



Gulf Research Centre Cambridge
Knowledge for All

Workshop 12

The Role of Sovereign Investment Vehicles in the GCC

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Abstract

GCC economies face a balancing challenge between domestic and foreign investments of their sovereign investment vehicles. While natural resources related income and investment returns are decreasing, the demand towards domestic deployment of capital and development is increasing in order to sustain growth. Prices of assets and securities in international markets have risen much in the last decade, as such the sovereign investment vehicles' expectations on future returns remain low while at the same time demand for capital to finance domestic infrastructure projects remains high. This also represents an opportunity to implement some reforms to generate growth and jobs in the long term without losing the focus on maintaining and expanding fiscal savings managed by the sovereign funds and development banks.

Description and Rationale

GCC countries are continuing to adjust to lower oil prices. Although the governments have reduced the spending, fiscal and external accounts have deteriorated, hence generating financing needs. Economies are still growing, but at a much lower pace. This is not surprisingly since the global growth environment is fairly negative as well. Furthermore, sectors that in the past were the main drivers of growth such as retail, real estate, shipping and banking are now struggling because of changes in consumer habits, new technologies and stricter regulations. In particular new technologies such as AI have the potential to disrupt old models without creating too many jobs. In addition, GCC are not only facing economic and financial challenges. In terms of security, the region is experiencing high levels of violence and uncertainty that likely are not going to decrease anytime soon.

Taking into consideration the above context, we propose a workshop with the aim of examining the optimal role of sovereign investment vehicles – SIVs - (e.g. sovereign wealth funds, central banks, development banks) in catalyzing capital flows and domestic resources for the purpose to improve the welfare of the states and pursue geopolitical strategic interests.

This workshop compares and analyses critical dimensions, such as SIV's national policy frameworks and broader asset allocation, to assess the processes of fiscal re-adjustments and the potential for reducing or exaggerating existing inefficiencies (e.g. avoiding duplications and crowding out). Thereby it will link directly with the research on political economy of public enterprise in the MENA region through a comparative perspective, especially given GCC SIVs large exposure to domestic state- owned enterprises. Finally, the workshop will look at how foreign investments can support national strategic interests.

Scholarly Contribution to Gulf Studies

The project builds on and compliments past GRM workshops, such as “Public-private partnerships for infrastructure delivery in the GCC: Challenges and the opportunities”; “Challenges Facing GCC Oil and Gas Exports”; “Economic Diversification: Challenges and Opportunities in the GCC”; “Fintech, Digital Currency and the Future of Islamic Finance in the GCC- Strategy, Operational and Regulatory Issues”; “A Debate on Economic Sustainability: In the GCC and Elsewhere.”

The workshop will leverage a new perspective on an emerging stream of literature on industrial policy in the twenty first century (Rodrik, 2004; Lin 2011, Stiglitz et al. 2013; Mazzucato, 2015), which emphasizes that public investment is inherently afflicted with a number of challenges some originating from poor capacity and weak governance. These can be accentuated when government investment institutions, with even partially overlapping mandates, compete for investments, as well as political, financial, and human resources, leading to redundant costs.

The workshop will also tap into a recent scholarship that highlights the potential of SIVs to promote social welfare and reduce inequality of citizens in the sponsor community (Lansley, 2016); thus to enhance the local impact.

Anticipated Participants

The workshop welcomes papers from scholars in the field of economics, finance, political science and international relations. The papers can either focus on one GCC country or propose comparative studies among GCC countries or between GCC and other countries/regions. Case studies are encouraged. The workshop is mainly intended to raise awareness about the optimal role of SIVs, and it welcomes research on the following topical areas:

1. GCC SIVs and the Industrial Revolution 4.0
2. GCC SIVs Privatization and Capital Market Development in GCC countries
3. GCC SIVs in Global Energy Transition
4. GCC SIVs Role in Attracting Foreign Investments
5. GCC SIVs and their Role in Building a stronger Private Sector
6. GCC SIVs their Accountability and role in Social Service Delivery Systems
7. GCC SIVs Regional Soft Power and Geopolitics
8. GCC SIVs and Risk Management

These are some questions the workshop is addressing. Why are the SIVs so important in this adjustment process? What are the barriers and how can they be overcome? How can SIVs be used efficiently to smoothen this adjustment? How SIVs should manage the current risks in capital markets? How SIVs should allocate money in the current situation? How GCC can use their SIVs to advance strategic interests in foreign affairs?

