What Do We Know about State-controlled Entities and especially SWFs

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What do we know about State-Controlled Entities and Especially SWFs?

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A Presentation Snapshot

➢ Factual Overview re Sovereign Wealth Funds (SWFs) and State-Owned Enterprises (SOEs)

➢ Concerns relating to sovereign FDI (SFDI)

➢ Conclusions
Definitions: What is a SWF?

Despite the plethora of definitions, the IMF and OECD agree on the following definition:

SWFs are government controlled investment vehicles that have a broad, long-term focused investment mandate and are financed with currency reserves accumulated through foreign trade in commodities or products. These foreign reserves are managed separately from the official reserves of the monetary authorities. These funds can also be financed through budget surpluses resulting from foreign income.

Two Main Types of SWFs

1. Those that derive their revenues from commodities, such as oil, gas and mineral resources
   - 2/3 of SWFs are oil-related

2. Those that derive their revenues principally from trade surpluses
SWFs are Big ...

- A number of estimates exist re the aggregate value of SWFs, ranging from $1.9 trillion to $3.5 trillion.
- Eight SWFs have at least $100 billion in assets as of 2008.
- By 2015, the total assets of SWFs are predicted to range anywhere between $5.8 trillion and $15 trillion.

... The Largest SWFs Having more than $100bn assets ...

<table>
<thead>
<tr>
<th>Country</th>
<th>Fund</th>
<th>Assets, $bn</th>
<th>Date Established</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAE</td>
<td>Abu Dhabi Investment Authority and Council</td>
<td>500-875</td>
<td>1976</td>
</tr>
<tr>
<td>Norway</td>
<td>Government Pension Fund - Global</td>
<td>375</td>
<td>1960</td>
</tr>
<tr>
<td>Singapore</td>
<td>Government of Singapore Investment Corporation</td>
<td>200-300</td>
<td>1951</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Saudi Arabian Monetary Agency</td>
<td>270</td>
<td>1952</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Kuwait Investment Authority</td>
<td>213</td>
<td>1953</td>
</tr>
<tr>
<td>China</td>
<td>China Investment Corporation</td>
<td>200</td>
<td>2007</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Exchange Fund Investment Portfolio</td>
<td>150</td>
<td>1993</td>
</tr>
<tr>
<td>Russia</td>
<td>Reserve Fund</td>
<td>128</td>
<td>2006</td>
</tr>
<tr>
<td>UAE</td>
<td>Investment Corporation of Dubai</td>
<td>82</td>
<td>2006</td>
</tr>
</tbody>
</table>

Source: Based on Edwin M. Truman data, May 21, 2008 (footnotes omitted)
... but they are not as big as other pools of anonymous capital

<table>
<thead>
<tr>
<th>Investment Vehicle</th>
<th>Assets, $tn</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>SWFs</td>
<td>2.9</td>
<td>4.38</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>2.25</td>
<td>3.17</td>
</tr>
<tr>
<td>Private Equity Funds*</td>
<td>0.7</td>
<td>0.99</td>
</tr>
<tr>
<td>Mutual Funds**</td>
<td>21.8</td>
<td>30.98</td>
</tr>
<tr>
<td>Pension Funds**</td>
<td>26</td>
<td>36.59</td>
</tr>
<tr>
<td>Insurance**</td>
<td>17.4</td>
<td>24.49</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>71.08</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

* As of 2007
** As of the end of 2006

Source: Edwin M. Truman and International Financial Services London

State-Owned Enterprises

- **SOEs are:**
  - "Companies over which the state has significant control, through full, majority, or significant minority ownership" (Robert M. Kimmit).
  - Many different types of SOEs exist in developed countries and emerging markets, ranging from enterprises in which public authorities at various levels have blocking rights for certain decisions to full and direct management control. Their exact role is not always clear. VW? Lenovo?

- **Purpose of SOEs:**
  - To supplement the private sector, possibly especially where the state is best positioned to provide a particular good or service.
SOEs (Cont’d)

➤ 6 of the 10 largest companies in the world are SOEs

<table>
<thead>
<tr>
<th>Country</th>
<th>Company</th>
<th>Assets, $bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>Saudi Aramco</td>
<td>781</td>
</tr>
<tr>
<td>Mexico</td>
<td>Petróleos Mexicanos</td>
<td>415</td>
</tr>
<tr>
<td>Venuzuela</td>
<td>Petróleos de Venezuela S.A.</td>
<td>388</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Kuwait Petroleum Corp.</td>
<td>376</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Petrolan Nacional Berhad</td>
<td>232</td>
</tr>
<tr>
<td>Algeria</td>
<td>Sonatrach</td>
<td>224</td>
</tr>
</tbody>
</table>

Source: McKinsey & Company

Sovereign FDI

➤ The large-scale assets of SWFs and SOEs are misleading in terms of SFDI.

➤ FDI Definition: “The investments made by a resident entity in one economy (direct investor) with the objective of obtaining a lasting interest in an entity resident in an economy other than that of the investor (direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated” (IMF).
SFDI by SWFs: No Systematic Data Exist

- One estimate is that SWFs have 25% of their assets abroad (Truman 2008).
- Assuming that SWFs invest 25% of their assets abroad, they might have $725 billion invested beyond their home country borders in 2008. This data, however, appears inaccurate re FDI because most of this capital is portfolio investment.
- The World Investment Report (2008) indeed estimated that, in 2007, SWFs’ FDI was only $10 billion, which approximately accounts for 0.2% of their aggregate assets and 0.6% of total FDI flows in that year. In contrast, private equity funds’ FDI was $460 billion in that year.

**Conclusion:** We have no systematic data re SFDI, only examples. The SFDI amount is far less than the total assets invested abroad by SWFs. One thing is clear: SFDI by SWFs is quite small, including relative to that of other asset classes.

