

Sovereign Wealth Funds

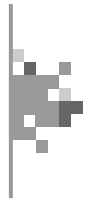
Issues for Trade Unionists



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UNI Global Union
Avenue Reverdil 8-10
1260 Nyon
Switzerland
Tel: (+41 22) 365 21 00
Fax: (+41 22) 365 21 21
E-mail:
contact@uniglobalunion.org
www.uniglobalunion.org

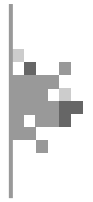




Sovereign Wealth Funds: Issues for Trade Unionists

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Foreword

During 2006, UNI Global Union undertook to bring private equity “out of the shadows”. As a result of our work together with Global Union colleagues, private equity has become front page news. Governments around the world have woken up to the impact of private equity on their national economies.

Our attention has now been drawn to sovereign wealth funds. This report is the first look by a Global Union at the world of sovereign wealth funds and the issues for trade unions.

For the sake of simplicity, sovereign wealth funds can be described as government investment vehicles. They have massive financial resources. It is estimated that they own 2.5% of the world’s financial assets and it is predicted that this will increase to 9% within a decade.

Sovereign wealth funds are purchasing shares in publicly quoted companies. As their financial clout grows, thousands of businesses and millions of employees will have to contend with a new kind of shareholder.

As we have had to examine the implications of private equity on our members, we have to do likewise for sovereign wealth funds.

We have a range of concerns. What type of shareholder will they turn out to be? What are the implications for transparency, corporate governance and financial instability? What, if any, are their principles on union rights and labour standards?

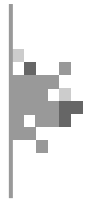
2007 has been the year when financial instability has shaken confidence in financial markets. Today we have the sub-prime crisis; perhaps the next financial storm will be private equity and perhaps, slowly percolating for the future, financial instability for companies, when sovereign wealth funds switch investments.

Each demands our attention. That is why we have produced this report.

Philip J. Jennings
UNI General Secretary

November 2007





Introduction

Private equity funds have been in the spotlight for some time. But when China announced in May 2007 that it would invest \$3bn of its \$1.2 trillion reserves in private equity firm Blackstone, Sovereign Wealth Funds (SWFs) suddenly hit the news media. The combination of authoritarian, nascent super-power, the shadowy world of private equity and the even less understood SWFs had politicians and editors all over the developed world reaching for their soundbites. This paper draws together information on SWFs, explaining what they are and identifies both general concerns about them and issues they raise of particular importance to trade unionists.

Background

The background to the discussion of Sovereign Wealth Funds (SWFs) is the dramatic increase in financial globalisation over the last thirty years and the 'financialisation' of the economy. The IMF's research department (IMF, 2007: 4) defines financial globalisation as the 'extent to which countries are linked through cross-border financial holdings'.

Ron Dore (2002) characterises financialisation as:

'the increasing dominance of the finance industry in the sum total of economic activity, of financial controllers in the management of corporations, of financial assets among total assets, of marketised securities and particularly of equities among financial assets, of the stock market as a market for corporate control in determining corporate strategies, and of fluctuations in the stock market as a determinant of business cycles'

Or as the International Trade Union Confederation (ITUC, 2007: 12) put it: 'the predominance of financial activities over production of goods and services.'

While the World Bank, IMF and other International financial institutions (IFIs) generally consider financial globalisation to be a positive development, even the IMF (2007a) concedes that the evidence is not entirely convincing. It (ibid) notes that although in principle it 'should enhance international risk sharing, reduce macroeconomic volatility, and foster economic growth, in practice the empirical effects are less clear-cut.' For former US Treasury Secretary Lawrence Summers, the flow of capital from the developing to the developed world over recent years is 'the principal irony of the international financial system' (Summers, 2007). SWFs are the latest manifestation of this 'irony'.



What are SWFs?

SWFs have received increasing media and political attention over the last year. However, outside the rarified atmosphere of stock markets and financial journalism, little is known about them. The IMF's chief economist describes them as 'black boxes' (Atkins and Schieritz, 2007), The British *Sunday Telegraph* (Kleinman, 2007) refers to 'the new barbarians at the gate' while the *Economist* (2007) depicts a world in which 'a secretive society is emerging of governments flush with foreign assets, some of them petrodollars, that are increasingly calling the shots in international finance.'

Less dramatically, the American government (US Treasury, 2007: 1) notes that there 'is no single, universally accepted definition of a SWF' but uses the term to mean:

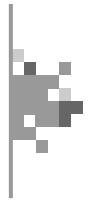
a government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves of the monetary authorities (the Central Bank and reserve-related functions of the Finance Ministry).

The US Treasury draws a distinction between SWFs and ordinary domestic pension funds and identifies two categories of SWF – commodity and non-commodity funds. The source of the foreign exchange assets is seen as the key difference:

- Commodity funds are established through commodity exports (either owned or taxed by the government). They can have several purposes, including stabilisation of fiscal revenues, inter-generational saving, and balance of payments sterilisation. With recent prolonged and sharp rises in commodity prices, many of these funds have developed into savings funds.
- Non-commodity funds are typically established through transfers of assets from official foreign exchange reserves.

In practice, there appears to be little difference in the way that both kinds of SWF operate. According to the US Treasury (2007:1), SWF managers differ from traditional official reserve managers in that they usually have a 'higher risk tolerance' and expect higher returns. Although they have received much public attention recently, SWFs are not new. The Kuwait Investment Authority began in 1953, the Abu Dhabi Investment Authority (ADIA) was founded in 1976 and Singapore's Government Investment Corporation (GIC) was set up in 1981.

Traditionally governments held investment assets as a tool to protect their currencies and banks. Therefore they had to be fairly liquid – in order to be available for emergencies, such as propping up the currency. Often they were held in precious metals, then in dollars. Today they are widely used by natural resource-rich countries as a preparation for when the resource runs out. They are also increasingly used by those countries with large reserves (particularly in Asia). In the past, where reserves were invested at all, they tended to be placed in safe but low yield US Treasury bonds.



Increasingly, SWFs are looking to increase their returns through equity investment, with the goal of 'higher returns earned by taking greater risk,' explains Kim Young, the Korea Investment Corporation's head of planning (Wehrfritz and Adams, 2007).

An early example of such a fund acting as an 'endowment to replace shrinking natural resources' (Economist, 2007) was in 1956 when the British colony of the Gilbert Islands (now Kiribati) set up the Revenue Equalisation Reserve Fund (RERF) as a trust fund to invest profits from its non-renewable phosphate mining industry (Brown and Ahlberg, 1999). This fund has now grown into a \$520m investment portfolio.

