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## Chapter 7

# **The Political Significance of the Gulf Cooperation Countries' Sovereign Wealth Funds' Investments in Central and Eastern Europe**

This chapter analyzes the potential political risks associated with the investment activity of the Gulf Cooperation Council (GCC), a “political and economic alliance” (Encyclopedia Britannica’s website) consisting of the following member states: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates, hence almost the entire Arabian Peninsula.

The GCC funds rank third in terms of the value of investments (excluding investments in treasury bonds) in Central and Eastern Europe (CEE), behind Norway’s and Asian funds, as they have been the origin of around a fourth of all SWF investments in the region. Consequently, it is necessary to analyze whether these investments do not pose political risks, understood as a threat to national security and political stability of each of the countries.

This chapter starts with an analysis of the importance of the GCC SWFs in terms of their global investments. It then analyzes the main directions of these investments, both in terms of targeted countries and targeted sectors, before outlining the GCC funds’ investment activity in CEE and providing a comparison with these funds’ global investment activity in order to estimate their interest in the studied region. Then, the chapter presents GCC countries’ political and economic interests, both at the global scale and in CEE. Finally, the conclusion intends to answer the question regarding the political risks involved with GCC SWFs’ investments in CEE.

## **7.1. The global importance of GCC countries’ SWFs**

The GCC countries’ funds account for the most important group of SWFs in terms of assets under management. According to data available on the Sovereign Wealth Fund Institute’s website, as of October 2014 the Middle East’s (of which GCC SWFs form a significant part) SWFs’ assets represented ca. 37.1% of global SWF assets, less than their Asian counterparts (which accounted for approximately 39.1% of the global SWF assets). However, an analysis of only the world’s 10 biggest SWFs (which accounted for around 75% of all SWF assets as of September 2015 puts GCC SWFs in the first place (with 43.3% of the assets), before Asian funds (with 40.4% of the assets). Table 7.1 below presents the major SWFs from GCC countries with some of their key characteristics.

Table 7.1. Major SWFs from GCC countries

<b>SWF</b>	<b>Country</b>	<b>Assets under Management (USD billion)</b>	<b>Linaburg-Maduell Transparency Index</b>
Abu Dhabi Investment Authority (ADIA)	United Arab Emirates	773	6
SAMA Foreign Holdings	Saudi Arabia	671.8	4
Kuwait Investment Authority (KIA)	Kuwait	592	6
Qatar Investment Authority (QIA)	Qatar	256	5
Investment Corporation of Dubai (ICD)	United Arab Emirates	183	5
Abu Dhabi Investment Council (ADIC)	United Arab Emirates	110	n/a

Source: Sovereign Wealth Fund Institute website, <http://www.swfinstitute.org/sovereign-wealth-fund-rankings/> [accessed: 01.09.2015].

GCC SWFs present some key characteristics (besides the obvious geographical criterion), which may allow to class them as a distinct group among SWFs. First, they are almost uniformly funded by commodity (mostly oil) revenues, unlike for example Asian funds, which are much more frequently funded by non-commodity revenues (mostly state foreign exchange reserves). Second, the fact that they are funded by commodity revenues may also have a direct impact on their investment behaviour. According to Bazoobandi (2011), GCC funds have a “higher risk appetite” and adopt a longer-term investment policy than SWFs funded by non-commodity revenues. Third, SWFs are generally considered as relatively opaque investors (Truman 2007; Kotter, LeI 2008) compared to other global financial institutions, unwilling to provide much information regarding the size of their assets under management or their overall investment motives. However, a comparison of the values of the Linaburg-Maduell Index for GCC SWFs (included in Table 7.1 above, with values from 0 to 10 – 0 meaning opacity and 10 meaning transparency) with the value of the Index in the case of other major SWFs (an average of 5.2

