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Contents

1 Introduction 3
   1.1 Rise of Sovereign Wealth Funds 6
   1.2 Defining Sovereign Wealth 11
   1.3 Distinguishing Sovereign Wealth from State-Owned Enterprises 15
   1.4 Distinguishing Sovereign Wealth Funds from Sovereign Development Funds 34

2 Domestic Political Risks 46
   2.1 Managing Domestic Political Risk: Procedural Legitimacy 47
   2.2 Managing Domestic Political Risk: Substantive Legitimacy 51

3 Domestic Governance Risks 57
   3.1 1MDB 57
   3.2 LIA 60
   3.3 Managing Domestic Governance Risk: Anti-Corruption Mechanisms 64

4 International Political Risks 70
   4.1 Evidence of SWF Politicization 72
The Political and Governance Risks of Sovereign Wealth

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ABSTRACT

Sovereign wealth funds (SWFs) are designed to solve critical domestic policy problems. Poorly managed SWFs and SWFs that are managed as tools of economic nationalism or mercantilism will present problems for both the sponsor country and for host countries that receive SWF investment. This article discusses these and other significant concerns presented by sovereign wealth, addressing both domestic and international risks. As described in the article, these risks fall along four dimensions: domestic political risks, domestic governance risks, international political risks, and international governance risks.

The International Forum of Sovereign Wealth Funds’ (IFSWF) Santiago Principles provide a basic framework to manage and mitigate each of these types of risk, although they have limitations as a form of soft law that relies on the SWFs’ own internal compliance efforts. Notwithstanding these concerns, SWFs have proven themselves to be generally benign investors, suggesting that present governance

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and host country regulatory structures have successfully mitigated international risks to this point. The same is not true, however, of domestic risks presented by SWFs, which remain a serious concern for governments and, to a lesser extent, markets generally.
Introduction

Sovereign wealth funds (SWFs), as entities that operate at the “intersection of money and politics,”\(^1\) introduce a myriad of political and governance concerns. Some of these concerns, such as the purpose, accountability, and legitimacy of the fund, operate domestically. Other concerns, such as the potential use of SWFs as tools of a new form of mercantilism,\(^2\) implicate the international reach of sovereign wealth.

While the risks highlighted in the press and academic commentary have been varied, they essentially fall into two interrelated categories of risk. The first category is political risk, which is the risk that political power may be exercised in a way that threatens other countries, investors, and markets generally. The second category is governance risk, which is the risk that a business enterprise will be managed poorly and fail to achieve its objectives. These two categories of risk, in turn, fall along domestic and international dimensions. As identified in Figure 1.1, each of these dimensions of sovereign wealth risk is associated with particular

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\(^1\)Christopher Balding, Sovereign Wealth Funds: The New Intersection of Money and Politics (2011).

Introduction

<table>
<thead>
<tr>
<th>Political</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td></td>
</tr>
<tr>
<td>Legitimacy and</td>
<td>Corruption</td>
</tr>
<tr>
<td>Accountability</td>
<td></td>
</tr>
<tr>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Politicization</td>
<td>Negative political and financial</td>
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<tr>
<td></td>
<td>externalities</td>
</tr>
</tbody>
</table>

Figure 1.1: Dimensions of Sovereign Wealth Fund Risk

concerns that may threaten the interests of the fund, the fund’s sponsor government, and markets in which SWFs operate.

The first dimension of risk concerns the domestic political implications of sovereign funds. A primary concern in this dimension is the legitimacy of the fund and of the fund’s place in the political economy of the state. Legitimacy of a SWF is tightly linked to questions of the SWF’s purpose, its political accountability structure, and the political costs and benefits associated with the fund.

The next dimension, domestic governance risks, concerns the related issue of internal fund management. Aside from the domestic political issues arising from the funds, SWFs also present internal governance risks, as would any private fund. They must be created, funded, and managed according to sound governance principals if they are to achieve their purposes. A primary risk in this dimension is that a poorly governed SWF will be used as a tool of corruption, as seen in some recent SWF governance failures.

While these domestically oriented risks are significant, most of the concern around SWF activity relates to their use in international markets. As with domestic risks, these international risks implicate both political and governance concerns. The political risks are perhaps the most widely discussed and include the possibility of SWFs’ use as tools of mercantilism and economic espionage. The potential for SWF politicization (and the politicization of other state-controlled enterprises (SCEs)) has catalyzed a variety of regulatory responses from governments around the world.
Finally, because SWFs operate in international markets, they may impact those markets in ways that—even beyond intentional politicization—create negative externalities for other countries. For example, will SWFs increase in size such that their market influence or potential failure risks significantly damaging markets in which they operate?

Although there are many risks that may accompany SWF creation and governance, these four categories present the most important issues facing the countries that have created SWFs (“sponsor countries”) and the countries that receive investment from SWFs (“host countries”). This article examines each of these four types of risk—domestic political risks, international political risks, domestic governance risks, and international governance risks—and how sponsor countries and host countries identify and manage key aspects of these risks through a variety of regulatory and governance mechanisms. In particular, the article focuses on the effort to mitigate these risks through a set of best practices (the Santiago Principles) promoted by the International Forum of Sovereign Wealth Funds (IFSWF).\(^3\)

The article begins with a brief introductory history of the rise of sovereign wealth, from its early precursors in the United States to the large and more recently created funds of natural resource-rich countries. The introduction also provides a discussion of how SWFs have been defined by both observers and the funds themselves and distinguishes SWFs from other important state-controlled enterprises, including state-owned enterprises (SOEs) and sovereign development funds (SDFs).

The article then turns to the risks created by these funds. In Part 2, the article reviews the domestic political risks associated with SWFs and how the domestic legitimacy of SWFs is tied to the substantive and procedural legitimacy in the creation and operation of the fund. In Part 3, the article turns to the most publicized risk posed by SWFs: the potential that they could be politicized and used as mechanisms

\(^3\)Int’l Working Grp. of Sovereign Wealth Funds, Int’l Forum of Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices (“Santiago Principles”) (2008), https://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf [hereinafter Santiago Principles]. For the reader’s convenience, the article includes the text of the Santiago Principles in Appendix E.
of mercantilism. This part will also detail how host countries have responded to acquisitions of domestic firms by foreign state-controlled enterprises, such as SWFs and SOEs, by amending their procedures for reviewing acquisitions that pose potential threats to national security. Part 3 will also distinguish the investment behavior of SWFs from SOEs and discuss how the risks associated with SOE investment are typically of a greater magnitude than those posed by SWFs. Part 4 turns to domestic governance risks for SWFs and then discusses the mechanisms that are designed to mitigate such risks. In Part 5, the article examines SWFs’ governance risks from an international perspective and how best practices like the Santiago Principles attempt to provide multilateral self-regulatory mechanisms. The article then concludes.

1.1 Rise of Sovereign Wealth Funds

A standard impression from news media and even academic literature on SWFs is that these funds are relatively new entities, sprung up to manage recently-acquired natural resource and trade imbalance wealth amassed by Gulf States, rising Eastern tigers, and other developing countries. That is, SWFs are portrayed, especially in the Western press, as the shadowy hands of potentially (or actually) unfriendly nations. It would not be an exaggeration to say that SWFs are sometimes represented as the financial wing of the “other,” with all the cultural baggage such a view implies, and thus make easy targets for isolationists, nationalists, and others who would benefit from such narratives.

But the present reality of SWFs is much more complicated, in part because SWFs do not easily fall into archetypes and simple categories. Although SWFs can indeed be categorized in a variety of ways, such as by source of funds, by purpose, or by investment mandate, in point of fact there are only a few dozen funds (thus creating a small population

\[\text{This impression accurately encompasses many of the world’s most important SWFs (though would not include the world’s largest SWF, Norway’s Government Pension Fund – Global).}\]
size from which it is difficult to draw broad conclusions\(^5\)), and each is as unique as the country that created it. Each fund is also subject to countless evolutionary forces, like technological innovation, domestic and foreign political changes, and financial and economic shifts.