Oil and gas producing countries have adopted the same model and are believed to account for two thirds of the assets of SWFs (Jen, 2007). Singapore changed the way that SWFs were perceived when it set up Temasek in 1974. It brought together state investments and became an active player in world markets. It now has a wide range of holdings including in Singapore Airlines, the Indian ICICI Bank, China Construction Bank and Standard Chartered, the UK emerging markets bank. As reserves in Asian countries have rocketed in recent years, more countries have followed Singapore. Morgan Stanley (Jen, 2007) predicts that by 2015, these two types of SWF will be about the same size (around US\$6 trillion each) and China's SWF (likely to be named the Huei Lian Company) will be the single largest SWF.

SWFs can have several different objectives. Norway's Government Pension fund is widely viewed as successful in acting both as a buffer against oil price volatility and as a long-term savings vehicle. Singapore's two funds, GIC and Temasek frequently take large stakes in companies in which they invest. They are seen (Economist, 2007b) as attempting to use their investment to try to import expertise (with special attention paid to telecoms and banking). The Korean Investment Corporation sees part of its role as to bring in fund managers, investment banks and financial skills (while training up Koreans in such skills) in order to develop Seoul into a 'regional financial hub' (Wehrfritz and Adams, 2007).

The key players

The long established funds such as those of Kuwait, Abu Dhabi, Norway and Singapore are influential for different reasons (Norway is seen as a model of transparency and good governance; Singapore as an example of an influential non-commodity-based SWF). Table 1 illustrates a selection of the large SWFs. Others with (usually smaller) SWFs include Algeria, Azerbaijan, Botswana, Canada, Chile, Iran, Kazakhstan, Malaysia, New Zealand, Oman, Qatar, Taiwan, Trinidad and Tobago, Uganda and Venezuela (Rozaanov, 2005; Truman, 2007).



Table 1: Selected sovereign-wealth funds: estimated assets (March 2007)

Country	Fund	Assets, \$bn	Inception year
United Arab Emirates	Abu Dhabi Investment Authority	875	1976
Singapore	Government Investment Corporation (GIC)	330	1981
Saudi Arabia	Saudi Arabian funds of various types	300	n/a
Norway	Government Pension Fund – Global	300	1996
China	State Foreign Exchange Investment Corp + Central Huijin*	300	2007
Singapore	Temasek Holdings	100	1974
Kuwait	Kuwait Investment Authority	70	1953
Australia	Australia Future Fund	40	2004
US (Alaska)	Permanent Fund Corporation	35	1976
Russia	Stabilisation Fund	32	2003
Brunei	Brunei Investment Agency	30	1983
South Korea	Korea Investment Corporation	20	2006
			*not yet finalised

Source: Morgan Stanley; The Economist, 24 May 2007.

What the snapshot in Table 1 does not reveal is the likely future development. It now looks as though China (possibly with India close behind) will become the key SWF in the near future. China has \$1.2 trillion in foreign-exchange reserves - increasing by over \$1 billion a day (Economist, 2007) - and so will be looking for a vehicle for its investment. It is widely believed that China will model its SWF on Singapore's Government Investment Corporation (GIC). This invests across a range of different options in both geographic destination and type of investment (see Figure 1). It is currently believed to have an asset mix of about 50% equities, 20-30% bonds, and 20% in private equity, real estate and commodities with 45-50% in the USA, 30% in Europe, 10% in Japan and 10% in the rest of Asia (Brookes, 2007).

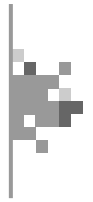
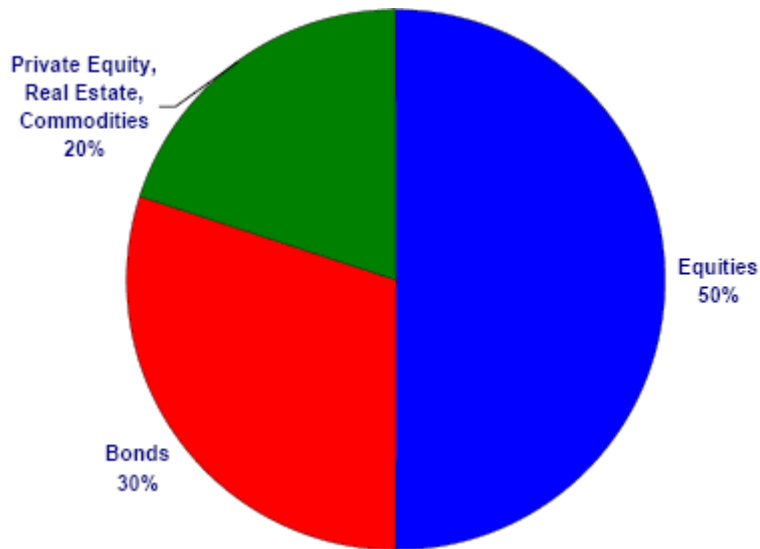


Figure 1: Singapore GIC's estimated allocation



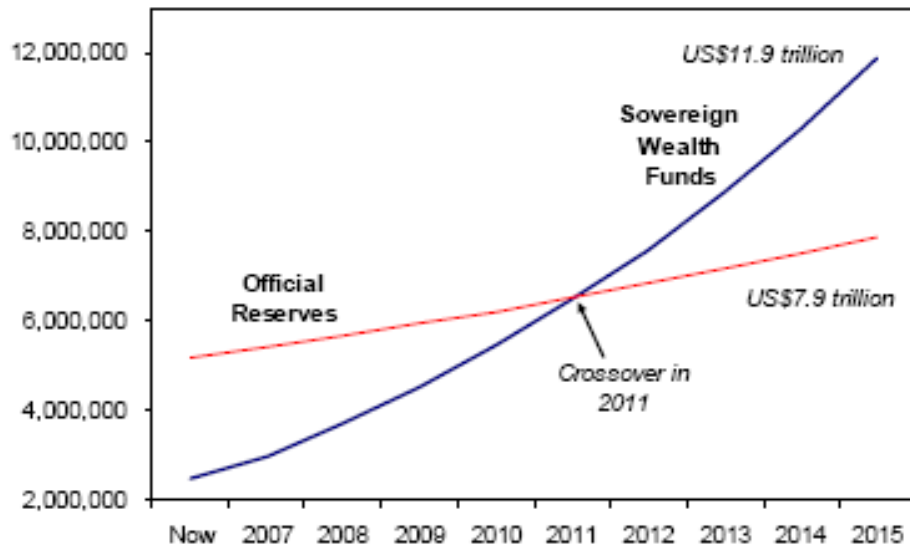
Source: Brookes (2007)

Size of SWFs

The lack of transparency around SWFs means that solid data is difficult to find and market estimates of their size vary (the figures in Table 1 are estimates). However, what *is* clear is that there has been a significant shift in capital flows: 'emerging market countries, as a group, have become net exporters of capital and an important investor class in mature markets over the past five years' (Pazarbaşıoğlu et al, 2007). The IMF notes that this rapid growth in cross border flows has gone hand in hand with changes in the investor base, in turn driven by three key trends. One of these is the emergence of sovereign wealth funds as key players (the other two are the growth in assets under the control of institutional investors and the rise of hedge funds).



