Sovereign Wealth Funds and Social Arrears: Should Debts to Citizens be Treated Differently than Debts to Other Creditors?

Patrick J. Keenan
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The recent emergence of sovereign wealth funds as active and important players in international financial markets has raised a host of questions about their likely effect on markets and states. Sovereign wealth funds are investment vehicles through which governments invest foreign currency reserves or the windfall earnings from profitable commodities. In recent years, these funds have become important sources of capital in the financial markets, and appear likely to become even more powerful if the liquidity crisis sparked by problems in the mortgage industry continues or spreads. The debate about sovereign investments has largely focused on what might be called the Trojan horse problem: the possibility that states will use sovereign wealth funds—which are nominally private—to make investments that advance their strategic interests against other states rather than maximize wealth. Left out of the discussion is concern for the potential domestic effects of such funds. One common assumption regarding sovereign wealth funds is that greater government wealth will translate into economic development and improvements in social welfare for the citizens of the state. But for people who live in many of the states currently profiting from high commodity prices, a sudden and unregulated influx of cash can lead to a host of harms that have now been well

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1 One study of the total size of sovereign wealth estimates that the 54 largest sovereign wealth funds control approximately $5.3 trillion in assets. See Edwin M. Truman, Peterson Institute for International Economics, A Blueprint for Sovereign Wealth Fund Best Practices 1, Policy Brief no. PB08-3, Apr. 2008 (hereinafter TRUMAN, BLUEPRINT FOR SOVEREIGN WEALTH FUNDS). In response to recent financial crises in the U.S. and Europe, these funds have become more active. See, e.g., The Invasion of the Sovereign-Wealth Funds, ECONOMIST, Jan. 17, 2008 (reporting that sovereign wealth funds had invested a total of $69 billion in investment banks in the months after the subprime mortgage crisis began in 2007).

2 For example, in 2007 Temasek, one of Singapore’s sovereign wealth funds, took a $5 billion stake in Merrill Lynch. See Eric Dash, Merrill Lynch Sells Stake to Singapore Firm, N.Y. TIMES, Dec. 25, 2007. Merrill needed the infusion of capital to help it deal with the subprime mortgage crisis. Id. And Merrill was not alone in receiving an infusion of capital from a sovereign wealth fund. In November 2007, Citigroup raised $7.5 billion from the Abu Dhabi Investment Authority. David Wighton, Abu Dhabi’s Big Place in the Citi, FIN. TIMES, Jan. 24, 2008, at 2. UBS received $9 billion from the Government of Singapore Investment Corporation. Id.

3 See, e.g., Peter Navarro, Op-Ed., Sovereign Wealth Funds: China’s Potent Economic Weapon, CHRISTIAN SC. MONITOR, Feb. 8, 2008 (arguing that SWFs have the potential to be a “Trojan horse for mercantilism and realpolitik”).

4 Much of this worry is hypothetical, but carries a great deal of weight nonetheless. See, e.g., Asset-Backed Insecurity, ECONOMIST, Jan. 17, 2008 (suggesting the following hypothetical scenario: “suppose that Venezuela bought Alcoa and set about closing its aluminium smelters in the United States in order to move production to Latin America”).
documented by political scientists and human rights scholars. There is a real risk that abusive or despotic regimes will use sovereign wealth funds as a tool to retain power rather than as a means to fund economic development and improve social welfare. Although the debate surrounding sovereign wealth funds has not yet done so, it should raise important questions for scholars of human rights and development. In addition, a separate but important factor in favor of my approach has to do with the current incoherence that characterizes the development and investment policies of many wealthy states. As I show below, they provide substantial development assistance to improve the social welfare of people in poor countries while welcoming investments that are likely to have the effect of reducing social welfare in those very same countries.

I. INTRODUCTION

Sovereign wealth funds create a regulatory and theoretical challenge because they serve two masters with very different agendas. On the one hand, when SWFs participate in the financial markets, they are expected to behave as private actors, motivated only by profits. Among scholars and policy makers, the most prominent concern about sovereign wealth funds is that they could operate in the market as tools of state policy. For example, if a SWF took a controlling stake in a corporation in a vital industry, the managers of the SWF could use that stake to advance the strategic interests of the government that controlled it, rather than seeking profits without a strategic objective. In conventional accounts, the response to this concern is that SWFs should be treated as a benign force so long as they act like ordinary market participants—maximizing profits, rather than the strategic power of the controlling government. It remains to be seen whether there is legitimacy to the claim that SWFs will be used to advance state policy in an inappropriate way, though the limited evidence available so far suggests that most SWFs are profit-maximizing.

5 See, e.g., Roland Beck & Michael Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, EUROPEAN CENTRAL BANK OCCASIONAL PAPER no. 91, July 2008, at 5 (arguing that "[o]ver the longer run, any impact of SWFs … will depend critically on the motives underlying the investment decisions of such funds. While fully return and risk-motivated investments may affect financial stability rather positively … non-commercial motives might have a negative impact on financial stability").

6 This kind of concern undermined an attempt by China’s national oil company to purchase the American oil company Unocal. See Stephanie Kirchgessner, “Congressional Angst” Scuppers Chinese Bid, FIN. TIMES. Aug. 3, 2005, at 22 (reporting that members of Congress feared that CNOOC’s investment would amount to giving control of Unocal to the Chinese government).

7 See, e.g., WILLIAM MIRACKY, ET AL., ASSESSING THE RISKS: THE BEHAVIORS OF SOVEREIGN
On the other hand, to citizens in the state that created the SWF they are purely an instrument of public policy whose chief justification is to improve social welfare in the state. To citizens, a well-run SWF should become a reliable source of income that drives economic and social development. Many of the states benefiting from high oil prices, for example, are states in the developing world. These states have received substantial oil revenues in the last five years, and especially in the last two years. They now face an unusual problem, at least for them: what should they do with all the cash? Many of these states have embraced SWFs as a means to transform short-term wealth from the commodities boom into long-term development. Under the right circumstances this is an entirely sensible strategy. It can allow the state to diversify its portfolio by creating multiple income streams from a single income stream and make the economy less vulnerable to swings in commodity prices. This explains why one argument commonly made in favor of SWFs is that they are a better means to improve a state’s social welfare than the available alternatives.

But in many other states, increasing the amount and concentration of resources controlled by the government is not likely to improve or even sustain current levels of social welfare. It is likely to reduce it. Part of the reason for this is that rulers in states that receive windfalls from resources or other sources often attempt to consolidate their control over access to those resources. The widespread emergence of sovereign wealth funds creates a risk that such rulers will further insulate themselves from political
accountability by allowing them to move even more of the state’s resources outside the typical channels of domestic political control. This potential negative externality associated with sovereign wealth funds runs directly counter to the typical objection to such funds.

What is missing from the current debate about sovereign wealth funds is a theory that makes sense of their dual public/private missions in a way that fully accounts for their domestic effects. Without such a theory there is no coherent account of how and why to regulate SWFs. For example, regulations that create incentives for SWFs to behave as private players may well make them less accountable to the citizens of the home country. Regulations that encourage SWFs to be accountable to citizens risk encouraging strategic behavior that might disrupt financial markets (and reduce returns).

To illustrate the problem, I highlight a seeming anomaly—that some states with large sovereign wealth funds are also the recipients of development assistance from other states. For example, in 2006, Algeria received just over $204 million in development assistance from foreign governments. At the same time, the government of Algeria controlled a sovereign wealth fund worth $47 billion. Consider Libya: it received $37 million in development assistance while controlling a SWF worth $50 billion. Nigeria received $11 billion in development assistance and controlled a SWF worth $11 billion.

13 See, e.g., Aaron Tornell & Phillip R. Lane, The Voracity Effect, 89 AM. ECON. REV. 22, 42 (1999) (arguing that in where political and legal institutions are weak, competition for resource rents can produce “a more-than-proportional increase in redistribution” of wealth from resource rents).
14 For a limited exception, see Anders Aslund, The Truth About Sovereign Wealth Funds, FOREIGN POL’Y, Dec. 2007 (arguing that SWFs are often an inappropriate policy tool because they centralize economic decision making in the government rather than permitting citizens to make their own investment decisions).
15 Anna Gelpern has proposed a taxonomy of issues relevant to the regulation of sovereign wealth funds, including what she calls “[p]ublic internal accountability,” which she describes as the available domestic mechanisms to ensure that SWFs “further [a] domestic public purpose.” Anna Gelpern, After MAI, Beyond CFIUS: Sovereign Wealth and Global Governance, available at http://ssrn.com/_____.
17 The statistics regarding the size of sovereign wealth funds are drawn from a comprehensive report done by Edwin M. Truman, who drew on available from the International Monetary Fund, state disclosures, and other public sources. See TRUMAN, BLUEPRINT FOR SOVEREIGN WEALTH FUNDS, supra note 1, at 2.
19 See OECD.stat, at http://stats.oecd.org/wbos/index.aspx?usercontext=sourceoecd and TRUMAN,
The aid recipient/capital exporter anomaly shows the complicated nature of sovereign wealth funds and the need for more scholarly attention to their dual roles as instruments of public policy and participants in private markets. First, consider the perspective of citizens of the recipient state. To them, such aid is both an indication that social problems exist, and that their government is unable to meet those needs on its own. States traditionally accept development assistance reluctantly, and only to meet real needs. For many poor states, particularly those with a history as a colony, the acceptance of development aid comes at a cost that is difficult to measure, but is often discussed in terms of eroded sovereignty or an a reduction in national pride. That the state accepts development assistance is evidence that those in power recognize that there are unmet social needs.

Next consider the perspective of aid donors. For donors, a state’s acceptance of development aid is an indication that the recipient cannot, on its own, afford to meet the needs of its citizens. When the recipient of this largesse is also the steward of a multi-billion dollar investment fund, donors may well ask whether their dollars would be better spent elsewhere. One way to interpret a state’s decision to create a sovereign investment vehicle despite being the recipient of development aid is that the state’s own government thinks that its development is a bad bet. If the government of Angola has decided that it is a better long-term investment to buy shares in foreign corporations than to build roads or provide basic education or improve health care for the people of Angola, then why should foreign donors conclude that development aid is a good investment?

To this point, the debate regarding regulation of SWFs has involved mostly scholars focused on tax issues, corporate law, and national security. But there is much that scholars of human rights and economic development can contribute to account for the impact of SWFs on recalcitrant regimes and vulnerable populations, which requires a focus on the domestic effects of sovereign wealth funds on developing countries.