If the modern reality of SWFs is complex, so too is the history of sovereign wealth. The modern paradigm of a SWF dates to the 1950s with the creation of Kuwait’s fund. Among other purposes, the fund was designed to provide for future generations and, ultimately, decrease the country’s dependence on oil. The idea of a fund to manage wealth derived from natural resources was not a new one, however—such a notion dates at least back to the U.S. Congress Land Ordinance in 1785. As the United States claimed or purchased additional territories and as these territories transitioned to statehood, the new states typically did not have an economic base to support the basic public goods and

\(^5\)On this point, a word of caution is in order. High quality data on SWF activity is available through academic sources and through commercial databases, and numerous studies make use of hand-collected data on hundreds or even thousands of SWF activities. Studies based on such data should be used with caution and managed expectations, however. Unlike data on other kinds of market activity—say, for example, thousands of trades executed by hundreds of parties—much of the data on SWF activity is evidence of thousands of trades executed by dozens, and sometimes only just a handful, of SWFs. What SWF data does well is to give a sense of how a particular SWF acts within a market, but in reality, the sample sizes are quite small because there are a relatively small number of SWFs. Even though the data show thousands of investments, the dataset may be dominated by the trades of a small group of SWFs, each of which may be exercising a particular investment strategy. Thus, some statistical evidence that a SWF is behaving “politically” may actually be reflective of the investment choices of a single, large SWF, but say very little about how “SWFs” as an entity class may act in the market. Indeed, it is perhaps more useful to not think of SWFs as a defined entity class, like “insurance companies” or “public pension funds,” but rather take them for what they are—a small but powerful group of investment giants that operate in complex domestic, regional, and international political environments, some of which are, by their governance structures, better able to resist meddling by the political class and others of which are expressly intended to (at least occasionally) support the political activities of the political class. Thus, to say that “SWFs” sometimes act politically risks being a meaningless statement; it may be accurate, however, to say that a particular fund occasionally acts politically in its investments. As highlighted throughout this paper, the crucial questions are why and in what context the fund behaves politically. Is it through occasional domestic investments? It is in decisions to invest in regional partnerships?
services—such as school systems—to support the growth of civil society. To remedy this concern, the United States government set aside certain public lands that the states could use as assets to pay for these services.

The idea set out in the Land Ordinance was simple: surveyors would divide the U.S. territories into six-miles-square sections, with “lines running due north and south, and others crossing these at right angles.” These townships were then subdivided into one-square-mile lots, numbered 1 to 36, with section 16 allocated for public school purposes, as shown in Figure 1.2.

Later, other states received sections 16 and 36, and still others received sections 2, 16, 32, and 36. The use of the plots had both a direct and indirect benefit for schools. First, the land could be used for the actual placement of the school at the heart of the township lands, a deliberate symbol of the central importance of education to the growing country. Importantly, however, the land could also be used indirectly, as property held in trust for the financial benefit of the school system. Like many modern SWFs, this results in a portion of the state’s natural wealth held in trust for current and future generations.

But the simplicity of this proto-SWF, 16th plot system also created problems. First, it ignored the fact that settlements were typically developed around “natural, economic, and military features without

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regard for the artificial township boundaries.” Second, when the states did not use all the land for schools and sought to manage the lands through leasing or sale of mineral, water, or timber rights, the checkerboard holdings resulting from the subdivision made such management impracticable and diminished the value of the holdings. Some states were later allowed to select other sections in lieu of the 16th or 36th section, thereby cobbling together larger, contiguous sections of land with greater value. However, in many cases the most desirable sections had already been sold off to resource extractors, leaving the states with relatively poor plots to support their schools.

Some states, particularly those in the Midwest, effectively liquidated these assets over a relatively short period of time. Many Western states, however, continue to hold their lands in trust and eventually created permanent funds to help fund education (and other governmental services) over time. There remain several such U.S. Land Ordinance state funds with over $1 billion in assets under management, including the Texas Permanent School Fund ($44.5 billion), New Mexico’s Land Grant Permanent Fund ($17.6 billion), the Permanent Wyoming Mineral Trust Fund ($7.8 billion), and the Arizona Permanent Fund ($2.5 billion), all of which date from the 1800s. The idea of a government setting aside commodity wealth to help fund government services for present and future generations—the basic financial arrangement at the core of most modern SWFs—is thus over two centuries old.

Despite this lengthy history, the term “sovereign wealth fund” connotes for most observers a giant Middle Eastern or Asian fund, not a relatively small U.S. state fund. This, of course, is due to much of the

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8Id.

9The Texas Permanent School Fund was set up through a different legislative process than the funds arising out of the Land Ordinance Act. The fund was created through a $10 million settlement from the U.S. government in exchange for the surrender of lands that later became parts of the states of New Mexico, Colorado, and Oklahoma.

10All amounts are based off the most recent available annual reports prepared by the funds.
news coverage surrounding SWFs in the early stages of the Financial Crisis. SWFs made several notable investments (and in some cases, what could be considered bail-outs) of Western financial institutions in 2007 and 2008. Several SWFs that derived their wealth from rising oil prices found themselves flush with cash and in search of dollar-denominated assets. One of the most important SWF acquisitions around this time was a $7.6 billion (4.9% stake) in Citigroup by the Abu Dhabi Investment Authority. In another high-profile investment, China Investment Corporation (CIC) took a position worth about $5.6 billion in Morgan Stanley. And Temasek (Singapore) invested billions in Merrill Lynch, Barclays, and Standard Chartered. In response to these acquisitions, reporters and analysts (soon followed by regulators) around the world began to discuss whether SWFs posed a “threat or opportunity” to host countries.

Identifying potential risks associated with SWFs is predicated on identifying and analyzing the source of the risk. At the beginning of the Financial Crisis, the very term “sovereign wealth fund” was only a few years old, having been coined in 2005 by analyst Andrew Rozanov in an International Journal of Central Banking article entitled “Who Holds the Wealth of Nations?” The basic concerns that animated the creation of SWFs—intergenerational savings, management of currency


1.2 Defining Sovereign Wealth

SWFs are one of many types of public funds that overlap in various ways according to their purposes, funding, and governance structures. Sharing numerous similarities with SWFs are public pension funds, SDFs, and some SOEs. Yet there are distinctive characteristics, agreed upon by most observers, which help distinguish SWFs from these close relations.

Much of the work of defining sovereign wealth has been undertaken by the funds themselves. The IFSWF, a council of leading sovereign funds, grew out of International Monetary Fund (IMF) efforts in 2007-2008 to encourage “further analysis of key issues for investors and recipients of SWF flows, including a dialogue on identifying best practices.”16 In 2008 the IFSWF established the Santiago Principles, a set of non-binding best practices for SWFs. In the Santiago Principles, the IFSWF defines SWFs through a series of statements:

- Sovereign wealth funds (SWFs) are special-purpose investment funds or arrangements that are owned by the general (both national and subnational) government.

- The definition of SWFs thus excludes, inter alia, foreign currency reserve assets held by monetary authorities for the traditional

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16Santiago Principles, supra note 3, at 1.
balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.

• Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets.

• SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.

• SWFs have diverse legal, institutional, and governance structures. They are a heterogeneous group, comprising fiscal stabilization funds, savings funds, reserve investment corporations, development funds, and pension reserve funds without explicit pension liabilities.\textsuperscript{17}

Taking these statements together, the IFSWF defines SWFs through three key elements. First, SWFs are “owned by the general government, which includes both central government and subnational governments.”\textsuperscript{18} Second, the investment strategies of SWFs “include investments in foreign financial assets, so [they] exclude[] those funds that solely invest in domestic assets.”\textsuperscript{19} Third, SWFs are established “by the general government for macroeconomic purposes, are created to invest government funds to achieve financial objectives, and (may) have liabilities that are only broadly defined, thus allowing SWFs to employ a wide range of investment strategies with a medium- to long-term timescale.”\textsuperscript{20} The Santiago Principles also help define SWFs by distinguishing them from other funds. SWFs are different, for example, from reserve funds that exist to serve “traditional balance of payments purposes.”\textsuperscript{21} While SWFs

\textsuperscript{17} Id.
\textsuperscript{18} Id.
\textsuperscript{19} Id.
\textsuperscript{20} Id.
\textsuperscript{21} Id.
may invest some reserve assets, “the intention is not to regard all reserve assets as SWFs.”

