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Souvereign Wealth Funds: Reality and Perspectives

Bagratuni Karina Yu.[1], Danilina Marina Viktorovna[2], Vanyurikhin Philip[3], Surkova Ekaterina Valerievna[4], Vanyurikhin Gennady[5], Panagushin Valery Petrovich[6], Karabakhtciev Segey[7] and Ermolaeva Elena Nikolaevna[8]

[1] *Ph.D., Associate Professor, Finance University under the government of the Russian Federation (Finance University), Moscow, Russia*
[2] *Ph.D., Associate Professor, Finance University, REU Plekhanov, Moscow, Russia*
[3,5,7] *Ph.D., RUDN, Moscow, Russia*
[4] *Ph.D. in economics, Associate Professor, Department Economy of Industry, MAI (Moscow Aviation Institute), National Research University, Moscow, Russia*
[6] *Ph.D. in economics, Professor, Department Economy of Industry, MAI (Moscow Aviation Institute), National Research University, Moscow, Russia*
[8] *Ph.D. in economics, Associate Professor, Department Economy of Industry, MAI (Moscow Aviation Institute), National Research University*

ABSTRACT

The article analyzes the current situation and the problems of the SWFs. More detailed is presented the functioning of the SWFs of Russia.

Keywords: SWFs, economy, Reserve Fund, National Welfare Fund, Russia, GDP.

Souvereign wealth funds (SWFs) are large institutional investors which can invest all over the globe. As shows Prabhod Mudlapur in his publication [1], for most countries, which have SWFs, the size of their SWF is appreciable to the size of their annual GDP, and in some case, a multiple of the same (see Table 1).

Table 1
Comparizon of the size of SWFs to their GDPs

SWF-holding states	*GDP(bil USD)*	*GDP Growth Rate % (2015-16)*	*SWF size (bil USD)*	*SWF-size to GDP as %*
Norway	376	1.6	885	226
China	391	6.9	2038	17
UAE	375	3.8	1262	336

(Contd...)

SWF-holding states	*GDP(bil USD)*	*GDP Growth Rate % (2015-16)*	*SWF size (bil USD)*	*SWF-size to GDP as %*
Saudi Arabia	673	3.5	736	109
Kuwait	110	1.8	592	538
Singapore	296	2	530	179
Qatar	156	3.6	335	214
South Korea	1466	2.6	108	7.3
Australia	1256	2.2	92	7.3
Russia	1276	-3.7	123	9.6

Source: [1].

Ten years ago SWFs of the Middle East and of the Northern Africa (MENA) werelarge investors, buying shares of companies and immobility. Over the past 20 years, as notes A. Amico in her publication [2], high revenues from the sale of hydrocarbons have allowed Middle Eastern sovereign wealth funds to multiply and grow. Some Middle Eastern SOFs are pure financial investors. Since many of them belong to state-owned enterprises, before becoming financial investors their portfolios tend to be diverse, and often include real estate and equity stakes of private companies. These assets also include large investments in advanced economies - a reality that has surprised financiers in Europe and the United States [2].

As notes A. Amico, in order to dispel fears about the possible political implications of investment, the International Monetary Fund convened 26 SIFs - more than 30% of them from the Middle East countries - to develop the "Principles of Santiago". The goal was to promote transparent and rational management of the SSC, in addition, the IMF wanted to make sure that they adequately take into account the investment risks, and also help maintain global financial stability [2]. But since 2008 the situation has changed significantly. During the global financial crisis, investment in fixed assets began to occur much less frequently, and efforts to ensure the transparency of sovereign funds and their accountability gave way to competition for their capital. Being far from the printing press, the SFB became recipients of financial resources aimed at stimulating investment in Europe.

At the same time, the Middle East SFF faced new constraints due to austerity of budgetary funds caused by falling prices for hydrocarbons. Governments largely abandoned the effort to divide sovereign funds into several "pockets" that would reflect various investment objectives [2].

As the largest public investors, the SFB should assume more responsibility for its investments. In fact, the only way for the SFB to protect wealth for future generations - the purpose for which they were created - is to really participate in corporate governance [2].

This advice would be useful for the souvereign wealth funds of Russia as well. The sovereign funds of Russia provided relatively painless passage of the global financial crisis of 2008-2009 and maintain economic stability at the present time. Because of this, their volume has significantly decreased. In December 2016, the amount of the Reserve Fund for the first time in its history fell below 1 trillion rubles. At the end of April 2017, it was 931.25 billion rubles or $ 16.34 billion, and in the National Welfare Fund - 4.1925 trillion rubles or $ 73.57 billion.

