7. Sovereign Wealth Funds and macroeconomic stability: before and after their establishment

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1. INTRODUCTION

Macroeconomic stability describes a situation of an economy that minimizes its vulnerability to external shocks and increases the prospects for sustainable economic growth. Todaro and Smith (2009) posited that the main objectives of macroeconomic stabilization are to control inflation, restore fiscal balance and eliminate current account deficits. The achievement of macroeconomic stability is a serious challenge in many developing economies. This is because inflation variability, interest rates and exchange rates fluctuations, high government deficits and national debts have caused economic crises in several countries. Hence, the International Monetary Fund (IMF), European Union (EU) and other international organizations are focused on assisting these countries to achieve macroeconomic stability.

The five variables of macroeconomic stability identified by Maastricht Criteria[1] are: low and stable inflation rate (capped at 3 per cent); low currency fluctuations (maximum of 2.5 per cent); low and long-term interest rate (maximum of 9 per cent); low fiscal deficits relative to GDP (within 3 per cent); and low national debt relative to GDP (pegged at 60 per cent). Basci (2012) added sustained growth as one of the indicators of macroeconomic stability. Developing economies are now grappling with policy options to stabilize their economies, and one such policy decision is the establishment of Sovereign Wealth Funds (SWFs).

According to Allen and Caruana (2008), SWFs are government-owned investment vehicles that are invested in overseas for a long-term period. They are set up for a variety of macroeconomic purposes as well as the maximization of benefits that are typically funded by foreign exchange assets and commodity-exporting revenues. An investment vehicle can be classified as an SWF if it possesses five basic features, namely: sovereign (is independently managed from official reserves), high foreign currency exposure, absence of explicit liabilities, high risk tolerance, and a long investment horizon (see Gomes, 2008; Jen, 2007). Moreover, Allen and Caruana (2008) highlighted the economic and financial benefits of SWFs