FESSUD

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

FESSUD

FINANCIALISATION, ECONOMY, SOCIETY AND SUSTAINABLE DEVELOPMENT

Working Paper Series

No 135

The Nature, Performance and Economic Impact of Sovereign Wealth Funds

I. Anthopoulos, C. Pitelis and C. Liakou

ISSN 2052-8035

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

The Nature, Performance and Economic Impact of Sovereign Wealth Funds

Authors: I. Anthopoulos[2] C. Pitelis[1,2] and C. Liakou[2]

Authors affiliations: [1]University of Brunel and [2]University of Athens

Abstract: We analyse the nature and economic performance of sovereign wealth funds (SWFs). Following a historical excursion, we discuss extant views on the nature, performance, economic impact and regulation of SWFs. Following these we pinpoint some limitations and outline some elements of a political economy-based conceptual framework, required for a more comprehensive appreciation of the issue.

Key words: sovereign wealth funds, performance, economic impact, regulation

Date of publication as FESSUD Working Paper: January 2016

Journal of Economic Literature classification: G10, G12, G20

Contact details: cnp100@cam.ac.uk

Acknowledgments: This research has received funding from the European Union Seventh Framework Programme (FP7/2007-2013) under grant agreement n° 266800.We are very grateful for comments and discussion on earlier versions of the paper to Wlodek Dymarski, and Malcom Sawyer.

Website: www.fessud.eu

Introduction

The aim of this report is to provide a short historical account of SWFs and discuss their nature, performance and economic impact and regulatory policy responses. I addition we briefly outline the basic missing elements of a political economy-based conceptual framework, which we consider necessary for a better appreciation of this important phenomenon. We then conclude.

Short Historical Account of SWFs

The first SWF ever established was a "Permanent School Fund" in 1854. The aim of that SWF was to fund public education in the State of Texas, through its revenue. In the same vein the Permanent University Fund followed in 1876 in order to fund universities in the State of Texas. In more recent years, in 1953, the Kuwait Investment Authority established a SWF based on oil revenues, which today holds a position among the ten SWF with the highest value worldwide, reaching $410 billion.

Following the Kuwait Investment Authority's inception, a string of SWFs formations followed, where this period is referred to as the first phase of their evolution. These SWFs were:

- the Revenue Equalization Reserve Fund of Kiribati which was created in 1956 as a commodity SWF based on phosphates,
- a non-commodity SWF by New Mexico State Investment Council in 1958,
- a non-commodity SWF by Caisse de dépôt et placement du Québec in 1965,
- a non-commodity SWF by Temasek Holdings in 1974,
- the Permanent Wyoming Mineral Trust Fund based on minerals in 1974 and
- three oil-based SWFs by Abu Dhabi Investment Authority, Alaska Permanent Fund and Alberta's Heritage Savings Trust Fund established in 1976

In the 1980s the oil SWFs started to take over. More specifically, in 1980 Oman's State General Reserve Fund established a SWF based on oil, in 1981 the Government of Singapore Investment Corporation established a non-commodity SWF, in 1983 the Brunei Investment Agency and in 1984 the International Petroleum Investment Company established their SWF based on oil. In 1985 the Alabama Trust Fund and in 1986 the Louisiana Education Quality Trust Fund Company established their SWF based on oil and gas (Sovereign Wealth Fund Institute, 2014). Moving on to the next decade, the main SWFs that were established based mostly on oil exports and less on non-commodity funds, were Norway's Government Pension Fund-Global, the Hong Kong Monetary Authority Investment Portfolio, Malaysia's Khazanah National and Botswana's Pula Fund, based on diamonds and minerals.

Since the late 1990s, the SWF trend came to sudden rise with an overwhelming number of SWFs forming. This second phase from the late 1990s has been linked to the surge of commodity prices and global payment imbalances coinciding with the rise of the East Asian export- led economies, such as Iran, Azerbaijan, Kazakhstan, Iraq, Qatar, Abu Dhabi, but also other oil exporters notably Venezuela, Gabon, Algeria, Mexico, Trinidad and Tobago, and Equatorial Guinea. Beginning in 2005 and up to 2008, a third phase in the development of SWFs emerged, with 25 SWFs establishing in these years, 12 of them based on oil. Moreover, during that period the SWF term itself was conceived in 2005, attributed to Rozanov. Importantly during that time, there was a distinct change in the attitude of policymakers and observers, from a cautious stance towards SWFs to one where these entities were viewed as 'lenders of last resort' during a time of financial and economic distress (Curzio & Micelli, 2010). The last phase began in the aftermath of the 2007/08 recession, where SWFs absorbed heavy losses in their investments in major US and European investment banks; these losses were estimated to exceed $57 billion (Bortolotti et al, 2009). As a result, SWFs were then seen to enter a period of retrenchment and rethinking of their investment strategy and portfolio towards a more transparent long term horizon, which was underpinned by the Santiago Principles and the International Forum of Sovereign Wealth Funds (IFSWF) (Curzio & Miceli, 2010).

In Europe, only five countries have established SWFs so far. First Norway established in 1990 the "Government Pension Fund", based on the revenue of country's oil exports. Ireland was the second European country and the first of the European Union's countries that established a non-commodity fund for national pension reasons. In 2008, under the uncertainty of global financial crisis, France and Finland proceeded in the establishment of non-commodity SWFs, focusing on strategic investments and management of governments property respectively. Finally, in 2011 Italy established a non-commodity fund for strategic purposes. Table 1 shows the asset value of these SWFs:

Table 1: Assets and origin of European SWFs

Country	Fund	Assets US$Billion	Inception	Origin
Norway	Government Pension Fund - Global	893	1990	Oil
Ireland	National Pensions Reserve Fund	27.4	2001	Non-commodity
Finland	Solidium	11.5	2008	Non-commodity
France	Strategic Investment Fund	25.5	2008	Non-commodity
Italy	Italian Strategic Fund	6	2011	Non-commodity

Source: Sovereign Wealth Fund Institute (2014)

The Nature and purpose of SWFs

There is no commonly held definitions of SWFs, however there are several notions brought forward that are mutually related. For example the US Treasury defines SWFs as a *'government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves of the monetary authorities (the Central Bank) and reserve-related functions of the Finance Ministry'*(US Treasury, 2007:1). Under the same logic, the International Working Group on Sovereign Wealth Funds (IWGSW) established under the support of the IMF, specify that SWFs are *'special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, sovereign wealth funds hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses, and/or receipts resulting from commodity exports'* (IWGSW, 2008: p.3, Udaibir S. Das et al. 2009, p.5). Moreover, Aizenman and Glick (2008) defined SWFs as saving funds controlled by sovereign governments that hold and manage foreign assets. As Lyon (2007) moreover argued, SWFs are government owned funds acting in the interest of the state, rather than the market's interest.

On the basis of these definitions certain common characteristics of SWFs can be outlined. First of all, SWFs must be owned by a sovereign state but at the same time be distinguished from the traditional central bank holdings of a country (Jen, 2007; Kimmitt 2008).In addition, SWFs usually prefer riskier assets that bring high yields rather than assets geared towards liquidity, which are traditionally sought by central banks. Moreover, SWFs usually are characterised by a low level of indebtedness allowing them to pursue long-term investment strategies[1] (Beck & Fidora, 2009). At the same time, however, SWF also invest in highly leveraged institutions like hedge funds and private equity firms, whilst recent SWFs are involving leverage in their transactions (Curzio & Micelli, 2010). In a survey conducted by the *International Working Group* (*IWG*) of Sovereign Wealth Funds 80% of the respondent funds declared that they did not use leverage directly, whilst 20% used leverage indirectly by investing in leveraged institutions such as hedge funds and only a third of the respondents used leveraged financial instruments (IMF, 2008). Lastly, there is a common characteristic amongst SWF to be involved in large scale investments; 68% of transactions completed amounted to $1 billion or more and over 50% of these acquisitions involved a 20% in the target company (ibid). On the other hand, Curzio and Miceli (2010) argued that this data is skewed as it only refers to publicly reported transactions, which is biased towards large scale investments whilst small scale investments are not included in the sample. Nonetheless, Miracky and Bartolotti (2009) confirmed the previous finding that SWFs usually take controlling stakes, although this takes place only in emerging economies. In the OECD for example, they find that SWFs avoid control, especially in strategic sectors, whilst Asians SWFs acquired controlling stakes in more than 50% of their transactions.