The law on the budget for 2017 assumes that the Reserve Fund will be completely exhausted this year and the government will switch to using the funds of the National Security Fund. To cover the budget deficit, it is planned to send 1,061 trillion rubles from the Reserve Fund and 663.5 billion rubles from the National

Welfare Fund [3]. But thanks to rising oil prices, the threat of depletion of the "airbag" has decreased. The reserve fund can be saved, and the NWF funds may not be needed. The condition for this is to keep the price of oil at $ 50 per barrel, as all additional revenues (over $ 40 per barrel) will be used to replenish the Reserve Fund.

Given the structure of investment of Russian sovereign funds without high oil prices, they will not be replenished [3]. According to the report of the Ministry of Finance, the volume of the Reserve Fund increased by $ 0.16 billion from January to April 2017, while in the ruble equivalent the volume decreased by 42 billion (from 973 billion rubles to 931 billion rubles). In other words, the income received from the placement of the Reserve Fund's funds in foreign currency accounts with the Bank of Russia does not compensate for the exchange rate difference from the revaluation of assets. About 40% of FNB funds are reserved for infrastructure projects (BAM, Transsib, etc.), projects of Rosatom, Russian Direct Investment Fund (RFPI). But in 2015 it was decided not to start financing new projects from the NWF. There is also the possibility of suspending financing of some of the projects already approved. At the same time, loans issued by the National Welfare Fund for projects bring 6.5% per annum in currency and 23.63% in rubles (data of the Ministry of Finance). The yield of US debt in dollars and the EU in euros is 1% per annum [3].

Table 2 presents the Details of the functioning of the National Welfare Fund of Russia in the beginning of its functioning and at the current stage according to the data of the Ministry of Finance of Russia.

Table 2
Details of the functioning of the National Welfare Fund of Russia

S.No.	*Indicator*	*January 2008*	*February 2008*
1	Volume at the beginning of the period	–	783,31
1.1.	Revenues	782,80	–
1.1.1.	Including the revenues from replacement	–	–
1.2.	Exemptions	–	–
1.3.	Exchange rate difference from revaluation of assets in foreign currency	0,51	–6,28
2	Volume at the end of period	783,31	777,03
2.1.	Including in percent of GDP	1,9%	1,9%
3	For reference:		
3.1.	The volume of the fund's assets at the end of the period (billion US dollars)	32,00	32,22
3.2.	Income from placement, credited to the federal budget	–	–
3.3.	Estimated amount of income from placement on accounts with the Bank of Russia at the end of the period	1,09	5,74
4	Currency structure of the fund's funds on accounts with the Bank of Russia at the end of the period (in the relevant currency) **		
4.1.	US dollars	10,42	14,31
4.2.	Euro	12,73	9,74
4.3.	Pound sterlings	1,39	1,62
4.4.	Roubles	–	–
5	Placed in other authorized assets at the end of the period	–	–
5.1.	Roubles	–	–
5.2.	Foreign exchange	–	–

(*Contd...*)

S.No.	Indicator	Май 2017	Июнь 2017
1	Volume at the beginning of the period	4 192,50	4 192,30
1.1.	Revenues	–	–
1.1.1.	Including the revenues from replacement	–	–
1.2.	Exemptions	–	–
1.3.	Exchange rate difference from revaluation of assets in foreign currency	–0,21	193,19
		4 192,30	4 385,49
2	Volume at the end of period	4,5%	4,8%
2.1.	Including in percent of GDP		
3	For reference:		
3.1.	The volume of the fund's assets at the end of the period (billion US dollars)	74,18	74,22
3.2.	Income from placement, credited to the federal budget	11,13	4,31
3.3.	Estimated amount of income from placement on accounts with the Bank of Russia at the end of the period	3,87	–0,62
4	Currency structure of the fund's funds on accounts with the Bank of Russia at the end of the period (in the relevant currency)		
4.1.	US dollars	19,40	19,40
4.2.	Euro	20,76	20,41
4.3.	Pound sterlings	3,83	3,83
4.4.	Roubles	–	–
5	Placed in other authorized assets at the end of the period	1 510,60	1 567,39
5.1.	Roubles	755,12	777,57
5.2.	Foreign exchange	755,48	789,82