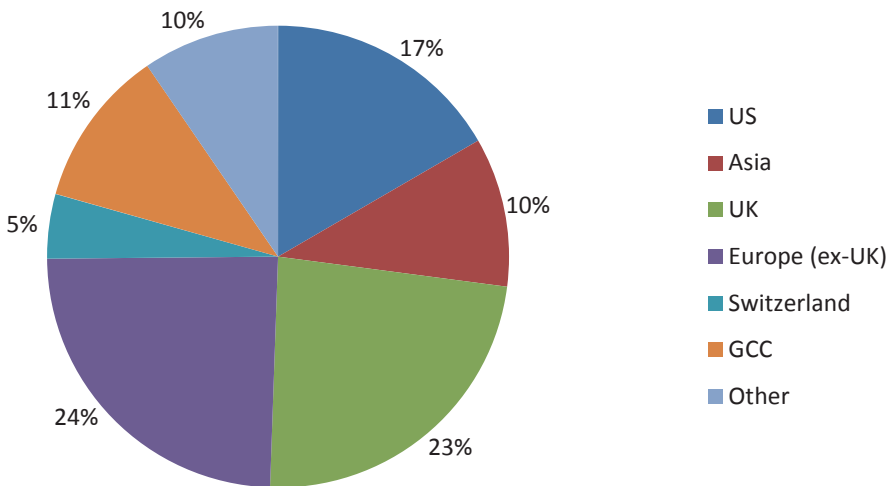
for GCC SWFs and 7.3 for non-GCC SWFs) may lead to the conclusion that Gulf funds are even more opaque than their peers from other parts of the world. This is confirmed by an analysis of the results achieved by SWFs funded by receipts from the sales of oil in the Truman fund scoreboard (Aizenman, Glick 2008).

## **7.2. The directions of GCC SWFs' global investments**

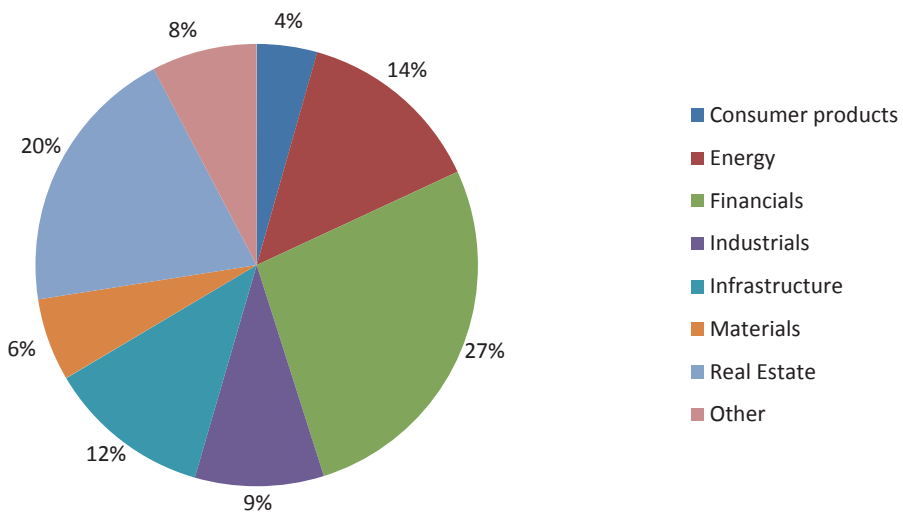
Based on data available in the transaction database of the Sovereign Wealth Fund Institute, the total value of GCC SWF transactions closed between the years 1974 and the third quarter of 2014 may be set at around USD 233 billion. However, there is no common investment pattern for Gulf SWFs (and, in fact, there are sometimes significant differences between the behaviours of each Gulf SWF, some of them being a consequence of government mandates to invest in given sectors, as it is in the case of the International Petroleum Investment Company (IPIC), founded by the Abu Dhabi government “to invest in the energy and related sectors across the globe,” as mentioned on the fund’s website). Nevertheless, almost 48% of these investments were directed toward countries forming part of the European Union (EU) as of August 2014, with the United Kingdom (UK) alone accounting for 23.5% of all Gulf funds’ investments, and so nearly half of the European investments. The other two major destinations were the United States (US) (which accounted for 16.6% of the investments) and Asian countries (which accounted for 10.4% of the investments, of which over three-fourths were directed solely to China and Taiwan). This is summed up in Chart 7.1 below.

Concerning the recipient industries, the financial, real estate, energy, infrastructure and industrial sectors have accounted for 82% of all GCC SWF investments since 1974. Some of the investments in the infrastructure sector have caught the attention of the media and politicians, especially at the height of the crisis in 2008 and 2009. In fact, GCC SWFs have invested some of their funds into companies managing airports, ports or water facilities, which, along with the funds already mentioned opacity, brought doubts whether these investments would not be dangerous for the recipient countries from a national security point of view. However, it is interesting to note that according to the Sovereign Wealth Fund Institute Transaction Database, the totality of the investments in the infrastructure sector has been carried out after 2007,

and so during times when these investments were much more attractive in terms of price. This could mean that these investments were economically motivated. In fact, should these investments be politically motivated, it is most probable that the transactions would be carried out irrespective of the price. Chart 7.2 below presents a breakdown of GCC SWF global investments by sector.

