Foreign Direct Investments of Gulf Sovereign Funds in Light of the Effects of Recent Crises

-A Study ofThe Russian-Ukrainian Crisis and the Covid-19 Crisis-

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Abstract:

This study aims to highlight the effects of the Russian-Ukrainian crisis and the Covid-19 crisis on the direct investments of Gulf sovereign funds, especially since the latter has been seeking for years to achieve economic diversification and contribute to the development of the economies of the Gulf countries. The study concluded that the most important impact on Gulf funds lies in the decline On the one hand, its funding sources and the increase in withdrawals to cover the increasing expenses of the countries that own it.

Keywords: Gulf Sovereign Funds, Russian-Ukrainian crisis, Covid-19, Foreign Direct Investment, Economic diversification.

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1. Introduction :

Sovereign wealth funds (SWFs) are crucial for the economies of Gulf Cooperation Council (GCC) countries, managing a significant portion of their wealth. SWFs aim to generate financial and social returns for socioeconomic development. In the Gulf region, SWFs are categorized based on investment objectives: stabilization funds prioritize liquidity, savings funds focus on long-term investments, and development funds contribute to domestic economic development through equity investments. The GCC countries recognize the need for diversification and efficient resource allocation to reduce dependence on oil prices. Transparency, better practices, knowledge transfers, and foreign direct investment are important for the growth of SWFs. Gulf SWFs vary in approaches to saving, spending, and investing, reflecting different priorities and time horizons. They contribute to industries of the future, energy transitions, cross-border partnerships, and national champions. Recent dealmaking by Gulf SWFs involves alternative assets, co-investment with private equity and venture capital firms, and broader geographic focus. Overall, Gulf sovereign funds play a vital role in economic development and shape the economic landscape of their countries.

2. Strategies used by Gulf sovereign funds in developing foreign direct investment

2.1. Importance of foreign direct investment outside the hydrocarbon sector

Foreign direct investment (FDI) plays a crucial role in promoting economic development and diversification in countries heavily reliant on the hydrocarbon sector. This essay will discuss the importance of FDI outside the hydrocarbon sector, with a focus on the role of Gulf sovereign funds in developing foreign direct investment.

Sovereign wealth funds (SWFs) have emerged as transformative tools for national development strategies in rentier economies. These funds, based on shared rents from oil production, are managed by the state and serve as inter-generational savings accounts. While not all sovereign funds are based on natural resource wealth, those in the Gulf states are exclusively funded by oil and gas revenues.

In the Gulf region, most sovereign wealth funds are deployed abroad to achieve two primary objectives: diversify national economies from oil dependency and generate high returns. However, these funds are also increasingly used to extend political reach and leverage economic means to achieve foreign policy goals.

The importance of FDI outside the hydrocarbon sector is particularly evident in countries like Oman, which lacks the same level of wealth as its neighbors. Oman has relied on extensive external finance to fund its fiscal budget since 2014. To combat this dependence, Oman has established various investment funds like the Oman State General Reserve Fund and the Oman Investment Fund. These funds aim to encourage domestic investment that serves the goal of economic diversification away from oil dependency.

The Omani government faces significant pressure to create jobs for its nationals and diversify its economy away from oil production. It has developed a national transformation strategy focused on economic diversification through key performance indicator targets within programs like Tanfeedh. This strategy involves streamlining multiple ministerial stakeholders and disrupting inefficient management to integrate parallel investment silos across ministries(Karen , 2019).

To enhance their role in the region, Gulf sovereign wealth funds must reassess their income sources and spending due to plummeting oil prices. They need critical strategies that aim to diversify GCC economies through efficient resource allocation and provide economic development and independence. Transparency, better practices in structure and governance, investment behavior, knowledge transfers, and foreign direct investment are key factors for the growth of SWFs and local economic growth.

In FDI outside the hydrocarbon sector is of utmost importance for countries heavily reliant on oil production. Gulf sovereign wealth funds play a vital role in developing foreign direct investment and promoting economic diversification. By deploying these funds abroad, Gulf states can not only diversify their economies but also extend their political reach. However, to enhance their role in the region, these funds need to reassess their income sources, adopt transparent practices, and focus on better investment strategies. Overall, FDI outside the hydrocarbon sector contributes significantly to national development and reduces dependency on oil revenues.

