Sovereign Wealth Funds: What's the big idea ... and what could it mean for Britain?

David G. Green, Eugene O'Callaghan, John Penrose MP, The Rt Hon Liam Byrne MP, Adam Dixon, John Crompton, Dag Detter, Richard Hyde, Hari Menon, Rachel Neal

Edited by Jim McConalogue

CIVITAS

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Overview of chapters

Sovereign wealth funds (SWFs) can be defined as a government-owned and -controlled investment fund with no outside beneficiaries or liabilities (at least, none beyond the relevant government and citizenry) which invests its assets according to the interests and aims of the sovereign sponsor. They can be understood as reflecting the changing nature of capitalism – playing an important role in both global financial markets and representing important domestic investors/owners of capital.

In the public debate, SWFs refer to government-controlled investment funds holding financial assets – consisting, for example, in stocks, bonds and property – which enable countries to invest 'excess capital.'[1] In democratic countries, the purpose is often driven towards the benefit of the national economy and its citizens. Some say it can stabilise the economy by diversifying its investments. Others will claim it can generate wealth for future generations.

As we outline in Chapter 1, at present, the United Kingdom does not have a sovereign wealth fund. The Conservatives pledged to make the creation of a sovereign wealth fund a central part of their long-term plan in their 2017 manifesto, but no such fund has been introduced and there has not been any commitment to doing so by the Sunak administration. The latest proposal by the Liberal Democrats came at the party's 2021 spring conference, where its leader, Sir Ed Davey, put forward the idea of a 'sovereign green wealth fund' to invest in green technologies and thereby grow the

1 See, for example: 'Sovereign Wealth Funds: An Introduction', https://www.investopedia.com/articles/economics/08/sovereign-wealth-fund.asp

country's green wealth and create more manufacturing jobs.

If Labour are to form the next government, we do know from their own fund proposed by the Shadow Chancellor, Rachel Reeves, that Labour's mission is to 'build British industry.' This would be done through a National Wealth Fund, with Labour's Green Prosperity Plan putting an initial £8 billion into a central pot to help build British industry. It would mean that when public money is spent on such projects, British people will own a share of that wealth and therefore benefit from returns on those investments.

In Chapter 2, ***John Crompton and Dag Detter*** argue that the long-term rejection by UK governments to implement a sovereign wealth fund and/or public wealth fund is rooted in what they call a strange combination of a simplistic approach to managing public finances and an esoteric theory about the financial power of Government – both of which they claim are wrong and a risk to our financial stability, as it prevents the Government investing systematically to meet future needs.

The Government currently focus on debt-based fiscal rules and targets, but by assessing government finances based on net worth instead, Crompton and Detter claim this will give the Government the opportunity to act similarly to corporations and individuals: invest and manage based upon long-term needs.

A globally diversified sovereign wealth fund, they suggest, would allow us to invest to meet liabilities, while public wealth funds (at national and regional levels) would enable assets to be better managed and value extracted for the taxpayer without resorting to under-priced asset sales. Such funds could therefore potentially provide the opportunity to improve public finances by upwards of four per cent of GDP per year – the total which is roughly needed to meet the long-term fiscal challenges caused by an ageing population and rising healthcare costs – within a couple of decades.

In Chapter 3 in this collection, ***John Penrose MP*** argues the UK is facing three major problems: that we save less, invest less, and build less economically vital, growth-promoting infrastructure than we should; that Britain is better at inventing clever new widgets than at turning them into profitable, world-beating companies based in the UK; and that we have an ageing population, with fewer working-age people to foot the bill. However, the creation of a UK sovereign wealth fund, Penrose suggests, could go a long way in helping to tackle these problems, as well as creating an 'anchor investor' for British entrepreneurs and start-up businesses. As well as being a 'financially sensible' idea, it would allow us to grow faster in the future, and enable us to become a fairer society.

The fund, Penrose argues, would need to be built slowly, across generations, and it could be done through making it the legal owner of all the existing and future state-owned commercial investment funds, land and property, and ensuring the fund owns the rights to all future mining and extraction. Secondly, Penrose proposes the fund should be set up as a National Insurance Trust to maintain its independence and prevent politicians attempting to interfere with it, because the money wouldn't belong to the Government but directly to each and every voter instead.

As with other SWF proposals, it may be of interest that with Penrose's idea for a National Insurance Trust, one assumption would presumably be that the objective of, say, a team of pension fund trustees hoping to generate a maximum rate of returns for a given risk profile would still need to conform to overarching policy objectives in the national interest. Some method would need to be found to ensure the fiduciary obligations of the trustees align with society's wider interest.

In Chapter 4, ***Liam Byrne MP*** contends there is a clear way to fix the UK's inequality of access to the best returns on investment: the creation of a sovereign wealth fund which is owned by all citizens and which they can all can benefit from. Adopting Matt Bruenig's suggestions of how money can be raised for such a fund in America as a basis for his recommendations, Byrne makes his own case for how the UK can best generate the capital needed.

Firstly, following Bruenig's idea of ring-fencing some state assets, Byrne claims the UK could sell its shares in British banks. And whilst the Institute for Public Policy and Research (IPPR) suggests using asset sales, including the Government stake in Royal Bank of Scotland and the wind down of UK Assets Resolution programme, Byrne proposes we could also add the Crown Estate and fold in our 'dormant assets' to this – as well as future sales of the future radio spectrum for mobile services, and the UK Government's 'knowledge assets.' Secondly, as Bruenig also suggested, Byrne argues we could borrow to invest. Thirdly, Byrne proposes we could use our foreign currency reserves – which he labels 'the most under-discussed assets in British politics.'

Together, it is possible these could generate £50-£70 billion, with a degree of tax revenue – or levies – needed to reach the £100 billion target figure.

In Chapter 5, the founder and Chairman of Civitas, ***David G. Green*** discusses the idea of the UK implementing a democratised sovereign wealth fund – the 'British People's Wealth Fund' – which would be independent from government and owned by individual citizens who would receive dividends. It could invest in British businesses by providing loans and taking an equity stake in some companies. And it would be initially funded by selling shares to British citizens, who could then, after one year, sell back to the wealth fund at par value or sell privately at the market price, but only to other British citizens.

As well as funding economic growth through investment in new productive assets, a British People's Wealth Fund would, according to Green, have other advantages. It would reduce our reliance on international bond markets. It would enhance our self-sufficiency and help to reduce the price of natural gas by investing in the North Sea. It would help prevent the Government being coerced into unwanted measures that can occur when entities are owned or dominated by systemically challenging foreign states who are in control of significant parts of our essential infrastructure. Finally, it would assist in overcoming our historically low rate of investment.

The model of a sovereign wealth fund works well in other countries. As such, Green finds a British People's Wealth Fund would increase investment and give everyone a chance of holding a stake in our future prosperity.

In the subsequent essay, in Chapter 6, ***Professor Adam Dixon*** strikes a note of caution in engaging directly with the plan for a sovereign wealth fund. He puts forward the argument that a sovereign wealth fund for the UK, whilst not necessarily a poor policy option, may also not be the most ideal policy choice. The author suggests that if long-term savings are the priority for Britain, then reinforcing the pension system and private savings is likely easier than setting up a completely new entity. If Britain were to set up a strategic investment fund, then it poses the question: since Britain already has a world-class financial services industry, why isn't it investing in British industry and entrepreneurs already? And how can we therefore be certain a state-owned investment fund would? So, instead, Dixon believes it is likely much more cost-effective and potentially more effective in terms of desired outcomes to look at existing competencies and capabilities. There is also the challenge, Dixon points out, of how well a strategic investment fund would be able to compete with private sector investment funds.

In Chapter 7, ***Eugene O'Callaghan*** examines Ireland's sovereign wealth fund experience since 2001 and specifically focuses on two funds: the National Pensions Reserve Fund (2001-14) and the Ireland Strategic Investment Fund (2014-present). Since around 2006, O'Callaghan says both funds have been committed to responsible investment, which has led to commitment to global principles and frameworks, detailed responsible investment policies, active ownership (voting and engagement with investees), certain portfolio exclusions and a focus over time on specific issues.

O'Callaghan suggests a great deal can be learned by studying the history of Ireland's sovereign wealth funds since the beginning of the century: strategic investment funds can make a positive difference to any type of economy; that, particularly for strategic investment funds, governance is the critical foundation; investment should only be on a commercial basis; and it is essential there is flexibility and creative thinking in the design and implementation of sovereign wealth funds.

In Chapter 8, ***Richard Hyde and Hari Menon*** propose the UK can learn five key lessons from Singapore's Sovereign Wealth Fund and its Public Wealth Fund. These lessons are: existing assets (such as some of the central bank reserves of the Bank of England) should be leveraged as an initial endowment for any future UK fund; the fund should have a clear purpose; to ensure a fund delivers its purpose, we must look to how the fund's investment activity is organised; the scale of wealth funds is important to ensure it delivers substantial benefits; and, finally, the long-term success of a fund depends on how good its governance is.

By introducing a UK sovereign and/or public wealth fund which follows these lessons, Hyde and Menon say it could improve the lives of the people of the UK in both the short- and long-term. This is because, as a result of its Sovereign and Public Wealth Funds, Singapore has, for instance, gained access to an additional revenue stream in most years to supplement the annual tax collection, and has also been able to inject considerable amounts of capital into its domestic economy.

Finally, in the last chapter, with ***Rachel Neal***, we allude to the fact that a number of policy-makers, economists and investment theorists have suggested that the best way of nudging Britain towards the creation of its own sovereign wealth fund is to enable it to develop, merge and steer the existing investment funds within the UK's existing state-owned development bank – British Business Bank – into a single coherent vehicle. Even the Bank's chief executive has said this is what is intended. But what is the British Business Bank? We outline the work of the Bank, which is an independently managed but government-owned bank that brings expertise and finance to smaller business finance markets. The chapter analyses the Bank's aims and objectives, including its various programmes/schemes, subsidies, collaborations and funds, such as the Start Up Loans programme, British Patient Capital, and the Nations and Regions Investment Funds. Following this, we look at examples of sovereign wealth funds in European countries, in order to provide a flavour of the different objectives and strategies taken and understand what Britain can learn from its European neighbours and their respective wealth funds.

1.

A Sovereign Wealth Fund – What's the big idea?

Jim McConalogue

The definition and rationale for sovereign wealth funds

The idea of a sovereign wealth fund (SWF) is complex in terms of the reasons for existence and larger policy purpose.

The prevailing definition of SWFs according to Clark, Dixon and Monk (2013) is that:

> 'SWFs are government-owned and controlled (directly or indirectly) investment funds that have no outside beneficiaries or liabilities (beyond the government or the citizenry in abstract) and invest their assets, either in the short or long term, according to the interests and objectives of the sovereign sponsor.'[2]

Historically, SWFs are government-controlled investment funds whose purpose has been to serve some policy objective of the sovereign sponsor since ownership rests with the state and is at a most fundamental level, its beneficiary.[3] As 'agents of the state', SWFs should be viewed as political in the specific sense that they serve a policy purpose, including the improving of economic activity in the domestic economy which we might assume is otherwise not well served by the

2 *Sovereign Wealth Funds: Legitimacy, Governance, and Global Power.* By Gordon L. Clark, Adam D. Dixon, and Ashby H. B. Monk. Princeton, NJ: Princeton University Press, 2013.

3 Dixon, A., Schena, P., & Capapé, J. (2022). *Sovereign Wealth Funds: Between the State and Markets*. Agenda Publishing. p.9.

market.[4] Globally, aggregate SWF assets under management amount to approximately $11.16 trillion, as of January 2024, according to Global SWF.[5]

SWFs can be understood as a reflection of the changing nature of capitalism. If a casual observer stood at the end of the twentieth century and attempted to ask the question of what economic model had prevailed at that time, we would begin to describe something akin to a more globalised market capitalism – the sort of economic model that defined the hyper-globalised capitalism throughout the 1990s and 2000s. The barriers to trade and flow of capital were being reduced, blurring the boundaries between national and global; with borders being seen as unimportant. The international economy was becoming more global. The globalisation of finance and the growth in multinational corporations had combined with a ceding of sovereignty and control over markets and private actors. With the supposed development of market-based governance came a hollowing out of state functions. It was not to last.

The 2008 financial crash painfully demonstrated to populations across the world that their economies, livelihoods and way of life had grown very dependent upon global processes and economic performance. This put some of our economic approaches in reverse gear. The outcome of the financial crisis meant a larger role for the state, at least in curbing the excesses of financial markets. While globalisation did not lead to a complete retreat of the state, the subsequent two decades ensured more direct involvement of states in supposedly free markets.[6]

At this juncture of de-globalisation, sovereign wealth funds have become key players in global financial markets but they

4 Dixon *et al*., 2022, p.19.

5 Global SWF (2023) Available at: https://globalswf.com/ (Accessed: 24 November 2023).

6 Dixon et al., 2022. pp.5-18.

also represent important domestic investors and owners of capital.[7] They do not necessarily represent (although potentially could, if designed crudely) a politicisation of the market. But even as investors from within the state, SWFs are normally focused on aligning to market norms and expectations. The concept of an SWF does not put it at odds therefore with the trend towards liberalism but does mean the state has some role to play in governing the economy. For those who profess such funds represent a challenge to free markets, it is clear they are mostly market-conforming vehicles. So, the same principles of Western free markets and liberalism apply. The state can devise a regulatory and legal architecture for free and fair markets but with the proviso that it should remain on the sidelines.

Types of sovereign wealth funds

According to the International Forum of Sovereign Wealth Funds (IFSWF), across the world the policy objectives of sovereign wealth funds generally fall into the following three categories:

1. Stabilisation funds

These funds are 'established with the primary objective of off-setting macroeconomic volatility in fiscal balance and the economy.' A stabilisation fund 'generally has short- to medium-term investment horizons.'[8]

2. Saving funds

These funds exist to make sure there is inter-generational equity by allowing future generations to benefit from

7 Dixon et al., 2022.

8 IFSWF (2014) Santiago Principles: 15 Case Studies. Available at: https://www.ifswf.org/sites/default/files/SantiagoP15CaseStudies1_0.pdf (Accessed: 25 January 2024).

a windfall stemming, for example, from the current generation's exploitation of natural resources. They can also serve a pension reserve function by off-setting future liabilities related to ageing populations.[9] In addition, sovereign wealth funds can have other purposes that result in a smoothing of an economy's consumption-savings profile.[10] To meet these objectives, savings funds often 'have long-term investment horizons and invest in accordance with a broad and diversified strategic asset allocation designed to preserve and build long-term wealth.'[11]

3. Reserve investment corporations

These vehicles 'manage excess foreign exchange reserves' and usually invest in portfolios that are 'more broadly diversified and longer-term than traditional reserve portfolios', and through this endeavour 'reduce the overall portfolio's holding cost'.[12] However, if required, they can be called upon to supplement the liquid reserves used for sustaining a country's external accounts or exchange rate policy.[13]

As internationally comparative case studies, Norway, Australia, Korea, New Zealand and Singapore each have sovereign wealth funds which offer examples of those difference types of fund.

9 Ibid.
10 Ibid.
11 Ibid.
12 Ibid.
13 Ibid, p.11.

Table 1.1. Different types of sovereign wealth fund

Country	Name of fund	Main source of fund	Policy purpose	Assets under management
Norway	Government Pension Fund Global	Oil and natural gas	Savings fund (intergenerational equity and pension reserve)	$1.477 trillion
Australia	Future Fund	General government/ foreign exchange reserves	Savings fund (pension reserve)	$144.1 billion
Korea	Korea Investment Corporation	General government/ foreign exchange reserves	Reserve investment corporations (excess foreign exchange reserves)	$181.4 billion
New Zealand	New Zealand Superannuation Fund	General government/ foreign exchange reserves	Savings fund (pension reserves)	$39.7 billion
Singapore	GIC Private Limited	General government/ foreign exchange reserves	Reserve investment corporations (excess foreign exchange reserves)	$770 billion

Source: IFSWF (2014) Santiago Principles: 15 Case Studies, p12. Available at: https://www.ifswf.org/sites/default/files/SantiagoP15CaseStudies1_0.pdf (Accessed: 29 August 2023). For assets under management figures, see SWFI (2024) *List of 171 Sovereign Wealth Fund Profiles by Region* Available at: https://www.swfinstitute.org/profiles/sovereign-wealth-fund (Accessed: 25 January 2024). Figures correct as of 25 January 2024.

Adam Dixon and colleagues have offered an important variation on this taxonomy. They classify three types of SWF based on where the accumulated capital comes from and its policy remit: commodity-based funds; surplus savings funds and strategic investment funds.

Commodity-based SWFs receive their capital from natural resource revenues and have a natural policy basis and management over time.[14] *Surplus saving funds* can be reserve funds derived from accumulated foreign exchange or pension reserve funds. Finally, *strategic investment funds* (SIFs) differ from both the above in that they are skewed towards a focus on national economic development priorities. As the number of countries establishing an SWF grows, the honing in on national economic development and making investments of strategic national priority has become a more definitive and widely recognised goal.[15] Some funds emerge as holding companies of state-owned companies and other productive assets which can contribute to their national competitiveness and that of the state-owned companies in their own right, as they compete in global markets.[16] In others, governments have decided to actively support economic development through an SIF, all within the economic philosophy of developing flourishing free markets underpinned by strong foundations of the rule of law – that is, on market-conforming grounds and in which the state has a limited and specified role.

A distinction is also sometimes drawn in the literature between a sovereign wealth fund and a national or public wealth fund (NWF/PWF). As pointed out by Detter and Fölster, at a national level there are generally two types of public wealth funds. An SWF 'is primarily concerned with managing reserve liquidity, typically investing in securities traded on major mature markets', and is 'designed to optimize a portfolio by trading securities to achieve a balance between risk and returns.' In contrast, an NWF/PWF:

14 Dixon et al., 2022. p.10.
15 Dixon et al., 2022. p.17.
16 Dixon et al., 2022. p.17.

> '[I]s an asset manager, concerned with managing a portfolio of operational assets. NWFs seek to maximize the portfolio value through active management including the development, restructuring, and monetization of individual assets.'[17]

Because a government owner of commercial assets faces conflicts of interest, commercial assets owned by the public sector are governed within a separate system – a public wealth fund (PWF) – away from the line ministries.[18]

Singapore, for instance, has both an SWF and an NWF. Its SWF (as noted in the table above) is GIC; and its NWF is Temasek.[19] Temasek has consolidated all the commercial assets owned by the government and was employed to separate the regulatory and policy-making functions of government from its role as a shareholder of commercial entities.[20] Together, GIC and Temasek manage a portfolio worth more than double Singapore's gross domestic product (GDP).[21]

17 Detter, D. and Fölster, S. (2015) *Public Wealth of Nations: How Management of Public Assets Can Boost or Bust Economic Growth.* Palgrave Macmillan. In Detter, D. (2020) *Public Commercial Assets: The Hidden Goldmine.* Available at: https://www.adb.org/sites/default/files/publication/575651/governance-brief-40-public-commercial-assets.pdf (Accessed: 23 November 2023).

18 Detter, D. (2023) *The Public Wealth Fund - a Double-Edged Tool.* Available at: https://blog-pfm.imf.org/en/pfmblog/2023/03/the-public-wealth-fund-a-double-edged-tool (Accessed: 23 November 2023).

19 Detter, D. and Fölster, S. (2015) *Public Wealth of Nations: How Management of Public Assets Can Boost or Bust Economic Growth.* Palgrave Macmillan. In Detter, D. (2020) *Public Commercial Assets: The Hidden Goldmine.* Available at: https://www.adb.org/sites/default/files/publication/575651/governance-brief-40-public-commercial-assets.pdf (Accessed: 23 November 2023).

20 Detter, D. (2020) *Public Commercial Assets: The Hidden Goldmine.* Available at: https://www.adb.org/sites/default/files/publication/575651/governance-brief-40-public-commercial-assets.pdf (Accessed: 23 November 2023).

21 Detter, D. (2023) *The Public Wealth Fund - a Double-Edged Tool.* Available at: https://blog-pfm.imf.org/en/pfmblog/2023/03/the-public-wealth-fund-a-double-edged-tool (Accessed: 23 November 2023).

In this collection, in Chapter 2, Crompton and Detter differentiate between SWFs and PWFs. SWFs exist to invest public funds in a diversified portfolio of investment assets in order to meet future needs. These could be *explicit* liabilities like public sector pensions, or *implicit* liabilities such as expected healthcare and pension costs associated with an ageing population. PWFs exist to manage existing public commercial assets – frequently property or infrastructure-related – in a way that will maximise financial value to the taxpayer.

What about a British sovereign wealth fund?

The idea of a British sovereign wealth fund has been floated in regular policy discourse over the past decade, not only by all the main political parties but several of the country's think tanks, albeit in different guises. Although some of the ideas have been touted previously, the general thinking among UK political parties is that whoever forms the next government would be likely to launch a type of growth fund to invest in the economy. As the current Chancellor, Jeremy Hunt had sought for the British Business Bank to consider its design. Labour has long proposed a national wealth fund.[22] There are apparently discussions with Treasury officials exploring the idea of setting up a sovereign wealth fund, particularly seeking input from financial sector experts to see how such a scheme might work. One idea being floated was for a domestic fund which would pool nationally-owned assets along the lines of Singapore's Temasek sovereign wealth fund.[23] However, the challenge to getting the design of a

22 (2024) 'How to design a UK wealth fund is baffling both Labour and the Tories', *Financial Times*, 4 January 2024. Available at: https://www.ft.com/content/1437a2df-d41e-4a99-aa2a-9619961bfb10 (Accessed: 15 January 2024).

23 Ford Rojas, JP. (2023) *Time for a British sovereign fund? Treasury seeks views from experts.* Available at: https://www.thisismoney.co.uk/money/markets/article-12765199/Time-British-sovereign-fund-Treasury-seeks-views-experts.html (Accessed: 15 January 2024).

national wealth fund right is seen as critical to attracting institutional capital at scale.[24]

The British Business Bank has acknowledged it is already focusing on the new Growth Fund (see Chapter 9) to enable investments of pension fund assets in British growth companies. The Bank is also keen to work with (via pension funds) two private sector collaborators to help deliver its Long-term Investment for Technology and Science (LIFTS) initiative (again, see Chapter 9).[25] The Chancellor had requested the Bank's involvement in developing the proposals. The ambition is to enable greater allocation of money into productive investments in the UK. The chief executive of the Bank has referred to the proposed institutional funds as creating the essential UK competition to overseas US venture capital firms who are very interested in UK scale-up companies. If UK institutional money invests in those companies, it accrues to the benefit of the UK economy and its own growth prospects.

The assigning of state-owned commercial assets into an independent ring-fenced holding company at arm's length from short-term political interference, but with professional management, can bring economic benefits to a country as well as a higher degree of strategic and financial expertise.[26] It is worth considering the proposals in brief which have been put forward so far by economists, think tanks and political parties, and the kind of economic models they attempt to subscribe to.

24 (2024) 'How to design a UK wealth fund is baffling both Labour and the Tories', *Financial Times*, 4 January 2024. Available at: https://www.ft.com/content/1437a2df-d41e-4a99-aa2a-9619961bfb10 (Accessed: 15 January 2024).

25 See 'State fund to boost pension investment in UK growth', *The Times*, 5 February 2024.

26 See SWFI (2015) *Deep Dive with Dag Detter, Co-Author of The Public Wealth of Nations*. Available at: https://www.swfinstitute.org/news/32000/deep-dive-with-dag-detter-co-author-of-the-public-wealth-of-nations (Accessed: 25 January 2024).

Conservative Party

In its 2017 manifesto, the Conservative Party said it would make the creation of a UK sovereign wealth fund 'a central part' of their long-term plan for Britain. It was stated in the manifesto that the party would:

> '[C]reate a number of such funds, known as Future Britain funds, which will hold in trust the investments of the British people, backing British infrastructure and the British economy.'

