# The Ukrainian Crisis:

## The Role of Sovereign Wealth Funds in Sustainable Development

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## Introduction

Interdependence is the feature of the capitalist economy in our time. No country can achieve desired economic results without public and private investments that play an important role in pushing up the economic and development indicators. The international environment is filled with economic competition to attract foreign direct investment (FDI), and sovereign wealth funds have recently contributed to many achievements in this growth in the countries in which they invest. The total assets of the ten richest sovereign wealth funds (SWFs) in the world amounted to about $7.1 trillion, down from $6.718 trillion during last year, compared to less than 6 trillion at the end of 2020.

Theoretically, there is a wide area for SWFs to invest in sustainable development sectors and support the Sustainable Development Goals (SDGs), and what makes SWFs attractive for sustainable development financing is their intrinsically broad and long-term nature. SWFs tend to have long-term or well-defined commitments, which enable to invest in illiquid assets. Furthermore, some SWFs, such as sovereign development funds, have a specific mandate to invest in sectors that support the social, economic and environmental development of local economies.

Recently, the largest SWFs in the world have suffered some losses as a result of the spread of the Covid-19 and the outbreak of war between Russia and Ukraine. For example, the Norwegian SWF announced losses of 74 billion dollars during the first quarter of 2022 due to the war in Ukraine, to represent the first quarterly losses of the largest sovereign fund in the world since 2020, due to the war and closures in China as a result of the renewed outbreak of the Corona virus.

The report discusses the definition of sovereign wealth funds, the impact of sovereign wealth funds in achieving sustainable development goals, and finally, the repercussions of the Russian-Ukrainian war on the effectiveness of SWFs in sustainable development globally.

## First: Defining the Sovereign Wealth Funds (SWFs)

A sovereign wealth fund (SWF) is a state-owned investment fund consisting of government-generated money, which is often derived from surplus state reserves in order to provide a benefit to the country's economy and its citizens. SWF financing can come from several sources; Popular sources, reserves surplus from revenues from state-owned natural resources, trade surpluses, bank reserves that may accumulate from budget overruns, foreign exchange operations, funds from privatization, and government transfer payments.

The first SWFs in the world arose in Kuwait in 1953 under the name of the "Kuwait Investment Authority", relying on revenues from the sale and investment of oil in order to preserve the rights of future generations of it. It began to be active in the American and European markets significantly and acquired the shares of large financial institutions such as: "Morgan Stanley", "Merrill Lynch", "Citigroup" in the United States of America, and "UPS" in Switzerland. Subsequently, the emergence of SWFs in many countries of the world continued, depending on their financial surpluses from oil revenues, balance of payments or cash reserves.

In general, SWFs usually have a target purpose, because some countries possess SWFs as economic entities when they have an excess of offshore transactions that can be comparable to private venture capital. The Sovereign Wealth Fund Institute (SWFI) provides countries and companies with the information and necessary advice for the success of their transactions and investments, in addition to facilitating the activities of sovereign funds, pensions, endowments, pension fund, and central bank events around the world.

SWFI is a global organization designed to study sovereign wealth funds, pensions, endowments, pension funds, family offices, central banks and other long-term institutional investors in the areas of investment, asset allocation, risk, governance, economics, politics, trade and other related issues. The SWFI was founded by Michael Maduell and Karl Linaburg in late 2007. The institute, initially, focused only on sovereign wealth funds, and then began to analyze all kinds of investors from public institutions. As well as, the institute has also

developed the Linaburg-Maduell Transparency Index (LMTI) since 2008 as a way to rank the transparency of sovereign wealth funds.

According to SWFI, there are 143 sovereign funds in the world, distributed according to each continent, and they can be summarized in the following table:

| | Area/ Region | Num of SWFs |
|---|---|---|
| 1 | Middle East | 28 |
| 2 | Asia | 27 |
| 3 | Africa | 25 |
| 4 | Europe | 22 |
| 5 | North America | 18 |
| 6 | Latin America | 14 |
| 7 | Australia and the Pacific | 9 |

Figure No. 1: The Number of Sovereign Wealth Funds in Each Continent. Source: SWFI.