According to Aizenman and Glick (2008), SWFs can be divided in commodity SWFs arising from exports, taxes or other government owned revenue, and non commodity SWFs arising from transfer of assets from foreign exchange reserves. In an attempt to group SWFs Clarke (2014) distinguishes four types of SWFs, shown in Table 2 below.

[1] The lack of liabilities is not a necessary condition to motivate a long term investment strategy. For example, banks often transform short-term liabilities into long-term assets. Nevertheless, from a balance sheet perspective, a low degree of short-term liabilities favours the pursuit of long-term strategies (Beck & Fidora, 2008).

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

Table 2: Examples of purpose and source of SWFs

Purpose/Source	*Commodity Revenues*	*Fiscal Revenues*	*Foreign Reserves*
Revenue Stabilization	Russia: Reserve Fund		
	Kuwait: Reserve Fund		
	Mexico: Oil Stabilization Fund		
Future generations/ Public Pensions	Russia: National Prosperity Fund	Australia: Future Fund	
	Kuwait: Future Generation Fund	New Zealand: Super Fund	
	Norway: Government Pension Fund		
Management of government holdings	Saudi Arabi: Public Investment Fund	Singapore: Temasek	China: Bank holdings managed by CIC
		Malaysia: Khazanah	
		Vietnam: State Capital Investment Corporation	
Wealth or risk/return optimization	Abu Dhabi Investment Authority (ADIA)	Singapore: Government Investment Corporation (GIC)	Singapore: Foreign reserves managed by GIC
	Brunei Investment Authority (BIA)		Korea: Foreign reserves managed by KIC
	Qatar Investment Authority (QIA)		China: Foreign reserves managed by CIC

Source: Clarke (2014)

Moreover, according to their purpose, the IMF identifies five types of SWFs. These are:

- stabilization funds, that try to smooth boom or bust cycles and stabilize the fiscal impact
- savings funds, that focus on the spread of wealth in current and future generations evenly
- reserve investment funds, that aim in the increase of return
- development funds, that focus on investments in policies in the home country
- contingent pension reserve funds, which aim to build assets in order to add towards future funding liabilities.

However, the above types can be also combined, and therefore a SWF can have more than one objective. Besides, during time there are SWF that changed their strategic objective and role, such as China's or Singapore's SWFs.

With the aforementioned characteristics and types of SWFs in mind, the world's largest, which hold 60% of total SWF assets, termed commodity SWFs, are found in oil-exporting economies, notably the Arab Gulf countries, the ex-Soviet republics, Brunei and Norway. These types of SWFs have been established in order to cushion government revenues against large fluctuations in oil prices, sterilize capital inflows[2] and/or be used as an instrument to accrue savings for future generations since natural resources are not renewable and are expected to be depleted at some time in future (Barnett et al, 2001); these are further classified, respectively, as stabilization funds or savings funds (Griffith & Ocampo, 2009). These SWFs have a tendency to be more conservative in their investment decisions, aiming more on fixed income rather than equity investments (Ziemba, 2007). However, as they get larger due to increasing prices in commodity prices, their focus moves away from 'stabilisation' objectives' to 'savings objectives' and adopt a longer term developmental investment strategy and effectively begin investing in a broader range of asset.

The other types of SWFs, non-commodity based, financed out of the accumulated foreign currency reserves that result from large trade surpluses and privatisation procedures, are found in Singapore, S. Korea, China and other East-Asian exporting nations (Curzio & Micelli, 2010). These SWFs, termed as reserve funds by Griffith & Ocampo (2009), focus on reducing the opportunity cost of holding excess foreign reserves by taking up aggressive investment policies with more leverage in an effort to acquire direct equity stakes for higher returns (Weiss, 2008).

[2] Currency sterilisation is a type of monetary action where a nation's central Bank insulates itself from the foreign exchange market to buffer the effects of a changing monetary base by selling or buying the domestic currency in order to stabilize the value of its local currency.

However, SWFs are not homogeneous. There are significant differences in their asset allocation, source of financing , investment horizons and process, institutional and legal structure, transparency, and risk tolerances making it a difficult task to generalize about their investment strategies as a generalised class (Rozanov, 2008; Curzio & Micelli, 2010). For example and as previously mentioned, a commodity SWF may initially pursue a stabilization investment strategy however, if the assets under control exceed the levels needed for stabilization, the country may either change the investment strategy of the fund and/or create a new 'development fund' with a more aggressive investment approach. This explains why countries have multiple SWFs; for example, the UAE's primary fund, the Abu Dhabi Investment Authority, was created in 1974 to invest its surplus in assets that deliver steady gains over a longer time period. However in 2002, the UAE also formed Mubadala Development for it to practise direct investment projects with higher returns (Weiss, 2008).

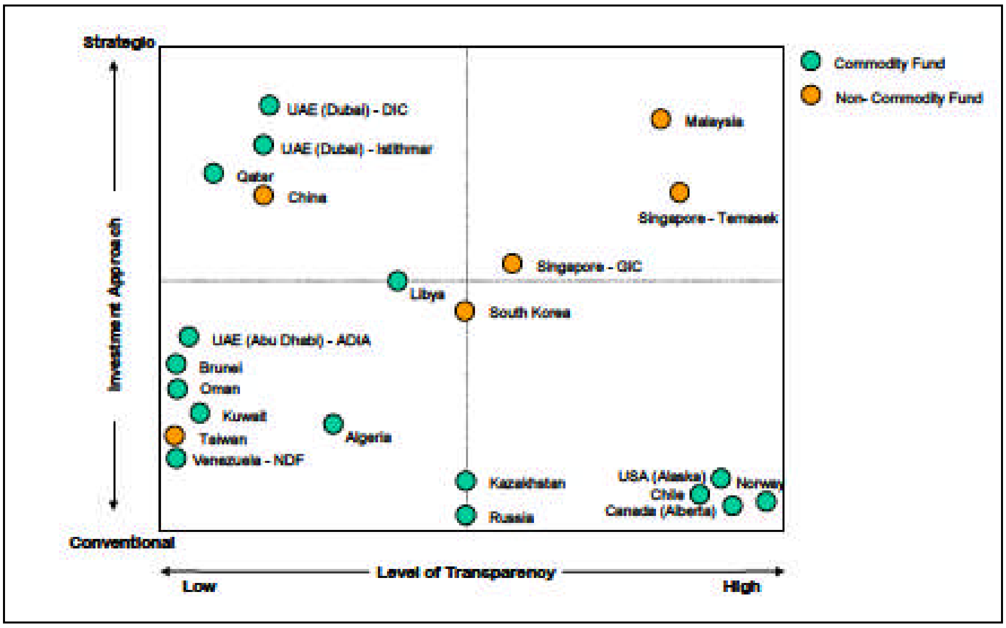
Another significant difference between SWFs is their size, ranging from under $1 billion to as large as an estimated $737 billion in the case of Norway's Government Pension Fund Global. Seven countries (Norway, China, Kuwait, Russia, Saudi Arabia, Qatar, Singapore and the UAE) accumulate over 80% of the total SWF assets, with each of them possessing funds of over $100 billion[3]. Making it clear that there are three classes of countries which are the dominant players in the SWF industry: Arab oil exporters, the two non-Arab oil exporters (Norway & Russia) and two export led economies of Eastern Asia.

