Sovereign Wealth Fund Investments

A Case Study Analysis

by

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A Thesis Submitted to the Honors College
In Partial Fulfillment of the Bachelor's degree
With Honors in
Public Management and Policy
THE UNIVERSITY OF ARIZONA
May 2010

Approved by:

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Abstract

Sovereign Wealth Funds are an emerging economic force in the world of finance that has spurred both excitement and worry over what they represent. Because SWFs are institutional investors in the form of government connected hedge funds, there is worry that SWFs could be using investment as a political weapon instead of for financial investment. Despite evidence that supports the idea that SWFs are long term investors which invest based on financial return, these fears persist. Through case study analyses of Dubai Ports World, Temasek Holdings Ltd., the Norwegian Government Pension Fund, and the Chilean SWFs, several points can be made that point to how to make SWF investment more acceptable to Western markets and world markets in general. Analysis of the cases found that SWF investment is more successful if SWFs are transparent in their strategy or philosophy of investment, and if SWFs and recipient of investment governments are willing to treat SWFs like private investors instead of as public or government related investors. Furthermore, this study finds that governments who benefit from investment from SWF investment should maintain an economic environment conducive to both domestic and foreign investment rather than use protectionist measures.

Keywords: sovereign wealth fund, best practices, transparency, institutional investors

Contents

Introduction

The financial crisis of 2007 created an opportunity for respected high profile Western firms such as Morgan Stanley, Barclays, Blackstone Group, Citibank, and Merril Lynch to be bought fairly cheaply. This situation led to a rise of investment by sovereign wealth funds (SWFs) into high profile western firms raising awareness to the public about the level of foreign ownership of some of the largest firms in the Western market raising national security concerns. Particularly in the United States, but in most countries, the public does not have much knowledge on SWFs allowing for ample opportunity for misinformation regarding SWFs to circulate such as that most SWFs invest based on political motive or that SWFs have malicious intent when investments are. Scholars recognize this and have helped to mitigate the effects of these arguments.

To help dispel such rumor it is important to understand the scope of SWFs. SWFs are institutional investors created by the central government of a country to invest excess natural resource or trade surplus revenues for the purpose of the creating a long term debt management and growth fund for generations to come. The majority of SWFs come from resource rich nations, such as Norway, Saudi Arabia, the United Arab Emirates (UAE), and China as well as others. The structure of these entities and their level of transparency vary among each group as does the amount of wealth that these entities control. According to the Sovereign Wealth Institute (2010), a research group that monitors the growth and actions of SWFs around the globe, SWFs account for nearly $2 to 3 trillion in assets and funds. Of this amount, the countries with the greatest share are the UAE, particularly the emirate of Abu Dhabi at $627 billion; Norway, $445 billion; Saudi Arabia, at $431 billion; and China with at least $288 billion. The lowest SWFs in terms of assets under management are Mauritania and Indonesia each with $0.3 billion in assets under management. Clearly SWFs are in control of large asset pools, which are as of today's financial situation, a source of badly needed capital for world markets.

But, the countries that control this capital are not the traditional allies and trading partners of the United States and other Western nations, and in some cases, have been known to harbor enemies of the United States causing tension and misunderstanding. (Broder, 2006) However, historically SWFs have acted as long term investors in Treasury Bonds, and more recently in large corporations. The acquisition of stocks in large corporations usually comes in the form of large deals of 5 to 10% depending on the type of deal it is. Arguments have been made that this investment could be a disguise to vie for economic leverage such that the threat of divesting investment could be used to gain political goals although there is no proof that malicious intent has been made any SWF investment for the past sixty years. Despite the historical record, the negative sentiment toward SWFs is often seen in the merger and acquisition of assets in critical sectors of industry such as security of ports or energy. One such example that will be covered in more detail later in this paper is the acquisition of the ownership of United States ports on the eastern seaboard from a British company by the Dubai Ports World SWF in 2006 raising issues of national security for these types of investments.

While SWFs have existed for nearly sixty years, the number and size of SWFs has grown considerably across the world. (Badian & Fidora, 2008) Given that the majority of these institutional investors are of nonwestern background, some do not use the expected the management principles followed in most Western business markets and as such SWFs may encounter obstacles or misunderstanding simply because of managerial practices. In turn, governments both Western and nonwestern are beginning to create policy specifically to deal with SWFs and other institutional investors, but the policy response varies widely creating a plethora of market regulation across the globe. The solution to this policy and management issue is not to adopt only Western practices, but instead must focused on finding practices that work best in all markets. Thus the purpose of this case study analysis of SWFs is to find the practices that both governments and SWFs can use to allow for successful investment while protecting the rights of both the investor and the community receiving investment.

Literature Review

The literature regarding Sovereign Wealth Funds (SWFs) comes from a multitude of sources including policy analysts, economists, politicians, and international organizations as well as others. In reviewing the literature, several points about SWFs are agreed upon while the other points are still disputed. These points will concern the size, influence, behavior of SWFs, and the policy solutions that should be used by governments or SWFs to ensure successful investment.

The literature review will be structured as follows. First a definition of what a SWF is for this study will be established. Then, detailed review of why SWFs exist, the size and number of SWFs, the historical behavior, and regulatory responses to SWFs is made. Included in this review are the perceived reasons for concern over SWFs in relation to each point.

What is a Sovereign Wealth Fund?

A majority of scholars that study SWFs consider SWFs to be state run or funded institutional investment vehicles. SWFs are created to invest excess foreign reserve assets, like the Chinese Investment Corporation, or to invest nonrenewable resource revenue, such as oil or natural gas profits, in ways to prevent backlash from potential economic market volatility or for the benefit of future generations. While it is agreed that SWFs are government connected or controlled entities, some scholars consider funds created in the United States at the state level, such as the Alaskan Oil Fund and the California Public Employees Retirement System (CALPERS), to be SWFs. For this study, entities to be considered SWFs are central government created institutional investors.

Point 1: SWFS exist due to global trade imbalances

Large trade imbalances and the rising price of commodities, especially energy commodities, has allowed for emerging market economies such as Saudi Arabia and China to accrue large sums of money in the form of foreign reserves or commodity revenues. The high saving rate of these countries has helped them to hold onto the money for longer than would be the case in most industrialized countries and now these countries have chosen to invest the money to secure future generations a way to sustain their lifestyle. While most of the SWFs in the world are in the emerging market economy countries, some are industrialized economies such as Norway or Russia.

Furthermore, it is speculated by Drezner (2008) and Truman (2008b) that SWFs arose due to changes in policy, technology, and shifts in the financial system as a whole.

Point 2: SWF Size and Number

A conservative estimate for the combined size of the world's SWFs is roughly $3 Trillion worth of assets under management. (Gieve 2008, Drezner 2008, Epstein & Rose 2009, Anderson 2009) There is speculation that SWFs could be worth up to $15 trillion currently are expected to grow in size and number dramatically over the next two decades.

