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We Don't Want To Conquer You; We Have Enough To Worry About: The Russian Sovereign Wealth Fund

Recently, few economic topics have received more political attention than the potential impact of Sovereign Wealth Funds (SWFs). Until recently, scholarly and political attention to SWFs was almost exclusively focused on the impact these funds may have on Western countries.[1] The little attention paid to the impact SWFs have on countries where these funds originate has been largely negative, often characterizing such funds as products of "authoritarian regimes in semi-developed countries, where citizens don't have a chance to demand smarter economic policies."[2] The failure to consider the domestic context within which SWFs operate has resulted in an incomplete understanding of the impact these funds may have on Western countries. By examining the Russian Sovereign Wealth Fund (RSWF),[3] its interaction with domestic constituencies, and the process of its evolution, I offer a different institutional portrait of SWFs than that which has become widely accepted in Western policy circles.

1. Indeed, during recent hearings of the Senate Foreign Affairs Committee, Professor Jagdish Bhagwati discussed the perceived threat of the "Super Seven" SWFs to U.S. economic security. *Sovereign Wealth Funds: Foreign Policy Consequences in an Era of New Money: Hearing Before the S. Comm. on Foreign Relations*, 110th Cong. (2008) (statement of Jagdish Bhagwati, Professor, Columbia University).

2. Anders Aslund, *The Truth About Sovereign Wealth Funds*, FOREIGN POL'Y, Dec. 2007, http://www.foreignpolicy.com/story/cms.php?story_id=4056.

3. For the purposes of this paper the term "Russian Sovereign Wealth Fund" or "RSWF" refers to the Stabilization Fund of the Russian Federation during the period prior to February 1, 2008 and to the Reserve Fund and the Fund for the National Well Being thereafter. Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2007, No. 63-FZ, Art. 5, Part 15.

In Russia, the existence and performance of the RSWF is a matter of intense public debate that encompasses all economic and social levels of society,[4] including even officials of the Russian Orthodox Church.[5] The relationship between the RSWF and its critics is illustrative of the domestic constraints faced by SWFs, a phenomenon that must be understood by Western policy makers as they begin to analyze the supposed threat posed by SWFs.

DOMESTIC CRITICISM OF THE RSWF

From its beginning in 2004, the RSWF has been conceptualized as a tool of Russia's domestic economic policy. The stated purpose for the creation of the RSWF was the need to insulate the country's budget from the volatility of the oil market by providing a source of funds with which to supplement the budget in case of a decline in oil prices.[6] Accordingly, the initial role of the RSWF was limited to accumulating wealth, which it was not allowed to invest.

From inception the way in which the RSWF functioned was overwhelmingly criticized within Russia. Critics argued that the "real" purpose of the RSWF was to protect Russia against increasing inflation by giving the government the option of withdrawing extra liquidity from the country's economy, thereby making the nature of the Fund one of "sterilization" rather than "stabilization."[7] Critics argued that sterilizing these funds was useless, and worse, counterproductive, as the money would lose its value because of inflation.[8] Indeed, an audit performed by the Accounts Chamber of the Russian Federation showed that between 2004 and 2005 the Fund lost approximately sixty million rubles due to inflation, while private accounting firms and think tanks estimated losses of around 100 to 130 billion.[9]

4. D. A. Ovcharov, *K Voprosu Ob Ekonomicheskoi Sushchnosti Stabilizatsionnogo Fonda* [*On the Question of the Economic Nature of the Stabilization Fund*], *in* EKONOMIKA ROSSII: OSNOVNYE TENDENTSII I PERSPEKTIVY RAZVITIIA 101 (2005) (Russ.).

5. *Bogatstvo I Bednost': Istoricheskie Vyzovy Rossii* [*Wealth and Poverty: Historical Path of Russia*], RUSSKAIA LINIIA, Mar. 5, 2007 (Russ.), http://www.rusk.ru/newsdata.php?idar=170761.

6. Mikhail Kopeikii, *Stabilizatsionnyi Fond: Den'gi Dolzhny Rabotat'* [*Stabilization Fund: The Money Must Work*], IZVESTIA, Mar. 13, 2006, at 5 (Russ.).

7. In this context, sterilization is the practice of removing excess monetary funds from the economy in an effort to reduce inflation. A.D. Nekipelov, *Stabilizatsionnyi Fond: Mezhdunarodnyi Opyt, Segodniashnie Potrebnosti i Budushchee Rossii* [*Stabilization Fund: International Experience, Today's Needs and the Future of Russia*], *in* DOKLADY INSTITUTA EVROPY RAN 10, 11 (2007) (Russ.).

8. Tat'iana Zykova, *Stabfond: Kopit' Nel'zia Potrati't* [*Stabilization Fund: Save, Can't Spend*], ROSSIISKAIA GAZETA [ROS. GAZ.] (Russ.), Jan. 23, 2007.

