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Research article

SOVEREIGN WEALTH FUND – A PARADIGM SHIFT FOR NIGERIA

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Abstract

On May 2011 Nigeria formally exited from the 'ignoble club' of member countries of Organization of Petroleum Exporting Countries (OPEC) that do not at that time have a Sovereign Wealth Fund (SWF) and joined the elite club of countries with SWF following the assent of the Nigerian President to the Nigerian Sovereign Investment Authority Act – an act that establishes the Nigerian Sovereign Wealth Fund. For many years, the absence of an institutional framework to manage the proceeds of crude oil earnings from a highly volatile income stream has exposed the country to cycles of booms and busts with negative implications for fiscal operations. Around 80% of Nigeria's public revenues come from oil, leaving the government dependent on a highly volatile income stream. Public expenditures have tended to follow the boom and bust cycles of the oil market. This contributes to damaging "resource curse" effects including indebtedness, currency instability, inflation, weak growth rates and limited economic diversification. There was therefore an urgent need to delink government expenditure from the vagaries and fluctuations of crude oil revenue through the establishment of SWF – a fund that promises to serve as a stabilizer, a guarantee for future generations and a critical provider for the huge infrastructural needs of the country. In this paper, we briefly reviewed the literature on SWF including the rationale for establishing the Nigerian SWF. It is our view that the establishment of a SWF by Nigeria is a step in the right direction and argued that if well managed, the fund could be a paradigm shift in fiscal operations in Nigeria and a catalyst to unlock the huge economic potentials of the country.

Keywords: Sovereign Wealth, Economic Development, Economic Imperative

1. Introduction

The recent global economic and financial crisis which triggered distressed assets, high bank insolvency and loss of market trust in developed economies, and threatened large-scale private sector default in emerging economies (IMF, 2009), may in one area be a blessing in disguise for Nigeria. The crisis seems to have jolted the country from its many years of fiscal slumber and for once, the government appears to have started thinking outside the box. This 'radical thinking' is in the area of establishment of a Sovereign Wealth Fund (SWF). It should be recalled that for many years the country has depended almost entirely on a highly volatile income stream – oil revenue and the boom-bust cycle associated with this revenue source has in many occasions left the country in dire financial straits. Thus the establishment of a Sovereign Wealth Fund (SWF) could perhaps be described as one of the most profound economic decisions the Nigerian government has made in recent times. The Nigerian SWF became a reality on May 2011 when the President assented to the Nigerian Sovereign Investment Authority Act (NSIA) Act.[1]

SWFs by definition are saving funds controlled by sovereign governments that manage foreign assets. It is estimated that SWFs assets could be well over $4.7 trillion (see Ziemba, 2008, Lyons, 2007 and Truman, 2008). With such enormous assets, sovereign wealth funds have revolutionized the global financial services industry with influences on international capital flows. According to Uzor (2011), SWFs are now at the heart of international political economy, wielding enormous political influence internationally – at the intersection of financial and political diplomacy. Their growth has been tremendous in the recent past, and they are expected to grow further in the near future. Indeed, Jen (2007) projects global SWF assets will total $12 trillion in 2015; IMF Survey (2008a) projects an increase to $8-13 trillion by 2013 while Lyons (2007) projects a total of $13 trillion by 2017.

There has been a renewed interest in sovereign wealth fund in the wake of the economic crisis that engulfed the global economy in late 2007. Although SWFs are not new phenomenon in global finance, their recent activities and growth have stirred up attention and debate around the world. Indeed, the global economic crisis provided SWFs a golden opportunity to take centre stage in global finance and they somewhat became lenders of last resort in the episode. For instance, the Chinese SWF Vehicle – China Investment Corporation was reported to have injected $5 billion into Morgan Stanley. The United Arab Emirates' SWF – Abu Dhabi Investment Authority acquired 4.9 percent equity share in Citibank, while Merrill Lynch received $5 billion from Singapore's Temask Holdings. In all, sovereign wealth funds injected well over $50 billion into financial institutions that were in dire need of liquidity especially in the United States and Europe (Uzor, 2011). SWFs were veritable instruments for economic stabilization and they helped to a large extent to mitigate the full impact of the crisis at the time. Their increasing importance for global financial markets has elicited greater scrutiny and debate in recent times (see Aina, 2011 and Heuty, 2011).

