Sovereign Wealth Funds

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This note summarises the background to and issues surrounding Sovereign Wealth Funds (SWFs), which have received a great deal of political and media attention through the creation of China's fund and the large investments made by SWFs in various Western financial institutions during the global 'credit crunch'. This note originally appeared as an article in the July 2008 edition of the Library's *Economic Indicators* Research Paper.

Contents

1 What is a Sovereign Wealth Fund?

There is some disagreement about what defines a Sovereign Wealth Fund (SWF), but generally they are state-owned bodies intended to deliver financial returns from the investment of a country's foreign exchange reserves or other assets acquired through those reserves. The *Sovereign Wealth Fund Institute*, a research organisation, distinguishes SWFs from public pension schemes and state-owned enterprises, and defines an SWF as:[1]

> a state-owned investment fund composed of financial assets such as stocks, bonds, real estate, or other financial instruments funded by foreign exchange assets. SWFs can be structured as a fund or as a reserve investment corporation. Some funds also invest indirectly in domestic state owned enterprises. In addition, they tend to prefer returns over liquidity, thus they have a higher risk tolerance than traditional foreign exchange reserves.

While SWFs are government-owned, wide variety is also seen in their level of independence from Government, and how they are managed.

1.1 Why have an SWF?

A recent *Oxford Economics* overview of SWFs, noted that they are typically set up for one or more of the following reasons:[2]

- **Macroeconomic stabilisation** – economies that are dependent on oil and other commodities are exposed to sharp moves in world commodity prices. The main aim of SWFs in these countries is to smooth the short- and medium-term fluctuations, and thereby promote domestic economic stability.
- **Seeking higher returns** – non-commodity-based economies that currently hold reserves far higher than needed for normal usage are increasingly trying to maximise returns rather than holding them in low return, risk-free assets.
- **Future generations** – some SWFs have been created with the long-term goal of creating a pool of wealth for future generations, to be used after natural resources have been depleted.
- **Domestic industries** - some SWFs have been used to restructure and encourage domestic industries.

The International Monetary Fund also see SWFs as a "heterogeneous group", with varying objectives, which can overlap and change, namely:[3]

(i) stabilization funds, where the primary objective is to insulate the budget and the economy against commodity (usually oil) price swings

(ii) savings funds for future generations, which aim to convert non-renewable assets into a more diversified portfolio of assets and mitigate the effects of Dutch disease;

(iii) reserve investment corporations, whose assets are often still counted as reserve assets, and are established to increase the return on reserves;

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1 Sovereign Wealth Fund Institute, "About SWFs" page (the organisation states that is "an impartial organization designed to study Sovereign Wealth Funds and their impact on Global Economics, Politics, Financial Markets, Trade, and Public Policy.", "About us" page)

2 Oxford Economics, Economic Outlook, "The economic significance of Sovereign Wealth Funds", January 2008, p1

3 International Monetary Fund, Sovereign Wealth Funds: A Work Agenda, February 2008, para 8

(iv) development funds, which typically help fund socio-economic projects or promote industrial policies that might raise a country's potential output growth; and

(v) contingent pension reserve funds, which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government's balance sheet.

1.2 History & growth

SWFs date back to at least the 1950s, but their size and general interest in them has increased dramatically in the past few years, particularly with creation of China's SWF (the China Investment Corporation, CIC) and the large, high-profile investments made by many SWFs in Western financial institutions during the global 'credit crunch'.

There is general agreement that the first SWF was the Kuwait Investment Board,[4] created in 1953 to manage funds raised through oil exports (pre-dating Kuwait's independence from the UK in 1961). An office was established in London in 1953, "with the aim of investing surplus oil revenues to reduce the reliance of Kuwait on its finite oil resource."[5] It describes itself as "an autonomous government body responsible for the management and administration" of two of Kuwait's major funds.[6]

However, as the *Financial Times* has noted, SWFs are "rapidly becoming a huge force in global markets and economies".[7] As at December 2007 some $46 billion had been invested in Western financial companies since the second quarter of 2007.[8] Another estimate from June 2008 was that $55 billion being invested by SWFs in US and European financial institutions since the end of 2007.[9] SWFs were in the headlines in the UK again on 26 June, when Barclays Bank announced a £4.5 billion share issue, with the Qatar Investment Authority investing £1.8 billion.[10] Temasek of Singapore and the China Development Bank had previously invested in Barclays back in July 2007.[11]

The Director of the International Monetary Fund's Research Department noted that SWFs' "total size worldwide has increased dramatically over the past 10–15 years" from $500 billion "at most" in 1990 to a current estimated $2-3 trillion.[12] International Financial Services London (IFSL) report that SWF assets "more than doubled" between 2001 and 2007 to total of $3.3 trillion, partly due to the large increases in trade imbalances and the rising price of oil.

