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It's Just Business, Or Is It?: How Business and Politics Collide With Sovereign Wealth Funds

By MATTHEW SAXON*

I. Sovereign Wealth Funds: Suspicions and Reactions

A. *What is a Sovereign Wealth Fund?*

The U.S. Treasury Department defines Sovereign Wealth Funds ("SWFs") as government investment vehicles funded by foreign exchange assets, which manage those assets separately from official reserves.[1] Basically, any time a government aggressively invests a large amount of its official reserves abroad it could be classified as a SWF. These pools of government money are invested more aggressively than traditional government reserves because they are intended to generate large returns.[2]

B. *Why have lawmakers suddenly become concerned with sovereign wealth funds?*

There are several reasons why these vast pools of government money have stirred suspicion. First, most SWFs are controlled by countries with a low degree of government accountability compared to a Western-style democracy.[3] Some of the largest funds reside in the United Arab Emirates, Singapore, Saudi Arabia, Russia, China,

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* Bachelor of Arts, Colgate University, J.D. Candidate, University of California, Hastings College of the Law, May 2009.

1. Clay Lowery, Under Secretary for International Affairs, Remarks at the Federal Reserve Bank of San Francisco's Conference on the Asian Financial Crisis (June 21, 2007).

2. David McCormick, Under Secretary for International Affairs, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs (Nov. 14, 2007).

3. Tom Holland, *A Passive Solution for Sovereign Wealth Funds*, SOUTH CHINA MORNING POST, Sept. 3, 2008, at 12.

and Kuwait.[4] A low degree of government accountability makes it is easier for these governments to take huge risks with state money.[5] Consequently, of the ten biggest SWFs, only one is a Western-style democracy: Norway. However, Norwegian law prohibits the funds' investment from becoming too risky by requiring 60 percent of the fund to be in fixed income, a constraint not felt by other less accountable regimes.[6] Overall there are about forty SWFs in the world today[7].

The second cause for the increased suspicion surrounding SWFs is their value. By 2015, SWFs collectively could be worth $12 trillion, up from $2.5 trillion today.[8] To put that number in perspective, the total amount of money under management in the world's hedge funds is around $1.4 trillion.[9] This fact becomes even more remarkable when one considers that the $1.4 trillion dollars in hedge funds is spread out among thousands of independent firms, while the $2.5 trillion to $3 trillion of sovereign wealth fund money is essentially controlled by a few heads of state. Although there currently are about forty SWFs, the top seven funds control $2.27 trillion, which further exaggerates the concentration of wealth.[10]

The third reason for the recent interest in SWFs is their sudden increased activity. Middle Eastern funds spent around $82.4 billion this year, compared to just $4.5 billion in 2004.[11] The principal reason for the recent increase in activity is the credit crisis that has

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4. Editorial, *Sovereign-wealth Funds: The World's Most Expensive Club*, ECONOMIST, May 26, 2007, at 79 [hereinafter, World's Most Expensive Club].

5. Anders Åslund, *The Truth About Sovereign Wealth Funds*, FOREIGN POLICY, Dec. 2007.

6. Rachel Ziemba, *Responses to Sovereign Wealth Funds: Are 'Draconian' Measures on the Way?*, ROUBINI GLOBAL ECONOMICS SERVICE, Nov. 2007, at 6, *available at* http://www.rgemonitor.com/economonitor-monitor/220669/responses_to_sovereign_wealth_funds_are_draconian_measures_on_the_way.

7. David McCormick, Under Sec'y for Int'l Affairs, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs (Nov. 14, 2007).

8. Robert Schroeder, *SEC Looking at Sovereign Wealth Funds*, MARKET WATCH, July 31, 2007, *available at* http://www.marketwatch.com/news/story/sec-grappling-sovereign-wealth-funds/story.aspx?guid={9BBBCE9F-EF92-4D48-A6BF-C14F2E334E8A}.

9. Editorial, *Sovereign Impunity*, WALL ST. J., Dec. 1, 2007, at A12.

10. The World's Most Expensive Club, *supra* note 4, at 79.

11. Nick Timiraos, *Will Overseas Funds Be a Juggernaut?*, WALL ST. J., Dec. 1, 2007, at A11.

been reaping havoc on U.S. financial institutions.[12] Financial institutions have been making massive write-downs and desperately need cash on their balance sheets. SWFs have cash and are willing to invest it.[13] Congress, which desperately wants to alleviate the pain of the current crisis, has thus far approved these investments. As Senator Charles Schumer noted, "[w]hat would the average American say if Citigroup is faced with the choice of 10,000 layoffs or more foreign investments?"[14] The fact that SWFs have come to the rescue of many U.S. companies proves that they can offer great benefits to the global financial system.