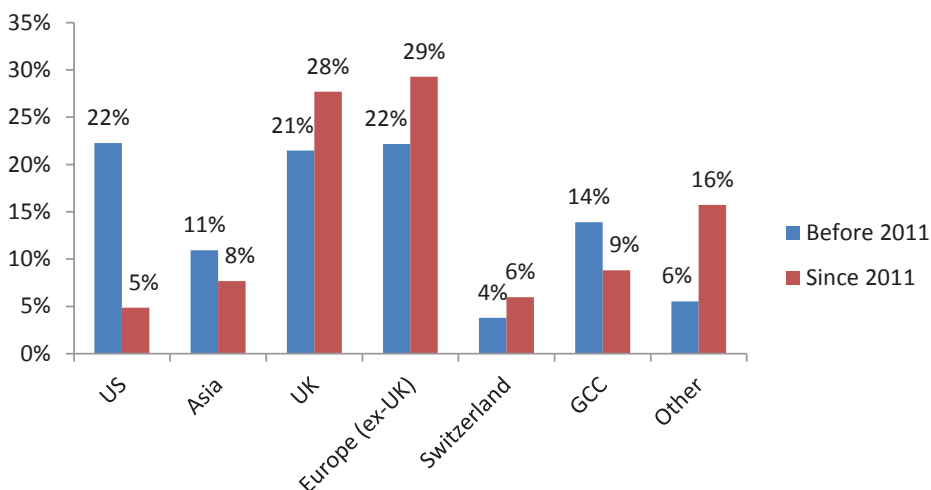


**Chart 7.1.** The geographical destinations of GCC SWFs' global investments since 1974 (% of total)  
Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.



**Chart 7.2.** GCC SWF global investments by sector since 1974 (% of total)  
Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.

GCC SWFs' investment policy has been significantly changing over time, which is especially visible in the analysis of the evolution of their geographical asset allocation policy. In fact, a comparison of the funds' investments between the years 1974 and 2010 with the investments made between 2011 and the third quarter of 2014 shows that with time, GCC SWFs have significantly decreased their investments in the US. While these investments made up around 22.2% of the investments before 2011, their share decreased to only 4.9% in the years since 2011. On the contrary, an analysis of the same two periods shows that there has been a significant increase in the share of the investments directed toward the EU (43.6% of the investments before 2011, and 56.5% of the investments since 2011).



**Graph 7.1.** Share of GCC SWF investments by region before and since 2011 (% of total)  
 Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.

### 7.3. GCC SWF investments in CEE

While Gulf SWFs seem to have increased the share of the European investments in their total investments over time, no such trend may be observed in the case of their CEE investments. Based on data from the Sovereign Wealth Fund Institute Database, the Sovereign Wealth Center and government official information, the total value of GCC SWF investments in CEE may be estimated at around USD 785 million. However, considering that the transaction values of some of the investments have not been disclosed, the total value of GCC

SWFs' exposure to the region, based on the estimations presented in the fourth chapter of this paper, could be set at ca. USD 875.5 million.

Both relative to the share of CEE in their total investments and to the share of their investments in the sum of SWF investments in CEE, the region seems to be underinvested by GCC SWF funds. The following calculations include only the investments whose value has been disclosed. First, investments in CEE countries make up only ca. 0.38% of Gulf funds' total investments (while, as it has been mentioned, investments in the EU accounted for ca. 48% of the total investments). Second, GCC SWF investments in CEE made up around 21,5% of all (excluding investments in treasury bonds) SWF investments in the region. In turn, the share of GCC SWF total transactions in global SWF transactions (based on the Sovereign Wealth Fund Institute Transaction Database) amounted to ca. 27.4%. It is therefore possible to conclude that while globally CEE countries have been only a minor destination for global SWF investments, the region has been an even less important destination for Gulf funds. Table 7.2 below presents the exposures of each of the Gulf funds to CEE, excluding the estimates of the undisclosed investments.

