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INTERNATIONAL INVESTMENT OF SOVEREIGN WEALTH FUNDS

(Note by the Secretariat)

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It is circulated as background for the Investment Committee's consultation with BIAC, TUAC and NGOs on sovereign wealth funds to be held on 13 December 2007, starting at 3:00 p.m.

Andrea Goldstein; Email: andrea.goldstein@oecd.org; Tel.: ++33 1 45 24 89 46

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INTERNATIONAL INVESTMENT OF SOVEREIGN WEALTH FUNDS

The emergence of sovereign wealth funds (SWF) as major international investors has aroused public unease. Concerns relate to risks that SWFs' investment flows may destabilise financial markets, and that investments by foreign government-controlled investors – SWFs or state-owned enterprises - may be motivated by political objectives and pose potential security threats. OECD countries and non-OECD partners are looking for ways to address these concerns while avoiding unnecessary restrictions on international investments.

SWFs have been growing rapidly

Sovereign wealth funds (SWFs) – government-owned investment vehicles that are funded by foreign exchange assets - have existed for several decades. What is new is their spectacular growth, driven by large current account surpluses and increased revenues in oil producing economies, and the size of their overseas investments, especially by SWFs from non-OECD emerging economies (see table).

Table. Largest 11 sovereign wealth funds, 2006

Country	Year established	Assets under management (US$ bn.)
United Arab Emirates	1976	688
Norway*	1990	316
Singapore (GIC)	1981	215
Kuwait	1976	174
Russia	2004	122
Singapore (Temasek)	1974	108
China	2003	66
Qatar	2005	50
Algeria	2000	43
United States (Alaska)	1976	40
Kuwait	1961	39

Sources: Peterson Institute for International Economics, August 2007, and OECD Secretariat.
* SWF classified by OECD Global Pension Statistics as pension reserve fund.

International investment by SWFs raises concerns in host countries

In fact, the assets managed by SWFs represent a small part of global financial markets. But since SWFs (and other new investment vehicles) are not closely supervised by home country financial market authorities, there is less opportunity to control for possible negative impacts of their investments on global market stability.

When an investor, such as a SWF or a state-owned enterprise (SOE), is controlled by a foreign government, host countries perceive a risk that the investment decisions can be motivated by political objectives, rather than by normal profit considerations, and that they can target security-sensitive and other "strategic" assets.

SWFs provide benefits

Several of the objectives that guide SWFs, in particular diversification of assets, search for better returns than on exchange reserves and longer-term strategies, suggest that they can contribute to greater stability in the global financial system.

Recent major deals by non-OECD SWFs

Apart from a few exceptions it is difficult to keep track of many deals concluded by SWFs, unless they are notified to financial services regulators. Recent examples by non-OECD SWF so far in 2007 include:

- *Singapore's Temasek invested £975 million in Barclays bank, equivalent to 2.1% of issued share capital; US$315 million in China Eastern Air, equivalent to 8.3% of the enlarged capital and acquired a 10% stake in Minh Phu, Vietnam's largest shrimp processor and exporter for an undisclosed sum.*
- *China's newly-formed state investment fund purchased the largest external stake in Blackstone, a private equity group that, indirectly through its holdings, is one of the largest employers in the US;*
- *Delta Two, a fund backed by the Qatar Investment Authority, is close to gaining control of J. Sainsbury, one of Britain's largest supermarket chains; and purchased jointly with Borse Dubai, which is 60% owned by the Investment Corporation of Dubai a 50% stake in the London Stock Exchange.*

SWFs' overseas investments also provide new capital to the host countries' enterprises and can deliver other benefits normally associated with foreign investment.

OECD countries wish to avoid unnecessary discriminatory restrictions on foreign government-controlled investments

OECD countries have a long-standing commitment to promote the freedom of investment. The OECD Codes of Liberalisation and the National Treatment instrument of the Declaration on International Investment and Multinational Enterprises provide standards of open and transparent investment policy.

During the past year, in view of changing perceptions of national security, OECD countries and non-OECD partners have worked together on "freedom of investment and national security". They agree that any policy responses to national security concerns should remain consistent with rights and obligations under international agreements. And they agree that any restrictions on investment should also be guided by the principles of proportionality, regulatory transparency and predictability, and accountability of the implementing authorities.

Restrictions on foreign government controlled investors

Very few OECD countries practice statutory discrimination against foreign government controlled investors.

Four, out of thirty, OECD members have lodged reservations under the OECD Code of Liberalisation of Capital Movements in order to allow the maintenance of restrictions targeted at inward investment by foreign governments or foreign state-owned enterprises.

Foreign government ownership is reported by as another OECD member to be a consideration in applying the public interest test of merger reviews under its competition law. In another OECD Member, this commands a second-stage investigation in its national security-related investment review mechanism.

None of the ten non-OECD countries that have adhered to the OECD Declaration on International Investment and Multinational Enterprises have exceptions to its National Treatment instrument in this area.

In particular, "proportionality" means that a restriction and the burden imposed on a foreign investor should be proportional to the objective pursued and that other available remedies to the problem should be used before considering new restrictions.

For instance, host country financial market regulations, including disclosure rules, apply to SWFs and will promote transparency and discipline; merger reviews under competition law can help address market distortions which might arise from foreign government support for corporate takeovers. National security-focussed investment reviews and related intelligence services are designed to protect essential security interests.

Home countries can ease concerns by promoting transparency of their SWFs

There is little systematic information on the corporate governance and objectives of SWFs. And practices among SWFs vary widely. For instance, the Norwegian Government Pension Fund – the biggest equity owner in Europe – is very transparent and adopts high standards, including the OECD Principles of Corporate Governance and the OECD Guidelines for Multinational Enterprises. Other SWFs publicly disclose little information on their governance or investment strategies.

It is in the interest of SWFs and their home country governments to ensure that high standards of transparency, risk management, disclosure and accountability are observed. This will not only facilitate public acceptance of SWFs' access to foreign markets, but will also support their financial management and ultimately benefit the country's own development.

Freedom of Investment and the G8 Heiligendamm Declaration

"…we remain committed to minimize any national restrictions on foreign investment. Such restrictions should apply to very limited cases which primarily concern national security. The general principles to be followed in such cases are non-discrimination, transparency and predictability. In any case, restrictive measures should not exceed the necessary scope, intensity and duration. Applicable treaties relating to investment remain unaffected. We encourage the OECD to continue its work on these issues, especially by identifying best practices and by further developing general principles. We will work with the OECD and other fora to develop further our common understanding of transparency principles for market-driven cross border investment of both private and state-owned enterprises."

Extract from Heiligendamm G8 Declaration June 2007, paragraph 11

OECD countries have developed unique Guidelines for Corporate Governance of State Owned Enterprises (the SOE Guidelines). The Guidelines include guidance on issues that are of interest to both SWFs and SOEs.

International co-operation can build mutual trust and keep markets open

The OECD Investment Committee and its non-OECD partners have agreed that over the coming period they will follow a two-track approach to these issues:

- Dialogue among governments, SWFs and the private sector to improve understanding of both home and host country approaches to foreign investment;

- Exchange experiences in relation to national security protection and develop shared views on investment policies that observe the principles of proportionality, transparency and predictability, and accountability and that also avoid unnecessary restrictions to international investment, including by SWFs.