Sovereign wealth funds (SWFs) are on their way to a new normal. Having operated for many decades in quiet niches of global financial markets, SWFs became the subject of considerable political controversy in the years preceding the recent global financial crisis. During that time, the public discourse in many recipient countries metamorphosed from unawareness to reservations, and in a few cases to outright rejection. When financial markets slipped into the crisis, concerns gave way to busy courting of the SWFs for their capital, while the value of their assets under management was under pressure in light of the general market downturn. Despite the previous controversies, policy toward SWFs has not resulted in protectionist stances in most countries. The initiative taken by the SWFs themselves leading to the Santiago Principles, and the Organisation for Economic Co-operation and Development’s (OECD’s) efforts at constructing guidelines for good policy responses, have helped to attenuate concerns in recipient countries, and encouraged reasonable policy measures.

With a view to the long term, the key question is whether these measures suffice to ensure a stable equilibrium of interests between state investors and recipient economies. After all, sovereign investments have strong potential to grow, and to become a symbol of the increasing wealth of emerging economies and their increasing participation in and ownership of financial assets at the global level. To that end, policymakers and market participants will find it beneficial to transcend this fragile equilibrium between competing interests. SWFs and recipient economies will need to translate voluntary commitments into concrete policy measures, and avoid, on the one hand, politically sensitive transactions, and, on the other hand, protectionist measures against foreign private or public investors.

This chapter discusses the prospects for a political environment that encourages efficient capital allocation in the long run, against the backdrop of recent policy initiatives, and based on a review of underlying economic forces and political rationale.

1The potential benefits of SWFs to their home economies are described in Kern, 2007. A discussion of the sovereign investments relative to other uses of government revenues is provided in Blackburn, 2008.
The political controversy around SWFs has been sparked by their fast and strong rise as government-owned investment vehicles funded by the transfer of state-owned assets that are set up to serve the objectives of economic stabilization, saving for future generations, investment and development, or the funding of contingent pensions through investing the assets on a long-term basis, often overseas.

Globally, this class of institutional investors—comprising more than 60 entities—was estimated to have well over US$3.7 trillion of assets under management in 2010 and has grown impressively, driven by high incomes from commodity sales and reserves accumulation for existing SWFs, as well as the establishment of new entities. The assets are concentrated in the top SWFs, 10 of which are believed to manage more than US$100 billion each, and totaling more than three-quarters of all sovereign assets. In addition, SWF assets are concentrated in geographic terms: They are predominantly found in emerging and developing countries, as shown in Figure 3.1, especially in Asia and the Middle East, together home to more than two-thirds of all SWF assets.

**Figure 3.1** Regional Distribution of Assets Held by Sovereign Investors, Percentage of Total, May 2010

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2Figures on SWF investments presented in this chapter are based on completed and reported equity transactions by state-sponsored investment vehicles. The total volume of investments flows, including nonreported equity transactions and investments in other asset classes, is substantially higher.
The size of the state-owned funds, their concentration, and their growth have greatly influenced the public debate, in the course of which SWFs were at times characterized as state funds of disquieting size and opaque intentions. This perception was particularly pronounced in the United States and Europe, the major recipients of SWF investments, absorbing half of all reported capital contributions by state-sponsored investment vehicles worldwide, followed by Asian economies absorbing one-third of the investments, and the Middle East, in which less than one-tenth of assets have been invested (Kern, 2009).

This perception has changed. Most important, growing awareness about the relative size of sovereign investors has helped calm the debate. SWFs are—albeit large and growing—a relatively small group of institutional investors, whose total assets under management amount to merely one-sixth of the investment-fund industry, and to less than 4 percent of bank assets worldwide (Figure 3.2). In aggregate, the reported and completed direct equity investments by SWFs worldwide amounted to US$215 billion between 1995 and 2009 (Figure 3.3). This figure is dwarfed by private capital flows, for example, the US$700 billion of private capital expected to be invested in emerging markets in 2010 alone (Institute of International Finance, 2010). In addition, SWF investments are only one part of a broader trend in the course of which foreign direct investments from emerging markets—whether from public or private sources—have accelerated substantially since the 1990s. With US$290 billion of foreign direct investments, emerging economies have multiplied their participation in global corporate ownership from its past levels (UNCTAD, 2010). But again, it is useful to recall that this compares with a total of nearly US$2 trillion in foreign direct investment...
globally, almost half of which originates in the European Union (UNCTAD, 2010).\(^3\) (See also Chapter 15 of this book for a further discussion on the relative size of SWFs.)

