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**Book**

## Sovereign Wealth Funds: Between the State and Markets

Finance Matters

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# Sovereign Wealth Funds

Adam D. Dixon  
Patrick J. Schena  
Javier Capapé

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# SOVEREIGN WEALTH FUNDS

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# **SOVEREIGN WEALTH FUNDS**

## **Between the State and Markets**

**ADAM D. DIXON, PATRICK J. SCHENA  
AND JAVIER CAPAPÉ**

**agenda**  
publishing

For  
Olga, Fay, and Juno  
Tina and Michela  
Mariana

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## INTRODUCTION

At the joint annual meeting of the International Monetary Fund (IMF) and the World Bank in 2007, on the eve of the global financial crisis, the United States forwarded a proposal to keep global financial markets open to investment from sovereign wealth funds (SWFs) – large state-owned institutional investors that few people were aware existed but whose capital was (and would become) an important resource in the forthcoming crisis. In the years prior, politicians in the United States and Europe had made sceptical remarks about this newly emerging class of institutional investors, with many coming from oil-rich countries in the Middle East or illiberal east Asian powers, such as China, with the implication that such investors had mercantile and geopolitical motivations underpinning their investment decisions. Once the crisis and subsequent recession materialized, such criticism mostly vanished. The IMF sponsored a working group on SWFs, which devised a set of governance and disclosure principles, known commonly as the Santiago Principles. The working group would eventually become the International Forum of Sovereign Wealth Funds (IFSWF) – a voluntary grouping of SWFs whose aim is to promote the Santiago Principles, and hence greater transparency and understanding of SWFs. Ultimately, the Santiago Principles and the IFSWF have become important mechanisms through which SWFs – and, as such, state capital – are legitimized in global financial markets.

Since the introduction of the Santiago Principles over a decade ago, SWFs are seemingly accepted as benign giants, acting on commercial grounds. What is more, there are now upwards of 100 sovereign funds, from fewer than 50 in the first decade of the century. Assets under management have nearly tripled, to over \$9 trillion. From developing to developed economies, governments across the globe are looking at establishing SWFs as an economic policy tool, whether to manage natural resource revenues or to catalyse new industries at home as part of reinvigorated and muscular industrial policies. But their acceptance by other financial market actors and the international policy community should not be taken for granted. The concerns about “state capital” that engendered criticism

in the early years of this century have reappeared, and may come to haunt SWFs yet again.

The aim of this book is to provide an accessible overview of what SWFs are, how they are different, what they do and what influence they have, as well as some of the global and national political economy dynamics that shape what they are and how they operate. As such, this book aims to be an accessible reference for students and practitioners alike of political economy and globalization, broadly defined.

We approach the topic as researchers and analysts of SWFs who bring years of regular interaction with the SWF community, which provides us with a nuanced and empirically grounded understanding of these actors and the issues they face and have faced. Although we would not claim to be ethnographers in the traditional sense, we have benefited from being in the room or having “close dialogue” with those who have.<sup>1</sup>

The book comprises six chapters, working from an introductory chapter that answers the basic question of “What is an SWF?,” providing a definition and delineating various types of SWFs, through to four chapters that unpack the short global history of SWFs, how they are being made legitimate actors in global financial markets, the role they play in global financial markets as providers of capital and their role in economic development at home and abroad.

In [Chapter 1](#), we take a simple definition that an SWF is a state-sponsored institutional investor that is liable only to the state and invested in accordance with a mandate defined by the interests of the state. By this logic, SWFs have a freedom of action that is unconstrained in comparison to other large institutional investors, such as public pension funds, which are liable to their members and sponsor. But this simple definition says nothing about the diversity of SWFs in terms of their source capital, their size and their investment mandate. We then unpack the different types of SWFs, from commodity-based funds that are part and parcel of natural resource revenue management, to surplus savings funds and strategic investment funds. We also situate this taxonomy in an historical frame, noting how different types of sovereign wealth funds have emerged in the context of particular economic conjunctures.

SWFs are often assumed to be a source of patient capital on account of their attachment to the state. They should have a long horizon. In [Chapter 2](#), we use this framing to consider the short history of SWFs. There are two problems with this logic, however. First, the assumption that the “state” has a longer planning time horizon, which sovereign wealth funds likewise embody, is problematic, since many SWFs are from states that are young, or with young regimes. It is unclear how sustainable SWFs are over time when such regimes change. Governments come and go. Second, although SWFs have been welcomed in global financial markets, it is uncertain whether this will continue, as more and more states

become increasingly concerned with the presence of state capital and establish their own SWFs. In other words, the global political order is not static.

In the global political order, the norms and conventions that underwrite markets emphasize the role of market actors as mainly private agents. Although the power resources and therefore the scope of action of any agent – public or private – is contingent on various factors, such as the scale of their financial resources and the sophistication of the tools and organizational resources at hand, the assumption of the global market order is that, in principle, relations of exchange occur subject to an exclusively commercial logic. As agents of the state, and assuming that all states have geopolitical and national economic interests, this exclusively commercial logic is not a given. Consequently, the role of SWFs as legitimate global market actors operating with strictly commercial intent cannot be presumed; it must be established and reinforced. Hence, in [Chapter 3](#), we outline and analyse the history and evolution of the structures of governance under which SWFs have defined their engagement in the global political order, unpacking the history of the drafting of the Santiago Principles and their continued institutionalization through the IFSWF.

If the main concern of sceptics, separate from general ideological reservations about state capital, is that SWFs can negatively influence the functioning of global capital markets in the interest of their sponsoring states, there are few SWFs of significant scale and reach to shape global markets in any significant way. Most SWFs are of limited size to even draw attention, save for individual transactions or in their home media markets. Although sceptics would be hard pressed to find evidence of large SWFs upending market functions at an aggregate level, some large SWFs are nonetheless important market actors, at least in terms of shaping certain trends. In [Chapter 4](#), we discuss the place of SWFs in public equities and in private markets. We consider how Norway's GPF has been an important figure in efforts to incorporate sustainable finance and climate change considerations in investment decision-making, and how increasing numbers of SWFs are taking up the cause through new initiatives, such as the One Planet Sovereign Wealth Funds framework. We also consider how some SWFs, such as Singapore's Temasek and GIC, have become influential in private markets through their participation in – and, in some cases, leadership of – large investment consortia, such as those focused on disruptive innovation.

Market influence is not always contingent on the size of the SWF, however. In recent years there has been a concerted growth in so-called strategic investment funds, which are focused on supporting national economic development through targeted investment in specific sectors, including infrastructure. Many of these funds have limited financial resources, focusing instead on attracting and leveraging foreign (and domestic) investors to join and advance investment projects. [Chapter 5](#) therefore considers the role of the sovereign fund in economic

development. SWFs can have an indirect or direct role in economic development. For example, many commodity-based funds are invested in a portfolio of international securities to minimize so-called “Dutch disease” and to address the limited absorptive capacity of some less diversified emerging economies, particularly during periods of high or volatile commodity prices. An SWF can thus serve to mitigate the impact of fluctuations in natural resource revenues received by the government over time and enhance the sustainability of economic development. By contrast, in the case of a dedicated strategic investment fund, or other types of SWFs that are allowed to invest domestically, investing at home is meant to directly shape economic development by addressing market failures and conditioning and catalysing sectors for greater global competitiveness. What is key, however, is that such investment is supposed to be market-conforming and generative of financial returns to the government. Notwithstanding this, a fund that makes strategic domestic investments must reconcile its commercial interests with the economic and industrial policy goals of the state and political pressures from parochial interests.

At a fundamental level, SWFs are creatures of the state. This does not mean they cannot be designed to operate as commercially driven organizations free of direct political meddling. Nonetheless, they are a form of state capital. Consequently, they are seen by some as representing and driving the emergence of a new state capitalism. But what is state capitalism? Rather than simply summarizing the preceding chapters, our final chapter reflects on recent work that critically engages with state capitalism as a theoretical construct and an empirical object. SWFs in most cases, though certainly not all, operate in a commercial manner no different from cognate private sector investors. Hence, their working within and reinforcing a liberal market order suggests the need for greater care in how we understand them as state capital. Nevertheless, even if SWFs have not challenged the liberal market order in a fundamental way, how we understand the liberal market order will be increasingly difficult without also understanding state capital, and the place of the SWF therein.

## 1

# WHAT IS A SOVEREIGN WEALTH FUND?

At the end of the twentieth century, the economic mood was one of triumphant market capitalism. The Soviet Union had become a thing of the past; China had firmly committed to embracing market logics and integrating itself into the world economy; and the neoliberal revolution ushered in by the likes of Ronald Reagan and Margaret Thatcher, in the United States and the United Kingdom, informed policy choices and policy designs across countries poor and rich alike (Harvey 2005). Barriers to trade and the flow of capital had been decisively reduced, blurring the boundaries of national markets. The international economy increasingly resembled a *global* economy, criss-crossed by complex networks of production and finance, coordinated by multinational corporations and financial institutions in global cities such as London, New York, Hong Kong and Singapore. A world economy characterized materially and discursively as a system of sovereign nation states seemed to have ceded authority and control to the market and private actors, retaining only the limited regulatory and legal architectures necessary to ensure proper functioning.<sup>1</sup> For many, globalization, and the growth of increasingly market-based forms of governance that it brought with it, heralded the hollowing out of the state (Cerny 1999). The state, and the possibilities it brings as an agent of economic governance, were relegated to the sidelines, and delegitimized as the appropriate site for shaping distributional outcomes. Those decisions, by contrast, were left to the market – a market populated with independent private agents.

Driving globalization before and after the millennium has involved, in significant part, the increasing expansion and integration of financial markets, or what some refer to as financialization (Mader, Mertens & Van der Zwan 2020). The 2008 global financial crisis, the worst since the Great Depression, demonstrated the degree to which many economies had become absorbed by and dependent on global financial processes, flows and performance (Clark, Dixon & Monk 2009). Whereas the expansion of financial markets drove globalization, pooling ever greater sums of capital to grease the wheels of trade and commerce, the



globalization of financial markets became necessary to capture value creation no longer tied to the prospects of a national economy but to those of a global marketplace where borders are fluid and, moreover, where value produced from economic activity is conferred on the shareholder (Clark & Wójcik 2007; Dixon 2014b). Beginning in the 1980s, the shareholder value paradigm became the norm in the global economy. As such, the place of the investor in contemporary capitalism, from the individual to private equity firms and large asset managers, has become increasingly visible and important (Preda 2005). This contrasts with early stakeholder forms of corporate governance, characteristic of the so-called “golden age” of capitalism after the Second World War in the advanced democracies of Europe, Japan, and to some extent the Anglo-American economies, where shareholder value did not receive exclusive priority and, for that matter, where financial markets mattered little to the prospects and possibilities of the firm (Lazonick & O’Sullivan 2000).

Curiously, globalization and financialization have not actually led to the wholesale retreat of the state. Rather than ceding ground to private agents and markets, with the state sitting on the sidelines, the last two decades have actually seen the growing and direct involvement of states in supposedly free markets. The 2008 global financial crisis was a reminder of the critical lender-of-last resort role played by the state, and the excesses of unbridled markets. If much of the response, at least in the West, was premised on returning to the status quo ante whereby state intervention and direct involvement are no longer the norm, the global economy is anything but. In particular, state capital in various forms is ascendant. For example, state-owned enterprises (SOEs) now dwarf the largest privately owned multinational corporations and are increasingly integrated in global networks of trade and commerce (Bruton *et al.* 2015; Musacchio & Lazzarini 2014). Sovereign wealth funds, the focus of this book, have likewise become important players in global financial markets, and in some countries important domestic investors and owners of capital. These state-controlled institutional investors have grown in almost exponential terms, from a handful before the millennium to over 90 today, and with assets in excess of \$9 trillion.<sup>2</sup>

But the ascendance of SOEs and SWFs does not necessarily portend a return to the greater politicization of markets, at least at the operational level of these funds and the transactions they make, or a return to non-market forms of planning and economic distribution. By contrast, these agents of the state are, as most evidence suggests, focused on conforming to market norms and expectations in how they operate, how they transact with counterparties and how, ultimately, they compete (Rose 2013). In this respect, the market logic espoused in the neoliberal revolution of the 1980s is still manifest, though with actors that are slightly at odds with what its intellectual forbears had expected with regard to the state’s role in the economy (Peck 2010). The liberal norms

that underwrite the global economic order are still based on the expectation that states individually and in concert provide the regulatory and legal architecture of markets, but the state must remain, in principle, on the sidelines. Tolerance of a state player is limited (Truman 2010; Lavelle 2017). In short, the legitimacy of SOEs and SWFs in the global political economy, or simply their acceptance, rests on their capacity to conform to prevailing expectations. Indeed, as agents of the state that fulfil one or more policy objectives and that reflect a political decision on the part of the state to retain and control capital, SWFs and SOEs can never fully be seen as apolitical (Clark & Dixon 2017).

What complicates any attempt to generalize the rise of state capital in general, and SWFs in particular, as indicative of some significant material change in the global economy is the sheer diversity of the field. Although they are concentrated in the so-called Global South and partial democracies and autocracies, SWFs are present in countries across the income and political spectrums. Moreover, they range from the very small, with less than \$1 billion under management, to mega-sized funds such as Norway's Government Pension Fund Global (GPF), which has over \$1 trillion under management. The source capital of SWFs is also different, from natural resource revenues and excess foreign exchange reserves to fiscal surpluses and legacy ownership claims over state assets. Their policy functions range from stabilizing government revenues from volatile natural resource revenues to saving for future generations to supporting national development objectives. As a result, how SWFs invest and where can be very different, from passive portfolio to very targeted strategic investment.

This chapter unpacks the diverse field of SWFs. It provides, in short, an answer to the question "What is an SWF?". The next section provides a comprehensive definition of what an SWF is and what SWFs provide for the state as policy tools. Thereafter, the chapter delineates different types of SWFs, focusing on their source capital, their policy function and how this influences the scope of the SWF as a financial institution. The final section concludes, considering the agency that SWFs provide as a power resource for the state at home and in the global economy.

## **Defining sovereign wealth funds**

What is an SWF? Answering this question is difficult and problematic, for several reasons. On the one hand, what constitutes a "fund" can be a variety of different things. Any pool of capital could be considered a fund. But how a fund is invested and what it is invested in can vary significantly from one fund to the next. Funds can be invested in safe low-risk assets or high-risk, high-return assets. They can be invested on a short-term time horizon or a long-term

horizon. Funds can be an accounting entry on some balance sheet (e.g. of the central bank), with asset management delegated to third parties, or they can be a separate institutional and organizational unit that is the “fund”, with some asset classes managed in-house (Aguilera, Capapé & Santiso 2016). At the same time, defining what wealth means is a normative process. Often wealth assumes some degree of abundance; yet there are SWFs from countries across the income spectrum, from rich to poor. Many are from developing countries, where the SWF is a tool to support development, such as limiting the adverse effects of the so-called “resource curse” from volatile natural resource revenues. In short, having an SWF does not necessarily signify wealth in the sense of being rich. Finally, the “sovereign” in SWFs can manifest in a number of forms. “Sovereign” is used often as shorthand for “the state”, but effective control of a state is very different from one country to the next, from a single party or ruling family to a multi-party democracy (Dixon & Monk 2012). This has implications for who controls and benefits from an SWF. The “sovereign” in SWFs does not, for example, necessarily signify the peoples’ wealth (see Cummine 2016).

With such variability of characteristics, the proliferation of SWFs in the last decade has only further complicated definitional problems. When the investment management professional Andrew Rozanov coined the term in 2005, the sovereign wealth fund mainly captured new commodity and foreign exchange reserve funds that were beginning to have a larger presence on the world stage and were beginning to diversify their portfolios into different asset classes (see Rozanov 2005). Although some SWFs had been around for decades, such as the Kuwait Investment Authority (KIA), established in 1953, more and more countries – as the next section discusses – were starting to accumulate capital in a significant way, thus necessitating some terminological precision. SWFs started to receive more attention in 2006, when Western governments, particularly the United States but also in Europe, became suspicious of the intent and implication of growing pools of state-controlled capital (Norton 2010; Lavelle 2017). As discussed further in [Chapter 3](#), this led to the establishment of the International Working Group of Sovereign Wealth Funds (IWG), organized in conjunction with the International Monetary Fund to derive a set of Generally Accepted Principles and Practices (GAPP), commonly referred to as the Santiago Principles. The understanding and definitional debates at that time typically considered SWFs as serving some macroeconomic function (e.g. resource revenue management, foreign exchange management), invested in foreign assets, as portfolio investors aiming for a broadly diversified asset allocation.<sup>3</sup> This largely reflected the characteristics of the member funds of the IWG, which later became the International Forum of Sovereign Wealth Funds. This implicitly excluded other types of state-controlled investment funds, however, such

as government holding companies and strategic investment funds investing in domestic assets.

In practice, what constitutes an SWF includes various types of government-owned and -controlled institutional investor. Clark, Dixon and Monk (2013: 16), provide a technical definition of SWFs as follows:

SWFs are government-owned and controlled (directly or indirectly) investment funds that have no outside beneficiaries or liabilities (beyond the government or the citizenry in abstract) and invest their assets, either in the short or long-term, according to the interests and objectives of the sovereign sponsor.

This definition is useful in that it is broad enough to include SWFs that invest in foreign and/or domestic assets, and the variety of types and sources of capital (see following section). It also stresses that SWFs are government-controlled investment funds whose purpose is to serve some policy objective and interest of the sovereign sponsor, as ownership rests with the state and the state is the beneficiary. This is important in distinguishing SWFs from other large asset owners, such as public employee pension funds, for which a government may be the sponsor of a fund but the assets are, in principle, owned by the government employees as pension liabilities (i.e. deferred wages). By contrast, the Clark, Dixon and Monk definition holds that SWFs have no outside liabilities; there are no outside creditors that can lay direct claim to the assets of the SWF. This is different from the claims that a holder of a sovereign bond has on a government. In short, the SWF is an investment vehicle in which the absence of a specific liability to an outside party (this does not exclude possible intragovernmental liabilities) affords the sovereign sponsor a freedom of action with regard to what the purpose of the SWF is and how it operates accordingly. This does not mean that SWFs are necessarily subject to political influence in terms of operational and investment decisions (see [Chapter 3](#)).

Although we find that defining SWFs as investors without liabilities as a general condition to distinguish SWFs from other types of institutional investor is a necessary exercise, this has the effect of excluding some SWFs, particularly strategic investment funds, that use leverage when making certain investments or those that have raised capital to increase their assets under management (operating comparably to private equity funds). For example, the 1Malaysia Development Berhad (1MDB), which eventually collapsed under a shroud of corruption, issued bonds to fund investment projects that were, in turn, guaranteed by the International Petroleum Investment Company (now part of Abu Dhabi's strategic investment fund Mubadala). Based on Clark, Dixon and Monk's definition, 1MDB would be excluded as an SWF. Yet 1MDB was owned by the

Malaysian state and controlled directly by the prime minister, and the fund itself claimed to be an SWF. Hence, we take a slightly more flexible view that includes SWFs that have financial liabilities, but with the caveat that the SWF must have other variables that distinguish it from other institutional investors that are not an SWF (e.g. a public employee pension fund).

### **A taxonomy of SWFs**

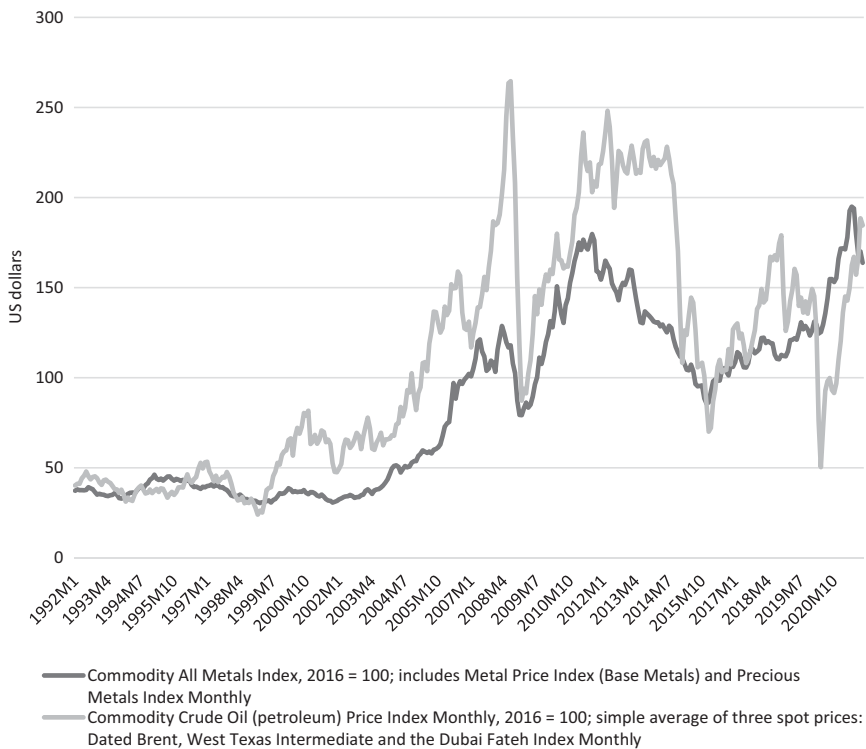
A basic means of classifying SWFs is based on where the accumulated capital comes from and the policy remit. Focusing on the source of capital is not arbitrary. Where the capital comes from reflects important characteristics of the sponsoring country's (political) economy, global economic dynamics and what the SWF is (or is supposed to be) for. Source capital is limited, however, in that it does not necessarily indicate how or in what an SWF invests. We classify three types of SWF based on source capital: commodity-based funds; surplus savings funds; and strategic investment funds. Although these categories are useful in helping explain the origins of SWFs and the intended policy purpose they may support, this does not necessarily mean there is within-group homogeneity regarding the investment policy of the SWF and its specific policy purpose. At the same time, the categories are not necessarily mutually exclusive in some cases. For example, there are strategic investment funds in the Middle East, such as Abu Dhabi's Mubadala, which are not considered commodity-based funds yet the source capital, in the main, is derivative of hydrocarbon revenues. Equally, although we distinguish strategic investment funds as a separate category, this does not mean that SWFs in other categories do not engage in strategic investment activities. As such, our classification should not be read as a typology for theory building.

### **Commodity-based SWFs**

SWFs that receive their source capital from natural resource revenues, namely finite hydrocarbon or mineral resources, have a special place in the SWF universe. On the one hand, the first and oldest SWFs, as [Chapter 2](#) discusses, are commodity-based funds. On the other hand, the commodity-based SWF has a more natural – or, rather, less controversial – policy basis than other types of SWF, given the nature of natural resource revenues and their management over time. This does not hold, for example, for strategic investment funds for which capital allocation could be left to market dynamics and private sector agents; or in the case of surplus savings funds, which emerge from macroeconomic policy

decisions, such as trying to manage the exchange rate to optimize the terms of trade rather than operating a free float. This does not mean that commodity-based SWFs have nor should follow the same policy prescriptions with regard to how natural resource revenues are managed over time.

Commodity-based SWFs have grown in number and, in particular, in size as a result of the historically high commodity prices (short-term volatility and two significant price collapses in 2008 and 2015 notwithstanding) in the last 20 years in comparison with the 1990s. As [Figure 1.1](#) shows, hydrocarbon and mineral prices were on average more than double or triple what they were before 2000. The reasons behind such high prices stem from the very globalization (and, arguably, also the financialization) discussed in the introduction of this chapter. The rapid growth of emerging economies and their burgeoning middle classes, mainly in China but also in India, coupled with sustained demand in advanced economies, drove commodity prices to heights rarely seen beforehand. For producing countries, this translated into a significant revenue windfall.



**Figure 1.1** Crude oil and metals price indices, 1992–2020

Source: IMF primary commodity prices.

Existing producers, such as Norway and Gulf states, saw significant inflows, while strong commodity demand pushed production to new places, providing an opportunity for some developing countries to benefit, particularly in Africa. For rich and poor alike, however, this rapid growth in commodity revenue posed a problem. Revenue windfalls can have a significant negative effect on the economy and need to be managed.

There are three properties of non-renewable natural resource revenues. First, whereas natural resources are finite, the revenues thereof are necessarily temporary. Although the production time horizon can be long for some countries with significant reserves, in many cases this is not the case. Second, natural resource revenues are prone to significant price volatility (sometimes to a very significant degree), such that they are inherently unreliable and any one producer cannot individually moderate. For governments that depend on these revenues to cover public spending, which is the case for most major commodity-producing countries, this poses a significant challenge in budgetary planning from one year to the next. Spending decisions made during boom periods are difficult to cover when revenues collapse. Such pro-cyclical spending decisions then lead to a deterioration in national accounts, as governments plug deficits with increased borrowing. Third, windfall revenues are inflationary on domestic prices and the exchange rate. Referred to conventionally as “Dutch disease”, in reference to the experience of the Netherlands after the discovery of major gas reserves in 1959, this inflationary pressure constrains the development of other sectors in the economy, limiting the buffer that economic diversification of the economy would bring. Hence, windfalls can make the economy even more reliant on the extractives sector (for a general overview of the issues, see Auty 2001).<sup>4</sup>

For natural-resource-producing countries, the SWF has become a tool to address these problems (Alsweilem & Rietveld 2018). At a basic level, the SWF allows the government to hold foreign-denominated assets purchased from natural resource revenues. In other words, the government keeps the natural resource revenues out of the domestic economy, which addresses the absorptive capacity issue (i.e. the capacity of the economy to absorb efficiently in a short period) as well as the inflationary effects that would occur if revenues from international sales were converted into the local currency. This does not mean, however, that the SWF is necessarily a savings vehicle for future generations. This is a common misconception of what a commodity-based SWF is.