According to the Sovereign Wealth Institute (2010), the number of SWFs currently number at 55, including individual funds set up by several US states. The majority of these funds were created within the last fifteen years, with the oldest fund being the Kuwait Investment Authority. Of these 55 entities some of the largest and more well known SWFs are the Abu Dhabi Investment Authority with an estimated $627 billion, the Norway Government Pension Fund at around $450 billion, China Investment Corporation at $288 billion, and Singapore's two SWFs, Government of Singapore Investment Corporation ($247 billion) and Temasek Holdings Ltd. ($122 billion). While the total share of assets under management by private hedge funds is larger than the estimated assets under management by SWFs, SWFs rapid increase in size and number has brought to the forefront the underlying concerns towards this type of institutional investor, namely transparency and investment motive.

Point 3: Concerns over Investment Behavior

The primary concern over SWFs among governments and the public, particularly of Western countries, is that SWFs are too opaque in terms of transparency and the motives by which SWFs are unclear. The issue at hand is whether SWFs are investing based upon strategic motive and or whether they are investing based upon potential financial return as say a private investor would. Another concern is that because governments are connected to SWFs governments could influence the market so as to make investment by their SWF easier perhaps through the use of national intelligence agencies or through threat of war. Related to this is the notion that SWFs are out to control target market industries such that the home country would be able to use the SWF investment as leverage in diplomatic matters.

The literature overwhelmingly disproves these concerns as minimal or overblown. Scholars tend to point to the historical behavior of SWFs as evidence that the political concerns currently associated with SWFs as unwarranted and that portfolio analysis of SWFs shows that the influence SWFs would have on company's is not great enough to produce such results.

Point 4: Historical Behavior

Historical behavior of SWFs has not validated the national security concerns stated in the previous section. SWF investment behavior has been found to be economically driven over the past 50 years. Scholars tend to acknowledge that SWFs are long term investors, despite the common perception of SWFs to lay citizens that SWFs are primarily strategic investors.

According to Abdelal (2010) of two SWFs in Abu Dhabi illustrates the two types of behavior that SWFs could use for investing. Abdelal found that Abu Dhabi's Abu Dhabi Investment Authority (ADIA) historically has acted with a long term, return on investment (ROI), and low key investor strategy. This means that ADIA has invested in companies on the basis that ADIA would be holding the equity or stocks for long periods of time. The sizes of the stakes made by ADIA are less than 5% although this is not always the case. Abdelal juxtaposed the strategy used by the ADIA with that of Mubadala which uses an investment behavior known as strategic investment, which Abdelal feels is "at odds with the current financial system." Mubadala invests on the basis that the recipient will help develop Abu Dhabi through projects that enhance Abu Dhabi's global competitiveness. While Mubadala's investment strategy is not purely financial in nature, it is financially minded instead of being focused on political motivations of the United Arab Emirates, which Abu Dhabi is a member of.

A statement on investment of SWFs by Roubini (2008) reflects the differences between ADIA and Mubadala, but also SWFs in general. Roubini says the rationale for investment varies from fund to fund, but that the underlying reason for investment is financial return of the investment. He further insinuates that the movement "away from traditional low risk treasury bills to equities, stocks, and control of foreign companies" is based on the increased ROI that investment in those areas generates albeit with increased risk.

According to Anderson(2009) in regards to the recent global financial crisis, SWFs are not interested in "saving institutions too big to fail" and uses a statement from Badar al-Saad of Qatar that

SWFs have social and economic obligations to their home countries. This seems to defend the argument that SWFs are acting like traditional private investors in that the SWFs will look only to invest in opportunities that look to return a profit for their stakeholders, which in this case are the government and citizens of the home country. Furthermore, Anderson finds that SWFs respond to poor investment climates much like that of private investment by moving investment elsewhere or divesting stakes in the market. Anderson states that the poor investment climate in the US and Europe in 2007 led to a decline in SWF investment in financial services in the area as well as a shift to investment in emerging markets and real estate.

Mendelson (2008) argues that SWFs act as long term investors and that they act like private hedge funds based upon their use of being transparent. Mendelson states that SWFs are as transparent as needed, but no more, much like how a traditional hedge fund would behave. Furthermore, Mendelson finds that SWFs typically avoid purchasing large controlling stakes in companies and that the companies or industries in which they invest are not in sensitive areas. If anything, Mendelson argues that the increased focus on SWF investment is diverting attention from monitoring State Owned Enterprises, state owned companies that act as traditional companies but on behalf of the state, which he feels is more concerning than SWFs.

Several scholars (Badian, & Harrington, 2008; Ervin, 2007; Das, 2008; Balding, 2008) consider the reason increased attention to SWF investment stems primarily from the increase of investment by SWFs in western firms and equity markets between 2006 and 2009. Purchases of stakes between 4.9% and 9.9% in western firms such as Morgan Stanley, Citigroup, Blackstone, as well as other companies scared policy makers and the public unnecessarily. According to Thornton, Reed, and Ihlwan (2008), “SWFs were responsible for 35% of the mergers and acquisitions in 2007” much higher than in past years. However, this investment seems to have reflected the environment at the time. The prices of stocks and equities in these firms was a historical low and given the historical profitability of the firms, the time was ripe for long term investment in these firms.

Concern over the investment by SWFs during this period is believed to be overblown. Balding (2010) states that the portfolio analysis of SWFs does not indicate any investment motive other than that based on ROI and that the fear of the public and policy makers over the perceived size of SWFs is evaluated inconsistently making the perceived influence of SWFs on firms and international markets much greater than is actually the case.

Related to Balding's findings are the findings of the *Economist* (2006) that SWF investments are typically in convertible stock similar to private firms. This means that SWFs are investing in the same type of stocks as private firms and thus are held by the same rules that private firms are. In addition to this finding, the *Wall Street Journal*'s (Coker, & Malas, 2009) monitoring of the recent arbitration case between the ADIA and Citigroup suggest that SWFs are acting based on financial motives. The ADIA invested $7.5 billion of Citigroup equity units with 11% dividends agreeing to convert the units to common stock in March 2010. Since the purchase, ADIA has seen the movement of other SWFs such as Kuwait Investment Authority (KIA) and Government of Singapore Investment Corporation (GIC) out of Citigroup with considerable profit. Having seen this move ADIA now wants to do the same by breaking its contract. Currently Citigroup and ADIA are in arbitration over the matter, but the behavior by ADIA in this instance seems to defend the notion that SWFs are financially motivated rather than politically motivated.

Lastly, analysis of SWF investment by Beck and Fidora (2008) indicate similar findings. Beck and Fidora (2008) find that there is no data to suggest malicious behavior from SWF investment or divestment. Although the outflow of investment by SWFs to markets than the US and Europe is certainly viewed with disdain by policy makers it simply reflects the investment environment and potential of these markets at a particular time. Beck and Fidora (2008) would agree that SWFs are simply putting money in the places that appear to return the most profit over the long term.

