GRIPS Discussion Paper 24-9

The UK's New Sovereign Wealth Fund: Some Preliminary Observations

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September 2024

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Abstract[1]

The newly elected Labour government of the United Kingdom (UK) introduced the National Wealth Fund (NWF) in July 2024, a £7.3 billion ($9.34 billion) initiative aimed at bolstering investment in key infrastructure projects, particularly in industries crucial for the green energy transition. The NWF is intended to attract private sector investment, with the government partly sharing the financial risk of costly projects with long gestation period. Chancellor Rachel Reeves describes the fund as a 'concierge' for investors, designed to streamline investment into the UK. However, there is debate about whether the NWF is an orthodox sovereign wealth fund found in countries with budget and/or trade surpluses such as Norway and Singapore. Instead, it appears more akin to a development or strategic sovereign wealth fund, channelling capital towards industries critical to the UK's long term economic health. The fund's initial budget, although significant in and of itself, pales in comparison to the world's largest sovereign wealth funds and may fall short of the estimated £50-60 billion ($64-77 billion) needed annually to meet the UK's net zero goals. Additionally, concerns have been raised about the fund's sustainability and whether it can effectively address the UK's underinvestment malaise, which stems from structural factors such as a blocker-friendly planning system and post-Brexit political uncertainties.

Keywords

Sovereign Wealth Funds, United Kingdom, Net Zero, Public Investment, Market Failure, Critical Industries

[1] The Pound sterling to US dollar exchange rate applied in this paper is approximately 1:1.2793 (August 1, 2024). Official data provided by Bank of England Database: https://www.bankofengland.co.uk/boeapps/database/Rates.asp?TD=1&TM=Aug&TY=2024&into=GBP&rateview=D.

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Introduction

In early July 2024, the freshly elected Labour government wasted no time in launching a much touted £7.3 billion ($9.34 billion) fund, merely days after prevailing in the 2024 United Kingdom (UK) general election. Reports indicate that the National Wealth Fund (NWF) is to catalyse and attract billions of pounds of private sector cash for big infrastructure projects across the UK. Of particular interest to the NWF are the 'new industries of the future' (UK Government 2024). According to Chancellor Rachel Reeves, the fund would essentially operate as a 'concierge service for investors and businesses that want to invest in Britain, so they know where to go' (Markortoff and Kollewe 2024).

There has been some speculation about what the fund is supposed to entail. One of which involves the form the NWF is to take. For example, Williamson (2024) asks whether Reeves' plan is tantamount to the establishment of a sovereign wealth fund (SWF) seen more commonly in non-liberal market economies. Implicit in her message is the supposed connection between such funds and authoritarian regimes (Carney 2018).[2] Other analysts raise questions about the fund's function. More specifically, there are concerns that the NWF's aims overlap with those of existing organisations (Jameson and Howat 2024).

With the above as a backdrop, this paper addresses these and related concerns. The main goal is to present a balanced evaluation on the issue, in addition to analysing it in the context of broader economic forces in the UK and beyond. The paper relies on secondary data such as government documents, newspaper essays, published reports, and academic manuscripts. The use of these sources allowed for data verification and triangulation, resulting in a clearer reading of the situation from multiple perspectives. Although details are sketchy due to the very recent nature of Reeves' announcement, it is still possible to draw certain useful inferences.

The paper first focuses on the backdrop leading up to the NWF's establishment. Its basic structure and other relevant parameters will be discussed here. Following this, it discusses the proximate reasons justifying the creation of the NWF. It then explores structural factors which might impede the fund's effectiveness. In so doing, critique will be levied against several key aspects of the UK economy. The paper concludes by summarizing the main findings and outlining implications for future studies.

[2] This is a common misconception as arguably the best managed SWF is Norway's Government Pension Fund. While not as well known, other SWFs in liberal market economies include the Alaska Permanent Fund and Future Fund, respectively of the US and Australia.