Although the IFSWF speaks of “funds,” it also notes that the definition includes the use of the word “arrangements” as an alternative to “funds,” which allows for “a flexible interpretation of the legal arrangement through which the assets can be invested. SWFs vary in their institutional arrangements, and the way they are recorded in the macroeconomic accounts may differ depending on their individual circumstances.”

Academic commentators have also provided numerous definitions of SWFs. In an extensive review of such definitions (and of the business of defining SWFs generally), Capapé and Guerrero note that SWFs are constantly evolving, “making it hard—if not impossible—to come up with an all-embracing definition for a wide variety of SWFs.” Instead, they argue for a “concentric” definition, like layers of an onion, to give a “better idea of the nature of SWFs and leave others to argue the toss when it comes to specific cases.”

In their review of SWF research providing working SWF definitions, Capapé and Guerrero note 11 features, shown in their model (see Figure 1.3), that researchers regularly cite. Under their model, the “closer to ‘the core’” we see certain characteristics, “the more the feature has been used to define SWFs.”

And yet, a definition of SWF will always remain elusive because it will be tied to the club of SWFs, the IFSWF. Any fund that is part of the IFSWF may be thought to be an SWF by definition: it is, after all, the forum of SWFs, and so the definition may drift through admission of new funds with novel purposes. And yet, the definition will also be more expansive than the membership of the IFSWF, because there will undoubtedly always be funds which analogize closely to the various

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22 Santiago Principles, supra note 3, at 1.
23 Id.
25 Id. at 4.
26 Id.
member funds of the IFSWF, yet for whatever reason do not choose to be part of the forum.

This article will adhere to the IFSWF definition, with the caveats noted above that any definition of a SWF must be imprecise, self-referential, and fluid. Working from this definition, SWFs are special purpose investment funds or arrangements, owned by the general government, that hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets.
1.3  Distinguishing Sovereign Wealth from State-Owned Enterprises

As the IFSWF definition implies, SWFs may also be more clearly defined by distinguishing them from other types of state-controlled entities, which also helps to clear away some conceptual underbrush to help identify sources and types of risk. This section will distinguish SWFs from the most important category of state-controlled enterprise (SCE), the state-owned enterprise (SOE). The differences fall along several axes: differences in purpose, differences in structure, and differences in investment behavior.

A. Differences in purpose.

Economic theories tend to see SOE creation as either the result of market failure or, more sinisterly, as a form of rent-seeking in the public sphere. In this more cynical view, SOEs are merely the evidence of failure or corruption, and provide inferior outcomes compared to private actors operating in free markets. In response to this view, Stiglitz has noted that such suppositions are based on contestable beliefs about the nature of markets: first, that markets, by themselves, will yield efficient outcomes, and second, that market efficiency is more important than distributional justice (whether between persons or between generations).\(^\text{27}\) The contestability of these suppositions is a result of what he identifies as shortcomings in markets that reveal them to be Pareto inefficient.\(^\text{28}\) Writing a decade before the Financial Crisis, Stiglitz noted that externalities (including negative externalities, such as pollution, and positive externalities, such as innovations), public goods, imperfect information, and incomplete markets are all factors that “give rise to problems in the market economy.”\(^\text{29}\)


\(^{28}\) Id.

\(^{29}\) Id.
from adequately resolving externality problems.”

Thus, for Stiglitz it is not necessarily the case that SOEs should only arise in the event of a market failure. They may also arise simply where the market is less efficient, for whatever reason.

If SOEs arise to combat market inefficiencies, how can they be governed to ensure that they effectively accomplish their purposes and not simply introduce one kind of inefficiency to replace another? To help reduce political risks and governance inefficiencies, the Organisation for Economic Co-operation and Development (OECD) has been at the forefront of providing guidance and best practices for SOEs. OECD standards of accountability and transparency are designed “to allow the public,” the ultimate owner of the SOE, to “assure itself that the state exercises its powers in accordance with the public’s best interest.” Among these transparency mechanisms is the development and publication of a rationale for the purpose of the SOE, which provides markets and the public with the government’s objectives and priorities as an owner. From a 2015 survey of 28 jurisdictions, the OECD has categorized a variety of SOE rationales. The five general categories of SOE purposes and rationales include:

(1) supporting national economic and strategic interests;

(2) ensuring continued national ownership of enterprises;

(3) supplying specific public goods or services (after deeming the market cannot supply the same goods or services);

(4) performing business operations in a “natural” monopoly situation; and

(5) creating or maintaining a state-owned monopoly (or oligopoly) where market regulation is deemed infeasible or inefficient.

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30 Id.
32 Id. at 16.
33 Id. at 19.
Of the five rationales, the two most common rationales were “supporting national economic and strategic interests” (cited by 15 jurisdictions) and “supplying specific public goods or services (after deeming the market cannot supply the same goods or services)” (cited by 11 jurisdictions).  

Compare this to SWFs, which are generally created to respond to broad macroeconomic policy goals. These goals vary according to the macroeconomic challenges faced by a given sovereign. For example, as Clark and Monk note, Singapore established GIC (formerly the Government of Singapore Investment Corporation) to “insure the welfare of its citizens against global economic and financial instability and regional political instability.”  

Norway, meanwhile, established the Government Pension Fund – Global (GPF-G) to “manage resource wealth and underwrite government pension obligations on behalf of future generations.” Likewise, the Australian Future Fund is designed to help promote intergenerational equity “while ensuring macroeconomic stability in the face of burgeoning public and private wealth.” Some of the Gulf funds were created to help “preserve their resource wealth given past experience of ‘windfalls’ lost to corruption, poor investment, and arbitrary decision-making,” while China’s Investment Corporation helps produce stronger returns from its large dollar holdings (themselves part of a macroeconomic strategy to manage foreign currency valuations and fluctuations).  

To conceptualize and simplify these two sets of general categories, consider again the rationales for each type of sovereign-controlled entity. In the case of SOEs, the primary functions of the entities may be summarized as the provision of a set of goods, services, or employment to the general public. In some cases, this responsibility is due to a true market failure that makes it difficult for private industry to provide a solution or because of a long-standing public ownership model that,

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34 Id.  
36 Id.  
37 Id.  
38 Id.  
39 Id.
while ultimately more efficient to dissolve, nevertheless would create
dramatic short-term political costs if it were to be dissolved. This,
among other reasons, may explain the fact that “ensuring the continued
national ownership of enterprises” remains a rationale for the existence
of SOEs.\textsuperscript{40}

SWFs, by contrast, perform a different role. As described below,
SWFs are not designed to be operating companies that provide goods
and services to citizens; they do not respond to market failures that
make it difficult or even impossible for the private sector to provide
such goods or services. SWFs instead \textit{help to secure macroeconomic
policy goals, such as currency stabilization, financial stabilization, and
intergenerational equity}. So, while both SOEs and SWFs help to achieve
policy goals, the ways in which they do so differ considerably, with
SOEs directly acting as providers of goods, services, and employment\textsuperscript{41}
and SWFs acting as long-term stabilizers.\textsuperscript{42}

\textsuperscript{40}It is worth noting that of the five categories of SOE purpose, this purpose
was mentioned by only one out of 28 jurisdictions. “Performing business operations
in a ‘natural’ monopoly situation” was cited by only one as well, while “creating
or maintaining a state-owned monopoly (or oligopoly) where market regulation is
deemed infeasible or inefficient” was cited only three times. \textit{See OECD, supra note
31, at 19.}

