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The Geographic Challenges of Establishing Sovereign Wealth Funds in Frontier Markets: A Case Study Analysis

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Introduction

Sovereign wealth funds (SWFs) face numerous, complex challenges in their establishment and growth. Like any investor, they seek investment returns in financial markets. SWFs face additional challenges stemming from their sovereign ownership: as state owned entities, they are embedded in the political economies of their host countries, and must navigate their complexities. Further complicating the matter is the location of many new SWFs. Over the past decade, SWFs have proliferated in frontier markets, far from the centers of global finance, adding a series of geographic challenges. Examining the development of SWFs in Mongolia and Trinidad and Tobago, this paper examines how policymakers in frontier markets learn to build effective SWFs, despite the geographic, political, and knowledge management challenges they face.

The first section presents a brief overview of the policy objectives of SWFs, and the impetuses behind their creation. The section explores the resources that are available to policymakers in states creating new sovereign funds, as well as what resources are needed. This paper asserts that high-level advisory on macroeconomic policy issues is readily available and transferable, while training on ground-level, intrinsic implementation skills is also available but not easily applied in frontier markets. The section

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explores why implementation skills are particularly important in the investment management industry, and how the geographical contexts of new SWFs reinforce this challenge.

The second section examines the development of SWFs in Mongolia and Trinidad and Tobago as case studies, based on research interviews. This section analyzes the development of SWFs in these countries, and applies the theoretical explorations of section one to these experiences. In the case of Mongolia, the Mongolian government understands SWF policy principles, but faces domestic political concerns and resource constraints that inhibit the establishment of an SWF conforming to these principles. In the case of Trinidad and Tobago, policymakers have also faced resource constraints, but have found methods to cope with the lack of funding and expertise. Future iterations of the paper aim to draw upon the experience of additional frontier SWFs, to allow for a more comprehensive comparative analysis of common challenges, and how policymakers have successfully addressed them.

Drawing from the exploration of the geography of finance in the first section, and the frontier SWF case studies in the second, the third and final section of this paper suggests potential methods to mitigate the geographic and knowledge management challenges faced by new SWFs in frontier markets.

Challenges

This first section explores the high-level policy objectives of SWFs, and then examines the geographic challenges of effectively advancing these policy goals. There are a multitude of reasons for establishing a SWF. One can divide SWFs into three broad categories: reserve investment corporations, commodity stabilization and investment funds, and pension reserve funds (Monk 2010). Well established academic literature documents the economic problems each category of funds is established to address. This paper does not examine the efficacy of SWFs in solving these economic problems, but merely points out that SWFs are a widely accepted policy tool for addressing these problems.[2]

Furthermore, this academic literature has become accepted by policymakers at multilateral institutions, and it is now easily transferable and accessible globally. Many International Monetary Fund (IMF) and other multilateral institution working papers often take the form of "how-to" guides for policymakers in governments establishing SWFs (Das et al 2009). The recent proliferation of SWFs across six continents,

[2] For the economic rationale of investing excess foreign exchange reserves see Aizenman and Glick 2008. Dutch disease, the harm to manufacturing and exports caused by natural resource exploitation, was identified by Corden and Neary (1982) and Corden (1984) , and is a major rationale for commodity revenue investment funds. Commodity revenue is also invested to maintain a country's productive capacity (Solow 1986). Pension Reserve funds are established to help countries respond to the fiscal pressures of ageing populations by allowing for tax-smoothing and increasing national savings rates (Yermo 2008).

and into such far-flung locales as Angola, Mongolia, and Papua New Guinea (to cite three of the newest SWFs), demonstrates this point.

The motivations driving the establishment of SWFs are diverse, and respond to a variety of unique economic policy challenges, but one global commonality is that the number of SWFs globally is increasing rapidly, and at an accelerating pace. As many SWFs have been founded in the past decade as in all years prior, and with a more diverse geographic distribution, suggesting that SWFs are seen as an important, or even necessary, policy tool around the world.[3]

Policymakers within the host government make the final decision of whether to establish an SWF, and economic policy considerations are always the explicit motivation and justification for the fund. But domestic political considerations can be equally important, and numerous external actors also influence the establishment of an SWF. These factors can include political pressure, technical assistance from both multilateral institutions and other governments, and regional dynamics. The following case studies will explore the interplay between the economic policy objectives of the SWFs in Mongolia and Trinidad and Tobago, and how domestic political considerations and interaction with multilateral organizations has influenced the funds' progress toward achieving their goals.