To fill this gap in the literature, I develop a theory of social arrears, which could be used to define what a state owes its citizens, and to determine whether a SWF is being used to pay this debt. I argue that to reconcile the dual public/private missions of sovereign wealth funds, a
government’s unmet obligations to its citizens should be treated like unpaid debts to other creditors, which typically would constrain the government’s investment options until the creditors are satisfied. By “social arrears” I mean the unmet social development needs that a state apparently has the resources to address, but has chosen not to. To help define social arrears and demonstrate the usefulness of the concept, I draw an analogy from the International Monetary Fund’s policy regarding lending into arrears. This policy regulates the IMF’s engagement with states that wish to borrow money from the IMF but are behind in their payments to other lenders. The IMF takes a policy position that its aid should go to development projects, not to servicing other debts. This policy does not amount to an outright ban on any engagement with states which are behind in their payments to other lenders. But it certainly creates an incentive for states to resolve their debt problems with other lenders if they want to receive assistance from the IMF.

With a theory of social arrears in place, I explore how the theory could inform public policy. I argue that before states with substantial social arrears are permitted to use international financial markets, those states should be required to pay their debts to their own citizens. If they do not do so, then those regimes should not be permitted to invest state money in the financial markets in London or New York while other states provide development or humanitarian assistance necessary to meet the social needs of citizens.

This theoretical approach, and the specific policy measures I propose to implement it, is consistent with current policies and regulations relating to financial markets. Despite rhetoric about the openness of financial markets and the increased mobility of capital, the U.S. and the E.U. both treat access to financial markets as conditional, not obligatory. For example, entities that wish to use markets in the U.S. or the E.U. may do so only if their non-market behavior is consistent with the national interest of the state in question. In the U.S., two categories of investors have been barred: those whose past actions demonstrate that they threaten national security and those who are associated with regimes accused of gross abuses of human rights. For example, Osama bin Laden’s investments would be barred because he represents a threat to national security. Charles Taylor, the former president of Liberia who is accused of widespread human rights abuses in neighboring Sierra Leone, is barred from investing in U.S. markets because of his human rights record. In the E.U., states are permitted by E.U. directive to define the conditions for themselves as long as the conditions fall under the national interest rubric.
After this introduction, this Article proceeds in four parts. In Part II, I lay out the empirical case showing that there are a number of states receiving windfall profits from the sale of commodities while also receiving development assistance. I consider this anomaly and explore briefly whether this inconsistency among aid, investment, and security policies might be justifiable. I argue next that this inconsistency—whatever other justifications it might have—is easily addressed. In Part III, I consider three precedents from similar contexts that show ways in which states or international institutions have successfully regulated aid or foreign investments. To do this, I draw an analogy to the International Monetary Fund’s policy regarding lending into arrears and I present and critique the various justifications for development assistance. In Part IV, I develop a theory of social arrears to help identify when states are failing their citizens to such an extent that other states should take steps to reduce the harm. In Part V, I describe how my proposal might be implemented in practical terms. What are the legal mechanisms through which this proposal could be put into force? In addition, in this part I anticipate and address several possible objections.

II. THE PROBLEM: SOVEREIGN WEALTH FUNDS, CONCENTRATED WEALTH, AND SOCIAL WELFARE

One of the principal reasons that sovereign wealth funds have sparked concern among scholars and policy makers is their perceived lack of transparency, though the arguments in favor of transparency sometimes vary. Some scholars have argued that the failure of most sovereign wealth funds to disclose their investment strategies and the metrics by which they will measure performance makes it difficult for other central bankers, investors, and other market participants to make informed decisions. For example, if a SWF measures performance using both economic and political metrics, the SWF’s interest in a corporation may stem from the government’s desire to control that corporation even if it loses money. A separate concern regarding transparency is that the lack of transparency may cause states to adopt unnecessarily stringent regulations out of a fear


22 See, e.g., SOVEREIGN WEALTH FUNDS—A WORK AGENDA, supra note 11, at 16-17 (arguing that the “absence of SWF data can hinder economic analysis and potentially mislead policymakers, market participants, and other commentators about a country’s economic performance”).
that market forces are insufficient to discipline SWFs.\textsuperscript{23} Such regulations might have the effect of artificially reducing the capital available to corporations and entrepreneurs, thereby slowing growth or reducing the ability of the financial markets to recover from a liquidity crisis (such as the current mortgage-related crisis in the U.S.).

Regardless of whether these concerns turn out to be reasonable, they ignore the risk that sovereign wealth funds will become a source of what I have previously called “unconditioned wealth.”\textsuperscript{24} As I use the term, unconditioned wealth is wealth received by states unaccompanied by strong political or market conditions. Unconditioned wealth has several characteristics. First, it is concentrated in the hands of a small number of people. For example, in Angola, a small coterie of elites receives and has almost complete control over that country’s vast oil wealth.\textsuperscript{25} The second condition depends in part on the first: those who control the wealth are not politically accountable to an engaged, informed electorate. In some states, the lack of political accountability is both a cause and an effect of unconditioned wealth.\textsuperscript{26} In states where the only way to accumulate wealth is through politics, unconditioned wealth can provide politicians with the resources they need to hold onto power against their challengers. Third, unconditioned wealth is not subject to the discipline that the financial markets impose on other forms of wealth.\textsuperscript{27} This is, of course, a form of a common principal-agent problem. When those who manage wealth know that the principals on whose behalf they manage it have no means to hold them accountable, it should come as no surprise that the managers act in their own interests and not in the interests of the supposed principals.

A. States as Aid Recipients and Capital Exporters


\textsuperscript{25} See HUMAN RIGHTS WATCH, SOME TRANSPARENCY, NO ACCOUNTABILITY: THE USE OF OIL REVENUE IN ANGOLA AND ITS IMPACT ON HUMAN RIGHTS 16-17 (2004) (describing centralization of control over oil revenue and failures to account for the revenue). The Human Rights Watch report was based on data uncovered by the IMF during its 2002 and 2003 consultations with Angola. Id. at 36 n.76.

\textsuperscript{26} See, e.g., HUMAN RIGHTS WATCH, WORLD REPORT 76-81 (2008) (describing Angolan government’s attempts to retain power through political violence and press restrictions, among other means).

\textsuperscript{27} See Ian Taylor, China’s Relations with Nigeria, 96 THE ROUND TABLE: THE COMMONWEALTH J. INT’L AFF. 631, 635 (2007) (describing production sharing contracts, which often permit host country governments to avoid market scrutiny or discipline).
States whose citizens need development and humanitarian assistance even while their leaders invest abroad via sovereign wealth funds highlight the gulf that often lies between those in power and citizens in poor states. In this part I show that there are states that are both capital exporters and aid recipients. For example, in 2006, Nigeria received $11 billion in official development assistance.\textsuperscript{28} At the same time, Nigeria’s Excess Crude Account, a government-controlled fund created to invest the country’s vast oil revenue, has approximately $11 billion in assets under its management.\textsuperscript{29} As Table 1 shows, Nigeria is not alone. A number of states are both recipients of official development assistance at the same time that they have millions or billions of dollars in their sovereign wealth funds.

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Algeria</td>
<td>$208.5 million</td>
<td>$47 billion</td>
</tr>
<tr>
<td>Angola</td>
<td>$170.7 million</td>
<td>$200 million</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>$205.6 million</td>
<td>$5 billion</td>
</tr>
<tr>
<td>Botswana</td>
<td>$65 million</td>
<td>$7 billion</td>
</tr>
<tr>
<td>Chile</td>
<td>$83 million</td>
<td>$15.5 billion</td>
</tr>
<tr>
<td>China</td>
<td>$1.2 billion</td>
<td>$606 billion</td>
</tr>
<tr>
<td>Iran, Islamic Rep.</td>
<td>$121 million</td>
<td>$13 billion</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>$171 million</td>
<td>$21.5 billion</td>
</tr>
<tr>
<td>Libya</td>
<td>$37 million</td>
<td>$50 million</td>
</tr>
<tr>
<td>Malaysia</td>
<td>$240 million</td>
<td>$25.7 billion</td>
</tr>
<tr>
<td>Mauritania</td>
<td>$187 million</td>
<td>$300 million</td>
</tr>
<tr>
<td>Nigeria</td>
<td>$11 billion</td>
<td>$11 billion</td>
</tr>
<tr>
<td>Oman</td>
<td>$34.8 million</td>
<td>$2 billion</td>
</tr>
<tr>
<td>Sao Tome &amp; Principe</td>
<td>$21.5 million</td>
<td>$20 million</td>
</tr>
<tr>
<td>Timor-Leste</td>
<td>$209 million</td>
<td>$3 billion</td>
</tr>
<tr>
<td>Trinidad and</td>
<td>$12.9 million</td>
<td>$500 million</td>
</tr>
</tbody>
</table>


\textsuperscript{29} Statistics regarding sovereign wealth funds come from TRUMAN, BLUEPRINT FOR SOVEREIGN WEALTH FUNDS, supra note 1, at 2, table 1.
Before moving on, it is important to make two brief observations about the data presented in Table 1. The second column contains the figures for official development assistance, which is just one kind of aid that states provide to other states.\textsuperscript{30} Official development assistance is a useful indicator in this context because it is money ostensibly dedicated to improving social welfare in the recipient state. It does not include military assistance or private sector investments, for example. Although there is robust scholarly debate about the many motivations that might explain the provision of development assistance, one important reason is to help the recipient state develop its economy and society.\textsuperscript{31} Particularly because the figure does not include other forms of aid, it can be interpreted as a rough approximation of the amount of help a state needs. Put more bluntly, it is a form of charity—perhaps provided for selfish reasons and put to inefficient uses—and states that do not need it typically do not accept it.

The third column shows the amount of money, in dollars, that is controlled by the sovereign wealth funds for each state. The term “sovereign wealth fund” captures a variety of investment vehicles that may pursue different investment strategies, raise funds from different sources, and be subject to differing levels of oversight. Scholars are devoting considerable attention to sorting out these issues, but to date there is not a single agreed-upon definition of the term. Nonetheless, the broad outlines of the term are clear. Sovereign wealth funds are investment vehicles set up by a state, funded with state resources, and managed with the goal of achieving a market rate of return.\textsuperscript{32}

\begin{table}
\centering
\begin{tabular}{|l|c|c|}
\hline
Country & Development Assistance & Sovereign Wealth Funds \\
\hline
Tobago & & \\
Venezuela, RB & $58$ million & $800$ million \\
Vietnam & $1.8$ billion & $2$ billion \\
\hline
\end{tabular}
\end{table}

B. \textit{Conventional Justifications for Development Assistance and Sovereign Wealth Funds}

\textsuperscript{30} See OECD GLOSSARY OF STATISTICAL TERMS, available at http://stats.oecd.org/glossary/detail.asp?ID=6043. The OECD describes official development assistance as grants or loans “administered with the promotion of the economic development and welfare of developing countries as the main objective.” \textit{Id.}

\textsuperscript{31} See supra, Part II.B.1.