9. Kopeikii, *supra* note 6, at 5.

Responding to these criticisms, in 2006 the government permitted the use of the RSWF's money for economic purposes such as servicing of foreign debt, investing in debt securities of foreign states, and to make up the deficit of the Russian Pension Fund.[10]

Throughout 2006 and 2007 the RSWF continued to grow thanks to rising oil prices, as did the intensity of the criticism it faced. Critics advanced two lines of criticism. First, they criticized the conservative nature of RSWF's investment strategy, which permitted only investments in government bonds, not lucrative corporate securities.[11] Second, they argued that the RSWF should invest within Russia.[12] The Ministry of Finance (Ministry), the authority primarily responsible for the RSWF, defended the Fund's investment strategy in light of the Fund's primary economic goal of maintaining the stability and safety of the Fund's assets, which would be undermined by investing in risky corporate securities. The Ministry resisted calls to invest the proceeds of the RSWF within Russia, arguing that widespread corruption was likely to result in the proceeds of the Fund being stolen and that doing so would increase inflation.[13]

Justifying its position, the Ministry referenced the profitable Norwegian Government Pension Fund, which prohibits investment within Norway as evidence of the success of the exclusively external investment strategy.[14] Advocates of an internal investment strategy disagreed, arguing that Norway was a bad model for the RSWF because of the differences between the two countries. Already developed, Norway enjoys a high standard of living and has limited internal investment opportunities because of its relatively small size and labor force. In contrast, Russia has many socioeconomic problems, including low standards of living for significant portions of its population.[15] Moreover, underdeveloped territory and infrastructure in Russia offers great

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10. Nekipelov, *supra* note 7, at 10-11.

11. Zykova, *supra* note 8.

12. *Id.*

13. *See* Iurii Voronin & Iurii Maksimov, *Kak Razymno Rasporiadit'sia Stabilizatsionnym Fondom* [*A Reasonable Way to Spend the Stabilization Fund*], 9 ROSSIISKAIA FEDERATSIIA SEGODNIA 2006; Interview with A.D. Nekipelov, Vice President, Russian Academy of Sciences (Oct. 27, 2005).

14. It bears noting that unlike the RSWF at the time, the Norwegian Fund permits investment in corporate securities. Konstantin Smirnov, *Fradkovu Ponravilsia Norvezhskii Stabfond* [*Fradkov Likes the Norwegian Stabilization Fund*], GAZETA [GAZ.] (Russ.), Mar. 30, 2006, at 13 (Russ.).

15. The differences between Norway and Russia are clear; Norway has the sixth highest per capita GDP, whereas Russia is a distant seventy-fifth. CIA World Factbook, Rank Order GDP Per Capita (PPP), https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html (last visited Nov. 2, 2008).

potential for investment, which could be used, together with Russia's abundant and well-educated labor force, to develop sophisticated scientific and technologic industries critical to the modern economy. These differences, argue the critics, make the Norwegian fund's goals and style inappropriate for the RSWF, which should be focused on promoting development in Russia.[16]

GOVERNMENT'S RESPONSE

In part responding to these criticisms of the RSWF, the Ministry reconceptualized the RSWF. First, in 2006, reacting to calls to invest excess funds in internal development, the government created an Investment Fund dedicated exclusively to investing in internal infrastructure and development projects by transferring sixty-nine billion rubles from the RSWF.[17] Second, on February 1, 2007, responding to demands that the RSWF be permitted to invest in private sector companies, the Ministry replaced the Stabilization Fund with two funds: the Reserve Fund, which retained the initial purpose of the Stabilization Fund and which may be invested only in government bonds,[18] and the Fund for National Well Being (NWB Fund), which may invest in corporate securities and is designed to support the Russian pension system.

Thereafter, the debate has mainly focused on the NWB Fund and how the money in the Fund should be managed, spent, and invested. The way in which the NWB Fund's resources should be spent has been a point of significant debate.[19] Many advocated using this money for medical services, science, and education.[20] Leading Russian banks suggested the money be made available to Russian banks to provide them with long term liquidity, which they have

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16. Oksana Dmitrieva, *Kursom na Kiribati* [*The Way to Kiribati*], KOMMERSANT [KOMMERS.] (Russ.), Nov. 2, 2006, at 8.

17. Ol'ga Stroinova, Aleksandr Rzheshevskii & Iurii Koverdovskii, *Rossiia Investitsionnaia* [*Investing in Russia*], PARLAMENTSKAIA GAZETA [PARL. GAZ.] (Russ.), Dec. 12, 2006, at 3.

