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<td>AIG</td>
<td>American International Group</td>
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<td>FED</td>
<td>Federal Reserve Bank</td>
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<td>Foreign Direct Investment</td>
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<td>GAPP</td>
<td>Generally Accepted Principles and Practices (Santiago Principles)</td>
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<td>GDP</td>
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<td>GIC</td>
<td>Government Investment Fund (Singaporean SWF)</td>
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<td>GPF</td>
<td>Government Pension Fund (Norway’s SWF)</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
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<td>NSIA</td>
<td>Nigerian Sovereign Investment Authority (Nigeria’s SWF)</td>
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<td>SWF</td>
<td>Sovereign Wealth Fund</td>
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<td>UK</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>USA</td>
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Abstract:

Sovereign Wealth funds are public funds charged with the recycling of national wealth on private markets. Their swift movement from obscurity to celebrity has coincided with the increasing presence of other public investment machines. This has lit the tinderbox of suspicion and trepidation in their hosts. Nonetheless, many recipient states face an increasing quandary of protecting their genuine national and economic interests whilst also attracting the mutually profitable capital these funds provide. This capital influx has never been more vital, given the toxic combination of humungous debts, deficits and low saving rates in many recipient states.
Introduction:

For much of the last century, states played an active role in markets through the interposition of entities for the maximisation of profit as well as the actualisation of cynical policy gambits. This ideology came to what is now regarded as a hiatus with the collapse of the Soviet Union and the supplanting of former economies built on statist models with the diametrically opposed ideology of liberal capitalism. The dawn of the new century has seen a number of forces collide – an increasing disposition of states to recycle their wealth abroad in instruments other than sovereign debt instruments, the rise of transnational normative frameworks for global market and business behaviour and increasing global imbalances which have created a widening gulf between surplus and deficit countries.¹ Among the more visible indicators of this seismic change is the rise and rise of a new class of idiosyncratic investors (formally public yet functionally -private) called Sovereign wealth funds. All forecasts both academic and political predict an exponential growth in the size of these funds.² That said, the picture is not entirely rosy. First the nature of these funds continues to dominate discourse in political circles, not least because of the conflation of an inherent sovereign status with a functionally private investment behaviour. This has created a revolving door of opinion about the nature of these funds, with some convinced that governmental nexus is the principal determinant of nature and others divided on whether the functional separation from the apparatus of state gives off a great deal of information these funds.

Second, the presence of these funds on overseas private markets has reopened long-festering and familiar concerns over the benefits and dangers of foreign investment, with a flooded list of motives ascribed to these funds.

In search for answers to the sovereign fund conundrum, this dissertation pursues a critical analysis of public investments in overseas private markets. In a chronological order, the first chapter investigates the political economy of state capitalism and the much peddled return of the state. It sheds instructive light on modes of public investments in private markets ranging from Central Banks reserve management to State Corporations acquiring significant stakes in diverse markets. Further light is shed on the shortcomings of these corporations and their impacts. The analysis moves along to the reinvention of the state by way of a wealth fund. Here, a flashback technique is employed in tracing the history of these funds, revealing diverging genealogical accounts. The dissertation investigates the raison d'être of creating SWFs, illuminating the crucial macroeconomic and political benefits the establishment of these funds bring to owning states. The focus turns to the familiar definitional and structural conundrums besetting these funds and their investment strategies.

The penultimate chapter explores the extant regulatory framework for sovereign wealth investment, examining the structural flaws embedded. Finally, a conclusion reached that a great deal of coordination is required to balance the protracted policy concerns of recipient states with the mutually beneficial investments sovereign funds bring.

The main and last chapter is devoted to the policy concerns of recipient states vis a vis the market-centred investments of sovereign funds which has created a regulatory quandary. For this reason, the familiar concerns of national security and financial stability are probed from a historical perspective as well as in the context of SWFs. For a resolution of the regulatory quandary, proposals are put forward, geared towards utilising existing regulatory
frameworks in such a way that genuine policy concerns are not shunted out, whilst also extracting a great deal of compromise from sovereign funds and their owners as well as recipient states.

In conclusion, the dissertation calls for a laser focus on ways to achieve equilibrium between host states and sovereign wealth funds.

The methodology employed is a critical analysis of the subject matter. Reliance is placed on research, studies, industry papers, reports, reputable newspapers and magazines, and data from International organizations and agencies. The final findings are based on deductions from a critical analysis of these sources. This paper employs a simple introduction, analysis, and conclusion format.
CHAPTER 1: STATE CAPITALISM & PUBLIC INVESTMENTS IN OVERSEAS PRIVATE MARKETS

1.0 - INTRODUCTION:

As the cold war stumbled to an end, the ideology that governments could micro-manage national economies and generate prosperity became obsolete. A neo-liberal consensus on the power of markets to own and control the means of production, distribution and exchange and the dilution of the role of the state became sage. After almost two decades of extensive statist reform and privatization, many believe the western bete noire of State Capitalism has made a comeback to destabilise what was thought to be a political economy set on a trajectory of increasingly unfettered free markets. To buttress this position, sceptics point to the growing presence of State-owned entities in private markets and the widespread nationalisation of private institutions during the credit and liquidity crisis.

Rather unsurprisingly, many observers and states view these developments with apprehension. The chief reason is the idea that Statist capitalism and the ideals of liberal capitalism are boxed in different silos. According to political scientists, the former sees the state as an integral part in the workings of the economy, whilst the latter is wedded to the idea of laissez faire markets where the role of the state is nothing but diluted. This uneasy dialectic between state and markets has been challenged by the reinvention of the state in quasi-private ways through SWFs- state-owned and controlled entities which recycle budget and/or commodity surpluses on private markets in search of higher premiums. The aims of these

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3 Xu Yi-Chong, The Political Economy of Sovereign Wealth Funds (1st edn, Palgrave Macmillan 2010) p 7
5 A Dixon & A Monk, Rethinking the Sovereign in Sovereign Wealth Funds [2011] 37 Trans Inst Br Geogr 104
6 Supra N 1
funds are usually variegated but analysts argue they are principally focused on the stabilization of the national balance sheet for different periods, the diversification of the central bank's reserves, smoothening inter-generational revenue of country, prevention of national socio-economic crisis and assistance of the government’s overall development strategy. Sovereign Wealth Funds (SWF) are, therefore, hybrid entities whose nature, ownership and governance structure is not similar to any other public or private organization. What is intriguing about these funds is that they owe allegiance to their owners and constituents as entrepreneur or manager of scarce resources as well as exude a fundamental impulse that keeps the capitalist engine of profit and risk maximisation alive.

In a world of economics, finance and law where everything is black and white, these colour-coded chameleons defy belief. Similar to the debate between states and markets, a great body of literature has emerged questioning the motives of these funds and their ability to stabilise an already besieged global financial order.

This chapter is not solely devoted to the SWF saga; it also dissects the general paradigm of public investments in private markets. In a chronological order it considers the concept of Central bank led Capitalism which involves the presence of state monetary institutions in Private markets. It equally, observes the increasing presence of State-owned corporations in private markets. The following section delves deeper into the workings of Sovereign wealth Funds, with instructive light shed on their definition, structure and investment strategies.

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1.1 - Central Banks:

Since central banks were established (arguably with the establishment of the Bank of England in 1694) the polemics between these entities and the political system has dominated intellectual and political discourse. Although, the cardinal function of central banks which is to maintain price and monetary stability has rarely been challenged, the pendulum of controversies has swung from the 1980s to 90s debate about structure, institutional independence, inflation targeting and monetarism to the extant discourse about central bank complacence in the wake of the financial crisis. Yet, what remains largely hidden beneath routine discourse is the investments of these institutions.

Central banks as public monetary authorities (usually independent from government) have gone beyond their traditional bagehotian role as lender of the last resort and also beyond their Keynesian or Minskyian role of ‘mopping up’ manageable debris to become traditionally conservative and secretive holders and managers of official reserves. This has coincided with an exponential growth in the amount of reserves held and managed by Central Banks across the world.

According to the International Monetary Fund, A country’s international reserves refer to “...those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments, financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing).”

The ownership of these reserves is subject to considerable debate. One school of thought contends that official reserves are owned by the government or public. On the other side, it is

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8 Ralph Atkins, Beware Central Banks Buying Spree, Financial Times (London, 19 June 2014) Available at http://www.ft.com/cms/s/0/460ca86a-f6fa-11e3-9e9d-00144feabcd0.html#axzz3C0kX4TJA
argued that the official reserves held in a central bank may be part of the Central Bank’s balance sheet and thus owned by the central bank.\textsuperscript{10} Whoever formally owns the reserves, the reality is they are nearly always managed by the Central Bank—either as principal or in the case where the assets are owned by the government as agent (the main exception is where the reserves are part of a separate wealth investment fund) and however independent the bank is, the ultimate decisions on a country’s currency and the wider economy may lie with the Government and these decisions will of course have consequences for the management of the reserves.\textsuperscript{11}

For reserve managers, including central banks, there is a trilogy of objectives: \textbf{Security, Liquidity & Returns}. First, authorities will always value the security of reserves: this is entirely predictable as assets held on behalf of others attract a higher degree of fiduciary duty and safety and official reserves are no exception. Secondly, official reserves management must always be conducted in a way as to ensure that reserves are available as and when they are required. Thus, reserve management authorities will prioritize liquidity i.e. the ability to convert assets into cash. Thirdly, Managers of Reserves like Central Banks may try to maximise returns. Unlike other public reserve investment institutions like SWFs, Central banks generally invest in marketable, liquid and short-term instruments (although recent evidence discussed below suggests a radically emergent trend)\textsuperscript{12}. This search for market premium is a fundamental impulse of capitalism which was traditionally viewed as a shibboleth of the private sector. Increasingly, however, such sentiments are losing steam and

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\item[] \footnotesize\textsuperscript{11} Ibid
\item[] \footnotesize\textsuperscript{12} J Aizemann & R Glick, Sovereign Wealth Funds: Stylized facts about their Determinants and Governance (2009) 12(3) International Finance 351
\end{itemize}
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the pursuit of returns by central banks as autonomous and independent public monetary institutions is now a legitimate and central element of official reserves management.\textsuperscript{13}