وفيما يخص ترتيب صناديق الثروة السيادية، فإنه تم رصد أعلى 10 صناديق سيادية ثروة في العالم، وجاءت كالآتي:

| | Fund | Value of Assets |
|---|---|---|
| 1 | Government Pension Fund of Norway | 1.4 trillion dollars |
| 2 | China Investment Corporation | 1.2 trillion dollars |
| 3 | Kuwait Investment Authority | 738 billion dollars |
| 4 | Abu Dhabi Investment Authority | 698 billion dollars |
| 5 | Saudi Public Investment Fund | 620 billion dollars |
| 6 | Hong Kong Monetary Authority Investment Portfolio (HKMA) | 589 billion dollars |
| 7 | GIC (Singaporean sovereign wealth fund) | 578 billion dollars |
| 8 | Temasek Holdings of Singapore | 484 billion dollars |
| 9 | Qatar Investment Authority (QIA) | 450 billion dollars |
| 10 | National Council of China Social Security Fund | 447 billion dollars |

Figure No. 2: Ranking of the top ten SWFs in the world. Source: SWFI.

From the above, the Middle East contains the largest number of sovereign wealth funds (28 funds). Four Funds belonging to the Middle East are located among the ten richest SWFs. This shows that oil revenues are the main source for the largest sovereign investment funds in the world. In conjunction with the rise in oil prices and the increase in imports of raw materials-producing countries, the wealth of these funds has increased, and foreign cash reserves are also a major source.

## Second: Impact of SWFs on the Sustainable Development

In 2015 all UN member states adopted the Sustainable Development Goals (SDGs), also known as the Global Goals, as a global call to action to end poverty, protect the planet and ensure all people enjoy peace and prosperity by 2030. The 17 Sustainable Development Goals are complementary. That it realizes that work in one field will affect results in other areas, and that development must balance social, economic and environmental sustainability.

There are many definitions related to the term "sustainable development." Perhaps the most important and widely used is the concept presented by the UN's World Commission on Environment and Sustainable Development in 1978 as: "Development that meets the needs of the current generation without compromising the ability of future generations to meet their needs." Also, the International Union for Conservation of Nature (IUCN) 1987 defined it as: "Development that takes into account the environment, the economy and society." The following figure shows the main objectives of the concept of sustainable economic, social and environmental development:

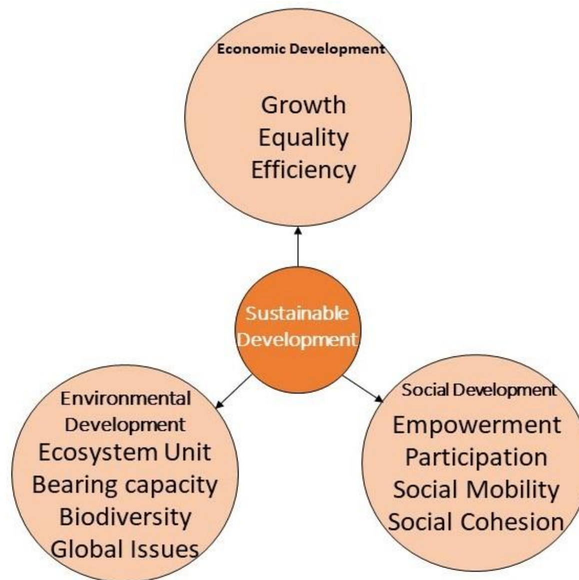



Figure 3: The main sustainable development aims.

The biggest impact SWFs can have on the Sustainable Development Goals (SDGs) is through long-term investments in alternative private market asset classes such as infrastructure, real estate, agriculture, timber, venture capital, and private equity. Determining how and to what extent SWFs can reach and promote the SDGs requires an assessment of where the SDGs actually fit into existing asset classes and investment products. It also requires understanding the strategies that sovereign funds have to promote specific sustainable development goals, measuring their exposure, and establishing programs that facilitate investment.