For some countries, there are reasons to sequester resources as long-term savings for future generations, as Norway does, for example. For developing countries where capital is scarce and the population can benefit from greater spending on health, education and better infrastructure, this is a poor policy choice, particularly as the costs of their sovereign debt probably exceed the financial returns they would receive from investing natural resource revenues in

global capital markets. For such countries, the emphasis should be saving only that which is necessary to smooth out the volatility in natural resource revenues over the short and medium term, and with regard to macroeconomic stability and absorptive capacity. SWFs that fulfil this function are referred to as stabilization funds (Ossowski & Halland 2016).

Having an SWF to manage natural resource revenues may also serve political interests. In some resource-rich countries, such as some Gulf states, political authority is concentrated in the form of an absolute monarchy and is, in part, sustained by what is referred to as a rentier social contract (for more extensive discussions, see, for example, Beblawi 1990; Ross 2012; van der Ploeg 2011; Rosser 2006; Gelb 1988; Karl 1997). Here, governments rely on natural resource revenues to cover public spending and investment, and therefore placate public demands. This means there is little need to revert to popular taxation and the democratic accountability that is expected thereof. In this equation, the SWF helps the ruling regime manage this relationship over time. The SWF turns finite natural resources into a financial resource whereby the regime can utilize the returns of the SWF to cover public outlays, such that the rentier social contract persists beyond the production time horizon of natural resources.

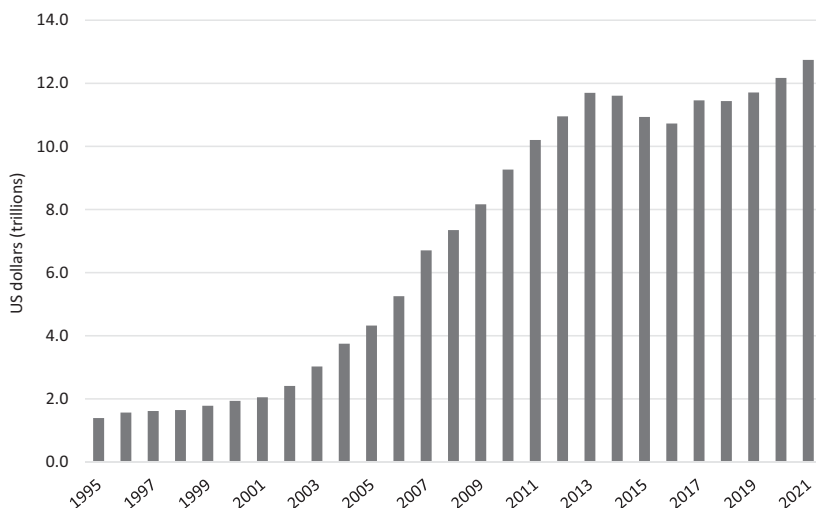
### Surplus savings funds

Taxonomies of SWFs frequently distinguish between two additional types of savings funds: reserve funds, typically derived from accumulated foreign exchange; and pension reserve funds. Although the policy purpose of these two types of funds is different, we combine these, and other similar reserve funds, into a single category: surplus savings funds. The point is to distinguish savings funds that are not derivative, at least primarily, of natural resource revenues and the management thereof. This would include, for example, the Australia Future Fund, which was established in 2006 from government surpluses and the proceeds from privatizing Telstra, the former state telecoms company. Part of the fortuitous fiscal position of the Australian government at that time, and thereafter, has been supported by the country's success as a commodity exporter, particularly in minerals (Clark & Knight 2011). Yet the Future Fund is not typically conceived of as a commodity-based SWF, as it is not directly linked to a natural resource revenue management framework. This is a further example of the difficulty of separating SWFs into distinct categories in a theoretically meaningful way.

The example of the Australia Future Fund, and the fortuitous fiscal position that underwrote its foundation, is part of the east Asian growth story of the last 20 years, which is also the basis for most surplus savings funds. These funds,



## SOVEREIGN WEALTH FUNDS



**Figure 1.2** Total world foreign exchange reserves, 1995–2021

*Source:* IMF currency composition of official foreign exchange reserves, 1995–2021.

such as GIC of Singapore, the Korea Investment Corporation or the China Investment Corporation (CIC), are generally financed from foreign exchange reserves, which have ballooned in the last two decades (see [Figure 1.2](#), which shows the total global volume of accumulated foreign exchange reserves) (Aizenman, Cheung & Ito 2015). In the case of the CIC, for example, it was established in 2007 with initial capital financed through a swap transaction with the People’s Bank of China (PBOC), the country’s central bank, and the State Administration of Foreign Exchange (SAFE). In effect, the Chinese government lent money to itself. This money was available because of China’s huge current account surpluses from its booming exports to the rest of the world, which were supported through a low exchange rate policy. Maintaining this low exchange rate as part of an export-led growth model required amassing huge amounts of foreign currency, which was placed mainly in US Treasuries. There is a cost to doing this, however, as the return on US Treasuries was lower than the rates that the PBOC had to pay bond holders in China to sterilize the purchase of foreign exchange (Balding 2012). This created an incentive to reinvest these reserves in higher-yielding assets through an SWF. Within China there was also public criticism about having such large holdings concentrated in US public debt, as well as strategic arguments from the National Development and Reform Commission that reserves should be used to secure supplies of key natural resources as a matter of national security (Liew & He 2010).

The existence of different incentives and motives for diversifying foreign exchange reserves is one reason we refrain from the simple “reserve fund” classification. It is also to emphasize that the accumulation of massive reserves is not a natural outcome of market dynamics; export-led growth models in east Asia have been supported by low-exchange-rate policies, which reflects a development strategy taken by governments. But the emphasis on amassing huge savings in east Asia is also a consequence of the 1997 Asian financial crisis. That crisis saw significant economic and social hardship across the region. Countries, such as South Korea, had to go to the IMF for support in covering their balance of payments. But going to the IMF for any country has a cost, which is often political. IMF support comes with conditions in the form of policy reforms, which may not be socially acceptable (e.g. raising taxes, cutting public services, reducing workers’ rights). Since then, reserve accumulation in the region can be seen as a form of insurance (Griffith-Jones & Ocampo 2009). With massive financial reserves at their disposal, governments would no longer need to seek assistance from an external party, namely the IMF, therefore avoiding the conditions and constraints that come with such assistance. An SWF helps reduce the costs of this policy (i.e. the costs of holding foreign exchange reserves) by investing in higher-yielding assets.

As mentioned above, another reason governments have established surplus savings funds is to cover deficits in social security from demographic ageing. Most advanced economies, and some emerging economies (e.g. China), are experiencing rapid demographic ageing. Women are having fewer children, and people are living longer. As most have some form of basic old age social security provision that is organized by the state, and often on a pay-as-you-go basis whereby the current working population pays for the retirement benefits of pensioners, an ageing society places greater demands on workers. Increases in national productivity (i.e. producing more with less) mitigate the costs of caring for an ageing society, but such growth is usually not enough.<sup>5</sup> Likewise, efforts to reduce social security benefits are met with stiff public resistance. Pension reform is a political minefield (Orenstein 2008). Consequently, some countries have established funds financed with some budget surplus, or often proceeds of state asset privatizations, which are dedicated to relieving the costs of the “baby boom” retirement in the next several decades (Palacios 2003).

Examples include France’s Fonds de réserve pour les retraites (FRR) and the New Zealand Superannuation Fund (NZSF). The aim with such funds is to achieve financial returns greater than the risk-free rate and, moreover, national economic growth. By this logic, the SWF with a remit to support the social security system can tap into global economic growth, which, for a developed economy, is typically greater than national economic growth. In this way, the state can also capture some of the value of multinational corporations, which

have become increasingly difficult to tax at the national level. Although these surplus savings funds have a policy remit to support old age pensions, they should not be confused with public employee pension funds or contributory, earnings-related social insurance programmes. For example, the Canada Pension Plan Investment Board, which claims explicitly not to be an SWF, invests the mandatory contributions from all working Canadians above age 18 (except in Quebec, which has an equivalent fund for Quebec residents) made to the Canada Pension Plan. As such, the capital in the fund is the property of the beneficiaries; it is not owned or controlled by the Canadian federal government. This contrasts with France's FRR, which was established in 2001 with proceeds from state privatizations and other fiscal surpluses (Dixon 2008). That the French government was able to repurpose some of the FRR's assets to cover deteriorating conditions in other parts of the French social security system after the 2009 financial crisis, thus altering the FRR's mission significantly, demonstrates the state's ownership and control over the fund.

### Strategic investment funds

Another pension reserve fund that saw significant change after the 2008 global financial crisis was Ireland's National Pensions Reserve Fund (NPRF). In the middle of the 1980s Ireland's economy was in crisis. Unemployment was high. People were emigrating. Taxation was oppressive, and the national debt had ballooned. By the late 1990s the situation had reversed, thanks to a programme of national economic regeneration, with the country being referred to as the "Celtic tiger", in reference to the booming so-called "Asian tiger" economies of the period. But the country faced a problem: what should be done with the burgeoning fiscal surplus brought from the turnaround (Lane 2001)?

For Charlie McCreevy, the minister of finance, the solution was to put the money in a savings fund to be used later, between 2025 and 2055, to supplement a third of the cost of the pay-as-you-go social welfare pensions and public service pensions. In 2000 the NPRF was established in law, and it began operations in 2001. Until 2008 the NPRF operated as expected for this long-term objective, investing in a broadly diversified global portfolio. Then global equity markets crashed, and the portfolio lost 30 per cent of its value. Of greater significance, the Irish economy and the country's banking system were facing a collapse of epic proportions. The government re-legislated the NPRF to allow funds of €7 billion to be used to recapitalize the Bank of Ireland and Allied Irish Banks. In 2010 a further €10 billion were transferred out of the NPRF as part of the government's contribution to the €85 billion EU/IMF Programme of Support for Ireland. By 2011 it had become clear that the NPRF's days were numbered,

with the government announcing an initiative to establish a strategic investment fund, repurposing the fund on investments of “strategic” importance to the Irish economy. In 2014 the NPRF was officially decommissioned, and the Ireland Strategic Investment Fund (ISIF) began operations with a mandate to “invest on a commercial basis in a manner designed to support economic activity and employment in Ireland” (NPRF 2015: 4).

The Irish case is mentioned as it encapsulates an interesting shift in the field of SWFs towards a focus on national economic development priorities in general, and in particular the emergence of strategic investment funds (SIFs), which can also be referred to as sovereign development funds (Dixon & Monk 2014; Santiso 2009). To be sure, all SWFs regardless of type and source capital are implicitly geared towards supporting national economic development. Commodity-based SWFs exist, in principle, to manage natural resource revenues over time, thus providing stability and sustainability in those revenues in support of national economic development priorities broadly defined (this does not mean that such development is necessarily inclusive across the society). Yet the relationship with and contribution to national economic development are unrelated to the specific investments in the portfolio of the fund. As SWFs have matured and the number of countries establishing one has grown, the focus on national economic development and making investments of strategic national priority has become more explicit (Sчена, Braunstein & Ali 2018). This is most evident in the eponymous strategic investment fund (SIF; see Chapter 5 for an in-depth discussion and analysis).

The incidence of a SIF typically results from two processes. First, there are funds that emerge as holding companies of state-owned companies and other productive assets, which were founded during periods of significant state economic planning. Examples include Singapore’s Temasek, Malaysia’s Khazanah Nasional Berhad and Kazakhstan’s Samruk-Kazyna. Such funds are more than simple holding companies, in that they typically have, or have been given over time, a broader mandate to oversee and drive better corporate governance, operational and financial performance of state companies in line with (global) market conditions and management norms. The objective is to contribute to national competitiveness for the country as a whole, and for specific state-owned companies individually, competing in global markets.<sup>6</sup>

In the Kazakh case, for example, Samruk-Kazyna was established in 2008 through the merger of Samruk, a state holding company, and Kazyna, a state development company. Samruk-Kazyna holds controlling stakes in most of Kazakhstan’s industry, which are remnants of the Soviet period. Samruk-Kazyna’s development as a SIF has been informed specifically by the experience of the aforementioned funds of Singapore and Malaysia (for more extensive discussions of the Singaporean and Malaysian experience, see, for example,

Braunstein 2019; Gomez *et al.* 2018; Carney 2018). The objective is to improve the performance and competitiveness of state assets in line with global market norms and expectations of management and corporate governance, which will support their partial privatization, as well as to catalyse new industries and economic opportunities in the country, as it develops towards a market economy. This latter objective is related to the second process driving the creation of SIFs.

The second process is comparable to the Irish case: governments are deciding there is a need to actively support economic development. Other examples include the Russian Direct Investment Fund (RDIF), Senegal's Fonds souverain d'investissements stratégiques (FONSIS) and Rwanda's Agaciro Development Fund.<sup>7</sup> In short, governments are addressing what they assume to be a market failure, or, in the case of developing countries, an underdeveloped financial system and capable private sector, necessary to identify and develop new economic opportunities (Schena & Ali 2017). In Ireland's case, for example, capital markets had been effectively frozen when the ISIF was conceived.<sup>8</sup> In developing countries, governments are not leaving development to the private sector alone. The emergence of SIFs reflects, by this logic, a partial rejection of the so-called Washington Consensus (Güven 2018). We say "partial rejection" because the objective of developing vibrant private markets underpinned by strong institutional foundations (e.g. the rule of law) still holds. Indeed, it is important to stress that SIFs operate on comparable terms and norms expected of cognate private investors (e.g. private equity funds). They are market-conforming. Moreover, a key feature of SIFs in their catalytic role is to attract private capital (and other sovereigns), thus leveraging public funds and ensuring the market oversight that private capital brings to a transaction.

## Conclusions

This chapter begins with reference to the mood at the turn of the century. Markets were ascendant and national sovereignty was in decline, or, at least, as some had ruminated. To be sure, the role of the state in the economy had declined, particularly in the advanced economies, but also in the ex-Soviet bloc and many developing countries that had embraced (not necessarily willingly) the Washington Consensus. The world economy looked very different from the decades immediately after the Second World War, where the modernization theory that drove international development policy and the political consensus around welfare state expansion was much less hostile towards state intervention and involvement in the economy. But the seeming reclusion of the state (which, many would say, never left) did not last long. The explosion of SWFs, and other forms of state capital (e.g. SOEs), is a reminder of the enduring place of the state

in capitalism. For some, this suggests the emergence of a new state capitalism (see, for example, Lyons 2007).

Although claims of a new state capitalism may exaggerate the presumed secular shift in the dynamics of global capital accumulation inherent in such claims, the rise of SWFs and other types of state capital are still of significance regarding the power resource they provide the sponsoring state (see [Chapter 6](#) for further discussion on the new state capitalism). Our point here is not to suggest that SWFs are tools to be used for political coercion in international and domestic politics. Nor is this an argument that SWFs are necessarily politicized organizations or used in specific ways relating to how and in what they invest to advance some political agenda, domestic or international. Nonetheless, as agents of the state, SWFs are necessarily political, in that they serve a policy purpose, from managing natural resource revenues to catalysing economic activity in the domestic economy, which is presumed to be underserved by the market and the private sector. Although it may seem contradictory, the point of our claim is to emphasize the inherent nature of SWFs as state entities, and the nuances this brings in terms of their relations with the political sphere at home and abroad, yet without presuming that SWFs are political, at least at the operational level and in their investment strategy. As this chapter shows, like the subsequent chapters, SWFs are too varied in their origins, what they do and who they serve to be able to make any viable claim as to their behaviour and intentions in aggregate.



## THE SHORT HISTORY OF SOVEREIGN WEALTH FUNDS

The oldest existing SWF is generally considered to be the Kuwait Investment Authority, which was originally established in 1953 as the Kuwait Investment Board to manage the country's burgeoning oil wealth. As Kuwait was a British protectorate at that time, the Kuwait Investment Board was established in London. This is materially and symbolically significant, as it is evidence of the enduring and fundamental link between global high finance and the SWF organizational form of state capital. In other words, the SWF form is not some exotic construct that is foreign to global finance and the liberal international order but, rather, an endogenous creation thereof. This is important for understanding the place and evolution of SWFs in global capital markets in particular, and contemporary globalization and the relationship between states and markets in general. SWFs are state entities, but this does not mean that an SWF necessarily takes a form, as an investment institution, that is specific to and derivative of the sponsoring state, although such elements of state sovereignty appear (Dixon & Monk 2012). The SWF does not necessarily exist as some backlash to globalization and financialization, as some sort of Polanyian double movement. SWFs should be seen as existing in a conceptual space that can account for their various attributes as a state entity representing a specific country while seeing them as "global" institutions.

But the contemporary global nature of the SWF form does not necessarily characterize earlier existing SWFs. Indeed, although contemporary SWFs are part and parcel of the changing global political economy and globalization, it is important not to discount the link with the national and local context. For example, the still existing Texas Permanent School Fund (TPSF) was established in 1854 by the Texas state legislature, with an initial allocation of \$2 million from the proceeds of land forfeiture to the US federal government after the state was annexed, for the purpose of supporting public education in the state. The TPSF has since received revenue from oil and gas receipts (Rose 2011). This link with local social policy, in this case education, is a reminder that an SWF typically has



a key public policy role and should not be assumed as an instance of hoarding or following some fashion or fad, although the latter should not be discounted either (Chwieroth 2014).

Although a subnational entity, the TPSF shares some of the key elements that define many national-level SWFs today, particularly commodity-derived SWFs that exist to transform natural resource wealth into financial wealth.<sup>1</sup> But the TPSF represents another possibly important feature of SWFs, which is longevity. Indeed, for some, SWFs are considered to be long-term institutions and thus potentially long-term investors (Bolton, Samama & Stiglitz 2011). This assumption, we would argue, derives theoretically from a presumed implicit separation of the state from the market, as two distinctive spheres of society. States are also presumed to have a certain degree of longevity. As such, there is an assumption that, as a state entity that nonetheless is in the market, the SWF retains a certain level of independence from the general short-termism of the market.<sup>2</sup> This does not mean that such presumed longevity translates necessarily into a long-term investment policy. That is still a matter of the design, capability and commitment of the SWF as an investment organization to employ long-term investment strategies, and not least the commitment and stability of the state sponsor.

There are two key problems with assuming that SWFs are or even can be long-term institutions, which, we should emphasize, is not necessarily synonymous with a long-term investment strategy. By “long-term”, we mean capable of transcending the temporalities of the market, which in practical terms means never having to sell an asset, or massively reduce a portfolio.<sup>3</sup> First, it is not possible to take as given the longevity of the state. On the one hand, most contemporary nation states are relatively young. Most countries in Africa, for example, achieved independence only in the latter half of the twentieth century. At the same time, political regimes across the spectrum from authoritarian to liberal-democratic can be unstable and, ultimately, short-lived. Dictators are overthrown and democracies may rewrite their constitutions (e.g. France has had five republics). Whether an SWF can adapt to such disruption and instability is an empirical question, but it nevertheless calls for caution in assuming SWF longevity.

The second problem with making a claim of longevity is that most SWFs are relatively new. Most current SWFs were established in the first two decades of the twenty-first century. Few existed before then. Hence, the history of SWFs is quite short. At the same time, there have been several instances of SWF failure, and SWFs that never developed beyond the pre-planning stages. As such, long-standing SWFs are not the norm but, rather, outliers. This complicates expectations of the longevity of SWFs, and ultimately whether, in aggregate, SWFs can be considered a likely source of patient capital in a world of market short-termism.<sup>4</sup>

In this chapter, we unpack this short history of SWFs. In the next section, we consider the development of what can be considered “old” SWFs, which were established before or around the early 1980s – or, for heuristic purposes, the period that precedes contemporary neoliberal globalization and the financialization of the global economy (Dore 2008). The sections thereafter consider the periods from the early 1980s to around the millennium, which we frame as the take-off period of contemporary financial globalization, and 2000 to the present, which we frame as one of the consolidation of the SWF trend. In this latter period, however, we observe a boom in the number of funds established, with many created on weak policy, institutional and financial bases. Several countries establishing SWFs seem to be following a fashion and fad, or are establishing an SWF prematurely, which poses questions as to their potential longevity.

### **New states, new sovereign funds**

British imperialism left many legacies in its wake. Although there are insufficient cases to make a general claim, it is nonetheless telling that the earliest contemporary SWFs still in existence were set up in former British colonies or protectorates in the Middle East and south-east Asia. By 1952 Kuwait had become the largest exporter of oil in the Persian Gulf. Kuwait, as already mentioned, set the stage early on to manage its burgeoning newfound hydrocarbon wealth, but with a fund based in the City of London that ensured it access to global capital markets.<sup>5</sup> It would cease to be a British protectorate in 1961, although the presence of Kuwaiti sovereign wealth in the City of London, a key focal point historically and continuously of global high finance, remained. In 1965 the Kuwait Investment Board was reorganized as the Kuwait Investment Office, as the asset manager for the KIA.

During the 1960s the British presence elsewhere in the Persian Gulf became increasingly untenable, following the general unravelling of the British overseas empire and European colonialism around the world. The United Arab Emirates (UAE), which at the time was referred to as the Trucial States, and like Kuwait was a British protectorate, became an independent country in 1971. Hydrocarbon revenues had already become important in the 1960s, particularly in Abu Dhabi, where the bulk of UAE reserves are concentrated. In 1967 Abu Dhabi established a Financial Investments Board within the Department of Finance to manage the emirate’s increasing excess oil revenues. In 1976 Sheik Zayed bin Sultan Al Nahyan, the ruler of Abu Dhabi and the first president of the United Arab Emirates, created the Abu Dhabi Investment Authority (ADIA) as a separate organization operating at arm’s length from the government. Since then ADIA has become one of the largest SWFs in the world, with a globally

diversified portfolio of assets (for case studies on the Kuwaiti and UAE SWFs, see Bazoobandi 2013).

While Kuwait and Abu Dhabi were setting the example for saving excess oil revenues through the SWF form, another newly independent country, in south-east Asia, was similarly integrating the SWF into its national and economic development following the cessation of British rule. Singapore became fully independent in 1965, after being expelled by Malaysia, which had been a protectorate of the United Kingdom until 1957. Unlike Kuwait and Abu Dhabi, Singapore had no natural resources from which it could draw revenues. The country's only alternative was to industrialize and become an important trading and financial hub for the region. The path taken by Singapore can be seen as stated, with the state taking an active role in shaping and driving industrial policy, through the ownership and guidance of key industrial firms and sectors. In the country's early years, state-controlled statutory boards were created to develop the city state's infrastructure, including housing, transport and communications. In 1961 the Economic Development Board (EDB) was established, to funnel public investment into the industrial sector. The EDB provided capital as well as managerial direction. In 1968 it was repurposed to focus on promoting inward foreign direct investment (FDI). The EDB's equity holdings were transferred to the Ministry of Finance, which were then transferred to a new holding company in 1974 (Low 2001; Schein 1996).

That holding company, Temasek, would act as a monitor of state holdings for the ministry but would not take a guiding role. By 1979, however, Temasek was changing tack, focusing on driving greater synergies between portfolio companies, making new investments and fostering mergers (Yeung 2011).<sup>6</sup> In effect, Temasek adapted and repurposed itself as a strategic investment fund, which we explore in more detail in [Chapter 5](#). Arguably, this was a key turning point, as Temasek has become the gold standard for many SWFs. Temasek today is still a major shareholder of domestic public firms, some of which are still majority state-owned (e.g. Singapore Airlines), but it is now a major global investment firm with offices in major capital markets around the world.

Although Singapore helped foster rapid industrialization through active public investment that supported growing export performance and rapid economic growth, this did not mean that the country operated a loose fiscal policy. On the contrary, the government focused on achieving budget surpluses. In addition, citizens had mandatory savings obligations through the Central Provident Fund, which could be used for retirement, housing and healthcare costs. But, as a small city state, this meant that Singapore faced absorptive capacity constraints. In 1980 a review was conducted into how Singapore should manage its growing foreign reserves. The next year the Government of Singapore Investment Corporation was established, which would later be renamed simply as GIC. GIC

would set out to achieve higher risk-adjusted returns than conventional reserve management, to preserve and enhance the country's international purchasing power. In effect, GIC would underwrite the autonomy of the small and relatively young city state. Today GIC is one of the largest SWFs in the world, with ten offices around the globe and a staff of around 1,800, setting a standard for aspiring designers of SWFs.

### Finance goes global

The 1980s were not a significant period in the creation of SWFs. GIC was formed early in the decade, and the small Sultanate of Brunei would follow suit with the creation of the Brunei Investment Agency in 1983. The decade nonetheless marked a turning point for global finance. In 1983 the Conservative government led by Margaret Thatcher in the United Kingdom dethroned the more risk-averse “old boy” networks of financiers that had dominated the City of London, by settling a range of antitrust cases with the London Stock Exchange (LSE) over its rules on how stocks are traded and the exclusion of foreigners. On 27 October 1986 the LSE's rules changed in what has become known as the “Big Bang”, which ushered in major changes to the London financial market (Plender 1986). Although London had a long history as an international financial centre, the “Big Bang” brought the “global” into full relief, with large American investment banks and other foreign financial institutions making major inroads into the previously club-like London financial market. This would solidify links with other major financial centres, such as New York and Hong Kong, and partly detach such centres from their national and regional moorings to become part of a global capital market (Cassis 2006).