Armed with these reserves, Central banks have been able to invest in foreign currencies like the dollar and gold. This investment policy serves as a lever for local currency stabilisation against speculative attacks. More so, Central banks recruit external managers to manage reserves on private markets with a view to accumulating returns on investments. According to the Chilean Central bank, 3\% to 5\% of its total investment portfolio is outsourced to external portfolio managers.\textsuperscript{14}

If recent evidence is anything to go by, it is that a new form of central-bank led capitalism is underway with the increasing presence of the world’s central banks on private markets. According to a report from the Financial Times and the Official Monetary and Financial Institutions Forum (OMFIF), a central bank research and advisory group, banks like the People’s bank of China and its investment arm the China state Administration of Foreign Exchange (SAFE) are leading a profit maximisation and diversification drive into global equity markets. Whilst the SAFE has established itself as the world’s largest public sector holder of equities, it also appears the People’s bank of China is now itself buying minority equity stakes in systematically important European corporations. This interest in European Institutions has been derided as ‘calculated’ because it counters the monopoly of the American dollar and shines a light into Beijing’s global ambitions.\textsuperscript{15} The attractive proposition of equity investments has also caught the attention of central banks in Europe such as the Swiss and Danish Central banks. The former is reported to have an equity quota

\textsuperscript{13} Ibid at 354
\textsuperscript{15} Supra N 8
of about 15% worth about $500m at the end of 2013. On a more negative note, this increased presence in equity markets has sparked fears of an asset price bubble.16

Another conjuncture in Central bank led capitalism can be seen in the use of unconventional monetary policies which go beyond the routine lender of last resort function of Central Banks. A particularly illustrative example is bout of Quantitative easing injected by western Central banks in the wake of the Financial Crisis. This involved injecting liquidity and stimulating domestic economies, not by cutting interest rates but by purchasing financial assets directly from banks and financial institutions (private markets) through the creation of bank reserves/ money. In the immediate aftermath of Lehman Brothers collapse, International Banks stopped trusting each other as the inter-bank lending markets became toxic. Consequently, the Federal Reserve upped its commercial paper and asset-backed commercial paper purchase to restore financial stability. This capital injection strategy was followed by the Bank of England and the European Central Bank whose coverage extended from government gilts to corporate bonds and other financial instruments. As the crisis deepened, so did the depth of Central bank Balance sheets. According to IMF Statistics, the Balance sheets of the Fed and the BOE more than tripled between July 2007 and January 2012 from approximately 5% of GDP to about 20% of GDP. Over the same period, the ECB experienced an exponential growth in its asset and liabilities base from 12.5% of GDP to 32% of GDP.17 In effect, Central bank Balance sheets became not only bloated but riskier, calling into question the notion that central banks place greater weight on holding safer assets.18

16 ibid
The responses to these unconventional policies remain evenly balanced with some attributing the slow but steady recovery to the magnitude of these policy innovations\(^{19}\) and others questioning the wisdom of a central monetary authority holding stockpiles of bought-in assets which could create exit problems and low yields. Yet, what is clear is that these assets bought by central banks can be sold to return balance sheets to pre-crisis levels, with considerable yield for the central banks involved.\(^{20}\)

### 1.2. STATE-OWNED CORPORATIONS

State-owned corporations are an archetypical mode of public investments in the private sector. These entities are usually incorporated by an enactment of the state legislature or parliament. They are also powered by public resources which sometimes give them market leverage over private competitors. Furthermore, the phenomena of ownership and control rests on the home state save in circumstances where the corporation in question is publicly listed. In the latter case, the state or its emanation is usually the majority shareholder followed by other shareholders. Control of these entities can be done directly or indirectly through the appointment of professional or political figure heads as directors and managers. State-owned corporations may take the form of Multinational or Transnational corporations engaged in direct investment outside its home country or similar arrangements may be set up involving the acquisition of stakes in other corporations.\(^{21}\)

Years after the *coup de grace* of the Soviet Union, the retreat of state-owned corporations and the enthronement of the free and unfettered markets doctrine, state capitalism seems to have

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19 Martin Wolf, Lunch with the FT: Paul Krugman, Financial Times (London, May 26, 2012), [http://www.ft.com/intl/cms/s/2/022ac5f5-0a3d-11e1-9a94-00144feabdc0.html#axzz2FLp6o2gy](http://www.ft.com/intl/cms/s/2/022ac5f5-0a3d-11e1-9a94-00144feabdc0.html#axzz2FLp6o2gy)

20 Supra N 18

launched a remarkable comeback.\textsuperscript{22} In a world where the tides of economic development and growth has swung from west to east and even south, struggling recipient economies increasingly depend on a capital influx from private and public investors. With the private sector recovering from a protracted credit, liquidity and confidence crisis, the lot has fallen on powerful state-owned entities, many of which are pre-disposed towards statist models of economic development. As such, hundreds and possibly thousands of state-owned corporations are acquiring stakes not just in domestic markets but also overseas. In sectors as diverse as energy, defence, power generation, telecoms, aviation and financial services, these corporations are setting the pace through the proliferation of subsidiaries and the acquisition of stakes in moribund companies. In the energy sector for instance, State-owned oil corporations have dislodged the so-called seven sisters. According to Forbes’ 2013 statistics\textsuperscript{23}, 7 of the top 10 international oil companies are state-owned and in chronological order they are; Saudi Aramco, Gazprom, National Iranian Oil Company (NIOC), Rosneft, PetroChina, Pemex and the Kuwaiti Petroleum Company. Cumulatively, these companies control over 3-quarters of the world’s energy reserves and have revenues larger than some countries. In contrast, the private oil companies on the list produce just about 10\% of the world’s oil and gas and hold about 3\% of its reserves.\textsuperscript{24} The tale of public investments in private markets is not just an oil story; there are also significant statist footprints in a broad range of sectoral markets. In the metals and steels industry, Chinese and Russian metallurgy corporations are throwing sharp elbows in the competition for market share in Africa.\textsuperscript{25} In the utilities sector, the State-Grid Corporation of China is flexing its financial muscle in Europe.

\begin{itemize}
  \item \textsuperscript{22} The State Advances, The Economist (October 6\textsuperscript{th} 2012) Available at http://www.economist.com/node/21564274
  \item \textsuperscript{23}Christopher Helman, The World’s Biggest Oil Companies, Forbes (November 17\textsuperscript{th} 2013) http://www.forbes.com/sites/christopherhelman/2013/11/17/the-worlds-biggest-oil-companies-2013/
  \item \textsuperscript{24} Ian Bremmer The Return of State Capitalism, (2008) 50 (3) Survival 55, 57
  \item \textsuperscript{25} China and South Africa Sign Business Deals, Wall St J (August 25th 2010) http://online.wsj.com/news/articles/SB100014240527487034447004575448911926722310
\end{itemize}
through the acquisition of significant stakes in European Grid networks. Moreso, The French government retains an 85% percent majority stake in Electricité de France (EDF) which is a household name in the European utilities markets. In mining, Russian mining corporations like Ruschrome are investing over $1.6 billion in platinum mining in East Africa. The list extends into infrastructure where Chinese corporations are investing in African and western roads and railways. In financial services, Corporations from China and the United Arab Emirates have been acquiring significant stakes in banks. According to a report from the Wall Street Journal, the China Development Bank, a Chinese government controlled corporation acquired a 3.1% stake in Barclays a British bank. In the tobacco industry, Japan tobacco which controls over 66.4% of Japan’s tobacco production, continues to broaden its international reach through the acquisition of key tobacco and pharmaceutical corporations across the world.

Despite mutually profitable benefits, these public footprints in private markets pose enormous difficulties. First, in a multipolar world where interests constantly evolve, state-owned corporations may lurch from purely commercial activities to political activities. This is particularly so where the home state itself has a different philosophical orientation of the role of the state, here, Russia and China come to mind. Secondly, State-owned corporations like their privately-owned counterparts may become massive exporters of harm. This is potentially tricky given the acutely scrupulous corporate social responsibility crusade launched by academics, international organisations, non-governmental institutions and host

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26 China State Grid quietly builds Méditerranéen network, Reuters (August 10, 2014)  
http://uk.reuters.com/article/2014/08/10/utilities-mediterranean-china-idUKL6N0QB5NF20140810

27 Zimbabwe-Russia Joint-Venture to invest $1.6 Billion in Platinum Mine, Moscow Times (August 5th 2014)  

28 Kathlene Caulderwood, Chinese Money diverted away from Oil towards other Sectors, I.B Times (May 15, 2014)  
http://www.ibtimes.com/chinese-money-africa-directed-away-oil-toward-other-sectors-1584805

29 E Curran & D McMahon, Barclays, China Development Bank ink new Pact, Wall St J (March 26, 2014)  
http://online.wsj.com/news/articles/SB10001424052702303949704579462101918756012

states. If anything, an irresponsible action by a state-owned corporation in the territory of another state may ignite diplomatic, social and legal problems. Thirdly, questions can be asked about the rationality of concentrating strategic industries like energy in the clutches of state-owned Corporations that are often plagued with bureaucracy, profligacy and political cronyism. In the words of Ian Bremmer, this trend poses mammoth risks for consumers of energy end-products and even importing states.\textsuperscript{31} As we can see from the ongoing Ukrainian crisis, State-owned corporations and the commodities they produce or distribute can be used as political weapons and foreign policy tools with immeasurable costs to consumers.\textsuperscript{32} Finally, the political leverage and revenue generated by state corporations can embolden recalcitrant states to pursue reckless and bellicose foreign policy gambits, secure in the knowledge that there will be little or no international pressure. A recent and ongoing example is the obduracy of European states to back hard-hitting sanctions against the Russian Federation and its emanations like Gazprom for the invasion and annexation of parts of Ukraine. These European states were held back due to their inordinate reliance on Russian Gas and threats from corporations like Gazprom to turn off the taps.\textsuperscript{33}

Whether or not the state went away or whether the state has rebounded continues to fuel animated discourse. This is further investigated in the next section.

