The primary concern of politicians and economists stems from the potential for the state to interfere in business matters and either protect or favor a certain business. The interests of government and business are fundamentally different interests. However, if governments favor certain business this creates the possibility that national interests may become corporate interests instead. This chapter explores the fear of politics and sovereign wealth fund becoming closely intertwined, the evidence that they have or not have merged, and the primary concerns such as national security that states might use sovereign wealth funds as instruments of state power. While the evidence that sovereign wealth funds have acted historically as instruments of state power or in collaboration remains thin, the logic behind the fear is not irrational. Drawing upon specific cases where the profit maximizing investment logic and the public policy interests of states have intersected, the politics of sovereign wealth is studied in both the international and
domestic context. The sheer size of financial strength make sovereign wealth funds defacto political instruments in both the domestic and international context.

Keywords: sovereign wealth fund, public policy, political economy, sovereign immunity, taxation, international relations

The concern of policy makers about sovereign wealth funds (SWFs) concerns the funds' potential to wield political influence in international economic affairs. As one central banker put it, sovereign wealth funds “challenge these deeply held assumptions about the world economy” (Hildebrand 2007). The regulation of sovereign wealth funds will pose an excellent test case as to how developed countries manage global financial regulation, specifically in their dealings with less developed countries (Drezner 2009). The question of whether sovereign wealth funds will work to maximize shareholder value or act as political extensions of the state is a valid worry expressed by a wide range of policy makers. Irrespective of the research and data about sovereign wealth fund investment, opinion about SWFs is formed by politics (Deutsche Bank 2007). Before the global recession in 2008, target countries demonstrated skepticism to downright hostility toward SWFs, while during the recession they could not encourage enough investment or rescue packages of failed companies. Much of this stemmed from a clear lack of knowledge, admitted by IMF officials, about sovereign wealth funds (Johnson 2007). Initially, countries negotiating from a position of strength pushed to curtail the influence of sovereign wealth funds; however, with ballooning budget deficits, failing banks, and collapsing equity markets, policy makers' fears about mixing business and politics have evaporated. Though research indicated that SWFs acted similar to other asset managers, and were not politically motivated, the concern remained (Beck and Fidora 2008). One study by a current Obama administration economic official noted that SWF countries “have a history of mixing politics with business” (Farrell et al. 2008). Such rhetorical flourishes demonstrated little detailed knowledge of sovereign wealth funds, their divergent investment strategies, or their economic situations. There is little recognition of the divergent investment strategies based upon the source and hedging necessity of countries (Xiang et al. 2009). The possibility of SWFs proving that their investments are motivated by financial interest, rather than political opportunism, as a means to avoid regulatory scrutiny has been raised as a possibility, though there is little evidence of how SWFs might parade their good intentions (Badian and Harrington 2008). Concern demonstrated by the Obama administration’s National Economic Council Director Larry Summers and Deputy Director Diana Farrell accurately captures the concerns of many with little evidence for how SWFs might be accepted as profit-motivated investors.1

Research into the political influence of SWFs has been stunted with an obsession over predatory investments for the purpose of corporate destruction or national security encroachment (Cohen 2009). The supposed “great tradeoff” between investment and security is simplistic at best and overlooks more important issues. First, despite the obsessive focus on the political influence of sovereign wealth funds on international economic affairs, a more pertinent concern is their impact on domestic politics. Also, a deeper and more economically plausible concern is the global imbalances that SWFs represent (Gieve 2008). Whereas sovereign wealth fund international investment remains
relatively small compared to other asset managers, SWFs dominate domestic politics\textsuperscript{2}. Sovereign wealth funds are typically the outgrowth of foreign exchange reserves and not established as funds before significant capital accumulation (Das 2009). Abu Dhabi, with a population of less than one million people, manages an SWF plausible estimated between $500–600 billion US dollars with some estimates ranging much higher. In China with a per capita GDP of $3,500 US dollars, the China Investment Corporation (CIC) has assets under management of more $300 billion US dollars with an additional infusion of $300 billion expected from foreign exchange reserves\textsuperscript{3}. The Singaporean funds GIC and Temasek own, manage, or impact in some form a large percentage of local industry through a large network of subsidiaries and crossholdings. With sovereign wealth funds playing such influential roles locally and frequently driving investment, their roles in local politics are vitally important. Though some have argued for the economic logic of sovereign wealth funds based upon economic criteria, this remains a point of some contention (Ping and Chao 2009). It is reasonable to ask whether the states have become wards of the sovereign wealth funds. SWFs’ overwhelming financial clout gives them significant influence domestically. In light of the major domestic and regional investment allocation of SWFs, it is important to understand their local political influence.

Second, the advisability and impact of quasi-public investment from foreign governments, while a valid concern, has been lost among hypocritical and rhetorical flourishes. Investment from foreigners, especially public and quasi-public investors, will always be viewed politically. Even the most strident critics, however, can point to no example where sovereign wealth funds leveraged their political connections for gain or had obtained national security secrets through commercial investment. As one researcher noted, plainly this all “exists in the realm of the hypothetical” (Truman 2008). Though valid concerns exist, much of the debate and rhetoric resembles a solution in search of a problem. Instead, the new normal is the acceptance by developed country governments of the role of sovereign wealth funds as a new form of institutional investor (Deutsche Bank 2008b). This hypothetical debate has obfuscated very real concerns. Adam Smith accepted the potential need to restrict international trade on the basis of national security concerns; however, these valid concerns can be obscured by protectionist rhetoric. The criticisms of SWF investment, however, have a broader and more troubling focus, defining the investment as a concern about the role of politics in commercial decisions. Though a laudable objective to separate politics from investment decisions, this focus seeks to restrict all SWF investment and separate investment based upon political affiliation. As with the distinction made around nuclear weapons, investment is analyzed based upon the political affiliation of the donor country\textsuperscript{4}. Investment from friendly SWF countries is treated differently from potentially threatening countries. Analyzing the political influence of investment decisions creates an ambiguous and expansive regulatory environment that requires further analysis.

The 500-Hundred-Billion-Dollar Gorilla
The potential influence wielded by a few billion dollars of investment in capital markets numbering in the trillions of dollars pales in comparison to the influence of SWFs on their home countries. This influence stems from obvious and subtle factors that make SWFs
important in economic management and political actors in their own right. First, the size of SWFs forces upon the government and the fund itself an inescapable reality of the fund’s central relevance to political decisions. While US and European policy makers and analysts worry about the impact of a few billion dollars of investment by SWFs into multitrillion-dollar capital markets, SWFs occupy a central and commanding position in their home economies, holding assets in some cases in multiples of the domestic GDP. To provide some context, if the United States had a sovereign wealth fund with the same amount of assets per inhabitant as Abu Dhabi, it would conservatively hold $100 trillion. If such an institution existed in the United States, it would dominate politics and especially the debate surrounding economic and financial policy. Norway, Hong Kong, Singapore, and Kuwait SWFs collectively hold more than $1 trillion of assets representing less than 20 million people and total purchasing power adjusted GDP of less than $1 trillion. Though SWF assets total around $3 trillion collectively, their sizes relative to their domestic economies make them vital players in decisions of economic policy. The SWF assets of one country in the relative size of international capital markets may be small, but their absolute and relative size at home give them oversized influence. SWFs may make profit-motivated investments, but it is fanciful to believe they do not occupy an important role in the political structures of their home countries. The sizes of SWFs make them central to policy making. Directors, executives, and managers are appointed by governments to oversee SWFs. It is foolhardy to believe that governments are not involved in oversight and decision making or can make claims of complete independence. However, governments and citizens have a right to hold their officials accountable to ensure that public assets are prudently and profitably managed. Institutions of such weight cannot escape the gravity of political involvement.

