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POLICY BRIEF

INTERNATIONAL POLITICAL ECONOMY & FUTURE OF MULTILATERALISM: A PLATFORM FOR COOPERATION FOR G20 SOVEREIGN WEALTH FUNDS

Task Force 5

THE FUTURE OF MULTILATERALISM AND GLOBAL GOVERNANCE

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الاقتصاد السياسي الدولي ومستقبل التعددية: منصة تعاونية لصناديق الثروة السيادية لمجموعة العشرين

فريق العمل الخامس

مستقبل التعددية والحوكمة العالمية

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ABSTRACT

This policy brief proposes the creation of a platform for cooperation among the Group of Twenty (G20) states' sovereign wealth funds (SWFs). The platform should allow for multiple practices that include long-term cooperation, direct investments, and the formation of bilateral/trilateral/multilateral investment accords. Ultimately, it would encourage the G20 states to strengthen their economic cooperation, bolster mutual interests, improve multilateralism, and develop opportunities for their SWFs. Additionally, it would act as an emergency tool in easing the impact of a global crisis, such as the current COVID-19 pandemic, as it can be employed as an anti-crisis measure via the investments of the G20 states' SWFs.

يقترح ملخص السياسة هذا إنشاء منصة للتعاون فيما بين صناديق الثروة السيادية لدول مجموعة العشرين. ومن شأن هذه المنصة السماح للممارسات المتعددة التي تتضمن تعاونًا طويل المدى، والاستثمارات المباشرة وصياغة اتفاقيات استثمارية ثنائية/ثلاثية/متعددة. وفي نهاية المطاف، ستشجع هذه المنصة دول مجموعة العشرين على تقوية تعاونهم الاقتصادي، وتعزيز اهتماماتهم المشتركة، وتحسين التعددية، وإيجاد فرص لصناديق الثروة السيادية. وعلاوة على ذلك، ستكون بمنزلة الأداة العاجلة لتخفيف أثر الأزمات العالمية، مثل جائحة كوفيد19-، حيث يمكن عدّها تدبيرا مضادًا للأزمات من خلال استثمارات صناديق الثروة السيادية لدول مجموعة العشرين.

CHALLENGE

Since its creation in September 1999, the Group of Twenty (G20) has resolved various global financial and economic issues. Promoting economic development and political stability across the globe, the G20 has become a key player in resolving the world's emergent crises (Snower 2018). Yet, there is a lack of an effective coordination instrument that could generate efficient cooperation among its members. The G20 can be more successful in its global efforts if it can strengthen economic cooperation among its member states, while enhancing mutual interests.

Unlike traditional multilateral organizations, the G20 is an informal forum that needs to expand its array of economic instruments to promote economic cooperation and create a greater alignment of interests among its members. Therefore, without compromising its unique character, the G20 needs to adopt an innovative approach that would utilize its existing capability. This policy brief recommends the creation of a platform that would bring together the SWFs of the G20 states, allowing for greater coordination among these funds and for synergy effects with other cooperation tracks among the G20 countries.[1]

1. The administration or the governing body of the proposed platform should consist of the representatives of the G20 states' SWFs or any equivalent representatives. These representatives should be high-level delegates, such as the SWF CEOs, concerned ministers, or their deputies. This kind of representation will ensure the functionality of the proposed platform and its swift implementation. Nevertheless, this brief does not intend to narrow the setup of the administration of this platform, as the finalization of the structure is left to the concerned member states. It should be also noted that the term "platform" is the most appropriate to be used for this proposal, as it has been previously used in a similar context in the G20 and other multilateral institutions—for example, see Global Partnership for Financial Inclusion (n.d.) and OECD (n.d.). The meetings of the delegates of this platform can be convened whenever necessary. Nevertheless, it is expected that they hold their key meetings during the G20 presidency.

Most of the member states of the G20 have a centrally controlled SWFs, albeit of various sizes.[2] The list includes Australia, China, India, Italy, Mexico, Russia, Saudi Arabia, South Korea, and Turkey. Canada and the US have SWFs at the sub-national level. Other G20 members have already planned for or examined the possibility of creating their own SWFs. The existing SWFs, or those that will potentially be created, can be viewed as assets that instill an increased sense of partnership among the G20 members.

The significance of this proposal lies in the benefits it could bring, as well as the feasibility of its implementation, which has been demonstrated in preceding collaborations. For instance, in October 2018, Saudi Arabia's sovereign wealth fund, the Public Investment Fund, joined forces with the Russian Direct Investment Fund in the joint Russia–China Investment Fund (Reuters 2018). Following this lead and considering other possible methods could be a valuable start to forge increased economic and political ties among the G20 members. Likewise, direct investment of each member state's sovereign fund in the other G20 states would undoubtedly complement the aforesaid account.

