the Notes page which simplifies the key points of every chapter.

The book cites mainly journal articles with limited references to publications like The Financial Times and The Economist, indicating that reference sources are evidence-based as well as empirical studies-based, and have been reviewed by experts in financial studies, and not just cited by unverified sources.

Initially, Dixon, Schena and Capapé (2022) define SWFs as state-sponsored institutional investors that operate independently as agents for the government, and invest based on the interests and mandates of the state. Thus, the authors do not define SWFs as signifying individual wealth.

The authors also portray that the state uses SWFs for financial stability and to ensure fiduciary obligations are aligned to stakeholders. The stakeholders are government, the citizens, the management, the investee companies, financial markets and global organizations like The International Monetary Fund (IMF).

The authors also describe SWFs as playing a significant role in a country's financial planning by:

- Alleviating balance of debt and credit payment pressures.
- Supporting domestic industries especially supporting investment state-owned enterprises (SOEs).
- Serving as a long-term savings vehicle for a state.

Moreover, the authors also explain the three taxonomies of SWFs which are :

- Commodity-based,
- Saving funds, and
- Strategic investment funds.

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The taxonomy of SWFs is used to explain how SWFs make investments across a range of asset classes in foreign and/or domestic assets, such as stocks, bonds, real estate, private equity, hedge funds, precious metals, and other alternative investments. Thus, there is extensive diversity of SWF characteristics in managing state capital.

Interestingly, in giving a description of the definition of SWF, the authors reject 1Malaysia Development Berhad (1MDB) as a good example, as it was fully controlled by one person – the Prime Minister of Malaysia – not a board. 1MDB was thus not functional as a Malaysian SWF as defined by the authors.

On the other hand, the authors thoroughly detail the historical context and development of successful SWFs in Chapter 2, emphasizing how globalization and financialization affect state intervention in the capital and investment markets.

Most of the historical descriptions of SWFs mentioned by the authors expose the reasons SWFs exist in new states after independence from colonial powers. There is also story telling about successful SWFs and the challenges faced through the establishment of the SWFs in new states before and after the World War.

There is an example stated in this book about the Texas Permanent School Fund (TPSF), created by the Texas state legislature in 1854. Initially seeded with only USD $2 million by the Texas state government from the revenues of land forfeiture following the state's annexation, the TPSF currently comprises more than USD$53 billion in assets. Hence, it is known as the effective model for providing funding for public primary and secondary education in the state of Texas.

Another SWF, the Kuwait Investment Board (KIB) was founded in London in 1953, when Kuwait was still a British protectorate and the British were in charge of overseeing the nation's growing oil resources. Currently, KIB has the mandate to invest surplus oil revenue and reduce Kuwait's reliance on a single finite resource. Consequently, the Kuwaiti Dinar (KWD) has held the title of the highest-valued currency in the world due to KIB's investment stability. After independence, KIB is now known as the Kuwait Investment Authority (KIA).

The authors highlighted that the 1990s were an important turning point for new states developing sustainable SWFs. There is also a brief story about how a financial market became global and expanded its investments abroad, even exceeding its investments domestically. Also highlighted is how the "Big Bang" happened, and the abrupt deregulation of the financial markets on the London Stock Exchange, and a long description about worldwide SWF operations during the ten-year period of major financial crises between 1997 and 2007, especially in Thailand, Malaysia, Indonesia and South Korea.

Additionally, this book identifies Norway's SWF as a great model, pointing out on how they successfully developed as one of the world's biggest investors. The Norway SWF, known as Government Pension Fund Global (GPFG) is the biggest investor in global markets comparable to Russia, Iran, Bahrain, Singapore and other Middle Eastern SWFs. Currently, GPFG has assets valued at more than USD$1 trillion. Norway's SWF has demonstrated the need to prioritize international investments for diversification, stability, and long-term wealth management.

The authors describe how states have legitimacy as investment actors in financial markets and their contributions to economic development both domestically and internationally in Chapter 3. This chapter explores the ways states react during geopolitical uncertainty as well as fierce financial market competition. Since the Unocal shareholder event in 2005 involving SWFs of the United States and China, competition in the capital market has become ambiguous.