Additionally, SWFs transparency and openness can vary. Most of the funds provide publicly their information in details, while some of them are sparing or introvert on sharing their data. The next figure shows the largest SWFs and their allocation according to their openness and transparency.

[3] Authors own calculation based on 2013 data from Sovereign Wealth Fund Institute – see http://www.swfinstitute.org/fund-rankings/

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

Figure 1. Allocation of largest SWFs according to their transparency



Source: Standard Chartered and Oxford Analytica, Lyons (2007)

FESSUD

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Growth and Performance of SWFs

The Growth of SWFs

SWFs are growing according to Aizenman and Glick (2008), representing $3.1 trillion of major global investment pools, while at the same time hedge funds were at $1.9 trillion and private equity funds at $0.8 trillion (Clarke, 2014). SWFs assets reached $4.5 trillion by the end of 2010. In contrast, private equity funds reached $2.6 trillion and hedge funds reached $1.8 trillion (Miceli, 2011). Moreover, by the end of 2013, SWFs are estimated to control assets totaling nearly $6 trillion (Sovereign Wealth Fund Institute, 2013). It is not surprising therefore, that some have identified SWFs as one the most important growing "power brokers" in the world economy (Farrell et al. 2008).

As Aizenman and Glick (2008) point out, commodity price blooms, protection of income for future generations and asset accumulation are mostly responsible for this growth. As countries increase their earnings from exports, savings are used as a stabilizer in case commodity prices suddenly fall. Moreover, imbalances in trade prices push towards a mechanism of protection of income for future generations. Finally, many countries are accumulating assets more than they need in order to create strong reserves.

Geographical Distribution

According to Miracky and Bartolotti (2009), SWF investments peaked in the first half of 2008, amounting to a total of $128 billion with 175 total transactions. However, in the third and fourth quarter of 2008, SWF investments declined by almost 50% in total transactions and 14% in value. Another study conducted by Kern (2009), arrived at a similar result and finds strong SWF activity between 2004 and 2008, with a particular focus the financial sector in 2007 and 2008. Kern (2009), similar to Miracky and Bartolotti (2009), estimated that by 2009 the rate of SWF investments dropped by 50% with a number of funds shifting their investment focus to domestic markets. Bartolotti and Miracky (2009) also found that in 2008, SWF investments shifted from an international to a domestic focus, marking a distinct reversal of the previous declining domestic investment trend since 2002. However, they argued that in 2009 the trend reversed when all transactions that had taken place were international; in particular, these authors argued that in 2009 OECD members received almost 90% of all transactions with Europe being the preferred investment destination, confirming the view that SWFs tend to prefer international investments.

On the other hand, Balding (2008) argued that whilst most SWFs do invest internationally, this takes place in regional markets. The author showed that this pattern of near abroad investing is prominent between Asian funds. For example, he showed that Singaporean SWFs mainly invest within its city state, which represents 65% of all its investments, and in its surrounding Asian continent. Moreover, the study showed that the Chinese CIC invests mostly in its own country, with a large number of acquisitions in the banking industry. These funds, Balding (2009) argued, invest in Europe or the US as a way to diversify their portfolio, but such investments do not constitute the majority of their investments. In stark contrast however, Balding (2009) highlighted that the Middle Eastern SWFs traditionally have preferred the US and Europe (UK specifically) as there is a clear lack of opportunities in their domestic and regional markets. Recently however, these funds have started to turn towards their regional emerging markets, such as Dubai or Abu Dhabi. In a similar vein, Chhaochharia and Laeven (2009) showed that SWFs have a propensity to invest in countries that have similar cultural characters.

In Kern's (2009) study the author examined the geographic destination of SWF investments from 1995 to 2009 and found that it is rather equally shared between Asia, which receives 31% of all transactions, Europe, which receives 30% and the US, which receives 20%. The United Kingdom attracts the greatest portion of SWF investments in Europe, equalling to almost 50% of the total amount invested; Germany is the second largest recipient, but far behind the UK, with less than 15% of total EU investments. Kern (2009) argued that the distribution in the EU is consistent with the emerging SWF

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

investment trend in the financial sector that appeared before and during the financial crisis.

Moreover, Kern (2009) identified that Asian SWFs are the most active in the period from 1995 to 2009, with their total transactions amounting to $79 billion, which represents 43% of the total amount of SWF investments. Middle Eastern funds follow with total transactions of $53 million, representing 29% of the total. On the other hand, Bartolotti and Miracky (2009) calculated that the most active SWFs in the period from 1981 to 2008 weree found in the Asia-Pacific region, representing 70% of total transactions or 62% of total value. In addition, the leading SWFs in term of number of deals were Temasek (Singapore) with 43% of the total, Government of Singapore Investment Corporation (GIC) with 16% and Khazanah (Malaysia); whilst in term of transactional value, the Chinese Investment Corporation (CIC) led with $82 billion, with GIC ($73 billion) and Temasek ($ 56 billion) following next. Bartolotti and Miracky (2009) made the important observation that the two of the largest SWFs, the Abu Dhabi Investment Authority and Norway's Government Pension Fund-Global, are missing. They explain that this is due to the fact that both have little or no recorded transaction because they sub-contract their investments to asset managers.

Sectoral Distribution

Kern (2009) showed s that in the period from 1995 to 2009 SWFs investments were mainly directed to the financial sector, which attracted 42% of total investments or $78 billion of the total. His findings were partially verified by Bartolotti and Miracky (2009), who illustrated that the first quarter of 2008 marked the peak point of SWF investments in the financial sector of Western economies, consisting of $58 million and represented 96% of the total value in that year. These authors however, argued that SWF investments in the financial sector was only a recent trend; specifically, they claimed that prior to 2008, SWFs investments towards the financial sector totalled less than 30% of total transactions, which equal a little over 50% of total value. The authors gave three reasons why SWFs

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

began to invest in the financial institutions of Western economies in the onset of the 2007/08 crisis: firstly, with the decline in share prices, SWFs recognised opportunities of large profits in what appeared as bargain acquisitions as the sector traditionally had realised significant returns. Secondly, the crisis appeared as a unique entrance point in the financial sector of Western economies, and lastly, Western governments exerted pressure on SWFs to enter and rescue their banks.

At the same time, this period marked a significant change in attitude towards SWFs in recipient countries – from a cautious and distrustful feeling; Western policy makers started welcoming SWFs as a potentially stabilising agent with enough liquidity to bail out some of the world's largest investment banks (Curzio & Micelli, 2010). In effect, this made SWFs gain important stakes in US and European banks. Nevertheless, with the collapse of Bear Sterns in 2008, the boom of SWF investment in the financial sector came to a sudden halt, as no investments were made, except for two exceptions (QIA's investment in Barclays in June 2008 and Temasek's in Merrill Lynch in July) from the second quarter of 2008 until 2010. In an interview with Alexander Mirtchev, a global strategic solutions provider, he states that in fact "prominent SWFs became notorious for their big-name acquisitions, in particular in the financial sector. Now they are sitting on the paper losses from their investments, but with the full understanding that name recognition, past performance of the targeted corporation, etc., are important, but should hardly be the determining factors. For example, Temasek invested 8.3 billion US dollars into Merrill Lynch, which was later acquired by Bank of America in an all-stock deal worth 50 billion dollars, while Government of Singapore Investment Corp (GIC) invested billions into Citigroup and Swiss bank UBS. The state- owned Kuwait Investment Authority injected a total of 5.0 billion dollars in Citigroup and Merrill Lynch in January 2008. The Abu Dhabi Investment Authority, controlled by the largest member of the United Arab Emirates, poured 7.52 billion dollars into Citigroup in late 2007. Now, more than ever, they could be considered to be risk-averse investors"(Mirtchev, 2010: 26). Curzio and Micelli (2010) explain that this reversal took place as SWFs recognised their immediate exposure to an excessive concentration of risk in a sector of the economy that had just realised a stock market drop that exceeded 80%. Moreover, SWFs acknowledged the high uncertainty of the future prospect of investment banks as policy talks at the time suggested strict regulations to be placed upon the nature and practices of investment banks.