S.No.	Indicator	Июль 2017	Август 2017
1	Volume at the beginning of the period	4 385,49	4 449,35
1.1.	Revenues	–	–
1.1.1.	Including the revenues from replacement	–	–
1.2.	Exemptions	–	–
1.3.	Exchange rate difference from revaluation of assets in foreign currency	63,86	–23,67
2	Volume at the end of period	4 449,35	4 425,68
2.1.	Including in percent of GDP	4,8%	4,8%
3	For reference:		
3.1.	The volume of the fund's assets at the end of the period (billion US dollars)	74,72	75,36
3.2.	Income from placement, credited to the federal budget	5,95	0,45
3.3.	Estimated amount of income from placement on accounts with the Bank of Russia at the end of the period	2,87	5,70
4	Currency structure of the fund's funds on accounts with the Bank of Russia at the end of the period (in the relevant currency) **		
4.1.	US dollars	19,40	19,40
4.2.	Euro	20,41	20,41
4.3.	Pound sterlings	3,83	3,83
4.4.	Roubles	–	–
5	Placed in other authorized assets at the end of the period	1 573,51	1 562,64
5.1.	Roubles	777,57	777,57
5.2.	Foreign exchange	795,94	785,07

Source: [4].

Good results in 2017 shows another SWF – souvereign wealth fund of Norway. The state pension fund of Norway (the sovereign investment fund of the country, formed on the basis of the country's oil revenues) in the first half of 2017 increased the value of its assets by 499 billion kroons (about $ 63 billion), which was the best result in its history. This is stated in the fund's message." The stock markets showed themselves this year especially well, so the fund's income in the first two quarters was about 6.5%. This gives a total of 499 billion kroons, which is the best semi-annual result in Norwegian kroons in the history of the fund, "said Trond Grande, Deputy Head of Norges Bank Investment Management. According to him, the record profitability is explained, first of all, by the huge amount of funds accumulated in the investment fund. By the end of the second quarter, the total value of the assets of the Norwegian sovereign fund exceeded 8 trillion crowns, or $ 1 trillion. By this time, 65.1% of the fund's total funds were invested in shares, 32.4% - in bonds, and the remaining 2.5% - in real estate [5].

For half a year, the Norwegian government withdrew 40 billion kroons from the fund. For the first time, the authorities of Norway unsealed their "kubyshka" last year, taking out 105 billion kroons from it. To date, the total value of the assets of the State Pension Fund of Norway is estimated at slightly more than 7.7 trillion kronor ($ 972 billion). Thus, for each Norwegian there is an average of about $ 181 thousand [5].

The central bank of the country and the Sovereign Fund now use a kind of index consisting of 23 currencies, but now it is planned to abandon it and use an index consisting of three major currencies: the dollar, euro and the British pound. While the decision is not made, the proposal is now being considered by the Ministry of Finance, but if approved, the document will be submitted to the parliament. If the decision is made, the fund will obviously start selling bonds of developing countries, as well as countries whose bonds are not nominated in the three currencies, including Japan [6].

According to the Financial Times, the fund will have to sell $ 140 billion of paper, of which $ 20 billion fall to Japan, $ 40 billion to the securities of developing countries. The sale will affect Russia. The share of ruble-denominated government bonds is 0.6% and is approaching $ 2.2 billion. Thus, GPFG is one of the largest holders of Russian securities: in total foreign ownership is $ 25 billion of bonds of $ 93 billion. It is also worth noting that in this case it is about investing in bonds. As for shares, in them the Sovereign Fund of Norway holds about 65% of assets and there is no question of reform of investments in this area [6].

The sovereign fund of Norway in the first half of the year earned a record profit. The fund's income for the second quarter amounted to 202 billion Norwegian kroner ($ 26 billion), for the first half-year - 499 billion kroons. The return on the fund's investments in shares was 3.4%, in bonds - 1.1%, in real estate - 2.1%. The largest positive contribution to the fund's profitability in the II quarter was made by investments in shares of Nestlé, Chinese Tencent and Swiss Novartis. The largest losses the fund suffered from investments in shares of General Electric, AT & T and IBM. The volume of assets of the Sovereign Fund of Norway as of June 30, 2017 was 8020 billion kroons ($ 1.01 trillion) [6].

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In order to conclude, the brief analysis of the activity of some SWFs show the diversity of their activity and existing problems. The difference in the activity of the funds is ion the dependance from the level of the development of the national economy and the internal and external problems of the country.

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