Is the Erecting of Barriers against Sovereign Wealth Funds Compatible with International Investment Law?

Mathias Audit *

I. INTRODUCTION

In the 1990's, no one could have foreseen that state-owned companies would become major players of globalization. Following the fall of the Berlin wall, their presence in international business transactions had been steadily decreasing. However, this trend has changed since the beginning of the Second Millennium. Since then, some states are again playing a role in the international economy. However, unlike during the Cold War era, these are not socialist states engaged in international trade with Western companies. Instead, we are seeing a genuine form of state capitalism by which some of them are using specific investment vehicles to invest assets in North American and European markets. Sovereign Wealth Funds (SWFs) represent this not-so-new trend of states involved in globalization.

Historically, the first SWFs are supposed to be the Kuwait Investment Authority and the Kiribati Revenue Equalisation Reserve Fund, which started in the 1950's. But it is clear that the major impact of SWFs on global economy is much more recent.

Firstly, twenty new SWFs have been established since 2000, including twelve since 2005. Amongst the recent SWF owners are some major countries like Russia and China, whose geopolitical interests are much greater than those of traditional SWF owners like the Gulf countries. Moreover, new states are planning to create SWFs, like Brazil, Libya, Algeria, and Venezuela.

Secondly, SWFs have never been so wealthy and this is largely due to the origin of their financial resources. If some of them rely on their central banks' reserves like China Investment Corporation, most of them draw their wealth from the exploitation of raw materials. Therefore, increase of their assets is proportional to the dizzying rise of oil and gas prices. In fact, oil's incomes are supposed to represent two thirds of the SWF's assets, which have been evaluated in 2007 between 2,200 and 2,500 billions US Dollars¹. A Morgan Stanley's Report even states that this amount could reach 12,000 billions.

---

* Dr. Mathias Audit, PhD (Paris I Panthéon-Sorbonne), is a Law Professor, University of Paris Ouest Nanterre La Défense, France. The author can be contacted at mathias.audit@wanadoo.fr.

¹ Martin Wolf, We are living in a brave new world of state capitalism, FINANCIAL TIMES, Oct. 17, 2007.
US Dollars by 2015\(^2\). Only speaking about the three richest SWFs, it is said that 875 billions US Dollars are at the Abu Dhabi Investment Authority's disposal, while assets of Government of Singapore Investment Corporation and Government Pension Fund-Global from Norway are between 320 et 330 billions, respectively\(^3\). Therefore, the influence of SWFs on global economy is already very high and it is quite certain that it will be even greater in a very near future.

However, an essential aspect of SWFs' functioning is that these abundant financial resources are not locally invested. Using SWFs, their governmental owners are investing in European and North American markets. Besides, placements are quite variable, ranging from acquisition of shares, via subscription of bonds, or other financial securities, and real estate. Some SWFs have even chosen to take stakes in hedge funds.

For the moment, financial analysts consider the impact of SWFs on global economy to be positive\(^4\). Especially since the beginning of the financial crisis, several SWFs have been supporting some major western banks. In December 2007, Government of Singapore Investment Corporation had hence invested in the Swiss bank UBS, while at the same time China Investment Corporation was buying 9.9% stake in Morgan Stanley. In the meanwhile, City Group had announced that it would sell $7.5 billion of securities to the Abu Dhabi Investment Authority. As of February 2008, the Investment Authority from Qatar has also taken a participation in the capital of Credit Suisse.

But this positive impact does not place SWFs above all suspicions. Even if SWFs are proper legal persons, their assets come directly from their home governments' resources. Therefore, the question of their independency arises. Regardless of the search of financial return, SWFs could be used by their home governments to achieve international policy goals. As such, host countries may frown upon SWFs' investments on their soil\(^5\).

For example, a SWF taking equity stakes in strategic economic sectors of a Western country could be seen as a problem. It is obvious that the US Government would not accept that China Investment Corporation invests in the US military industry. For similar reasons, Germany does not want the new Russian SWF launched in February 2008 to invest in the German energy sector.

Hiding behind the investor, the presence of a foreign government whose interests are not purely economic or financial could always be suspected. Therefore, attendance of representatives of a foreign SWF at the board of any strategic company could be seen as undesirable. Taking a majority stake would be seen as even more problematic. Besides, it is not only defense, energy and high-tech industries that are susceptible of