IDSA POLICY BRIEF

India Woos GCC's Sovereign Wealth Fund: Policy, Scope and Precautions

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In 2007, a small piece of research by Steven Jen generated ripples about the role and significance of Sovereign Wealth Fund (SWF) in the world of finance. The term SWF was coined by Andrev Razanor in 2005, and IMF defined it as "assets held by governments in other country's currency". Although, SWF has a history of more than half a century, it gained currency only since 2000. SWFs have been created by the governments for different motives. Based on the objectives of national governments, in its Global Financial Stability Report (2007), IMF has categorized SWFs into five different groups, namely, (i) Stabilization Funds; (ii) Saving Funds for Future Generation; (iii) Reserve Investment Corporate; (iv) Development Funds; and (v), Contingent Pension Reserve Fund. Records show that two-third of SWFs are held by the basic commodity exporting countries. Globally, SWFs are broadly managed by three entities – national governments, central banks and private investors. In the GCC, the lines between private and state are often times blurred. For instance, in the UAE, the DIC (Dubai International Capital) was established in 2004 and capitalized with $13 billion. There is some confusion about its status, given that it is a holding but at the same time owned by the ruler of Dubai. SWFs may be funded by forex reserves, commodity export (oil), earnings from privatization and fiscal surpluses. SWFs are characterized typically by: (a) high foreign currency exposure; (b) no explicit individual liabilities (unlike pension funds, for example); (c) high-risk tolerance; and (d) a

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long-term investment horizon, etc.

Size & Spread of SWFs

Evidence reveals that SWFs have made substantial progress both in terms of geographical reach and asset accumulation. For instance, in 1990, only a few SFWs were active with around $500 billion of assets in less than a dozen countries. But today their number has grown to approximately 35. Their assets swelled to around $2-3 trillion and they are doing business in more than 27 countries. Given the rate of growth, some studies have predicted that by 2012 SWFs would potentially grow to the size of $10-12 trillion. Steven Jen, an analyst in Morgan Stanley (2007), projected that the total size of SWFs could reach $12 trillion by 2015. Similarly, the projection made by Standard Chartered also prints to a similar figure, i.e. $13.4 trillion over the next decade. In terms of growth rate, Global Insight calculated that for three years in a row SWFs have grown 24 per cent annually and now their value exceeds $3.5 trillion.

Are the assets accumulated by the SWFs too hgh? A comparison with other traded assets reveals that the current assets of SWFs are higher than that of hedge funds ($1.7 trillion) and their predicted asset size by 2012 (i.e. $12-13 trillion) is equivalent to the size of the global pension fund ($15 trillion); and of the insurance stood at $16 trillion. However, in comparison to investment companies ($21 trillion), securities traded in dollar denominators ($50 trillion) and financial market assets ($190 trillion) it is quite low.

The growth pattern of SWFs depends on the source of their finances. Oil-based SWFs have shown a rapid trajectory of growth depending upon the international movement of petroleum prices. Whereas SWFs originating from emerging economies (of Asia) such as China, Singapore, Malaysia, South Korea, are driven by the quantum of foreign exchange they have built up, which have shown a tendency of gradual and steady growth.

GCC Based SWFs: Origin, Significance, Size and Spread

The GCC has the credit of establishing the first SWF in the world. In 1953, Kuwait established the Kuwait Investment Board “with the aim of investing the surplus oil revenue in order to provide a fund for the future and reduce Kuwait's reliance on its single finite resource." Since then and particularly after 2000, as evident from the table below, the region recorded one of the highest numbers of growth of the SWFs, totaling 15 in number, in the world. Their growth was largely galvanized by two developments that occurred gradually over a period: one, increased participation of new prosperous private investors as well as of state authorities aiming to diversify their resource-based economies by utilizing their huge surplus funds (oil wealth), which is cyclical in nature; second, Gulf investors gained greater confidence and maturity in financial dealings over time.