The fourth reason for the increase in attention around SWFs is the mystery that surrounds these funds. SWFs have proven adept at avoiding U.S. and European regulatory law,[15] they lack transparency in general,[16] and they could have undesirable effects on shareholders.[17]

It is not coincidental that when SWFs buy shares in a U.S. company, the deal is usually for 4.9 percent or 9.9 percent.[18] Edwin Truman, a fellow at the Peterson Institute for International Economics, points out, "[t]hey negotiate contracts in light of the regulatory regime in the United States."[19] U.S. securities and banking laws increase the amount of scrutiny and oversight when investors reach a 5 percent or 10 percent threshold.[20] Abu Dhabi's recent investment in Citigroup brought its total stake in that company up to 4.9 percent.[21] A Chinese investment fund executive admitted that the 9.9 percent stake that China bought in Blackstone

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12. This note was written at the outset of the financial crisis (when it was merely known as the "credit crisis") and does not incorporate information after March of 2008.

13. Editorial, *The invasion of the sovereign-wealth fund*, ECONOMIST, Jan. 19, 2008, at 11 [hereinafter, Invasion].

14. Dennis K. Berman & Bob Davis, *Lobbyists Smoothed the Way For a Spate of Foreign Deals*, WALL ST. J., Jan. 25, 2008, at A1.

15. David Enrich, Damian Paletta & Randall Smith, *Citigroup, Merrill Seek More Foreign Capital*, WALL ST. J., Jan. 10, 2008, at A1 [hereinafter, Citigroup].

16. Timiraos, *supra* note 11, at A11.

17. Katharina Bart, Rick Carew, Chip Cummins & Marcus Walker, *Barriers to Entry*, WALL ST. J., Jan. 15, 2008, at C1 [hereinafter, Barriers to Entry].

18. Citigroup, *supra* note 15, at A1.

19. *Id.*

20. *Id.*

21. *Id.*

was meant to avoid garnering attention from Congress.[22] The Chinese also bought a 9.9 percent stake in Morgan Stanley in December 2007.[23] Other countries have caught on; Singapore's investment in Merrill Lynch will keep its stake in Merrill just below 10 percent.[24]

SWFs, for the most part, are not transparent since all disclosures are made on a purely voluntary basis.[25] Many of the funds release little information about their investment aims or holdings, which further deepens the anxiety in Europe and the U.S.[26] The lack of available information can lead to an increase in volatility in markets, since markets do not like uncertainty.[27]

This lack of transparency has made lawmakers nervous. In a recent Presidential debate, Hillary Clinton emphasized the need for transparency in SWFs. She argued that, "[w]e've got to know more about them (SWFs), they've got to be more transparent . . . I want the United States Congress and the Federal Reserve Board to ask these tough questions."[28] Senator Evan Bayh (D. Ind.) declared, "[a] lack of transparency that characterizes many sovereign-wealth funds undermines the theory of efficient markets at the heart of our economic system."[29] In the long run greater transparency would be a good thing for the SWFs themselves because lawmakers would feel more comfortable with them, and would therefore be less likely to interfere or over-regulate.

The lack of transparency may also make shareholders nervous. SWFs may have both positive and negative effects on shareholders. They can be good because the share price may go up, as was the case when China infused Morgan Stanley with $5 billion, jolting shares up 4 percent.[30] Further, SWFs may benefit investors in

22. Berman & Davis, *supra* note 14, at A1.

23. *What's News*, WALL ST. J., Dec. 20, 2007, at A1.

24. Citigroup, *supra* note 15, at A1.

25. Bob Davis, *Wanted: SWFs' Money Sans Politics*, WALL ST. J., Dec. 20, 2007, at C1 [hereinafter, Money Sans Politics].

26. *Id.*

27. Timiraos, *supra* note 11, at A11.

28. Susanne Craig, David Enrich & Robin Sidel, *World Rides to Wall Street's Rescue*, WALL ST. J., Jan. 16, 2008, at A1 [hereinafter, Wall Street's Rescue].

29. Press Release from Senator Bayh, Senator Bayh Raises Concerns with Sovereign Wealth Funds (Nov. 14, 2007), *available at* http://www.senate.gov/~bayh/record.cfm?id=287530 (last visited Feb. 26, 2008).