The early funds, they said, would be formed out of revenues from shale gas extraction, dormant assets, and the receipts of sale of some public assets. In addition, pension funds with an interest in joining Future Britain funds would be encouraged to do so.[27]

However, seven years down the line, no such funds have been created by the Conservatives, nor does there seem like any plans to by the current Conservative Government under Rishi Sunak. In 2021, the Conservative MP Mark Pritchard asked the chancellor 'what plans he has to establish a Sovereign Wealth Fund.' In response, the then treasury minister John Glen MP said:

> 'In relation to establishing a sovereign wealth fund, the Government remains open to the introduction of new financing instruments but would need to be satisfied that they would meet value-for-money criteria and would be consistent with wider fiscal objectives. The Government continues to monitor the case for new financing instruments and will keep this under review.'[28]

27 Conservative Party (2017) *Forward Together: Our Plan for a Stronger Britain and a Prosperous Future. The Conservative and Unionist Party Manifesto 2017*. Available at: https://ucrel.lancs.ac.uk/wmatrix/ukmanifestos2017/localpdf/Conservatives.pdf (Accessed: 17 August 2023).

28 Pritchard, M. and Glen, J. (2021) *UIN 140016*. Available at: https://questions-statements.parliament.uk/written-questions/detail/2021-01-19/140016 (Accessed: 17 August 2023).

This position of no crystallised commitments contrasts uniquely with the position of the Labour Party.

Labour Party

In the latter half of 2022, Rachel Reeves, the Shadow Chancellor, set out the Labour Party's mission to 'build British industry' in every region of the UK – investing in homegrown products, including battery factories, clean steel plants, renewable-ready ports, the world's largest hydrogen electrolyser plant, and net-zero industrial clusters in every region.

The projects will be funded by a National Wealth Fund, with Labour's Green Prosperity Plan putting an initial £7.3 billion into a central pot to help build British industry. This will mean that when public money is spent on these projects, the British people will own a share of that wealth and therefore benefit from returns on those investments.[29] Their overarching current clean energy plan means they will spend a total of '£28 billion a year in the second half of the parliament at the latest', although there remain questions over partly dropping the plan.[30] The means of establishing the National Wealth Fund will be achieved by upgrading existing functions from the UK Infrastructure Bank and the British Business Bank.

Liberal Democrats

In 2018, Vince Cable – the former leader of the Liberal Democrats – unveiled his proposal to create the first-ever

29 Labour Party (2022) *Labour will "build British industry" to create jobs and grow economy*. Available at: https://labour.org.uk/press/labour-will-build-british-industry-to-create-jobs-and-grow-economy/ (Accessed: 17 August 2023).

30 Labour Party (2023) *Make Britain a clean energy superpower to cut bills, create jobs and deliver security with cheaper, zero-carbon electricity by 2030, accelerating to net zero*. Available at: https://labour.org.uk/wp-content/uploads/2023/06/Mission-Climate.pdf (Accessed: 25 January 2024).

UK sovereign wealth fund, a 'Citizen's Wealth Fund.' Cable claimed that creating a sovereign wealth fund would be 'a long term, non-government vehicle' to achieve 'stability and wealth', which would help 'protect the country from future economic crises.'

The fund would be built up over 10 years through tax reforms (that is, wealth taxes) and by selling off the taxpayers' then £2.6 billion stake in Royal Bank of Scotland. The aim was to build up to £100 billion through these measures.

The party said the fund would be 'kept at arm's length' from government and managed by professional fund managers. They added it would have 'robust accountability measures' and a 'strong emphasis on environmentally sustainable and ethical investment'.

Once the fund had reached a large enough size, Cable said it could generate enough income to be a new source of public funding and that the money made could either fund public services or be used to pay an annual dividend to all British citizens.[31]

In subsequent years, at the Liberal Democrats' 2021 spring conference, the leader of the party, Sir Ed Davey, put forward a 'sovereign green wealth fund' proposal. He said that, in the month prior, the Government had raised £9 billion to build wind farms on English and Welsh coasts.

Sir Ed told the conference:

> 'This green wealth… belongs to the British people.
>
> 'So I say, let's invest it in a sovereign green wealth fund. Let's invest this windfall from wind power into more climate action, to build new infrastructure and attract more private investment.'

31 Ashworth, L. (2018) 'Liberal Democrats announce plans to create UK's first sovereign wealth fund', *City AM*, 16 September. Available at: https://www.cityam.com/liberal-democrats-announce-plans-create-uks-first-sovereign/ (Accessed: 17 August 2023).

He claimed that by using the money to invest in green technologies, the UK could grow its 'green wealth even further' and create 'thousands of manufacturing jobs'.[32] It is not currently known if the policy has been amended since that date.

The 'John Penrose model' and the case for a UK sovereign wealth fund

In an early paper published by the Social Market Foundation think tank in 2016, the MP John Penrose called for a UK sovereign wealth fund to be created in order 'to address "long-term and structurally ingrained weaknesses" of the economy.'[33]

In *Time to think big: A UK Sovereign Wealth Fund* (2020) for the Reform think tank, John Penrose again developed his argument further, saying that establishing a UK sovereign wealth fund would fix some of the major problems facing Britain's economy.

If the UK sets up a sovereign fund similar to Norway's, Penrose contends we could slowly build a savings pot which would pay for state pensions and the costs incurred by an ageing population. It would reduce or even prevent the otherwise inevitable high tax burden on future generations to shoulder the costs.

Additionally, Penrose suggests a UK sovereign wealth fund would create an 'anchor investor' for entrepreneurs and start-up businesses.' This would, as a result, make it easier to turn inventions into world-beating UK firms by helping to stop 'founder flight' – whereby UK companies move abroad for the next stage of their growth.

32 BBC News (2021) Liberal Democrats propose '*sovereign green wealth fund*'. Available at: https://www.bbc.co.uk/news/uk-56475256 (Accessed: 17 August 2023).

33 Social Market Foundation (SMF) (2016) *Conservative MP calls for UK sovereign wealth fund.* Available at: https://www.smf.co.uk/press-release-conservative-mp-calls-for-uk-sovereign-wealth-fund-to-address-long-term-and-structurally-ingrained-weaknesses-of-the-economy/ (Accessed: 29 August 2023).

Finally, the sovereign wealth fund would eventually 'create a huge pot of patient, long-term investment capital' that could be used for a host of things – from transport infrastructure projects to full-fibre broadband – and allow the nation to grow faster in the future.

The fund would obey carefully devised fiscal rules while building slowly – over decades and across generations – as investment returns compound. And there are a number of 'investment acorns' we must 'plant' to help grow the fund, according to Penrose. The fund should, in this view, be the legal owner of all the existing and future state-owned commercial investment funds. These investment funds are already investing into the kinds of early-stage companies which the new fund might encompass, and the profits should be ploughed back into more of the same.

As the author suggests, the National Fund – a charity which was set up decades ago to help towards repaying national debt – would be a good starting point to seed the establishment of a UK sovereign wealth fund.

There will be risks in creating a sovereign wealth fund, but the most important principle would appear to be the protection of its independence. The objective:

> '…is to set up the Fund as a National Insurance Trust with a heavyweight board of trustees like the Bank of England, to maintain its independence. The Trustees would keep political interference and meddling at arms-length, and have the same legal duties as any other pension fund trustees to make sure the money is invested safely and profitably.'

Moreover, framing the fund as a Trust for UK taxpayers would mean the money would not belong to the government, but the public. As such, it would be even more difficult for politicians to try and interfere with it. On this view, if the

UK were to establish its own sovereign wealth fund, it would transform British society for the better, as well as its economy.[34]

Tristan Hanson and Eric Lonergan and the case for a UK sovereign wealth fund

In an article in *The Financial Times* in November 2017, Tristan Hanson and Eric Lonergan, then at M&G Investments, made the case for a UK sovereign wealth fund to be established. They argued that increasing investment via a sovereign wealth fund could help solve the deficiencies in housing and infrastructure, as well as support innovation and small businesses.

According to Hanson and Lonergan, the fund will create productive assets which benefit future generations and it could also invest in a range of assets (infrastructure, homes, venture capital, and so forth) – though the emphasis should be on domestic assets as it would have the largest direct impact on the UK economy.

The fund, they suggest, should be financed by selling UK government bonds.

Whilst some may express concern over increasing public debt, by creating a sovereign wealth fund, Hanson and Lonergan claim additional liabilities would be matched by new assets on the other side of the balance sheet – and so there would be no actual increase in government debt. In fact, the likelihood is that such a fund would actually reduce future levels of net public debt.

Hanson and Lonergan favour a sovereign wealth fund as the vehicle for boosting UK investment, something which they argued has so far proved difficult without one.[35]

34 Reform (2020) *Time to think big: A UK Sovereign Wealth Fund.* Available at: https://reform.uk/ (Accessed: 29 August 2023).

35 Hanson, T. and Lonergan, L. (2017) 'Guest post: Time for a UK sovereign wealth fund', *The Financial Times,* 23 November. Available at: https://www.ft.com/content/7bc111c1-de98-3857-a2a5-9156476e31a8 (Accessed: 29 August 2023).

IPPR and the case for a UK Citizens' Wealth Fund

In the 2018 paper entitled *Our Common Wealth: A Citizens' Wealth Fund for the UK*, Carys Roberts and Mathew Lawrence for the IPPR think-tank put forward the idea of a UK Citizens' Wealth Fund which 'would have the goals of spreading capital ownership to counter the effects of a declining wage share, and redistributing wealth between and within generations.'

The fund, its assets and its returns would ultimately be owned by UK citizens. It is therefore important that it is run in the citizens' best interests, with a democratically agreed mandate and parameters.

Dividends from the fund 'would provide a tangible return from the fund to people in the UK, and a clear benefit from investment.' They would be paid out on the basis of a one-off 'capital dividend' rather than an annual payment (that is, 'a minimum inheritance' to all). The dividend would be worth £10,000 and paid to people in a lump sum once they turn 25, thus meeting what it views as 'intergenerational justice objectives'. One option, they suggest, would be for the returns in the first year of payment to be divided in decreasing increments between year-cohorts from age 25 to 34, so that when introduced, those aged up to 25-34 would be eligible for a payment, but the older the recipient, the smaller the payment.

Most sovereign wealth funds are capitalised using royalties and tax revenues from natural resources or fiscal surpluses. But even when these aren't available, there are numerous sources the UK could use to capitalise a Citizens' Wealth Fund, which the authors suggest may include one-off asset transfers and capital receipts. This could be implemented by transforming the proceeds of asset sales into a permanent asset; future royalties and rents; and/or transferring the

Crown Estates into the fund.[36] Borrowing is also an option. The IPPR research also considers potential revenue streams such as: a scrip tax (that is, 'a tax on corporate profits paid by firms issuing equity to government instead of cash'); hypothecated wealth taxes; and/or annual returns.[37] This might be contrasted with David Green's proposal in this collection that a wealth fund should be owned by individual citizens who would receive dividends. The managers would only be enabled to use deposits to buy gilts or invest in UK productive enterprises – the initial funding would come from selling shares to citizens.

Developing long-term economic policy

Irrespective of the merits of each of the above proposals, there is a notable desire for many to introduce a British SWF to address the current absence of economic long-termism. There remain several advantages to the way those wealth funds can act, notably, when it comes to disruptive innovation and thinking about longer investment horizons. SWFs are not held back by current financial liabilities.[38] They have the flexibility to invest a part of their portfolios over longer investment horizons. They therefore must adapt to long-term macroeconomic trends at the same time.[39]

36 Several proponents of SWFs have often suggested bundling the Crown Estate into one such fund. However, if the UK were to 'nationalise' the Crown Estate by annexing its assets into a sovereign wealth fund, then a new method would need to be found to index and justify (in part) the Sovereign Grant. The Estate assets are hereditary possessions of the Sovereign held 'in right of the Crown'.

37 IPPR (2018) *Our Common Wealth: A Citizens' Wealth Fund for the UK.* Available at: https://www.ippr.org/ (Accessed: 29 August 2023).

38 Dixon et al., 2022. pp.63-4.

39 Dixon et al., 2022. p.63.

They also help to address the wider concern for economic resilience. For example, when Covid-19 hit the global economy, SWF resources were often enlisted to secure medical equipment, financial rescue packages and so forth to manage pandemic and lockdown arrangements. Dixon et al. give the example of a longer term approach to economic resilience adopted by Ireland's Strategic Investment Fund (ISIF), which ordinarily invests to enhance economic growth and development.[40] The Irish Government accepted Covid-19 impacts on job security and supply chain disruption, for example, and within the ISIF mandate, then developed a €2 billion Pandemic Stabilisation and Recovery Fund (PSRF) to invest in enterprises (that is, the major employers), who would be severely hampered by the pandemic.

Looking across the preferred UK policy options, among the political parties it is notable that past and present Labour and Liberal Democrat Party policies lean towards a sovereign wealth fund generating greater investment into green infrastructure and projects. The Conservatives have no concrete proposal but are accepting of 'new financing instruments' which conform to wider governing fiscal objectives. However, the MP John Penrose proposes a policy which might be seen as more permissible within the Conservative brand – its policies could vary between supporting entrepreneurs, small business and growth promoting infrastructure, although the party itself has shown no wish to create a supportive pension fund at this stage.

There has often been criticism of SWFs, arguably sometimes from the most liberal economic point of view. For example, some may well argue that 'public borrowing will likely crowd out private investment' – that is, investment would inevitably be thought of as public

40 Dixon et al., 2022. pp.63-4.

borrowing increases. Others have pointed to the rising proportions of UK pensions invested in bonds while the proportion invested in UK equities has fallen. If SWFs are to be used as a basis for pension provision, it might be argued that government borrowing is hoovering money out of productive investment and more borrowing will reduce the savings available to invest in the economy. However, several of the chapters in this collection offer a considered rebuttal to these arguments. The SWF, like with existing British Business Bank funds, would conceivably bring benefits to both investors and the often unnoticed smaller businesses that are start-ups, high growth, or simply viable but underfunded, so the Bank has seemingly stepped in for viable projects where others haven't. Also, other proposals suggest the SWF could well be set up for citizen investors who are buying shares in productive enterprises via the fund, which is not government money but private funding. And should we not consider all immediate benefits, particularly where it can be shown the fund could earn a surplus over the debt interest?

The funds tend to be seen as (partial) solutions to prevailing long-term policy challenges – of climate adaptation, of pensions, of social care – broadly expressing a sense of compassion and the need of affordability for 'future generations.' There are also a wide range of proposals as to what assets or investments it might hold to generate wealth from the Crown Estates, taxes on corporate profits, through to making it the legal owner of current state-owned commercial investment funds, notably over the British Business Bank's existing funds. Government would need to think carefully about what such a fund would be designed for from the outset, combined with a deeper electoral legitimacy as to what its purposes are.

2.

Why the UK doesn't have Sovereign Wealth Funds – and reasons why it should

John Crompton and Dag Detter

The UK Government's long-term rejection of proposals to invest to fund future expenditure is rooted in a strange combination of a simplistic approach to managing public finances, and an esoteric theory about its own financial power.

Both are wrong, and individually or in combination could be highly dangerous to financial stability, though this is not the focus of this chapter. What is more, the UK Government approach is denying the country the opportunity to improve public finances by over four per cent of GDP per year within a couple of decades, without raising taxes or cutting spending. This is roughly in line with what the Office for Budgetary Responsibility (OBR) has identified as the fiscal adjustment needed to meet future demands on public services over the coming generations.

Wealth funds – of two different types – are the key to exploiting this opportunity, and we will develop this point further below. But first we will look at the financial management framework that underpins current UK Government thinking, in order to identify what needs to change in order to unlock the public benefits that wealth funds can offer.

Why good accounting is essential for good financial management

Governments around the world insist that private sector organisations, and many public sector ones, produce regular, timely, comprehensive financial accounts. The larger, more complex the organisation, the more demanding the accounting requirements. Accounting is all-pervasive; management information systems provide the information on a day-to-day basis that is aggregated into formal financial accounts. Everyday actions are driven by, and aligned with, the basis on which the organisation's financial performance is judged.

However, with the exception of New Zealand, governments do not hold themselves to the accounting requirements that they impose on others, and neither do they use accounting information as the basis for decision-making.

Instead, most governments – and notably the UK and EU countries – rely on debt-based fiscal targets or rules. These comprise an in-year target or rule related to whether revenues are meeting expenditures, together with a target for total government borrowing. Both are usually expressed as a percentage of GDP.

Seen through an accounting lens, these rules are deeply flawed, for two reasons.

First, they ignore most of the balance sheet. On the liability side of the balance sheet, only debt liabilities are taken into account. Non-debt liabilities such as public sector pension obligations are ignored. In the UK, non-debt liabilities are somewhat larger than total government debt. Not to measure or control these seems like a very strange omission.

On the asset side, debt-based targets pay no attention to whether borrowing is used to fund long-term investment or near-term consumption. This is not to say that the

Government does not measure this – it does. But the debt target always dominates. As a result, the purchase of an asset which would deliver public benefits (financial or otherwise) for decades to come is treated in the same way as spending on current services that benefit only today's recipients. This can only distort decision-making and penalise investment. Moreover, as we shall see, there are strong reasons to believe that the value of government assets – especially property assets – is severely understated on government balance sheets, including in the UK.

Second, debt-based targets tell us very little about intergenerational fairness. As we have seen, if we only measure debt we pay no attention to whether the proceeds of debt issuance have been used to invest for the future, or simply to meet current needs. Neither do we know whether other liabilities are being stored up for the future.

The basic output of a company's – or government's – accounts is an assessment of Net Worth, which is the difference between total assets and total liabilities. If the accounting is done well, Net Worth therefore addresses both of the problems highlighted above, and allows regular assessments of the legacy that each cohort of taxpayers are leaving to their successors.

Unfortunately, the current position is pretty bleak; the latest UK Whole of Government Accounts (for the year 2020-21) put UK Government Net Worth at negative £3.3 trillion,[41] around 150 per cent of GDP, or a deficit of almost £50,000 per UK resident. Whilst there are reasons to believe that certain assets are undervalued and the true deficit smaller, these figures show a very poor return on 70-plus years of relative peace and prosperity, and represent a strong warning that something needs to change.

41 Whole of Government Accounts, 2020-21.

But not only does assessing government finances based on Net Worth make sense analytically, it also allows governments to act like other organisations and borrow to invest, and provides incentives throughout government for decision-makers to take into account, and manage, the value of the assets that they use and the liabilities that they incur in delivering government services.

This is essential if governments are to take advantage of the opportunities which wealth funds can offer.

Planning for the future – is the Government omnipotent or omniscient?

A proper balance sheet can tell us a lot about the current state of government finances, but says nothing about the future.

In fact, the outlook for government finances – especially in the most developed countries – is poor. As populations age and life expectancies increase, healthcare and retirement costs rise, and a smaller proportion of the population will be economically active and able to generate the surplus necessary to meet these rising costs. All this is on top of the known, high and growing liabilities already incorporated in the balance sheet, including financial debt and the rather larger commitments to public sector pensions and other future costs.

The UK OBR forecasts that in 50 years' time, assuming current trends and current tax and spending policies, UK Government debt will have risen to an 'unsustainable' 310 per cent of GDP.[42] A more complete analysis, including an assessment of other liabilities, might be even more alarming.

To keep debt at current levels relative to GDP, the OBR estimates that an immediate and permanent 'fiscal adjustment' – a reduction in spending or increase in revenue

42 OBR Fiscal sustainability report July 2023.

– of 4.4 per cent of GDP is required – that is, in excess of £100 billion per year in current terms.

Common sense would suggest that an organisation confronted with known future liabilities would take steps now to save and invest for the future. But the UK Government has not done that. Rather, over the course of the last generation it has increased its borrowing from around 20 per cent of GDP to around 100 per cent today.[43] And in sharp contrast to the rules it sets for other employers, the UK Government does not invest money to fund pension commitments that it makes to its employees – commitments which, as we have seen, fall outside the scope of its financial management framework.

The decision to leave the very large majority of non-debt liabilities unfunded is not just driven by short-term financial expediency. It also embodies a conscious long-term policy position that sits more with HM Treasury, as the UK's permanent institutional guardian of public finances, than with ephemeral political leaders.

In essence, the Treasury's position is that government has an asset that no other body has – the power to tax. As long as future needs are capable of being met within the Treasury's view of future tax capacity, there is no problem, and the Treasury will also take care of intergenerational fairness along the way, through unspecified means. In effect, the Treasury is relying on its power and wisdom, and assuring the outside world that they should rely on these too.

All this might work in a theoretical world, ruled by a benign dictator with perfect foresight. But we are privileged

43 Statista, *Public sector net debt expressed as a percentage of GDP in the United Kingdom from 1900/01 to 2028/29*. Available at: https://www.statista.com/statistics/282841/debt-as-gdp-uk/ (Accessed: 15 January 2024).

to live in a democracy, and a consequence is that political parties compete for electoral support based on policies that need to yield results within the four- to five-year life of a government. There is very little sign that the OBR's long-term concerns exert influence over near-term fiscal decisions; the expansion of debt in recent years, the Government's severe negative Net Worth position and the current (early 2024) political focus on foreswearing tax increases or even enacting tax cuts in the run-up to a mandatory 2024 General Election all suggest that the opposite is true.

The power to tax may be valuable and unique, but to use it requires the ongoing consent of the electorate, and at present this does not appear to be forthcoming on anything like the scale that the UK's long-term fiscal position requires. And indeed, the financial markets' reaction to the October 2022 Liz Truss/Kwasi Kwarteng mini-budget, and the sustained increase in the UK Government's cost of borrowing that has followed, suggests that belief in the Government's financial strength and wisdom has worn rather thin. So, Treasury orthodoxy – that the power to tax obviates the need to invest – appears to threaten both long-term solvency and intergenerational fairness.

How sovereign wealth funds can help fix long-term public finances

If we break away from Treasury doctrine and accept that governments – like other organisations – should manage their finances in relation to Net Worth, not Net Debt, and should be willing to invest to meet future needs, then we unlock the potential for sovereign wealth funds to make a major contribution to meeting the fiscal challenges of the coming decades.

The expression 'sovereign wealth fund' can be used to cover a wide range of government-funded investment activity. Our focus is on two types of fund that address the challenges (and opportunities) on the two sides of the Government balance sheet.

The first – which we will refer to as SWFs – exist to invest public funds in a diversified portfolio of investment assets in order to meet future needs. These could be explicit liabilities like public sector pensions, or implicit liabilities, like expected healthcare and pension costs associated with an ageing population.

The second we will call PWFs (for 'public wealth funds'). In our terminology, these exist to manage existing public commercial assets – frequently property or infrastructure-related – in a way that will maximise financial value to the taxpayer.

The SWF opportunity

SWFs (as we describe them) have been around for many years, and typically have been set up to translate surpluses arising from natural resource exploitation or trade for the long-term benefit of the national population. A good example is Norway, which, at an early stage of its development of North Sea resources, resolved to invest the Government's oil and gas-related revenues. Singapore's Government Investment Corporation (GIC), China's China Investment Corporation (CIC) and State Administration of Foreign Exchange (SAFE) all invest foreign reserves generated through export activity.

The UK might be thought to have missed a trick by not following Norway's example and investing government oil revenues in a similar fund. But the scale of UK revenues was relatively modest relative to the UK economy – at its brief mid-1980s peak, only around three per cent of GDP per year, and under one per cent of GDP each year since 1986-87.[44] So even if all revenues had been invested as received and had earned returns of three per cent above GDP growth, all of which were re-invested, the total value would have been around 80 per cent of GDP today,[45] in contrast to Norway's current SWF holdings of $1.5 trillion or 315 per cent of GDP.[46]

However, the UK has non-debt liabilities relating to pensions and other commitments which are effectively debt, even if they are not recognised in fiscal targets. If the UK were to borrow money to fund these liabilities (or alternatively, to divert other government revenues) and invest in a globally diversified portfolio, it would be highly likely, over time, to earn a significantly higher return than that incurred on the debt. Statistics suggest that an annual surplus of three per cent over the cost of funds might reasonably be expected, though a more precise estimate of expected return would depend upon the investment strategy selected. What is more, the UK would be acquiring an investment portfolio which in the event of a UK or £ crisis would provide a valuable source of financial resilience.