Goldman Sachs have observed that SWFs' rise is due to global imbalances in the world economy, and that their investments in developed country economies "rebalance the world economy".[13] In the past it has been primarily countries with oil reserves, such as Norway

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4 Kuwait Investment Office from 1965, then Kuwait Investment Authority from 1984, see Kuwait Investment Authority, "Kuwait Investment Office in London" page

5 Kuwait Investment Authority, homepage

6 *ibid.*

7 "How sovereign wealth funds are muscling in on global markets", *FT.com*, 24 May 2007

8 In December 2007 $46 billion was estimated to have been invested in Western financial companies since the second quarter of 2007. ("Dollars 46bn invested in western institutions", *Financial Times*, 12 December 2007, p18)

9 Stephen Schwarzman, "Reject sovereign wealth funds at your peril", *Financial Times*, 20 June 2008, p11

10 "Barclays seeks to put investors' minds at ease", *Financial Times*, 26 June 2008, p21

11 "Why sovereign wealth funds can't get enough bank shares", *The Observer* , 22 June 2008, Business & Media p5

12 Simon Johnson, Economic Counsellor & Director of Research Department, IMF, "The Rise of Sovereign Wealth Funds", *IMF Finance & Development Quarterly* (44:3), Sep 2007

13 "The Rise of Sovereign Wealth Funds", *IMF Finance & Development Quarterly* (44:3), Sep 2007

and the Gulf States, or other commodities that have operated SWFs, sourced from their foreign exchange earnings. China's fund is based on the rapid growth of foreign exchange from its goods exports, and in particular its current account imbalance with the US. The IMF has noted that SWFs "will become less important only if the countries with large surpluses begin to run prolonged current account deficits."[14]

Five countries account for 75% of the total value of SWF assets. The United Arab Emirates (UAE) has the largest funds, valued at $875 billion (giving a 27% 'market share'), followed by Singapore ($503 billion, 15%), Norway ($380 billion, 12%), China ($377 billion, 11%) and Saudi Arabia ($314 billion, 10%).[15]

The table below shows individual funds and their countries – the largest is the UAE's Abu Dhabi Investment Authority ($875 billion):[16]

Largest 20 Sovereign Wealth Funds

Fund	Country	Inception year	Assets ($ bn)
Abu Dhabi Investment Council	United Arab Emirates	1976	875
Government Pension Fund of Norway	Norway	1990	380
Government of Singapore Investment Corporation	Singapore	1981	330
Saudi Arabia - various holdings	Saudi Arabia	n/a	300
Kuwait Investment Authority	Kuwait	1953	250
China Investment Corporation	China	2007	200
Hong Kong Monetary Authority Investment Portfolio	China	1998	163
Temasek Holdings	Singapore	1974	159
Stabilisation Fund (and National Welfare Fund)	Russia	2004	157
Australian Future Fund	Australia	2004	61
Qatar Investment Authority	Qatar	2000	50
Libyan Arab Foreign Investment Company	Libya	1981	50
Revenue Regulation Fund	Algeria	2000	43
Alaska Permanent Fund	US	1976	40
National Pensions Reserve Fund	Ireland	2001	31
Brunei Investment Agency	Brunei	1983	30
Korea Investment Corporation	South Korea	2005	30
Khazanah Nasional	Malaysia	1993	26
Kazakhstan National Fund	Kazakhstan	2000	22
Alberta's Heritage Fund	Canada	1976	16
Others	-	-	87
Total			**3,300**

Source: IFSL, *Sovereign Wealth Funds 2008* , chart 4 (based on SWF Institute, IFSL estimates)

The *Economist* notes that SWF-managed assets account for only 2% of the total $165 trillion of global traded securities: they account for less than pension funds, mutual funds, insurance companies, but more than hedge funds and private equity.[17] However, the IFSL note that SWFs are growing much more quickly,[18] and that they "are likely to become more important