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[1]The Nigerian Sovereign Investment Authority Act, 2011 (NSIA Act 2011) which establishes the Nigeria Sovereign Investment Authority (NSIA) has the principal aim of building a savings base for Nigerian citizens, enhancing the development of Nigerian infrastructure and providing stabilization support in times of economic stress, among others. The NSIA as the governing authority is empowered to make regulations and policies as it may determine to be most effective to achieve the objective of the fund. It also has the power to invest in equity, debt, private equity, real estate, infrastructure, fixed income securities and all other asset classes at the international and domestic level. Thus, the portfolio scope of the fund is subject to the assessment criteria, policies and procedures developed from time to time by the NSIA on the advice of its external asset managers. The Act requires adherence with the Generally Accepted Principles and Practices developed by the International Working Group of Sovereign Wealth Funds, otherwise known as the Santiago principles. The Act reflects the legal propriety of the Nigerian SWF and is aimed at ensuring management independence and accountability, corporate governance, and transparency in the fund's transactions (NSIA Act, 2011).

In this paper, we shall attempt to briefly review the literature on SWFs and the economic imperative for Nigeria to establish the one. To this end, the paper is structured into five sections. Following the introduction in section one, section two will briefly review the literature on SWFs while section three will focus on Nigerian SWF. Section four will deal with some of the challenges confronting SWFs and measures adopted to streamline these challenges. Section Five will conclude the paper with some recommendations for managing the Nigeria SWF.

2. Review of Literature on Sovereign Wealth Funds (SWFs)

Sovereign Wealth Funds have in recent times become an important class of investors in terms of the size of assets under sovereign control. Sovereign Wealth Funds (SWFs) are generally defined as state-owned investment vehicles, which manage a diversified portfolio of domestic and international financial assets (Grillies, 2009). The U.S. Treasury, Kimmitt (2008) defined sovereign wealth funds as government investment vehicles funded by foreign exchange assets, and managed separately from official reserves. The evolution of SWFs dates back to the 1950s, when some major commodity exporting countries, particularly oil-rich countries, were looking for a way to invest funds originated by foreign exchange assets. Kuwait established the first modern SWF in 1953, eight years prior to its independence in 1961. Some advanced industrialized countries have also established SWFs. Norway's Central Bank has control over the second-largest sovereign wealth fund. The earliest sovereign wealth funds were established in the Persian Gulf States in the 1950s following the discovery of crude oil. The Kuwait Investment Authority that was set up in 1953 for the purpose of managing its excess oil revenues is the oldest sovereign wealth fund (Uzor, 2011). The source of seed capital for these SWFs derives from recurring foreign exchange receipts from natural resource exploitation and they are sometimes called commodity funds. The next group of sovereign wealth funds was established during the oil boom era of the 1970s when oil exporting countries such as the United Arab Emirates, Saudi Arabia, and Alberta established SWFs to absorb excess liquidity that could potentially have adverse effects on their economies. More recently, another round of oil and natural resource boom, and enormous accumulation of foreign exchange reserves amongst non-commodity exporters have thrown up new entrants in the comity of nations with sovereign wealth funds. Countries in this later group are more economically and geographically diverse than their earlier counterparts. They include China, South Korea, Venezuela, Iran and Algeria. Some of the newer SWFs are from countries that are not natural resource exporters.

According to Heuty (2011), sovereign wealth funds are usually funded from three major sources. The first source is revenue from commodity exports and this is common amongst natural resource-exporting countries especially crude oil. Examples of SWFs held by natural resource-exporting countries include Kuwait Investment Authority, Norway's Government Pension Fund and the United Arab Emirates' Abu Dhabi Investment Authority (SWI, 2011). The second mode of financing SWFs is through the transfer of assets from a country's foreign exchange reserves and this is common amongst non-natural resource exporting countries such as China, Singapore, and South Korea. The third financing strategy is disbursement from sovereign debt on international markets. Sometimes a country does not utilize all the capital it raised from international market; these excess funds are then transferred to either its foreign reserves or sovereign wealth fund holdings.

From the foregoing, it could be seen that while SWFs have existed for more than fifty years, over the past decade they have rapidly expanded to become a source of investment of systemic importance (see Kimmit, 2008; Cree, 2008; and IMF, 2008a). They can offer a source of investment and market liquidity at a time of real pressure. Yet, as state-owned investment vehicles, some have raised questions about the risk that these investments may interfere with the normal functioning of market economies (IMF, 2008b and Johnson, 2010). All projections expect SWFs to continue growing fast in size and number - a rapid growth that intensifies both the opportunities they offer and the concerns they inspire. It is therefore not surprising that the rise of SWFs has attracted attention in several developed economies and triggered a debate within international fora. Within the EU, several Member States were at time contemplating whether or not to make their own policy response. However, the EU canvassed for a uniform response under the aegis of EU rather than each member country listing its own rules of engagement (CEU, 2008).

