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Sovereign Investment: Concerns and Policy Reactions

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Edited by Karl P. Sauvant, Lisa E. Sachs, and Wouter P.F. Schmit Jongbloed (New York: Oxford University Press, 2012).

Sovereign Investment: Concerns and Policy Reactions provides the first major holistic examination and interdisciplinary analysis of sovereign wealth funds. These funds currently hold five trillion dollars' worth of investments, almost twice the amount in all the hedge funds worldwide, and could hold much more by 2015. In addition, state-owned enterprises – another form of sovereign investment – play an important role in the flows and stocks of foreign direct investment.

The rapid rise of sovereign wealth funds and state-owned enterprises remains relatively unregulated, but the International Monetary Fund has helped to establish voluntary rules to introduce transparency and uniformity as regards sovereign wealth funds, and a number of countries have strengthened their regulatory frameworks regarding sovereign investment in general. What rules and procedures should govern sovereign investment? What bodies should enforce them? Do the current rules answer the national security concerns of host countries? Focusing on the foreign direct investment dimension of this issue, the editors of this volume, Karl P. Sauvant, Lisa E. Sachs, and Wouter P.F. Schmit Jongbloed, address these questions in a collection of essays by leading authorities from the IMF, OECD, academic institutions, law firms, multinational enterprises, and think tanks.

Sovereign Investment

CONCERNS AND POLICY REACTIONS

Editors

Karl P. Sauvant

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Summary Table of Contents

1

SOVEREIGN INVESTMENT: AN INTRODUCTION

*Wouter P.F. Schmit Jongbloed, Lisa E. Sachs, and Karl P. Sauvant**

THE PROCESS OF global economic integration has accelerated over the past three decades. Among the many dimensions and impacts of this process, this volume focuses on the concerns for and policy reactions to sovereign foreign direct investment (FDI). World FDI flows rose from US$40–50 billion during the first half of the 1980s, to US$1.7 trillion in 2008—declining to US$1.3 trillion in 2010 due to the Western financial crisis and recession. The stock of this investment amounted to US$18 trillion at the end of 2009.[1] Despite the trend toward market liberalization and privatization during this period, the role of the state has arguably become more important in recent years. Indeed, many of the emerging market state-owned enterprises (SOEs) that survived the earlier waves of privatization are now flourishing, thanks in particular to booming global commodity prices and increased export earnings. Emerging market governments have also drawn on their accumulating foreign exchange reserves to establish sovereign wealth funds (SWFs) for investment abroad.

A. SOVEREIGN FOREIGN DIRECT INVESTMENT VEHICLES

The presence of the state in the domestic economy is long standing. The position it has taken therein has fluctuated over time with economic doctrine and market cycles, limiting the role of the state domestically or calling for international expansion. More recently, sovereign capital has once again played an active role in the international market. Rather than holding reserves in dollar-denominated U.S. Treasury bonds, states now actively seek to diversify the allocation of their sovereign funds over sectors,

* We are grateful to Subrata Bhattacharjee, Ken Davies, Mark Kantor, and Stephan Schill for their kind willingness to comment on parts of this chapter. The usual disclaimer applies.

1. Data are drawn from the UNCTAD online database at http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sRF_ActivePath=P,5,27&sRF_Expanded=,P,5,27 (*World Investment Report* 2010); *see also* U.N. Conf. on Trade and Dev., World Investment Report 2010: Investing in a Low-Carbon Economy, U.N. Doc. UNCTAD/WIR/2010 (July 22, 2010).

industries, and across borders. This volume discusses this trend, with emphasis on the two major manifestations of state capital in the international market, SWFs and SOEs (together substantially comprising the category of state-controlled entities, or SCEs), and the accompanying concerns and policy reactions of host countries to their growing activity.

1. Sovereign Wealth Funds

Sovereign wealth funds are not a new phenomenon, yet their number and the resources available to them have risen dramatically in recent years. Despite the multifarious impact of the Western financial crisis, eleven new SWFs were established in 2009,[2] more than in 2006, the heyday of international finance.[3] SWFs controlled, as of March 2011, a little over US$4 trillion in assets,[4] nearly twice the amount controlled by hedge funds. Some observers predict that this amount could reach US$15 trillion or even US$20 trillion by 2020.[5]

SWFs are typically categorized by the source of their funding or by their mandate.[6] Although there are variations, most SWFs are government-funded investment vehicles, distinct from the official reserves of countries, managing foreign denominated assets.[7] About sixty percent of total funding for sovereign wealth funds comes from oil and gas revenues; the remaining forty percent are more diffuse and include export earnings (mostly from raw materials and commodity trade) and financial holdings. Considering these funding sources, it is not surprising that Asia, with forty percent,

2. *See infra* Figure 1.
3. However, none of the most recently established SWFs (as of 2009) features on the index of largest SWFs by assets under management, as maintained by the SWF Institute. Sovereign Wealth Fund Inst., *available at* http://www.swfinstitute.org/ (last visited May 23, 2011). For a list of largest SWFs by assets under management, *see infra* Ch. 2. For a broader, more comprehensive list of SWFs *see* Edward Truman, Sovereign Wealth Funds: Threat or Salvation? (2010); *see also infra* Table 2.1.
4. Sovereign Wealth Fund Inst., *supra* note 3.
5. John Nugée, *Sovereign Wealth Funds' Coming of Age: Unrivaled Titans to Uncertain Mortals*, 4 Vision 1 (2009); Tina Aridas, *The Largest Sovereign Wealth Funds (SWF)—2010 Ranking*, Global Finance Magazine, Mar. 2010, *available at* http://www.gfmag.com/tools/global-database/economic-data/10300-largest-sovereign-wealth-funds-swf-2010-ranking.html#axzz1NH8mUg0o. *But see* Steffen Kern, Sovereign Wealth Funds—State Investments During the Financial Crisis, Deutsche Bank Research (2009), *available at* http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000244283.pdf (offering a more conservative estimate of US$7 trillion).
6. *See infra* Ch. 2 for further discussion on the categorization of SWFs.
7. The International Working Group of Sovereign Wealth Funds' Santiago Principles defines SWFs as "special-purpose investment funds or arrangements that are owned by the general government. Created by the general government for macro-economic 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." Int'l Working Grp. of Sovereign Wealth Funds, *sub nom.* Int'l Forum of Sovereign Wealth Funds, Generally Accepted Principles and Practices: "Santiago Principles" 3 (2008) [hereinafter Santiago Principles]. *See also* Simmone Mezzacapo, *The So-Called 'Sovereign Wealth Funds': Regulatory Issues, Financial Stability and Prudential Supervision*, Eur. Econ. Papers 378 (2009), *available at* http://ec.europa.eu/economy_finance/publications/publication15064_en.pdf.; Ashby Monk, *Sovereignty in the Era of Global Capitalism: The Rise of Sovereign Wealth Funds and the Power of Finance* (Oxford Univ. Sch. of Geography and the Env't Working Paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1587327.

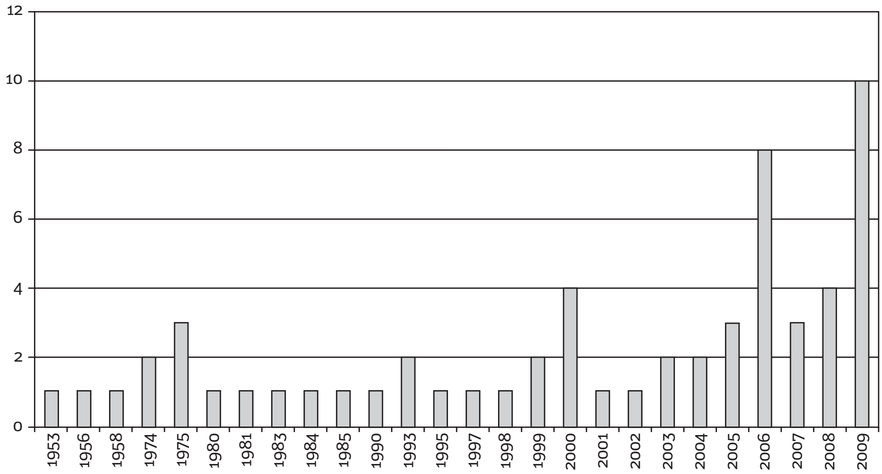

FIGURE 1. Number of SWFs Established, by Year.

