The Rationale for Sovereign Wealth Funds in Nigeria: Issues and Considerations

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Abstract

A significant concern of sovereign wealth funds to monetary policy formation and implementation is the volatility in government revenue arising from sharing of the monetized oil proceeds which normally led to spikes in both exchange and short-term interest rates with disruption effects on the monetary transmission mechanism. To complicate the process, the excess liquidity sharing arising would lead to significant cost on the part of the central bank for liquidity mop up operation. This study reviews the aftermath of the current sovereign wealth funds in Nigeria and its potential of enhancing stability and policy coordination.

Key words: sovereign wealth funds, policy, Nigeria
J.E.L. classification: E00, E02, E03, G32

1. Introduction

The growth in recent years of Sovereign Wealth Funds (SWFs) has generated an extensive body of literature. Much of these literatures is largely descriptive. A huge portion is normative relating to foreign direct investment. Only a few fractions considered economic-theoretical issues and their implication on monetary policy coordination and savings for future generation. While, the sovereign wealth funds are invested globally, possibly because it consists a pool of money derived from a country reserves which are set aside for purpose of the benefit of economic stability and developmental financing.

In terms of concept, sovereign wealth funds are state owned investment which comprises of financial assets such as stocks, bonds, property and natural resources. SWFs may be held by the Apex bank, which accumulate funds through prompt supervision of bank and management of deposit money banks. Other sovereign wealth funds are pool of savings that are invested in various form such as Foreign Currency Deposit, Special Drawing Right (SDRs) and required deposit by International Monetary Fund (IMF). Success recorded from the sovereign wealth funds as evidence by Norway, China, Saudi Arabia, Singapore, Kuwait and United Arab Emirates have shown that sovereign wealth funds have several potentials of reducing inflationary pressures, transparency in economic management, increase saving for future generation and enhance economic stability.

Despite the glory attached to this relative initiative the need to review the existing framework of the sovereign wealth funds in Nigeria become crucial, since emphasis to provide solution to the controversies surrounding the Excess Crude Account (ECA) persist. Also, the need to put an end to budget shortfalls and ensure sound economic stability is the major concern of this study. The remaining part of this paper is broken into four segments. Next it starts with segment evolution of sovereign wealth funds and the Dividend of Sovereign Wealth Funds in segment 2. Followed by Literature review in segment 3and concluding remarks in segment 4.

2. Some Background

2.1. Evolution of Sovereign Wealth Funds

The establishment of the stabilisation funds precursor formed the foundation of the sovereign wealth funds. The stabilisation funds was meant to offset the revenue declines perceived from consistent decline in commodity prices or production growth which has led to volatility in the price of natural resource such as metals, diamond, crude oil among others. This stabilisation funds was designed to promote local development by smoothening spending during boom and burst period (Wolf, 2009). Because of the domestic financial sector recapitalization, the need for institutionalization and reallocation of resources the sovereign wealth funds was established. The Kuwait sovereign wealth funds were widely acknowledged as the oldest in the world. It was established in 1953 to assume the responsibility of managing the Kuwait's State Assets. Likewise, the Singapore investment corporation established in 1981 as private company to facilitate government savings to meet budget deficits and currency volatility, along side with the sovereign wealth funds established by United Arab Emirate, Saudi Arabia, China as well as the Norwegian Sovereign Wealth Fund established in 2008 (Blackson, 2011).

In Nigeria, the controversies surrounding the Excess Crude Account (ECA) has led to the establishment of the Nigerian Sovereign Wealth Funds as an urgent solution to meet the budgets shortfalls as well as enhance stability through policy coordination between the monetary and fiscal policies. By 2011, the Nigerian Sovereign Investment Authority (NSIA) was established and mandated to received, manage, and invest in a diversified medium and long-term revenue of the government. To make effective policy, the Governing Council was established and head by the president. This move gave room for independent body capable of holding, acquiring and disposing assets in its corporate name (Martin, 2008).

To carry out its mandate effectively, the NSIA has been broken down to three operational responsibilities which include Future Generation Funds (FGF), Nigerian Infrastructure fund (NIF) and Stabilisation Funds. While, the FGF is targeted at providing the future generation with savings, the NIF was targeted at making investment related to critical infrastructure such as power sector restructuring, agricultural growth, dams construction and sewage treatment. The stabilisation fund was considered for effective conduct of sound fiscal policy for reducing fluctuation in price level.

2.2. Dividends of Sovereign Wealth Funds

One of the major challenges to monetary policy formulation from government is the volatility in oil revenue. It is a very good development that establishes a mechanism for setting up the SWFs which will smoothen out the effects of volatility of oil prices and permit the intertemporal transfer of benefit from oil wealth (Tule, 2014). From the monetary policy perspective, sovereign wealth fund is expected to smoothen volatility in the financial market (money and capital market) and exchange rate which is often associated with sharing of government revenue. Given the dynamic structure of Nigeria economy, the recourse to the excess crude account in the course of budget implementation is to benchmark price of crude oil the budget. Suggesting that the government has to operate a fiscal deficit marked by improvement in term of trade that will impact on inflationary pressure and output growth.