The following tables illustrate how this might work and the effects on government finances, assuming an initial Net Worth of -100 per cent (rather lower than the Whole of Government Accounts estimate), annual investment rate of five per cent of GDP (roughly in line with recent levels of government borrowing). There are two examples: in one case, 100 per cent of investment is assumed to be debt financed, in the other, 50 per cent. (In this case, the implied real cost of government borrowing is zero per cent; a higher real interest rate would increase the positive impact on government finances under these assumptions.)

44 Source: Institute for Fiscal Studies (IFS TaxLab).

45 Authors' estimate, using IFS TaxLab data.

46 Norges Bank Investment Management. Available at: https://www.nbim.no/ (Accessed: 15 January 2024).

Table 2.1. Assumptions

Initial Net Worth as % of GDP	(–100%)
Pension liabilities as % of GDP	100%
Annual funding as % of GDP	5%
Annual (real) return on investments vs borrowing costs	3%

Table 2.2. Results

Funding strategy	100% debt	50% debt 50% other
After 16 years:		
Funding status	Fully funded	Fully funded
Net worth	(–76%) [+24%]	(–34%) [+66%]
Annual revenue impact as % of GDP	+3%	+3%

This might look like a 'free lunch,' and in a sense it is; the Government balance sheet is currently being used very inefficiently for the reasons described above, and the SWF strategy would address this historic failure.

But there are some important points to note.

First, the ability to use government debt to fund an SWF will of course depend upon debt financing being readily available in the required quantities on reasonable terms. This is likely to depend heavily on the overall state of government finances – and in particular, that government credit is and remains strong and that UK Government sterling debt is seen as being of low risk. But a financial framework which targets Net Worth improvement (which is a pre-requisite for the SWF strategy to make sense) and so breaks away from a quarter century of borrowing to fund current expenditure is highly likely to be welcomed by capital markets, now and for the long-term; the SWF would enhance this strategy further through accelerating Net Worth improvement, generating a stronger revenue base and creating a more resilient balance sheet.

Second, there might be concerns that this strategy would increase the Government's risk exposure. In our view, the risks are very limited. Even in a 100 per cent debt-funded strategy, the only incremental risk that is being incurred is the re-investment risk – the obligation to pay future pensions is already in place. Over a century of investment data provide a high level of confidence that a strategy of continually borrowing and investing over a sustained period of time will generate significantly higher returns than the cost of government debt.

Third, there is of course a need for a good deal of fine-tuning. The best asset mix for the SWF will depend upon a number of factors, not just expected return – liquidity, and correlation with other assets and liabilities to name but two. The rate of investment and the extent of debt versus tax financing will also need careful consideration. But the principle – that there is a very large, low-risk, high-return opportunity to improve government finances – seems undeniable.

Finally, this opportunity has been presented as a way of addressing the UK's public sector pension liabilities which total around 100 per cent of GDP and are likely to expand over time unless there are changes to public sector workers' retirement benefits. But there is no reason to stop when the pensions are funded; in principle it would make sense to keep on borrowing and investing to pre-fund longer term, less explicit liabilities such as expected future healthcare and retirement costs.

The PWF opportunity

Turning to the asset side of the balance sheet, the UK was an early adopter of privatisation for state-owned businesses and real estate since the early 1980s and has returned or transferred to the private sector a wide range of industrial, transport, utility, infrastructure and property assets.

However, the UK still has a considerable portfolio of public commercial assets at all levels of government, most notably property holdings that are valued in the Whole of Government Accounts at £409 billion,[47] or rather, less than 20 per cent of GDP.

This seems likely to be a considerable underestimate, for two main reasons.

First, applicable accounting standards require most government-owned property to be valued on the basis either of its current use or its historic cost. Much may have changed over the decades or even centuries since the decisions that determine these properties' current use or book value were taken, and these accounting values might therefore vary radically from market values which would better reflect the opportunity cost of holding these assets. So, these accounting standards should be changed to enable the principles of accrual accounting to be properly applied to governments.

Second, and reflecting the accounting standards, comparisons of the market value of government property holdings with accounting values typically show large discrepancies. For example, in the City of Pittsburgh, market values of government-owned property were recently estimated at 70 times the accounting value.[48] In the UK, Transport for London (TfL) – the recipient of much central government funding for investment and for dealing with Covid-related costs – reports property holdings of around £19 billion. But this value appears to represent less

47 Whole of Government Accounts 2020-21.

48 Ball, J. Crompton, J. Detter, D. (2022) 'Mapping the unknown', *IMF F&D Magazine*, March 2022.

than 15 per cent of TfL's total holdings by number of individual properties; the full market value is likely to be closer to £100 billion.[49] Overall, it has been estimated that governments in developed countries typically own property valued at about 100 per cent of GDP, whether analysed on a local or national basis.[50]

Historically, if the Treasury identifies surplus property on a department's or other government's entity books, it tends to push for that property to be sold. This is of course consistent with debt-based fiscal targets or rules; if an asset is not required, it should be sold and debt reduced.

But this has two negative consequences. First, it provides an incentive for departments to conceal assets or to obscure their true values; admitting to owning a valuable asset might result in the requirement to sell it, and a corresponding reduction on central funding. This is bad for transparency and accountability, and is likely to lead to bad asset allocation. Second, the Government's experience of selling property assets is that prices received for often poorly-managed properties can greatly understate their long-term value.[51]

A PWF offers at least a partial solution to the first problem, and a full solution to the second one. A PWF exists to manage a portfolio of public commercial assets – property, but also potentially infrastructure or operating businesses. To ensure a commercial focus and insulation from political interference or from the commercial inexperience of political leaders, it should be operated on an arm's length basis, with an independent board, clear commercial goals and commercial terms of employment. PWFs can be organised

49 Ball, I., Crompton, J., and Detter, D. (2021) 'Tilted Balance Sheet: Making the most of public sector assets'. *Public Finance*, December 6, 2021.

50 Detter, D. and Folster, S. (2018)'Unlocking Public Wealth', *IMF F&D Magazine*, March 2018.

51 See for example, Bond, D. (2018) 'MoD loses up to £4bn in homes deal with UK private equity group'. *Financial Times*, January 30, 2018.

on a national or regional/local level; examples of the former include Temasek in Singapore, Khazanah in Malaysia, ADQ in Abu Dhabi and of the latter, Copenhagen By & Havn in Denmark, and Hamburg Hafen in Germany.

Birmingham City Council offers an excellent example of where a PWF could transform local authority finances. In September 2023, Birmingham issued a Section 114 notice that stated that it was, in effect, insolvent because of its liabilities under prior years' equal pay claims. The total sum involved was £760 million, of which several hundred million had already been anticipated; the extra cost was therefore not especially large for the UK's largest local authority, overseeing a region with 1.1 million residents[52] and a GDP of £32 billion[53] as of 2021.

Birmingham City Council's annual report[54] states that the authority holds non-residential property valued at £2.5 billion, together with residential property valued at £3.0 billion. These values are not market values, for the reasons described above. But separately, the council reports ownership of 26,000 acres (just over 10,000 hectares) of land,[55] representing just under 40 per cent of the total area under its jurisdiction.

If the actual value of Birmingham City Council's holdings is more in line with the 100 per cent GDP guesstimate referenced above, then a value of £30 billion would be expected. To use another metric, UK property values as a whole appear to be around four to five times GDP,[56]

52 Birmingham City Council website, referencing 2021 Census.

53 Birmingham City Council website, data are for 2021.

54 Birmingham City Council Draft Statement of Accounts 2021-22.

55 Birmingham City Council report, *Community Property Assets* 15 March 2022.

56 Authors' estimates, using data on residential and commercial property values from Statista.com. Other sources suggest similar magnitudes.

suggesting that the property within the council's area is worth £120-£150 billion. Birmingham City Council's 40 per cent share of the land area – which includes considerable holdings in central Birmingham – also suggests that there is a great deal of actual or potential value in its property portfolio.

By establishing a PWF – in this case an Urban Wealth Fund – Birmingham could set up an apparatus free from political interference which would manage its portfolio along commercial lines, ensuring best use of available assets and – of particular importance – developing under-utilised property to maximise value, most likely in conjunction with private sector partners. This could have a major positive effect on the council's long-term financial position, as profits could be distributed to it in the form of dividends. To provide an order of magnitude, if (say) the value of a developed property portfolio was £20 billion, a five per cent yield on this portfolio would yield Birmingham £1 billion per year – three to four times its current estimated operating deficit. Moreover, development of the portfolio should also benefit public policy goals in the areas of urban regeneration and housing provision.

Within the UK, PWFs have very broad potential application, especially in relation to property management and development, both at central and local government level. The sheer scale of the portfolio probably requires the use of multiple vehicles at central government level; local governments, by contrast, might need to pool property holdings to extract desirable economies of scale. At both levels of government, central leadership is required to establish the necessary institutional frameworks to enable these organisations to operate efficiently and safely within the public sector without sacrificing their commercial objectives.

In aggregate, the International Monetary Fund (IMF) estimates that public commercial assets on government hands produce returns that are 1.5 per cent below what should be expected. In the case of assets which are not properly identified on government balance sheets and which are severely undervalued and presumably undermanaged, this seems like a low number. But if we assume (in round numbers) that the true value of UK Government property is 100 per cent of GDP versus a reported 20 per cent, and that this represents the undermanaged part of the portfolio, then this suggests that commercial management could unlock value of the order of 0.8 x 1.5 per cent of GDP, or 1.2 per cent.

One final point. Despite the lack of good accounting for government property values, it is not difficult to derive a working estimate for actual or potential value that can provide a sound basis for developing a PWF strategy. Modern online mapping technology, used in combination with the UK Land Registry, allows usable working data for any given urban area to be generated in a few weeks, and at very modest cost. Lack of data is not an excuse for a failure to examine this valuable opportunity.

Summary and conclusions

We have argued in this chapter that the UK's long-established focus on debt-based fiscal rules and targets, in conjunction with some rather complex (and highly challengeable) financial management doctrines, has had the effect of preventing the UK Government from investing systematically to meet future needs. Moreover, the failure to put accrual accounting at the centre of government finances further obscures financial reality and intergenerational fairness. Given the challenges facing UK Government finances, now and for the future, it is high time to address these issues.

By switching to accounting-driven financial management and adopting Net Worth-based measures of the Government's financial position, the Government can open-up the opportunity to act as any other rational corporation or individual would do: invest and manage based upon long-term future needs.

On the liability side, this could mean recognising that non-debt liabilities are just as real as debt liabilities. Investing to meet these liabilities through a globally diversified SWF can strengthen balance sheet metrics and income flows and improve financial resilience. This is true even if the SWF is financed entirely through the proceeds of incremental government borrowing.

On the asset side, national and local government entities have very large property holdings whose values appear to be systematically and severely understated in government accounts. By establishing PWFs at a national and regional level, assets can be better managed and value extracted for the taxpayer without resorting to under-priced asset sales.

Taking these SWF and PWF initiatives together, there seems good reason to believe that within a couple of decades there is scope for a major improvement in government finances. Fully funding existing public sector pension liabilities via a globally-diversified SWF would increase government revenues by the equivalent of three per cent of GDP, whilst a conservative estimate of the value created by better management of property assets via PWFs is 1.2 per cent. The total of over four per cent is roughly what is needed to meet the long-term fiscal challenges caused by an ageing population and rising healthcare costs.

This chapter is based on a recently published book, 'Public Net Worth—Accounting, Government and Democracy', by Ian Ball, Willem Buiter, John Crompton, Dag Detter, and Jacob Soll (Palgrave MacMillan, 2024).

3.

A British Sovereign Wealth Fund to create an 'anchor investor' for entrepreneurs and start-ups – and halt 'founder flight'

John Penrose MP

Genuinely lasting political legacies are incredibly rare, and positive ones which burnish their owner's reputation in history are rarer still. But, oddly, there's no shortage of genuinely tough, modern problems that offer the chance of political immortality for any government or minister with the bravery and vision to solve them. For example, most economists would agree on at least three things about Britain.

Firstly, that we save less, invest less, and build less economically vital, growth-promoting infrastructure than we should. We've got a rock-and-roll economy that lives for today, and doesn't invest for tomorrow.

Secondly, that Britain is better at inventing clever new widgets than at turning them into profitable, world-beating companies. Brilliant British academic discoveries have a harder time getting out of the lab and into a factory than in Silicon Valley. And when they do, they are more likely to be bought by big firms like Google or Tencent and then moved abroad, so the wealth and jobs in cutting-edge sectors of the world's new economy are created by clusters of firms based in other countries rather than here in the UK.

And finally, that Britain's demographic timebomb of ever-more elderly people, with ever-bigger medical bills, social care costs and state pensions, funded by ever-fewer working-age folk, is about to create a massive, structural challenge for our economy. We are ageing faster than our economy can possibly grow, and marking up the costs faster than working-age people's wages can possibly rise. In other words, we are writing enormous IOUs that promise us all a warm, comfortable retirement, and expecting our children and grandchildren to pay the bills when they're due.

Unless we do something, the result will be ever-higher taxes, or ever-bigger borrowing as future generations struggle to cope with the extra spending. And, equally importantly, because big government debts hamstring economic growth – crowding out private sector investment so wealth-creating projects can't happen and driving up interest rates so the remainder cost more than they should – we risk stifling growth and stunting our wealth creators for years.

These three problems aren't just theoretical questions for ivory-towered academic conferences: the Government's 2023 Autumn Statement shows how politicians are searching for real-world answers too. Giving firms a 100 per cent tax exemption on growth-creating capital investments in new machinery (called 'full expensing' in the jargon) is a big, bold attempt to fix at least part of our anaemic investment track record. And upgrading the British Business Bank's Patient Capital Fund into a fully-fledged and better-capitalised Growth Fund should help more British inventions make the leap from lab coats to profitable businesses successful too.

But there's still a long way to go, and the effects of these three problems on UK jobs and living standards are already showing up in our democracy and politics: try explaining to someone in Manchester why it takes so long to commute to a job on the other side of the city, when it would take half the time in London. Or to a young professional why there aren't enough high-skill, high-paid jobs to enable people in their 20s and 30s to afford a decent place to live.

Even worse, the demographic timebomb is creating a moral test for us all, and we're failing it badly. Doing nothing isn't an option: the pitiless arithmetic of more and more pensioners being funded by fewer and fewer working-age taxpayers will see to that. Carrying on as we are, or kicking the can down the road and hoping that something will turn up, simply isn't financially sustainable. If we just try to muddle through, we will be leaving a cold and mean future of much higher taxes and worse public services to our children and grandchildren. It isn't right or fair to burden them with enormous bills because we were too lazy, or too cowardly, to fix the problem while there was still time. Our demography should not become their destiny. Future generations will have their own bills to pay, so we shouldn't expect them to pick up the tab for ours as well.

The good news is that there's at least one genuinely big, political legacy-creating idea that would deal with all three of these problems in one go. If we set up a UK Sovereign Wealth Fund like Norway's extremely successful version, we could create a pot of savings to pay for a good chunk of the state pension and benefits that we've promised ourselves when we retire. It would build slowly over time and would go a long way to preventing our children and grandchildren from having to shoulder the costs of our lifestyle through higher taxes in years to come.

Not only that, but a sovereign wealth fund would create an 'anchor investor' for British entrepreneurs and start-up businesses, to make it easier for all those clever inventions to get out of our country's university research labs and scale up into world-beating UK firms.

Anchor investors can help stop 'founder flight' – where UK companies move abroad for the next stage of their growth, partly by strengthening Britain's venture-capital ecosystem for funding cutting-edge technology businesses. And partly by using the fund's financial muscle as an investor on company boards to stop key new-economy firms and technologies from moving abroad. Either way, it will mean the jobs and wealth of new industries will be born, grow and become established in clusters of UK firms, instead of in the USA or China.

It would be financially sensible too. The assets in Britain's Sovereign Wealth Fund would be safe, 'investment grade' shares, properties and infrastructure, just like a pension fund. They'd earn a better return than government bonds too: why repay gilts for a modest saving when the same money invested in a long-term commercial infrastructure project somewhere could earn the taxpayer far more instead?

Last but not least, in time the sovereign wealth fund would create a huge pot of patient, long-term investment capital, weaning us off our rock-and-roll addiction to consumer spending and equipping us to grow much faster in future.

Seeding the Fund

Like saving for a pension, we've got to put a little aside for a long, long time, so the fund would build slowly as investment returns compound. It would take decades, but taking our time makes sense for a project this big, because it wouldn't be fair to expect current taxpayers to pay to set up the new system while they're still paying their taxes to fund the old one too – that would be asking them to pay twice. Instead, we need to spread the costs by building the fund across the generations.

But the demographic timebomb is already ticking, so even though it's a project that will take 50 years or more to fully mature, we've got to set up, and start saving into, the fund straight away. We need to plant plenty of investment acorns so the fund can grow into a forest of mighty oak trees.

The first would be to make the fund the legal owner of all the existing and future state-owned commercial investment funds, for example those held in the British Business Bank. These are already investing in just the kinds of early-stage companies which the new fund should cover, and the profits should be ploughed back into more of the same.

We should do the same thing with state-owned land and property, making the fund the legal owner of everything from the Crown Estate, to heritage buildings like Somerset House and valuable chunks of real estate around city-centre hospitals. Lots of them have long-term leases, but as each one comes up to be redeveloped or re-let in future, the fund could manage the process and invest the profits on behalf of us taxpayers.

Lots of other countries have sovereign wealth funds already, and most of them were set up with the proceeds of mining and drilling for everything from oil to copper. We can't go back in time to change how we spent our bonanza of North Sea Oil revenues, but we can change our ways so the fund owns the rights to all future mining and extraction, whether it's of gravel for building, lithium in Cornwall or mineral deposits that haven't even been discovered yet. Either way, if we are reducing Britain's non-renewable natural capital by digging or pumping it out of the ground, we ought to replace it with financial capital on the national fund's balance sheet, so it can be invested forever instead of just spent today.

Sticky-fingered politicians

There will be a few risks along the way, of course. The biggest will be sticky-fingered politicians who, as soon as the fund gets big enough to be tasty, will want to grab bits to spend on whatever will help them get re-elected. Whether it's proposals to invest in politically fashionable projects which won't earn any investment returns, or which preserve jobs in a key marginal constituency, or which ease the pain of a difficult public spending round, a long-term project like the fund will inevitably become a target over the years.

Fortunately, the UK's fund won't be the first to face these risks. It will need rock-solid defences to make sure it doesn't get diverted from what it was created to deliver, and there are already tried and tested ways to build them.

The most important is to set up the fund as a National Insurance Trust, with a heavyweight board of trustees like the Bank of England, to maintain its independence. The Trustees would keep political interference and meddling at arms-length, and have the same legal duties as any other pension fund trustees to make sure the money is invested safely and profitably. And framing the fund as a Trust for UK taxpayers would make it much harder for politicians to raid or interfere with it, because the money wouldn't belong to the Government but directly to each and every voter instead.

Social and financial capital

Even though the fund would take decades to reach full maturity, our economy would feel the benefits much sooner. From the first day it was set up, the fund would start rebalancing Britain's economy, creating stronger and more reliable financial foundations so we invest more for the long-term. The extra infrastructure, from better railways and roads to faster broadband, would level up places that hadn't seen enough investment in the past, and help the entire economy grow faster.

Likewise, the presence of an enormous 'anchor investor' would help British tech start-ups grow without moving offshore, so the jobs and innovation clusters of the new digital economy are built in the UK rather than China, India or USA. And, in turn, the faster growth and extra jobs would underpin stronger and better public services, insulate us against future big economic shocks like the last banking crisis, and build our international heft around the world.

But the real prize of establishing the fund isn't just the way it would transform our economy; it's how it would change British society for the better too. Setting up a new sovereign wealth fund would create a political legacy for this Government as profound as the Attlee Government's creation of the NHS or the modern welfare state. We would have made post-Brexit Britain a generationally fairer society, by refusing to leave today's IOUs for future generations to pay.

We'd become a more socially-just society, too, because rich and poor would all own the same, equal stake in the fund and the wealth it contained. Everyone in British society would get their state pension and benefits paid to them as dividends by the fund, rather than by the Government.

Britain would become the biggest and most equally distributed asset-owning democracy on earth. And our generation would be remembered as the one that broke the mould, and got it done. Our post-war governments created new institutions like the NHS and the welfare state, which helped to forge a new Britain and are still core parts of our society today. This is our generation's chance to do the same, and for the Government Minister who introduces it to chisel their name and legacy into the history books forever.

4.

A British Sovereign Wealth Fund: An answer to Britain's wealth inequality?

The Rt. Hon. Liam Byrne MP

In January 2023, Oxfam calculated that the richest one per cent of Britons hold more wealth than the poorest 70 per cent of Britons. The gulf between the haves, have-nots and have-yachts in today's Britain grows and grows and grows. At an alarming rate. This inequality of wealth is stymying opportunity and progression, harming our society and damaging our democracy. And this is not simply a problem for the here and now. It is a problem for the future because of the force that James Meade knew all too well: 'the "to-him-that-hath-shall-be-given" principle'. The state of equality in any society, argued Meade, depends on the balance between equalising and 'disequalising' forces. If the rates of return enjoyed by small savers were somehow vastly greater than the returns enjoyed by the very rich, then society would slowly move towards a more equal state. But, in fact, the opposite is true, as Thomas Piketty illustrated in 2014: 'It is perfectly possible,' Piketty wrote in *Capital:*

> '[T]hat wealthier people obtain **higher average returns** than less wealthy people…[and therefore] It is easy to see that such a mechanism can automatically lead to a radical divergence in the distribution of capital' (my bold).

As such, a powerful 'disequalising' force is why, today, the rich carry on getting richer than the rest of us, because of the problem of 'differential returns'; big money makes more money than small money.

So, if we want to build a democracy of wealth, more equality of wealth, we must not only improve earnings for all and spread capital to all; we must do one thing more: provide everyone with access to the sort of superior returns that are only possible if you are lucky enough to own a giant amount of assets. And the way to do that is to build a sovereign wealth fund.

We can learn a lot about just why the very rich enjoy such high returns by looking at their investments. Not that this is easy. Professor Brooke Harrington, who literally wrote the book on the wealth-management habits of the super-rich, told me that it is hard to generalise about their portfolios because:

> '[T]he defining feature of financial services to these clients is customisation: you and I get "off the rack" clothes while the ultra-rich get bespoke clothes, cut and tailored specially for them. Same with their investment plan.'[57]

The property firm Knight Frank surveys more than 600 private bankers, wealth managers and family offices every year for its Wealth Report. Their research for 2021 (published 2022) found that, on average, their definition of high-net-worth individuals (those worth $1 million or more) parked around 27 per cent of their fortunes in property.[58] The reason is simple, Knight Frank explained, as the value of property is somewhere between a bond and cash, so it 'enjoys the upside of rising rents and values in times of economic expansion, but also security of income during times of volatility'.[59]

57 Professor Brooke Harrington, private correspondence.

58 Knight Frank (2022) The Wealth Report. Available at: https://www.knightfrank.com/siteassets/subscribe/the-wealth-report-2022.pdf, (Accessed: 18 December 2023) p.37.

59 Ibid.

But, by and large, most of the wealthiest spread the balance of their investments across shares, bonds, real estate and a bit of venture capital, alongside plenty of chichi collectibles.