2.1. Diversification of investment portfolio

Gulf sovereign funds have shifted their investment strategies towards diversification in recent years, moving away from traditional sectors such as real estate and hydrocarbons. The construction, transport, tourism, and telecom sectors have historically received the majority of investments. However, there has been an increase in investments in banking, finance, and other sectors to address the lack of presence in consumer goods and light industries.

Gulf sovereign funds have formed partnerships with companies in industrial countries to venture into new sectors and diversify their investments. For example, their presence in Egypt has expanded to include manufacturing, organic farming, communication technology, financial services, and logistics.

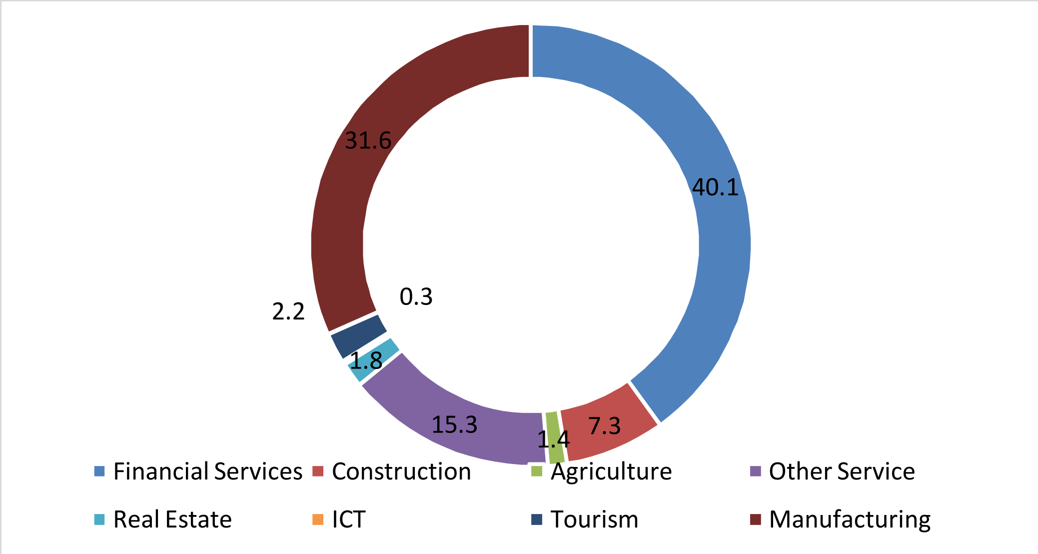
Gulf wealth investors are now focusing on assets that generate growth and higher returns, rather than low-risk assets with low returns. They have diversified their investments into private equity and listed shares, aligning with global trends towards innovation-driven industries.

These funds are also becoming tools for political power, investing in industries of the future, preparing for the global energy transition, strengthening cross-border partnerships, and building national champions.

Domestically, Gulf sovereign wealth funds are attracting foreign investment and co-investing in the domestic economy through strategic funds. Saudi Arabia's PIF is a prime example, driving the development of major projects in sectors like tourism, entertainment, energy, mining, and telecommunications.

In addition to their role as financial investors, these funds are expected to create jobs, contribute to decarbonization goals, and stimulate the domestic economy. This has led to an increasing appetite for risk among Gulf sovereign funds..

Fig N° 1: Non-Oil Sector Direct Foreign Investments in Egypt 2007-2008 (% of Total)



Source: AbdullahBaabood, The Growing Economic Presence of Gulf Countries in the Mediterranean Region, Mediterranean Politics, P209, On the Web site: https://www.iemed.org/wp-content/uploads/2021/03/The-Growing-Economic-Presence-of-Gulf-Countries-in-the-Mediterranean-Region.pdf

It is clear from Figure 1 that there are two sectors that account for about 2/3 of the total direct investments of Gulf sovereign funds in Egypt during the years 2007 and 2008, where we find that the financial services sector accounts for the largest percentage with more than a third of the investments, followed by the manufacturing sector with 30% of the total investments. Direct, while the remaining investments, estimated at about one-third, were distributed among: Other Service, Construction, Tourism, Real Estate, Agricultyre and ICT.

