SOVEREIGN WEALTH FUNDS: THREAT OR SALVATION?

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INTRODUCTION

1. Sovereign Wealth Funds (SWF) and the International Financial System (IFS)
2. SWF Scoreboard
3. The Santiago Principles
4. Host Country Responses
5. Conclusions and Recommendations
SOVEREIGN WEALTH FUNDS and the INTERNATIONAL FINANCIAL SYSTEM
SWFs and the IFS

• SWFs are **pools** of government-controlled assets—often including international assets.
• SWFs are **diverse** in their origins, objectives, and investment strategies.
• Five years ago, no one knew what a SWF was—the **descriptive term** had just been coined.
• Countries with such funds joined an **exclusive club** to which they had not applied for membership.
SWFs and the IFS

Because of their diversity, it can be misleading to generalize about the role of SWFs.

1. They are *governmental* vehicles and therefore *political*.

2. They are part of saving and investment processes, *transferring wealth* year-to-year or generation-to-generation.

3. Their *financial results* are most important to their *home* countries.
SWFs and the IFS

SWFs are symptomatic of two tensions:

1. Dramatic redistribution of growth and potential wealth
2. Much of the newer wealth is controlled by governments.

SWFs give rise to five broad concerns:

1. Mismanagement of investments and corruption
2. Pursuit of noneconomic or economic-power objectives
3. Financial protectionism
4. Financial market instability
5. Conflicts of interest
SWFs and the IFS

• These tensions and concerns are shared by many other government investment vehicles: foreign exchange reserves, government-controlled financial or non-financial institutions, and pension funds.

• Including pension funds, SWFs are small, about $9 trillion in total assets and $4 trillion in cross-border assets, compared with global totals of about $250 and $100 trillion.

• However, nonpension SWFs sextupled in size from 2002 to 2007, before setbacks in 2008–09, and they are back in the news.
## SWFs and the IFS

<table>
<thead>
<tr>
<th>Country</th>
<th>Fund name</th>
<th>Total assets (US$ billion)</th>
<th>Foreign assets (US$ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAE (Abu Dhabi)</td>
<td>Abu Dhabi Investment Authority</td>
<td>620</td>
<td>620</td>
</tr>
<tr>
<td>Norway</td>
<td>Government Pension Fund-Global</td>
<td>432</td>
<td>432</td>
</tr>
<tr>
<td>Japan</td>
<td>Government Pension Investment Fund (P)</td>
<td>1,264</td>
<td>260</td>
</tr>
<tr>
<td>Singapore</td>
<td>Government of Singapore Investment Corporation</td>
<td>248</td>
<td>248</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Kuwait Investment Authority</td>
<td>203</td>
<td>203</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Exchange Fund</td>
<td>205</td>
<td>174</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Stichting Pensioenfonds ABP (P)</td>
<td>254</td>
<td>125</td>
</tr>
<tr>
<td>China</td>
<td>China Investment Corporation</td>
<td>298</td>
<td>98</td>
</tr>
<tr>
<td>Russia</td>
<td>Reserve Fund</td>
<td>95</td>
<td>95</td>
</tr>
<tr>
<td>Russia</td>
<td>National Welfare Fund</td>
<td>90</td>
<td>90</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td></td>
<td><strong>3,709</strong></td>
<td><strong>2,345</strong></td>
</tr>
</tbody>
</table>

**Totals**

- Nonpension SWFs            3,500  3,000
- Pension SWFs               5,700  1,200
- All SWFs                   9,200  4,200
SWFs and the IFS

- Since 2007, **SWFs have matured** under the glare of international attention.
- The **rules of the game** surrounding their activities have been codified in the **Santiago Principles**.
- SWFs now can expect to be held to **high standards of accountability and transparency**, at home as well as abroad.
- Owners of SWFs expect a degree of **reciprocal responsibility** from the countries in which they invest.
SWF SCOREBOARD
In 2007, I developed a **scoreboard** for SWFs. The scoreboard focuses on their **structure, governance, accountability and transparency**, and **behavior**. The 2009 edition includes **33 elements** for **53 funds** of **37 countries**.

