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Considering a US Federal Sovereign Wealth Fund

Could a Sovereign Wealth Fund Secure America's Economic Future?

Sovereign funds have come into their own on the global investment front. Over the past decade plus, sovereign funds from around the globe have expanded their capabilities, improved their reputations and increased transparency such that they have gained well deserved acceptance as mainstream investors and asset managers across public equity, private equity, real assets, and credit.

Throughout this period, the US has often been the market of greatest interest for deployment of foreign sovereign capital. The relative size and attractiveness of US capital markets has remained second to none. At the same time, the US tax code provides one of the most generous tax privileges available to foreign Sovereign Wealth Fund (SWF) investors as compared to the tax treatment provided by other countries to these institutions.[1] Foreign sovereigns provide substantial capital to US markets, and in return obtain strong commercial returns with access to US tax privileges. It is an arrangement that benefits all involved: investors, investees, and the US population more broadly.

By contrast, US sovereign institutions have generally not kept pace with their global peers. While the US has enormous pools of public capital deployed and deployable (e.g., public pensions, state sovereigns, and certain federal [e.g., Social Security] funds), the investment model for US sovereigns has been relatively passive and indirect. As a result, US sovereigns typically outsource investment activities to third parties (incurring substantial management fees), adopt passive investment models, or both. This can result in substantial foregone revenue opportunities for US sovereign institutions when compared to the results achieved by foreign peers. Further, when US sovereign capital is deployed abroad, it rarely has access to corresponding tax privileges offered by the US.[2] The result is a relative economic shortfall for the beneficiaries of the various pools of US sovereign capital.

Perhaps recognizing the benefits that other countries have realized from their SWF activities, US President Donald Trump on February 3 ordered the Secretaries of the Treasury and Commerce to develop a plan for the establishment of a federal SWF for the US ("the Order"[3]). As part of the administration's related communications, President Trump suggested that the United States could create a SWF to manage and invest national resources, potentially leveraging the country's vast economic assets. The fact sheet specifically references $5.7 trillion in directly held federal assets plus the value of the extensive US natural resource reserves as potential funds for investment. The President's original idea was to use this fund to invest in US infrastructure and other national priorities. A plan must be submitted by May 4, and "shall include recommendations for funding mechanisms, investment strategies, fund structure, and a governance model." (The Treasury intends to establish the fund in the next year.)

The Order thus represents a unique opportunity for the US to reflect on its current approach and future vision to join the ranks of those successful, active sovereign investors for years to come. There are great potential benefits to a more evolved model, including financial and government security considerations; however, it will not be a quick or inexpensive journey to achieve the model or the results that have been posted by the global sovereign fund community over the past decade. In addition to substantial investment

[1] IRC section 892. The US tax policy for providing such privilege, as well as the basis for providing such privilege as a matter of sovereign immunity principles, is beyond the scope of this paper.

[2] 2022 SWF Global Tax Guide - Updated guide to be published in Summer 2025.

[3] A Plan For Establishing A United States Sovereign Wealth Fund – The White House

into resources, important cultural and philosophical considerations must also be addressed to make a US sovereign fund successful (including the expanded role of government in investing for financial gain, risk management, and the potential for conflicts of interest—to name just a few). A serious, informed debate regarding a US federal sovereign fund is thus warranted.

In this article, we provide background on the evolution of sovereign funds and the current role of sovereign capital around the globe. We also consider sources of funding for a US sovereign fund, and the possible impact that a successful sovereign investment program could provide the US, financially and by strategically increasing domestic control considerations. Finally, we briefly discuss the tax exemption provided by the US to foreign sovereigns and the potential for the US to seek reciprocal benefits.

Part 1: What are sovereign funds?

At their most basic level, sovereign funds represent capital aggregated by sovereigns (governments) for various reasons and deployed for investment purposes. For the purposes of this article, we will focus on two primary types of sovereign investors (1) "classic" SWFs and (2) public pension funds ("PPFs"). Depending on the fund, investments may be limited to opportunities within the country, opportunities outside of the country, and/or other specific limitations as further discussed below.