Background: What We Know Now

For several months at least, Labour has been developing the NWF, drawing on insights from a taskforce of esteemed financial industry experts. Notably, the group included Aviva's chief executive, Amanda Blanc, and former Bank of England governor Mark Carney. It also served as a central pledge in the party's manifesto for the 2024 UK general election (Markortoff and Kollewe 2024). With £7.3 billion ($9.34 billion) of cash injection provided by the Treasury, the NWF would prioritise investment in targeted industries, especially those facilitating the UK's green energy transition. The fund will seek to deploy £1.8 billion ($2.3 billion) of public funding to ports, £1.5 billion ($1.92 billion) for gigafactories (including for electric vehicles), £2.5 billion ($3.2 billion) to clean steel, £1 billion ($1.28 billion) for carbon capture and £500 million ($640 million) to green hydrogen (Markortoff 2024).

The NWF is expected to boost investment in the aforementioned industries, highlighting the government's determination to share the risk of channelling cash into long term projects with investors. It is projected that up to £3 ($3.84) of private investment will be leveraged from every £1 ($1.28) of public funding (Markortoff 2024). These projects are anticipated to generate approximately 650,000 new employment opportunities. Taking a longer-term perspective, the fund is anticipated to play a catalytic role in delivering the £50-60 billion ($64-77 billion) of additional annual investment required to meet the UK's net zero and adaptation requirements (Jameson and Howat 2024).

To date, the NWF has garnered support from important stakeholders. For example, CS Venkatakrishnan, chief executive of Barclays, one of the UK's largest banks, has praised the initiative. He claims that the NWF, along with other reforms, is set to simplify investor access to the partnership finance that is often needed to get infrastructure and other net zero projects off the ground (UK Government 2024). Victoria Barbary, the director of strategy and communications at the London-based International Forum of SWFs, also expressed optimism on the NWF. For her, strategic investment funds with stellar governance credentials are attractive to third party capital because it integrates local market knowledge with external expertise, which in turn reduces market risk and crowd in private investment into strategic industries (Detonni 2024). Unions, a traditional vote bank for the Labour Party, echoed similar sentiments. 'This announcement shows steel, automotive and energy workers that Labour is serious about investing in our industrial base and the towns it supports. Public investment is an urgent first step in boosting strategically important industries that have been neglected for the past 14 years,' said the general secretary Paul Nowak of the Trades Union Congress (TUC) (Taaffe-Maguire 2024).

Yet, it must be mentioned that the idea of a SWF (or other types of governmental organization) investing in strategic industries is not entirely new in the UK. Under the leadership of then Prime Minister Theresa May (2016-2019), her Conservative Party's

2017 election manifesto pledged to make SWFs 'a central part of our long-term plan for Britain'. It did not materialize eventually (Detonni 2024). Further back in the 1970s, there was the National Enterprise Board set up by the Labour government of Harold Wilson (1964-1970; 1974-1976). In practice, it served to rescue ailing UK companies, often with mixed results (The Economist 2024). The board was eventually combined with other entities to form the British Technology Group (BTG) in 1981.

So, what makes the NWF different then? For a start, it is in line with the moves of other major economies in pursuing growth in future-oriented industries. In particular, the race to net zero has turned into a de facto competition across the world. It would not be in the UK's interest to remain on the sidelines while its peers implement big ticket financing schemes such as the US government's Inflation Reduction Act, which is worth up to £391 billion ($500 billion) (Badlam et al. 2022). While the NWF and related green financing ventures are unlikely to match the war chest of two of the largest economies i.e. the US and China, they are comparable to the schemes of similarly-sized peers like Canada and Australia (The Economist 2024).

A parallel observation is the noticeably greater willingness by governments worldwide to establish SWFs and intervene in the economic ecosystem since the 2008 global financial crisis (Dixon et al. 2022). Some of the most prominent include Kazakhstan's Samruk-Kazyna and Hong Kong's Hong Kong Investment Corporation. Although their exact modus operandi differs, what is commonly accepted about these SWFs is their role in mitigating market failure, especially in the provision of public goods with potentially significant upside but which might be underfunded by private markets (Truman 2010). Put another way, SWFs, if properly mobilized, are a useful policy tool to facilitate long term investment in infrastructure, innovation, and other critical industries, promoting sustainable economic growth and diversification.