30. *What's News*, *supra* note 23, at A1.

another less obvious way. Since SWFs have become large, influential shareholders in many financial institutions, these funds have the ability to hold the management accountable for mistakes and lackluster performance.[31]

However, the problem is that SWFs may not feel comfortable demanding such accountability if they think it will lead to political backlash and increased regulation. SWFs are reluctant to be too vocal, which effectively gives management a free pass, and hurts average shareholders who rely on a major shareholder to hold management accountable. As the Wall Street Journal reports, "Worse, every incendiary article, news report and political speech about the 'danger' posed by sovereign investment reinforces the instinct of such funds to be headline-shy, controversy-averse, and unwilling to join other shareholders in pushing noisily for change, even needed change."[32]

SWF investments may also hurt shareholders. Most shareholders are not active, meaning that they do not vote, resulting in the possibility that a SWF could have disproportionate control.[33] If only 5 percent of a company's shareholders vote, then a SWF with a 10 percent stake can control the company. The director of one Swiss bank fears that poor turnout at shareholder meetings could artificially inflate a SWF's influence and lead to an informal veto right.[34] However, the fact that SWFs have a disproportionate stake is negative only if it is used improperly and thus far there is scant evidence of such impropriety. As long as SWFs have purely financial motives, they should be encouraged to hold management accountable when circumstances require.

The final and most important reason for the concern over SWFs is their possible political motivations. Sovereign countries control SWFs. Consequently, SWFs could be used to achieve political instead of financial ends. The possibility for investing money with dual motives has caused "widespread suspicion in Washington and European capitals, especially in regards to funds run by Russia, China, and the oil states of the Middle East."[35] Adrian Blundell-Wignall, the deputy director of the Organization for Economic

31. Holman W. Jenkins, Jr., *Sovereign Wimp Funds*, WALL ST. J., Jan. 23, 2008, at A24.

32. *Id.*

33. Barriers to Entry, *supra* note 17, at C1.

34. *Id.*

35. Money Sans Politics, *supra* note 25, at C1.

Cooperation and Development, points out that national pension funds do not face political backlash because their motivations are seen as purely commercial.[36] He goes on to suggest that SWFs should adopt a similar structure, in which SWF managers would have a fiduciary duty to the citizens of the country to produce the highest return possible.[37]

Such an obligation may assuage some of the fears in the West, however, it is not clear how such a fiduciary duty would be enforced. Any politically motivated investment would probably be made at the behest of the head of state. It would be unlikely for the head of state to punish a fund manager who violated his fiduciary duty by making a politically motivated investment that the head of state endorsed.

Under the current structure of most SWFs, political leaders have no fiduciary duty and can actively engage in investment strategies for any reason.[38] *The Economist* acknowledged this reality, "[t]he motives of the sovereign moneymen could be sinister: stifling competition, protecting national champions, engaging in geopolitical troublemaking."[39] The U.S. Treasury Deputy Secretary Robert Kimmett asserts, "[t]he benefits of SWF investments to the recipient countries depend on the extent to which the behavior of SWFs is economically driven . . . rather than politically driven."[40] In the short life span of the SWF almost all evidence points to a purely financial motivation.

Russia is the only SWF country that has indicated that it may be willing to use its wealth as a political weapon. Russia cut off a gas pipeline to Ukraine after that country elected a pro-Western government; Russia claimed it was accidental.[41]

Even SWFs run by fully democratic U.S. allies have motivations that sometimes go beyond the financial bottom line. Last year, Norway divested itself of its shares in Wal-Mart Stores, Inc., valued at $416 million, citing serious and systemic human and labor rights

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36. *Id.*

37. *Id.*

38. Invasion, *supra* note 13, at 11.

39. *Id.*

40. Robert Kimmitt, *Public Footprints in Private Markets*, FOREIGN AFF. MAG., January/February, 2008.

41. Ambrose Evans-Pritchard, *EC to Rule on Sovereign Wealth Funds*, THE TELEGRAPH, Nov. 29, 2007.

abuses as its reason.[42]

There are obviously potential situations that would be far more troubling than Norway's divestment based on an aversion to Wall-Mart's labor abuses. For instance, there is the possibility that oil-producing governments may try to use their clout in financial institutions to prevent the institution from investing in alternative energy.[43] Another possibility was recently pointed out by former-Treasury Secretary Lawrence Summers, who asked, "[w]hat about the day when a country joins some 'coalition of the willing' and asks the U.S. president to support a tax break for a company in which it has invested?"[44] These are hypothetical situations, but Western countries should be aware of them. Fortunately, it will not take a set of protectionist regulations to prevent these hypotheticals from becoming reality. As discussed in section III, a country can sufficiently protect its interests, and simultaneously welcome SWF investments.

