Innovating Sustainable Development through Strategic National Investment: The Palestine Investment Fund

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ABSTRACT

The gap to attain the UN Sustainable Development Goals (SDGs) is widening, burdened by significant capital shortfalls. Investment by global asset owners, such as sovereign wealth funds, is often cited as an appropriate source to narrow this gap. However, classic barriers to foreign direct investment into emerging economies – information asymmetries, institutional weaknesses – nonetheless prevail. Frequently overlooked are a rapidly emerging class of sovereign investors – strategic investment funds or SIFs, that invest domestically within strategic sectors of their own national economies often by serving as an

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institutional bridge to actively mobilize foreign capital. This paper examines sovereign wealth funds in the context of the global development finance conundrum, focusing specifically on the role of strategic investment funds as agents of national development. Our empirical backdrop is the case of the Palestine Investment Fund (PIF) in Palestine's national development. The expansive growth of SIFs since the 2008 global financial crisis lends support to innovative approaches to national development – and capital mobilization - that are based on strong governance and local institution building designed to return control of the national development agenda, and responsibility for its execution, back to national governments.

According to the Organization for Economic Cooperation and Development (OECD), the gap to reach the UN Sustainable Development Goals (SDGs) in developing countries totaled nearly USD 4 trillion in 2020, increasing measurably due to the COVID-19 pandemic. [1] Moreover, the OECD further estimates that less that 1 percent of global finance would close this gap.[2] The fundamental development challenge is, of course, to mobilize such capital flows. As the OECD makes clear, 80 percent of global finance is held in high-income countries. To resolve this impasse, it contends that high-income countries must: (1) help break down the barriers that block access to financing in developing countries; and (2) align financing at home to improve needs-based allocation.[3]

Such prescriptions are more easily made than achieved. Global capital is controlled by both public and private institutions with mandates from ultimate owner-stakeholders that usually require returns on invested capital based on pre-established risk thresholds. Thus, whether from public or private sources, an investor's degree of risk tolerance plays a critical role in capital allocation and in part explains directionality and scale in global investment flows. Global investment tends to flow to countries with fewer structural and institutional shortcomings, i.e. fewer risks.[4] In fact, the Kearney Direct Foreign Investment Confidence Index supports this contention: developed economies account for nineteen of the top twenty-five spots in the 2023 index.[5]

Development finance over many decades has centered on multilateral development banks, bilateral aid agencies, and NGOs to provide a foundation for funding international development. The role of such development finance institutions (DFI) is especially relevant when serving as a bridge between grant-based or concessional funding on the one hand, and market-based financing on the other. In addition to simply sourcing capital, the support of DFIs can extend to project preparation, capacity

enhancement, and risk mitigation and management. The latter is critical to expanding project capital structures to institutional sources of both equity and debt. It is also consistent with directly confronting the many barriers to mobilizing capital for development. Not least among these are information asymmetries, underdeveloped local capital markets, and institutional and capacity gaps—whether legal, regulatory, or governance related.[6] Still, DFIs and their partners continue to struggle to narrow not only the SDG gap, but also the widening gap in global infrastructure.

In response to both the discrete structural challenges of sustainable development and a persistent shortage of both human and financial capital, a growing number of emerging economies have established sovereign investment programs designed to mobilize inward direct investment.[7] Labelled strategic investment funds (SIFs) by the World Bank,[8] SIFs are distinct in the broader realm of sovereign wealth funds (SWFs) in that they invest primarily or exclusively domestically with a focus on strategic sectors of the national economy, often with foreign public or private investment partners. The objectives of this paper are to understand sovereign wealth funds in the broader context of global development finance in order to provide a critical overview of SIFs as agents of national development, and to introduce one such case—the Palestine Investment Fund (PIF)—to illustrate key features and attributes of SIFs that, we suggest, are essential to the successful execution of their mandates.[9]