Workshop Director Profiles

Juergen Braunstein is a postdoctoral fellow at Harvard Kennedy School's Belfer Center where he co-leads the project on *Geopolitics of Renewable Energy*. He is also a member of the Sovereign Wealth Community of Practice, Collaboration for Development (C4D) platform at the World Bank Group. He coordinated the New Climate Economy Special Initiative on financing the urban transition under the leadership at the London School of Economics (LSE) Cities. His areas of expertise include financial instruments, emerging markets and state-owned enterprise reform and Sovereign Wealth Funds (SWFs). He was researcher at the Kuwait Programme on Development, Governance Globalisation in the Gulf States, where he worked on one of the first databases on SWF equity investments in OECD economies. His work on SWFs appeared in the *Review of International Political Economy*, *New Political Economy*, *Journal of Economic Policy* and *Global Policy*. Juergen is the author of "Capital Choices: Sectoral Politics and the Variation in Sovereign Wealth" (2019) with Michigan University Press. He has a B.A. from the University of Vienna and a masters and doctorate from the London School of Economics.

Mattia Tomba – Senior Research Fellow at the Middle East Institute NUS – is a multi-disciplinary investment professional with a track record of investments and acquisitions in

different asset classes, sectors, and geographic areas. He has an extensive experience in evaluating, negotiating, and structuring direct investments globally across all parts of the capital structure, in public and private markets.

He worked with the Qatar's Sovereign Wealth Fund, where he managed an equity portfolio and worked on large private equity and real estate transactions worldwide. Previously he was part of the Goldman Sachs Group (Whitehall Real Estate Funds) where he was involved in the portfolio management and strategic planning of large European acquisitions. He began his career with the Private Wealth Management team of Merrill Lynch.

Mattia is a Senior Fellow at the Middle East Institute at the National University of Singapore where he focuses on Asia – Middle East relations. He also sits on the Advisory Council of the Center for Sovereign Wealth and Global Capital at the Fletcher School (Tufts University).

He graduated from the Fletcher School at Tufts University (Boston) with a MA in International Affairs and from Bocconi University (Milan)/Science Po (Paris) with a BS in Business Administration.

Selected Readings

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Workshop 12

The Role of Sovereign Investment Vehicles in the GCC

Paper Presenter Abstracts:

Gulf Sovereign Wealth Funds: Building an Economic Diversification Strategy

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Abstract:

In the case of oil-exporting countries, high oil prices for a prolonged period of time have endowed the Gulf region with generous revenues enabling them to create sovereign wealth funds (SWFs) using these surpluses in order to further promote and diversify their economies away from oil and gas. However, the recent abrupt decline in the prices of oil in summer 2014 and their high unpredictability in general, posture solid difficulties to the Arab Gulf region. Indeed, this sharp decrease in oil prices is still having crucial impacts on their revenues and thus reducing the capacity of the Gulf States to continue supplying public services and especially mega-infrastructure projects.

One challenge in the Gulf States vision is to empower the private sector to assume a fundamental part of accomplishing sustainable development, innovation, and entrepreneurship as well. SWFs are considered real impetuses to diversify and develop the Gulf Cooperation Council (GCC) countries.

This paper aims to investigate possible linkages through which Gulf sovereign investments can bolster governments' efforts in terms of economic development and diversification domestically and overseas. Thus, this study will clarify the extent to which oil funds help to achieve economic diversification and participate in financing sustainable development in the Gulf region. However, these funds are still called for more transparency in terms of disclosing their strategic goals in order to be more active and lead to a more sustainable future. In this case, empirical studies would provide a more accurate answer to the question of whether Gulf-based SWFs are helping in achieving economic diversification.