The G20 states are among the leading investors abroad and are the most likely destination for the investments of their SWFs. Hence, it is only natural that there should be an accompanying framework to benefit the G20, which is an ideal multilateral institution for launching such a cooperative platform. The G20 represents around 80% of the world's economic output, making it a logical setting to establish a platform for their emerging SWFs. Besides, the G20 has traditionally been actively involved in addressing political–economic issues across a wide spectrum, including those pertaining to cooperation among the G20 members in the political and financial spheres. Thus, developing a framework for G20 SWFs would be a continuation of these historical trends, and would lay the foundation for further growth of economic and investment ties among the G20 members.

2. Indonesia and South Africa are currently in the process of developing SWFs.

PROPOSAL

The proposed platform is beneficial as it could serve multiple purposes. It could bridge the gaps in the global governance framework for SWFs, complementing the "OECD [Organization for Economic Cooperation and Development] Long-term Investment Project," "One Planet Sovereign Wealth Funds Framework," "G20 Guiding Principles for Global Investment Policymaking," and "Santiago Principles." The creation of this platform would allow for large pools of investment to be directed toward facilitating the development and diversity of the G20 economies, particularly in critical sectors such as technology, human capital development, healthcare, and infrastructure. Despite the wide variety of funding sources and motivations behind the funds, the G20 economies have broadly similar geographic and private equity distributions within their portfolio, indicating significant room for cooperation. As bilateral and trilateral cooperation has already taken place among some of the G20 states' SWFs, the natural progression of this trend is to further increase cooperation. Thus, the creation of this platform for the G20 SWFs is the next step for ensuring greater prosperity and growth for the future.

Without disregarding the principles and practices that have already been established, the current policy brief recommends the following:

- The creation of a platform that can provide opportunities for collaboration among the G20 states' SWFs;

- Such a platform should allow for multiple practices, including long-term cooperation, direct investments, and the formation of bilateral, trilateral, and multilateral investment accords;

- It should ultimately encourage the G20 states to strengthen their economic cooperation and their mutual interests, improve multilateralism, and provide investment opportunities for their SWFs, while enhancing the development and growth of critical sectors; and

- It should also function as a vital emergency tool in the event of a severe global crisis, such as the ongoing COVID-19 pandemic, as it can be utilized as an anti-crisis measure via the investments of the G20 states' SWFs.

The Practicality of the Proposal

The formation of the proposed platform for SWFs among the G20 states could address some of the crucial gaps in the system of global governance, most notably in the investment sphere. As yet, there has been no similar vehicle or platform in the global economy that allows for an exchange in investment preferences across countries. This framework would be complementary but different from the "OECD Project on Institutional Investors and Long-term Investment," as it would primarily focus on encouraging SWFs to create investment pools to provide opportunities for cross-border investment in the G20 states. This has the ancillary benefits of mitigating risk, enhancing due diligence, improving efficiency, and simplifying the investment selection process (Gelb et al. 2014).

In this respect, the proposed platform for the G20 states' SWFs may also be viewed as a gateway to form investment alliances across states, on a bilateral, trilateral, and multilateral basis. The SWFs within such a platform may act as agents of investment liberalization akin to the conclusion of trade liberalization accords between regional integration blocks (Lissovik, Bespalov, and Bystriksky 2019).

The formation of a platform for SWFs could allow for a multilateralization of the accords and alliances concluded by SWFs bilaterally across the G20 states. A platform for G20 sovereign wealth funds may also be significant for those G20 states that do not have their own SWF. It could serve as a framework for exchanging international best practices with respect to the use of fiscal rules and the benefits of incorporating SWFs into states' macroeconomic framework. Consequently, it could encourage those states without an SWF to obtain the relevant experience and the knowledge to create their own SWF. Furthermore, such a platform may enable the G20 states to discuss the treatment of overseas investments by SWFs from the standpoint of the importers of SWF capital investments; these discussions between G20 states as exporters and importers of SWF investments may contribute toward overcoming investment barriers. Moreover, discussing and witnessing investment flows is advantageous for the states without an SWF. The ability to participate in investment discussions would mitigate fears of economic dominance by the SWFs in the importer states, as this would allow greater transparency, furthering the goals adopted in the Santiago Principles. The platform would also benefit the G20 states without an SWF by attracting investments from the G20 states in which SWFs play an important role in outbound financial flows.