In addition, some of the concerns in the recipient countries have been dispelled by the approach SWFs have taken to their investments for the time being. A considerable share of SWF assets is understood to be invested in company equities, listed or unlisted, worldwide. Although real estate, debt securities, derivatives, and cash are also part of SWFs’ portfolios, public policy issues have clearly centered on the question of corporate ownership on the part of state investors. Concrete substantiation of investment strategies has remained sparse so far.\(^4\)

Anecdotal market evidence suggests that SWFs generally prefer to acquire small minority stakes in target companies. Other investment strategies notwithstanding, an oft-cited example is Norway’s Government Pension Fund–Global, whose holdings—as one of the largest state-sponsored funds—averaged 1 percent of the world’s listed companies at the end of 2009. The vast majority of the fund’s equity investments are understood to be stakes of less than 2 percent. For publicly reported equity purchases by SWFs, however, the stakes in individual companies are substantially higher (Figure 3.4): Almost two-thirds of all reported transactions result in stakes of 20 percent or higher, and one-quarter of the deals represent outright takeovers (Kern, 2009).

\(^3\)On the relative economic importance of SWFs, see also Balding, 2008.

\(^4\)For a review of sovereign investment strategies, see, for example, Bernstein, Lerner, and Schoar, 2009; and Chhaochharia and Laeven, 2008.
Publicly reported stakes, however, make up only a fraction, approximately one-fifth, of total SWF equity holdings.

A further calming factor in the public debate has been the long-term approach most SWFs are understood to pursue regarding their equity holdings. Although no specific evidence is available on this subject, SWFs’ low 1:4 relationship of asset sales to purchases since 1995 suggests that most assets are held for relatively long periods. When SWFs divested assets in the past, they sold them directly to private investors in two-thirds of all cases, and in nearly 90 percent of these cases to foreign investors outside the SWF’s home jurisdiction. In only 15 percent of all cases were assets sold directly to another state-sponsored investor—half of this 15 percent went to domestic state-investment vehicles and the other half to foreign state investors. The remaining 20 percent of SWF asset sales were executed through secondary market sales (Kern, 2009). SWFs’ claim of being similar to conventional institutional investors is further supported by the fact that the majority of equity assets sold to the private sector are sold through private placements or market sales.

Finally, a key factor in rationalizing the debate has been the observation that none of the transactions reported so far has proved harmful to the security and broader economic interests of the recipient economies. In fact, foreign state

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5The long-term ratio of asset sales to investments is likely to be altered by the pickup in asset sales in the wake of the crisis, albeit only temporarily.
6Reference period is 1995 through mid-2009.
investments in defense-related companies—one of the most critical issues in political debates in the United States and the EU—have played an insignificant role in past years, at 1 percent of the invested total. More important, SWF investments have focused on enterprises in the technology, commodities, real estate, and services sectors, and manufacturing industries, with a share between 10 percent and 15 percent each. The most significant development, however, has been the participation of state-sponsored investors in the financial industry between 2006 and 2009. Spurred by falling equity prices for financial firms in the course of the crisis, the share of investments in the financial sector in completed and reported investment transactions by SWFs between 1995 and mid-2009 amounted to 42 percent, or US$78 billion. Overall, the figures suggest not only that the concerns about security issues in recipient economies, especially in the United States and Europe, may have been overestimated, but also that SWFs were broadly perceived as beneficial investors in normal as well as crisis conditions.\(^7\) This new rationality in dealing with SWFs represents a good basis for building mutually beneficial and productive business relations between foreign state investors and recipient countries in the longer run.