According to Uzor (2011), SWFs are essentially separated pools of financial assets (primarily but not exclusively internationally invested) owned by governments to achieve economic, financial and other strategic objectives. SWFs are usually distinct from country's foreign exchange reserves. Whilst there are well established norms for investing foreign exchange reserves, same is not so for sovereign wealth funds. They are also separated from government and non-financial corporations, purely domestic assets, and assets owned and controlled by sub-national governments. SWFs are usually composed of financial assets such as stocks, bonds, real estate, or other financial instruments funded by foreign exchange assets. They can be structured as a fund or as reserve or as a reserve investment corporation. Some funds also invest indirectly in domestic state-owned enterprises. The International Monetary Fund (IMF, 2008a) identified five classes of sovereign wealth funds with potentially overlapping functions. These are Stabilization Funds (this is primarily designed to insulate the budget and the economy against commodity price swings). Savings Fund for Future Generations (this enables the conversion of non-renewable assets into a more diversified portfolio of assets to mitigate the effects of Dutch disease). Reserve Investment Corporations (these assets are still counted as reserve assets and are established to increase the return on reserves, though at a higher risk). Development Funds (designed to help fund socio-economic projects and infrastructure and usually have large domestic component). Contingent Pension Reserve (particularly to finance social security and health expenditures for rapidly ageing populations). Like other investors, sovereign wealth funds seek to achieve their goals by using financial markets to diversify risk, transfer funds through time, and to maximize returns.

Moreover, in terms of foreign exchange assets, SWFs fall into two categories. One is Commodity SWFs which are funded by commodity exports, either owned or taxed by government (e.g. the Gulf States, Norway, and Russia). According Aizenman and Reuven (2008), this class of SWFs have been established for various purposes, including stabilization of fiscal revenues, management of inter-generational savings, and sterilization of the effects of balance of payments inflows on domestic inflation. The second type, non-commodity SWFs are funded essentially by the transfer of assets from official foreign exchange reserves (e.g. China, and other Asian Countries). It is estimated that funds derived from oil and gas export revenues account for two thirds of the total assets held by SWFs, with the rest consisting of funds mainly controlled by Asian surplus exporters (SWI, 2011).
Over the past decade SWFs have grown rapidly[2]. Originally, they were confined to a limited number of countries. Today, more than thirty countries have SWFs, with twenty new SWFs created since 2000. Sustained capital account surpluses for the oil producing and Asian economies have led to reserves well beyond the needs of foreign exchange rate management. Some of these reserves have been channeled into SWFs. The assets managed by SWFs are estimated at $1.5–2.5 trillion – equivalent to about half of global official reserves, or the combined assets of all hedge funds and private equity firms. This makes SWFs a small but significant share of the global equity market capitalization of $50 trillion (SWIm 2011). Even if estimates of the SWFs future scale differ, it is clear that their growth trajectory will continue.

2.2 Growth of Sovereign Wealth Funds

From the brief historical narrative, it is clear that SWFs are not new in global financial configuration. What is however, new about SWFs is their size, recent investment trends, countries of origin, and growth rate. According to Jen (2007) the growth of SWFs may be attributed to countries running persistent current account surpluses and accumulating net foreign assets. SWFs have arisen as a by-product of these current account surpluses in circumstances where sovereign governments choose to retain control of the foreign assets acquired. The structures,

[2] According to the Sovereign Wealth Fund Institute (2011), sovereign wealth assets are estimated at over US$4 trillion as at 2011.

mandates, and objectives of SWFs however vary from country to country and in recent times, they have become important symbols of state capitalism.

Several researchers have provided reasons for the accumulation of net foreign assets by sovereigns and the resulting growth of sovereign wealth funds (see IMF, 2008b; Jen, 2007; Johnson, 2007, Maslakovic, 2008, Ziemba, 2008). First, the recent commodity price boom has swelled the sovereign asset holdings of commodity-exporting countries where the public sector controls commodity exports or heavily taxes the revenues earned by private commodity exporters. Earlier commodity price booms vividly illustrate the adverse effect on competitiveness of domestic inflation and large real appreciations induced by using these windfall gains for domestic expenditures, particularly when the gains are transitory. For example, the windfall gains associated with the sharp rise in the price of oil in 1973–1974 induced oil-exporting countries to increase government spending; this spending fell sharply when oil prices collapsed in the early 1980s. Consequently, some sovereigns have sought to deal with these concerns by saving a share of the gains in SWFs. In some cases these savings are used as a financial stabilizer if commodity prices fall and tax revenue declines. In other cases, SWFs serve as mechanisms to transform concentrated exposure of public assets to volatile commodity prices into a more balanced and diversified global exposure, thereby protecting the income of future generations.

