Defining Sovereign Balance Sheets Through A Sovereign Wealth Fund. Tax Backed Securitiies.

Sovereign balance sheets are not well defined in particular because it is hard to define and quantify the assets of a country. The difficulty in quantifying a country's assets can impact a country's ability to raise debt especially in times of financial stress.

One simple way of solving the definition problem is to create a Sovereign Wealth Fund. The SWF is capitalized by injecting state assets such as land, hard assets like resource rights and the capitalized tax base. The definition and quantification of the capitalized tax base is difficult but can be partially solved by a securitization.

With an SWF with a defined asset base it is possible to raise debt. In fact it becomes possible to issue a range of liabilities, secured or unsecured, convertible (to an underlying asset), fixed or floating rate, mezzanine or senior. The cost of debt would depend on the quality of the assets and how the SWF was managed. One important factor would be the dividend policy of the SWF. The dividends would be paid to the Treasury of the country.

With such definition, it is likely that the SWF would become the primary funding vehicle of the sovereign.

The Treasury could of course continue to issue debt but the poor definition of solvency, the reliance on confidence as opposed to asset value, would probably deter investors relative to the debt issued by the SWF.

To better define the capitalized tax base we securitize tax revenues. All tax revenues would be collected by an SPV, a tax collection vehicle (TCV). The TCV is basically a conduit which collect taxes and issues liabilities called Tax Backed Securities (TBS). The TBS would be tranched and rated and the stability of the tax revenues would be reported for full transparency towards efficiency pricing of the tranches. TCV's can be allocated free of payment to the SWF to capitalize it, or sold in an open auction.

All this structuring is for nothing, of course, if bankruptcy laws were weak or did not apply to the securitizations or the SWF's liabilities. By structuring the sovereign's assets and liabilities in a standard private corporate structure, albeit one where the equity was owned by the sovereign, bankruptcy laws could be applied in a clear and transparent way to define priority of claim. This would go a long way to bringing fiscally delinquent sovereigns back into the capital markets.