\textsuperscript{31} Supra N 24
\textsuperscript{32} Ukraine Crisis : Russia Halts Gas Supplies to Kiev BBC ( June 16th 2014) \url{http://www.bbc.co.uk/news/world-europe-27862849}
\textsuperscript{33} Ibid
1.3 - Sovereign Wealth Funds:

Years after John Maynard Keynes’ prescient idea about getting deficit and surplus countries together to foster global stability, a new perspective as well as new class of surplus investor has emerged. The perspective is that of increasing capital mobility from the former net importers of the East and South to the former net exporters of the west. The new class of surplus investors are Sovereign Wealth Funds.\(^3^4\) These funds are best understood as a genus of national investment vehicles or public repositories of wealth.

Armed with a war-chest of fiscal surpluses and rising commodity receipts, these state-owned funds have taken advantage of an economic climate defined by burgeoning commodity prices, record deficits, massive stockpiles of foreign exchange reserves, global imbalances, and a stability crisis. In the past, surplus country holdings took the form of central bank purchases of U.S Treasury & agency securities. Over time, investments into less liquid and riskier assets emerged as did new institutional forms. The reinvention of the state into this kind of quasi-private and hybrid form continues to be viewed as a rude awakening, not least because of the traditional skirmish between market and state capitalism and long festering policy arguments against opening the floodgates of foreign investments. Sovereign Wealth Funds not only challenge this skirmish, their very nature conflates the ideals of the duo. Intriguingly, these funds are public, yet they display the fundamental capitalist impulse of risk diversification and profit maximisation, through organised and targeted interventions in private markets.\(^3^5\) Although their progenitors (Central Banks) displayed this kind of impulse by pursuing conservative and safe investments in liquid securities, they seldom showed the low aversion to risk that Sovereign funds reveal on an almost day to day basis in market transactions. The functions of these funds are variegated, however, their crucial roles include


\(^{3^5}\) Ibid
the recycling of fiscal surpluses and commodity receipts, stabilisation of the national balance sheet for different periods, diversification of the central bank’s reserves, smoothening inter-generational revenue, hedging against procyclical periods and the assistance of the government’s developmental strategy. Of all instruments of state capitalism, these funds have dominated international headlines in recent years, not least because of a sharp spike in number, the amount of capital at their disposal, its very nature as government-owned and a rapid rise from obscurity to celebrity. Having introduced this new sect of international investors, it is important to flashback to their history as well as investigate the increasing attractiveness of this form of public investment.

1.3 (a)- History and Concept of Sovereign Wealth Funds

Sovereign Wealth Funds are not new entities. In fact, modern accounts of their existence suggest that the Kuwaiti Investment Authority established in 1953 to invest its surpluses was the world’s first Sovereign Wealth Fund. However earlier reports trace the origin of Sovereign Wealth Funds to 1816 when France created the Caisse des Depots et Consignations (CDC) to manage government and overseas tax-exempt funds collected by French savings banks and post offices. Following the 1997-1998 Asian financial crisis, emerging economies began accumulating reserves cushions; this trend was wired by high commodity prices and huge United States demand. This has led to a shift in the economic centre of gravity from the traditional big players of the west to emerging markets in Asia and commodity-rich countries in the Gulf and Africa and an exponential rise of funds from newly exporting states.

36 Supra N 7
37 Xu Yi-Chong, The Political Economy of Sovereign Wealth Funds (1st edn, Palgrave Macmillan 2010) pg 1
38 Ibid
The concept of Sovereign wealth funds has become an attractive proposition for resource-rich countries and countries with large amounts of official reserves. With global markets volatile and the direction of commodity prices shrouded in uncertainty, more and more countries are joining the clamour to establish Sovereign Wealth funds. But is this enthusiasm justified?

Not many will dispute that it is politically and economically prudent for governments to save for the rainy day. By establishing a Sovereign wealth fund, Governments can use draw-downs to pay up for pension black holes, cushion the domestic economy from future price and economic shocks and ensure future generations benefit from the extraction of finite resources.\(^{39}\) For commodity-exporting countries, the establishment of these funds is advisable, not least to insulate against cyclical inflationary trends. This is as a result of a lot of foreign currency exposure into the domestic economy, which could be due to payments for exports of commodities or other goods and services. Unless a preponderance of this money is not spent on locally manufactured products, this could boost domestic demand and cause the economy to heat up if it does not have the capacity to meet the amplified demand.\(^{40}\)

Therefore, by establishing a sovereign wealth fund, the foreign currency inflows instead of being converted into local currency and spent, can be kept in its original form and invested abroad for returns\(^{41}\).

Again, most countries suffer from what is called the ‘Dutch Disease’ which occurs when a country experiences a massive increase in resource exportation that diminishes industrialization and diversification. With finite fossil fuels that are non-renewable, most resource-rich states remain inordinately reliant on proceeds from resource exportation

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\(^{39}\) PriceWaterCooper Report on the Impact of Sovereign Wealth Funds on Economic Success (October 2011)  
\(^{40}\) Ibid  
\(^{41}\) Ibid
without diversifying into manufacturing or other alternative livelihoods. An increasingly sensible way of preventing this plague and diversifying national wealth is to accumulate the commodity-driven wealth and invest it overseas for returns. The rapid inflow of foreign currency also affects local currencies by appreciating it and consequently damaging the competitiveness of export-reliant sectors like manufacturing. The panacea again is to hold wealth in the original form of the foreign exchange, rather than convert it to local currency. By so doing, the wealth in its foreign currency form can be invested overseas for returns through a fund. The political and economic attractiveness of sovereign wealth funds can also be seen in developmental strategy. Here, funds may be established to pursue market premiums abroad which will in turn be utilized in the home country’s developmental strategy.

Moving away from core macroeconomics, Countries also set up Sovereign Funds to pursue Strategic motivations for foreign policy and developmental goals. Simply put, Sovereign funds are endogenously modelled machines tasked with the pursuit of exogenous power and influence through the transfer and maximisation of the state’s proprietary assets. This is particularly so, given the commingling of global economic power and global political power. Therefore, countries with unmistakably ambitious motives, armed with a war chest of foreign exchange reserves, commodity receipts and fiscal surpluses can set up Sovereign Wealth Funds to pursue mercantilist or strategic goals with a view to transforming the leverage obtained into genuine political power and influence.

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42 John Patton, Sovereign Wealth Funds in a Globalised World (2012) 6(1) International Business 1, 5
43 Supra N 39
1.3 b- Definitional Challenges, Nature and Structure of Sovereign Wealth Funds

Like much else about Sovereign wealth funds, there is little consensus on a definition. The differences in definition reflects the ambiguity of the instrument itself- to some government owned, to others public but nongovernmental and to a third category, formally sovereign yet functionally private. Underlying the ambiguities and the means to overcome them is a loyalty to a strict dichotomy between public and private law and actors.\(^{45}\) It is this combination of fidelity to the public/ private divide combined with the assumptions about the nature of sovereign funds that serves as the footing for regulatory approaches.

The search for a definition for Sovereign Wealth Funds began after 2005 when Andrew Rozanov an economist with a private investment firm coined the phrase Sovereign Wealth Fund.\(^{46}\) According to Rozanov, these funds were neither traditional pension funds nor traditional reserve assets supporting national currencies. Instead, they are pool of funds managed separately under guidelines distinct from those applicable to central bank reserves, to achieve more broadly diversified and risk-tolerant sovereign wealth.\(^{47}\) This definition sparked a revolving door of opinions from academics, policymakers, the business community and institutions. For academics, SWFs are a pool of domestic assets owned and managed by governments to achieve a variety of economic and financial objectives, including the accumulation and management of reserve assets, the stabilisation of macroeconomic effects and the transfer of wealth across generations.\(^{48}\)

To policymakers like Mr. Clay Lowery, (a former Assistant secretary in the United States Treasury), SWFs are government investment vehicles, funded by foreign exchange assets,

\(^{45}\) Supra N 1

\(^{46}\) Andrew Rozanov, Who Holds the Wealth of Nations? (2005) 15 Central Banking Journal 52

\(^{47}\) Ibid

\(^{48}\) Fabio Bassan, The Law of Sovereign Wealth Funds (1\(^{st}\) edn, Edward Elgar 2011) 18
and which manages these assets separately from official reserves”. To him, there are five ingredients that characterise sovereign wealth funds: Sovereign; High foreign currency exposure; No explicit liabilities; High risk tolerance; Long investment horizon.

To the business community, sovereign meant autonomous, somewhat insulated from market pressures, and therefore freer to take long risks. To institutions like the International Monetary Fund, Sovereign Wealth Funds are government-owned investment funds, set up for a variety of macroeconomic purposes, commonly funded by the transfer of foreign exchange assets that are invested long-term overseas. Although, this troika of definitions follow different paths, they find common ground on the subjective characteristic of public ownership and management and the objective element of sovereign fund activities and purposes.

Sovereign funds are idiosyncratic institutions with traits similar to other institutions like Official reserves and pension funds. These three categories of public funds have different characteristics, but are not necessarily mutually exclusive. There could be some overlap between SWFs and Pension Funds. The best example is Singapore’s GIC. But even Norway’s GPF could be another example. On the overlap with Central Banks, some authors have argued that some sovereign funds as we know it began as official reserves. That said, there are divergences. Unlike official reserves managed by Central banks, Sovereign Wealth Funds and Pension funds tend invest in riskier assets as well as stay long term in markets. Unlike pension funds; Sovereign wealth funds do not have specific future liabilities.

From forays into thin thicket of definition above, it is possible to discern an assumption shared about sovereign wealth funds - The assumption of public ownership. As seen above, many see sovereign funds as government-owned. However credible such a position is, it runs

49 Supra N 34
51 B Phillip Winder, Sovereign Wealth Funds: Challenges and Opportunities (2010) Vol XVII (2) M.E.P 31, 32
the risk of over-simplifying an intricate creature. In a modern state, sovereign power can create legal personalities such as “corporations”, “state agencies” and “departments” which belong either to the public or private law domains. That said, there is arguably a discrete category of legal personalities which is public and yet non-governmental. Such entities are called “nongovernmental public bodies.” They include state pension funds, central banks and securities regulators which are not part of the conventional apparatus of state but still perform public functions. Sovereign funds can pass for such bodies by virtue of their management and investment of public funds and their marked separation from the apparatus of government. Another view often espoused is that sovereign wealth funds are formally public but functionally private. This view reflects a growing perspective that sovereign wealth funds are a manifestation of new forms of public/private conflation through instrumentalities and actions that are neither fish nor fowl. In effect, they are funds controlled by states as fiduciary for the greater or ultimate owners (citizens) but involved in making inroads into private markets. To complicate matters further, SWFs are not consistently treated as either public or private entities. The United States for example treats them as public for tax purposes, yet as private bodies for immunity purposes and as a foreign investor.