Classic SWFs are generally established for a specific remit. These are essentially state-owned investment funds that manage capital frequently derived from revenues generated by natural resources, trade surpluses, or other sources. The assets under management ("AUM") of SWFs is substantial, often individually and certainly in the aggregate.[4] The remit for each SWF is typically defined in local country legislation or policy and can include stabilizing an economy, saving for future generations, and/or diversifying national income sources. SWFs are typically investing very large sums of capital with quite long-term goals. The vast size and long-term perspective of SWFs can make them ideal sources of capital for businesses, and they often provide ballast for short-term disruptions in the markets. We saw this play out in the global financial crisis ("GFC") when SWFs provided much-needed capital to many US and global financial market participants. In fact, in many ways the helpful role played by SWFs during the GFC led to the acceptance of these funds into the more central role they play today.

The second type of sovereign funds for our purposes are PPFs. These are pools of capital, established by sovereigns for retirement (and sometimes other, e.g., long-term/disability) benefits.[5] PPFs have liabilities, unlike classic SWFs, based on the actuarial/payout obligations to underlying beneficiaries. PPFs around the world have evolved significantly over the past few decades, particularly in countries such as Canada, Australia, and those in Northern Europe. Notably, many Canadian pension funds have transitioned to very sophisticated direct investment models.[6]

This shift, often referred to as the "Maple Revolution," has been mirrored by many Australian funds, as well as pension funds in Denmark and the Netherlands.

As a result, successful global SWFs and PPFs have expanded their internal investment teams and significantly enhanced their capabilities to directly manage vast sums of capital. These enhancements have been adopted not only in home country jurisdictions, but also through a strategic push towards international investment and direct management in other financial centers through the opening of foreign subsidiary offices. These foreign offices have proven to be drivers of positive returns by providing in-person connectivity to local market activities and experience without needing to move talent away from major financial centers (like New York, Silicon Valley, or London).

It is important, and sometimes difficult, to contrast SWF and PPF investment activities that are made for financial returns with capital that is deployed by governments for purposes more traditionally associated with core government spending (e.g., social programs, defense). The line can blur (e.g., investing into infrastructure such as an airport or highway which may be made to serve a direct government/societal need, or may be viewed as an investment opportunity for financial gain). As a result, one of the early challenges to the acceptance of capital from foreign sovereign funds was the skepticism that investments were being made not for financial gain but rather to obtain undue influence through economic leverage or by gaining access to information made available because of owner or investor status.

To address this concern, in 2008, 26 member countries of the International Forum of Sovereign Wealth Funds came together (in Santiago, Chile) to develop and adopt the "Santiago Principles", a principle-based and voluntary approach to governance, investment, and risk management for SWFs. As stated in the Objective and Purpose of the Santiago Principles, "[Sovereign] investments have helped promote growth, prosperity, and economic development in capital-exporting and -receiving countries. In their home countries, SWFs are institutions of central importance in helping to improve the management of public finances and achieve macroeconomic stability, and in supporting high-quality growth." The principles generally focus on transparency, clear purposes and guidelines, and professional and ethical conduct of sovereign fund activities

[4] As reported by Global SWF in its 2025 Annual Report, the total AUM of SWFs globally is estimated to be $13 trillion, with several of the largest funds exceeding one trillion dollars individually. Total AUM of SWFs, PPFs, and central banks is estimated to be $54.9 trillion.

[5] Examples include: Stabilization Funds (intended to stabilize the national economy by buffering against volatile commodity prices and economic shocks, such as Chile's Economic and Social Stabilization Fund); Savings Funds (intended to save wealth for future generations, ensuring long-term financial security and intergenerational equity, such as Norway's Norges); Reserve Investment Funds (intended to earn higher returns on excess foreign exchange reserves, such as Singapore's GIC); and Development Funds (intended to support national economic development and diversification by investing in strategic sectors and infrastructure, such as United Arab Emirates's Mubadala Investment Company).