C. *Sovereign Wealth Funds' Reactions to Western Fears*

SWFs recognize that regulators in the U.S. and Europe are worried about their emergence. They have taken an interesting and clever approach to stay below the radar. First, SWFs have made every effort to relieve the fears of regulators by promising to be passive participants[45] and by buying non-voting stock.[46]

Despite efforts to keep a low profile, SWFs have sent a clear message that they are willing to take their money elsewhere if Western countries over-regulate. This is a reality that the U.S. and Europe must face as emerging economies continue to present attractive alternative investment opportunities. The U.S. and Europe should attempt to attract SWF investment and not scare it away, especially considering that American and European financial institutions and corporations are desperate for cash. Kuwait's investment fund is cutting its U.S. and European investments from 90 percent to 70 percent of its portfolio.[47] The fund's manager is

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42. Timiraos, *supra* note 11, at A11.

43. David Wessel, *The Risks of Sovereign Funding*, WALL ST. J., Dec. 13, 2007, at A2.

44. *Id.*

45. Andrew Batson and Jason Dean, *China Investment Fund May Tread Softly*, WALL ST. J., Sept. 10, 2007, at A2.

46. Ziemba, *supra* note 6, at 5.

47. Henny Sender, *Deep Well: How a Gulf Petro-State Invests Its Oil Riches*, WALL

moving the money to China and India, due to the rapid economic growth in those countries.[48] The chief executive of Dubai International Capital, a government-owned investment fund, has made clear that he is looking to invest more in Asia than Europe and the U.S. He asserted that this was partly due to geography, but also reflected worry about the U.S. economic and regulatory conditions.[49] The head of China's SWF has stated that if any country has misgivings about China's SWF being there, the fund may just leave and look to invest elsewhere.[50] Unfortunately, unfounded xenophobic fears have already blocked foreign investment from entering the U.S.

Perhaps the most famous example of political backlash against a state-controlled foreign investment in the U.S. is the Dubai Ports deal, which collapsed under grassroots political opposition. Dubai Ports World, which is controlled by Dubai's government, attempted to acquire a British company that controlled U.S. ports.[51] The deal fell through due to the strong political backlash.[52] Turned away by U.S. lawmakers, Dubai Ports World is now expanding around the world in places like China, Peru, and Vietnam.[53] Of course, the U.S. Coast Guard controls security at all U.S. ports, so regardless of which country owns the port, the security is unaffected.

The U.S. government should not be so quick to react to the fears of the electorate because there are sufficient procedures in place that scrutinize all foreign investment deals. In fact the U.S. system is so effective that the Europeans should consider using it as a model for their own investment laws.

II. U.S. and European Approaches

A. *U.S. Foreign Investment Law*

The U.S. has laws in place that regulate and investigate foreign investment deals, however some lawmakers are now questioning

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ST. J., Aug. 24, 2007, at A1.

48. *Id.*

49. Barriers to Entry, *supra* note 17, at C1.

50. Steven R. Weisman, *China Tries to Reassure U.S. About Its Investing Plans*, N.Y. TIMES, Feb. 1, 2008, at C2.

51. Timiraos, *supra* note 11, at A11.

52. *Id.*

53. Wessel, *supra* note 43, at A2.

whether those regulations are sufficient to deal with the rapid expansion and aggressive tactics of SWFs.[54] This section will analyze both current U.S. procedures and proposals lawmakers have set forth to amend those procedures.

Officially, the U.S. welcomes all investments except those that could compromise national security.[55] Treasury Secretary Henry Paulson maintained, "[w]e welcome foreign investment in the United States from sovereign wealth funds or any direct investment."[56] He has also stated, "I'd like nothing more than to get more of that money. But I understand that there's a natural fear that they're going to buy up America."[57]

All foreign investment in the United States is subject to the Foreign Investment and National Security Act ("FINSA").[58] FINSA created the Committee on Foreign Investment in the United States ("CFIUS"), which implements the Act.[59] The committee reviews foreign investments in the United States, looking for possible national security issues.[60] The Act requires heightened scrutiny when a foreign state controls an investment, as is the case with SWFs.[61] However, if a government buys a small voting stake or a passive stake in a company, where it does not seek to influence the company's behavior, it is presumed not to pose a national security threat.[62]

Some government officials would like to expand the foreign investment review process. The Treasury Department recently stated that it is considering reviewing non-national security concerns when it comes to SWFs.[63] David McCormick, the Under

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54. Wall Street's Rescue, *supra* note 28, at A1.