Thus, it appears that the consensus among scholars is that SWFs are long term investors and that past behavior validates this claim. While future behavior may change it is viewed as unlikely since the success of today's SWFs is based off of long term financial motives.

Point 5: SWF Regulation and Policy Response is Mixed

There are several modes of action that scholars call for SWF treatment:

- Continue the status quo of mostly open market policy that varies from country to country
- New Regulatory Minimalism emphasizing open markets
- Strong Regulation or Status change of SWFs in recipient countries

Stay with the status quo

Epstein and Rose (2008) are only one of the major proponents of continuing the status quo of having varying regulation toward SWFs based on the country. In regards to the United States, Epstein and Rose feel that the Committee on Foreign Investment in the United States (CFIUS) and the Financial Investment and National Security Act (FINSA) of 2007 which take SWF investment on case by case basis are more than enough to combat malicious behavior by SWFs should such behavior arise. Furthermore Epstein and Rose state that international organizations such as the International Monetary Fund or the Bank for International Settlements could be used to mitigate disputes regarding SWF investment. Balding's (2008) portfolio analysis of SWFs seems to suggest that current SWF regulation is sufficient in that simple monitoring of SWF behavior is all that is needed.

Regulatory minimalism

More commonly scholars promote forms of regulatory minimalism so as to keep away from populist protectionist policy response yet promote desired behavior from SWFs such as increased transparency measures. One type of soft regulation mentioned in the literature is the development of a best practices document or code for SWFs to follow. In the OECD Investment Letter of October 2007 the OECD Investment Committee recommended that the home country governments of SWFs encourage SWFs to be more transparent perhaps using the OECD's State Owned Enterprise Guidelines as example. In addition to these guidelines, proposals for a SWF best practices document have been made in the international environment. The IMF and various SWFs including the ADIA have created a working group to formulate principles for SWFs to follow. This IMF Working Group created what is now known as the Santiago Principles. The Santiago Principles act as a philosophical underpinning SWF behavior and promote transparency in purpose and holdings. One criticism of the 24 principles outlined in the Santiago Principles is that they do not denounce opaque behavior or strategic investment although the push for more forthcoming and transparent behavior is welcomed by many scholars. Another criticism is that the Santiago Principles are voluntary therein making the document a toothless mandate that could be ignored by SWFs. Furthermore, faith in international organizations to enforce the principles is limited and, as Fleischer suggests, would be ineffective since not all nations with SWFs belong to international organizations such as the IMF, the World Bank, or the World Trade Organization.

Other minimalist measures not involving international organizations have been considered for dealing with SWFs too. Reed (2009) argues that tweaking of the FINSA Act should be the minimum course of action taken. He promotes the strengthening of current FINSA powers as well as expanding capacity and jurisdiction of FINSA. Further funding for personnel and training for CFIUS whose powers were expanded by FINSA are also considered essential to the effectiveness of such policy so as to encourage foreign investors to submit to voluntary filings and not lose market advantage in terms of time by doing so.

Another measure would be to have all law that makes all stock purchased by SWFs become nonvoting stock. Gilson and Milhaupt (2008) argue that this would still allow SWFs to enter markets yet assuage fears of strategic or political investment that the public may hold. Thus, SWFs would have the ability to invest in high yield markets without the fear of retaliation by recipient governments. One potential drawback to this approach however is that SWFs may choose to invest elsewhere because of the dual standards created for SWFs which private firms would not have to compete with. However, Gilson states that SWFs who want to invest in highly successful, in this case American firms, would still invest because to the potential financial returns which would be the main reason for their investment.

One last type of regulatory minimalism, as posited by Anderson (2009), is policy in recipient countries, particularly democracies, to increase public knowledge of SWFs and their importance. Anderson (2009) as well as most other scholars agree that to avoid populist protectionist policy from entering the policy agenda, the public must be adequately informed so as to better steer elected officials to enact policies that reflect the public but also have the long term stability of the country in mind. This approach would help SWFs gain greater notoriety and dissuade politicians from using populist measures to garner votes for election.

Strong regulation or change

The last form of policy response is strong regulation or policy change. One of the more vehement proponents of change has been Fleischer (2009). Fleischer considers the status quo as a system that does not reflect the times and is not a viable option for policy towards potential SWF investment issues. According to Fleischer, SWFs have a similar status as foreign dignitaries in the United States in that SWFs do not have to pay any taxes on the profits made from investments. This fact is what Fleischer feels is archaic about the current regulatory policy toward SWFs in the United States and is a strong proponent for change in this regard. Fleischer argues that there are three options that would be most effective in dealing with the shortcomings of the current arrangement.

1. Treat SWFs exactly like private investors under US investment law.
2. Impose an excise tax on returns from investment
3. Impose an excise tax based on the condition that a SWF does not follow a predetermined set of best practices.

The first option proposed would treat SWFs exactly like other investors in the US market including the regulatory and tax requirements. This would help generate revenue for the US while giving SWFs the same treatment as private investors including the choice to not follow a best practices document. The second proposal would be seen as too populist to pass, but would generate the most revenue for the US. Unfortunately, it would likely deter some investment even driving investment to other countries. The last proposal would help promote compliance to best practice standards such as the Santiago Principles, but the issue of enforcement of the standards is the major concern. In all Fleischer posits that current law should be amended to view SWFs the same as private hedge funds, foreign or domestic, because the political environment would be most amiable to it and the loss of profits by SWFs would be minimized most encouraging further investment in the United States.

Overall, the proposal by Fleischer to recognize SWFs in a similar fashion to private firms reflects the consensus found in the literature that SWF behavior is nearly identical to low key investment behavior of long term oriented private investors.

Summary of Literature

The literature seems to state that SWFs are here to stay and that the number and size of SWFs is likely to grow. Fears over the transparency of SWFs as well as the motives behind investment are the primary concerns of the public and policy makers, and the majority of scholars are in agreement that some form of policy response is needed. As to what type of response is needed or considered most effective, there is still debate over the issue; however, it is clear that the issue is complex as it involves altering the current system which has allowed large influxes of capital into the United States and potential foreign diplomatic and economic backlash to whatever measures are taken.

Methodology

Case studies will be the primary method used to analyze the factors that allowed SWF investment to be successful. Instrumental case studies will serve to provide a broader understanding of the study question and to provide greater insight of the issues related to the study question. The study question mentioned prior is a series of questions related to SWF investment that will be explained shortly. Each case study will include a brief background on the SWF being analyzed as well as the investment environment in which the specific case took place. The first case will be an analysis of the Dubai World-Port Authority Deal of 2006; the second case will analyze the Shin Corporation-Temasek Holdings Company deal; the third case analyzes the investment of the Norwegian Government Pension Fund-Global; and the fourth will analyze the investments of the Chilean SWFs.

The following questions were used in determining the criteria for analysis.

- What factors have led to SWF investment deals failing or succeeding?
- Do political or financial factors play more or less the same role?

- Does the government type and transparency of either the recipient government or SWF play a part in the success of a deal?