Kern (2009) showed that the rest of the investments made by SWFs in 2009 went to the: manufacturing industry ($25 million or 14% of total), services and retail sector ($24 million or 13%), real estate sector ($21 million or 11%), energy and raw material sector ($18 billion), technology sector ($17 million or 9%), and defence sector ($2 million or 1%). Curzio and Micelli (2010) argued that in both Europe and the US, the financial sector dominated inward investments from SWF in 2009; however, in Asia, the sectoral distribution was much more evenly distributed with manufacturing gaining the most investments from SWF equalling 35%, whilst the financial sector attracts only 15%. Moreover, these authors claimed that SWFs would begin to diversify their investments towards manufacturing, infrastructure, energy resources and engineering-related sectors, changing their existing strategy, in an attempt to harness technology transfers and strengthen their domestic economies.

Future prospects

Directly after the crisis, there was considerable debate surrounding the likely future growth rate of SWF's asset accumulation. Estimates prior to the crisis were overwhelmingly optimistic, with some practitioners suggesting that the total of assets managed by SWFs could reach $12 trillion by 2015 (Jen, 2007), although this forecast was revised to $9.7 trillion to reflect the impact of lower asset valuations and declining oil prices (Jen & Andreopoulos, 2008). At the same time non-commodity-based SWFs were also adversely affected as their countries' trade surpluses shrank due to falling demand in the West. Moreover, some SWFs saw their reserves reduce in size as some governments used funds to support national budgets during the global financial recession (Kern, 2009).

Overall, SWFs were adversely affected during the economic downturn, specifically those with a high percentage of equity and alternative investments (real estate, commodities, financial derivates etc) in their portfolio as global equity markets fell by 50% from their peak levels. Beck and Fidora (2009) suggest that SWFs were estimated to have shrunk by 30% after the crisis, putting their total value to below $3 trillion in 2009. Nevertheless, as SWFs tend to be long-term investors, these losses were not actually realised but were just book losses. In fact, the value of FDI directed by SWFs actually increased by 15% compared to the previous years (Paton, 2012).

Growth projections aside, there is no obvious reason why SWFs are going to become less important players in the global financial markets in the future. The driving forces behind the structural imbalances in the global economy, exemplified in the accumulation of large external surpluses, are still in place. Asia is likely to remain an international exporter over the coming year and their apparent need to accumulate savings is likely to lead to a further expansion of emerging economies' possession of foreign assets. Therefore, despite the fact that SWFs experienced losses on their assets, as most investors did through the crisis, their continued importance in the global financial markets cannot be easily discounted (Beck and Fidora, 2009).

Impact on invested company

A number of scholars focused on large shareholders in order to explain the impact of SWFs on their targeted firms (Kotter & Lel 2011; Bortolotti et al, 2009). This literature claims that large shareholders are generally associated with favourable outcomes on the invested firm because of active monitoring of the firm's performance (Shliefer and Vishny, 1986). Not having to withstand capital requirements and taking on debt, SWFs may benefit the firm by dictating its long-term investment strategy and offer liquidity at times of uncertainty. At the same time, however, due to political pressure both in the host country and at home, SWFs might choose not to engage as an active shareholder. In addition, SWFs can transfer a firm's assets out of the host country leveraging their positions as large shareholders if they take up a majority share (Shliefer & Vishny, 1997). Since a SWF is owned by foreign government, the fund may also have additional political and social objectives besides profit maximization. A number of scholars point out that government ownership entails two problematic issues, agency conflicts (Banerjee, 1997) and political interference (Shleifer & Vishny, 1994). There is a substantial body of literature that argues that government ownership is associated with inefficiency, poor financial performance and weak managerial incentives. Moreover, it is suggested that high levels of corruption and the weak legal environment of many SWF nations can expose the targeted firms to the possibility that SWF investments be utilized for personal gains of politicians or their supporters (Johnson and Mitton, 2003). On the other hand the fact that SWFs are linked to countries that have outperformed economically more market-oriened economies, raises question marks about such claims, see below.

Having summarised the basic tenets under which academics situate SWFs in the 'large shareholder' literature, we examine some of the best known studies conducted which examine the impact of SWF on a firm's performance. Beginning with Chhoaochharia and Laeven (2008), the authors showed that the announcement of a SWF investment on a targeted firm had a positive effect on the targets share price. They explained that share prices increase when SWFs buy stakes in the targeted firm mainly because these investments take place when firms are in financial distress. However, the main finding of their study is that in the long-run, the performance of SWF investments tends to be poor. The study of Bartolotti et al (2009) confirms that the announcement of a SWF investment yields a positive increase in share price, which according to them shows evidence that investor's welcome SWF investments. Despite this, these scholars also find that a firm's performance decreases the two years after the SWF investment, leading them to the conclusion that SWFs have a negative impact on the firm's profitability in the medium run.

Kotter and Lel (2011) scrutinized the investment strategies and performance of SWFs, to see whether they create value in the firms they target. By using a sample of 417 investments made by SWFs into 326 separate companies from 1980 to 2006, they found

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

that SWFs usually invest in financially distressed, large companies with poor performance. In addition, they discovered that there are no real changes in the targeted firm's profitability, growth, investment or corporate governance after the SWF investment. The authors concluded that SWFs offer no lasting, important improvements in the performance of the target firms, but neither do they cause any damage on the targets. Dewenter et al (2009) examined a sample of 196 SWF equity purchases and 47 divestments from 1996 to 2008 in an attempt to analyse the impact of SWF investments on target firms. Their findings indicated that SWF investments obtain important positive returns and significant negative returns for divestment only at the time of the announcement. Knill et al (2009) examined the impact of SWFs investments on return and volatility and found evidence consistent with the aforementioned authors. Their findings suggested a positive market reaction to investment announcement, whereas in the long run they found a significant negative effect on the targeted firm profitability.

Fernandes (2009) employed a sample of 8,000 SWF holdings in 58 countries from 2002 to 2007 in order to observe how operating and financial performance alters after a SWF investment. Contrary to the previously mentioned studies, his findings indicated on the whole that SWFs create value in the target firm by improving the firm's net profit margin; however, as Bartolotti et al (2009) argued, Fernandes (2009) did not explain how SWFs achieve these changes. In addition, Sun and Hesse (2011) studied the stock market reaction to SWF investments and claimed that the short term impact of the announcement depends on the different sector, different market (emerging or developed), level of corporate governance and type of action; overall however, the study concluded that SWF do not destabilise equity markets and recommended that SWFS should be given more development space.

In a different framework, Bernstein et al (2009) used sample of 2,662 investments by 29 SWFs from 1984 to 2007 and indicated that only 20% of these cases involved investments in listed companies, whilst 24% of all these cases involved politicians in the SWFs decision-making process. Importantly they showed that when politicians are

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

involved in the SWFs decision-making, the funds have a greater probability of investing at home rather than abroad, and this influence reduces the performance of the fund. Moreover, their study showed that SWFs were more likely to invest at home when equity prices were higher and invest abroad when foreign prices were higher, indicating a form of trend chasing. The very important implication from this study was that when politicians are involved in the SWF investment making process, they may create distortions in the profit maximisation incentives of the SWF, which in the end could destabilise financial markets.