\textsuperscript{32} See Beck & Fidora, supra note 5 (noting the lack of a “commonly accepted definition,” but providing a list of characteristics that help to describe a sovereign wealth fund).
The purpose of a theory of social arrears is to define when states are failing their own citizens even when they have the means to do better, which should help to determine when sovereign wealth funds should be encouraged or discouraged. As I have framed the argument, when states are in arrears to their own citizens, it should be difficult for the ruling regime to create an investment vehicle to further concentrate wealth in its own hands. To the extent that my argument can be interpreted as an argument in favor of constraining a state’s ability to set its own path toward economic development, it is important have a coherent account of the reasons that states provide development assistance and the reasons that states create sovereign wealth funds. At their most basic, the justifications for accepting development assistance and for creating SWFs are the same: to improve the welfare of the citizens of the recipient state. My theory, and the means I propose to implement it, is at least theoretically justified because it would create an incentive for poor country governments to invest in their own countries, and remove incentives for the leaders of commodity rich states to act in ways that benefit themselves but not the nation.

1. Development Assistance

Scholars and policy makers typically advance one of two general arguments to explain why wealthy states provide development assistance to poorer states. The first is that aid is provided as a form of state policy with the goal of influencing the recipient state. This account—sometimes stated normatively, sometimes descriptively—holds that states simply cannot justify intentionally reducing their own short-term welfare by giving away money without at least the hope of improving their long-term welfare by advancing strategic or economic objectives. President Richard Nixon stated the normative argument perhaps most clearly: “remember that the main purpose of American aid is not to help other nations but to help ourselves.” Alberto Alesina and David Dollar, among others, have found empirical support for the descriptive claim. In a study of the distribution

33 See, e.g., Nicholas Eberstadt, Foreign Aid and American Purpose 135 (1988) (arguing that the purposes of American foreign aid are “to augment American political power throughout the world” and to “support the postwar liberal international economic order that the United States helped create and is committed to preserving”).


35 See generally Alberto Alesina & David Dollar, Who Gives Foreign Aid to Whom and Why? 5 J. Econ. Growth 33, 33 (2000) (“We find considerable evidence that the pattern of aid giving is dictated by political and strategic considerations”).
of foreign assistance, they found that political considerations are more predictive of the allocation of development assistance than economic considerations.\textsuperscript{36} For example, they found that “a non-democratic former colony gets about twice as much aid as a democratic non-colony,” and that considerations such as “voting patterns in the United Nations explain more of the distribution of aid than the political institutions or economic policy of recipients.”\textsuperscript{37}

The second justification for providing development assistance is typically stated in terms of morality or beneficence.\textsuperscript{38} Under this approach, wealthy states should provide assistance to poor states or their inhabitants simply because the needs of the poor are great and the costs to the wealthy are relatively insignificant.\textsuperscript{39} Regardless of which justification for the provision of aid is more powerful, there is broad consensus on what recipient states should do with the aid they receive. Realists and humanitarians alike expect that, at the least, development assistance will be used to improve the welfare of the inhabitants of the recipient state. They may well have different predictions or expectations regarding the additional effects of aid, but aid providers expect that it will be used to improve welfare.\textsuperscript{40}

2. Sovereign Wealth Funds

Investment vehicles that are funded and controlled by states are not a new phenomenon, but their recent growth has been nothing short of staggering,\textsuperscript{41} driven in large measure by current account surpluses and increasing commodity prices.\textsuperscript{42} As scholars and policy-makers have begun to examine sovereign investments more closely, they have developed a

\textsuperscript{36} Id. at 55 (finding that aid allocations “may be very effective at promoting strategic interests, but the result is that bilateral aid has only a weak association with poverty, democracy, and good policy”).

\textsuperscript{37} Id.

\textsuperscript{38} There is, of course disagreement among philosophers about whether the provision of foreign constitutes a moral duty, based in ideas of justice, or an act of charity, which is praiseworthy but not required. See, e.g., Opeskin, supra note 34, at 23 (describing at least four principal approaches to understanding the moral dimensions of foreign assistance).


\textsuperscript{41} See MRACKY, supra note 7, at 7 (noting that in 2007, sovereign wealth funds “invested $92 billion in publicly-recorded equity transactions, compared with just $3 billion in 2000”).

\textsuperscript{42} See Butt, supra note 23, at 73 (reporting that “global foreign-exchange reserves have [increased] by 140% over the past five years”).
number of ways to categorize state-controlled investment vehicles. Robert Kimmitt proposes a taxonomy based on the source of funds and the entity’s investment strategy.\(^{43}\) Kimmitt identifies four types of state-controlled entities: “international reserves, public pension funds, state-owned enterprises, and [sovereign wealth funds].”\(^{44}\) On this account, SWFs are funded by excess foreign exchange reserves (beyond the amount the state needs as insurance against a currency crisis or a steep drop in demand for its exports) or from revenue from commodities. Typically, SWFs are managed with a greater tolerance for risk than would be true for a pension fund or traditional currency reserve.\(^{45}\)

The principal argument in favor of SWFs is that they permit governments with large pools of capital to earn a higher return than would be available if they invested solely in, for example, U.S. Treasury bonds. For resource-rich states, two possible benefits are particularly salient. The first is that SWFs have the potential to “help ensure continued prosperity for citizens” even after a nonrenewable resource such as oil has been fully exploited.\(^{46}\) SWFs can also help resource-dependent states avoid the economic consequences of fluctuations in commodity prices. Although it has appeared recently that oil and other commodity prices are a one-way ratchet, there have been a number of commodity busts in recent decades that had devastating effects on the domestic economies of producer nations. By diversifying the state’s portfolio, a SWF can help smooth out the bumps that will inevitably arise in single-source economies. In the end, the arguments in favor of SWFs all focus on their potential to improve the lives of people living the states that create such funds.

The emergence of SWFs has sparked lively discussion among scholars and policymakers regarding the likely effects of SWFs on the global economy, states on the receiving ends of their investments, and the state that controls the fund.\(^{47}\) For most observers, the principal concern is that SWFs will make investments in pursuit of political, not economic, goals. Part of the reason for this concern is that most SWFs do not fully disclose their holdings, investment criteria, and management rules. In the absence


\(^{44}\) Id.

\(^{45}\) See Butt, supra note 23, at 74 (“SWFs … are generally managed with a higher risk tolerance than official foreign exchange reserves”).

\(^{46}\) Id. at 78.

\(^{47}\) See generally SOVEREIGN WEALTH FUNDS—A WORK AGENDA, supra note 11 (summarizing the issues raised by the emergence of sovereign wealth funds); MICHAEL F. MARTIN, CONGRESSIONAL RESEARCH SERVICE, CHINA’S SOVEREIGN WEALTH FUND, Jan. 22, 2008 (summarizing issues relating to sovereign wealth funds and possible areas of Congressional action).
of information, it is possible to imagine that a state might create a SWF with multiple objectives, both strategic and economic. In this context it is perhaps not surprising that when Dubai Ports World sought to take a controlling interest in the company that operates most of the ports in the U.S., there was great public outcry. DPW’s protestations notwithstanding, many observers feared that the purchase might have been pursued for political and economic reasons. Although the that states will use economic means to achieve strategic ends remains a central theme of the debate about whether, how, and why to regulate sovereign wealth funds, it is not the only worry.

A related concern is that states will use SWFs to manipulate their currency or engage in some other mischief in global financial markets. Lawrence Summers, for one, has indicated that one reason that SWFs have garnered so much attention is that, given their increasing size, they might be used to “assert political pressure on a government to rescue a bank they have invested in” or launch a “‘speculative attack’ on another country’s currency.”48 A final area of concern arises due to the opaque nature of most SWFs. Because they do not release the same types and quantity of information as other entities, the “absence of SWF data can hinder economic analysis and potentially mislead policymakers [and] market participants.”49

C. Connecting Concentrated Sovereign Wealth and Social Welfare

Sovereign wealth funds are a mechanism by which states with a single source of income can convert that income into long-term development.50 One problem faced by any country that derives the majority or more of its income from the sale of a single commodity is finding a way to convert that income into longer-term more secure wealth before the commodity runs out.51 For example if the country depends on the sale of timber as its primary source of income, the managers of that commodity know that sooner or later that timber industry will slow down, or the country’s supply

49 SOVEREIGN WEALTH FUNDS—A WORK AGENDA, supra note 11, at 16.
50 See, e.g., id. (arguing that sovereign wealth funds can “facilitate the saving and intergenerational transfer of proceeds from nonrenewable resources and help reduce boom and bust cycles driven by changes in commodity export prices”).
51 See, e.g., John Rowse, Using the Wrong Discount Rate to Allocate an Exhaustible Resource, 72 AM. J. AGRIC. ECON. 121 (1990) (describing the management challenges associated with the extraction of non-renewable resources).
of timber will start to contract. The same is true for countries that derive most of their income from the sale of oil, natural gas, diamonds, or any other nonrenewable commodity. This is the goal of many states in the Persian Gulf, for example. Dubai is perhaps the most prominent example, with its strategy of diversifying its economy from an oil-reliant economy to an economy that depends on financial services, tourism, and other sectors.\footnote{See generally UGO FASANO & ZUBAIR IQBAL, GCC COUNTRIES: FROM OIL DEPENDENCE TO DIVERSIFICATION (2003) (surveying attempts by Bahrain, Dubai, and other states in the United Arab Emirates to diversify their economies away from oil).}