The “Big Bang” is certainly not the only relevant event in recent financial history, but it represents a general turning point in the development of global capital markets and contemporary globalization generally. The “Big Bang” represents a key example of the neoliberal zeal to deregulate finance and unleash markets and their integration at a global level. Moving capital from one geography to another became increasingly easy (G. Clark 2005). For institutional investors, this meant greater ease in diversifying their portfolios to capture the leading edges of economic growth and innovation wherever in the world they may be (Harmes 1998). The investment universe for investors has grown massively since then, from which SWFs have benefited.

While capital markets were experiencing important material changes that increased opportunities for investors, there were also important cultural changes taking place around the role of finance and investment in society and global capitalism. In the first wave of globalization, between 1850 and 1914, during which

capital markets saw a high degree of integration, the investor was reconfigured along two lines: first, the transformation of investment into a science, in comparison with the eighteenth-century image of investment as speculation (gambling), and thus a menace to the social order; and, second, the construction of a right to invest as a legitimate activity grounded in human nature, whereby access should be extended across classes to rectify social inequalities. In the second wave of globalization, since 1980, the investor-capitalist once again took centre stage in global capitalist development. The investor-scientist and the right to invest coincide, as they did in the first wave of globalization, to create a cultural figure with universal validity that legitimizes global market expansion (Preda 2005). Again, like the material opportunities created through global financial integration, this important cultural shift that started to take hold in the 1980s is – as we note later – significant for explaining, in part, the wholesale embrace of the SWF form by governments of all stripes across the globe, even where the underlying macroeconomic policy conditions for establishing an SWF barely hold.

For global SWF development, 1990 can be seen as an important turning point. In that year Norway established the Petroleum Fund of Norway, which in 2006 had its name changed to the current one: Government Pension Fund Global. As the fund's asset base expanded to grossly exceed its original purpose (stabilization), it adapted to a long-term savings mandate and to the role of a “universal owner” – i.e. one that owns large portions of many asset classes (particularly those publicly traded) (Hawley & Williams 2007). Now the largest SWF in the world, with assets under management exceeding \$1 trillion, heavily invested in public equities, the GPFG owns roughly 2 to 3 per cent of publicly traded companies globally; the significance of this, and its ethical screen, we discuss in [Chapter 4](#). Becoming such an important global owner would not have been possible without the significant integration of global capital markets over the last several decades. Yet, and notwithstanding the broader abovementioned cultural significance of the investor-capitalist in legitimizing new forms of global financial engagement (e.g. through an SWF), Norway established its SWF to manage its burgeoning hydrocarbon wealth and to limit the negative macroeconomic effects arising from massive commodity exports (specifically Dutch disease and absorptive capacity constraints), while ensuring that future generations of Norwegians could benefit from the hydrocarbon wealth generated today.

In 1969 oil and gas reserves were discovered in the Norwegian territorial waters of the North Sea, with production starting in 1971. By 1990 Norway had begun to amass significant income, with the potential to distort Norway's economy and society. Parliament passed the Government Petroleum Fund Law, establishing the Petroleum Fund as part of a comprehensive resource revenue management framework, which would limit how much current revenues the government could spend. This limit would support long-term savings, while

leaving income denominated in foreign currency to mitigate against Dutch disease. Although the groundwork for the Norwegian SWF was established in 1990, it would still take until 1998 before the fund started to become the powerhouse global equity investor it is today, with an initial portfolio allocation of 40 per cent. In 2000 non-government bonds were allowed in the portfolio and five emerging markets were added to the equity benchmark (Backer 2009). We consider the role of GPF in the sustainable finance movement in [Chapter 4](#).

Although the magnitude of Norway's oil and gas revenues relative to the size of its economy and population meant that the absorptive capacity constraints provided significant policy rationale for creating an SWF, it is noteworthy that other North Sea oil and gas producers have not also established SWFs. For instance, the United Kingdom has used royalties and taxes from North Sea oil and gas production to finance current expenditures. The Labour government led by James Callaghan considered establishing an oil fund in the late 1970s. In 1977 government economic advisor Gavin McCrone drafted a Green Paper suggesting the establishment of an oil fund, but the economic crisis in the late 1970s put pressure on the government to spend revenues rather than save them (Macaskill 2014). The Conservative government in the 1980s chose to continue spending the revenues to support decreases to income taxes.<sup>7</sup> The Netherlands, another North Sea oil and gas producer, established the Fonds voor Economische Structuurversterking (FES) in 1993 to reinvest gas revenues in infrastructure projects, and later, in 2005, in the Dutch knowledge economy. But this was not an SWF invested in financial assets but, rather, an additional budgetary fund that the government used to help finance large projects (Ros 2009). The FES was abolished in 2012.

### **Insuring against crisis**

The timing of the GPF's foray into global capital markets in the late 1990s coincides with the beginning of the boom in SWF development. The ten-year period between 1997 and 2007 was bookended by major financial crises. In July 1997 concerted attacks against Asian currencies drove countries in the region with pegged exchange rates and large foreign currency liabilities into twin foreign exchange and banking crises. Affected countries, including those most severely impacted, namely Thailand, Malaysia, Indonesia and South Korea, began slowly to re-emerge in 1998, only to have Russia default on foreign currency borrowings, which again threw global financial markets into turmoil. In the aftermath of this tumultuous period, emerging market countries re-examined their macroeconomic policies and began to rebuild and adroitly manage their foreign exchange holdings. Some of these countries, such as Indonesia, were

commodity exporters, whereas others mainly exported goods and services. Both drew a common lesson from the crisis: a large foreign reserve base is a critical source of liquidity that provides insurance while affording self-reliance against volatile capital flows.<sup>8</sup>

As emphasized in the last chapter, self-reliance also means not having to go to the IMF for assistance in the event of a crisis and having to accept the domestic economic reform conditionalities that come with such assistance. Bailout conditionalities generally mean steep cuts to public services and labour market reforms, which are unpalatable to the public and thus ultimately problematic for governments and political leaders. Hence, in the period from 1998 to 2008, foreign exchange balances were not simply restored but expanded dramatically. Having been a recipient of IMF financial support and associated conditionalities during the 1997 Asian financial crisis, South Korea eventually established an SWF, the Korea Investment Corporation, in 2005.

Also contributing to the build-up of foreign exchange balances was a near-quadrupling in the price of oil, which further extended the reserve holdings of the official institutions of oil exporters, such as Norway and the countries of the Persian Gulf. Although it re-established a foundation for the global balance of payment stability, this rapid accumulation of assets presented real challenges. Export revenue growth often outstripped the ability of many exporting countries to absorb large flows of capital into their domestic economies and financial markets. In many cases, holdings also exceeded the reserves required for intervention in the event of either a fiscal or foreign exchange crisis. Moreover, when held in low-risk government bonds (generally US Treasuries), returns on these assets were comparatively low, often below the costs of many exporters to borrow in sovereign debt markets (Rodrik 2006). Having already established SWFs able to invest in higher-yielding assets, Gulf countries such as the United Arab Emirates and Kuwait, Norway in Europe and Singapore in Asia were all able to invest excess reserves at higher rates of return. Foreign currency revenues were either transferred or flowed directly into these funds, often bypassing national central banks.

For the world's largest holder of foreign exchange reserves, China, seeking higher yields through an SWF became normalized with the creation of the China Investment Corporation in 2007. In 2001 China's foreign exchange reserves were just over \$250 billion, but growing rapidly; by 2009 they exceeded \$2 trillion. Within the Ministry of Finance there were proponents for creating a new fund to diversify reserves into higher-yielding assets, to outperform the State Administration of Foreign Exchange, controlled by the People's Bank of China. This initiative was not shared by the latter, however. SAFE had already been investing in foreign equities through its Hong Kong subsidiary, which it established in 1997. In this bureaucratic tussle, the Ministry of Finance would

eventually win out, and the CIC was born, taking over the investment of some of China's reserves. This did not mean that SAFE relinquished its foreign equity holdings. Nonetheless, the CIC is the only Chinese SWF mandated officially to diversify the country's foreign reserves (Dixon 2019).

### **The appearance of wealth**

So far the history of SWFs seems quite simple. On the one hand, a handful of major oil- and gas-exporting countries, primarily in the Middle East but also Norway, mostly with relatively small populations, accumulated increasing revenues from historically high commodity prices in an SWF. On the other hand, several, mostly east Asian, export-oriented economies with growing foreign exchange reserves established SWFs to achieve higher risk-adjusted returns. The largest existing SWFs come from these cases. To be sure, there are other new cases that fit this profile. For example, Chile, the world's largest copper exporter, established a stabilization fund in 2007 as part of a comprehensive resource revenue management framework. Oil-rich Timor-Leste likewise established a savings fund in 2005, just five years after the country's independence from Indonesia. Although natural resource revenue management is certainly an important explanatory factor in many new SWFs in developing countries, establishing an SWF is not necessarily a good policy choice.

Ever since the early part of this century there has been a proliferation of new SWFs, mostly in developing countries in the Global South. In many cases, however, SWFs have been established when resource revenues are small, distant or uncertain. Bauer and Mihalyi (2018) refer to these as "premature funds," which they argue is a manifestation of the "presource curse." The latter occurs when the discovery of new hydrocarbon or mineral resources engenders overoptimistic expectations on the part of politicians, citizens and international institutions (Cust & Mihalyi 2017). There are several costs and risks with establishing an SWF too soon, however. First, establishing an SWF to sequester savings is viable from a total government balance sheet perspective only if the returns garnered by the fund exceed the government's cost of borrowing. For many developing countries, however, borrowing costs tend to be high in general, and, in particular, higher than the total return that an SWF can generate. Most SWFs from developing countries are invested in low-yielding AAA government securities. There is, furthermore, limited institutional capacity to take greater risk in the SWF portfolio. Hence, rather than providing a source of savings for the country, the SWF is actually costing the government money. The second and third problems with establishing an SWF prematurely are the limited size of the resource revenues and their uncertainty, in that what revenues do exist can be managed without



the need of an SWF. In effect, there is insufficient scale, which is important for developing the effective and capable investment institution necessary for taking on greater investment risk.

There are several possible explanations for the proliferation of “premature funds”. Bauer and Mihalyi (2018) note that they are often a function of overzealous politicians, coupled with poor international advice. Establishing an SWF has become the siren call for any new discovery of natural resource deposits. An additional complementary explanation can be added to this. The giant SWFs in the Middle East and Norway are symbols of opportunity. The SWF symbolizes the transformation of natural resource wealth into long-term financial wealth (Alsweilem & Rietveld 2018). The SWF is a symbol of modernity – a modernity that is culturally and materially characterized by high finance. In effect, having an SWF is symbolically important for signalling the ambition of the country, or, at least, those in charge.

Consider the case of Zimbabwe, a country endowed with significant mineral wealth. During the Government of National Unity, a coalition between Robert Mugabe’s ZANU-PF and Morgan Tsvangarai’s MDC party from 2009 to 2013, the idea of an SWF was developed in the coalition government’s Medium Term Plan, with a focus on using mining royalties to finance development in mining regions and development generally across the country. In 2014 legislation was passed establishing an SWE, with the fund going into operation in 2015 – in principle, at least. In practice, however, the fund has not been operationalized in any serious manner. There are several issues with the proposed Zimbabwe SWF that have hampered its development (Matambo 2021). On the one hand, the mandate of the fund is too broad. The Zimbabwe SWF is supposed to support socio-economic development by investing domestically, save current natural resource revenues for future generations and provide macroeconomic stability. The Zimbabwe SWF is thus supposed to be a sovereign development fund, an intergenerational savings fund and a stabilization fund all at the same time. Such diverse mandates require different investment strategies and different human resource needs. Commodity-based SWFs that are considered to be well run and governed, such as Norway’s GPF, which is focused on intergenerational equity, or Chile’s Fondo de Estabilización Económica y Social, which is focused on macroeconomic stability, have single mandates. On the other hand, Zimbabwe’s SWF has been hampered by a weak system for capturing and accounting for natural resource rents. A prerequisite for any commodity-based SWF is such a system; resource rents are the *raison d’être*. Without a clear fiscal framework, the SWF cannot adequately develop and operationalize its mandate.

If the proliferation of premature funds and funds with limited source capital and weak policy bases bring into doubt the expected longevity of the SWF form as an aggregate phenomenon in the global economy, there are several important

cases when an SWF has been drawn down completely, was short-lived or has experienced significant disruption. For example, in 2000 Algeria established a hydrocarbon revenue stabilization fund, the Fonds de régulation des recettes pétrolières (FRRP). Algeria benefited massively from the boom in oil prices in the early 2000s, with foreign exchange reserves increasing from \$12 billion in 2000 to \$143 billion by 2008. Some of these were funnelled into the new fund. Managed by the country's central bank, the FRRP held highly liquid securities, mostly high-grade foreign government bonds, with a mandate to support government spending of petroleum revenues by absorbing excess petroleum revenues beyond a benchmark price (Belaïcha, Bouzidi & Labaronne 2012). The FRRP remained, in effect, a separate account at the central bank, never developing into a separate SWF organization with a mandate to diversify assets into higher-yielding investments.<sup>9</sup> But, for a stabilization fund of this kind, such additional institutional capability is not necessary. In 2015 the FRRP had \$32.5 billion in assets. With petroleum income declining and ongoing budget deficits, however, the fund was drawn down completely by the summer of 2017 (Moussa 2021). Since then the FRRP has had some replenishment of funds, but only temporarily (Rezouali 2020). For some, the drawdown of the FRRP could be seen as an indication of failure, particularly if SWFs are thought to be long-term institutions. Yet it can also be regarded as fulfilling one of the key roles of a resource revenue stabilization fund: maintaining government spending when revenues decline.

In neighbouring Libya, a different approach to sovereign investment was taken, one that suggested a more sophisticated and ambitious long-term-oriented SWF. In 2006, after international sanctions had been lifted and Libya was partially welcomed back into the international community, the Libyan Investment Authority (LIA) was established. With an initial allocation of \$8 billion, the LIA grew to over \$64 billion by 2010, making it the largest SWF in Africa, with a diversified portfolio of domestic and international investments in multiple sectors including agriculture, real estate, oil and gas, and financial services. In 2011, in the middle of the Arab Spring, Muammar Gaddafi, the country's ruler since 1977, was overthrown and killed. Since then the country has been embroiled in civil conflict, with multiple competing claims as to who constitutes the legitimate government. In 2021 an interim unity government was formed with plans for elections. Given the fragmented and uncertain domestic sovereignty – i.e. the structure of political authority in the state and the degree of control exercised by those in power – the overseas assets of the LIA have been frozen by the United Nations Security Council since 2011 (see UN 2011).

The case of the LIA demonstrates the clear link between an SWF and the stability of sovereignty. Hence, the longevity of an SWF is ultimately contingent on the underlying stability of the state (regardless of political form). If the breakdown of the country is the most significant impediment to the functioning of

the LIA, significant governance failures had already started to appear before the fall of Gaddafi. Awash with cash, the new fund embarked on several risky deals and partnerships, which eventually led to serious losses. In short, the LIA did not have the investment governance capacity to assume such risks, nor could it ensure that conflicts of interest were avoided.<sup>10</sup> For example, the LIA committed \$300 million of capital in an unknown hedge fund, Palladyne International Asset Management, which had links to the former chairmen of Libya's National Oil Corporation. Although Palladyne invested only just over a half of the committed capital, it recorded losses of \$50 million from 2008 to 2010. In another highly publicized case, the LIA invested \$1.2 billion in 2007–08 in complex equity and currency derivatives through the investment bank Goldman Sachs. By 2010 these derivatives had lost 98.5 per cent of their value (Bauer 2017). The LIA would eventually sue Goldman Sachs in UK courts in 2016 to try to recoup the losses, claiming that the investment bank had exploited the fund's inexperience. LIA lost the case (for a comprehensive exposé on the LIA case, see Eaton 2021).

## Conclusions

The title of this chapter is purposive. Rather than “A short history of sovereign wealth funds”, which would suggest a brief synoptic account of the field, the title is “The short history of sovereign wealth funds”. There are two reasons for this. First, notwithstanding a handful of outliers, most SWFs are recent creations. The existence of state-sponsored trust funds, such as the subnational Texas Permanent School Fund, certainly undermines any perceived novelty of the SWF, as do key exemplars such as KIA or Singapore's two SWFs, Temasek and GIC. Yet most SWFs, including some of the largest, such as the China Investment Corporation and the Norwegian GPF, have appeared in the last 20 to 30 years, which, not incidentally, coincide with neoliberal globalization and the increasing financialization of the global economy. In [Chapter 6](#) we expand further on the significance of this periodization in the emergence of SWFs.

The second reason for this choice of title is to emphasize the contextual variables that shape the potential longevity of the SWF as an investment institution and, in turn, the potential weaknesses of the SWF. As a state-sponsored institution, the SWF is only as stable as the state. SWFs that have persisted over time, and in the process matured as investment institutions, have done so in the context of political stability, and hence political commitment to the policy underwriting the SWF. Singapore's foray into sovereign investing coincides with a political system that has seen limited variation. Singaporean politics has been dominated by the People's Action Party and the late Lee Kuan Yew and now his progeny. Commitment to Temasek and GIC has been steadfast, with both

highly integrated into the country's economic policy and development. To be sure, SWFs can survive changes in government. Norway has a vibrant multi-party parliamentary democracy that has seen regular changes during the lifespan of the GPF. What is key is that the GPF is integrated into the country's natural resource revenue management and macroeconomic policy. Moreover, the GPF reflects the Norwegian social contract, which facilitates its transcendence of party politics.

But, as discussed in the previous section, some SWFs are short-lived or exist in name only. The LIA, for example, remains in a suspended state until the UN Security Council unfreezes its assets. Some political stability has returned to Libya since the end of the Second Libyan Civil War in 2020, but the UN Security Council nonetheless has reaffirmed the freeze on LIA's assets (UN 2020). Although the Libyan case shows the significance of the international community in shaping the opportunities and constraints for SWFs – a discussion we take up further in the following chapter on the Santiago Principles – the case demonstrates the inextricable link between the SWF and its sponsoring state and the sovereignty conditions of that state. SWFs, as financial institutions, may be designed and governed to operate independently of the state and the stability (politically and socially) thereof. Yet the SWF is nonetheless a state entity and subject to state prerogatives, which may change over time.



### 3

## LEGITIMIZING STATE ACTORS IN GLOBAL MARKETS

Interest in Unocal as a takeover target began to build in early April 2005, when Chevron, a leading US producer of hydrocarbon products, reached an agreement to acquire the former Union Oil of California for \$16.6 billion in cash and shares. In June 2005 CNOOC Ltd, the Chinese National Offshore Oil Company, a state-owned Chinese enterprise and China's largest offshore oil and gas producer, decided to enter into the bidding. CNOOC formally proposed an all-cash acquisition of Unocal at \$18.5 billion, or \$67 per share. On the evening of 14 July 2005 Unocal's board of directors met and rejected the CNOOC bid, leaving CNOOC's management at an inflection point: to sweeten or to abandon the bid (Politi & Guerrera 2005). CNOOC's management was well aware of the risks of closing this deal. In fact, its higher bid was interpreted as compensation to Unocal shareholders for the risk that the US government might block the bid. As expected, the offer met with widespread public debate, which included issues ranging from preferential Chinese government financing available to CNOOC to concerns about the transfer of US energy assets to a Chinese-owned company (Kim 2007).

The discussion set in motion lobbying efforts by bidders and other interested parties to influence the discourse. The transaction would be subject to US government review by the Committee on Foreign Investment in the United States (CFIUS), as required under the 1988 Exon–Florio Amendment to the Defense Production Act of 1950.<sup>1</sup> Members of Congress were already struggling with US–China trade issues, ranging from a large bilateral deficit to constituent concerns about lost business and jobs to Chinese competitors. By late July 2005 investor sentiment was questioning CNOOC's ability to gain federal approval in an environment of increasing acrimony. On 2 August CNOOC abandoned the bid, citing a political environment in the United States that substantially increased its risk in the transaction and its ability to close (CNOOC 2005).

The rules, norms and conventions that buttress global financial markets focus largely on the role of actors as private agents. Although the power resources and therefore the scope of action of any agent – public or private – are contingent on various factors, such as the scale of their financial resources and the tools and organizational resources they control, a critical assumption of the global market order is that, in principle, relations of exchange are based on commercial interests. When sovereign states act through agents, however – including commercial agents, such as SOEs or SWFs – does this assumption universally hold? And, if called into question, does it not also challenge the legitimacy of the state agent, whether an SOE or SWF?

CNOOC is not an SWF. This example highlights a fundamental reality, however: when an investor's motives are challenged, disruptions can occur to the orderly flows of goods, services and capital internationally. Such frictions reduce the efficiency of markets. Remediation of these frictions can come in the form of regulation to legislate and enforce governance *or* through a demonstrated commitment on the part of agents – public or private – to adhere to a governance model that promotes trust-building among market participants.

In this chapter, we examine the history and evolution of the structures of governance under which SWFs have defined their engagement in the global market order. Formally known as the Generally Accepted Principles and Practices for Sovereign Wealth Funds – more conventionally known as the Santiago Principles – these voluntary standards serve as a practice benchmark and are increasingly recognized as building blocks of institutional governance among state-controlled investment institutions. The Santiago Principles form the foundation for the International Forum of Sovereign Wealth Funds, a global body of sovereign funds whose members have signed up to the Principles. Adoption is voluntary, but the Santiago Principles bond member funds, or at least promote adherence, to a governance model agreed and accepted by the international community. As such, they have become an important vehicle through which the investment objectives of sovereign investors are exercised and can be understood.

The chapter is organized as follows. In the next section we briefly discuss legitimacy as it pertains to financial institutions in general and SWFs in particular. In the section thereafter we detail the political and economic context in which the Santiago Principles were initiated, and who the actors were. We then unpack the structure and intent of the Santiago Principles, followed by a section on their institutionalization through the IFSWF. The penultimate section considers the extent to which the Santiago Principles are being implemented by SWFs and the significance in terms of the aggregate transparency of SWFs.

## Legitimacy through governance

Legitimacy is a social construct. It is frequently identified with a rule, institution or leader, conveying a right to act, often on behalf of others. For example, in political science, legitimacy is the belief that an institution or leader has the right to govern (I. Clark 2005). In the case of organizations, underlying the concept of legitimacy is trust on the part of stakeholders in the capacity of the institution to act (Johnson, Dowd & Ridgeway 2006). Trust implies holding a positive perception about the actions of an institution and is strengthened over time through reliability, observability and equity in actions and outcomes (O'Neill 2014). Thus, legitimacy exists *in the eye of the stakeholder*. Functional transparency is important, because it allows stakeholders to observe – i.e. to monitor – institutional performance. Furthermore, integral to both trust-building and legitimacy is institutional governance, which is an institution's body of rules, regulations and inter-organizational processes that govern decision-making and drive performance outcomes.

In financial markets, institutional legitimacy, functional transparency and governance can have multiple dimensions, resulting from a multiplicity of operating environments and stakeholders. For example, perceptions of the legitimacy of a financial institution, such as a bank or SWF, to operate can differ significantly if the institution serves exclusively its own domestic market or makes investments primarily for the benefit of its owner-beneficiaries (Morris & Vines 2014). When it operates internationally, however, the scope of outcomes and the breadth of stakeholders can widen considerably. Likewise, views on transparency and the strength of governance can be influenced by social norms and legal structures, which also differ between the home market and those of other jurisdictions.

Consider the case of an SWF that invests its assets in global markets. Home-country stakeholders – including its government owner and the general public – will expect the fund to execute its mandate. These may include stabilizing fiscal flows or investing efficiently for the benefit of future generations. In this role, both its operational capacity and its financial performance can contribute to or detract from its legitimacy as an investor in the eyes of its domestic stakeholders (Al-Hassan *et al.* 2013). In global markets, however, a sovereign wealth fund's behaviour and actions have consequences for an expanded body of stakeholders. These may include investee companies, investment counterparties, regulators and – more abstractly – markets and their constituents. Here, issues of corporate control, market volatility, price efficiency and even system stability can arise and bring into question the legitimacy of a sovereign investor to operate in local markets.



Formal host-government responses can vary widely, from mandated reporting requirements and government investment review boards to regulatory restrictions. Impacts can result in increased legal and reporting costs to include forced divesture. Whether justified or strictly the result of perception, fear or mistrust, challenges to the legitimacy of a fund and its right to invest can become overtly politicized, with real consequences for and genuine risks to its investment operations.

A governance model that includes some level of disclosure, which increases transparency, can build trust and thus contribute to institutional legitimacy, both at home and in global markets. Importantly, however, disclosure and transparency are not synonymous. Whereas disclosure can be legislated, transparency, like legitimacy, is a social construct with differing standards, and even forms, that stakeholders – whether domestic or foreign – will assess and value in their own ways. Dixon (2014a), for example, offers a framework that identifies at least five discrete “forms” of transparency in the constitution and operations of SWFs, based upon the political, procedural, policy, operational and performance features of individual funds. We return to this framework in the penultimate section below.

