VOLUME X No. 108 W E D N E S D A Y June 11, 2008

SOVEREIGN WEALTH FUNDS: ARE THEY A REAL AND PRESENT DANGER TO ANYBODY ?

How To Allay The Fears Of The West

The countries of the world with the most surplus cash, today, that cash, known more popularly as Sovereign Wealth Funds, are, in order of their wealth:

Name of Country	Current Size Of The Sovereign Wealth Fund
Japan	$US1,274 billion
The United Arab Emirates	$US500 billion to $US875 billion
Norway	$US375 billion
The Netherlands	$US316 billion
Singapore	$US200 billion to $US330 billion
Kuwait	$US213 billion
Saudi Arabia	$US270 billion
The People's Republic of China	$US200 billion

All of the above, with the exception of the sovereign wealth funds, held by Japan and The Netherlands, are non-pension funds.

The source of the sovereign wealth funds of the other 6 countries is fundamental to understanding some of the mechanics of the governments of these countries.

For Japan, which appears to have the largest accumulated amount of money in its war chest, at this time, the sovereign wealth fund came from employee contributions.

The same holds true for Singapore and The Netherlands where the governments of these countries impose relatively heavy taxes on its working population.

For The United Arab Emirates, Norway, Kuwait, and Saudi Arabia, the source of these countries' sovereign wealth funds was natural resources – crude oil exports, in fact, for the most part.

Only in the People's Republic of China has this government's sovereign wealth fund come about due to the amassing of foreign exchange reserves.

It is estimated by The World Bank that the total size of the world's sovereign wealth funds is about $US5,308 billion.

The perceived problems that are said to face the world, today, with regard to this massive amounts of money, sloshing around foreign currency exchanges and equity markets, includes:

1. How the money is spent;

2. Where the money is spent; and,

3. The bona fides of the governments that control the money.

For the above-mentioned 8 countries, there is little danger to the world, it has been determined, but the same cannot be said for some other governments of the world.

This matter has been the bone of contention for the government of the US for some time.

For instance, what actions may one expect from the government of Venezuela, led by President Hugo Rafael Chávez Frías.

President Hugo Chávez is considered by the Bush Administration of The United States of America not to be friendly to The Land of The Free of The Home of The Brave; he is listed by the Bush Administration as being on a par with certain other, unmentionable leaders of the world.

Nevertheless, Venezuela is known to have accumulated about $US22 billion in its war chest and it is a supplier to the United States of considerable quantities of crude oil.

This country's sovereign wealth fund, theoretically, could be used, in part or in whole, to the detriment of the United States.

In the hands of an irresponsible government, massive amounts of money could play an important role in the destabilisation of just about any economy of the world, today.

A sovereign wealth fund is generally accepted as being government-owned and controlled assets.

Sovereign wealth funds are funded, in the main, by foreign exchange reserves, earnings from the sales of commodities, the result of the privatisation of entities, formerly owned by governments, and pension contributions.

In this century, it is unquestionable that sovereign wealth funds pose an international challenge, one that has never before existed in the history of man.

The estimated size of the global capital markets, today, is about $US190 trillion.

Of that massive amount of money, it is estimated that $US15 trillion, or about 7.89 percent, is under the control of various governments of differing shades of red and pink.

Iran, at this juncture, is known to own a sovereign wealth fund, the current size of which is about $US10 billion.

Iran is known, also, to have funded insurrectionists in Iraq where the US and its allies are fighting insurgents and, as such, it is very clear that the government of Iran cannot be considered a bosom friend of most of the countries of the Western World.

It may be speculated that had Iran the financial wherewithal of, say Japan, such a sovereign wealth fund could become a veritable weapon in the hands of somebody of the calibre of President Mahmoud Ahmedinejad.

In addition to the aforementioned matters, regarding Iran, the country is known to be in the process of building nuclear reactors, contrary to formal agreements that it signed with the United Nations, some years ago, and although the country claims that it is only interested in nuclear power for peaceful purposes, few governments of the Western World believe this diatribe.

Sovereign wealth funds, held by countries of the ilk of Iran, poses the biggest challenge – which is a diplomatic way of stating a *'threat'* – to countries, such as the US and most countries of Western Europe.