The exchange of international best practices could include not only investment patterns and operational efficiency aspects, but also best practices in employing rules-based macroeconomic policies associated with the operation of SWFs. This is particularly important for emerging economies whose financial markets are presently witnessing a high level of volatility. As the experience of numerous emerging markets suggests, the use of SWFs and the associated economic policy rules results in greater policy credibility, lower sovereign bond spreads, as well as a higher capacity to deal with economic downturns. The experience of the Russian Federation in the past two decades is a relevant example of the achievements made in using economic policy rules and SWFs to improve the quality of the macroeconomic policy mix.

Perhaps, the most important rationale for creating a platform for SWFs is to create a framework for building common project pipelines, most notably those geared toward development. The specific focus in this regard would be the development of transportation connectivity and infrastructure. The SWF platform, therefore, needs to work closely with the Global Infrastructure Hub, created by the G20 to promote infrastructure development. Another potential area of cooperation among the SWFs of G20 countries could be a coordinated strategy to diversify national economies. Apart from infrastructure and connectivity, potential areas of focus could include joint projects in "green energy" as well as human capital development.[3] Such a coordinated strategy may allow for a diversification of risks for resource exporters on a long-term basis, thereby creating additional venues for economic cooperation in priority sectors.

A need could also arise for reconciling and bringing together the main principles and standards pertaining to the investment policies of the G20 states, including those concerning SWFs. In particular, the set of principles governing investments from SWFs could be upgraded in view of the increasing importance of factors such as the UN's Sustainable Development Goals as well as the environmental issues pertaining to investment (as reflected in the environmental, social, and governance principles).

3. This can be achieved through consultation with the One Planet Sovereign Wealth Fund Framework.

The framework would also serve to harmonize these priorities and the Santiago Principles with the initiatives and guidelines elaborated by the G20, including the G20 Guiding Principles for Global Investment Policymaking (G20 2016).

The platform would also play a vital role during times of emergency or global crises (such as the ongoing COVID-19 pandemic), as it would be accessible for coordinated anti-crisis measures. Thus, without undermining the objectives of the G20 SWFs, the platform can help direct and coordinate profitable investments to support key industries affected by the crisis, with the economic effects of such investments amplifying the effects of coordinated fiscal spending undertaken by G20 countries. One example of particular importance would be the coordinated investment into sectors related to human capital development, most notably healthcare and education. The operation of such a G20 SWF platform to counter an economic slowdown could act in tandem with other platforms that may be formed. A coordinated anti-crisis response from such platforms may deliver an emphatic effect with respect to global needs, while further strengthening the anti-crisis institutional framework at the global level.

The Feasibility of the Proposal

Based on the data in the appendix, this policy brief argues that there is a higher possibility of cooperation between SWFs that share a similar purpose. Funds that have the purpose of saving are interested in high returns; consequently, a development fund would welcome the investment of a savings fund to help develop the state. Stabilization funds are often conservative, and it is argued that the highly conservative nature of their investments is not compatible with the other funds. However, despite their incompatibility as investment partners to the other funds, they can share best practices for incorporation into a state's macroeconomic framework.

These suggestions are feasible as they are based on the data available for G20 funds. There is a significant overlap of shared investment opportunities among the funds because of the geographic location of an investment or similar investment interests. For instance, Saudi Arabia’s Public Investment Fund, the Korean Investment Corporation (KIC), and Australia’s Future Fund have diverse funding and purposes, but share geographical areas of interest for their investments and have similar investment focus.

- Geographically, Saudi Arabia's Public Investment Fund has a majority of its assets invested in Saudi Arabia, but plans to equalize international and domestic investments by 2030. Its international investments are mostly in North America, particularly in private equity.[4] These investments in private equity are dominated by the USD 45 billion infusion in the Softbank Vision Fund, although other hedge fund investments have also been negotiated, such as the Blackstone Infrastructure Fund. Other private equity investments, such as venture capital investments, have been clustered in technology and transportation sectors (e.g., in Uber and Lucid Motors). Traditional assets have been focused on listed equities such as Disney (US) and POSCO (South Korea).[5]

- The KIC has a majority of its foreign assets invested in North America (KIC 2019). This is equivalent to 47.92% of its total assets.[6] It should be noted that, while the KIC has historically focused on traditional assets, the greater profitability of its alternative assets since 2009 has encouraged KIC to increase the percentage of its investment. From 2017 to 2018, the increase was from 14.4% to 16.4%. There are signs that the KIC is continuing this strategy as it recently announced opening a San Francisco office to focus on alternative assets in Silicon Valley (Jae-hyuk 2020).