Under certain conditions, sovereign wealth funds have the potential to be a form of unconditioned wealth, and one that Western governments and market participants unintentionally sustain. Perhaps the closest analogue the sovereign wealth fund problem is the revenues that come from the sale of natural resources.\footnote{In earlier work, I presented a much fuller version of this argument. See Patrick J. Keenan, \textit{Curse or Cure? China, Africa, and the Effects of Unconditioned Wealth}, BERKELEY J. INT’L L. (forthcoming 2008).} In resource-rich states, particularly those with weak domestic political institutions, citizens rarely benefit from the resources. Other things equal, states that rely heavily on oil or mineral revenue tend to be less democratic than other states.\footnote{See Michael L. Ross, \textit{Does Oil Hinder Democracy}, 53 WORLD POL. 325, 346 (2001) (arguing, based on empirical study, that “a state’s reliance on either oil or mineral exports tends to make it less democratic”).} Resource wealth can lead to an increase in rent-seeking behavior in the form of attempts to bribe those in power.\footnote{See Elissaios Papyrakis & Reyer Gerlaugh, \textit{The Resource Curse Hypothesis and Its Transmission Channels}, 32 J. COMP. POL. 181, 188 (2004) (arguing that the presence of natural resources and weak domestic institutions creates incentives for people to attempt to bribe those in power to gain access to the resource revenue).} Resource-rich states are less likely to become democratic and more likely to have sustained autocratic rule.\footnote{See Jay Ulfelder, \textit{Natural-Resource Wealth and the Survival of Autocracy}, 40 COMP. POL. STUD. 995, 996 (2007) (arguing, based on empirical study, that resource wealth is positively associated with autocratic forms of government and negatively associated with transition to democracy).} Underlying this is the fact that the presence of resource wealth (as opposed to other forms of wealth) increases the payoff from holding power.\footnote{See, e.g., Silje Aslaksen & Ragnar Torvik, \textit{A Theory of Civil Conflict and Democracy in Rentier States}, 108 SCANDINAVIAN J. ECONOMICS 571, 584 (2006) (showing that the presence of resource wealth increases the payoff associated with holding power).} Politician managers have a strong incentive to use wealth to hold onto power rather than develop the state.\footnote{See Aaron Tornell & Phillip R. Lane, \textit{The Voracity Effect}, 89 AM. ECON. REV. 22, 42 (1999) (arguing that where domestic institutions are weak, resource wealth is associated with greater redistributions of wealth from economically efficient activities to economically inefficient but politically useful activities).}
With very few exceptions, the concerns raised about sovereign wealth funds all relate to the potential for these funds to disrupt the global financial markets or the states on the receiving end of investments. What is left out is a fully-developed recognition of the potential domestic effects of sovereign wealth funds.

III. BENEFITS FOR THOSE IN DEBT TO OTHERS: AN ANALOGY TO THE IMF’S POLICY ON LENDING INTO ARREARS

Sovereign wealth funds serve both public and private purposes, and answer to public and private masters. On the private side, sovereign wealth funds are similar to many other investment funds: their purpose is to maximize the return to shareholders and serve as a source of capital in the markets; they answer to regulators in the markets in which they do business, and to the shareholders and managers of the enterprises in which they invest. On the public side, the most compelling purpose of sovereign wealth funds is to improve social welfare in their home states; their public-side master is the people for whose benefit they exist. The current literature on sovereign wealth funds is largely devoted to consideration of private-side issues, such as the likely effect on the capital markets of one form of regulation or another, or the justifications for taxing (or not) SWFs in host states. One weakness of the current literature is that there is no coherent account of public-side issues. How can people in states with SWFs ensure that they actually improve domestic social welfare? Another weakness of the current literature is that it lacks a coherent account of the potential for public-side regulation might help accomplish private-side objectives. Put another way, is there a way to use private-side regulation to make it more likely that SWFs will fulfill their domestic obligations?

To get some traction on these issues, I draw an analogy to the International Monetary Fund’s policy on lending into arrears, which

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59 The most notable exceptions are Professor Anna Gelpern and former Assistant Secretary of the Treasury Edwin Truman. In her taxonomy of accountability concerns for SWFs, Gelpern notes that “[p]ublic internal accountability is achieved within the political system of the capital-exporting state.” Gelpern, supra note 15. Truman notes that one concern about SWFs should be the risk that “governments may mismanage their international investments to their own economic and financial detriment.” TRUMAN, BLUEPRINT FOR SOVEREIGN WEALTH FUNDS, supra note 1, at 2. Even while suggesting this concern, Truman notes that the harm from such behavior is likely to be “negative consequences for the global economic and financial system, including large-scale corruption in handling the huge amounts of money involved.” Id.

regulates the circumstances under which a state may benefit from the assistance of the IMF if that state is in debt to private creditors. The IMF’s policy attempts to balance its goals of assisting states in distress (and stabilizing the economy) with its desire not to pour money into states that have defaulted on their obligations to other creditors. By monitoring arrears, the IMF has the ability to determine whether its beneficiaries are fulfilling their domestic obligations.

Examining the evolution of the IMF’s policy yields important lessons about ways to address arrears, which, taken together, can point the way toward a workable approach to handling arrears in other contexts. The first and most basic lesson to draw from the IMF’s experience is that defining arrears is more fluid than it might initially seem. The evolution of the IMF’s policy shows flexibility on each element, obligation and tardiness. At first the policy covered only arrears to private creditors. Today the policy covers arrears to private creditors and on bonded debt. A workable policy on arrears must consider to whom debts are owed, not simply whether there are debts. The second lesson is that the decision whether to lend into arrears—regardless of how the term is defined—does not depend solely on whether a state is creditworthy. The history of the IMF’s policy shows an increasing interest in the process by which debtor states resolve their credit problems. The IMF requires states that seek loans notwithstanding arrears to private creditors to demonstrate not only that they are working toward a resolution of the private debt, but that they are operating in “good faith” as they work out their credit problems. Third and finally, the IMF’s support depends on the results of the debtor state’s negotiations with its private creditors and on the state’s willingness to make necessary changes to its financial and economic policies. In practice, this means that the IMF is able to exercise more influence over the debtor state’s internal policies than would otherwise be possible.

The basic concept of arrears is simple. For example, the IMF defines “arrears” as “debt, either domestic or external, resulting from payments not being made when due.” This definition incorporates two important

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63 See IMF Policy on Lending into Arrears, supra note 61 (presenting the rationale for the IMF’s decision to include bonded debt in the lending into arrears policy.

64 International Monetary Fund, Glossary of Selected Financial Terms, available at http://www.imf.org/external/np/ef/glossary/showTerm.asp?term=arrears. The full definition reads as follows: “Arrears: A stock of outstanding debt, either domestic or external, resulting from payments not being
elements that are uncontroversial in most contexts but require some consideration to be useful for my purposes. The first element is that there is some obligation to make the payment. Arrears arise when required payments are not made. Absent some other consideration, the failure to make some other kind of transfer—relief from foreign debt, for example—would not give rise to arrears. The second element is that the payment is past due. Not all debts qualify; only those that remain owed after their due date amount to arrears. Much of international economic law is concerned with managing, resolving, or avoiding the myriad disputes that might arise when states, firms, and individuals incur and collect debts, including past due debts. Most important for my theory, however, is the law and policy relating to the provision of benefits to entities that are in arrears to others.

Before moving on, it is useful to preview the work that the IMF analogy does in my theory, partly to show its utility and partly to acknowledge that it is imperfect. The IMF’s policy regarding lending into arrears is primarily a means to avoid harm to the IMF. As I show below, the original legal basis for the IMF’s policy was the provision of its charter requiring it to safeguard its resources. To be sure, the policy has evolved significantly since then, but the basic goal remains: avoid lending money to states that appear unlikely to repay it. Consider an example from Argentina. In 2001, after several attempts to restructure its debt to private creditors to avoid default, Argentina was unable to service its foreign bonds and the IMF cut off further distributions. One of the IMF’s stated goals was to protect its resources—to avoid pouring more money into Argentina without some indication that the money would be repaid. Standing in the way of repayment were Argentina’s debts to private creditors, which were treated as constraining obligations. The IMF did not suggest that Argentina

65 The issues surrounding sovereign debt are not new, and despite the work done by the IMF and other institutions, not fully resolved. For a useful history of sovereign debt crises, see Ross P. Buckley, Why are Developing Nations So Slow to Play the Default Card in Renegotiating their Sovereign Indebtedness?, 6 CHICAGO J. INT’L L. 345, 346-352 (2005) (tracing the history of sovereign defaults from the sixteenth century to the early years of the twenty-first century). For an analysis of many of the policy question relating to sovereign debt and default, see generally Prasanna Gai, et al., Crisis Costs and Debtor Discipline: The Efficacy of Public Policy in Sovereign Debt Crises, 62 J. INT’L ECON. 245 (2004) (developing econometric model to identify optimal policy responses to sovereign debt crises).

66 See, e.g., IMF Policy on Lending into Arrears, supra note 61, at vii (stating that, despite the need for changes in policy, the new policy must provide “adequate safeguards for the use of the Fund’s resources”).

67 ANNA GELPERN, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS, AFTER ARGENTINA 2-3, No. PB05-2 (Sept. 2005).
ignore these debts or treat their repayment as virtuous but not required. Instead, the IMF recognized that Argentina could not avoid accounting for the debts as it sorted out its credit problems. To be clear, I do not suggest that the IMF insisted that Argentina repay every dollar that it owed. And the reasons that the IMF and others gave such weight to Argentina’s private debts were complicated and surely were grounded as much in raw political economic calculus as in the law of contract. But regardless of the reasons that the private debts were accorded such importance, the fact remains that they were, and accounting for them was an important part of Argentina’s recovery.

Contrast this experience with a hypothetical example. In this case, imagine that Argentina has a surplus of currency reserves that it wishes to invest abroad through a sovereign wealth fund. Simultaneously, most people in Argentina are impoverished, there are few paved roads, and the majority of people lack access to potable water and basic health care. Political institutions are sufficiently weak that there is little that citizens can do to influence government policy. Under my theory, these conditions would amount to arrears, and a prohibition on the provision of benefits to sovereigns in the face of social arrears would prohibit Argentina’s sovereign wealth fund from investing abroad. The goal of the policy would be to protect the interest of the people of Argentina by requiring the government to attempt to satisfy basic domestic needs before investing abroad. With respect to social arrears, what is missing is a reason to treat them as constraining obligations—factors that must be addressed as part of any program of recovery or development.

The IMF analogy is useful in another way as well. One way to frame the IMF’s involvement with a state is that it is conferring a benefit on the recipient state. Its concern for arrears is grounded in its interest in ensuring that the benefit is not wasted. Another reason for its attention to arrears—one which, as I show below, has become increasingly prominent—is its interest in policy coherence. If the goal of IMF involvement is to help states improve domestic social welfare, then the IMF must have some way to determine if this is occurring, and how the IMF’s policies have affected the state’s behavior. Similarly, when a state allows other states access to its capital markets or to invest in its corporations, that state is conferring a benefit on other states. If the proceeds of these investments provide the ruling regime with tools to hold onto power illegitimately or to abuse its citizens, then the benefits have been wasted. This is particularly important for those states that provide development assistance. Their goal is to improve welfare in the recipient state, and any evidence that their money is
being wasted should be a cause for concern. When there is systematic waste—or the potential or it—then the donor state’s policy is incoherent and unlikely to succeed.