Economically, SWFs in developing countries contribute to the optimal use of idle economic resources, which are represented in public sector projects and public properties from land and real estate, which is reflected in an increase in the gross domestic product and the creation of productive job opportunities, and alleviating the burden of losing public projects on the public budget. Most of the world's countries have become importer and exporters of foreign direct investment (FDI) due to the liberalization of the global economy, the increase in production and trade, and the trend towards a market economy and economic integration. Thus, the importance of sovereign funds in the developing world increases to be a major source of financing in light of the high external indebtedness.

Thus, international sovereign funds play a role in sustainable development and economic development specifically for the various countries of the developing and developed world; As capital flows motivate countries to develop strategies to attract investments by sovereign funds (or foreign investments in general), which contribute in some way to increasing exports and support the local product in spreading in foreign markets.

On long-term, SWFs can make an important contribution to growth in various ways, but perhaps most importantly by financing long-term projects, such as infrastructure, clean technology, real estate and agriculture. Infrastructure, in particular, is a subject of great interest to attract long-term investment, as most countries around the world struggle to address the investment deficit in infrastructure, in which the nature of investment provides great benefits to societies by contributing to economic and social growth, which further emphasizes the value of having long-term investors in these assets.

Economic infrastructure relates to canals, pipes, aqueducts, and devices that provide power and water, provide protection against flooding, and remove waste. It also includes roads, railways, airports, and ports that allow the safe movement of people and goods between communities. These services directly support the well-being of households as well as the production activities of enterprises at different points in the value chain, and are thus directly related to the competitiveness of firms and economic development.

Also, the energy industry, which includes generation, transmission, and distribution, is an integral part of the backbone of the modern economy. Without adequate investment and a reliable supply of energy, the economy will not be able to function efficiently.

Infrastructure services are the physical facilities that provide the building blocks for a functioning society; within this concept, social infrastructure (e.g., health and education) can be distinguished from economic infrastructure.

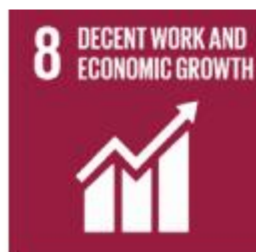
Social sustainability is measured by inflows of foreign direct investment, where unemployment, poverty and hunger are reduced, the standard of living is

improved, and social capital is increased by improving the quality of education and health and reducing inequality.

Additionally, broadening the mandate of SWFs to include green investment can support long-term sustainable development by diversifying the economy away from hydrocarbons, taking advantage of thriving sectors such as clean technology, renewable energy, low-carbon transportation, and enhancing resilience against climate change. Moreover, the specific characteristics of SWFs (intergenerational nature, medium to long-term investment horizon, greater risk tolerance) make them well suited to support green investments, particularly green infrastructure projects.

On the basis of each goal-by-objective, there is significant variation in the ability of SWFs to access investment opportunities that advance individual SDGs. There are set of SDGs for the real economy that can be highly invested; set of climate-related SDGs for which there is little pure investment, set of social sustainable development goals that are difficult for SWFs to reach in a programmatic way, and set of SDGs for sustainable infrastructure that can be accessed as investment opportunities, but require new and innovative financing models and approaches on the part of sovereign funds.

1- **SDGs (3), (8) and (12):** are easily investable by sovereign wealth funds, and nearly all institutional investors have some access to them already. The SDG related to economic growth is likely to be a component of all investment portfolios. The SDGs for Responsible Consumption, Production and Health can be reached by virtually any allocation of health care or manufacturing and consumer products.



2- **SDGs (13), (14) and (15):** Focusing on climate change and environmental conservation are hard to reach as simple investments, but a portfolio approach to measuring their exposure is workable. For example, investments in sustainable agriculture companies or clean energy and infrastructure affect both climate change and the environment. The portfolio's impact on these climate sustainable development goals is also better indicated by the specific qualities of individual investments, rather than the investments themselves. For example, a real estate portfolio does not inherently advance climate sustainable development goals, but a portfolio in which all of its properties require low-energy certification or reports on energy practices for its assets can justifiably promote climate action.