A second factor behind the growth of SWFs is the effort by many emerging market countries to accumulate large stockpiles of international reserves by running persistent current account surpluses (see Aizenman 2007). Many of these countries, particularly in Asia, now hold more reserves than needed for prudential reasons. Attempts to diversify these reserves into potentially higher-yielding assets entail transferring them from the control of the central bank to the Treasury or to quasi-public entities, such as SWFs, with the mandate to pursue financial strategies aiming at higher long-run returns. For example, China set up the China Investment Corporation with assets worth $200 billion to manage more aggressively a portion of its over $1.6 trillion in foreign reserves (as at June 2008) (SWI, 2011).

It should be noted that the global sum of all current accounts adds up to zero. Hence, the growing current accounts surpluses of natural resource/commodity exporters and Asian countries especially China are the mirror image of the growing current account deficits of other countries, especially the U.S. in recent years. In this regard the excess saving and accumulation of foreign assets by surplus countries is the counterpart of the excess demand and issuance of foreign liabilities by deficit countries. The resulting international wealth transfer from debtors in one country to creditors in others fosters the growth of SWFs when sovereign governments choose to retain control of the foreign assets accumulated.

We must continue to emphasize that SWFs are fundamentally different from monetary authorities holding official foreign reserves, where liquidity and security issues necessitate a short investment horizon and low risk tolerance. Central banks generally invest their foreign exchange reserves conservatively in safe and marketable instruments that are readily available to monetary authorities to meet balance of payments needs. In contrast, SWFs typically seek to diversify foreign exchange assets and earn a higher return by investing in a broader range of asset classes, including longer-term government bonds, agency and asset-backed securities, corporate bonds, equities, commodities, real estate, derivatives, and foreign direct investment.

Moreover, SWFs typically make little use, if any, of leverage, in contrast to hedge funds and private equity funds which generally engage in highly leveraged transactions. SWFs also differ from large institutional private investors such as mutual and insurance funds, in that although they hold assets, they generally have no specific liabilities to be paid to shareholders or policyholders. SWFs similarly differ from sovereign pension funds (SPFs) in that the latter, while government owned, have explicit liabilities, such as workers pensions. For this reason, SWFs typically have had less incentive to be transparent about their investment and management practices (Truman, 2008). However, as

SWFs invest more of their assets in private financial markets; greater concern has arisen as to the extent to which they should follow the practices of private institutional investors (IMF 2008b).

2.3 Rationale for Establishment of Sovereign Wealth Funds

Several reasons have been adduced in the literature why countries establish SWFs. It appears the source of the SWFs largely determine their purpose. SWFs established and owned by natural resource countries act as an intergenerational transfer mechanism whereby today's export earnings are used to guarantee future government pensions, asset liquidity, and fiscal revenues. In these countries, SWFs also serve the purpose of delinking and stabilizing government budgets and export revenues which would otherwise mirror the volatility of commodity prices. Countries establish SWFs as a means of diversifying their income sources in order to be able to absorb shocks arising from revenue fluctuations. Moreover, most resource endowed countries especially crude oil endowed, set up commodity stabilization funds during periods of oil price booms to mitigate the impact of crude oil price volatility on government spending. With continuous rise in crude oil prices, the commodity stabilization funds metamorphose into sovereign wealth funds as the funds become too large for just stabilization (Uzor, 2011).

Another reason why natural resource-endowed countries establish SWFs is the accumulation of savings for future generations as natural resources are non-renewable and are expected to be exhausted in the future. It is argued and rightly so that setting aside a portion of today's earnings from natural resources will guarantee future generations some level of prosperity. This class of SWF is prevalent in the Middle East – home to the largest concentration of sovereign wealth fund money in the world. The region has over thirteen major SWFs (SWI, 2011). The main objectives of SWFs in the Middle East region are to secure long term wealth for future generations, generate funds necessary for future pension and healthcare liabilities, and minimize their countries' reliance on oil revenue in the long term.

Another group of countries that have established SWFs are those that have accumulated reserves in excess of what may be needed for prudential intervention or balance of payment purposes. The source of reserve accumulation for these countries is largely not linked to primary commodities. This is mostly prevalent in Asia where some countries are experiencing rapid accumulation of reserves and huge currency account surpluses. After the harrowing regional financial crisis of 1997-98, a number of Asian countries have built up large war chests of foreign exchange reserves in order to guarantee that they would never again be vulnerable to international financial markets and international creditors. According to Uzor (2011) these countries resorted to reserve accumulation as a means of protecting their domestic policy autonomy in place of, or in combination with capital controls.