Source: Oxford SWF Project and Money Supply, *Financial Times*; and Ashby H.B. Monk, "Sovereignty in the era of global capitalism: The rise of sovereign wealth funds and the power of finance," School of Geography and the Environment, Oxford University (2010).

and the Middle East, with thirty-five percent, are the dominant home regions for SWFs, with Europe trailing at seventeen percent.[8]

More recently, there has been a notable trend of SWFs seeking to diversify their sources of funding by reaching out to the private capital market through bond offers, Islamic finance devices or even selling equity participations in subsidiaries.[9] This may signal an increased appetite for risk by sovereign investment funds, the drying up of direct government funding, or a response to continuing pressure for further transparency and accountability.

Sovereign wealth funds are established for a number of reasons. The most prevalent reasons center on desires to enhance the diversification of national wealth, stabilize revenues, carry wealth over to future generations, further socio-economic objectives, and achieve higher rates of return than are realized on instruments of foreign exchange. Notably, the size, purpose, and investment patterns differ by fund and over time; some funds have explicit stabilization mandates, while others are explicitly or implicitly mandated to concentrate on guaranteeing future wealth (Norway's fund is mandated to grow in perpetuity), securing strategic asset positions, or fostering regional development goals.

The optimal macro-economic structuring of SWFs in light of these national objectives and mandates is dictated by—and in turn dictates—whether funds receive transfers from current or capital accounts.[10] An analysis of the revenue streams behind these

8. Sovereign Wealth Fund Inst., *supra* note 3.
9. *See* Table 1.
10. *See infra* Ch. 3 (providing further implications hereof).

macro-economic accounts further clarifies the position that individual SWFs hold and guard, both within the national and international economy.

During the Western financial crisis, these funds initially provided much-needed liquidity to developed country financial institutions. However, as the financial crisis and recession progressed, many SWFs retrenched and refocused on the domestic and regional economy.[11] This shift was driven by diverse concerns, ranging from disappointing returns on previous investments, the reverberations of the financial and economic crisis, uncertain political and regulatory reception, and shifting domestic priorities for states with SWFs. However, it now seems that international investment by SWFs is once again on the rise. Importantly however, as Figure 2 indicates, the size of these investments is still modest compared to the peak years of 2007 and 2008. This could signal that SWFs are making more but smaller investments—possibly seeking smaller shareholding positions.[12]

TABLE 1
SWFS AND THEIR SUBSIDIARIES RAISING CAPITAL FROM THE PRIVATE SECTOR, 2010

Fund	Subsidiary	Private Capital Raising	Date
Temasek Holdings		Bond Issuance	2005–present
Temasek Holdings	Mapletree Investments	Initial Public Offering of 2 REITs (first, $910 million)	2010
Mubadala Development Company		Bond Issuance ($1.75 billion)	2009
Bahrain Mumtalakat Holding Company		Bond Issuance ($750 million)	2010
Khazanah Nasional		Sukuk Issuance ($1.1 billion)	2010
Qatar Investment Authority	Qatari Diar	Bond Issuance ($3.5 billion)	Forthcoming 2011
China Investment Corporation	Central Huijin Investments Ltd	Bond Issuance ($22 billion)	Ongoing 2010
Government of Singapore Investment Corporation	Global Logistic Properties	Initial Public Offering	2010

Source: Victoria, Barbary, Bernardo Bortolotti, Veljko Fotak, & William Miracky, Monitor Grp., Sovereign Wealth Fund Investment Behavior: Semi-Annual Report: January–June 2010, 20 (2010).

11. *See infra* Ch. 4 for further discussion.
12. Victoria Barbary, Bernardo Bortolotti, Veljko Fotak, and William Miracky, Monitor Grp., Sovereign Wealth Fund Investment Behavior: Semi-Annual Report: January–June 2010 (2010) [hereinafter SWF Investment Behavior 2010], *available at* http://www.feem.it/userfiles/attach/2010102015964MonitorFEEM_SWF_ReportH1-2010.pdf.

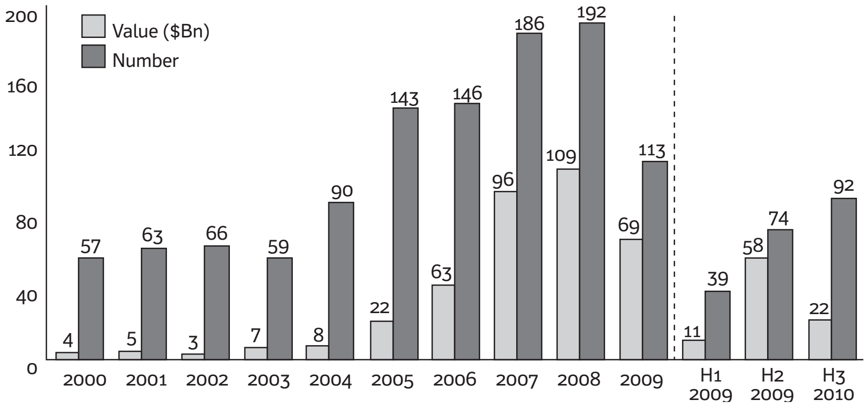

FIGURE 2. SWF Equity[a] Transactions, by Number and Volume, 2000–H1 2010.

[a] Based on publicly available data for SWF equity and real estate deals, joint ventures and capital injections from the Monitor—FEEM SWF transaction database.

Source: Victoria, Barbary, Bernardo Bortolotti, Veljko Fotak, & William Miracky, Monitor Grp., Sovereign Wealth Fund Investment Behavior: Semi-Annual Report: January–June 2010 2, fig. 1. (2010).

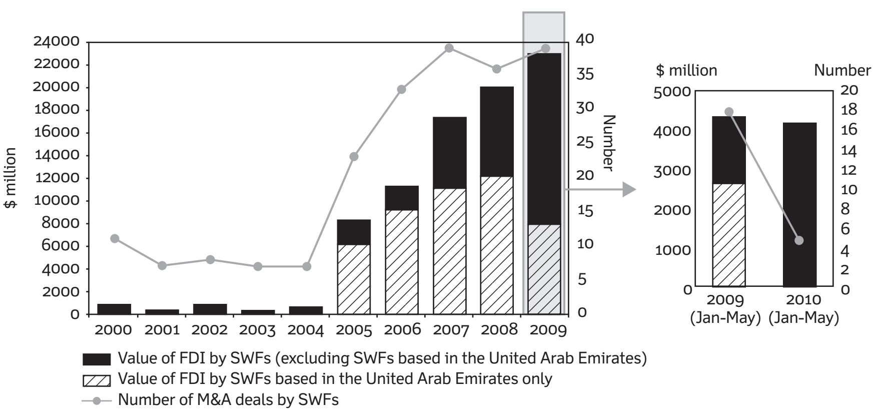

FIGURE 3. FDI by Sovereign Wealth Funds,[a] 2000–May 2010 (US$ million).

[a] Cross-border M&As only; greenfield investments by SWFs are assumed to be extremely limited. Data show gross cross-border M&A purchases of companies by SWFs, i.e., without subtracting cross-border sales of companies owned by SWFs.

Source: UN Conf. on Trade and Dev., World Investment Report 2010: Investing in a Low-Carbon Economy, 14, fig. I.10, UN Doc. UNCTAD/WIR/2010 (July 22, 2010).

Despite reductions in the total amount of funds under control of SWFs—mostly as a result of the Western financial crisis and ensuing economic downturn—the value of FDI by SWFs, as measured by UNCTAD, based on cross-border mergers and acquisitions resulting in ten percent ownership or more, increased in 2009.[13] In 2010, though,

13. *See infra* Figure 3. Data is available from UNCTAD's cross-border M&A database. U.N. Conf. on Trade and Dev., FDI Statistics: Division on Investment and Enterprise, *available at* http://www.