The global proliferation of SWFs based on the belief that SWFs can be used to address multiple, diverse economic policy challenges has been propegated by multilateral institutions and through bilateral assistance relationships. In the two case studies, the SWFs aim to address at least two distinct economic challenges: commodity price volatility and intergenerational savings. Multilaterals such as the International Monetary Fund, World Bank, Asian Development Bank, and Inter-American Development Bank utilize, at the minimum, two methods of spreading the SWF doctrine. Technical assistance teams encourage the establishment of SWFs to address these economic challenges, and the IMF has conducted extensive research on the topic. More forcefully, the establishment of an SWF can be recommended as a component of assistance packages.[4]

SWFs can emerge as appealing policy solutions that can theoretically address numerous economic challenges, concurrently satisfying the desires of multiple domestic and foreign stakeholders, thereby smoothing the path to implementation. However, attempting to operate the SWF so that it addresses

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[3] Author's calculation based on data from the SWF Institute. A chart is attached in the appendix.

[4] In both case studies, but especially in Mongolia, it sounded like the host governments established SWFs because the funds can theoretically address multiple policy challenges, satisfying all domestic and foreign stakeholders, making the SWF an easier sell. However, the devil is in the details—operating an SWF so that it address multiple (or even one) of the policy objectives became the larger challenge. Informal conversations with SWF host governments in multiple countries support this point, and policymakers themselves are often aware of the inconsistencies of the objectives they are mandated to achieve.

multiple policy objectives can lead to conflicting policies, harming the SWF's ability to effectively achieve any single objective.

Other external pressures and issues not related to economic policy can also lead governments to establish SWFs. Monk suggests that SWFs, particularly in the Middle East, are sometimes established to legitimize local economic activity, as the SWF represents a modern institution that creates a financial link with the global economy (2010). Clark and Monk posit that in the Middle East, the establishment of a SWF can be driven by a desire to emulate neighboring governments and signal to neighbors and local elites that the country has reached modernity, and has achieved a position of importance in global finance (2011). Other scholars have suggested that local elites establish SWFs to maintain their grip on economic power, and to pacify domestic and foreign adversaries (Hatton and Pistor 2011).

Clearly, there are many motivations for governments to establish SWFs, from globally accepted economic policy objectives, propagated by multilateral institutions, to reasons based on political considerations, to other non-economic motives. The multitude of motivations for fund establishment, and available funding because of imbalanced global capital flows, has led to a dramatic rise in the number of SWFs over the past decade, particularly in frontier markets. Once the government decides to establish a SWF, the fund's construction raises numerous policy and operational challenges which new funds must learn to manage, and often struggle to do so. In frontier markets, funds face numerous geographic challenges relating to their location, access to human talent, and political environments, which the following section will discuss.

Geographic Challenges

"Geographic challenges" refers to the difficulties of operating a SWF in a place where the investment management industry is undeveloped, and far from current global centers of finance. While technology has enabled investors to overcome many significant barriers related to the flow of information (the internet can convey market data just as quickly to Ulaanbaatar as to New York), geography nonetheless presents significant challenges. In particular, SWFs in frontier markets must cope with geographic challenges related to human capital, politics and operating processes.

Human capital represents the most significant challenge faced by SWFs in frontier markets. A major consequence of geographic isolation is a lack of highly skilled professionals necessary to manage the SWF, and to invest in the global markets to achieve the fund's policy goals. Bachher and Monk (2012) identify a series of challenges faced by sovereign investors in frontier markets, including their status as public agencies with lower pay scales than private competitors, and locations in places with shallow or

non-existent financial labor pools. Additional challenges include laws prohibiting the hiring of foreigners[5], and a lack of financial professionals with knowledge of the country or region where the SWF is based.

Governance, also described as "organizational coherence" or "an institution's clarity of mission and its capacities" (Clark and Urwin 2007), represents a second series of challenges facing SWFs in frontier markets. Studies suggest that poor governance, measured by a matrix of factors including board competency, poor delegation or responsibilities to management, and inadequate compensation schemes, can harm pension fund returns by 100 to 300 basis points (Ambachtschher 2007). Other governance challenges faced by pension funds include developing an investment philosophy with firm-wide support, creating a decision-making process that incorporates the institution's comparative advantages and disadvantages, and is responsive enough react to market events in a timely fashion (Clark and Urwin 2007). While literature does not exist on the effects of governance on SWF performance, the impact of poor governance on SWFs may correspond to these figures.[6] Because governance practices are often inherited from the sponsoring institution, and many of the new SWFs are sponsored by governments with poor governance practices (Kauffman *et al.* 2010), the impact of poor governance may be more even significant.[7]