2.2. Strategic partnerships and joint ventures

Gulf sovereign funds have implemented strategic partnerships and joint ventures to diversify their foreign direct investments. They have shifted their focus towards sectors like construction, transport, tourism, telecom, energy, and finance. This has been achieved through partnerships with companies in industrial countries and leveraging their experience in GCC countries. For instance, Gulf investments in Egypt have expanded beyond real estate and hydrocarbons to include manufacturing, farming, IT, finance, and logistics. The funds have also diversified their investment allocation by investing in alternative assets and industries of the future, such as private equity and listed shares. This shift is driven by a desire for higher returns and growth opportunities. Additionally, Gulf sovereign wealth funds are accelerating domestic investments, particularly in Saudi Arabia where the Public Investment Fund (PIF) focuses on various strategic sectors and initiatives like NEOM.(SWF, January 1, 2023) Co-investment partnerships with other wealth funds or financial investors have also been expanded to achieve cost savings, portfolio diversification, and support for domestic development plans. Overall, these strategic approaches contribute to the economic development and independence of Gulf countries.

2.3. Investment in key industries and sectors

Gulf sovereign funds have shifted their investment strategies away from traditional sectors and towards more diversified and innovative industries. This diversification is driven by an appetite for new opportunities and a desire to prepare for a post-oil economy. The banking and finance sector has been a notable area of investment, with Gulf sovereign funds seeking partnerships with companies in industrial countries to gain experience in diversifying portfolios. They have also expanded their presence in sectors such as manufacturing, organic farming, communication technology, financial services, and logistics. The high returns on investments and potential growth of Mediterranean countries make them attractive destinations for Gulf investors. Despite global financial crises, Gulf economies have achieved high growth rates, and their financial surpluses are estimated to rise even under worst-case oil price scenarios.

Gulf sovereign wealth funds are increasingly interested in investing in neighboring regions like Iraq and Turkey, focusing on industries such as infrastructure development, healthcare(William L. Megginson and author, 2023), financial services, agriculture, real estate development, mining, and artificial intelligence-powered marketing. Regional dynamics, including stability and increased integration between the Mediterranean and the Gulf, further strengthen this relationship. Overall, Gulf sovereign funds are strategically diversifying their investments to prepare for a future beyond oil and maximize long-term profitability. See.

3. Contribution of Gulf sovereign funds to the development of Gulf countries' economies

3.1. Job creation and economic growth

Gulf sovereign funds have shifted their investment strategies towards higher-yielding assets such as private equity and listed shares, diversifying into technology and innovation-driven companies. They are also showing interest in sectors like healthcare, logistics, renewables, broadband, and digital infrastructure. Some funds focus on attracting foreign investment and co-investing domestically. Saudi Arabia's Public Investment Fund (PIF) has been driving the development of giga-projects and investing in various sectors. These efforts contribute to job creation, economic growth, and infrastructure development. External factors like oil prices and global conditions influence their strategies, leading to a greater emphasis on diversification and resource allocation. Transparency and better practices in fund structure, governance, and investment behavior are also important. Overall, Gulf sovereign funds play a crucial role in the socioeconomic development of the region. (William L. Megginson and author, 2023, p. 272)

Table N°1: Investment patterns of sovereign wealth funds

Asset class	Developed		Developing		Transition		Total		G7	
	Number of deals (%)	Value (%)	Number of deals (%)	Value (%)	Number of deals (%)	Value (%)	Number of deals (%)	Value (%)	Number of deals (%)	Value (%)
Public equities	26	8	71	92	3	0	100	100	21	7
Fixedincome and treasuries	100	100	0	0	0	0	100	100	29	62
Hedgefunds	100	100	0	0	0	0	100	100	100	100
Infrastructure	28	23	63	67	8	10	100	100	16	10
Privateequity	55	57	44	42	1	1	100	100	48	48
Real estate	60	70	37	30	3	0	100	100	35	45

(*): All SWF investments – including domestic deals

Source:William L. Megginsonandothers, Sovereign wealth funds in the post-pandemic er, Journal of International Business Policy, Academy of International Business, 2023, p5.

