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## **CRITERIA FOR EVALUATING THE EFFECTIVENESS OF SOVEREIGN WEALTH FUNDS**

**Abstract.** This article discusses the criteria for evaluating the effectiveness of sovereign funds. In addition, each proposed criterion examined and analyzed a set of complex indicators that assess the degree to which each criterion is met. In particular, the economic policy chosen in the activities of sovereign wealth funds is consistent with the level of use of market revenues, fiscal stability, anti-cyclical fiscal policy, ensuring the required level of asset liquidity, ensuring maximum return at the appropriate risk level, socio-economic efficiency of investment projects. evaluation indicators based on transparency criteria.

**Keywords:** sovereign wealth fund, stabilization fund, development fund, unit trust, pension reserve fund, efficiency, effectiveness, investment, economic efficiency, investment projects, discount rate, net present value.

## **СУВЕРЕН ФОНДЛАР ФАОЛИЯТИ САМАРАДОРЛИГИНИ БАҲОЛАШ МЕЗОНЛАРИ**

**Аннотация.** Ушбу мақолада суверен фондлар фаолият самарадорлигини баҳолаш мезонлари ўрганилган. Шунингдек, ҳар бир таклиф этилган мезон таркибида у ёки бу мезоннинг бажарилиш даражасини объектив баҳолайдиган комплекс кўрсаткичлар ўрганилган ва таҳлил қилинган. Жумладан, суверен фондлар фаолиятида танланган иқтисодий сиёсатнинг бозор конъюнктура даромадларидан фойдаланиш даражасига мувофиқлиги, бюджет барқарорлиги таъминланганлиги, циклларга қарши бюджет сиёсати юритилиши, активлар ликвидлиги зарурий даражасини таъминлаш, Мос келадиган риск даражасида максимал даромадлиликни таъминлаш, инвестиция лойиҳаларининг ижтимоий-иқтисодий самарадорлиги, суверен фонд фаолиятининг максимал шаффофлиги мезонлари асосида баҳолаш кўрсаткичлари келтирилган.

**Калит сўзлар:** суверен фонд, барқарорлаштириш фонди, тараққиёт фонди, жамғарма фонди, пенсия заҳира фонди, самарадорлик, натижадорлик, инвестициялар, иқтисодий самарадорлик, инвестиция лойиҳалари, дисконт ставка, соф жорий қиймат.

### **Introduction**

In international practice, sovereign wealth funds have become a driving force for investment and innovation processes in the implementation of major infrastructure projects, the rapid development of the economy in order to build modern high-tech production facilities, the active attraction of foreign investment.

In accordance with the Decree of the President of the Republic of Uzbekistan No. 3751 of May 11, 2006, the implementation of projects on modernization and technical re-equipment of leading sectors of the economy, as well as achieving continuous, stable and balanced socio-economic development and effective structural and investment The Fund for Reconstruction and Development of the Republic of Uzbekistan, established to implement the policy, has been making a significant contribution to increasing investment in the economy and innovative

development of the country. The authorized capital of the fund is currently 18 billion soums. At one time, the assets of the world's largest sovereign wealth funds totaled \$ 1.0 trillion. more than US \$ [1]. In some countries, not one, but several sovereign wealth funds have been established and a number of investment operations are being carried out in the world market in order not to lose the value of public funds. The Fund for Reconstruction and Development has allocated \$ 400 million for 3 months of 2018 to ensure socio-economic development by presidential decrees. [2]

Fund for Reconstruction and Development fund (hereinafter referred to as the Fund) is negatively affected by a number of shortcomings, primarily related to the irrational use of available resources, the superficial study of the economic feasibility and profitability of projects included in the investment program.

There is no concept of long-term development of sectors and regions of the economy, taking into account the real possibilities of using the Fund's financial resources and attracting foreign investment. As a result, there are cases of initiating projects that are not economically viable, inefficient use of financial resources of the fund, which ultimately leads to a decrease in the investment attractiveness of the country as a whole.

These circumstances require a radical overhaul of the procedure for forming investment programs, its financing mechanisms, increasing the transparency and efficiency of the selection of proposed projects. Therefore, one of the most important issues is to assess the effectiveness of the fund.

### **Analysis of the relevant literature**

Depending on the costs and their consequences, it will be possible to talk about economic, socio-economic, institutional, social and environmental efficiency. However, the difference between such concepts is gradually disappearing.

