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Special Section: the Geopolitics of Sovereign Wealth Funds

# Sovereign Dilemmas: Saudi Arabia and Sovereign Wealth Funds

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## Abstract

While the countries of the Gulf Cooperation Council (GCC) can claim over half of SWF assets globally, the largest and most strategically important state, the Kingdom of Saudi Arabia, has heretofore lacked a dedicated investment fund. This paper challenges some of the conventional wisdom on SWFs in explaining the Saudi government's reticence to launch an SWF and its recent decision to cautiously move in this direction. First, while Washington policy makers raise fears of enemies using SWFs against US interests, Saudi foreign assets have been used in support of its continuing alliance with the United States. And second, while critics decry the lack of transparency of SWFs, the Saudi launch of a new SWF could represent a move toward greater transparency, by working to separate “private” sovereign funds from “public” ones. Indeed, the launch of a SWF fits into a broad pattern of reforms rationalising Saudi governing institutions as King Abdullah has moved to control spendthrift princes, to streamline decision making, and to attract more foreign investment.

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# Notes

1. McKinsey reports that oil exporting nations as a group have now surpassed Asia as the largest source of net global capital flows in the world. McKinsey Global Institute, 'The New Power Brokers: How Oil, Asia, Hedge Funds, and Private Equity are Shaping Global Capital Markets' (Oct. 2007) p. 45.
2. J. P. Morgan estimates in 2007 have Gulf sovereign wealth funds accounting for \$1.7 trillion of the \$3-3.7 trillion held by sovereign wealth funds. J. P. Morgan Research, 'Sovereign Wealth Funds: A Bottom-Up Primer', May 22, 2008.
3. For a sceptical view about the risk profile of Gulf SWFs, see Jean Francois Seznec, 'The Gulf Sovereign Wealth Funds: Myth and Reality', Middle East Policy 15/2 (Summer 2008) pp. 97-110.
4. See for instance Benjamin Cohen, 'Sovereign Wealth Funds and National Security: The Great Tradeoff', Working Paper (Santa Barbara: UCSB Dept. of Political Science 20 Aug. 2008).
5. Robert Kimmitt, 'Public Footprints in Private Markets', Foreign Affairs 87 (Jan./Feb. 2008); Edwin Truman, 'Sovereign Wealth Funds: The Need for Greater Transparency and Accountability', Peterson Institute for International Economics Policy Brief 08.6 (Aug. 2007).
6. Institute of International Finance, Economic Report: Gulf Cooperation Council Countries (Jan. 16 2008). Also cited in Afshin Molavi, 'Rising Gulf,' Newsweek International Web Exclusive, August 6, 2007.
7. For more on this transformation see Rawi Abdelal, Ayesha Khan, Tarun Khanna, 'Where Oil-Rich Nations are Placing their Global Bets', Harvard Business Review (Sep. 2008).
8. Bill Spindle, 'Boom in Investment Powers Mideast Growth', The Wall Street Journal, 19 July 2007.

9. Source: Institute for International Finance; Jadwa Investments; Brad Bourland, 'Industrialization in the GCC: Context, Facts and Implications', presentation to Georgetown conference on Industrialization in the Gulf, 27 March 2008.
10. Institute of International Finance, Economic Report: Gulf Cooperation Council Countries (Jan. 2008).
11. Ibid., p. 1.
12. Rachel Ziemba, 'What are GCC Funds Buying', RGE Monitor (June 2008).
13. McKinsey Global Institute (note 1) p. 53.
14. Ibid., p. 3.
15. Reproduced from: Institute of International Finance (IIF), 'Economic Report, Gulf Cooperation Council Countries' (16 Jan. 2008) p. 9.
16. Ziemba, 'What are GCC Funds Buying' (note 12) p. 4.
17. Rachel Ziemba, 'GCC Sovereign Wealth and Islamic Finance', RGE Monitor (Aug. 2008).
18. McKinsey Global Institute (note 1) pp. 65-66.
19. Ziemba, 'What are GCC Funds Buying' (note 12) pp. 4-6.
20. Ibid., p. 7.
21. Ibid., p. 8.
22. Ibid., p. 2.
23. Estimates drawn from: Brad Setser and Rachel Ziemba, 'Understanding the new Financial Superpower-The Management of GCC Official Foreign Assets', RGE Monitor (Dec. 2007).
24. Ziemba, 'What are GCC Funds Buying' (note 12) p. 19.
25. Sources in the banking industry also indicate that SAMA is fairly transparent in terms of defining benchmarks and sharing them with Western banks that come calling. They also mention that SAMA is much more technocratic than the other Gulf SWFs which are beset by patronage relationships.