55. Steven R. Weisman, *Sovereign Funds Stir Growing Unease*, INTERNATIONAL HERALD TRIBUNE, Aug. 21, 2007, at 1 [hereinafter, Sovereign Funds].

56. Henry Paulson, Sec'y of Treasury, Address at Beijing, China (Aug. 1, 2007), *available at* http://www.treas.gov/press/releases/hp525.htm.

57. Sovereign Funds, *supra*, note 55.

58. David McCormick, Under Sec'y for Int'l Affairs, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs (Nov. 14, 2007).

59. Foreign Investment and National Security Act (FINSA) of 2007, 50 U.S.C. § 3 (West 2007).

60. David McCormick, Under Sec'y for Int'l Affairs, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs (Nov. 14, 2007).

61. *Id.*

62. Berman & Davis, *supra* note 14, at A1.

63. David McCormick, Under Sec'y for Int'l Affairs, Testimony before the

Secretary for International Affairs, highlighted the concerns that SWFs generate, which include, "inefficient allocation of capital, perceived unfair competition with private firms, or the pursuit of broader strategic rather than strictly economic return-oriented investments."[64] McCormick also stressed that a shift in SWFs' assets could cause financial instability and volatility since they are large, concentrated, and often non-transparent.[65] Despite these concerns, most Treasury officials have maintained that FINSA is enough to protect national security.[66]

Alan Larson, the Senior International Policy Advisor at Covington & Burling LLP, detailed how FINSA should be implemented during his testimony in front of a Senate Panel on foreign investment in the United States.[67] Larson set forth four policies for effective implementation of FINSA.[68]

First he asserted FINSA should focus on the narrow class of investments that raise threats to national security.[69] Some lawmakers have argued that they should expand the class of investments subject to review.[70] Such a proposal would be misguided. Once the review process is broadened beyond national security there is no clear line on where to stop it. This will exacerbate the fear and uncertainly among foreign investors and stifle investment in the U.S. FINSA should continue to focus only on deals that have clear national security implications.

Second, he recommended investigators focus on acquisitions that establish control, defined as the ability to direct, determine, and decide major business issues, as opposed to acquisitions that result in a minority interest.[71] Again this is a prudent strategy. Focusing on every deal would dilute CFIUS' resources, and would delay

Senate Committee on Banking, Housing, and Urban Affairs (Nov. 14, 2007).

64. *Id.*

65. *Id.*

66. *Id.*

67. Alan P. Larson, Senior Int'l Policy Advisor, Covington & Burling LLP, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs (Nov. 14, 2007).

68. *Id.*

69. *Id.*

70. Berman & Davis, *supra* note 14, at A1.

71. Alan P. Larson, Senior Int'l Policy Advisor, Covington & Burling LLP, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs (Nov. 14, 2007).

almost all SWF investments in the U.S.

His third recommendation is for FINSA to focus on acquisitions where a foreign government controls the investment entity.[72] Obviously, this would directly implicate SWFs, which are by definition controlled by the government.

Finally, Larson contends that "national security" should remain undefined in order to retain flexibility when determining which deals to scrutinize.[73] The disadvantage in not defining the term "national security" is that it makes the U.S. review process somewhat opaque. If the U.S. and Europe are going to demand transparency from SWFs, the U.S. and Europe also have an obligation to be as clear and transparent in their regulatory schemes. SWFs will want consistency, and they will want to know what to expect from the review process. By designating specific sectors of the economy as sensitive to national security, the U.S. can forewarn SWFs about a possible investigation. For the time being Congress seems content with leaving the review process as it stands.

The Securities and Exchange Commission ("SEC") has been somewhat more skeptical than the Treasury Department. Christopher Cox, Chairman of the SEC, questioned the motives of the sovereign wealth funds.[74] Cox was concerned with the growing governmental and potentially political influence over capital market flows that the sovereign wealth funds portend, stating that SWFs present "challenges to a regulatory system premised on free markets, the free flow of information and investor incentives based on profit and loss."[75] For the time being it seems unlikely that Congress, the SEC, or the Treasury Department will enact significant changes to CFIUS.