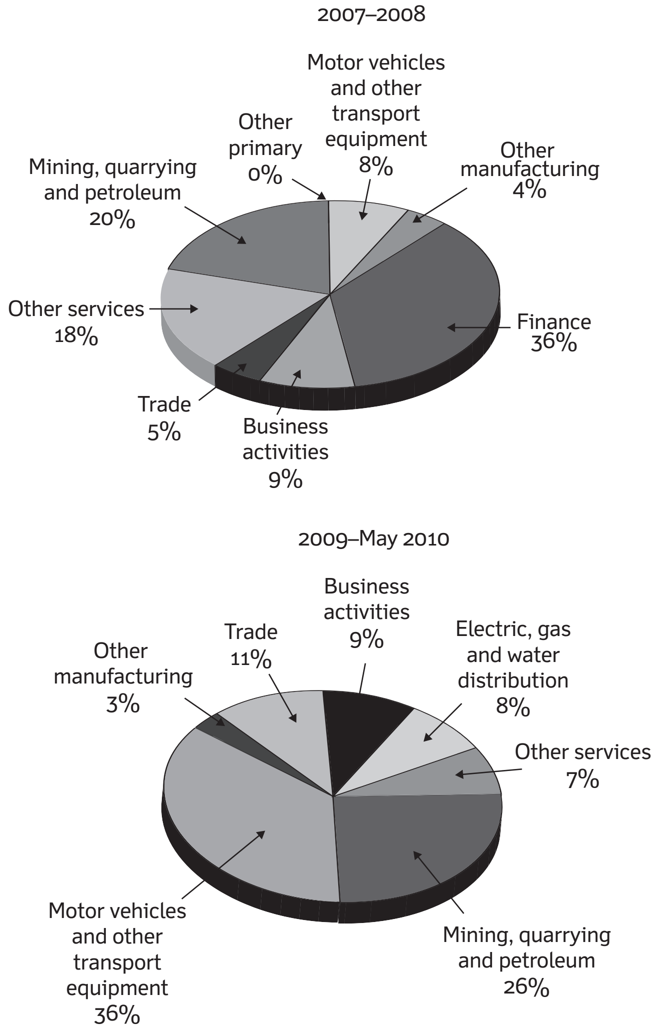

FIGURE 4. FDI[a] by Sovereign Wealth Funds, by Main Target Industry, 2007–2008 and 2009–May 2010.

[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.

Source: UN CONF. ON TRADE AND DEV., WORLD INVESTMENT REPORT 2010: INVESTING IN A LOW-CARBON ECONOMY, 15, fig. I.11, UN DOC. UNCTAD/WIR/2010 (July 22, 2010).

FDI by SWFs dropped to about US$10 billion from a high of US$26.5 billion in 2009, with investments from Gulf region SWFs nearly absent (Asian and Canadian SWFs

unctad.org/fdistatistics (last visited May 23, 2011). From January to May 2010, however, SWF directed FDI fell compared to the same period in 2009, notably showing no mergers or acquisitions by United Arab Emirate funds (the largest investors). *See* U.N. CONF. ON TRADE AND DEV., WORLD INVESTMENT REPORT 2010: INVESTING IN A LOW-CARBON ECONOMY, U.N. DOC. UNCTAD/WIR/2010 (July 22, 2010) [hereinafter INVESTMENT REPORT 2010].

were the main investors in 2010).[14] The 2009 increase in FDI value stands in marked contrast to private equity funds' outflows. SWF investment behavior was not, however, uniform; there were significant differences among SWFs, with some even temporarily halting all FDI activity.[15]

Whereas investments in the financial sector used to dominate SWF FDI strategies before and during the early days of the crisis, cross-border mergers and acquisitions (M&As) in the financial sector in 2009–2010 amounted to only US$0.2 billion, down by ninety-eight percent from 2007–2008.[16] Instead, SWFs reoriented themselves toward primary sector assets and manufacturing industries.[17] They further retrenched somewhat geographically with a focus on Asia. However, over three-quarters of SWFs' publicly reported expenditures in 2009, and forty-seven percent of the deals, occurred in Organisation for Economic Co-operation and Development (OECD) member countries, with Europe accounting for almost forty percent of the total value of expenditure.[18]

The rising number and prominence of investments by SWFs in the past decade has been accompanied by increased scrutiny and wariness regarding the increased role of the state—a dynamic addressed later in this chapter and explored in depth throughout the present volume.

2. State-Owned Enterprises

State-owned enterprises (SOEs), another vehicle of sovereign foreign direct investment, differ from SWFs by their sources of funding as well as by their mandate. Typically, SOEs are funded through the proceeds of their activities—although some may receive state subsidies—rather than by foreign reserves of the sovereign, and they are focused on their respective industry.

SOEs have been at the forefront of sovereign intervention in the economy for centuries. The role of SOEs has seen large changes over the past hundred years, in response to and following U.S. Government responses to the Great Depression (and again to the Western financial crisis), European and Japanese Government-led approaches to postwar reconstruction, import-substitution industrialization of many developing countries, and Thatcher-era privatizations. Although the trend toward market liberalization and privatization has replaced the traditional industrial-style SOEs of the Soviet era, SOEs have in the past years ramped up their international expansion, markedly buying assets in many economies and pursuing greenfield opportunities.

In terms of FDI, SOEs are much more significant sovereign investment vehicles than SWFs by virtue of the amounts invested through them. A number of the world's

14. U.N. Conf. on Trade and Dev., World Investment Report 2011: Non-Equity Modes of International Production and Development, 14–15, U.N. Doc. UNCTAD/WIR/2011 (July 26, 2011).
15. U.N. Conf. on Trade and Dev., World Investment Report 2010: Investing in a Low-Carbon Economy, 14, U.N. Doc. UNCTAD/WIR/2010 (July 22, 2010).
16. *See* Investment Report 2010, *supra* note 13. *See infra* Ch. 6 for an analysis of entry and exit decisions by SWFs.
17. See *infra* Figure 4.
18. *See* SWF Investment Behavior 2010, *supra* note 12, at 12.

largest multinational enterprises (MNEs) are state-owned. More specifically, among a combined list of the world's 100 largest non-financial MNEs and the largest 100 headquartered in emerging markets (200 in total) in 2010, forty-nine were SOEs (in terms of foreign assets). Together, they controlled roughly US$1.8 trillion in foreign assets. Of these forty-nine, the twenty-nine that were headquartered in emerging markets controlled total foreign assets worth US$400 billion, and those headquartered in developed countries US$1.4 trillion.[19] In the case of the most important emerging market outward FDI investor, China, SOEs may account for over eighty percent of FDI outflows and the country's outward FDI stock.[20] However, China is not alone—SOEs also play an important role in the outward FDI of a number of other emerging markets, such as Russia and Singapore.[21]

Generally, SOEs are more prone than their private sector competitors to goal ambiguity, and they tend to have limited internal and external constraints on management. These governance characteristics may, to a certain extent, support the empirical evidence pointing to the underperformance of SOEs from developed economies, compared to their private sector competitors. The evidence from emerging market SOEs, however, seems to present a more mixed performance.[22]

Outward FDI by SOEs is important both because of its magnitude and because SOEs, like SWFs, are owned and controlled by the state. The heightened attention toward FDI by SWFs is, therefore, directly relevant for FDI by SOEs.