[6] There are also Central Banks and other State-Owned Enterprises that could be considered (and act like) SWFs, but we will set those aside for purposes of this discussion.

to ensure protection of the sovereign state and a positive effect on global financial markets. Investee countries shared feedback on the principles. Importantly, the US was a member country and host of one of the meetings leading to the Santiago Principles. These principles, as well as the more transparent activities of sovereign funds (including during the GFC, mentioned above), have gone a long way to reduce the skepticism surrounding sovereign capital.

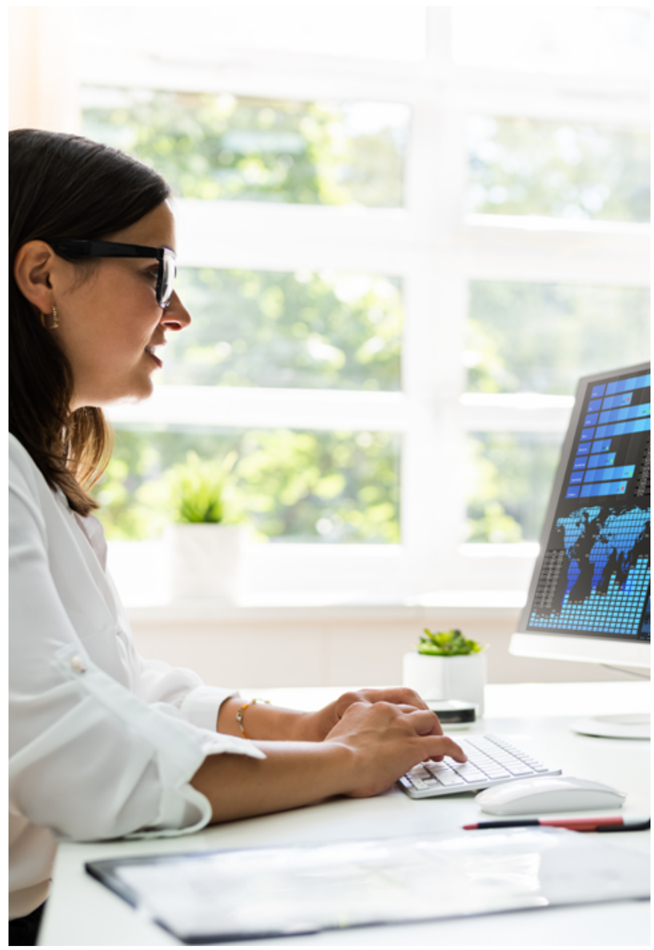
A certain level of skepticism endures, however, such that transparency and reputation are of great importance. Poorly managed, a national SWF could be detrimental economically and reputationally. It could be viewed as a form of "pay to play", targeting investments to private businesses that do not deliver financial returns for the public but rather deliver political results to those in control of the fund would be enormously detrimental. Scandals like the 1Malaysia Development Berhad (1MDB) situation have seen SWF funds misappropriated, diverting money to private citizens and political campaigns, including financial mismanagement through excessive payments to contractors, instead of promoting the stated goals of the fund.

Part 2: Does the US even have the capital available for a SWF?

The Order references $5.7 trillion of available capital for such a fund, and the President has stated that a federal SWF should have approximately $2 trillion in AUM. This would make it among the world's largest fund. At the same time, many are skeptical that the US has the capital available for a sizeable US national SWF by pointing to certain traditional sources of SWFs capital, such as mineral royalties, foreign reserve balances and trade surpluses. Looking only to these sources on a historic basis, however, is exceedingly narrow. Based on conservative estimates, the US capital already being managed as sovereign capital (SWF and PPF) across federal and state funds exceeds $15 trillion.[7] So where is this capital?