PIF traces its origins to the signing of the Oslo Accords between the Palestinian Liberation Organization and the Israeli government in 1993.[10] The agreement brought hope of peace to the Middle East and of independent statehood for the Palestinian people. Political optimism fueled robust economic growth, which supported private-sector investment, augmented by significant donor contributions. Anticipating the development needs of a future Palestinian state, Yaser Arafat issued a presidential decree in 2000 establishing the Palestine Investment Fund with a mandate to manage the commercial activities of the Palestinian government for financial return. PIF was formally established as a public shareholding company in 2002 after consolidating the commercial assets and investments held by the Palestinian government. Its total capital at the time was USD 574 million, representing the aggregate value of consolidated assets.[11] During its initial years, PIF focused primarily on achieving its financial return objectives. However, as the peace process stagnated and donor funding declined, PIF adapted its strategy to play a more active role in the Palestinian economy, aiming to achieve specific economic and social strategic goals through interventions and strategic partnerships. The Fund is an active member

of the global institutional investment community, a full member of the International Forum of Sovereign Wealth Funds (IFSWF), as well as a member of the Global Impact Investing Network (GIIN).

SOVEREIGN WEALTH FUNDS AND DEVELOPMENT FINANCE

Often, contemporary discussions on solving for development capital shortfalls include sovereign wealth funds among potential sources of funding available for direct investment. Such arguments center on the capacity of sovereign funds as long-term investors to finance development projects in emerging economies at scale.[12] However, the empirical evidence of sovereign wealth fund investment in emerging economies, particularly in projects involving national development, is scant at best. Of the approximately one hundred sovereign wealth funds that are thought to exist, only about twenty-five very actively engage in direct – as opposed to strictly portfolio – investment internationally.[13] These are generally large funds with very diversified portfolio holdings, typically with long-term savings mandates. They include, for example, the Abu Dhabi Investment Authority, the Government Investment Corporation of Singapore, the Government Pension Fund Global (Norway), the China Investment Corporation, the Kuwait Investment Authority, and the Qatar Investment Authority. The evidence across a sample of over 2,000 direct SWF investments since 2006 strongly indicates that the majority of sovereign wealth funds that invest directly prefer to deploy capital in developed market economies (amounting to some 52 percent of all transactions over that period) as opposed to emerging economies.[14] This distribution is consistent with the 2023 Kearney DFI Confidence Index rankings.[15] Rather, direct investment by sovereign wealth funds in emerging economies has generally been concentrated geographically, with some 22 percent directed to India and China alone. Thus, taken together, these data suggest that SWFs, as direct foreign investors, have to date not been a major source of development capital for emerging economies.

Traditionally, sovereign wealth funds were established to diversify and enhance the return of liquid reserve assets and/or to promote inter-generational equity through long-term savings. Alternative SWF mandates have been less well studied but are equally as relevant from a macro-economic perspective. Among these are so-called development mandates, whose contemporary origins can be traced to Temasek. Temasek is a state investment company of the Singaporean government, whose original mandate was to manage publicly held, but unlisted state-owned enterprises, such as

Singapore Airlines, with the ultimate goal of privatizing these holdings to recycle capital for future investment. Other sovereign development funds have studied, and some have attempted to implement, its model. Typically, development funds invest exclusively domestically. This is not only consistent with short-term economic and fiscal planning objectives, but also a long-term national development agenda or plan. Since 2010, the number of sovereign funds with domestic mandates has increased substantially, growing from approximately 8 in 2010 to nearly 30 in 2023.[16]

While many early development funds centered primarily on managing state assets, more recently established funds have assumed hybrid mandates that have significantly extended their operational reach beyond asset management. These can include targeting discrete economic bottlenecks, supporting the diversification and sustainable development of a state's economy, building out its strategic sectors, and/or expanding the breadth and depth of local capital markets. Importantly, many such mandates have included the parallel objective of mobilizing foreign institutional capital to supplement traditional sources of development finance. Introduced above as strategic investment funds, the World Bank identifies SIFs as having several core characteristics. In the World Bank's assessment, SIFs are government- or DFI-capitalized and invest predominantly in unlisted assets to achieve both financial returns and policy objectives. They deploy long-term patient risk capital, executing as professional investment managers. Their aim is to catalyze co-investment at the fund or project level.[17] In the period between 2000 and 2019, over thirty funds were established with national strategic mandates.[18] These ranks have expanded in recent years to include, for example, funds in Egypt, Indonesia, and Ethiopia.