It would be a mistake to heighten our regulatory standards without evidence that such a step is necessary. Thus far, there is no evidence that SWFs are investing in the U.S. with ulterior political motives. Until SWFs demonstrate that their goals are political or non-commercial, the regulators should rely on the current system, which has proven to be sufficient.

72. *Id.*

73. *Id.*

74. Schroeder, *supra* note 8.

75. *Id.*

B. *European Approaches*

This section will discuss and contrast the approaches employed by Europe's three largest economies, Germany, Great Britain, and France, in dealing with SWF investment.

i. *Great Britain*

There has been little political backlash against SWFs in Britain. In a speech last year, Alistair Darling, Chancellor of the Exchequer, opposed any new protectionist policies in Britain.[76] He maintained that an open economy has always been good to Britain, and it would be good for the rest of the world as well.[77] Gordon Brown, before becoming Prime Minister, clearly set out his position on foreign investment, stating, "[p]eople [are] saying, '[c]lose the borders, shelter our industries, protect our jobs' - even the people that are arguing that know that it's an illusion to think that you can stop change."[78] Brown sees the influx of foreign money as inevitable; Britain has a choice to either welcome the money or stand by and watch as another country welcomes it. He has rejected the latter approach.

Commenting on Britain's laissez-faire attitude, a recent *The Wall Street Journal* article declared, "The United Kingdom is for sale."[79] The article went on to explain that as the rest of Europe puts up barriers to block foreign investment, Britain has taken the opposite approach.[80] While the U.S. does not allow foreign companies to buy airlines, shipping firms, television networks, and other security related industries, Britain embraces all foreign investment.[81] It is unlikely that Britain will impose any new regulations on SWFs.

Attitudes in Britain have certainly changed since 1987. In that year Kuwait's SWF bought 20 percent of British Petroleum. The British government responded by forcing the SWF to sell half of its

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76. Alistair Darling, Chancellor of the Exchequer, Speech at the London Business School (July 25, 2007), *available at* http://www.hm-treasury.gov.uk/speech_chex_250707.htm.

77. *Id.*

78. Alistair MacDonald and Jason Singer, *Britain for Sale: Foreign Owners May Be Secret of U.K.'s Success*, WALL ST. J., Sept. 21, 2007 at A1.

79. *Id.*

80. *Id.*

81. *Id.*

stake.[82] In contrast, the Qatar Investment Authority recently bought a 20 percent stake in the London Stock Exchange, which comes on the heels of a deal in which another group from Dubai bought a 28 percent stake.[83] One major reason for the change in attitude, and the sometimes vehement opposition to increases in oversight, is Britain's current position as a leader in attracting foreign investment flows.[84] Britain does not want to jeopardize its status by making investment more burdensome.

Britain, almost certainly, will be critical of any EU response that would lead to stricter regulations and impede foreign investment. Alistair Darling has already gone on the offensive, criticizing the more protectionist minded European governments, stating, "I think it is nonsense. Economic patriotism is protectionism, and there is no other name for it."[85] As long as Darling and Brown are in power, Britain will retain its laissez-faire approach, despite grumblings from Germany and France.

ii. Germany

It has been a different story in Germany, where Chancellor Angela Merkel stated that purchases by foreign governments pose a risk.[86] Merkel made clear that her central concern is the commingling of business and politics, asserting, "State-owned funds can also have politico-strategic aims in mind that could be problematic in sensitive areas."[87] The German government has labeled SWF activity as "mischievous behavior."[88] In a separate statement Merkel confirmed her uneasiness, asserting, "One cannot simply react as if these are completely normal funds of privately pooled capital."[89] Much of the German anxiety over SWFs seems to stem from concerns over Russia; Chancellor Merkel has twice stepped in to defend German companies from Russia.[90] In its efforts

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82. *Asset-backed insecurity*, ECONOMIST, Jan. 19, 2008, at 71.

83. MacDonald & Singer, *supra* note 78, at A1.

84. Evans-Pritchard, *supra* note 41, at 5.

85. *EU to Consider Protection from State-Funded Foreign Takeovers*, EURACTIV.COM, (July 24, 2007), http://www.euractiv.com/en/innovation/eu-consider-protection-state-funded-foreign-takeovers/article-165798 (last visited Feb. 26, 2008).

86. Sovereign Funds, *supra* note 55.

87. Vidya Ram, *Merkel Plays Protector*, FORBES, July 20, 2007.

88. Invasion, *supra* note 13, at 11.

89. Ziemba, *supra* note 6, at 7.

90. Evans-Pritchard, *supra* note 41, at 5.

to protect itself from Russia, Germany must be careful not to scare away non-threatening foreign investment.