O.S. Sukharev, a well-known Russian neo-institutionalist, distinguishes between commercial, budgetary and social types of efficiency. [3]

Commercial efficiency - if it means the coverage of financial costs of a program or project, budget efficiency - means that budget revenues will be higher than the costs of achieving the set goal. Social efficiency, on the other hand, represents the productivity of creating social goods to meet the social goals and interests set by society.

A.Vasin emphasizes that efficiency should show the extent to which the management of the fund will achieve the goals and achieve the planned results. This is the essence of management efficiency - the degree to which the goal is achieved in accordance with the costs incurred. [4]

Determining the numerical values of the Fund's efficiency and effectiveness indicators is also difficult. This is characterized by the selection of an evaluation indicator characterized by a high share of subjectivity associated with costs. But even so, this task requires serious attention.

Efficiency and effectiveness are not exactly the same indicators. Efficiency represents the level of achievement of the goals and objectives set before the establishment of sovereign wealth funds. To measure performance, clear plans and

goals must be set without which the “calculation / evaluation point” cannot be determined. In turn, it should be noted that the effectiveness and efficiency of management are interrelated. In particular, management efficiency may be achieved, but efficiency may decline due to increased management costs. Management costs can be considered in different ways:

- a sharp increase in the budget deficit not related to raw materials or a decrease in budget security due to a decrease in the income of sovereign wealth funds in the downward trend in commodity prices;
- a steady increase in management costs, provided that the efficiency of the placement of sovereign wealth funds is provided.

### **Research methodology**

The main purpose of the study is to develop scientific and practical proposals and recommendations to improve the mechanisms and methods of assessing the cost-effectiveness of projects funded by the Fund for Reconstruction and Development in real sector enterprises in the country as a result of studying and analyzing the performance of sovereign wealth funds. Comparison, grouping, and economic statistical methods were widely used in the research process. As a result of the study, conclusions were made on the evaluation of the effectiveness of sovereign wealth funds, and scientific and practical recommendations for improving the evaluation criteria were developed.

Also, within the framework of each of the proposed criteria, a set of indicators that objectively assess the level of implementation of this or that criterion was analyzed and proposals for improving the activities of sovereign wealth funds in the country were developed.

### **Analysis and results**

In practice, the management of sovereign wealth funds is considered by financiers in the narrow sense as the management of the process of investing funds, namely the choice of investment instruments and investment objects, as well as changes in the requirements for investment assets.

It seems that the whole management is focused on the effective investment of funds, without focusing on the purpose of the fund.

It is important to evaluate the effectiveness of sovereign wealth funds in each country.

The criterion for assessing the effectiveness of sovereign wealth funds is a set of performance indicators. Criteria and indicators for assessing the effectiveness of sovereign wealth funds are given in Table 1.

**Table 1**

**Criteria and indicators for assessing the effectiveness of sovereign wealth funds [4]**

	<b>Criteria</b>	<b>Indicators</b>	<b>Evaluation features</b>
	Correspondence of the selected economic policy to the level of use of market conjuncture revenues	Coefficient of use of market conjuncture income	The compliance of the received income with the target income is checked

Ensuring budget stability	NBD (Non-Raw Material Budget Deficit), PNBD (Initial Non-Raw Material Budget Deficit)	The dynamics and variability of these indicators are assessed
Pursuing fiscal policy against cycles	NBD (Non-Raw Material Budget Deficit), PNBD (Initial Non-Raw Material Budget Deficit)	The correlation of these indicators with the price of raw materials is estimated
Ensuring the required level of asset liquidity	A market spread is a time when stocks can be potentially bought	Analysis of the compliance of these indicators with the values given in the formation of the investment declaration
Ensuring maximum profitability at the appropriate risk level	Return on investment, investment risk, Sharp ratio, Trainor ratio, "observation error", "information ratio"	"Plan / reality" analysis is conducted
Socio-economic efficiency of investment projects	PP (return on investment), NPV (net income), IRR, MIRR (internal rate of return), R (return on investment), PI (profitability index), increase in the level of employment in the region, increase in wages and so on	A "plan / reality" analysis is conducted both at the design stage and during the implementation process. Based on these indicators, a decision is made on the implementation or rejection of the project
Maximum transparency of sovereign wealth activities	Linaburg-Madwell transparency index	Maximize performance

As part of the assessment of management effectiveness for all sovereign wealth funds, in our opinion, the criterion of the level of use of market conjuncture income should be applied to the selected economic policy. The level of use of market conjuncture revenues can be analyzed using the market conjuncture (raw material) income utilization coefficient, which is defined as the ratio of the use of market conjuncture income to expenditure purposes (transfers to the budget, extra-budgetary funds, etc.) to the received market conjuncture income. Crisis situations show that the level of use should be in line with the chosen economic policy of the state.

