

UPSC Civil Services Examination

UPSC Notes [GS-III]

Topic: Sovereign Wealth Fund (SWF)

Sovereign Wealth Fund which is also known as the sovereign investment fund is an investment fund for real and financial assets. These financial assets include bonds, stocks, real estate and precious metals. Sovereign Funds are the state-owned investment funds which also invest in alternative investments such as private equity fund. The SWFs are funded by the foreign exchange reserves that are held by the central bank. They are controlled by the government of a country with trade surpluses and abundant foreign monetary reserves.

This article will talk about the sovereign wealth fund in details. Sovereign Wealth Fund (SWF) is an important topic for the [IAS Exam](#) and is included in the GS-III section of the [UPSC Syllabus](#).

History of Sovereign Wealth Fund

The Sovereign Wealth Funds were first established in the U.S. during the mid-19th century as non-federal U.S. state funds. These funds were established to fund specific public services. The first state to establish the Sovereign Funds for funding public education was Texas. The first Sovereign Wealth Fund which was established for a sovereign state was Kuwait Investment Authority. It was established from oil revenues before independence in the year 1953. As per several estimations, the present worth of Kuwait's fund is approximately US\$600 billion. Revenue Equalization Reserve Fund of Kiribati, established in the year 1956, was another early registered Sovereign Fund. The fund has since then grown to \$520 million. Although the SWFs have existed for over a century, the number of sovereign wealth funds has increased dramatically since the year 2000. Andrew Rozanov first used the term 'sovereign wealth fund' in the year 2005. He used the term in the Central Banking Journal in the article entitled, "Who holds the wealth of nations?"

As per the transaction database of Sovereign Wealth Fund Institute (SWFI), around US\$9.26 billion were recorded in the last half of 2012 for direct sovereign wealth fund transactions. During the first half of 2014, the direct global sovereign wealth fund amounted to \$50.02 billion according to the SWFI.

Objectives of Sovereign Wealth Fund

Some of the major objectives of the Sovereign Wealth Fund (SWF) are mentioned below:

- Protecting and stabilizing the economy and budget of a country from excess volatility in exports.
- To earn greater returns than the foreign exchange reserves.
- To assist the monetary authorities to dissipate any unwanted liquidity.
- To increase savings for future generations.
- Providing funds for the social and economic development of a country.
- To provide a sustainable long term capital growth for the targeted countries.

Significance of Sovereign Wealth Fund

The Sovereign Wealth Funds were formed to benefit the citizens and the economy of a country. SWFs have a higher risk tolerance than traditional foreign exchange reserves because as per the non-profit Sovereign Wealth Fund Institute, they prefer returns over liquidity. SWFs were created to help the governments during any budgetary surpluses or during low international debt. Some countries depend on raw material exports like oil, copper or diamonds and cannot hold this excess liquidity as money for immediate consumption. The main reason for developing an SWF in such country is due to the unpredictability of extraction, high volatility of resource prices and exhaustibility of resources. Other reasons for creating SWFs may be economic, or strategic, such as war chests for uncertain times.

The Sovereign Wealth Funds can be further classified into the following categories:

1. Savings Funds
2. Stabilization Funds
3. Reserve Investment Funds
4. Strategic Development Sovereign Wealth Funds (SDSWF)
5. Pension Reserve Funds

Sovereign Wealth Fund (SWF) is an important investment fund and forms an important topic under the Economics section. Candidates preparing for [UPSC 2020](#) are also advised to keep a track on the latest [current affairs](#) related to several economic developments in the world.