At the same time, policy issues may reemerge, depending on a number of economic and political factors. Realistically, SWFs will continue to grow in business size and economic and political weight. Even taking into account the setback from the crisis, which resulted in sizable imputed losses on SWFs’ asset portfolios and weakened inflows of new funds from parent governments, SWFs’ assets can be expected to double over the next decade. See Figure 3.5. Given their potentially rising financial weight, and with it their growing economic and political influence, SWFs are set to remain under close, if not intensifying, scrutiny by market participants and policymakers.

\(^7\)Further evidence on the portfolio composition of SWFs has been provided by Balding, 2008; Fernandes, 2009; and Fisher, 2008. Evidence on the role of third-party asset managers has been presented by Clark and Monk, 2009.
SWFs AS FOREIGN INVESTORS IN THE UNITED STATES AND THE EU: THE POLICY ISSUES

The size, growth, and investment activities of SWFs have made them the subject of economic and political concerns in recipient countries, especially the United States and the EU. These fundamental concerns were the background against which a number of measures were targeted at state investors, and they explain the political dynamics behind investment policies in many countries worldwide.8

Financial Market Stability

The SWF industry as a whole represents an economically influential part of the global financial sector. Equally important, individual SWFs have grown to substantial size, bringing them in the league of the largest institutional investors worldwide. This, and the size of many of their individual investment transactions, has given rise to questions regarding the potential impact of SWF transactions on financial market stability. Thus, it is conceivable that an individual transaction undertaken by one SWF might lead to herd behavior by other market participants, resulting in excessive capital movement and price and rate changes for the subject asset as well as—if spillover effects occur—for correlated assets. At the extreme, such herd behavior can exert a destabilizing effect on financial markets. The probability of herd behavior and spillover effects may be aggravated by SWFs’ comparative opacity, and may be further complicated if markets react sensitively to unverifiable market rumors.

Empirically, however, SWF investments have had no detectable impact on financial stability. An analysis of the effects of the equity purchases made by sovereign investors in 2007 and 2008 suggests that no strong or lasting impact on bank share prices existed (Kern, 2008). Although all indicators—including share price, share-price volatility, and abnormal returns—showed aberrations in selected cases, none of them was extraordinarily strong or sustained (Figure 3.6). Even in cases for which the events’ impacts could be identified, the direction of the impacts was not homogeneous. In some cases the investments were likely critically important to stabilizing the capital conditions at the invested institution; however, it would be premature to regard SWF commitments as fundamentally altering market sentiments in a fragile market environment.9

State Funding

Drawing on budgetary revenues or official reserves, SWFs are state-funded investment vehicles, open to the charge that their activities stand in contrast to the concept of a free-market economy with minimum state intervention and that they distort market activities because their funds are not refinanced under

8An overview of the political issues discussed in the context of the SWFs can be found in Greene, 2008; and Rose, 2009.
9For further evidence, see, for example, Beck and Fidora, 2008; Kotter and Lel, 2008; and Sun and Hesse, 2009.
market conditions or do not originate from market activity. With states having provided support to the financial sector in industrial economies in response to the financial crisis, and the critical importance of that support for restoring well-functioning markets, this argument has receded to the background in the current debate. The practical impact of foreign state investments on enterprises, however, remains subject to scientific scrutiny, suggesting that a negative impact on the long-run performance of enterprises with shares owned by SWFs cannot be excluded.\(^{10}\)

**Sale of Strategic Assets and Know-How**

Although SWFs emphasize their commercial objectives, much of the public debate in recipient countries has centered on the concern that foreign investors with non-financial motivations could seek control of companies and assets. Such control, it was conjectured, could pose a threat to national security and public order, especially in the defense industry, public and private infrastructure, high technology, and financial markets, but also with respect to access to natural resources worldwide. This issue was seriously considered in many recipient countries, even though it is certainly not specific to SWFs. In fact, states have a number of means and institutions at their disposal through which investments can be pursued. These include public pension funds, development banks, state-owned enterprises, and other public entities. Of these institutions, SWFs are the least suspicious with

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\(^{10}\)Evidence on a negative impact has been provided by Bortolotti, 2010. A competing view has been presented by Fernandes, 2009.
regard to political investment objectives, given their commitment as long-term-oriented financial investors, mainly seeking small minority stakes. Many of the SWFs also have proven and long-standing track records as reliable partners of the companies in which they have invested. Although no significant cases of security issues involving SWFs have been observed in practice, the political concerns have remained the single most critical issue in political and public perception.