With these questions in mind the theoretical framework behind the analysis is concerned with validating or disproving the theory that SWF investment is only successful if SWFs and recipient countries are in consensus on the rules of investment and if investment is not in what the recipient country may define as a critical sector, a sector of the economy that is associated with national security or nationalistic concerns. In order to better analyze the case studies in this study six units of analysis will be utilized to best determine the reason for failure or success of investment by an SWF.

1. *Government Type* that supplies the SWF with funding. The rationale behind this unit of analysis is that democratic governments may be more wary to allow investment from authoritarian regimes.
2. *Perceived Transparency* of the SWF by international ratings and standards. This unit of analysis is based primarily on the findings of the Sovereign Wealth Fund Institute. The transparency of a SWF, as will be discussed more in the literature review, is one of the major contentions that scholars and governments have with SWFs.
3. *Type of Investment* made by the SWF in the target market. This factor will look into whether investment is in non-voting shares or in direct controlling shares as well as the size of the investment in terms of the size of the stake purchased.
4. *Sector of Investment*. Examples would include telecommunications, real estate, equity markets, and energy.
5. *Recipient government type* will be analyzed for the purpose of determining whether democratic governments behave differently towards SWF investment than other government types.
6. *Political Environment*. This will look into whether the deal was well known publicly, in the political system, or if there were issues such as underlying security concerns that may have helped create an adversarial investment environment.

Thus these units of analysis will be used to prove or disprove the theory behind this study: If SWF investment is successful then both SWF and recipient countries have mutual understanding of the financial and political environment such that behavior by one party or the other is seen as legitimate.

Criteria for the interpretation of the findings are based upon a single definition of a successful investment by a SWF. Successful SWF investment is defined as investment that is accepted by the recipient country in whole without major reservations. An example would be if a SWF A tried to purchase a 5% stake in Company G in Country A and the investment received governmental or public backing. This definition focuses on the deal being perceived as legitimate and lawful by all parties who would have a stake in the matter.

Case Study Analysis

The case study analysis is structured to juxtapose the differences in management styles by several SWFs looking at specific deals or set of deals by SWFs. Two of the case studies are unsuccessful investments while the other two are seen as successful. Each case study analysis will begin with an introduction to the SWF, its background, and a description of the investment deal or deals. Analysis is made based upon the six factors described in the Methodologies section: Government Type, Type of Investment, Sector of Investment, Recipient Government Type, Perceived Transparency, and Political Environment. While discussion of all of the factors may not be discussed in each case, the most important factors for each case are discussed.

Dubai Ports World 2006

Dubai Ports World (DPW) is an international, state funded and run firm that is considered one of the major leaders in port management and maritime services. It is a subsidiary of the government run Dubai World, a holdings and investment company that invests to create projects in primarily the Middle East. (Sovereign Wealth Institute, 2009)

In 2006, Dubai Ports World bought out Peninsular and Oriental Steam Navigation Company, an English ports management firm. This purchase increased the global presence of Dubai Ports World by broadening the firm's managerial reach to all over the globe, including six ports in the United States: Miami, New York, New Orleans, New Jersey, Baltimore, and Philadelphia. (Williams, 2006; "Arabian Dreams", 2006) National security concerns raised by legislators within the US Congress led to the deal being amended such that the North American port contracts were sold off while the ownership of P&O remained under Dubai Ports World. (Williams, 2006; Cox, 2008)

The failure of the success of the DPW takeover of P&O contracts in the United States is explained by primarily the lack of DPW to consider the investment environment in the United States at the time of the P&O purchase, however this analysis will consider all six possible factors outlined in the Methodologies section to illustrate their importance to the success of investment.

First, the government type of Dubai is a monarchy that is connected to several other city-states through a federal framework. This government type may be at odds with that of the type in United States, a representative democracy, in that the each emirate acts as a monarchy while interaction between the emirates is more like a federation. (CIA World Factbook, 2010b) The government in Dubai, or the United Arab Emirates of which Dubai is a member, is not considered as transparent as that of the United States. While this fact has not stopped peaceful and profitable relations between the two nations, the issue of transparency is a common complaint towards Middle East nations by the US public and legislators. (Broder, 2006)

Secondly, the transparency of the Dubai Ports World was challenged too by US legislators although the US Administration did trust the firm and consider it transparent. Dubai Ports World runs and maintains the ports that the US uses in the Middle East, namely Port Rashid and Jebel Ali giving the firm a history of cooperation with the US. Thus, the US Coast Guard and President Bush found the deal to be sound. (Howell, 2006; Curtiss, 2006) However, according to a Congressional poll support for the deal was split by party lines with 44% of Republicans favoring the deal, 29% not favoring, and 29% saying it was too early to know; while, for the Democrats only 20% favored, 66% did not favor, and 14% said too early to know. (Cohen & Bell, 2006) For all intents and purposes Dubai Ports World was seen as legitimate overall in the eyes of the US Administration but not in Congress.

Third, analysis of the investment type indicates that the deal should have worked. Dubai Ports World would become the owners of the contracts that P&O had already established with the ports of Miami, New Jersey, New York, Baltimore, Philadelphia, and New Orleans, but the control over security and daily management of these ports would have stayed in the control of local governments and the US Coast Guard. (Meckler & Machalaba, 2006, March 9) Furthermore, the deal can be characterized like that of a merger in which the operations of firm stay the same but sign under which the firm is advertised switches to the new firm. Lastly, P&O being a British firm means that these ports were already under foreign management before Dubai Ports World considered buying P&O. Thus, investment type was clearly not factor which hurt the Dubai Ports World deal since it had occurred before..

The fourth factor to consider is what sector of the economy Dubai Ports World was buying into in the American market. The market of port operations and management is difficult to defend as a critical sector because of the similarities between port management across nations. Port management and maritime services are also seen as a low margin business making it difficult for small domestic firms to maintain a healthy stream of revenue thus promoting the rise of large multinational companies to respond to such operations. (Meckler and Machalaba, 2006, March 9) However, because ports are the source from which goods enter a nation there is a linking of ports to national security, which legislators used to rally the public. Thus, while the sector may not be entirely critical, it is a sensitive sector due to the link to national security.

It is the tie to national security that illuminates the primary reason for the failure of the Dubai Ports World deal in the United States. The deal came five years after the events of September 11, 2001 and during a time when the United States has been arguably considered anti-Arab. The link of several of the September 11th terrorists to the UAE did not help the situation by indirectly associating Dubai Ports World, a firm which used financial motivation for buying out P&O, with an outlandish notion that the firm could compromise US security goals. (Broder, 2006, February 6; Li, 2006) Furthermore, the public did not understand the lengths to which the UAE has been an ally to the United States through its allowance of the US military to use UAE ports and bases, and by participating in the US Container

Program (Darwish, 2006) that allows US Customs officials to inspect freight containers abroad. Thus, because the public knew only what the legislators said and there was little if any action taken by Dubai Ports World to ease the American public into the notion that an Arab company would be managing several of the largest ports in the United States, the deal failed.