On the whole, the academic body of literature suggests that SWF investments help create value in the firms they invest in at the time of the announcement as indicated by the studies of: Bartolotti et al (2009); Chhoaochharia and Laeven (2008); Dewenter et al (2009); Knill et al (2009) and Kotter (2011). This can be explained by the arguments put forth by Kotter and Lel (2009) and, Curzio and Miceli (2011) who argue that since SWF invest in large underperforming companies with financial difficulties, any announcement to invest in these distressed companies will be highly welcomed as positive information is spread to investors. In the long run however, their effects are not as clearly distinguished as suggested by the contrasting reports from Fernandes (2009) and, Sun and Hesse (2011) against Knil et al (2009), Bortolotti et al (2009) and Chhoaochharia and Laeven (2008). Curzio and Miceli (2011) explain that this is understandable since in the long run, other factors come into play, such as macroeconomic conditions, which are essentially out of the funds control. On the whole it is clear that more empirical research is needed to give a clearer answer as to whether the effects of SWFs on financial markets are stabilising or not.

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Benefits and challenges to the financial system

In the aftermath of the global recession, Western governments have realised that in certain cases SWFs could benefit the functioning of the world financial system by providing liquidity in a period when trust in the financial sector had faded. For example, SWFs came to the rescue of the troubled US and other financial institutions in late 2007 by investing over $60 billion in Western banks and investment firms such as Citicorp, Merril Lynch, Morgan Stanley and UBS (Cohen, 2008). In addition, by investing in Western firms, SWFs help emerging economies share a common interest in the performance of the firms they invest in and ultimately, integrate them into the global economic system and in important policy making positions (Curzio and Miceli, 2010).

However, taking into account the size of SWFs and their opaque nature, some scholars argued that they may also act as destabilising agents in the financial system. Importantly, the way they are sometimes negatively perceived in the countries they invest in, SWFs may indirectly lead to a domino of protectionist measures to capital flows. At the same time scholars, especially in the US and those from an international relations perspective, point to the national security challenges faced from SWFs. Firstly, SWFs are seen as extensions of a state and this causes great concern from market participants and government officials that question their intrinsic motivation. SWFs are often are viewed as maximizing their country's strategic interest rather than maximising their profits. Drezner (2008) for example argued that a SWF can influence a country's policies by taking direct ownership or control over a strategic sector of the economy, and either sabotage the firms they purchase, and/or through the use of investment withdrawal threaten a country's capabilities.

Secondly, SWFs were accused of lack of transparency in their actions; for example, one of the largest SWFs, the Abu Dhabi Investment Authority (ADIA) has never revealed its structure, performance, investment objectives or size (Cohen, 2008). In fact, there is a strong correlation between political characteristics of the home country and SWF transparency; Norway's SWF, for example, has never hidden its objectives, ownership structure and pattern of investment. This is very troublesome as 27 out of the 53 of SWFs are defined as "authoritarian regimes" according to The Economist Intelligence Unit's index of democracy , and own 62% of total SWF assets – whilst, only 10 SWFs are described as "full democracies" (EIU, 2008). At the same time, the only check against a SWF financial misbehavior is relying upon the incentive of the investors to make sure their fund is profitable, what Greenspan calls "counterparty surveillance". However, in many cases this counterparty surveillance is missing, especially in countries where there could be a lack of accountability on their side.

Drezner (2008) also voiced s concern over some fast growing SWFs. He argued that SWFs based in authoritarian countries have two main advantages over SWFs based in democratic nations. Firstly, authoritarian SWFs are thought to be less transparent and hence, will profit from a faster decision making process. Secondly, since authoritarian regimes are better in suppressing dissent, they should be able to invest in unpopular short term investments that could yield much greater long term rewards. Analysts refer to this second advantage as the "patient capital" of authoritarian regimes, which allows their SWFs to act in a more strategic fashion. Drezner (2008) goes on to argue that the ultimate concern for Western societies is that state-led development through SWFs poses a rival to liberal free-market democracy, which could erode the West's 'soft power'-in effect leading the rest of the world to question what the US and EU have achieved over the years.

Nonetheless, the empirical evidence does not seem confirm the above concerns; Curzio and Miceli (2010) argued that in fact SWFs up until now exhibit behaviour typical of an economically rational investor seeking profit maximisation, except in a few cases that will be further discussed below. Moreover, SWF investments do not target politically sensitive sectors of the economy such as IT, telecoms, defense and aerospace. As the study of Kern (2009) illustrates, which was referred to in earlier sections of this paper, only 10% or $18 billion of the total value of SWF investments went to the aforementioned industries. The Monitor Group in 2008 also reported that out of the 785 acquisitions worth

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

$250 billion or more from 2000 to 2008, less than 1% of total investments went to the defence, aerospace and high technology sector.

In addition, there have been cases of SWFs working in cooperation with each other, which may provide a stabilizing force in financial markets. As indicated by Alexander Mirtchev, an independent director of Kazakstan's SWF Samruk-Kazyna, "they realize that their level of expertise is not universal and find that obtaining additional expertise via cooperation is a viable option for them". This in effect also provides SWFs with a new level of legitimacy as Mirtchev correctly points out "several parties to the transaction have to open their books more, which would increase transparency in the often secretive industry. So, recent examples of SWFs working together are much more commercially orientated rather than having any political imperative". Examples of such cooperative investments include India and Oman's joint investment fund, which aims in investing a total of $1.5 billion (Mirchev, 2010: 31).

As previously mentioned however, there have been some cases where SWFs have acted with a political agenda in mind. The first case was witnessed in 2007 under an agreement between China and Costa Rica, where the former agreed to buy Costa Rican government bonds in exchange for Costa Rica to cut ties with Taiwan (Anderlini, 2008). Another incident took place when Singapore's Temasek Holdings acquired Shin Corporation in Thailand in 2006, which is claimed to have sparked the military coup that occurred a few months later in that country (Curzio and Miceli, 2010). The last incident that this paper will refer to is the event that took place in 2008 where the Chinese Investment Corporation allegedly funded the state-owned Chinese aluminium company Chinalco in order to thwart the hostile takeover by English mining company BHB Billiton of the Australian mining company Rio Tinto. By blocking this merger, the creation of a mining monopoly was avoided, which would raise the price of iron ore, a fundamental commodity for the Chinese industry (Curzio and Miceli, 2010).

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Recent academic literature has emerged attempting to quantitatively measure the relationship between political factors and SWF investment choices. Knill et al (2011) examined this relationship in the period from 1984 to 2009 using a sample of over 900 acquisitions. The study found evidence that SWFs are inclined to invest in countries with which they have a weaker political relation, which contrasts with other financial agents. The explanation, argued here by the authors, is found in the motivation SWFs have to improve the political relation with the recipient country.

In a related study, Karolyi and Liao (2009) examined the motives behind failed and completed acquisitions from 1990 to 2008, considering SWF led acquisitions and, more broadly, government led acquisitions, comparing them both with corporate acquisitions. The main findings of their research shows that government acquisitions differ slightly from corporate ones as the former aim for geographically closed nations and are less receptive to variations in legal institutions, economic development and accounting practices. The authors claim however, there are more stringent differences between government led acquisitions and SWF-led ones, as the latter seek larger targets with less financial constraints and as a result these transactions are less likely to fail. Even though the market reactions for SWF-led acquisitions are positive, they are much smaller than those experienced with government led acquisitions. These authors concluded that SWF led acquisitions are not motivated any differently from corporate led cross border deals, with the economic consequences appearing to be very similar.

The last study of this sort conducted by Avendano and Santiso (2009), examined the difference between the investment decisions of SWFs from those of mutual funds. The study explains that based on the geographical and sectoral aspect of the investment, there is no difference in the investment pattern of these two financial agents. Importantly, this study confirms that SWF investments are motivated by a rational profit maximisation motive, debunking concerns of political bias.