\textsuperscript{41}In OECD countries, SOEs are typically concentrated in network industries
and in the financial sector. Electricity, gas, transportation, telecommunications,
and other utilities SOEs make up 51\% of all SOEs by value and 70\% of all SOE
employment. \textit{OECD, The Size and Sectoral Distribution of State-Owned Enterprises
8 (2017), http://dx.doi.org/10.1787/9789264280663-en.} Overall, SOEs average 2-3\%
of national employment among OECD countries. \textit{Id. at 25.} In Norway, the percentage
is near 10\%. \textit{Id.}

\textsuperscript{42}This is not to suggest, of course, that SOEs do not have an important impact
on the public finances of the government-owners. An EU study notes that majority
owned SOEs account for trillions in assets and millions of jobs in OECD member
countries, and that as of 2013, about 10\% of the 2000 largest global enterprises
are majority owned by public. \textit{European Comm’n, European Union, State-Owned
Enterprises in the EU: Lessons Learnt and Ways Forward in a Post-Crisis Context
7 (2016), http://dx.doi.org/10.2765/99224 (European Economy Institutional Paper
31).} This share would be 20\% if minority-owned public companies were included in
the calculation. \textit{Id.} In the EU, SOEs have a small but significant impact on revenues
for some member states. General government revenues from SOEs in Finland, for
example, accounted for 1.5\% of GDP on average between 2005-2014 and averaged
about 1\% in other SOE-heavy jurisdictions, including Sweden, Estonia, Malta,
Slovakia, and the Netherlands. \textit{Id. at 12.}
B. Differences in structure.

SOEs also differ from SWFs in that the former are typically created as operating companies, while the latter are created to function as investment vehicles. Because SOEs are formed as operating companies, they will generally have large numbers of employees and managerial staff, as would (and perhaps even more so than would) a comparable private employer. In a review of 40 countries primarily in the OECD area but also covering India, Brazil, Argentina, and Saudi Arabia, the OECD identified 2,467 commercially oriented SOEs (excluding China) with a value of approximately $2.4 trillion and employing 9.2 million people. Looking at China alone, the survey identified over 51,000 SOEs, valued at approximately 29.2 trillion and employing 20.2 million people.

Nearly all SOEs (92%, as measured by value) are incorporated entities and are thus subject to the laws and regulations applicable to private entities. Indeed, nearly half of all majority owned SOEs are publicly listed entities. As such, they may be under some pressure from minority shareholders (as well, of course, from their majority government owners) to maximize their performance. As the OECD notes:

With an increasingly prevalent practice of “commercialisation” of SOEs in recent decades and growing expectations for improved performance, many governments have made efforts to professionalise boards of directors and sought to make boards perform better by ensuring their independence and shielding them from ad hoc political intervention. Governments have taken a number of steps to implement the three-layered approach in line with their company laws to improve the efficiency and performance of boards of state-owned enterprises. In an increasing number of countries, SOE boards have evolved from oversight bodies entrusted

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43 OECD, supra note 41, at 7–8.
44 Id. at 42 tbl. A.7.
45 Id. at 8.
46 Id.
with compliance toward driving performance and establishing corporate strategy.\textsuperscript{47}

If in many ways SOEs are acting more like private operating companies, what is the private analogue for SWFs? Because SWFs can perform different types of functions, there is no single analogue, and for some functions (such as protecting against \textquote{\textipa{Dutch Disease}}\textsuperscript{48}), there is no common private analogue. Indeed, SWFs may invest in a variety of ways, as indicated by the stark differences between the asset allocations of SWFs that serve as stabilization funds, on the one hand, and SWFs that act as savings funds on the other, as shown in Table 1.1 below.

In broad terms, all SWFs generally operate as investment funds, whatever their particular underlying macroeconomic purpose. Different types of SWFs may operate similarly to various types of investment funds, although they often invest more conservatively in practice. For instance, an intergenerational savings SWF is somewhat analogous to a large university endowment fund, in that it is used to save for future generations while producing some current income. In a 2012 survey, the IMF found that the average asset allocation for savings-oriented SWFs was 58% equities, 16% sovereign fixed income, 16% \textquote{other} investments (including alternative investments), 6% other fixed income (such as corporate), and 4% cash.\textsuperscript{49} By comparison, a 2017 survey of asset allocations for the largest university endowments (with assets under management of $1 billion or more) indicates an average approximate


\textsuperscript{48}Dutch Disease refers to a kind of \textquote{resource curse} in which \textquote{a booming export sector increases the relative price of non-tradable goods and services, thus hurting the rest of the tradable goods sector.} Its name arose from the effects attributable to the discoveries of North Sea gas on the Dutch manufacturing sector.” Jean-Philippe Stijns, \textit{An Empirical Test of the Dutch Disease Hypothesis Using a Gravity Model of Trade} 2 (Int’l Trade, Working Paper No. 0305001, 2003), \url{https://papers.ssrn.com/abstract=403041}.


Full text available at: \url{http://dx.doi.org/10.1561/109.00000021}
Table 1.1: Differences in SWF Stabilization and Savings Funds

<table>
<thead>
<tr>
<th></th>
<th>Stabilization funds</th>
<th>Savings funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment horizon</td>
<td>Short term</td>
<td>Long term</td>
</tr>
<tr>
<td>Asset composition</td>
<td>Limited to highly liquid assets</td>
<td>Broader asset classes</td>
</tr>
<tr>
<td>Currency composition</td>
<td>Negatively correlated with commodity prices</td>
<td>Matching net import of the country</td>
</tr>
<tr>
<td>Performance benchmarks</td>
<td>Minimizing expenditure volatility and maintaining adequate liquidity</td>
<td>Achieving real expected returns for long-term periods to maintain the long-term purchasing of the wealth</td>
</tr>
<tr>
<td>Risk tolerance</td>
<td>Low risk-return profile</td>
<td>Active investment management with higher risk-return profile</td>
</tr>
<tr>
<td>Asset and liability management</td>
<td>Ensuring the sustainability of future fiscal expenditure</td>
<td>Maximizing net value of the fund taking into account the correlation between asset prices and liabilities</td>
</tr>
</tbody>
</table>

Source: IMF (2013)
allocation of 32% equities, 7% fixed income, 4% short-term securities and cash, and 57% alternative investments, including private equity, hedge fund, and venture capital investments.\textsuperscript{50}

Because SWFs are investment funds, even though they may in some cases be set up as corporate entities, the distinctions between SWFs and SOEs become clearer. SWFs are generally large funds, with diverse holdings; they usually have a small number of investment professionals on staff, with various administrative teams handling trading, reporting, and regulatory compliance. They are not designed to manage the enterprises in which they invest. By contrast, SOEs are operating companies, with staffing levels suited to that purpose. The ownership structure of a SWF may be similar to a given SOE, in that the SWF may be owned by the same state holding entity as the SOE or may report to the ministry of finance in the same way as a SOE. However, as noted above, SWFs are typically not providers of goods and services, even though they may own shares (and in some cases, a significant number of shares) in companies that are providers of goods and services.

The fact that SWFs may own operating companies does not change their nature as typically very lean organizations; such is the case with other types of investment funds, such as private equity funds, that also own operating companies and yet are not themselves operating entities. As will be discussed in the next section, however, SWFs may be distinguished from private equity firms in that their holdings are generally much more vast, which constrains their ability to actively manage companies within their portfolio.