Corporate Governance

Finally, critics of foreign state fund investments have argued that SWFs—especially if domiciled in emerging economies—may not be able to live up to corporate governance requirements as established in many traditional industrial economies. In particular, whether SWFs would be able to meet standards of corporate governance and the responsibilities associated with seats on governing or supervisory boards has been at question.

POLICY RESPONSES: A DANGER OF PROTECTIONIST REFLEXES?

As these concerns were increasingly articulated, governments in many countries were quick to review their domestic rules governing incoming investments. In the end, legislative or regulatory initiatives were limited, with concrete changes in market-entry conditions in Australia, Germany, the Russian Federation, and the United States, while the European Union has announced that it will explore the need for EU-wide policy adjustments. The outcomes vary considerably, from the establishment or refinement of reasonable review mechanisms for inward investments to the establishment or heightening of outright protectionist barriers to entry of foreign capital.

Australia

Australia has maintained a foreign investment screening process since 1975, as introduced by the Foreign Acquisitions and Takeovers Act. The process is designed to ensure that foreign investment in Australia is consistent with the national interest. The process requires that significant foreign investment proposals be notified to the government and examined by the Foreign Investment Review Board (FIRB), which advises the Treasurer, who can reject proposals deemed contrary to the national interest or can impose conditions. The FIRB examines whether foreign investments might have adverse implications for national security, economic development, or government policies. In 2008, the government issued additional principles applicable to foreign state investors, including the operational independence of investors from the government, clear

11For evidence on SWF investment practices, see Avendaño and Santiso, 2009.
12For a review of associated issues, see Backer, 2008; Gilson and Milhaupt, 2008; and Monk, 2008.
13Extensive comparative accounts can be found in US GAO, 2008; and Kern, 2008.
commercial objectives, the adherence to adequate and transparent regulation and supervision, and the economic impact of foreign state investments on Australian business. Even though none of these principles establishes qualitatively new criteria, the intervention clearly set the tone for investment policies at a time when the Australian public was particularly concerned about the entry of foreign state investors in the areas of natural resources, commodities, ownership and exploration rights, and processing. Unlike the policy measures in the United States and Germany (discussed below), the Australian approach explicitly includes broader economic and societal interests in its review criteria, and does not confine itself to questions of national security in a strict sense.\textsuperscript{14}

**Germany**

Germany’s response to foreign state investments\textsuperscript{15} was one of the most carefully watched developments in this policy area; nonetheless, the law that emerged from the debate turned out to be a very balanced solution and not nearly as restrictive as expected by some. The law envisages the establishment of a review process, under the auspices of the Federal Ministry of Economics, for foreign investments originating outside the EU or the European Free Trade Association and leading to a stake in a listed or unlisted German company of more than 25 percent of its capital. The federal government can prohibit or approve with conditions a transaction found to be in violation of the country’s security or public order. The law largely resembles the basic functioning of the Committee on Foreign Investments in the United States review process, but with its high trigger value, a generally lean review process, and its transparent structure, the German investment law is one of the less restrictive in an international comparison. In the final analysis, the quality of the new law can only be judged by the way it is applied in practice. Optimally, the process would and should be invoked in as few cases as possible, and certainly only in circumstances where a material threat to public order or security can be detected (Deutsche Bank, 2009; Kern, 2008).