Capital Base of the GCC SWFs

As far as the estimation of the capital base of the GCC SWFs is concerned, it is not an easy task. Most SWFs are operating on a personalized and informal basis, and thus, their operations are not transparent. But there is one important source through which we can arrive at a fair estimate, i.e. oil revenues. The size of surplus oil revenue depends upon the level of oil prices. We know that oil prices started rising since 2003, from $27.69 a barrel in 2003 to $147 a barrel in July 2008. The quantum of surplus oil revenue also grew simultaneously. A simple aggregation of total capital of SWFs enumerated in the table leads us to a figure of $1.2- $1.6 trillion. Rapheali and Bianca (2008) put it around $1.5 trillion. Behrendt (2008) bifurcates the assets managed by the two agencies of the GCC; one by SWFs and second by the central banks. He estimates that SWFs own approximately $1 trillion and the central banks $460 billion, and the combined assets stand at around $1.5 trillion. If these figures are correct then SWFs managed by the GCC countries, including Iran, roughly account for half the total assets accumulated by the major SWFs of the world. Looking at future prospects, McKinsey estimates that the assets of GCC countries would grow to approximately $2.4 trillion by 2010 and $8.8 trillion by 2020, and this accumulated wealth will be invested through SWFs. If these projections are correct, then 66 per cent of wealth amassed by SWFs would belong to the GCC SWFs.

An intra-GCC comparison of the SWFs which are 15 in number (inclusive units are not counted separately), indicates that four of them, namely, UAE-based Abu Dhabi Investment Authority (AIDA), Saudi based SAMA (Saudi Arabian Monetary Authority), Kuwait Investment

Authority and the Qatar Investment Authority, control the lion's share, both in terms of capital base as well as geographical spread. Their combined assets account for approximately 85 per cent of the total GCC-based SWFs' assets. The UAE has the largest number of SWFs with the highest quantum of wealth in the GCC; its six SWFs control 49-56 per cent of the total assets managed by the fifteen GCC SFWs.

Oil prices fluctuated, the capital base of the SWFs also fluctuated. According to one recent work (March 29, 2009) "the global financial distress has inflicted heavy losses on state funds from the Gulf oil heavyweights and their assets are likely to erode further in 2009 because of low oil prices". The report further notes that "assets of those funds, especially the ADIA, had largely been overestimated and calculated its current capital assets below $300 billion." Similarly, the asset value of other major GCC SWFs like the KIA and the QIA are also overestimated. According to the same report 2006 and 2007 were the golden years for the GCC's SWFs because of high oil prices and strong global equity markets. The expected fall in the GCC's SWFs could be from $1.4 trillion to $1.2 trillion in the second quarter of 2008. But, if oil prices are the barometer of the GCC's wealth, prices have climbed back to $70 a barrel. This means again the GCC countries would be enjoying a huge surplus in their central kitty which means a further increase in the capital size of their SWFs.

India

In recent years, India has realized the potential of the GCC SWFs to finance its fast growing economy. During two consecutive recent visits to GCC countries, one by Prime Minister Manmohan Singh to Oman and Qatar last year and another during the current year to Kuwait by Vice president Hamid Ansari, Indian authorities have invited GCC capital. Dr. Singh said to Omani business captains "Our infrastructure financing needs are estimated to be 500 US billion dollars in the next five years. India offers a large and growing market. Despite the global economic downturn, the Indian economy is expected to maintain a growth rate of 7 to 7.5% next year." During this visit, India and Oman signed an MoU to establish an Indo-Oman Investment Fund with a seed capital of $100 million with one expectation what this would increase up to $1.5 billion in the