The boundary between traditional development funds and strategic investment funds is ambiguous at best. Notwithstanding this, a core distinguishing feature of SIFs is their intended role as an anchor partner that can de-risk foreign capital, while serving as a credible professional conduit for both foreign and private investment in domestic projects. This can be an especially challenging task and requires consensus among policy elites, institutional clarity of purpose, and diligence in execution if the market frictions that impede the flow of foreign direct investment (i.e., institutional shortcomings and other threats to economic, social, and political stability) are to be overcome.[19] Poor execution by government-owned investment funds, including SIFs, can unquestionably undermine national objectives by conflating budgetary and extra-budgetary resources, directing scarce capital to underperforming projects, or by allowing leakage to occur through poor governance or patronage.[20] Thus, in its multi-year

initiative to document the formation and operational practices of SIFs,[21] the World Bank has found that a well-functioning SIF must be: 1) legitimate in the eyes of both domestic and international stakeholders; 2) secure in its permanency; 3) adaptable to shifts in national priorities; 4) receptive and responsive to the requirements of commercial investors; 5) sensitive to distortive effects (i.e. "crowding-out") of its own participation in or engagement with local markets; and 6) committed to effective execution of its mandate through an optimized organizational design that reflects strong governance, independent management, effective monitoring and auditing, and operational transparency that builds trust with investment partners and effectively aligns multi-stakeholder interests.[22]

However, is an optimal design and governance framework sufficient to achieve strong operational and investment performance and to attract foreign and/or private capital? The operational performance of the SIF is ultimately determined by its ability to originate and fund bankable investment projects at returns consistent with the risk-return profiles of co-investment partners. Effective execution rests on the ability of its investment teams to leverage its access to, and understanding of, local resources, including those of its government owner; to exploit domestic market informational advantages; to enforce transactional governance in the local market; and to mitigate operational and political exposures that emanate from institutional gaps, i.e. to de-risk.[23]

How then to assess the operational performance of SIFs? First, it is important to consider the return structure of their performance. Strategic funds often have hybrid mandates, which makes a robust analysis of performance potentially challenging. Moreover, most strategic funds invest primarily through risk assets (i.e. equities) under a so-called double bottom line objective that pursues both financial and socioeconomic returns. In this respect, such mandates can resemble those of national development banks and therefore require a more nuanced approach to assessing and reporting on performance that necessarily precludes comparisons with other sovereign wealth funds or long-term institutional investors.[24] Generally not concessionary, SIF returns can reflect positive externalities, i.e. benefits to discrete populations, sectors, and the local economy more broadly, some of which are difficult to identify precisely and to measure. Thus, while traditional cash flow return measures, such as internal rates of return, can be useful tools, they must be augmented with the use of key performance indicators (KPIs) to develop a more complete view of the utility of capital deployed by all stakeholders. In this regard, performance assessment and reporting can resemble that of private equity investors with discrete impact mandates.

PIF's mandate, organizational structure, governance, and overall operating model is consistent with the stylized portrayal of the strategic investment fund which we have outlined. PIF pursues a "double bottom line" mandate of contributing to economic development while targeting an acceptable rate of financial return.[25] In pursuing this dual mandate, PIF views partnerships with the private sector and international institutions as central to bridging the public investment gap, reducing funding fragmentation, and supporting innovative solutions to Palestine's socioeconomic problems, including stimulating private-sector growth and creating job opportunities for youth. Thus, PIF's investment strategy focuses on investing in, and attracting investors to, strategic projects in key but underdeveloped sectors of the Palestinian economy: renewable energy, healthcare, agriculture, infrastructure, real estate, technology, entrepreneurship, and the capital market in Palestine. To this end, in attracting investments to Palestine, PIF sees its role as catalytic and focused on reducing the risks associated with these investments. In doing so, PIF originates ideas and bears the majority of, if not the total, development cost.