14 "The Rise of Sovereign Wealth Funds", *IMF Finance & Development Quarterly* (44:3), Sep 2007
15 IFSL, *Sovereign Wealth Funds 2008*, table 3
16 See also SWF Institute "Fund Rankings" page
17 Graphic in "Sovereign-wealth funds: Asset-backed insecurity", *The Economist*, 17 Jan 2008, see also Oxford Economics, Economic Outlook, "The economic significance of Sovereign Wealth Funds", January 2008, p1
18 IFSL, *Sovereign Wealth Funds 2008*, p1 and chart 2

participants in global financial markets over the coming years as inflows from trade surpluses and commodities exports continue."[19]

Estimates of the future growth of the SWF vary. The International Monetary Fund (IMF) has said that SWFs could reach the $10 trillion level by 2012 "based on the likely trajectory of current accounts".[20] Morgan Stanley have predicted that they could be worth $12 trillion by 2015,[21] and SWFs will exceed global official currency reserves by the end of 2011.[22] The IFSL predicts SWFs will be valued at $5 trillion in 2010 then exceed $10 trillion in 2015.[23]

Both Japan and India have recently considered establishing their own SWFs.[24] Brazil also confirmed in May 2008 that it would launch an SWF with up to $20 billion of assets primarily financed from budget surpluses.[25] With recent oil discoveries in Brazil, the country's finance minister has said the fund could be worth £200-500 billion in 3-5 years time.[26] Russia too is working towards an SWF, to be managed by a government agency, after dividing its oil stabilisation fund earlier this year "into a $129 billion Reserve Fund, which will cushion the budget from a fall in oil prices, and a $33 billion National Wealth Fund (NWF) earmarked for riskier investments."[27] The latter "is intended to buoy the pension system as the Russian population ages and the share of those working shrinks", and will be permitted to invest in foreign stocks and bonds.[28]

1.3 Two Sovereign Wealth Funds in brief

Norway

Norway's 'Government Petroleum Fund' was set up in 1990, and was renamed the 'Government Pension Fund – Global' in 2006.[29] It is now valued at around $380 billion.[30]

The Fund's source is the state's petroleum revenues, net financial transactions related to petroleum activities, and returns from the Fund's investments, while it also covers the state's non-oil budget deficit. Norway's Finance Ministry is responsible for the Fund's, while Norges Bank has operational responsibility, investing in financial assets outside of Norway only, using guidelines established by the Finance Ministry.[31]

China

The China Investment Corporation (CIC) is perhaps the most well-known, and most controversial, SWF. However, with an estimated $200 billion of assets it is only the sixth largest, and is relatively new having only been created in 2007 (although it took over the pre-existing Central Huijin Investment Corporation).

19 *ibid.* In addition to this, $6.1 trillion was "held in other sovereign investment vehicles, such as pension reserve funds, development funds and state-owned corporations" and a further $5.3 trillion in "official foreign exchange reserves not held in other sovereign investment vehicles."

20 "The Rise of Sovereign Wealth Funds", *IMF Finance & Development Quarterly* (44:3), Sep 2007

21 "Governments go shopping", *The Economist*, 26 July 2007

22 Morgan Stanley Global Research, "*How Big Could Sovereign Wealth Funds Be by 2015?*", May 2007, p2

23 IFSL, *Sovereign Wealth Funds 2008*, p1

24 "Push for Japanese sovereign fund", *Financial Times*, 6 Dec 2007, p6 and "India weighs up benefits of wealth fund", *Financial Times*, 22 April

25 "In plan for sovereign wealth fund, Brazil charts a different course", *International Herald Tribune*, 14 May 2008

26 "Brazil in $200bn sovereign fund plan", *Ft.com*, 8 June 2008

27 "Putin: No sovereign wealth fund in Russia yet", *Reuters*, 30 June 2008

28 "Russia Creates a $32 Billion Sovereign Wealth Fund", *New York Times*, 1 February 2008

29 This move was part of pension reforms, to highlight the Fund's role in funding public expenditure on pensions; however, the Fund is not earmarked for pensions.