Second, SWFs occupy a central role in the economic management of the country. Sovereign wealth funds must decide how to invest and spend their capital for the benefit of their citizens and the inherent obligation a government holds to its people (Keenan and Ochoa 2009). Despite the perception of SWFs as predatory international investors, they invest large amounts domestically or regionally and consequently control large amounts of the local economy. Sovereign wealth funds manage the monetized financial assets of real natural-resource wealth within a prudent economic framework for depletion and domestic political constraints (Deutsche Bank 2008a). Some have even made the argument that SWFs owe a specific debt to their citizens as managers of public wealth (Keenan 2009). The Singaporean, Chinese, and Abu Dhabi funds dominate their economies. The Singaporean funds Temasek and GIC own, or have a significant stake, in almost every domestic company of any size ranging from financial services and shipping and transportation to real estate and consumer goods. The Abu Dhabi Investment Authority (ADIA) operates similarly with holdings across a range of industries throughout Abu Dhabi, the United Arab Emirates (UAE), and the Arab world. (p.75) The range of holdings and crossholdings and subsidiaries gives ADIA an interest in just about every business in Abu Dhabi. The Chinese fund (the CIC), on the other hand, does not have as diversified a portfolio of Chinese holdings, but it has significant positions in state-owned banks as well as various other businesses. With approximately 50% of its asset base dedicated to investing in Chinese business, the CIC has taken positions in large national
champion banks and small solar-panel companies. Some have even questioned the seemingly uncontroversial position that SWFs should invest in the domestic infrastructure (Klein 1996). Sovereign wealth funds have a central place in the local economy because they generally own the foundation of the domestic business community.

However, SWFs’ influence extends beyond their direct holdings. Sovereign wealth funds, both directly and indirectly, play significant roles in the development of long-term economic planning. Due to the sustained capital base provided by an SWF and the expectation of future accumulations, countries use them as a source of development funding. In the late 1970s, the UAE placed full-page advertisements in the international newspapers touting its development vision in partnership with ADIA, “ensuring that the country’s source of income is moving as rapidly as possible … away from dependence on the exhaustible oil and gas sector (New York Times 1978a).” Even when not owning the assets directly, ADIA was guaranteeing loans for Emirates Telecommunications to expand capacity services in a bond offering arranged in partnership with banks like Chase Manhattan, Deutsche Bank, and Union Bank of Switzerland (Wall Street Journal 1977). Temasek, with a goal of developing Singapore as a financial center, publicly listed its web of subsidiaries, demanding that they earn profits while holding a controlling interest and encouraging cooperation with each other (Wall Street Journal 1983). The CIC, though with less of a track record, follows a similar path in taking key stakes in companies that chart the course of Chinese development. Even Norway maintains two funds with foreign and domestic holdings, respectively, with a development plan targeting the eventual depletion of oil reserves. As stable pools of capital focusing on long-term investment, SWFs have and will continue to play large roles in the economic policy and management of their respective states. The assumption is that the accumulated capital will provide for stable income over time, implying a role in domestic economic policy. (p.76)

Third, most SWFs contribute to the social protection and development framework of their countries. Developed countries with SWFs like Singapore, Norway, Dubai, and Abu Dhabi have created social welfare systems for citizens modeled upon the western European model that provide for high levels of education, health, and social security. Well before its rise to developed country and dominant SWF status, Abu Dhabi was touting the development of its education, health, and social security system (New York Times 1978a). Kuwait and Saudi Arabia provided jobs and education for all citizens with public and quasi-public employment, at times accounting for more than 50% of all jobs. This spending was not funded directly by the SWFs but was frequently worked out in concert with it as part of the long-term development plan to try and diversify away from natural resource-reliant economies. Though Norway had a more developed social security system with health and education provisions for residents, significant debate has taken place about the proper level of intergenerational savings and whether the fund should increase its public transfers to increase social spending. The countries with higher levels of personal income view the SWFs as able to provide greater levels of social spending. The shift from income and wealth generation to wealth and income consumption or preference is to be expected as leisure becomes more valuable to people.
Sovereign wealth funds in less developed countries view these assets as developmental capital. Most major SWFs now come from well-developed economies with higher levels of per capita income like Singapore, Norway, and Abu Dhabi. New SWFs are being created in developing countries with a lower level of per capita income and different intentions for their newfound wealth. While better known for its headline-grabbing international investments, the CIC has dedicated the majority of its capital to domestic holdings. Purchasing portions of state-owned but publicly listed banks, or small holdings of solar-panel makers, the CIC has played a much larger role in providing investment capital for the high technology and financial services industry. This furthers the overall goal of the government of promoting strategic sectors of the economy. A primary investment sector of sovereign wealth funds from lesser developed countries is for basic infrastructure. Domestic investment frequently targets telecommunications, transportation, natural resources, and financial services. The State Oil Fund of Azerbaijan, with a focus on improving its human capital, provides education grants for top students that guarantee employment and a good salary after graduation. A major question for SWFs in developing countries is how much to dedicate to social spending. In countries like Ghana that have new oil discoveries, the policy debate revolves around how much to dedicate to public spending, focusing on economic development, and how much to set aside in a diversified investment portfolio. Though economic research indicates that large public spending increases accomplish little, it is reasonable to question how much of the newfound wealth should be dedicated to increasing social service spending. For developing countries, the focus is less on creating a social safety net and more on creating a prosperous economy.

Before turning to more detailed analysis of domestic political interactions between the government and the SWF, it is important to note the role of the government in economic activity. Though research has focused on the potential for investments to mix business and politics, this studies a real problem from the wrong direction. In most countries, the dividing lines among government, sovereign wealth fund, and other companies are blurry at best. In most countries with an SWF, the state owns large portions of the economy. While research has focused on the potential political clout of SWF investment in foreign countries, this misses the larger issue of who manages the investor. For instance, the government of Abu Dhabi owns ADIA and the state-owned oil company, Abu Dhabi National Oil Company (ADNOC), and its overseas investment subsidiary, International Petroleum Investment Company (IPIC). The IPIC was the creation of ADIA in a joint venture with ADNOC, and both IPIC and ADNOC are owned by the government. The government is making deals with itself, and ADIA is only one of many government-owned firms expanding overseas. Examples of this type of intergovernmental self-dealing abound, but they give rise to the question of how to count sovereign wealth fund assets. Similar holdings, crossholdings, joint ventures, and subsidiaries exist in every country with sizeable SWFs. Research that fails to account for the investment or business behavior of non-SWF state-owned companies misses important information.