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Regulatory approaches

SWF investments are subject to varying regulation policies, which are greatly shaped by the recipient country's view on what challenges these funds present. Thatcher (2012) argues that broadly, there are two perspectives that have dominated the regulatory framework of a country towards SWF investments, a concern over economic governance or one over national security. He claimed that the EU and UK have regarded SWF investments more as an economic governance issue, with the policy ideology and choice leaning towards 'free trade' rather than 'protectionist' measures. On the other hand, the US policy debate is highly contested, with views separated between the presidency, which favors an open free trade measures and Congress, which view SWFs as a national security issue. Lastly, in recent years a convergence towards a coordinate multilateral framework has emerged, which has been supported by both recipient countries and SWFs.

US regulatory framework

Historically the US has been concerned about the impact of foreign investments and the issue of national security, with the first regulation enacted in 1950 during the Korean War in the form of the Defense Production Act (DPA), which included Section 721 that regulated FDI. Then in 1975, the Committee on Foreign Investment in the United States (CFIUS) was formed to evaluate the impact of foreign investments on the national security of the US. In the backdrop of increased concern over Japanese investments in the US, Congress approved the Exon-Florio Amendment to the DPA, giving the US president power to block acquisitions deemed as a national security threat.

After a number of blocked high profile acquisitions by foreign investors, such as the failed endeavor by the China National Offshore Oil Corporation (CNOOC) to acquire Unocal, the ninth largest oil company in the US, in 2005 and the 2006 attempt by Dubai Ports World to acquire the Peninsular and Oriental Steam Navigation Company (P&O) in 2006, the US President signed the Foreign Investment and National Security Act (FINSA) in 2007. This

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Act empowered the ability of the CFIUS to protect the national security of the US by giving it the option to review any merger, acquisition or takeover that gave 'control'[4] to a foreign investor. If the review judges that an acquisition jeopardizes national security it immediately turns into an extensive investigation; however, most importantly for our paper, the amendments introduced by FINSA actually report that when a state controlled entity is involved, such as a SWF, an investigation is enacted straight away.

Scholars point out to the increased complicated nature of investing in the US, which is the most demanding in terms of regulatory red tape out of all the OECD countries. According to IMF (WP/09/179), the legal framework determines the asset categories that a SWF can invest in. More specifically, SWFs are not allowed to invest in domestic market or in private equity, real estate, and hedge funds.

As a result, SWFs may be discouraged to invest in such an environment. However, a report by UNCTAD reported that FDI flows to the US have continuously grown from 2005 to 2008 making it difficult to assess whether these regulatory changes slowed inward investments. Curzio and Miceli (2010) argue that the regulatory framework in the US is efficient; however other scholars suggest that some changes are needed. For example, Gilson and Milhaupt (2008) advocate the suspension of SWF voting rights until these have been transferred to non-state actors. The authors argue that this would separate investments with a strategic political motivation from those with a solely profit maximizing incentive. However, this would only risk pushing SWF investments out of the US and trigger retaliatory measures abroad against American investors (Curzio and Miceli, 2010). As Rose and Epstein (2009) argue, SWFs have acted so far as rational investors whilst any risk of them acting with a political motive is already greatly mitigated by the existing regulation. A greater risk to the American economy would be to take excess action against SWFs, which would drive their significant investment away and possibly create hostility towards the US that may be expressed with violent action.

[4] Control is defined as any acquisition where important decision-making influence could be exercised – this means that even acquisitions that are control less than 10% are subject to review.

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

EU regulatory framework

The European Union has in place fundamental internal and international obligations that do not allow it to block investments from foreign investors. Article 63 of the Treaty on the Functioning of the European Union (TFEU), prohibits 'all restrictions on the movement of capital between member states and *between member states and third countries'*. The significance of this Article is that it extends free capital movements to also include non-EU nations, where capital movements are defined by the Court of Justice to consist of portfolio and direct equity investments. However, exceptions are also included in the TFEU that allow member states to restrict inward FDI in cases where national security is deemed at risk. This is also the framework within which SWFs are regulated, despite the fact that there are specific and varying national regulations in place for foreign state owned investments.

In Germany for example, which according to Kern (2009) receives the second largest proportion of SWF investments in Europe after the UK, its Federal Government implemented an amendment to the Foreign Trade and Payments Act in 2009. This act calls for an investigation when a foreign investor or European Free Trade Association (EFTA) member obtains over 25% control in a private or public German company. France issued a ruling in 2005 that updated the L 151-3 (2004) article of the Code Monetaire e Financinier, providing the regulatory body the power to enact an investigation when a foreign investors' direct or indirect acquisition results in a 30% controlling stake or voting rights of a company operating in France and takes place any of the eleven sectors of the economy that are deemed politically sensitive.

On the other hand, in the UK both the Labor and Conservative parties have sought to reject controls over SWF investments as they appreciate the positive economic consequences these investments may generate for their domestic firms and production. The most relevant regulatory policy affecting SWFs in the UK is the 2002 Enterprise Act. Before this Act, ministers in cooperation with the Monopolies and Mergers Commission (MMC) would have the ability to block foreign takeovers if the MMC judged the takeover as a threat to the general public interest. However, these controls were dissolved in 2002 under the Enterprise Act, and the current legislation allows ministers to block a SWF investment only if the merger or acquisition represents a direct threat to national security or to financial stability (Thatcher, 2012). Hence, major high profile investments have taken place without extreme public outcry in recent history, such as Qatar Investment Authorities 7% stake in Barclays or its 20% majority stake in the London Stock Exchange (Marhik, 2008). Nonetheless, the UK has called for greater transparency and regulation of SWFs, supporting the IMF's initiative for a multilateral framework, which will discussed in greater detail later.

In contrast to the direct activity towards SWF investments, the EU Commission has not implemented a set of common regulatory policy. Instead, it has called for 'A common European approach to Sovereign Wealth Funds' as suggested by its memorandum in 2008, which calls on EU members to avoid protectionist measures, support multilateral solutions presented by the IMF and OECD, and respect EU's treaties on the movement of free movement of capital. The Commission however, in regards directly to SWFs, advocates that these funds need to act in accordance of good governance practices, such as clearly defining their investment policies and to develop good risk-management policies, and to show more transparency by publishing reports on their portfolio activities, investment positions and leverage composition.

Many scholars have highly praised the approach advocated by the EU Commission, arguing that it is the most efficient way of preserving Europe's openness to foreign investments[5]. Other scholars, argue that this approach even though is good at combining the varying national responses from its member states, does not offer a safeguard against potential harmful SWF investments. Notably, Barysch et al (2008) suggest instead that the EU needs to create a similar regulatory body as the American CFIUS, which will have the task of evaluating SWF investments. This approach however, was rejected by the Commission as in practice it is infeasible for a number of reasons, but most obvious is the

[5] See Gugler and Chaisse (2009) or Prost et al (2009).

fact that the Commission itself does not have the power or legitimacy to settle agreements on direct investments from foreign investors. A better framework suggested by Roller and Veron (2008) would be to adopt a legislation at the EU level, implemented on a national level, which would define the 'rules of the game'- sensitive sectors, definition of control etc. This would create a clearer, more coordinated and consistent regulatory action amongst national members against SWF investments.

Towards a multilateral framework

In an attempt to provide a multilateral framework to deal with SWFs, the IMF in 2008 created the International Working Group of SWFs (IWG) that involved 23 countries owning SWFs, as well as representatives from recipient countries, and permanent observers that included: Saudi Arabia, Oman, Vietnam, the OECD and the World Bank. The main aim and focus of this working group was to collectively create principles concerning the governance of SWFs by drawing up a code of conduct that would be used for future reference. As Curzio and Miceli (2010) state, the negotiations went very smoothly and the formation was characterized by success as it was able to accommodate different actors with conflicting interests, managing to create an environment of cooperation amongst home and recipient countries. As a result, in the third meeting in Santiago, Chile, the IWG published the 24 guiding principles, labeled as Generally Accepted Principles and Practices (GAPP), or also called the Santiago Principles.