Lastly, instead of starting the NWF from scratch, it will be managed by the existing UK Infrastructure Bank (UKIB), with support from the British Business Bank (BBB) (Markortoff and Kollewe 2024). There would still be a formal head helming the NWF. This person is yet to be appointed, but the UK government has promised to reveal further details on this matter by late 2024 (Markortoff and Kollewe 2024). At least from what can be inferred from these announcements, a clash with pre-existing institutions has seemingly been avoided. This concern is a valid one – the NWF's priorities share substantial overlaps with the UKIB (Jameson and Howat 2024). The latter was launched in 2021 and invests in infrastructure to 'tackle climate change and support regional and local economic growth'. There are also plans to revamp the BBB, best known for administering the COVID-19 pandemic business loan schemes and has experience in venture capital (Markortoff 2024). Placing the NWF under the control of the UKIB will, in principle at least, allow it to generate impact rather quickly.

Immediate Points to Consider: The (De)Merits of Bean Counting

Notwithstanding the fanfare surrounding the NWF, there is still room to play devil's advocate. If one were to consider the immediate milieu surrounding the NWF, then several questions can be raised. Firstly, what Reeves is promoting is *not* a SWF, at least not the versions seen in places like Norway and Singapore, where there are chronic surpluses garnered through annual government budgeting and/or international trade (Truman 2010; Orchard 2021). If one were to take the statement that 'the NWF is meant to boost investment in key industries while giving investors the confidence to park money in the UK by showing that the government is willing to share the risk of pouring cash into long term infrastructure projects' (Markortoff 2024) at face value, then the NWF would most resemble in ethos – if not substance – what financial experts term a 'development/strategic SWF' (Dixon et al. 2022). Among the more prominent SWFs of this ilk are Samruk-Kazyna, the Russian Direct Investment Fund (RDIF), and Malaysia's Khazanah.

These three entities are established to support industries deemed strategic to their respective nations' long term economic health. While some of them – such as Khazanah – invest in foreign markets, the lion's share of their portfolio remains in the domestic market. They are also no strangers to pursuing joint investment with foreign and local business groups. Vittori and Kumar's (2024) report demonstrates that, instead of investing capital abroad to mitigate macroeconomic volatility and diversify the domestic economy, as is typically expected of SWFs, the RDIF is geared towards establishing joint ventures with foreign firms and financiers to invest within Russia itself. The fund has facilitated over 100 deals, with only about 10% of the investment money coming from Russia. The broader thesis here is that it is important to understand in greater depth what the NWF is modelled after and benchmarked against. Getting the specifics right will help taxpayers and analysts alike to ask more relevant questions.

Secondly, and related to the previous point, there ought to be more discussion on the NWF's budget. To begin with, what is the likelihood that the £7.3 billion ($9.34 billion) initially allocated by the government will achieve its intended tasks? Williamson (2024) argues that the NWF is dwarfed by the who's-who of the SWF world. The largest range from China Investment Corporation at close to £2.15 trillion ($2.75 trillion) to Korea Investment Corporation at about £156 billion ($200 billion). Even supposedly 'mid-sized' SWFs like Khazanah and RDIF are worth around £23 billion ($30 billion) and £31 billion ($40 billion) respectively. Additionally, as mentioned previously, approximately £50-60 billion ($64-77 billion) of annual investment is needed to reach net zero in the UK. Even if the NWF is designated to play only a catalytic role here, the money currently offered by the Chancellor is likely to fall short of such a goal. While the NWF's inception is undoubtedly a good start, greater financial commitment in the coming years is required to sustain this momentum (Barradale 2024).