Table No. 1 shows the distribution of sovereign wealth fund investments according to different types of asset classes, where we find that developed countries acquired the largest share of asset classes, 4 out of 6: bonds, hedge funds, private equity, real estate, and the acquisition rates were, respectively, 100% and 100%. 55% and 60%, as for the public shares, they were directed primarily to developing countries.

3.2. Transfer of technology and knowledge

Gulf sovereign wealth funds are playing a vital role in promoting the transfer of technology and knowledge to support the development of Gulf countries' economies. They have adopted various strategies, including investing in startups and forming co-investment partnerships. These funds have invested in companies like Okadoc and TruKKer, providing financial support and facilitating the transfer of technological expertise. Co-investment partnerships allow them to share costs, information, and diversify portfolios. These alliances with other investors also help bring companies to the Gulf region, supporting domestic development plans. Asian assets have been a focus for many Gulf sovereign wealth funds, leading to partnerships that promote economic growth and transfer technology from advanced economies. Strategic alliances with entities like KKR Credit, BlackRock, and Bain & Company further drive economic development. Gulf countries have also implemented policy actions such as establishing free trade zones and special economic zones to attract foreign direct investment and foster innovation. Educational reforms align graduates' skills with market needs and efforts to promote entrepreneurship and private sector employment are increasing. The commitment of Gulf sovereign funds to technology and knowledge transfer aligns with broader economic development goals and showcases their dedication to creating an environment conducive to growth. Overall, these funds actively contribute to the development of Gulf economies by facilitating the flow of expertise and innovation while ensuring long-term sustainability.

3.3. Infrastructure development

Gulf sovereign wealth funds are actively involved in infrastructure development to support the economies of Gulf countries and diversify beyond the hydrocarbon sector. They expand co-investment partnerships to achieve cost savings, share information, and attract companies to the region. These funds have shown a growing focus on Asian assets and formed partnerships in sectors like data centers and electric vehicle batteries. They also establish strategic alliances to tap into growth potential in other regions such as Asia and India. Additionally, they invest in neighboring countries like Egypt and Iraq, as well as explore opportunities in Turkey. Overall, Gulf sovereign wealth funds contribute to the development and prosperity of Gulf countries while fostering economic cooperation with other nations.

4. Impact of the Russian and Ukrainian crisis on Gulf sovereign funds

4.1. Economic repercussions on Gulf countries

The Russian and Ukrainian crisis has negatively affected Gulf countries' sovereign wealth funds (SWFs) due to a decrease in energy demand and a dip in oil prices. This has resulted in a drop in government revenues and a loss of confidence, impacting the petrodollars that have protected Middle Eastern economies from global economic downturns. As a result, Gulf SWFs have experienced a decrease in liquidity.(SWF, January 1, 2023)

The crisis has also influenced investment decisions by Gulf SWFs. Previously adventurous in their investments, Gulf investors have become more cautious and deferred some of their decisions to assess the potential impact of the crisis on their investments.

There are concerns about political objectives behind certain sovereign wealth funds, such as Russia using its fund for strategic purposes and Singapore's fund being linked to political turbulence in other countries. Strategies should be developed to address sovereign wealth funds that use their assets for political gain.

Finding the right balance between protecting against threats and remaining open to economic opportunities is essential. Restricting SWF investments through defensive regulations could harm economies and strain international relationships. Greater transparency alone may not fully resolve this issue.

Sovereign wealth funds also raise concerns regarding democracy promotion efforts. These funds can support "rentier states" that do not rely on their citizens for revenue generation, making democratization more challenging. China's sovereign wealth fund challenges the assumption that economic growth leads to increased political freedom.

Looking ahead, sovereign wealth funds could potentially rival the liberal free-market democracy model. Governments can use these funds, along with state-owned enterprises and extensive regulations, to accelerate economic development, buy off dissent, and promote technology transfer. If this model proves sustainable, it could challenge the path taken by advanced industrialized states.