To assess the effectiveness of the management of sovereign wealth funds, it is necessary to use the criteria of fiscal sustainability and anti-cyclical fiscal policy in order to ensure the budget system budgets or budget balance (to cover the deficit).

From an economic point of view, the budget balance is a situation in which a portion of budget expenditures quantitatively corresponds to the total amount of revenues from all sources of financing, which ensures budget stability. The budget deficit, which is not related to raw materials, is essentially a cyclical deficit, the factor of its formation is the market situation (prices for raw materials).

The main way to ensure cyclical budget balance is the formation and use of all types of budget reserves to ensure the sustainability of the expenditure side of budgets. Sovereign funds are also included in these budget reserves.

One of the main criteria for assessing the effectiveness of the management of sovereign wealth funds used to ensure the balance of budgets of the budget system is to ensure the required level of liquidity of the assets of sovereign wealth funds.

As a rule, the criteria for ensuring the maximum possible liquidity for the funds of such funds are determined based on their strategic importance. Liquidity of securities is a feature of its ability to sell in the market with maximum speed and minimal financial losses, namely liquid assets - the ability to turn into money. This feature describes the potential price losses that can be observed in selling it through the time during which the stock can be sold.

Price-related losses are determined by the size of the spread, namely the difference between the best selling price and the best buying price. To make appropriate comparisons and select the most liquid medium, it is advisable to calculate the relative spread according to the following formula:

$$M = \frac{(Pd - Ps)}{Pd}$$

here,

M - the relative market spread;

Pd - maximum demand price (maximum quotation for purchase);

Ps is the lowest bid price (minimum sales quote).

Absolute market capacity can be characterized by the average volume of trades on a security being analyzed over a given period. The ratio of the volume of a package of securities to the average market turnover on this issue represents the ratio of the expected period in which this package can be sold to the conditional production. This indicator is determined by the following formula:

$$T = \frac{N_p}{N_b}$$

here,

$N_p$  is the number of securities in the portfolio;

$N_b$  is the volume of securities transactions on that day.

It is advisable to apply the criterion of ensuring maximum return at the appropriate risk level as a criterion for assessing the effectiveness of fund management for sovereign wealth funds, whose goal is to ensure the maximum probable level of return on investment.

Based on the market efficiency hypothesis and modern theory of investment formation proposed by Louis Bashele [5] and further developed by Harry Markovits [6] and William Sharp [7], a number of indicators can be distinguished to assess the effectiveness of sovereign wealth portfolio management. These indicators are actively used by experts in the management of hedge funds, mutual funds and others.

A portfolio that does not have a portfolio of other investments that are able to generate greater returns at the same risk level is considered effective [8].

Given that determining the return on investment at the expense of sovereign wealth funds requires complex mathematical calculations, we will cover this in more detail in our next articles.

It should be borne in mind that non-raw material shortages are caused by a systemic problem in the economy - the low level of diversification of the economy and the focus on raw materials. Sovereign funds will be established in the country to pursue investment policy that will serve the development of the national economy, reduce the dependence of the national economy on exports of raw materials, increase its diversification, reduce the dependence of the economy on raw material prices. The funds of these funds will be invested in the most priority sectors in terms of economic development. In this case, for sovereign wealth funds, it is advisable to apply the criterion of socio-economic efficiency of investment projects implemented at the expense of these funds. In the practice of evaluating the effectiveness of investment projects are used indicators that characterize the economic and social efficiency. Based on these indicators, the feasibility of the investment project is assessed.

The following indicators characterize the commercial efficiency of the project: payback period of the investment - PP (Payback Period); net current value - NPV (Net Present Value); Internal Rate of Return; return on investment - R (Profitability); profitability index - PI (Profitability Index).

The calculation of these indicators is based on discounting the expected cash flows from the project. As a rule, the yield of alternative risk-free investments is used as a discount rate (for example, the European Commission recommends the use of the average real yield of government securities for a certain period since 1980) [9].