30 IFSL, *Sovereign Wealth Funds 2008*, chart 4

31 See Norwegian Ministry of Finance "Government Pension Fund" page and two-page fact-sheet.

The CIC purchased a 9.9% stake in investment bank Morgan Stanley in 2007, prompting controversy as the SWF is seen by some as a strategic arm of the Chinese Government, with potential political motives (see part 2.1 below). However, CIC President and Chief Investment Officer, Gao Xiqing, has said that CIC was "investing for financial return not political motive. CIC was only making passive investments in companies and would walk away from countries that were publicly hostile".[32]

For more on China's SWF, see a detailed Congressional Research briefing.[33] There is also a separate Hong Kong Monetary Authority Investment Portfolio, managed by Hong Kong's Monetary Authority, and valued at $163 billion.

2 Policy towards SWFs & recent developments

The recent prominence of SWFs has generated policy questions as to how these funds, often considered secretive, should act and what restrictions or limitations should be imposed on them, particularly in 'strategic' economic sectors. Multi-national institutions, such as the IMF and the Organisation of Economic Co-operation & Development (OECD), as well as the European Union and individual countries have been looking at policies towards SWFs over recent months.

2.1 Transparency seen as key

The focus is generally on transparency. As the IMF's Director of Research has noted,[34]

> Unfortunately, there's a lot we don't know about sovereign funds. Very few of them publish information about their assets, liabilities, or investment strategies. It's thought that they've traditionally been "long only": that is, they pursue buy-and-hold strategies, with no short positions and perhaps no borrowing or direct lending of any kind. They probably have long horizons and, like other long-term investors, are willing to step in when asset prices fall. This likely exerts a stabilizing influence on the world's financial system. But there is also anecdotal evidence that some sovereign funds have placed investments with other leveraged funds. […]

He also observed that 'rogue traders' were a potential issue, noting that heavy losses after acting "without the approval of the appropriate credit risk managers" could "awaken calls for regulation of cross-border capital flows when decisions by sovereigns are involved."

An index of SWF transparency, the 'Linaburg-Maduell Transparency Index' has been developed by SWF Institute researchers. This is based around Norway's SWF, widely seen as the benchmark of transparency. It has ten "essential principles", including the availability of governance information and having independently audited annual reports. This produces in a transparency rating from 1 to 10, with 8 recommended "in order to claim adequate transparency."[35] On this measure the Norwegian fund scores 10, whereas the largest fund, the Abu Dhabi Investment Authority, scores 3. China's CIC scores 2, and Honk Kong's Fund 7, as does Singapore's Temasek (Singapore's GIC scores 6).

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32 "Chinese fund tries to calm west's fears", *Financial Times*, June 2008, p4
33 "China's Sovereign Wealth Fund", Congressional Research Service briefing, 22 January 2008
34 "The Rise of Sovereign Wealth Funds", *IMF Finance & Development Quarterly* (44:3), Sep 2007
35 SWF Institute, "Linaburg-Maduell Transparency Index" page

The IMF's Director of Research also observed the "real danger" to be that SWFs, along with other "government-backed investment vehicles":[36]

> may encourage capital account protectionism, through which countries pick and choose who can invest in what. Of course, there are always some national security limitations on what foreigners can own. But recent developments in the world suggest there may be a perception that certain foreign governments shouldn't be allowed to own what are regarded as an economy's "commanding heights." This is a slippery slope, which leads quickly and painfully to other forms of protectionism. It's important to preempt such pressures.

However, the IMF found "no clear evidence that SWF investments have been motivated by narrow political objectives."[37] The *Economist* also argued that, despite the various "imagined fears" about SWFs,[38]

> it is hard to find examples of sovereign-wealth funds abusing their power. As with private-equity groups and hedge funds, the anxieties owe less to reality than to a mix of secrecy and suspicion. With a few exceptions, like Norway, which opts for disclosure, you cannot tell what a sovereign-wealth fund's objectives are, precisely how much money it manages and where it has made its investments. Already the funds use the full range of investment options, including hedge funds and private equity, which further covers their tracks. […] Secretive and possibly manipulative, they are almost designed to raise suspicions. That is why the chief threat they pose is of financial protectionism.

2.2 OECD & IMF work

Nevertheless, the G7 Finance Ministers meeting in October 2007 called on both the IMF and the OECD to develop guidelines for SWFs.[39] The IMF is focusing on their management and accountability, while the OECD is focusing on recipient countries' policies towards investments by SWFs. So far, neither has completed their work.