Unlike a private legal personality whose structure and governance is defined in the company laws and articles of associations of a company, the structure and governance of SWFs is not set in stone. Some Sovereign funds are normally established through a piece of legislation. Whilst others rely on company law rules to fill some organizational gaps. This cloud of structural uncertainty serves to illustrate how enigmatic sovereign wealth funds are.

As mentioned before there has been no clear and straightforward view on the definition of SWFs. There is also no consensus on the nature, the structure, ownership and governance of

52 Supra N 1 at 439
53 Ibid at 436
In a world built around the twin silos of public and private, these funds represent an assault on the traditional public-private divide. Their hybrid nature has demolished the long-standing assumption that private and public actors are distinct. Yet, they cannot wholly escape their chameleonic character as sovereigns and quasi-private entities engaged in private markets.

1.4 Investments and Strategies of Sovereign Wealth Funds.

The portfolios of Sovereign wealth funds are made up of securities both equity and debt, and other sophisticated financial instruments such as derivatives. If recent evidence is anything to go by, these funds are also investing in Real Estate, infrastructure both domestically and transnationally and in Agriculture.\(^{54}\) Evidence also suggests that these funds are passive investors who typically do not purchase more than 10% of the capital stock of corporations. That said, there has been recent evidence of Sovereign wealth funds showing increased shareholder activism in the election of the management of investee corporations.\(^{55}\) These funds also favour buy and hold strategies on private markets. An instructive example is the failure of many sovereign funds to branch out of western capital markets during the financial crisis. Sovereign Funds also show a low aversion to risk.

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\(^{54}\) Jamil Anderlini, China’s Sovereign Wealth Fund Shifts focus to Agriculture (17th June 2014) Financial Times Available at [http://www.ft.com/cms/s/0/64362b08-f61a-11e3-a038-00144f6abdc0.html#axzz3C0kX4TJA](http://www.ft.com/cms/s/0/64362b08-f61a-11e3-a038-00144f6abdc0.html#axzz3C0kX4TJA)

\(^{55}\) Paul Rose, Sovereign Wealth Funds: Passive or Active Investors (2008) 118 Yale L. J 104, 105
Conclusion:

This chapter elaborated on the public money in overseas private markets paradigm. Drawing from a wide range of evidence, it revealed that Central Banks as Public Monetary Authorities separate from governments increasingly patrol capital markets in search of risk-adjusted returns. The same goes for State-owned corporations, albeit with significant concerns. Yet, the most publicised ‘indicators’ of the state’s ‘rebound’ are SWFs. It was established that these funds defy the traditional black and white view of the world, with their colour-coded chameleonic nature. Also established was the lack of consensus on the definition and structure of these funds. The raison etre for their creation was examined, revealing a raft of macroeconomic benefits associated with these funds. Further analysis investigated their investment strategies, which have thus far proved benign. Yet, a great deal of fear has ensued in overseas markets, leading to an increasingly acrimonious regulatory debate, where SWFs are entrapped between regulation and politics. The next chapter dissects this regulatory debate and the framework underpinning SWF investments.
CHAPTER 2:-

THE EXTANT REGULATORY FRAMEWORK FOR SOVEREIGN WEALTH FUND INVESTMENT

2.1- Sponsoring Countries Laws and Oversight Networks

The regulation of investment by SWFs is certainly an important policy objective of the home country. From the inception of the investment fund, there are almost always regulatory limits on the nature, percentages, issuing company and the country of the origin of the securities in which SWFs could invest. In fact, the fund itself is almost always underpinned by way of a constitutional statute.\(^{56}\)

Home state regulation also extends to levels of public law oversight in form of executive or parliamentary oversight. For example in Singapore, the appointment and removal of members of the board of the country’s two Sovereign Wealth Funds requires the assent of the country’s executive. More so, the financial reports and proposed budgets of these funds must also be submitted to the executive for its imprimatur and finally, the executive is constitutionally entitled to any information concerning the country’s sovereign wealth funds.\(^{57}\) In the Nigerian Sovereign Investment Authority Act, powers to appoint the members of the fund’s board of directors is reserved for the Nigerian executive.\(^{58}\) Equally, the funding formula and investment targets of the Nigerian fund is enshrined in statute to ensure the smooth


\(^{57}\) ibid

\(^{58}\) Section 16 (2) Nigerian Sovereign Investment Authority Act
disbursement of public money to the Sovereign wealth Fund.\textsuperscript{59} This blend of executive and parliamentary oversight, as well as the funding structure of many funds will raise perennial questions about the political independence of these funds. Moving on, some SWFs are also subject to home state regimes of accountability, transparency and disclosure.\textsuperscript{60}

Certain SWFs have now been mandated by home state laws to pursue investments that comply with environmental, human rights and ethical concerns in their investments. Norway provides an instructive example, where the country’s SWF (Government Pension Fund Global) has been mandated to adopt environment-friendly and ethical investments which are closely scrutinised by the Norges Bank. That said, the efficacy test for this kind of oversight arrangement is always in its implementation. In the Norwegian case, the SWF continues to acquire international investment clout because of its scrupulous adherence to corporate governance standards and its green and ethical investments which has seen it divest stakes in many corporations.\textsuperscript{61}

\textbf{2.2- European Union Approach to Third Country Sovereign Wealth Funds}

The most recent evidence of European Union Policy on Sovereign wealth funds can be found in the European Commission’s Specific communication entitled ‘A common European approach to Sovereign Wealth Funds.’ This intervention came arguably as a result of Member states action pursuant to article 65 of the treaty on the functioning of the European Union to limit the flow of inward investments from third country sovereign wealth funds. In the Communication, the European Union Commission set out its case for a common EU approach as well as its direction of travel on Sovereign fund issues.\textsuperscript{62} Although this text is of

\textsuperscript{59} Section 29
\textsuperscript{60} Supra N 56
\textsuperscript{61} Terry Macalister, Ethical Business: Norway ejects mining giant Rio from its pension portfolio, GUARDIAN, Sep. 9,2008
\textsuperscript{62} Harry McVea, Corrupting Capitalism: Sovereign Wealth Funds and The United Kingdom’s Regulatory Framework (2013) JBL 444
little legal significance, it underscores five cardinal principles. First, the EU affirmed its commitment to an open investment environment, it also avowed its support for Multilateral work with organisations like the OECD and IMF on SWFs. Thirdly, the EU accentuated the presence of an existing legal framework to enable member states respond efficaciously to the risks posed by SWFs, it also called on Member states to respond in ways harmonious with the EU treaty obligations and international commitments and finally to do so in a proportional and transparent manner.

The absence of hard rules and regulations from the European Union has prompted suggestions that the EU Commission views the issue of SWFs as a matter of economic governance and is therefore not in the mood to tame these funds. However credible this position is, it is worth noting that the European Union is armed with a loaded arsenal of treaty weapons which allows it to make legislative interventions within its balance of competence. Therefore, any suspicion that SWF investments are seriously disruptive to the proper functioning of the internal market may trigger a robust response from the European Union. However, this may not go down without a scuffle with the more capital libertarian member states.

2.3- OECD Regulations

Multilateral institutions like the OECD have also been involved in the articulating regulatory frameworks for Sovereign Wealth funds. In its maiden report on SWF investment, the 1961 (amended 2010) OECD Code on Liberalisation of capital movements, the principle of National treatment provided for in the 1976 Declaration on International investments and Multinational companies (amended in 2000) and its guidelines on corporate governance for state-owned entities were said to apply to SWFs. These OECD measure call *inter alia* for non-discrimination to foreign investments, transparency and disclosure, non-protectionism, and the progressive liberalisation and the gradual elimination of capital movement restrictions.

The OECD went further in 2008 to issue a declaration on SWFs and recipient countries policies. This declaration reflects established OECD commitments on the progressive liberalisation of trade and investments. It contains commitments on non-protectionism, non-discrimination among investors in like circumstances, progressive liberalisation save in cases of legitimate national security concerns and also calls on national governments to adopt legislative measures that are transparent, proportional to clearly defined security risks and subject to accountable application. Although the OECD has rarely acquired the reputation of a toothless talking shop, its measures suffer from acute implementation problems especially from non-member countries. More so, legitimate questions can be asked about whether

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64 Sovereign Wealth Funds and Recipient Country Policies, Report by the OECD Investment Committee, April 2008
65 Declaration on Sovereign Wealth Funds and Recipient Countries Policies, OECD 2008
capital exporting countries outside the conventional OECD bloc consider themselves part of the traditional OECD community.

2.4 Santiago principles

The protection of Sovereign wealth funds’ investments and host states vital national and economic interest are two sides of the same coin. In a quest to coordinate these competing interests, International soft law institutions have formulated non-binding principles and standards. An authoritative example is the Santiago Generally Accepted Principles and Practices (GAAPs) produced by the IMF in conjunction with several SWFs commonly known as the International Working Group. The so-called Santiago principles contains a far-reaching definition of Sovereign Wealth Funds and establishes a voluntary framework of 24 behavioural standards on operational independence in investment decisions, risk management, transparency, disclosure and accountability.