**The Russian Federation**

In 2008, the Russian Federation introduced a federal law on foreign investments in companies having strategic importance for state security and defense,\textsuperscript{16} establishing a process of approval of foreign investments in strategic sectors in the Russian Federation. The process features the specification of 42 strategic sectors in which foreign investments are outlawed or can be prohibited by the government. Furthermore, it sets threshold values for foreign shares in Russian companies triggering the review process and establishes notification requirements and sanctions. The law marked a substantial tightening of conditions for foreign investments in

\textsuperscript{14}For details, see Australia, Treasurer of the Commonwealth, 2008. Also Kern, 2008.

\textsuperscript{15}Dreizehntes Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung, Drucksache 16/10730.

the Russian Federation, especially in the strategic sectors identified by the new rules. In addition, investments in areas outside the realm of the strategic sectors ring-fenced by the new laws are regulated by a number of existing general or sectoral rules, which are tight by international standards. As a result, the Russian investment framework is one of the most restrictive regimes worldwide, as reflected in the OECD’s measures for market openness, in which the Russian Federation—before the additional restrictions in the new law—ranked third to last.

**The United States**

Since 1988 the United States has operated a review process for foreign investments, undertaken by the Committee on Foreign Investments in the United States (CFIUS), on the basis of which the U.S. president can prohibit incoming investments. Existing rules were strengthened in 2007 and 2008 to extend the range of transactions open to CFIUS review and to broaden the definition of the review criteria of national security to encompass transactions involving critical infrastructure, energy assets, and critical technologies. Further implementing regulations substantially lowered the trigger value for setting off the CFIUS process and increased the reporting requirements for the companies involved. The Foreign Investment and National Security Act reform clearly sharpened CFIUS as a policy instrument, raising the complexity of the review and making it one of the most demanding foreign investment processes among the industrial economies—not least for sovereign investors.

**The European Union**

With the entry into force of the Lisbon Treaty, the EU has assumed exclusive competence on foreign direct investment policy as part of its common commercial policy. In the long term, this new competence may substantially change the framework conditions of foreign investment flows into the EU. Foreign investment policy until 2009 used to be an exclusive prerogative of the member states, leading to a total of almost 1,200 bilateral investment agreements, which account today for almost half of the investment agreements currently in force around the world.

In response to these new EU-level powers, the EU Commission has decided to explore the feasibility of developing an international investment policy for the EU. In a first Communication, the Commission announced that it intends to enable the EU to enlarge, and better define and protect, the competitive space that is available to all EU investors, building on the body and substance of the bilateral arrangements that already exist. In the long term, the Commission is planning to achieve a situation where investors from the EU and from third countries will not need to rely on bilateral investment treaties entered into by the member state for an effective protection of its investments.

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17For details on the U.S. CFIUS process see, for example, Jackson, 2006a, 2006b, 2008. A detailed account of the economic and political arguments in the United States has been provided by Truman, 2008.

18For details on the U.S. CFIUS legislation and its implementation, see US GAO, 2008. A detailed account of the political debate has been provided by Epstein, 2009.
In the interim, the Commission has issued a Proposal for a Regulation establishing transitional arrangements for existing bilateral investment agreements between the member states and third countries. The act is aimed at maintaining the status quo by authorizing the continued existence and application of bilateral agreements between the member states and third countries, and avoiding the erosion of rights and benefits available to investors and investments under international investment agreements.

The transfer of exclusive powers in investment policy to the EU represents an historic opportunity for the EU to greatly simplify and encourage investments across the Union. In the end, the EU can only succeed in completing the single market if it manages to establish a joint EU-level investment policy. With the transitional act and its Communication, the Commission has laid the basis for the conceptual debate that will be important to arrive at such a single policy.

THE INTERNATIONAL DIMENSION: ENSURING OPEN MARKETS IN A FRAGMENTED REGULATORY ENVIRONMENT

Rules to govern foreign investments have remained a national prerogative. In practice, most economies worldwide impose substantial regulatory barriers in the form of direct and indirect hurdles on foreign investment. This discourages important investments, or—if they are undertaken notwithstanding—substantially raises the cost, especially considering that the barriers differ widely from country to country, with no general patterns.