What is truly remarkable is that these investment strategies have broken the link between risk and reward. Risk is quite low. But returns are sky high. Brooke Harrington explains, 'Some special investments are only available only to the ultra-rich,' Brooke goes on:

> '[W]ith high rates of return and lower risk of losses than are available to regular people like us. That's really important, because that defies the laws of finance, where risk is supposed to be rewarded with returns, and low risk means low returns.'

These are the sorts of investment opportunities that are simply not available to the poor.

This *gulf* in returns enjoyed by the rich and poor was recently surveyed and mapped by some economists from the IMF and elsewhere, who got their hands on some rare data from Norway – almost the only country to actually publish tax returns.[60] The results are astounding. Looking at 12 years' worth of data, the team confirmed that some individuals earn markedly different average returns on their net worth – and that these differences were not explained by some taking risky bets that came off while others buried their gold in the garden; returns were 'positively correlated with wealth'. But the scale of the differences was incredible. In fact, the richest 10 per cent enjoyed returns *18 per cent* higher than the poorest tenth. And these differences persisted over time, and down the generations: you were more likely to enjoy higher returns on your assets if your parents enjoyed higher returns too.

60 Fagereng, A. et al (2020) 'Heterogeneity and Persistence in Returns to Wealth', *Econometrica: Journal of the Econometric Society* 88(1) pp.115-170. Available at: https://onlinelibrary.wiley.com/doi/abs/10.3982/ECTA14835 (Accessed: 18 December 2023)

The agreeable returns enjoyed by the wealthiest affect the make-up of the income that flows into the bank accounts of the very richest. What unites the wealthy is that they draw a significant chunk of their income from investment, not wages. The picture is best clarified by asking: where does investment income in the UK go? And the answer is unsurprising: it goes to the rich. In fact, investment income is far more unequally distributed than any other form of income: an extraordinary 57 per cent of total investment income goes to the richest 10 per cent of households.[61]

There is one obvious way in which we can fix this inequality of access to the best returns on investment. We can create one giant fund, owned by all citizens, in which all citizens share, and from which all citizens enjoy a dividend. This is not some radical flight of fancy. This sovereign (or social) wealth fund (SWF) has been around for almost a century and is now one of the most important features of the global investment landscape.

The basic concept of a SWF is simple. As Matt Bruenig explains in his paper *Social Wealth Fund for America*, 'the government owns a large pool of income-generating assets and then uses the return on those assets for social welfare purposes.'[62] Once upon a time, the concept was proposed as the ultimate phase of socialism, whereby the workers could finally own the means of production. But modern advocates of the idea now range from inequality guru Tony Atkinson to former Greek Finance Minister Yanis Varoufakis, from democratic presidential contender Hillary Clinton to Conservative MPs.

61 The survey is known to under report the number of precise individuals with very high incomes and understate the level of their incomes. An adjustment to correct for this is made to 'very rich' households in FRS-based results using HMRC data.

62 Bruenig, M. (2018) *Social Wealth Fund for America*. The People's Policy Project. Available at: https://www.peoplespolicyproject.org/projects/social-wealth-fund/ (Accessed: 18 December 2023).

Norway, in the 1990s, began squirrelling away proceeds from the country's oil boom to safeguard oil wealth for the benefit of future generations, given that oil-related income would inevitably decline. Nowadays, its fund is worth an incredible £1 trillion – around £185,000 for every Norwegian. Figures for 2022 showed that the fund invests in 9,300 companies globally and owns 1.3 per cent of all listed stocks in the world.[63]

But the SWF idea is not a mere lodestone of Scandi-socialism. Republican Alaska has a similar model. Often lauded as 'the most popular program in the history of the US', it dates to 1976, when Alaska's maverick governor founded the fund with royalties from the oil industry. By 2018, it was worth 113 per cent of Alaska's GDP. Among outcomes paid for by its dividends are lower poverty, increased attainment by disadvantaged young people, and, it is said, a rise in part-time employment of up to 17 per cent. Australia, too, has followed the pattern: its Future Fund was created to help pay for future civil-service pensions, while a second fund, the DisabilityCare Australia Fund, supports Australians with significant and permanent disability.

These are just a few examples from a constellation of more than 70 such funds in countries as diverse – politically, geographically and culturally – as Singapore, New Zealand, France, Ireland and most countries in the Arabian Gulf, as well as nine US states.[64] And at least 40 of these funds have been created since 2005. At the time of writing, the world's largest funds have been estimated at $11.4 trillion (or, £9.4

63 Fouche, G. (2022) *Rocky ride ahead for Norway's $1.2 trillion wealth fund*. Available at: https://www.reuters.com/world/europe/norway-sovereign-wealth-fund-ceo-warns-rocky-ride-ahead-2022-05-03/ (Accessed: 18 December 2023).

64 Roberts, C. and Lawrence, M. (2018) *Our Common Wealth: A Citizens' Wealth Fund for the UK*. IPPR. Available at: https://www.ippr.org/files/2018-04/cej-our-common-wealth-march-2018.pdf (Accessed: 18 December 2023).

trillion).[65] That is a bigger asset base than the £3.3 trillion invested in private equity and the £2.7 trillion invested in hedge funds.

Crucially, Sovereign Wealth Funds invest in assets that generate excellent returns that far outstrip the sort of returns the humble saver might enjoy. As such they can help conquer today's inequality of access to the best returns, because they are – like the super-rich – able to build diverse and substantial portfolios of assets that would always be far beyond the reach of the UK's poorest households, especially when interest rates are low.

In a 2022 study, State Street Global Advisors found the average five-year return for an SWF based in Europe was an extraordinary 8.3 per cent.[66] And between 2018 and 2020, the assets of SWFs grew at an annual clip of 11.3 per cent, the explanation being that 'the acceleration in asset under management growth is largely a function of market gains.' Needless to say, these sorts of returns have been radically bigger than the tiny percentage returns enjoyed by low-income savers in desultory bank and savings accounts.

Now, we must not pretend these funds are perfect. Some funds, because they invest abroad, lead to capital improvements at home getting ignored. Some funds have made poor investment choices. Some do not provide the sort of transparency that would be essential to ensuring popular support. And investment strategies would inevitably become a matter of debate in public.

65 SWFI. *What is a Sovereign Wealth Fund?* Available at: https://www.swfinstitute.org/research/sovereign-wealth-fund and https://globalswf.com (Accessed: 18 December 2023).

66 Hentov, E. and Ale, J. (2022) *How Do Sovereign Wealth Funds Invest? With Strategic Diversification.* SSGA. Available at: https://www.ssga.com/library-content/pdfs/official-institutions-/how-do-sovereign-wealth-funds-invest.pdf (Accessed: 18 December 2023).

But we cannot let the perfect become the enemy of the good. We see that SWFs can provide equality of access to the best returns, one step to bridging that gulf of wealth inequality. But where does the money come *from*? And where does the money *go*?

Around the world, the precise purposes of SWFs vary. Some nations need to stabilise the volatility that is inevitable with exporting natural resources. Some funds – like Chile's Economic and Social Stabilization Fund (ESSF) – are 'rainy day funds,' stabilisation funds, on which governments can draw to cover the odd financial crisis in exchange rates. Recently, the governments of Qatar, Russia, Singapore and Norway each drew down directly from their SWFs to stabilise public finances when deficits soared. Others made investments to support coronavirus-stricken economies.

Other funds are designed to invest for the long-term, to diversify from, say, a dependency on oil. These 'savings funds' focus on building up national assets – converting assets and revenues in the present into renewable assets and revenues for the future. Some are looking for higher returns for their foreign exchange reserves, while others are trying to carve out a new position in the world, by, for example, hosting the World Cup. These 'strategic funds' focus on supporting the domestic economy. They may, for instance, concentrate on development (start-up and growth) of strategically important firms and industries, or on building critical national infrastructure, as in the case of Ireland's Strategic Investment Fund (ISIF). Finally, some countries want to boost savings and opportunities for future generations.

Here in the UK, the basic choice to wrestle with is whether each year we would pay out a little money to everyone or pay out a larger sum to a smaller number of people who need it.

Consevative MP John Penrose advanced the view that such a fund would help mobilise investment in critical new national infrastructure as well as raise funds to help pay down the national debt and offset the gigantic size of future public pension liabilities.[67]

The centre-left Institute for Public Policy Research (IPPR) has proposed a Citizen's Wealth Fund,[68] which, it argues, could quickly build a fund of £186 billion by 2029–30, yielding a four per cent real return, which would be enough to pay all UK-born 25-year-olds a one-off capital dividend worth £10,000. This is likely to have a lot more impact than an annual payment to everyone from a similar size of fund. In fact, a four per cent payout to all adults from that sized pot would only amount to £129. For some, £10,000 might not sound much, but it is a lot more than the net financial worth of 40 per cent of British households. If the dividend were paid into a universal lifetime savings account, to which savers could then add in a tax-incentivised way, that could knock years off the timescale for amassing a house-deposit.

The big question, of course, is where the money going into the fund would come from.

67 Penrose, J. (2016) *The Great Rebalancing: A sovereign wealth fund to make the UK's economy the strongest in the G20.* SMF. Available at: https://www.smf.co.uk/publications/the-great-rebalancing-a-sovereign-wealth-fund-to-make-the-uks-economy-the-strongest-in-the-g20/ (Accessed: 18 December 2023). Penrose, J. (2020) *Time to think big: A UK Sovereign Wealth Fund. Reform.* Available at: https://reform.uk/publications/time-think-big-uk-sovereign-wealth-fund/#:~:text=This%20Reform%20Perspectives%20argues%20that,the%20challenges%20facing%20future%20generations. (Accessed: 18 December 2023). John also sponsored a Westminster Hall debate on UK SWF in 2016.

68 Roberts, C. and Lawrence, M. (2018) *Our Common Wealth: A Citizens' Wealth Fund for the UK*. IPPR. Available at: https://www.ippr.org/files/2018-04/cej-our-common-wealth-march-2018.pdf (Accessed: 18 December 2023).

Generally speaking, around the world, the funds are used to store windfalls of national wealth to ensure that the money is not all spent at once and that there is a semblance of a wealth transfer to the next generation. The money that goes in tends to come from a wide variety of surpluses – like a surplus on a government budget, or foreign currency operations, or through privatisations – and, of course, natural resource exports. What could the UK use?

UK public sector assets today total £2.14 trillion. This includes everything from the rail and road network (£460 billion) through to shares in 515 companies the Government bought during Covid-19 lockdowns.

But the Government's liabilities are £5 trillion. The biggest obligations are the public sector pensions bill, out to the year 2067, which totals £2.2 trillion, or 40 per cent of the liabilities. The Treasury's dirty secret is that the net worth of Britain's public sector has been in steep decline since the late 2010s. It deteriorated by 50 per cent between Brexit and Covid.

So, we need to be imaginative. As Matt Bruenig explains in his excellent book, there are basically five ways of raising the money for a social wealth fund: we can solicit voluntary contributions; we can ring-fence existing state assets; we can borrow at low interest rates and invest the money in higher yielding investments; we can re-deploy foreign currency reserves or some part of the monetary base; and we can impose judicious levies.[69]

The first source, voluntary contributions, is basically a form of philanthropy. It might be a possibility – after all, the very rich do bequeath assets to the nation – but it feels

69 Bruenig, M. (2018) *Social Wealth Fund for America.* The People's Policy Project. Available at: https://www.peoplespolicyproject.org/projects/social-wealth-fund/ (Accessed: 18 December 2023) p.36.

like a case of hoping for the best, while having to plan for the worst. Then there is potentially ring-fencing some state assets. Now that is a good idea. The UK still has significant chunks of shares in British banks, which, when sold, could add up to £13.5 billion. The IPPR recommended using asset sales, including the Government stake in Royal Bank of Scotland and the wind down of the UK Assets Resolution programme. To this, we could also add the Crown Estate and fold in what are called 'dormant assets' – the cash in UK bank and building society accounts that has lain untouched for 15 years. (These accounts have been valued at £3.7 billion, of which just £2 billion is ever expected to be reunited with their owners.) Future sales of the future radio spectrum for mobile services could add another £10 billion.

An even bigger asset Is the state's knowledge capital. Since South Korea's Intellectual Discovery fund first opened in July 2010, sovereign patent funds (SPFs) have begun to show how smart use of intellectual property can be a money-spinner. The UK Government's 'knowledge assets' – intellectual property, tech, data and other intangibles – have been valued at around £150 billion. We should fold our public-sector-owned intangibles together and work harder to maximise the yield.

Then there is the possibility of borrowing to provide some of the capital base for the fund. Even after the debacle of the short-lived Conservative Government of Liz Truss and her first chancellor, Kwasi Kwarteng, interest rates on government 10-year bonds were only 3.312 per cent – whereas average returns for sovereign wealth funds, as mentioned, have been north of eight per cent. So, with these sorts of differentials, it would still be profitable to borrow to invest.

And there are the foreign currency reserves, which are, in my experience, the most under-discussed assets in British politics. Using foreign exchange reserves has cross-party support. John Penrose, for example, proposed that a UK SWF could be capitalised by using foreign reserves – mimicking the approach taken by Singapore, which is another country without a significant natural-resource base. The UK's foreign currency reserves are in remarkably good shape, after a 10-year programme to build up the pot to around £155 billion,[70] where today it sits in the nation's Exchange Equalisation Account. In 2021, it had a little windfall, as the UK was gifted £19 billion in IMF 'special drawing rights,' as part of a global issue of £443 billion-worth of new paper, effectively valued against a basket of international currencies – and we could use half of the cash equivalent, say, £10 billion, for a social wealth fund.

If we put all these potential sources of investment capital together, we could probably see our way, fairly easily, to somewhere between £50 billion and £70 billion. That still leaves something of a gap in reaching a target figure of £100 billion, which is probably the minimum investment needed to generate the sort of dividends that would make a difference to peoples' lives. And that implies that a degree of tax revenue – or levies – will be needed to plug the gap.

How to do that in a fair manner *that* is acceptable across the political spectrum is another topic entirely. But just because it is difficult does not mean that we should discount the fundamental shift a UK Sovereign Wealth Fund could instigate in providing more equal access to wealth across our peoples and throughout our nations, irrespective of the

70 HM Treasury (2022) *Exchange Equalisation Account: Report and Accounts 2021–22*. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1092747/E02772868_HC_602_EEA_Report_and_accounts_2021-22_Accessible.pdf (Accessed: 18 December 2023).

family you were born into or the wealth you do or don't inherit – and shifting our future towards a more equitable landscape for our economy, society and democracy.

5.

A People's Wealth Fund

David G. Green

Many countries have successful sovereign wealth funds. Indeed, some of them own a good deal of our own infrastructure. The Sovereign Wealth Fund Institute maintains a list of 100 sovereign wealth funds ranked according to assets under management. The largest is the Norway Government Pension Fund Global (GPFG), with $1.4 trillion of assets. It was established to ensure that revenue from North Sea oil was invested to pay for future pensions. The second largest is the China Investment Corporation (CIC), with $1.2 trillion, followed by the SAFE Investment Company, based in Beijing and created to handle China's foreign exchange reserves, currently managing around $1.0 trillion. South Korea and Singapore also have funds that invest excess foreign reserves to offset macroeconomic instability. Many oil-rich nations in the Middle East have sovereign wealth funds, as do several US states, including Alaska, Colorado and Idaho.[71]

The main political parties in the UK have all supported the creation of a UK sovereign wealth fund. The 2017 Conservative manifesto said that a Tory government would create a number of 'Future Britain' funds, which would hold in trust the investments of the British people. Initial funds were to come out of revenues from shale gas extraction, and the sale of dormant and public assets. However, the idea was not in the 2019 manifesto and nothing has been done so far.

71 SWFI, *Top 100 Largest Sovereign Wealth Fund Rankings by Total Assets.* Available at: https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund (Accessed: 4 January 2024).

Labour has proposed a National Wealth Fund, to create good, well-paying jobs by investing alongside the private sector in 'gigafactories, clean steel plants, renewable-ready ports, green hydrogen and energy storage'.[72] At the 2023 Labour conference, both Rachel Reeves and Keir Starmer voiced support, and stressed their belief that initial government funding would attract substantial additional funds from the private sector.

Vince Cable put forward a proposal for the Lib Dems in 2018. It was to be financed by selling the Government's stake in NatWest Bank.

The British Business Bank (BBB) has an ambition to become the UK's sovereign wealth fund, investing directly in companies, whereas at present it only operates through third parties. In an interview for the *Financial Times*, its CEO Louis Taylor called on ministers to give the BBB an enhanced role. Currently it invests in venture capital funds that in turn provide financing for individual companies, especially in technology and the life sciences. Its subsidiary, British Patient Capital, was launched in 2018, with an initial £2.5 billion of government funding. Taylor wants the BBB to become a 'sovereign growth fund with long-dated infrastructure' and the freedom to reinvest any proceeds. Operating on strictly commercial lines, he said it would come 'without the stigma of government ownership, statism or picking winners'.[73]

One of the reasons the Conservatives have not created a sovereign wealth fund is the concern that governments

72 Labour Party, *Get Britain building again.* Available at: https://labour.org.uk/missions/economic-growth/ (Accessed: 4 January 2024).

73 'British Business Bank aims to become 'sovereign growth fund'', *Financial Times*. Available at: https://www.ft.com/content/e3827995-823c-49d4-82ca-87b8feb43371 (Accessed: 4 January 2024).

would not make commercially sound decisions. It's a valid concern, but every proposal for a UK wealth fund anticipates insulating investment decisions from short-term political calculations. The underlying assumption is that markets allocate capital efficiently and that state subsidies will interfere with the process, possibly leading to 'crony capitalism.' Money will go to companies with good political connections, not commercially sound projects; or party-political interests will determine investments, leading to the propping up of lame-duck industries in marginal seats; or vanity projects will multiply, possibly named after political leaders or associated with them as their 'legacy.'

Moreover, according to the critics, governments are no good at selecting promising business ventures. If civil servants or elected politicians make decisions, they are likely to invest badly because they don't bear the risk of failure. Entrepreneurs, by comparison, will invest more wisely because they stand to lose everything. This frequently-voiced argument is not relevant to the proposal in this essay because it does not envisage government employees making decisions. Investments will be based on sound commercial judgements about companies within the UK.

A democratised sovereign wealth fund

If the UK were to create a sovereign wealth fund, the model could be democratised to give every British citizen a chance to share in the productive capital of the nation. Here is one way it could work. Instead of creating a state body with the Government retaining any profits, we should establish a people's wealth fund owned by individual citizens who would receive dividends.

The fund could be called the British People's Wealth Fund, and managers would only be permitted to use deposits to buy gilts or to invest in productive enterprise in the UK. The fund should not invest overseas. Initial funding will not come from government borrowing or the earmarking of tax revenue but by selling shares to UK citizens.

How should shareholders in the British People's Wealth Fund be rewarded? There would be an income from the interest on government bonds and some investments will produce profits. One possibility is that, for the first year, shareholders could receive a fixed rate of five per cent. Subsequently they would receive dividends. A rule could be made that half of all profits must be paid in dividends, and the other half reinvested. All receipts would be tax free.

Deposits would be locked in for the first year, and after that shareholders could sell back to the wealth fund at par value or sell privately at the market price, but only to other British citizens. A designated exchange will be necessary to handle share transactions.

To ensure independence from the Government and to avoid hostile takeovers, the wealth fund would be registered as a company limited by shares, with one shareholder, the relevant Secretary of State, who would be legally obliged not to interfere in day-to-day management. This is the corporate structure of the British Business Bank, which has worked well so far. It follows that the shares available to members of the public would be non-voting.

To ensure wide participation, it would be a simple matter for the Government to cover any losses. The promise that you can't lose but could gain a great deal would be a legitimate reward for investing in your own homeland. The wealth fund could invest in businesses by making loans but also by taking an equity stake in some companies. This would allow shareholders in the wealth fund to benefit from any dividends paid as well as any increases in the market value of successful enterprises.

In addition to creating a pot of new money to encourage economic growth through investment in new productive assets, establishing a people's wealth fund would also have some other advantages.

First, we have recently been forcefully reminded that a government that wants to increase public borrowing by selling gilts to bond dealers is going to have to pay a high rate of interest. A people's wealth fund would reduce reliance on international bond markets. As a result of quantitative easing, the Bank of England owns about one quarter of UK Government gilts. It has already started to reduce its holding, which could put public policy-making even more at the mercy of international bond markets. Instead of borrowing from foreigners, it would be beneficial for interest payments on bonds to go to British citizens via the wealth fund, potentially boosting consumer spending as well as insulating governments from overseas pressure.

Second, the war in Ukraine and the conflict in Gaza have focused minds on the importance of energy security. A people's wealth fund could invest in the North Sea, enhance our self-sufficiency and help to reduce the price of natural gas. Climate change alarmists argue that much of the oil would be exported, but even if some of the oil and gas is sold overseas, the tax revenue and export receipts will benefit everyone in the UK. Moreover, any increase in output helps to reduce world market prices.

Third, when entities are owned or dominated by epoch-defining, systemically challenging foreign states who are in control of significant parts of our essential infrastructure, we may find that our government is coerced into unwanted measures. No doubt this is why the Government recently reduced the role of Chinese companies in building new nuclear power plants.

Nevertheless:

- China General Nuclear Power Group (CGN) owns a one-third stake in the power plant Hinkley Point C, now under construction.
- The China National Offshore Oil Corporation (CNOOC) is responsible for about a quarter of the UK's North Sea oil production.
- The China Investment Corporation (CIC) sovereign wealth fund owns 8.7 per cent of Thames Water.
- CIC also has a 10 per cent stake in Heathrow Airport, and 61 per cent of Cadent Gas, which supplies around 11 million homes and businesses.
- CK Infrastructure Holdings, based in Hong Kong, dominates the supply of gas in the north of England, and also in Wales and South West England. It has a monopoly on the supply of electricity to London through a company called UK Power Networks.
- Moreover, British Steel has been bought by Jingye, a Chinese steel maker. It plans to shut down its blast furnaces and to replace them with electric arc furnaces, which melt scrap metal but are not capable of extracting iron from iron ore, rendering us even more reliant on imports from China.

All Chinese companies are under some degree of influence from the Chinese Communist Party (CCP). They may be nominally private but there is no true independence in China. Our reliance on Chinese imported manufactures is now so great that many foreign policy decisions have to consider the preferences of the CCP. Parliament's Foreign

Affairs Committee has recently warned that Britain's net zero drive has left us dangerously exposed to Beijing, when China has already 'weaponised' the supply of critical minerals 'for political leverage'. Alicia Kearns, chair of the Foreign Affairs Committee, said:

> 'It is particularly clear that we need to confront the weakness created by our dependency on a single state: China. These minerals power modern life and if China pulls the plug, we will all pay the price.'[74]

The Henry Jackson Society estimated the extent of the UK's overall dependency in 2020. It thought that 'strategic dependency' arose when a nation was a net importer of a product and imported more than 50 per cent from China when China controlled more than 30 per cent of the global output. These conditions were met for 57 categories of goods and services. Reliance on China for basic pharmaceuticals was especially strong. Some British manufacturers would run into trouble if they were no longer able to obtain components from China. Research by the trade association Make UK found that 65 per cent of large UK manufacturers rely on Chinese imports and are consequently vulnerable to Chinese pressure.

Fourth, a sovereign wealth fund would help to overcome our historically low rate of investment. The Office for National Statistics has published expenditure on gross fixed capital formation (GFCF) for 34 OECD member states from 1997-2017. Over that period the UK annual average was six percentage points lower than the OECD average. In 2017, the UK was bottom of the table, with 16.7 per cent spent on GFCF as a percentage of GDP. Italy spent 19.6 per cent; Germany, 20.5 per cent; the USA, 20.8 per cent; France, 21.7

74 *Telegraph*, 15 December 2023.

per cent; and Japan, 24.6 per cent.[75] The latest UK figure for 2022 was 18 per cent, still too low for a nation that needs to make up lost ground.