In principle, the voluntary standards enshrined in the Santiago Principles and which lie at the heart of the IWG’s work is laudable. As a venerable first step, they provide an important international environment within which stricter global standards can be fashioned and endorsed. Secondly, the principles rightly prioritise transparency and the improvement of information flows, which represents the basis upon which investors and other market counterparties, as "rational actors", base assessments about the arrangements into which they enter. Thirdly, by rejecting a one-size-fits all model of regulation, the principles can be adapted to suit the needs of individual SWFs irrespective of their size, organisational structure, or investment objectives. An added advantage in this respect is that the approach is
sufficiently "dynamic" to be capable of responding to changing global circumstances. Yet the reliance on a voluntary framework is in itself problematic. First, the adoption of principles raises questions regarding the appropriateness of self-regulation for such powerful actors. Secondly, the principles in question have been drawn up with high level generality and breadth making it likely that they are a mere compromise. Thirdly, they are entirely voluntary, meaning that enforcement action cannot be taken in the event of non-compliance. In terms of disclosure, most principles require adherence to the disclosure requirements of host and home states, but fail to say what kind of information should be disclosed, how and when, meaning that problems are nevertheless sure to remain, not least because of the highly complex nature of the many financial products that SWFs trade and the markets in which they operate, as well as the proprietary nature of their trading strategies and investment policies, the rapidity of their market positions, and the lack of repeat dealings with counterparties. Fourth, there is no auditing body to monitor compliance with the principles even by those states that have declared their intention to adopt them. The fifth concern relates to the requirement for SWFs to disclose investment decisions that are subject to considerations other than economic and financial ones. Here, it is difficult to see how funds are incentivised to disclose such information and even if such intentions are present, it is difficult to see how funds will state them beforehand and how aggrieved host states can prove these considerations ex-post.

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66 Supra N 62 at 444
67 Supra 48 at pg 51
68 ibid
69 Supra N 48 at Pg 51
2.5 **Host Country Regulations:**

With markets still recovering from the greatest economic crisis in modern history, so also has regulation emerged as an attractive tool to police the insidiousness of self-reinforcing markets. Regulators haunted by the hard lessons of a less vigilant past have begun to utilize statist power to police and protect domestic economies from the threat of instability. In the wake of this reinforcement, Sovereign wealth funds appear to be entrapped. Many recipient states candidly admit the stabilising role these funds play and can play but are increasingly petrified of the insidious effects of a free rein in domestic markets. Top of the concern is that these funds are symptomatic of a wider malaise in which instruments of globalisation can be utilised strategically, with humungous consequences for National and Economic security. (These risks are investigated in the next chapter). Another concern iteratively revealed is that sovereign wealth funds represent a new contradiction between statist and liberal ideologies of international political economy.

Till date, the accusations of nefariousness are yet to be substantiated. On the contrary, sovereign funds played a benign role in salvaging systemically important institutions during the financial crisis with huge haemorrhage to their portfolios. In spite of all these, a regulatory avalanche has ensued in many recipient states. The litmus test for this regulatory intervention is not just about addressing market failure, it is also about striking a balance between the long festering policy concerns of recipient states and an investment regime which does not read ‘closed for business.’ In effect, regulatory interventions must and should be balanced, proportionate and tailored to clearly defined risks as opposed to protectionist.

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71 ibid
72 ibid
and restrictive. In the context of sovereign wealth funds, there are genuine concerns that many extant regulatory policies do not satisfy the afore-mentioned test.  

Generally, The Regulation of SWFs from the perspective of Host states follows two dimensions, the first is Market-access and the second is post-entry. These are analysed below.

2.5(a)- Market-Access Regulation:

These restrictions consist of two types of measures before SWFs enter into the market. Some countries have adopted a general prohibition of foreign stake-holdings in domestic corporations above a specified threshold percentage. For example, SWFs are prohibited from buying more than 5% of individual Italian companies. Whilst this provision applies more to third country SWFs in lieu of those from European Union member states where such a rule is likely to breach EU treaty provisions on freedom of capital and establishment, it is likely to put off SWF investors and further stifle the availability of ready capital in failing economies such as the Italian economy. Another form of market access regulation is the review of foreign investment now applied across many recipient countries from the United States to countries like Germany, Australia and China.

In the United States, the Committee on Foreign Investments is charged with the responsibility of screening covered foreign investments transactions to source out national security dangers. The remit of this committee originally did not capture SWF investment because in most cases

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2 Colum.Bus.L.Rev 728, 744
74 Supra n 48 at pg 69
75 Ibid
the latter refrained from taking controlling stakes in companies and investing in shares above 10 percent of the capital stock. In response to this lacuna, the US Congress enacted the 2007 Foreign Investment and National Security Act (FINSA) and consequently broadened the remit of this committee and increased congressional oversight. Under the new rule, the president is authorised to block foreign investments that might impair national security.76

Similar processes are applicable in Germany, Australia, Canada, China, Russia and Japan just to mention a few.77

On the other side of the Atlantic, Britain favours a libertarian approach to SWF investment. According to Mark Thatcher, policy-makers view inward SWF investment as a vital national interest.78 This economic governance approach has often been conflated with light-touch regulation of Foreign Investment. As such, a growing xenophobic movement has seized the initiative. Flashpoints include the botched Pfizer takeover of Astra Zeneca. This was met with repeated calls from both sides of the political divide for the broadening of the slim public interest test in the Enterprises Act 2002 and increased governmental policing of strategic industries like Research, Development and Sciences. This could have an impact on sovereign wealth investments.

In many cases, these policy interventions are tailored to genuinely conceived risks, yet they could be more counter-productive than initially thought. First, it emits a hypocritical reek given that the now-protectionist economies sold the trade liberalisation dogma to the new capital exporters in the heydays of market liberalism. Secondly, such policies run the risk of creating perceptions in home countries that sovereign investments are unwelcome and with the arbitrage opportunities presented in emerging economies, Sovereign funds could be tempted to shift their capital flows there. In fact, the Wall street Journal recently reported the

76 Ibid at pg 71
77 Ibid at pg 74
78 Supra n 63
frustrations of the head of the China Investment Corporation Gao Xiqing where he lamented the hostile nature of the American investment regime. That said, Regulators as market umpires should engage in a cost-benefit analysis of the capital Sovereign Funds provide. They must also take cognisance of the inharmonious interests between national policies and the yearnings of recipient corporations, many of whom are suffering from low capital buffers. As such, a way must be found to make sure that regulatory interventions on market access do not suffocate the macroeconomic benefits these capital inject.

2.5 (b)- Post-Entry Regulations

The regulatory avalanche facing sovereign wealth funds does not stop at the borders of recipient countries; it also applies after their investments have crossed recipient frontiers. For example, it is routine for competition laws to target the investments of Sovereign Wealth Funds given the likelihood for anti-competitive commercial strategies, the creation of market dominance and the erection of barriers to preclude entry of more efficient rivals in the market. A recent example is the dispute between the Indonesian anti-competition watchdog (KPPU) over the Temasek shareholding in Indosat (a telecommunications corporation). This resulted in the SWF having to dispose its 40.8% stake to Qater Telecom for US.$ 1.8 Billion.

Given that Sovereign Wealth Funds invest primarily in corporate and public securities, they also have to comply with Securities Regulations on insider trading, fraud, and disclosure in to create a level-playing field between investors. For example, in the United States, once a Sovereign Wealth Funds position exceeds 5% of shares in a publicly-traded Corporation, it

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must comply with reporting requirements by way of a Schedule 13D filing.\textsuperscript{81} Greater percentage holdings equally trigger greater reporting requirements.\textsuperscript{82} In effect, this alerts gatekeepers and other investors to the size of SWFs’ interest. Furthermore, non-compliance with these securities regulations could result in public and private litigations against sovereign wealth funds, potentially triggering tensions between home and host countries. Although the American Foreign Sovereign Immunities Act (FSIA) provides immunity for the instrumentalities of foreign states from taxation and suits in American courts, this immunity does not preclude suits like the above involving SWFs commercial activities.\textsuperscript{83}

**Conclusion**

Whilst there are conceivable risks associated with sovereign wealth funds, they have till date been nothing but market stabilisers. The macroeconomic benefits of these funds cannot be overemphasised, yet many recipient states have long feared the risks associated with foreign investments. That said, there is the important need to strike a balance between these cardinal considerations in ways which will not drown out sovereign investments or the national or economic security of host states. Proposals to bridge this gap are analysed in the next chapter.

\begin{itemize}
\item \textsuperscript{81} 7 C.F.R § 240.13d-1(e) (ii)
\item \textsuperscript{82} Supra N 56 At 1257
\item \textsuperscript{83} Joel Slawotsky, Sovereign Wealth Funds and Jurisdiction under the FSIA (2009) 11 U. Pa. J .Bus. L 967 at 997
\end{itemize}
CHAPTER 3:- THE DILEMMA OF RECONCILING THE NEED FOR SOVEREIGN WEALTH INVESTMENTS AND THE POLICY CONCERNS LIMITING SUCH INVESTMENTS

3.0- Introduction:

An apparition continues to follow recipient countries of a type of fund that supposedly buys strategic resources around the world, hollows out companies, gorges up financial institutions and threatens the sovereignty of the countries in whose resources and companies it invests. It is the spectre of Sovereign Wealth Funds- government-sponsored and controlled investment vehicles widely derided by the most savage critics as the Trojan Horses and bogeymen of global finance.\textsuperscript{84} Although many concerns ascribed to SWFs have proved premature, and unsubstantiated, recipient countries are still haunted by the fear the unknown, leading to a precipitous slide towards Naked Protectionism.\textsuperscript{85}

Much has been made of the slide towards naked protectionism but little time and space has been devoted to reasons for this. First, there is a growing unease in Western recipient states of an anti-western capital surge from certain countries classed as political risks.\textsuperscript{86} If anything, the political grandstanding in the United States Congress in the wake of the Botched Dubai Ports-World sale lends credence to this position. Also, there seems to be a burgeoning nationalist sentiment against the acquisition of strategic industries especially by statist and foreign actors and this is not a preserve of any one geographical location. All these meshed

\textsuperscript{84} Supra N 3
\textsuperscript{85} Supra N 73 at 737
\textsuperscript{86} J Chaise, D Chakraborty and J Mukherjee, Emerging SWFs in the Making: Assessing the Economic Feasibility and Regulatory Strategies (2011) 4 J.W.T 837 at 838
together runs the risk of reducing the current foreign investment regime from a liberal process of capital flows to a mere profiling exercise which could in the long run prove counterproductive.