Returning to legitimacy, the assessment of a fund’s governance model must similarly be “localized”. Does the governance structure of the fund create and build a relationship of trust between the fund and each of its stakeholders? Monk (2009) views institutional legitimacy as being dependent on how closely the quality of a fund’s governance aligns with societal expectations and norms for these practices – i.e. they are market-specific. In Monk’s view, and ours, for a fund to achieve legitimacy, both domestically and internationally, it must reconcile its governance model – including its policies concerning disclosure *and* transparency – with those expected for other market participants.

## **Open for business**

Global financial stability is a key domain of the IMF, which each year critically assesses global markets to identify sources of systemic vulnerability. The IMF monitors changes in official reserve positions by designing reporting standards and conducting regular surveillance. The objective of the IMF is to evaluate the overall volume of foreign reserves held by governments and their ability to provide liquidity in the face of balance of payments shortfalls. When excess reserves are transferred to a sovereign investment fund, they may become less accessible to a central bank for balance of payments stabilization; they may also be under-reported, and, as such, less observable under IMF surveillance. In 2005

an IMF expert group on reserve assets first acknowledged the challenges and possible opacity (Galicia-Escotto 2005). Work to reconcile reserve reporting with the holdings of SWFs continued over the subsequent three years and was integrated with the IMF's broader initiatives on SWFs (IMF 2007b). This did not progress beyond recommending voluntary disclosure of SWF foreign assets not otherwise included in reserve reporting, however (IMF 2008b). The IMF's efforts notwithstanding, such constraints on the transparency of SWF foreign holdings did little to dispel perceptions of SWFs as potential sources of systemic instability.

Whereas financial stability is the domain of the IMF, national security is that of host governments. In the United States, in particular, the period after the 9/11 attacks in 2001 was marked by heightened concerns about terrorist acts against key infrastructure and national security targets, and extended to anxiety over foreign control of US assets. Such apprehension fuelled an escalation of protectionist sentiments in the United States, even as the administration of President George W. Bush sought actively to maintain an open international trading and investment regime. The matter rose to national prominence in the United States in 2005 with CNOOC's attempted acquisition of Unocal. It did not end there, however.

In late November 2005 Dubai Ports World (DPW) proposed to acquire the Peninsular and Oriental Steam Navigation Company (P&O). DPW is a state-owned company of the United Arab Emirates, long a security partner of the United States; P&O is a UK-based firm that operates port facilities globally, including in the United States. In December the two companies filed an official notice with CFIUS. By mid-December the transaction appeared on its way to CFIUS approval, pending final regulatory signoffs (Treasury 2006). Broad congressional opposition surfaced, however, and began to grow. It is important to note that P&O was only the operator of the US ports; ownership remained with local authorities. Calls to block the deal on national security grounds focused in part on Dubai's role in the trans-shipment of nuclear components to Iran, North Korea and Libya (Kirchgaessner & Alden 2006). Although the acquisition closed in the United Kingdom in early March 2006, the UAE government ordered DPW to relinquish control of US assets to an American company (Paleit 2006).

Even if taken together, on commercial grounds the CNOOC and DPW deals were of marginal consequence to the US macroeconomy. The impacts of both resounded throughout the US political economy, however, raising the spectre that growing protectionist sentiments linked to state investment would raise the cost of doing business, discourage foreign investors and deter foreign investment. This threatened the Bush administration's commitment to an open international trading and investment regime.

## Tracing the origins of the Santiago Principles

The US Department of the Treasury was both surprised and alarmed by the political reactions to the CNOOC and DPW deals. It was its job to provide policy support and to deliver on the administration's commitment to ensuring that the United States remains an attractive destination for foreign capital (IFSWF 2018).<sup>2</sup> The Treasury understood well the scale of the build-up in assets among official institutions, and also that US markets would be a target for both portfolio and direct SWF investments. The US Treasury was similarly conscious of the opacity of SWF holdings. Although neither CNOOC nor DPW were SWFs, the Treasury feared that more SWF investment would accelerate calls for financial protectionism, not only in the United States but globally among recipient countries.

In often overshadowed comments at the San Francisco Federal Reserve Bank in June 2007, the acting undersecretary of the Treasury for international affairs, Clay Lowery, proposed the first element of a twofold response that would ultimately lead the way to a governance framework for SWFs. It called for the IMF and World Bank to establish a joint task force to work towards the development of “best practices” for SWFs. The creation of a joint task force would remove the United States from an overt role in this enterprise. Drawing on their “broad membership”, the IMF and World Bank could then build consensus for “best practices” from the bottom up from among countries “that have these funds, countries in which they invest, and countries that simply have a stake in a healthy overall international financial system” (Lowery 2007). The second element of the US Treasury's response – only later to become known – was to actively engage with GIC in Singapore and the Abu Dhabi Investment Authority to prepare a draft statement of principles for sovereign investment that addressed the issues and concerns of *both* sovereign investors and recipient countries (Treasury 2008).

Ostensibly taking a back seat in formal engagement, the US Treasury remained integral to the ongoing work of both the multilateral institutions and GIC and ADIA. Importantly, it served as a recruiter, coordinator and sounding board, but also as a leading voice navigating the contours of the global policy discussion between governments and experts. By August 2007 a clear objective for its ongoing initiatives began to emerge among the wider policy community: to increase transparency, accountability and predictability, with the broader goal of enhancing the financial stability in home countries and internationally (Truman 2007). In October 2007 these initiatives reached a critical juncture, culminating in a meeting hosted by the Treasury and bringing together all key stakeholders, including the finance ministers of the

G7, the heads of the IMF, the Organisation for Economic Co-operation and Development (OECD) and the World Bank, and the heads of SWFs and central banks from China, Kuwait, Norway, Russia, Singapore, South Korea, the United Arab Emirates and Saudi Arabia. Following the meeting, the International Monetary and Financial Committee of the IMF formally endorsed the IMF's role in this ongoing multilateral dialogue on best practices (IMF 2007a). For its part, the OECD stepped up efforts to develop a corresponding set of best practices for host-country investment regimes.

Clarity around the US Treasury's work and position came increasingly into view with publication of the January/February 2008 issue of *Foreign Affairs*. An article, by deputy secretary of the US Treasury Robert Kimmitt (2008), was noteworthy for its largely balanced positioning of the issues. The article highlighted the role of sovereign investment funds in foreign reserve accumulation and the concentration of risk in large opaque portfolios. It also encouraged recipient countries to support cross-border investment that was "economically driven", however. Kimmitt called on recipient countries to be open to foreign investment, even to the point of foreign control, and to avoid the imposition of discriminatory tax and regulatory policies, while giving equal treatment to all investors. Importantly, the article also floated a core set of basic principles that would later be revealed to have been drawn from the ongoing discussions between GIC, ADIA and the Treasury. These were five policy principles prescribed for sovereign investment behaviour, centred on commercial intent, professional integrity, fair and competitive practices, open communications in support of a stable global market environment and full compliance with all applicable recipient country regulations related to financial disclosures.

On 20 March 2008 the core principles agreed by GIC, ADIA and the US Treasury were finally released (Treasury 2008). In announcing the agreement, the Treasury also emphasized the parallel work of the IMF and OECD. At this point the pace accelerated, with the goal of developing and announcing a governance platform by the time of the IMF/World Bank 2008 annual meetings in October. Within one month work streams would be created and the parliamentary work of drafting the framework would begin. SWFs took centre stage; recipient countries were represented and engaged for their views but would not participate in drafting. The IMF administered. For most SWF participants, the motivation and the task were both clear. To maintain and expand access to recipient country markets, they would need to overcome suspicions over their investment motives by building trust between investor and investee countries by committing to an internationally accepted governance framework. Nonetheless, there was something inherently paradoxical about how this drama was to unfold.

## Negotiating governance

Throughout 2007 ominous signs began to appear on the financial horizon, driven largely by a rapid deterioration in the mortgage market in the United States, extending to securities backed by mortgages, then to the banks and financial institutions that held both as assets. Liquidity concerns drove the US Federal Reserve to mobilize facilities to ensure the orderly functioning of markets. The capital positions of major global banks weakened drastically. The S&P 500 peaked in October 2007. Within five months, in March 2008, the investment bank Bear Stearns had collapsed. Ready sources of liquidity had dried up and large pools of uncommitted patient capital were scarce. The stability of the global financial system required concerted action to restore and re-establish confidence in financial institutions and markets. SWFs held large pools of liquidity. Between late November 2007, as the Treasury's plan emerged, and October 2008, when the working groups were to complete their mission, the S&P 500 declined 42 per cent. In the same period SWFs collectively committed approximately \$50 billion to support the capital positions of six global financial institutions, including Barclays Bank, UBS, Merrill Lynch, Morgan Stanley, Credit Suisse and Citigroup. Under such circumstances, could recipient countries legitimately argue that SWFs posed a threat either to global financial market stability or to the stability of recipient country capital markets?

This backdrop enveloped the International Working Group of Sovereign Wealth Funds, which was established in late April 2008 in Washington, DC, in the first of three rounds of negotiations. The IWG consisted of 26 funds, most with little knowledge of their peer institutions or any level of prior mutual engagement. Chairs were nominated: H. E. Hamad Al Hurr Al Suwaidi, under-secretary of Abu Dhabi Finance Department, and Jaime Caruana, director of the Monetary and Capital Markets Department of the IMF (IWG 2008b). The early meetings in the April round were preoccupied with basic introductions, as funds sought to know and understand each other's operating models and views across a range of issues. The tone was one of guarded cooperation. At the outset, some members, particularly those who had been long established, were annoyed at the process and questioned their involvement. Others were frustrated by the apparent hypocrisy of host countries welcoming sovereign capital to stabilize their distressed banks, while arguing the potentially destabilizing effects of SWF investments. Work was organized into three subcommittees, supported by IMF staff, whose task was to build upon the nine original principles formulated by GIC, ADIA and the US Treasury (IFSWF 2018).

At the outset, discussions were contentious. Consensus was eventually reached, however, on three points that were to define the boundaries – i.e. the limitations – of the framework, and so the degree of authority it would carry.

First, the framework would be referred to broadly as “general” principles and not be characterized explicitly as “best” practices. Second, and critically, the Santiago Principles would be entirely voluntary in nature. Third, in keeping with their voluntary nature, the Santiago Principles would require no surrender of sovereignty but remain completely subordinate to domestic laws and regulatory requirements. This third point was seemingly obvious but became the nexus around which the more challenging issues of disclosure and transparency were to coalesce.

Matters of transparency, specifically operationalized as disclosure rules, were intimately related to the local political and governmental structures under which a fund existed, the charter of the fund, the domestic legal regime in which it was created and the local regulatory environment in which it operated. Mehrpouya (2015) shows that SWFs reflect the practices of their governments with respect to the disclosure of official state information, including that related to fund operations. In the case of Middle Eastern countries, for example, most sovereign funds lacked annual reporting; neither did they disclose portfolio or governance information. Conversely, funds from Western democracies, such as Norway and Australia, offered greater public disclosure. In the case of Norway, this was to appease national political demands. For Australia, disclosures targeted the professional investment community and regulators.

In the final stages of the IWG discussions, agreeing on reporting practices would become intractable to the point of being debilitating. The Kuwait Investment Authority’s views on this matter carried the discussion. Under Kuwaiti law, employees of the KIA were prohibited from disclosing “data or information about their work or the position of the invested assets, without a written permission from the Chairman of the Board” (IFSWF 2018: 27). Kuwait could not accept provisions in the Santiago Principles that would require the public disclosure of its total assets or investment strategy. Instead, the Santiago Principles would take a minimalist approach to public disclosure, while carefully compartmentalizing other reporting and disclosure provisions on a “need to know” basis.

## **Understanding the Santiago Principles**

The work of the IWG ended in time for the IMF/World Bank October 2008 annual meeting. The Santiago Principles – as they would come to be known – were released under the formal rubric of the Generally Agreed Principles and Practices of SWFs. They were grounded in four “guiding objectives”, which most certainly reflected the legacy that defined their origins. The first objective was to reiterate the importance of maintaining a stable global financial system

and free flow of capital and investment. This was undoubtedly paramount to SWFs, which, notwithstanding their investments in developed market banks, remained cautious about the spectre of protectionism. The second objective was to emphasize that all investors comply with applicable regulatory and disclosure requirements in the countries in which they invest. The third objective was to accentuate the prevailing point that investment be motivated by an economic and financial risk–return calculus. The final objective was overarching and stressed the need for governance structures that were both rigorous and transparent with respect to operational controls, risk management and accountability.

In form, the GAPPs number 24 discrete articles organized into three pillars: first, legal framework, objectives and coordination with macroeconomic policies; second, institutional framework and structure; and, third, investment and risk management. As essential to understanding the GAPPs is the detailed commentary – “Discussion of the GAPP – Santiago Principles” – released along with the Santiago Principles (IWG 2008b: 11–25). GAPPs 1 through 5 are the foundation of pillar 1 on legal work. These address the legal foundation of the fund under home countries’ laws. They also prescribe that the policy purpose of a fund be defined and publicly disclosed; that a fund’s investment be aligned with the policy objectives of local fiscal and monetary authorities; and that rules related to funding, withdrawal and spending activities be discussed publicly. GAPPs 6 through 17 treat the institutional framework and governance. They address several key themes, including roles and responsibilities as between governing bodies and fund management, the operational and investment independence of management, accountability, compliance with host-country regulatory and disclosure requirements and, finally and more broadly, monitoring/audit and reporting. GAPPs 18 through 23 are centred specifically on investment and risk governance, and so are more technical on matters related to investment policy and strategy, the role and use of investment performance benchmarks, risk management and the exercise of shareholder rights.

GAPP 24 is often overshadowed by the other 23. IWG treatment of GAPP 24 originally centred on matters related to the auditing and verification of fund compliance (see Mehrpouya 2015). The strict application of verification rules would prove to be inconsistent with the voluntary nature of the final product, however. Instead, GAPP 24 prescribes a “regular review of the implementation of the GAPP ... by or on behalf of the SWF” (IWG 2008b: 9). Seemingly procedural, this provision lays the foundation for the ongoing work of the IWG with respect to disclosure. We return to this below.

As a non-binding, voluntary framework dominated by home-country laws and regulations, the GAPPs share features of an expanding body of transnational “soft law” – i.e. new regulatory modes, contractual arrangements, standards,

rankings and monitoring frameworks. In this regard, they have the capacity, as regulatory innovations, to fill gaps in the global financial regulatory body, particularly in areas such as transparency and prudential engagement. “Soft law” constructs bypass state authority in favour of voluntary adoption. In exchange, they offer access to membership, resources and certifications and base compliance on socialization, acculturation or other normative pressures rather than coercion. Importantly, because such rules are voluntary and beyond the threat of formal legal sanction, they engender broad interpretation and adaptation with respect to national laws, investment and risk practices and even norms with respect to transparency and disclosure (see Norton 2010).

As mentioned earlier, the most contentious issues discussed and resolved by the IWG are matters related to disclosure. The theme of disclosure appears in at least ten individual GAPPs. Disclosures target key stakeholders and the general public variously and include discrete calls for public disclosure of certain types of information. In addition, the GAPPs are intended to complement and reinforce both host- and home-country disclosure requirements. GAPP 15, for example, requires that SWF operations and activities in host countries comply with all local regulatory and disclosure requirements. On the matter of public releases, the GAPPs expressly call for the public disclosure of the legal relationship between the SWF and the state, its policy purpose, any funding and withdrawal rules and sources of funding, the fund’s investment policy and any non-economic or financial investment criteria, its general approach to voting shares and its risk management framework.

In many respects, the GAPPs embody the critical links between disclosure, transparency and governance introduced earlier in this chapter. They also reflect the limitations inherent in the exercise in parliamentary diplomacy through which they were created, however. They certainly fall short in mandating disclosure, although they nonetheless can offer a blueprint for reconciling home-country laws, regulations and socially accepted practices with host-country expectations. To critics, they miss the mark entirely: rather than constituting a governance framework to mitigate divergent interests between sovereign funds and recipient countries, the Santiago Principles more effectively regulate the relationship between fund managers and their owners, and so undermine their founding objective (Bismuth 2017).

As we suggest at the outset of this chapter, transparency is a social construct that is fundamental to building trust in relationships of exchange. What, then, do the GAPPs offer to SWFs with respect to disclosure and transparency? The origins and negotiations culminating in the GAPPs of course centred on SWF disclosures. It is important to note, however, that the members of the IWG interpreted – and the Santiago Principles acknowledge – that disclosure and transparency would be *shared* goals, extending to recipient-country investment



screening processes and policies with regard to the equal treatment of investors – i.e. what Truman (2008a) refers to as “reciprocal responsibility”. This point is important, and it is taken up again below.

### **Institutionalizing the GAPPs**

The work of the IWG was not expected to end with the completion and adoption of the GAPPs. If the process to fortify SWF governance accomplished anything, it succeeded in establishing a professional affinity group. In other words, it established a community of professional investors, which, although diverse, recognized a commonality of shared interests and objectives. In some respects, the work of the IWG was incomplete. The Santiago Principles anticipate re-examination of aspects of the GAPPs, as well as ongoing coordination and consultation between funds. To this end, the IWG agreed to consider the establishment of a standing group of SWFs to periodically review the GAPPs and to share information related to their implementation. The Kuwait Declaration serves as the bridge from the IWG to the creation of an international member organization – the International Forum of Sovereign Wealth Funds – and the establishment a permanent secretariat to support its work (IWG 2008a). It is perhaps curious, then, that the fears of SWF investment motives that spurred the Santiago Principles transformed an amorphous cohort of state investment funds with only limited prior engagement into an organized and expanding international member organization.

The Kuwait Declaration defined the purpose of the IFSWF as to meet and to share views and to facilitate an understanding of the Santiago Principles. The Declaration strongly reinforced the non-binding nature of the Santiago Principles by emphasizing that the work of the IFSWF would carry no legal force. It would serve, first, as a platform for the sharing of knowledge and idea among member funds, including sharing experiences on the application of the Santiago Principles, such as on operational and technical matters. Second, it would promote cross-stakeholder engagement to improve communications to lower barriers to cross-border investment.

Membership in the IFSWF would be open to all SWFs that participated in the IWG. Prospective new members could apply to join but had to endorse the Santiago Principles and meet its definition of an SWE.<sup>3</sup> Leadership would be vested in a chair and two deputy chairs, elected by members. But its day-to-day work would be the responsibility of a secretariat, whose permanent staff would primarily fill roles to assist in the coordination of IFSWF activities, facilitate communication between members and between the IFSWF and external stakeholders and maintain and update necessary documentation.

The first new members of the IFSWF were admitted in 2014. By the end of 2021 the IFSWF had expanded to 34 full members and six associate members.<sup>4</sup> Qualified funds may pursue membership by first becoming associate members for a period no longer than three years. Full membership requires the adoption and demonstrated implementation of the GAPPs. Application for full member status is made to the IFSWF board working through the Secretariat. The Secretariat was established in August 2014 as an independent non-profit based in London. Although much of its work can be described as consultative, focused on knowledge sharing and knowledge building, its influence extends well beyond coordinating meetings, addressing enquiries and serving as an official communication channel for the Forum. Its role as “gatekeeper” of the membership process is important in expanding institutionalization of the GAPPs among new SWFs. Related to this is its oversight and administration of GAPP 24.

Although the IFSWF has grown in number, it has also seen the exit of two key founding members in recent years: Norway and Chile. Both countries were present at the founding of the Santiago Principles, and both are still important models of sound SWF governance, transparency and robust natural resource revenue management. The departure of two prominent members, especially one being the largest SWF in the world, would seem to be a major setback for the IFSWF and, as such, the Santiago Principles. This is not the case, however. Norway and Chile are still fervent proponents of the Santiago Principles; both continue to assess periodically how they adhere to them. Chile, for example, conducts a review every two years of the adherence of how its SWFs comply. This is done to demonstrate to the Chilean public as well as the international community that its SWFs are managed according to international best practice (Ministry of Finance 2020: 20). This demonstrates that the Santiago Principles are and can be relevant beyond the promotional role that the IFSWF plays.<sup>5</sup>

### **The evolving practice of governance**

Empirical evidence related to the application and implementation of the GAPPs by IFSWF members has been of considerable interest to stakeholders – including independent researchers – since the Santiago Principles were first released. At least four independent initiatives have been launched in the intervening years. These include the Linaburg–Maduell Transparency Index (LMTI),<sup>6</sup> the GeoEconomica Santiago Compliance Index; the Global SWF Governance, Sustainability and Resilience (GSR) Scoreboard; and the SWF Scoreboard, developed by Edwin Truman of the Peterson Institute of International Economics (Truman 2008b). The LMTI and GSR continue to be updated regularly. The Santiago Compliance Index has not been updated since 2014.

Truman's work on the SWF Scoreboard began in 2007 and is updated periodically. It is widely considered to be rigorous and objective, taking a critical view of issues related to transparency and accountability. The Scoreboard was last refreshed in 2021. The previous Scoreboard, completed in 2016, and Truman's summary were reviewed with the IFSWF's membership at its 2018 annual meeting in Marrakesh, Morocco, on the tenth anniversary of the publication of the Santiago Principles.<sup>7</sup> Truman's analysis and conclusion attribute to the Santiago Principles and the IFSWF "substantial contributions to the transparency and accountability" of many funds, which he suggests is enhanced by the "peer pressures" of membership (Truman 2018). To understand a source of peer pressure, we return to GAPP 24.

To give operational effect to GAPP 24, the Secretariat launched an initiative to promote periodic updates and disclosure of GAPP implementation experiences. The Santiago Principles refer to these as "self-assessments", to be undertaken by the fund in cooperation with its owner or through third-party verification.<sup>8</sup> Disclosure of the self-assessment is not mandated and so is left entirely to the discretion of the owner, based on applicable national laws or regulations. Although the task of preparing these reports is the charge of each member, responsibility for motivating, organizing, coordinating and publishing them rests with the Secretariat. The Forum instituted a self-assessment process in 2014 and, at the same time, made a self-assessment review a formal requirement of the membership application process. The Secretariat has institutionalized the self-assessment by requesting that member funds prepare self-assessments biennially and by then publishing the submissions on its website. Through 2019 the Secretariat had overseen three self-assessment cycles. The first of these was completed in 2015, the second in 2017 and the third in 2019.<sup>9</sup>

The 2017 and 2019 self-assessment submissions indicate progressively greater membership participation. The overall quality of the 2017 submissions varied considerably. Some were detailed and carefully documented; others were prepared with less rigour and offered fewer details or supporting documentation. After the publication of the 2017 self-assessments, the Secretariat worked with member funds to develop a set of guidelines to assist in the preparation of the self-assessments. The guidelines are to be a key feature of the institutionalization of the GAPPs. They were designed to promote a higher degree of consistency across the submissions with respect to clarity and completeness. They should also serve to guide applying members in preparing their self-assessments for submission to the Secretariat. Importantly, they were motivated by and drew extensively from the commentary and explanations included in part II, "Discussion of the GAPP – Santiago Principles" (IWG 2008b: 11–25).

The round of self-assessments undertaken in 2019 was more consistent in scope and coverage, suggesting perhaps application of the guidelines. This cycle

included near-universal member participation in the self-assessment process. Importantly, the submissions reflected material improvements in the level of disclosure; greater detail, including in some instances on matters related to investment processes and operations; and a heightened attention to documentation, which included extensive references to a variety of online materials on both fund and owner websites.<sup>10</sup> This latter observation, although anecdotal, might suggest a more widespread adoption of disclosure measures beyond those prescribed by the self-assessment process itself.

Despite the improvement, an objective analysis of the 2019 self-assessments might suggest that their overall quality as disclosure documents is neither uniform nor complete. Applying Dixon's (2014a) transparency framework to the self-assessments across five forms of transparency – political, procedural, policy, operational and performance-related – we conclude that results are mixed.<sup>11</sup> Yet, in a comparative context at the fund level, evidence of material progress can be observed. Before discussing this further, we need to briefly unpack the framework (see also [Table 3.1](#)).

Political transparency refers to the exogenous rules and regulations underpinning the fund's operations. This form of transparency is about clarifying the objectives of an SWF in relation to a policy goal or set of policy goals and the relationship between the SWF and the state sponsor. Procedural transparency focuses on how decisions are made, and by whom, with the objective of clarifying the governance architecture and the investment decision-making process. Policy transparency relates to the rules and objectives that the fund imposes on its own operations and personnel in implementing investments. Operational transparency refers to the way the investment strategy, underpinned by investment beliefs, is implemented and by whom, with the objective of clarifying how the fund puts policies into action, such as how the fund plans to access financial markets. Performance transparency focuses on the investment outcomes achieved by the fund, with the objective of illuminating whether an SWF is performing as designed and in keeping with its mission.