A. Early Policy: Safeguarding the IMF’s Resources

When the IMF promulgated its first policy regarding arrears in 1970, it permitted loans to states in arrears only in very limited circumstances, and only if the state had in place a program to eliminate the arrears within a fixed period of time.68 The policy had two principal objectives. The first was to protect the IMF’s resources, consistent with Article V of the IMF’s Articles of Agreement, which required the IMF to adequately safeguard its resources.69 From a banking standpoint, the IMF’s policy was entirely rational—“IMF lending to a member country with arrears was considered inconsistent” with the requirement that the IMF establish adequate mechanisms to safeguard its resources.70 The second objective of the policy rule was to ensure that states did not impose inappropriate currency restrictions because of their potential to undermine the state’s “perceived creditworthiness,”71 and because of the potential to interfere with “the smooth functioning of the international payments system.”72

In 1980, the IMF modified its policy to lengthen the time during which debtor states would be permitted to eliminate arrears (and still qualify for IMF loans), and to acknowledge that some states might need to renegotiate their outstanding debts.73 The IMF’s early policy proved inadequate to respond to the Latin American debt crisis of the 1980’s as states in desperate need of assistance had accrued substantial debts and arrears. Part of the problem was that the IMF’s arrears policy had the effect of “pressuring sovereign debtors to settle with private creditors to gain access to IMF funds.”74 Thus the unintended consequence of the IMF’s desire to

68 Throughout this section, my discussion of the evolution of the IMF’s policy on lending into arrears draws on the comprehensive history and thorough analysis in Lee C. Buchheit and Rosa M. Lastra’s Lending into Arrears—A Policy Adrift, 41 INT’L LAWYER 939 (2007). Buchheit and Lastra argue that the IMF’s rules regarding arrears has come drifted away from the original purposes of the IMF and the arrears policy. Id. at 952.
69 International Monetary Fund, Articles of Agreement, Art. V, Sec. 3(a).
70 Buchheit & Lastra, supra note 68, at 941.
71 Buchheit & Lastra, supra note 68, at 941.
72 International Monetary Fund decision no. 3153-(70-95), Oct. 26, 1970.
74 GELPERN, AFTER ARGENTINA, supra note 68, at 9, box 3.
safeguard its funds and assist states in crisis was to make those states even more vulnerable to the vicissitudes of the private markets.

B. Recent Policy: Influencing Negotiations and Internal Policies

After the debt crisis in Latin America exposed important weaknesses in the IMF’s arrears policy, the Fund modified the policy. In 1989, the Fund adopted a policy that would permit the IMF to provide loans to states even if they were in arrears to commercial banks. This shift in policy was intended to reduce the leverage that commercial banks had over sovereign debtors by preventing banks from negotiating unfairly with states desperate for assistance from the IMF. The new policy amounted to a move toward influencing the conduct of negotiations between debtor states and creditor banks by shifting bargaining power from banks to states. In 1998, the IMF modified its arrears policy again, this time permitting lending into arrears only when there was evidence that the debtor state and the creditor bank were negotiating in “good faith.” As it now stands, the IMF’s policy requires it to judge the fairness of the negotiations as a precondition to providing assistance to states in distress. This shows that the IMF approach has a much to do with shaping policy that affects the welfare of the state as with protecting the IMF’s assets.

IV. SOCIAL ARREARS: A THEORY OF DOMESTIC OBLIGATIONS

What do states owe their citizens? Arriving at an answer to this question can help sort out the public and private claims on sovereign wealth funds. When the International Monetary Fund assesses the creditworthiness of a state seeking its assistance, one factor it must consider is the state’s indebtedness to other creditors. In the conventional model, the issue of arrears becomes relevant when a state cannot fulfill its obligations to private creditors but nonetheless wishes to receive further benefits. My aim

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75 See IMF Policy on Lending into Arrears, supra note 61, at 1 (describing 1989 changes in arrears policy).
76 See Buchheit & Lastra, supra note 68, at 945 (arguing that "the primary motivation for the 1989 shift in LIA policy was to neutralize the ability of private creditors to use the IMF’s ‘no arrears’ rule as negotiating leverage over sovereign debtors").
77 IMF Policy on Lending into Arrears, supra note 61, at 1 (describing 1998 changes in arrears policy).
78 See Gelpert, After Argentina, supra note 67, at 9 (arguing that the new policy puts the IMF in the position of “evaluating the quality of a country’s dialogue with its creditors”).
is to use this basic framework to fashion a theory that accounts for a new reality: states sufficiently wealthy to export capital, but whose citizens live in such poverty and deprivation that other states provide charitable assistance. In the conventional model of arrears—most fully developed by the IMF—the foundational elements are obligation and tardiness. The debtor must be obligated to repay, and the agreed-upon period for repayment must be past. In my theory of social arrears, I include these elements and add the element of capacity, by which I mean that the state in question must have the resources to address the social needs of its citizens. In this Part, I argue that the elements of obligation, tardiness, and capacity can form the basis of a theory of social arrears. In addition, I show that all three elements have solid foundations in international law. This is relevant not to show that my theory of social arrears is somehow mandated by existing law. Instead, I identify plausible precedents for obligation for much more pragmatic reasons. Other things equal, a new theory is likely to be more palatable if it is made up of commonly-understood elements. In addition, it is useful to show that we know how to regulate similar issues, even if we have chosen not to do it for some other reason.

Before moving on, it is important to acknowledge that the taxonomic approach I take in this Part, although useful as a way to identify and articulate the elements of my theory, risks obscuring the syncretic nature of social arrears. For example, a useful theory of social arrears must distinguish between unmet needs and genuine arrears. This means showing more than that a state has unmet development needs, because this is surely true of every country in the world. Even among the richest economies of the world, including, for example, the United States and Japan, it is possible to find pockets of deep poverty and compelling evidence of other unmet social needs. Instead, a useful theory of social arrears must show that there are unmet social needs, and that the state has not fulfilled the needs. Thus, for example, the unmet needs should include basic needs such as health, education, access to food and water, or personal security. It would not be sufficient to identify unmet demand for broadband Internet service, or inadequate but nonetheless functional transportation. In addition, the arrears must be reasonably pervasive; that is to say, the needs must be present in widespread areas or felt across a substantial segment of the population. For these reasons, Section IV presents several mechanisms through which social arrears might be addressed, and considers a number of possible objections to the theory.

The objective of this Part is to specify the content of a theory of social arrears. I identify legal sources for each of the elements—obligation,
tardiness, and capacity—and give content each. In addition, I argue that the content of the obligation element should include the provision of health care, education, and security. Although much of this material is framed in the language of rights, I do not argue that the implementation of a theory of social arrears is somehow compelled by existing international law. In Section IV, where I address implementation issues, I argue that the recent increase in commercial activity by state entities provides a new and potentially powerful means to facilitate development, even in states in which domestic political accountability is limited or non-existent. In this part, however, my objective is simply to show that the elements of the theory are supported by international law.

A. State Obligations

In the financial model of arrears, the element of obligation is simple enough. In it, the notion of obligation is contractarian: the debtor state has explicitly agreed to the terms that the creditor bank is attempting to enforce.\(^{79}\) When the state fails to fulfill that explicit agreement, the state’s debts become arrears. With social arrears, the element of obligation requires more elaboration. The concept of obligation contains within it two elements: why do states owe their citizens something, and what is owed?\(^{80}\)

Although the bases for arguing that states owe their citizens something—the why issue—are contested, there are three approaches that support the claim. All of these approaches depend in part on a theory of statehood, an issue to which I devote some attention. First, under the duty to protect, a doctrine with deep roots in international law, states are required to take steps to protect citizens (and others, under the right circumstances) from a range of threats.\(^{81}\) Second, the very concept of human rights—the idea that individuals have rights that states and others must respect—supports the claims that states owe something to their citizens. The third

\(^{79}\) For a basic definition of default and debt, see International Monetary Fund, Glossary of Selected Financial Terms, available at http://www.imf.org/external/np/ext/glossary/showTerm.asp#118.

\(^{80}\) There is one potential additional issue consideration: to whom duties are owed. Largely because the substantive obligations I have identified are well established (even if not universally accepted), I have chosen not to address this issue in any depth. To be sure, there are many thorny debates regarding this question. For example, although there are certainly arguments to the contrary, it is relatively uncontroversial to claim that basic education should be provided to all persons. Because my theory is an attempt to address only the most severe deprivations, it is not necessary to consider whether all persons should receive a free post-secondary education, or if that benefit should be reserved for citizens or some other group.

\(^{81}\) See generally DINAH SHELTON, REMEDIES IN INTERNATIONAL HUMAN RIGHTS LAW 47-54 (2000) (describing the history of the state duty to protect individuals from human rights violations).
theory provides somewhat weaker support, but is nonetheless important. Under international law, there is a notion that, along with the perquisites of sovereignty, statehood comes with a set of obligations or burdens.

The content of a state’s obligations—the what question—has been the subject of debate in the human rights literature for decades, and many questions remain unresolved. For example, must states provide free education to all citizens through the age of 10 or 16? Must states provide Western-style health care for all citizens, or would community-based clinics staffed by nurses suffice? My approach to questions like these is to answer them generally, not specifically, and to rely on existing international legal doctrine for guidance. There is broad consensus that states must provide access to health care, education, and take steps to ensure personal security.

1. Sources of State Obligations

Debating the bases for the intuition that states owe something to the people living within their territory has been a preoccupation of international law scholarship. In this Part, I consider in some detail the concept of statehood, including its legal definition and recent debates over the concept of failed states. Other scholars have written about what they call "failed states," entities in which the governments, for a variety of reasons, have effectively ceased to function. These scholars have written about the failure of governments, and most have mentioned in passing the concept of statehood and its legal definition. Both of these areas help to illuminate what a state owes its citizens by helping to define what a state is, and how an entity can cease to be considered a state by virtue of its failure to meet certain domestic obligations.

The 1933 Montevideo Convention formalized a definition of statehood that continues to define what it means to be a state. Under the Montevideo definition, states should “possess the following qualifications: a) a permanent population; b) a defined territory; c) government; and d) capacity to enter into relations with other states.” This definition came not from centuries of consistent thinking about the parameters of statehood; instead, it represented contemporary conceptions of what statehood entailed. The Restatement of Foreign Relations Law defines as state as

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having a "defined territory," a "permanent population," a "government" and the "capacity to conduct international relations." In its Comment, the Restatement explains what is meant by these requirements: "A state need not have any particular form of government, but there must be some authority exercising governmental functions and able to represent the entity in international relations." Within the short phrase "some authority exercising governmental functions" is almost the entire range of activity that matters to the citizens of a state. For example, a functioning state must have a government that can protect its citizens and other people within its borders from violence, whether caused by internal or external sources. This does not mean that a high crime rate dooms a state, or that a state that suffers an attack from without ceases to be a state. Rather, to be a state, an entity must have in place mechanisms to respond to internal or external violence, such as criminal laws and a criminal justice apparatus. It is not the effectiveness of the apparatus that matters; what matters most is that it exists.