Figure 2: Rapid Growth of SWFs Projected (USD million)

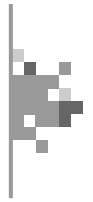


Source: Morgan Stanley Research estimates, Morgan Stanley (2007)

The US Treasury (2007: 2) reports that 'market estimates of aggregate assets of known SWFs range from \$1.5 – 2.5 trillion' which compares with the approximately \$5.1 trillion in official foreign exchange reserves at the beginning of 2007. It also notes the concentration that exists and reports estimates that two thirds of SWF assets are held by just four funds (the UAE's ADIA, Norway's Government Pension Fund-Global, Singapore's GIC, and Russia's Oil Stabilisation Fund). Around two-thirds of SWFs assets are attributed to commodity funds and one third to non-commodity funds.

The *Economist* (2007) suggests that by the end of this year the size of the funds could reach \$2.5 trillion (compared with around \$1.6 trillion in hedge funds). It is thought that \$450 billion in transfers from reserves are being added annually. However Morgan Stanley (Jen, 2007) think that the trend will continue and that the \$2.5 trillion predicted for this year could reach \$12 trillion by 2015, and even before then could exceed the size of the world's total official reserves. It is estimated (Morgan, 2007) that SWFs currently hold 2.5% of the world's financial assets but that this could increase to 9% in a decade.

It is difficult to grasp the scale of the telephone-type numbers associated with SWFs. China's new Investment fund is expected to be worth around \$300bn. To put that in perspective, the UK *Guardian* (Wachman, 2007) quoted an analyst who explained



that even after adjusting for inflation, the post World War Two US Marshall Plan was only worth \$100bn. To further illustrate the scale of the investments, Goldman Sachs Asset Management is valued at \$33 billion and Blackstone, the largest private equity fund, has \$80 billion in assets under management (Wehrfritz and Adams, 2007).

Concerns over SWFs

SWFs have caused concerns for a number of reasons:

- The recent growth in their number
- The speed of their accumulation of assets
- The sheer size and scope of the larger SWFs

As they grow, so too does their potential impact on various markets. As a result, there is much speculation about the future consequences of SWFs and the response of national and international regulatory authorities. The array of concerns is wide-ranging, although some of them may be contradictory. Jeffrey Garten (2007) sums it up as follows:

These funds are going to have the ability to buy any global company, to create panic in markets if they move too precipitously, even to dwarf the political clout of international financial institutions. They can no longer be ignored.

Among those calling for greater scrutiny or tighter regulation are the IMF, the US Treasury and the German Chancellor. Others are more sanguine, the *Economist* (2007a) suggests that even SWFs controlled by authoritarian regimes are not as dangerous as some warn because most countries have processes to block unwelcome takeovers in security-sensitive areas. Other observers (like former US Treasury Secretary, Lawrence Summers) argue that many of the problems and concerns identified below would be resolved or reduced if SWFs invested through intermediary asset managers (Summers, 2007).

At the international level, The Group of Seven industrialised countries are “obviously concerned about sovereign wealth funds ... and their behaviour, influence and standards,” according to one expert. In their 19 October statement, the G7 finance ministers and central bank governors agree that SWFs are “increasingly important participants in the international financial system” and “see merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability”. They also say they are “committed to strengthening ... dialogue with countries involved” and ask “the IMF, World Bank, and OECD to examine these issues”.



Here is the relevant section of the G7 statement:

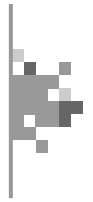
“Cross-border, market-based investment is a major contributor to robust global growth. In this context, we agreed that sovereign wealth funds (SWFs) are increasingly important participants in the international financial system and that our economies can benefit from openness to SWF investment flows. We see merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability. For recipients of government-controlled investments, we think it is important to build on principles such as non-discrimination, transparency, and predictability. We are committed to strengthening our dialogue with countries involved and look forward to discussing these issues at our Outreach Dinner later this evening. We ask the IMF, World Bank, and OECD to examine these issues.”

The IMF is seeking to develop "some level of guidelines" setting out best practice for SWFs, according to its new managing director, Dominique Strauss-Kahn. Mr Strauss-Kahn said on 2 November that many of the IMF's shareholder governments were asking it to develop "deeper insight into sovereign wealth funds". He said the IMF analysis should seek to distinguish between different types of sovereign funds - presumably based on transparency, investment objectives and other criteria. "They should not all be put in the same box," Mr Strauss-Kahn said (FT, 3 November 2007).

Foreign ownership

The impact of globalisation, the growth of multinationals and cross border ownership has changed the shape of the world economy. For example, the Confederation of British Industry estimates that 50% of the UK's largest companies are under foreign ownership (Brummer, 2007). However despite this, it remains controversial among many for national household names to pass into foreign hands (OECD, 2006). This has been boosted by a combination of factors: the heightened international security situation; the increased activity of countries regarded as having lower standards of corporate behaviour and openness to foreign investment than OECD countries; and concerns over access to energy and certain raw materials that are in short supply (OECD, 2006). The emergence of SWFs has given this 'economic nationalism' a focus, particularly in the case of some countries' SWFs.

Within the general debate about foreign ownership, questions have been raised about whether all SWFs are a problem or just some; whether it makes any difference if the SWF invests via an intermediary or directly; and whether investment through an SWF is any different to direct investment of a foreign state.



National strategic interests

Concerns about foreign ownership are not new. Even concerns about foreign SWF ownership have occurred in the past (when Kuwait bought 20% of BP in 1988, the UK government forced a reduction in the holding to 9.9% after protests about the potential influence of such a key oil producer on one of the top oil companies). In more recent times the United States has blocked foreign ownership of Unocal, Global Crossing and P&O's American ports.