The self-assessments are largely effective in describing the policy goals of member funds and clarifying the relationship between the fund and the state. These are generally factual and statutory. Similarly, regarding procedure, the self-assessments on balance provide clarity as to the formal governance architecture of each fund. More challenging are issues related to policy, however, or what Dixon describes as the rules and objectives imposed on decision-makers when implementing an investment mandate. Here disclosures vary, but only infrequently extend beyond general descriptions of rules and objectives. More in-depth discussions of constraints on decision-makers are missing. Similarly, on matters of operational performance, disclosures are also mixed. Although some funds provide very detailed descriptions of investment and

**Table 3.1** A framework for SWF transparency

<i>Area of transparency</i>	<i>Objectives</i>	<i>Methods</i>
<b>Political</b>	To clarify the policy goals of the SWF	Mission statement
	To clarify the relationship of the SWF vis-à-vis the state sponsor	Legal framework
<b>Procedural</b>	To clarify the governance architecture of the SWF	Board selection procedure (including requisite qualifications) Internal and external delegation procedures Corporate engagement procedures
<b>Policy</b>	To clarify the rules and objectives imposed on decision-makers in implementing an investment mandate	Disclosure of investment beliefs and strategic vision  Corporate engagement policy
<b>Operational</b>	To clarify the way and investment strategy is implemented and by whom	Disclosure of internal and external mandates
		Disclosure of asset allocation, specific targets, and intended holding periods Corporate engagement actions
<b>Performance</b>	To clarify the investment outcomes achieved by the fund	Short- and long-term performance metrics External audits
	To clarify how investment outcomes serve policy goals	Qualitative assessment of investment activities Qualitative assessment of organizational culture and effectiveness

Source: Dixon (2014a: 589).

risk management processes, others treat these questions in a more superficial way. Finally, with respect to investment performance, and specifically returns, diversity certainly dominates the format, horizon and depth of detail that individual funds choose to publicly disclose. Some funds, such as the New Zealand Superannuation Fund, report on their investment performance monthly, while others, such as Temasek in Singapore, report annually. Singapore's GIC does not report annually but, rather, on the basis of a rolling five-, ten- and 20-year horizon.

Persistent shortcomings notwithstanding, the IFSWF's implementation of the self-assessment process was a critical step in institutionalizing disclosure as a practice among members, whose obligation with respect to the process is otherwise non-binding and whose participation is strictly voluntary. Most importantly, whether upon admission to the Forum and through subsequent submissions, an IFSWF self-assessment serves as a self-disclosed public benchmark of a member's governance framework in the context of the GAPP and exposes that member's practices both to critical review by stakeholders and also to reputational challenges that arise from the disclosure practices of SWF peers.

## Conclusions

The SWF governance framework known as the Santiago Principles traces its origin to rising protectionist sentiments in the United States on the eve of the 2008 global financial crisis. It was conceived and marshalled by the US Department of the Treasury with support from the IMF and the OECD. The negotiations that ultimately gave rise to the Santiago Principles were constrained by the need to reconcile calls for greater disclosure with constraints imposed by domestic laws and regulations. At its closing, the IWG fashioned a community from a previously shapeless cohort of sovereign investors, defined a baseline for SWF governance and established a new global organization to represent the interests of SWFs where none had existed previously.

The governance framework shaped by the Treasury and adopted by the IWG addressed concerns about transparency and financial stability through a self-regulatory model that was to be entirely voluntary. There would be no enforcement. Rather, the Santiago Principles were aspirational at their birth, only later to become institutionalized through the work of the IFSWF. Although there is no evidence that the governance structures enshrined in the Santiago Principles have "hardened" with time (they remain voluntary), there is evidence of components of the Santiago Principles finding their way into treaty obligations, such as the proposed Trans-Pacific Partnership (TPP).<sup>12</sup> Furthermore, not so veiled references to the GAPP and the IFSWF are sometimes made by multilateral finance institutions when providing macroeconomic guidance to emerging market countries. Does this imply, then, that questions of SWF governance are no longer a barrier to access to recipient-country markets? Have SWFs as state agents achieved legitimacy as actors in global financial markets?

The institutionalization of the Santiago Principles reflects a drive to legitimize state investors through the application of a globally accepted governance framework. Sovereign wealth funds understood this process to be reciprocal. With respect to disclosure, the funds adopted a mutually agreed platform, then

organized as an international member organization through which the Santiago Principles transformed into a more functional form of governance. The expectation at the time, and still, is that a demonstrable commitment to governance and enhanced disclosure would alleviate concerns among recipient countries of the motives and practices of these investors, reduce tensions and lower barriers to the flow of capital, particularly to developed economies. In the intervening years since the adoption of the Santiago Principles, the openness to recipient-country markets has not necessarily improved. In recent years there has been a narrowing of openness to (some) state capital, particularly in the United States and in Europe, as governments strengthen national security legislation and provide greater latitude to restrict foreign investment on nationality security grounds (Bauerle Danzman 2021).

The English cleric Charles Caleb Colton once quipped that “imitation is the sincerest form of flattery”. In early 2019 the German economy minister, Peter Altmaier, proposed the creation of a state-owned fund to be established to protect key German companies from takeover by foreign firms (Zettelmeyer 2019). This raises an important question: was it ever about governance? Perhaps, then, the greater irony in the work to institutionalize SWF governance through the Santiago Principles is to have legitimized the role of state investment funds so as to serve the interests of recipient countries themselves.

## THE NEW GIANTS IN GLOBAL FINANCE: MYTHS AND REALITIES

In the midst of the 2008 global financial crisis, *The Economist* (2008) magazine published a cover portraying SWFs as Chinook helicopters carrying pallets of gold with the title “Invasion of the sovereign-wealth funds”. The image of military helicopters coupled with the word “invasion” manifests a certain bellicosity, with SWFs preparing a takeover of a weakened counterpart – in this case, global financial markets. But another interpretation is also possible, one in which the pallets of gold are part of a rescue operation to help those in desperate need following a disaster. This dichotomous image has reflected the key concerns around the role and place of SWFs in the financial markets since their growing emergence in the mid-2000s. With their massive size, could SWFs destabilize markets (Beck & Fidora 2008)? Or are they patient giants, providing much-needed long-term stability?

Despite nearly 100 SWFs operating at the end of 2020, only 17 managed assets greater than \$100 billion, and only two of those managed more than \$1 trillion in assets. The reality is that most SWFs manage less than \$5 billion. As discussed in [Chapter 1](#), there is significant variability and heterogeneity among SWFs. Some focus exclusively on domestic investments (e.g. Russia, Iran and Bahrain), whereas others invest only in international markets (e.g. Norway). Such heterogeneity takes the form of variations in mandates and operating objectives, and is an important element in understanding which SWFs are the most influential global investors. Indeed, when examining the influence of SWFs in global financial markets, we need look only at a handful of institutions.

When generic headlines in the financial press state that “sovereign wealth funds invest in a specific sector”, this usually refers to one of the top ten most active SWFs that engage regularly in large, visible direct investments. On an annual basis, the direct investment activity of SWFs is not especially large when viewed in the context of aggregate gross foreign direct investment.<sup>1</sup> For example, in the period from 2017 to 2020, direct deals totalled approximately \$100 billion annually.<sup>2</sup> In contrast, global FDI averaged \$1.5 trillion over the



same period (excluding 2020) (UNCTAD [United Nations Conference on Trade and Development] 2020). The total deal value of global merger and acquisition (M&A) activity was \$2.9 trillion in 2020 and \$3.3 trillion in 2019 (Makrygiannis 2020). Most SWF direct investments are made by a small group of funds. Led by Singapore's two funds, Temasek and GIC, this group includes Norway's GPF, Abu Dhabi's funds Mubadala and ADIA, the Qatar Investment Authority (QIA), the China Investment Corporation, Australia's Future Fund and the much smaller Russian Direct Investment Fund and the Ireland Strategic Investment Fund.<sup>3</sup> Within the top ten, most deals were completed by the two SWFs from Singapore. In effect, even among the largest direct deals involving an SWF, there are few actors.

Although the total participation of SWFs remains small, the influence of SWFs manifests itself in megadeals, which are transactions valued at more than \$5 billion. As such deals are infrequent yet large, there is typically significant media exposure, which amplifies the position of SWFs as major players in global capital markets. In the period from 2008 to 2019 SWFs joined at least 38 megadeals, such as the China Investment Corporation's \$13 billion acquisition of European logistics company Logisor, the commitments made by the Saudi Public Investment Fund (PIF) and Abu Dhabi's Mubadala in Japan's SoftBank Vision Fund (\$45 billion and \$15 billion, respectively), the participation of ADIA in the large buyout consortia of ThyssenKrupp's elevators unit (\$19 billion) and Nestlé Skin Health (\$17 billion) and GIC's acquisition with Brookfield Infrastructure Partners of US railway firm Genesee & Wyoming (\$8.4 billion). Nonetheless, direct SWF involvement in M&A megadeals is still limited. Consider that in 2019 there were 98 deals closed worth at least \$5 billion globally (Aliaj *et al.* 2020). SWFs participated directly in just four of them.

Ultimately, despite the growing number of SWFs and their aggregate assets under management, there are few SWFs among all global financial actors that have the size and transact in sufficient volume to impact markets on a global scale. In this context, we refer specifically to the capacity of certain SWFs to influence market trends, investor preferences, deal terms and pricing structures as a function of their scale, market presence and reputation. Other such actors include major central banks, some international finance institutions, major investment banks, institutional asset managers and large pension funds.

In this regard, then, some SWFs can indeed be as influential as large institutional investors. For instance, the investment practices of Norway's GPF, as we show in this chapter, have important signalling effects on the evolution of sustainable investment practices in public equities markets. In a similar way, some SWFs – such as Temasek and GIC – have become influential in private markets, as they participate in direct investment consortia to drive capital to discrete market sectors, such as those related to disruptive technologies.

In the next section, we consider the place of SWFs in listed equity markets, focusing on the case of Norway's GPFG as an influential investor in shaping the development of sustainable finance and, increasingly, the integration of climate change considerations in investment decision-making. The section thereafter segues into a discussion on how SWFs view climate change both as an investment risk factor and also an opportunity to earn investment returns. Here we highlight the case of the One Planet Sovereign Wealth Fund initiative. The penultimate section examines the role of SWFs as sources of long-term patient capital in private markets, particularly in disruptive technology sectors.

### **Agents of influence**

Much of the current attention on and scrutiny of global equity markets centres on the increasing growth of index funds. These are low-cost passive investment funds that are indexed to a variety of markets and sponsored by three of the largest global investment managers: BlackRock, Vanguard and State Street. Since the turn of the century these three managers have collectively quadrupled their ownership of the US S&P 500 index, with an average aggregate stake of 20 per cent of the holdings of the benchmark (Bebchuk & Hirst 2019). Hence, Blackrock, Vanguard and State Street can wield considerable influence on behalf of their clients by voting on board proposals. Research analysing the proxy voting of these managers demonstrates that they exercise their shareholder rights in a consistent, if not controversial, way by voting most of the time with management. The concentration of shareholder rights in this handful of organizations suggests that they have become systemically important to the functioning of global public equity markets (Fichtner, Heemskerk & Garcia-Bernardo 2017). In this regard, the somewhat smaller holdings of public equities even by the largest SWFs significantly constrain their ability to exert considerable influence over the managements of their investee companies.

Total SWF holdings in listed equities amounted to roughly \$3.4 trillion at the end of 2020.<sup>4</sup> This represents just 3.6 per cent of total global market capitalization.<sup>5</sup> This level of ownership is insufficient to claim that SWFs in the aggregate are systemically important, especially when compared to the largest institutional investment managers. Moreover, studies of the impact of SWF investment in publicly listed firms suggest mixed conclusions. For example, there is some evidence consistent with SWF investment negatively affecting the market value and operating performance of portfolio companies. The discount to firm value appears to trend higher as the size of the SWF stake increases and is accentuated when an SWF holds a board seat (Bortolotti, Fotak & Megginson 2015; Bernstein, Lerner & Schoar 2013). Other studies, however, suggest that

SWFs often refrain from active engagement as shareholders in public companies (Fernandes 2014). This is consistent with SWFs, as direct investors, frequently eschewing board membership. Thus, in the aggregate, the evidence is mixed as to the long-term effects of SWF investment on corporate governance and valuation (Megginson & Gao 2020).

Nevertheless, individual SWFs can be influential asset owners. The GPF, managed by Norges Bank Investment Management (NBIM), owns 1.5 per cent of all listed equities globally and more than 2.5 per cent in Europe (some 9,123 companies in total). The GPF is by law not allowed to own more than 10 per cent of the shares of any single firm, but this does not deter NBIM, on behalf of the GPF, from exercising ownership rights to influence corporate behaviour. For example, the GPF has been active in encouraging proxy access rights for US-listed companies, which allow it to nominate candidates to boards of director. The GPF has also set a precedent by publishing its voting intentions prior to general meetings to raise awareness of its position vis-à-vis other shareholders. Given the visibility of the fund as one of the world's largest and most transparent, attributable in part to Norway's liberal-democratic governance, the decisions taken by the fund are scrutinized, challenged and imitated (Vasudeva, Nachum & Say 2018).

The overall objective of the GPF is to realize long-term value creation while investing sustainably, integrating economic, environmental and social considerations. As such, the GPF, under the stewardship of the NBIM, has established standards in the way large asset owners approach responsible investing, through the introduction of ethical guidelines (see below for discussion), low-carbon transition strategies, corporate governance guidelines and active corporate engagement strategies to hold responsible top managers and board members of its investee companies. Although the GPF does not hold seats on portfolio company boards, its engagement strategy has nonetheless been influential in pressuring investee company boards (Aguilera *et al.* 2021).

A core feature of the governance of the GPF is the application of an ethical investment screen. This ethical investment policy is as much a reflection of Norway's social and political values as it is about externalizing and giving global effect to such national values. The GPF is, as such, a tool for supporting intergenerational equity and long-term welfare at home, while promoting Norway's national commitment to global justice. By this logic, the GPF is necessarily a political entity, because it reflects and is embedded in Norwegian political consensus and the machinery of government. In 2002, early in the life of the GPF, the government was faced with a dilemma over the fund's investments in certain companies as being potentially in conflict with Norway's treaty commitments under international law. The government established the

Advisory Commission on International Law, to determine whether the fund's investment practices did violate Norway's treaty commitments.

In March 2002 the commission received a request to review the investment of the fund in Singapore Technologies Engineering, which, through a subsidiary, was engaged in the production of anti-personnel mines. This was deemed to conflict with Norway's commitments under the Ottawa Convention on Anti-Personnel Mines. As a result, the government excluded ST Engineering from the fund's investment universe. In 2004 the commission was replaced by a new Council of Ethics, consisting of experts on ethics and international law, to advise the Ministry of Finance. It is the minister of finance who then decides to divest and/or exclude violating firms from the fund's investment universe. The Council of Ethics is focused on avoiding the risk of doing wrong, while similarly guarding against reputational risks from actions undertaken by an investee company that imply Norwegian complicity (Chesterman 2007).

The council applies criteria based on products and corporate conduct (see the guidelines for observation and exclusion from the Government of Norway 2019). Under the former, for example, companies are excluded from investment consideration if they produce weapons that violate fundamental humanitarian principles through their use; if they produce tobacco; or if they sell weapons or military materiel to states that are subject to investment restrictions.<sup>6</sup> Mining companies and power producers that derive 30 per cent of their income from thermal coal are also subject to exclusion. With respect to conduct-based criteria, companies can be excluded for systematic human rights violations, serious violations of the rights of individuals in situations of war or conflict, severe environmental damage and actions taken at a corporate level that lead to unacceptable greenhouse gas emissions or that indicate gross corruption or a serious disregard for fundamental ethical norms.

Through the ethics screen, the GPFG hence wields the threat of exit – i.e. divesting of its shareholdings – to further influence the actions of investee companies. For example, in 2006 the GPFG blacklisted Walmart and its Mexican subsidiary, Walmart de Mexico, for what the Council of Ethics considered systemic human rights and labour rights abuses in its operations.<sup>7</sup> In 2019 the GPFG reversed the decision to exclude the company, stating that the “grounds for exclusion are no longer present” (NBIM 2019). The threat of exit by a prominent shareholder can be a powerful tool to align the interests of other long-term institutional investors on key issues of corporate governance.

Despite ethical screening by one of the world's largest asset owners, there is insufficient evidence in the aggregate that “naming and shaming” have a material effect on the value of targeted companies and the ability of such companies to raise capital. But that is not necessarily the aim of the GPFG. Rather,

it is to avoid Norwegian complicity in products and corporate conduct that go against Norway's values and commitments under international law. In contrast, the GPF's influence is arguably more significant in its signalling of Norway's commitment to sustainable and ethical investment and the influence this has on other institutional investors. Since the scrutiny of SWFs intensified in the mid-2000s, Norway has represented an important benchmark against which other SWFs are evaluated. The GPF has regularly topped scoreboards relating to SWF transparency and adherence to the Santiago Principles, which Norway helped devise (see [Chapter 3](#)).

On the matter of climate specifically, Norway, as an oil producer, has been criticized for not setting emission targets for the GPF. Notwithstanding this criticism, in 2019 Norway's parliament approved a divestment strategy for fossil fuel holdings (including coal, oil and gas) and also committed to redirect a portion of the GPF's holdings to unlisted renewable energy infrastructure (NBIM 2021). NBIM became a founding member of the One Planet Sovereign Wealth Funds (OPSWF) initiative, joining ADIA, the KIA, the NZSF, the QIA and the PIF. This initiative, established in 2017, is focused on promoting the integration of climate risk criteria into SWF portfolio strategies and encouraging investments that support transition to a "low" emissions economy. Although the OPSWF's members themselves may not exert strong and independent influence over the pricing of carbon risk, the OPSWF through its leadership elevates climate change as a critical risk factor in managing institutional capital. We elaborate further on this in the next section.

### **On the road to net zero**

Climate risk is increasingly recognized as a financial risk by global banks, asset owners and investment managers as well as financial regulators.<sup>8</sup> Investors have acted by significantly expanding their allocations to sustainability strategies. The responses of SWFs have been mixed, however. A study by the United Nations Environment Programme found that only 0.15 per cent of SWF assets under management was invested in sustainability-related sectors in the period from 2015 to 2017 (Capapé 2017). Reinforcing this point, a joint survey conducted in 2020 by the IFSWF and OPSWF found that, although 85 per cent of their members accept that climate change is affecting global economic and financial systems, and 93 per cent recognize that climate change represents a risk and/or an opportunity for their investment portfolios, only 30 per cent had invested more than 10 per cent of their portfolios in climate change strategies (IFSWF & OPSWF 2020). In a comparable survey the following year, 71 per cent of the

81 SWFs surveyed had integrated climate change into investment decision-making and strategy (IFSWF & OPSWF 2021). Investing for climate change is becoming mainstream.

For SWFs from countries whose economies are dependent on fossil fuel production to lead in the transition to a low-carbon economy is certainly challenging, and arguably paradoxical. One would expect that fossil fuel interests would be so great as to effectively trump any efforts to facilitate transition away from fossil fuels. Nonetheless, SWFs are increasingly taking an active role. First, as direct investors in their own domestic markets, many development-oriented SWFs have mandates to invest in economic transformation (see [Chapter 5](#)). For some, such as Mubadala and the PIF, this includes making investments to diversify sector development so as to lower national dependence on hydrocarbon exports. More broadly, at the portfolio level, SWF investment strategies have included divesting from old forms of energy to decarbonizing across holdings.<sup>9</sup> This is often combined with active engagement of portfolio companies, including increasingly via the exercise of ownership rights. Thus, both directly and by leadership and example, SWFs could advance, as Vasudeva (2013) argues in the case of Norway's GPF, the progression of domestic firms through the diffusion of norms.

The New Zealand Superannuation Fund is a founding member of the OPSWF initiative. New Zealand's economy and government spending are not dependent on fossil fuel production, however. The NZSF's \$43 billion portfolio is nonetheless exposed to climate-related risks. In 2017 management took active measures to decarbonize about 40 per cent of the fund's holdings, based on the critical assessment that it was not adequately compensated for the risks posed by climate change. It has shared its decarbonization model and publicly disclosed its divested holdings to advance its overall climate strategy (NZSF 2020). Beyond simply reducing fossil fuel exposure, this includes integrating climate risks into investment analyses and valuation models, engaging with investee firms through active ownership and proactively searching for investment opportunities in such areas as alternative energy, energy efficiency and transformational infrastructure. An extension of this overall strategy is cooperative engagement at the international level.

Reflecting on the OPSWF, Adrian Orr, former CEO of the NZSF and concurrently chairman of the IFSWF, noted that, although it seems ironic that five out of the six founding members of the One Planet Sovereign Wealth Funds are oil-producing funds, they "have the most to lose and the most to gain if they get it wrong or right. So, they are highly incentivized" (Adamson 2018: 57). The NZSF, together with the other founding members of the OPSWF, have summarized their challenges around 12 recommendations arranged around three principles: alignment, ownership and integration.

*Alignment* necessitates that SWFs build climate change considerations discretely into their decision processes consistent with their investment horizons. This exercise requires that they adapt to new operational and informational systems, including adopting effective reporting and disclosure standards, to meeting prospective, climate-specific regulations and policies anticipated in the future (PRI [Principles for Responsible Investment] 2021). The sense of urgency of this issue is increasingly manifest across the investment management sector. This is exemplified by the recent letter by BlackRock's Larry Fink (2021) to CEOs worldwide, which identifies climate as *not just* a financial risk *but also* an historic investment opportunity.

SWFs as asset owners are called to navigate this risk versus opportunity nexus. As discussed in previous chapters, the early years of the twenty-first century were characterized by high oil prices, which accelerated the accumulation of capital by commodity-based SWFs while also encouraging the establishment of new funds. The shock of the 2008 financial crisis reverberated through the oil markets, as crude prices dropped from over \$150 per barrel in 2008 to \$58 by early 2009. Despite recovering in the aftermath of the financial crisis, oil prices have remained volatile and vulnerable to both demand *and* supply shocks, as well as geopolitical tensions (see Figure 1.1 in Chapter 1). Adding to the uncertainty is the rate of adoption of alternative energy sources. Concerns over the depletion of petroleum assets have given way to their being stranded in the ground.

Traditional oil giants are rebranding as integrated energy companies, acquiring renewable energy assets and planning for a lower-carbon future. Fossil fuels will not be likely to power cars in the second half of the century, driven by increased regulation of combustion engines and consumer preference. Corporations will probably limit their reliance on carbon-emitting sources of energy such as coal, as they will want to ensure continued access to competitively priced financing. Thus, to ensure the asset and energy source rotation, corporates will need to sell high-emitting assets and begin acquiring new sources of energy while exploring new sustainable business opportunities.

As asset owners, SWFs have invested in both high green-house gas (GHG) emitting "brown" assets, those that are high greenhouse gas (GHG) emitters, but also in low-GHG-emitting "green" assets.<sup>10</sup> As long-term owners, SWFs are a potential source of patient capital to corporates, including energy companies, as they execute asset rotation strategies. In June 2020, for example, GIC joined a consortium led by two major infrastructure investors – Brookfield and Global Infrastructure Partners – to acquire a substantial stake in the Abu Dhabi National Oil Company (ADNOC) gas pipeline subsidiary company for \$10 billion. Although this was ostensibly a "brown" transaction, the investment

thesis is more complex and illustrates the trade-offs but also the opportunities available to long-term asset owners. ADNOC, as a top ten worldwide oil and natural gas producer, is unquestionably responsible for a vast amount of GHG emissions annually. ADNOC's announced plans to develop sophisticated technologies for carbon capture, utilization and storage are expected to reduce its GHG emissions by 25 per cent by 2030, however, while contributing more broadly to "greening" – i.e. to transitioning – the energy industry.

SWFs as asset owners also participate in the low-carbon transition by investing directly in alternative energy sources, such as wind, solar and green hydrogen. For instance, in 2014 the European utility company Naturgy established Global Power Generation with the KIA to increase its international power generation portfolio. Currently the joint venture has an installed capacity of 3.5 GW in ten countries. In 2019 Naturgy sold its gas distribution pipelines in Chile to State Grid Corporation of China, while accelerating the development and acquisition of solar and wind farms in Australia through Global Power Generation, with the help of the Kuwaiti SWF. Other examples of asset rotation facilitated by SWFs are emerging, such as the 2020 joint venture established by the QIA and Enel Green Power (the Italian global integrated company) to finance, build and operate renewable plants in sub-Saharan Africa.

SWFs are also active direct investors in alternative sources of energy that help mitigate or adapt to climate change. SWFs have invested in electric vehicles through Tesla and Lucid Motors, in the largest solar and wind farm developments globally, in more sustainable food and meat-free protein producers and in carbon-free infrastructure, from urban transportation to efficient railroads and smart mobility. The IFSWF's data indicates that SWF investments in agri-tech, forestry and renewables increased almost sixfold from eight investments valued at \$324 million in 2015 to 18 investments valued at \$2 billion in 2020 (IFSWF & OPSWF 2021).

We argue that three sources of influence reinforce this movement as SWFs increase their engagement globally. First, legitimacy is at stake for SWFs – such as the NZSF and Norway – that have established ambitious goals for reducing carbon. Societal pressures will drive SWFs to divest themselves of brown investments and to align portfolio emissions to those of the country. The announcement by Norway to create a renewable energy infrastructure unit is a case in point: asset class diversification while reinforcing the country's commitment to a sustainable future. The Ireland Strategic Investment Fund's responsible investment focus and the Korea Investment Corporation's effort to integrate environmental, social and governance (ESG) criteria when selecting external managers are additional examples, as is the aforementioned integrated climate change strategy designed by the NZSF.