Merkel advocates a unified EU response that would resemble the CFIUS in the United States.[91] However, more investment friendly European countries such as Great Britain and Ireland are not fully on board with such a "common response" since it would force them to step up their foreign investment oversight laws.[92]

Germany is in the process of drafting a law that would enable it to block corporate takeovers by SWFs, however, the criteria for blocking the takeover bids are still being debated.[93] The German Finance Minister said that he wants sectors such as media, telecommunications, and banking protected from foreign state controlled funds.[94] One proposal would give the German government the ability to block investments resulting in 25 percent ownership in strategic sectors.[95]

Some provisions of the bill are clear examples of the difficulties of maintaining a protectionist stance in a globalized world. For example, the bill would exempt bids from other European Union countries from increased scrutiny.[96] After all, Germany could hardly survive without investment from other European nations, and strict regulatory laws against all foreign investment could have the undesired effect of chilling even European allies from investing in Germany.

Other provisions may have a similar undesired affect. For instance, Chancellor Merkel would like Germany to be able to invoke the law when Germany thinks foreigners are trying to buy German companies for "mischievous reasons."[97] Figuring out what qualifies as a "mischievous reason," and when a certain bid meets the criteria would be an exercise in mind reading. The law currently would not necessarily limit intervention to specific sectors like defense. This leaves many financiers fearful that all SWF

91. Ziemba, *supra* note 6, at 7.

92. *Id.* at 6.

93. Marcus Walker, *Germany Tinkers With Foreign-Takeovers Plan*, WALL ST. J., Jan. 14, 2008, at A2.

94. MacDonald & Singer, *supra* note 78, at A1.

95. Ziemba, *supra* note 6, at 7.

96. Walker, *supra* note 93, at A2.

97. *Id.*

investment could be eliminated.[98] If an investment in any sector were open to a heightened review process, it would be a significant deterrent to investing in Germany.

Despite the strong rhetoric, it seems likely that the proposed German law will eventually mimic the U.S. CFIUS. Even if this turns out to be the case, SWF investment in Germany still could be hampered because SWFs may have doubts that the German process will be as efficient, translucent, and unbiased as the U.S. process, which SWFs have become accustomed to over the years.

The German's delay in legislative action may indicate that German politicians are quick to satisfy German nationalists with big rhetoric, but slow to take action that will hurt Germany's chances of competing with other European countries. Regardless, Germany must be wary of an overzealous law that would stifle foreign investment.

iii. France

France has largely echoed the fears and concerns voiced in Germany. Officially, France supports a coordinated EU response, and like Germany, France seems to be wary of SWFs in general.[99] France's tradition of protecting its "national champion" companies will probably persist, at least under the leadership of President Nicolas Sarkozy.[100] President Sarkozy has already promised to protect "innocent French managers" from the "extremely aggressive sovereign funds."[101] At a European Union summit President Sarkozy warned, "We've decided not to let ourselves be sold down the river by speculative funds, by unscrupulous attitudes that do not meet the transparency criteria one is entitled to expect in a civilized world. It's unacceptable and we have decided not to accept it."[102] Sarkozy objects to the current situation where SWFs can buy any French company, while denying France the opportunity to invest in their home countries.[103]

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98. *Id.*

99. Ziemba, *supra* note 6, at 7.

100. *Id.*

101. Invasion, *supra* note 13, at 11.

102. Catrina Stewart, *Kudrin Defends Fund as Oil Soars*, THE MOSCOW TIMES, Oct. 22, 2007.

103. Andrew Sorkin, *What Money Can Buy: Influence*, N.Y. TIMES, Jan. 22, 2008, at C1.

France and Germany do not see completely eye to eye on all issues, which further confuses the European situation. One difference is that France would prefer a code of conduct instead of stronger direct regulation.[104] It is not clear what a code of conduct would entail, but presumably it would include recommendations for increased transparency and disclosure.

Germany has also been critical of French law. Both France and Germany seek to protect their most prized companies. France, however, has a very broad definition of "strategic industries" which receive heightened protection.[105] Germany views this approach as overly protectionist.[106] Such a broad definition could be used as a pretext, allowing France to guard its companies against any foreign threat.

The French and German protectionist attitudes have not gone unnoticed by SWF managers. Lou Jiwei, head of China's investment fund, recently said that his fund would not invest in some European countries because he felt extremely unwelcome there.[107] Germany and France should tone down their rhetoric because it seems that they are losing investments based solely on their strong language.