B. CONCERNS

The rise in frequency and magnitude of sovereign FDI (SFDI) has been met in recent years with growing concern by policy-makers in a number of host countries, especially developed countries. Chief among those concerns is the belief that such investment has the potential to advance policy objectives of the home countries of such investment.[23]

19. Karl P. Sauvand and Jonathan Strauss, *State-controlled entities control nearly US$ 2 trillion in foreign assets*, 64 Columbia FDI Perspective, Apr. 2, 2012.
20. Karl P. Sauvant, *Is the United States Ready for FDI from China? Overview*, *in* Investing in the United States: Is the U.S. Ready for FDI from China? 1 (Karl P. Sauvant ed., 2009). Note that these figures do not include SOEs administered by regional governments. *See also* Leonard Cheng and Zihui Ma, *China's Outward FDI: Past and Future* 15, *available at* http://www.nber.org/books_in_progress/china07/cwt07/cheng.pdf. In the case of China, the country's outward investors (public and private) benefit from a policy regime that supports outward FDI. *See generally* Qiuzhi Xue and Bingjie Han, *The Role of Government Policies in Promoting Outward FDI from Emerging Markets: China's Experience*, Foreign Direct Investments from Emerging Markets: The Challenges Ahead (Karl P. Sauvant, Geraldine McAllister, with Wolfgang Maschek eds., 2010).
21. Thorsten Nestman and Daria Orlova, *Russia's Outward Investment* (Deutsche Bank Research, Apr. 30, 2008), *available at* http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000224964.pdf; Daisuke Hiratsuka, *Outward FDI From and Intraregional FDI in ASEAN: Trends and Drivers* (Inst. of Dev. Econ. Discussion Paper No. 77, 2006), *available at* http://www.ide.go.jp/English/Publish/Download/Dp/pdf/077.pdf.
22. *See infra* Ch. 5.
23. *See generally* Robert Kimmit, *Public Footprints in Private Markets*, 87 Foreign Aff. 119 (2008). Investments by Chinese SCEs in Africa's natural resource industries are often looked at with some suspicion by some observers. *See* Theodore H. Moran, *China's Strategy to Secure Natural Resources and*

As Truman succinctly summarized for one vehicle of SFDI: "The reality is that governments own SWFs, governments are political organizations, and it is naive to pretend that they are not."[24] The purchase of the Shin telecom businesses of then Thai Prime Minister Thaksin Shinawatra by Singapore's SWK Tamesek could be seen as a paradigm example of the politicization of investment decisions by SWF.[25]

Although SWFs are generally considered macro-economic entities that concentrate on long-term wealth management, some also engage in micro-economic policy. One way in which this is done turns on the role SWFs take in the diversification of Gulf state economies, as in the case of development in United Arab Emirate and Qatari aerospace industries, through a network of holdings, supply relations, and product purchases centering around EADS.[26]

SWFs also took large stakes in financial institutions, interpreted by some as examples of investments that are not primarily driven by commercial risk and reward analyses. The larges stakes taken by SWFs in Western financial institutions in the wake of the Western financial crisis are a paradigm example. More recently, as the financial crisis morphed into a recession, and with the development of national and international standards of conduct, this fear was overshadowed by an increased desire for the capital supplied by such investments.[27]

Overall, concerns over state-controlled investments as tools for promoting national policy objectives appear to be in large part fueled by apprehensions about both adverse national security implications in sensitive or strategic industries and by a perceived lack of transparency, especially in the case of SWFs.

1. National Security

The most important and prevalent concern about SCE investment relates to the issue that such investments may have detrimental impacts on host countries' national security. In particular, sovereign investment in strategic industries has raised numerous concerns, including, for instance, about foreign access to sensitive technologies or of foreign control over natural resources, key industrial complexes or critical

Opportunities, Peterson Inst. for Int'l Econ. (2010) (providing an analysis). The investment, or rather divestment, decisions by the Norwegian Pension Fund Global can, at times, also be considered as examples of state-directed, not primary risk-return related, allocations. *See* Gordon Clark and Ashby Monk, *The Norwegian Government Pension Funds: Ethics Over Efficiency*, 3 Rotman Int'l J. Pension Mgmt. 14 (2010); Simon Chestermann, *The Turn to Ethics: Disinvestment From Multinational Corporations for Human Rights Violations: The Case of Norway's Sovereign Wealth Fund*, 23 Am. U. L. Rev. 577 (2008).

24. Xue and Han, *supra* note 20, at 41.

25. *See* Anna Paulson, *Raising Capital: The Role of Sovereign Wealth Funds*, Chi. Fed Letter, Jan. 2009, *available at* http://www.irrcinstitute.org/pdf/Sovereign_Wealth_Funds_Report-October_2009.pdf.; Suntharee Lhaopadchan, *The Politics of Sovereign Wealth Fund Investment: The Case of Temasek and Shin Corp.*, 18 J. Fin. Reg. & Compliance 15 (2010).

26. Daniel Haberly, *Strategic Sovereign Wealth Fund Investment and the New Alliance Capitalism: A Network Mapping Investigation*, Env't. & Plan. A (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1751590.

27. *See infra* Ch. 6 (discussing investment and network effects).

infrastructure. There are of course also various grey areas, for example, where an attempted M&A involves a national champion.

Host governments have been similarly concerned about the tendency of some SWFs to direct part of their investments in support of, and to facilitate, home country industrial planning.[28] Concern in this context is in part driven by the fear that these investments may result in the prioritization of critical supplies to the foreign investor's home country or, alternatively, may lead to a ceasing of industrial support for security efforts of countries hosting SCEs.

Although compromising national security is the most common host country concern involving SFDI, "national security" is rarely defined in relevant legislation. Wide discretion is maintained to allow extensive leeway to conduct reviews of inward SFDI by any review agencies. Depending on the regulatory approach, national security either serves as a generally limiting concept (although broad in application), or merely provides an umbrella, under which other concerns, such as energy security, cluster. There seems to be a trend among host countries toward greater flexibility in the scope and use of national security considerations, which at times seems to come at the expense of predictability.[29]

2. Transparency

Lack of transparency regarding the structure, governance and investment strategies of sovereign investment vehicles is another principal area of concern for host (and, in an increasing number of cases, also home) countries. Figure 5, an index capturing the degree of transparency of SWFs, shows that a number of these funds are indeed not very transparent, if measured on the basis of ten indicators.[30] The lack of transparency of some SCEs impedes an understanding of their market efficiency and regulatory compliance and thus gives rise to an information disparity[31] that as a general matter makes

28. Alexander Dyck and Adair Morse, *Sovereign Wealth Fund Portfolios* (Chicago Booth Research Paper No. 11–15), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792850.
29. *See infra* Ch. 7, offering further analysis and categorization of FDI related national security regulation.
30. The Sovereign Wealth Fund Institute recommends a minimum rating of 8 on the Linaburg-Maduell Transparency Index Ratings in order to claim adequate transparency. The index ranks SWFs in terms of their transparency based on the following ten indicators, where the Fund: 1. Provides history including reason for creation, origins of wealth, and government ownership structure; 2. Provides up-to-date independently audited annual reports; 3. Provides ownership percentage of company holdings, and geographic locations of holdings; 4. Provides total portfolio market value, returns, and management compensation; 5. Provides guidelines in reference to ethical standards, investment policies, and enforcer of guidelines; 6. Provides clear strategies and objectives; 7. Clearly identifies subsidiaries and contact information, if applicable; 8. Identifies external managers, if applicable; 9. Manages its own website; and 10. Provides main office location address and contact information such as telephone and fax. *Linaburg-Maduell Transparency Index*, SWF Inst., *available at* http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/.
31. *Testimony Concerning Foreign Government Investment in the U.S. Economy and Financial Sector Before the Fin. Servs. Subcomm. on Domestic and Int'l Monetary Policy, Trade, and Tech. and the Subcomm. on Capital Mkts., Ins., and Gov't Sponsored Enters*. 100th Cong. (2008) (statement of Ethiopic Tafara, Director,