As noted above, this relatively passive style of management also distinguishes SWFs from SOEs in terms of their governance, management, and employment structures. While both SWFs and SOEs usually will have boards and day-to-day managers, SWFs, as investment funds, are characterized by large assets under management by fewer managers; SOEs, especially those designed to be operating companies, usually will have fewer assets managed by many more individuals. Norway’s $1

trillion GPF-G is managed by a Norges Bank Investment Management staff of 550 persons.\textsuperscript{51} Norway’s Statkraft electricity generating firm, by contrast, has assets of less than $19 billion and employs over 3,300 persons.\textsuperscript{52}

C. Differences in investment behavior.

SWFs are set up as investment funds, but they are not set up like private equity funds; they are much larger and invest much more broadly. Here, the effect is similar to that created by the structural management differences described above. This means that it is more difficult, simply as a matter of resource allocation, to engage in the active governance of their portfolio companies as compared to private equity funds. As a point of comparison, China Investment Corporation’s 2010 Form 13F filing (which discloses institutional investor holdings for investors managing over $100 million in U.S. equity securities) revealed investments in the U.S. alone of 67 companies.\textsuperscript{53} Many of these were relatively modest investments in 100,000—500,000 shares, with a few larger investments in Citigroup (9 million shares), Morgan Stanley (about 59 million shares), and Teck Resources (101 million shares), among a handful of others.\textsuperscript{54} The total investment in U.S. equities by CIC as reported in the filing totaled less than $10 billion.\textsuperscript{55}

By the nature of their investment model, private equity investments are more concentrated. Apollo’s private equity (PE) fund, Fund VII, which managed $14.7 billion in assets, was also in full operation in 2010.\textsuperscript{56} Their portfolio only held three companies acquired in 2008.


\textsuperscript{53}China Inv. Corp., Report for the Calendar Year or Quarter Ended: December 31, 2009 (Form 13-F) (Feb. 5, 2010), https://www.sec.gov/Archives/edgar/data/1468702/000095012310009135/c95690e13fvhr.txt.

\textsuperscript{54}Id.

\textsuperscript{55}Id.

five acquired in 2009, and eight acquired in 2010. More important
than the number of portfolio companies, however, is the nature of the
ownership. In the case of PE investments, the PE firm will typically
control and actively manage the company so that it can be resold or
taken public at a higher value. By contrast, CIC’s investments in its
2010 portfolio reveal a predominantly passive investment portfolio, with
only a few investments that suggest a more active (but non-controlling)
ownership.

Control (and even significant influence) may be ascertained by
reviewing filings required under Section 13 of the Exchange Act of
1934. Under the 13D beneficial owner report, a person or group of
persons acquiring beneficial ownership of more than 5% of a voting
class of a company’s equity securities must file a Schedule 13D with
the SEC. The 13D requires an acquirer of 5% or more of a company’s
equity securities to disclose, among other things, the purpose of the
transaction, including any plans or proposals which the reporting persons
may have which relate to or would result in extraordinary corporate
transactions (such as a merger, reorganization or liquidation), a sale
or transfer of a material amount of assets of the company, changes in
the board or management, or changes to the company’s business or
corporate structure. Form 13G is used when an acquirer obtains 5% or
more (but less than 20%) of a company’s equity securities, but intends
to hold the securities passively. A 13D filing thus signifies active or
controlling ownership (or the intention to actively manage or control),
whereas a 13G filing indicates a passive investment.

As an example of “control” for 13D purposes, in 2010 CIC owned
about 16% of AES Corporation through its wholly owned subsidiary,
Terrific Investment Corporation. Under a stockholder agreement,

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(last visited July 25, 2019).
60 Id.
61 § 240.13d-102.
62 The AES Corp., Schedule 13D (Mar. 19, 2010), available at
https://www.sec.gov/Archives/edgar/data/874761/000090342310000180/cic-
13d_0319.htm (filed by China Inv. Corp. and Terrific Inv. Corp.).
Terrific was entitled to place one director on the AES board, necessitating a Form 13D filing even though the investment represented a minority stake in the company. CIC also filed a 13D in connection with its investment in General Growth Properties, Inc., in which (combined with subsidiaries Stable Investment Corporation and Best Investment Corporation) CIC owned 28.3% of the General Growth Common Stock. Through investment in additional subsidiaries, Stable and Best controlled three seats on the nine-member General Growth board. Through Stable and Best, CIC also controlled 15.1% of the Howard Hughes Corporation and had the ability to place one director on the Howard Hughes board.

By contrast, CIC has a number of significant investments that do not implicate control. In 2010, CIC and its subsidiary Land Breeze held 10.5% of Penn West Energy Trust, filing their beneficial ownership disclosure under Form 13G. CIC’s investment in Teck Resources was also disclosed under 13G; even though CIC owned 17.5% of the company, it did not have a board seat or managerial control over the company.

CIC also held a substantial stake in Morgan Stanley; as of June 2010,

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63 Stock Purchase Agreement by and Between Terrific Inv. Corp. and The AES Corp. (Nov. 6, 2009), available at https://www.sec.gov/Archives/edgar/data/874761/000090342310000180/ex1.htm.


65 Id.


CIC beneficially held 11.64% of Morgan Stanley’s common stock, and Best, a wholly-owned subsidiary, held 8.63%.

More recent data may be found in Norges Bank’s Form 13F filings on behalf of the GPF-G. In its filing, dated November 13, 2018, Norges Bank listed U.S.-traded equity assets totaling over $263 billion. The fund also lists over 2,000 investments. Of these, only a few companies triggered a 13D filing (and usually the filing simply disclosed the fact that Norges Bank had reduced its ownership to less than five percent). Norges Bank made only 17 13G or amended 13G filings (involving 13 companies) and no 13D filings in 2018.

Norges Bank invests GPF-G funds in over 9,000 companies in markets around the world, with high concentrations in North America and Europe. By policy of the fund, the GPF-G may own no more than 10% of any listed company. The GPF-G strategy is, then, very much like a passive indexing strategy, with this important exception: GPF-G, despite its passive investment strategy (as naturally determined by its 10% investment limitation), nevertheless seeks to position itself as an active owner, even though it is does not seek to control companies. Distinguishing the fund’s strategy from a purely passive strategy, Norges Bank notes,

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69 Morgan Stanley, Schedule 13G (June 18, 2010), available at https://www.sec.gov/Archives/edgar/data/895421/000089183610000114/sc0058.htm (filed by China Inv. Corp. and Best Inv. Corp.). Under a 2007 agreement with Morgan Stanley, CIC purchased equity units that were to be converted into common stock in August of 2010; the 11.64% is the as-converted percentage of shares. In order to avoid regulatory scrutiny, CIC began selling off shares of Morgan Stanley in July 2010. Li Qing & Sun Huixia, CIC’s Bitter Payoff for Morgan Stanley Stake, MarketWatch (Aug. 8, 2010), https://www.marketwatch.com/story/china-wealth-fund-hit-by-morgan-stanley-investment-2010-08-08.


71 Id.


74 Id. at 69.
A passive strategy would attempt to mimic a benchmark index by following set rules. Such a strategy would not be compatible with current requirements and expectations when it comes to responsible investment, environment-related mandates, investments in real estate, investments in emerging markets, factor exposures or risk management. Such a strategy would therefore require a different management mandate to the one we have today.\textsuperscript{75}

The Norges Bank investment style is not designed to generate “alpha” through a few well-chosen and managed investments, but it is rather to improve the returns provided by a market-wide portfolio. As stated by the fund’s fiduciaries, Norges Bank’s strategy is designed to “improve the long-term economic performance of our investments,” as well as to “reduce financial risks associated with the environmental and social practices of companies in our portfolio” by considering governance and sustainability issues that could impact the performance of the fund.\textsuperscript{76}

SOEs and SWFs may both present risks associated with their investment behavior. Because SWFs are often making direct equity investments in markets, the role of state-controlled enterprises (SCEs) has focused on the risks presented by SWFs to countries in which they invest. By contrast, the concerns over SOEs have tended to be focused on the domestic risks presented by poor SOE management. Take, as an example, the description of the concerns presented by SOEs in the OECD Guidelines on Corporate Governance of State-Owned Enterprises.\textsuperscript{77} The OECD identifies a spectrum of risk posed by SOEs with politicization on one end and passivity on the other. SOEs, the OECD argues, may suffer from politicized management and interference, “leading to unclear


lines of responsibility, a lack of accountability[,] and efficiency losses in the corporate operations.” 78 On the other extreme, the OECD also warns against passive ownership that may “weaken the incentives of SOEs and their staff to perform in the best interest of the enterprise and the general public who constitute its ultimate shareholders[.] and raise the likelihood of self-serving behaviour by corporate insiders.” 79 These governance concerns are exacerbated by the lack of private market discipline ordinarily imposed by the takeover market and the threat of bankruptcy.