On the other hand, some investment by SWFs appears to attract very little attention, despite the target being either of strategic or symbolic importance. For example, the Dubai SWF has a 3.1% stake in aerospace group EADS and the China Development Bank (CDB) - with its mission to support 'the State's policies to implement disciplined development and build a harmonious society' (CDB, 2007) - and Singapore's Temasek have both bought stakes in the UK's Barclays banking group without provoking any notable opposition.

National strategic interests can be interpreted more broadly than simply national security. It is widely believed that former Thai Prime Minister Thaksin Shinawatra was deposed in a military coup because he allowed the sale of the Thai telecoms group, the Shin Corporation, to Singapore's Temasek SWF. The potential military application of the telecom technology played a part in the debate about the justification of the coup.

Several countries have long had legal means of restricting unwelcome foreign investment in certain circumstances. France and Germany have 'negative lists' restricting foreign investors' access to certain sectors and activities; the US has its (recently strengthened) Committee on Foreign Investment (CFIUS) as a result of the 1988 Exon-Florio amendment to the Defense Production Act; China has a screening requirement on mergers with a national economic security impact involving foreign investors; and Russia has a framework for security issues related to foreign investment (OECD, 2006; Willman, 2007a). Canada is reviewing its rules on foreign investment and ownership (and in July 2007 the Russian Parliament discussed proposed legislation that would restrict foreign ownership in 39 economic sectors and the FSB security service will carry out scrutiny of possible foreign investment (Kerevan, 2007).

China's investment in the Blackstone Group, the private equity firm, was the catalyst for much fevered speculation, and politicians like US Senator Jim Webb lost little time in warning of the dangers of countries such as China effectively buying access to sensitive information related to national security (Reuters, 2007). It seems that the Chinese government played its hand very carefully with its purchase of Blackstone stock and reportedly received informal approval from the US Treasury first. Perhaps as part of the understanding, China has also agreed to waive its voting rights within Blackstone. They may not wish to do so in future purchases, especially if they base their SWF on Singapore's Temasek which takes direct stakes without using an intermediary.



Nevertheless, there is pressure for tightening up restrictions. Germany has been particularly vocal in calling for concerted action across the European Union. The EU has begun an inquiry about whether SWFs represent a threat to the Single Market.

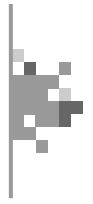
Peter Mandelson, the EU Trade Commissioner rejects a vetting process on the grounds that it would deter investors and argues for the EU to allow Members States to use so-called golden shares as part of a Europe-wide strategy to prevent foreign ownership of companies deemed to require special protection (Willman, 2007a). Some in the SPD, Germany's junior coalition partners, reportedly favour putting certain sectors, like telecoms, energy and banking, under special protection through the state acquiring blocking minorities of shares. This approach is not supported by the Chancellor. It is associated with France's designation of certain firms like food multinational Danone as 'strategic' when under threat of foreign takeover (Benoit, 2007a).

It now looks as though the German government will announce new measures in Autumn 2007 (Benoit, 2007b). It currently has no comparable mechanisms to those of the USA, UK or France but is believed to be considering the creation of a system based on the American CFIUS model (Williamson, 2007). Berlin is wary of Chinese takeovers of large enterprises such as banks as well as that of smaller engineering companies, seeing such acquisitions as a means of gaining access to patents and intellectual property (Benoit and Schieritz, 2007). Volker Kauder, parliamentary leader of Angela Merkel's Christian Democratic Union, argued that: 'This is about protecting important industrial sectors from the political influence of other states' (Benoit, 2007a).

State ownership

Some of the discussion has focussed on the claim that SWF investment constitutes a kind of 'backdoor nationalisation' (Brummer, 2007) – albeit state ownership by a foreign state. Several commentators have noted the irony of pro-privatisation national governments welcoming foreign state investment – sometimes in the very sectors that were privatised just a few years before. The nationalisation of industry is described by the liberal UK *Observer* newspaper (2007) as 'perverse' – *even if* the state carrying out the nationalisation is Britain, but 'if the state in question were China or Russia it would be sheer madness.'

Despite the 'perversity' of such investment, it is clear that once again, not all investment in this category generates the same disquiet. The transformation of some state-owned enterprises into publicly owned multinational enterprises is not common but neither is it without precedent – especially in the utilities sector (de Miguel and Sanz Mulas, 2007). For example, the takeover of London Electricity by the French state-owned EDF hardly raised an eyebrow. However the prospect of the Russian-owned



Gazprom bidding for control of Centrica, parent company of British Gas, is highly controversial.

Former US Treasury Secretary, Lawrence Summers claims that the question of how SWFs are invested 'is profound and goes to the nature of global capitalism' (Summers, 2007). He argues that all of the other concerns are secondary and that state-owned funds taking ownership of formerly privately-owned companies carries with it particular risks – especially if the ownership is taken through direct investment. He argues (*ibid*) that:

The logic of the capitalist system depends on shareholders causing companies to act so as to maximise the value of their shares. It is far from obvious that this will over time be the only motivation of governments as shareholders.

Whether multinationals actually operate according to the pure logic of capitalism as outlined by Summers is perhaps secondary to the concern that authoritarian regimes (China and Russia are usually cited) with a 'shaky' or 'partial' commitment to capitalism (Observer, 2007; Economist, 2007) allegedly have other agendas to simply maximising returns on investment.

In any event not everybody agrees with Summers' analysis. John Willman, a *Financial Times* leader writer and a strong supporter of privatisation, argues against blocking acquisitions of privatised companies by SWFs. Willman (2007b) says that the reason for supporting privatisation is that government are not good owners of commercial assets. They waste taxpayers' money and protect monopolies that are against the public interest. Privatisation breaks up such monopolies and the regulatory bodies protect the public interest. However, he claims that if

a foreign government-owned company chooses to buy one of the privatised elements and the regulatory regime is effective, the only person at risk is the foreign taxpayer whose capital is probably being misallocated.

'States don't act like shareholders': politics rears its ugly head

Much of the concern relating to SWFs is because many believe their investments are seen as tools of government policy rather than as a vehicle for maximising returns in the way that an individual investor would operate.

According to the *Financial Times* (Parker, 2007) EU Internal Market Commissioner Charlie McCreevy thinks that SWFs pay above market rates in order to acquire strategic companies and thereby distort the Single Market. In Europe, much of this discussion is a coded reference to what is seen as Russia's aggressive use of energy for national political purposes – 'resource nationalism'. Former Soviet Bloc states are reportedly nervous of Russian takeovers in the energy sector in particular.