Temasek Holdings Ltd. and Shin Corporation 2006

Temasek Holdings Ltd. is one of two SWFs established by the government of Singapore. Temasek has been very successful in the majority of its investments especially in the United States and in Asia. In 2006 Temasek held investments in a diverse assortment of companies ranging from Google Inc. to Honeywell to Verizon Wireless. (U.S. Securities and Exchange Commission, 2006, March 31) Temasek seeks opportunities that aim to bring a large financial return and thus that is why Temasek pursued a controlling share of Shin Corp. (Temasek Holding Ltd., 2010)

Shin Corporation is a holding company based in Thailand created by the Shinawatra family that has business in satellite transponder rentals and related service, wireless telecommunications including trading and rental of equipment and accessories; internet investments and internet service provider (ISP) services; information technology such as computer services; media broadcasting such as airtime rental, media production, telephone directory production, and advertising services; low-fare Airline service, Thai Air Asia; and a Consumer Finance arm providing loans and other services. (Mergent Online, 2005) Of note is the fact that the contracts for Thai military satellites are through Shin Corp's satellite arm and one of the main television stations in Thailand in 2006, iTV, was under the media arm of Shin Corp. (Anwar, Doran, & Sam, 2009)

In January 2006, Temasek purchased a 49.2% stake in Shin Corp. for $3.8 billion USD from the Shinawatra family, the original founders of Shin Corp. (Anwar, Doran, & Sam, 2009) The deal occurred shortly after a change in Thai foreign investment law which increased the stake that a single foreign company may control of a domestic company from 25% to 49%. (Anwar, Doran, & Sam, 2009) The deal resulted in then Thai Prime Minister Thaksin, a member of the Shinawatra family and original founder of Shin Corp., receiving approximately $1.9 billion in tax free profits. (Kazmin, 2008, June 18) Shortly thereafter the Thai military and public became suspicious of the intentions of Prime Minister Thaksin as well as Temasek. Issue over public corruption directed at Thaksin, possible spying by the Singapore government through Shin Corp., and the issue of the de facto control of Temasek over Shin Corp being 96% through the use of nominees (Balfour, 2007, February 27), having a local investor invest in a company for a foreigner so as to circumvent foreign investment law, caused serious backlash against Shin Corp. and led to the military coup that forced Thaksin into exile. (Anwar, Doran, & Sam, 2009) Profits for Shin Corp. dropped 60% (Anwar, Doran, & Sam, 2009) and the iTV arm of Shin Corp. was hit with fines of upwards of $2.8 billion in fines resulting in the closing of iTV in 2007 (Mergent Online, 2005; Balfour, 2007, February 27). Furthermore, pressure from the Thai government and citizenry put pressure on Temasek to sell off some of its stake in Shin Corp. particularly the satellite communication portion.

Needless to say, the acquisition of Shin Corp by Temasek was clearly not successful. Concern over SWF transparency, investment type, investment sector, and the political climate in the target market played a large part in the failure of the deal at least in the short term while host recipient government types did not play much of a factor.

One of the contentions that Thai government officials and informed citizens had with Temasek is its governing structure. The structure of the governing board of Temasek left Thais unsure as to whether the firm was controlled directly by the Singapore government or if it was more separated from the government. (Anwar, Doran & Sam, 2009) This brought greater scrutiny to the fact that Shin Corp controlled the satellites used for Thai military communication as well as regular mobile phone service for Thai citizens. Concern over the structure of Temasek's board thus became an issue of national security.

Temasek purchased a controlling stake in Shin Corp of 49%. This in effect gave Temasek the majority vote in decisions made by Shin Corp. To make matters worse, de facto ownership of Shin Corp by Temasek was 96% (Kazmin, 2008, June 18) by several sources through Temasek purchasing controlling stakes of Shin Corp's other share holders. Given this situation, Temasek had near full control of the company despite foreign investment law stating that Temasek could not control such a share. (Anwar, Doran, & Sam, 2009) Although nominally Temasek did not control 96% of Shin Corp, the public and Thai government after the coup perceived it as having such control and circumventing Thai law. (Anwar, Doran, & Sam, 2009)

In addition to the investment type of the Temasek-Shin Corp deal, the sector of investment is extremely important in this case study too. Shin Corp. had long standing contacts in the Thai telecommunications and media sectors. It even leased its satellites for use by the Thai military and was a significant firm in the wireless communication and internet sectors in Thailand. (Anwar, Doran, & Sam, 2009) While Shin Corp did have an airline subsidiary and a consumer finance arm, the market share and contacts of Shin Corp in the satellite and telecommunications sectors gave the firm a level of importance to Thais such that Shin Corp was seen as part of protected sectors. Thus, when Temasek, a foreign government funded holdings company, purchased a majority stake in Shin Corp many Thais were skeptical over the intentions of the purchase.

Lastly, the political climate surrounding the Temasek investment into Shin Corp was not ideal for the investment to work. Prime Minister Thaksin, whose family profited immensely off of the deal, was under investigation for public corruption. The timing of deal also seemed very peculiar. Temasek made the offer to purchase the 49% stake in Shin Corp not long after foreign investment law had been altered to allow such a deal. Furthermore, given that Shin Corp was seen as involved heavily in strategic sectors it is not unrealistic to expect political backlash against the deal, but with the corruption charges Thaksin was associated (Anwar, Doran, & Sam, 2009; Daniel 2007, October) with the backlash against Temasek only increased. Despite stating that the investment was purely financial, the Thai government and citizens made their opinion known by causing Shin Corp to lose 60% of its profits one year after the deal. (Anwar, Doran, & Sam, 2009)

While it may not be entirely known if Temasek had any political motivation for investing in Shin Corp, what is known is that Shin Corp did present an opportunity for Temasek to make a lot of profit. Assuming that profit was the motive behind investment, the timing of the investment and with whom it was done reflected a lack of insight into the Thai business and political environment at the time by Temasek. If Temasek had looked into the ways the investment could be considered given the involvement of Shin Corp in several key sectors of the Thai economy it is possible that Temasek could have made the deal work.

Norwegian Government Pension Fund- Global

The Norwegian Government Pension Fund- Global (NGPF) is considered to be the epitome of how SWFs should act. The fund has clear a purpose that is accessible to the public and has clear policies on investment such that when the fund invests the recipient of the investment is aware of what the fund will act. As a result the fund has had few if any failed investments other than the typical booms and bust related to the market cycle. This case study will focus on why NGPF investments have done well and have avoided major controversy.