A people's wealth fund can be expected to reverse that failure and provide vital support for economically viable independent small and medium-sized enterprises.

Would it work in the UK?

The sovereign wealth funds of numerous foreign countries show that the model works. We used to have something similar for a couple of decades after 1945. The Industrial and Commercial Finance Corporation (ICFC) was founded by the Bank of England and the major British banks in 1945 to provide long-term investment for small and medium-sized enterprises. During the 1950s and 1960s, it became the largest provider of capital for unquoted companies in the United Kingdom. It was eventually privatised.

The ICFC was a commercially viable operation. It kept its interest rates low but did not provide capital at rates below the market norm. Loans provided by the ICFC were made at a fixed rate of interest, a risky strategy for the Corporation but highly beneficial to recipient companies who faced predictable annual repayments. The ICFC aimed both to 'earn respectable profits' and to 'act as an accelerator in the process of a firm's own capital formation'.[76] If the proposed wealth fund pursued a similar strategy, the impact could be transformational.

75 ONS (2017) *An international comparison of gross fixed capital formation*. Available at: https://www.ons.gov.uk/economy/grossdomesticproductgdp/articles/aninternationalcomparisonofgrossfixedcapitalformation/2017-11-02 (Accessed: 4 January 2024).

76 Merlin-Jones, D. (2012) *Extending Lending: The Case for a State-backed Investment Bank*. Civitas. Available at: https://www.civitas.org.uk/content/files/ExtendingLendingJan12.pdf (Accessed: 4 January 2024).

Most overseas sovereign wealth funds increase the power of government within their respective nation. My proposal is intended to increase the economic independence of the people by allowing any citizen to buy a stake in Britain's productive assets. The proposal differs from buying shares in individual companies in that investments are limited to the UK. Some might say that this is not operating on purely commercial lines, but this claim fails to take into account the fact that many products can be manufactured just as well in the UK as anywhere else. Often the main factors that influence business location decisions are under the sole control of governments and have little to do with the technical efficiency of operating in one place rather than another. Today, the influence of state subsidies and concessions on location decisions is especially strong. The Chinese Communist Party has long provided vast, often undisclosed, subsidies, and now the US Government has retaliated with the passing of the misnamed Inflation Reduction Act. If a British wealth fund tipped the balance in favour of locating in the UK, it would not add to the 'distortion' of markets but merely correct for distortions already taking place. If we do not recognise this reality, we could be left with very little manufacturing within a decade or so.

In all, a people's wealth fund would increase investment and give everyone a chance of holding a stake in our future prosperity.

6.

A Sovereign Wealth Fund for the United Kingdom? Rich doesn't necessarily mean rich

Professor Adam Dixon

Sovereign wealth funds seem to be everywhere these days, and governments of all stripes want one. Indeed, the number of funds has exploded. A couple of decades ago the number was in the low tens. Today there are more than 100, depending on what counts as a sovereign wealth fund. Most, however, are relatively small. The number of sovereign wealth funds with any real fire power to move markets, funds with, say, more than $100 billion, are less than 20. The majority are much smaller and many new sovereign wealth funds are focused on catalysing economic development of some kind or managing other state assets. They are 'development' funds or 'strategic investment funds' that form part of a country's (or region's) industrial policy.[77]

For most people, and this includes policy-makers and financial journalists, they don't think of these smaller funds but the really big ones. When they imagine a sovereign wealth fund, they think of Norway's $1.3 trillion fund, the big funds in the Middle East, or the China Investment Corporation. I don't base this on a scientific survey, but on my more than 15 years researching sovereign wealth funds

77 For a contemporary history and overview of sovereign wealth funds, readers are invited to read, Dixon, A.D. et al (2022) *Sovereign Wealth Funds: Between the State and Markets.* Agenda Publishing. The book is available free to download at: https://library.oapen.org/handle/20.500.12657/63872 (Accessed: 12 January 2024).

and having been an interloper in various policy debates and international conferences. I base this also on the many instances where I've tried to explain what my research is about to lay people or other academics. Usually, I'd get a response of the type, 'Oh, like Norway, right?'

I point this out – what I believe to be the common perception – as it matters for debates around establishing new sovereign wealth funds. I would conjecture that Norway is in the back of the mind of most policy-makers anywhere in the world when considering the establishment of a fund in their own country. They don't think of Norway necessarily in terms how the Norwegian fund is governed or how transparent it is – though there are many useful and not-so-useful lessons from the Norwegian case. They think of Norway because the fund is so large, particularly in relation to the size of the population. Norwegians look very rich! And who doesn't want to be rich?

For several years, I was an expert advisor to the OECD Development Centre for their Policy Dialogue on Natural Resource-based Development. Over a period of a four years between 2015-2018, I attended bi-annual meetings in Paris and wrote a series of background papers on sovereign wealth funds for the participants, covering various issues from natural resource revenue management to the governance of these funds. Most of the participant countries were emerging markets, many from Africa, and many with potentially significant or already significant natural resource revenues from hydrocarbons or minerals. The aim of the meetings was to foster better management of these revenues to support economic growth and development.

At this meeting, Norway's example was often mentioned. I got the sense that some thought that establishing a sovereign wealth fund would lead to greater wealth. I found myself saying more than once, 'we have to remember that

Norway was rich before it got rich.'

Norway has a massive sovereign wealth fund that certainly will be highly welcome to future Norwegians. But before the Norwegians set up their fund in the 1990s, Norway was already a high-income, developed economy. The Norwegian sovereign wealth fund was set up to manage its burgeoning hydrocarbon revenues as a matter of macroeconomic necessity. It wasn't setup with the aim of making the country rich. Norway was already wealthy – wealthy in terms of having a robust democracy, quality education, and high standards of living.

Norway, to be fair, uses its natural resource revenues to support government spending and the generally high quality of life for its citizens. But, and this is a key point I want to stress, Norway would likely manage to have a high standard of living without a sovereign wealth fund.[78] The latter is nice to have, but it isn't decisive. Norway's nearest neighbour, Sweden, doesn't have a sovereign wealth fund (it does have significant public pension funds, however) and it also has a high standard of living and is an engine of innovation.

In reflecting on this with the resource-rich developing countries at the OECD meetings and in several other international meetings I've attended, I didn't argue that establishing a sovereign wealth fund was a bad policy choice.[79] I did, however, emphasise that Norway wasn't

78 This point should not be read as suggesting Norway didn't need to establish a sovereign wealth fund to manage its hydrocarbon revenues. Establishing a sovereign wealth fund in Norway as part of a coherent system of natural resource revenue management has been absolutely important for the country's macroeconomic stability, which necessarily supports the health and ongoing development of the economy.

79 See, for example, my remarks and background paper for the Wilson Center Africa Program in Washington, DC, in 2016. Wilson Center (2021) *Africa: Year in Review* 2020. Available at: https://www.wilsoncenter.org/person/dr-adam-dixon (Accessed: 12 January 2024).

the best example to follow. Norway focuses on saving its hydrocarbon revenues, whereas most developing countries are better off investing current revenues in infrastructure and human capital but with an eye to the absorptive capacity of the economy and the volatility of commodity revenues. This means having a stabilisation fund of mostly liquid securities that smooths out the volatility of commodity prices and thus provides more certainty to the public purse.

The other key point to make is that a sovereign wealth fund is only as effective as the broader terrain of economic governance. If public finances are a mess, if the central bank is poorly run, if the rule of law is weak and so forth, having a sovereign wealth fund isn't going to be that helpful for economic development, especially over the long-term. Nor is a sovereign wealth fund going to be useful if access to education is limited and the quality poor, or basic infrastructure is lacking. Who cares if a country has a sovereign wealth fund in 30 years' time if the country and its citizens don't have the skills or the opportunities to be productive? Establishing a sovereign wealth fund in most cases should be a second or third-order priority.

Many new sovereign wealth funds, as I mentioned earlier, are not in the business of managing natural resource revenues. They are strategic investment funds and hence the example of Norway is moot. Strategic investment funds typically have a mandate to invest in infrastructure and new industries, help reform existing state-owned enterprises, support development of the financial sector, and act as a co-investor with other foreign institutional investors to facilitate foreign direct investment. But these funds shouldn't be seen as another government agency operating on terms expected of a civil service. Generally, these new funds are set up as (semi)independent organisations, meant to operate just like any other investment fund you'd find on Wall Street or the City of London – at least that's the idea. For developing countries with shallow capital markets and a limited financial services sector, this is an attractive policy option. The state steps in where the market doesn't or where a market doesn't yet exist.

The example par excellence is Temasek of Singapore. Temasek was established in 1974, in the early years of the country's independence and early on in its economic transformation. Temasek was initially a holding company of the Government's shares in state-controlled or government-linked firms. It was hence firmly embedded in the Government's economic development apparatus, led by senior civil servants. It wasn't a strategic investment fund as we think of them today. Over time, Temasek sold off some of its shareholdings, mainly in those investments that weren't made necessarily on commercial grounds.[80]

In the last couple of decades, Temasek has transformed into a strategic international investor with investments around the world. It has retained holdings in the crown jewels of the Singaporean economy, but the Singaporean growth machine has sufficient self-propulsion such that Temasek isn't a crucial player anymore. Takeaway Temasek or the country's other sovereign wealth fund, GIC, and Singapore will still be rich. The country's highly skilled workforce and integration in global value chains and global financial markets are arguably of much greater value.

Does the United Kingdom need a sovereign wealth fund?

Talk of establishing a sovereign wealth fund in the United Kingdom is not new. There was a chance with the Callaghan

80 For more on this history, I would recommend reading, Braunstein, J. (2019) *Capital Choices: Sectoral Politics and the Variation of Sovereign Wealth*. Ann Arbor: University of Michigan Press.

Government in late 1970s when North Sea oil production was ramping up. The Scottish nationalists brought the issue up more recently during the independence referendum in 2014. If only Britain had put money aside like Norway! In hindsight, maybe Callaghan was right to suggest the establishment of an oil fund. Thatcher used oil revenues instead to reduce the tax burden. But this is history. North Sea oil production is in decline and the tax burden is the highest it has been in more than a generation.

If the British Government has any money to set aside in a savings fund, which is not clear it does, taxpayers aren't going to go for that. Some will want tax cuts, others will tell Parliament to do its job and spend the money on any number of things from the NHS and education, fixing potholes, or funding the military to be able to respond to all the authoritarian countries on the march around the world. Current and future generations in the UK want skills and quality infrastructure. A trust fund is nice to have, but most people want to be productive and innovative today – and they want that for their children as well.

Besides, the biggest winners would likely be the asset management firms that will take a nice fee for investing that money on the Government's behalf, assuming a fund wouldn't, at least initially, invest the portfolio directly. Some will make that argument without doubt. And, whether returns after fees are better than what the Government spends on debt service is a whole other story. But this assumes that a British sovereign wealth fund would be a long-term savings fund. If long-term savings is a priority, then reinforcing the pension system and private savings is likely easier than setting up a completely new entity.

But what if a British sovereign wealth fund isn't setup to be a long-term savings fund like Norway's Government

Pension Fund Global (GPFG)? What if what Britain needs is a strategic investment fund? When Singapore set up Temasek, it wasn't the powerhouse economy it is today. Recall that it was setup to manage the Government's holdings in state-owned businesses. The UK doesn't have many of those anymore, aside from a handful of holdings. A fund that acts as a holding company makes little sense. But this is one role of many. The catalytic role is still compelling. But is it?

If Britain needs a strategic investment fund to catalyse new industries, one must ask what all those private equity, venture capital, investment banks, merchant banks, high street banks, and list goes on, in London are doing. London has some of the most capable financiers in the world that know how to raise capital and invest it accordingly. To be sure, London is an international financial centre, and much activity is global in scope. But there is still a domestic market, and it's not all concentrated in London.

If Britain's world-class financial services industry isn't investing in British industry and entrepreneurs, why is that the case? I won't attempt to answer that question here. The question I would ask is, if they aren't, how can we be certain that a state-owned investment fund will do any better? If Britain's world-leading financial sector isn't mobilising capital for the UK, maybe that's because the commercial case isn't there? That doesn't mean there isn't good reason for a state-owned fund to come in and nudge things along a bit. But the toolkit of government is broad. Rather than creating something new and spending public funds on teams of external consultants that will be waiting to advise the Government on setting-up a new fund, it is likely much more cost-effective and potentially more effective in terms of desired outcomes to look at existing competencies and capabilities.

The other challenge for a strategic investment fund operating in a highly developed financial market, assuming it is supposed to operate on commercial terms, is how well it competes with other investment funds from the private sector. How can the state investor ensure that it has access to deal flow or that it isn't the last in line? Can the state investment fund attract the best talent and offer a competitive pay package? Such problems aren't insurmountable, but they aren't trivial either. It's easy to look at successful examples like Temasek. But doing the same in a different time and context is likely harder than it seems.

Although it may seem that I'm offering a purely market liberal perspective that is at base sceptical of state intervention, and hence the establishment of a sovereign wealth fund, my argument is more nuanced than that. The point is not that a sovereign wealth fund is a poor policy option, even for a country like the UK. Nor am I arguing that state intervention to foster markets, drive innovation and so forth, is best left to market forces. The point, rather, particularly in a case like the UK, is that a sovereign fund may not be the most ideal policy choice. The UK, its Government, its entrepreneurs, its universities, its citizens, are capable and possess potential that many countries would love to have. There are many ways to unleash that potential.

7.

Ireland's Sovereign Wealth Fund experience, 2001-2023: Flexibility for a developed economy

Eugene O'Callaghan

This is one perspective[81] on Ireland's Sovereign Wealth Fund (SWF) experience since 2001. This essay seeks to outline Ireland's sovereign wealth fund history and to articulate how these funds have, in a highly flexible manner, supported the development and management of the Irish economy through periods of rapid change in economic conditions.

The common threads underpinning this flexibility, while at the same time delivering strong investment performance, have been:

- Clarity on objectives and strategy, even as these have been changing;
- Consistent fund architecture, governance and management;
- Adaptability of the investment team; and
- Portfolio liquidity.

In general, there are three types of SWF – rainy day funds to provide liquidity when needed by government, inter-generational funds to save for future generations, and strategic investment funds that invest commercially with

81 The author was CEO of the Ireland Strategic Investment Fund (ISIF) from 2014-2021 and of its predecessor the National Pensions Reserve Fund (NPRF) from 2010-2014. From 2005-2010 he worked as a senior member of the NPRF team.

impact objectives (economic, environmental or social). Ireland's experience is that its two SWFs to date have, over the last 20-plus years, combined and rotated in full or in part across each of these SWF types.

This essay will first introduce the National Pensions Reserve Fund which served as an inter-generational fund from 2001-2014, and will then describe its successor, the Ireland Strategic Investment Fund, which over its lifetime up to the present has implemented a number of strategy variations as material changes to economic conditions occurred, often quite rapidly.

The Early Years: National Pensions Reserve Fund (2001 – 2014)

The National Pensions Reserve Fund (NPRF) was established in 2001 as an inter-generational savings fund with a mandate 'to meet as much as possible of the costs of social welfare and public sector pensions between 2025 and 2055'. Its goal was to maximise longer term return subject to risks acceptable to the NPRF Commission.

The Commission was the board of trustees established to operate and oversee the NPRF and comprised external and non-political independent financial and business experts, including, at all times, one or two members from outside Ireland.

The Manager was the National Treasury Management Agency (NTMA), a government agency whose mission, across five main business areas (one of which is SWF investment) is to manage public assets and liabilities commercially and prudently. NTMA, across all of its activities, seeks to operate to the highest private sector commercial standards and has significant flexibility in its remuneration policies as compared with traditional civil service departments.

The macro backdrop was that the Irish economy had performed very well in the 1990s, the demographics of the country were young, and pension payments by government (social welfare and public sector workers) were funded on a cash basis each year from tax revenues. Government decided to set up a sovereign wealth fund to prepare for the next generation when it was projected that the ratio of workers (paying tax) to pensioners (receiving pension payments) would reduce from 5:1 around the turn of the century to 2:1 by 2050. In other words, there would not be enough tax received on an annual basis for the next generation in Ireland to fund ever more substantial pension costs and establishing a savings fund would enable current taxpayers to contribute to the pensions they would receive in due course.

The NPRF was seeded with the proceeds of the privatisation of the state-owned telecom company (€6 billion), with Exchequer contributions of one per cent of gross national product (GNP) injected annually (typically around €1.5 billion) and no withdrawals were permitted before 2025.

Traditional Sovereign Wealth Fund (2001–2008)

NPRF operated a conventional manager-of-manager model across global asset classes – initially bonds and equities with diversification into real estate and private equity after about four years of operation. Although heavily exposed to equities, a generally prudent investment strategy was followed (for example, being significantly overweight in cash in advance of the 2008 crash).

By the end of 2007, the fund had grown to over €21 billion and represented in excess of 13 per cent of GNP, which was becoming a meaningful amount in the context of the state's finances. Performance up to 2007 was independently assessed and found to be 'a very good result'.

More generally, public stakeholder review of performance commonly compared results with those of the 'average Irish pension fund' with quarterly published manager league tables providing easy comparators. While NPRF performed solidly against this comparator, it did result perversely in more focus from certain stakeholders on relative performance. For example, in 2005, an under-performance of one per cent against the average Irish pension fund in a year when the fund return was over 20 per cent was more harshly criticised than performance in 2008, when the NPRF outperformed the average Irish pension fund by four per cent. Nevertheless, the fund's absolute return in 2008 was a deeply negative -30 per cent and the fund size fell to €16 billion.

In retrospect, while objective performance evaluation is vital, it may have been preferable to tailor the NPRF's benchmark for its particularly long-term timeframe and its specific risk appetite and to introduce a wider performance scorecard, where both absolute, real (net of inflation) returns and absolute returns in excess of risk-free rates would also have been important elements.

The investment team in NTMA over that period typically ranged from 10-15 people, with key functional heads in asset allocation, public markets, private markets and risk. In addition, the investment team was supported by NTMA corporate functions, including finance, operations, IT, legal and HR.

The Commission was a key contributor throughout this period, constantly challenging and supporting the investment team with high levels of credibility and insight derived from their individual expertise and experiences.

Re-capitalising Irish banks post GFC (2009-2011)

Following a sustained period of very strong economic growth over the preceding 15 years, and triggered by a classic real estate boom and bust, the Irish economy crashed in 2008. GDP fell by 10 per cent over the three years to 2010, the tax base collapsed, the banking system collapsed under the weight of severe bad debts and Ireland (an AAA rated counterparty in 2008) lost access to sovereign bond markets and its credit rating fell to junk status. This was a genuine financial crisis.

In 2009, having passed amending legislation relating to the NPRF that reflected the need 'to remedy a serious disturbance in the economy', Government front-loaded Exchequer contributions to NPRF for 2009 and 2010 of €3 billion and directed NPRF to invest €7 billion to partly recapitalise Ireland's two leading banks (AIB and Bank of Ireland) which were experiencing severe difficulties. Government also suspended further annual Exchequer contributions to NPRF.

Because NPRF had increased its cash position and had substantial bond holdings, it had significant liquidity and was able to fund these bank capital injections without materially compromising the rebound potential of its portfolio following 2008. This was a crucial factor in enabling the rebuilding of NPRF's portfolio value after equity market bottoms were reached in early 2009.

In late 2010, Ireland entered into an €85 billion three-year financial support programme with the 'Troika' – IMF, European Union and European Central Bank. This programme provided liquidity support for Ireland's fiscal and banking system needs and committed Ireland to a series of austerity measures, public sector pay cuts, structural reforms and bank recapitalisations. Of the €85 billion, it was agreed that Ireland itself would provide €17.5 billion.

The bulk of Ireland's contribution to the Troika

Programme came from NPRF via NPRF's investment, under direction from the Minister for Finance, of a total in excess of €20 billion into AIB and Bank of Ireland (which included the 2009 investment and further substantial investments in 2010 and 2011).

To fund these directed investments, NPRF needed to liquidate a significant proportion of its portfolio, which was mainly in liquid assets. These asset sales took place mainly in 2011, after the equity portfolio had regained significant value since 2009. After the directed bank recapitalisation, investments were completed during 2011, and NPRF's discretionary portfolio was valued at approximately €5 billion.

Transition phase (2011-2014)

In 2011, which was the epicentre of the financial storm that hit Ireland, there was an acute shortage of capital available for investment in businesses and projects in the Irish economy. The banking system had been rescued from collapse, it was dealing with a myriad of loan exposure problems and its capacity for new lending and investment was very low. Domestic businesses were struggling and international confidence was low. The only bright spot was the export sector, driven by multinational companies with substantial operations located in Ireland, which continued to deliver improved performance year on year.

Government therefore decided in late 2011 that it wished to convert NPRF into a strategic investment fund which would focus on investment in areas of strategic importance to Ireland, investing on a commercial basis to earn attractive, risk-adjusted returns while also acting as a catalyst for attracting third party investment capital to Ireland.

Developing the strategic investment fund concept, drafting and passing the relevant legislation, and establishing the new fund inevitably took time and was of secondary priority compared to many of the other difficulties faced by the country. The outcome was this process was not eventually completed until late 2014. This in turn presented a substantial transition-related dilemma for the Commission – the existing NPRF global long-term mandate and the Commission's statutory responsibilities, including for risk appetite, remained legally in place, but Government had indicated it wished to radically change the focus of the fund towards investment in Ireland.

The Commission resolved this dilemma via a 'straddling two horses' approach aligned with remaining prudent. It decided that:

(i) It would continue to invest significantly in global equities, but purchase 'put option' protection to ensure NPRF asset values would not be unduly depleted by major market movements.

(ii) It also determined that NPRF could prudently invest up to 20 per cent of its assets in Ireland (previously Irish investment exposures had been negligible), to avail of attractive investment opportunities in Ireland as capital was scarce and in anticipation that the NPRF mandate would be changed.

From capital scarcity to booming economy: Ireland Strategic Investment Fund (2014 to present)

The Ireland Strategic Investment Fund (ISIF) was established in December 2014 and all NPRF assets, which at that point were valued at just over €7 billion, were transferred to the ISIF.

The ISIF mandate is to 'invest on a commercial basis to support economic activity and employment in Ireland'. It therefore has a 'double bottom-line' mandate – both financial return and economic impact. It was also charged with catalysing co-investment from the private sector in investments in Ireland in which it participated.

Governance

The NTMA governance was overhauled as part of this new legislation. The board of the NTMA was assigned responsibility for approving the ISIF investment strategy. This comprises six independent members with senior-level expertise in business/finance/economics/law and so forth, two senior Government Secretary-Generals, and the NTMA CEO.

The legislation also established an Investment Committee, which comprised two of the independent board members together with three additional external members with substantial relevant expertise and experience. The Investment Committee advises the board on strategy, approves ISIF investments and oversees implementation of the ISIF strategy.

This multi-layered governance architecture was very important in keeping political influences away from ISIF's investment decision-making in the domestic economy, while at the same time maintaining accountability for performance and an ability for political and government considerations to be taken into account in ISIF's overall investment strategy.

Double bottom-line

In relation to the double-bottom line mandate:

Financial return

- The financial return objective was to exceed the cost of Irish Government debt over a rolling five-year period. This created a deliberately slow-moving benchmark, appropriate for a fund that would be investing largely in private markets.

- The underlying rationale was that exceeding the cost of government debt would justify the fund's existence as compared with using the fund's assets to pay down debt.
- Setting a lower (rather than higher) target return rate enabled the fund to invest not just in high-risk and high-return opportunities, but also in lower risk and lower return debt investments where the economic impact was expected to be significant.
- The key consideration for each individual investment was 'risk adjusted expected return', and the job of the investment team was then to build a portfolio of investments which delivered an overall blended return in excess of the cost of government debt.
- Ensuring risk adjusted expected return was always commercial was a key task of the investment team, and this in Ireland's case was further ensured due to EU competition rules which effectively prohibited provision by ISIF of any state assistance on investment transactions.