Understanding the role of the state in economic activity matters if we are to understand the impact and role of the sovereign wealth fund within the domestic context. While the
research on the international political influence of the SWFs has focused on the funds, to
the government it is one more subsidiary agency and in some cases not even the largest
or most important. Furthermore, as active investors with clear investment records,
some research indicates that SWFs may play an important part in improving operating
performance and profitability of target companies (Fernandes 2009). In China, the four
major banks, including the largest by market capitalization in the world, in which the
government is either the controlling or significant shareholder, manage total assets of
approximately $5 trillion with 1.4 million employees. The Chinese central bank manages
foreign exchange reserves of more than $2.2 trillion with a much larger ability to influence
global markets by its pronouncements on the currency and debt markets. In Saudi
Arabia, the state-owned oil company Saudi Aramco has an estimated revenue of $200
billion. The Saudi government also maintains significant holdings in companies such as
Saudi Telecom, which manages numerous joint ventures throughout the Arab world.
Little research has focused on the acquisitive nature of the state-owned enterprises,
while great worry has been focused on the potentially predatory nature of the SWF. While
state-owned enterprises have demonstrated (p.78) their interest in making
international acquisitions, sovereign wealth funds have preferred the ease of portfolio
investment abroad. The concern about potential SWF predatory investment seems
misdirected at best. SWFs become political creatures within the domestic framework that
fights for resources and influence like numerous other actors and institutions to which
the government responds.

One last issue remains before focusing directly on the politics of sovereign wealth funds.
Though SWFs, especially from less democratic countries, are reluctant to reveal their
funds’ holdings and policies, they invest the bulk of their funds in public markets. The
opaque funds of nondemocratic countries are forced into transparent markets and the
price transparency of public markets. Though a complete portfolio disclosure by an SWF
is unrealistic, the public markets provide significantly more information about activity,
holdings, and accountability. The CIC has taken a lot of criticism about its ill-fated
investments in American financial services companies, and the public is increasingly
worried about central bank holdings of US government debt and dollar reserves. Though
governments have taken to listing companies while maintaining a controlling interest in a
company, this allows an increased degree of transparency, allowing small investors and
the public at large to assess the financial state of the company. The public and
researchers may not know the exact portfolio of the SWF, but it is increasingly easy to
know the financial statuses of the major companies within its portfolio. All major equity
markets have regulations requiring disclosure of holdings above a certain threshold and,
in some cases, additional measures. The very anonymity that nondemocratic SWFs prefer
is swept away by their embrace of public international capital markets. More important,
especially for domestic politics, it is much more difficult for the state to continue to
support loss-making enterprises with public finances. Private loss-making companies that
enjoy government subsidies can remain hidden from public view, while publicly listed
companies, even with the government as the controlling shareholder, face pressure to
earn profits. This price transparency also enables the government to evaluate the ability
of its financial managers against broad financial market benchmarks.\footnote{The irony of}
nondemocratic and opaque SWFs embracing the democracy of price-transparent markets should comfort to some degree those seeking greater transparency. If the SWF has shareholders in the form of its citizens, then knowing the performance of its major holdings will allow the fund to hold its managers and government accountable for returns.

The political influence and lure of SWF flow from the assets under management. Despite the best attempts of well-intentioned governments and fiscal rules, stabilization and sovereign wealth funds have been unable to restrain public spending. Governments, secure in their knowledge of expected future commodities, have been unable to restrain government spending. This does not necessarily indicate poor performance by the SWFs, because they are only government-linked enterprises and not controllers of the public purse. The political implications come in two ways. First, the government may seek access to outside funding to sustain high levels of public spending or during economic downturns. Though this may fit into the stabilization fund design, it may not fit with the sovereign wealth fund design. If specific mechanisms do not exist for conditions of withdrawal such as an economic downturn, then politicians may seek to use the fund for political ends. This draws the fund into a political position rather than being strictly investment focused. To date, politicians have recognized the potential dangers and attempted to avoid creating internal conflicts of interest between the state and the sovereign wealth fund. This does not mean that politicians have abandoned their proclivity to spend, only that funding increases and special projects have been created elsewhere in public accounts and are not reliant on sovereign wealth funds.

Second, just as SWFs might make investments for geopolitical reasons internationally, the larger danger is that they will receive pressure to make domestic investments by public authorities or well-connected persons. For the citizens of the country, this is a larger concern for the long-term performance of the SWF and the state. Historically speaking, governments have not been effective investors. Though governments have established governance mechanisms to shield their SWFs from political pressure and allow them to focus on superior risk-adjusted returns, there remains the subtle ability of the well connected to apply pressure for favored investments. Though long-term data for a variety of funds do not exist, there is some evidence that SWFs are not good investors compared to the broader market. Speculation has focused on a government ability to favor a preferred actor or provide nonpublic information to SWFs, but it seems more likely that political constraints prevent them from being pure risk-focused investors, which may lower their overall returns. The Kuwait Investment Office (KIO) was forced to sell its “portfolio investment” in the scotch producer Arthur Bell after it was disclosed in a public filing that the KIO was partnering with the Irish brewer Guinness for Guinness to purchase Bell (Sunday Times 1985 1985; Wall Street Journal 1985a, 1985b). The Muslim government raised strong objections to this KIO investment, noting the incompatibility with traditional values irrespective of potential financial gains. Domestic politics play a major role in the framework for investment decisions. However, if SWFs are being favored by governments, there is no evidence they are earning abnormal returns either domestically or internationally.
Barbarians at the Gate, or What Constitutes National Security?
The strongest objections to SWF investments, however, come from developed countries. Despite their larger political influence domestically than internationally, the rhetoric about SWFs from developed Western countries paints a grim, (p.80) inaccurate picture of predatory investment. Though there is agreement that cross-border investment should only be restricted in light of “market integrity and national security concerns,” there have been numerous calls for legislation and a regulatory framework with little understanding as to what problems need to be controlled (Greene and Yeager 2008). Despite all the attention paid to the potential for political influence on investment-making decisions across international borders, even the most ardent critics of SWFs yield that this remains “largely in the realm of the hypothetical” (Truman 2008). The concern about politically motivated investment, while reasonable as a concern, bears no basis in factual history and is prompted more by rhetorical fear mongering of the “new barbarians at the gate” than by experience. One study found that only one small investment could be considered as an investment in a national security industry (Deutsche Bank 2008b). More worryingly, a major problem of the theory of protectionist investment is its uneven and hypocritical application between investors. For instance, political or noneconomic motivation in investment decision making is accepted, even encouraged, for some public or quasi-public investors but is criticized when coming from other states. Furthermore, even if an SWF government lobbies another government on behalf of a proposed investment, it is not clear that this constitutes unacceptable behavior. Many governments, including many Western governments, have lobbied other states on behalf of private concerns regarding foreign investments. Though the concern about politically motivated investment is reasonable, its application is driven by the politically motivated.