From an international perspective, no global agreements exist that provide national governments with guidelines, let alone binding rules, to encourage the liberalization of investment regimes or at least their standardization. In addition, a growing number of international and bilateral agreements, although useful for facilitating cross-border capital flows, further fragment the operational environment for international investments. As of end-2008, almost 5,800 international investment agreements (IIAs), including almost 2,700 bilateral investment treaties, more than 2,800 double taxation treaties, and more than 270 free trade agreements, were in place (Kern, 2008).

The severity of investment barriers has been measured across various categories of direct and indirect hurdles as well as sectors. The EU and its member states are, on average, the most open and liberal economies in the world, with the Netherlands, Portugal, Romania, Slovenia, Belgium, Spain, and Germany leading the field. Japan, the United States, and other industrial and emerging economies follow. China, the Russian Federation, and India, in contrast, are among the most restrictive countries (Kalinova, Palerm, and Thomsen, 2010). Paradoxically, a comparison of the degree of restrictiveness on foreign direct investment to the volumes of sovereign assets at issue suggests that it is, in particular, countries with extensive state-owned funds at their disposal that currently maintain the strictest regimes for preventing foreign investments from entering their domestic markets.
With protectionist reflexes against foreign state investors in potential recipient countries looming, the finance ministers of the Group of Seven\(^\text{19}\) asked the OECD to examine possibilities to provide principles for foreign investment policies. In response to this mandate, the OECD issued its Declaration on Sovereign Wealth Funds and Recipient Country Policies (OECD, 2008b), calling for

- no protectionist barriers to foreign investment in recipient countries;
- no discrimination among investors in like circumstances;
- investment restrictions only to address legitimate national security concerns, and subject to the principles of transparency, predictability, proportionality to clearly identified national security risks, and accountability; and
- adherence to OECD General Investment Policy Principles (OECD, 2008b), including, in addition to the above, progressive liberalization, commitment to not introducing new restrictions, and unilateral liberalization.

These principles and the detailed guidance the OECD provides are important yardsticks for national investment policies. The extent to which this guidance will lead to more open and harmonized investment regimes is a different question, critically hinging on four factors (OECD, 2009):

1. **Political climate.** Following the benign international conditions in the 1990s, further market opening faced increasing opposition through the first decade of the 2000s. General concerns about the impact of globalization and concrete national and sectoral protectionist interests in many economies have considerably weakened the political momentum for further liberalization of capital movements.

2. **Application of the guidelines.** The OECD guidelines are nonbinding standards, leaving political application to national governments, so the degrees of commitment and the methods of implementation and enforcement necessarily vary. On the one hand, the OECD has used its peer review process to promote adherence to the standards. On the other hand, the recent dramatic rise in the economic importance and volumes of foreign investments warrants a much stronger commitment to these guidelines by national governments that should result in binding rules along the lines of trade agreements under the World Trade Organization.

3. **Symmetry of market access.** Cross-border investments not only suffer from high regulatory barriers, but also from the asymmetric way in which many economies pursue foreign investments and benefit from open markets elsewhere while maintaining restrictive rules on inward investment. These asymmetries are counterproductive, and policymakers should work toward reducing them.

4. **Scope of the guidelines.** OECD guidelines have only a limited geographical reach, and primarily address the traditional industrial countries. It is

\(^{19}\)The Group of Seven comprises Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.
encouraging that the OECD has made special efforts in its SWF-related work to include some 20 non-OECD countries in its discussions, and intends to maintain and enhance this dialogue.

GOOD CONDUCT BY SWFs: THE KEY TO GREATER ACCEPTANCE IN RECIPIENT COUNTRIES

Another important political development in response to the rise of SWFs has been the call for rules for the good conduct of these funds, resulting in the Group of Seven’s request to the IMF to explore ways of reaching international standards (IMF 2008b). In October 2008, the International Working Group of Sovereign Wealth Funds (IWG) issued the results of this process, presenting a set of 24 Generally Accepted Principles and Practices (GAPP), also known as the Santiago Principles (IWG, 2008b).

