Sovereign and Social Equity Funds

Capitalizing on low interest rates

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Fiscal and monetary policy in the EU

- Europe is slowly crawling out of its decade-long crisis
- Due to institutional arrangements (Stability and Growth Pact, Sixpack, …) countries cannot use their fiscal space and have been following policies of budgetary anorexia at times of deficient aggregate demand.
- Low aggregate demand have led to the need for expansive orthodox and unorthodox monetary policies (low interest rates and Quantitative Easing)
- Banks have to recapitalise so seem less willing to use any of the extra credit to provide loans.

- What other options then do governments have to make good economic use of the current boon of extremely low interest rates?

Back to principles

- During an economic downturn, governments should increase their net borrowing by increasing spending and investment to boost demand and counteract deleveraging behavior of private sector.
- This also yields a positive multiplier if spending is financed by taxes.
  - These multipliers are larger in recessions (IMF, Corsetti et al.)
- Productive investments to help boost social welfare and long-run productivity and environmental viability of the economy
  - Early childcare, re-training of those whose jobs are threatened or have been lost due to trade, immigration, and above all technological change, care homes for the elderly, and green building and other sustainability projects
- Need for Golden Rule: borrow if the social return on investment exceeds the social rate of interest. The latter is less for longer horizons.
- “Juncker-Plan” v. 8C, European Investment Bank, other public-private-partnerships.

Interest on bonds still at record lows

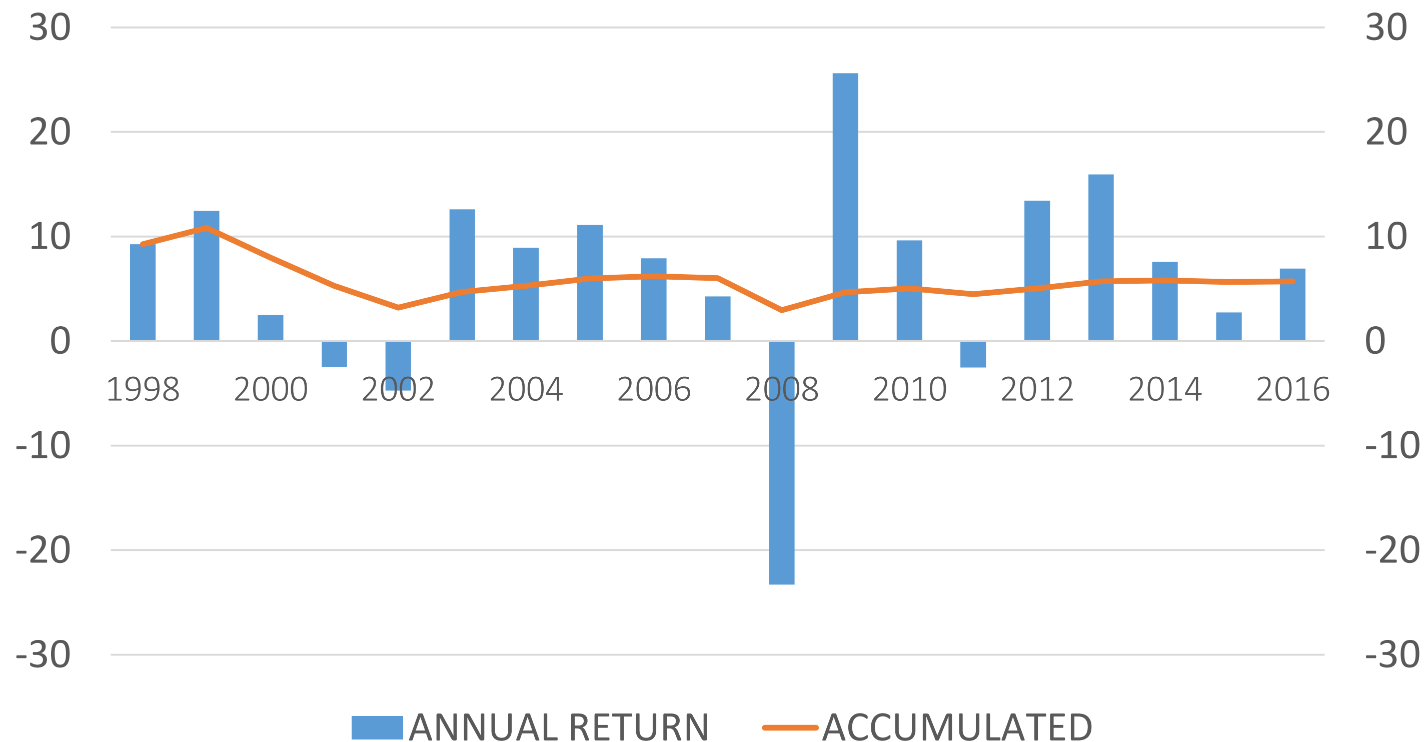
€ zone	10-yr bond
Germany	0,26 %/yr
Lithuania	0,31 %/yr
Netherlands	0,49 %/yr
Finland	0,52 %/yr
Luxembourg	0,55 %/yr
Austria	0,59 %/yr
Belgium	0,87 %/yr
Latvia	0,99 %/yr
Slovenia	1,01 %/yr
France	1,03 %/yr
Ireland	1,06 %/yr
Slovakia	1,09 %/yr
Malta	1,32 %/yr
Spain	1,7 %/yr
Italy	2,35 %/yr
Cyprus	3,37 %/yr
Portugal	4,04 %/yr
Greece (GR)	7,52 %/yr

Non € zone	10-yr bond
Denmark	0,33 %/yr
Czech Republic	0,63 %/yr
Sweden	0,66 %/yr
United Kingdom	1,24 %/yr
Bulgaria	1,75 %/yr
Croatia	2,71 %/yr
Hungary	3,52 %/yr
Poland	3,81 %/yr
Romania	3,96 %/yr

'Euro area yield curves' 30-year rates:
1.26% for AAA and 2.25% non-AAA

How bad are governments at investing?

Return on Norway's Government Pension Fund Global ("Norwegian Oil Fund") was 6.9% in 2016 (5.7% per year accumulated over 18 years). Highly diversified portfolio: 60% shares tracking Footsie and 40% bonds tracking Barclays index.



Why wealth funds?

- Sovereign Wealth Fund: returns for future generations
  - Distribution of Wealth / Participation in financial markets
  - Active investor (repatriation of dividends and more)
  - Good return on investment for general budget (Norwegian model w/o the oil)
- Social Equity Fund: social policy investing via the financial market
  - Early childcare, re-training of those whose jobs are threatened or have been lost due to trade, immigration, and above all technological change, care homes for the elderly, and green building and other sustainability projects.
  - Social investment funds: some older people live in an owner-occupied house and are solvent but not liquid in cash. So let them sell their house and keep on living in it, and pay a low rent.
  - Such projects do not have access to well-functioning financial markets, help overcoming capital market imperfections.
  - Private-public partnerships (PPPs), not only to get more cash but above all to unleash more crucial knowledge of the private sector to be put to use for social investments.

Sovereign and Social Wealth Funds

- Borrowing costs for governments are now at historic lows:
  - Private sector wants liquidity and is willing to pay a premium for it (government as "borrower-of-last-resort")
  - Quantitative easing to stabilise financial markets and effectively finance government spending.
  - Regulation forcing certain actors to by safe assets.
- But governments cannot capitalise on cheap financing due to national and EU regulation.
- The government as private investor is possible if 60% debt/GDP violations are tolerated.

  $\Rightarrow$ Building financial and/or social equity for long-run prosperity.