All foreign investment is viewed through the lens of political motivation. Irrespective of SWF involvement, all international investment bears the weight of political motivations. Even though many note the benign history of SWF investment, the political and government-linked nature of funds engenders an inherent distrust of stated motivations (Gugler and Chaisse 2009). Though not considered an SWF, the Chinese central bank, which has accumulated more than $3.3 trillion of foreign exchange reserves and high-quality fixed-income assets, has a more politically motivated foreign investment decision-making process than the CIC. Leaving aside institutional ownership of investments, the political nature of any foreign investment manifests itself in two ways, which become more relevant when studying SWFs. First, foreign investment from countries considered friendly or culturally similar are treated more favorably than investment from other countries. Of the top ten investors by country into the United States, only China and the Middle East are in the top ten. The other eight countries make up 73% of this investment by dollar amount and are rarely mentioned politically despite their large financial presence. 10 According to the US Treasury, Ireland, with a population (p.81) of less than 5 million people, is a larger investor in the United States than the Middle East, which has a population of more than 135 million and SWF assets of at least $1 trillion. 11 There are, however, no congressional hearings or worried newspaper articles about the national security threat from Irish investment in the United States. Countries treat investment from countries they trust better than from countries they do not trust. Although
nationalistic reasons may exist for countries to treat investment differently based upon the political relationship with the source country, this violates the principles that sovereign wealth fund critics seek to uphold as well as legal agreements of nondiscrimination of investment. Transparent rules and free markets do not operate on a whimsical case-by-case basis of when to allow investment. Though issues specific to the quasi-public nature of SWFs and national security exist, they should not be allowed to act as a protectionist defense to prevent foreign investment.

Investment treatment based upon the source country applies even more starkly for quasi-public entities and SWFs. Japan holds more long-term US Treasury debt in absolute terms, and this is significantly higher in relative terms when adjusting for various factors such as population. Yet the purchase of US public debt by the Chinese has drawn much more criticism. China does maintain a fixed exchange rate promoting export growth and a large trade deficit with the United States; however, similar holdings of US treasury debt by Japan elicit no concern. This differentiation between the source of investors predates the 2005 discovery of sovereign wealth funds. In 1978 the congressional subcommittee on citizens and shareholder rights investigated the multiple stakes held by ADIA and KIA in publicly listed airlines (New York Times 1978b). Investments from countries viewed as friendly or culturally similar were received very differently than countries viewed as threatening or culturally different. Middle Eastern and Asian SWFs have been criticized, both internationally and domestically, for their high-profile purchases of financial services companies, while Norwegian holdings of the same companies have been ignored.

Second, the relative power of the source country impacts the political sensitivity of the destination country. Rapidly changing power relationships change the reception of investment between states. A country can become a threat simply by its rapid accumulation of power whether or not it intends to use the resources at its disposal. One influential consulting firm wrote a report ominously titled “The New Power Brokers: How Oil, Asia, Hedge Funds, and Private Equity Are Shaping Global Capital Markets” (Farrell et al. 2007). The clear implication is the shift in power toward Asia and oil producers. SWF countries blessed by the good fortune of petroleum geography have not demonstrated an inclination to acquire assets (p.82) with the intent of threatening, implicitly or explicitly, other countries. Their rapid growth in financial clout presages a shift in relative power between states, causing insecurity for those losing power. Countries witnessing or experiencing rapid shifts of power in a bilateral relationship become insecure, believing the other country could threaten their security. States also project future changes in relative power. The evolution of SWFs presages a shift in the power between states (Drezner 2008). For instance, states that are expected to grow rapidly relative to their own power pose more of a security threat than states not expected to grow rapidly. The multidimensional weighting of power incorporates a variety of measures and time factors, but focuses heavily on the relative power relationship. Especially when considering the reception of investment, states focus on the changing power dynamic of the relationship.

The analysis of relative power manifests itself in the reception and type of investment
from other countries and SWFs. During the period of rapid Japanese growth up until 1990, the concern about investment resembled the analysis of the Chinese economy, with its protectionist behavior, close relationship with government, and currency manipulation. Japan’s later stagnant economy and poor demographics reframed US receptivity toward Japanese investment. The concern about Chinese investment in the United States stems from the rapid shift in geopolitical power and China’s expected future growth. As the balance of relative power shifts between the two largest economies in the world, the perceived threat is greater than investment from other smaller states. SWFs like the Qatar Investment Authority (QIA) and the Azerbaijan State Oil Fund (ASOF) enjoy little scrutiny of their activities in developed capital markets, because they pose no relative power threat to target investment countries.

Relative power applies not only to the particular country investing, but also to investment size. The Norwegian Global Pension Fund (NGPF) limits its investment in all companies to 2% of outstanding shares, while Middle Eastern and Asian funds have purchased larger headline-grabbing stakes. In many cases, the fund investments show significant overlap, but Middle Eastern and Asian fund investment bears greater scrutiny due to the relative sizes of the investments. Middle Eastern funds have purchased larger stakes, inviting more attention to their investment intentions. Despite their stated preference to make long-term investments that avoid scrutiny, many funds like Temasek, GIC, ADIA, CIC, and KIA have made large investments in flagship brands like Citibank and UBS. These relatively large investments in national brands invite publicity and scrutiny of the intentions of the investors. A more diverse investment base with relatively smaller positions, similar to the portfolio held by NGPF, does not attract attention. Equity investments receive more attention than passive debt investment due to the relative control accorded the investor over assets. The primary proposals over how to regulate SWF investment focuses on this issue by removing the ability to control equity investments with little to no attention paid to fixed-income investments. This explains why SWFs stress their lack of involvement in management, and their boards through which they might exert control. Governments are willing to accept the passive nature of fixed-income investment that yields little additional increases in relative power to a potentially threatening state, but they are reluctant to sell assets with relative control increases that accompany equity stakes.

The timing of the investment also matters. Before the financial crisis and ensuing recession that began in the United States and Western Europe in late 2007, there was resistance to SWF investment. Expanding economies and high asset prices engendered resistance to foreign investment, especially from Chinese and Middle Eastern SWFs. However, once the severity of the financial crisis became apparent, there was criticism of SWFs for not investing more during the global time of need. Sovereign wealth funds during the financial crisis were the “white knights” of international finance (Couturier et al. 2009). Expanding economies with less need for money were braver and willing to refuse capital even at a political cost, while countries in weaker economic positions had fewer qualms about accepting foreign investment. The arguments underlying the criticism is protectionist and political and not based on any sound underlying principle. Before the
financial crisis in 2008, SWF investment was criticized as politically motivated. After the financial crisis, SWFs were criticized for not investing in developed countries. The change was political and was based on the strength of the recipient and not on a change of behavior in the investor. SWFs cannot, however, avoid the political implications of any international investment, much less from government-linked entities.

Despite the recent discovery of SWFs, there have been a few notable international incidents between funds and target countries. First, the KIO purchased a major stake in British Petroleum (BP) after its privatization rose at one point to more than 20%, before being forced by the UK government to divest itself over three years beneath 5% of outstanding shares. The KIO acquisition of BP demonstrates the concerns of developed-country governments and the frustrations of the acquiring SWF's state governments. Purchased on the open market with full disclosure after the 1987 global stock market crash and botched privatization of BP, the KIO acquired 22% of shares, believing the company, from a confluence of factors, to be undervalued (New York Times 1987a, 1987b, 1988a; Wall Street Journal 1988). After publicly announcing its intention to raise its stake above 22.5%, the KIO agreed not to purchase more than 22% after the British Monopolies and Mergers Commission (BMMC) investigated the holding more thoroughly (New York Times 1988b). Nearly one year after the KIO began building its stake in BP through open market purchases, the BMMC, in protection of the "public interest," ordered a share divestiture beneath 10% because it feared that "unlike other shareholders, Kuwait is a sovereign state with wide strategic interests and could be expected to exercise its influence in support of its national interest" (New York Times 1988c 1988d). This case provides a clear example of the delicate political landscape faced by both acquiring and target investment states.