These strictly voluntary principles cover three broad areas: the first area, represented by the first five principles, is concerned with: the legal framework of SWFs; the publication and clear definition of objectives; publication of financing source and the provision of relevant statistical data. The second area is represented from GAPP six to 17, which defines a structure of governance to ensure a division of roles and responsibilities in order to guarantee independence of management from political interference. Importantly, GAPP 11 and 12 recommend SWF to prepare annual reports of the funds operation, with GAPP 17 advocating that these reports be readily available to the public.

The last area is concerned with the investment strategies of SWF, embodied in GAPPs 18 to 24. Here the guideline advises that SWF investments need to be based on sound principles of portfolio management, which clear show the fund's use of external managers, use of leverage, degree of risk exposure and the way in which it exercises its ownership rights.

As the Santiago Principles are based on a voluntary nature, the International Forum of Sovereign Wealth Funds (IFSWF) was created by the IWF in order to monitor their compliance. Again however, the IFSWF would not be backed with any legal force but instead its aim is to facilitate an area where SWF countries and recipient countries could exchange ideas and views on the activities of SWFs, with the ultimate goal of encouraging the Santiago Principles. Although there are a number of positive outcomes the GAPP and IFSWF can achieve, such as improving SWF transparency and contribute towards stability in financial markets by promoting open markets, there are a number of criticisms that can be rightly voiced as the empirical evidence shows that compliance with the Santiago Principles is weak.

The study of Behrendt (2010) is a critical reference point, which examines the rate of compliance of the SWFs that belong to the IWG. The authors' results illustrate that there is an irregular level of compliance where some funds are close to full compliance; however, the majority of SWFs are far from it. Not surprisingly, the most compliant funds were those that were already in line with the principles before the formation of the IWG – these include: the New Zealand Superannuation Fund, Norway's Government Pension Fund-Global, the Australian Future Fund and the Ireland Pension Fund. Some SWFs, such as the Chinese Investment Corporation made significant improvements in terms of its financial transparency whilst, SWFs in the Middle East and Africa (MENA) region showed the least level of compliance. From these results, an important correlation between the SWFs level of compliance and the level of democracy in the SWFs home country. In fact, Behrendt (2010) identifies three groups of SWFs that are directly linked with the previous observation: the first group, which includes highly compliant SWFs, belong to democratic

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

governments. The second group, which is also the largest one, includes SWF that show moderate compliance and come from countries with lower democracy ratings. The last group consists of SWFs from the MENA region, which are the least compliant but also originate from nations with authoritarian regimes. The author concludes that an improvement in the compliance of SWFs that are owned by authoritarian regimes could trigger democratic reforms in the political institutions of these countries.

At the same time the IWG and Santiago Principles were established, the OECD began a process of offering guidelines to SWF recipient countries in an attempt to promote open markets and generate a workable framework for foreign investments. Despite the legitimate expressed concern of recipient FDI countries towards potential geo-strategic motivations of SWFs, which the OECD acknowledged, the OECD called for its members to carefully apply their regulations against SWFs in a manner that would not cause a spiral of protectionist measures. Accordingly, the OECD specified certain principles that would promote equal treatment of investors regardless of nationality, increase transparency and accountability, and suggest ways to restrict investments only when the national security of a country is really in jeopardy. The OECD would not legally enforce these principles but like the Santiago Principles, these would be based on a voluntary framework depending on the goodwill of the recipient countries.

It is important however, to critically evaluate this self-regulatory and voluntary approach of these multilateral frameworks. As Curzio and Miceli (2010) argued, even though this framework might be too optimistic, it can become an effective approach if incentives are part of the equation, encouraging recipient and home countries to comply with both sides of the principles. It is in the interest of SWFs to comply with the Santiago Principles so that recipient countries view their investments as trustworthy and beneficial to them, which will only further promote open markets. This will achieve a mutual trust between SWFs, home countries and recipient countries and achieve a global economic system that is stable and open to international investments. It is however, important to not show hypocrisy towards SWF and also demand other financial actors, such as hedge funds and investment banks, to become more responsible and transparent.

Critical Discussion and Conclusions

SWFs are part and parcel of a country's developmental industrial policies (DIPs) as well as its approach to inter-national integration and international trade and investment policies (ITIPs) and supra-national governance. However these issues have not been integrated, often not even raised, in the SWFs literature. A major characteristic of DIPs and ITIPs refers is that they can be diametrically opposed between nations and in terms of underlying economic theory (Pitelis, 2014).

It is important to place SWFs within a framework of sustainable global value creation, and assess their implications and the requisite regulatory policies in its context. This is beyond the scope of this deliverable. The issue is pursued in WP6 that discusses issues of supra-national governance and the opportunities for Europe to benefit by aligning the legitimate interests of SWFs with its own interests.

References

- Aizenman J., Glick R. (2008), Sovereign Wealth Funds: Stylized facts about their determinants and governance, National Bureau of Economic Research, Working Paper 14562
- Anderlini J. (2009). 'China Considers extra $200bn for CIC Sovereign Wealth Fund', *Financial Times*, December 21.
- Avendano, R., & Santiso, J. (2009). Are Sovereign Wealth Funds' Investments Politically Biased? A Comparison with Mutual Funds. *OECD Development Centre*, Working Paper 283.
- Avgouleas Emilios (2009): The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy. Journal of Corporate Law Studies, Volume 9, Number 1, pp. 23-59(37), Hart Publishing
- Balding, C., (2008). A Portfolio Analysis of Sovereign Wealth Funds. *Available at SSRN:* http://ssrn.com/abstract=1141531
- Banerjee, A. V. (1997). A theory of misgovernance. *The Quarterly Journal of Economics*, 112(4): 1289-1332.
- Barysch, K., Tilford, S., & Whyte, P. (2008). State, money and rules: An EU policy for sovereign investments*. Centre for European Reform.*
- Beck, R., & Fidora, M. (2008). The impact of sovereign wealth funds on global financial markets. *Intereconomics*, *43*(6): 349-358.
- Beck, R., & Fidora, M. (2009). Sovereign wealth funds–before and since the crisis. *European Business Organization Law Review*, 10(03): 353-367.
- Behrendt, S. (2010). Sovereign Wealth Funds and the Santiago Principles: Where Do They Stand?. *Carnegie Endowment for International Peace.*
- Bernstein, S., Lerner, J., & Schoar, A. (2013). The Investment Strategies of Sovereign Wealth Funds. *The Journal of Economic Perspectives*, 27(2): 219-238.
- Bortolotti, B., Fotak, V., Megginson, W. L., & Miracky, W. (2009). *Sovereign wealth fund investment patterns and performance* (No. 22.2009). Nota di lavoro//Fondazione Eni Enrico Mattei: Institutions and markets.

- Butt, S., Shivdasani, A., Stendevad, C. and Wyman, A. (2008), Sovereign Wealth Funds: A Growing Global Force in Corporate Finance. Journal of Applied Corporate Finance, 20: 73–83. doi: 10.1111/j.1745-6622.2008.00170.x

- Chhaochharia, V., & Laeven, L. (2008). *Sovereign wealth funds: their investment strategies and performance*. Centre for Economic Policy Research.
- Chhaochharia, V., & Laeven, L. A. (2009). The investment allocation of sovereign wealth funds. *SSRN eLibrary*.
- Cohen, B. J. (2008). Sovereign wealth funds and national security: the Great Tradeoff. *International Affairs*, 85(4): 713-731.
- Dariusz Urban (2010) Sovereign Wealth Funds - new players on global financial markets, Comparative Economic Research. Volume 12, Issue 1-2, Pages 115–128, ISSN (Print) 1508-2008,DOI: 10.2478/v10103-009-0007-6, February 2010
- Davis, J., R. Ossowski, J. Daniel, and S. Barnett. (2001). Stabilization and Savings Funds for Nonrenewable Resources, Experience and Fiscal Policy Implications, *IMF Occasional paper # 205.*
- Dewenter, K. L., Han, X., & Malatesta, P. H. (2010). Firm values and sovereign wealth fund investments. *Journal of Financial Economics*, 98(2): 256-278.
- Drezner, D. W. (2008). Sovereign wealth funds and the (in) security of global finance. *Journal of International Affairs*, *62*(1):, 115-130.
- Epstein, R. A., & Rose, A. M. (2009). The regulation of sovereign wealth funds: the virtues of going slow. *University of Chicago Law Review*, 76:111.
- Epstein, R. A., & Rose, A. M. (2009). The regulation of sovereign wealth funds: the virtues of going slow. *University of Chicago Law Review*, *76*(111).
- European_Commission (2008). A common European approach to Sovereign Wealth Funds. Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions COM(2008) 115 provisional ENFarrell, D., & Lund, S. (2008). The world's new financial power brokers, *McKinsey Quarterly*, 1: 82.