The challenges of process and poor governance discussed above suggest that learning to establish and operate a SWF require both significant transfer of knowledge of economic policy and investment as well as experience in finance and operating a complex firm. One common method of sidestepping this challenge is outsourcing, and many SWFs (as the case of Trinidad and Tobago will demonstrate) outsource almost all of their investment activities. SWFs can outsource both investment and operational processes. However, while outsourcing can directly address deficiencies in human talent and investment process, challenges of governance and political interference may be more difficult to circumvent. In particular, outsourcing cannot prevent unexpected, politically motivated changes in contribution or withdrawal policy. Furthermore, successful outsourcing is dependent on the SWFs ability to select investment managers and other service providers, which the fund may not be equipped to do.

SWF Proliferation vs. Sticky Knowledge

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[5] Based on author's conversation with an investment professional at an SWF based in a frontier market.
[6] The national importance of SWFs and the intense national and international scrutiny many SWFs receive may also affect their governance (both positively and negatively).
[7] The citation is for the World Bank governance rankings. Mongolia ranks in the 25th-50th percentile on most governance indicators. I have not plotted the correlation between poor governance and countries with new SWFs, but expect there to be a strong overlap.

The contrast between the rapid proliferation of SWFs in frontier markets, on the one hand, and the many challenges that they must learn to cope with, on the other, is exacerbated by the nature of the investment industry. Investment is a hyper-competitive industry focused on the production of one "product", a rate of return that is achieved through execution of investment strategies. Thus, the financial industry is one globally unified market aimed at capturing a completely non-differentiated product, investment return. Investment is thus based solely on execution, and the ability to innovate within the investment process itself. [8] While SWFs investment strategies diverge widely, most allocate a significant portion of their portfolio to globally competitive financial markets.[9]

Clark and Monk posit that the ability to compete within the financial industry is based upon three intangible assets: human capital, the process of decision-making, and the data and information infrastructure and architecture (2012). While technology has mitigated the impact of geography on access to financial data, human capital and the process of decision making are two areas where SWFs in frontier markets suffer their greatest comparative disadvantages.

Further increasing the difficulty of strengthening human capital and institutional processes is the nature of the knowledge involved in these aspects of the investment process. Human capital and investment processes rely heavily on "tacit knowledge", or knowledge that is best conveyed through demonstration and experience, in contrast to "codified knowledge," knowledge that is easily verbalized or transferred through writing.

SWFs in frontier markets face multiple impediments to learning how to resolve challenges of human capital and process, discussed above. Coping with human capital challenges is particularly difficult. As discussed above, many SWFs are unable to pay competitive salaries to attract human talent, face restrictions on hiring foreigners, and suffer from shallow local labor pools. And even when SWFs are able to hire employees with the requisite knowledge, sharing knowledge from an individual to the broader firm is challenging (Gertler 2003). Similarly, tacit knowledge does not travel easily between heterogeneous groups:

> This is because its transmission is best shared through face-to-face interaction between partners who already share some basic similarities: the same language; common 'codes' of communication; shared conventions and norms; personal knowledge of each other based on a past history of successful collaboration and informal interaction (Gertler 2003).

[8] This may not hold true for all financial markets, for example private equity, infrastructure, and other alternatives, but it does hold true for the highly liquid sovereign debt and global equity markets in which SWFs participate.
[9] It is worth noting that, unlike pension funds and commercially motivated investors, an SWF's fulfillment of its policy objective may not depend on investing well or achieving a target rate of return.

Such difficulties in spreading tacit knowledge help explain why, despite improvements in information technology, the financial industry remains highly concentrated in a small number of global cities. Tacit knowledge is typically conveyed through demonstration, and reinforced through interaction, conditions which further stress the difficulties of investing in the global markets from a frontier market. New SWFs in frontier markets will have to find methods to overcome these knowledge barriers if they are to compete successfully in the global financial markets.

Because institutional processes are largely based on tacit knowledge, geography further complicates the development of new SWFs in frontier markets. Innovation in financial institutions often depends on learning from networks and competitors. Gertler asserts that innovation is often spatially sticky, since innovation requires networks of multiple heterogeneous entities, including corporations, universities, and civil society (2003). These requirements for successful investment in the global markets, combined with the increasing popularity of SWFs as economic policy tools in frontier markets, leave many new SWFs with policy mandates they are poorly equipped to fulfill.