3- **SDGs (1), (2), (4), (5), (10) and (16):** They are ones of the SDGs for social development, which many do not easily translate into investment opportunities because they require concerted efforts or investment programs in order to reach them. Some social projects that aim to provide education to low-income communities or reduce poverty may provide selected opportunities for social impact through investment, but it is likely that these opportunities are only available through direct private investment or targeted private funds. For the SDGs related to poverty, hunger and education, some pure investments or impact investment funds are available; but the SDGs related to gender and inequality can be reached primarily by investing in companies that promote the SDGs as part of their business practices (rather than as their core products or services). These SDGs can also generally be accessed by SWFs that have a mandate for economic development in emerging economies, as these investments naturally target the reduction of poverty and inequality through secondary effects.

4- **SDGs (6), (7), (9), and (11):** Public investment opportunities readily available for these objectives are scarce, but directed funds and direct investment programs can make them more accessible to SWFs. There are innovative examples of sovereign wealth funds creating direct investment programs aimed at promoting sustainable development goals for sustainable infrastructure and achieving investment returns. These SDGs also overlap significantly with government policy, creating the potential for collaborative programs between sovereign wealth funds and governments to creatively package investment opportunities in support of the SDGs and provide risk-adjusted returns.

## Third: The Repercussions of the Russian-Ukrainian war on the Effectiveness of SWFs

Since the beginning of the war in Ukraine, Western countries have imposed economic sanctions on Russia to tighten the screws on it -most notably its removal from the Swift regime. Russia attracted the sixth largest number of sovereign wealth deals during the period from October 2020 to December 2021, until it reversed its decision to launch the war.

However, it is also worth bearing in mind the low- and relatively limited at this point- importance of the Russian economy to the global financial system, with Russia accounting for less than 2% of global banking assets. The exposure of

foreign banks to Russian borrowers is also modest with just over $100 billion in assets and has been halved since the annexation of Crimea in 2014. Thus, the first-order effects on the global financial system are likely to be contained, although the risks cannot be excluded infection.

Thus, the greatest impact may be from the second-order geopolitical, macroeconomic, and systemic shifts that can result from the crisis. However, some economic analysts have suggested that the European economy will be vulnerable to collapse, as Europe depends to meet its gas needs on 38% of Russian imports, and about 30% of crude oil, as Russia is the second largest producer of oil and natural gas in the world.

As described by the International Monetary Fund (IMF), the conflict is a severe blow to the global economy that will hurt growth and raise prices. Unprecedented sanctions against Russia will weaken financial intermediation and trade, which will inevitably lead to a deep recession there. The decline in the ruble exchange rate fuels inflation, and leads to a further decline in the living standards of the population.

While external exposures to falling Russian assets are limited by global standards, pressures on emerging markets may increase if investors seek safer havens. Likewise, direct exposures to Russia by most European banks are limited and manageable.

According to the Sovereign Wealth Funds Institute (SWFI), by the end of 2021, the total assets of the ten richest sovereign funds- which were referred to - amounted to about $7.1 trillion, down from $6.718 trillion last year, compared to less than 6 trillion at the end of 2020. In the same context, the decline in asset prices in Russia and the imposition of sanctions on sovereign foreign investments in Russia directly affected sovereign wealth funds.

The first quarterly losses for the world's largest sovereign fund since the outbreak of the Covid-19 pandemic in April, when the Norwegian sovereign wealth fund (with $3.1 trillion in assets) announced losses of $74 billion during the first quarter of 2022 (a 9.4% decline in its assets). Trond Grande, executive vice president of the Norwegian SWF, said that the fund, which achieved a 5.14% investment return last year, is still declining, but not sharply during the

second quarter, adding that the state of uncertainty has increased sharply because of what is happening in Ukraine.