The consequences of legislative or regulatory steps that restrict SWF investments must be carefully considered. Blocking investments in the United States could harm the economy and strain international relationships, as the US is the largest source of foreign direct investment in the world.

In conclusion, the Russian and Ukrainian crisis has negatively impacted Gulf countries' sovereign wealth funds, leading to a decrease in liquidity and cautious investment decisions. Political objectives behind certain funds and their impact on democracy promotion efforts are also concerning. Striking a balance between protecting against threats and remaining open to economic opportunities is crucial, and restrictive measures should be carefully considered to avoid harming economies and international relationships.

4.2. Changes in investment strategies and priorities

Changes in investment strategies and priorities for Gulf sovereign funds have been influenced by external factors, such as the Russian and Ukrainian crisis. These funds play a significant role in foreign direct investment and have evolved in response to changing geopolitical dynamics.

Sovereign wealth funds can impact democracy promotion efforts by enabling the persistence of "rentier states" that do not rely on their citizens for revenue. This poses a challenge for democratization, as governments with large assets can buy off discontented groups and withstand downturns.

The growth of China's sovereign wealth fund challenges the assumption that economic integration will lead to demands for political freedom. China could resist pressures towards democratization using its financial power, requiring a reassessment of long-term approaches towards Beijing by the United States.

The rise of sovereign wealth funds, combined with rising nationalism and anti-American sentiment, may reduce the incentive for democratic transitions. In the event of a revolution, countries like Saudi Arabia could sell off investments in the US to induce a financial panic, although this would be economically costly.

Even gradual democratization processes could lead to nationalist parliaments using sovereign wealth funds to constrain US actions. Capital-rich democratic societies may inject political conditionality into their capital markets, similar to how interest groups in the US leverage finance to alter foreign behavior.

Sovereign wealth funds represent an alternative development path that challenges liberal free-market democracy. Governments can use these funds, along with state-owned enterprises and extensive regulation, to accelerate economic development and pacify dissent. If this model proves sustainable, it could challenge the liberal democratic path taken by advanced industrialized states.

Gulf sovereign wealth funds have recognized the importance of transparency in their operations, indicating a growing recognition of the political challenges they may face. However, during times of crisis, precipitous withdrawals from the US could occur, which would be detrimental to both economies and US interests. Prudent approaches should be taken during crises to prevent negative effects on economies and financial stability.

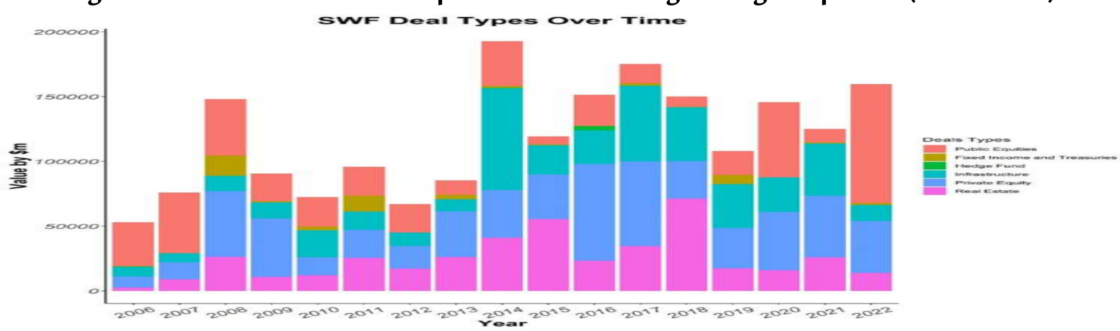
In Gulf sovereign funds are influenced by external factors and have implications for democracy promotion and US foreign policy. The rise of these funds and rising nationalism pose challenges for democratic transitions. Managing sovereign wealth funds provides insights into reform agendas and accountability to citizens. Transparency is slowly being recognized as important, but caution is needed during times of crisis.