For many Recipient Countries, the existential quandary is how to protect their National or Economic Security and financial stability as well as attract the ready capital Sovereign Funds provide. This is coming against the backdrop of huge budgetary constraints and massive sovereign debt commitments. This Chapter pursues a juxtapositional analysis of the existential quandary. It sets up a market-centred investment regime against the policy concerns militating against such a regime viz National Security and financial stability. It pursues a historical analysis of National Security. It also highlights the hierarchy of interests inherent in sovereign investments; it concedes that there is no fool proof solution to the great trade-off between Host countries interests in sustaining the openness of capital markets and the contiguous policy concerns present. It concludes by proffering solutions to arrest the existential quandary regulators and policy-makers face.

3.1- MARKET-ORIENTED INVESTMENT vs HOST STATE POLICY CONCERNS

As has been iteratively observed, there is a nexus between a liberal investment regime and economic growth, ie the more capital is provided in a country, the more its absorptive capacity increases, leading to a maximisation of productivity, creation of jobs, revenue mobilisation and domestic development.87 To put it in more concrete terms, the 2014 World Investment report published by the United Nations Conference on Trade and Development

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UNCTAD – (JOBS FIGURES UKTI) estimates that inward foreign investments into the UK will peak at US $37.1 million, whilst the value of UK inward FDI stock is estimated to have increased by 8.3 percent during the last year, reaching a record level of US$1,606 billion (£975 billion). These figures also show that the FDI to GDP ratio in the UK has widened by over 3% reaching 63.3%.

On the other side of the Atlantic, the United States Bureau of Economic Analysis puts inward investments from foreign firms at $166.4 billion dollars in 2012. Further statistics on employment revealed that majority-owned U.S. affiliates of foreign companies employed 5.6 million people in 2011, up 3.3 percent from the previous year and compared to the 1.8 percent increase in total U.S. private-industry employment in that year. Going back much further, Foreign-owned firms re-invested more than 50% of their US income back into the US Economy and made 13% of US tax payments in 2006.

In these straightened times, when the global financial crisis is slowly easing away and recipient countries are reeling from decade-long low saving rates, deficits and debts, the benefits of foreign inward Investments cannot be over-emphasised, not least to galvanise these economies, finance the burgeoning deficits and get host economies back to pre-crisis levels. That said, there are reasons for caution. First, Foreign investments have been known to ferment national security risks, where critical industries are acquired for geo-political rather than commercial reasons. Secondly, foreign investments have been linked to financial stability concerns. Here it has been averred that the unrestricted influx of foreign capital could heat up recipient economies, resulting in boom and bust cycles. Further, it has been

http://www.esa.doc.gov/Blog/2013/06/19/foreign-direct-investment-us-part-i-employment
91 Supra N 73 at 745
averred that the inordinate reliance on foreign capital could lead to instability in the event of a serial divestment.\textsuperscript{92}

Individually and collectively, recipient countries have begun to address these challenges, many times citing policy concerns such as National security and Financial Stability. The response all too often has been a higher incidence of protectionist, restrictive and xenophobic measures less favourable to foreign investments.\textsuperscript{93} This has precipitated a great trade-off between a Liberal investment regime and these policy concerns. One there may not a fool-proof solution to. These concerns will be broadly analysed in the next paragraph.

\section*{3.2- National Security, Sovereign Funds and other related Concerns in Investment Regulation:}

In an age of ever-increasing globalisation, governments across the world face a notoriously difficult balance between encouraging economically beneficial foreign investments and protecting essential security interests. This delicate balance is sometimes seen in investment policies where broad and open-ended constructions are adopted which often blur the lines between Military and Economic concerns.\textsuperscript{94} One of such policy concern is National Security. Although academic journals and policy papers are replete with interpretations of the term National Security, its true meaning in the realm of investment regulation continues to confound.

The term National Security is a nebulous and elusive concept for which an etymology is not immediately clear. Its application and appellation varies from country to country. More so, there seems to be a ubiquitous presence for National Security and other related terms in

\begin{flushleft}
\textsuperscript{92} Supra N 88  \\
\textsuperscript{93} UNCTAD Investment Policy Monitor 5\textsuperscript{th} May 2011  \\
\textsuperscript{94} Supra N 87
\end{flushleft}
Investment treaties between nation-states and Declarations of organisations like the OECD and WTO.

In the realm of Investment Regulation, concerns about the protection of National security interests have been sounded repeatedly throughout history, but in retrospect, they have been occasionally substantiated. These concerns were arguably first expressed during the World Wars, with the enactment of the Trading with the Enemy Act in America and Britain in 1917 and 1939 respectively. Years later in the 1960s, European anxiety about American investment was widespread, resulting in debates about the advantages afforded to the United States by the Bretton-Woods international monetary system and the possibility of economic control from the Americans, a scenario that never materialised. The 1970s was dominated by demands for a New International Economic Order; here the concern was that the transnational corporations of Developed countries were exploiting poor countries in the south. The countries spear-heading this economic revolution wanted an international consensus on the regulation of Transnational Corporations in line with the National and economic interests of the recipient countries particularly in the African continent.

Much later in the 70s, the national security fervour again erupted in response to petrodollar investments from oil-producing nations in Countries like the United States. This led to protracted congressional investigations in the United States which belatedly discovered that the said investments were largely from Western Allies and Not Middle-Eastern countries. In the wake of the 1980’s dollar crunch, Japanese Corporations stashed with ready capital sought to purchase American Corporations in strategic industries like defence. An instructive flashpoint case was the attempted acquisition of Fairchild (A United States Semi-Conductor

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96 Jonathan Kirshner, Sovereign Wealth Funds and National Security: The Dog that will Refuse to Bark (2009) 14(2) Geopolitics 305, 307
97 Supra N 96 at 169
Manufacturer) by Fujitsu. This changed the terms of the foreign investment debate from fears about American competitiveness to fears about National Security driven this time by patent populist and xenophobic concerns.98

The harrowing events of the early noughties combined with the growing presence of state-backed investors not only sparked changes in Western foreign policy, it became an enforced obstacle to the notion of free and unrestrained foreign investment.99 The ensuing response was a sullen reinforcement of a long-held fear that the forces of Globalization and financialization could unleash rampant market forces that threaten to undermine national stability and prosperity; for which states in turn must construct and evolve institutional and policy defences. This culminated in a higher incidence of restrictive foreign investment measures for which the botched Unocal and Dubai Ports World incidents in the United States are smoking guns. Although most of these acquisitions were unsuccessful, they left a poisonous narrative, much of which are still in the trail of foreign investors like Sovereign Wealth Funds.100

Although a Definitional Conundrum besets the term National Security, What is clear is that it embodies a set of policy responses aimed at protecting the national, cultural and economic well-being of the recipient country as well as its vital interests and industries.101 This has resulted in preventative and precautionary measures aimed at sourcing out investment dangers and protecting essential security interests. This then poses a pertinent question of how one defines a strategic or essential industry. One linked to defence is understandable, however in other areas it is more difficult to say. This has given policy makers considerable latitude to subsume other interests within the rubric of essential security concerns or national

98 Supra N 97
99 ibid
100 Supra N 36
security, leading to topical innovations like the concept of Critical Infrastructure for which a broad selection of industries ranging from defence to telecommunications are actively policed.

For the most savage of critics, National Security albeit a legitimate concern for nation states, is at risk of becoming a proxy for host countries’ concern about their exceptionality and indispensability.\textsuperscript{102} This narrative feeds into concerns harboured by western nations about the tectonic shift in the balance of economic and political hegemony from West to the East which coincidentally is home to the biggest Sovereign funds. Also, there appears to be a growing unease in Western Capitals about the meteoric rise of state capitalist machines which appear to be at variance with the orthodox free market ideology.\textsuperscript{103} If anything, this has the potential to transform the foreign investment regime from a serious process of directional capital flows to a mere profiling exercise which may prove counter-productive going forward. It may also whip up retaliatory or tit-for-tat policies to restrict investments from protectionist countries as we now see in net capital-exporters like China, Russia, Singapore and the Gulf Countries, with immeasurable costs for the world investment order.\textsuperscript{104}

Before dissecting the National Security concerns ascribed to Sovereign Wealth Funds, it is imperative to contextualise these funds and their activities on private Overseas Markets.

Sovereign Wealth Funds are State sponsored and controlled funds associated with the recycling of budget and commodity surpluses into host countries. From home countries perspective, these surpluses have the potential to maximise returns, hedge against price and economic volatility as well as assert the sovereignty of the sponsoring state.\textsuperscript{105} Nonetheless, SWFs have important domestic macroeconomic and national risks. This is by virtue of their

\textsuperscript{102} Supra N 96
\textsuperscript{103} Supra N 87
\textsuperscript{104} Souvik Saha, CFIUS Now Made in China (2012) 33 Nw. J. INTL. L & BUS 199, 219
\textsuperscript{105} Supra N 5
position as managers of scarce public money that could have been spent domestically rather than invested abroad. Therefore, from a home state perspective, the design and purposes of the SWF can be a source of domestic instability if it does not chime with the homes government’s broader macroeconomic objective.¹⁰⁶ According to the IMF, poor management of funds by home states could create fiscal and monetary policy risks for the home country. In the sphere of fiscal risks, losses from Sovereign funds could lead to budgetary fragmentation, open up black holes in public sector balance sheets and create resource allocation and cash management difficulties. As for monetary policy, funds with the discretion to pursue both foreign and domestic investments may create asset price bubbles and sterilisation challenges for domestic monetary institutions. This is due to a sizeable shift from foreign to domestic assets.¹⁰⁷

From host country perspective, the ready capital provided by SWFs can galvanise recipient corporations, create employment for indigenes and stimulate economic growth. An added advantage from SWFs is that they are typically un-leveraged and have the ability to stick around much longer than most private portfolio investors in the face of transitory market swings. A prime example, being the influx of sovereign capital into cash-strapped western institutions like Citigroup, Merrill Lynch, Morgan Stanley, Barclays and UBS in the wake of the credit and liquidity crisis and the investments into Sovereign bonds and treasury bills in this torrid time. This injection augmented the capital buffers of hitherto heroically efficient host corporations and salvaged recipient countries.¹⁰⁸

Notwithstanding this benign investment behaviour, there are deductive risks as well - at least in the view of many recipient countries. One issue of immense concern is the possibility that