First, the US does in fact have sovereign funds. Many years ago, the US was prolific in establishing classic SWFs at the state level. Some of these funds still exist (the Alaska Permanent Fund, the Texas Permanent School Fund), but they are relatively small. The Texas Permanent School Fund is thought to be the first sovereign investor and was formed in 1854. It has almost $57 billion in assets today, which it invests to support Texas public schools. In total, the 23 state funds that still exist have $359 billion in AUM, which equals the size of some significant investment market players. While they have a strong history and admirable purpose, these funds are managed in a decentralized manner from an overall US perspective, and do not band together or with the power of other US public assets to act as a major market player.

The second, much larger source of funds are our US PPFs which are quite substantial in terms of size and represent far and away the largest aggregate AUM globally for PPFs of any country standing at around $12 trillion. Currently, their participation in alternatives is frequently via external fund managers. As such, their direct participation in sophisticated financial transactions can be quite limited. This means that they generally are not sharing in management fee income, participating in portfolio company governance, or realizing other value like some foreign peers. Beyond this large pool of state sovereign PPFs, there are other massive pools of US sovereign capital.[8] The US Social Security Trust Fund, for example ("Trust Fund"). As of the latest available data, the aggregate AUM of the Trust Fundis $2.9 trillion.



[7] Based on data from the Sovereign Wealth Fund Institute.

[8] On the US tax front, this class of investor is often referred to as "super exempt"—a term that is used somewhat loosely, and often interpreted to mean that there are no US federal or state filings or tax payments required of these funds full stop. This position is sometimes based on section 115, sometimes based on more fundamental/broader sovereign immunity claims. Either way, the tax functions within these organizations are understandably limited or non-existent as there is no need to consider taxes as a domestic matter. But when they invest cross border, or into more sophisticated structures, internal resources in this regard can be beneficial.

We have the capital. So how have we been investing it?

The short answer is largely as passive indirect investors, observers of the journey taken by our global peers, and paying for the services of external managers. Moving away from this model is expensive. Building internal resources and capabilities to operate like non-US SWFs or PPFs requires considerable investment in people and technology, and important culture change in the management (and ownership) of risk. The need for investment into internal resources at scale, to potentially manage many trillions of dollars as set forth in the Order, needs to be carefully considered.

Successfully managing large sums of capital directly necessitates the employment of investment professionals with sophisticated skill sets and corresponding compensation levels—more commensurate with bankers and private funds than typical government pay bands. The leading sovereign investors around the globe have taken this step towards upscaling, with staff headcount into the thousands. So a threshold question is whether the US sovereign will recruit and pay for the skill sets needed to manage these funds directly, or will the US sovereign act as another level of passive intermediary? These are economic and cultural considerations that will need to be anticipated.

What incremental economic benefit might an actively managed (global model) US SWF provide?

While difficult and imprecise, we can try to directionally estimate the difference in returns that might be obtained via an actively managed US sovereign by comparing the results achieved through means of passive sovereign management with those of a well-run (generally considered low-risk), global SWF investor: Norges Bank. Here again, the point is not to draw conclusions but rather to raise important considerations. Last year, Norges achieved a return of $220 billion on its $1.7 trillion of AUM.

If we start with the Trust Fund, at around $3 trillion, with activities like the Norges SWF, could we anticipate an approximate $390 billion return? While returns for the Trust Fund are not typically broken down year by year in public reports, they generally mirror the yields on medium- to long-term US Treasury securities, which have ranged from approximately 1% to 3% over the past decade. This is because the Trust Fund is subject to very limited investment options (treasuries) to ensure liquidity. If we use the high end (3% return), then the return was likely $90 billion versus $390 billion.[9] The additional $300 billion in annual return would go a long way to solving for our Social Security funding deficit. In fact, according to the 2023 Social Security Trustees Report, the present value of the 75-year shortfall is approximately $22.4 trillion. This deficit could be largely eliminated if the Trust Fund achieved compounding returns commensurate with global sovereign capital. Appreciating that there are many important considerations to actively manage any portion of the Trust Fund, it is something to at least consider.