Table 7.2. Gulf funds' investments in CEE

<b>SWF</b>	<b>Investments in CEE value (USD million)</b>	<b>% of total SWF investments in CEE (excluding investments in T-bonds)</b>	<b>Major targeted sectors</b>	<b>Targeted countries</b>
Abu Dhabi Investment Authority	256	7.5	Real Estate	Czech Republic, Poland, Slovakia
Kuwait Investment Authority	421	12.3	Real Estate	Poland
Qatar Investment Authority	n/a	n/a	Real Estate	Poland
Oman State General Reserve Fund	108	3.2	Real Estate	Hungary
<b>Total</b>	<b>785</b>	<b>23.0</b>		

Source: own calculation based on sources listed in Annex 1.

As it is well shown by Table 7.2 above, in their investments in CEE countries, GCC SWFs have primarily been interested in the real estate sector. The targeted assets included mainly office buildings, real estate management companies and shopping malls. Such a preference for the sector is in accordance with the global evolution of GCC SWF investment policy – taken alone it has been the target of almost a third of all GCC SWF investments since 2011, up from around 14.3% of the investments before 2011, which demonstrates well the growing interest of Gulf funds for real estate assets. However, the financial, real estate, energy, infrastructure and industrial sectors still remain among the preferred sectors of Gulf funds (although their share in the total investments have decreased, and in general one may note that the funds have gradually distributed their investments more equally among industries). The question is therefore why Gulf funds invest so little (relative to other SWFs) in CEE and once they invest in the region why do they barely invest in sectors other than real estate. The following two subchapters will analyze whether a possible reason is not the low level of political and economic interests of GCC states in the region.

#### **7.4. GCC countries' global political and economic interests**

Despite the fact that one of GCC's main founding aims was to “achieve coordination and integration among Member States in all fields, including coordination of their policies and trade relations with the other countries and regional and international blocs” (Gulf Cooperation Council's website), there is currently no foreign policy common to all the GCC member states (Chatham House 2014). Nevertheless, there seem to be some similarities among the Gulf states' foreign policy strategic goals. An essential similarity in this respect is the traditional political competition with Iran: as a matter of fact, the desire to unite against Iran was one of the primary ambitions behind the establishment of the GCC itself in 1981 (Ulrichsen 2009).

The absence of a common GCC foreign policy may be a reflection of the fact that the Middle East region “still remains one of the least integrated in the world,” which might be a consequence of the “lack of strong states” (Council on Foreign Relations 2012). Such a lack of strong states could stimulate political competition between the countries. This phenomenon could have in turn been reinforced by the political instability that the region

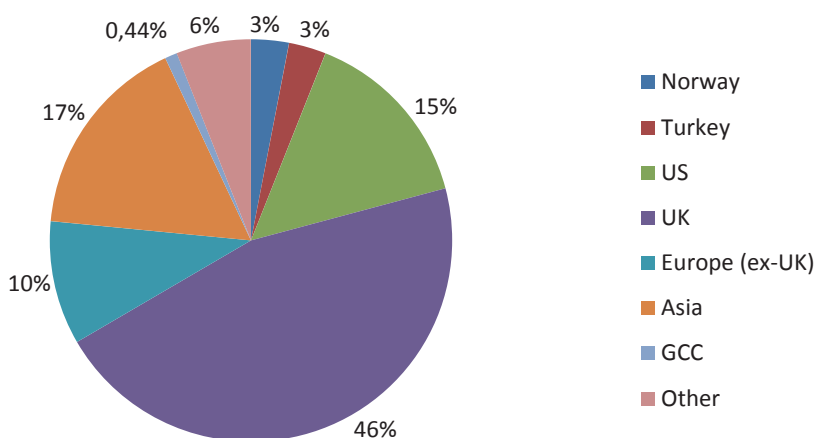


has witnessed in the past years, with the so-called Arab Spring, the growth in power of the Islamic State or the Yemeni civil war to name only the major events. Therefore, all this may have led the GCC states to focus especially on the regional developments in their foreign policies and put a relatively lower emphasis on extra-regional affairs. As an example of such focus on the regional level it is worth to quote the official website of the Qatari Ministry of Foreign Affairs, which states that in terms of international cooperation, Qatar will aim to “enhance the regional role of Qatar on the economic, political, and cultural levels especially within the framework of the Gulf Cooperation Council, the Arab League, and the Islamic Cooperation Organization” (Qatar’s Ministry of Foreign Affairs” official website).

