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Subject: FW: WSJ article on a Paris G20 Initiative proposal

Date: Sat, 29 Oct 2011 07:10:17 +0000

FYI

From: [REDACTED] [mailto:[REDACTED]]

Sent: Friday, October 28, 2011 5:24 AM

Subject: WSJ article on a Paris G20 Initiative proposal

Dear Davos 2011 and Dalian 2011 YGLs,

I chatted with a number of you in Davos and Dalian on the topic of the importance of mutual equity stake-holding relationship in the current context of elevated geo-strategic tension, as well the YGL initiative on G20. Attached for your leisurely reading is an article WSJ just ran today on a proposal of a multilateral sovereign wealth fund, which is part of the "YGL G20 Paris Initiative" proposals to the French chair. http://cn.wsj.com/gb/20111028/KAI153108_ENversion.shtml) WSJ has run it in both Chinese and English, which allowed me to directly circulate it to Chinese policy makers.

The concept is also embedded in the Euro zone rescue package that was reached yesterday. Europe calls for capital injection from China. Chinese will likely call for a multilateral package where BRIC countries and IMF all get involved. They will probably also want any investments to be equity in nature.

I welcome any comments.

Kevin

A Multilateral SWF: G20 Should Promote Growth by Investing Surplus in Productive Assets

The Wall Street Journal

October 28, 2011

The G20 leaders will meet later this week in Cannes, and one of the key challenges they will confront is how the world should manage the continued global economic imbalances -- the surplus nations will keep generating surpluses while the deficit nations will accumulate more deficits.

The last year the US had a trade surplus was 1976, and the country has been running a trade deficit every year since for 35 years. China has been running a consistent surplus since early 1990s. Countries like Saudi Arabia and UAE have been generating surpluses from their oil sales for the past twenty years and will continue to do so in the foreseeable future. As a result, China has accumulated a foreign currency reserve of \$3.2 trillion, currently held between SAFE, the investment arm of its central bank PBOC, and China Investment Corp, its SWF. Saudi's SWF and reserve assets are close to \$1 trillion and UAE over \$600 billion.

While the damage of the global economic imbalances, especially the inability of the US to productively use the recycled surplus, was crystallized in the aftermath of the Lehman crisis, the imbalances have taken decades to form, and are not something that could be easily reversed overnight. This economic reality is also deeply intertwined with cultural habits such as the tendency to save by the Chinese, the penchant to spend, a.k.a. to realize the American Dream by the Americans, and a preference to 35-hour work week, month-long vacations and weekly strikes in France. Under these circumstances, in the midst of a global crisis, no reasonable mind should expect that economic policy makers could suddenly and magically change all these to restore a 'global economic balance'.

It may be useful for the G20 leaders to recognize that the current global imbalances have existed for decades for deeply rooted reasons, many of which simply reflect common-sense reality. It may also be useful to recognize that jobs that have moved to India, China or Vietnam over the last three decades will not come back to Illinois overnight. It may further be useful to recognize that any attempt to suddenly reverse the imbalances now, in the immediate aftermath of a severe crisis that many would argue is not over yet, might simply dictate even deeper austerity measures and trigger even more losses of government and private-sector jobs in deficit countries, and

further reduce global aggregate demand.

Instead of trying to stop the accumulation of surplus, G20 leaders should take the surplus as it is, and focus on identifying solutions to channel these surplus resources into productive uses globally, in a way that benefits the owners of the surplus resources, the recipient countries and the overall global economy.

One such solution is to pool the resources from the sovereign wealth funds (SWFs) and central bank reserves of surplus countries to form a growth-oriented equity-focused Multilateral SWF (M-SWF). The M-SWF should be managed professionally and independently to make equity and equity-like investments in productive assets in deficit countries as well as other countries with long-term growth opportunities, with the explicit purpose of generating long-term commercial returns for the investors as well as delivering future productivity gains to the recipient countries. For example, the M-SWF could invest in building a high-speed railway in the U.S., a hotel in Rwanda, an oil refinery in Vietnam, or a mining services company in Mongolia, all in need of capital for such investments that would increase the future productivity of these economies, not to mention creating immediate local jobs. It could also invest in strengthening high-end manufacturing capacity in Italy that would better take advantage of its existing brand values.