The IMF is developing a voluntary SWF management code of conduct, having previously produced similar forms of guidelines on fiscal transparency and the management of foreign exchange reserves.[40] Its work agenda was approved by the IMF's Executive Board in March 2008.[41] So far this work has included a survey of SWFs, a roundtable meeting of governments and SWF officials, as well as co-ordinating work with the OECD, the World Bank and the European Commission.[42]

An International Working Group of Sovereign Wealth Funds (IWG) was set up earlier this year. This group includes representatives of 25 SWFs, including China, Norway, Russia, and the United Arab Emirates, with the IMF providing the group's secretariat support. Saudi Arabia, the OECD and the World Bank are permanent observers. The IWG intends "to present by October 2008 a set of SWF principles that properly reflects their investment practices and objectives."[43] An initial draft of a best practice text is expected to be ready for

[36] "The Rise of Sovereign Wealth Funds", *IMF Finance & Development Quarterly* (44:3), Sep 2007
[37] IMF, Sovereign Wealth Funds: A Work Agenda, February 2008, para 15
[38] "Sovereign-wealth funds: Asset-backed insecurity", *The Economist*, 17 Jan 2008
[39] "G7 ministers want new guidelines for sovereign wealth funds", *The Times*, 20 October 2007, p61
[40] "IMF Intensifies Work on Sovereign Wealth Funds", *IMF Survey online*, 4 March 2008
[41] "IMF Executive Board Discusses a Work Agenda on SWFs", *IMF Public Information Notice 08/41*, 1 April 2008
[42] "IMF Intensifies Work on Sovereign Wealth Funds", *IMF Survey online*, 4 March 2008
[43] "International Working Group of Sovereign Wealth Funds is Established to Facilitate Work on Voluntary Principles", *IMF press release 08/97*, 1 May 2008

the IMF's Executive Board to discuss ahead of this autumn's IMF/World Bank Annual Meetings.[44]

The OECD's work has focused on the opposite side of the issue, the policies of countries in receipt of SWF investments, in order to avoid unwarranted protectionism.

The OECD's Secretary General, Angel Gurría, laid out a "common OECD position" on SWF policy in a letter to G7 finance ministers in April 2008.[45] The OECD says its member countries "are committed to keeping their investment frontiers open to sovereign wealth funds (SWFs) as long as these funds invest for commercial, not political ends."[46] Accompanying this was a report, *SWFs and Recipient Country Policies*, the work of the 30 OECD member countries, 14 non-members, and the European Commission.[47] It acknowledged that national security concerns were legitimate but that these "should not be a cover for protectionist policies".[48]

The OECD's position is based on the principles in pre-existing "investment instruments" on capital movements, and international investment and multinational enterprises. These "call for fair treatment of investors", and include: commitment to non-discrimination; transparency; progressive liberalisation; undertakings not to introduce new restrictions; and not to insist on reciprocity as a condition for liberalisation.

The OECD Ministerial meeting on 4-5 June 2008 adopted an "OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies", stating that:[49]

- Recipient countries should not erect protectionist barriers to foreign investment.
- Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
- Where such national security concerns do arise, investment safeguards by recipient countries should be:
  - transparent and predictable,
  - proportional to clearly-identified national security risks, and
  - subject to accountability in their application.

It is expected that the final report of the OECD's Freedom of Investment project, of which the SWF work forms a part, will be released in Spring 2009.[50]

44 "IMF Executive Board Discusses a Work Agenda on SWFs", *IMF Public Information Notice 08/41*, 1 April 2008
45 OECD Secretary General's letter , 4 June 2008; http://www.oecd.org/dataoecd/34/9/40408735.pdf
46 "Sovereign wealth funds an opportunity, not a threat", *The Guardian*, 9 Apr 2008
47 "OECD countries stay open to commercial investments by sovereign wealth funds", *OECD press release*; and OECD report, available at http://www.oecd.org/dataoecd/34/9/40408735.pdf.
48 OECD report, p4
49 "OECD Declaration on Sovereign Wealth Funds & and Recipient Country Policies" (C/MIN(2008)8/FINAL), 5 June 2008, p2
50 OECD Secretary General's letter, 4 April 2008; http://www.oecd.org/dataoecd/34/9/40408735.pdf.