Regarding economic goals, one needs to consider the relative dependence of Gulf economies on revenues from sales of commodities, which makes these economies vulnerable to changes in global commodity prices. This is perhaps why the energy sector is among the most frequently targeted by the Gulf funds globally. At least one of them, the IPIC, has a clear mandate to invest in energy companies (the fund’s investments in the sector account for over 41% of its total investments). In order to decrease the mentioned financial dependence from the sales of commodities, it has become fundamental for Gulf states to diversify their revenues (which, in particular, means moving revenue streams to foreign economies, and, at best, to more remote parts of the world).

Such a need for revenue diversification used to be a major justification for the creation of SWFs in most of the Gulf countries. A proof of the fact that Gulf SWFs are (at least, in part) meeting this commitment is that compared to other SWFs, GCC funds have made few domestic investments: the share of the domestic investments in the total value of their investments as of August 2014 stood at ca. 11% versus 20.5% for SWFs globally. However, in the years 1974–2006 this share has amounted to only 0.44%, which means that almost the totality of their investments were directed abroad (and outside of the Arabian peninsula, as there were no investments in other GCC countries).

At the same time, as it has already been mentioned, in terms of geographic asset allocation policy, many Gulf SWFs have strongly focused on investments in the UK. This was especially significant in the years 1974–2006, when investments in this country accounted for ca. 46% of all GCC SWF investments, while investments in other European countries accounted for only 10%, as it is shown by Chart 7.3 below.



**Chart 7.3.** The geographical asset allocation of Gulf SWFs' investments in 1974–2007 (% of the investments  
Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.

A potential explanation for this strong focus on the British economy is that Gulf funds chose long-term growth and stability over short-term profitability. They invested significantly more in the UK or the US than in the CEE economies (on a relative basis), despite the fact that the latter have been offering more attractive rates of economic growth in the past years. This policy may be also exemplified in Gulf funds' highly notorious investments in some of the most prestigious Western companies and brands. Finally, it is also essential to stress that besides long-term stability and the development of the economy, the UK has strong historical ties and the US have strong political ties with many GCC countries – this may be also an important decision-factor for Gulf SWFs.

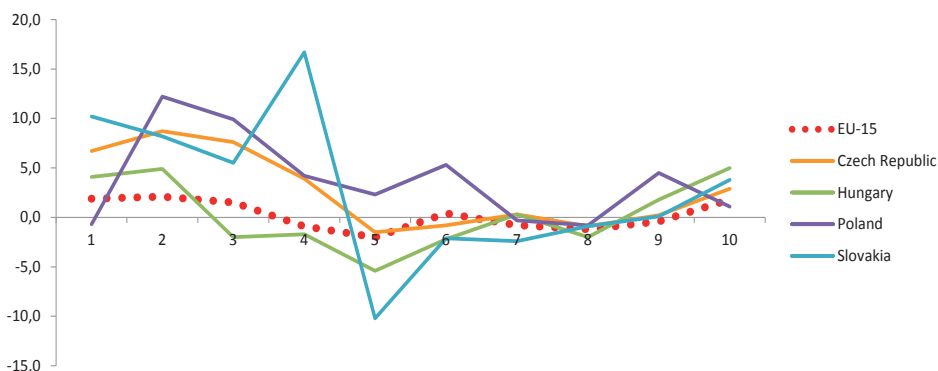
## 7.5. GCC countries political and economic interests in CEE

In line with what has been said regarding the fact that Gulf countries have so far focused mostly on the Arab world and less on extra-regional affairs in their foreign policies, it is important to see that CEE countries are almost nonexistent in the policies of GCC countries. A good illustration of this lack of interest is the limited diplomatic network that these countries have in CEE countries: for example, Oman and Bahrain do not have any diplomatic mission in any of the CEE countries; Qatar does not have an embassy in the Czech Republic, Slovakia, nor in any of the Baltic countries although it does have an embassy in most Western European countries. Qatar is a good proxy in this respect,

as the country “has been engaging in an ever-expanding foreign policy” (Khatib 2013) since 1995. It may be assumed that the lack of an expanded network of diplomatic missions may usually be, in turn, a disadvantage for companies or funds that aim to invest in a foreign country.