26. When looking at foreign holdings, it may also be worth considering the role of state-owned enterprises (SOEs), such as Saudi Basic Industries (SABIC), which take strategic stakes in foreign companies. Notably in 2007, SABIC and China's Sinopec Corporation agreed to invest more than \$1 billion in a petrochemicals plant in northern China.
27. Source: Amadan International Consulting.
28. Rachel Ziemba, 'Petrodollars: How to Spend It', RGE Monitor (20 March 2008).
29. Economist Intelligence Unit Country Briefing, 'Saudi Arabia economy: Boom budget', The Economist (18 Dec. 2007).
30. Ibid., p. 4.
31. Ahmed Saeed, 'The New Rules of the Game: Gulf Wealth and the Global Economy', CSIS Gulf Roundtable Series (31 Jan. 2008).
32. See Jean Francois Seznec, 'Industrialization in Saudi Arabia: A New Paradigm', available at <[www.bitterlemons.org](http://www.bitterlemons.org)> (21 Sep. 2006).
33. Philip Winder, 'Musings on Sovereign Wealth Funds and Saudi Investment Policy', Comments made at the Euromoney Saudi Arabia conference, 7 May 2008.
34. Middle East Economic Digest (Sep. 2008).
35. It is notable that Saudi domestic equity market capitalisation makes up roughly half of total GCC market cap. McKinsey estimates these at GCC 732 billion; Saudi Arabia 326 billion.
36. For a full account of the conspiratorial climate see Ibrahim Warde, *The Price of Fear: The Truth Behind the Financial War on Terror* (Berkeley: University of California Press 2007) ch. 7.
37. Seznec (note 32) p. 2.
38. Andrew England, 'Saudi Arabia Approves Setting Up New Fund', Financial Times (15 July 2008).
39. Interestingly, a Time article from the era of the first oil boom notes SAMA's "terror of American politicians standing on the floor of the Senate and accusing them of buying up America." Charles Alexander, 'Squirreling Away \$100 billion', Time, 13 July 1981.

40. See David Spiro, *The Hidden Hand of American Hegemony* (Ithaca: Cornell University Press 1999); Eric Helleiner, 'Political Determinants of International Currencies: What Future for the US Dollar?', *Review of International Political Economy* 5/1 (2008) pp. 92-121.
41. For an exhaustive listing of the economic reasons for keeping the dollar peg see John Sfakianakis, 'Why Saudi Arabia is Right not to Revalue', *Financial Times* (10 Oct. 2007).
42. Adam Robinson and Ed Morse, 'Insight: Saudi Arabia Holds Key to Oil and Dollar Link', *Financial Times* (24 Oct. 2007)
43. Personal interview conducted November 2007. See also Shawkat Hammoudeh and Ramazan Sari, 'Do GCC Countries Finance US Current Account Deficit?', *Researcher's Review*, *Zawya Community Blogs* (posted 3 Dec. 2007) available at <http://blogs.zawya.com/print/shawkat.hammoudeh/071203064331/>.
44. Economic Intelligence Unit Country Briefing, 'Saudi Arabia Economy: Boom Budget', *The Economist* (18 Dec. 2007).
45. Many international relations theorists working on the Gulf have noted a shift to more multilateral policies in security. See Gerd Nonneman, 'Determinants and Patterns of Saudi Foreign Policy: 'Omnibalancing' and 'Relative Autonomy' in Multiple Environments', in Aarts and Nonneman (eds.), *Saudi Arabia in the Balance* (New York: NYU Press 2006) pp. 315-352.
46. McKinsey Global Institute (note 1) p. 51.
47. Interview with Financial Analyst, Lehman Brothers (Aug. 2008).
48. Nimrod Raphaeli and Bianca Gersten, 'Sovereign Wealth Funds: Investment Vehicles for the Persian Gulf Countries', *Middle East Quarterly* (Spring 2008) pp. 45-53.
49. Interview with portfolio manager working with Saudi Arabia.
50. Steffen Hertog, 'Shaping the Saudi State: Human Agency's Shifting Role in Rentier-State Formation', *International Journal of Middle East Studies* 39/4 (2007) pp. 539-563.
51. For a very compelling argument about how this division of ministries has left SAMA in technocratic, non-royal hands, and how this technocratic divide affects Saudi reform

efforts see Jean Francois Seznec, 'Stirrings in Saudi Arabia', *Journal of Democracy* 13/4 (Oct. 2002) pp. 33-40.

52. Roula Khalaf, 'Transparency is in Everyone's Interest', *Financial Times*, 19 May 2008.

53. Hossein Askari, 'Sovereign Wealth Funds: Prosperity and Harmony - Or Just Greed', *Asia Times* 23 (May 2008).

54. Steffen Hertog, 'Building the Body Politic: Emerging Corporatism in Saudi Arabia', *Chroniques du Yémen et de la Péninsule Arabe* 12/1 (2005).

55. 'Interview Transcript: Mansour al-Maiman', *Financial Times*, 28 April 2008.

56. Souhail Karam, 'Saudi Plans \$5.3 Billion Investment Firm, Tech Focus', *Reuters*, 6 May 2008.

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