Many SWFs have developed strategies to circumvent or overcome these geographic challenges. Many SWFs have established offices in global financial centers, with allows them better access to human talent, and provides closer proximity to the markets and service providers. SWFs also leverage relationships with service providers to reduce geographic isolation by locating SWF employees at provider sites, or bring service providers to SWF locations. Such relationships provide SWFs with the tacit knowledge, and access to networks that are necessary to invest innovatively and competitively.

Mongolia[10]

The Government of Mongolia and its SWFs serve as a case study for the discussion of the effects of geography and knowledge transfer on the establishment of SWFs in frontier markets. The Mongolian Development Fund was established by law in 2007, and efforts gained urgency during the 2008 financial crisis. As the prices of Mongolia's commodity exports crashed, Mongolia entered a fiscal crisis and was forced to seek international assistance. The IMF provided financial assistance, and encouraged Mongolia to establish a SWF to help manage the impact of commodity price instability. At the same time, at the behest of a World Bank funded advisor, Mongolia passed a fiscal stability law limiting fiscal deficits, similar to a Chilean law limiting fiscal deficits. It's not completely clear how Chile became Mongolia's

[10] Unless otherwise stated, quotes and facts in the Mongolia section are based on the author's 2012 interview with a well-informed observer of the Mongolian SWF. Many of the interviewees statements can be corroborated by news articles, publications by multilateral institutions, and the Mongolian government's own publications.

model; one possibility is that Chile was a used as a model because both countries are major copper exporters.

The Human Development Fund, established in 2009, replaced the Mongolian Development Fund. Its exact origin is uncertain, but from its founding the fund has had a domestic investment focus, different from either of the funds suggested by the IMF. However, shortly after the fund's founding, it was used as a mechanism for cash distribution and untargeted social spending (Ognon 2013). Cash distribution had the potential to exacerbate one of the problem the fund was envisioned to address: the overheating of Mongolia's economy. Outside observers such as the World Bank were especially critical of the fund, which served as an instrument for politicians to fulfill election promises of cash handouts to citizens, rather than to accomplish the policy aims the IMF had initially envisioned.

The law establishing the Fiscal Stability Fund, first proposed in 2008, passed in 2010, and the fund now holds approximately $300 million, according to a recent presentation by the Mongolian Ministry of Finance (Ognon 2013). A funding formula based on a reference price of copper was suggested, but not immediately implemented. The value of the fund is expected to begin to increase rapidly in early 2013, when production at an enormous copper and gold mine, Oyu Tolgoi, is expected to begin. Mineral royalties account for over 30% of the government's revenues, and will increase further once Oyu Tolgoi comes online. Based on a study conducted by the Ministry of Finance with support from the World Bank, the Central Bank will manage the fund until assets reach 10% of GDP (Ognon 2013). Funds in excess of that amount will be managed jointly by the Central Bank and Ministry of Finance for long-term financial return (Ognon 2013).

Bureaucratic and organizational challenges have also hindered the implementation and effectiveness of the new SWFs. The long-term fund has not yet been established, and "it's clear the Minister of Finance has not read the [World Bank consultant's] report", nor does there appear to be a political consensus behind establishing the long-term fund. While some officials within the government are now fully aware of the fund's potential objective and strategy, Mongolian news agency Montsame quoted the Prime Minister supporting a policy of cash handouts from the SWF to generate jobs and income. The Central Bank is tasked with administering the FSF, but has only a minimal capacity to do so because it lacks professional staff with investment management experience. Since the fund's founding, all assets have been held in cash because investment processes have not yet been established.

The Central Bank is a member of the World Bank's Reserve Asset Management Program (RAMP). RAMP is an advisory and management program of the World Bank Treasury that assists official institutions such as central banks, pension funds and commodity funds. RAMP assists members through

designing fund rules, developing governance and strategic asset allocation capabilities, expanding internal management capabilities, and providing information technology, legal, and communications support. RAMP also conducts on and off site educational programs, and provides internships to members. Finally, RAMP manages over $100 billion in member assets. RAMP is open to all official institutions of World Bank member countries.

It is unclear why the fund remains in cash, and has not yet been invested, given the Mongolian government's ongoing relationship with RAMP. The Mongolian Central Bank also has a strong relationship with the People's Bank of China, and *China Daily* reported that in 2012 the two countries expanded their currency swap agreements, but suspicion of Chinese influence prevents them from seeking technical assistance from the Chinese.