This is not to suggest that discussions of SOE governance do not include impacts on markets and other markets participants. The OECD’s SOE guidelines state, for example, that SOEs should operate on a level playing field with private enterprise (to the extent that the SOE is engaged in normal commercial or economic activities). 80 The OECD guidelines also suggest that SOEs should be subject to other jurisdictions’ tax laws. 81 For SWFs, many of the Santiago Principles are clearly focused on matters of corporate governance and domestic oversight of SWFs. In contrast to SOEs, the discussion of SWFs has typically focused on international impacts as much as (if not more than) domestic impacts. The “Objective and Purpose” of the Santiago Principles acknowledges the Principles’ importance in demonstrating “to home and recipient countries[.] and the international financial markets,” that SWFs

78 Id.
79 Id.
80 Id. at 11.
81 “As a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations. Laws and regulations should not unduly discriminate between SOEs and their market competitors. SOEs’ legal form should allow creditors to press their claims and to initiate insolvency procedures.” Id. at 20. This argument has also been applied, of course, to SWF activities. Vic Fleischer argues, for example, that preferential tax treatment for sovereigns in the U.S. should be replaced by a simpler system that would treat SWFs and SOEs as private foreign corporations. See generally Victor Fleischer, A Theory of Taxing Sovereign Wealth, 84 N.Y.U. L. Rev. 440 (2009).
are appropriately governed and that SWFs invest on a financial and economic basis.\textsuperscript{82}

The lack of focus on SOE investment implications (at least relative to concerns over SWF investment) is ironic. Because SOEs more frequently function as operating companies (or holding companies for operating companies), they may be used in ways that pose a more direct threat to foreign governments than do the diversified holdings of SWFs. While SWFs may be part of a broader strategy of investment, they are generally ill-suited to engage in the kinds of activities that would implicate national security (though this potential for politicization indeed remains a key risk for SWFs).

The supposition that SOEs present greater risk is supported by a review of the investment activities of China in critical U.S. technologies. As noted above, while CIC has made some influential and even controlling investments in U.S. firms, other vehicles are more frequently used to “acquire expertise from abroad and to develop indigenous innovation.”\textsuperscript{83} According to an analysis by the Defense Innovation Unit Experimental (DIUx), a U.S. Department of Defense investment unit, China uses a variety of mechanisms to invest in and acquire technology from U.S. firms.\textsuperscript{84}

First, China uses standard venture capital investments in start-up firms. Some of these investments are channeled through U.S. venture capital firms; many SWFs invest through such mechanisms, although China’s CIC does not indicate that venture capital investments form part of its portfolio. China has a number of dedicated venture firms making greenfield investments in early-stage companies in the U.S.\textsuperscript{85} Second, large Chinese firms also make investments in venture deals.

\textsuperscript{82}Santiago Principles, supra note 3, at 4.
\textsuperscript{84}Id. at 16.
\textsuperscript{85}DIUX lists as examples of Chinese venture firms West Summit Capital, Westlake Ventures (owned by the Hangzhou government), GGV Capital, GSR Ventures, ZGC Capital, Hax, and Sinovation. Id. at 8. Sinovation, they note, has made over 300 investments in startups, including in 25 artificial intelligence firms. Id.
DIUx notes that Baidu, Tencent, Alibaba, and JD.com participated in 34 deals worth $3.4 billion in 2015 alone. As with venture capital investments, many of these deals are indirect, through Chinese funds investing as limited partners in U.S. private equity funds.

Because of U.S. regulators’ focus on Chinese investments, described in detail below, mitigating structures are occasionally used to help insure deal approval. DIUx notes, for example, that a potential acquisition of Lattice Semiconductor was structured through a special purpose vehicle, with a U.S. private equity management team (Canyon Bridge) investing Chinese capital. The deal was structured with the expectation that it would be more likely to be approved than a direct investment. The attempted acquisition failed, however, after President Trump issued an executive order requiring Canyon Bridge and Lattice to “take all steps necessary to fully and permanently abandon the proposed transaction.”

While SOEs may be more suitable vehicles for forwarding Chinese technology development goals, the structure of the Chinese SOE system also has a disadvantage: its vast, sprawling scale, which may make it more difficult to coordinate policy goals than coordinating with CIC or other more closely-controlled investment funds. An added complication for regulators trying to analyze the risk posed by Chinese SOEs is that there are two types of SOEs operating in international markets for corporate control: central SOEs that are owned and controlled by the central Party and local SOEs that are controlled by local governments or local government-controlled holding companies. Centrally owned SOEs are typically controlled by the State-owned Assets Supervision and

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86 Id. at 9.
87 Id. at 10.
88 Brown & Pavneet, supra note 83, at 10.
Administration Commission (SASAC), which governs 96 firms. These firms make up most of the Chinese “national champion” companies that play a vital role in achieving state policy goals. The vast majority of SOEs, however, are locally owned companies, with some 116,499 firms as of the end of 2016. The central government tries to resolve difficulties of coordination through chains of ownership and corresponding political and financial control, as explained by Lin and Milhaupt:

Though the elite firms that serve as the outward face of Chinese SOEs... are listed on stock exchanges in Shanghai, Hong Kong, or other world financial capitals, they are nested within vertically integrated groups. Each company’s majority shareholder is the core (parent) company of the group—which is itself 100% owned by SASAC. The core company coordinates the group’s activities and transmits business policy to group members, who are contractually bound to promote the policies of the state. Individual corporate groups are often linked through equity ownership and contractual alliances to groups in the same or complementary industries, to provincial-level business groups, and even to noneconomic state-controlled institutions, such as universities.

The resulting coordination, though not perfectly efficient, allows the Chinese government to effectively use SOE investment to further its policy goals, such as the Made in China 2025 plan. China’s Belt and Road initiative also provides insights into how China uses its SOEs and SWFs. The Belt and Road Initiative, viewed by some as the “trademark foreign policy project” of Xi Jinping, seeks to “expand Chinese influence

90For a list of these firms, see Central Enterprise Directory, SASAC (Dec. 29, 2017), http://www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html.
93See infra note 298 and accompanying text.
through financing and building infrastructure around the world, with a focus on Asia, the Middle East, Africa, and Europe." The Belt and Road Initiative is financed primarily through Chinese state-owned banks; as of the end of 2016, the majority of the funding (52%) comes from state-owned commercial banks, including the China Development Bank (26%), and the Export-Import Bank of China (21%). A small percentage of financing comes from the Asian Infrastructure Investment Bank, the New Development Banks, and the Silk Road Fund. The Silk Road Fund in turn receives 65% of its financing from China’s State Administration of Foreign Exchange (SAFE) and 15% of its financing from the CIC. CIC also indirectly supports the Belt and Road Initiative through investment in publicly traded Chinese commercial banks. However, it is through state-owned firms, rather than SWFs, that the bulk of the initiative is funded.

SWFs can and do contribute to national policy goals that are furthered through the acquisition of companies and financing of projects in foreign jurisdictions. However, as has been outlined in this section (and as evidenced by their behavior), they are poorly suited to these goals by their limited purposes and investment fund structures. On the other hand, because of these differences, SWFs themselves are subject

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94 This view, provided by the U.S.-China Economic and Security Review Commission in their 2018 Report to Congress, admittedly views the initiative through the lens of U.S. economic and national security interests:

Beijing wants to use BRI to revise the global political and economic order to align with Chinese interests. Official Chinese communiques focus on the initiative’s economic objectives—building hard and digital infrastructure, fueling domestic development, and expanding markets and exporting standards. But China also seeks strategic benefits from BRI, despite its insistence to the contrary. Beijing’s geopolitical objectives for the project include securing energy supplies, broadening the reach of the PLA, and increasing China’s influence over global politics and governance.