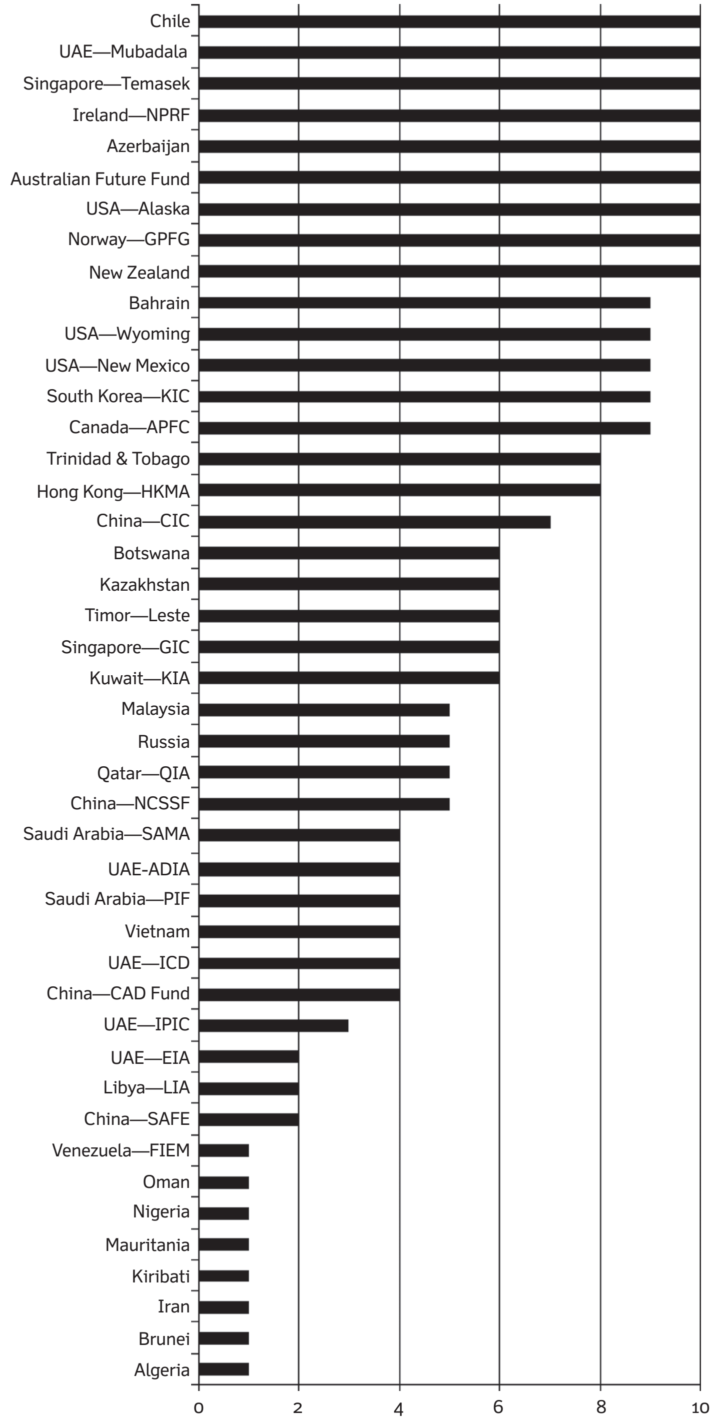

FIGURE 5. Linaburg-Maduell Transparency Index Ratings, Q1-2011 (Index 0–10).

Source: Linaburg-Maduell Transparency Index, SWF INST., http://www.swfinstitute.org/tag/swf-transparency/.

it harder for any interested person to allay suspicions of secretive investment strategies. The aforementioned problems can, however, be quelled by increasing both openness and enhancing scrutiny of SWFs which would likely lead to increased legitimacy of SWFs and SOEs in both target and home markets as well as build essential trust.[32]

Increased voluntary SWF disclosure is a signal of the likelihood that SWFs' investment choices are financially based. In the reverse, SWFs that direct their investments for political ends are more likely to be opaque.[33] Opacity, in effect, has a direct market impact as it signals possible capture by political interest. While other financial instruments like hedge funds are notoriously opaque, the fact that they are privately run signals to key market players that they are driven solely by commercial objectives. Thus similarly nontransparent practices often compound concerns in SWFs and SOEs contexts.[34]

Some policy-makers remain especially concerned about the possibility of a political bias in investments made and managed by state-controlled entities in strategic or sensitive industries, especially when they take the form of mergers and acquisitions.[35] This concern is, however, not readily substantiated. When comparing historic equity investment decisions by SWFs with those by mutual funds, SWF investments do not differ greatly from mutual fund investments.[36] In fact, investment decisions by SWFs seem characterized by a lack of regional and industrial diversification and a degree of trend chasing.[37]

Transparency concerns are further exacerbated by disquiet concerning inefficient and unaccountable management and macro-economic political capture that results in both rent-seeking behavior and inefficient long-term strategies that mainly support immediate tactical interests.[38] In light of these concerns, there are ongoing efforts to promote transparency in the institutional structures behind SWFs.

Office of Int'l Affairs, U.S. SEC), *available at* http://www.sec.gov/news/testimony/2008/ts030508et.htm.

32. *See* Dyck and Morse, *supra* note 28.
33. *See, e.g.*, Jason Kotter and Ugur Lel, *Friends or Foes? Target Selection Decisions of Sovereign Wealth Funds and Their Consequences* 101(2) J. FIN. ECON. 360 (2011), pp. 362–363. (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1292407.
34. *See infra* Chs. 2 & 5 for further discussion.
35. Such policy-makers include U.S. Rep. Duncan Hunter (Gary Hufbauer, Thomas Moll, and Luca Rubini, *Investment Subsidies for Cross-Border M&A: Trends and Policy Implications* 1 (U.S. Council Found. Occasional Paper No. 2, 2008), *available at* http://www.uscib.org/docs/usc_foundation_investment_subsidies.pdf.) and Rolatand Koch (Roland Koch, *Staatsfonds gehören nicht zur globalen Marktwirtschaft—auch Deutschland muss sich schützen* [*State Funds Are Not Part of the Global Market Economy–Germany Must Protect Itself*], 7 IFO SCHNELLDIENST 3, 3–5 (2007)).
36. *See infra* Ch. 8.
37. *See* Shai Bernsteain, Josh Lerner, and Antoinette Schoar, *The Investment Strategies of Sovereign Wealth Funds* (Harvard Bus. Sch., Working Paper No. 09-112, 2009), *available at* http://www.hbs.edu/research/pdf/09-112.pdf.; Vidhi Chhaochharia and Luc Laeven, *The Investment Allocation of Sovereign Wealth Funds* (SSRN Working Paper Series, July 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1262383.
38. *See infra* Ch. 3. *See further* EDHEC-Risk Institute, "An Integrated Approach to Sovereign Wealth Risk Management" (June 2011), *available at* http://www.top1000funds.com/wp-content/uploads/2011/07/An-Integrated-Approach-to-Sovereign-Wealth-Risk-Management-LR.pdf.; Ingilab Ahmadova, Stela

3. Other Concerns

Aside from concerns about national security and transparency, sovereign investment also raises other concerns. These include the risks of heightened uncertainty in shallow financial markets when SWFs move in or out of these markets,[39] of fueling FDI protectionism[40] and of large concentrations of liquidity possibly distorting asset prices through politically motivated investment strategies.[41] Additionally, some commentators have noted that sovereign investment in part leads to a (re)blurring of private and public spheres by infusing capital markets with sovereign capital through the infusion of FDI by SOEs and SWFs.[42] The potential for (re)blurring is troubling in part because in times of financial downturn or distress a (re)blurring of markets has high visibility and thus has a potentially greater negative influence on the market. Further, the deep pockets of SOEs become even more pronounced. This becomes problematic when SOEs are able to outbid and outlast commercial competitors, acquiring strategic assets that would otherwise be more difficult to obtain when peer companies have access to deep financial markets to mount a defense or compete fully in the M&A market.[43]

Generally, with the strong performance of commodity markets and large investment needs in mature industrial economies and emerging markets, opportunities for reinvestment of sovereign reserves abound. As FDI by SCEs increases, it is likely to lead to international investment disputes, in line with the rise of such disputes generally. This, in turn, raises a host of issues, not least concerning the standing of SOEs before dispute resolution bodies.[44]

Tsanib, and Kenan Aslant, *Sovereign Wealth Funds as the Emerging Players in the Global Financial Arena: Characteristics, Risks and Governance*, Revenue Watch Inst. (September 2009), *available at* http://pfmc.az/attachments/373_ENG%20SWF1.pdf.