- The investments of Australia's Future Fund are geographically similar to the other funds although there are important differences (Future Fund 2019). Australia's Future Fund mirrors the KIC as the largest percentage of its investments are located in the US, although it differs in terms of domestic investments being the second largest area of investment. Its private equity investments are similar to that of the KIC, accounting for 16% of its total assets, with 61% of that investment in the US.

Therefore, despite differences in political systems, region, or culture, increased connectivity among these state-owned funds makes these investments viable. There is a significant overlap between these three funds, showing that there is room for collaboration despite their different funding sources and objectives.

4. Other prominent areas of investments for alternative asset classes are in France, Russia, UAE, and Kuwait.
5. For more information on the Public Investment Fund, see Crunchbase (n.d.), Al Riyadh (2017), Jones and Said (2020), and Public Investment Fund (n.d.).
6. This does not include private equity assets that do not have a geographical breakdown; 57.32% of traditional assets are based in the US of a total of 83.6% of the total assets of the fund.

A precedent has already been set for this form of cooperation. G20 SWFs have seen partial bilateral forms of cooperation. For example, in 2009, the Queensland Investment Corporation, a provincial SWF in Australia, signed an agreement with the KIC to collaborate on investment opportunities and sharing information (Jung-a 2009). Such a bilateral agreement can form a starting point for the current proposal, which envisions a multilateral platform to increase these forms of cooperation, while demonstrating the realistic implementation of the proposal.

Moreover, the Russia Direct Investment Fund can provide further guidance for SWF collaboration. The fund was created to attract investment within the state and has formed partnerships with other G20 SWFs such as the Public Investment Fund, KIC, CDP Equity (Italy), National Investment and Infrastructure Fund (India), and China Investment Corporation (China). The partnership with the China Investment Corporation has grown to include a trilateral arrangement, which is a precursor to the investment framework envisioned within this policy brief. In 2018, the Saudi Arabian Public Investment Fund invested 500 million in a joint fund with Russia and China. The aim of this fund is to invest in Saudi, Russian, and Chinese projects and achieve significant returns on the investment (Reuters 2018). Bilateral and trilateral agreements have therefore been an intrinsic part of SWFs that share different funding and purposes; this proposal seeks to further expand them to a potential multilateral level.

Disclaimer

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APPENDIX

Defining the G20 SWFs

A sovereign wealth fund (SWF) is a special-purpose investment fund that has no or limited liabilities and is owned by a state. Typically, this definition includes funds that exist as part of a central bank or are held by the central bank of the state. Nevertheless, despite the conceptual confusion surrounding the inclusion of SWFs with central banks, there is a need to distinguish the two. Broadening the definition of SWFs to include central banks would result in any state-owned enterprise or any government involvement in investment to come under the ambit of an SWF, thereby weakening it as a concept. Likewise, pension funds are excluded from this definition because of the explicit liabilities they pose. However, defining SWFs in this manner does not preclude any investment arms of central banks, state-owned enterprises, or state-owned pension funds from operating within the suggested platform.[7] The inclusion of these state-backed entities can only strengthen a multilateral standardization platform as envisioned within this proposal.

SWFs can be categorized into different types depending on their funding sources and the purpose of their investment. The four types of funding sources are commodity, foreign exchange reserves, fiscal, and transfer. Commodity funds are those derived from non-renewable resources, primarily oil. Foreign exchange reserve funds rely mainly on foreign currency surpluses that accumulate through trade. Fiscal funds include raising capital through issuing bonds or by inviting investments from the private equity market. Transfer funds are when state assets are transferred to an SWF. This can be done by transferring stakes in companies or state-owned enterprises to the fund.

The purpose of the funds can be stabilization, savings, or development. Stabilization funds are created to foster economic safety through injections of capital, when there is a debt crisis or an economic collapse. Savings funds are focused on generating wealth for future generations of the state. However, development funds primarily serve two purposes: diversification of the national economy and infrastructure investments within the state.

7. Another relevant example is the Alaska Permanent Fund, which technically has predictable and static liabilities because of the dividends they pay the citizens of the state. For more on the definitions of SWF, see Braunstein (2019).