Proposals to address "failed states" fall into two camps. Some propose that the United Nations or other international institution put a failed state under a sort of trusteeship or guardianship, taking over the governmental functions until the local people are again in a position to govern themselves. The other camp rejects the "failed state" concept, and with it the trusteeship solution, as neo-colonial. This camp argues that an appropriate response must be based on the local people's right to self-determination.

Despite the many differences of opinion about how to define a state, and how best to respond to state failure (and, indeed, if such an idea is coherent), these varied approaches agree on many things. We expect a functioning government to have control over at least most of its territory, to maintain the rule of law, to protect its citizens from violence from internal and external sources, to have some role in regulating the commerce that

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86 Id.
87 Perhaps the most prominent article in this vein was Gerald B. Helman and Steven R. Ratner's Saving Failed States, published in 1993. In it, they argued in favor of intervention by the United Nations to forestall state failure or rebuild failed states. See Gerald B. Helman & Steven R. Ratner Saving Failed States, 89 FOREIGN POL'Y 3 (1993). Their proposals sparked debate among scholars and policymakers that has not yet abated. See, e.g., Stephen D. Krasner, Sharing Sovereignty: New Institutions for Collapsed and Failing States, 29 INT'LS SECURITY 85 (2004) (arguing in favor of creating new institutions to administer states that are unable to undertake basic functions).
88 See, e.g., Ruth Gordon, Saving Failed States: Sometimes a Neocolonialist Notion, 12 AM. U. J. INT'L L. & POL'Y 903 (1997). In her seminal article, Professor Gordon analyzes the problem of state implosion in the context of the needs and constraints of local communities.
takes place within its borders and between its enterprises and the rest of the world, and to provide an administrative structure that permits the people living within its borders access to basic services. This list of functions is deliberately vague; not all governments provide the same set of services or perform the same functions, or perform them all efficiently or effectively. The government of a poor state can be described as functioning reasonably well even though it does not provide the generous welfare benefits available in many countries in Western Europe, for example. Even without arriving at a precise definition of the set of functions that a state government must perform, one can see why scholars have concluded that an entity whose government fulfills virtually none of those functions is no longer a state. More important than this conclusion, however, are the reasons for it. To be a state is to be capable of meeting the basic needs of people living in the state. Entities that do not or cannot perform this function can cease to be states.

2. Substantive Obligations

In the human rights literature, rights are often roughly divided into two categories, civil and political rights on the one hand, and economic, social, and cultural rights on the other hand. This division is reflected perhaps most clearly in two documents that form what is sometimes referred to as the “international bill of rights”:89 the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social, and Cultural Rights. Since the dawn of the United Nations system, scholars and policy makers have debated the relative importance of the two sets of rights, rehearsing what have become familiar arguments. One camp maintains that civil and political rights are more important because their exercise permits individuals to act as a collective to determine the best course toward the realization of the other rights. The other camp argues that greater emphasis should be placed on the realization of economic and social rights to ensure that individuals have their basic biological and social needs met; without addressing these needs, the argument goes, it is impossible for individuals to meaningfully exercise their other rights. This disjunction, although the subject of much discussion, is difficult to sustain when confronted by real-world problems. To bring some coherence to the debate, Amartya Sen, among others, has argued for an approach that places

more emphasis on the combined effect of the failure to realize a range of rights. This approach, even if not universally accepted, has the virtue of recognizing and attempting to account for the layered and contingent nature of individual achievement and experience.

In the end, I focus on three areas which, taken together, go a long way toward defining the quality of an individual’s life. Adequate health care, access to education, and some assurance of personal security are all central to individual and collective welfare. Beyond the theoretical arguments in favor of focusing on these issues, there are two pragmatic reasons to select them. First, much of development assistance that flows to poor countries is targeted at these problems. Put another way, it is a state’s failure to provide or ensure these amenities, and the individual suffering that flows from this failure, that prompts other states to provide development assistance. The second pragmatic argument in favor of these three issues is that they are relatively uncontroversial. Virtually no serious scholars argue that states have absolutely no obligations in these areas. In the rest of this Part, I briefly survey the vast literature supporting my claim that these three issues are widely considered state obligations. Before moving on, it is useful to recall that I do not argue that international law compels the approach that I advocate. Instead, my argument is slightly less ambitious. I argue that, as a matter of policy, there are sound reasons to treat these issues as a state’s obligation, and for other states to respond to the failure to fulfill these obligations as a defaulted debt that must be resolved before the state is permitted to receive further benefits.

A state’s obligations to ensure adequate health care and education are specified in the International Covenant on Economic, Social and Cultural Rights. Article 12 recognizes the right to “the highest attainable standard of physical and mental health.” Article 13 guarantees the “right of everyone to education.” In addition to international agreements, states have begun to guarantee these rights in domestic constitutions.

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90 See AMARTYA SEN, DEVELOPMENT AS FREEDOM 10-11 (1999) (arguing that the realization of different forms of rights is essential to, and constitutive of, development).
93 See, e.g., Varun Gauri, Social Rights and Economics: Claims to Health Care and Education in Developing Countries, 32 WORLD DEV. 465, 465 (2004) (noting that “[o]f the 165 countries with available written constitutions, 116 made reference to a right to education and 73 to a right to health care. Ninety-five, moreover, stipulated free education and 29 free health care for at least some population subgroups and services”).

International law is less clear with respect to personal security, but there is a growing consensus that states must ensure some measure of domestic stability. First, international law has long recognized that, under appropriate circumstances, states bear responsibility for injuries to non-citizens suffered in the state.\footnote{See Philip C. Jessup, Responsibility of States for Injuries to Individuals, 46 Colum. L. Rev. 903, 904 (1946) (noting that the “law governing the responsibility of states for injuries to aliens is one of the most highly developed branches” of international law).} Under this doctrine, a state could seek compensation for an injury suffered by one of its citizens abroad.\footnote{See Henry J. Steiner & Philip Alston, International Human Rights in Context 82 (2000) (tracing the history of the rights of states to compensation for injuries done to their citizens by other states).} This doctrine eventually came to mean that host states bear responsibility for injuries to individuals suffered within the state, regardless of the nationality of the injured party or whether her state (assuming she was a citizen of another state) was willing to seek compensation on her behalf.\footnote{See generally Jessup, supra note 97 (arguing that a more generalized doctrine of responsibility had emerged from the practice of states).} The most protective version of this doctrine is a generalized state responsibility to protect. Those who advocate this doctrine argue that the duty of states to protect individuals is sufficiently strong to compel other states to intervene in when individuals face conditions of extreme “violence, deprivation and abuse.”\footnote{Louise Arbour, The Responsibility to Protect as a Duty of Care in International Law and Practice, 34 Rev. Int’l Stud. 445, 445 (2008).}

B. Tardiness

Determining when a debt payment is late is often straightforward. Typically, the loan agreement includes a timetable for repayment and provides a formula for determining when late payments become actionable.
arrears. With social arrears, the question is more complicated. The most useful approach to the issue comes from the jurisprudence that has developed in South Africa regarding that country’s constitutional obligation to protect economic, social, and cultural rights. South Africa’s constitution guarantees to each citizen the right to education, health care, and adequate housing, among many other rights. Under the constitution, the government is required to ensure the “progressive realization” of these rights in light of “available resources,” among other considerations.

South Africa’s Constitutional Court has considered this provision on a number of occasions, and in so doing provided a useful model for a theory of tardiness (and for a general theory of social arrears). The court’s most thoughtful treatment of the issue came in South Africa v. Grootboom, decided in 2001. In that case, the plaintiffs had been forcibly evicted from their dwellings (they were illegally squatting in a township) and they

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101 A focus on South Africa should come as no surprise. Since its post-apartheid constitution went into effect in 1996, it has become a sort of laboratory of constitutional theory. Part of the reason for this is that South Africa’s constitution is perhaps the most comprehensive and specific in the world. Consider just the Bill of Rights, which guarantees rights in 27 separate substantive areas, sometimes in extraordinary detail. For example, under Article 28(1)(a), children have a constitutional right to a “name and a nationality from birth.” Article 33, which guarantees “just administrative action,” provides individuals with a right to “written reasons” if their “rights have been adversely affected by administrative action.” For a more detailed analysis of the development of constitutional theory, see, e.g., Jeremy Sarkin, The Drafting of South Africa’s Final Constitution from a Human-Rights Perspective, 47 AM. J. COMP. L. 67 (1999) and John Dugard, International Law and the South African Constitution, 8 EUR. J. INT’L L. 77 (1997).

102 See S. Afr. Const. 1996 arts. 29 (Education), 27 (Health Care) & 26 (Housing).

103 In the South African constitution the provisions guaranteeing adequate housing, access to health care, and education are all subject to similar limitations. Section 26, which covers housing, provides that the “state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realization of this right.” Id. at art. 26(2). Section 27(2) contains an identical limitation with respect to health care. Section 29, covering education, deviates slightly from this approach. There the constitution provides as follows: “Everyone has the right (a) to a basic education, including adult basic education; and (b) to further education, which the state, through reasonable measures, must make progressively available and accessible.”

104 South Africa v. Grootboom, 2001 (1) (SA) 46 (CC) (S. Afr.). The Constitutional Court’s opinions from three cases are particularly relevant. Grootboom is the most salient for my purposes, but the others merit a brief note as well. In Soobramoney v. Minister of Health, Kwa-Zulu Natal 1999 (1) SA 765 (CC) (S. Afr.), the court held that a provincial hospital’s refusal to provide free kidney dialysis to Soobramoney did not violate the constitutional guarantee of access to adequate health care. Id. at 776. Central to the court’s analysis was its conclusion that the government’s decision—regarding the medical services it would subsidize and those it would not—was “rational” and “taken in good faith.” Id. The court noted that the government had identified its funding priorities mindful of the fact that there were simply not enough resources to meet every need, and that the state’s priority would be to help as many people as possible. Id. In Minister of Health v. Treatment Action Campaign, 2002 (5) SA 721 (CC) (S. Afr.), the Constitutional Court held that the government’s refusal to provide the drug Nevirapine to pregnant women to prevent mother-to-child transmission of HIV violated the right to adequate health care. Id. at 750. There the court found that the government’s refusal to provide the drug was unreasonable because it had received the drug virtually free from pharmaceutical companies and there were no real questions as to the effectiveness or safety of the drug. Id. at 740 & 745.
sued the government, claiming that its failure to provide them with emergency housing violated the constitution’s guarantee of adequate housing, and seeking immediate assistance with housing. The Constitutional Court held that the plaintiffs were not entitled to housing “upon demand,” thereby denying them immediate relief. Instead, the court held that the constitution required the government to “devise and implement a coherent, co-ordinated programme designed to meet its” constitutional obligations, and that the government had failed to do this. The court’s focus was on the government’s program. Most important was whether the government had set its priorities in a rational way—having considered their effects and costs—not on whether a particular person was experiencing unconstitutional conditions.