Major GCC-Based Sovereign Wealth Funds

No.	Country	Name	Formed (Year)	Origin	Estimated Size ($Billions)	Transparency Ratings
I	Kuwait	Kuwait Investment Authority	1953	Oil	$213	6
		(i) General Reserve Fund (GRF)	1976	Oil	$39	--
		(ii) Future Generation Fund (FGF)	1982	Oil	$174	--
II	Qatar	Qatar Investment Authority	2003	Oil	$62	5
III	Saudi Arabia	Saudi Arabian Monetary Authority (SAMA)	1952	Oil	$433 (Nov, 2008)	2
IV	Saudi Arabia	Public Investment Fund	2008	Oil	5.3	3
V	UAE (Abu Dhabi)	Abu Dhabi Investment Authority (AIDA)	1976	Oil	$500-875 (Latest $627)	3
VI	UAE (Abu Dhabi)	International Petroleum Investment Company (IPIC)	1984	Oil	$14	--
VII	UAE (Abu Dhabi)	Mubadala Development Company	2002	Oil	$14.7	7
VIII	UAE (Dubai)	Istithmar World	2003	Oil	$12	--
IX	UAE (Dubai)	Dubai International Capital	2004	Oil	$13	--
X	UAE (Dubai)	Investment Corporation of Dubai	2006	Oil	$82	4
IX	UAE	RAK Investment Authority	2004	oil	$1.2	3
XII	Bahrain	Mumtalakat Holding Company	2006	Oil	$14	7
XIII	Oman	State General Reserve Fund	1980	Oil & Gas	$8.2	1
VIX	Oman	Oman Investment Fund	2006	Oil & Gas	--	--
XV	Iran	Oil Stabilization Fund	1998	Oil	$13	1
	Total				$1,598-$1,973	--

Note: (i) The scale of Transparency Rating of the SWF is measured at 10. Source: Data compiled from the papers Arab News, Khaleej Times, Kuwait Times, and other Gulf newspapers.

next two years. "The Fund", Dr. Singh said, "is the first, but long overdue, step to facilitate investments in infrastructure, tourism, health, telecom, utilities, urban infrastructure and other sectors. I would call upon captains of Oman's industry and financial companies to invest surplus liquidity into key infrastructure sectors in India. We are determined to create a hospitable climate for investment, particularly foreign investment from friendly countries like Oman." Dr. Singh expressed similar views before the Qatari Chamber of Commerce stating that India welcomes the business captains of Qatar to invest in India.

While addressing the KCCI (Kuwaiti Chamber of Commerce and Industry), a similar view was expressed by Vice president Hamid Ansari during his recent visit to Kuwait. He said, "From an Indian perspective, the two most important prerequisites for growth are energy security and development of infrastructure… India is in a position to absorb US$ 500 billion investment in the next decade or so to meet the growing infrastructural needs. It is here that we see the new horizon of our engagement with the Gulf region."

During his visit to Saudi Arabia, Pranab Mukherjee, India's External Affairs Minster explicitly stated that the Indian economy is growing at 8 percent "and we require huge investments, particularly in infrastructure. This sector alone can absorb $500 to $600 billion." He also referred to the Bilateral Investment Promotion and Protection Agreement (BIPPA) that was signed during the Saudi King's historic visit to India in January 2006. Mr. Mukherjee also gave reference to the Indo-Arab Investment Projects Conclave (IAIPC) which has already identified projects worth around $200 billion in the energy and infrastructure sectors.

The GCC countries have also reciprocated with interest in investing in India. Due to the depressed economic scenario in Western countries, Kuwaitis have shifted their investment targets from slow-growth economies like the US, UK and Germany to rapidly-growing Asian economies like China, India and Turkey. The Chief of KIA said "Why invest in 2 per cent-growth economies when you can invest in 8 percent-growth economies". "India will be a centre of power in Asia, the most attractive destination for FDI and perhaps one of the fastest growing economies in the world," said Ali Mohammed Thunayan Al-Ghanim, chairman of the KCCI.

According to Qatari daily *Ashraq,* China has already tapped more than $250 billion of GCC money for its service and real estate sectors. Malaysia has primarily focused on tapping the GCC central banks assets through the route of Islamic Finance. According to Dr Zeti Akhtar Aziz, Governor, Bank Negara Malaysia "The GCC nations topped by the UAE, were increasingly focusing on making their investments in Asia which crossed $18 billion in 2006 and is projected to rise to a level of $20-30 billion this year (2007)". Vince Cook ("*Across the miles from the GCC into Asia*", Financial Review, May 26, 2008) brought forth that "Singapore will cultivate Islamic banking by leveraging its reputation as a well-respected regional financial centre and its leading positions in capital markets and asset management".