3 UK, EU & US positions

3.1 UK Government position

In October 2007, the *Times* reported comments from the Chancellor of the Exchequer, Alistair Darling, that some countries' moves to regulate the activities of SWFs appeared to be "pure protectionism", noting that "Britain has had a tremendous benefit from liberalised trade over the past few years ... we are therefore vehemently against moves to re-establish protectionism."[51] The Chancellor has also said that SWFs "need to play by the rules", and that "When a company is not acting in a commercial way or we have reason to believe it is going to make an investment where there is an issue of national security, then we have powers to take action."[52] These powers exist under the Enterprise Act 2002, but the Chancellor has not specified which companies it would use them in relation to.[53]

In a December 2007 speech the Economic Secretary to the Treasury, Kitty Ussher, said that SWF investment "benefits London, and there are advantages for the Funds, too – the City has a wealth of expertise in managing assets, and using London as a base allows Funds to keep close to the world's financial markets."[54] She went on to welcome SWFs "using London in that way and - open and international as it always has been - London will continue to welcome commercial investment from around the world."[55] She stated that she would be sending this message to the Chairman of China's CIC,[56] while the Prime Minister, Gordon Brown, reportedly urged China's CIC to establish offices in London as an international hub during his visit to China in January 2008.[57]

International Financial Services London (IFSL) have noted that London "is an important centre in the SWFs market as a clearing house and location from where some of these funds are managed."[58] In addition to the Kuwait Investment Authority, it notes that Brunei Investment Authority, Abu Dhabi Investment Authority and Temasek/the General Investment Corporation of Singapore have established London offices.

A working party of the Prime Ministers' Business Council was set up in December 2007 to develop policy proposals on SWFs, to "air suggestions that include restricting the voting rights of the funds, and forcing them to adhere to strict rules on transparency and corporate governance."[59] SWFs were then reportedly discussed at the February 2008 Business Council meeting.[60]

The Economic Secretary to the Treasury's December 2007 speech also acknowledged that SWFs' growth "has raised concerns - that they may have a negative impact on global stability, and that they may make investments for non-commercial reasons."[61] She said "all investors need to behave commercially, and be seen to behave commercially, and they have

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51 "G7 ministers want new guidelines for sovereign wealth funds", *The Times*, 20 October 2007, p61

52 "Rising power of the sovereign funds", *Sunday Times*, 28 October 2007, Business p4.

53 "Chancellor backs G7 move to get tough on sovereign wealth funds": 'Political' investments not tolerated, says Darling", *The Guardian*, 20 October 2007

54 Speech at The Economist "London's Financial Markets: Where Next?" Conference, London, 4 December 2007, para 53

55 *ibid.*, para 54

56 *ibid.*, para 54

57 "Brown urges China fund to use City as hub", *Financial Times*, 19 Jan 2008

58 International Financial Services London (IFSL) Research, *Sovereign Wealth Funds 2008*, p1 & p3

59 "Brown gathers business leaders for summit on sovereign wealth funds", *The Observer*, 3 Feb 2008, p2

60 *ibid.*

61 Speech at The Economist "London's Financial Markets: Where Next?" Conference, London, 4 December 2007, para 50

to meet the appropriate standards of governance and transparency",[62] and welcomed the IMF and OECD work. In a document released in March 2008 alongside the Budget, the Government stated that "to harness the investment potential" in SWFs,[63]

> the UK will engage fully with the ongoing work in the IMF and OECD to set out best practice guidelines. SWFs raise important and complex global issues, requiring a global approach. It is in the interest of all parties to improve standards of governance and transparency and promote fair investment frameworks. This needs to be developed with SWF sponsoring countries and recipient countries through dialogue to build confidence.

In a May 2008 speech on SWFs, the Economic Secretary to the Treasury said she hoped the OECD and IMF work would help "build trust between countries with sovereign wealth funds, and countries where they are seeking to invest."[64] She also acknowledged that "some funds have concerns about this international process", but saw "a real economic rationale for developing best practice on corporate governance and transparency - and I do believe this process will benefit the funds in the long run, as well as being reassuring in recipient countries." [65]

3.2 EU position

A European Commission Communication issued in February 2008 recognised the benefits of SWFs but states that SWFs needed to be more transparent over their investment strategies and objectives.[66] In summary this proposes:[67]

> […] that EU leaders endorse a common EU approach to increasing the transparency, predictability and accountability of SWFs. This common approach will strengthen Europe's voice in international discussions aiming to establish a code of conduct including standards in areas of transparency and governance.

It would like to see an agreed code of conduct by the end of 2008. As well as highlighting "some basic governance and transparency standards that should be included in a voluntary code of conduct for SWFs" the IMF is working on, the Commission highlight five principles:

1. commitment to an open investment environment both in the EU and elsewhere, including in third countries that operate SWFs;
2. support of multilateral work, in international organisations such as the IMF and OECD;
3. use of existing instruments at EU and Member State level;
4. respect of EC Treaty obligations and international commitments, for example in the WTO framework;
5. proportionality and transparency.