In developing a platform or any kind of multilateral arrangement for investment, the principal targeted actors are savings and development funds. Noting the typology of funding is essential to ascertain possible levels of commitment to investment. Similarly, a shared purpose is needed to determine funds that have similar objectives. Using this typology, it is easier to identify funds that could partner with other funds in shared investments. This has been compiled in the following infographic, which displays the characteristics of the G20 SWFs.[8]

8. It should be noted that the figures in the infographic are subject to change and are correct as of January 1, 2020. Sub-state SWFs such as those in Canada (Alberta Heritage Fund) and the US (Alaska Permanent Fund) are not included. Central banks with significant investment arms that are sometimes included as SWFs, such as Banque Publique d'Investissement France and Saudi Arabian Monetary Authority, are also excluded because of the conceptual confusion they might create. It should be noted that, while the Russian Direct Investment Fund does not directly invest outside of Russia, it has made external investments through subsidiary funds.

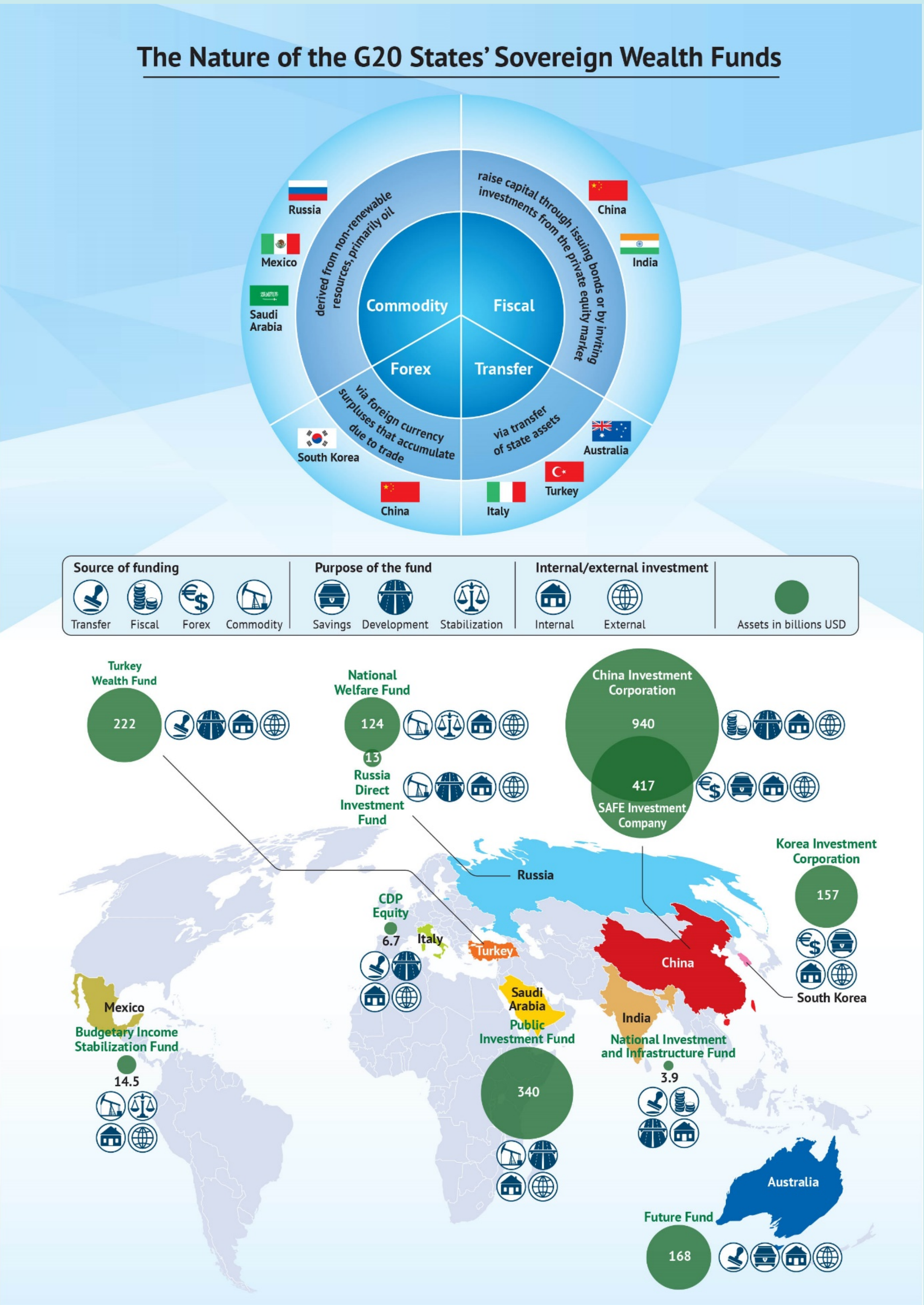

Figure 1: **Nature of the G20 States' SWFs**

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