How Sovereign Wealth Funds are Impacting Infrastructure Projects in Emerging Markets

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Abstract of Presentation

In recent years, sovereign wealth funds (SWFs) have risen in number, grown substantially in total assets under management, and realigned their investments in response to the global financial crisis and other economic changes. One area of increased focus is infrastructure projects in emerging markets, a trend with the potential to impact economic development significantly in these regions.

SWFs have cited various reasons for this shift toward infrastructure. First, although public equities remain SWFs' largest single asset class overall, increased volatility in these markets and the risks inherent to investing in them has encouraged SWFs to seek alternatives. Second, due to the low interest rates that have followed the global financial crisis, SWFs have reduced their exposure to fixed income investments, which have traditionally comprised another core asset class. Third, the cost and duration of many infrastructure projects provide a good match for SWFs' large amounts of capital, long-term investment horizons, and comparatively low need for liquidity. As a result, many industry analysts as well as SWFs themselves expect that this trend toward alternative assets such as infrastructure will only continue.

Moreover, although developed countries still account for a majority of SWFs' allocations at a portfolio level, many of these investors have significantly increased their placements in emerging markets in recent years and plan to continue doing so. This is motivated not only by the desire to diversify portfolios but also by the increase in investment opportunities that such markets have been providing. In addition, many of the largest SWFs are themselves located in the Middle East and Asia and often invest in emerging economies in those areas due to regional ties. Further increasing allocations to such markets, many developing countries are using new or existing SWFs to invest in their own domestic infrastructure.

This recent growth in SWFs' infrastructure investment comes at a time of great need. Analysts estimate that up to $67 trillion may need to be spent on infrastructure globally by 2030, and that developing countries may account for nearly half of this amount. At the same time, the financial crisis has reduced banks' lending capacity and increased the cost of borrowing, thereby inhibiting many potential investors from contributing to this need. But SWFs, with large pools of cash precluding the need for bank financing, can help to fill this void by further devoting funds to infrastructure.

To be sure, SWFs cannot by themselves support the developing world's immense infrastructure requirements, which will have to be met by a combination of changes including productivity increases. In addition, not all infrastructure projects provide a good match for SWFs' typical risk profiles, so these investors may not help at all in some situations. But the prospect of increased SWF investment in this area at least offers one positive sign in an otherwise daunting financial picture.

As a result, emerging economies in great need of infrastructure development should avoid the protectionist impulses that many developed nations tended to exhibit toward SWFs prior to the financial crisis. Instead, such investment, made with appropriate political and legal protections in place for all parties, should be acknowledged for its urgent necessity and encouraged in its proper execution.