The European Commission's President, José Manuel Barroso, stated that:[68]

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62 Ibid., para 51

63 HM Treasury, *The UK economy: analysis of long-term performance and strategic challenges*, March 2008: para 3.80

64 Speech by the Economic Secretary to the Treasury, Kitty Ussher MP, at 'Sovereign Wealth Funds: A British and Norwegian Perspective', Bloomberg, London, 6 May 2008, para 28

65 *ibid.*, para 35

66 "A common European approach to Sovereign Wealth Funds", European Commission Communication, 27 Feb 2008

67 "Commission puts forward proposals to the European Council on sovereign wealth funds and financial stability", *European Commission press release*, 27 Feb 2008

> Europe must remain open to inward investments. Sovereign wealth funds are not a big bad wolf at the door. They have injected liquidity and helped stabilize financial markets. They can offer reliable long-term investments our companies need. To ensure this, we need global agreement on a voluntary code of conduct – it is to this end that we make a contribution today. It must avoid some funds being run in an opaque manner or used for non-economic objectives. The EU should take a common approach, without different responses from Member States that could fragment the single market. I have already made clear that we may propose European legislation if we cannot achieve results by voluntary means.

In a March 2008 speech, the EU Trade Commissioner, Peter Mandelson, said that SWFs simply cannot afford to underestimate how important reassurance about systems of transparency and governance is in ensuring that unfounded suspicion doesn't mushroom into a protectionism that is in nobody's interest".[69] He concluded that:[70]

> Our focus should not be on demonising them [SWFs], or stoking public fears about foreign investment. Our chief concern should be integrating the sovereign wealth funds effectively into the global financial system by working with them on a voluntary international code that preserves an open global investment climate and gives the funds the access they want and the recipient countries and publics the reassurance they need. This is the route Europe has settled on, and I believe it is the right one.

This matter was considered by EU leaders at the March 2008 Spring European Council. They welcomed the Commission's work, acknowledged SWFs' "very useful role as capital and liquidity providers with long-term investment perspective", but noted concerns about "the emergence of new players with a limited transparency regarding their investment strategy and objectives has raised some concerns relating to potential non-commercial practices."[71] The Council agreed that a "common European approach taking into account national prerogatives, in line with the five principles proposed by the Commission" was needed, and pledged support for the work towards an internationally-agreed voluntary SWF code of conduct.

Philip Whyte and Katinka Barysch from the Centre for European Reform have warned against the EU "providing cheap protectionist ammunition to its member-states", favouring "alternative solutions that ease fears about foreign political control without succumbing to the temptation of protectionism". They note moves in some countries to protect their energy or other strategic sectors, and acknowledge that "doing nothing may not be an option":[72]

> If the EU fails to agree a common line, individual EU countries will probably take measures of their own. And the barriers that resulted could impede the free movement of capital, both from outside the EU and within.[73]

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[68] *ibid.*

[69] "Putting sovereign wealth in perspective", *Speech to OECD Conference, Paris*, 28 March 2008 (see also a November 2007 speech on SWFs by Charlie McCreevy, EU Internal Market Commissioner)

[70] *ibid.*

[71] European Council, 13/14 March 2008, *Presidency Conclusions*, 14 Mar 2008, para 36

[72] Philip Whyte & Katinka Barysch, "What should Europe do about sovereign wealth funds?", *Centre for European Reform Bulletin 56* (October/November 2007)

[73] *ibid.*

3.3 US position

In the US, the Committee on Foreign Investment in the United States (CFIUS) "is able to review investments from sovereign wealth funds just as it would other foreign government-controlled investments, and it has and will continue to exercise this authority to ensure national security."[74] The President's Working Group on Financial Markets, chaired by the Treasury Secretary, and including regulators, has also initiated a review of SWFs.[75]

In March 2008, the US concluded an "Agreement on Principles" for investments by the Singapore and Abu Dhabi SWFs, outlining five policy principles for SWFs and four for recipients of investment:[76]