Over time, the enormity of these foreign reserves exceeds the typical buffer that a country requires. There was therefore, the need to use some of the reserves to make strategic investments by purchasing critical foreign assets hence these countries established SWFs to manage a segment of their reserves. These SWFs are driven by self-insurance and mercantilist motivations. Prominent amongst these countries is China which set aside $200 billion of its record high $1.6 trillion foreign exchange reserves to establish the China Investment Corporation (CIC) in 2007. South Korea also established a SWF in 2005 with holdings of approximately $30 billion. Another notable Asian country with substantial SWF is Singapore which has SWFs – Temasek (established in 1974 and with assets of $110 billion) and the Singapore Investment Corporation (established in 1981 with assets estimated to be between $200 and $330 billion) (SWI, 2011).

3. The Nigerian Sovereign Wealth Fund

Before delving into the Nigerian Sovereign Wealth Fund, it is imperative to review the operations of the forerunner fund – the Excess Crude Account (ECA). Former President Olusegun Obasanjo's economic team introduced the oil benchmark price and the Excess Crude Account in 2003. By setting a conservative oil benchmark price and saving the revenues received over that price, they sought to discontinue the destructive pattern of volatile spending. After a presumably an encouraging start (including the repayment of Nigeria's external debt), the ECA failed to serve its intended purpose. Even with heavy withdrawals, the ECA balance reached $20 billion in late 2008 following a historic oil price boom. But within few years government exhausted these savings, leaving a paltry balance of $3.2 billion as at 2011 (Aina, 2011). Moreover, the huge withdrawals from the ECA did not increase the quality or quantity of infrastructure, even though most outflows were designated for this purpose. National power supply, for example, remains below 4000MW despite an excess of $14 billion in ECA spending on the sector by the last two administrations. Besides, a cursory look at Nigeria's fiscal history will show that Nigerian leaders are familiar with the wastage of windfalls; for instance, similar problems occurred in 1992, when the Middle East conflict caused prices to spike and over USD$14 billion excess crude windfall could not be accounted for by the then Military President Ibrahim Babaginda.

According to Gillies (2011), for a fund to be successful, its balance must be protected from the short-term political pressures to spend. The rules establishing the fund must bind the hands of the current leader, and be seen to be binding on the successors as well. In Nigeria, where political power changes frequently, a leader will be more inclined to save if assured that the next leader will also be bound by prudence. The primary shortcoming of the ECA was the failure to provide these kinds of protections and guarantees. President Obasanjo's withdrawals from the ECA ostensibly appeared ad hoc and discretionary, rather than as components of a long-term development plan. His withdrawals included at least $8 billion for independent power plants, and $10 billion to compensate for overly optimistic budget revenue projections. These withdrawals, and the flimsiness of their justification, accelerated as the 2007 elections approached and the former president faced political battles and shorter horizons (Katz and Ojong, 2009).

The late President Umaru Yar'Adua also withdrew from this fund to appease state governors who were resolutely demanding access to the ECA balance. Federal and state authorities reached a so-called gentlemen's agreement that permitted 80% of the inflows to be distributed across the three levels of government. From then onwards, the balance in the account quickly depleted, and the governors enjoy regular transfers from the country's "savings." The current President - Goodluck Jonathan continued this practice - authorizing a $2 billion outlay as one of his first actions as Acting President. These withdrawals contribute to damaging instability in state-level incomes.

The political pressures which drove this underperformance will always be present, especially given the very fluid and competitive nature of Nigerian politics. Savings will remain vulnerable and require careful protection. The ECA has lacked such protections. While other factors have contributed to poor performance, such as consistently unrealistic oil revenue projections, weak and malleable governance structures have played a decisive role.

In response to the depleted ECA and the 2008 fiscal crisis, the National Economic Council announced in June 2010 that it would consider reforming the ECA, possibly through the creation of a Fund. The primary explanation given was that Nigeria is the only OPEC member without such a fund. This is hardly adequate. A SWF should be adopted only if it best serves a coherent long-term economic strategy, and its design should reflect the specifics of the country's context.

However, following the President's assent of the Nigerian Sovereign Investment Authority (NSIA) Act in May 2011, and the transfer of a seed capital of $1 billion from the Excess Crude Account (ECA) to the NSIA in October 2011, Nigeria effectively established a Sovereign Wealth Fund (SWF). The Nigerian SWF is composed of three separate portfolios namely: the Nigerian Infrastructure Fund, the Future Generations Fund and the Economic Stabilization Fund. Each component represents at least 20 percent of the total fund. The Nigerian Infrastructure Fund is a portfolio of investments specifically related to and with the object of assisting the development of critical infrastructure that will attract and support foreign investment, economic diversification and growth. Infrastructure that this Fund is expected to focus on include: power generation, distribution and transmission, agriculture, dams, water and sewage treatment and delivery, roads, port, rail, airport facilities, and similar assets that will stimulate the growth and diversification of the Nigerian economy. The Fund is expected to act as a lead investor for domestic and international partners seeking to invest in the development of infrastructure in the country.