The GAPP are designed as a voluntary framework that is subject to home-country laws, regulations, requirements, and obligations. They provide guidance for appropriate governance and accountability arrangements,20 as well as guide the conduct of appropriate investment practices on the part of SWFs. With the GAPP, the IWG aims to further develop the level of transparency and quality of governance of SWFs worldwide, including a commitment to financial, nonpolitical objectives. With regard to transparency, the GAPP seek to improve knowledge of investment strategies, including details on the intended use of voting rights, risk management, and the use of financial leverage. Regarding governance, the GAPP aim at better information about organizational structures and processes, most importantly featuring a commitment to a separation of SWF asset management from government (Kern, 2008).

Despite the breadth of the GAPP and their voluntary nature, their adoption in 2008 signaled a remarkable achievement on the part of the IMF and the members of the IWG, especially considering the political challenges along the way. Reaching agreement on the GAPP marks an important step. Their success in practice will depend on three critical questions:

- **Fulfilling expectations of key stakeholders.** Can the GAPP satisfy the expectations of the various stakeholders—policymakers in SWF home countries and in recipient economies, market participants, and the wider public? If the GAPP fail to address the key concerns of the main parties to future investment transactions, there is a risk that they will become ineffective and SWFs will continue to face difficulties accessing certain economies and gaining acceptance as reliable institutional investors.

- **Securing broad support and adherence.** Will SWFs and the states that run them—participating in the IWG process or not—subscribe and adhere to these principles in practice? If an SWF decides not to embrace the GAPP, whether that SWF will in practice be confronted with heightened political

20For first evidence on institutional and operational practices of SWFs, see IWG, 2008a.
scrutiny or even resistance in the recipient economies, remains to be seen. Subscribing to the GAPP could lend a cachet to SWFs, signaling to recipient economies that those entities are committed to financially motivated investments and fulfilling minimum standards of transparency and governance.

- **Ensuring oversight and implementation.** Will SWFs and the IMF succeed in overseeing and ensuring implementation of the GAPP, or is there a risk that these voluntary commitments will remain unobserved in the countries to which they are particularly addressed? If committing to the GAPP were to develop into a seal of quality, SWFs would need to back up their commitments with actions. They should adhere to financial objectives and implement and apply transparency and governance standards in a way that can actually be monitored by all stakeholders.

The establishment of the International Forum of Sovereign Wealth Funds (IFSWF) in 2009 as a voluntary standing group of SWFs to discuss issues of common interest and facilitate an understanding of the Santiago Principles and SWF activities has been an important measure toward the implementation of the GAPP. Similarly, the efforts by a number of SWFs to enhance their public reporting in the wake of the adoption of the Santiago Principles can be seen as progress in the spirit of the principles. These first steps, it is hoped, will inspire more far-reaching efforts at meeting requirements and expectations set by the Santiago process.

**CONCLUSION: THE GLOBAL PERSPECTIVE**

SWFs and their investments are one facet of a new phase of globalization that will lead to ownership of assets globally and a new quality of the participation of emerging markets in the global economy. Because many emerging markets have made tremendous economic progress in recent years and are becoming wealthier, private individuals and public institutions in these economies are increasingly engaging in international investments. This engagement has boosted capital flows from the emerging economies to the traditional industrial economies and resulted in greater and more active participation in global capital markets.

Both are positive and highly welcome developments, considering that—owing to the economic realities in earlier phases of globalization—capital had traditionally flowed from industrial countries into emerging markets. The growing international investments by emerging markets are likely to help them achieve a more established role in world finance commensurate with their increasing importance in the global economy.

Foreseeable economic developments of this kind, and their growing magnitudes, call for early and coordinated policy approaches. The IMF’s coordinating strategy on SWF transparency and governance is a positive example of how a swift and targeted policy response brought emerging markets to the negotiating table, actually making them the drivers of the process.

If SWFs can be regarded as harbingers of the escalating international involvement of emerging markets in global economics and finance, their case illustrates
that intensification of the dialogue increases the chances of achieving mutually acceptable policy outcomes. Ultimately, stronger participation of the emerging markets in international economic and financial policymaking and diplomacy will be needed. Their participation will be an important element for reaching joint rules in globalized capital markets.

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