Economic impact

- Economic impact was based on the economic concept of additionality – where an investment made would generate positive economic impact (Gross Domestic Product (GDP) at economy level or Gross Value Add (GVA) at enterprise level) that would otherwise not have been achieved.
- The corollary was to ensure that ISIF avoided deadweight (where its capital was replacing capital that would otherwise be readily obtainable from the market) and displacement (where the business or project invested in succeeded at the expense of other participants in the economy).

- A secondary economic impact objective was to crowd in co-investment alongside ISIF's investment – thereby achieving the economic impact of a project/business but using lesser amounts of ISIF capital and encouraging wider investor participation in investment in Ireland.

ISIF, in practice, assessed every investment for **both** financial return (risk-adjusted expected return) and economic impact (additionality). Failure to deliver on either test would cause an investment opportunity to be declined.

Implementation of economic impact principles sometimes resulted in counter-intuitive decisions. For example, the subset of the small and medium-sized enterprise (SME) sector engaged in service businesses in the domestic economy would not pass the displacement test – as investing in a service business that did well would generally be at the expense of another business in the same sector. In which case, at macro level, market demand and total economic activity would not be increased due to an ISIF investment in one such service business. In contrast, an SME that exported its product or service would add to economic activity (GDP) if it was successful and grew, and therefore would pass the additionality test.

The other aspect of additionality that emerged over time but which was not appreciated at the outset was that economic additionality inherently forces ISIF to be complementary to existing investors and financiers active in Ireland and not competitive with them. If the finance being sought was readily available from the marketplace, then ISIF would not invest.

What was also less appreciated at the outset was the difference between failing on financial return and failing on economic impact – if the investment is lost, the money is gone forever and can never be recycled; however, if the investment is good financially but economic impact does not materialise, then the investment can be sold and the fund can 'try again' for economic impact with a new investment.

The strategy and the ISIF's subsequent operations identified ISIF's strategic differentiation (as compared with private sector participants in investment in Ireland): ISIF is long-term, flexible as to the nature of its investment across the capital structure and can add value as a sovereign investment partner (with other investors, customers, attracting staff and so forth).

Finally, ISIF has developed and implemented a reporting regime which publishes portfolio summaries, financial returns, multiple economic impact metrics at portfolio level and a detailed line-by-line listing of every investment held by the Fund.

ISIF 1.0 (2015-2018)

The first objective was to develop an investment strategy. While strategic investment funds have become much more commonplace in recent years, in 2015 there was no established precedent for ISIF and it had to find its own way, much like any start-up business.

ISIF's initial strategy (ISIF 1.0) identified areas in which it would invest as follows: infrastructure, energy, commercial real estate, housing, SMEs, food and agriculture sector, private equity, venture capital and an allocation for innovation. These were all areas where it was assessed that commercial opportunities would be available, where ISIF's capital could deliver additionality and where third-party co-investment could be catalysed. The strategy byline was: 'Enabling, Growing, Leading Edge'.

ISIF invested both directly into transactions (lending and equity investment) and via funds (private credit and private equity funds), in all cases seeking to deliver on both legs of the double-bottom line. The rationale for the mixture of both approaches, direct and funds, was that funds on the one hand provided scale and reach that was beyond the capacity of the ISIF investment team and would also crowd in co-investment via other investors in the fund, while direct investment enabled ISIF capital to be more precisely targeted and to capitalise on ISIF's inherent flexibility.

The biggest management challenge was recruiting the investment team. The key requirements for the new investment team were expertise and experience in banking, private equity investment, corporate finance, business management and accounting. The NTMA provided corporate support functions including legal, finance, operations, IT and HR.

The NTMA, although a state entity, operates in commercial markets across all its business units and has a remuneration policy which broadly reflects market rates, although there are no long-term share option or carried-interest like elements. Ultimately, the key motivation for high-quality individuals to join the ISIF team lay in its mandate and its unique positioning at the centre of Ireland's investment ecosystem, and in the value team members attached to contributing to a significant national investment initiative.

A vital enabler for a strategic investment fund is for it to have the capability to originate and execute private markets transactions. Most conventional investment involves the portfolio manager selecting from assets and securities which are already widely available – strategic investment on the other hand requires the investment team to identify and even create opportunities similar to private equity management, source and evaluate candidate investments and execute on timeframes that are consistent with private sector counterparties. For ISIF, this meant hiring team members with drive, entrepreneurial spirit and networks and then using every opportunity to engage with market participants (market engagement events, meetings with financial advisory firms and banks and so forth) to explain ISIF's strategy and source opportunities.

ISIF 2.0 (2019-2020)

During 2018, a scheduled review of ISIF was undertaken by the Minister for Finance and an amended strategy was agreed which took effect at the beginning of 2019. The wider context was that the Irish economy was recovering from the global financial crisis at a much faster rate than had been anticipated and the Minister was anxious to ensure that ISIF capital would not contribute to 'overheating' the economy. It had also been established that ISIF was requiring less capital than initially envisaged. This was due to a combination of co-investment multiples being higher than expected (1.7x against a target of 1.0x) and realisations beginning to occur significantly sooner than expected, particularly in a number of technology company investments which turned into big 'winners.'

Therefore, €3.5 billion of ISIF's capital of just over €9 billion could be set aside for other policy purposes – to capitalise new specialist state entities in the areas of SME finance and social and affordable housing, and to capitalise a 'rainy day' fund that Government wished to establish.

Furthermore, it was agreed that ISIF capital within its double bottom-line mandate would narrow its focus and target investment in 5 Priority Themes, being areas of enduring importance to the Irish economy that should be invested in irrespective of the stage of the economic cycle.

These Priority Themes were:

1. Regional Development (to counterbalance the economic strength of the Dublin area);
2. Housing (Ireland was suffering from a significant shortage of housing);
3 Scaling indigenous businesses (to counterbalance the strength of foreign direct investment owned businesses in Ireland);
4. Climate change; and
5. Brexit (where commercial capital could help address adverse impacts on Irish businesses of Brexit).

The new strategy byline was: ‘Thinking in decades, making a difference’.

This was a powerful example of the ISIF mandate being adapted to suit medium-term economic conditions, while the fund continued to operate under unchanged legislation, governance and management.

Pandemic Stabilisation and Recovery Fund (2020)

When Covid struck in the first quarter of 2020, it brought significant economic and business uncertainty and, as we all recall, the temporary closure of many business sectors. The Irish Government introduced a range of support measures for businesses (small businesses in particular) and workers that had been affected.

There was a gap for medium to larger businesses affected by Covid which ISIF quickly pivoted to fill. Within a couple of weeks, it established a €2 billion sub-portfolio, the Pandemic Stabilisation and Recovery Fund (PSRF), to invest in medium and large-scale businesses impacted by Covid-19, using its capital to support firstly stabilisation and then a return to viability. PSRF investment was both direct into businesses and via fund investments and focused on sectors hardest hit by Covid such as travel, tourism, aviation, SMEs and retail.

Again, ISIF's flexibility to adapt its investment in the face of significant macro developments was demonstrated while continuing to operate under unchanged legislation, governance and management.

Examples of investments

ISIF has made in excess of 150 investments and has averaged around two new investments per month throughout its life.

Example of investments made, to give a feel for its varied portfolio, and all of which passed the double-bottom line tests of expected financial return and economic additionality, are as follows:

- Infrastructure: relocation of Cork Port, a major runway upgrade in Shannon Airport, undersea transatlantic data cables.
- Housing: develop finance vehicle, student accommodation, site development and infrastructure finance firstly in Dublin and then nationwide vehicle.
- Urban renewal in Kilkenny and Limerick.
- Energy: renewable energy businesses (wind, solar, battery storage).
- Food and agriculture: flexible loan finance product for dairy farmers, forestry, specialist food processing company, emerging food tech business.
- Technology and healthcare early-stage businesses with global aspirations in logistics software, mobile marketing, cybersecurity, personalised medicine.

- PSRF investments in aviation, aviation leasing, aparthotels and international payments.

Fund investments were across multiple asset classes including Private Debt (SME/regional/growth), Private Equity (growth), Venture Equity, Venture Debt, Real Estate, Infrastructure, Renewable Energy.

Milkflex – ISIF investment in flexible loans for dairy farmers

The abolition of milk quotas within the European Union provided the opportunity for Irish farmers to invest in growing their milk production and to operate at greater scale. Milk is a commodity and the big financial challenge for farmers is to manage the significant volatility of the monthly milk price. Furthermore, Irish farmers are generally unwilling to pledge, as security for borrowings, land that has passed down through the generations in their families. And cost of funds is always important to borrowers. The finance challenge therefore was to make capital available to farmers that could address these key challenges.

ISIF joined forces with Glanbia (a large farmer co-operative plc), Rabobank (the Dutch bank renowned for its strength in the food sector) and Finance Ireland (an Irish non-bank lender with a specialist agri-finance division) to design and deliver Milkflex, a bespoke dairy farm loan product with the following characteristics:

- To finance growth investment in on-farm productive assets (livestock, milking infrastructure, land improvements) and/or investment in farm sustainability (for example, organic and low emissions grass fertilisation methods).

- Loans between €25,000 and €300,000, unsecured.
- Attractive interest rate (3.75 per cent over Euribor).
- Loan repayments just from April to September (milk production season).
- Inbuilt flex triggers that temporarily reduce or suspend loan repayments if milk prices fall below pre-defined trigger levels (set about 10 per cent below the prevailing milk price), and temporarily increase loan repayments if milk prices rise above pre-defined trigger levels (set about 10 per cent above the prevailing price).
- Repayment suspension in the event of an outbreak of animal disease.
- Normal term of eight years, extendable by up to two years if volatility triggers were enacted.

From the farmer perspective: Milkflex enabled their loan repayment obligations to be broadly matched against milk revenues. Furthermore, the interest rate was low given the farmer's land was not provided as security against the borrowing.

From the lender perspective: unsecured lending to small businesses is usually fairly high risk. The key feature of Milkflex, which dramatically reduced credit risk, was that repayment amounts due were withheld by the Glanbia co-operative from their regular monthly payments to borrower farmers for milk supplied. In this way, provided the farmer continued to produce milk, repayment to the lenders was essentially assured.

From a financial structuring perspective: ISIF, Glanbia and Rabobank had the flexibility to accommodate the variability in cashflow and loan durations caused by fluctuations in monthly borrower repayments, while Finance Ireland had the necessary loan origination capabilities.

Milkflex was a highly successful product and won European awards for co-operative innovation. Subsequently, a wider version of Milkflex was launched that made the product available nationwide via additional participating farmer co-operatives. By 2023, Milkflex had loaned over €300 million to more than 2,500 dairy farmers via 19 participating farmer co-operatives.

Post pandemic (2022-2023)

Covid's impact was less than expected and Irish businesses have displayed great resilience and ability to rebound. The PSRF had invested around €600 million – €400 million in aviation and €200 million across tourism and SME businesses – when it was discontinued in 2022. ISIF reverted to its broad Priority Themes under ISIF 2.0, with the Brexit theme dropped as its negative impact on Irish businesses transpired to be less than anticipated.

The Priority Themes were reshaped slightly to reflect updated economic conditions and economic needs as follows:

1. Climate change;
2. Housing and enabling investment;
3. Scaling indigenous businesses (to counterbalance the strength of foreign direct investment owned businesses in Ireland); and
4. Food and agriculture …

…with regional development to be considered across all 4 Priority Themes, while an ability was reserved to invest in any compelling national theme that may arise.

2023 SWF developments

Given very strong tax receipts and projections that such strong returns would persist, the Irish Government in October 2023 announced a plan to establish two additional sovereign wealth funds:

- *Future Ireland Fund* – dedicated to inter-generational savings in the context of long-term ageing demographics to help meet costs of future healthcare and pensions after 2041.
- *Infrastructure, Climate and Nature Fund* – a liquidity fund to ensure in the event of economic shocks that resources will always be available to support Ireland's investment in climate and environmental focused projects.

Legislation to govern both of these funds is currently being drafted and is expected to be introduced in 2024.

Responsible investment

Since around 2006, the NPRF and ISIF have been committed to responsible investment – to applying global best practices, to transparency and to incorporating environmental, social and governance principles into its analysis and decision-making.

These practices have resulted in commitment to global principles and frameworks, detailed responsible investment policies, active ownership (voting and engagement with investees), certain portfolio exclusions and focus over time on specific issues (including, for example, climate change, board governance and gender diversity).

Looking back…

The main takeaways, I think, are as follows:

Strategic Investment Funds can make a difference to any economy.

Emerging or troubled economies with capital shortages…

…or developed high-performing economies that will always have unmet investment needs and shortages of genuinely long-term capital.

Governance is the critical foundation.

Especially for strategic investment funds, necessary to define the mandate, assign accountability, and then…

…separate investment decision-making from political and government influences.

Investing only on a commercial basis is a must.

Otherwise, the sovereign fund just becomes another arm for government policy driven expenditure.

Vital to embed flexibility and creative thinking into SWF design and implementation.

Flexibility – to adapt to changing conditions and to develop transaction structures to suit all parties.

Creative thinking – in developing strategy and investment opportunities … the power of possibility.

8.

The activist state as successful investor: Lessons for the UK from Singapore's experience of having both a Sovereign and Public Wealth Fund

Richard Hyde and Hari Menon

Singapore has been a pioneer of the non-commodity-based, state investment vehicle. The city-state has both a Sovereign Wealth Fund (SWF) and a Public Wealth Fund (PWF).[82] The former is the Government of Singapore Investment Corporation (GIC) which began with an endowment from excess foreign currency reserves. The latter is Temasek, which was formed to oversee state-owned enterprises.

This chapter provides an overview of Singapore's two funds. It also elicits five lessons for any UK policy-makers considering setting up a UK SWF or PWF — a policy prospect which some have suggested a number of UK politicians are currently wrestling with.[83] These lessons are focussed on

82 Temasek, which actively manages operational assets by developing, restructuring and monetising them can be characterised as a Public Wealth Fund (PWF). The GIC, which primarily manages reserve liquidity by investing in international equity, debt markets and other assets, is a Sovereign Wealth Fund (SSWF). Source: Detter, D (2023) *The Public Wealth Fund – a Double-Edged Tool*. Available at: https://blog-pfm.imf.org/en/pfmblog/2023/03/the-public-wealth-fund-a-double-edged-tool (Accessed: 26 November 2023)

83 Gordon, S. (2024). *How to design a UK wealth fund is baffling both Labour and the Tories.* Available at: https://www.ft.com/content/1437a2df-d41e-4a99-aa2a-9619961bfb10 (Accessed: 8 January 2024).

identifying a source for the initial endowment, the purpose of the fund, the approach to investment, the importance of scale, and governance. Heeding lessons from Singapore's success will help UK policy-makers create an effective SWF or PWF that will deliver benefits for the UK across many generations.

The economic and social benefits that accrue from Singapore's SWF and PWF

The development of policies that pay dividends over multiple generations, such as establishing a successful SWF or PWF, is difficult. Good intentions often fall foul of a combination of the continuous barrage of short-term problems, the inevitable difficulties of implementation and the back and forth of day-to-day politics.

Singapore is fortunate to have had leaders with:

- The foresight to see the potential economic return that might be made on otherwise largely idle excess reserves.
- The insight to understand that state-owned assets could form the basis of a fund for generating sizeable financial returns.
- The capability and resilience to see the policy through, from the idea and the establishment of both GIC and Temasek, to their effective ongoing management, over time.

Across the many decades of their existence, both the GIC and Temasek have delivered a good rate of return as a result of their investment activities. Table 8.1 highlights the average annual return from both entities over the past 20 years.

Table 8.1. Key GIC and Temasek performance metrics[84]

GIC	Temasek
Between 2003 and 2023, the GIC delivered an annualised 4.6 per cent return above global inflation.	Between 2003 and 2023, Temasek achieved an annualised total shareholder return of 12 per cent – roughly 10 per cent above core inflation.[85]

As a result of the success of the GIC and Temasek, Singapore:

- Has access to an additional revenue stream (in most years) to supplement annual tax collection. This increases the amount that can be spent by the state on its priorities, for any given level of tax or borrowing burden.
- Gains additional financial security because of the substantial 'rainy day fund' that can be drawn upon in emergencies. In particular, this can help to ensure that public finances can recover comparatively quickly from shocks – a situation that might leave other countries in more difficult fiscal positions.
- Benefits from being able to bolster the solvency of welfare schemes such as long-term pension liabilities. This is particularly important when there are demographic challenges such as those facing Singapore.
- Can inject considerable amounts of investment capital into its domestic economy, including high growth sectors that help sustain Singapore's dynamic economy.
- Gains a more stable currency, which in turn has resulted in advantages for exporters and facilitated inward investment.

84 By way of a performance benchmark, for the GIC and Temasek, the annualised total return on equity investment in FTSE 100 companies on the London Stock exchange, between 1984 and 2022, was 7.5 per cent. Source: Bright, A. *What are the average returns of the FTSE 100?* Available at: https://www.ig.com/uk/trading-strategies/what-are-the-average-returns-of-the-ftse-100--230511 (Accessed: 19 November 2023).

85 Temasek (2023). *Performance* overview. Available at: https://www.temasekreview.com.sg/overview/performance-overview.html (Accessed: 19 November 2023).

Lesson 1: Leverage existing assets as an initial endowment for a fund

Foreign reserves as the source of the initial endowment for the GIC

Through the 1970s, a newly independent Singapore went through a period of rapid industrialisation with a strong export focus – a recipe for success that several East Asian nations have followed. As such, it was a haven for foreign capital. Along with trade surpluses, these investments gave the Monetary Authority of Singapore (MAS) more foreign reserves than it needed to maintain its exchange rate-based monetary policy. In 1981, the then Deputy Prime Minister and Chairman of MAS, Dr Goh Keng Swee,[86] made the decision to invest the central bank's excess reserves for additional fiscal security and created the GIC.[87] The GIC was the first SWF not based on commodity-related earnings.

Nationalised industries as the source of the initial endowment of Temasek

Temasek was initially created in 1974 to manage the Singapore Government's various national enterprises. When Singapore gained its independence in 1965, it needed to find a way to boost economic activity. Building on the colonial legacy of naval shipyards, petroleum refineries, waste disposal services, manufacturing workshops and banks, the Singaporean Government took them over and built a variety of state-owned industries. Thirty-five different companies were created in a decade. To relieve the Government of the burden of corporate management, the

86 Made of Bold. Available at: https://madeofbold.sg/ (Accessed: 10 October 2023).

87 Ibid.

then Finance Minister, Dr Goh Keng Swee, created Temasek Holdings to own and operate the 35 companies and act as a steward of the assets.

Gradually throughout the 1990s, Temasek reduced its ownership of many of the nationalised companies it was originally overseeing, as part of a corporatisation strategy.[88] Of the 35 it started with, eight remain under Temasek's auspices, including the Singapore Airlines Group, the Development Bank of Singapore (now known simply as DBS) and the Singapore Zoo.[89] Off the back of the corporatisation strategy, Temasek has pursued an internationalisation strategy.[90]

Lesson 2: The purpose of any fund should be clear

The origins of the GIC and Temasek have resulted in each fund having purposes that are similar in some respects but different in others. There is some overlap, for example in their role as contributors to the NIRC (National Investment Returns Contribution) which bolsters Singapore's annual public finance position.

However, there are clear differences too. The GIC, for example, is an SWF and invests Singapore's 'spare cash'

88 Wilson Ng (2009) 'The evolution of sovereign wealth funds: Singapore's Temasek Holdings', *Journal of Financial Regulation and Compliance,* 18, pp.6-14. Available at: https://www.researchgate.net/publication/227429706_The_evolution_of_sovereign_wealth_funds_Singapore's_Temasek_Holdings (Accessed: 25 January 2024).

89 Temasek. *About Us.* Available at: https://www.temasek.com.sg/en/about-us (Accessed: 11 October 2023).

90 Wilson Ng (2009) 'The evolution of sovereign wealth funds: Singapore's Temasek Holdings', *Journal of Financial Regulation and Compliance,* 18, pp.6-14. Available at: https://www.researchgate.net/publication/227429706_The_evolution_of_sovereign_wealth_funds_Singapore's_Temasek_Holdings (Accessed: 25 January 2024).

internationally (that is, it is effectively a fund manager).[91] By contrast, Temasek is in essence an investment firm because it invests its own assets, and has more of a domestic economic development role.

The purposes of the GIC

The Singapore Government highlights three primary functions for the GIC:[92]

- *Emergency ('rainy day') Fund:* To provide the Government with extra funds in the event of a national emergency and help minimise the need to drastically hike tax revenues or increase borrowing.
- *Supplementary Fund:* To complement the Government's annual budget through a steady stream of investment income and help maintain the solvency and utility of Singapore's welfare provision (see box below).
- *Stabilising Fund:* To help maintain the credibility of Singapore's exchange rate and monetary system.

Under the law governing the GIC, the Government is allowed to receive up to 50 per cent of the annual returns each year as part of the NIRC supplement to the annual budget.[93] The remaining 50 per cent of GIC's returns are required to be kept for future generations.

91 As the GIC itself notes, it manages most of the Government of Singapore's assets, except those deposits in the MAS. Source: GIC. *Frequently Asked Questions.* Available at: https://www.gic.com.sg/who-we-are/faqs/#:~:text=We%20manage%20most%20of%20the%20Government%E2%80%99s%20financial%20assets%2C,fund%20manager%2C%20not%20an%20owner%20of%20the%20assets (Accessed: 9 October 2023).

92 BIS (2019) *Ravi Menon: How Singapore manages its reserves.* Available at: https://www.bis.org/review/r190313b.htm (Accessed: 11 January 2024).

93 Ministry of Finance. *How do Singaporeans benefit from our Reserves?* Available at: https://www.mof.gov.sg/policies/reserves/how-do-singaporeans-benefit-from-our-reserves (Accessed: 9 October 2023).

The GIC helps bolster Singapore's pensions system

Singapore's Central Provident Fund (CPF) is the source of old age pensions for Singaporeans. The GIC plays an important role ensuring the system delivers sufficient savings for workers, so that they have a comfortable pension on which to retire.

When workers and employers contribute to the CPF, their savings are used to buy Special Singapore Government Securities (SSGS). The proceeds from these securities are given to GIC to add into their pool of funds for their investments. Consequently, a portion of the GIC's annual investment returns is used to pay interest on those securities. The GIC's scale means that even though its revenues might fluctuate somewhat from year-to-year, it can deliver a consistent return on the securities and in-turn the CPF.

The GIC contribution helps ensure the CPF delivers a growing pot for Singaporeans, giving them peace of mind about their retirement. The position of the GIC contrasts with that of pension funds, for example, that typically adjust the risk-level of their investments based on the number of years a worker has left before retirement, which will tend to reduce the return that can be expected on pension contributions in the later years of a lifetime in employment.

The purposes of Temasek

Temasek Holdings began as the steward of Singapore's nationalised industries.[94] Its success has seen it expand

94 Wilson Ng (2009) 'The evolution of sovereign wealth funds: Singapore's Temasek Holdings', *Journal of Financial Regulation and Compliance,* 18, pp.6-14. Available at: https://www.researchgate.net/publication/227429706_The_evolution_of_sovereign_wealth_funds_Singapore's_Temasek_Holdings (Accessed: 25 January 2024).

beyond that specific role in recent years, into a more rounded investment vehicle that, for example, also delivers a contribution to the NIRC. Further, since 2003, it has been contributing a portion of returns in excess of its cost of capital to community programmes in Singapore.