Often, investment projects aimed at developing the economy, for example, investments in import-substituting technologies, infrastructure and other investments with high capital capacity, are characterized by low or even negative return on investment, as well as long payback period. It is then recommended to evaluate the overall effectiveness of projects to evaluate long-term and low-profit projects (projects for the construction of bridges and tunnels are almost non-existent). Social efficiency is characterized by an increase in the employment rate of the population in the project area, the average wage rate of those employed in the implementation of this project, and the predominance of the average wage rate over employment in other sectors. The socially beneficial effect of the construction of bridges, additional railways, etc. can be assessed by obtaining information about the number of passengers crossing the bridge, the volume of cargo passing through this bridge, resource savings. This problem, despite its complexity, is not considered insurmountable [10].

In assessing the development of funds, it is necessary to take into account that the direction of investment is consistent with the long-term economic strategy for the development of the country, plans to diversify it and reduce dependence on raw materials.

In our opinion, the most important criterion for evaluating the effectiveness of sovereign wealth funds is to ensure maximum transparency. It should apply to all types of sovereign wealth funds. The increase in the number of sovereign wealth funds and the amount of funds accumulated in them draws serious attention to itself, as the fact that the funds of the funds can have a serious impact on the stock markets increases the transparency of activities.

The principle of transparency is the result of the joint efforts of sovereign wealth fund managers in developed economies and emerging markets to create a comprehensive framework that provides a clearer understanding of fund activities.

It is recommended to use the Linaburg-Madwell Transparency Index, developed by Carl Linaburg and Michael Madwell of the Institute of Sovereign Wealth Funds, as an understandable indicator of the level of transparency or information transparency of sovereign wealth funds [11].

The list of indicators and criteria provided is not exhaustive due to the constant development of sovereign wealth funds, the emergence of new goals and objectives. However, this system of criteria can be the basis for conducting an evaluation of the effectiveness of almost any sovereign wealth fund.

Criteria for assessing the effectiveness of the management of individual sovereign wealth funds should be applied based on the specific type of sovereign wealth funds. The distribution of criteria for assessing the effectiveness of management by type of sovereign wealth funds is given in the table below.

**Table 2**

**Criteria for assessing the effectiveness of the management of sovereign wealth funds by type of fund [4]**

№	Funds criteria	Stabilization funds	Pension reserve funds	Unit trust	Development funds
	Conformity of the level of use of conjunctural incomes to the chosen economic pol	+	+	+	+
	Ensuring budget sustainability	+	-	-	-
	Pursuing fiscal policy against cycles	+	-	-	-
	Ensuring the required level of asset liquidity	+	+	+	+
	Ensuring maximum profitability at a given risk level	-	+	+	-
	Socio-economic efficiency of investment projects	-	-	-	+
	Ensuring maximum transparency of sovereign wealth activities	+	+	+	+

Thus, in assessing the effectiveness of stabilization funds, it is necessary to use the criteria of fiscal sustainability, anti-cyclical fiscal policy and the necessary level of liquidity of assets of sovereign wealth funds.

The criterion for ensuring the maximum return on investment at the appropriate level of risk should be applied to savings and pension funds, the main purpose of which is to ensure the maximum possible return on investment.

The criterion of socio-economic efficiency of investment projects should be used to assess the effectiveness of development funds used to finance investment projects aimed at diversification and development of the economy.

Criteria for ensuring maximum transparency of sovereign wealth funds, compliance with the level of use of business income in the selected economic policy, as well as ensuring the required level of liquidity should be used to assess the effectiveness of all sovereign wealth funds, regardless of the type of fund.

### **Conclusions and suggestions**

As a result of the study of the criteria for evaluating the effectiveness of sovereign wealth funds, the following conclusions were drawn.

First, the evaluation of the performance of sovereign wealth funds shows the extent to which fund management achieves goals and achieves planned results as a result.

Second, in assessing the effectiveness of sovereign wealth funds, the level of use of conjuncture revenues in accordance with the chosen economic policy, ensuring fiscal stability, fiscal policy against cycles, ensuring the required level of liquidity of assets, ensuring maximum profitability at a given risk, socio-economic efficiency of investment projects.

transparency criteria should be used.

Third, in the structure of each of the above proposed criteria, it is necessary to use complex indicators that objectively assess the level of implementation of this or that criterion.

Fourth, when applying the criteria for evaluating the effectiveness of sovereign wealth funds, it is advisable to use certain types of funds based on their goals and objectives.

Fifth, the criteria for ensuring maximum transparency in the activities of sovereign wealth funds, compliance with the level of use of market revenues in the selected economic policy, as well as ensuring the required level of liquidity should be used to assess the performance of all sovereign wealth funds.

Sixth, in order to ensure maximum transparency of sovereign wealth funds, it is proposed to use the Linaburg-Madwell Transparency Index for all types of sovereign wealth funds.

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