In the context of a theory of social arrears, this approach would mean that determining whether a state’s debts to its citizens were past due would call for an assessment of the state’s plan to deliver the relevant services. It would not depend on whether, at a given moment, some citizens were experiencing inadequate conditions. To be sure, evidence that such conditions were widespread would be an important factor in the decision.

\[105\, Grootboom, supra note 104, at 66.\]
\[106\, Grootboom, supra note 104, at 66.\]
\[107\, Specifically, the Constitutional Court found that the government’s housing program could reasonably be broken into three components: long-, medium-, and short-term plans to address the country’s housing problems. The court found that the long- and medium-term components of the plan were adequate, but that the short-term component was inadequate because it did not provide assistance for people like Ms. Grootboom, whose needs were immediate and severe. Grootboom, supra note 104, at 66.\]

\[108\, For a thorough analysis of the Constitutional Court’s jurisprudence in this area, see Karin Lehmann, In Defense of the Constitutional Court: Litigating Socio-Economic Rights and the Myth of the Minimum Core, 22 AM. U. INT’L L. REV. 163 (2006). Lehmann’s comprehensive history of post-apartheid constitutional litigation considers two jurisprudential approaches to litigation regarding economic and social rights. Consider a case involving, for example, a claim that the state’s failure to provide adequate housing or education violates the constitution. Under one model, which she labels the “reasonableness approach,” when courts are faced with such a claim, the court’s duty is to determine whether the state’s approach to the problem is reasonable. If so, then the court does not examine the details of the government’s spending priorities. Id. at 165. The second model, labeled the “minimum core” approach, would require the court to identify “the minimum core of each of the rights that have come before it.” Id. at 165. The minimum core approach would allow courts to determine those elements of a social program without which the program would be unconstitutional. For my purposes, it is not necessary to resolve this issue for two reasons. First, the lively scholarly debate notwithstanding, each approach necessarily incorporates elements of the other. It really is not possible to assess the reasonableness of a social program without some notion of what the basic elements must be. Similarly, it would be difficult to specify the minimum core of a particular right with no regard for what the government could actually provide. Second, the analytical models that Lehmann and others have identified are most salient with respect to judicial decision making, when judges are confronted with competing sets of demands. In contrast, my approach is an attempt to bring some theoretical coherence to policy. In this context, an element of each analytical model will surely be necessary.\]
But the focus of the decision would be on the state’s policies designed to improve the conditions.

C. Capacity

The element of capacity is less analytically distinct than the other two elements, and therefore requires less elaboration. It is entirely possible that the considerations important to this factor are subsumed in the other factors. Nonetheless, it is useful to identify capacity as a separate element even if only as a form of affirmative defense. Before a state can be said to be in social arrears, it must have the financial wherewithal to address at least some of the unmet needs. Thus, to pick an easy example, I would not argue that the government of Somalia faces social arrears. It has virtually no money and no realistic possibility of meeting the development needs of its population. That is not to suggest that the government of Somalia does not bear responsibility for the social conditions within the country, just that it is difficult to reasonably argue that the government of Somalia could, but has chosen not to, meet the social development needs of the population. Instead, I focus on those states in which there is—or appears to be—sufficient wealth to meet many of the social needs of the population, but where the government has apparently chosen not to meet those needs. The reasons for this are more practical than theoretical. Indeed, it might be entirely consistent with my approach to hold even the very poorest states accountable for the conditions in which their citizens live.

The issue is not whether a state’s budget has a particular ratio of education spending to defense spending, for example. Instead, the issue is whether the state’s leaders have chosen to invest state funds abroad in the face of deprivation at home. For my purposes, the most important element of this calculation is whether there are substantial state-controlled investment vehicles that are active internationally. From the perspective of citizens, when leaders decide there is sufficient money in the state’s coffers to invest abroad, it would be difficult not to conclude that should be enough money to provide access to basic services.

V. IMPLEMENTATION AND POSSIBLE COMPLICATIONS

The goal of my theory is to put the debts that states owe to their citizens on the same footing as the debts owed to other creditors. The increasing popularity of sovereign wealth funds has made this issue even more salient because it is now appears that some of the states with the poorest populations actually have substantial resources that the regimes in
power have chosen not to invest internally. To give effect to this normative goal, it is important to recognize the hybrid nature of sovereign wealth funds. They attempt to increase a state’s wealth by investing it in the same way a private investor would. They must answer to financial regulators—as private investors must—and to the citizens who own the money the SWF invests. My policy proposals attempt to harness some of the tools of financial market regulation to bring some coherence to the policy goals of recipient and donor states.

In this Part, I advance three specific proposals that would build on existing law and policy to better ensure that sovereign wealth funds are used for their intended purposes. First, I propose that the Committee on Foreign Investment in the United States include social arrears as a factor in its review of potential investments. CFIUS, a body created by statute to review foreign investment for various national security issues, plays an important (though limited) role in shaping the kinds of investments that foreign corporations may make in the United States. My proposals would broaden the range of investments that CFIUS would be required to review, and add one additional factor for it to consider. Second, I propose a similar change to the implementation of the President’s authority under the International Emergency Economic Powers Act. Under that statute, the President has the power to prohibit or restrict the financial transactions in which foreign persons or entities may engage. I propose that the President consider social arrears as a factor when exercising this authority. Finally, I propose that states in Europe exercise the authority reserved to them under the Code of Liberalization of Capital Movements, which sets out the parameters for financial market regulation in Europe, to restrict investments that come from states with substantial social arrears. Under the Code, states in Europe are permitted to restrict inward investments if those investments would be contrary to state policy. Restricting investments in the face of social arrears would be entirely consistent with this approach.

Before moving on, it is important to acknowledge that my proposals amount to second-best solutions. They call for the imposition of new rules or restrictions on investments from sovereign wealth funds. These new rules would be enforced by regulators in destination states. Of course, it would be far simpler for the states that own sovereign wealth funds to pursue the normative goals that I have identified as principal justifications for SWFs. For example, regimes in control of SWFs might divide the wealth into shares and distribute those shares to citizens. Alaska has just such a system for the distribution of its oil revenue. Oil dividends are paid individually to citizens, thereby increasing the sense of ownership that
citizens feel about the resource, and providing an incentive for citizens to exercise oversight of those who control the revenue. This approach is potentially effective in places with strong institutions of political accountability, but not especially promising in states that do not already have such institutions. For this reason, my approach targets the actors with the greatest potential to enforce the changes I propose.

A. Including Social Arrears as a Condition of Access

All states place some kind of restriction on access to their financial markets. In the United States, for example, the list of people and entities whose access to U.S. financial markets is either blocked or restricted runs 394 single-spaced pages and includes individuals and businesses whose activities are subject to sanctions under a wide range of programs. In the U.S., there are two principal tools—the Committee on Foreign Investment in the United States, which reviews foreign investments, and the President’s authority to bar investments under the International Emergency Economic Powers Act—that permit the government to reject inward investment if it would be contrary to the interests of the U.S. In Europe, the OECD’s Code of Liberalization of Capital Movements, which sets policy regarding restrictions on capital, similarly permits states to reject inward investment if it would be contrary to the national interest. My proposals

110 For a thorough discussion of the benefits of natural wealth accounts, see Martin E. Sandbu, Natural Wealth Accounts: A Proposal for Alleviating the Natural Resource Curse, 34 WORLD DEV. 1153, 1156-1159 (2006) (describing the potential for natural wealth accounts to increase citizen oversight of political leaders by harnessing behavioral biases). See also Keenan, supra note 53 (discussing natural wealth accounts as part of a coordinated approach to increasing citizen involvement in financial management decisions made by politician managers).
112 The Office of Foreign Assets Control is part of the U.S. Department of the Treasury and is charged with maintaining a comprehensive list of people and entities whose assets and activities are subject to sanctions of some sort. See Office of Foreign Assets Control, History, available at http://www.treas.gov/offices/enforcement/ofac/mission.shtml.
would modify existing policy to recognize social arrears as a legitimate reason to reject investment from a SWF. Although I focus on the U.S. and Europe, similar measures could be implemented in other markets as well.

1. United States

In the United States it would be possible to prohibit investments from states with substantial social arrears by modifying existing statutes. In this Part, I show how to do so, and I argue that doing so would be consistent with current U.S. policy and would not require a major reworking of U.S. law. The official policy of the United States, as stated by the President, is to “support unequivocally” international investment because of its potential to promote “economic growth, productivity, competitiveness, and job creation.”

Foreign investment is therefore not only permitted, it is encouraged. But there are restrictions on foreign investment. Such restrictions are typically enforced in one of two ways, both of which nominally focus on national security concerns but are actually more focused on national interests more broadly.

a. Broadening the Scope of Review by the Committee on Foreign Investment in the United States

Certain investments from abroad are reviewed to determine “the effects of the transaction on the national security of the United States.” The review can result in a restructuring of the proposed transaction or a rejection of the transaction altogether. The purpose of the statute is to ensure that foreign states are not able to obtain control of companies or industries essential to the national security of the U.S. The Committee on Foreign Investment in the United States, which conducts the review, was formed in 1975 by an executive order executed by President Ford; now it is authorized by statute. Since September 11, 2001, the scrutiny to which foreign investments are subjected has increased, and the scope of the statute was broadened in 2007.

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118 See CFIUS, 50 U.S.C.S. § 2170 (k).
As the statute now exists, CFIUS must first determine if a transaction falls within its purview; if so, it must investigate the transaction. Two types of transactions come in for review: (a) “covered transactions,” which are those that would result “in foreign control of any person engaged in interstate commerce,”120 and (b) “covered transactions” in which “foreign control” would be exercised by or on behalf of a foreign government.121 Although the exact extent of CFIUS’s review is determined by the type of transaction—foreign-government controlled transactions are subject to greater scrutiny—both types are evaluated to determine the likely effect of the transaction on national security. To make this determination, CFIUS is required to consider a number of specified factors122 and is permitted to consider “such other factors” as it or the President finds appropriate.123

Expanding the scope of CFIUS review to include consideration of social arrears would be consistent with the statute’s purpose and structure. In its current form, the statute gives CFIUS great authority to influence the investment decisions made by foreign entities. CFIUS review into a covered transaction includes a period during which the parties to the transaction can negotiate with the committee and with each other to arrive at a structure for the deal (and for the entity that will result from the deal) that will satisfy the committee’s security concerns. This suggests that as the committee balances the value of open markets and foreign investment in the United States and the importance national security, one of the tools available to it is to determine ownership structures and investment decisions made by foreign corporations and foreign governments.