Despite their strong rhetoric, Germany and France seem to understand the need for SWF investment, so there is a possibility they could strike a compromise with Britain and adopt a unified EU system.

iv. European Union

The European Union as a whole is looking into the adoption of an institution similar to the CFIUS in the United States.[108] The European Commission is worried that different approaches by different EU countries will eventually lead to a race to the bottom where no regulation exists because each country is trying to attract the most investment.[109] The problem is that there is not a unified

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104. Ziemba, *supra* note 6, at 7.

105. Hugh Williamson, *EU 'Should Vet State-Funded Bids'*, FINANCIAL TIMES (London), July 18, 2007, *available at* http://www.ft.com/cms/s/0/f19a2a2a-3561-11dc-bb16-0000779fd2ac.html?nclick_check=1.

106. *Id.*

107. Bob Davis, *China Investment-Fund Head Says Focus Is on 'Portfolios'*, WALL ST. J., Feb. 1, 2008, at A13.

108. Invasion, *supra* note 13, at 11.

109. Ziemba, *supra* note 6, at 6.

front in Europe; British officials continue to maintain that it is not an issue that requires regulation at the EU level.[110]

Gordon Brown has been critical of the approaches offered by his European colleagues, Brown believes that "national champion" companies, which Spain, France, and Italy seek to protect from takeover, will emerge through competition, not government interference.[111] The U.S. tends to side with Britain. Alan Larson is apprehensive about the protectionist approaches being taken by some European countries, warning,

> [S]ome of these laws [in Europe] already tilt too far in the direction of investment screening. They place limitations on inward investment and acquisitions based not on national security reasons, but rather on fuzzy rationales such as economic security or maintaining the dominant position of national champions. There is a real risk that new laws and regulations will go too far in restricting investment.[112]

Larson also highlights another major source of tension between European countries: "economic security."[113] As Larson points out the term "economic security" is not easily defined, and it seems to be nothing more than a "fuzzy rationale" used to defend protectionist laws.[114]

The "economic security" approach will only cause more confusion and suspicion between SWFs and Europe. If Europe wants SWFs to be more transparent, it is difficult to justify foreign investment laws that are based on hollow rationales such as "economic security." SWFs will feel insecure when making deals in Europe, and rightfully so. The entire deal could be blown up if it is a "threat to economic security." Precise, clear language should be used whenever possible to ensure that foreign investment laws result in predictable, consistent outcomes.

III. Conclusion and Recommendations

Transparency and clarity are the keys to a successful relationship between SWFs and the West because these attributes

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110. Evans-Pritchard, *supra* note 41, at 5.
111. Ziemba, *supra* note 6, at 6.
112. Larson, *supra* note 71.
113. *Id.*
114. *Id.*

will create trust between the two sides. SWFs from around the world should collaborate and compose a set of standards and disclosure requirements that apply to all SWFs. Information about current investments, investment-goals, and investment strategies need to be disclosed. Transparency will help SWFs in the long run by assuaging Western fears and thereby creating more investment opportunities and fewer regulations.

Regulations on SWFs need to be written with the utmost clarity, so that SWFs are able to anticipate the regulatory and oversight procedures to which their investments will be subject. Undefined terms and provisions that allow a state to arbitrarily block an investment will deter foreign investments. The West cannot demand greater transparency from SWFs, while its own review procedures remain arbitrary, subjective, and opaque.

Europe is more likely than the U.S. to react legislatively to SWFs since the U.S. already has procedures in place. Europe needs to unify its response. This will be a difficult task, but it is necessary both to prevent European countries from unfairly protecting their industries, and also to prevent a race to the bottom where every country tries to attract investment by relaxing regulatory laws. The common European response should closely mimic the CFIUS. SWFs are already familiar and comfortable with this process, and CFIUS has proven itself to be a sufficient form of regulation.

SWFs and the West are not familiar business partners, but that is likely to change as each side realizes the potential advantages of a relationship. The West will gain access to large amounts of risk-seeking capital. The SWFs will gain greater access to large Western markets. As the world economy continues to become more integrated, protectionist barriers will pose greater risks. Protectionism will be tempting at times, but in the long run protectionism will only isolate countries from the benefits of the global economy. More progressive countries that welcome this new form of capital will have a distinct advantage over more insulated countries. As long as it's just business for SWFs, Western governments have nothing to fear.