First, the KIO was targeting a British national champion. The BP privatization was one of the largest in the world at the time and was brought to market by Margaret Thatcher's government to demonstrate the resilience of British industry. Though the transaction was completely legal, British Petroleum meant much more to the country and government than a simple privatization. Second, the KIO investment came on the heels of a botched privatization when the British government was enlisting the treasury and central bank to ensure the stability of the offering after a global stock market plunge. There was a sense that, while its action was legal, Kuwait was taking advantage of a bad situation created by the British and a collapsing global stock market. The targeting of a national icon, coupled with the sense of relative powerlessness relative to a small Middle East oil exporter, prompted a political inquiry into an open market and legal purchase. Third, the BMMC acted to protect the "public interest," citing only the concern that the KIO was owned entirely by the Kuwaiti government, a sovereign state. With no mention of national security or what constitutes the "public interest," this landmark ruling haunts investment by SWFs under the fear that the wrong investment may be revoked on the basis of "public interest" however vaguely defined, even if it is completely legal. The concern and focus in negotiations with the United States and European countries have been in defining acceptable investment sectors and criteria for oversight so as to avoid future problems.
If SWFs fear a vague and ill-defined investment oversight environment, target countries fear a lax and politicized investment process. This toxic mix came together for the ADIA and the Bank of Credit and Commerce International (BCCI)\textsuperscript{14}. Formed in 1972 by the Pakistani financier Agha Hasan Abedi, the BCCI operated at its height in forty-eight countries, counting dictators and drug dealers among its clients, with even Princess Anne of England noting its “very good service” \textit{(Times of London} 1991a). The BCCI was closed in 1991 by a multinational task force led by the Bank of England and the Luxembourg Monetary Authority due to poor lending and money laundering for drug dealers and despots; ADIA and the Abu Dhabi ruling family owned 77\% of BCCI shares at the time of its seizure \textit{(New York Times} 1991a). ADIA and the Abu Dhabi ruling family were at the center of the BCCI scandal. According to the Senate Foreign Relations Committee report \textit{(p.85)} on BCCI, “There was no relationship more central to BCCI’s existence from its inception than that between BCCI and Sheikh Zayed and the ruling family of Abu Dhabi” \textit{(Senate Foreign Relations Committee 1992)}. Enraged by what it viewed as unnecessary actions prior to the implementation of its restructuring plan to save the bank, Abu Dhabi shareholders mounted a vigorous defense of their actions, enlisting campaign press advisers for President George Bush to represent them \textit{(New York Times} 1991b 1992).

To defuse the tension, and understanding its economic and political importance, the Governor of the Bank of England, Robin Leigh-Pemberton, flew to Abu Dhabi to meet with ADIA and the ruling family \textit{(Times of London} 1991b). Sovereign wealth fund investment could not avoid being political. The political delicacy of the BCCI fallout extended to the ADIA holdings of UK stocks, bonds, and real estate. There were reports that the Sheikh of Abu Dhabi had planned to order ADIA to divest itself of all UK assets \textit{(Times of London} 1991a). No one underestimated the importance of the ADIA and Abu Dhabi as investors in the United Kingdom, because only months earlier, rumor had an ADIA 500-million-pound trade in the currency markets pushing the pound down 1\%. Also, later volatility in stocks was attributed to heavy ADIA selling to cover BCCI losses \textit{(Times of London} 1991c 1991d). Though the exact accounting of its specific trades and importance in moving the markets is unclear, later academic research confirmed the importance of Abu Dhabi investment in the United Kingdom \textit{(Kanas 2005)}. News stories debated the culpability or victimization of BCCI’s Abu Dhabi shareholders, and the political ramification impacts SWFs today \textit{(Wall Street Journal} 1992 1992).

The importance of politics and the fears of target countries are encapsulated succinctly in the ADIA and BCCI relationship. First, at best, ADIA and Abu Dhabi shareholders did not display the diligence, oversight, and scrutiny required of majority shareholders. This concern about operational controls and management was recently noted in the Santiago Principles created by the International Working Group of Sovereign Wealth Funds (IWG). Principles 22 and 23 urge the creation of a framework which “manages the risks of its operations ... (with) timely reporting systems, which should enable the adequate monitoring and management of relevant risks ... and reported to the owner” \textit{(International Working Group of Sovereign Wealth Funds 2008 2008)}. Internal controls and investment management were also essential parts of the nonbinding agreement reached by the United States with Singapore and Abu Dhabi \textit{(US Treasury 2008a)}. Poor internal controls prompted concerns about SWF-induced financial market volatility.
Although research to date does not support the theory that SWFs cause market volatility, it is incumbent upon SWFs to employ strict risk management and oversight of their investments. In the BCCI case, the Sheikh of Abu Dhabi and the ADIA argued they were victims as much as anyone else (Wall Street Journal 1992 1992). Assuming the validity of this position does not speak highly of the management and oversight capability of a shareholder with 77% of outstanding equity. Today ADIA stresses its role as a portfolio investor while eschewing management responsibilities, (p.86) though it espoused a similar investment approach prior to the BCCI collapse. Shareholders with 77% of outstanding equity must employ strict oversight of a company. Furthermore, the repetitive claims that ADIA made about being a passive shareholder before the BCCI incident does little to comfort policy makers who hear the same arguments today. SWFs are responsible for their investments. Poor management leading to spectacular collapses and financial volatility, either through punitive measures or sales to cover losses, does concern foreign governments.

Second, the overlap of interests between the ruling family of Abu Dhabi and the ADIA further politicized and complicated an already tense situation. For instance, according to the Senate Foreign Relations Committee report on the BCCI, “Abu Dhabi did, from 1981 onward, own ever increasing percentages of BCCI, principally through Sheikh Zayed’s son, Sheikh Khalifa, and the Abu Dhabi Investment Authority” (Senate Foreign Relations Committee 1992 1992). In other words, shareholdings held by the ruling family of Abu Dhabi and ADIA were treated as one and the same. The overlap between the ADIA and the ruling family extended well beyond financial interests. The US attorneys Clark Clifford and Robert Altman represented the government of Abu Dhabi, the ruling family and various family members, and ADIA on a variety of matters. Writing about the position of the law firm who handled matters after Clark and Altman, the report delicately notes that the “conflict always existed, but was only highlighted after BCCI’s closure, once the creditor and depositor interest became represented not by Patton Boggs, but by BCCI’s liquidators” (Senate Foreign Relations Committee 1992). The importance of the distinctions among personal, public, and corporate interests increases due to the Foreign Sovereigns Immunity Act (FSIA). Intended to shield foreign governments and public officials from lawsuits with regards to their public actions on behalf of the government, the FSIA was invoked in the BCCI case to shield Sheikh Al-Nahyan and other members of the Abu Dhabi ruling family from the ensuing civil and criminal litigation. Though the FSIA contains a provision allowing legal proceedings against the commercial activities of a state, the case of Abu Dhabi and Sheikh Al-Nahyan, as with most SWF and hosting states, demonstrates the complexity of differentiating between public and private activities. Though he was the head (p.87) of state and acting on behalf of the government of Abu Dhabi, Sheikh Al-Nahyan also acted in a personal capacity and for the benefit of ADIA. This created some difficult situations for the US government as it both requested sovereign immunity protection for the Sheikh and complained about his refusal to cooperate by potentially invoking sovereign immunity protection (Federal Reserve Bulletin 1994; US District Court 1996 1995 and Senate Foreign Relations Committee 1992). The courts found, however, in the case of Sheikh Al-Nahyan and other heads of state, that FSIA does not specifically refer to heads of state or to their commercial activities, so consequently
they remain immune under the previous statute still in force (Tosini 2007).