> Policy Principles for Sovereign Wealth Funds (SWFs)
>
> 1. SWF investment decisions should be based solely on commercial grounds, rather than to advance, directly or indirectly, the geopolitical goals of the controlling government. SWFs should make this statement formally as part of their basic investment management policies.
>
> 2. Greater information disclosure by SWFs, in areas such as purpose, investment objectives, institutional arrangements, and financial information – particularly asset allocation, benchmarks, and rates of return over appropriate historical periods – can help reduce uncertainty in financial markets and build trust in recipient countries.
>
> 3. SWFs should have in place strong governance structures, internal controls, and operational and risk management systems.
>
> 4. SWFs and the private sector should compete fairly.
>
> 5. SWFs should respect host-country rules by complying with all applicable regulatory and disclosure requirements of the countries in which they invest.
>
> Policy Principles for Countries Receiving SWF Investment
>
> 1. Countries receiving SWF investment should not erect protectionist barriers to portfolio or foreign direct investment.
>
> 2. Recipient countries should ensure predictable investment frameworks. Inward investment rules should be publicly available, clearly articulated, predictable, and supported by strong and consistent rule of law.
>
> 3. Recipient countries should not discriminate among investors. Inward investment policies should treat like-situated investors equally.
>
> 4. Recipient countries should respect investor decisions by being as unintrusive as possible, rather than seeking to direct SWF investment. Any restrictions imposed on investments for national security reasons should be proportional to genuine national security risks raised by the transaction.

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[74] "Statement by Deputy Assistant Secretary Robert Dohner before the U.S.-China Economic and Security Review Commission", US Treasury Department press release, 7 February 2008

[75] *ibid.*

[76] "Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment with Singapore and Abu Dhabi", *US Treasury Department press release*, 20 March 2008

Also, in June 2008, the US and China announced talks pursuant to a bilateral investment treaty. The *Financial Times* reported that the US "would seek a "high standard"" treaty, which "would strengthen investor rights in China", to ensure that foreign and domestic investors are treated equally, with the widest possible sectoral coverage.[77] It noted that "analysts believe that China will favour a more limited investment treaty of the kind it already has with some other nations", but that it was "anxious to ensure that its investors", its SWF included, "are allowed to buy US assets without discrimination."

Oxford Economics consider that the US will see "calls for greater protectionism against SWFs – mostly aimed at China" becoming "increasingly vocal as the November 2008 elections approach." It noted that "suspicion will have been reinforced" by the China's CIC $1 billion stake in Bear Stearns, the investment bank, and the $7.5 billion investment by Abu Dhabi Investment Council into Citigroup.[78]

4 **Additional resources** (see also footnotes)

[Please note that some resources are only available to Parliamentary network users]

Anders Åslund, "The truth about sovereign wealth funds", Foreign Policy, December 2007

Aaditya Mattoo & Arvind Subramanian, "Currency Undervaluation & Sovereign Wealth Funds: A New Role for the WTO", *Peterson Institute for International Economics*, January 2008

Council on Foreign relations, "Sovereign Wealth Funds" page

Dr Gerard Lyons, "State Capitalism: The Rise of Sovereign Wealth Funds", *Standard Chartered 'Thought Leadership' paper*, December 2007

Financial Times, 'In depth' guide to Sovereign Wealth Funds

International Monetary Fund, Sovereign Wealth Funds: A Work Agenda, February 2008

Jen, S., "Sovereign Wealth Funds: What they are and what's happening", *World Economics* 8:4 (2007), pp1-6

Kern, S., "Sovereign Wealth Funds - State Investments on the Rise", *Deutsche Bank Research*, September 2007

Kimmit, R. M., "Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy", *Foreign Affairs*, January/February 2008

Martin, M. F. "China's Sovereign Wealth Fund", *Congressional Research Service briefing*, January 2008

Morgan Stanley Global Research, "*How Big Could Sovereign Wealth Funds Be by 2015?*", May 2007

Oxford Economics, Economic Outlook, "The economic significance of Sovereign Wealth Funds", January 2008

77 "Washington and Beijing to discuss investment treaty", *Financial Times*, 19 June 2008, p11

78 Oxford Economics, Economic Outlook, "The economic significance of Sovereign Wealth Funds", January 2008, p31

Truman, E. M., "Sovereign Wealth Funds: The Need for Greater Transparency and Accountability", *Peterson Institute for International Economics*, August 2007

Weiss, M. A. "Sovereign Wealth Funds: Background and Policy - Issues for Congress", *Congressional Research Service briefing*, January 2008