First, the government type of Norway factors into the internal governance of the NGPF. Norway according to the CIA World Factbook (CIA, 2010a) is a constitutional monarchy. The constitution has established a parliament that represents Norwegian citizens and keeps the king in check. Furthermore, as with many other Nordic governments, a focus on consensus and paternalistic policy has resulted in policies that push openness in government and policy that reflects the long term interests of the citizens. Thus, since the NGPF is an arm of the Norwegian government it must fall in line with the same ideals. In fact, it is even listed in the annual budget of the country and is subject to changes in public opinion reflected at the polls or in the legislature. (Chesterman, 2008; Qvigstad, 2009, May 13)

As a result of the tradition of openness in Norway, the NGPF is one of the most transparent SWFs in existence. NGPF is only second to New Zealand according to a study by the Peterson Institute (Truman, 2008a), an organization that periodically ranks SWFs based off their transparency in business and reporting practices. The NGPF is held accountable by the legislature of Norway for its investments and for funding, although the funding comes directly from oil sales. According to Jan Qvigstad (2009, May 13), the Deputy Governor of Norges Bank, the NGPF was founded to "support prudent management of Norway's petroleum wealth" and to act as a "long term savings instrument… to cope with future commitments linked to an ageing population." As such the purpose of the fund is clear, but the way in which the fund is organized promotes transparency too.

According to Qvigstad (2009, May 13), the organizational structure of NGPF is tied to all aspects of government. It is owned by the Ministry of Finance which defines the mandate and serves a monitoring function of over the fund including evaluation of the fund's performance. Furthermore, changes in investment guidelines must be presented to the Norwegian parliament before implementation can take place. The fund is managed by the Norwegian central bank, Norges Bank. Norges Bank implements the NGPF investment strategy and acts as an advisor to the Ministry of Finance on investment strategy. Lastly, the fund issues quarterly statements to the public much like that of private firms to report on the performance of the fund. Furthermore, the fund has self imposed rules that create an upper limit of investment in company of 5% helping to dissuade fears of from host country officials. All together these organizational structures interact in such a way that accountability, professionalism, and transparency are created while investment returns are best maximized.

The NGPF is clear in its investment types as well. As of May 2009, the fund only invested abroad on the assumption that doing so would enhance expected returns and diversify risk. According to Qvigstad (2009, May 13), the fund's investment strategy is to maximize financial return with moderate risk. Equities and fixed income instruments make up the portfolio of the NGPF, coming in at 60% and 40%, respectively. In addition to being open about what types of investments the fund makes, the strategy that the fund uses is disclosed.

The NGPF uses a strategy known as active ownership. (Qvigstad, 2009, May 13) While the fund has holdings in nearly 7,900 companies, the fund does not shirk its right to vote. The fund has a goal of participating in all general meetings that the fund has shares in. Qvistag (2009, May 13) states that active ownership is displayed in other ways including dialogue and engagement with companies, collaboration with other investors, submissions to regulatory agencies, and through research and public communication. While much of the literature in the field states that SWFs might be best to forego voting rights, NGPF does the opposite. Illustrative of this fact, is that the NGFP uses its position as a shareholder much like that of a private investor by voting in ways that promote equal treatment and influence. Some of the topics that the fund has focused on the past are children's rights and clean air and water. (Qvigstad, 2009, May 13) In addition to using voting rights to promote active ownership, NGPF uses its investments as a form of voting. For example, when the Norwegian Ethics Council recommended that the fund divest its holdings in the Canadian mining company Barrick Gold based upon findings that one of the company's mines in Papua New Guinea was depositing toxic materials into the local river near the mine, the fund followed the recommendation because the company was not following the standards set by the fund for investment. ("Norway's public pension fund bars Barrick Gold", 2009)

While the NGPF does not discriminate based upon recipient government type for its investment there is a tendency for the fund to invest in the Euro-area and the United States as well as North America. According to the fund's own figure published online the main areas for investment in both equities and fixed income instruments is the Euro Area, the United States, Australia and Japan. (Norges Bank Investment Management, 2009, December 31) The site also reports that the majority of investment by the NGPF is in Europe at 50% for equities and 60% for fixed income instruments. In addition to these figures the site also publishes the quarterly reports and annual reports for the NGPF.

Lastly, the consideration of the political climate in which investments are made must be taken into account. While the fund does act on the basis of financial returns, it is evident that the fund is not to foregoing the beliefs of the Norwegian people. The example of the divestment of Barrick Gold shares by NGPF showed that if the companies that the fund is invested in do not follow the ethical guidelines of NGPF the fund will punish them for such action. That is not to say the fund would use its fund as a political weapon, but more so as a consequence for using behavior that the fund does not condone such as environmental degradation or not honoring human rights (Chesterman, 2008). However, this does raise the question of whether investment by the NGPF is politically motivated. In this regard, it is more accurate to say the investment by NGPF is based more on idealistic standards that reflect the Norwegian people (Tranøy, 2009) rather than political motivation such as securing votes in the United Nations or better treatment of Norwegian business in an area in exchange for investment. Furthermore the political climate behind NGPF investment is mitigated by the fact that the fund must invest based upon published guidelines of investment rather than on reasons made behind closed doors. Given this fact, it is no wonder that the fund has been successful in diversifying its portfolio without controversy.

Chilean Sovereign Wealth Funds: The Economic and Social Stabilization Fund and the Pension Reserve Fund

The analysis of the Chilean SWFs is similar to that of the NGPF in that there is not much controversy over the types of investments the fund is modeled after the NGPF (Kandell, 2007). Thus, the form of this analysis is structured much the same as NGPF.

Chile is a South American nation that has large deposits of copper. Much of the Chilean economy is based off of the sale of copper and at times the Chilean economy has been subject to market swings based on the price of copper in the international market. Thus, Chilean officials have sought to avoid the “Dutch disease,” the faltering of an economy due to reliance on one source of income usually a natural resource, (Financial Times Ltd., 2009) by creating two SWFs (Davis, 2007, May 14). According to Kandell, the Economic and Social Stabilization Fund (ESSF) was created in 2006, taking over what was known as the Copper Stabilization Fund valued at $2.56 billion while in 2007, the Pension Reserve Fund was created. Both of the funds are financed by the sale of Chilean copper and are valued at approximately $21.8 billion combined. (Sovereign Wealth Institute, 2008)

Modeled broadly after the NGPF, the funds have clear goals. The PRF’s objective is to “serve as a complementary source of funding for future pension contingencies.” (Chilean Financial Committee, 2008) The ESSF on the other hand is meant to “to finance possible future fiscal deficits and to pay down public debt” helping “to isolate fiscal spending from the volatility of government revenues.” (“Chile Annual Report” 2008) Thus the funds are meant to aid the Chilean federal government in dealing with issues that arise with an ageing population and to keep macroeconomic stability through the diversification of revenue flows.

Transparency of the funds is kept through careful watch by the Chilean republic’s legislature through the Financial Committee. The Committee was created under the Fiscal Responsibility Law and is given the task of advising the Finance Minister on matters of the funds' investment, and serving as a communicator between the Ministry of Finance and the funds. Furthermore, the Financial Committee publishes its meetings online for the public to see and is involved in the publication of quarterly reports on the funds made by the Ministry of Finance.

