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Sovereign Wealth Funds- A Challenge for India

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Indian reserves have been increasing steadily over the last few years. Following the economic superpowers of the world like Norway, France and China, India is all set to further its role as a global player by venturing into Sovereign Wealth Funds (SWF), thanks to an estimated surplus of Rs. 2,50,000 crores in its balance of payments. Though the idea was also proposed back in 2008, it was rejected due to the heavy fiscal and current account deficits. The SWF are intended to help secure the energy assets overseas, as the country's demand is expanding and is expected to double by 2030. Also, with this fund, the government is expected to acquire assets to ensure supply of fertilizers in India. On one hand, this decision has gathered vehement opposition but on the other, eminent economists, RBI spokespersons etc. have encouraged the move.

Sovereign Wealth funds are state owned investment funds or entities established from balance of payments, official foreign exchange operations. They are part of a country's foreign exchange reserves that have been separated to invest in global equity, infrastructure, commodities and other financial instruments. Normally, if not invested, these reserves would increase at paltry rates. SWFs are a way to improve the country's finances as well as hedge against future crises. Some countries like United Arabs Emirates have created SWFs to diversify their revenue streams. The

country extracts revenues majorly through oil exports. UAE sets aside some portion of this revenue in the form of SWF to invest in other assets and also to hedge against any oil crisis.

However, a growing number of funds are turning to alternative investments, such as private equity, which are not accessible to most retail investors. The International Monetary Fund reports that sovereign wealth funds have a higher degree of risk than traditional investment portfolios, holding large stakes in the often-volatile emerging markets.

They have been broadly categorized as:

Savings Fund- to create wealth over longer term so as to meet future needs. For commodity exporting countries, savings funds help to convert non-renewable assets (such as oil) into financial assets for the benefit of present and future generations.

Stabilizing Funds- created by countries which have natural resources in abundance, in order to provide budgetary support and insulate themselves from volatile international commodity prices.

Pension Reserve Funds- to finance public pensions.

While there are a number of reasons why countries around the world establish SWFs, the unsaid rule which dictates their creation is the existence of excessive surpluses in the coffers of the initiating nation. Since India's debt is shrinking, the government wants to make hay while the sun is shining. But this plan accompanies dozens of apprehensions igniting debates all over the nation. There is an amalgamation of criticism and appreciation for sovereign wealth funds. History is fraught with examples of consequences of these funds, both positive and negative. On the positive end, these

funds have helped the Western banks CitiGroup, Merrill Lynch, UBS and Morgan Stanley, to overcome the struggle they faced as a consequence of mortgage crisis during 2006-2008. Sovereign Funds are also major holders of government debt and are now being actively courted by European governments to aid in solving the Euro zone debt crisis. Sovereign Wealth Funds act as overseas investment and savings vehicles – which may affect economic growth by lowering inflation and restraining exchange rate appreciation.

Assume a situation of an increase in the money supply in the economy (for any reason). The possible two mechanisms that could be responsible for the resultant increase in inflation are: increasing domestic demand or a rise in money deposits.

Now, when there is excess money supply in the economy, unless the majority of this money is not spent on locally produced goods and services, this will boost domestic demand and could cause the economy to heat up if it does not have enough capacity to meet the extra demand. Also, money inflow causing a rise in money deposits in the local banking system might trigger an increase in the credit supply. Instead of converting these inflows into the local currency and spending them, a portion may be kept in as foreign currency and invested abroad using the Sovereign Fund. In this way the fund may reduce the impact on domestic demand from inflows of money – and so limit the feed to inflation in the short term.

Usually, the influx of foreign currency is used to buy domestic currency, and exchange rates bid up. By investing into the sovereign funds, the pressure for appreciation is mitigated because the demand for the domestic currency is

depressed (demand replaces investment). Funds also provide a system for allocating government funds and in doing so may increase transparency of a government's financial policy and reduce corruption. Moreover, being a store of wealth it also enables the investors, in times of crisis, to provide the government with loans at cheaper rates than they would otherwise have.