39. Stefano Curto, *Sovereign Wealth Funds in the Next Decade*, World Bank Econ. Premise (Apr. 2010), *available at* http://siteresources.worldbank.org/EXTPREMNET/Resources/EP8.pdf.
40. Karl P. Sauvant, *FDI Protectionism Is on the Rise* (World Bank Policy Research Working Paper 5052, 2009), *available at* http://www.vcc.columbia.edu/pubs/documents/FDIprotectionismisontherise.pdf.
41. For a discussion of whether or not this is the case for sovereign investments specifically, or is of a more general concern *see infra* Ch. 7. *See also* Tamara Gomes, *The Impact of Sovereign Wealth Funds on International Stability* (Bank of Canada Discussion Paper 2008-14, 2008), *available at* http://www.bankofcanada.ca/2008/09/publications/research/discussion-paper-2008-14/; Roland Beck and Michael Fidora, *Eur.Cent. Bank, The Impact of Sovereign Wealth Funds on Global Financial Markets* 5 (Occasional Paper Series No. 91, 2008), *available at* http://www.ecb.int/pub/pdf/scpops/ecbocp91.pdf.
42. Larry Backer, *Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-Owned Enterprises, and the Chinese Experience,* 19 Transnat'l L. & Contemp. Probs. 3 (2010); *see also infra* Ch. 9.
43. *See infra* Ch. 5.
44. Mark Feldman, *The Standing of State-Owned Entities Under Investment Treaties*, *in* Yearbook on International Investment Law and Policy 2010–2011 (Karl P. Sauvant ed., 2011). For further discussion *see generally* Michael Nolan, *Roundtable on States and State-Controlled Entities as Claimants in Investment Arbitration: Round Table Report*, Vale Columbia Center. on Sustainable International Investment (Mar. 19, 2010), *available at* http://www.vcc.columbia.edu/files/vale/content/Roundtable_Report_FINAL.pdf.

The reinvestment of sovereign reserves held by emerging markets raises somewhat unique concerns. Specifically, as large amounts of sovereign reserves are reinvested, high levels of transparency and institutional infrastructure may be necessary so that the compatibility of the resulting flows of capital is ensured to be in line with the national interests of both host and home countries. Such infrastructure, however, might require policy adjustments in capital budgeting, taxes, and administrative regulation. Such adjustments would, however, above all involve making choices about how to protect the broad national interest of both home and host countries.[45]

It is not immediately clear to what extent these various concerns are systematically valid across the wide range of FDI projects undertaken by SCEs. In addition, it is not clear how the possibility of a negative impact from opacity and potential government control of SCEs differs systematically and substantially from similar concerns regarding private enterprises, notably privately held MNEs and hedge/mutual funds. Regardless of the evidence (or lack thereof), however, it is public perception that drives policy reactions.

C. POLICY REACTIONS

In response to these and other concerns[46] emanating out of what Gilson and Milhaupt have dubbed *new mercantilism*—government attempts to ensure that company-level behavior results in country-level maximization of economic, social, and political benefits—a number of governments instituted new policy measures touching upon inward FDI by SCEs.[47] Such national responses have mostly concentrated on creating or ramping up already existing mandatory investment review mechanisms, with a strong national security focus. At the supranatural level, however, policy reactions are almost exclusively directed at enhancing transparency, accountability, and the avoidance of FDI protectionism. These supranational responses, and the EU's in particular, have sought to address the immediate concerns emanating from SFDI as well as to respond to measures taken at the national level.

1. Country Reactions

As noted *supra,* the perception of host country governments of the perceived risks of sovereign investments often center on national security considerations. The vehemence of a host country's regulatory response, beyond enforcing general competition rules, depends largely on the strategic importance and economic sensitivity of the

45. *See infra* Ch. 10. *See also* John Gieve, *Sovereign Wealth Funds and Global Imbalances*, 48 Bank of England Quarterly Bulletin 196 (2008).
46. As noted earlier, the present discussion of concerns focuses on concerns relating to SFDI. A number of concerns additionally relate to the broad role of non-FDI investments by state-controlled entities (and of SWFs in particular). For more lengthy discussion *see generally* Xu Yi-chong and Gawdat Bahgat, The Political Economy of Sovereign Wealth Funds (2010).
47. Ronald Gilson and Curtis Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 Stan. L. Rev. 1345, 1346 (2008). *See infra* Ch. 11 for analysis of the regulation of SFDI at a conceptual level.

targeted industry. This is exemplified in part by qualifiers on investments in the telecommunication industry, the protection of national champions, and restrictions on investments relating to the defense and commercial infrastructure. Domestic protection of critical industries on national security grounds is generally permitted through trade and investment agreements while, on the other hand, economic protectionism is not. At the same time, though, the concept of "national security" and similar concepts are typically not defined, making it at times difficult to distinguish legitimate national security concerns from protectionist or other considerations.

In addition to countries' overarching desire to maintain a broad scope of national security review, stands the trend toward adopting self-judging national security clauses in international investment agreements.[48] National security review mechanisms, in combination with essential security exceptions in international treaties, have particular implications for inward SFDI. Where national investment review agencies take a hostile view toward certain types of FDI, it may be difficult to ascertain unequal treatment between sovereign and private investors when such decisions are considered self-judging. For example, a good faith determination in response to national security concerns by the Committee on Foreign Investment in the United States (CFIUS)—the United States' investment screening agency—is likely to be deemed unreviewable by international dispute settlement tribunals where such determination falls within both the realm of review and scope of essential security exceptions of international agreements.[49]

Some commentators have argued that the above concerns are best allayed through more extensive use of existing regulatory bodies at the national level, coupled with a focus on increased accountability and transparency of both sovereign investment vehicles and host country regulations.[50] However, the divergence of approaches to national

48. *See generally* Katia Yannaca-Small, *Essential Security Interest Under International Investment Law*, *in* International Investment Perspectives 2007: Freedom of Investment in a Changing World (2007). For example, the United States has argued that its key national security clause is self-judging. *See for trend New ICSID Annulment Decision Exposes Possible Gap in United States Investment Treaty Protection*, Skadden, Arps, Slate, Meagher & Flom LLP (2010), *available at* http://www.skadden.com/Index.cfm?contentID=51&itemID=2159. However, it should be noted that, absent particular language, several investor-state arbitration panels and the International Court of Justice have found national security language reviewable. *See, e.g.,* Certain Norwegian Loans (France v. Norway), 1957 I.C.J. 9 (July 6); CMS Transmission Co. v. Arg., ICSID Case No. ARB/01/8, Certified Award (May 12, 2005), 44 ILM 1205 (2005); LG&E Energy Corp. v. Arg., ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006); Sempre Energy Int'l v. Arg., ICSID Case No. ARB/02/16, Award (Sept. 28, 2007), *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC694_En&caseId=C8; Enron Creditors Recovery Corp. Ponderosa Assets, L.P. v. Arg., ICSID Case No. ARB/01/3, Award, (May 22, 2007). *But see* annulment decisions in: Sempra Energy Int'l v. Arg., ICSID Case No. ARB/02/16, Decision on Arg.'s Application for Annulment of Award (June 29, 2010); Enron Creditors Recovery Corp. Ponderosa Assets, L.P. v. Arg., ICSID Case No. ARB/01/3, Decision on Application for Annulment (July 30, 2010); CMS Gas Transmission Co. v. Arg., ICSID Case No. ARB/01/8, Decision on Annulment (Sept. 25, 2007), 46 ILM 1136 (2007).

49. *See infra* Ch. 12 for further analysis of essential security exceptions in U.S. trade and investment agreements.

50. *See infra* Ch. 13.

security review may at core be indicative of an underlying need to contextualize national responses to SOE and SWF investments. In part, this can be done by individualizing approaches, and narrowing the review to the considerations uniquely relevant to a particular type of situation and investment. Currently, there is a marked trend of increasing the breath of discretionary national security related investment reviews as well as international investment agreements. However, these developments are not without their problems. Wide divergence in review mechanisms and the criteria used to review foreign investments opens the possibility for unwarranted discrimination against investor type. Additionally, it is unclear whether such mechanisms—some of which explicitly include a strict review of SFDI—will pass muster under international investment law.[51] What follows is a brief description of some national review mechanisms, in the framework of which some accord SFDI a special place.[52]

United States

While the United States' regulatory framework is to a very large extent open to FDI,[53] some curbs to investors nevertheless exist. For example, there are ownership restrictions, tied to particular sectors of the U.S. economy. These particularly abound in the shipping, air transport, mining, telecommunications, financial services, energy, and investment company sectors.[54] Ownership restrictions, tied to overarching national security concerns, are also encapsulated in statutory requirements limiting ownership to a U.S. entity in some cases as a means to further restrict ownership or control of that U.S. entity by a foreign entity.