The Future Generations Fund is a diversified portfolio of appropriate growth investments for the benefit of future generations. This Fund is targeted at providing future generations with a solid savings base for such a time, when the hydrocarbon reserves of Nigeria are exhausted, with due regard to macroeconomic factors. The Fund will build an intergenerational savings base by investing in longer term assets that generate returns to accumulate wealth for the next generations of Nigerians. The Economic Stabilization Fund is also a portfolio of investment to provide supplemental stabilization funding based upon a specific criteria and at such a time when other funds available to the Federation for stabilization needs to be supplemented. This will act as a last-resort source of finance during periods of fiscal deficit to protect the integrity of the budget and to delink government expenditure from the vagaries and fluctuations in oil revenue. This stabilization function will ensure the smooth functioning of government and delivery of key services during periods when revenues from petroleum sales are less than the level anticipated and approved by the National Assembly.

The Nigerian Sovereign Wealth Fund replaced the Excess Crude Account (ECA) which had acted mainly as a stabilization fund. As stated earlier, the Excess Crude Account was established in 2004, with the main thrust of protecting planned budgets against shortfalls due to volatility of crude oil prices. The account was used to save crude oil revenue above a base amount derived from a defined benchmark price stipulated in the federal budget. The ECA somewhat delinked government expenditures from oil revenues and insulated the economy from external shocks especially during the global economic crisis. The country's ability to weather the storm of the crisis has been attributed to the ECA and the robust external reserves that were built prior to the impact of the economic downturn on crude oil prices. Surging crude oil prices saw the ECA rise almost four-fold, from \$5.1 billion in 2005 to over \$20 billion by November 2008, accounting for more than one-third of Nigeria's external reserves at that time.

3.2 Potential Benefits from Sovereign Wealth Fund

According to Cree (2008) sovereign wealth fund have grown in popularity amongst natural resource endowed countries and also foreign reserve rich countries. Crude oil being a non-renewable resource will someday become history and it will only be fair to future generations to ensure intergenerational transfer of proceeds from current crude oil exploitation. Nigeria's mono-product economy no doubt exposes it to the vagaries of crude oil price volatility in the international commodities market. The SWF is expected to act as a fiscal stabilizer and buffer. With a SWF in place, government budget funding is expected to be more guaranteed as fluctuations in earnings can be smoothened from the economic stabilization component of SWF. This will engender stability in the funding of government long term projects that would otherwise have suffered the negative impact of revenue fluctuation. The Fund is also expected to facilitate a more efficient allocation of earnings from crude oil by diversifying the country's economic base. This will enable other sectors of the economy to grow as economic activities will no longer be concentrated in the petroleum sector. The SWF symbolizes prudent fiscal discipline and potentially will enable the diversification of the country's assets.

By joining the league of countries with SWFs albeit belatedly, Nigeria's standing in the comity of nations is expected to receive enormous boost as the country will be better placed to negotiate effectively in the comity of nations. SWFs have become veritable tools for international diplomacy and relevance, as countries with substantial SWF are treated courteously since withdrawal of their investments could have disastrous consequences on the economies of the host nations. Countries that have been able to use their SWFs as instruments of international diplomacy include China and Russia especially since the recent global economic downturn. Powerful countries have become somewhat subservient to the whims and caprices of these countries due to their ability to direct the flow of finance in the global economy. Nigeria as Africa's largest crude oil exporter stands to benefit from its SWF as the African continent is expected to become home to one of the largest pools of sovereign wealth funds in the world. As a natural resource rich continent, the era of foreign aid may be over sooner than expected as most aid giving nations are currently grappling with austere economic conditions.

3.3 A Paradigm Shift for Nigerian Economic Development

The discovery of a natural resource (especially in a developing country) is potentially both beneficial and harmful at the same time. This is because it has been established that countries endowed with natural resources paradoxically experience lack-luster economic growth. This occurrence has been attributed to a variety of factors, amongst which is the concentration of economic activities in the natural resource sector. Over time, the natural resource sector crowd out economic activities in other sectors by pulling away labour and capital and reducing the competiveness of non-resource exports. Nigeria like most crude oil producing countries have been plagued with this malaise often referred to as resource curse, paradox of plenty or Dutch disease. This argument has been advanced as the reason why some natural resource endowed countries have development challenges especially in the economic front. This is so because there is also the tendency of unrestricted spending of revenue from natural resources which culminates in the disruption of basic economic fundamental that are sine qua non for the growth and development of the economy.