95 Id. at 276, fig. 3.

96 Id.

97 Id. at 277.
to risks that are typically not as prevalent or serious for SOEs.

SWFs will, of course, operate under governance structures and manifest investment behaviors suited to their ostensible policy goals because such structures and behaviors reduce agency costs associated with the basic principal-agent problem at the root of all managed investment funds, including SWFs. But, in order to counteract the trust deficit that might exist between host countries and the SWF, SWFs should be inclined to invest predictably and adhere to standards of conduct like the Santiago Principles.\textsuperscript{98} Doing so will serve to reduce transaction costs associated with sovereign investment because it will attract less regulatory scrutiny. Because SWFs are the ultimate repeat players, with (typically) thousands of investments around the world, they are at greater risk for increased transaction costs than smaller and less widely diversified investors. And, because many regulators (including the Committee on Foreign Investment in the United States (CFIUS)) will review existing ownership if they are given reason to suspect that a change in investment behavior might implicate new national security risks, SWFs who lose regulators’ trust may put large portions of their portfolio at risk for review. A dramatic shift in transaction costs may thus put in jeopardy the achievement of the core purposes of the SWFs; their very nature as repeat market players serves to mitigate some of the risk that they will behave in a way that creates national security risks for host countries. For SOEs or special-purpose entities that are one-time or rare players in a market, there are no portfolio or business risks comparable to those faced by SWFs.

\textsuperscript{98}Note that SWFs have varying degrees of compliance with the Santiago Principles. To date, host countries have not been proactive in rewarding compliance, though they undoubtedly evaluate the risks posed by different SWFs, and disclosures suggested by the Santiago Principles help to identify these risks. For a view on how compliance may be rewarded by host countries and facilitated by third-party verifiers, see Sven Behrendt, GeoEconomica, The Santiago Principles: What’s Next? (Mar. 2016), http://www.ifswf.org/sites/default/files/Publications/Moving%20the%20Santiago%20Principles%20foward.pdf.
1.4 Distinguishing Sovereign Wealth Funds from Sovereign Development Funds

As a final, important distinction, SWFs may be distinguished from a newer category of funds that are designed more specifically for domestic development purposes: SDFs. A development purpose has sometimes been an express part of SWF mandates, and indeed a number of sovereign funds have been created expressly to help fund domestic activities. Some of these have been in existence for decades, including Temasek of Singapore (1974) and Khazanah in Malaysia (1993). But to specifically distinguish development purposes from more traditional SWF purposes (such as smoothing revenue and currency fluctuations, providing intergenerational savings, and preventing Dutch Disease), some observers have separately categorized funds with a development mandate.

The number of such development-oriented funds has grown significantly in recent years. As compiled by Patrick Schena, Juergen Braunstein, and Asim Ali,99 the list includes at least 20 funds (Table 1.2).

SDFs may be thought of as funds that are designed to boost their local economies through, for example, “national strategies of industrial diversification” and “financing long-term [domestic] projects and infrastructures.”100 In Clark and Monk’s schema, SDFs can be categorized by how their missions align along two axes, 1) their operative objectives (in terms of how tightly or loosely coupled the SDF is to national assets),

<table>
<thead>
<tr>
<th>Country</th>
<th>SWF</th>
<th>Year</th>
<th>Status</th>
<th>Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Romania</td>
<td>Sovereign Fund for Development and Investment</td>
<td>2017</td>
<td>announced</td>
<td>Health infrastructure, infrastructure, technology, defense, energy</td>
</tr>
<tr>
<td>Armenia</td>
<td>Armenian Investment Fund</td>
<td>2017</td>
<td>announced</td>
<td>Agriculture, industrial production, transport and logistics infrastructure, as well as in technology</td>
</tr>
</tbody>
</table>

Financing Source: Debt/Equity/Borrowing

Size: €10 bn

Local and international sources, including RDIF and Armenia’s SME funds

Full text available at: [http://dx.doi.org/10.1561/109.00000021](http://dx.doi.org/10.1561/109.00000021)
Table 1.2: (continued)

<table>
<thead>
<tr>
<th>Country</th>
<th>SWF</th>
<th>Year</th>
<th>Status</th>
<th>Size</th>
<th>Financing Source</th>
<th>Sectors</th>
</tr>
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<tbody>
<tr>
<td>Turkey</td>
<td>Turkey Asset Management</td>
<td>2017</td>
<td>established</td>
<td>n.a.</td>
<td>Debt/Equity/Borrowing</td>
<td>Communication and transport infrastructure,</td>
</tr>
<tr>
<td>Guyana</td>
<td>Guyana Sovereign Wealth Fund</td>
<td>2017</td>
<td>established</td>
<td>n.a.</td>
<td>Budget surplus/oil</td>
<td>Infrastructure (social and economic)</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>Bangladesh SWF</td>
<td>2017</td>
<td>announced</td>
<td>$10 bn</td>
<td>FEX reserves</td>
<td>Infrastructure (social and economic)</td>
</tr>
<tr>
<td>Egypt</td>
<td>Amlak (Egypt-SWF)</td>
<td>2017</td>
<td>announced</td>
<td>n.a.</td>
<td>External sources (i.e. GCC)</td>
<td>Communications, logistics and travel infrastructure</td>
</tr>
</tbody>
</table>

Full text available at: http://dx.doi.org/10.1561/109.00000021
Table 1.2: (continued)

<table>
<thead>
<tr>
<th>Country</th>
<th>SWF</th>
<th>Year</th>
<th>Status</th>
<th>Size</th>
<th>Financing Source</th>
<th>Sectors</th>
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<tbody>
<tr>
<td>Nigeria</td>
<td>Infrastructure Fund</td>
<td>2016</td>
<td>established</td>
<td>US$25 bn</td>
<td>Local and international sources, including Nigeria’s SWF and domestic pension funds</td>
<td>Logistics and energy infrastructure</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Indonesian SWF</td>
<td>2016</td>
<td>announced</td>
<td>up to US$320 bn</td>
<td>Ministry of State-Owned Enterprises</td>
<td>Oil/gas, consumer goods, banking, construction and housing</td>
</tr>
<tr>
<td>India</td>
<td>India SWF</td>
<td>2016</td>
<td>established</td>
<td>US$3 bn</td>
<td>Budget</td>
<td>Infrastructure</td>
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<tr>
<td>Country</td>
<td>SWF</td>
<td>Year</td>
<td>Status</td>
<td>Size</td>
<td>Financing Source</td>
<td>Sectors</td>
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</tr>
<tr>
<td>South Africa</td>
<td>Green Strategic Investment Fund</td>
<td>2016</td>
<td>established</td>
<td>n.a.</td>
<td>Budget</td>
<td>Low carbon infrastructure</td>
</tr>
<tr>
<td>Thailand</td>
<td>Thailand Future Fund</td>
<td>2016</td>
<td>established</td>
<td>US$3 bn</td>
<td>Budget</td>
<td>Infrastructure (social and economic)</td>
</tr>
<tr>
<td>Ireland</td>
<td>Ireland Strategic Investment Fund (ISIF)</td>
<td>2014</td>
<td>established</td>
<td>US$8.4 bn</td>
<td>Assets of the National Pensions Reserve Fund</td>
<td>Transport infrastructure, education, tech. development, low carbon infrastructure, agriculture, waste management, water</td>
</tr>
<tr>
<td>Country</td>
<td>SWF</td>
<td>Year</td>
<td>Status</td>
<td>Size</td>
<td>Financing Source</td>
<td>Sectors</td>
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<tr>
<td>France</td>
<td>Bpifrance</td>
<td>2013</td>
<td>established</td>
<td>€32.6 bn</td>
<td>Merger between Caisse des Depots, the former SWF, the Strategic Investment Fund, and OSEO</td>
<td>Advanced materials, aeronautics, automotive components, biotech, contract research, oil and gas engineering</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Baiterek</td>
<td>2013</td>
<td>established</td>
<td>US$12.7 bn</td>
<td>SOEs</td>
<td>Infrastructure (transport), financial services, energy, telecom, SME</td>
</tr>
<tr>
<td>Country</td>
<td>SWF</td>
<td>Year</td>
<td>Status</td>
<td>Size</td>
<td>Financing Source</td>
<td>Sectors</td>
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<tr>
<td>Rwanda</td>
<td>The Agarico Development Fund</td>
<td>2013</td>
<td>established</td>
<td>n.a.</td>
<td>Voluntary contributions by Rwandans at home and abroad.</td>
<td>Broad mandate - economic development of the country</td>
</tr>
<tr>
<td>Gabon</td>
<td>Gabonese Strategic Investment Fund</td>
<td>2012</td>
<td>established</td>
<td>US$0.14 bn</td>
<td>10% of oil revenue goes to fund, 50% from excess budget</td>
<td>Infrastructure (social and economic)</td>
</tr>
</tbody>
</table>
Table 1.2: (continued)