The Diverse Domestic and International Strategies of Saudi Arabia's PIF

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Abstract:

Once shadowed by the country's largest sovereign wealth fund, SAMA Foreign Holdings, the Public Investment Fund (PIF) of Saudi Arabia has grown in prominence, both domestically and abroad. Granted the ability to invest abroad in 2014, the Fund has drawn the attention of the global financial community due to its plans to invest over \$100bn abroad in the coming years. Despite the sizeable economic clout of the PIF, there remains little academic literature on the Fund or its role in Saudi Arabia's political economy. Tracing the PIF's history from its establishment in 1971 to today, this paper seeks to provide an initial characterization of the Fund and its distinct investment strategies. An exploration of the PIF's earliest investments reveals how, despite its mandate to foster economic diversification, the PIF rapidly became a tool for patronage and clientelism. Led by its institutional history, the PIF's domestic investments today continue to belie the political forces that influence its decision-making process. In addition to serving as a tool for political purposes, the PIF's domestic investments are underpinned by a dirigiste approach to economic development. Conversely, however, the ability to invest abroad represents a junction in the PIF's history. In stark contrast to its politically-driven, state-centric domestic investments, the PIF's international investments are largely driven by the sole pursuit of profit. Rather than portraying the PIF's portfolio as an eclectic collection of investments, this paper demonstrates that the PIF's domestic and international investments are driven by distinct strategies.

The Ticking Clock of Climate Change: Diversifying Economies in the GCC and the Role of Sovereign Wealth Funds

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Abstract:

Climate change will significantly impact the Gulf nations, as their current economic dependence on oil and gas revenues places the region in a fragile situation. To survive and sustain a prosperous economy in the long term, the region must diversify, and sovereign wealth funds are expected to play an important role to achieve diversification. This paper examines what the Gulf Cooperation Council (GCC) countries have done so far to combat climate change, to what extent the GCC incorporates considerations of climate change into its larger economic diversification strategy, and to what extent sovereign wealth funds are taking actions specifically to support the economic diversification process and clean energy in the different GCC nations. Drawing from academic research and interviews, the paper reveals that while steps are being taken, there is a missing link between climate related policies and economic diversification efforts. Sovereign wealth funds are not currently confident enough to invest in green energy projects or technologies to support the larger efforts.

GCC sovereign wealth funds (SWFs) as catalysts for foreign direct investment (FDI) in the Gulf

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Abstract:

An oft-ignored role that sovereign wealth funds (SWFs) can play is mobilising inward capital to enter into productive partnerships with local investors. This role might appear counter-intuitive, as SWFs are routinely mandated to focus on foreign portfolio holdings to help diversify away from domestic economies, whereas some are downright prohibited from (co)investing at home. Despite such constraints, benefits of bringing SWFs into play seem substantial in overcoming foreign investors' barriers to entry, especially with respect to economies considered risky at sovereign level, dominated by exportation of non-renewable resources, where indigenous capital formation is sluggish, innovation subdued or access to globally competitive financial centres arduous. On the other hand, equipping SWFs with investible assets comes at an economic cost and economic value can only enhanced if foreign-domestic partnerships result in demonstrable synergies (e.g. knowledge spill overs). Transparency, accountability and professionalism are key, as the tricky interface between SWFs and foreign capital might engender dysfunctions, especially in emerging economies (Al-Samman and Mouselli 2018).

The role of Saudi SWF PIF as geopolitical power house

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Abstract:

Saudi Vision 2030, and the emergence of the SWF Public Investment Fund, is not only focused on the widely presented economic diversification of the Kingdom. The role of the SWF at present has become a major geopolitical power house, forging new economic, military and geopolitical relations within the shifting balance of regional and global alliances. PIF, especially when looking at the major investment schemes in Russia, China, India and the Arab world, has become one of the strategic instruments of the House of Saud to align economic diversification inside of the Kingdom with a perceived need to address the setting up of new alliances to counter or substitute the historical Western focus.

The paper will be addressing the role of the PIF inside of the Kingdom (Saudi Vision 2030, economic diversification, stability) and address in particular the growing strategic investments done in China, Russia and the Arab world. The latter is a clear sign of using SWF investments and strategies to set up and support regional-global power plays of the Kingdom.

To What Extent has the Sovereign Wealth Fund Assisted Qatar's Security and Foreign Policy in Resisting the Blockade

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Abstract:

The tiny Gulf State of Qatar is currently being blockaded by fellow GCC members Saudi Arabia, the United Arab Emirates and Bahrain in collaboration with Egypt but has largely

withstood the sanctions. One means by which the Qatari government has managed to withstand the challenges of the blockage is the use of its sovereign wealth fund (SWF).¹ Indicates that \$30 billion dollars of the domestic holdings of Qatar's SWF has been transferred to the Ministry of Finance and that further assets could be sold from the SWF to meet budgetary requirements if required. With over \$335 billion in assets invested around the world, Qatar Investment Authority, which manages the country's main SWF, is the 14th largest according to the Sovereign Wealth Fund Institute².