Second, SWFs are active co-investors (70 per cent of all direct deals in 2020) with both private and public peers. As global investors and asset managers increase their carbon reduction commitments, their engagement in co-invested deals will face increasing scrutiny on climate change actions, in turn heightening their due diligence of investment partners on matters related to climate risk. Working with traditional co-investment partners and consortia, SWFs will inevitably need to adapt to continue to access deal flow at scale.

Third, SWFs are increasing their pace of collaboration. Again, the One Planet Sovereign Wealth Funds framework is one such example. Although these networks facilitate information and knowledge sharing, they also attract allegations of “greenwashing”. In other words, they are liable to accusations that affiliation is sought with other “green” investors to enhance brand and market access rather than to adapt to more sustainable investment practices. To address such criticism, the most robust among these member organizations require members to tighten their controls and requirements to align with the organization’s principles.

The UN-backed Principles for Responsible Investment, established in 2006, serve to illustrate this. Signatories commit to incorporate ESG issues into investment analysis and decision-making processes and to engage as active owners by integrating ESG issues in ownership policies and practices, seeking disclosure on ESG issues by the investee companies. In 2017 the PRI put a delisting mechanism in place for signatories that do not fulfil minimum requirements. The PRI had more than 4,900 signatories as of May 2022. In 2018 165 were identified for not meeting requirements. In 2020 at least 28 of those were delisted or voluntarily withdrew (PRI 2020).

Reinforcing the work of member organizations, the European Union is leaning on ESG regulation to enhance transparency and expose and pressure laggards (European Commission 2018). Such regional and global initiatives create an opportunity for governments to exert global influence through the promotion of standards for sustainability and carbon disclosure. SWFs, as large global investors with deep knowledge and understanding of global financial markets, have a potentially important role to play in these initiatives, either collaboratively with or on behalf of their governments.

Transitions are filled with paradoxes. SWFs are positioned to engage the low-carbon transition by adapting their investment processes, aligning their long-term goals and pursuing investment opportunities that arise from transition processes. Nonetheless, SWFs continue to hold assets in traditional carbon-intensive industries. Effective recycling of portfolio assets will require a clear mandate from their owners, time and a concerted effort to overcome inertia to adapt.

## Disruptive innovation

Many SWFs are not encumbered by current financial liabilities. This provides them with the flexibility to invest portions of their portfolios over longer investment horizons. Consequently, SWFs must monitor and adapt to long-term macroeconomic trends, such as the multi-decade structural decline in interest rates. New risks – such as climate change and the disruption posed to traditional industries by emerging technologies and business models – likewise challenge investment strategies and have opened the door to alternative approaches to asset allocation focused on longer horizons. The continued search for higher-yielding assets, coupled with the capacity of SWFs to invest directly and over extended investment horizons, has had a material impact on both scale and process in private capital – particularly private equity and venture capital (VC) – markets.

Consider, for example, Temasek and GIC, the two Singaporean funds. Both employ strategies that involve investing in new technologies and disruptive start-ups. In 2014 they were among a small group of five SWFs that accelerated participation in earlier-stage venture capital financing. As this strategy became more rooted in their investment models, both funds opened offices in San Francisco, New York and Beijing, to be closer to these markets so as to monitor trends and build local market expertise. Then little-known start-ups in which SWFs had invested in 2014–15 – Didi, Uber, Airbnb, Xiaomi and Snapchat – transformed into disruptive forces that have impacted traditional sectors, such as transportation, hospitality, electronic devices and social media. By 2020 increased capital flows to private equity and VC markets had driven up valuations, while adding to the “dry powder” of private equity and VC funds. In the intervening period at least 16 SWFs developed venture capital programmes, tripling the number of funds joining VC rounds (IFSWF 2020). Joined by other institutional investors, SWF direct *and indirect* investment in private equity contributed to a trend among venture-backed companies, such as Uber, to “stay private longer” (Erdogan *et al.* 2016).

Among preferred destinations for SWF venture investments in disruptive tech are the United Kingdom, Singapore and, among EU countries, Germany. Among emerging economies China and India dominate. The United States remains the strongest geography for SWF technology-focused investment, however, driven in large measure by the strength of a robust ecosystem to foster and finance technology innovation. For example, in the biotechnology sector, 61 per cent of SWF venture deals since 2005 were closed in the United States. Temasek, Mubadala and the Alaska Permanent Fund Corporation have led US SWF investment in the sector. In the Chinese biotech sector, which has received

19 per cent of investment, Temasek and GIC have led SWFs. During the Covid-19 pandemic SWFs have been active participants in record global deal volume, with 2020–21 dwarfing prior years' activity.<sup>11</sup>

SWFs access private markets both directly and indirectly. The latter traditionally involves investing through a private equity limited partnership; the former involves deploying capital directly into private investments. A third model highlights the predisposition of SWFs to actively partner with or through experienced private equity professionals to leverage experience, local market expertise and deal flow. As such, SWFs are active co-investment partners and engage in several distinct types of structures that reduce costs, facilitate deal sourcing and promote risk sharing (Sчена & Perales 2018). Among these are (1) third-party private equity platforms, such as the Softbank Vision Fund; (2) in-house SWF venture platforms, such as, for example, Temasek's Vertex Holdings; (3) joint investment vehicles established by SWFs to promote investment between countries, such as the Russia–China Investment Fund; and (4) private investment platforms, sponsored by sovereign or public entities to access equity participation in private equity managers. Here, for example, we note Constellation Capital, a private markets platform managed by Wafra, the New-York-based private markets arm of the Public Institution for Social Security of Kuwait.<sup>12</sup>

SoftBank's Vision Fund is a useful example of the confluence of several SWF partnering trends in disruptive sectors. The Vision Fund, with \$98.6 billion in capital commitments, is the handiwork of Masayoshi Son, chairman and CEO of SoftBank, the Japanese multinational conglomerate and global investor. The Vision Fund was invested in 83 portfolio companies as of September 2020. Less than a year after its inception it had already deployed \$30 billion. The Vision Fund targets investments of \$100 million or more in growth-stage companies across a variety of technology sectors, including artificial intelligence, robotics, communications infrastructure, telecoms, computational biology, biotech, cloud technologies, internet-enabled consumer businesses and fintech (Sчена & Perales 2018). Both the Public Investment Fund of Saudi Arabia and the United Arab Emirates' Mubadala are heavily invested in the Vision Fund, with committed capital of \$45 and \$15 billion, respectively.

The management of the Vision Fund has favoured transportation and logistics, acquiring significant stakes in Uber, Oyo, DoorDash and Grab. It has also invested significant stakes in several other disruptive sectors, including consumer (ByteDance), enterprise software (Slack, acquired by Salesforce), fintech (C2FO) and frontier tech. Despite successes, however, challenges have plagued the Vision Fund and complicated SoftBank's intention to raise a Vision Fund 2. Not least among these is relatively weak performance in 2021, as a result of investment missteps among its portfolio companies. Betting on the transformation of the workplace, Son and SoftBank made an \$18 billion commitment to

WeWork, the circular economy's answer to powering the gig workplace of the future. WeWork reached a private valuation of \$47 billion in January 2019, only to see that plummet to below \$8 billion by the end of 2019.<sup>13</sup>

The \$45 billion commitment made by the PIF to the Vision Fund is the single largest-ever commitment or investment made by any SWF. As a development-oriented fund, the PIF's commitment was motivated by a desire to rapidly scale Saudi investment in innovative sectors with the goal over time of “localizing” – i.e. bringing investee firms and their technologies to the Kingdom (Torchia, Kalin & Rashad 2018). Nevertheless, recent challenges, including the WeWork debacle, have prompted the PIF not to participate in Vision Fund 2 but, instead, to closely monitor its existing \$45 billion stake, while pursuing its mandate to foster a domestic development agenda, complicated by the Covid-19 pandemic.

Another active SWF in the VC space is Mubadala, which is a diversified investment company that also has a strategic mandate (see also [Chapter 5](#)). It has established its own ventures unit, which leverages Mubadala's newly established presence in Silicon Valley. It has also launched three VC funds and actively supported the establishment of Abu Dhabi as an innovation hub by co-founding a collaborative technology incubator along with Microsoft and the Vision Fund. Mubadala is today recognized as one of the most prominent venture investors among SWFs (Capapé 2020). The thematic focus of its direct investments, in some respects, mirrors that of the Vision Fund and includes life sciences and digital health, cyber-technologies, airspace security, the digitization of the enterprise, insurance tech, fintech and the application of blockchain to financial services (Schena & Perales 2018). Although Mubadala has also opted not to invest in Vision Fund 2, it continues to leverage its relationship with SoftBank as a co-investment partner.<sup>14</sup>

The example of the Vision Fund thus serves to provide context for a key component of SWF investing strategy in private markets: partnering and co-investment. In this regard, SWFs have taken up a place among other long-term institutional investors to embrace collaborative models to deploy capital in scale to technologies and companies capable of driving disruptive innovation. In doing so, they can hedge “disruption risk” to traditional sectors of their portfolios, while building capacity to understand the forces that drive long-term returns.

## Conclusions

With the immediate onset of the Covid-19 pandemic, SWF resources were enlisted to secure medical equipment, finance rescue packages and fill fiscal imbalances brought on by the pandemic and government lockdowns. These

measures are each consistent with the emergency mandates of sovereign funds. A longer-term approach to economic resilience was undertaken by the Ireland Strategic Investment Fund, a development-focused fund that invests primarily domestically to enhance economic growth and development in Ireland.<sup>15</sup> The Irish government recognized the significant medium- to long-term impacts – job insecurity, supply chain disruptions – posed by the pandemic to the Irish economy. Consistent with the ISIF's mandate, it carved out a €2 billion sub-portfolio – the Pandemic Stabilisation and Recovery Fund (PSRF) – to invest in medium- and large-scale enterprises that, as significant employers, would be negatively and materially impacted by the pandemic.

From the perspective of portfolio investment, it is interesting to observe that, during the first six months of the pandemic, the biotechnology sector attracted disproportionate attention among SWFs investing in private markets. From January to September 2020 the value of SWF biotechnology transactions doubled the average of the previous three years. This marked a substantial increase and included investments made by Qatar Investment Authority in CureVac, Temasek in BioNTech and the Russia Direct Investment Fund in Sputnik V, and followed earlier investments in the sector, including that by ADIA in Moderna in 2018. Only in the case of the RDIF, a strategic investment fund, was an SWF enlisted to play a direct role in vaccine development and distribution. The response by most other SWFs, such as ADIA, the QIA and even the Alaska Permanent Fund, was strictly that of private market financial investors.

Despite this sizable deployment of capital to the biotech sector, the immediate strategic impacts of these investments during the pandemic do not necessarily find their way into government policy. Singapore, which invested in BioNTech through Temasek, authorized the US/German vaccine, as well as Moderna's vaccine, for emergency use. The United Arab Emirates, one of the countries that led vaccinations worldwide, did not approve Moderna's vaccine for emergency use until July 2021, however, despite ADIA's investment in the company. Instead, the United Arab Emirates early on relied heavily on Sinopharm, as well as Russia's Sputnik V, Pfizer/BioNTech and Oxford/AstraZeneca. Although a discerning analyst might infer that the Covid-19 pandemic created the opportunity for governments to tap SWF assets to secure vaccines and increase social protections to combat the pandemic (apart from the Sputnik V vaccine, developed with the coordination of the RDIF), the connection between SWF investment activity during the pandemic and non-economic – i.e. strategic – motivations is not evident. Thus, despite the role of SWFs as government-owned investment vehicles, the pandemic evidences the weak and often asymmetric link between SWFs, governments and national strategic goals.

If some viewed the arrival of SWFs on the global financial scene as an invasion, as *The Economist* magazine portrayed it in 2008, it would become quickly

apparent that, rather than dominating international finance and threatening host-country markets, SWFs would be swept into the mainstream of global capital. On 15 January 2008 the governments of Singapore, Kuwait and South Korea stepped in to fund much of a \$21 billion recapitalization of Citigroup and Merrill Lynch. As highlighted in [Chapter 3](#), this would expand to \$50 billion across six global banks by October 2008, with much of this invested capital remaining in place for many years thereafter. Today aggregate SWF assets under management are approximately \$10 trillion. SWFs have taken their place in global markets as long-term institutional investors, with a predisposition to leverage investment partners to build capacity, source investment opportunities and share risks. Importantly, however, to focus solely on a count of aggregate assets will belie a level of participation – and influence – in global capital markets that only the largest funds enjoy.



## TOOLS OF STRATEGIC DEVELOPMENT

As financial scandals go, it had all the makings of a thriller: jet-setting bankers, multi-million-dollar yachts, Hollywood sound sets, opulent, celebrity-filled parties, custom diamond jewellery, warehouses of priceless art.<sup>1</sup> For the government of Malaysia, however, the manipulation of financial institutions and markets and the theft of over \$4.5 billion in leveraged state assets was hardly fiction. The origin of 1MDB was as a small investment fund in the Malaysian state of Terengganu. Having been established a mere eight months previously, the Terengganu Investment Authority would undergo a dramatic transformation in July 2009. In line with the wishes of the prime minister, Najib Razak, it would become a federal-based sovereign wealth fund to be known as 1Malaysia Development Berhad (1MDB) (Sidhu 2009).

1MDB began operations in 2009 with the goal to drive long-term economic development in Malaysia by catalysing foreign direct investment. It was financed through capital transfers from the Malaysian government and later by bond issuances intermediated by the investment bank Goldman Sachs. The remainder of the story is tumultuous, however: the fund was effectively usurped by a little-known Malaysian businessman, Jho Low, working closely with the prime minister (Hope 2020). Najib saw in the fund a financing vehicle to pursue his political ambitions. In 2016 Malaysia's Finance Ministry dissolved 1MDB's advisory board as the US Department of Justice pursued civil action against the fund to recover diverted assets (Johnson 2016). Najib received millions in personal transfers from 1MDB companies and was eventually indicted and convicted by a Malaysian court for abuse of power, a charge that parallels others – money laundering and criminal breach of trust – for which he was also convicted (Tay 2020).

1MDB's mission was ostensibly to build partnerships with foreign investors to finance long-term growth and development in Malaysia. Such mandates among sovereign funds are not unusual. The term “development fund” had already been used in 2007 to describe sovereign funds that deploy capital to finance national socio-economic projects (IMF 2007b: 46). Of course, as we have stressed in



previous chapters, SWFs have long been acknowledged as serving a broad range of macroeconomic objectives that support national development, including stabilizing fiscal flows, insulating fragile economies from the inflationary effects of volatile revenue streams and minimizing disruptions to sector development and employment caused by Dutch disease. The investment objective of a development fund, however, is far more direct and purposeful: to invest competitively for financial return while targeting discrete sectors and projects to advance national economic development.

In sharp contrast to 1MDB, Malaysia's first SWF – Khazanah Nasional Berhad – began operations in 1994 with the dual mandate to advance both intergenerational savings and strategic economic development. Unlike 1MDB's short and turbulent existence, Khazanah, over nearly 30 years, has evolved from a largely passive custodian of Malaysian government-linked corporations into a professional investment organization capable of active engagement with portfolio companies to enhance both financial and operational performance. Owned by the Malaysian Ministry of Finance, Khazanah's investment strategy prioritizes national development objectives through leadership in deploying capital and also attracting foreign investment (Nowacki & Monk 2019). With a clear mandate, a well-defined legal structure and a functioning governance model, Khazanah has garnered emulation as a development-oriented investment fund (Dixon 2022).

The juxtaposition of Khazanah with 1MDB highlights starkly one dimension of the broader debate over the role of sovereign funds in economic development: the governance of extra-budgetary investment in a national economy. In this chapter we examine the role of the sovereign fund as an agent in national economic development. By investing competitively (similar to a private market actor) in the domestic economy, a sovereign fund can potentially mitigate the negative effects of missing markets and incomplete contracts for capital and professional services, while generating financial returns for the government. A fund that makes strategic domestic investments must also reconcile its own commercial interests with the economic policy goals of the state, however, while navigating the political shoals of local parochial interests.

From here our chapter proceeds by first establishing the role of the state in confronting the development conundrum. As agents of their governments, SWFs have been the focus of considerable debate over state investment in economic development. Our next two sections respectively present the traditional “case against”, then the “case for”, SWFs as domestic investors in economic transformation. The *scope and practice* of domestic investment by SWFs are taken up in a section on their evolution as strategic investors in their local economies. Evaluating the operational and investment performance of SWFs with development mandates is especially challenging. In our last section we offer a lens

through which to assess SWF contributions to national economic development and highlight some examples of successes and continuing challenges.

### **SWFs and the economic development conundrum**

Timor-Leste (East Timor) achieved independence from Indonesia in 2002. The island country boasts sizable reserves of both oil and gas, which it has exploited through licensing agreements, the revenues from which are deposited in the nation's Petroleum Fund. The local economy is small (2019 GDP: \$2 billion) and entirely resource-dependent, with the oil and gas sector accounting for 90 per cent of the country's revenues (EITI [Extractive Industries Transparency Initiative] 2020). Direct foreign investment is negligible. As hydrocarbon assets are steadily depleted, the government has struggled to develop a plan to diversify the national economy.

The Timor-Leste Petroleum Fund (TLPF) had assets in 2020 of approximately \$18 billion, all of which are invested in international capital markets, predominantly in the United States (TLPF 2020). The TLPE, modelled on the Norwegian GPF, is designed to insulate the local economy from volatile oil and gas prices. Accordingly, all resource revenues flow directly into the TLPE. Transfers from the TLPE to the government budget are capped at 3 per cent annually of the TLPE's wealth.<sup>2</sup> Thus, resource revenues find their way from the TLPE to the national economy through budgetary expenditures approved by the country's parliament. Yet, given the development needs of the Timorese economy, there is a question as to whether the country is best served by an SWF with assets of over nine times its GDP. In other words, should Timor-Leste repatriate a larger fraction of its capital invested internationally to finance national development projects? The question itself belies a more complex set of policy challenges that frames the debate over the role of sovereign funds and national development.

The relationship between capital flows and economic development has indeed confounded economists for many years. Contrary to expectations, and economic theory, capital does not flow readily from rich to poor countries (Lucas 1990). Rather, with increases in commodity prices and concomitant growth in state financial assets, capital has migrated steadily to developed markets, as states – such as Timor-Leste – recycle current account surpluses internationally (Schna 2017b). This puzzle has engendered various explanations, which have coalescence along two lines: differences in economic fundamentals; and imperfections in international capital markets (Alfaro, Kalemli-Ozcan & Volosovych 2008). The former refers to things that affect production and absorptive capacity, such as technological development, factors of production, the role of government and institutional quality. The latter focuses on political and sovereign risk factors,

accentuated by asymmetric information. Importantly, these explanations are not mutually exclusive. In practice, factors such as poor institutional quality, including weak investor protections and fragile governance structures, are quite consistent with heightened political and sovereign risk (see also Reinhart & Rogoff 2004). Moreover, in emerging economies, financial underdevelopment can compound the effect of weak institutions and inhibit the efficient intermediation of capital, including foreign capital (Prasad, Rajan & Subramanian 2007).

The pathway from improving institutional quality to strengthening governance, reducing sovereign risk and, ultimately, increasing investment flows inexorably places governments – or, more broadly, the state – at the centre of efforts to reduce or eliminate market frictions. Although there may be some agreement on the nature of the underlying development challenge, the role of the state in this process remains much debated. For some, the state's role in the economy is viewed strictly as that of a *catalyst*, whose role is limited to, for example, maintaining a competitive regulatory regime and providing education, core infrastructure and basic research (Porter 1990). At the opposite pole, although still in the view of a capitalist market economy, are those who view the state's role as *mission-oriented*. In this model, government takes a lead role in planning and financing development through special-purpose financial institutions (Mazzucato & Penna 2016; Mazzucato 2021). The middle ground is occupied by those who view the fundamental role of the market as a resource allocator and that of the state as a facilitator (Lin 2011). In this model, state investment is funded through revenues, including tax receipts, and is channelled through central budgets.

In practice, the role of the state in national development has well-established empirical roots, particularly in postwar Asia.<sup>3</sup> Today a variety of state-owned institutions interact with private institutions in product and capital markets. These institutions range from state-owned enterprises, banks and insurers to national development banks, pension funds and state investment companies. They can each serve the broader interests of the state in developing markets and building out commercial and financial infrastructure. They can also act as a conduit to mobilize and channel capital for domestic investment.<sup>4</sup> The roots of development-focused sovereign funds reside in this legacy. Among the earliest of these was the aforementioned Temasek, established by the Singaporean government in 1974 and capitalized by the inter-governmental transfer of assets, including shares of Singaporean state-owned enterprises.

In establishing Temasek, Singapore's minister of finance challenged the notion that politicians and civil servants could successfully administer state assets and instead tasked Temasek with their efficient management, growth and disposition (Braunstein 2019). At its inception as a state holding company, Temasek's founding mission was twofold. First, it was to increase the efficiency and to eliminate redundancies among SOEs through more effective management and

inter-corporate coordination. Second, it functioned as a financing vehicle, essentially in the form of an internal capital market, for portfolio companies by leveraging its scale and credit standing to issue bonds in global markets (Schna, Braunstein & Ali 2018).

By 2000 five additional strategically focused funds had been established, with mandates that ranged from managing state operating assets to investing in domestic infrastructure. Among these, as mentioned above, was Khazanah in Malaysia. Beginning in 2000 the pace of adoption increased dramatically; over 30 additional development-oriented funds were established between 2000 and 2019 (Divakaran 2019).<sup>5</sup> This “genre” of fund has become the most rapidly emerging as governments explore the role of public investment companies to channel investment into strategic sectors of their national economies. Not coincidentally, this growth has occurred in parallel with a re-examination of the traditional role of sovereign funds.

### The argument “against”

It is important to emphasize that the term “sovereign wealth fund”, as discussed in Chapter 1, was coined *retrospectively* in 2005 to describe a then expanding body of state investment funds that had emerged to capture and manage rapidly growing natural resource revenues. Their primary objective was to help provide fiscal stability in the face of volatile commodity prices. A second, and no less important, objective was to transform fiscal surpluses into long-term savings to promote intergenerational equity. The basic design and operating model of these resource-based funds was to facilitate balancing public expenditures (consumption) with the long-term accumulation of financial assets (savings), so as to sustain government spending and investment levels long after resources revenues ended. Derived from the *permanent income hypothesis*, this approach is bounded by the capacity of both the local economy and local capital markets to absorb large flows of new capital (van der Ploeg & Venables 2012).<sup>6</sup>

Governments, of course, have various means to channel savings to finance public spending. This occurs most frequently through a centralized budgetary process. In contrast, sovereign funds are often viewed as “extra-budgetary” – i.e. as operating outside or in parallel to a state’s budgetary process (Bauer 2015). This assessment is important and underlines several discrete risks that can arise from SWF investment in domestic markets when constraints to absorbing this capital – whether physical, institutional or commercial – are present. For example, sovereign domestic investment can potentially undermine government attempts to sterilize capital inflows. This could incubate Dutch disease, with resultant higher inflation, real exchange rate appreciation and a loss of

national competitiveness. Domestic investment can also weaken procurement and destabilize the project coordination that generally accompanies legislative oversight of budgetary processes. This can undercut budgetary control and lead to unequal treatment of expenditures (Das, Mazarei & van der Hoorn 2010). Beyond challenges to budgetary discipline, externalities – or unanticipated side effects – can arise from the inability of governments to effectively identify and execute projects that are investable or that “crowd out” the private sector. More threatening still are investment projects that become targets for rent seeking or political capture by domestic elites (see, for example, Barnett and Ossowski 2003).

To mitigate such risks, policy consultants and multilateral development banks have traditionally advised a rules-based approach to integrate sovereign investment into the budgetary process (UNCTAD 2006). This requires governments to define savings and withdrawal rules, to manage the flow of resource revenues into and out of SWF portfolios. On the outbound side in particular, savings flow from the SWF to the central budget to finance both spending and approved capital projects. Under this framework, SWF assets, until they are transferred, are invested *exclusively offshore* (Bauer 2015). Timor-Leste is an example of this model in practice.

### **The argument “for”**

Of course, the development requirements of resource economies such as Timor-Leste are far more diverse and complex than a single prescriptive model can satisfy. There are several key questions in considering the employment of an SWF in domestic markets. For instance, what is the scale of resource revenues relative to GDP? Do home governments have the capacity to identify investable projects and to deploy capital efficiently? Can they borrow in global capital markets? If so, can they earn returns on domestic investments that are higher than both their cost to borrow *and* their returns on foreign-invested capital? Moreover, if such economies, and their financial systems, are truly constrained from absorbing large inflows of capital, how can governments initiate a process to mobilize capital to relieve these constraints without becoming weighed down by foreign debt?

Formal challenges to the “traditional advice” emerged as early as 2006. Analysts began to re-examine the utility, and broad applicability, of ring-fencing natural resource revenues and investing them offshore (UNCTAD 2006). The level of development of the local economy must surely affect this decision, as will the breadth of the economy’s absorptive constraints, the availability of local capital and the efficiency of a government’s public investment programme (van der Ploeg & Venables 2012). For example, developed economies with abundant

public and private capital, such as Norway, might be well served by investing sovereign fund assets internationally and repatriating them to meet fiscal obligations. For emerging countries with low levels of both public and private capital, however, it is precisely this deficiency of capital that represents the most significant barrier to relieving development constraints. For such cases, this prescription had evolved: park capital offshore but repatriate it to build needed domestic assets at a pace and scale to initiate, then efficiently drive, long-run growth.