Similarly, M-SWF funds could be invested in taking large equity stakes of major state-owned ports in Greece, thereby supplying resources to the government which could in turn be used to strengthen its vulnerable banks. While long-term investing is the goal of the M-SWF, it should also build in a sensible drawdown policy to give the sovereign investors an orderly way to withdraw their capital when there are pressing domestic needs. In cases where there is a strong development imperative but the need for a 'kicker' to reach commercial returns, M-SWF could partner with bilateral, multilateral and privately funded concessional finance sources. The Gates Foundation, for example, has taken a keen stand in supporting key objectives of a global development agenda with its considerable resources and convening power.

Ideas about a global sovereign investment platform have been raised before. In 2008, Klaus Schwab, executive chairman of the World Economic Forum envisioned 'a Global Investment Fund, a unique investment vehicle that will enable the largest Sovereign Wealth Funds to play a leading stabilizing role in global financial markets while simultaneously achieving superior market returns.' In 2009, World Bank President Robert Zoellick proposed that SWFs channel 1% of their assets to productive and profitable projects in developing countries such as in Africa. World Bank's private sector arm International Finance Corporation (IFC) subsequently set up a subsidiary IFC Asset Management Company to pool assets from SWFs for co-investments with IFC into emerging markets. Joseph Stiglitz of Columbia University recently argued for the importance of channeling surplus into productive uses in his speech at the World Bank in September.

For the concept of pooled investable assets to work, we need three primary principles, so the fund could be structured attractively to both SWF investors and recipient countries. First of all, the focus on growth dictates that the key threshold for M-SWF investments is the ability to translate into future productivity, i.e., funds should be invested in productive assets, rather than being used to give loans to borrowers who just want bigger houses or more cars. Secondly, the equity nature of these investments means that, for deficit countries, these investments would not further exacerbate their indebtedness and, for investor countries, they would enjoy equity upside if and when the economic growth of deficit countries eventually resume. Third, M-SWF would be multilateral and should pool assets together from a large number of countries, hence reducing any potential geopolitical complications associated with investments made by a single country SWF, be it China or the United Arab Emirates.

Today, the central banks and SWFs of surplus countries have at least \$8 trillion dollars of assets. If we pool even 10% of these assets into an M-SWF, it could achieve significant interventions in Europe, the U.S. and elsewhere. For investor countries, the M-SWF portfolio would complement their existing investments made by SWFs and central bank reserves. In the short term, for recipient countries, significant capital injections by the M-SWF would provide an opportunity for them to jump-start their economy and to gain valuable time to improve their productivity and competitiveness. In Europe, M-SWF could provide cash infusion to sovereigns and companies alike in exchange of equity stakes in productive assets. In the long run, establishing south-north and south-south equity-stakeholder relationship complements the traditional FDI flows that go from north to south, and could usher in an era of substantive mutual stake-holding relationship that goes beyond empty talks about international coordination. Such substantive mutual stake-holding relationship should align the economic and financial interests of all countries involved, spread the benefits of economy gains, as well as share the downside risks among all participants. That relationship is badly needed in an increasingly globalized and hyperconnected world we live today.

Critics will surely find all kinds of problems with this proposal, but no one could deny that the global economy is in trouble today, that economic problems could well spread into political and military arenas, and that a fundamental root cause for our problems is that the interests of nation states tend to diverge, especially in a crisis. Without a forceful intervention, as the economic situation continues to worsen in the advanced economies with likely spillover into emerging economies, we will only see deeper protectionism, more capital controls and domestic priorities increasingly overriding global obligations, to the detriment of all. With a growth-oriented and equity-focused M-SWF, we have a real opportunity and a relatively simple solution to genuinely align the economic interests of both surplus and deficit countries and to make it prosperity for all. These are objectives G20 leaders should aim for in Cannes.

M-SWF is one of the nine proposals that were developed for the French government, this year's G20 Chair, by the 'G20 Paris Initiative Task Force' of the World Economic Forum's Young Global Leaders community. Anthony Stevens (Oliver Wyman), Parag Khanna (New America Foundation) and Jill Otto (JP Morgan) also contributed to the proposal.

About the Author: Kevin Lu is a Director of the Multilateral Investment Guarantee Agency (MIGA), the private sector investment guarantee arm of the World Bank Group. He is a Council Member of the Emerging Markets Advisory Council at the Institute of International Finance (IIF) based in Washington, DC. He is also a member of the Forum of Young Global Leaders. This column focuses on policy issues related to international finance and political economy, especially those relevant to the emerging economies. It also examines many fundamental changes that are occurring in the advanced economies, in the context of the significant shifts of economic weight towards emerging markets. The opinions are his own.