SWFs are national wealth management agencies that primarily invest in foreign assets with a relatively long-term investment horizon. They have become prominent institutional investors in the global capital market³. Broadly, SWFs can be classified into two categories according to their source of funding: commodity-based and non-commodity-based. Countries in the GCC (of which Qatar is a member) as well as Russia and Norway, among others, have commodity-based SWFs. In contrast, most of China's SWF's are non-commodity based³.

Although SWF investors have indicated that their investments are purely business transactions, concern about how they could possibly be used to influence domestic activities (especially from Western governments) has led to debate about their real purpose⁴. In this respect, ⁵argue that SWFs' voting rights in companies should be suspended so as to mitigate the concerns of Western powers⁶, however, indicates that GCC SWFs could have a foreign and security policy undertone. However, ⁷indicate that SWFs have generated positive returns on their investments and it can be said that they are legitimate elements of the investment milieu. The investments of SWFs in foreign assets have been seen by SWFs as a way of insuring against challenges that could affect them in future. Additionally, SWFs have also been seen as stabilisation funds that have been set up to buffer the country's budget from commodity price volatility or external shocks.

Qatar's SWF and its innovative foreign and security policy have supported the country in its attempts to withstand the blockade. Instead of a purely bandwagoning foreign and security policy that would have seen the country within the sphere of influence of Saudi Arabia, Qatar has been able to deploy the vast proceeds from its gas and oil exports to carve out an independent foreign security policy that has given it influence. In addition to the investments made by its SWF around the world which have provided the country with some

¹ Qatar National Bank, *Qatar Restructures Sovereign Wealth Fund as Blockage Continues* (London, Middle East Eye, 2017).

² Mohammed Sergie, *The Gulf Country with a \$335 Billion Global Empire*, (New York, Bloomberg, 2017)

³ Li Xie, Wing Thye Woo, Zhichao Zhang and Zhuang Zhang, "A Multiple-Goal Investment Strategy for Sovereign Wealth Funds: An Application to China," (Durham, Earth Institute at Columbia University, 2015).

⁴ Vidhi Chhaochharia Vidhi and Luc Laeyen, *Sovereign Wealth Funds: Their Investment Strategies and Performance*, (Washington, IMF, 2008).

⁵ Ronald Gilson and Curtis Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, (Mimeo, Stanford Law School, 2008).

⁶ Gawdat Bahgat, *Sovereign Wealth Funds in the Gulf: An Assessment* (London, London School of Economics, 2011).

⁷ Veljko Fotak, Bernardo Bortolotti and William Meggison, *the Financial Impact of Sovereign Wealth Fund Investments in Listed Companies*, (Mimeo, University of Oklahoma, 2008).

soft power, Qatar has been able to develop relations with the opposing side in the current geopolitical mixture.

Qatar's relationship with Turkey means that its ports have been used to ensure the delivery of vital supplies during the blockade, while its relationship with Iran means that Qatar Airways has continued to have access to airspace to maintain contact with the outside world. Hosting two US military bases and its SWF investments in Russia also mean that the microstate has been able to use its SWF as well an innovative foreign and security policy to ensure that it can withstand what would otherwise have been an economic disaster. The use of its SWF to stabilise the domestic economy at this challenging time has demonstrated the importance of these funds. It also indicates that the current crisis should be a lesson for Qatar and other countries in the region of the need to accumulate emergency funds in SWFs to support governments in times of need.

The role of GCC sovereign wealth funds on GCC capital markets integration

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Abstract:

The main purpose of the paper to capture the common trend driving the long-run co-movements between major GCC capital markets (Saudi, Dubai, and Qatar) and the foreign exchange reserves corresponding to Saudi, UAE, and Qatar at post-international financial crisis era of 2008⁸. Results of multivariate cointegration test suggest there is evidence of long term association between the two sets of data. To assess the impact of the international financial crisis on GCC Sovereign Wealth Funds (SWFs) behavior we further investigated cointegration between one of the biggest GCC SWF, SAMA investment in foreign securities, and Dubai and Qatar stock markets prices before and after August 2008. Our finding indicate, while there is no significant evidence of long term association between the two stock markets and SAMA fund before the financial crisis, but there is a strong evidence of cointegration at the post-financial crisis period. This result support an evidence of risk aversion attitude of SAMA fund, as opposed to the findings of other studies that associate the primary motives of GCC SWFs with political or non-profit objectives. Short-term effect analysis of foreign exchange reserves on the stock prices indicate change in Dubai stock market prices influenced by change in foreign exchange reserves of the three countries, and volatility in this market is associated with one month lagged own volatility. Changes in Qatar stock market prices are influenced by changes in UAE and Saudi foreign