The same general comparison can be applied to our state PPFs. Our PPFs generally do not restrict themselves to investing in treasuries, so their return is better than the Trust Fund. That said, like the Trust Fund shortfall, there is also a shortfall for many US public pension systems, often referred to as the "unfunded liability." This a significant concern for state and local governments. The exact figure can vary depending on the assumptions used for investment returns, discount rates, and other factors, but estimates of the total unfunded liability for US public pension systems typically range from $1 trillion to over $4 trillion.[10] Suffice it to say that anything that can increase the rate of return on a net basis—such as improved capabilities and access to the largest, most lucrative investment opportunities available to sophisticated global sovereigns—would be quite beneficial in this respect. And the publicly available information bears this out. Based on estimates using publicly available data, over the past decade, the Canada Public Pension Investment Board has seen an average annual growth rate of around 10%, and Australia's superannuation system experienced an average annual growth rate of about 8 to 9% over the past decade. Contrast this with the average annual growth rate for US public pensions over the past decade, which has been around 7%. The extra 2 to 3% per year, compounded year over year, would go a long way toward eliminating the shortfall.[11]

While the Order does not explicitly reference an intention to invest our social security or PPF funds, it seems clear that the US government is taking the foregone opportunity seriously and looking at how we can participate in sophisticated investment like the current global players. By aggregating this capital from various US sovereign pools, the infrastructure and personnel can be centrally built, leveraged, and deployed to the benefit of the beneficiaries behind the pools. This would be a much more efficient, timely, and impactful approach than expecting each US SWF and PPF to independently play catch-up to the global momentum.

[9] Note that the average return for the Norges SWF is 6.34%, so lower than the results from the most recent year. That said, the average rate of return of 6.34% is still more than twice the (high end) estimated return for the Trust Fund.

[10] State and local government pension plans are the primary contributors to this shortfall. Some of the most underfunded state pension systems include those in Illinois, New Jersey, and Kentucky, among others.

[11] The comparison of returns across funds for any single year is challenging, in part due to management fees and staffing costs, as well as volatility of public markets. A multi-year average provides some directional insight.

Part 3: Beyond the numbers

As noted, foreign sovereign capital plays a crucial role in US financial markets and our private and public sector participants are greatly appreciative and highly reliant upon this reliable and sophisticated source of capital.

That said, one policy-related question is how comfortable is the US government in having large assets owned by non-US governments—our public companies, important real estate tracts, or infrastructure (ports, waterways, data centers, and power transmission), to mention just a few? And could a US SWF be used to address this concern? Recently, the administration floated the idea of using the proposed US SWF to invest in TikTok. Thus, it seems clear that the US government has seen certain foreign investment in business activity in the US as politically sensitive and believes that a US SWF investing public assets could alleviate these concerns. Other potential investment targets mentioned for the new US SWF have included medical research and infrastructure projects, suggesting that protecting national security and public health and well-being is being considered along with financial returns in building the case for a federal SWF.

With a US sovereign investor, the US could decide which industries would most benefit from foreign investment and which would benefit from domestic investment and use capital allocation for a return (rather than interest-free loans and tax incentives) to achieve those strategic priorities. The US could also use its local investment management talent to benefit the US public, rather than private and foreign interests, if the federal SWF is a professional market participant paying sufficient compensation to attract civic-minded professionals.

Further, a strong US sovereign investor could reduce the cost of US infrastructure and capital by incentivizing domestic investment instead of foreign investment (as tax incentives for foreign investment are never returned in tax to the US public but financial returns to the US public will ultimately be subject to US tax). And there is precedence: US allies like Canada already strongly incentivize domestic investment by local PPFs through their tax policies because they are less interested in attracting foreign capital for infrastructure investment.