¹⁰⁶ Supra N 50
¹⁰⁷ Ibid
¹⁰⁸ Edwin Truman, Sovereign Wealth Funds: Threat or Salvation? (1st edn Peterson Institute of Economics, 2010)
Sovereign Wealth Funds may be used to further the geopolitical aims of their sponsors with immeasurable costs to the national or economic security of the recipient state. Here, a whole set of motives, some quite alarming, have been ascribed to SWF investments including but not limited to: economic sabotage, concealing attempts by foreign governments to obtain technology, resources, or expertise to benefit national strategic interests, the asset-stripping of recipient corporations, a fast-buck mentality, concentrating ownership of corporations in undemocratic hands, obtaining diplomatic and political leverage for sponsoring countries and a propensity for corrupt investments.109 These concerns have been aggravated in western recipient states by the entry of Russia and china - two nations with obdurate geopolitical and foreign policy ambitions into the SWF business as well as the rapid increase in funds from undemocratic middle-eastern states. 110

For some, the incessant demonology of SWFs over strategic motivations or politically biased investments are premature and unsubstantiated because SWFs are as conservative in their competition for market share as other institutional investors like Mutual and Pension funds and rarely take up significant stakes in foreign industries to carry out these nefarious allegations. The proponents of this pro-SWF position equally argue that the preponderance of evidence suggests that SWF investments in 'politically-sensitive industries' while existent, is somewhat limited. In fact, SWFs generally eschew high-profile investments which might attract unwanted political firestorms.111

Notwithstanding these firm positions, the opponents from the other side of the SWF debate are equally unrelenting. Ian Bremmer sees the mandate of SWFs which includes: financing infrastructure development and recapitalising the state sector as functions which may not be

109 Ibid
110 Supra N 3 at 113
111 Supra N 73 at 743
insulated from politics. In similar vein, Daniel Haberly argues that the developmentalist mandate given to many SWFs could mean that they view their investments not only through the prism of a corporate shareholder but also from the prism of a national stakeholder i.e. individual investments are leveraged to build and reinforce specific relationships of significance to national interests. In this context, he cites the instructive example of the openly strategic tactics of Mudabala the Abu Dhabi Sovereign Wealth Fund which in its 2007 report admitted that its purchase of a 35% stake in Piaggio Aero, an Italian manufacturer of private jets, was due to “the opportunity to begin manufacturing aircraft in Abu Dhabi soon”. If anything, this network analysis suggests a more widespread strategic dimension to the wider investments of Mudabala than is publicly acknowledged.

As for politically biased investments, SWF sceptics argue that the tales of the future cannot be gleaned from the tea leaves of the past. In effect, a relatively apolitical past is not an accurate indicator of future performance. Secondly, they contend that the insulation of commercial investments from political considerations is not immediately clear since the line between political and financial power has worn perilously thin. This position has been echoed by Anna Gelpern, who argues that SWFs are part of a new generation in global finance where the diverse tributaries of economics, politics and law come in continuous and intimate contact. More trenchantly, Fabio Bassan argues that under the logic of globalisation, economics may absorb politics; he further posits that increased dependence between countries, however intractable, has bridged the gap between these playing fields.

In similar vein, Edwin Truman an eminent scholar of SWFs activities has averred that “even

112 Supra N 24 at 56
114 ibid
115 Qingxiu Bu, China’s Sovereign Wealth Fund: Problem or Panacea (2010) 11 J.W.T 849, 858
116 Supra n 34
117 Supra N 48 at 3
if the actions of an SWF are not motivated by non-economic considerations, non-economic motives will read into the SWF decisions just the same.”\textsuperscript{118}

Whilst the reverse is equally arguable, there have been instances across the board where political considerations have permeated or at least threatened to permeate into the commercial activities of sovereign funds. For instance, The China Investment Corporation (one of China’s bloated funds) has many communist party politicians in sensitive positions. This internal structure is likely to lead to a politicisation of investments and further increase concerns in host states that Sovereign funds provide an invisibility cloak for direct political or governmental intervention in host economies.\textsuperscript{119} In similar vein, but less perilously, the ethical investment policy of Norway’s Sovereign Wealth Fund provides more evidence of the amalgam of political and economic motives in Sovereign Fund overseas investments. By pursuing such an investment policy, Norway is seeking not merely to project its public wealth into private global markets in search of returns; it is also constructing a principled framework that blends the imperatives of its public policy.\textsuperscript{120}

Another misgiving that has arguably prompted the national security response is the fact that SWFs as hybrid state capitalist innovations sit uneasily within host states’ regulatory paradigm, premised on the existence of an ascertainable boundary between public and private capital.\textsuperscript{121} This boundary had come under enormous strain as the statist and private ways of transnational trade converged. Yet, the uneasy dialectic between states and markets prevails. Earlier Proponents of free market liberalism contended that it is for markets to own and control the means of production, distribution and exchange whilst statist authority is used to

\textsuperscript{118} Supra N at 108
\textsuperscript{119} Ibid at 857
\textsuperscript{120} Supra N 108 at pg 41
\textsuperscript{121} Supra n 34 at pg 20
either regulate capital mobility or respond to the imperatives of global financial Markets.\textsuperscript{122} Interestingly, with Sovereign Wealth Funds, the sponsoring state is not strictly regulating the mobility of capital; it has instead become part and parcel of the very structure of capital mobility from which it was distinguished in earlier analysis. More so, host state regulators faced with the double whammy of losing beneficial sovereign capital and a skirmish with desperate domestic corporations have iteratively pointed out the potential for conflicting interests given that government ownership of Sovereign Funds makes them both market referees and market players\textsuperscript{123} (Regulator and Regulatee).\textsuperscript{124} In principle, this has the potential to brew up contradictory legal and political demands.

In sum, Sovereign Funds have been nothing more than stabilising forces in overseas private markets yet they are at the epicentre of an international crisis of trust and legitimacy. The eccentricities of public ownership and the propensity to seek higher premiums on private markets is not only enigmatic; it has become a lightning rod for host state fears over national or economic security. Regulators and policymakers haunted by the mistakes of the past have found an easy way of making up lost ground, by taking up cudgels against this peculiar type of fund that is both public and quasi-private in nature and struggles to fit comfortably into neat legal and regulatory boxes.\textsuperscript{125} The argument has always been that even when SWFs act commercially, their sovereign status is not diminished thus decision-making may not be insulated from politics. More daunting yet is the reality that these funds are an erosion of the distinct roles of states and markets. For many recipient economies the deep-seated fear is not just about the peculiarities of this funds, it is also about the nebulous boundaries between state apparatus and the market in SWF owner states like Russia and China. This and many

\textsuperscript{122} E Helleiner & T Lundblad, States, Markets and Sovereign Wealth Funds (2008) 4 German Policy Studies 59, 62
\textsuperscript{123} Supra N 111 at pg 53
\textsuperscript{124} Supra N 34 at pg 23
\textsuperscript{125} ibid
other factors have entrapped Sovereign Funds in the shadow of regulation and politics in which a vital concern is held up– National Security.

The burden of proof is on both parties to this quagmire. For Sovereign Funds, adherence to the Santiago principles and other codes of best practice is an essential part of the depoliticisation package. However, they must do more to assert their political independence from sponsoring states. For Regulators, the challenge has never been more daunting, they must disentangle rhetoric from reality and find ways to bring about a more proportionate balance between the incredibly beneficial capital Sovereign funds bring and the risks they exude. The proposals to counter this quandary are analysed below.

3.3- Financial Stability

Another prominent feature in policy toolkits is Financial Stability, this is often tied to the low-level transparency of SWFs and sometimes suffused within the National/Economic security paradigm. Although this has been a long standing concern about foreign investments, it has become more integral in the wake of the 2007-2009 juddering halt in market confidence. In the context of Sovereign funds, regulators and academics appear petrified by the stability risks these funds may bring. For example, many argue that actual or rumoured transactions by opaque funds may affect relative valuations in particular sectors and result in herding behaviour from other investors, with mammoth risks to financial institutions.\(^{126}\) This is due to a lack of information, which means that market actors may interpret a fund’s withdrawal or purchase of positions as a signal of the long-term viability of the instruments involved.\(^ {127}\) More so, it is argued that deeper markets like the currency market can be

\(^{126}\) Tao Sun & Heiko Hesse, Sovereign Wealth Funds and Financial Stability- An Event Study Analysis, IMF Working Paper, October 2009  pg 3
\(^{127}\) Ibid
affected at least momentarily by rumours or actual announcement of changes in currency allocations by central banks or sovereign wealth funds.\textsuperscript{128}

According to Sun and Hesse, Market disturbances could ensue if a sovereign fund invests through another institutional investor like a hedge fund, that is leveraged or subject to margin requirements. This kind of investment strategy it is argued could amplify market changes. This is made much worse in a situation where the sovereign fund is less transparent, here, market actors may find it difficult to anticipate changes in asset allocations and risk preferences, leading to increased volatility.\textsuperscript{129} Further, sceptics argue that a divestment or repositioning of assets by sovereign wealth funds could in itself create market disturbances.

However plausible this position appears, it assumes too facilely that the outflow of capital through divestments would not be offset by other investors both private and public. Secondly, it is instructive to note that the size of SWFs in comparison to other institutional investors is derisory, so a serious damage to the market seems inconceivable.\textsuperscript{130}

Given the benefit of hindsight, it is worth noting that sovereign funds were one of the few market stabilisers in the wake of the 2007-2009 financial crisis. As typically unleveraged investors, they injected long-term capital. Whilst private investors suffered from a protracted confidence crisis, these funds augmented the buffers of systematically important institutions. More benignly, a considerable amount of sovereign funds took the painstaking decision to remain during this torrid market swing, with substantial costs to their overall asset value.

Having investigated the long festering policy concerns of recipient states, and the dilemma posed, the panacea lies not in outlining these challenges but in proffering credible and workable solutions to them. Below is a set of proposals to resolve the regulatory dilemma.

\textsuperscript{128} Ibid
\textsuperscript{129} Supra N 126
\textsuperscript{130} Ibid
3.4. PROPOSALS TO RESOLVE THE DILEMMA.