The BCCI case and related litigation sharpened the standards that protect public officials who act on behalf of the sovereign and seek to clarify the capacity in which the individual was acting. The court targeted the capacity in which the official acted, noting that the actions must be “neither personal nor private, but were undertaken only on behalf of the sovereign” (American Bar Association 2002).\(^{16}\) The trend in jurisprudence has been to expand the definition of commercial activities so that sovereign immunity is limited to actions on behalf of the sovereign for purely public or diplomatic behavior. There remains substantial scope for reconciliation of commercial and sovereign immunities law between and within different jurisdictions (De Meester 2009). For instance, there has been no case that has tested sovereign immunity for SWFs. It would seem a foregone conclusion that an SWF would fall into the commercial activities exception. However, given the right set of circumstances, it is not inconceivable that an SWF would seek to shield its actions under the sovereign immunities protection, given lingering definitional and political problems (Granne 2008). One report in 1988 indicated that the ADIA office in London “is believed to have sovereign immunity” while noting it is taxed like a sovereign (Sunday Times 1988). As a result of the ensuing ambiguity, SWFs are considering “noncommercial risks” to their investments abroad (Faily et al. 2009). The inability to distinguish personal, political, and financial interests became a problematic aspect in relations among Abu Dhabi and other states in the BCCI case.

The Political, Legal, and Regulatory Framework

The focus by policy makers and scholars studying SWFs has been on correcting the public use of power through private investment via a proper (p.88) regulatory framework. The proposals to deal with the state and investment fund relationship, however, demonstrate a hypocritical disregard for the problem they supposedly seek to correct: the overlap of public and private interests. Rather than ignoring this public and private overlap, it has been argued that a new idealized investor ethos is represented in SWFs (Backer 2009). The correction of the problem requires a clear understanding of what needs to be legislated or regulated, and there is a startling lack of clarity of logic around what constitutes a problem. The sovereign shareholder presents some unique circumstances that should not obscure underlying issues of political and legal fairness, and that ignores existing structures (Rose 2008). There are a number of major concerns. The first primary concern is that SWFs constitute a national security threat to states by potentially purchasing military or technological secrets. Exceptions to trade and investment on the grounds of national security have been recognized as legitimate for many years (Smith 2008). Even many supposedly free trade advocates have expanded the definition of national security to include industries linked remotely, if at all, to national security to justify protectionist policies. National security has evolved into “public interest” as in the BP case. There is an evolving patchwork of national regulations and legislation designed to systematically address concerns about national security assets (Hemphill 2009). The national security defense of investment or trade protectionism is well founded because countries could use their funds to obtain sensitive technologies or military hardware (Markheim 2008). Even when not specifically referencing the public
interest, many national security arguments put forth about investment are stretched well beyond security matters into public interest. Though national security is a legitimate exception to free trade and investment rules, the argument that SWFs pose any threat to the target countries fails on numerous counts. First, predatory and threatening states have cheaper and more efficient methods to obtain national security technology or information than purchasing a company via an SWF. Cyber warfare and human espionage are much more active, efficient, and cost-effective methods of obtaining national security secrets and technology (Financial Times 2010a 2010b). Damaging cases of human espionage, in both governments and corporations, cost significantly less than purchasing financial assets for the sake of technology acquisition. It is much simpler to privately purchase intelligence about the desired asset than to publicly acquire the company holding the technology.

Second, the concept of national security has been stretched beyond recognition into a nearly worthless policy concept designed to promote protectionist policies. As one scholar notes, the gaming and gambling industry in France is considered a strategic industry worthy of government protection. The US Treasury noted its interest in considering “non-national security issues related to distortions from a larger role of foreign governments (US Treasury 2007 2008b). Politicians trumpet their concern about investments in “strategic industries” and their impact on economic security (Agence France Presse 2008; Epoch Times 2008). Investments (p.89) by SWFs in banks during the financial crisis were criticized for potentially compromising national and economic security, though it is difficult to understand how investment in financial services and credit creation might in any way endanger national security, even with greater public involvement (Pistor 2009). In fact, research indicates that the market welcomes SWF investment in financial services firms (Mietzner et al. 2008). If restrictions in international investment are to be justified by invoking reasons of national security, then national security must mean something tangible beyond any industry with politically connected lobbyists.

Third, the United States already maintains a comprehensive set of laws that is designed to safeguard national security secrets from foreign investors and governments. A robust regulatory regime already approves foreign acquisitions that might encroach on sensitive industries or technologies, and SWFs remain subject to all the laws of the host country (Epstein and Rose 2009). There are still some states that do not have a well-developed legal and regulatory framework for what constitutes a national security industry and the requisite review and appellate procedures to oversee foreign investment (Roller and Veron 2008). In fact, there is some confusion about the legal status of state-linked investment and the decision-making process within Europe about foreign investment regulation (Doran et al. 2009). To clarify investment decision making, it is incumbent upon states to provide a transparent legal and regulatory framework for investors to deal with valid concerns like national security (Rose 2008). Having laws and regulations that deal specifically with foreign investment, industry-specific investors, and government-owned investors, the United States maintains a broad and comprehensive set of laws and regulations designed to prevent national security breaches (Archibald 2008).
researcher has noted with regard to sovereign wealth funds and national security, “warnings about potential national security consequences of foreign investment and foreign ownership have been sounded repeatedly through history, but in retrospect they have invariably been false alarms” (Kirshner 2009). In short, the national security argument promoted to enact protectionist regulation is inaccurate in its understanding of foreign investment regulation and national security.