Nigeria is believed to have the potential of becoming one of the world's largest economies. A Goldman Sachs report suggested that Nigeria will overtake both South Africa and Egypt to become Africa's strongest economy, and that by 2025 could become one of the 20 largest economies in the world and 11th in 2050 (Uzor, 2011). Although these predictions may appear ambitious, evidence from the East Asian Economic Miracle gives impetus to the possibility of a dramatic turnaround in the fortunes of a country if fundamental economic principles are backed by political will, and prudent fiscal regime. It has been variously argued that one of the banes of the Nigerian economy is its near complete reliance on crude oil earnings as revenue source. This situation has continued to thrive due largely to the dearth of infrastructure to support other productive sectors of the economy especially agriculture and manufacturing. By establishing an infrastructure fund to develop critical infrastructures in the country, Nigeria may well be on track to discovering the missing puzzle in the quest for accelerated economic growth and development.

The absence of an institutional framework to manage the proceeds of crude oil earnings from a high volatile income stream has exposed the country to cycles of booms and busts. There is therefore, the need to delink government expenditure from the fluctuating price of crude oil. Prior to the commencement of the sovereign wealth fund, Nigeria was one of the three member countries of the Organization of Petroleum Exporting Countries (OPEC) that do not have a sovereign wealth fund. The other two countries are Iraq and Ecuador. Nigeria's best attempt at managing its excess earnings during periods of high crude oil price was the creation of an Excess Crude Account (ECA). The ECA was however, lacking in the requisite legality thus making it vulnerable to political exigencies. Another major shortcoming of the ECA is that it was merely a stabilization fund that warehoused excess liquidity that was used to augment government revenue when it falls below a specified threshold. The sovereign wealth fund however, is an all encompassing fund that seeks to serve as a stabilizer, a guarantee fund for future generations, and will also address the dire infrastructure needs of the country. The sovereign wealth fund could be the catalyst the economy requires to jumpstart a holistic growth and development.

4. Issues and Challenges of SWFs and the Santiago Principles

Sovereign wealth funds have come under intense scrutiny and have acquired much notoriety in public debates in recent years as a result of their growing role in global financial markets and finance. These criticisms are myriad but bother mostly on their effects on individual firms, capital markets, national politics, and their efficiency. SWFs have been criticized for their tendency to be secretive and political in investment decisions. They however, justify their covertness for fear of protectionist response to their investment propositions. There are also national security concerns as SWFs could be used to secure control of strategically important industries for political rather than financial gain. This has raised concerns about the invasive tendencies of SWFs and the ability of foreign countries who are recipients of their investments. This fear could potentially culminate in investment protectionism which could be antithetical to the free flow of investment in the global economy (see Kimmitt, 2008; Heuty, 2011, Truman, 2008).

Another concern about SWFs is that some countries may not be fully prepared before establishing such funds. Some analysts argue that the mere fact that a country has foreign exchange surpluses does not mean it should establish a sovereign wealth fund. Often times, those countries are still faced with basic economic challenges such as poverty, unemployment and current account deficits. It is argued that in many instances, the foreign exchange reserves are not really earned reserves but are borrowed reserves and as such the SWF may not be sustainable in the long run.

Sovereign wealth funds have also been criticized for their ineffectiveness in acting as stabilizers and buffers when the need arises. A study by the International Monetary fund (IMF, 2008b) on SWFs in natural resource exporting countries concluded that there is little evidence to show that sovereign wealth funds have achieved the goals of smoothening out liquidity and government expenditures between times of strong and weak natural resource prices. The study concluded that countries that have SWFs had difficulty in harmonizing fund operations with fiscal policy. It is argued that there is the tendency of conflict between operations of SWF and other economic policies of the government. If both are not properly aligned, the overall objectives of government policies may be undermined. The IMF study also discovered a paradox in the relationship between SWFs and their home countries – the more reliant a country is on one commodity, the less effective its SWF is in achieving set goals. Another pertinent finding of the study is that only few countries have drawn down from their SWFs holdings for the greater national well being (Uzor, 2011).