Apparently McCreevy also believes that SWFs could be vehicles for the black market distort and buy up banks for purposes of money laundering. Summers (2007) says that among the reasons that states invest in private companies (above and beyond the wish to maximise returns on investment) may be a desire to improve the competitiveness of their national companies, to extract technology or achieve influence.

Transparency, corporate governance and financial instability

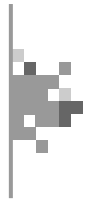
There are several concerns relating to transparency and corporate governance and their effect on the stability of the financial markets. Although Norway's fund is held up as an exemplar of transparency, public disclosure of investment strategy, our knowledge of the internal accountability mechanisms or long term goals of most SWFs is extremely limited. Lack of transparency is seen by many commentators as a potential source of destabilisation. The lack of openness means that SWF behaviour is difficult to predict and markets fear unpredictability. The Economist (2007a) argues:

If the Abu Dhabi Investment Authority, with an estimated \$875 billion under management, decided to unwind a big position and nobody knew why, it could start a panic.

Simon Johnson, chief economist at the IMF warned that increasing numbers of financial flows go through 'black boxes' like SWFs. He said that it was worrying that we don't know what happens' and that concerns about SWFs were similar to those over hedge funds (Atkins and Schieritz, 2007). Clay Lowery, a senior US Treasury official says that the danger lies in the fact that because so little is known about their investment policies, minor comments or rumours can increase volatility in capital markets. The absence of private citizens as shareholders meant, he said, that SWFs are not usually subject to market disciplines, as they are controlled by public servants only indirectly and imperfectly accountable to the citizens of the state (Willman, 2007a). Lowery said SWFs 'are typically not regulated by their domestic regulators, and the extent of indirect regulation may also be limited' and he called on the IMF and World Bank to develop best practice on transparency for SWFs to help maintain openness in international investment (Guha, 2007).

Norway's SWF sets the standard for transparency. It is reportedly the biggest equity owner in Europe (Willman, 2007a). It lists forty eight pages of its investments on its website, does not invest in private equity funds, hedge funds or real estate. It is an activist investor, typically with relatively small ownership shares in individual companies. The Norwegian Ministry of Finance lays down its management strategy:

'the Fund shall be safely managed based on the objective of high return subject to moderate risk in order to contribute to safeguarding the basis of future welfare, including national pensions' (Norges Bank, 2007).



Some American politicians point to a different threat (Plender, 2007) claiming that distortions in the international economy are deliberately being created by the accumulation of reserves, holding down domestic currencies and promoting exports when what is needed is currency reform in many of those countries with large SWFs.

When China invested in the Blackstone private equity group it deflected criticism by waiving its full voting rights. This may have met some objections but opened up the deal (and any future similar investments) to a different form of criticism. Plender (2007) maintains that by accepting a limitation on its voting rights, China has contributed to the undermining of good corporate governance within Blackstone as:

the liability of the general partner to the common unit-holders is limited and the Blackstone partnership agreement reduces or eliminates the fiduciary duties owed by the general partner to the unit-holders in relation to managing the considerable conflicts of interest inherent in the business.

So China appears to be damned whether or not it takes up voting rights. For China, as Plender (*ibid*) suggests, the issue of corporate governance is probably of less importance than being able to gain access to intellectual capital and private equity management skills.

There is another concern about financial instability and that relates partly to the changing direction of SWF investment strategy and partly to their sheer size. The amount of capital at their disposal and their shift out of low yield bonds to equities arguably risks destabilising the market as large investment flows take place from low risk to high risk areas. This should result in a rise in the price of assets with greater risk attached to them – equities, corporate bonds, private equity, real estate and commodities. Equally the price of government bonds should fall. Some analysts argue that this could cause problems in distorting the costs of equity, making it artificially low (Plender, 2007). However, the exact impacts are difficult to predict because of the secrecy surrounding SWF activity (Chung, 2007). US Treasury official Clay Lowery (Guha, 2007) has warned that, with insufficient checks and balances, SWFs could invite corruption and become ‘self-perpetuating’ interest groups. Finally, there are worries about the level of competency within some of the SWFs (Financial Times, 2007).

Potential for an anti-globalisation backlash

Some have raised the spectre of a backlash against globalisation focused around the activities of the SWFs. It is feared that ‘financial protectionism’ or ‘economic nationalism’ could grow in response to SWF activity – particularly if this was seen to represent a threat to national interests, however defined. Earlier this year, Serck-Joo Hong (2007), President and CEO of the Korea Investment Corporation warned:



Possible expansion of financial protectionism could bring about adverse effects on the still ongoing globalisation process – one of the major factors bringing global prosperity.

The OECD (2006) reported the view among a roundtable of private sector participants that opposition to investment on the grounds of security or strategic interests is on the increase and commented that this will result in slower growth.

The controversy over SWFs may initially provoke a 'national' reaction to SWFs in particular and globalisation in general but it may also have the effect of raising wider questions about the nature and type of globalisation that is acceptable. This may be a debate that many governments and financial institutions would find unwelcome.



Questions and issues for trade unionists

Few would seriously suggest that all foreign investment should be prevented. In fact, many such as the influential *Financial Times* columnist, Martin Wolf (2004) argue that 'The world needs more globalisation, not less.' Whether the world needs more financialisation is perhaps a different question. However the debate over the growth and impact of SWFs has focussed attention on the wider issues of foreign investment. In particular it raises questions about what *type* of investment is welcome, by whom, in what sectors, and with what safeguards.

Foreign state ownership through SWFs has been described as a threat to jobs, profits, the nation's tax base and ultimately economic and national security (Brummer, 2007). That may well be so, but – excluding the possible specific questions about national security, however defined - it is questionable whether SWFs are any more damaging than other forms of financialisation like private equity funds or hedge funds, or even (to a certain extent) general foreign direct investment (FDI).

In all the discussion among ministers and financial institutions about the impact of SWFs, there has been virtually nothing about their impact on the workers in the companies in which the funds invest. Millions are employed in companies controlled by private equity funds (ITUC, 2007: TUC, 2007) and SWFs are moving in the same direction. There are some similarities between SWFs and private equity funds (particularly in terms of their opacity, but there are also some crucial differences.

Who is the employer?