The second primary concern about SWFs is the argument that investment will not be made for financial gain but to further political goals by the investor countries. This argument is deficient for a number of reasons. First, there is no principled argument being made against politically motivated investment in general, but only against politically motivated investment that is deemed threatening. The NGPF has chosen a political investment strategy by which it determines the ethical appropriateness of target companies. This is an inherently political statement of the values of the country that ignores potential financial returns. The NGPF lists the companies that they will not invest in due to ethical concerns about their products or other behavior. Despite the concern over politically motivated decision making in investments, no one criticizes the NGPF for its inclusion of factors (p.90) that are not solely financial. The critique of politically motivated investment is instead a method to weed out SWFs whose politics the host country disagrees with. If there is true concern about the mixture of politics and investment, then it should apply to all SWFs with nonfinancial investment criteria or behavior. Second, states do not criticize politically motivated investments from other governments as long as they also suit the host countries' own political motivations. The United States protests against Chinese investment in its financial services companies and also holds hearings about the impending national security threat, yet it welcomes Chinese purchases of federal government debt that keep borrowing costs low. The former actions do not match US political motivations and are criticized; the latter action does match US political motivations and is not pursued with similar vigor. If investment target states want credibility for their concern about politically motivated investment, they must abide by principles of free markets and nondiscrimination and not selective enforcement. Third, governments have always lobbyed or coerced on behalf of their own companies and investments both domestically and internationally. The United States, Europe, and Japan have a long history, up to and including today, of lobbying other governments on their own behalf for favored companies and in some cases using coercive force against others. Unless the United States and Europe agree to forgo special exemptions for domestic corporations with foreign interests, foreign governments will continue to press the interests of their own companies. Fourth, an SWF does not give a country a means it does not already possess to acquire technology or industries. If a country wants to partner with a company either by offering tax credits, subsidies, or other financial incentives as inducements to acquire technology or industrial knowledge, they are not prevented from using public funds by the absence of SWFs. Though some argue that SWFs may seek to act as a primary source of outward foreign direct investment, there is little evidence that SWFs will take a more active role in investment (Park and Estrada 2009; Rios-Morales and Brennan 2009). Many governments use packages of financial incentives to lure companies to locate operations. Singapore, for instance, when seeking
to increase its status as a financial center, offered to outsource asset management to companies willing to locate banking and finance operations in Singapore. Governments with or without SWFs maintain the power of the purse.

The third primary criticism of SWFs is their lack of transparency. Though the concern over transparency has dominated policy debates, there are numerous reasons for why the concern over transparency is misplaced (Truman 2007a). First, the argument seeks to impose reporting and portfolio disclosure requirements not required of other investors. For instance, one report on transparency argues that “regular reports on the investments by SWF [should] include information on (p.91) specific investments” (Truman 2007b). Neither hedge funds nor private equity funds are specifically required to disclose their holdings, and large warehouse and investment banks maintain opaque investment disclosures. Support for transparency promotes a discriminatory and protectionist stance to require regulations above and beyond what is required of similar investors. It has been noted that “the desire expressed by recipient countries to go further in terms of regulation comes up against the level playing field argument that SWFs should be given the same treatment as other unregulated investors such as hedge funds and private equity funds” (Banque de France 2008). Disclosure requirements in the form of investment reporting and audits for institutional investors such as mutual funds come from investors’ acceptance of capital in the public marketplace to avoid potential misuse of funds. Based upon a variety of reforms involving SWFs, there is some reason to believe they will be a force for improved corporate governance (Gelpern 2009). Though the Norwegian finance minister stressed the importance of building trust via investment and operation transparency in 2008, other officials remain open to the idea of changing the level of openness (Halvorsen 2008). There is some evidence supporting the idea that disclosing investment builds trust and lowers concerns when SWFs invest overseas (Rose 2009). As a private investor not soliciting or accepting investment from the market, it is singularly punitive and discriminatory to impose regulations on SWFs that are not imposed on other investors. The discriminatory treatment by target states of investment based upon investor source, government or private, would seem to contravene a variety of accepted standards of international economic relations (Audit 2008). Transparency requirements seek to impose discriminatory regulatory burdens on SWFs to promote a protectionist agenda.

Second, though it is argued that increased transparency will reduce instability or potential financial crises, there is no evidence to support this for either SWFs or other financial institutions. To accept this argument, it would mean that SWFs induce volatility and, if so, that transparency would reduce this and conversely that legislated transparency of financial institutions has reduced volatility. Research indicates that SWFs do not cause volatility for financial markets and that they have increased stability by making investments during down periods and acting as long-term investors (Gomes 2008). Nor does SWF investment appear to have any long-lasting impact on stock prices (Raymond 2008). As one study notes, “There was no significant destabilizing effect of SWFs on equity markets” (Sun and Hesse 2009). In other words, SWFs do not move markets. Furthermore, there is no indication that increased transparency for mutual
funds, private equity funds, hedge funds, or banks has reduced volatility by increasing market discipline over portfolio holdings. Though some have questioned if SWFs might contribute to a chaotic unwinding of global imbalances, thus precipitating a market collapse, there is no evidence of this to date; rather, indications are that SWFs have reduced volatility (Beck and Fidora 2009). As one SWF executive noted, “There was a perception that banks were transparent until the financial crisis hit ... just being quoted (p.92) in the press doesn’t mean they were transparent.” Theoretically, transparency is designed to increase market discipline by the disclosure of asset risks held by financial institutions. SWFs have not contributed to global financial market volatility while developed-country bailouts have been noted for their lack of transparency (Grennes 2009). However, even with higher levels of transparency for various financial institutions, the market did not accurately value or appreciate the risks within the portfolios of financial institutions.

Third, SWFs must comply with all legal and regulatory requirements for investment disclosure with financial, national security, and industry-specific bodies in their host countries. Managing an SWF does not permit the countries or investors to avoid standard filing, disclosures, and other legal requirements of other investors. As one investor noted in testimony before Congress, “The United States has a robust, layered set of laws and regulations that protect important government interests associated with any investment, sovereign or otherwise” (Marchick 2008). The one primary exclusion to this treatment is that, in many countries, SWFs are not taxed (Weiss 2008). In other words, the tax status of an SWF is that of a foreign government that is exempt from taxation rather than a commercial enterprise subject to taxation. The lack of taxation levied on SWFs presents them with a significant economic advantage over other institutional investors unequally benefiting a foreign government (Knoll 2008). Though some have argued against changing the sovereign taxation exception, based upon the principle of equality of investor status, which SWFs claim to want, it would seem an improvement to apply all laws equally (Melone 2008). There remains, however, uncertainty about the application of tax law on sovereigns, which should be clarified in a nondiscriminatory manner (Pricewaterhouse 2010). This is one legislative question of investor equality that might be worth revisiting in order to also remove any question of sovereign immunity. If the purpose of transparency is to ensure that SWFs follow all legal and regulatory requirements and do not engage in predatory or nefarious activity, many other institutions and requirements ensure that they are complying with the law. As numerous examples of corporate scandals demonstrate, regular reports and transparent disclosures do not dissuade malicious activities. Fourth, disclosure of portfolio holdings can cause adverse effects to investors and the market. The disclosure levels being promoted for SWFs exceed the reporting requirements of all other investors and are discriminatory. There is also a loss of efficiency in investment activities when institutions are required to announce and disclose their holdings at short intervals. The argument for increased SWF transparency is discriminatory in order to promote protectionist policies. (p.93)

Despite the calls for increased regulation of SWFs, there is a clear lack of understanding
about the regulatory framework within which they exist and subsequently what new regulation would hope to achieve. Though the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) have taken leading roles in the formulation of regulatory principles, there remains doubt about the direction of a global framework. It has been noted that SWFs and investment target governments will benefit from policies that “carefully balance strategic interests with the benefits of allowing for the efficient flow of capital across borders” (Paulson 2008). Western government and SWF states have been working to increase the efficiency of existing reporting requirements and to clarify or pass legislation pertaining to national security or strategic industries while maintaining an open investment climate (OECD 2008). The International Working Group of Sovereign Wealth Funds (IWGSWF) has worked with the IMF to create the Santiago Principles, but critics contend that the principles lack any standing or enforcement mechanisms to reduce the standing of international institutions (IWGSWF 2008; Elson 2008). The IWGSWF has convened numerous meetings to work with its members on formulating best practices and to urge developed countries to maintain open and transparent investment regulations (IWGSWF 2009, 2010). The SWFs and investment hosting countries have a mutually beneficial interest in improving standards that promote apolitical investment. The funds can wait until legislative or regulatory actions prompt unwelcome changes or they can work to frame the discussion about government-linked investment. Furthermore, improved business practices and corporate governance standards are in the interest of target country and sovereign wealth funds alike. While they need not yield sovereignty over their investment policy to other countries, SWFs can ease fears about their operations.