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**Key SFDI Investments**

<table>
<thead>
<tr>
<th>Year</th>
<th>Country</th>
<th>Region</th>
<th>Sector</th>
<th>Activity</th>
<th>Value (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>$2,100</td>
<td>Asia</td>
<td>Manufacturing</td>
<td>New investment</td>
<td>$1 billion</td>
</tr>
<tr>
<td>2009</td>
<td>$1,500</td>
<td>Europe</td>
<td>Energy</td>
<td>Expansion</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>2010</td>
<td>$1,000</td>
<td>Middle East</td>
<td>Construction</td>
<td>Joint venture</td>
<td>$1 billion</td>
</tr>
<tr>
<td>2011</td>
<td>$750</td>
<td>Latin America</td>
<td>Consumer Goods</td>
<td>Acquisition</td>
<td>$750 million</td>
</tr>
<tr>
<td>2012</td>
<td>$600</td>
<td>Africa</td>
<td>Technology</td>
<td>Joint venture</td>
<td>$600 million</td>
</tr>
</tbody>
</table>

**Source:** UNCTAD, World Investment Report (2008)
SFDI by SOEs: No Systematic Data Exist

➢ During 2003-2005, about 80-85% of Chinese OFDI flows and stock were accounted for by SOEs (Cheng and Ma). Virtually all of the top 30 Chinese MNEs are SOEs.
➢ A number of emerging market SOEs are important outward investors.
   • Ex. Petronas (Malaysia), Gazprom (Russia), Petrobras (Brazil) and Indian Oil Company (IOC)
➢ SOEs from developed countries are also significant direct investors.
   • Ex. EDF (France), Deutsche Post and VW (Germany)
➢ While we do not have systematic data, it appears that FDI by SOEs is only a small share of total FDI, although it can be high for individual emerging markets.

Commonly Voiced Concerns re SFDI

Sovereign investors:
1. Use their investment as a policy and/or economic tool of their home country governments;
2. Should not be able to invest in a country’s strategic industries or “national champions”;
3. Are not transparent;
4. Use their state-status to benefit from advantages unavailable to the private sector.

Overarching question: are these concerns vis-à-vis SFDI in general or vis-à-vis SFDI from emerging markets only, and to what extent do they also apply to FDI by private firms?
1. Policy Tool

- “Public sector owners might have other objectives, including national political interests, such as accessing military technology, controlling strategic resources or markets, and influencing public opinion.” (Sir John Gieve 2008)
- Presumably Sir John’s point refers to outward FDI from developed countries and emerging markets in that state-controlled entities, can indeed have broader objectives, but it may also apply to privately-owned entities.
- However, there is a lack of evidence, one way or another, that this routinely takes place by investors from emerging markets and developed countries.
- It is important that host countries have appropriate regulatory frameworks in place and have the legal and institutional frameworks to ensure that international investors (public and private) respect their laws and regulations.

2. SFDI in “Strategic Sectors” and National Champions

- Obvious question: What constitutes a country’s "strategic sector" or "essential security interests", and who judges what?
- Different countries have tailored approaches in this respect.
  - Ex. China → more of a national economic security approach
  - Ex. U.S. → more of a military and security approach
- Ex. of strategic sectors in different countries: critical infrastructure, aviation, airports, atomic energy, defense, oil and gas, telecom (in most Western countries), “famous trademarks or China time-honored brands” (China), lottery business, and retail trading (except single brand retail) (India), and cryptography (Russia).
- Question of national champions? Ex. Inco Ltd. (CA), Arcelor (LX)

**Crucial:** National security should not become a protectionist tool vis-à-vis SFDI from emerging markets and developed countries. Need for an international approach?
3. Transparency

- Lack of information re sovereign investors' portfolio
  - Ex. Investment portfolio, strategic asset allocations, investment objectives, corporate governance structures, asset capitalizations, share of assets used/reserved for FDI, and who manages them
- Truman's transparency index
- Applies also, to a certain extent, to hedge funds, private equity funds, and mutual funds.
- Important, but is it sufficient? For example, Milhaupt and Gilson argue that:

Transparency (Cont'd)

- "... An SWF's investment motives are not transparent regardless of an SWF's formal disclosure – its public statements, reports or filings. Suppose that pursuant to a new regulatory requirement of an NGO-promulgated code of best practices, an SWF states that it operates independently of its government owner. Why would anyone believe this statement? Even if true in the past, it will be true in the future only of the government so chooses ... Transparency ... - the ubiquitous current policy response to concerns about SWFs – does not address the real problem. Additional disclosure simply cannot distinguish between strategic and non-strategic investors.

- Raises the broader question of the role of large pools of anonymous capital in the world economy.
4. Unfair Advantage?

- It is often argued that sovereign investors can unduly benefit from their public status relative to private investors, e.g. through preferential financing.
- Thus, one OECD study notes that large Chinese SOEs “have inherent advantages in undertaking large foreign investments since they enjoy formal as well as informal support from the government in the area of finance, networking, information access, and administrative procedures.”
- This is probably correct; just as it is for private MNEs from many countries.

Conclusion

1. We know that there is a lot that we don’t know. More research needed.
2. Insufficient systematic evidence to validate the mentioned concerns, one way or another.
3. A case can be made to allow governments to protect their national interests; but this needs to be balanced against the need for predictability for foreign investors and, more broadly, the rule of international investment law.
4. Tricky to discriminate against SFDI on the basis of insufficient evidence concerning a relatively small part of FDI and a flexible definition of what constitutes essential security interests, especially also since a number of concerns also apply to private investors.
5. There is also the broader objective of integrating emerging markets and their firms into the international economy and especially the world FDI market.
Thank you!