Also mentioned is the disclosure of concerns about state surplus reserve management transparency. It appears that whenever surplus reserves are moved to a sovereign investment fund, there is a possibility that they become harder for a central bank, and especially bodies like the International Monetary Fund (IMF) and World Bank, to control, trackback, and stabilize the financial flows globally. Thus, it reveals the errors in financial reports.

For that reason, the authors are very keen to emphasize the importance of implementing the SWF governance framework known as the Santiago Principles. In this book, the explanation of the 24 Generally Accepted

Principles and Practices (GAPP) of the Santiago Principles is written at length to ensure the readers have a better understanding of the multiple dimensions of functional transparency and governance.

Starting from the legal framework, proper reporting of performance is clearly explained, based on real case scenarios that have happened in western countries. However, the number of SWFs (especially in Malaysia) that have agreed to follow the Santiago Principles protocol is not clearly indicated in this book. There are also no criticisms linking the Santiago Principles to threats to national sovereignty.

The authors' debate makes readers consider whether or not SWFs are the biggest investment agencies for their respective states, in Chapter 4. Readers begin to realize that SWFs actually have to compete with private giant asset managers as well as big publicly listed companies like BlackRock, Vanguard and State Street.

SWFs are struggling to consistently generate decent investment income, hampered by various forms of risk. The risks of climate change and natural disasters are among the worst that destabilise global economic and financial systems. Moreover, the risk of Covid-19 has shown that SWFs are struggling to invest and to spend for rescue efforts, obtain medical supplies, and correct budgetary imbalances caused by the pandemic and government lockdowns. Disruptive innovation is also a point of concern in the sustainability and growth of SWFs as powerful financial market actors.

SWF responsibilities as tools of strategic national development are revealed in Chapter 5. The SWFs are intended not only to focus on and sustain development, fund returns and growth investment in the domestic financial market, but also deploy capital, prioritize sustainable development, and contribute to long-term prosperity for the nation.

However, the authors point out a different story for 1MDB. 1MDB was tangled with financial scandals due to power abuse. They remark negatively, pointing to 1MDB's poor performance and strategic abuse as a financial tool, to pursue Najib Razak's political ambitions during the time he was Prime Minister of Malaysia.

This notwithstanding, the authors still have a positive perception of Khazanah Nasional Berhad, due to its consistently better performance in balancing risk and returns while benefiting domestic economies and societies. Khazanah Nasional Berhad has been successfully carrying out its responsibilities and mandate to protect national economic interests.

Besides Malaysian SWFs, the book debates the ways that the SWF of Timor-Leste (East Timor) replicates the Norwegian GPFG model, and the diversity issues among the SWFs of Singapore, Senegal, Kazakhstan, India and Ireland.

The authors repeatedly affirm that to ensure the sustainability of SWFs as successful tools of national development, continuously enhancing institutional quality is needed to fortify governance, taking lower sovereign risk, and boosting investment flows to critical industries and domestic infrastructure, to ensure national development goals are achieved.

The authors also try opening readers' minds to the existence of state capitalism, which SWFs are creating, particularly in new states, in Chapter 6.

They portray China as a new state using SWFs to maintain its dominant role as an owner or investor-shareholder, determining economic policy and influencing state-owned enterprises. Hence, China's increasing use of SWFs in the global political economy. However, there are questions whether Ireland and Norway are taking the same approach, or if they are making limited interventions in the capital market. The question is, to what extent should the state use SWFs to intervene in the capital market.

In conclusion, this book is relevant to anyone interested in global finance and economics as it shows that SWFs are helping to make nations wealthier and avoid falling into prolonged economic crisis. SWFs function as a buffer, balancing fluctuations in the capital market. Readers can also expect a better understanding of how SWFs offer insights into economic stability, diversification, and long-term wealth management. Individual investors or investee companies however, may find that this book only provides fundamental knowledge for portfolio diversification, and you may still need to seek other resources as a guideline when considering investment opportunities in SWFs.