SOVEREIGN WEALTH FUNDS IN THEORY AND PRACTICE

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KAROLINUM

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LIST OF ABBREVIATIONS

CalPERS Californian Public Employee's Retirement System
CDM Consensus Demand Meter
CFR Council on Foreign Relations
ČNB Czech National Bank
DECS Debt Exchangeable for Common Stock
DJIA Dow-Jones Index Average
EIA Energy Information Administration
ER Excess Return
ESA 95 European System of National and Regional Accounts
FED Federal Reserve System
FEEM Fondazione Eni Enrico Mattei
GAPP Generally Accepted Principles and Practices
GDP Gross Domestic Product
GLC Governmnet Linked Company
IFSL International Financial Services London
IMF International Monetary Fund
IMFC International Monetary and Finance Committee
IPO Initial Public Offering
LMTI Linaburg Maduell Transparency Index
MSCI Morgan Stanley Capital Index
NBIM Norges Bank Investment Management
NOK Norwegian Krone
OECD Organization of Economic Cooperation
PAYG Pay as you go
PES Advisory Board of the Czech Minister of Finance
PI Petersson Institute
PPRF Public Pension Reserve Fund
ROA Return on Assets
ROE Return on Equity
S&P 500 Standard and Poor's Index
SEA Sovereign External Assets
SEC Security and Exchange Commision
SPF Sovereign Pension Fund
SSRF Social Security Reserve Fund
SWE Sovereign Wealth Enterprise
SWF Sovereign Wealth Fund
TARP Trouble Asset Relief Program
TCUK The City UK
TSR Total Shareholder Return
UAE United Arab Emirates
WA Wealth Added Framework

INTRODUCTION

Sovereign Wealth Funds (hereafter referred as "SWFs") have been currently becoming a more and more important part of the international financial system. These institutions administrated USD 6.1 trillion under their asset management as of the end of 2013. SWFs are the funds owned by a state, set up for various macroeconomic purposes. Usually, they are financed through the transfer of foreign currency assets which are mainly long-term investments abroad. Even though their significance has been growing especially in the last years, SWFs do not represent a new phenomena and some of the funds from Kuwait, Abu Dhabí and Singapore have been existing for tens of years. The high prices of oil and other commodities, financial globalization and a permanent global disharmony result in a quick accumulation of foreign currency assets, especially in those states exporting oil and in some Asian countries. The growing number and size of SWFs in those countries and their growing role in international markets are a secondary effect.

In recent years people significantly changed their view on SWFs as investors. While these funds were regarded as unsought investors before the global crisis, in 2008 they were enabled to enter the largest American banks. This fundamental turnaround had to do with the need for failing financial institutions to gain financial means and in those days SWFs were the only ones which were willing to take over high risks and to provide those means. SWFs can be officially regarded as standard players in the world financial market since 2008, when they accepted the principles of its functioning (the so called Santiago Principles). By setting up a SWF, their home countries gain many economic and financial advantages, for instance easier depositing of revenues and easier inter-generation transfer of revenues from non-renewable resources. From the point of view of international financial markets, these state investment funds can more easily attain better allocation of revenues from commodities surpluses in various countries and, at the same time, they can increase the liquidity of the market even at times of a world financial crisis. The increasing impact of SWFs also raises a number of questions, eg. about their transparency, size and investment strategies.

The aim of our publication is to provide a reader with some information on SWFs as a growing phenomenon in the global financial market including all macroeconomic and microeconomic connections. In this work[1], we analyze the establishment, development, current and future tasks of SWFs. We also discuss relevant basic concepts of this sphere because the issue of SWFs is not, in fact, covered in the Czech literature at all. The publication is divided into three main chapters: theoretical part, empirical part and concluding remarks.

1 An earlier version of this work was published in Czech in Karolinum Press in the year of 2011.

In the first chapter we focus on SWFs from the theoretical point of view, we present an overview of literature, explain basic concepts, SWF's investment strategies, pending trends and key transactions. In the second chapter we deal with SWFs from the empirical point of view. We analyze the development of these funds in recent years (including their impact on economy), two indices of SWFs' transparency and main SWFs' macroeconomic impact and potential risks. In this chapter we also discuss the theoretical possibility of setting up a SWF in the Czech Republic. In the third chapter we summarize this work and present our main conclusions and recommendations. We believe that this publication will be useful, not only for specialists, but also for those readers who want to get acquainted with this issue.

Prague, June 2014
Jan Ander
Petr Teplý

1. THEORETICAL PART

In this first chapter we focus on SWFs from the theoretical point of view. We provide theoretical background needed for the following empirical analysis. We present an overview of literature, explain basic concepts and SWF's investment strategies. Finally, we discuss pending trends and analyse key transactions.

1.1 LITERATURE REVIEW

Despite the fact that SWFs have been running on the market for several tens of years, this issue is not much covered in the Czech or foreign literature, even though recently there have been more and more new publications and analyses on this issue. One of the first more complete studies on SWFs was done by the McKinsey Global Institute (Farrel et al., 2007), in which these state investment funds were mentioned in the context of their growing force and impact resulting from increasing oil prices which created a significant source of their revenues. Other studies and analyses are developed by renowned international institutions, for example the International Monetary Fund (IMF) and the Organization of Economic Cooperation and Development (OECD), the Morgan Stanley bank, specialized institutions like the Sovereign Wealth Fund Institute in Las Vegas, Fondazione Eni Enrico Mattei (FEEM) under the University of Turino, Council on Foreign Relations (CFR), Peterson Institute or directly by universities (University of Washington, University of Michigan, University of