Some Precautions

Host countries have two strong apprehensions with regard to the intent and functioning of SWFs in general. The GCCs SWFs are rated very low on the governance, transparency and accountability scales. Noted Middle Eastern journalist Dana El-Baltaji writes that "In the Middle East, the principles of transparency and accountability are not part of the cultural DNA and have not been a priority of corporate development. There is also no obligation to reveal their financial dealings, for instance, how they practice corporate governance or their annual account".

The meteoric growth of GCC SWFs on the one hand and their opaqueness, and lack of accountability on the other means that they mostly operate on an informal and personalized basis, particularly in the West. These SWFs are mostly accused of taking over 'strategic' sectors such as infrastructure, telecom, media and energy. For instance, the ADIA Dubai Port deal generated opposition in the US Congress. Nationalistic fervour in the US and the impact of 9/11 terror attacks forced the ADIA to withdraw. This aspect has also been echoed in the Indian media. The *Business Standard*, noted "SWFs, the fastest growing entities in the financial world, have generated much concern in both developed and developing nations, including India… The real fear of these countries seems to be foreign control of local companies".

The issue of transparency and accountability has been taken up in a hesitant manner. Some policy measures have been formulated in order to ensure maximum transparency and accountability of SWFs. The Linaburg-Maduell Transparency Index fixes 16 principles for SWFs. Second, a comprehensive policy developed by the IMF has now been widely popularized. The transparency index is now much in vogue.

Policy Options for India

On account of the growing interest of GCC SWFs in emerging economies, particularly China, Malaysia, and South Korea, it becomes pertinent for India to explore this source seriously. Evidence reveals that during the first oil boom decade (1973-1984), the industrialized countries attracted around 60 per cent of the total GCC oil income - around 30 per cent ($62 billion) by the US alone and remainder ($58 billion) by the 20 industrialized countries. But during 2000-2008, GCC SWFs shifted their attention to the emerging Asian economies. For instance, between 2000 and 2008, out of 285 deals with a value of $136 billion, the GCC-based SWFs targeted 50 per cent assets valued at $68 billion in Non-OECD countries and 48 per cent ($65.28 billion) in OECD countries while 2 per cent ($4.08 billion) in the BRIC states.

In a recession hit world, India is the second fastest growing economy and this aspect must be strongly emphasized to the GCC countries. Although the GCC makes the least distinction between state-owned and privately-managed SWFs, we need to forge partnerships that involve the public and private sectors. Another step in this direction should be to convince the GCC investors that unlike the US and Western markets where they have suffered losses of roughly $2 trillion since the subprime credit crisis began, the Indian market is quite safe, stable and promising and that GCC SWFs would benefit from its rapid economic growth.

Indian businesses should also point to GCC investors the peril of over-relying on a few sectors. For instance, during the recent oil boom, the GCC SWFs predominantly invested in two areas-- financial (25%) and real estate (24%), and largely ignored other sectors. Thus, when the subprime credit crisis hit the financial and real estate markets, they failed to hedge their losses through portfolio management. This example should be utilized by Indians to convince GCC investors to invest in other emerging sectors such as health, transport, energy, infrastructure, construction, telecom, power, and tourism. These sectors are good not only from the point of 'better' returns but they are also safe and offer long term prospects. These sectors can be called *sunrise* sectors of the Indian economy.

Another significant step in the direction of attracting and strengthening India's claim to the GCC SWFs is to overcome the language barrier. We should open business portals in Arabic language, so the newly-moneyed investors who have mushroomed since the recent oil boom could directly establish their links with their Indian counterparts. There is no dearth of Arabic experts in India.

In brief, we should acknowledge the fact that SWFs are now a permanent feature of the international financial market. The gravity of financial power is shifting from Western countries to emerging economies and the Arab world. Hence, this is an opportune time for India to adopt proactive 'economic diplomacy' and win over the GCC SWFs.

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