The situation is further confused by conflicting recommendations from technical advisors. One multilateral institution has supported Mongolia's adoption of the "Chilean model" for its SWFs, while another advocates for a "Norwegian model". The two models differ significantly, as the "Chilean model" is based on a rule-based fiscal policy, in which government copper revenue enters the government budget, and then surplus (deficit) is allocated to (from) the two SWFs per a fiscal policy rule. The fiscal policy rule limits surpluses and deficits, and is linked to the global price of copper. In contrast, the "Norwegian model" stipulates that all government oil revenue enters the SWF, and then up to 4% of the fund value may be allocated to the government budget to cover a budget deficit. Additionally, the Norwegian fund performs both stabilization and savings functions, while Chile has created a separate fund for each purpose.

The conflict in selecting between the "Chilean model" and the "Norwegian model" extends to political divisions within the government as well, with the Ministry of Finance siding with the "Chilean model", and the Presidency supporting the "Norwegian model". Both contingents have brought in foreign consultants to support their respective cases, who are typically former government officials from the respective countries.

The interviewee considered the biggest impediment to operating the fund to be lack of human capital. "I think it's lack of expertise. They're out here in the middle of the steppe and they've never done it before. They just don't have the in-house expertise to handle it mechanically."

The interviewee stated that this lack of human capital is largely caused by Mongolia's geography and isolation from the world. As a percentage of the population, the Mongolian diaspora is very small.

Despite a literacy rate of 97%, and an effective post-secondary educational system, the Mongolian workforce lacks real world business experience, and a lack of integration into global financial networks:

> They think because they have an economics degree that they have a great understanding of how the economy should function and have a great level of financial expertise, but it's not really informed by the kind of real world experience that you might see in another country, where you've got people coming back from overseas…there are no foreign banks here operating, it's all local banks…no investment banks have offices here, no foreign insurance companies, so it's hard for people here locally to learn when you don't have that kind of base to learn from.

The shortcomings of the Mongolian labor force demonstrate the lack of experience, or tacit knowledge, necessary to operate a complex institution in the financial sector.

Despite this lack of resources, the interviewee believes that the most senior leadership of the Mongolian government has the skills to secure the expertise and establish the fund. However, as Mongolia is a young and turbulent democracy, there is little political incentive to do so. Much to the chagrin of multilateral institutions, Mongolia's first SWF, the Human Development Fund, was used for cash handouts to citizens rather than long-term investment. This was not the result of a lack of know-how, rather, it was necessitated by the desire to stay in office, and secure votes. These cash handouts contributed to the economy's overheating (Ognon 2013), an ironic phenomenon given that many SWFs are created to prevent this phenomenon.

The economic challenges the Government of Mongolia faces, commodity price instability, the need to avoid "Dutch Disease", economic overheating, and desire to save natural resource wealth for future generations, could all be addressed via the establishment of SWFs. And while Mongolia has been advised and intends to do this, significant geographic hurdles, including a lack of human capital, and domestic political challenges have thus far prevented SWFs from being implemented effectively.

Trinidad and Tobago[11]

Trinidad and Tobago's Heritage and Stabilization Fund (HSF) has faced geographic challenges similar to those encountered in Mongolia. However, the development of the HSF demonstrates how smaller SWFs in frontier markets can effectively overcome these challenges. Trinidad and Tobago's SWF began as interim fund in 2000, and was formally launched as the HSF in 2007.

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[11] Unless otherwise stated, quotes and facts in this section are sourced from a 2012 interview with Gov. Ewart Williams conducted by the Fletcher School's Sovereign Wealth Fund Initiative. A full citation appears in the bibliography.

Trinidad and Tobago is an oil exporting country, and experienced the boom and bust cycle in the 1970s and 1980s. Following this cycle, external debt increased, and the country endured a World Bank administered structural adjustment program. Having learned from this experience, the government saved excess oil revenues in the early 2000s, and began to develop the HSF, which was formally launched in 2007.

Norway's Government Pension Fund Global (GPFG) served as the model for the HSF. The GPFP model for both governance and transparency was directly replicated, but the investment strategy was modified because, while the Norwegian fund's investment strategy is now focused on a savings objective, the HSF has both stabilization and long-term savings objectives.

Like GPFG, the management of the HSF is outsourced to the central bank. However, while Norway manages much of its SWF internally through an independent unit of its central bank, Norges Bank Investment Management, the central bank of Trinidad and Tobago outsources the management to external managers. The HSF currently has a board with delegates its powers to the Central bank, but has no dedicated staff members.