Just as with private equity, investment by SWFs can obscure who exactly is the employer within a particular company or enterprise. The name on the door may remain the same but the real power and control is no longer with the 'company' but with the true owner, which is the SWF. The long-term interests of companies in which SWFs invest can be enhanced by the guarantee of workers' rights to collective bargaining, information, consultation and representation. Union representatives should have timely access to information before, during and after SWFs have taken over a company. They should be made aware of the source of the investment, the ultimate owners and party to future business plans for their company.

Unions could explore the possibility of testing European legislation on European Works Councils in relation to SWFs with the aim of gaining a vehicle for greater consultation. As SWFs grow, they will control or have increased shareholdings in companies covered by the EWC Directive. It is also possible that they may be covered themselves. The directive refers to 'undertakings and groups of undertakings. It



makes no mention of the type of undertaking, nor of where they are headquartered. This might be a more productive tactic if applied to SWFs than private equity funds as the latter are renowned for short term investment.

Unions could also push for amendments to the European Acquired Rights Directive (which safeguards acquired rights of employees transferred in the course of a transfer of an undertaking) so that it covers takeovers through share transfers. If amended and transposed into Member States' legislation it would oblige employers to inform and consult employee representatives before the transfer, would impose rules protecting employees against transfer-connected dismissals or changes to employment terms and conditions if the variation is by reason of the transfer.

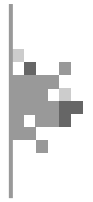
In the absence of such an amendment within the EU and outside the EU anyway, unions need to negotiate with existing employers succession clauses for takeovers which ensure continuity of employment; pay and conditions; union recognition and security of pension. They also need to press national governments for legislation to secure such rights to succession clauses. GUFs and the ITUC need to engage with SWFs directly to gain commitments to guarantee rights, jobs, pay, pensions and conditions of workers in any future takeovers. The precedent of International Framework Agreements could be transposed from multinationals to SWFs.

SWFs and national obligations under the ILO Conventions

The most obvious difference between private equity funds and SWFs is that the latter are controlled by nation states rather than private investors.

That offers some possibilities for unions that perhaps do not exist when dealing with private equity funds.

Nation states are signatories to ILO Conventions, private shareholders are not. This presents some leverage to unions in pushing for an explicit commitment to the ILO's Core Conventions within the companies in which SWFs invest. Clearly, there will be problems with SWFs owned by states that have not ratified key Conventions (like China with 87 and 98) or states that routinely ignore Conventions that they have signed. SWFs should be pressured to recognise GUFs as the legitimate vehicle for workers' representation at international level.



Pressure from the home country trade union movement

SWFs from countries with an active trade union movement or civil society may be able to place pressure in the home country on the SWF to commit to workers' rights in its investment portfolio. Countries like Australia, Canada, Chile, New Zealand, Norway, Trinidad and Tobago, South Korea have trade union movements with a history of international campaigning and could work with the international union trade union movement to exchange information, identify priorities and target SWFs.

Open the books

Just as the unions have led the demands for greater transparency in private equity, so they can in relation to SWFs. At international level the GUFs and ITUC could push a trade union agenda within the general demand for greater openness. Commentators like Jeffrey Garten (2007) call for a regulatory framework for SWFs based on three principles, which could be adapted by the trade union movement to cover organising and bargaining rights:

- **Transparency:** SWFs should be obliged to regularly publish details of their portfolios (much like the Norwegian SWF does). This would gain union support if at the same time the SWF was obliged to provide freedom of association details for each of the companies in which it invests (whether unions are recognised and whether collective bargaining takes place).
- **Reciprocity:** Garten demands that the 'economy of the SWF's home country must be as open as the country in which the SWF aspires to invest.' Unions could demand that, as a minimum, SWFs should insist on the same level of organising and bargaining rights in the companies in which they invest as exists in the home country (obviously this is only of advantage to the unions for those SWFs from countries with acceptable industrial relations frameworks).
- **Ownership guidelines:** Garten calls for SWFs to be limited to no more than 20 per cent of any company in the US or Europe, unless the host government relaxed the limit. SWFs should also be obliged to insist that any company within which they invest should as a minimum commit itself to the ILO Core Conventions.



Long term investments?

Perhaps in contrast to private equity funds, the US Treasury recognises that SWFs have a potentially stabilising role as long term investors (Guha, 2007). Without the short termist shareholder pressure for quick returns it is argued that they are more likely to develop portfolios with an emphasis on durable and sustainable investments. Given that previous research (Kaplan, 1991) suggests the private equity cycle of acquisition-restructure-exit is typically less than seven years, trade unionists might look more favourably at investment funds that were in for the long haul. That would presuppose a series of conditions relating to jobs, pay, pensions and conditions but the general point holds in comparison with private equity. An additional factor is that SWFs are sitting on a great deal of capital and therefore their use of debt to fund investment may be less than that of private equity funds. This in turn should reduce the pressure for short termism.

More research is required on the record of SWFs as long term investors and on the impact of their investment on the companies in which they invest. Unions' attitude to SWFs will, in part at least, depend on whether SWFs attempt to mimic private equity funds in realising cash on their investments in the quickest possible time at the expense of the future well being of the company and its workforce.

What sort of economy?

The debate around SWFs, like the related discussion on private equity has reopened questions relating to the type of economy that we have and that we would like to have – the place of foreign investment, the role of the state, democratic control, the regulatory framework, the nature of 'strategic' industries, transparency, governance, distribution of wealth and the position of the workforce and their representatives. This space for debate is an opportunity for unions at both national and international level to advance positions of advantage for workers and their families. In particular it offers the opportunity for trade unions to use the concerns over SWFs to press for a regulatory regime more favourable to workers and their representatives – not just those who work for companies owned by SWFs but also those in companies owned by private equity funds and hedge funds as well.



Information on individual funds

Data from the indicated media sources on sixteen SWFs is presented below. Here are some notes on other SWFs.

The Malaysia and Azerbaijan funds are considered to be transparent by Standard Chartered, while those of Venezuela and Taiwan funds are considered to have a relatively low level of transparency.

Saudi Arabia has a portfolio of foreign assets held by the central bank, the Saudi Arabian Monetary Authority, worth about \$248bn, according to official figures. Parts of the conservative portfolio, analysts say, could soon shift into a more active private equity style fund, seeking higher returns. Heavy Saudi money is in the hands of family-controlled companies, such as Olayan Group, and holding companies, the best known of which is Prince Al-Waleed's Kingdom Holdings.