Temasek owns and manages its own assets on a commercial basis. As was the case when its main function was overseeing Singapore's state companies, its assets are derived solely from the companies it has invested in, the returns made on those assets, as well as any divestments and the bonds it issues.[95]

In keeping with its origins, Temasek retains a strong national economic development role, with significant and ongoing direct interests in the Singaporean economy. Reflecting this key purpose, in 2023, 54 per cent of Temasek's portfolio was in companies headquartered in Singapore.[96] [97]

Lesson 3: The organisation of a fund's investment activity should ensure it delivers on its purpose

The overall structuring of the GIC's investment activity

The three purposes of the GIC ultimately determine the way the GIC goes about investing. For example, the GIC needs to be able to supplement annual tax revenues, support Singapore's pension system and step in on 'rainy days.' Because it is investing on behalf of the Singaporean Government (GIC's single client), the GIC also requires a high but sustainable rate of return on the assets it holds.

95 Temasek. *Ins & Outs of Temasek.* Available at: https://www.temasek.com.sg/en/about-us/ins-outs-temasek (Accessed: 2 October 2023).

96 GIC. *Our Policy Portfolio.* Available at: https://www.gic.com.sg/how-we-invest/our-policy-portfolio/ (Accessed: 2 October 2023).

97 Across its portfolio, Temasek holds shares in both listed (on the SGX) and unlisted Singaporean companies as well as some international businesses that have their headquarters in Singapore.

This leads the GIC to pursue the best returns around the world and invest accordingly.

To achieve this, the GIC operates two portfolios.[98] The Policy Portfolio is focused on long term returns and the Active Portfolio aims to deliver returns that 'beat the market':

- *The Policy Portfolio* consists primarily of nominal bonds and cash, developed and developing market equities, as well as private equity and real estate. This mix of assets is meant to deliver steady returns over a long-term horizon.
- *The Active Portfolio* is mainly funded through profits from the Policy Portfolio and takes a more hands-on approach to investing akin to a typical hedge fund, looking to deliver excess returns, typically over shorter time periods.

The GIC balances investment risk management and the need for good returns

Within the context of its two portfolios, the GIC is able to spread investment risk across a range of assets which helps reduce risk and maximise return. Further, the open-ended (cross-generation) nature of the GIC's activities means that the GIC can and does have a 20-year investment horizon and avoid some of the time and risk constraints that other investment entities such as pension funds face.

The GIC further helps mitigate investment risk by providing business support to some of the companies that it invests in. This is particularly the case where the GIC takes a sizeable stake. In such circumstances, providing extra support to help a firm succeed increases the chances of the GIC receiving the best return possible.

98 GIC. *How we build our portfolio.* Available at: https://www.gic.com.sg/how-we-invest/how-we-build-our-portfolio/ (Accessed: 2 October 2023).

The overall structuring of Temasek's investment activity

Temasek's two purposes – generating returns that benefit Singapore, for example through contributions to the NIRC, and encouraging the development of the Singaporean economy – very clearly guide the way Temasek organises its investment activity. For example, in contrast to the GIC, Temasek continues to invest a lot of its time, effort and resources in Singapore-based firms, as was noted earlier.

Further, because Temasek is managing its own assets and its history is in stewarding businesses, its mix of investment assets has remained much narrower than that of the GIC. It primarily sticks to equities, supported by some bond issuance. This is no doubt a key reason why Temasek focuses many of its investments on specific sectors and markets.[99] [100] As a result of these elements, a considerable proportion of its portfolio (53 per cent) is in unlisted assets across many economies.[101] Importantly for Singapore and Temasek's development purpose, a third of Temasek's unlisted investments are in Singaporean firms.[102]

99 Temasek (2023) *Pillars and Foundational Enablers.* Available at: https://www.temasekreview.com.sg/t2030-journey/pillars-and-foundational-enablers.html#resilient-and-forward-looking-portfolio (Accessed: 26 November 2023).

100 Temasek (2023) *Investment Update.* Available at: https://www.temasekreview.com.sg/portfolio/investment-update.html#nurturing-innovation (Accessed: 26 November 2023).

101 Temasek (2023) *Portfolio Performance.* Available at: https://www.temasek.com.sg/en/our-financials/portfolio-performance (Accessed: 26 November 2023).

102 Temasek. *How We Invest.* Available at: https://www.temasek.com.sg/en/our-investments/how-we-invest (Accessed: 25 September 2023).

Temasek's role as an incubator for new firms and technologies and innovator in financing

In 2014, the Singaporean Government launched its Smart Nation Initiative.[103] It aims to ensure Singapore is at the international frontier in developing and deploying new technologies for social and economic benefit. This initiative is supported by specific plans such as the Research, Innovation and Enterprise 2025 Plan[104] and the National Artificial Intelligence (AI) Strategy.[105]

Temasek has been able to contribute to the Smart Nation Initiative by leveraging its financial resources and expertise to help Singapore's technology eco-system by developing a suite of AI, blockchain, cybersecurity, data and sustainability solutions to better support the firms that Temasek invests in. The programme is called the Temasek Operating System (TOS).[106] Temasek see these actions as an important way to add value as an investor.[107]

103 EDB Singapore (2023) *How Singapore has become a leading force in tech innovation.* Available at: https://www.edb.gov.sg/en/business-insights/insights/how-singapore-has-become-a-leading-force-in-tech-innovation.html (Accessed: 5 January 2024).

104 National Research Foundation (2020) *Research, Innovation and Enterprise 2025 Plan.* Available at: https://file.go.gov.sg/rie-2025-handbook.pdf (Accessed: 5 January 2024).

105 Smart Nation Group. *National AI Strategy.* Available at: https://www.smartnation.gov.sg/nais/ (Accessed: 5 January 2024).

106 Temasek (2023) *Temasek Operating System.* Available at: https://www.temasekreview.com.sg/temasek-operating-system/ (Accessed: 26 November 2023).

107 Temasek. *Pillars and Foundational Enablers.* Available at: https://www.temasek.com.sg/en/about-us/our-t2030-journey/pillars-and-foundational-enablers#temasek-operating-system (Accessed: 26 November 2023).

Through the TOS, Temasek has effectively become a business incubator.[108] By boosting the success of the firms it invests in, Temasek can expect better returns for the fund and ultimately deliver more benefits for Singapore. Part of that gain can be expected to come from bolstering Singapore's wider efforts to remain at the technological frontier and sustain a dynamic economy by having more successful firms.[109]

Examples of firms that Temasek has helped incubate include:[110]

Aicadium – an AI solutions firm based in both Singapore and California, which supports other businesses in Temasek's portfolio to adopt AI for the benefit of their commercial operations.

Affinidi – a company that developed a platform which uses blockchain technology to verify Covid-19 test results across dozens of countries,[111] and which is now used by Singapore Airlines.

Istari – a cybersecurity business providing cryptography, cyber-incident response and cybercrime (for example, hacking) monitoring services.

108 Global SWF (2021) *Temasek Becomes Singapore Super-Incubator with a Suite of In-House Startups.* Available at: https://globalswf.com/news/temasek-becomes-singapore-super-incubator-with-a-suite-of-in-house-startups (Accessed: 30 November 2023).

109 Ibid.

110 Ibid.

111 Nolan, S. (2022) *How Singapore's Temasek is investing in the future with AI and blockchain.* Available at: https://govinsider.asia/intl-en/article/how-singapores-temasek-is-investing-in-the-future-with-ai-and-blockchain-chia-song-hwee-temasek (Accessed: 26 November 2023).

In addition to technology start-ups, Temasek has fostered new avenues for funding the growth of businesses and the development of technologies. Examples include:

Gen Zero[112] – a financing platform company wholly owned by Temasek that is solely focused on funding both start-ups and more mature companies which are developing decarbonisation solutions and looking to scale-up.[113]

65 Equity Partners[114] – an equity investment subsidiary of Temasek, which aims to finance established businesses, such as mid-sized firms that have regional or international growth ambitions.[115]

Lesson 4: Scale matters in order for a SWF or PWF to deliver substantial benefits

The GIC has grown from having roughly S$100 billion in assets in 2003 to being worth over S$700 billion in 2023. Consequently, the value of the GIC is around 200 per cent

112 GenZero. Available at: https://genzero.co/ (Accessed: 31 December 2023).

113 Temasek (2022) *Temasek launches GenZero, an investment platform company aimed at accelerating decarbonisation globally*. Available at: https://www.temasek.com.sg/en/news-and-resources/news-room/news/2022/temasek-launches-genzero-aimed-at-accelerating-decarbonisation-globally (Accessed: 1 December 2023).

114 65 Equity Partners. *About us.* Available at: https://www.65equitypartners.com/about-us/ (Accessed: 1 December 2023).

115 Temasek (2021) *Temasek establishes 65 Equity Partners to support family businesses and entrepreneurs with regional or global aspirations.* Available at: https://www.temasek.com.sg/en/news-and-resources/news-room/news/2021/temasek-establishes-65-equity-partners (Accessed: 31 December 2023).

of Singapore's GDP.[116][117] In 2003, the net value of Temasek's portfolio was S$63 billion. By the end of March 2023, Temasek had a value of S$382 billion.[118]

Due to the size of the GIC and Temasek, even a low rate of return can deliver a large amount of revenue. However, as shown earlier, the long-term return rates have been comfortably above inflation for both funds. The good rate of return is in-part a consequence of size. Agglomeration as a result of a larger fund facilitates greater diversification,[119] lowers the relative costs associated with doing business and boosts the fund's power in the market. Size therefore:

- Enables a fund to balance off poor-performing investments with more successful ones over time and underpins the ability to be an active investor (that is, both make new and divest existing investments regularly), which both the GIC and Temasek are known to be.[120]
- Increases the marginal return over ongoing operational costs.
- Is likely to give a fund the ability to get more favourable terms on deals.

116 GIC (2023) *FY2022/23 Report*. Available at: https://report.gic.com.sg/ (Accessed: 25 September 2023).

117 SWFI. *GIC Private Limited (GIC)*. Available at: https://www.swfinstitute.org/profile/598cdaa50124e9fd2d05b242 (Accessed: 10 October 2023).

118 Temasek (2023). *Temasek Review 2023: Our Compass in a Complex World*. Available at: https://www.temasek.com.sg/en/news-and-resources/news-room/news/2023/temasek-review-2023-our-compass-in-a-complex-world (Accessed: 22 November 2023).

119 Choueifaty, Y. and Coignard, Y. (2008) 'Toward Maximum Diversification', *The Journal of Portfolio Management*, 35(1), pp.40-51. Available at: https://www.pm-research.com/content/iijpormgmt/35/1/40 (Accessed: 25 January 2024).

120 Temasek. *How We Invest*. Available at: https://www.temasek.com.sg/en/our-investments/how-we-invest (Accessed: 25 September 2023).

The result of being a large fund is likely to be better and more consistent returns over the long run, compared to that achieved by smaller funds.[121 122]

Some of the ultimate benefits that arise from the size of the GIC and Temasek funds have been very evident to Singaporeans in recent years. For example, the GIC has been able to play a strong supporting role in times of crisis, through utilising its substantial asset base to help support rescue packages during the 2008 global financial crisis and more recently, the 2020-21 Covid-19 pandemic.

How the UK's public finances might have been helped if the Government had been able to access funds supplied by a SWF or PWF during the Covid-19 crisis

In 2022 the GIC, through the NIRC mechanism, provided the Government of Singapore with an extra S$21.6 billion, which equated to around 20 per cent of the annual public expenditure budget that year.[123] This helped Singapore to cover some of the unanticipated costs associated with dealing with the Covid-19 pandemic and avoid incurring greater levels of debt than might otherwise have been the case.

121 Beath, A.D. et al. (2022) *A Case for Scale: How the world's largest institutional investors leverage scale to deliver real outperformance.* Available at: https://www.imcoinvest.com/pdf/research/CEM-Benchmarking-Report_A-Case-For-Scale-February-2022.pdf (Accessed: 25 January 2024).

122 It should be noted that the benefits that can accrue from scale are influenced by factors such as the degree of competence of those managing the investments, the quality of the investment strategy and its implementation, etc.

123 Ministry of Finance (2022). *Republic of Singapore: The Revenue and Expenditure Estimates for the Financial Year 2022/2023.* Available at: https://www.mof.gov.sg/docs/librariesprovider3/budget2022/download/pdf/revenue-and-expenditure-estimates-for-fy2022-fy2023.pdf (Accessed: 11 January 2024).

A House of Commons report in 2023 estimated that the UK Government spent £229 billion in 2020/21 on pandemic-related support.[124] This required the UK taking on £313 billion of extra borrowing, which took government debt levels to a peacetime high. If the UK Government had been able to draw upon a 'rainy day' fund such as that available to the Singapore state (in the form of the GIC) a similarly large contribution from a UK equivalent SWF or PWF to that which the Singapore Government had available, would have seen around £221 billion[125] of support provided to cover Covid-19 expenditure. Being able to call on such reserves would have saved the UK Government from taking on some of the debt that it did and, as a result, it would have saved billions in debt interest payments.

Lesson 5: Long-term success depends on good governance

Another key to the long-term success of both the GIC and Temasek has been efforts by both to try and establish and sustain good governance practices. The external legal and international organisational structures that have been in place have helped ensure good stewardship of both funds. Despite some criticism of Temasek, potential risk such as the

124 Brien, P. and Keep, M. (2023). *Public spending during the Covid-19 pandemic.* Available at: https://researchbriefings.files.parliament.uk/documents/CBP-9309/CBP-9309.pdf (Accessed: 11 January 2024).

125 The OBR's Public Finances database estimated total UK Government spending in 2020/21 to be £1,107 billion. If we assume that, like the Singapore Government, a UK PWF could have supported 20 per cent of this expenditure, this would have amounted to £221 billion. Source: Office for Budget Responsibility (2021). *Public Finances database.* Available at: https://obr.uk/public-finances-databank-2020-21/ (Accessed: 25 January 2024).

misuse of assets appears to have largely been avoided, while effective overall risk management and a long-term outlook have been embedded.

The type of management of GIC and Temasek over many decades has been the result of a number of factors, that any UK SWF or PWF being established would likely want to learn from. These key factors include:

- *A sound legal framework that protects the autonomy of the fund.* To this end, GIC's legal relationship with the Singapore Government is determined by the Singapore Companies Act and spelt out within its annual reports along with clear rules about vital functions, such as what proportion of revenues, for example, are paid out to the Singapore Government and when. Similarly, Temasek is governed by the Companies Act as well as having a place in the Singaporean Constitution.
- *A clear division of responsibilities between the state interest on the one hand and the commercial operation of the fund on the other.* As the client of the GIC, the Singaporean Government sets out GIC's investment objective, alongside the risk parameters and investment horizon for GIC's assets. Within that framework, the GIC's Board of Directors determines GIC's long-term asset allocation and answers to the client on the portfolio's performance. GIC's Executive team works to formulate and execute investment strategies and investments in light of the directors' decisions. While the Government of Singapore is the single shareholder in Temasek, they play no role in investment strategies, investment decisions, or other business decisions.
- *Financial transparency.* Both the GIC and Temasek publish regular accounts, outlining their respective financial

positions. There is particular focus on the asset mixes of the two funds and the geographical spread of investments, among other information revealing the financial state of the two funds.

- *A strong approach to risk management.* The GIC's two portfolios encompass a wide diversity of investments across geographies, industries and asset classes to help manage risk. Temasek's portfolio is less diverse in asset classes, but its investment is spread across a range of sectors, geographies and business sizes and forms. In both funds, there is an emphasis on embedding a prudent risk management culture. The GIC, for example, has control measures in place to help minimise the risks of significant losses and reputational damage. To embed a culture of long-termism, Temasek deploys measures such as ensuring compensation for senior staff reflects portfolio returns and utilising deferred incentives and clawbacks.

Developing a UK SWF or PWF in light of the lessons from the Singapore experience

Find a source for the initial endowment

To set-up a SWF or PWF in the UK, an initial endowment will be needed. The Singapore example suggests at least two potential sources of capital can be utilised.[126]

126 A third option is to use revenues from natural resource exploitation. This is the basis of Norway's SWF. However, there is little hope of the UK following the Norway example, because the tax revenues extracted from North Sea oil and gas production, for example, has declined significantly since the mid-1980s. Between the mid-80s and 2019-20, tax revenues from North Sea gas and oil production have declined from more than £20 billion a year to £600 million. Source: Seely, A. (2023). T*axation of North Sea oil and gas.* Available at: https://researchbriefings.files.parliament.uk/documents/SN00341/SN00341.pdf (Accessed: 25 January 2024).

However, it will be difficult to replicate the Temasek example because UK equivalents of the large number of nationalised industries which were the backbone of Temasek for so long were privatised decades ago. Therefore, there are no state-run companies to act as the foundation for a UK PWF.

Singapore's GIC was established through utilising national currency reserves. It is the more promising example. The UK could replicate this and use some of the central bank reserves of the Bank of England. The latter has gross official reserves of US$190.5 billion.[127]

Have a clear idea of the purpose of the SWF or PWF

The lessons from Singapore outlined in this essay suggest that UK policy-makers contemplating an SWF or PWF of some kind should only proceed once a clear purpose or set of purposes for it, has been decided upon. For example, does the UK want a SWF that primarily focuses upon supplementing annual tax revenues, supporting the solvency of the welfare system, or to be available as a 'rainy day' fund when crises occur? Alternatively, is the main purpose economic development, for example boosting domestic infrastructure, industrial competitiveness, and local and regional growth?[128] Such decisions will, as the Singapore examples show, have important implications for the operation of the fund.

127 HM Treasury (2024) *UK official holdings of international reserves: December 2023*. Available at: https://www.gov.uk/government/publications/uk-official-holdings-of-international-reserves-december-2023 (Accessed: 25 January 2024).

128 If the goal is development, where the scheme might fit within the existing landscape – which includes the British Business Bank and the UK Infrastructure Bank – will need careful consideration.

Build the SWF or PWF by replicating the success of others

In addition to lessons about how to find an initial endowment for an SWF or PWF and the importance of ensuring the fund has a clear purpose (or purposes) behind it, the Singapore examples also show that:

- The purpose (or purposes) of the fund should directly shape the approach to investment. For example, choices over what to invest in, in what proportions and over which timescales are best shaped by whether the fund is ultimately focused upon maximising returns because it is there to help supplement tax revenues and welfare provision or act as a 'rainy day' fund. Alternatively, it may have a domestic economic development focus, and therefore is intended to help nurture the dynamism of UK based firms and contribute to driving-up the success of the UK in important sectors.
- Balancing risk effectively to ensure a good regular return over extended periods along with enough scope for prudently chasing higher risk and higher return investments where appropriate to achieve the fund's purpose. The GIC and Temasek experiences suggest this can best be achieved through having a fund of sufficient size and spreading risk through an appropriate agglomeration of a diverse range of asset types, being active investors and having a long-term investment culture.
- The right legal framework and effective governance are essential to achieving the goals of the fund over time. These necessarily have to include accountability mechanisms for fund performance, financial transparency (including clear rules on what reserves or annual returns can be accessed

by current or future governments), independence from arbitrary and short-term political interference and the ability to embed the right kind of investment culture.

The prospect of establishing a SWF or PWF offers up the prospect of delivering real benefits to the UK, both in the shorter and longer terms. However, these benefits will only materialise if the right policy decisions are taken to ensure that any SWF or PWF that is established is built well and operates effectively. To that end, Singapore's GIC and Temasek provide two promising models for the UK to take inspiration from.

9.

Creating a British Sovereign Wealth Fund from a government-owned economic development bank

Jim McConalogue and Rachel Neal

It has been argued by some policy-makers, economists and investment theorists that the best way of 'nudging' Britain towards the creation of its own sovereign wealth fund is to enable it to develop, merge and steer the existing investment funds within British Business Bank into a single coherent vehicle.

In fact, the Bank's newest Chief Executive, Louis Taylor, has set out their position to the *Financial Times* that this is what they intend for the Bank. The Bank wants greater independence to become a UK SWF that can reinvest proceeds from its venture capital investments.[129]

The Bank is already used by the Government to support policy choices commercially, in which the BBB invests in venture capital funds that in turn provide financing for companies in sectors including technology and life sciences. It also covers funding for start-ups and regional investment funds, having administered Covid recovery loan schemes. The idea is that the Bank is now of a size where it could usefully be self-sufficient outside of the Government budgeting process and that the capital it generates should in turn be recycled and accumulate over time.[130]

129 'British Business Bank aims to become 'sovereign growth fund'', *Financial Times.* Available at: https://www.ft.com/content/e3827995-823c-49d4-82ca-87b8feb43371 (Accessed: 31 August 2023)

130 Ibid.

Its growth agenda fits with the need for growth desired by nearly all political parties. Taylor also expressed that there was some scope to do much of this investing in a relatively fiscally neutral way through loan guarantees – while also hoping to expand the Bank's remit to plug additional funding gaps for British companies. Neither is there a wish for the Bank to become engulfed in the debate over Government ownership, statism or picking winners, because, as Taylor has argued, they are investing on a purely commercial basis.

But if we are going to suggest taking up any of those proposals or growing the existing Bank into a SWF, we might first need to ask ourselves: what exactly is this Bank, and what are we getting ourselves into?

What does the British Business Bank (BBB) do?

The BBB is government-owned but independently managed and brings expertise and Government money to smaller business finance markets. The BBB does not lend or invest directly. Working with over 130 partners (such as banks and leasing companies), businesses apply for finance through these partners who are then able to lend and invest more.

The aim of the BBB is to 'drive sustainable growth and prosperity across the UK, and to enable the transition to a net zero economy, by supporting access to finance for smaller businesses.' It has key objectives which help it to achieve this aim. It aims to ensure that small businesses can access the type of finance they need to start-up, survive and grow, and that innovative businesses have access to the right capital to start and scale. It also helps to ensure entrepreneurs can access the finance they need. Its modern mission also includes building a modern, greener economy through 'financing groundbreaking solutions to climate change', as well as helping small businesses transition to net zero.[131]

Overseeing various state investments

The BBB oversees numerous legacy loan and equity funds for which the Government has previously provided capital, often together with the European Regional Development Fund (ERDF), the European Investment Bank (EIB) and private investors. Examples include:

- Geographically specific funds that were originally set up by the former English Regional Development Agencies.
- JEREMIE funds of funds in the North of England regions.
- Regional Venture Capital Funds.
- UK High Technology Fund.
- Early Growth Funds.
- The Aspire Fund.[132]

Enterprise Capital Funds programme

Launched in 2006, the Enterprise Capital Funds programme assists those looking to operate in the UK market to raise venture capital funds. It specifically targets early-stage small businesses thought to have long-term growth potential.[133]

131 British Business Bank. *What we do.* Available at: https://www.british-business-bank.co.uk/about-us/who-we-are/what-the-british-business-bank-does/ (Accessed: 10 August 2023).

132 British Business Bank. *Overseeing other state investments.* Available at: https://www.british-business-bank.co.uk/ourpartners/managing-other-schemes-on-behalf-of-the-taxpayer/ (Accessed: 11 August 2023).

133 British Business Bank. *The Enterprise Capital Funds programme.* Available at: https://www.british-business-bank.co.uk/ourpartners/enterprise-capital-funds/ (Accessed: 11 August 2023).

Looking back to 2021/22 in review, it incorporated 39 funds, 31 fund managers, 705 portfolio companies, and a total commitment to funds at that stage of £1.851 billion.[134]

Start Up Loans

The Start Up Loans programme is delivered by The Start Up Loans Company, a subsidiary of the BBB, and is funded by the Department for Business and Trade. (In 2021, the Government announced that it would provide funding for 33,000 Start Up Loans over the following three years.) The aim of the programme is to encourage entrepreneurship in the UK, increase the rate of business creation and improve business survival prospects.

