# THE PROPOSED SOVEREIGN WEALTH FUND: A STATEMENT OF CONCERN

We, the undersigned business associations and economic policy groups, do not support the government's move to establish a Sovereign Wealth Fund (SWF) in the form of the Maharlika Wealth Fund (MWF) as proposed in House Bill No. 6398. We register our serious concerns and reservations against the proposed MWF on the principles of fiscal prudence, additionality, solvency of social pension funds, contingent liabilities, monetary independence of the Bangko Sentral ng Pilipinas (BSP), government in the economy, and transparency.

## Fiscal prudence

In other countries, commodity-based SWFs[1] are designed to optimally manage the windfall from the appropriate disposition of their natural resources for the benefit of future generations. These countries recognize that such natural resources are exhaustible and commodity prices are uncertain in the long run, while their current absorptive capacity for commodity earnings remains limited.

[1] See Massimiliano Casteli & Fabio Scacciavillani (2012). The New Economics of Sovereign Wealth Funds. Wiley & Sons, Ltd., United Kingdom.

On the other hand, non-commodity-based SWFs are designed to manage the accumulated foreign assets from persistent external trade surpluses and surpluses of state-owned enterprises (SOEs) with the objectives of preserving the value of their capital and realizing returns on investments in order to keep the long-term sustainability of the fund.

In contrast, the Philippines has neither commodity-based surpluses nor surpluses from external trade and SOEs.

Although the country is rich in mining resources, they remain undeveloped because of restrictive laws. In recent years, the supposed structural current account surpluses proved more transitory when import demand was muted by the pandemic. With economic recovery, the country is now experiencing large deficits, reflected by the decline in international reserves. Massive public spending has increased the fiscal deficit to 8%-9% of Gross Domestic Product (GDP) from only around 3% before the pandemic, and the national government debt has ballooned from 40% to 64% of GDP. Government-owned-and-controlled corporations (GOCCs) are no different; they are not generating large operating surpluses. The existential priority of the government is the management of the fiscal deficit and the public debt in order to avoid a downgrade of the country's credit rating. The priority for national government revenues and GOCCs' revenues is to cover public expenditures to keep the fiscal deficit and public debt from increasing further and undermining the delivery of public services.

**Additionality**

There is at present no gap nor "missing institution" in the economy that needs to be solved by the creation of an SWF. The country does not have a bonanza of commodity surpluses that need to be deployed. Instead of leaving a legacy of surplus funds to be managed for future generations, the current generation is leaving a legacy of heavy indebtedness which future generations need to pay or refinance. There is no need, or even justification, to pool the reserves of government financial institutions (GFIs) and pension funds into larger amounts in order to earn higher returns.

Requiring the Land Bank of the Philippines (LBP) and the Development Bank of the Philippines (DBP) to fund the SWF on the ground that they invest in government securities is in no way a creation of wealth. The LBP and DBP deposits exist because of the requirement for GOCCs to deposit their funds in government financial institutions.

Hence, there is no creation of wealth, or generation of new deposits, but mere round tripping, when funds of the LBP and DBP are diverted to the SWF.

**Actuarial solvency of pension funds**

The funds of the Government Service Insurance System (GSIS) and Social Security System (SSS) belong to the members. Pension funds are intended to pay for pension liabilities, benefits, salary, and housing loans of their members. The primary objective of the respective Investment Funds of the GSIS and SSS is therefore capital preservation with sufficient returns which demands conservative investment strategies. Currently, these strategies are properly being implemented. Therefore, there is no reason for diverting some of the funds of the GSIS and SSS to an SWF as it would simply expose the members' retirement funds to investments in assets with additional market risks and performance risks. It is not appropriate to impose on the GSIS and SSS members such risks on their retirement funds.

As it is, the actuarial life of the GSIS and SSS at present is around 40-43 years, which is far below the ideal 70 years which is the international standard for an actuarially "infinite" life. Should a portion of their investment funds be diverted to an SWF, their actuarial lives will likely be shortened further, because the funds will be invested in higher risk assets.

**Contingent liabilities**

The liabilities of the GSIS and SSS are guaranteed by the national government. Should their funds in the SWF suffer losses, their pension liabilities remain the same and will have to be settled by the National Government because of such guarantees. These potential losses will crystallize the contingent liabilities of the government in the pension funds into actual liabilities which will worsen the fiscal deficit and increase the need for further government borrowing.

**BSP Independence**

The provision requiring the BSP to contribute 50% of its cash dividends to the national government is problematic in many aspects.

Directed investments of the Gross International Reserves override the BSP's judgment on the macroeconomic and financial situation and its decision on the appropriate allocation of its foreign assets.

This is a direct assault on the constitutional mandate of the BSP as an independent central bank in promoting price stability and managing exchange rate volatilities.

Under the newly revised BSP charter, whatever the BSP declares as dividend should remain with the BSP as equity infusion of the National Government to complete its P250 billion capitalization. Instead of putting in more capital to the BSP, the SWF bill, in effect, deprives it of quicker capitalization and in the process, undermines the BSP's independence and its ability to discharge its role as the country's central monetary authority and systemic risk regulator.

The House Bill fails to realize that sequestering the dividends of GOCCs to the SWF will also impair the National Government's own ability to fund the fiscal deficit and increase the pressure to borrow more from both domestic and foreign sources. In the first place, we see no guarantee that this diversion of funds will result in higher returns to the National Government but instead more definitely result in higher interest rates and greater crowding out of private sector investments.

**Government in the economy**

In more ways than one, the proposed SWF will create a platform for the government to actively participate and intervene in the economy, a role which administrations since 1986 have tried to de-emphasize, learning the lessons of statist interventionist economic policies which resulted then in high fiscal deficits, high debt, and large losses of government corporations. There is wide concern that the creation of the SWF which is proposed to be exempted from the safeguards for good governance such as the Civil Service Act, Government Procurement Act, Governance Commission for GOCCs Act, Salary Standardization Law, and other similar safeguards signals a return to less transparent and centralized economic decision making as opposed to the market-oriented, decentralized private sector economy which has been the engine for growth in the last 36 years.

Under a more desirable decentralized decision making in the economy, there will be winners and losers who should be responsible for and will reap the benefits and losses of their decisions. In a centralized economy, the dominant decision maker can make bad decisions whose cost will affect the whole economy. Even supposedly professionally-run SWFs such as Temasek has incurred large losses from bad decisions. The case of the losses of the Malaysian SWF 1Malaysia Development Berhad (1MDB) due to corruption are well known.

The adoption of voluntary Santiago Principles in the MWF does not provide a strong assurance that the retirement funds of the GSIS and SSS members, or the reserves of GFIs will not be at risk.

In place of this SWF, we respectfully suggest that the executive and legislative branches continue to implement existing initiatives to strengthen the areas of transportation, public health, education and infrastructure, especially digital and agriculture, that can boost productivity and lower inflation. These initiatives can be executed within existing legal framework, without resorting to an untested approach with many potential infirmities.

Approved:

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Competitive Currency Forum (CCF)
Filipina CEO Circle (FCC)
Financial Executives Institute of The Philippines (FINEX)
Institute of Corporate Directors (ICD)
Integrity Initiative, Inc. (II, INC.)
Makati Business Club (MBC)
Management Association of The Philippines (MAP)
Movement for Good Governance (MGG)
Philippine Women's Economic Network (PHILWEN)
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