But the idea of investment in SWFs has ignited apprehensions too, about the political and economic dominance of foreign nations over the domestic financial institutions. This fear could also lead to investment protectionism, potentially damaging the global economy by restricting valuable investment dollars. Commentators and policymakers are concerned that SWFs as arms of their governments might be used by foreign governments to advance self-interests at the expense of the interests of developing domestic countries like ours. The potential actions most frequently mentioned are transfers of technology and explicit or implicit threats to disinvest if the country pursues policies at odds with the investor's interests. As witnessed during the global financial crisis, sovereign wealth funds from West Asia, China, Singapore and Norway suffered huge losses on their investments in Western banks and private equity funds. In addition to the fear of the increasing clout of foreign nations, transparency in accounts is a rabble rousing aspect. IMF after a recent survey found that nearly one fifth of the top 20 SWFs are not accountable to their domestic legislation.

For proper regulation and functioning, certain guidelines have been laid by the IMF which are to be adhered to on all accounts. Most importantly, the foreign exchange reserves of the country should be sufficient to meet its import demands for 3-4 months. As reported by the Business Week, India's

coverage amounts to 14 months. In addition, as per the Greenspan-Guidotti rule proposed by former Fed chief Alan Greenspan, the countries should hold enough financial reserves so that the reserves and short-term external debt are in equal proportion. Data released by the department of economic affairs showed that India's total external debt at the beginning of 2011-12 was \$306.1 billion. The short-term debt grew by \$13.1 billion 20.1 per cent to \$78.1 billion during the period under review. Short-term debt accounted for 23.3 per cent of India's total external debt, while the remaining (76.7 per cent) was long-term debt. The ratio of short-term external debt to foreign exchange reserves was 26.3 per cent at Dec 31, 2011 as compared to 21.3 per cent at March 31, 2011. India's foreign exchange reserves provided a cover of 99.6 per cent of the country's total external debt at the beginning of fiscal 2011-12, while it declined to 88.6 per cent by the end of the third quarter. Thus, India is unambiguously secure by a large margin, in both the aspects.

Associated Chambers Of Commerce and Industry (ASSOCHAM) say India is the only BRIC country bereft of SWF. According to secretary general D.S. Rawat, if India's GDP is to grow at 8%, then many sectors will have to grow at a higher rate and SWF will play a crucial role in that. Countries like Norway, Kuwait and Abu Dhabi with largest SWFs in the world, derive their revenues from oil and other non-renewable resources. To hedge themselves against the oil related risks and mitigate their financial risks, these countries reduce their long-term dependence on oil prices by investing in non-oil assets. Drawing a parallel he says, SWFs in oil and gas, coal and infrastructure sectors, will benefit the nation as India is a net importer of these commodities and their demand is likely to increase in the future.

They are viable and will abate the consequences of risks related to international commodity prices, thus helping in reducing inflation.

However, Mr. Rawat also pointed out, that quick decision-making and transparency should be built-in features of India's SWF. Given ubiquitous and deeply entrenched corruption in the Indian legislation, it is feared that crores would be cornered into individual pockets and the actual motive would remain engraved only on papers.

SWF's have helped some nations prosper and have degenerated some. India has to travel a long way to achieve the ultimate goal. If stringent measures to combat corruption and enhance transparency are undertaken, not only will the decision safeguard our position in the world, it will also extenuate the incessantly surging inflation and prices of foreign currencies. Otherwise, these funds may prove to be catabolic for the Indian economy. Political will is a bigger imperative than the bulk of money to activate the funds in order to benefit the nation and not just a few resourceful individuals.

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China & India: A Macroeconomic Comparison

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China and India will exercise increasing influence in international affairs in the coming decades. As prominent members of the G-20, their influence will be manifest in the global economy, in global politics, and in the global security environment. Each country's role on the world stage will also be affected by the progress that it makes and by the competition and cooperation that develops between them.

This is a comparative assessment of their prospects in this period in macroeconomic growth. Economic growth in China and India has become a particular focus of attention of the entire world. In recent decades, growth in both countries has exceeded expectations. Between 1980 and 2008, China recorded an average annual GDP growth of 9 percent, while India's growth during the same period was about 6 percent. Both countries face the challenge of sustaining such high rates of growth.

An anthology published by the World Bank (Winters and Yusef, 2007)¹ provides several analytic models for assessing developments in the Chinese and Indian economies and their impact on global markets through 2020. In addition to providing forecasts of the two countries' economic growth, this book analyzes what would occur if China were to grow at an annual average rate of 6.6 percent, and