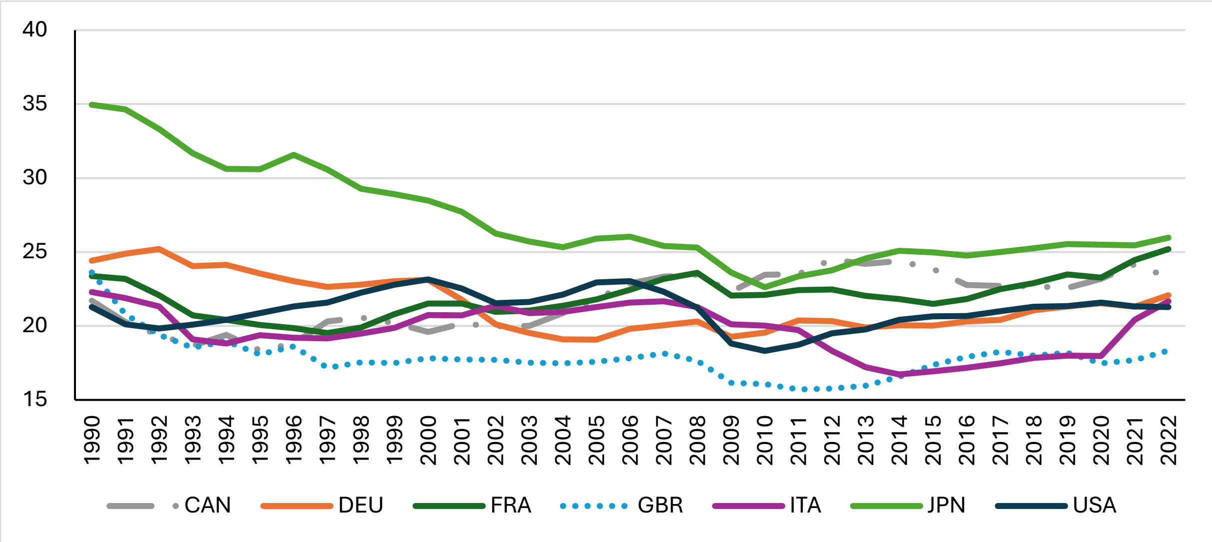
This leads to further questions regarding funding dynamics and sustainability. If the NWF is to have lasting impact, should not there also be some clarity on medium to long term funding? What is currently known is that the initial tranche of seed money will come from 'closing the loopholes' in the windfall tax on oil and gas companies (Markortoff 2024). Little is known beyond this, although Reeves did promise that further funding details will be outlined in the next budget. The point here is years of budget deficits has eroded investor confidence in the UK economy. Therefore, schemes, however grandeur, that do not have a clear purpose as well as coherent funding mechanism will likely be perceived negatively. To recap, as recent as September 2022, the UK market was rocked after the announcement of a mini-budget, which promised generous tax cuts without providing much detail on their cover. Further policy inconsistencies exacerbated uncertainties, leading to a steep fall in the value of the pound. It was not until several of these policies were reversed, following the resignation of the then Prime Minister, that confidence was restored. Therefore, the new Labour government would do well to take this episode as a precautionary lesson.

In addition, what is a realistic annual return for the NWF? As there is a social element to the fund, it is almost certain that its return will be lower than what one could reasonably garner from less risky avenues. Moreover, there is no guarantee – as with any investment – that the money will be recouped. Thus far, the Treasury has not revealed how much it intends to make from the NWF, although if the UKIB's own targets are any indication, it could be in the range of 2.5% to 4% (Markortoff 2024). Virtually all the better managed SWFs publish an annual report these days, so the least the NWF can do is to follow suit. It is in the public's interest to have a benchmark to measure the fund's performance against – a point made earlier but worth reiterating. As any diligent accountant would advise, the relevant yardsticks should be established ex-ante, rather than ex-post. In either case, more details on this topic will be welcome.

Longer Term Dynamics: Putting the Cart Before the Horse?

Perhaps more importantly, the suitability and long-term viability of the NWF hinges on other structural factors. It is true that the UK suffers from underinvestment in forward-looking industries and infrastructure. While all nations that reach a high-income level tend to trim their investment (conversely jacking up consumption), the UK has been amongst the worst performers out of all the Group of Seven (G7) economies, at least since the 1990s. Figure 1 shows that gross fixed capital formation in the UK has lagged its other G7 counterparts for virtually across the period surveyed. The UK has even invested less than Canada and Italy, two of the smallest economies in the group.

Figure 1: Gross Fixed Capital Formation of Group of Seven (G7) Economies, 1990-2022 (% of Gross Domestic Product)



Source: World Bank Indicators Database.

However, is the NWF the appropriate antidote to the UK's low capital formation levels? In other words, there needs to be a more detailed investigation on the main bottlenecks causing the nation's underinvestment. A survey by the Confederation of British Industry should offer some telltale signs. Only 5% of the manufacturers surveyed said that inability to raise external finance is holding them back from investing. Close to half of the manufacturers pointed to uncertainty about demand, while roughly 33% of them were worried about inadequate returns (The Economist 2024).