The programme offers loans ranging from £500 to £25,000 – at a six per cent interest rate – alongside free mentoring and support to individuals who are starting a new business or who have been trading for fewer than three years.[135] It maintains that for every £1 invested in the scheme, £3.30 of value is delivered back into the UK economy, having delivered more than £1 billion of funding to over 109,000 businesses since 2012.[136]

British Patient Capital

British Patient Capital is a commercial subsidy of the BBB and its mission 'is to enable long-term investment in innovative UK companies led by ambitious entrepreneurs

134 British Business Bank. *Enterprise Capital Funds: 2021/22* in review. Available at: https://www.british-business-bank.co.uk/enterprise-capital-funds-2021-22-in-review/ (Accessed: 25 January 2024).

135 British Business Bank. *Government Loans UK – Start Up Loans*. Available at: https://www.british-business-bank.co.uk/ourpartners/start-up-loans/ (Accessed: 11 August 2023).

136 British Business Bank *Start up loans.* Available at: https://www.startuploans.co.uk/ (Accessed: 25 January 2024).

who want to build successful, world-class businesses.' It wants to build the UK's innovation economy, as innovative businesses currently have a lack of access to finance to help them grow and fulfil their potential.

It manages the Life Sciences Investment Programme and the Future Fund: Breakthrough – but it also manages a £2.5 billion programme, which it says 'will unlock an additional £5bn in private capital to support UK businesses with high growth potential over 10 years.' Moreover, it invests:

> '…in a diversified portfolio of best-in-class venture and venture growth capital funds, and directly alongside our fund managers in the most promising later-stage UK companies in our underlying portfolio.'

In addition to providing its own funding, British Patient Capital report that they:

> '…are building the UK patient capital ecosystem and working to encourage more institutional investors to make allocations to the venture and venture growth capital market by demonstrating that a long-term patient capital investment strategy can produce commercially attractive returns.'[137]

Since launching, they have become the UK's largest domestic investor in venture and venture growth opportunities, managing both a funds and a co-investment programme.[138] Their total commitments to date sit at £1.9 billion-plus, with 1,190 high-growth companies in their underlying portfolio (as at 31 March 2023).[139]

137 British Patient Capital. *Our mission.* Available at: https://www.britishpatientcapital.co.uk/about/our-mission/ (Accessed: 11 August 2023).

138 British Patient Capital. *Our history.* Available at: https://www.britishpatientcapital.co.uk/about/our-history/ (Accessed: 25 January 2024).

139 British Patient Capital. *Funding innovation from Sheffield.* Available at: https://www.britishpatientcapital.co.uk/ (Accessed: 25 January 2024).

Coronavirus Business Interruption Loan Scheme (CBILS)

The CBILS, which closed for new applications on 31 March 2021, was designed to provide financial support of up to £5 million (in the form of either term loans, overdrafts, invoice finance or asset finance) to smaller businesses across the UK which were losing revenue and seeing their cashflow disrupted because of the Covid-19 pandemic. The scheme gave the lender a government-backed guarantee for the loan repayments to encourage more lending.[140] As at 31 March 2023, businesses had drawn a total of £25.9 billion through CBILS.[141] It is reported more than 93 per cent of CBILS facilities are either fully repaid (26.8 per cent) or on schedule (66.7 per cent).[142]

Bounce Back Loan Scheme (BBLS)

The BBLS, now well-known to the UK business community and which finally closed for new applications on 31 March 2021, was designed to enable businesses who were losing revenue and seeing their cashflow disrupted because of the Covid-19 pandemic, and who could benefit from £50,000 or less in finance, to access finance more quickly. The scheme gave the lender a 100 per cent government-backed guarantee against the outstanding balance of the facility (both capital

140 British Business Bank. *Coronavirus Business Interruption Loan Scheme (CBILS).* Available at: https://www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-scheme-cbils-2/ (Accessed: 11 August 2023).

141 DBT and Department for Business, Energy and Industrial Strategy (2023) *COVID-19 loan guarantee schemes performance data as at 31 March 2023.* Available at: https://www.gov.uk/government/publications/covid-19-loan-guarantee-schemes-repayment-data/covid-19-loan-guarantee-schemes-performance-data-as-at-31-march-2023 (Accessed: 25 January 2024).

142 Ibid.

and interest).[143] As at 31 March 2023, businesses had drawn a total of £46.6 billion through BBLS.[144] It is reported more than 77 per cent of BBLS facilities are either fully repaid (11.06 per cent) or on schedule (66.5 per cent).[145]

Future Fund

The Future Fund is a government scheme delivered by the BBB to support UK-based companies. Financial support ranges from £125,000 to £5 million, subject to at least equal match funding from private investors. The scheme was aimed at supporting companies facing difficulties from the Covid-19 outbreak but is now closed to new applicants.[146] As at 30 September 2023, the Future Fund held an equity interest of £652 million in 661 companies.[147]

Future Fund: Breakthrough

Future Fund: Breakthrough is separate from the Government's Future Fund. It is a UK-wide scheme delivered by British

143 British Business Bank. *Bounce Back Loan Scheme (BBLS).* Available at: https://www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-schemes/bounce-back-loans/ (Accessed: 11 August 2023).

144 DBT and Department for Business, Energy and Industrial Strategy (2023) *COVID-19 loan guarantee schemes performance data as at 31 March 2023*. Available at: https://www.gov.uk/government/publications/covid-19-loan-guarantee-schemes-repayment-data/covid-19-loan-guarantee-schemes-performance-data-as-at-31-march-2023 (Accessed: 25 January 2024).

145 Ibid.

146 British Business Bank. *Future Fund.* Available at: https://www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-schemes/future-fund/ (Accessed: 10 August 2023).

147 British Business Bank. *Future Fund Portfolio Overview.* Available at: https://www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-schemes/future-fund/future-fund-companies/ (Accessed: 10 August 2023).

Patient Capital (a commercial subsidiary of the BBB, described above) and it encourages private investors to co-invest with the Government in high-growth, innovative firms.

Key features of the scheme include:

- An initial fund size of £375 million.
- A focus on research and development companies.
- A minimum investment round size of £30 million.
- Companies must be UK-based with significant UK operations.
- The application is to be led by established venture capital investors.[148]

In the 2023 Autumn Budget, Chancellor Jeremy Hunt declared he would provide at least £50 million of additional funding for the BBB's Future Fund: Breakthrough programme.[149]

Growth Fund

Also announced by the Chancellor in the 2023 Autumn Budget was the creation of a new Growth Fund by the BBB. It is said the new fund will help to unlock an extra £75

148 British Business Bank. *Future Fund: Breakthrough*. Available at: https://www.british-business-bank.co.uk/ourpartners/future-fund-breakthrough/ (Accessed: 10 August 2023).

149 HM Treasury and Hunt, J. (2023) *£320 million plan to usher innovation and deliver Mansion House Reforms.* Available at: https://www.gov.uk/government/news/320-million-plan-to-usher-innovation-and-deliver-mansion-house-reforms (Accessed: 22 November 2023).

billion of financing for high-growth companies by 2030.[150] Additionally, it is proposed the Growth Fund will increase retirement earnings by an extra £1,000 per year for the average earner saving from the age of 18.[151]

Long-term Investment for Technology and Science (LIFTS)

The LIFTS initiative invited proposals for the establishment of new funds to crowd in UK institutional investment, particularly Defined Contribution (DC) pension funds, to support growth among innovative science and technology companies. An expected initial government-funded commitment of up to £250 million is to be available to support successful proposals.

The three key objectives of LIFTS are:

1. To unlock UK institutional investment.
2. To catalyse investment into UK science and technology.
3. To stimulate the UK VC ecosystem.[152]

Nations and Regions Investment Funds

The objective of the Nations and Regions Investment Funds is to provide for sustainable economic growth by supporting innovation and creating local opportunity for new and growing businesses. The BBB is responsible for

150 HM Treasury (2023) *Chancellor backs business and rewards workers to get Britain growing.* Available at: https://www.gov.uk/government/news/chancellor-backs-business-and-rewards-workers-to-get-britain-growing (Accessed: 15 January 2024).

151 HM Treasury (2023) *Chancellor backs business and rewards workers to get Britain growing.* Available at: https://www.gov.uk/government/news/chancellor-backs-business-and-rewards-workers-to-get-britain-growing (Accessed: 22 November 2023).

152 British Business Bank. *Long-term Investment for Technology and Science (LIFTS).* Available at: https://www.british-business-bank.co.uk/ourpartners/long-term-investment-technology-science/ (Accessed 10 August 2023).

administering the Nations and Regions Investment Funds on behalf of the Government. At the Spending Review 2021, the Government announced a £1.6 billion commitment to new funding via investment strategies that best meet the needs of the businesses in their nation or region.[153] (See Appendix for the range of regional investment funds as well as the Bank's Recovery Loan Scheme, British Business Investments and the ENABLE guarantee programmes.)

National Security Strategic Investment Fund

A collaboration between the Government and the BBB, the National Security Strategic Investment Fund 'invests commercially in advanced technology firms, alongside other investors, supporting long-term equity investment – "patient capital" – and harnesses the Government's unique technology expertise.' Two objectives of the fund are to accelerate 'the adoption of HMG's future national security and defence capabilities and the development of the UK's dual-use technology ecosystem.'[154]

The reason why each of these funds should be considered in turn is at the very least they provide a flavour of the holdings to be adopted by a British-based SWF, if ever there were the future political impetus to build one. It is not merely a philosophical exercise. After all, if the Bank is to develop its independence into a UK SWF that can reinvest proceeds from its venture capital investments, then those funds could very easily form the basis of an embryonic wealth fund.

153 British Business Bank. *Nations and Regions Investment Funds.* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/ (Accessed 10 August 2023).

154 British Business Bank. *National Security Strategic Investment Fund.* Available at: https://www.british-business-bank.co.uk/national-security-strategic-investment-fund/ (Accessed: 11 August 2023).

Learning from Britain's European neighbours

Britain needn't look further than some of its near European and Scandinavian partners in learning how to shape its policy objectives, or existing funds, towards a broader national wealth fund. There are a wide variety of sovereign wealth funds across the world which exist for many different objectives. In some cases, amongst our near European partners, the fund is set up to manage oil assets and revenues to create wealth for future generations (Norway). In others, it will support economic activity by supporting investment across the policy priorities of climate, housing, indigenous business, food and agriculture (Ireland). Here are a series of examples which provide a flavour of the different objectives and strategies taken, including their dates of establishment and amounts of investment:

Fonds Strategique d'Investissement (France FSI)

Founded in 2008,[155] the mission of the France Strategic Investment Fund is to support the development of SMEs with a growth project; to support companies in sectors undergoing change in order to develop industrial redeployment; and to secure the capital of strategic companies, important for their sector, in order to support them in their development. Its objectives are to help progress companies with plans for the future and to provide equity to finance innovative industrial projects.[156]

155 SWFI, *Fonds Strategique d'Investissement (France FSI).* Available at: https://www.swfinstitute.org/profile/598cdaa50124e9fd2d05b188 (Accessed: 14 August 2023).

156 Republique Francaise (2015) *Strategic Investment Fund.* Available at: https://www.prefectures-regions.gouv.fr/centre-val-de-loire/Region-et-institutions/L-action-de-l-Etat/Economie-entreprises-emploi-et-finances-publiques/Fonds-Strategique-d-Investissement (Accessed: 14 August 2023).

Norges Bank Investment Management (Norway GPFG)

The Norway GPFG was founded in 1990[157] and allows the Norwegian Government 'to manage oil assets and revenues sustainably, while saving and creating wealth for future generations.'[158] The main difference between Norway's GPFG and other similar funds, it suggests, is that it effectively converts oil assets into an investment portfolio, allowing a systematic management of the funds, and to live off the returns of the investment rather than the common practice of spending the value of the asset itself.[159] Its current assets amount to $1,477,729,733,526.[160]

Vækstfonden (Danish Growth Fund)

The Danish Growth Fund was established in 1992 and its current assets amount to $4,024,636,176.[161] Since January 2023, the Fund has been included under the new state loan fund, Denmark's Export and Investment Fund.[162]

157 SWFI, *Norges Bank Investment Management (Norway GPFG).* Available at: https://www.swfinstitute.org/profile/598cdaa60124e9fd2d05b9af (Accessed: 14 August 2023).
158 Centre for Public Impact (2019) *The Government Pension Fund Global (GPFG)* in Norway. Available at: https://www.centreforpublicimpact.org/case-study/government-pension-fund-global-gpfg-norway (Accessed: 14 August 2023).
159 Centre for Public Impact (2019) *The Government Pension Fund Global (GPFG) in Norway.* Available at: https://www.centreforpublicimpact.org/case-study/government-pension-fund-global-gpfg-norway (Accessed: 14 August 2023).
160 SWFI. *Norges Bank Investment Management (Norway GPFG).* Available at: https://www.swfinstitute.org/profile/598cdaa60124e9fd2d05b9af (Accessed: 15 January 2024).
161 SWFI, *Vækstfonden (Danish Growth Fund).* Available at: https://www.swfinstitute.org/profile/5e39a2cafcbe7e8ca7140346 (Accessed: 15 August 2023).
162 Innovayt, *Funding Programmes.* Available at: https://innovayt.eu/funding/vaekstfonden/ (Accessed: 15 August 2023).

The Danish Growth Fund provides access to investment capital for Danish companies, particularly SMEs,[163] in a bid to create growth and innovation in these companies and to expand the Danish capital ecosystem.[164] Since 1992, the Danish Growth Fund has, in collaboration with private investors, co-financed growth in over 7,900 Danish companies, with a total commitment of more than DKK 24.9 billion.[165]

The financing for the Danish Growth Fund derives from a number of sources:

- Initial funding at inception in 1992 was DKK 2 billion. By the end of 2018, their equity had increased to DKK 5.6 billion and liquid assets including stocks and bonds amounted to DKK 1.5 billion. Their equity is influenced by profits and losses and by capital contributions from the Danish Ministry of Business.
- A series of state grants that finance their loan and guarantee activities.
- Loans taken in connection with the 'Vækstlån' product (ordinary loans) and green investments.
- Loans taken to finance the Danish Growth Fund's capital contribution to the Dansk Vækstkapital initiative.[166]

163 Ibid.

164 Development Aid, *Danish Growth Fund/Vækstfonden*. Available at: https://www.developmentaid.org/donors/view/235507/danish-growth-fundvaekstfonden (Accessed: 15 August 2023).

165 Devex, *Vaekstfonden*. Available at: https://www.devex.com/organizations/vaekstfonden-132032 (Accessed: 15 August 2023).

166 Devex, *Vaekstfonden*. Available at: https://www.devex.com/organizations/vaekstfonden-132032 (Accessed: 15 August 2023).

United Kingdom

While the UK does not (yet) have an exclusive SWF, some of its key governing objectives most likely overlap with Ireland's fund – investing on a commercial basis to support general economic activity and employment – as well as Denmark's Growth Fund – investing in Danish SMEs to spur growth and innovation and expand the capital ecosystem available to companies. In fact, the development of several investment funds by the British Business Bank such as British Patient Capital, the Start Up Loans programme and the Future Fund would appear to present similar policy interests and frameworks to those in Ireland and Denmark, to name but a few European examples.

Appendix

Nations and Regions Investment Funds coordinated by the British Business Bank

South West Investment Fund

The South West Investment Fund aims to drive sustainable economic growth by supporting innovation and creating local opportunities for new and growing businesses across the South West. It was the first of the Nations and Regions Investment Funds to be launched and will deliver a £200 million commitment of new funding to the area. The fund offers a range of commercial finance options – with loans ranging from £25,000 to £2 million – and equity investment of up to £5 million.[167]

Investment Fund for Northern Ireland

The Investment Fund for Northern Ireland – launched in autumn 2023 – is a £70 million investment fund to support the growth of SMEs in Northern Ireland. The fund will offer a range of commercial finance options – with loans ranging from £25,000 to £5 million. By improving the supply of early-stage finance for smaller Northern Irish businesses, it seeks to tackle an identified funding gap.[168]

167 British Business Bank. *South West Investment Fund (SWIF).* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/south-west-investment-fund-swif/ (Accessed 11 August 2023).

168 British Business Bank. *Investment Fund for Northern Ireland (IFNI).* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/investment-fund-for-northern-ireland-ifni/ (Accessed 11 August 2023).

Investment Fund for Scotland

Increasing both the supply and diversity of early-stage finance available to smaller businesses in Scotland, the Investment Fund for Scotland will deliver a £150 million commitment of new funding to the country – providing funds to businesses which may not otherwise receive investment and helping to remove barriers in accessing finance. Through its activities, the fund 'aims to drive sustainable economic growth by supporting innovation and creating local opportunity for new and growing businesses across Scotland.'

The Investment Fund for Scotland offers a series of commercial finance options – with smaller loans and debt finance ranging from £25,000 to £2 million and equity investment of up to £5 million.

The fund also has environmental, social and governance awareness embedded in its design and will assist the UK economy in its transition to net zero.[169]

Northern Powerhouse Investment Fund

The Northern Powerhouse Fund is a collaboration between the BBB and 10 Local Enterprise Partnerships in the North West, Yorkshire, the Humber and Tees Valley – and it is supported by the European Regional Development Fund (ERDF). The Northern Powerhouse Fund provides over £500 million of investment and 'to transform the finance landscape for smaller businesses in the North of England and to realise the region's potential to achieve economic growth through enterprise.'[170]

169 British Business Bank. *Investment Fund for Scotland (IFS)*. Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/investment-fund-for-scotland-ifs/ (Accessed 10 October 2023).

170 British Business Bank. *Northern Powerhouse Investment Fund*. Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/northern-powerhouse-investment-fund-npif/ (Accessed: 11 August 2023).

Northern Powerhouse Investment Fund II

On course to be launched in 2024, the Northern Powerhouse Investment Fund II is a £660 million investment fund to support the growth of SMEs across the North of England and to tackle the funding gap between the North and South of England, as well as to increase the supply and diversity of early-stage finance for smaller businesses. It will offer a range of commercial finance options – with loans ranging from £25,000 to £2 million, and equity investment of up to £5 million.[171]

Investment Fund for Wales

The Investment Fund for Wales – launched in autumn 2023 – is a £130 million investment fund aimed at driving the growth of SMEs in Wales. It will offer a range of commercial finance options – with loans ranging from £25,000 to £2 million, and equity investment of up to £5 million. 'By increasing the supply and diversity of early-stage finance for smaller businesses in Wales, it seeks to tackle an identified funding gap.'[172]

Midlands Engine Investment Fund

The Midlands Engine Investment Fund is a collaboration between the BBB and 10 Local Enterprise Partnerships in the West Midlands and East and South East Midlands – and it is supported by the ERDF. The Midlands Engine Investment

171 British Business Bank. *Northern Powerhouse Investment Fund II (NPIF II).* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/northern-powerhouse-investment-fund-ii-npif-ii/ (Accessed: 10 October 2023).

172 British Business Bank. *Investment Fund for Wales (IFW).* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/investment-fund-for-wales-ifw/ (Accessed: 11 August 2023).

Fund provides over £300 million 'to transform the finance landscape for smaller businesses in the Midlands and to realise the region's potential to achieve economic growth through enterprise.'[173]

Midlands Engine Investment Fund II

On course to be launched in the first half of 2024, the Midlands Engine Investment Fund II is a £400 million investment fund to support the growth of SMEs in the Midlands. It will offer a range of commercial finance options – with loans ranging from £25,000 to £2 million, and equity investment of up to £5 million.[174]

Cornwall and Islands of Scilly Investment Fund (CIOSIF)

Supported by the European Regional Development Fund and established by the BBB in collaboration with the Cornwall & Isles of Scilly LEP, the Cornwall and Islands of Scilly Investment Fund provides commercially-focussed finance through a Debt and Equity Fund. It provides £40 million of investment to boost the growth of SMEs in the area and 'aims to transform the finance landscape for smaller businesses in the area and to realise the region's potential to achieve economic growth through enterprise.'[175]

173 British Business Bank. *Midlands Engine Investment Fund (MEIF).* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/midlands-engine-investment-fund-meif/ (Accessed: 11 August 2023).

174 British Business Bank. *Midlands Engine Investment Fund II (MEIF II).* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/midlands-engine-investment-fund-ii-meif-ii/ (Accessed: 10 October 2023).

175 British Business Bank. *Cornwall and Islands of Scilly Investment Fund (CIOSIF).* Available at: https://www.british-business-bank.co.uk/nations-and-regions-investment-funds/cornwall-and-islands-of-scilly-investment-fund-ciosif/ (Accessed: 10 October 2023).

British Business Investments

British Business Investments is a government-owned, independently managed, commercial subsidiary of the BBB which seeks to improve smaller UK businesses' access to alternative finances whilst supporting the UK's transition to a net zero economy and generating a return for the taxpayer.

British Business Investments do not directly finance small businesses. Instead, it works with the market to provide funding through delivery partners. Investments are chosen and programmes are designed in response to needs and gaps in the market.[176]

ENABLE

ENABLE Guarantees

The ENABLE Guarantee programme is designed to encourage additional lending to smaller businesses and is open to all UK banks, UK branches of foreign banks, and asset and asset-based finance providers, as well as certain other categories of lenders who lend to viable SMEs operating in the UK.

Those participating banks are incentivised by a government-backed portfolio guarantee to cover a portion of a designated lending portfolio's net credit losses in excess of an agreed 'first loss' threshold, which they then receive in exchange for a fee.[177]

176 British Business Investments. *What We Do*. Available at: https://www.bbinv.co.uk/?_ga=2.22028024.2134004879.1689875640-1925870920.1687533639 (Accessed: 11 August 2023).

177 British Business Bank. *Wholesale solutions – our ENABLE Programmes*. Available at: https://www.british-business-bank.co.uk/ourpartners/wholesale-solutions/ (Accessed: 11 August 2023).

ENABLE Build

ENABLE Build was launched in April 2019 to make available up to £1 billion of guarantee support for smaller housebuilder finance. It is open to UK incorporated banks and UK branches of overseas resident banks who provide development finance to viable SMEs operating in the UK. To deliver the programme, the BBB works alongside Homes England.[178]

ENABLE Funding

ENABLE Funding was launched in November 2014 with the aim of improving the provision of asset and lease finance to smaller UK businesses by 'warehousing' newly-originated finance receivables from different originators – bringing them together into a new structure. Once the structure has sufficient scale, it will refinance a portion of its funding on the capital markets – meaning the BBB can help small finance providers to tap institutional investors' funds.[179]

The Recovery Loan Scheme (RLS)

The RLS is a government-backed loan scheme administered by the BBB on behalf of the Secretary of State for Business and Trade and is designed to support access to finance for UK businesses as they look to invest and grow. It aims to improve the terms on offer to borrowers.

Businesses are able to use the finance from the scheme for any legitimate business purpose – including managing cashflow, investment and growth – but businesses must be able to afford to take out additional debt finance for these purposes.

178 Ibid.
179 Ibid.

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Sovereign wealth funds (SWFs) are often discussed as government-owned investment funds with their benefits returning to the government and citizens – and which invests its assets according to the interests of the national sovereign sponsor. They play an important role in both global financial markets and in representing important domestic owners of capital.

This collection of essays sets out a definition and understanding of sovereign wealth funds. In particular, it looks across at various British ideas of wealth funds in which public money is spent on major commercial projects – and citizens are deemed to own a share of the wealth generated, thereby benefiting from returns on those investments. There are two comparative chapters which study Ireland's sovereign wealth fund experience since 2001 and also ask what we can learn from Singapore's two wealth funds.

Critically, it is also suggested a UK fund may not always be the most ideal policy choice: potentially, it may be more effective in terms of desired outcomes to look at existing capabilities. One further chapter describes the investment funds of the UK's existing state-owned development bank – the British Business Bank – and what this could mean for a single coherent fund.

Some authors argue that a globally diversified sovereign wealth fund would allow us to invest to meet liabilities, while public wealth funds would enable assets to be better managed and value extracted for the taxpayer. Another chapter then argues that the creation of a UK sovereign wealth fund could create an 'anchor investor' for British entrepreneurs and start-up businesses – a 'financially sensible' idea allowing us to grow faster in the future, and enable us to become a fairer society.

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