Writing in 2014, a World Bank team recognized the progressive growth of SWFs with development mandates, all while highlighting well-known management and governance challenges, namely low capacity, weak governance and regulatory frameworks and a lack of coordination between public entities (Gelb, Tordo & Halland 2017). Based on the team's empirical research, these same institutional barriers suggested several reasons for a professionally managed state-owned investment fund, including, first, to improve the quality of public spending and, second, to "crowd in" private investors so as to strengthen investment discipline. The World Bank found that many newly established funds had investment mandates that went beyond the operating objectives of earlier sovereign development funds. These objectives included attracting private capital, deepening domestic capital markets and building out institutional capacity through partnerships (Halland *et al.* 2016). To describe these funds, the World Bank settled on the term *strategic investment fund*, or SIF.

The stylized SIF is sponsored, and at least partially funded, by a single government, several governments or multilateral or regional financial institutions. Its investment mandate frequently includes a "double bottom line" with the strategic objective of generating financial *and* economic returns. To execute its mandate, a SIF often seeks to multiply the impact of its own capital by actively crowding in, or catalysing, third-party investment at either the fund or the project level, usually in the form of long-term risk capital, such as equity. In economies with weak domestic institutions, a SIF with strong management and investment credentials will also serve as a professional, domestic co-investor to third-party capital to reduce risk, integrate local market knowledge with external expertise and enhance the overall quality of its investment decision-making.

Thus, when functioning effectively, strategic funds can exploit proprietary local market knowledge and privileged access to opportunities (Bruce-Clark & Monk 2017). Their capacity to do so is predicated on a sound operating model, however, that combines strength in public financial management with robust institutional governance. The World Bank's analysis likewise called out the need for strong governance structures applicable to any SWF with a development mandate. These, at a minimum, include separation between ownership and management to permit effective oversight by a fund's board, managerial independence

in investment decision-making consistent with the fund's mandate, transparent and timely reporting and strong external audit systems (Halland *et al.* 2016). Each is considered central to a fund's ability to balance its investment objectives with the policy goals of the government, to maintain the integrity of the state's budgetary process, to reduce the probability of "leakage" of state assets through corruption, to circumscribe the parochial interests of local political elites and to offset risks posed by weak investor protections. Notwithstanding these considerations, the effectiveness of sovereign funds as tools to confront development challenges remains a question that is very much influenced by the discrete paths and institutional settings in which each is established and operates (see Dixon & Monk 2014, 2017).

### **Motivation, mandates, models**

Examining the development path of local economies is essential to understanding not only the operating and investment objectives of a fund but also the circumstances of and impetus for its creation. Slow growth and declining global trade and investment flows, low commodity prices, a persistent domestic infrastructure funding shortfall and underperforming state assets have all played a role in motivating new fund creation. Even so, two factors predominate *and interact*: deficits of capital; and institutional capacity. The persistence of market and institutional gaps has continued to interrupt the flow of foreign direct investment in emerging economies. This has resulted in a material reduction in investment in emerging markets since the global financial crisis.<sup>7</sup> Expanding the availability of resources for enhanced training and skill building is essential to narrowing these gaps. In this regard, the efforts by the World Bank to study market frictions to inbound FDI contribute to a deeper understanding of the potential role of SWFs in overcoming institutional barriers and reducing risks that constrain the flow of both foreign and private capital.<sup>8</sup>

Although sovereign funds that engage in development finance may share a common pursuit to advance national economic development, operating objectives vary widely. Some funds are tasked with promoting direct foreign investment as a stable, long-term source of development capital. The strategic imperative of others includes variously facilitating strategic restructuring to promote economic diversification and national competitiveness, managing and privatizing state-owned enterprises, closing infrastructure investment gaps, funding strategic economic development projects and even financing small- and medium-sized enterprise growth. In addition, some funds also include among their objectives developing and extending local capital markets, particularly private markets for equity risk capital, such as venture capital.

By way of example, the mandate of FONSI, Senegal's sovereign fund for strategic investment, established in 2013, is expressly to promote the role of the state as an investor, partner and complement of the private sector, with the aim of supporting direct investments in order to accelerate the economic and social development of the country (FONSI 2012). Among the newest development-oriented funds, the goal of the Indonesia Investment Authority (INA), established in 2021, is to stimulate national development by, in part, attracting foreign investors to the country. The government expects upwards of \$16 billion of foreign investment to partner with the new INA (Kim 2021a). Even among *prospective* SWF projects, development mandates persist. In 2019 the government of Kenya raised draft legislation to create a fund whose mandates would include stabilization and savings, and distinctly to "provide finance for infrastructure development priorities to foster strong and inclusive growth and development" (National Treasury 2019: 7).

Of the top 100 SWFs identified by the Sovereign Wealth Fund Institute,<sup>9</sup> approximately 40 per cent invest directly or indirectly to support a domestic economic development agenda. This cohort includes funds with discrete development and strategic investment objectives. A seeming commonality of purpose obscures considerable diversity in operating objectives and models, however. We highlight here five fund types distinguished across two operating models (see Table 5.1). These are the holding or investment company model and the investment fund model.<sup>10</sup>

Sovereign funds organized as holding companies are responsible for managing – and in some cases partially or fully privatizing – state-owned enterprises and other state assets. Many such funds have access to international capital markets and can raise external capital for liquidity, investment or to provide financing to subsidiary holdings. Among these, some are internationally diversified and invest in developed and emerging markets across a range of asset classes. Samruk-Kazyna, one of Kazakhstan's SWFs, is an example of a domestically centred state holding company. It is organized as a joint-stock company, whose assets include shares in Kazakh SOEs (Kalyuzhnova & Nygaard 2011). Among its objectives is enhancing the governance and operating performance of its holdings. Temasek and Khazanah, both introduced earlier, are examples of internationally diversified holding companies. Both funds likewise illustrate the effects of growth and scale on SWF mandates. Temasek and Khazanah have grown over time, and their mandates have evolved to include a broader global reach into strategic sectors and innovative technologies (as discussed in Chapter 4). Temasek's holdings include Singaporean SOEs, such as Singapore Airlines, but also extend to global investments, many of which target key sectors of Singapore's economy. Similarly, Khazanah's holdings include SOEs such as Malaysian Airlines,



**Table 5.1** Types of strategic investment fund

<i>Type</i>	<i>Model</i>	<i>Mandate</i>	<i>Capitalization</i>	<i>Examples</i>
State investment holding company – domestic	Holding or investment company	Holding companies organized under company law statutes; tasked with the management and privatization of state commercial assets, including state-owned enterprises	Equity in the form of cash or via the transfer of state-owned assets; debt via loans and bond issuances	Samruk-Kazyna
State investment holding company – internationally diversified	Holding or investment company	Holding companies organized under company law statutes that manage a diversified portfolio of domestic and international assets and privatization of state commercial asset, including state-owned enterprises	Equity in the form of cash or via the transfer of state-owned assets; debt via loans and bond issuances	Temasek, Khazanah
Sector-specific development or strategic investment fund	Investment fund	Fund managed as a unitary or sub-fund structure to invest in sector-specific national assets/projects, such as infrastructure; variants include catalysing investment strategic projects alongside foreign direct investors	Equity in the form of state capital transfers, including, in some cases, multi-equity investor models	National Investment and Infrastructure Fund (India)
Multi-sector development or strategic investment fund	Investment fund	Fund managed as a unitary or sub-fund structure to invest across sectors to promote national assets/projects, such as infrastructure	Equity in the form of state capital transfers	Ireland Strategic Investment Fund

<i>Type</i>	<i>Model</i>	<i>Mandate</i>	<i>Capitalization</i>	<i>Examples</i>
Globally diversified strategic investment fund	Investment fund	Funds designed to invest globally in strategic sectors consistent with national economic development goals	Equity in the form of state capital transfers	Mubadala

but range from early-stage investments in developed markets to large-scale national development projects.

SWFs organized under a fund model represent a pool of assets that is managed by an investment team or company that is usually owned in whole or in part by the sponsoring government. These may consist of funds with exclusively development or strategic mandates or sub-funds that exist as part of a larger multi-fund entity. Discrete types include: sector-specific mandates, such as infrastructure, in which the fund serves as an originator and lead investor for domestic investment projects; national economic development mandates, whereby the fund invests in strategic sectors of the national economy, often as part of a national development plan or agenda; and global strategic mandates, which are invested internationally in sectors and technologies that facilitate diversification of the national economy through knowledge or technology transfer and potential “localization”.

India’s National Investment and Infrastructure Fund (NIIF) is an example of a single-sector, multi-fund model established to catalyse direct investments in Indian infrastructure. The Indian government’s investment is limited to a maximum of 49 per cent of the fund’s capital. The remaining 51 per cent is raised from SWFs, other long-term foreign investors and government-linked institutions both within and outside India (Fernandez 2019). By contrast, the Nigeria Sovereign Investment Authority (NSIA), established in 2011, has three sub-funds, each with distinct mandates. These include stabilization, intergenerational savings and domestic investment in infrastructure. The latter focuses on mobilizing capital to close a significant gap in infrastructure buildout in Nigeria, which impedes diversification and national development (Orji & Ojekwe-Onyejeli 2017; Oshionebo 2017). Finally, Mubadala and the Public Investment Fund, both introduced in Chapter 4, are examples of sovereign funds that invest in whole or in part *internationally* to help diversify and transform the national economic base of the United Arab Emirates and Saudi Arabia, respectively.

## Achievements or aspirations?

Despite their continuing adoption by governments to promote national development, SWFs remain the subject of critical scrutiny domestically (see, for example, Singh 2020 and Lingga 2020). As instruments through which to implement national economic policy, when compared to government ministries and agencies, can SWFs operate with greater professional capacity and better access to information and resources? Can they mediate effectively between public and private sector interests and objectives? Can they foster a relationship of trust between governments and the various stakeholders of public investment? Can they serve as credible co-investors to both foreign and domestic providers of capital? Can they reduce leakage through corruption and poor management and materially improve the quality of public investment? Can they earn a return on their own operating cost base? In short, can SWFs invest more effectively than “politicians and civil servants” and enhance returns to public capital?

Standard measures of investment performance centre on returns. In the case of sovereign funds, these include financial returns on invested capital, generally measured as the return on investment or internal rate of return. Bruce-Clark and Monk (2017) suggest that, in fact, many development-oriented SWF funds have been successful in generating financial returns, which they attribute to proprietary local knowledge of local investment opportunities, “privileged” access to those opportunities and trust relationships with other investors. Among these are Temasek, Khazanah, the Public Investment Corporation (PIC) of South Africa and the Palestine Investment Fund. Certainly, financial performance is in part a function of the mandate and objectives of each fund, but it also reflects the quality and professional capacity of its management. For these reasons, when reported, the returns on developed-oriented SWFs vary widely (Bauer 2021).

In development finance, broader quantitative measures of performance are often applied to capture the economic rate of return of a project – i.e. the value of a project or investment net of the social and economic externalities attributable to it. Moreover, in the case of real assets, key performance indicators are being designed at the investment level to incorporate environmental and social risks and impacts. These are used to monitor and manage the performance of assets (Sчена & Kalter 2020). For example, the Ireland Strategic Investment Fund measures its performance based on both financial and economic returns. With respect to financial returns, the ISIF’s annual benchmark is the average cost of Irish government debt. ISIF’s economic goals are more complex, however, and linked to three discrete investment screening criteria that establish the government’s role for the fund regarding economic impact. These are *additionality*, *displacement* and *deadweight*. Additionality refers to

the additional economic benefits that are expected to result from an investment beyond those that would have otherwise occurred. Displacement refers to cases when the additionality created by an investment is offset by a reduction in benefits elsewhere in the local economy. Deadweight occurs when benefits from an investment would have been achieved even if the ISIF had not invested (IFSWF 2019). Together, these screening criteria are designed to ensure that the fund's investments contribute materially to Ireland's economic growth, while not marginalizing private sector investment.

Measures of economic performance of a fund's investment activity are tangible and generally measurable. The ISIF is rigorous in regularly reporting on the economic impact of its investments. This is not a practice that has been widely adopted by many development-oriented funds, however. Less tangible and so less measurable are indicators linked to *institutional performance*. Both Bruce-Clark and Monk (2017) and the World Bank (Halland *et al.* 2016) identify a number of key criteria that are generally qualitative and best described as operating principles and practices. These generally coalesce around four integrated themes: the alignment of a fund's mandate with its sponsor's national development goals; the strength of a fund's organizational capacity and quality of institutional management; the depth of a fund's capitalization; and, most critically, the robustness of a fund's governance model (Schena & Gouett 2022).

If an objective of establishing a development or strategic fund is to advance a national economic plan, then it is the responsibility of the government to first articulate its national development agenda clearly. Thereafter, the government must then define the investment objectives and mandate of the fund to establish a discrete boundary between investments undertaken under the national budget versus those undertaken by the fund.<sup>11</sup> Bruce-Clark and Monk (2017) refer to this as establishing "coherence" between the plan and a fund's objectives in order to avoid conflicts and to align the fund's return objectives – financial, economic, and social – with the development goals of the government. For example, if the fund is to pursue a "double bottom line" investment strategy that targets both financial performance and social and economic returns, these should be consistent with the government's development goals, avoid conflicts with investment objectives set for other government entities and reflect the operating boundaries of the fund vis-à-vis other fiscal and economic institutions. An interesting example in practice is the Saudi PIF, introduced in Chapter 4, which was launched in 2017 as a key node in the Kingdom's Vision 2030. Although the PIF's mandate certainly reflects its role in Saudi Arabia's long-term diversification strategy, the coherence of its investment programme with this strategy remains ambiguous.

Organizational capacity refers to the ability of development-oriented funds to leverage a local knowledge base, to exploit informational advantages and to leverage a unique role and access as a government-linked institution to originate,

structure, invest and monitor investments, in cooperation with its investment partners, to maximize both financial and socio-economic returns. This requires that funds match their capabilities and resources to the nature and scope of their investment strategies (Bruce-Clark & Monk 2017). For emerging market countries, capacity building is a formidable challenge. As public institutions, the task of SWFs to attract, compensate and retain world-class investment talent experienced in direct investing in private markets is difficult (see Bachher, Dixon & Monk 2016: ch. 3). This is compounded exponentially when fund leadership is sought among qualified nationals trained as investment professionals with experience and networks in global capital markets

SWFs are typically funded from surplus wealth, which derives from large holdings of excess fiscal and foreign exchange reserves. As such, the goal of a typical SWF is to manage and grow its portfolio of financial assets in accord with its mandate. Conversely, the objective of many development and strategic funds is to build out and grow the national base of real assets. In instances of capital scarcity, a development-oriented SWF will inevitably confront competing uses for capital, sometimes represented by contending political interests. Will funds be capitalized through allocations from the central budget? Will they be funded through central bank transfers? This mode of funding will be especially problematic for emerging economies when central bank reserves are required to manage volatile foreign exchange earnings. Will they be capitalized by “in kind” transfers of share ownership from government ministries or other government agencies? Will they leverage their capital base using debt?

In fact, the capital structures of development-oriented funds vary, and, as noted above, do often include external borrowing (Schena, Braunstein & Ali 2018). Nonetheless, the long-term financial resilience of any fund is dependent on its ability to manage its capital base, while mitigating both market- and project- or investment-specific risks. This places considerable strain on the capacity of management teams. Some strategic fund models (the aforementioned NIIF is one such example) are designed to be distinctly “catalytic” – i.e. to “leverage” or “multiply” the fund’s capital base by attracting both foreign and domestic co-investment in shareholding or partnership interests managed by the fund. Such structures include joint venture and co-investment platforms with embedded governance features designed to reduce risks to foreign investors. Funds that are established prematurely or that are undercapitalized may thus be constrained in their ability to mobilize external capital or, more threateningly, to maintain an adequate capital buffer to provide liquidity support for their investments, including fully participating in future funding rounds.

If active co-investment can allow a development-oriented fund to “multiply” or scale its capital base, it can, likewise, provide access to external expertise in deal structuring and pricing while also allowing the fund to benefit from the

investment monitoring of outside investors. Nevertheless, effective investment partnering with the goal of catalysing inward investment demands that a local SWF investment partner exhibit strong institutional governance characterized by a well-defined investment objective, an investment strategy and an operating model that establishes the independence of the fund's decision-making vis-à-vis the government. In the case of emerging economies with low levels of institutional capacity, this potentially extends to the ability of the fund to insulate co-investment partners from domestic risks posed by parochial political interests, including risks related to the expropriation or repatriation of capital. Even so, this thesis also evokes a fundamental challenge: can an SWF indeed serve as an island of good governance in a domestic political environment otherwise characterized by poor institutional quality (Sala-i-Martin & Subramanian 2013)? Indeed, Bauer (2021), citing the example of the Fundo Soberano de Angola, cautions the propensity of SWFs to undermine national development objectives by directing scarce resources to so-called “white elephants” or to the bank accounts of corrupt officials and fund managers.

## Conclusions

SWF investment mandates have traditionally been externally focused but have turned increasingly to address national economic development. The creation of development and strategic funds by national governments has indeed expanded dramatically since the 2008 global financial crisis. The primary objective of many such funds is to promote inward direct investment to advance discrete national development goals. Critical to their effectiveness are capacity building, professionalization and governance. Although SWFs have demonstrated promise in overcoming various challenges posed by economic development, including the financing of the post-Covid-19 recovery or the transition to carbon-neutral growth, they nevertheless remain vulnerable to weaknesses of capacity and political will. At the same time, it is necessary to recognize that “development” is never the handiwork of any one entity or policy.

By August 2021 the US Justice Department had recovered over \$1.2 billion of the assets misappropriated by the leadership of 1MDB (Department of Justice 2021). This sum is a fraction of the assets stolen, but it serves as an outsized reminder of the critical importance of organizational capacity and institutional governance to SWF performance. 1MDB never delivered on its goal to advance economic development in Malaysia. All the same, it has contributed immeasurably to a deeper understanding of the risks, and the structural requirements, of SWFs serving as instruments of national development.



## THE NEW STATE CAPITALIST NORMAL?

It has been nearly two decades since SWFs emerged with consequence onto the international scene. In [Chapter 3](#) we introduce the Santiago Principles and address issues related to the governance and legitimacy of SWFs. Since the Santiago Principles were written, and later institutionalized via the IFSWF, SWFs have gained increasing prominence in the global political economy. Moreover, as we highlight in [Chapter 5](#), their role as tools of strategic national development has expanded in both scale and scope. As [Chapter 4](#) has shown, SWFs, as asset owners and managers, are not fundamentally altering the structure or operations of global financial markets. Nonetheless, several larger funds, such as Norway's GPF or Singapore's Temasek, are playing influential roles among global investors committed, respectively, to sustainability and private markets.

Across all our chapters, readers will also appreciate the extensive diversity that characterizes SWFs. Some are capitalized from natural resource revenues, others by foreign exchange reserves, inherited state assets or budgetary allocations. Some have very sizable assets under management, but the vast majority are small by comparison. Some exist in liberal democracies, some in advanced economies, while others exist in single-party governments or function as fiscal or development institutions in emerging economies. Despite these many distinctions, SWFs share a common defining feature: they invest state capital.

The Santiago Principles have contributed in important ways to legitimizing the role of SWFs as institutions linked to state capital. Such legitimacy rests on a loose footing, however. The Santiago Principles are built on an intellectual foundation of liberal internationalism that today faces headwinds both nationally and globally. Although financial expediency may always motivate acceptance of capital investment – as was the case with SWF investments in the global banking sector in 2007–08 – concerns over the control or the exercise of ownership rights will always raise suspicions, whether among managers, labour, regulators or local and national politicians. When state-owned capital is involved, especially from a country whose values differ from the host country, suspicion can



escalate and give rise to stern resistance. The recent expansion of investment-screening mechanisms in the United States and Europe, noted at the end of [Chapter 3](#), is clear demonstration of growing concerns over the investment of state capital. In this regard, China has become a particular target both in the United States and Europe.

What precisely is state capital? It is easy – and convenient – to conflate state capital with “state capitalism”, and so with manifestly statist political economies such as China. Following this logic, it might be reasonable by extension to label an SWF as an expression of state capitalism. But is an SWF a necessary condition to identify a country as state capitalist? If this is the case, then would not Norway and Ireland be purveyors of state capitalism? These are, unquestionably, very different political economies from statist economies such as China. Consider, conversely, SWFs investing in global financial markets in a manner similar to other asset owners, without negative consequence for the liberalism of the market order. This raises an important question: why has the number of SWFs expanded so significantly across all types of political-economic systems in the relatively short span of 20 years?

Over the last decade there has been growing use of the term “state capitalism” across various social science disciplines. In this closing chapter, we begin by accepting that SWFs will never shed their material connection to state capital and the suspicions and challenges this brings. Accordingly, in the following sections, we offer a framework to understand SWFs in the context of state capitalism, as an analytical concept and empirical object. Thus, we unpack the varied usage of “state capitalism”, drawing on its varied intellectual roots, as well as more recent works, including by Alami *et al.* (2022) that seeks to move beyond the limitations of previous studies and further work by Alami and Dixon (2022, 2021) that focuses on explaining state capitalism as a global phenomenon in the recent world-historical transformations of capitalism. Our aim is to offer theoretical nuance to the global dialogue – and sometime debate – on the link between SWFs and state capital. We conclude with our own forward-looking take on what the future could hold for SWFs.

### **On the new state capitalism**

Recent references to “state capitalism” have been used to characterize certain types of national political economy (for an extended critique, see Alami & Dixon 2020a). No less importantly, its use has centred on describing and explaining visible manifestations of state involvement in the economy as through SOEs and SWFs. For example, scholars of international business and strategic management have been focused on understanding the increasing

growth – in numbers and size – and competitiveness of SOEs on a global scale (e.g. Wright *et al.* 2021). This work has been valuable in challenging expectations from neoliberal management theories that state firms are likely to perform less well than private counterparts, and for providing insights into the organizational and corporate governance modernization of SOEs. Elsewhere, work in the comparative capitalism tradition has focused on identifying the institutional features of a “state capitalist” ideal type or a “state-permeated” variety of capitalism (Fainshmidt *et al.* 2018; Nölke 2014; Nölke *et al.* 2019; Carney 2018). This work has been useful for debating the significance of national institutional features in shaping the modes of state intervention and the importance of state–business relations and networks. Work in international political economy has focused on implications for and threats to the liberal international order from the rise of “state capitalist” countries, specifically China (Kurlantzick 2016; Bremmer 2010; Meckling, Kong & Madan 2015). This work has been useful in understanding the coexistence and co-dependence of different forms of political economy in the international system and the limits of convergence theses towards greater political liberalism from deeper international economic integration.

Although there is much to draw from these debates in understanding “state capitalism” empirically, and in theorizing as such, there are several limitations. First, much of the literature tends to exaggerate the *novelty* of “state capitalism” in the current context, undervaluing historical usages of the concept of “state capitalism”, as a well as previous manifestations of state intervention across various types of political economy (see Sperber 2019 for an historical overview). Second, much of the literature is centred mainly on a national scale, which is insufficient for understanding the strategies and practices of state capital across various scales and their interconnections. Some of the literature advances a geographical bias that establishes state capitalism as a largely “Eastern”, “authoritarian” or “political” form of capitalism (Milanović 2019), which limits an appreciation of “state capitalism” in the Western core of the global economy (Alami & Dixon 2020b; Babić 2021; Kim 2021b). This similarly limits observing state capitalism as a global phenomenon, and so fostering discussion of the inter-referentiality, interconnections and combination of forms of state-controlled capital and explicit and implicit forms of statism. Third, much of the literature takes for granted any theory of the state, often portraying state capitalism as existing as a form of *strong* state involvement in organizing the economy, owning and controlling capital or influencing capital accumulation more broadly. The problem here is how to define “strong” without also clarifying the normal and ordinary role of the state in capitalism (Bonefeld 2017). Hence, without a robust theory of the state, it is impossible to adequately reflect on the specific conditions and implications of a strong role for the state.

To move beyond these limitations of existing state capitalism studies, Alami *et al.* (2022) construe state capitalism as a *problématique*, which acts to address the theoretical, political and geographical puzzles posed by the expansion of state intervention in an *historical totality*. Building on Peck's (2019) reflections of "plastic categories", this *problématique* is not an exercise to define the rigid boundary of specific models of state capitalism, neither is it intended to define binary categories.<sup>1</sup> Rather, it is a flexible analytic construct used to interrogate the rearticulation of state–capital relations and the variations in political, institutional, organizational and spatial forms these take, including the emergence of SWFs and their role in the (geo)political reorganization of global capitalism. Abstaining from overly rigid binaries (e.g. state vs market) also allows for a more complete reflection of what constitutes the separation of the state into public and private spheres, as well as the limits to state power set by legitimacy constraints established by domestic and international constituencies alike. One concrete example in our context is the scepticism towards SWFs investing in global capital markets (see Chapter 3).

The *problématique* that Alami *et al.* (2022) identify encompasses five dimensions. These dimensions are meant to aid the analysis of concrete instances of state capitalism. The dimensions are, moreover, meant as a set of interconnected propositions that, when used together to analyse "cases" of state capitalism, produce conceptualizations of state capitalism in theoretic terms that are more than the sum of each individually.