To resolve the existential regulatory quandary, the onus is on both parties. For regulators, the starting point is an appreciation of the vortex of mythologies about Sovereign wealth funds and to disentangle this rhetoric from reality. One of such regurgitated myth is that of SWF homogeneity.\textsuperscript{131} A corollary of this is that Sovereign Funds require Uniform Standards and benchmarks and can all be boxed into one silo. To illustrate, it is right that Sovereign Wealth Funds are a distinct investor class. Yet, it is equally right that within this discrete group, there is glaring diversity amongst members. For instance, it may not be prudent policy for funds dedicated to long-term savings, intergenerational wealth transfer or contingent pension reserve accumulation to also have a stabilisation role involving draw-downs to meet fiscal needs but for other funds with stabilisation roles, the use of drawdowns may be fiscally, politically and economically apposite. Secondly, unlike other institutional investors such as pension funds which have a defined beneficiary, SWFs hold assets in the shared interest of the community. There is no individual beneficiary. This unique trait sets them apart. But given the diverse nature of shared community interests they might serve, the funds share little in common operationally to warrants universal policy prescriptions\textsuperscript{132}.

In the light of the foregoing, it is pertinent for regulatory policy to be sensitive to this context-dependent diversity. Regulatory policies must also shed its self-defeating and hasty traits and take a longitudinal view of Sovereign Wealth Funds. This involves a recognition by the intractable forces that the very reason for a surge in sovereign capital is decades of

\textsuperscript{131} David Murray, SWFs: Myths and Realities (2011), Global Sovereign Fund Roundtable, London 5\textsuperscript{th} May 2011 at pg 4
\textsuperscript{132} ibid
expansionary policies, low savings, humungous deficits and a confidence and liquidity crisis in the private sector for which a protracted period of time and political will is required to remedy. 133 Secondly and most importantly, regulators should recognise that Sovereign funds are part of a globalisation and financialisation phase where the revolving doors of change and interests are in full tilt. In effect, it is deeply inimical to the ideals of globalisation and capitalism (which most regulators are wedded to) to wield a big stick towards a certain genus of investors because they are colour-coded and not black or white. If anything, such a regulatory policy is perverse and theoretically conservative. Thirdly, policymakers should indulge in a great deal of introspection on the hypocritical signal sent out by systematically erecting trade frontiers and simultaneously calling for the elimination of the same frontiers. The period of reflection should also extend to the potential consequences for the global economy.

Although the long festering policy concerns of national security and financial stability are genuine and emerging, regulators and policymakers must engage in a cost-benefit analysis of the macroeconomic benefits of Sovereign capital vis a vis the risks they exude to ensure an equilibrium of interests. IMF and OECD principles of regulatory proportionality and balance must be adhered to. More so, a depoliticisation policy in the realms of investment regulation is desirable, if not apt, to reassure foreign investors that decisions on market entry are made most desirably by technocrats and not politicians and based on purely commercial as opposed to political or xenophobic grounds. 134 Before going into the proposals proper, it is imperative to dissect the perspective of sovereign funds and their constituents to the regulatory quandary.

The Consensus ad idem is not just for home state regulators and policymakers, there is equally a role for Sovereign funds and their constituents. As evidenced in the Santiago

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133 Supra N 96 at 312
134 Supra N 95
principles, Sovereign funds and their managers must do more to assert their independence from the politics of their home countries. This involves pulling out all the stops to insulate market activities from the clutches of narrow political interests. This can be achieved by *inter alia* promoting sound institutional governance, embedding robust managerial independence, setting out the legal form and structure of the fund and its relationship with other public bodies like the Ministry of Finance and the Central Bank, setting out the risk appetite of the fund and establishing clear division of responsibilities between constituent members.\(^{135}\)

Although recent scorecards on Santiago compliance shows marked improvements in disclosure and transparency,\(^ {136}\) Sovereign funds must not resile from this significant leap towards increased global legitimacy. Instead, managers should disclose more to assuage the concerns of investee state regulators and put to bed the crisis of trust and legitimacy enveloping their increased global presence.

The proposals outlined below are not and do not pretend to be fool proof solutions to the regulatory dilemma. They are merely pieces in a much wider jigsaw of fund regulation. For starters, it would be desirable for Sovereign fund investments to be seen as an economic governance issue where market principles take pre-eminence with a limited role for government. This seems to be the position in Britain where there is the absence of a formalised screening or investment restriction process for foreign investments at large. Whether this formulae can survive politically expedient calls for reconsideration is not immediately clear. What is clear though is that the British economy in a latest survey of Sovereign Wealth Managers and Central Banks has been rated the most welcoming economy

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135 A Al-Hassan, M Papaioannou, M Skancke & C Chih Sung, Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management Pg 10
in the world for foreign public investment.\textsuperscript{137} This is in sharp contrast with the growing disquiet about the hostility of other investment destinations\textsuperscript{138}

Secondly, Jurisdictions that operate naked protectionist policies against these funds need to reconsider their policy positions. But then again, the amorphous nature of the word ‘protectionism’ makes it difficult to draw the line between protectionism and genuine investment restrictions.

Thirdly, for jurisdictions that operate investment screening or review mechanisms, there is need to continue with case by case policing of risks. Where this is not applicable, it should be implemented. There is also need to evaluate whether there exists any lines of business which consistently pose few national security problems and explicitly exempt these industries from review (an example of such industry could be retail). Recipient states should actively consider providing exemptions from review processes for SWFs of certain countries in exchange for the SWF abiding by sound market practices and measures like the Santiago principles. This will undoubtedly incentivise Sovereign Funds to depoliticise themselves. Equally, it could populate data repositories with information about Sovereign fund investments without the stress of regulatory skirmishes. Receiving such an exemption would be cost-efficient for funds as it would cost less to comply with exemption requirements than it would to undergo review processes. Norway’s Sovereign Wealth Fund appears to be a prime candidate for such an exemption. First, according to the World CIA Factbook, Norway does not have any ongoing conflicts with the United States (an archetypical recipient state) that might motivate it to harm the United States if given the opportunity. The same cannot be said of China, Russia and some Gulf states.\textsuperscript{139} Secondly, the Norwegian fund is known for its

\textsuperscript{137} http://www.ft.com/cms/s/0/0c91042c-f7a0-11e3-b2cf-00144feabdc0.html#axzz3B5jvKsrC
\textsuperscript{138} Supra N 79
scrupulous adherence to principles of transparency and governance. In fact, Score cards on Santiago compliance have always extolled the fund as the poster-child for model fund behaviour.

Further, there is need for an accord between home and recipient economies on definitions in investment regulation. This includes a fair amount of clarification on the meaning of vital terms like National Security, Economic Security, critical infrastructure, essential defence interests. The lack of consensus on these terms both in national legislations and multilateral instruments is a recipe for discord. The more these terms are illuminated, the less likely that Sovereign Wealth funds will hazard investments that may be seen as perilously political.\textsuperscript{140}

It is dangerously ironic that regulators crowing about poor levels SWF transparency, are themselves less transparent. At the moment, investment screening procedures in recipient countries are anything but transparent.\textsuperscript{141} To tackle the great trade-off between Sovereign Investments and recipient state policy concerns, regulatory policy must be systematically transparent and this should start with investment screening and review procedures. In effect, regulators must ensure the presence of a formal calculus on how decisions are taken as well as provide adequate guidance on potential red flags. For the most part, the decisions of the screening body should be amenable to some form of further review so as to provide redress to aggrieved parties. Another proposal to tackle the great trade-off, is the entrenchment of reciprocity in Sovereign Fund activities. This could be by way of multilateral and bilateral agreements or contracts between owner and recipient states on fair or free movements of Sovereign and other capital between the concerned territories. This enforceable commitment could incentivize both countries to periodically reappraise the efficacy of FDI limitations

\textsuperscript{140} Benjamin Cohen, SWFs and National Security: The Great Tradeoff (2008) 85 (4) International Affairs 713, 729
\textsuperscript{141} ibid
established in law and regulation as well keep statist investment arms within the confines of the agreement.142

Although these proposals are far from fool proof, they are a set of modest proposals to hedge against arbitrariness in review processes and generally tackle the growing gulf between much needed sovereign capital and Recipient states’ policy concerns.

142 Supra N 108
Conclusion

This dissertation sought to elaborate on the public money in private markets paradigm. This is tied to the increasing apprehension about the rebound of the capitalist state in several forms. In earlier analyses, it was established that public institutions like Central banks and State Corporations are acquiring significant stakes in markets ranging from equities to hydrocarbon. That said, a new class of public investor (Sovereign wealth funds) has emerged to recycle public wealth in exchange for risk-adjusted returns. Their nature and structure has provoked controversy, so has their propensity to straddle overseas markets in search of market share. Much of the concerns raised has proved precipitate, yet recipient state regulators are fearing the worst. The penultimate chapter of the dissertation investigated the extant regulatory framework underpinning the investments of SWFs, revealing huge concerns of fragmentation, implementation and the entrapment of these funds in the politics of both home and recipient states, for which a great deal of coordination both at the domestic and multilateral level is needed. In the last chapter, policy concerns such as National Security and Financial Stability were investigated from a historical angle, revealing how long-festering these concerns are. Yet, it was established that there is the pressing need to coordinate these hydra-headed problems of state policy without staunching the mutually beneficial flow of sovereign investment. This is even more vital given the terrifying blend of a slow global economic recovery, massive sovereign debts and deficits and a private sector sapped of confidence. As such, the paper proffered practicable and workable solutions to plug the gap. These solutions are by no means fool-proof, yet, they are part of the much wider jigsaw of fund regulation. They consist of a consensus ad idem between home and host states, within the precincts of existing regulation, but with a great deal of compromise from both sides. This will of course start with a genuine step towards greater international legitimacy
for SWFs through the Santiago principles on better governance, the insulation of politics from investment decisions and more high-level transparency. Further, the state parties involved must come up with reciprocal arrangements to tackle the mistrust between themselves. Recipient states regulators were tasked to view SWFs as a sect of investors here to stay, as well as depoliticise themselves and not fall prey to political hand-wringing. Also established was the need to make concessions where national risks are inconceivable and to do so without taking their eyes off the ball.
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