Many SWFs are based on oil and gas reserves. However, Botswana's \$6.8 billion Pula Fund is sourced through the diamond trade, Kiribati's \$460 million fund is from phosphate and Uganda's \$350 million Poverty Action fund is from aid.

In addition to China Investment Co Ltd, another Chinese fund, The Social Security Fund, may be interested in buying stakes in US-based private equity funds. The Social Security Fund has talked to Carlyle, KKR and TPG.

Sixteen Sovereign Wealth Funds

28 November 2007

FUND: Government Pension Fund **COUNTRY: Norway** **SIZE:** Global assets of \$327.5 billion as of June 2007, projected to reach \$500 billion by 2009. **BASIS:** oil/gas exports. **MANAGEMENT:** Knut Kjaer, head of the fund, stepped down in September 2007 but said he would serve until a successor was found. **TRANSPARENCY:** The fund is the most transparent of the 20 biggest sovereign wealth funds, according to a Standard Chartered study. It publishes its portfolio holdings annually. **INVESTMENTS/INFLUENCE:** Over time, could put up to 5% of its portfolio into private equity. Has remained a resolutely low-profile investor. Holds shares in about 3,500 companies. Stakes are typically kept below 1%, not allowed to exceed 5%. Fund has ethical guidelines.



FUND: **Abu Dhabi Investment Authority (ADIA)**, set up in 1976. COUNTRY: Abu Dhabi is the largest of the seven **United Arab Emirates (UAE)**. SIZE: Assets of \$250 billion to \$875 billion, according to the IMF. BASIS: oil/gas exports. MANAGEMENT-GOVERNMENT LINK: UAE President Sheikh Khalifa bin Zayed Al Nahyan chairs the fund. Sheikh Ahmed Bin Zayed Al Nahayan is the managing director. TRANSPARENCY: ADIA does not disclose its assets total and does not regularly disclose its investment activity. INVESTMENTS/INFLUENCE: Asset allocation includes 5%-10% private equity and 5%-10% percent other alternative investments. In recent years, ADIA has taken larger stakes in firms, such as an 8% stake in and a seat on the board of EFG-Hermes, Egypt's largest investment bank by value, as well as a 10% pre-IPO stake in US private equity firm Apollo Management LP. ADIA is the largest shareholder in two of UAE's largest banks, National Bank of Abu Dhabi and Abu Dhabi Commercial Bank. November 2007 - agreed to buy 4.9% stake in US bank Citigroup, which would make it the largest shareholder. ADIA had agreed not to own more than a 4.9% stake, and would have no special rights of ownership and no role in the management or governance of the bank, Citigroup said. ADIA would buy securities in Citigroup, to be converted into shares in 2010-2011.

FUND: **Mubadala Development Company**, set up in 2002 COUNTRY: Abu Dhabi, **United Arab Emirates (UAE)** SIZE: Portfolio reported in June 2007 to be "in the double-digit billions". MANAGEMENT-GOVERNMENT LINK: Chaired by Sheikh Mohammed bin Zayed Al Nahyan, the crown prince of Abu Dhabi. Khaldoon Khalifa al-Mubarak is the chief executive and managing director. Khaldoon is also chairman of the Executive Affairs Authority of the Government of Abu Dhabi. TRANSPARENCY: poor INVESTMENTS/INFLUENCE: High-profile investments such as the takeover of Swiss aircraft maintenance firm SR Technics with other UAE agencies, a 25% stake in Dutch fleet and vehicle management giant LeasePlan Corporation, a 5% stake in Ferrari, the Italian carmaker, a 7.5% stake in Carlyle Group, a US private equity firm, bought in September, and a 8.1% stake in US chip maker AMD (Advanced Micro Devices), bought in November 2007.

FUND: **Kuwait Investment Authority (KIA)**, set up in 1953, the first major SWF. COUNTRY: **Kuwait** SIZE: Assets of \$213 billion as of March 2007. BASIS: oil/gas exports. MANAGEMENT: The fund's managing director is Bader Al Sa'ad. TRANSPARENCY: Prohibited from sharing details on its managed assets with the public. INVESTMENTS/INFLUENCE: 7.2% stake in Daimler.

FUND: **China Investment Co Ltd**, started operations in September 2007, expected to become the world's largest SWF within a few years. COUNTRY: **China** SIZE: Assets of \$200 billion. BASIS: general trade surplus. MANAGEMENT-GOVERNMENT LINK: Lou Jiwei, a former finance vice minister, is chairman of the fund. Gao Xiqing, deputy head of the National Social Security Fund, is vice chairman and general manager. TRANSPARENCY: Will communicate with regulators and international agen-



cies. INVESTMENTS/INFLUENCE: May 2007 (before fund formally launched) - bought \$3 billion worth of non-voting shares in The Blackstone Group LP, giving it a 10% stake in the private equity firm whose holdings include companies that make satellite technology and software used by the US military. Several US lawmakers raised national security concerns. Chinese officials have said the fund will avoid politically sensitive deals by taking minority stakes in companies rather than pursuing corporate takeovers. But may also help major state-owned companies expand overseas, though Mr Lou has said investments will be dictated by commercial, not political factors.

FUND: Government of Singapore Investment Corp (GIC), set up in 1981. COUNTRY: **Singapore** SIZE: Assets of \$140 billion. BASIS: general trade surplus. MANAGEMENT-GOVERNMENT LINK: Lee Kuan Yew, former prime minister of Singapore, is chairman. Lee Hsien Loong, current prime minister, is deputy chairman. Closely tied to the government, with all but one of its 13 board members being current or former government officials, GIC executives or the heads of state companies. TRANSPARENCY: The fund does not make financial statements available. INVESTMENTS/INFLUENCE: Has maintained a low-key presence in financial and property markets, with little interest in buying big stakes in companies. About 80% of investments in the US, Europe and Japan. Private equity and hedge funds are among the nine markets in which the fund invests.

