Sovereign Wealth Funds and the Global Financial System

Center Forward Basics

April 2025

Overview

Sovereign Wealth Funds (SWFs) are government-owned investment funds and have become an integral part of many countries' economic strategies, providing a means for governments to manage national wealth. While countries like Norway and China have successfully implemented SWFs, the United States has yet to establish one. This Basic will examine the background and purposes of SWFs, the role of foreign currency reserves, and the broader context of U.S. dollar dominance.

Sovereign Wealth Fund Background

Globally, the largest sovereign wealth funds (SWFs) are often tied to resource-rich nations or those with surplus national income. For instance, the Government Pension Fund of Norway, which is the largest SWF, invests the country's oil revenue in global financial markets. Other major SWFs include the China Investment Corporation (CIC), which manages China's foreign currency reserves, and the Abu Dhabi Investment Authority (ADIA), managing assets derived from oil and gas revenues.

These funds typically focus on a range of investments—stocks, bonds, and alternative investments like hedge funds, private credit, private equity, and real estate—to create stable, long-term financial returns for their nations. Their success largely stems from their ability to manage surplus resources effectively, creating wealth for future generations.

Center Forward Basics

Center Forward brings together members of Congress, not-for profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

For more information, please visit www.center-forward.org

Establishing a SWF allows countries to generate wealth from surplus resources or revenues that can support future generations, much like a savings account for the state. By using a diverse range of investment vehicles, they can act as buffers in times of economic volatility, allowing governments to avoid excessive borrowing or sudden tax increases during financial crises. For resource-rich nations, SWFs provide a means to diversify away from dependence on volatile industries, such as oil, into other sectors like technology or infrastructure.

SWFs can fall into different categories depending on their purpose. Revenue-generating funds are typically established to invest surplus revenue, often from natural resources like oil and gas. Stabilization funds are designed to cushion the economy from volatile commodity prices and smooth government spending during downturns. Development funds are used for long-term investments in the country's infrastructure, education, and innovation to stimulate future economic growth.

An American SWF could be beneficial to offset future economic challenges and strengthen financial resilience. However, these benefits must be weighed against potential risks and challenges. Unlike many nations with substantial natural resource wealth or other surplus income, the United States does not have the traditional resources to fund a SWF. The U.S. has a highly diversified economy but does not generate the consistent surplus revenue necessary to establish a SWF of similar scale. Additionally, sovereign wealth funds can be influenced by political agendas, which might lead to suboptimal investments or economic policies. SWFs invested in long-term assets may be difficult to liquidate in emergencies.

In 2019, President Trump signed an Executive Order (EO) to potentially create a U.S. sovereign wealth fund. The EO outlined the strategic importance of such a fund in helping the U.S. manage its fiscal and economic challenges, especially amid rising national debt. While the EO sparked debate over the merits of creating a SWF in the U.S., it highlighted a growing awareness of how countries worldwide leverage SWFs for investment and economic stability. President Trump issued a new EO to the same effect on February 3, 2025.

Foreign Currency Reserves

Foreign currency reserves are assets a central bank holds in foreign currencies, primarily to support a nation's currency exchange rate and facilitate international trade. These reserves can include foreign banknotes, deposits, bonds, and gold. In the United States, the Federal Reserve is responsible for managing and executing currency reserves. The New York Federal Reserve is crucial in executing the country's foreign exchange operations. This is primarily done to maintain the stability of the U.S. dollar and manage the balance of payments. The NY Fed conducts open market operations and intervenes in currency markets to stabilize the value of the U.S. dollar when necessary.

U.S. currency reserves primarily consist of foreign currency deposits, special drawing rights (SDRs), and gold. SDRs, created by the International Monetary Fund (IMF), are international reserve assets that can be exchanged between countries. They are used as supplementary reserve assets, providing liquidity to the global economy.

U.S. Dollar Dominance

The U.S. dollar (USD) is the dominant global reserve currency. It is widely used for international trade and investment and is held by central banks as part of their foreign currency reserves. The benefits of this dominance include lower interest rates on debt due to the high global demand for the dollar and its significance in the global economy. However, the USD's dominance also comes with drawbacks, like disadvantaging US exporters due to a higher USD valuation.

Some recent developments suggest a gradual diversification away from the dollar by certain countries and economic blocs. Nations like China and Russia have been promoting the use of their currencies in international trade, especially in energy markets. However, these movements are relatively small and do not yet significantly threaten the U.S. dollar's dominance.

Currency Crises

A currency crisis occurs when a country's currency experiences a sharp decline in value, leading to economic instability and often requiring intervention by the International Monetary Fund (IMF). This is generally caused by investors losing faith in a country's ability to maintain its currency's value. Still, other underlying conditions can exacerbate the crisis or fuel speculation amongst investors about an impending crisis. These extenuating circumstances include poor economic policies, political instability, excessive borrowing, poor fiscal management, or external shocks. These crises often lead to massive economic instability as governments struggle to maintain currency pegs or manage inflation.

The U.S.'s floating exchange rate and reliance on the dollar help prevent currency crises within its borders. While the U.S. is not immune to economic turmoil, its role as the issuer of the global reserve currency and, especially, its floating exchange rate make a currency crisis practically impossible in the U.S.

Conclusion

Sovereign wealth funds allow nations to stabilize their economies, manage surplus resources, and create long-term savings. However, for the U.S., the lack of a consistent surplus and the complexity of establishing such a fund present significant challenges. Coupled with the complex dynamics of foreign currency reserves, dollar dominance, currency wars, and currency crises, these issues require careful consideration. As the global economic landscape evolves, it is essential for the U.S. to evaluate its options in managing its financial future, balancing risks, and leveraging its unique position in the world economy.

Links to Other Resources

- Cato Institute – A US Sovereign Wealth Fund is a Bad Idea
- Congressional Research Service – The U.S. Dollar as the World's Dominant Reserve Currency
- Corporate Finance Institute – Currency Crisis
- Council on Foreign Relations – The Dollar: The World's Reserve Currency
- International Forum of Sovereign Wealth Funds – What is a Sovereign Wealth Fund?
- International Monetary Fund – Dollar Dominance in the International Reserve System
- The White House – A Plan for Establishing a United States Sovereign Wealth Fund