Trinidad and Tobago sought and received technical assistance to establish the HSF from the World Bank's RAMP program. Williams stated: "Because we were members, when we started to think about the HSF, we sought technical assistance from the World Bank. We worked closely with them in the legal drafting and in thinking through the strategic asset allocation." They also worked closely with RAMP on manager selection, and the Central Bank receives training from RAMP with the long-term objective of more directly involving Central Bank staff in the investment process (like in Norway). The relationship between the central bank and RAMP has been very productive, and the HSF has functioned successfully for several years in cooperation with RAMP.

They also aim to construct a board that fully incorporates multiple local stakeholders—business leaders, trade unions, the energy sector, and the banking sector.

Understanding Trinidad and Tobago's Success

Based on the interviewee's description, policymakers in Trinidad and Tobago have built a successful, well governed, and transparent SWF, despite the lack of dedicated staff to the HSF. [12] Several factors have led to the HSF's successful development.

Perhaps most importantly, the impetus behind the fund arose domestically within Trinidad and Tobago. Having experienced a boom-and-bust commodity cycle, a broad consensus emerged within the government supporting the establishment of the fund. While policymakers have differing views on the exact functions of the HSF, they can be met through the hybrid (both savings and stabilization) nature of the fund. In contrast, Mongolia does not have such a long history with experiencing commodity boom and bust cycles, as a constitution allowing for a market economy was introduced relatively recently, in 1992. Additionally, the pressures behind the formation of an SWF in Mongolia were initially foreign rather than domestic, which hinders the formation of a domestic political consensus behind the fund, and the establishment of a specific investment mandate.

Trinidad and Tobago followed the "Norwegian model", which has transferred well to the HSF. One underlying reason for this could be that a model for accountable and transparent fund governance transfers more easily to Trinidad and Tobago than Mongolia, given Trinidad and Tobago's better performance on corruption and government effectiveness indicators (Kaufman et al 2010). Further, the domestic consensus behind a hybrid SWF model is well met by the structure of the Norwegian model, which can be adapted to perform both stabilization and savings functions.

One crucial area in which Trinidad and Tobago has succeeded is in committing to saving for the future, and resisting the temptation to spend windfall oil revenues now. This is likely a result of the country's experience of the 1970s and 1980s boom and bust cycle, and the painful structural adjustment it endured following this period. The experience may have giving policymakers the fortitude to withstand pressures to spend the revenue. Trinidad and Tobago also ranks highly in government effectiveness in comparison to Mongolia, which may also reflect the government's ability to create an SWF oriented toward medium and long-term economic policy challenges. In the Mongolian case, in contrast, the Human Development Fund was quickly raided for short-term political gain, perhaps a result of a poorly functioning political system, or limited public support for longer-term investment.

The strong prior relationship between the Central Bank and RAMP was a key factor of success of the HSF. The RAMP program provided assistance with manager selection, the fund's legal framework, and

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[12] One problem with directly comparing the HSF and the Mongolian fund based on the interviews conducted is the differing positions of the interviewees: a well-informed outside observer (Mongolia) vs. the policymaker who led the establishment of the HSF.

trainings for Central Bank employees. The HSF is building its internal capacities, and hopes to assume investment management responsibility over the long-term. This relationship may be the result of efforts of Mr. Ewart Williams, former governor of the Central Bank who served in several senior positions at the IMF. This long-time experience with the Washington multilateral institutions contrasts with the Mongolian experience, which is geographically distant, and did not closely engage these institutions until1992.

The comparison between the cases of Mongolia and Trinidad and Tobago reveals characteristics that could be indicators of potential success. These include:

- An organic, internal impetus for creating the SWF
- Popular understanding and experience with the economic challenges the SWF is designed to address
- Implementation of a model that can address all major concerns of policymakers (in Trinidad and Tobago, the ability to fulfill both the stabilization and savings objectives)
- A strong familiarity with the multilateral organizations from which the host government will receive support

Trinidad and Tobago demonstrated all of these characteristics, while Mongolia did not. Key, compounding difficulties in Mongolia were the large geographic barriers, including a lack of human talent, poor governance, and political challenges, which were perhaps so large that they prevented effective outsourcing. Trinidad and Tobago, on the other hand, was able to effectively contract with outsourcing providers to overcome the relatively smaller resource and geographic constraints it faced.