The US Commerce Department claims that, at the end of Fiscal 2006, the total holdings of foreign assets in the US amounted to about $US13.80 trillion, of which figure, private enterprise controlled somewhere in the region of 92 percent.

Conversely, foreign holdings of US assets were valued at about $US16.30 trillion.

As for US holdings of international financial assets, they totalled at least 20 percent of the global pool.

In short, the US economy is tied, hand and foot, to the international financial system, both on the assets side and the liability side.

<u>The Past Five Years</u>

During the past 5 years, the size of sovereign wealth funds has more than tripled, according to US Government statistics.

Meanwhile, during that same period of time, internationally, the value of capital markets has doubled.

The rise in the value of sovereign wealth funds, as just about everybody and his cat could speculate, is due to the increases in the price of commodities – especially the relentless rise in the price of crude oil and, of late, the increase in the price of staple foods.

This situation has helped to bring about international imbalances – which is another challenge to the Western World.

As the price of commodities rose, there was a weakening of what has come to be known as *'the home bias'* as countries' sovereign wealth funds sought to diversify their financial portfolios into international markets.

This caused:

a. A redistribution of cross-border wealth from traditional industrial countries, such as the US, to countries that, historically, had not been players of materiality in the international financial marketplaces; and,

b. Certain governments were seen to own, or control, substantial new internationally created wealth.

Point b was a sticking point for the US Government, only a few short years ago, when it was recognised that the PRC Government was going shopping in the US, trying to buy up strategic commodities, or take control of US companies, which, in turn, controlled a goodly slice of certain, US strategic commodities.

The US Congress sought to plug this perceived loophole with new (and protectionist/draconian) legislation.

At that point, the US Government voiced its concerns, openly, stating that there was a fear that certain governments of the world might mismanage their sovereign wealth funds – ironically, to their own economic and financial detriment.

There was, also, the fear that the size of some of the sovereign wealth funds could spawn corruption on an unprecedented, international scale.

Also, there was concern that the management of certain sovereign wealth funds could have a bias for politics, the mandate, being partially the pursuit of certain objectives, determined by the governments that controlled the funds.

This, to the Administration of President George W. Bush, raised national security concerns, once again.

Shades of 9/11!

Notwithstanding a belligerent attack on a country, a sovereign wealth fund, in the hands of an irresponsible government, had the propensity to create political conflicts between countries as well as foster economic distortions.

Also, in the management of assets, held by sovereign wealth funds, there is the probability for unscrupulous market manipulation, leading to instability and generating into uncertainty.

Which is, of course, not helpful to anybody in the long run.

A priori, it is difficult to make a determination about one sovereign wealth fund over another since it stands to reason that sovereign wealth funds may, also, be helpful in bringing stability to the marketplace.

The trouble is that there is a decided lack of transparency in most sovereign wealth funds and it is the opaqueness of these massive amounts of money that causes widespread consternation among the leaders of many Western nations.

Therefore, determinations have to be made on a case-to-case basis.

Only too often, concern has been voiced when it became evident that a sovereign wealth fund was purchasing certain international assets, raising the spectre that such purchases could well come into conflict with the selling country's political aspirations as well as the potential for unbalancing the status quo.

Sovereign wealth funds are here to stay.

They have been in existence for more than 50 years; they will be around for many decades to come.

The permanency of sovereign wealth funds cries out for countries to come to grips with the reality of the situation, sheathing the scimitars lest somebody gets cut, inadvertently, and learning to live with even the likes of the unpalatable governments of today's world.

It would appear, prima facie, that transparency and accountability of governments, which have control of massive amounts of money, locked into sovereign wealth funds, is the first step to resolving any misconceptions with regard to the existence of sovereign wealth funds.

But finding viable solutions to the fears, raised by the existing sovereign wealth funds, is the subject to ponder for another day.

-- E N D --

If readers feel that they would like to voice their opinions about that which *they have read in **TARGET**, please feel free to e-mail your views to editor@targetnewspapers.com. **TARGET** does not guarantee to publish readers' views, but reserves the right so to do subject to the laws of libel.*