Further, the regulatory framework also distinguishes between state-controlled entities and other firms for the purpose of screening incoming M&A transactions on national security grounds. National security screening, conducted by CFIUS,[55] is broadly described as a function of "the interaction between threat and vulnerability, and the potential consequences of that interaction for U.S. national security."[56] As part

51. *See infra* Ch. 9.

52. *See generally* Karl P. Sauvant, *Driving and Countervailing Forces: A Rebalancing of National FDI Policies*, *in* Yearbook on International Investment Law and Policy 2008–2009 (Karl P. Sauvant ed., 2009).

53. Foreign Direct Investment in the United States, 15 C.F.R. 806.15 (2010). *See also* World Bank, Investing Across Borders 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies 164 (2010), *available at* http://iab.worldbank.org/~/media/FPDKM/IAB/Documents/IAB-report.pdf.

54. *See generally* Michael Hagan and Heidi Johanns, *Sovereign Wealth Funds: Risks, Rewards, Regulation, and the Emerging Cross-Border Paradigm*, 8 M&A J. 1 (2008); Richard Epstein and Amanda Rose, *The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow*, 76 U. Chi. L. Rev. 111 (2009).

55. Authority to Review Certain Mergers, Acquisitions, and Takeovers, 50 App. U.S.C. § 2170 (2007); Foreign Investment and National Security Act of 2007, Pub. L. No. 110–49, 121 Stat. 246, *implemented by* 31 C.F.R. § 800.101 (2008). *See also* George Stephanov Georgiev, *The Reformed Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security*, 25 Yale J. Reg. 125, 126–129 (2008) (providing explanation and overview of CFIUS review).

56. Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States (Comm. on Foreign Inv. in the U.S. [CFIUS], U.S. Dep't of Treasury), 236 Fed. Reg. 74567 (Dec. 8, 2008).

of its review, CFIUS assesses a transaction's potential national-security related effects, scrutinizing everything from a transaction's potential effects on critical U.S. technologies and infrastructure to whether the transaction may affect long-term supply of critical resources and materials.[57]

CFIUS may review any merger, acquisition or takeover by or with a foreign entity that could result in foreign control of any entity engaged in interstate commerce in the United States.[58] A purchase of voting securities or comparable interests in a U.S. entity comprising more than ten percent of the outstanding voting securities of that U.S. entity is one indicia of control. This national security review mechanism does not apply to greenfield investment.[59] Importantly, foreign government ownership or control of the acquiring entity gives rise to a mandatory investigation by CFIUS, unless "the transaction will not impair the national security of the United States" according to the Treasury Department and any lead agency.[60]

Canada

Canada structures the safeguarding of its national interests through the Investment Canada Act.[61] The investment-screening framework centers on a "net benefit" test, gauging how investment proposals benefit Canada as a whole.[62] Additionally, Industry Canada, the administrative agency tasked with administering the Investment Canada Act, applies (since 2009) a national security test[63] and conducts a review of sovereign investments.[64] Where, for example, a non-Canadian SOE seeks to acquire a Canadian business, Industry Canada scrutinizes whether, if the acquisition goes through, the business will continue to have the ability to operate on a commercial basis such that it can choose where to export and where to process production. Industry Canada also takes into consideration the participation of Canadians in operations both inside and outside of Canada, potential to maintain levels of capital expenditure necessary to maintain competitiveness, and the ongoing support of research and development.[65]

57. Eve R. Pogoriler et al., *National Security*, 44 Int'l Law. 535, 540–543 (2010).
58. 50 App. U.S.C. § 2179.
59. Transactions that are Covered Transactions, 31 C.F.R. § 800.301 (2008).
60. *Id.*; *see also* David Fagan, *The U.S. Regulatory and Institutional Framework for FDI*, *in* Investing in the United States: Is the U.S. Ready for FDI from China? (Karl P. Sauvant ed., 2009). The U.S. policy response, in addition to a broader discussion of the U.S. regulatory process for inward FDI, is reviewed *infra* Chs. 14 & 15.
61. Investment Canada Act (ICA), R.S.C. 1985, c. I-21.8; National Security Review of Investments Regulation, SOR/2009-271 (Can.).
62. Industry Canada, Guidelines—Investment by state-owned enterprises—Net benefit assessment, (2007), *available at* http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#state-owned. Industry Canada is the Agency of the Government of Canada established pursuant to the Investment Canada Act.
63. National Security Review of Investment Regulations, SOR/2009-271 (Can.).
64. Industry Canada, *supra* note 62. Enterprises that are owned or controlled directly or indirectly by a foreign government are considered SOEs for the purposes of the Act. *Id.* Disclosure of ownership by a foreign government is mandated by the Investment Canada Regulations. *Id.*
65. *See infra* Ch. 16 for further discussion; *see generally* Subrata Bhattacharjee, *National Security with a Canadian Twist: The Investment Canada Act and the New National Security Review Test*, Colum. FDI Persp. 10 (2009) (offering a more detailed discussion of the review process).

Germany

Germany has been a host country to SFDI at least since the early 1970s.[66] In response to growing popular concern with such investment, the German Government amended the Foreign Trade and Payments Act,[67] establishing a national security review for FDI into Germany.[68] The result was a tightening of the rules for all foreign investors, not only sovereign investors. The review mechanism considers planned investments in which non-EU or non-European Free Trade Association[69] investors seek to hold twenty-five percent or more of the voting rights in a German business, and the transactions are deemed to pose a possible threat to the public order or national security of Germany. Investments from an EU company in which a non-EU entity holds twenty-five percent or more of the voting rights are equally covered, but a pre-clearance mechanism has been put in place.[70] The German authorities, in a guidance document,[71] acknowledge that such a review is only possible in a limited manner, due to the freedom of capital movements enshrined in the Lisbon Treaty, and explicitly draw upon case law from the European Court of Justice to delineate public security and public order. Importantly, no lower limit is placed on the value of the transaction, investment review is not industry-specific, and it also does not pertain to greenfield investments.[72]

These selected responses, all of which involve actions at the national level, are indicative of the suspicions that the rise of SFDI has created in some countries, with suspicions being raised the highest in developed countries. Further, it is noteworthy that these responses were initiated before the Western financial crisis unfolded. However, at the same time, they did not become stronger or spread, perhaps because many governments urgently sought to stimulate investment during the crisis. It remains to be

66. Kuwait Investment Authority (KIA) acquired a 14 % stake in Daimler-Benz AG in 1974 (Jim Henry, *Abu Dhabi Becomes Biggest Daimler Shareholder*, BNET.COM (Mar. 24, 2009), *available at* http://www.bnet.com/blog/auto-business/abu-dhabi-becomes-biggest-daimler-shareholder/465), while the Government of Iran invested in Friedrich Krupp Huettenwerke (also in 1974) and in Deutsche Babcock in 1975 (*Business: Bankers Grab the Booty*, TIME, Dec. 10, 1979, *available at* http://www.time.com/time/magazine/article/0,9171,912561,00.html).
67. Dreizehntes Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung vom [Thirteenth Law Amending the Foreign Trade and Payments Act], BGBL. I at 1150 (Ger.), Apr. 18, 2009, *available at* http://www.hohmann-partner.com/rechtsvorschriften/2010/awg_englisch-2009.pdf.
68. *Id.*; Schlaglichter der Wirtschaftspolitik—Monatsbericht: März 2008 [Highlights of Economic Policy—Monthly Report: March 2008] 7–11, BUNDESMINISTERIUM FÜR WIRTSCHAFT UND TECHNOLOGIE [FED. MINISTRY OF ECON. AND TECH.], Mar. 2008, *available at* http://www.bmwi.de/BMWi/Redaktion/PDF/Publikationen/Monatsbericht/schlaglichter-der-wirtschaftspolitik-03-2008,property=pdf,bereich=bmwi,sprache=de,rwb=true.pdf.
69. European Free Trade Association member states include Iceland, Liechtenstein, Norway and Switzerland, http://www.efta.int/about-efta/the-efta-states.aspx. See for link to German legislation BUNDESMINISTERIUM FÜR WIRTSCHAFT UND TECHNOLOGIE, *supra* note 68, p. 10, *see also* note 67.
70. *See supra* note 68.
71. BUNDESMINISTERIUM FÜR WIRTSCHAFT UND TECHNOLOGIE, EXPLANATORY MEMORANDUM, *available at* http://www.bmwi.de/BMWi/Redaktion/PDF/Gesetz/englische-begruendung-eines-dreizehnten-gesetzes-zur-aenderung-aussenwirtschaft,property=pdf,bereich=bmwi,sprache=de,rwb=true.pdf.
72. *See infra* Ch. 17 for further discussion.

seen, however, how responses at the national level will develop once economies have fully emerged from the crisis and its aftermath—especially if SFDI will grow further.