The funds' investment type is long term with emphasis on stable instruments. According to Kandell, both the ESSF and the PRF currently invest in only fixed income instruments such as US Treasury Bonds, but that the funds are planning on diversifying into stocks and other fixed income instruments. (Kandell 2007) Needless to say, this is conservative strategy of investment focusing primarily on mid to low risk investments that have a stable returns. As of March 2007 in an Annual Report published by the Chilean Ministry of Finance, the funds' investment policy resulted in 30% of the portfolios invested in money market instruments, 66.5% in nominal sovereign bonds and 3.5% in inflation-indexed sovereign bonds. According to Kandell (2006), limits on currency exposure resulted in allocations of the fund in the following currencies: 50% in US dollars, 40% in Euros and 10% in yen. This distribution could change due to a Chilean government statement in April of 2008 that investments will not be made in troubled US assets. (Ogier and Conger 2008)

While the funds are still relatively new, the Chilean government has large plans for the future. In recent meetings of the Financial Committee, discussion of hiring foreign managers to manage the funds is in the works. The Chilean Finance Minister Andres Velasco stated that "the funds are not to be invested in any assets not publicly traded" and "that it is not the intention of Chile to purchase and be involved in the management of companies". (Ogier & Conger, 2008) Such a statement makes clear that the investment strategy of the funds is financial return.

Discussion

The policy of SWFs and policy towards SWFs is in its early stages of development, but several lessons can be gleaned from the case studies of Dubai Ports World, Temasek, NGPF, and the Chilean SWFs. The first of which is how SWFs are going to be viewed by foreign governments. It is clear that SWFs are not perceived to be typical private investors. They are tied to the governments through their funding sources and sometimes, as is the case with Norway and Chile, through law. However, having this association with the government brings both positives and negatives. For one, having funds to invest is less of an issue, and disclosure of investment practices can be opaque or as transparent as the parent government wishes. This aspect is both a positive and a negative point in that less disclosure keeps investment strategy closed as if it were trade secrets, but it also makes foreign governments and citizens that are the recipients of SWF investment suspicious of the motives behind investment. For example the case of Temasek purchasing a controlling stake in Shin Corp. caused uproar in part because of the fact that Temasek is directly tied to the government of Singapore. Similarly, Dubai Ports World had to divest its P&O holdings in North America because of political controversy over the perceived relation of UAE to the September 11th attacks. The fact that both SWFs were perceived as arm's of their respective governments surely made a difference, especially given that the transparency ranking of Temasek and Dubai Ports World are so vastly different with Temasek at 10 for transparency and Dubai Ports World being ranked as a 4, with higher rankings denoting greater transparency. (Sovereign Wealth Institute, 2010)

One way in which this problem of perception has been alleviated is to be very transparent or at the very least extremely clear in what an SWF will invest in. The NGPF clearly states that its investments are reflective of the values of the Norwegian people and are under the scrutiny of the Norwegian Ethics Council. The NGPF divested its holdings in Barrick Gold based upon the opinion of the Ethics Council. Was this a shock to Barrick Gold? Perhaps, but Barrick Gold could not say that the NGPF did not disclose their basis for investment. Furthermore, NGPF clearly states that it will not purchase stakes in companies larger than 5% percent. This, as Qvigstad (2009, May 13) states, keeps the power of what essentially becomes the Norwegian vote in the management of a company fairly limited and thus there is nothing to fear in terms of political investment. By doing this NGPF tells the companies that it invests in that NGPF will be an active investor but that it is not in the business of taking over companies. In the case of DPW, DPW had the same general motive, but had a poor job performance persuading policy makers that it meant no harm although a major difference between the investments of DPW and NGPF is that DPW will purchase companies outright as was the case with P&O. Despite this difference, it is possible that had DPW better informed the American public of its investment strategy with the North American assets of P&O, DPW could have kept its holdings in North America.

The contrast between the cases of NGPF investment and that of DPW in P&O brings another lesson to be learned by both governments and SWFs alike: Monitoring of the political climate in an investment area is integral to the success of a deal. In the case of NGPF, investments are made based off of ethical standards that are clearly published so that investees are aware that investments of NGPF reflect the ideological and political climate of Norway. In this way investments are unlikely to be made by the NGPF in industries or countries that would cause political backlash in Norway or in the recipient country. In the case of DPW with P&O the situation was not monitored such that whole acquisition of P&O would be successful. UAE, the federal government to which Dubai is a part, was found to be connected to the September 11th attacks on the Pentagon and World Trade Center because several of the men involved hailed from UAE. With the DPW deal being only five years after the events of September 11th, adversarial sentiment towards the UAE, and Middle Easterners in general, was still in the minds of many Americans. This underlying sentiment is what caused the deal to fall through since policy makers in Congress were willing to use it to bring questions up on the deal despite the deal receiving a clean slate from CFIUS, the regulatory body that reviews foreign investment in the United States, and initial approval by President George Bush and the US Coast Guard. The fact that the deal was only reviewed due to a voluntary request by DPW to CFIUS should have been goodwill to the American people, but popular sentiment overshadowed this fact due to possible leaks of information to Al-Qaeda in UAE. (Cohen, D., 2008) Thus, because the political environment in the United States was still under the effect of September 11th , the deal failed and had DPW taken this into better consideration it is possible that it could have foregone the public relations frenzy incurred because of it while still purchasing P&O.

Additionally the case studies as well as the literature reveal that delineation between what are acceptable sectors for investment is integral to ensuring that investments by SWFs are successful for both the SWF and the recipient country. In the cases of DPW and Temasek, argument against the deals used appeals to national security either economic or defensive related. Law in the United States and in Thailand did not bar foreign investment in the areas of telecommunications or ports management making the legitimacy of such deals appear stronger in theory than in practice. Furthermore, in the case of DPW, the situation was further convoluted by the fact that the P&O which DPW purchased is a British company making the shift of ownership to different foreign hands seem not that controversial, although in reality it was controversial because of the UAE's connection to the September 11th attacks. In regards to Temasek, the Thai government did not delineate that telecommunications is a critical or sensitive sector therein giving Temasek no reason to not purchase a controlling stake of Shin Corp. While in both cases inferences regarding sensitivity of the deals could have been made, the fact that there was no explicit rule or official statement regarding the sectors that DPW and Temasek invested in made the deals legally less risky. Thus the combination of poor delineation of sensitive sectors from non-sensitive and poor insight on the part of both the recipient government and the SWF therefore created a greater likelihood for the investment to fail by masking the risk of the investments.

Minimizing risk is important in any type of investment especially those that are long term as is the case with most SWFs. As according to the case studies and the literature, SWFs investment with the goal of creating wealth to be used by future generations and not to make short term gains. Unfortunately, the main perception toward SWFs is suspicious of the motivation behind investment. Thus, it is no wonder that the deals that have floundered have been with SWFs that are not clear in their motive of investment. This is not to say that investment by SWFs needs to be transparent in all forms, but at least transparent in purpose. Norway and Chile have succeeded in this regard by clearly stating clear reasons behind their investments while Temasek and DPW use vague language to describe their investment strategy so that it encompasses any type of investment behavior. The latter example creates suspicion towards SWF investment by not giving the investee any information that would minimize perceptions of non-financial return motivated investment.