In addition, CFIUS—and the IEEPA, discussed below—show that, as a matter of policy, the United States is willing to forgo at least some potential economic benefits in the pursuit of other objectives, including policies aimed at improving the human rights situation in foreign countries. Both statues impose some barriers to U.S. financial markets. This means that some transactions that might make economic sense can be prevented entirely or restructured in a way that the market did not initially consider optimal when doing so advances the national interest.

120 CFIUS, 50 U.S.C.S. § 2170 (a)(3). In the language of the statute, such transactions are “covered transactions.” Id.
121 CFIUS, 50 U.S.C.S. § 2170 (a)(4). The statute refers to such transactions as “foreign-government controlled transactions.” Id.
b. Expanding the President’s Authority under the International Emergency Economic Powers Act

In addition to the CFIUS review, there is a separate mechanism by which the U.S. government can restrict or prohibit foreign investment. The President has the power, under the International Emergency Economic Powers Act,\(^\text{124}\) to prohibit or investigate a wide range of financial transactions involving foreign corporations, governments, or citizens. The purpose of the statute is to give the President the tools “to deal with any unusual and extraordinary threat … to the national security, foreign policy, or economy of the United States.”\(^\text{125}\) To exercise this authority, the President must declare a national emergency with respect to the threat.\(^\text{126}\) Presidents have used this authority to restrict financial transactions involving people or corporations associated with the UNITA rebel movement in Angola, crises in Belarus, Ivory Coast, Democratic Republic of Congo, Liberia, Sudan, Syria, and Zimbabwe.\(^\text{127}\)

c. Policy Coherence

The IEEPA allows the President broad latitude to determine what constitutes a threat to U.S. interests. For example, the Executive Order imposing sanctions on persons associated with the conflict in the Democratic Republic of Congo found that the “widespread violence and atrocities that continue to threaten regional stability … constitute[] an unusual and extraordinary threat to the foreign policy of the United States.”\(^\text{128}\) There was evidence of a threat to U.S. national security. Instead, the sole basis upon which the President declared a national emergency was violence that occurred in the DRC. To be clear, I do not argue that this designation was incorrect or should in any way be modified. The conflict in the DRC has and continues to inflict a deadly and tragic toll on the people of that country. Instead, I use this situation to illustrate the broader point that the U.S. has imposed market restrictions as a response to humanitarian crises that posed no direct threat to the U.S.

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\(^{124}\) See IEEPA, 50 U.S.C. § 1701.
\(^{125}\) Id. at § 1701 (a).
\(^{126}\) IEEPA, 50 U.S.C. § 1701 (b).
\(^{127}\) See U.S. Department of Treasury, Office of Foreign Asset Control, at http://www.treas.gov/offices/enforcement/ofac/programs/. The situations listed are in addition to restrictions placed with respect to situations that might appear more likely, including the wars in Afghanistan, the Balkans, and Iraq, and individuals associated with Iran.
At the broadest level of generality, the dominant principle is that access to U.S. markets is a privilege that can be lost or revoked if the party seeking access acts in a way that is contrary to American interests. Under my proposal, CFIUS and the IEEPA would be modified to empower the relevant authority to include social arrears among the factors that could lead to restrictions on access to U.S. financial markets. Doing so would be consistent with existing policy and could be implemented through existing statutes.

2. Europe

States in Europe have similar power to restrict or prohibit inward investment if the investment would be contrary to the national interest. The OECD’s Code of Liberalization of Capital Movements, which sets policy in this area, provides that the general policy encouraging free flows of capital permits states to restrict or prohibit transactions in the service of three broad goals: (1) to maintain “public order or the protection of public health, morals and safety;” (2) to protect a state’s “essential security interests;” and (3) to enable the state to fulfill “its obligations relating to international peace and security.” In the United Kingdom, for example, the government has the authority to intervene in financial transactions to protect the national interest. In France, the state is permitted to intervene in order to protect public health, security, or public order. Germany has a similar provision that also includes the advancement of foreign policy. As in the U.S., European law shows a recognition that access to financial markets is conditional on state behavior, and that one of the conditions is that states that violate Europe’s policies may not benefit from Europe’s financial markets.

130 See Industry Act, 1975, c. 68, § 13 (Eng.) (describing process by which the Secretary of State may block or modify a transaction if it is contrary to the national interest).
133 For a comprehensive survey of such statutes, see STEFFEN KERN, DEUTSCHE BANK RESEARCH, SOVEREIGN WEALTH FUNDS – STATE INVESTMENTS ON THE RISE, Sept. 10, 2007, available at
B. Implementation Issues

One difficulty with giving effect to the policies that I have proposed has to do with how to determine whether a state has social arrears, and if so, whether it has a plan to remedy those arrears. One way to accomplish this would be on a case-by-case basis, as the U.S. currently does under CFIUS. Such an approach has the benefit of allowing for nuanced and case-specific consideration of each transaction and its relationship to the state’s social deficits. But such investigations could become burdensome and could produce inconsistent results.

Another way to accomplish this goal would be to borrow from the model used by the Africa Growth and Opportunity Act, which permits corporations from African states that meet certain requirements to export their goods to the United States under preferential conditions. Under the AGOA model, states are certified annually by the President, based on specific written criteria that are set in the statute. Under this model, the determination as to whether there are substantial social arrears need only be made once for each state, which would make the investment process much more efficient than if each deal was required to be scrutinized for its social implications.

Another potential implementation issue is one that arises when any new regulation is proposed. Regulations, regardless of whatever benefits they may produce, also impose costs. As a general rule, if it possible to achieve the same benefits, or nearly so, without incurring the costs of the regulation, then that course should be followed. With this in mind, one potential mechanism by which to implement a social arrears policy would be reputational. Under this approach, there would be no legally enforceable penalty imposed on states that had substantial outward investments in the face of social arrears at home. Instead the only legal obligation imposed on those states (or on all states) would be disclosure requirements. Thus the state wishing to make the outward investment would be required to do no more than provide data regarding specified social conditions in the country. Consider a hypothetical example. Imagine that Nigeria’s sovereign wealth fund wishes to invest in Microsoft. Under a reputational approach, the SWF would be required to disclose to Microsoft (and its other shareholders)
information about Nigeria’s social arrears. Then Microsoft would weigh the possible reputational harm it might suffer through an association with such an SWF against its need for capital. Despite the potential potency of such reputational factors, there is little evidence that these alone would be sufficient to change state behavior. Indeed, recent empirical work has shown that economic considerations are the most effective tools for shaping state behavior. The most persuasive study was is Emilie Hafner-Burton’s 2005 article on the effect of preferential trade agreements and human rights agreements. Preferential trade agreements govern market access, and often include human rights conditions. Human rights agreements commit states to comply with certain norms but do not contain financial rewards or penalties. Based on an econometric analysis of the uses of such agreements and the incidence of repression and other human rights violations, Burton showed that agreements lacking economic conditions do not decrease human rights violations, while agreements conditioning benefits on improvements in human rights practices do decrease violations.

C. Possible Objections

One possible objection to this policy is that perhaps the policy, if applied across the board, would reduce welfare rather than increase welfare. Surely there are some investments that even the most committed social activists would want a government to make. After all, the theory behind sovereign investment funds is that governments that find themselves flush with cash from sources that might not last should come up with some way to transform this short-term wealth into long-term development. And investments outside of the country are one way to accomplish this. At the same time, it is not at all clear that outward investment by governments in the face of substantial social arrears is the best way to increase the welfare of the people of the country. As the optimal implementation of the social arrears policy might be to impose a kind of penalty on investments made by governments faced with substantial social arrears. On this model, states would be permitted to make investments but might, for example, be required to match the market investments with social investments at home.

137 Id. at 594 (describing scope of agreements).
138 Id. at 619 (finding that conditional agreements “are systematically more likely to decrease repression” than agreements without such conditions).
In this way, the controllers of the sovereign wealth funds would still gain access to the benefits of investments in foreign firms, but only if they were willing to pay a premium in the form of required social investment.

Another plausible objection to my approach is that the difference in specificity between social arrears and financial arrears are sufficiently great as to render the analogy meaningless. Recall the IMF’s policy regarding arrears. The IMF requires states with arrears to privatize creditors to negotiate in good faith to arrive at a settlement. Despite the complexity of the transactions that may be used to eliminate the arrears, in the end it is possible to know with reasonable certainty that all of the affected creditors have been included in the process, and that the arrears have been (or are being) repaid. To simplify greatly, typical arrears negotiations result in a settlement involving easily identified participants, a specific dollar amount that must be repaid, and the deadline by which the repayment must occur. Although this is not the case with social arrears, this objection misses the point of my theory. My aim is to create a theoretical framework for regulating sovereign wealth funds that accounts for their domestic effects in poor countries. To do this, it is necessary to put domestic obligations on an equal footing with other kinds of obligations. Once the policy framework accounts for this theoretical change, then it will be possible to identify the metric by which to measure social arrears.

Implementing rules regarding the measurement of social arrears might be more complicated, particularly with respect to two issues: the magnitude of the arrears, the identity of the “creditors,” and whether those creditors are satisfied. This increasing importance of the good faith requirement shows that the IMF considers its loans to be a benefaction in two distinct ways. Most obviously, states benefit from the fact that funds are provided on terms more favorable than would otherwise be available from private lenders. This is the mission of the IMF, and is intended to benefit states in financial or economic crisis. But the provision of funds in the first place hinges not solely on financial or economic factors, but on the way the state negotiates with its private creditors. It is not enough that states need the IMF’s help because of a crisis—that merely makes them eligible for assistance. In addition, states must also behave in a way that satisfies the IMF.

IV. CONCLUSION

Sovereign wealth fund are a way for states to invest in international financial markets to pursue investments with higher yields than would
otherwise be available. When states choose this path despite widespread poverty or deprivation at home, they are doing one of two things: either deliberately ignoring their debts to their own citizens, or pursuing a master plan to make as much money as possible to later help their people. If it is the latter, then evidence of that plan would be enough to keep them out of social arrears. But when donor states permit sovereign investments without such evidence, they are facilitating social arrears. My theory of social arrears and the policies I have proposed would go a long way toward creating a coherent regulatory approach to sovereign wealth funds that recognizes their international and domestic obligations.