4.2 The Santiago Principles

Due to the numerous criticisms on sovereign wealth funds and the need to streamline their activities to conform to global best practices, the International Working Group of Sovereign Wealth Funds (IWG-SWF) and the International Monetary Fund (IMF) proposed a set of 24 principles/practices (now known as the Santiago Principles) that assign best practices for the operations of SWFs. The purposes of the Santiago Principles are threefold. Firstly, to identify a framework of generally accepted principles and practices that would properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practices by sovereign wealth funds on a prudent and sound basis. Secondly, to enable home and recipient countries and the international financial markets to gain a better understanding of SWFs, and thirdly, to ensure that, through the pursuit of these principles and practices, SWFs would bring economic and financial benefits to home countries, recipient countries, and the international financial system.

The Santiago Principles are a voluntary set of principles and practices that the members of IWG/IFSWF support and either have implemented or aspire to implement. The principles seek to support the institutional framework, governance, and investment operations of sovereign wealth funds that are guided by their policy purposes and objectives, and consistent with a sound macroeconomic policy framework. The publication of the Santiago Principles was intended to help improve understanding of SWFs as economically and financially oriented entities in

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both the home and recipient countries. It is believed that this understanding would contribute to the stability of the global financial system, reduce protectionist pressures, and help maintain an open and stable investment climate. The Santiago Principles are also intended to enable sovereign wealth funds, especially newly established ones, to develop, review, and strengthen their organization, policies, and investment practices. The principles were drafted taking into cognizance the diversity of sovereign wealth funds, and not all principles were intended to be applicable for all SWFs. Since 2008 when the Santiago Principles were drafted, 25 nations have signed onto the principles.

5. Conclusion and Recommendations

Nigeria as a country is notorious for the financial profligacy of its leaders. Several opportunities in form of oil windfalls that would have transformed the country into a vibrant economy were all wasted. The establishment of a SWF may perhaps, be the most important economic decision taken by any Nigerian leader to jumpstart the march for meaningful economic development in the country. However, the following should be put in place to ensure the realization of the full impact possibilities of the fund.

a. A commitment by all in the legal standing of the fund

A fund with a contested or contestable legal standing will likely generate controversy and competing claims. The 1999 constitution of Nigeria requires that "all revenues collected by the Government of the Federation" enter the Federation Account, from which they are then allocated to the three levels of government according to the formula established by the National Assembly. Allocations of revenue outside the established formula usually generate objections. Courts' ruling on this issue have tended to side with the states, calling for a strict interpretation of the sharing of revenue across all the federal units rather than their retention by the federal government. As a result, centralized saving—the saving of revenues prior to their deposit in the Federation Account—has become a source of legal debate, and this controversy undermined the sustainability of the Excess Crude Account (Gillies, 2009). The furore that preceded the eventual signing of the Nigerian Sovereign Investment Act 2011 – an act that establishes the Nigerian Sovereign Wealth Fund is instructive in this instance. The rapid depletion of the ECA—in spite of the Fiscal Responsibility Act—illustrates the importance of a robust and binding legal foundation for any fund. A negotiated consensus is not enough: Priorities and personnel shift easily, and individual governments will inevitably seek to maximize available resources rather than support long-term saving. The resources and operations of the Fund must enjoy robust legal protection from the inevitable negotiations between the governments of the federation. Although the SWF enjoys a comprehensive and tightly drafted legal foundation, the act is not explicit in the Fund's relationship to the Constitution, governing structures, including rules for inflows and outflows, and the role of each federal unit with respect to the management of the fund and their access to its assets. There should be commitment of all – all the three tiers of government to ensure that the legal foundation of the fund is not tinkered with now or in the future.

b. There should be no discretionary power over the fund application

The act establishing the fund should never be subjected to discretionary powers of the President to ensure that the fate of Excess Crude Account does not befall the fund. Rules about inflows and outflows should reflect the specific purpose and objectives of the Fund. Although the Nigerian Sovereign Investment Authority Act 2011 has clear provisions on these issues, there should be political will to ensure these rules bind current and future leaders. These will protect the Fund from the day-to-day battles over resources between the various government units, and constrain access to its balance for any purpose other than the established long-term priorities.

c. Transparency

Calls for transparency in SWF operation is not new (see Truman, 2007). The growth in the size of SWFs in recent times has strengthened the call for greater transparency in the activities of the funds. For Nigeria SWF, transparency will help to enforce the rules that govern the fund and its financial flows. Transparency protects against abuse and reduces misunderstanding regarding the fund's purpose and operations. If everyone knows the rules, breaking them becomes more difficult. Transparency also sends encouraging signals to external stakeholders like investors, lenders and credit ranking agencies. Lack of transparency led to the confusion and suspicion that trailed the operations of the Excess Crude Account and consequently, the lack-lustre performance of the account. Widely-held knowledge of the fund, its purpose and its operations would bolster cooperation and support from the governments of the federation, the legislature and the public. Such a well-informed consensus would help to further safeguard the fund's sustainability.

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