- Based on systematic, regularly available, public information
- At least one fund “scores” on each element
SWF SCOREBOARD

- No fund scores a perfect 100%
- Average = 59%
- Three broad groups of SWFs
- Pension SWFs in RED
## SWF SCOREBOARD

<table>
<thead>
<tr>
<th>Comparison</th>
<th>Number</th>
<th>Mean score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension</td>
<td>13</td>
<td>84</td>
</tr>
<tr>
<td>Nonpension</td>
<td>40</td>
<td>50</td>
</tr>
<tr>
<td>Nonpension SWFS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>OECD</td>
<td>13</td>
<td>78</td>
</tr>
<tr>
<td>Non-OECD</td>
<td>31</td>
<td>43</td>
</tr>
<tr>
<td>Non-OECD</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle East</td>
<td>11</td>
<td>31</td>
</tr>
<tr>
<td>Non-Middle East</td>
<td>24</td>
<td>51</td>
</tr>
<tr>
<td>Non-Middle East</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asian</td>
<td>10</td>
<td>57</td>
</tr>
<tr>
<td>Non-Asian</td>
<td>14</td>
<td>47</td>
</tr>
</tbody>
</table>

- **Significant differences** between average scores of SWFs in different categories
- **Exception**: non-OECD and non-Middle East funds
- However, large dispersion of scores within each group

* significant difference at 5%
** significant difference at 1%
SWF SCOREBOARD

Comparison with 2007 Scoreboard
Average increase: **12 % points**

Significant increases for
GIC, Mubadala, Trinidad and Tobago, CIC, KIC, Alaska & ADIA (2010)
SANTIAGO PRINCIPLES
The **International Working Group** (IWG) of SWFs published their **Generally Accepted Principles and Practices** (GAPP or “Santiago Principles”) for SWFs in October 2008.

- A good piece of work—**IMF** deserves credit for facilitation role.
- The Santiago Principles have some **positive features** that were incorporated in the 2009 Scoreboard.
- Almost all the large SWFs participated.
- Contains **24 principles** with several sub-principles for a total of **30**.
- Only **20 have operational content** that can be verified ex ante.
The Santiago Principles alone would receive a score of 76.

- This implies that full performance would put an SWF near the top of the middle group on the SWF Scoreboard.
- The biggest weaknesses are with respect to accountability and associated transparency.

25 of the 33 SWF Scoreboard elements overlap with the 20 Santiago Principles elements.

- How do the 53 SWFs do on the intersection of the GAPP with the 2009 SWF Scoreboard?
SWFs score somewhat higher on the Santiago Principles. The average increase is only 3% points. Room for improvement.

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Mean Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFSWFs</td>
<td>23</td>
<td>63</td>
</tr>
<tr>
<td>Non-IFSWFs</td>
<td>21</td>
<td>42</td>
</tr>
</tbody>
</table>

** significant difference at 1%
HOST COUNTRY RESPONSES
HOST COUNTRY RESPONSES

• Countries with SWFs and the IWG and IFSWF have asked for a reciprocal response from host countries.

• Many countries with SWFs are also hosts to SWF investments.

• One might think that this would lead to greater tolerance of SWF investments.

• The perception in many countries with SWFs is that this has not been the case.

• Resentment at what appears to be a double standard.
In parallel with the IWG effort, OECD members considered whether SWFs should be subject to a special investment regime.

**GOOD NEWS:** Existing OECD investment codes were judged to be sufficient.

**BAD NEWS:** Nothing was done to promote or maintain open investment policies.
What might have been done?

1. **Extend coverage** of codes to non-members beyond best efforts.

2. Establish a **standstill** on new restrictions.

3. Establish a **review process**, including non-members, for cases in which OECD members have restricted investments.
What has been the actual response?

- Prominent recent cases of rejected investments: Canada, Japan, New Zealand.
- Several OECD countries tightened regimes for foreign investments: Australia, Canada, France, Germany, Italy, and the United States.
- At a minimum, transactions costs associated with foreign investments, in particular by governments, have been raised.
CONCLUSIONS AND RECOMMENDATIONS
CONCLUSIONS

1. SWFs are here to stay.
2. Distrust of funds has been substantially reduced by the Santiago Principles.
3. One risk is regulatory and institutional arbitrage.
4. A second risk is a further increase in financial protectionism.
RECOMMENDATIONS

1. Upgrade the Santiago Principles.
2. Increase reciprocal responsibility of host countries.
3. Improve data collection and related disclosures.
4. Long-run goal: comprehensive framework covering government investments.