Finally, from a financial perspective, some have suggested that a large US SWF investing primarily into US private markets might exacerbate existing constraints in those markets, either crowding out private investors in certain asset classes or distorting market dynamics.

Part 4: The question of taxes

As noted above, the US has one of the most generous tax exemptions for sovereign wealth in the world. The US offers complete exemption on US dividend and interest withholding tax (otherwise due at 30%) and exemption from capital gains tax on certain stock sales, among other income types, for sovereign investors who are not engaged in "commercial activity." This provision has been in the US tax code since the 1934 Act. The definition of commercial activity is imprecise and beyond the scope of this paper, but most foreign SWFs and PPFs can invest passively in significant (up to just under 50%) stakes in US private equity, real estate, public equity, and public and private credit without paying any shareholder-level tax. While the foreign governments cannot "control" the investee companies or receive income from commercial activity, they can benefit from section 892 even when potentially influencing the terms of equity and credit investments and portfolio company operations. The US also offers full exemption from its tax on foreign investment into US real property for qualifying foreign PPFs, through a more recent exemption that was introduced in 2015.

Certain other jurisdictions have sovereign tax exemptions that are like or more favorable than that provided by the US. For example, the United Kingdom has a very generous exemption that includes more commercial types of activity (in addition to the lack of domestic tax on dividends and certain share sales). Most countries, however, have much more limited sovereign tax exemptions that typically do not apply to the private equity, real estate, and similar investments that have driven outsized returns for this investor class. Many jurisdictions offer no special tax benefits to foreign government or pension investors. This begs the question whether the US might move in a more restrictive direction to align with other jurisdictions.

The Trump administration is very **focused on global tax and trade "fairness,"** where fairness can be interpreted to mean that the US should not offer more favorable tax or trade benefits to other governments than those governments offer to the US.

Speaking about tariffs, the president said, "[W]hatever countries charge the United States of America, we will charge them no more, no less. In other words, they charge us a tax or tariff, and we charge them the exact same tax or tariff. Very simple."

Considering the imbalance between sovereign tax exemptions around the world, the potential establishment of a US federal SWF, and the heavy reliance of foreign SWFs and PPFs on the exemptions provided by the US, some question whether there might be a change in the relevant US tax rules. There are no current proposals that would broadly change the tax benefits the US offers to SWFs and PPFs, but in the current US policy environment, it is difficult to say anything is off the table.

Conclusion: Where does this leave us?

Based on a fact sheet accompanying the president's proposal to create a US federal SWF, the proposal has two key motivations: ensure the long-term competitiveness and fiscal sustainability of the US and pursue national endeavors and magnify economic growth. These goals should not be controversial, but how we get there could be.

An ethically and actively managed, transparent US federal SWF that follows the Santiago Principles and establishes strong governance requirements could help the US diversify its investments, collect financial returns on investments it has historically made for international goodwill, and reduce significant budget deficits and liability underfunding through improved returns. If a large federal SWF is formed and joins together with other managers of US federal and state sovereign assets, then it could drive global markets to more fairness and transparency while ensuring the funding of strategic priorities through lower-risk capital. This will take time and investment to achieve.

But risks abound. Controls and transparency will be critical, and it will take time and money to establish, manage, and monitor such a fund. A SWF that does not apply a principled approach could also be used to exert undue influence over targets domestically and abroad.

Ultimately, like all matters in Washington, a national SWF will enjoy support from some and face challenges from others due to political, financial, and ideological factors. While the administration has indicated that the fund is to be seriously considered and will ultimately be created, observers are uncertain if the divided Congress will approve of this plan and if the President has control over enough resources to effect it without congressional appropriations. All we can hope for is a fully informed and open-minded debate.

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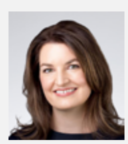

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