PIF: MANDATE, GOVERNANCE, AND ORGANIZATIONAL DESIGN

At its inception, PIF inherited various holdings across industries in different forms, including publicly traded shares, private equity investments, funds units, and debt instruments. PIF's first task was to consolidate these investments under one entity with a clear vision and mandate, establish a proper governance structure, and set a framework for accountability, transparency, and disclosure.[26] Today, PIF manages its investments in two principal subsidiaries: Amaar Group and Aswaq Investments. Amaar Group is PIF's impact investment arm that manages real estate, tourism, agriculture infrastructure, and traditional and renewable energy investments. Amaar Group plays a vital role in the initiation of new projects and the attraction of investors to these sectors. Aswaq Investments manages a portfolio of holdings in the local and international capital markets, including private equities, with the primary objective of achieving a financial return. In addition, Aswaq manages strategic investments in existing local companies operating in core sectors of the Palestinian economy, including healthcare, pharmaceutical, telecommunications, manufacturing, and banking. These investments aim to achieve targeted financial return while positively contributing to development indicators.

The foundations for PIF's governance structure are set out in its bylaws, which established PIF as a separate legal entity with financial

and administrative independence from the Palestinian government. As a public shareholding company, PIF has an independent board of directors and general assembly and adheres to Palestinian corporate law governance, reporting, and disclosure requirements.[27] PIF's governance structure is further embedded in internal policies and documented in a comprehensive governance and procedures manual based on best practices to ensure strong internal controls, proper authorization, and transparent operations.

PIF's strategic direction is set by a general assembly comprising thirty independent members appointed by the Palestinian president for three years and represents the business community, academia, regulatory agencies, and civil society. The general assembly also approves annual reports and financial statements, appoints external auditors, and approves the distribution of dividends to the Palestinian treasury. The strategic direction is then translated by a board of directors into investment strategy, objectives, an asset allocation framework, and financial and development KPIs. The board consists of nine independent members appointed by the president from leading business professionals, economists, and policymakers. The board oversees the executive management of these strategies in addition to the management of PIF's daily activities. The board exercises its duties through four board committees: a governance committee, an audit and risk committee, an investment committee, and a human resources committee.[28]

PIF's annual financial statements are audited by an international accounting firm and published in its annual report, and posted on PIF's website. In addition to external audits, PIF operations are subject to internal audit by an internal audit department reporting to the board audit committee. Under Palestinian law, PIF is subject to audit by the State Audit and Administrative Control Bureau, which reports to the government and the legislative council.[29]

ALIGNING PIF INVESTMENT STRATEGY WITH PALESTINE'S NATIONAL DEVELOPMENT CHALLENGES

The Palestinian economy, with a total GDP of USD 15 billion for 2021, faces two significant challenges.[30] The first is a persistent and substantial trade deficit: imports reached USD 8.19 billion in 2022 against total exports of USD 1.58 billion.[31] The second is a chronically high unemployment rate, which reached 25 percent in 2022, including 48 percent among youth graduates (19 to 29) with diploma certificates and higher.[32] These challenges in particular inform PIF's investment strategy and asset allocation. To address them, PIF has implemented a targeted strategy that

focuses on sectors and products that represent the most significant portion of the trade deficit. These include electricity, with an annual deficit of approximately USD 620 million, followed by animal feed at about USD 291 million, cement at USD 184 million,[33] and healthcare at USD 80 million.[34] With respect to strategic sector development, targets focus on those sectors with the highest potential for job creation, including small and medium enterprises (SMEs), real estate, agriculture, and technology.