⁸ As there is no foreign debts payable by these countries, change in foreign exchange reserves of these countries can be a good proxy for change in their sovereign wealth funds (SWFs).

exchange reserves, and volatility in this market is influenced by its own past month volatility. However, Saudi stock market is only influenced by change in Saudi foreign exchange reserves and its past month volatility.

Strategic Foresight for Sovereign Wealth Funds

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Abstract:

We face now, more than ever, a VUCA world – a world that is increasingly volatile, uncertain, complex, and ambiguous. This kind of world requires a better way to make investment decisions. If we are to learn anything from the past two decades, we know that it is the so-called ‘black swan’ events that take us off guard – in terms of sudden risks we must manage, and also in terms of missed opportunities. To use Donald Rumsfeld’s famous line: there are “unknown unknowns”. And it is in this area that SWFs need to start playing – particularly in regards to geostrategic regions of the world.

This increasingly ‘VUCA’ world poses problems to the large institutional investors of the Gulf, notably SWFs, which have been established during a geopolitical environment that was characterized by US dominance, globalization, and free market dynamics. But the world is becoming increasingly unpredictable, and SWFs need to adjust their investment approaches accordingly, to be prepared for the ‘unknown unknowns’ and position themselves optimally in geostrategic hotspots. SWFs cannot rely on traditional decision making processes anymore.

There are generally three ways to assist in making strategic decisions: through forecasting (empirical analysis and research), comparative analysis (looking at what others are doing), and ‘muddling through’ (reacting day to day to the crises and opportunities that appear). These traditional ways of basing decisions are no longer good enough. There is a fourth way, which is tailored to a world of turbulence: future scenario planning, which concerns itself with making strategic decisions based on plausible futures, generated from a range of driving forces.

Strategic foresight – or, strategic scenario planning – is not an academic theory, and its use is usually a methodology reserved for the large oil companies or progressive governments (Singapore, Finland, the Netherlands) who wish to identify driving forces propelling us into the future, and map out scenarios in order to prepare their governments or firms for those plausible futures. The CIA and Shell were the first major organizations to take this kind of methodology seriously. Thanks to it, Shell was able to anticipate and adapt to the global oil supply crisis of 1973 – and it rose from being the weakest of the seven global oil

companies into one of the strongest. Shell also demonstrated the usefulness of its secret ‘adaptive scenario planning’ in taming the oil crises of 1979 and 1986 much better than its counterparts.

Most portfolio managers use some form of scenario planning – it is a common theme popping up in MBA programs all the time. Some SWFs may also partially outsource this kind of research. However, strategic foresight planning and its methodology, the Shell/CIA kind, is highly specific and in-house; and it is not about forecasting the future through empirical data. It is about ‘super-forecasting’ the unknowns, through a complex but comprehensive and systematic analysis of driving forces and their combinations, an extraction of the most unlikely and likely scenarios, and then formulating a strategy based on those scenarios, parameters, and a toolbox of indicators. Due to the breadth and depth of this indicator system, it should be developed in-house and followed closely for all related investment matters.

An SWF can use the opportunity of a VUCA world to achieve both commercial and strategic objectives. Given this, future scenario planning is a better way to make investment decisions in a VUCA environment, particularly in geostrategic hotspots. Small countries located in geostrategic regions require investments in infrastructure, logistics, resource extraction and production, and other tools of economic development. We now traverse the crossroads of geostrategy and commercial priorities: SWFs need to start thinking in geostrategic terms – and identify those ‘unknown unknowns’. Strategic investments in the African continent and in the Caucasus: these regions may traditionally be classified as risky, but in a VUCA world, this paper argues that it is absolutely necessary to be there. With future scenario planning and a system of indicators to give decision makers a picture of that region and its driving forces into different plausible futures, these hotspots more than any other offer SWFs opportunities to merge commercial and national strategic interests.