Conclusion

This paper explores the imbalance between the rapid proliferation of SWFs in frontier markets, which is often based on sound economic policy, and the geographic challenges they face, including access to human capital and organizational coherence, that might prevent new funds from accomplishing their policy objectives. While the examination of two cases is insufficient to draw broad reaching conclusions, it nonetheless illuminates potential pitfalls and ways to address them.

Outsourcing is one method of circumventing many of the challenges faced by SWFs in frontier markets. Trinidad and Tobago has been able to successfully operate the HSF completely via outsourcing. The fund was established with outsourced technical assistance from multilateral institutions, and the current

investment management function is outsourced to external asset managers. In contrast, Mongolia has not been able to use outsourcing effectively, largely because of political challenges, and also because it lacked familiarity with outside service providers, either multilateral or private sector.

Developing this familiarity, and a baseline knowledge to allow outsourcing to occur, will require the development of basic competencies in Mongolia. Creating a community to discuss common challenges and share knowledge is one potential solution, and could lead to innovation within the SWF community. Current organizations, such as the International Forum of Sovereign Wealth Funds, and the Long-Term Investors Club, partially perform this function now. They could be expanded and improved.

The host country's governance practices, both at the SWF level as well as the governmental leval, may play a determinant role in the potential success of a new SWF, but one should note that some of the largest and most respected SWFs are hosted in non-democratic countries, and in countries that have received poor governance ratings. Consequently, governance should be viewed as one of many factors at play.

This paper suggests several potential courses of study. A broader comparative study of new SWFs across frontier markets could help identify and define common challenges. Additional perspectives on the challenges faced by new SWFs in frontier markets, and how they have either circumvented or addressed these challenges, could shed much light on these challenges. A comparison of frontier SWFs in democratic and non-democratic countries could also strengthen this analysis. Finally, input from multilateral organizations, and the advisors who engage directly with these funds would be extremely helpful. A study incorporating these multiple experiences across new SWFs, as well as insights from multilateral institutions, could help develop a set of best practices for the establishment of new SWFs in frontier markets.

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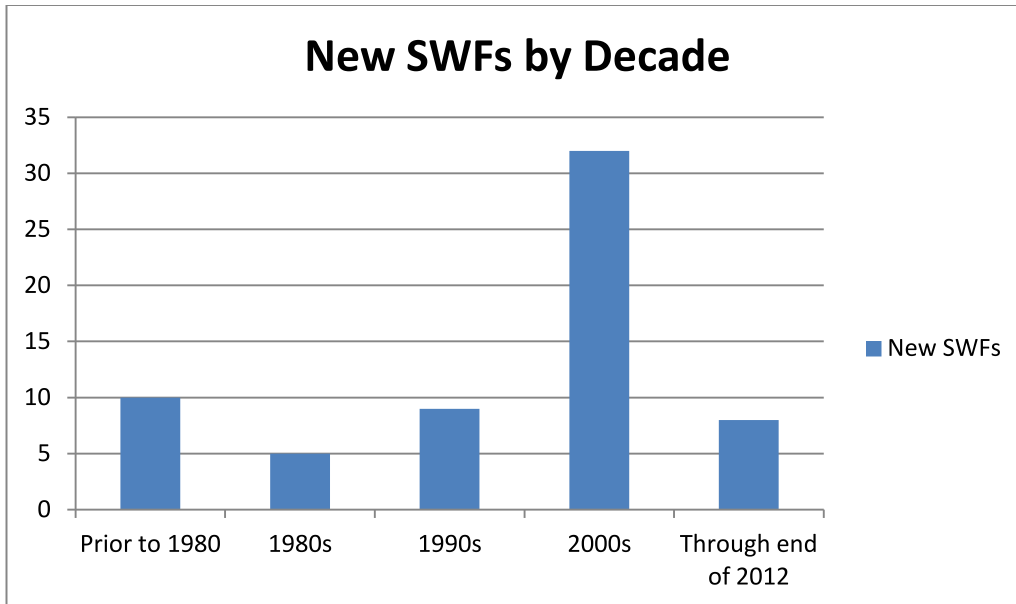
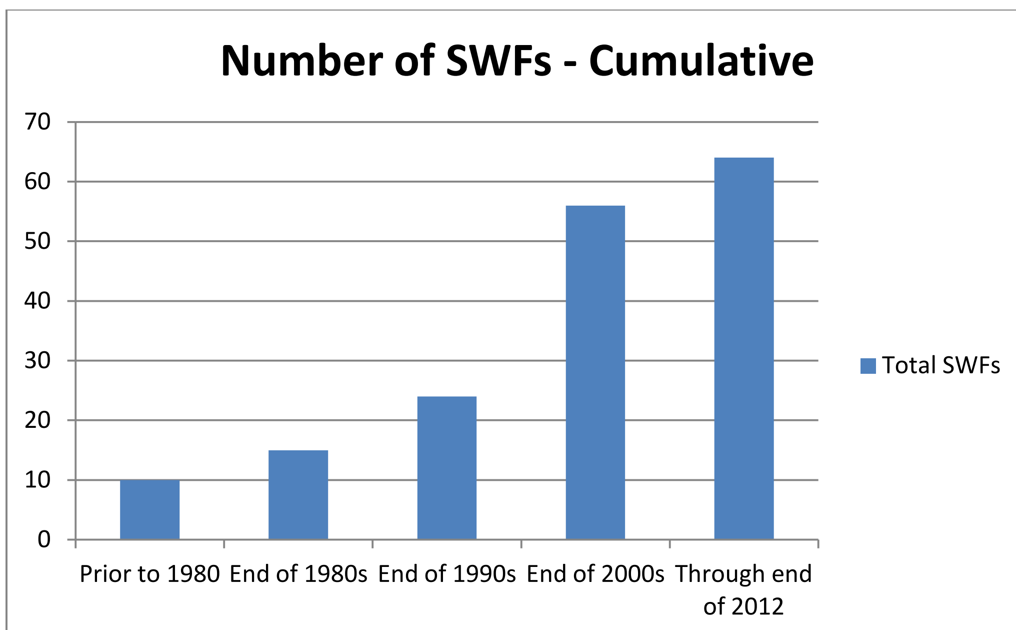
Appendix