The Political Hot Potato

The financial crisis and ensuing recession have focused policy makers on economic concerns closer to home. Investigations into financial scandals, irregularities, and politically motivated public investment have dominated European and American economic policy makers. The worry about foreign SWFs has melted away. The potential for serious political consequences to future investment, however, has not disappeared. The size and scope of SWFs and government-linked corporations require a more lasting solution. While international political concerns have dominated policy worries, domestic politics are a potentially larger concern because citizens deserve an understanding and oversight of (p.94) how the government is managing public assets. Governments should consider agreements, similar to trade agreements, that establish formal rules designed to foster an open, transparent, and predictable international economic environment. In the absence of agreements regulating the behavior of investors and target countries, the investment climate will remain purposely vague and ripe for political manipulation. Both parties would benefit from increased predictability and transparency in international government-linked investment.

Bibliography

Bibliography references:


Hildebrand, Philipp, 2007, “The Challenge of Sovereign Wealth Funds,” speech at the International Center for Monetary and Banking Studies.


Kanas, Angelos, 2005, “Pure Contagion Effects in International Banking: The Case of


US District Court, 1995, “Suggestion of Immunity, United States, on behalf of Sheikh


US Treasury, 2008b, Under Secretary for International Affairs David McCormick Testimony before the House Committee on Financial Services, March 5,


Notes:
(1.) The very valid concerns of Larry Summers and Diana Farrell are nonetheless ironic given that they took over and helped manage what should be considered one of the world’s largest sovereign wealth funds in the form of the Troubled Asset Relief Program (TARP). At the time they had assumed office and supported further politically driven investments in General Motors and Chrysler, which internal documents predicted had little chance of being recouped. It should be emphasized, however, that TARP began at the end of the Bush administration but was assisted by current Treasury Secretary
Timothy Geithner. If assets from the firms controlled by the US government are included, such as Citibank and AIG, which is the method used by many to value sovereign wealth funds, the total asset base for a US sovereign wealth fund would rank it as one of the largest in the world. Even today, after having received many repayments, the TARP sovereign wealth fund, using others’ definition of what constitutes a sovereign wealth fund, ranks as one of the world’s largest.

(2.) During my research for this book, two sources in different countries, each with well-known SWFs, told me I would have difficulty getting people to talk about it because they did not want to offend either the government or the fund.

(3.) The additional infusion was expected to be approved at the time of writing though it has not yet been completed.

(4.) The only reason for the nuclear weapons reference is that as analysts have noted, countries do not generally oppose allies obtaining nuclear weapons. A similar theory seems to hold true with sovereign wealth funds. Investment from friendly countries is more equal than investment from others.

(5.) This is the author’s purposefully conservative estimate of the Abu Dhabi Investment Authority (ADIA) based on stated asset values provided to the bond ratings agency Moody’s (Reuters 2009). It is very plausible that ADIA assets are significantly greater than the assumed value used here of $300 billion. If so, a comparable value for a US sovereign wealth fund could go higher than $200 trillion. Even the $100 trillion estimate, however, is greater than all assets currently in existence.

(6.) The CIC does not have the diversity of holdings or reach into the economy like the ADIA or Temasek for two reasons. First, is purely a function of time. ADIA and Temasek have been around much longer and grew rapidly with their economies. Second, ADIA and Temasek are much larger relative to their economy than the CIC. For instance, Temasek and the GIC combined manage a similar amount of money as the CIC but Singapore only has 5 million people compared to the 1.3 billion people for China.

(7.) This is not true for every major SWF like SAMA, but their influence is still substantial for reasons that will be addressed.

(8.) The major SWFs took significant stakes early in their countries’ nascent financial services companies and even formed joint ventures. Current research has focused on the SWF interest in financial services and the returns on investment (Mietzner et al. 2008). Most every sovereign wealth fund holds a significant stake in its national telecommunication carrier, airline, and bank.

(9.) This bypasses the debate about whether managers can actually beat the market, covered in chapter 3.

(10.) This is the author’s calculation and excludes the Cayman Islands and Luxembourg, which are popular international banking locations for a wide variety of investors from
around the world.

(11.) The US Treasury, for the purpose of groupings, describes the Middle East as Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. The author would like to stress that this estimate of SWF size is purposefully very conservative taken from the low end of estimates. This figure should not be used as an authoritative estimate of the SWF sizes for these countries.

(12.) Here I will deal only with SWFs and not state-owned enterprises. These other entities are arguably more important to understanding international business conflict and states, but this topic will be dealt with later in the book. To see a more complete version of the botched privatization, please see Ellis (2008) and the battle to delay or change terms due to the unforeseeable stock market crash, which led to the KIO purchase.

(13.) The specific details of these cases will be presented in greater detail in the case study section of the book in chapters 5 through 7.

(14.) This recounting of the BCCI scandal is not exhaustive but only intended to provide an example of the political framework being described here. For more exhaustive studies of the BCCI saga, the reader is referred to Beaty and Gwynne 2004, Potts et al. 1992, and Adams 1993.

(15.) A primary area of concern in the report is the treatment of BCCI shares by the ruling family, ADIA, and well-connected insiders. The report notes that shares seem to have been owned, noting its inability to trace all the changes in shareholdings, by many different people, families, and companies for the benefit of Abu Dhabi. Members of Abu Dhabi’s royal family in 1990 owned BCCI stock worth $750 million while having contributed “no more than $500,000 to BCCI’s capitalization.” This would constitute a return of 150,000%. ADIA, however, “appears to made some cash payments for its interest in BCCI ... [though] an unknown but substantial percentage of the shares acquired by Abu Dhabi overall in BCCI appear to have been acquired on a risk-free basis —either with guaranteed rates of return, buy-back arrangements, or both.” The Abu Dhabi representative questioned by the congressional subcommittee stressed he was “unaware” of stock sale purchase details, which the report tersely calls “nothing less than a refusal by the government of Abu Dhabi to answer the questions asked.”

(16.) The quote used here is cited from the ABA report “Reforming the Foreign Sovereign Immunities Act,” citing the case of Jungquist v. Nahyan involving Sheikh Al-Nahyan in an unrelated matter but likewise applicable to the First American v. Al-Nahyan case in that sovereign immunity did not apply to the Minister of Defense because he was not the head of state using “personal holding companies for personal as opposed to official acts.”

(17.) It should be noted that this is not a criticism of the NGPF but only meant focus attention on their inclusion of non-financial and value based decision criteria.
(18.) Detail about investments and sources used to analyze SWF activities will be presented in greater detail in the case study chapters.

(19.) This topic was studied in greater detail in chapter 3 and will not be actively pursued here.

(20.) The IWGSWF changed its name in 2009 to the International Forum of Sovereign Wealth Funds. For simplicity's sake, I use its original designation.