Some of the more likely structural reasons hampering investment include the nation's blocker-friendly planning system, political economic fallout after the UK's withdrawal from the European Union, and a lack of expertise on managing complex, megaprojects, especially in local government (The Economist 2024). These issues are not likely to be fixed in a short span of time, with or without an NWF. More worryingly, the supposed calls for smarter forms of state intervention since at least the 2008 global financial crisis have not generated the results that analysts have hoped for. For Berry (2022), interventionist mechanisms are often shaped by private economic actors implicated in the issues these interventions are designed to solve. Additionally, these mechanisms are sometimes employed to relieve the private sector from serving unprofitable market segments. All of these implies that neoliberal governance norms – long identified by some quarters as a stumbling block hampering UK economic vitality – have not only persisted, but also reconfigured themselves to forge new and sometimes 'innovative' forms of state-business cooperation (Berry 2020).

There is another concern regarding the NWF's funding scope. Although it is helpful in pushing green transition, does it really boost the UK's *overall competitiveness*? A key concern here is the allocation of £2.5 billion ($3.2 billion) to the steel industry to facilitate more environmentally friendly production. This is roughly one-third of the initial fund provided by the Treasury. Analysts familiar with the industry will point to several worrying trends. Firstly, it is an industry where overcapacity worries have existed for years. With major East Asian nations promoting their own 'national champions' in steelmaking, the competition will only get more vicious. For the UK at least, its key steel producing companies have gone through various rounds of mergers, but with no clear sight of their future. Compounding the issue is the UK's high energy cost and stringent environmental standards, at least relative to the East Asian economies.

Secondly, are not there more future industries that are sustainable, resilient, and adaptable to the evolving opportunities of the future than (clean) steel? The fund has earmarked £1.5 billion ($1.92 billion) for gigafactories (including for electric vehicles), which is laudable. Yet, it remains £1.0 billion ($1.28 billion) less than the sum provided to steelmakers. It is true that new, green technologies are inherently risky, and likely more so for modern ones than older ones. However, the other side of the coin of this supposedly risk-averse stance is the lock-in impact of older industries and the associated product and process know-how, which potentially hampers more path-breaking trajectories.

Conclusion and Implications for Future Studies

This paper has provided an overview of the NWF. The main points covered include the fund's basic structure and vision as well as the immediate reasons justifying its existence. In addition to drawing insights from SWFs in other economies, the broader socioeconomic context surrounding the NWF and the UK economy in general has also been examined. The overarching message here is that, while the NWF marks an ambitious (and arguably necessary) step towards addressing the UK's underinvestment in critical industries, its ultimate impact will hinge on several complex factors. Without tackling the deeper malfunction besetting the UK economy, including but not limited to political uncertainties post-Brexit and a lack of expertise in managing complex projects, the NWF *per se* is unlikely to achieve its intended goals. Phrased differently, the fund must be integrated into a comprehensive economic overhaul to ensure its lasting impact.

It is hoped that the observations put forth here will stimulate future research. For example, given China's growing prowess in industries critical to the green energy transition, the NWF and its partners would do well to collaborate with firms such as BYD Auto (electric vehicle) and JinkoSolar (solar panel). However, these decisions have increasingly been politicized. As one of the key allies of the US, the UK is bound to be pressured to 'choose sides'. If and when it does so, will that compromise the workings of institutions such as the NWF?

Recent studies offer valuable insights on this topic. Tjia (2022) demonstrates that collaboration between China and Kazakhstan has ushered in much-needed capital into Kazakhstani territory. This partnership has led to significant renewable energy initiatives, including solar power plants and hydropower dams. In Indonesia, the installation of the China Development Bank-financed Jakarta-Bandung High Speed Rail has eased traffic congestion between the Southeast Asian nation's largest and third-largest cities (see Liu and Lim 2023). As a substantial portion of the population still relies on internal combustion engine vehicles, many of which emit heavier-than-average pollutant, the railway has indirectly reduced the local economy's carbon footprint. Additional attention on these topics in relation to the NWF would likely enrich the scholarship.

Acknowledgement

The authors are grateful to participants of the 'Asia in Flux: Network Power, New Regionalism, and Global Development' conference, held in The Chinese University of Hong Kong from May 16 to 18, 2024. Their feedback and encouragement are especially helpful in the preparation of this paper. Any shortcomings that remain are ours.

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