Understanding Sovereign Wealth Funds: Investment Activities and the Political Dimension

***Ilker YAMAN** (http://orcid.org/0000-0002-3724-7467), Recep Tayyip Erdogan University, Turkey; e-mail: ilker.yaman@erdogan.edu.tr*

***Ahmet Burçin YERELI** (http://orcid.org/0000-0002-8746-6756), Hacettepe University, Turkey; e-mail: aby@hacettepe.edu.tr*

Keywords : Sovereign Wealth Funds, Political Implications, Investment Activities, Regulatory Issues.

JEL Classification Codes : G15, G38, G23, O50, F30.

Extended Abstract

This study aims to extensively examine the investment activities of sovereign wealth funds, whether the driving forces of these activities are economic or political, whether sovereign wealth funds threaten countries' economies and what are the reactions shown by the countries receiving sovereign wealth fund investments. This study contributes to a better understanding of sovereign wealth funds by contextualizing both the investment activities of these funds and the political reactions shown to their investments.

Sovereign wealth funds mostly with a long-term investment perspective are qualified as state owned investments funds. Sovereign wealth funds, which have become one of the important financial actors of 21st century and are in a search for commercial returns to protect and enhance asset accumulation of governments, are among the fast-growing financial investors, leaving behind many financial institutions such as hedge and private equity funds in terms of asset volume they manage.

The risks borne by sovereign wealth funds attract more attention than the benefits they provide. The fact that sovereign wealth funds, which have adopted economic objectives such as alleviating domestic economic fluctuations, supporting domestic socio-economic policies, diversifying national reserves, reducing dependence on single source income and saving for future generations, are largely belonging to non-democratic countries and countries where human right are not well developed, cause the activities of such funds to be sceptical. Also, the thought non-democratic governments may be seeking to use sovereign wealth funds as a political tool to weaken developed countries by buying strategically significant assets such as ports or by investing in strategic sectors such as defence and telecommunications, causes concerns about these funds. In addition, during the 2007-08 global financial crisis, investments made by sovereign wealth funds to financial distressed companies brought along both interrogating the activities of these funds and developing the belief that their activities may be related to political factors.

Concerns about sovereign wealth funds can be examined in three groups: political concerns, economic concerns and transparency concerns. Main political concern is the fact that sovereign wealth funds can serve the national interests of the home country and thus damage the national security of the host country. Main economic concerns for the sovereign wealth funds are investments made by such funds could cause fluctuations in financial markets and could create price bubbles. Finally, there are

concerns that the sovereign wealth funds exposed to political interference by the governments of their countries may harm the management and performance of the companies they invest in.

The prudent act of clearly articulating the activities and institutional structure of sovereign wealth funds has brought with it the adoption of regulatory and protective measures for the transparency and investments of such funds. The United States, France, Italy and Germany are among the countries that react most to sovereign wealth funds and bring regulations for such funds. Current regulations are shaped by the fact that sovereign wealth funds are more transparent, corporate governance principles are explicitly stated, existing regulations on such funds are re-audited and effects of sovereign wealth fund investments should be better measured.

As a result, there is little evidence that sovereign wealth funds follow non-commercial or strategic objectives. Firstly, our research shows that sovereign wealth funds do not act for political purposes but act to increase their own financial performance. However, even in a small number of cases, there is evidence that some sovereign wealth funds are exposed to political influence. In addition, sovereign wealth funds are cautious when investing in sensitive or strategic sectors and use voting rights only to achieve specified economic objectives. Moreover, there are expressed opinions that the investments made by the sovereign wealth funds contribute to the stability of the financial markets and the global economy. Finally, the results show that sovereign wealth funds are found to affect the performance of the companies they invest in both negative and positive.