In the energy sector, for example, PIF has launched several initiatives in both traditional and renewable energy. These include the Noor Palestine Solar Energy Program, with electricity generation capacity of 200 megawatts (MW), and the development of a new gas-fired power plant in the northern West Bank with capacity of 450 MW, representing 40 percent of Palestine's electricity consumption.[35] In the SME sector, PIF partners with local banks and international institutions to provide loan guarantee programs for credit facilities of USD 230 million,[36] while also targeting programs to further empower SMEs and microfinance institutions in Jerusalem and in refugee camps in Lebanon. To this end, PIF has a special fund for investment in SMEs to enable job creation across Palestine.[37] To promote the localization of healthcare services, PIF has partnered with private investors to build out a healthcare portfolio that includes five hospitals.[38] Three are fully operational, the fourth is under construction, and the fifth is in the planning stage. Each of these facilities contributes to the reduction of medical referrals abroad and creates local employment for doctors, nurses, technicians, and other healthcare professionals. More broadly, PIF's investment portfolio also includes cement production, animal feed production, food processing, and pharmaceuticals,[39] which together reduce import dependence while expanding a foundation of national competitiveness.

In aggregate, over fifteen years across 120 partnerships with the private sector and international organizations, PIF's investment program has spanned over sixty discrete projects with total invested capital of USD 2.1 billion, including USD 1.2 billion of partner investments. These investments helped create and sustain over 77,000 job opportunities, support over 13,000 SMEs, and contribute USD 2.9 billion to Palestinian GDP.[40] In addition to delivering development impact, PIF's cumulative earnings since inception have totaled some USD 1.15 billion, of which USD 783 million have been distributed to the Palestinian treasury as dividends.[41]

SUSTAINABILITY IN PRACTICE: PIF LEADERSHIP IN ELECTRICITY, HEALTHCARE, AND COVID-19 RELIEF

Electricity accounts for a significant portion of the Palestinian trade deficit. At an importation rate of over 98 percent, this amounts to USD 620 million.[42] To address this issue, Massader for Natural Resources and Infrastructure Development,[43] PIF's portfolio company in the energy sector, is partnering with local and international investment institutions to invest in both the traditional and renewable segments of the Palestinian energy sector to expand local power generation capacity and reduce imports. Despite abundant renewable energy potential, with an annual average of 3,000 sunshine hours and average irradiation levels of 5.4 kilowatt hours per square meter per day,[44] fully exploiting these resources is currently beyond Palestine's reach. First, because 61 percent of the West Bank's land, known as Area C, is under Israeli control with restricted use, land availability is a considerable constraint.[45] Second, with 270 interconnection points between Israeli electricity suppliers and Palestinian centers of demand, the absence of an integrated electricity grid represents a substantial bottleneck to transmission.

The Noor Palestine Solar Program, noted above, is a Massader-invested initiative to support the development of the renewable energy sector in Palestine, aiming to generate 200 MW of renewable energy (14 percent of the West Bank's electricity needs)[46] through scalable, inclusive, and innovative green energy solutions. The program includes two main components, utility-scale solar parks and rooftop solar for schools, and is expected to reduce imported electricity by USD 50 million annually. The geographically dispersed utility-scale solar parks program was launched specifically to overcome the technical obstacles related to the absence of a national grid. For its part, Massader, working with distribution companies, assumes all risks associated with developing and constructing the parks and ensures their connectivity to the local grid. Its model is based on clustering several large consumers to offset their energy consumption and create savings on their electricity bills. This project targets the manufacturing, healthcare, and agriculture sectors. The schools' solar rooftops program involves installing solar systems in 500 public schools in the West Bank and East Jerusalem with a total capacity of 35 MW.[47] The project aims to introduce sustainable green energy to schools to cover their electricity consumption, while generating excess energy for sale to distribution companies, expanding employment and freeing budgets for education investment. As importantly, beyond the impact of these investments on the national

economy, they have contributed directly to both institutional development and capacity-building by accelerating the process of enacting new laws and regulations to facilitate investment in renewable energy. Additionally, they have incentivized consumer utilization of renewables and built national technical capacity in the field, while encouraging additional private sector investment in solar energy projects in Palestine.