- Fernandes, N. (2009). Sovereign Wealth Funds: Investment Choices and Implications around the World. IMD International, Working paper
- Gilson, R. J., & Milhaupt, C. J. (2008). Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism. *Stanford Law Review*, *60*: 1345-1358.
- Greenspan, A. (2007). The Age of Turbulence. New York: Penguin.
- Griffith Jones, S., & Antonio Ocampo, J. (2009). Sovereign Wealth Funds: a Developing Country Perspective. *Revue d'économie financière (English ed.)*, 9(1), 241-254.
- International Working Group on Sovereign Wealth Funds (IWGSWF) (2008). *Sovereign Wealth Funds – Generally Accepted Principles and Practices – 'Santiago Principles'* http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf
- Jen, S and Andreopoulos, S. (2008). SWFs: Growth Tempered – US$10 Trillion by 2015. *Global Economic Forum*, 10 November.
- Jen, S. (2007). Sovereign Wealth Funds. *World Economics*, 8(4): 1-7.
- Johnson, S., & Mitton, T. (2003). Cronyism and capital controls: evidence from Malaysia. *Journal of Financial Economics*, 67(2): 351-382.
- Kern, S. (2009). Sovereign wealth funds–state investments during the financial crisis. *Deutsche Bank Research*, July.
- Kimmitt, R. M. (2008). Public Footprints in Private Markets-Sovereign Wealth Funds and the World Economy. *Foreign Affairs*, 87: 119.
- Knill, A. and Lee, B. and Mauck, N. (2011). Bilateral Political Relations and the Impact of Sovereign Wealth Fund Investment. *Available at SSRN: http://ssrn.com/abstract=1498518*
- Knill, A., Lee, B. S., & Mauck, N. (2009). Sleeping with the Enemy'or'An Ounce of Prevention: Sovereign Wealth Fund Investments and Market Destabilization. *Unpublished working paper. Florida State University*.
- Kotter, J., & Lel, U. (2011). Friends or foes? Target selection decisions of sovereign wealth funds and their consequences. *Journal of Financial Economics*, 101(2): 360-381.

- Liao, C. and Karolyi, G. (2009). What is Different About Government-Controlled Acquirers in Cross-Border Deals? *AFA 2011 Denver Meetings Paper*. Available at SSRN: http://ssrn.com/abstract=1571560
- Lyons, G. (2007). State Capitalism: The Rise of Sovereign Wealth Funds, Standard Chartered.

- Monk, A. H. B. (2008). Recasting the Sovereign Wealth Fund Debate: Trust, Legitimacy, and Governance, University of Oxford
- Marchick, M. (2008). Sovereign Wealth Funds and National Security 5. *OECD/City of London Conference on Sovereign Wealth Funds in the Global Investment Landscape*
- Miracky, W., & Bortolotti, B. (2009). Weathering the Storm: Sovereign Wealth Funds in the Global Economic Crisis of 2008. *Monitor Group and Fondazione Eni Enrico Mattei*.
- Mirtchev, A., "The Rising Global Significance of Sovereign Wealth Funds – A New Geo-economic and Geopolitical Factor Impacting Global Economic Security." Interview. G20 *Seoul Summit 2010* - Nov. 2010: 26-32. Accessed at http://viewer.zmags.com/publication/a1b5bdaf#/a1b5bdaf/1
- Patton, J. R. (2012). Sovereign wwealth funds in a globalized world. *International Business: Research, Teaching and Practice*, 6(1).
- Pitelis C.N (2014) Rejuvenating 'old' Eurpe, *Contributions to Political Economy*,
- Rozanov, A. (2005). Who holds the wealth of nations. *Central Banking Journal*, 15(4): 52-57.
- Rozanov, A. (2008). A Liability Based Approach to Sovereign Wealth. *State-Street Vision: Sovereign Wealth Funds*, 3(2): 15–20.
- Shleifer, A., & Vishny, R. W. (1986). Large shareholders and corporate control. *The Journal of Political Economy*, 461-488.
- Shleifer, A., & Vishny, R. W. (1994). Politicians and firms. *The Quarterly Journal of Economics*, 109(4): 995-1025.
- Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. *The journal of finance*, 52(2): 737-783.

- Stanley Morgan (2007). How Big Could Sovereign Wealth Funds Be by 2015?
- Thomas A. Hemphill (2009). Sovereign Wealth Funds: National Security Risks in a Global Free Trade Environment, Thunderbird International Business Review Vol. 51, No. 6, Wiley InterScience
- Thatcher, M. (2012). Western policies towards sovereign wealth fund equity investments: A comparison of the UK, the EU and the US. *Kuwait Programme on Development, Governance and Globalisation in the Gulf States,* Policy Brief #1
- The Economist Intelligence Unit (2008), Index of Democracy 2008, *The Economist.*
- US Treasury (2007). *Semi annual Report on International Economic and Exchange Rate Policies*, Appendix 3. http://www.treasury.gov/resourcecenter/international/exchangerate-policies/Documents/2007_Appendix-3.pdf
- Valeria Miceli (2011). Do Sovereign Wealth Funds Herd in Equity Markets?, Centre for Financial Analysis & Policy, Working Paper no. 40
- Udaibir S. Das, Yinqiu Lu, Christian Mulder, and Amadou Sy (2009). Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations WP/09/179, International Monetary FundVeron, N., & Hendrik-Roller, L. (2008). Safe and sound: an EU approach to sovereign investment. *Bruegel Policy Brief 2008/08*, November 2008.
- Weiss, M. A. (2008). Sovereign Wealth Funds: Background and Policy Issues for Congress, *Congressional Research Service*, Library of Congress.
- Ziemba, R. (2007). Responses to Sovereign Wealth Funds: Are 'Draconian' Measures on the Way?, *RGE Monitor*, November 2007.

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

Financialisation, Economy, Society and Sustainable Development (FESSUD) is a 10 million euro project largely funded by a near 8 million euro grant from the European Commission under Framework Programme 7 (contract number : 266800). The University of Leeds is the lead co-ordinator for the research project with a budget of over 2 million euros.

THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

This project has received funding from the European Union's Seventh Framework Programme
for research, technological development and demonstration under grant agreement no 266800

THE PARTNERS IN THE CONSORTIUM ARE:

Participant Number	Participant organisation name	Country
1 (Coordinator)	University of Leeds	UK
2	University of Siena	Italy
3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
5	Pour la Solidarite, Brussels	Belgium
6	Poznan University of Economics	Poland
7	Tallin University of Technology	Estonia
8	Berlin School of Economics and Law	Germany
9	Centre for Social Studies, University of Coimbra	Portugal
10	University of Pannonia, Veszprem	Hungary
11	National and Kapodistrian University of Athens	Greece
12	Middle East Technical University, Ankara	Turkey
13	Lund University	Sweden
14	University of Witwatersrand	South Africa
15	University of the Basque Country, Bilbao	Spain

Published in Leeds, U.K. on behalf of the FESSUD project.