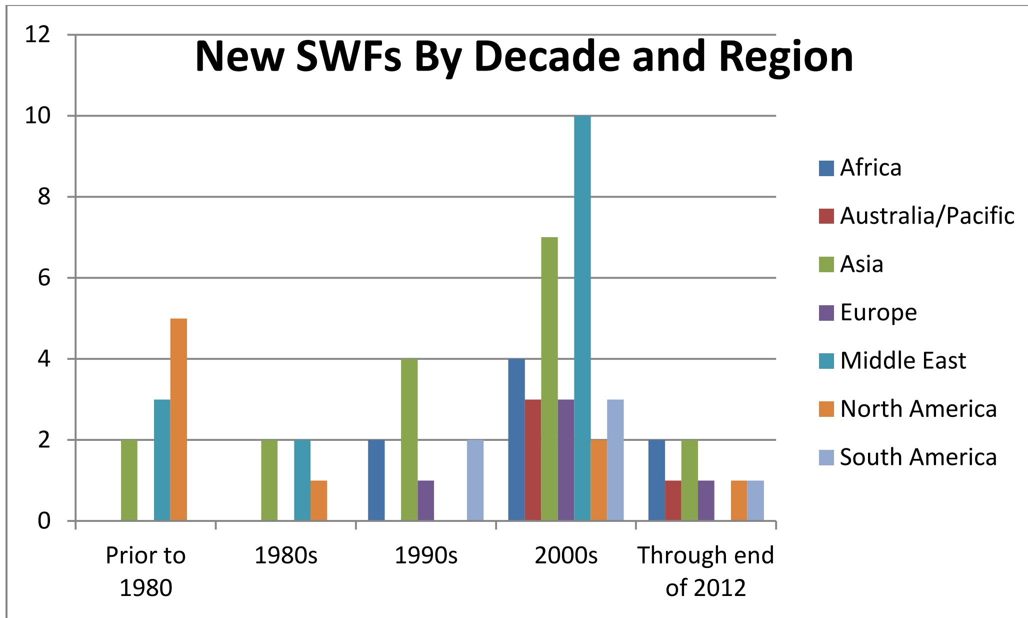
Charts created by author based on list of SWFs and dates of their establishment from the SWF Institute.



New SWFs by Decade
35
30
25
20
15
10
5
0
Prior to 1980
1980s
1990s
2000s
Through end of 2012
New SWFs



Number of SWFs - Cumulative
70
60
50
40
30
20
10
0
Prior to 1980
End of 1980s
End of 1990s
End of 2000s
Through end of 2012
Total SWFs


New SWFs By Decade and Region
12
10
8
6
4
2
0
Prior to 1980
1980s
1990s
2000s
Through end of 2012
Africa
Australia/Pacific
Asia
Europe
Middle East
North America
South America