FUND: Temasek Holdings COUNTRY: **Singapore** SIZE: Assets of \$108 billion as of March 2007. BASIS: general trade surplus. MANAGEMENT-GOVERNMENT LINK: S. Dhanabalan is chairman and Kwa Chong Seng is deputy chairman. The chief executive is Ho Ching, the wife of Singapore's prime minister. TRANSPARENCY: Audited annual reports published since 2004. INVESTMENTS/INFLUENCE: Over 60% of the portfolio is in the financial services and telecommunications sectors. Investment activities have aroused controversy in some Asian countries. Has taken a more activist approach than GIC, similar to a private-equity fund, by buying substantial stakes in some foreign companies and seeking some say in management. Temasek has built up stakes in more than 10 Asian banks. Owns 28% of Singapore's DBS Bank. Has a holding of 5% in Bank of China and 6% in China Construction Bank. In India it has a 9% holding in ICICI. July 2007 - took a 2.1% stake in Barclays Plc. August 2007 - increased its stake in Standard Chartered to 15%. Has encountered problems with its holdings in leading Indonesian and Thai telecoms groups. In November 2007, an Indonesian panel ruled that Temasek's investments in two local mobile operators breached anti-monopoly laws and ordered it to sell one of its holdings. Temasek said it would appeal against the decision. In 2006, Temasek's purchase of Shin Corp, Thailand's largest telecoms group, contributed to public protests against Thaksin Shinawatra, then prime minister, whose family controlled the company. Mr Shinawatra was later ousted in a military coup. November 2007 – FT reported that Temasek was seeking a lower profile in response to a growing backlash against SWFs.



FUND: **The Future Fund**, set up in 2006 to pay for the future pensions of public servants. COUNTRY: **Australia** SIZE: Assets of \$54 billion as of July 2007. Expected to grow to \$103 billion by 2020. MANAGEMENT: Managed by the Northern Trust Corporation, an American investment management group. Paul Costello is general manager. Has recently made appointments to strengthen its private equity team. TRANSPARENCY: The fund publishes an annual financial statement as well as performance benchmarks. INVESTMENTS/INFLUENCE: Held a 18.6% stake in Telstra Corp. Plans to increase its holdings of international stocks in 2008.

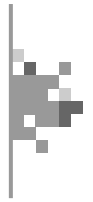
FUND: **Qatar Investment Authority (QIA)**, set up in 2005. COUNTRY: **Qatar** SIZE: Assets estimated at \$30 billion to \$50 billion. BASIS: oil/gas exports. MANAGEMENT-GOVERNMENT LINK: Prime Minister Sheikh Hamad bin Jassim bin Jabr al-Thani heads the fund. TRANSPARENCY: No formal reports are made public. INVESTMENTS/INFLUENCE: Holds 10% of the Swedish stock exchange OMX, which it has expressed an interest in increasing. Reduced its stake in the London Stock Exchange from 20% to 14%. Battling for regional financial leadership with Dubai. November 2007 - dropped a £10.6 billion (\$22.3 billion) takeover bid for British retail chain J Sainsbury, though still holding a 25% stake.

FUND: **Alaska Permanent Reserve Fund** COUNTRY: **United States** SIZE: Assets of \$37 billion post-dividend as of May 2007. BASIS: oil/gas exports. MANAGEMENT: Michael Burns is executive director. TRANSPARENCY: The fund publishes an annual and monthly financial reports. The fund's web site lists its stock holdings and its external asset managers. INVESTMENTS/INFLUENCE: Asset allocation includes 4% private equity.

FUND: **Brunei Investment Agency (BIA)** COUNTRY: **Brunei** SIZE: Assets estimated at \$30 billion. MANAGEMENT: The chairman of the fund is Pehin Dato Seri Setia Awe Hj Yahya bin Begawan Mudim dato Paduka Hj Baker. Pehin Hj Yahya is also Minister of Energy at the Prime Minister's Office. TRANSPARENCY: The fund does not issue regular financial statements or disclose the contents of its portfolio.

FUND: **National Welfare Fund**, expected to start in 2008 as a result of splitting Russia's \$141 billion budget stabilisation fund into two funds on 1 February 2008. Most of the money to go to a conservatively invested Reserve Fund, with the rest going to the growth-oriented National Welfare Fund. COUNTRY: **Russia** SIZE: Assets expected to be \$19 billion. Private equity likely to be included in the fund's portfolio. MANAGEMENT: The fund's management team not yet named. TRANSPARENCY: Nothing announced so far.

FUND: **Istithmar** COUNTRY: Dubai, **United Arab Emirates (UAE)** SIZE: Assets estimated at \$22 billion. INVESTMENTS: Has a private equity division. Assets such as Barney's department store in the US, stakes in Standard Chartered Bank, Kerzner



International and the QEII cruise liner. The real estate arm controls more than \$10 billion of investments, mainly in the US and Europe, including One Trafalgar Square.

FUND: Dubai International Capital (DIC), set up in 2004 within Dubai Holding. **COUNTRY:** Dubai is the second largest of the seven **United Arab Emirates (UAE)** **SIZE:** Assets of \$12 billion, aiming at \$25 billion by 2009. **BASIS:** real estate sales. **MANAGEMENT-GOVERNMENT LINK:** The fund is privately owned by Sheikh Mohammed bin Rashid al-Maktoum, Dubai's ruler and UAE prime minister, therefore not strictly speaking a SWF because not government-owned. Run by Sameer al-Ansari, who has served in Sheikh Mohammed's executive office. **TRANSPARENCY:** relatively transparent. **INVESTMENTS/INFLUENCE:** Owns 3% of EADS, which is the parent company of Airbus and also makes the Eurofighter (a further 5% of EADS is held by a state-owned Russian bank). Has stakes in private equity firms Carlyle, KKR and 3i. Also has stakes in Daimler and HSBC bank. Has acquired Madame Tussauds, the waxworks museum in London, Doncasters Group, a British engineering company, and Travelodge, a hotel group, among others. October 2007 – exploring a bid for Northern Rock, the struggling British mortgage bank, with Virgin Group. November 2007 – announced acquisition of a "substantial stake" in Sony, the Japanese consumer electronics manufacturer. A stake larger than 5% would have to be reported to regulators.

FUND: Alberta Heritage Savings Trust Fund **COUNTRY: Canada** **SIZE:** \$16.4 billion. **TRANSPARENCY:** high level, according to Standard Chartered study.

FUND: State General Reserve, set up in 1980. **COUNTRY: Oman** **SIZE:** \$10 billion **TRANSPARENCY:** low level, according to Standard Chartered study.

Sources: Reuters FACTBOX and FACTBOX = 2, 13 Nov '07; The Sunday Times, 28 Oct '07; The Times, 21 Sep, 1 Nov '07; Financial Times Deutschland, 22 Oct '07; Financial Times, 19 Nov '07 (2), 23 Nov '07; Wall Street Journal, 7 Nov '07; AP, 18 Oct '07; Bloomberg, 29 Sep '07; BBC NEWS, 18 June, 21 Sep, 16 Oct, 26, 27 Nov '07; BBC WORLD tv, 20 Nov '07; Standard Chartered press release, 15 Oct '07.

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