Sovereign wealth funds in the Gulf countries are facing significant losses due to the decline in asset prices in Russia since the invasion of Ukraine. The Mubadala Investment Company in Abu Dhabi and the Qatar Investment Authority were among the most active sovereign wealth funds in Russia over the past decade, and they are now among the funds most vulnerable to the repercussions Russia's growing financial isolation. Until March, the total investments of Gulf SWFs amounted to 69% of all assets purchased by state-owned investment entities in Russia. Gulf SWFs bet more on the Russian economy than other funds, and they look at Russia as a long-term investment and look to buy cheap assets.

Despite this, Gulf SWFs insist on continuing and investing in the Russian markets at the expense of European and American investments that withdrew from Russia in implementation of the sanctions and for fear of geopolitical risks and freezing their assets the Russian authorities, in response to Western sanctions. The same thing applies to Russian SWFs, which decided not to exit from investments in the Gulf and the Middle East.

The rise in global oil prices helped the Gulf sovereign funds not to be significantly affected by the losses that affect all major sovereign funds, and even to achieve unexpected gains, as well as the case for Russian oil and gas, which contributed to Russia's confrontation with Western sanctions. An analysis issued by the Sovereign Wealth Fund Institute stated, “While oil producers are getting richer thanks to higher oil prices, the European Union and the United States are considering banning Russian crude oil at a time when Brent crude recorded a massive rise to reach the level of 139.13 dollars per barrel, which is still lower than the highest its all-time level when it reached $147.50 a barrel, which it recorded in July 2008.

It is worth noting that oil and gas in particular are of great importance to Russia because it contributes about a third of its federal budget. As in 2021, oil and gas revenues amounted to 9.1 billion rubles out of a total of 25.3 billion rubles.

Regarding the impact of the war in Ukraine on sustainable development and the role of SWFs in this, the UNCTA noted in a report that “the conflict in Ukraine

could widen the annual gap of $ 3.6 trillion in financing needed to achieve the SDGs and worsen the debt burden in many from developing countries."

The war has squeezed global monetary liquidity, especially for developing countries, as investors flock to assets seen as less risky, and the cost of credit has actually risen since the conflict began, with bond yields soaring (an average of 36 basis points). The impact of the war on government spending worldwide has increased pressure on aid budgets, which were already low, as in 2020, official development assistance (ODA) from advanced economies was only 0.32% of GNI, less than half the commitment of 0.7 %.

Another UN report revealed that, on average, the poorest developing countries pay about 14% of revenue on their debts, while the figure is 3.5% for rich countries. As the pandemic has forced governments to cut budgets for education, infrastructure and other capital spending, the fallout from war will In Ukraine, rising energy and commodity prices, as well as renewed disruptions in the supply chain, are exacerbating these challenges and creating new ones.

The past year has also been marked by some progress in poverty reduction, social protection and investment in sustainable development, driven by action in developing countries and some large developing nations, including about $17 trillion in COVID-19 emergency spending.

In addition, official development assistance reached $161.2 billion in 2020, the highest level ever. However, 13 governments have cut this support to developing countries, and the record amount remains insufficient to meet the enormous needs. The United Nations fears that increased spending on refugees in Europe, another fallout from the war in Ukraine, could cut aid to the world's poorest countries.

## Conclusion

Investing in public listings that advance the SDGs is a low-impact but easily scalable way to integrate the SDGs into the SWF's investment strategy. While certainly beneficial, the scope of the SDGs that can be accessed via public markets is relatively narrow, and the impact that SWFs can achieve through this investment model is rather low because these rolls already have access to

capital markets. Thus, SWFs' investments in listed assets have a relatively low impact if individual investments are relatively small.

The repercussions of the Russian-Ukrainian war were not limited to the two countries, but also affected all countries of the developed and developing world. In the long run, the war could fundamentally alter the global economic and geopolitical system if energy trade were transformed, supply chains were reconfigured, payment networks were fragmented, and countries rethought their reserve currency holdings. Increasing geopolitical tensions threatens to increase the risks of economic fragmentation, particularly at the level of trade and technology.