The economic interests of GCC countries in CEE seem also to be limited. Trade ties between GCC and CEE countries remain very limited as they “account for less than 1% of the GCC’s total” (The Economist Intelligence Unit 2011). However, it is worth to note that trade between Asian and GCC countries has significantly increased in the last decades, while at the same time Asia has become an increasingly less and less important destination for GCC SWF investments (16.6% of GCC’s investments before 2007 and only 8.2% of GCC’s investments since 2011). This shows that trade may be not the best proxy for SWFs’ investments’ geographical directions. Therefore, perhaps a more accurate explanation for the low investments in CEE may be found in GCC countries’ above-mentioned revenue diversification policy. Here it is interesting to note that, for example, in 2014 Poland started to import gas from Qatar with around 1.5 billion cubic meters of annual imports of liquefied natural gas (The International Energy Agency 2014). However, these imports represent only around 1.5% of Qatar’s annual gas exports. Overall, comparing with other emerging and developed economies, CEE economies do not seem to be an attractive destination. As Bazoobandi notes it, “in contrast to the decline in investment in the Western markets, higher expected returns have become a key incentive for the Gulf governments to invest in emerging markets” (Bazoobandi 2011). However, although CEE countries’ growth rates have proven to be especially high in comparison with other European countries, they still remained less attractive than the rates achieved by some of the fastest growing Asian economies.

This search for extra profitability in the emerging markets may also help to explain why Gulf SWFs dedicated their CEE investments almost entirely to the real estate sector and rather avoided investing in other sectors: for example, it is worth to note that some of the investments in CEE’s real estate were directed toward shopping centers (which is for example the case of Abu Dhabi Investment Authority’s investments in Slovakia). As a matter of fact, owing mainly to high retail sales before the crisis of 2008, shopping malls were very dynamic sectors in the CEE economies. Graph 7.2 below compares retail sales annual growth in CEE’s major economies and in the 15 EU members from before the EU’s enlargement in May 2004.



**Graph 7.2.** Retail sales' annual growth in the main CEE countries and in EU-15 (%)  
Source: Eurostat.

Gulf funds may have been investing mainly in CEE's real estate because of the sectors' high business potential (relatively higher than the potential of other sectors). In other words, Gulf funds agreed to invest in CEE's peripheral economies only on the condition of higher expected returns, seeing these potential returns as a compensation for not investing in the European so-called core markets.

## 7.6. Conclusion: Are there political risks stemming from GCC SWF investments in CEE?

The previous subchapter mentioned the fact that Gulf SWFs are, overall, acting consistently with their governments' policy of diversifying state revenues. Furthermore, although, as it has been already underlined, investment patterns may vary significantly from one Gulf SWF to another, the geographical preference for investments in the UK, a country with close historical ties with many Gulf countries, proves that the latter are not evaluating their investments only in terms of economic factors but are also putting emphasis on political factors. These elements could mean that Gulf funds are not formulating their investment strategy independently from the government or based solely on economic and financial criteria and that they could be considered as tools used by Gulf states to reach their political goals. GCC SWFs have also invested globally in some fragile industries, such as infrastructure. All these elements could be considered as factors of political risk for recipient economies.

However, an analysis of GCC SWFs' global investment behaviour shows that ca. 70% of the investments have been directed toward the finance, real

estate, energy and industrials sectors, all relatively safe from a political stability perspective (investments in the energy sector could be potentially considered as a threat to the national security of recipient economies, however, the bulk of these investments were minority holdings in global oil and gas companies), with investments in the infrastructure sector accounting for around 12% of the investments. As this chapter has specified earlier, these investments in the infrastructure sector must also have been economically motivated at least to some extent, as they have all been carried out after 2007, when global asset prices were falling significantly due to the financial crisis. Finally, apparently none of the political risks involved with the mentioned investments in the infrastructure sector have materialized so far.

In the case of CEE countries, political risks associated with GCC SWF investments seem to be even more limited. Referring to the classification of the ways through which SWFs may pose political risks for recipient countries as presented in Chapter 2 of this book, it is first important to note that GCC countries have no specific political interests in CEE, which is well proven *inter alia* by the Gulf countries' scant diplomatic network in the region. Second, most SWF investments in the region have so far been directed toward real estate and other assets safe from a political risk perspective, with the investments having been most probably targeted owing to their attractiveness in terms of expected financial returns. Most importantly, contrary to some of the countries most targeted by Gulf funds in their investments, based on available information CEE countries have not been until recently the target of significant investments in sectors deemed sensitive from a national security point of view, such as, for example, energy or infrastructure. Third, also due to the fact that GCC SWFs have been mostly interested in real estate in their CEE investments the risk that some investments might be carried out in order to gain access to some technologies seems to be insignificant.

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