Conclusion

Understanding SWFS as institutional investors is very important since their influence is not diminishing in importance. Through the literature on sovereign wealth funds and the case studies presented several points are clear. SWFs as a whole act much like private investors because it is in the better interest of the SWF to act in a manner predicated on financial return than to use other strategies. History has shown this to be true, but the common perception of SWFs is that they may use resources that private investors do not have access to such as military might or intelligence services to gain an upper hand in markets over private firms. It is clear that to dispel this negative view of SWFs that common perception must be changed. Work towards this goal must be made by both governments and SWFs, but with the emphasis on SWFs.

The case studies have shown that being clear in one's investment practices and motives garner better support for SWF investment. The most successful model thus far is arguably the NGPF, but that is not to say that an SWF that is not as transparent could not be as successful; however, it is likely that using some of the strategies of the NGPF will result in better investments in that the NGPF and the recipient of investment are in agreement on how investment will be made and on what terms. In this regard, SWFs must accept that they will never be viewed in the same light as private investors despite their past behavior simply because of their link to government. Only through accepting this and taking action that reduces scrutiny of SWFs such as limiting investment stakes to a predetermined level or disclosing performance records, or closely following guidelines such as the Santiago Principles will SWFs become known as prudent long term investors by the financial and political communities as a whole.

Secondly, governments must be clear regarding what areas are open for investment by foreigners. Policy that grays the boundaries between critical and non critical sectors of the economy only propagates investments with higher risk. Thus, governments should clearly delineate what sectors are open to foreign investment or at least place caps on foreign investment in sectors that could be deemed critical such as telecommunications or port management.

Thirdly, changing regulation to match the current environment is important, but it must promote an open environment for investment. US legislation changed in response to DPW's investment in 2006 giving CFIUS more authority as well as more responsibility to review foreign investment, but this change has increased costs to investing in the US by increasing the time required to invest which becomes costly if the review must done several times. It is the opinion of the writer that taxing of income made by SWFs investment is satisfactory in that it would give SWFs treatment similar to that of private foreign companies, and it could be instituted instead of increasing review processes or setting investment quotas.

In all, SWFs are here to stay and the wealth associated with SWFs is only going to grow. With this growth will come greater influence in the market, but if this rise is anticipated by both government and SWFs the transition can be smoother than if the status quo were to stay the norm. Thus, to create better understanding between SWFs and the communities in which they invest, disclosure of investment motive and ideals, delineation of critical sectors of the economy from non critical sectors by governments, and maintenance of an open environment for investment must be made so as to allow for SWF investment but without the controversy associated with it today. If steps like these are taken, the perception towards SWFs will change from being suspicious to one that regards SWFs more like private investors.

Appendix A: Santiago Principles

Below are the Sovereign Wealth Fund Generally Accepted Principles and Practices "Santiago Principles" as published by the International Forum of Sovereign Wealth Funds, formerly known as the International Working Group for Sovereign Wealth Funds. For an electronic copy of the principles please visit http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf .

GAPP 1. Principle
The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

GAPP 1.1. Subprinciple.
The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.

GAPP 1.2. Subprinciple.
The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.

GAPP 2. Principle
The policy purpose of the SWF should be clearly defined and publicly disclosed.

GAPP 3. Principle
Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle
There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.

GAPP 4.1. Subprinciple.
The source of SWF funding should be publicly disclosed.

GAPP 4.2. Subprinciple.
The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

GAPP 5. Principle
The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

GAPP 6. Principle
The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

GAPP 7. Principle
The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

GAPP 8. Principle
The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

GAPP 9. Principle
The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

GAPP 10. Principle
The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

GAPP 11. Principle
An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

GAPP 12. Principle
The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

GAPP 13. Principle
Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

GAPP 14. Principle
Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

GAPP 15. Principle
SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

GAPP 16. Principle
The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

GAPP 17. Principle
Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAPP 18. Principle
The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

GAPP 18.1. Subprinciple.
The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.

GAPP 18.2. Subprinciple.
The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

GAPP 18.3. Subprinciple.
A description of the investment policy of the SWF should be publicly disclosed.

GAPP 19. Principle
The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

GAPP 19.1. Subprinciple.
If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

GAPP 19.2. Subprinciple.
The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

GAPP 20. Principle
The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAPP 21. Principle
SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

GAPP 22. Principle
The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

GAPP 22.1. Subprinciple.
The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.

GAPP 22.2. Subprinciple.
The general approach to the SWF's risk management framework should be publicly disclosed.

GAPP 23. Principle
The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

GAPP 24. Principle
A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

Appendix B: OECD State Owned Enterprise Guidelines

Below are the guidelines posited in the OECD Guidelines on Corporate Governance of State-owned Enterprises pages 12 through 17 as published by the OECD. The full document can be found at http://www.oecd.org/dataoecd/46/51/34803211.pdf .

I. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises

The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.

A. There should be a clear separation between the state's ownership functionand other state functions that may influence the conditions for state owned enterprises, particularly with regard to market regulation.

B. Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.

C. Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.

D. SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.

E. The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.

F. SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.

II. The State Acting as an Owner

The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.

A. The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy.

B. The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.

C. The state should let SOE boards exercise their responsibilities and respect their independence.

D. The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a co-ordinating entity or, more appropriately, by the centralisation of the ownership function.

E. The co-ordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

F. The state as an active owner should exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include:

1. Being represented at the general shareholders meetings and voting the state shares.

2. Establishing well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs' boards.

3. Setting up reporting systems allowing regular monitoring and assessment of SOE performance.

4. When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.

5. Ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals.

III. Equitable Treatment of Shareholders

The state and state-owned enterprises should recognise the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.

A. The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.

B. SOEs should observe a high degree of transparency towards all shareholders.

C. SOEs should develop an active policy of communication and consultation with all shareholders.

D. The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.

IV. Relations with Stakeholders

The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.

A. Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.

B. Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

C. The board of SOEs should be required to develop, implement and communicate compliance programmes for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.

V. Transparency and Disclosure

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

A. The co-ordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.

B. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.

C. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.

D. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.

E. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public.

Examples of such information include:

1. A clear statement to the public of the company objectives and their fulfilment.
2. The ownership and voting structure of the company.
3. Any material risk factors and measures taken to manage such risks.
4. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE.
5. Any material transactions with related entities.

VI. The Responsibilities of the Boards of State-Owned Enterprises

The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.

B. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.

C. The boards of SOEs should be composed so that they can exercise objective and independent judgement. Good practice calls for the Chair to be separate from the CEO.

D. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

E. When necessary, SOE boards should set up specialised committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.

F. SOE boards should carry out an annual evaluation to appraise their performance.

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