In the first instance, state capitalism, as an analytic construct, can be seen as a reference point for critical reflection on the (geo)political reorganization of global capitalism. Here, it is necessary to identify and examine the specific relations between state and capital, in addition to the configurations of political and economic power, including their relation to *global* capitalism. This requires analysing the organizational, institutional (e.g. SWFs; SOEs; national development banks), legal and spatial forms that politically mediate these relationships, as well as the agents and groups challenging them. Also relevant are questions related to the cross-form evolution of these relations, as are questions of space – or geographical/political/economic context – and scale. Thus, by focusing on specific configurations of political and economic power, we seek to avoid binary comparisons – state versus market – and stubbornly engrained assumptions, such as "statist" logics inevitably superseding private interests in certain political economies.<sup>2</sup>

The second dimension is anchored in a cautionary proposition: No state institution, form of intervention or development trajectory is assumed by default to be state capitalist. Thus, an SWF is not by default assumed to be an instrument of state capitalism, nor is the presence of a sovereign wealth fund evidence that the political economy warrants the moniker "state capitalist" (see Lyons 2007).

To employ the label “state capitalism” requires an explanation that engages the theoretical issues presented earlier, such as what constitutes a *strong* state. As a key component in a wider analytic process, this dimension ensures against vague or casual usage of the term “state capitalism”.

The third dimension of the *problématique* introduces a comparative or counterfactual perspective to interrogations of state capitalism (Kim 2021b; Babić 2021). Through such comparisons it becomes possible to substantiate the claim of state capitalism and what makes the object under analysis state capitalist. One of the most relevant examples is that of the United States and China, which are regarded as extreme opposites. China is frequently held as a state capitalist political economy, whereas the United States is viewed as a market-driven liberal economy. In many ways such a comparison makes sense, when simply comparing the degrees of the state ownership between the two economies. Here, China is taken as a state capitalist political economy. Nevertheless, massive defence spending by the US government, which results in significant revenues to defence contractors and aerospace companies, is generally not considered evidence that the US political economy is state capitalist. The United States may not exhibit state capitalism to the degree that China does, but this comparative exercise forces a dialogue about forms of state intervention, whether direct or indirect (Baltz 2022; van Apeldoorn & de Graaff 2022).

The fourth dimension of the *problématique* attributes to state capitalism epistemic qualities that permit it to serve as analytic host to understand the general role of the state in economy and society, *as well as* what separates the state and the economy. Consider again the case of China, as state capitalist, vis-à-vis the United States. Thus, by applying this fourth dimension to our analyses, it becomes possible to reflect critically on the forms of state action in cases otherwise not characterized as state capitalist and to compare modes of state intervention referred to as state capitalist with those not, even if they perform functionally equivalent tasks. Why, for example, should an SWF be linked to state capitalism organizationally if its investment management function is comparable functionally to private sector counterparts?

The fifth and final dimension of the *problématique* demands circumspection when studying cases of state intervention, including those of SWFs, in order to understand the evolving but historically discrete role of the state in capitalism in the current period. Is it simply coincidence, for example, that the number of SWFs has increased dramatically in the last two decades across a wide variety of political economies? There are certainly national considerations that explain the introduction of an SWF, such as windfall natural resource revenues. The aggregate expansion of sovereign funds globally, coupled with the growth of other forms of state capital, such as SOEs, requires analytic scrutiny that goes beyond a single case, however, or only national comparisons, devoid of a broader global

perspective. In short, what are the implications of any case under study beyond itself? What does it also tell us about the role of the state in the remaking of global capitalism? The aim here, then, is to establish the groundwork for theory building that is collective, continuous and cumulative.

### **State capitalist impulses and the sovereign wealth fund**

Alami and Dixon (2021) take the further step of extending the *problématique* by introducing the concept of “uneven and combined development” (UCD). Here, UCD is not intended as a theoretical construct but, rather, as a factual element to understand state capitalism better in its global context (Rioux 2015). Thus, UCD brings into relief the continuing, but unstable and multiscalar, remaking of capitalism as a global phenomenon. This methodological predisposition begins with the view that capital accumulation occurs as a global process. Accordingly, the principal analytical task is to identify the circumstances that drive the emergence and expansion of state capital and the role of institutions – state investment funds and state-owned enterprises – that engage with it. This also includes the emergence of strong forms of statism in this global process – i.e. the objects that typically constitute what is taken to mean state capitalism (Sperber 2019). This does not require beginning with an institutional or national unit of analysis as an instantiation of state capitalism but, instead, evaluating state capitalism more broadly from a global perspective, in order to avoid the *methodological nationalism* of much of the literature on state capitalism.

To avoid possible misinterpretation of this approach, it is necessary to clearly distinguish the *capitalist state* from *state capitalism*. These concepts do not operate at the same level of abstraction. Importantly, the former is taken as logically preceding the latter. The capitalist state is the political form of capitalist social relations, whose material reproduction is part of the expanded reproduction of such relations (Clarke 1991). As such, the capitalist state aims to remove impediments to capital accumulation, while managing economic crises and class conflict in the process. This means generally, but not exhaustively, altering or expanding the state’s involvement in economic and social processes, exercising influence over non-state economic actors and even, in some instances, taking direct control over the processes of capitalist production, including expanding its territorial scope. In this context, state capitalism represents an *immanent potentiality* – i.e. a set of impulses that emanate from within the capitalist state. As Alami and Dixon (2021: 14) note, this redirects analysis “away from constructing ideal-typical models of state capitalism juxtaposed to other (conventional) varieties of capitalism, and towards identifying the circumstances and conditions under which this potentiality is *actualized*”. In this way, we seek to

address directly the critique that all capitalism is state capitalism (Whiteside 2022), a contention that would otherwise render state capitalism nonsensical.

What explains the emergence of state capitalism, embodied in the expansion of the state's role as promoter, supervisor and owner of capital and manifest in the growth and global spread of enabling policies, institutions and, more generally, stronger forms of statism? Alami and Dixon (2021) trace this phenomenon to the political mediation of secular transformations of capitalism, in the broader context of the geographical remaking of global capitalism. Concretely, there are two historical-geographical transformations of capitalism germane to our discussion here. The first is the increasing automation and digitization of large-scale industry, propelled by the revolution in information and communications technology over the last 30 to 40 years. This transformation has contributed to, and, in fact, deepened, a new international division of labour that began in the 1960s that has shifted the centre of gravity of the global economy from the North Atlantic to the Pacific Rim. This new international division of labour is represented by the massive industrial upgrading of east Asia, including the concentration of low-skilled labour-investing production (Charnock & Starosta 2018; Scott 1998; Rolf 2021). At the same time, east Asia's industrialization, increasing urbanization and growing global middle class have driven an insatiable demand for natural resources, leading to historically high commodity prices and, as such, massive windfalls for exporting countries in Africa, the Persian Gulf and Latin America (Jepson 2020; Arboleda 2020).

The second transformation is that which underlies the so-called "secular stagnation" hypothesis, characterized, among some advanced economies, by slow growth, low rates of investment and high rates of savings (Summers 2016; Eichengreen 2015). The origins of this "long downturn", according to Brenner (2006), lie in a crisis of overproduction that began in the 1970s. Germany and Japan, and later the newly industrialized countries of northeast and southeast Asia, in particular China, fed overcapacity in global markets, squeezing profit margins and slowing investment. In the process, there was an increasing concentration in the ownership and control of capital, as firms sought to grow profitability through acquisition rather than through investments in new production (see also Alami & Dixon 2022). This is in part manifest in the growing corporate predisposition globally to repurchase shares, as well as in the increased indebtedness of corporate and public sector balance sheets, each accentuating the impacts of systematic risks on both public and private institutions. These trends pre-dated the 2008 global financial crisis and, rather than subsiding, have accelerated in its aftermath.

According to Alami and Dixon (2021), the political mediation of transformations and crises is embodied in a set of state capitalist impulses that is already encoded in the DNA of the capitalist state. Three examples serve to illustrate this

when analysing SWFs: a *productivist* impulse; an *absorptive* impulse; and a *stabilizing* impulse.<sup>3</sup> A *productivist* impulse may take the form of state intervention in production arrangements and in the competitive dynamics of productive capital. This impulse, for example, might be channelled through a strategic investment fund. As discussed in the last chapter, among the discrete roles of strategic funds is proving support to domestic firms through preferential credits, equity investment and strategic advice to enhance their competitiveness in global production networks, including to help them navigate the shifting geographical-cum-competitive dynamics of global value chains (Haberly 2017).

An *absorptive* impulse may arise from the uneven distribution of surplus across the world economy. This can afford some states the opportunity to become significant owners of capital. For example, the export-led growth of some east Asia economies, discussed in Chapters 1 and 2, resulted in a massive accumulation of foreign exchange and fiscal reserves, some of which was channelled into SWFs, such as the China Investment Corporation, transforming the utility of that capital from short-term uses, such as foreign exchange or budgetary management, into long-term uses available to further other state prerogatives (Dixon 2017).

Finally a *stabilizing* impulse may manifest itself in disruptions on a national scale resulting from tensions between global capital accumulation and the national political order. Thus, a stabilizing impulse, not to be confused with foreign exchange or fiscal stabilization (as in the case of a stabilization fund), can arise when a state is transforming its scale or geographies of intervention to strengthen its sovereignty and/or to protect the domestic political order (Carney 2018; Dixon & Monk 2012). In this context, an SWF could, for example, be used to buffer adverse impacts or other externalities resulting from economic transformation or crisis, in order to preserve socio-economic stability, and so the solidity of the extant political order.

## Looking forward

In Chapter 1 we emphasize that the growth of SWFs is not exclusive to any particular type of political economy or level of development. Our analysis suggests that there are certainly geographies where the number of SWFs or total assets under management is concentrated, such as in the Persian Gulf and east Asia. Nonetheless, SWFs exist across political and economic spectrums, with their rate of adoption increasing significantly in the last ten years. Alami and Dixon's (2021) UCD-based approach evokes the notion of a multiplier effect. In the case of SWFs, this may be reflected in imitative behaviour and competitive emulation (Chwieroth 2014) in both the introduction and spread of new SWFs and also in the discrete forms and mandates they take. For example, the experience of

Singapore's Temasek and Malaysia's Khazanah are cited explicitly in the design and reform of SWFs in other countries, such as Kazakhstan's Samruk-Kazyna, discussed in [Chapter 1](#). Consider also that the experience of Norway's GPF is often used as an exemplar and to justify the establishment of savings funds in places such as Timor-Leste and Ghana, among others (see, for example, Ackah 2021).

In 2008, on the creation of the French Fonds stratégique d'investissement (now incorporated into Bpifrance), President Sarkozy commented on the need for France to engage and collaborate with "respectable" SWFs, while having the means to protect French capital and economic interests from foreign takeovers. At the end of [Chapter 3](#), reflecting further on emulation, we highlight a similar but more recent suggestion by former German finance minister Peter Altmaier for Germany to establish a state-owned fund to protect key German companies from takeover by foreign firms (Zettelmeyer 2019). Are we to conclude from these observations that SWFs in Singapore, Malaysia and Kazakhstan, based on the characteristics of these political economies, are instruments of state capitalism? Are we, conversely, to conclude that SWFs in France, Ireland (ISIF) and Italy (CDP-Equity), or as proposed in Germany, do not, even though the mandates of such funds call for governments to deploy state capital domestically to strengthen national economic growth and development? This very question in some respects encapsulates the sense of the enigmatic that sometimes accompanies SWFs.

Our objective in writing this book is to address this ambiguity head-on by offering the reader, whether student or practitioner, a well-focused, multidimensional lens through which to understand SWFs *in their current state*. We have presented SWFs here for what they present themselves to be: institutions of state that manage state capital. This requires SWF managers to balance the operating requirements defined in their mandates with the constraints posed by both domestic and global markets, whether for resources, labour or capital. In some cases SWFs are called upon to build the microstructure of markets where this is weak or non-existent. In other cases SWFs, as co-investors, provide a conduit through which states can raise foreign capital despite institutional shortcomings that would otherwise increase investment risk and pose material barriers to capital flows. In still other cases SWFs provide liquidity to global capital markets, whether motivated by low prices and high returns or simply the discipline of rebalancing a massive globally diversified portfolio.

Although a clear view of the future of SWFs is beyond our scope, our frame of reference on that horizon is very much informed by a keen appreciation of the short, dynamic history of SWFs, their diversity of form and function and their capacity to evolve and adapt, but also – as in the case of 1MDB – to wither and die. The lessons we draw from this history and experience suggest to us that, as



institutions of the state, SWFs exist squarely between the state and markets and so can play a critical role in reconciling market processes with the allocation of scarce state resources.

Markets are dynamic and fluid, however, and crises, whether financial, environmental or viral, will recur. SWFs have demonstrated a genuine capacity to buffer: to mitigate the impacts of budgetary shocks or banking crises, to catalyse foreign investment into renewable energy projects or to mobilize responses to a global pandemic. We fully believe that their expansion as economic, fiscal and financial institutions of the state – whether through emulation or necessity – will continue. But, to be effective, the SWF – i.e. its role – must be woven into the institutional fabric of its home state. It must remain adaptive to meet the demands of domestic transformations, including those posed, for example, by climate change. It must enjoy the legitimacy that emanates from a trustful relationship with *both* domestic stakeholders and global partners that is grounded in a framework and culture of effective governance that reinforces its adaptability.

# NOTES

## Introduction

1. For more on our usage of “close dialogue” as a research methodology, see Clark (1998).

### 1 What is a sovereign wealth fund?

1. Debates as to what globalization is and what its effects are were extensive in the 1990s through the first decade of the new century. One key figure in those debates was Saskia Sassen (1996), and her work on sovereignty and the rise of global cities.
2. For a comprehensive list of existing and planned SWFs, see Capapé (2021).
3. See IMF (2008a). This document includes “development funds” as a type of fund, but attention is mainly geared towards commodity-based and reserve-based funds.
4. The term “Dutch disease” was coined by *The Economist* (1977) to describe the injurious effects of windfall gas revenues on the growth of other sectors of the Dutch economy. The principal link for resource economies is through the exchange rate: as capital flows into an exporter’s resource sector and sector revenues increase rapidly, upward pressure on its real exchange rate can reduce the competitiveness of its other exports, resulting in unbalanced sector development. Dutch disease can be induced by institutional, commercial and economic constraints on the ability of an economy to effectively absorb large capital flows (referred to as *absorptive capacity*).
5. For a critical take on demographic ageing and the policy responses thereof in relation to pensions, see Blackburn (2006).
6. By benchmarking performance and management norms with cognate firms in the private sector, these funds and, in turn, SOEs are trying to legitimize the ongoing state ownership of productive assets. In other words, if state assets are performing at least as well as if not better than the private sector, this reduces pressure to privatize state assets. The problem with this logic, however, is that, at the national level, a large state sector may be crowding out the private sector such that benchmarking at the national level may not be very meaningful.
7. Note that this book went to press just prior to the Russian invasion of Ukraine in February 2022. Western co-investors in Russia Direct Investment Fund projects, such as Bpifrance and Italy’s Cassa Depositi e Prestiti, announced a pause in cooperation. Other partners, such as the Saudi Public Investment Fund (PIF), Abu Dhabi’s Mubadala and the China Investment Corporation, have maintained ties. Pre-existing sanctions against Russia had already complicated the scope of the RDIF from its founding ambition to mobilize foreign capital for investment in Russia. Although Western investment partners are recoiling, it is not at all certain whether this will hold for other countries and their sovereign funds. The global reach of massively increased Western sanctions and the reputational implications of association may ultimately erode their resolve, however.
8. By 2014, when the ISIF became operational, risk capital markets in Ireland had returned to normal, and the economy started to boom.

## 2 The short history of sovereign wealth funds

1. The TPSF has also featured as the first SWF. As contemporary debate on SWFs focuses on international political economy, we emphasize national-level SWFs. This does not mean that subnational funds are irrelevant to global debates. Indeed, the Alaska Permanent Fund is a member of the International Forum of Sovereign Wealth Funds.
2. Such separation of the state and market is clearly debatable; see [Chapter 6](#) for further discussion on this point.
3. Although we frame the issue of long-term institutional stability as a necessary condition for employing a long-term investment strategy, institutional stability is also significant for those funds, namely stabilization funds, that invest on a short time horizon, as the policy objective of such funds, namely managing natural resource revenues, is typically long-term in nature.
4. By “patient capital” we mean the capacity to provide capital continuously to users of capital (e.g. firms) over time. Patient capital does not necessarily mean the provision of a long-maturity asset or lock-up period. See [Deeg and Hardie \(2016\)](#).
5. It is possible to consider the Saudi Arabian Monetary Authority (SAMA), which was established in 1952, in this mix as well. SAMA typically has not been drawn into debates about SWFs, however. More recently, Saudi Arabia has joined the realm of SWFs more explicitly with the transformation of its Public Investment Fund in 2015. Although it was established in 1971, and supported development, the PIF was “reborn” into a strategic investment fund, focused on supporting the national development plan, Vision 2030 (see [Chapters 4 and 5](#) for further mention of the PIF).
6. For a detailed description on the origins of Temasek and the evolution of the institution in the 1980s and 1990s, in connection to Singapore’s industrial policy, see also [Braunstein \(2019\)](#).
7. The issue of what happened to all the North Sea oil and gas revenues in the United Kingdom came to the fore again during the 2014 referendum on Scottish independence ([Gordon 2014](#)). See also [Cummine \(2016\)](#).
8. See the different models available and the Guidotti–Greenspan rule, analysed by [Jeanne and Rancière \(2011\)](#).
9. This point here is not to preclude the possibility of an SWF managed within a country’s central bank but to emphasize the lack of institutional development in the form of a separate asset management organization.
10. For institutional investors, such as pension funds as well as SWFs, the level of risk taken in the portfolio should be matched with an appropriate investment governance architecture, which relates to the human resources and procedural capacities at the board and managerial levels to assess and monitor investment risk. In simple terms, an investment fund should not take risks that it does not understand (see [Clark & Urwin 2008](#)).

## 3 Legitimizing state actors in global markets

1. CFIUS is a Treasury-chaired committee of representatives from 11 departments of the US federal government, including Defense, State, Commerce and Homeland Security.
2. Patrick Schena assisted in this publication through the drafting of the main text and conducting interviews with key informants.
3. The Santiago Principles define SWFs as follows: “SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets

to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports” (IWG 2008b: 27).

4. For specific details and a list of both full and associate members, see [www.ifswf.org/our-members](http://www.ifswf.org/our-members).
5. Based on discussions with key informants, the exits of Chile and Norway were not, as might be assumed, because of some fundamental criticism of the IFSWF. Rather, their departures seem to have been based on internal ministerial questions as to resource allocation and the usefulness of membership.
6. See [www.swfinstitute.org/research/linaburg-maduell-transparency-index](http://www.swfinstitute.org/research/linaburg-maduell-transparency-index).
7. Patrick Schena and Adam Dixon attended the 2018 annual meeting of the IFSWF.
8. See the discussion notes to GAPP 24 in IWG (2008b: 25).
9. The individual submissions by each fund for each cycle can be accessed on the IFSWF website.
10. Patrick Schena led independent reviews of the 2017 and 2019 self-assessments for the IFSWF. See Schena (2017a) and Schena *et al.* (2020).
11. Dixon’s transparency framework takes inspiration from Petra Geraats’s (2002) work on central banking. It is also important to recognize that this framework intentionally mirrors many of the elements of the Santiago Principles. The framework is meant not as a replacement but as means of further scrutinizing, and ultimately enhancing, the impact of the Santiago Principles.
12. See consolidated TPP text, chapter 17, “State-owned enterprises and designated monopolies”, article 17.1 (available at [www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/17.aspx?lang=eng](http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/17.aspx?lang=eng)). The TPP was signed in 2016 but was not ratified and did not enter into force, as the United States withdrew in 2017. The other countries party to the treaty negotiated a new agreement, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which came into force in 2018. The CPTPP incorporates most of the provisions of the TPP.

#### 4 The new giants in global finance: myths and realities

1. To gauge the total exposure of SWFs to privately owned assets is difficult, because of poor data availability. Researchers can trace deals made directly by SWFs, but a big share of their investment activity is made indirectly via third-party asset managers. Hence, mandates given to asset managers are not the main focus of this chapter (see Fotak, Gao & Megginson 2017).
2. Average of the years 2017–20, according to data from the IE Center for the Governance of Change “Sovereign wealth research” database.
3. The RDIF and the ISIF are focused on domestic investments, and hence we do not classify them as globally relevant. The ISIF manages the remaining global portfolio of the defunct National Pension Reserve Fund of Ireland, however; this is an inherited activity, which does not reflect the main mission of the ISIF.
4. Figures are from the IE Center for the Governance of Change “Sovereign wealth research” database.
5. This is calculated on data for 2020 from the World Federation of Exchanges database.
6. Investment restrictions pertain to “large-scale UN sanctions or other international initiatives of a particularly large scale that are aimed at a specific country and where Norway supports the initiatives.” See section 3-1(2)(c) of the “Management mandate for the Government Pension Fund Global”: NBIM (2010).

7. In its recommendation to the NBIM, the Council of Ethics based its decision on the following: "An extensive body of material indicates that Wal-Mart consistently and systematically employs minors in contravention of international rules, that working conditions at many of its suppliers are dangerous or health-hazardous, that workers are pressured into working overtime without compensation, that the company systematically discriminates against women in pay, that all attempts to unionise by the company's employees are stopped, that employees are in a number of cases unreasonably punished and locked in, along with a number of other circumstances ..." (see NBIM 2006).
8. Concerning the change in the discourse of the SEC (Securities Exchange Commission) in the United States, for example, see the speech made by the acting chair, Allison Herren Lee (2021).
9. Some have criticized the divestment movement for employing a crude distinction between fossil and non-fossil stocks, arguing that it should be replaced with a more nuanced appreciation of companies' climate impact and governance (see Mormann 2020). Divestment campaigners, such as McKibben (2021), have also emphasized that divestment must be coupled with investments in new technologies and renewables; divestment needs to be thought of in multidimensional terms.
10. We recognize that labeling low-GHG-emitting assets as "green" is problematic and controversial. Our usage here is not meant to be read in an instrumental sense but, rather, to reflect the processual nature of moving away from fossil fuels.
11. Figures according to data from the "Sovereign wealth research" database of the IE Center for the Governance of Change.
12. The other asset owners involved in Constellation Capital, in addition to the Public Institution for Social Security, include AP3, one of the five buffer funds for the Swedish national pension system; Railpen, the investment manager for the UK Railways Pension Scheme; and the Alaska Permanent Fund.
13. Including SoftBank direct investments, according to Softbank's COO Marcelo Claure's quote during an all-hands meeting with WeWork employees in October 2019 (see Ghaffary 2019).
14. See, for example, Softbank Vision Fund investment in Berlin-based mobility company Tier, along with Mubadala (Bradshaw & Kruppa 2020).
15. See Chapter 5 for details of the ISIF's mandate, organizational structure and governance.

## 5 Tools of strategic development

1. The story of 1MDB is adroitly told in the popular book by Hope and Wright (2018).
2. Petroleum wealth is defined as "equal to the value of the Petroleum Fund's investments plus the net present value of expected petroleum revenue from proven reserves and approved development fields" (TPLF 2020: 1).
3. For a review of literature on the east Asian developmental state, see Stubbs (2009).
4. Financialization is a contested concept, with various meaning and multiple usages. Here we employ Bruce-Clark and Monk's (2017) definition with regard to sovereign development funds, in which financialization pertains to a process of contributing to development through the expansion of capital market functions and the introduction of new types of financial intermediaries.
5. Shanthi Divakaran is a sector specialist at the World Bank.
6. The permanent income hypothesis links current consumption patterns with *expected future income streams*.
7. According to World Bank economists (Kose *et al.* 2017), investment growth and emerging market economies slowed significantly from 10 per cent per year in 2010 to less

than 3.5 per cent in 2016. They find that this investment slowdown was broad-based and accentuated by both financial market and policy uncertainty.

8. To further advance capacity building by governments considering the establishment of a development or strategic fund, the World Bank in 2017 launched a major initiative to document good practices and guidelines by SWFs by sponsoring research for a practical guide for fund establishment and operation. The guide is expected to be released in 2022.
9. See [www.swfinstitute.org/fund-rankings/sovereign-wealth-fund](http://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund).
10. With further reference to strategic and development fund taxonomies, see Schena & Gouett (2022).
11. Establishing boundaries for the execution of a fund's strategy provides clarity related to the operational role of the fund as a local financial institution.

## 6 The new state capitalist normal?

1. Plastic categories of analysis eschew rigid ones that, as Peck argues (2019: 1194), “beg binary answers (capitalism, yes or no)”. Plastic categories can be “held in constant dialogue (and tension) with empirical inquiries that call upon them as sensitizing devices (or maps) and not as a source of foreclosed conclusions”.
2. Consider the 1MDB corruption scandal in Malaysia that was discussed in the last chapter. This case demonstrated that state-owned investment vehicles can manifest accumulation strategies that span the boundaries of the public and the private, while implicating individuals who possess different class positions. On the one hand, the fraud involved the misappropriation of public funds by Najib Razak, the prime minister, and the financier Jho Low. Yet, on the other hand, the case involved the participation of leading global investment bank Goldman Sachs – an embodiment of high finance.
3. Alami and Dixon (2021) offer a fourth impulse they call the *disciplinary state capitalist* impulse, which focuses on state efforts to manage surplus populations.



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