3. Review of related literature

3.1 Conceptual clarification

The term sovereign wealth fund can be defined as accumulated savings of financial instrument owned by a state. Rozanvoc (2005) define SWFs as foreign exchange reserves earned by a state for a specific purposes. US treasury defines SWFs as government investment vechiles funded by foreign exchange assets that are managed sepereately by from reserves (US GAO Report, 2008). Wolf (2007) and Garten (2008) spell out the major characteristic of SWF, which includes, high currency exposure, lack of liabilities, risk tolerance and long term investments. In other to contribute to literature, Anderson (2009) claim that SWFs are characterised by state ownership and seperate management without no explicit liabilities (pension fund). Balin (2010) similarly acknowledged that investment choices and asset allocation strategies in SWFs have severe implication on the financial return on world business and often lead to risk exposure of the domestic economy. While, the concept of SWFs have drawn our attention to the important of global equity and the implication of government asset on risk and growth volatility, the need to understand the structure and pattern of government investment as well as financial policy suitable for institutional formation for realising the objectives of this funds is crucial to avoid credit crises in the economy.

3.2 Theoretical Exposition

In the extant literature, two main theoretical proposition justifies the existence of SWFs which are the financial management and economics theory. The financial management theory is an application of finance in international trade flow that persuade Central bank to accumulate foreign exchange reserve for building external reserves beyond the threshold of require future import bill (Rozanov, 2010). The financial management theory attempt to prevent risk and enhance foreign reserves, the economics theory considered price mechansim which is concerned with demand and supply of capital rooted in monetary policy framework. While, the economist considered the concept of lending when the entire money in the economy is reserve without quest for domestic investment. Beyond obvious both views point out the needs for SWF as an investment strategies for any economy that aspire for growth and equally point out risk dimesion for the same ambition.

3.3 Empirical Evidence

The debate on the rationale for sovereign wealth funds and it implication on investment strategies of the government have generated serious academic equieries in recent years. For instance, Fernandes (2009) investigates the rise in SWFs around the world using a dataset from 2002 and 2007, the results shows that SWFs have implication on stabilising effect on financial markets. Similarly, Bernstein, Lerner, and Schoar (2009) examines the direct private investment strategies across sovereign wealth funds state and their relationship to the funds organisational structures using P/E ration analysis. Their results shows that SWF is likely to stimulate investment in an environment with less political involvements. In a postgraduate thesis presented by Al-saidi (2012) on analytical study of sovereign wealth funds strategies and policies with attempt to address the main problem of sponsoring and invetee countries about governance and transparency of major SWFs in Oman. The results of the author suggest that Oman SWF has issues concerning governance, transparency, accountability and investment strategy which is rooted in its international policy mechanism.

Megginson (2014) analysed the evolution of the initial SWFs from stabilisation funds to stand alone wealth management funds using a survey research of 25 countries. The author observes that SWFs might have a potential threat to monetary policy formation during the period. Gelb, Tordo, Halland, Arfan, and Smith (2014) argues that a well governed sovereign wealth funds with sound mandate and professional management can improve the quality of public investment program. In 2015 paper, Ficova, forcast the future growthof sovereign wealth funds using a data from number of SWF and that any change a change in assets unders SWFs will lead to change in future investment during the period reviewed. Cheng (2015) examines the impact of sovereign wealth fund investment on international institutional investors and attempt to address a comprehesive gap in literature using a survey of the world major 24 SWFs with assets under management of 500 million USD between 2008 and 2012. The authors results shows SWFs a great variety in terms of funding mechanism , governance, asset allocation and investment strategies, but political objective has a severe implication on the degree of other international investors. The authors paper attempt to bridge the lacuna in literature but end up providing unnecessary complication on firm behaviour.

Beyond doubt the above reviewed studies, have attempts to identifies various threat to the potentials of sovereign wealth in their various location of studies. While, the highlights of there major findings includes: institutional difficulties, risk exposure, effect on stability of financial market, poliyical constraints among others. Despite the interesting findings and observation, it appears that there is no conclusion on the rationale for sovereign wealth funds and information supplied by these studies are provide more confusion and need further clarification. As such the preoccupation of this study is to bridge the observed lacuna in literature and provide strategies that will help realised the potentials of sovereign wealth funds in Nigeria.

4. Concluding Remarks

The current state of the Nigeria economy shows that oil revenue account for a larger share of government budget, as such the monetary policy environment is dominated by fiscal measures. Therefore, the rationale for monetary and fiscal policies coordination become obvious. Although, the Nigeria government have attempted to establish the monetary and fiscal polies coordinating committee (MFPCC) for creating a platform for harmonization of monetary, fiscal and debt policies with a view of promoting stability in the financial system.

This study queries the existing policy coordination arrangement and suggest urgent need to address the problem of excessive liquidity in the Nigerian financial system, especially when monetization of dollar revenue has curtailed the development of the foreign exchange market and weaken the pragmatic monetary policy efforts. By implication, there is high risk and high return on the aspiration of SWFs as such the Nigerian government need to trade with care to avoid collapse of the economy.

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