18. As of May 1, 2008, the Reserve Fund has over $129.8 billion U.S. under management, whereas the NWB Fund has $32.72 billion U.S. under management. *Sovokupnyi Ob"em Rezervnogo Fonda RF na 1 Maia Sostavil 3.06947 Trln Rub* [*Reserve Fund Valued at 3.06947 Trillion Rubbles*], PRAIM-TASS, May 4, 2008, http://www.prime-tass.ru/news/show.asp?id=780892 (Russ.); Dmitrii Vladimirov & Oleg Gladunov, *Neftedollary Ne Daiut Pokoia* [*Petrodollars Give No Rest*], ROS. GAZ.(Russ.), Nov. 16, 2007, at 2.

19. Iurii Fadeev, *Stabfond Bez Budushchego* [*Stabilization Fund Without A Future*], BOSS, Feb. 2008, at 3-4 (Russ.).

20. *See, e.g.*, *id.*

recently found difficult to obtain abroad.[21] Another approach, one strongly supported in recent public opinion polls and ultimately chosen by the Ministry, was to allocate the money within the NWB Fund to support the pension system.[22]

The debate concerning the NWB Fund's ability to invest in Russian companies has been particularly intense. Initially, the Ministry declared that investment would only be permitted in securities of foreign companies, and even then the size of the investment could not exceed five percent of the target company's shares.[23] However, critics argued that the "international only" investment strategy did not make sense in light of recent instability in Western financial markets, especially considering the higher rate of return on investment in Russian corporate securities.[24] This debate was conclusively resolved on June 17, 2008, when President Medvedev, in a speech instructing the government to develop rules for the operation of the NWB Fund, declared that the Fund would be allowed to invest in securities of Russian companies.[25]

Finally, debate concerning the NWB Fund has also focused on the type of management that should govern the Fund. Different options have been suggested, and it is likely that the management of the Fund will be outsourced to private asset managers. In fact, the possibility of outsourcing the management of the NWB Fund to non-Russian managers is being discussed.[26]

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21. *Zubkov Predlagaet Primeniat' PFR i FNB dlia Kreditovannia* [*Zubkov Proposes Using the Russian Pension Fund and NWB Fund to Provide Credit*], VSESMI, Apr. 8, 2008, http://www.vsemi.runews/1588391/2823635/ (Russ.).

22. *Na Chto Potratit' Den'gi iz Stabfonda?* [*What Should the Money from the Stabfond be Spent on?*], Levada-Tsentr, Apr. 4, 2007, http://www.levada.ru/press/2007040201.html (Russ.).

23. A. Kudrin, *Sredstva Rocciiskogo Fonda Natsional'nogo Blagosostoianiia Bydyt Vkladyvat'cia Iskliuchitel'no Za Rubezhom* [*NWB Fund's Assets Will Be Invested Exclusively Abroad*], PRAIM—TASS, May 31, 2008, http://www.prime-tass.ru/news/show.asp?id=691210&ct=news (Russ.); *Gozfondy ne Dolzhny Byt' Chernymi Investitsionnymi Iashchikami* [*The Gozfond Should Not Be a Black Box Investment*], GAZ. (Russ.), Feb. 1, 2008. This proposal is similar to the approach used by the Norwegian Fund, which is prohibited from obtaining control blocks in foreign companies. *See id.*

24. Vladimir Mytarev, *Stabfond Obespechit Natsional'noe Blagosostoiane* [*Stabilization Fund Will Guaranty National Well Being*], RIANOVOSTI, Jan. 25, 2008, http://www.rian.ru/finans/20080125/97751172.html (Russ.).

25. *Natsional'noe Blagosostoianie Ukhodit Na Rynok* [*National Well Being Goes to the Market*], KOMMERS. (Russ.), June 18, 2008, at 1 .

26. *See, e.g.*, *Upravlenie Fondom Natsional'nogo Blagosostoianiia Poruchat Chastnikam* [*Management of the Fund for the National Well Being Assigned to Private Actors*], LENTA.RU, Mar. 4, 2008, http://www.lenta.ru.news/2008/03/04/putin (Russ.).

CONCLUSION

In the five years since the creation of the RSWF, the Fund has undergone extensive reforms in response to domestic critics. The ability of these domestic actors to extract changes in the structure and management of the Fund contradicts the image of SWFs as possible tools of foreign policy distant from and deaf to the interests of citizens.

As governments of developed countries continue to evaluate the risks posed by SWFs, they must consider the domestic context within which SWFs operate, as it is this domestic context that largely determines the nature and investment approach being used by that particular SWF. In the case of Russia, the focus and the intensity of the debate surrounding the RSWF makes clear that the Fund is aimed at resolving internal economic problems, and there is nothing in its structure or goals to suggest that it could or would be used as a weapon against Western countries such as the United States.

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