5. Impact of Covid-19 on Gulf sovereign funds

5.1. Disruption to global economy and financial markets

The COVID-19 pandemic had a major impact on Gulf sovereign funds, disrupting the global economy and financial markets. Prior to the pandemic, these funds were benefiting from rising oil prices, but the invasion of Ukraine by Russia further intensified their challenges. During the pandemic, sovereign wealth funds acted as "rainy day funds," providing financial support to their governments. $211.3 billion was withdrawn from 33 funds across 27 countries in the first two years of the pandemic. The economic downturn resulted in paper losses of $800 billion for SWFs. Despite this, some funds took advantage of discounted stocks and bought stakes in struggling companies. SWFs are vulnerable but important during financial crises, providing stability and contributing to domestic economies through investments and bailouts. They also have the potential to play a major role in infrastructure development, which has become critical due to supply chain disruptions caused by the pandemic. Further research is needed to understand the broader impacts of SWFs and their contribution to democracy promotion efforts.

FigN° 2: Public investments in public shareholding during the period (2006-2022)



(*): 3 shows, while investments in public equities was approximately 21% of SWF investments in 2008, they have since reduced to 10.7% in 2022.

Source: William L. Megginson، opcit, p 7.

5.2. Implications for investment decisions and portfolio management

The COVID-19 pandemic has had significant implications for investment decisions and portfolio management for Gulf sovereign funds. These funds, which were established as macro-stabilization "rainy day funds," have been required to act as first-responders by their governments in response to the financial crisis caused by the pandemic. During the first two years of the pandemic, a total of $211.3 billion was withdrawn from 33 funds across 27 countries, with five funds having over 50% of their funds withdrawn and three funds being exhausted completely.

In addition to serving as emergency damage mitigation tools, Gulf sovereign funds have also contributed to bailouts of domestic industries. During the pandemic, $57 billion was injected into various sectors, including $19 billion into airlines alone. This behavior is not new, as funds have been utilized in the past to stimulate domestic economies and repay public debt.

However, the economic downturn resulting from the COVID-19 pandemic has also impacted Gulf sovereign funds themselves. It is estimated that these funds lost approximately 16% of asset values and suffered paper losses of US $800 billion during the height of the pandemic. This highlights the vulnerability of these funds to external factors such as market volatility.

Despite these challenges, Gulf sovereign funds have adapted their investment strategies in response to the pandemic. There is a trend towards increased investment in technology sectors, with investments in brick-and-mortar businesses decreasing significantly. The volume of investment in technology has increased sixfold since 2012, reaching 25% in 2021. Similarly, investments in healthcare have doubled during this period.
Furthermore, there is a growing emphasis on environmental, social, and governance (ESG) considerations in investment decisions. SWFs are taking advantage of opportunities opened up by the pandemic by investing more in ESG-focused sectors such as renewable energy and sustainable infrastructure.

The impact of COVID-19 on Gulf sovereign funds also highlights the importance of diversification and a long-term investment horizon. These funds have been actively investing in alternative sectors such as real estate, private equity, and venture capital, providing support to unlisted innovative technology firms. This approach offers an attractive alternative to traditional private equity firms with liquidity constraints.

However, geopolitical challenges remain for Gulf sovereign funds, particularly in relation to investments in major technology companies. Political consequences may arise when foreign countries invest in these companies, prompting a need for careful consideration of potential risks and implications for the SWFs and their domicile governments.The COVID-19 pandemic has posed significant challenges for Gulf sovereign funds. They have been required to act as first-responders to support their domestic economies and mitigate the impact of the crisis. While these funds have suffered investment losses, they have also adapted their strategies and taken advantage of emerging opportunities brought about by the pandemic. Moving forward, diversification, ESG considerations, and a long-term investment horizon will be key factors in navigating the post-pandemic era for Gulf sovereign funds.