A second intractable challenge facing the Palestinian government is rising expenditure on medical referrals, due to limited capacity in the Palestinian healthcare sector. Referrals are primarily to Israel and Jordan and mainly for cancer treatment. To address such capacity constraints and to localize medical treatment, PIF has partnered with the Arab Specialist Medical Complex Company (ASMC), which invests in and manages several hospitals in Palestine, including Arab Specialized Hospital in Nablus and the Istishari Arab Hospital in Ramallah. Through this partnership, the ASMC has added a department for the treatment of blood diseases and cancer to the Istishari hospital and has expanded its network with new hospitals: the Ibn Sina Specialized Hospital in Jenin, Al Istishari Hospital for Cancer Treatment (under construction), and Istishari Arab Hospital in Hebron (in the planning stage). Al Istishari Hospital for Cancer Treatment will be a milestone in developing the healthcare system in Palestine. It will offer cancer patients diagnostic and treatment services, including chemotherapy for adults and children, nuclear medicine therapy, and oncology clinics. This hospital in particular will reduce medical referrals abroad, while providing high-quality local healthcare and strengthening Palestine's overall capacity to deliver medical services.[48]

The abrupt onset of the COVID-19 pandemic in Palestine brought swift implementation of a state of emergency and closure of nonessential businesses. These measures were critical in containing the COVID-19 outbreak in Palestine. However, the economic costs were significant, particularly for the small and medium enterprises (SMEs) that are the backbone of the Palestinian economy, constituting 98 percent of all operating businesses, and represent the largest employer segment in the country.[49] In mobilizing COVID-19 relief efforts to address the economic consequences of the pandemic, PIF focused its support on maintaining the ongoing operation of SMEs to mitigate their vulnerability to the pandemic's impact. In addition to ongoing SME programs, PIF launched a special Esnad emergency program that finances facilities of over USD 31 million to provide liquidity relief to the smallest and most vulnerable SMEs. The program supported 1,500 entities to cover operating costs during the pandemic and maintained 2,600 jobs.[50] More broadly, by leveraging expertise and part-

nerships, PIF programs were able to sustain over 4,440 SMEs during the pandemic.

PIF TAKEAWAYS: THE ROLE OF SWFS IN SUSTAINABLE DEVELOPMENT

The significant contributions of PIF to Palestinian national development notwithstanding, the imposing gap to achieve the UN SDGs remains. That SWFs, as large global investors with stabilization, savings, reserve management, or even development mandates, can contribute meaningfully to closing that gap through direct investment in emerging economies is at best a simplistic contention that potentially obscures the very real role that sovereign investment can play to advance sustainable development. The experience of PIF in fact highlights the capacity of emerging economies to identify domestic barriers to capital flows and then to design innovative strategic investment strategies – and vehicles - to close institutional gaps and leverage limited domestic resources to mobilize inward flows of both human and financial capital.

The dispersion and progressive growth in the numbers of SIFs globally since 2011 substantiates the utility of an approach to national development that is based on strong governance and is focused on fulfilling the dual mandate of financial returns and meaningful and measurable environmental and social impact. Hardly panaceas, SIFs can nonetheless return control of the national development agenda—and responsibility for its execution—back to national governments. Speaking at the IFSWF 2022 Annual Meeting in Baku, Papa Demba Diallo, CEO of FONSIS, Senegal's strategic investment fund, acknowledged this duality: "the role of the corporation is not to make profit," he stated definitively, "but to make impact. The role of profit is to make impacts last."[51] ***f***

ENDNOTES

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