<table>
<thead>
<tr>
<th>Country</th>
<th>SWF</th>
<th>Year</th>
<th>Status</th>
<th>Size</th>
<th>Financing Source</th>
<th>Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senegal</td>
<td>Fonds Souverain d’Investissements Stratégiques (FONSIS)</td>
<td>2012</td>
<td>established</td>
<td>US$0.76 bn</td>
<td>State Budget</td>
<td>Agriculture, infrastructure, logistics, energy, social housing, mines, services (IT, health, education, tourism) SMEs</td>
</tr>
<tr>
<td>Country</td>
<td>SWF</td>
<td>Year</td>
<td>Status</td>
<td>Size</td>
<td>Financing Source</td>
<td>Sectors</td>
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<tr>
<td>Italy</td>
<td>CDP Equity SPA</td>
<td>2011</td>
<td>established</td>
<td>€4.9bn</td>
<td>90% gov CDP bank owned by Ministry of Econ and Finance, 10% Fintecna</td>
<td>Innovation, and high-tech, defense and security, financial industry, industrial infrastructure</td>
</tr>
<tr>
<td>Morocco</td>
<td>Moroccan Fund for Tourism De-</td>
<td>2011</td>
<td>established</td>
<td>US$1.8 bn</td>
<td>2/3 gov. budget and 1/3 from Hassan II Fund (owned by State)</td>
<td>Tourism infrastructure</td>
</tr>
<tr>
<td>Country</td>
<td>SWF</td>
<td>Year</td>
<td>Status</td>
<td>Size</td>
<td>Financing Source</td>
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</tr>
<tr>
<td>India</td>
<td>National Clean Energy Fund</td>
<td>2011</td>
<td>established</td>
<td>n.a.</td>
<td>Budget</td>
<td>Energy security, innovative projects in clean energy technologies</td>
</tr>
</tbody>
</table>

*Source: Patrick Schena et al., Capitalizing Economic Development Through Sovereign Investment: A ‘Paradox of Scarcity’? (May 1, 2017) (unpublished manuscript).*
and 2) their *investment* objectives (whether “strategic” or “commercial” in nature). This matrix results in four types of SDFs:

- *reinforcing*, in which the SDF is tasked with the responsibility to “reorganize, professionalize and innovate” state assets so that they compete more effectively within their respective markets;

- *crowding-in*, in which the SDF partners with private investors (and perhaps other SDFs or SWFs) to support emerging domestic industry;

- *catalytic*, in which SDFs help catalyze new industries and drive the process of diversification away from less sustainable industries and/or into new market infrastructure opportunities; and

- *financialization*, in which SDFs support and build up a country’s financial infrastructure.  

All of these roles differ from SWFs in that they are tasked with economic development, as opposed to solving macroeconomic concerns created by wealth accumulation. Put another way, it is typically the existence of a pool of *wealth* that drives the creation of a SWF. On the other hand, it is typically *scarcity* that drives the creation of a SDF. For example, as Clark and Monk note, a SDF may be needed to solve particular infrastructure problems or to catalyze economic development within a country that lacks technology-driven industry. This explains why many U.S. states have created development funds. For example, the State of Ohio has created “JobsOhio,” an economic development program funded through state-wide liquor sales, to catalyze technology industries in a state that is transitioning from a rust-belt economy.

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102 *Id.* at 11.

103 *Id.*

1.4. *Distinguishing Sovereign Wealth Funds from Sovereign*

The impact of SDFs will depend to a great extent on the governance structures employed by the fund sponsors. Because they tend to be oriented to domestic development concerns, SDFs implicate some of the same domestic political and governance risks that impact SWFs, while implicating to a lesser extent the potential international risks posed by SWFs. Additionally, the differences between SWFs and SDFs in purpose, governance strategies, and general risk mitigation strategies are significant enough that SDFs have merited their own burgeoning literature.
Appendix E. Generally Accepted Principles and Practices (GAPP)—Santiago Principles

In furtherance of the “Objective and Purpose,” the IWG members either have implemented or intend to implement the following principles and practices, on a voluntary basis, each of which is subject to home country laws, regulations, requirements and obligations. This paragraph is an integral part of the GAPP.

GAPP 1. Principle

The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

GAPP 1.1. Subprinciple.

The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.

GAPP 1.2. Subprinciple.

The key features of the SWF’s legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.
GAPP 2. Principle

The policy purpose of the SWF should be clearly defined and publicly disclosed.

GAPP 3. Principle

Where the SWF’s activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle

There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF’s general approach to funding, withdrawal, and spending operations.

GAPP 4.1. Subprinciple.

The source of SWF funding should be publicly disclosed.

GAPP 4.2. Subprinciple.

The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

GAPP 5. Principle

The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

GAPP 6. Principle

The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.
**GAPP 7. Principle**

The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF’s operations.

**GAPP 8. Principle**

The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

**GAPP 9. Principle**

The operational management of the SWF should implement the SWF’s strategies in an independent manner and in accordance with clearly defined responsibilities.

**GAPP 10. Principle**

The accountability framework for the SWF’s operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

**GAPP 11. Principle**

An annual report and accompanying financial statements on the SWF’s operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

**GAPP 12. Principle**

The SWF’s operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.
GAPP 13. Principle

Professional and ethical standards should be clearly defined and made known to the members of the SWF’s governing body(ies), management, and staff.

GAPP 14. Principle

Dealing with third parties for the purpose of the SWF’s operational management should be based on economic and financial grounds, and follow clear rules and procedures.

GAPP 15. Principle

SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

GAPP 16. Principle

The governance framework and objectives, as well as the manner in which the SWF’s management is operationally independent from the owner, should be publicly disclosed.

GAPP 17. Principle

Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAPP 18. Principle

The SWF’s investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies) and be based on sound portfolio management principles.
**GAPP 18.1. Subprinciple.**

The investment policy should guide the SWF’s financial risk exposures and the possible use of leverage.

**GAPP 18.2. Subprinciple.**

The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

**GAPP 18.3. Subprinciple.**

A description of the investment policy of the SWF should be publicly disclosed.

**GAPP 19. Principle**

The SWF’s investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

**GAPP 19.1. Subprinciple.**

If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

**GAPP 19.2. Subprinciple.**

The management of an SWF’s assets should be consistent with what is generally accepted as sound asset management principles.

**GAPP 20. Principle**

The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.
**GAPP 21. Principle**

SWFs view shareholder ownership rights as a fundamental element of their equity investments’ value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

**GAPP 22. Principle**

The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

**GAPP 22.1. Subprinciple.**

The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.

**GAPP 22.2. Subprinciple.**

The general approach to the SWF’s risk management framework should be publicly disclosed.

**GAPP 23. Principle**

The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

**GAPP 24. Principle**

A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.