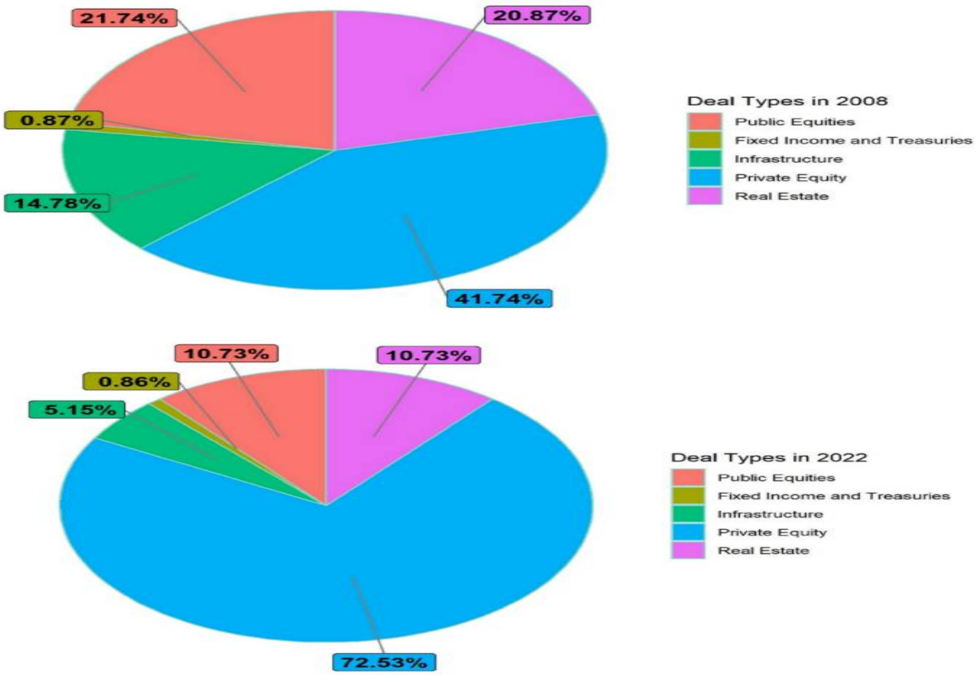
6. Conclusion

In conclusion, the most important results of the study can be concluded as follows:

- ✓ Gulf sovereign wealth funds are controlled by their governments, allowing close control over how resource wealth is spent. These funds align their spending with political, public, and personal objectives of the Gulf monarchies.
- ✓ Higher oil prices have led to a windfall for Gulf oil and gas producers, resulting in increased spending by the region's SWFs. In 2022 alone, the top five funds deployed more than $73 billion in investments.
- ✓ 3.Gulf SWFs have shifted their investment focus towards alternative assets and "industries of the future." There is also an emphasis on co-investments with private equity and venture capital firms, as well as a growing appetite for global startups.
- ✓ Gulf SWFs have expanded their international footprint and invested in various regions around the world. Recent deals in Asia reflect a strategy to accelerate growth in sectors such as gaming and e-sports, while investments in India and Southeast Asia focus on sectors with deep consumer engagement.
- ✓ Gulf sovereign investors show a strong appetite for Chinese assets, while Chinese venture capitalists and local officials seek to attract Gulf SWFs to key sectors prioritized by Beijing. This signifies a progression from trade partnerships to core investment relationships.
- ✓ Gulf SWFs have accumulated massive assets, developed seasoned teams, and crafted sophisticated investment strategies. Their expanding presence in the Mediterranean region and potential for further economic integration through initiatives like the Greater Arab Free Trade Area hold promise for future growth and development.
- ✓ Gulf sovereign funds have the potential to contribute significantly to economic diversification efforts. Their investments in sectors like sports, and food industry demonstrate a commitment to developing non-hydrocarbon industries.
- ✓ It is important to address challenges such as corruption, regulatory capacity, and centralized decision-making in some countries. Gulf sovereign funds should continue to prioritize transparency and good governance in their investment practices.
- ✓ The effects of the Russian and Ukrainian crisis and the Covid-19 crisis on Gulf funds were largely confined to the financing and withdrawal process, i.e. the decline in oil prices led to a decline in financing sources and the increase in spending at the time of the health crisis led to an increase in withdrawals.

✓ Gulf sovereign funds have the resources, expertise, and investment strategies to contribute significantly to economic diversification efforts. By expanding their international footprint and investing in sectors outside the hydrocarbon industry, these funds can play a crucial role in promoting sustainable economic growth and reducing dependence on oil revenues. Collaboration with international partners and addressing challenges related to governance will be key to realizing the future prospects of Gulf sovereign funds.

Appendix: Comparison of SWF deal types, 2008 vs. 2022.



Source: William L. Megginson،opcit, p 8.

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