2. Supranational Reactions

The national responses detailed *supra*, as well as those not mentioned specifically, have sparked renewed fears of FDI protectionism, including in supranational regulatory bodies. In contrast to national responses, though, the responses at the supranational level are voluntary in nature, consisting primarily of guidelines.

The starting point of the response by the EU was to confirm the commitment that all investors in the single market need to observe national and EU regulations and be granted the benefit of the free movement of capital. The European Commission emphasized that the existing regulatory framework "covers SWFs in exactly the same way as any other foreign investor,"[73] while the Member States retain the power to restrict the free flow of capital only in limited cases and for limited reasons.[74] These regulations have not changed with the enactment of the Lisbon Treaty. This soft law approach might well be bolstered in light of the EU's exclusive authority over foreign direct investment, granted by the Lisbon Treaty.[75]

The EU also supported international efforts to establish principles of transparency, predictability, and accountability. In response to growing concerns over the rise of sovereign investment and the fear of rising FDI protectionism,[76] the OECD launched discussions among its members and non-OECD governments, utilizing the OECD Investment Committee's project on Freedom of Investment, National Security and 'Strategic Industries' (FOI Roundtables) as a forum. These discussions led to a three-part OECD guidance.[77] The accompanying Ministers' Declaration noted, among other things, that, "if SWFs' investments were motivated by political rather than commercial objectives, they could be a source of concern . . . ."[78] It further reaffirmed OECD members' commitment

73. *A Common European Approach to Sovereign Wealth Funds*, COM (2008) 115 final (Feb. 27, 2008), section 3.1.

74. *Id.*

75. *See infra* Ch. 18 for further discussion on EU regulatory framework. For analysis of the impact of the exclusive FDI competency of the EU Commission following ratification of the Lisbon Treaty, *see Symposium on international investment law and the European Union*, *in* Yearbook on International Investment Law and Policy 2010–2011 (Karl P. Sauvant ed., 2011).

76. UNCTAD-OECD Report on G20 Investment Measures (Nov. 4, 2010), *available at* http://www.unctad.org/templates/Page.asp?intItemID=5716&lang=1 (providing joint report monitoring of investment law changes in light of the Western financial crisis.).

77. OECD, Guidelines for Recipient Country Investment Policies Relating to National Security (May 25, 2009) [hereinafter Recipient Country Policies], *available at* http://www.oecd.org/dataoecd/11/35/43384486.pdf; OECD, Guidelines on Corporate Governance of State-owned Enterprises (2005) [hereinafter Corporate Governance Guidelines], *available at* http://www.oecd.org/dataoecd/46/51/34803211.pdf; OECD, Guidelines for Recipient Country Investment Policy Relating to National Security (May 25, 2009) [hereinafter Recipient Country Guidelines], *available at* http://www.oecd.org/dataoecd/11/35/43384486.pdf.

78. *See* OECD, "OECD declaration on SWFs and recipient country policies," at the OECD Ministerial Council Meeting on 4–5 June 2008 in Paris, Ministers of OECD countries, *available at* http://www.oecd.org/dataoecd/0/23/41456730.pdf.

to preserving and expanding an open environment for investments by SWFs, while at the same time protecting legitimate national security interests. The FOI Roundtables also focused on the difficulty of distinguishing between commercial and political investments, suggesting that these exist along a continuum. OECD members highlighted the importance of strong governance and accountability in both home and host countries, especially to aid the credibility of a state's commitment to commercial objectives when investing directly abroad. OECD guidance instruments in support of the management of transparency and accountability,[79] together with the work of other international organizations and fora, were considered valuable in their efforts to better allay host country concerns.[80]

Countries with SWFs also responded to international concern about the increase in SFDI by establishing the International Working Group for Sovereign Wealth Funds (IWG), with support from the International Monetary Fund (IMF).[81] The IWG produced a set of Generally Accepted Principles and Practices for SWFs that is known as "the Santiago Principles."[82] The Santiago Principles provide for voluntary transparency and accountability standards for SWFs in three key areas: (1) the SWFs' legal framework, objectives and coordination with macroeconomic policies; (2) institutional framework and governance structure; (3) and investment and risk management framework. Although SWF compliance with the Santiago Principles is uneven,[83] there seems to be a trend toward greater compliance and hence greater transparency.[84] The work of the IWG and IMF on formulating the Santiago Principles has been well received by host and home countries alike, both for its commercial logic and as an example of international consensus building.[85] Despite the international welcome, the Santiago Principles are generally recognized as *de minimis* requirements in their scope and nature.[86]

To continue the work undertaken by the IWG and to further understanding of the Santiago Principles, the IWG established the International Forum of Sovereign Wealth Funds. This forum is a voluntary group of SWFs without supranational authority and whose communications do not have legal force.[87] The Forum has a

79. *See, e.g.,* Corporate Governance Guidelines, *supra* note 77.
80. *See infra* Ch. 19 for further discussion of OECD's policy response.
81. Press Release, Int'l Working Group of Sovereign Wealth Funds, International Working Group of Sovereign Wealth Funds is Established to Facilitate Work on Voluntary Principles (May 1, 2008), *available at* http://www.iwg-swf.org/pr/swfpr0801.htm.
82. *See* Santiago Principles, *supra* note 7, at 3.
83. Sven Behrendt, *Sovereign Wealth Funds and the Santiago Principles: Where Do They Stand?* (Carnegie Papers No. 22, 2010), *available at* http://www.carnegieendowment.org/files/santiago_principles.pdf.
84. Edward Truman, Sovereign Wealth Funds: Threat or Salvation? 134 (2010); *see also* Afshin Mehrpouya, Chaoni Huang, and Timothy Barnett, *An Analysis of Proxy Voting and Engagement Policies and Practices of the Sovereign Wealth Funds*, IRRCi SWF Report, Oct. 2009.
85. *See, e.g.,* Donghyun Park and Gemma Estrada, *Developing Asia's Sovereign Wealth Funds, Santiago Principles and the Case for Self-Regulation*, Asian J. Int'l L. (2011) *available at* http://journals.cambridge.org/action/displayFulltext?type=1&pdftype=1&fid=8195900&jid=AJL&volumeId=-1&issueId=&aid=8195898.
86. *See infra* Ch. 20 for further discussion on the work of the IMF and IWG.
87. *See* Kuwait Declaration tit. A, Int'l Working Grp. of Sovereign Wealth Funds, Apr. 6, 2009, *available at* http://www.iwg-swf.org/mis/kuwaitdec.htm.

professional Secretariat, initially staffed by the IMF, to facilitate its activities and direct communications.

Outlook

Sovereign investment will likely remain an important topic in the ongoing discussions on the role of markets, the diversification of national economies, the preservation of intergenerational wealth, and—as far as its FDI component is concerned—on concerns of national security and economic autonomy.[88] With SWF assets continuing to grow and potentially to surpass US$15 trillion in 2015,[89] and with the increasing role of SOEs in global markets, the continued relevance of state-controlled entities with respect to investment flows is assured. International dialogue and cooperation on matters of transparency, predictability, and security is and will therefore continue to be essential.

88. As mentioned in the Acknowledgement section of this volume, one such discussion was held at the third Columbia International Investment Conference, entitled "FDI by State-Controlled Entities: Do the Rules Need Changing?" *See infra* Ch. 21 for the rapporteur's report.

89. *See* sources cited *supra* note 5.