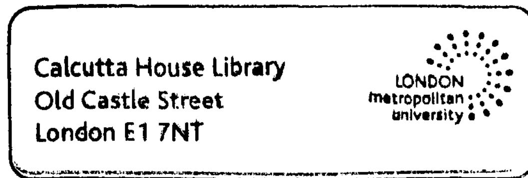
Sovereign Wealth Funds as Coping Mechanisms in the Global Economy:

Three Emirati Case Studies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Abstract

This thesis argues that Sovereign Wealth Funds based in small emerging market economies necessarily fulfil a double-sided coping function in today's globalised economy: a coping function because the task of promoting the home country's economic growth through closer integration into the global division of labour can only be fulfilled successfully if the manifold pressures emanating from the global market place are suitably absorbed and managed by the SWFS; a double-sided coping function because SWFs need to negotiate not only the pressures caused by the instability of the global economic space but also the pressures associated with the highly unequal structure of that space. To substantiate this argument three hypotheses are advanced all of which take as their point of reference, either directly or indirectly, the newly established 'voluntary' set of internationally agreed principles governing SWF conduct - the 'Santiago Principles'. The central hypothesis is that the net benefits of small EME based SWFs for their home countries are maximised when they conform to the Santiago principles because the voluntary nature of these principles allows SWFs to fulfil their coping function effectively. The preliminary hypothesis is that the net benefits will be lower when there are no internationally agreed principles of SWF conduct in place because of likely negative blocking actions on the part of foreign governments and regulators; however, the net benefits will still be positive inasmuch as SWFs can still fulfil their coping function. The third hypothesis is that the net benefits will be lower still, and possibly even minimal, if SWFs are forced to comply with an alternative and more strict set of rules of conduct because of the constraints these will impose on their room for manoeuvre in the global economy thus undermining their coping function. To help verify these hypotheses, a combination of quantitative and qualitative research techniques is used with triangulation and the case study approach serving as the all-encompassing methodological framework. The three case studies chosen are Abu Dhabi's ADIA, one of the world's largest SWFS, Dubai's ICD, a medium sized SWF, and Fujairah's FIE, one of the world's youngest and smallest SWFs.

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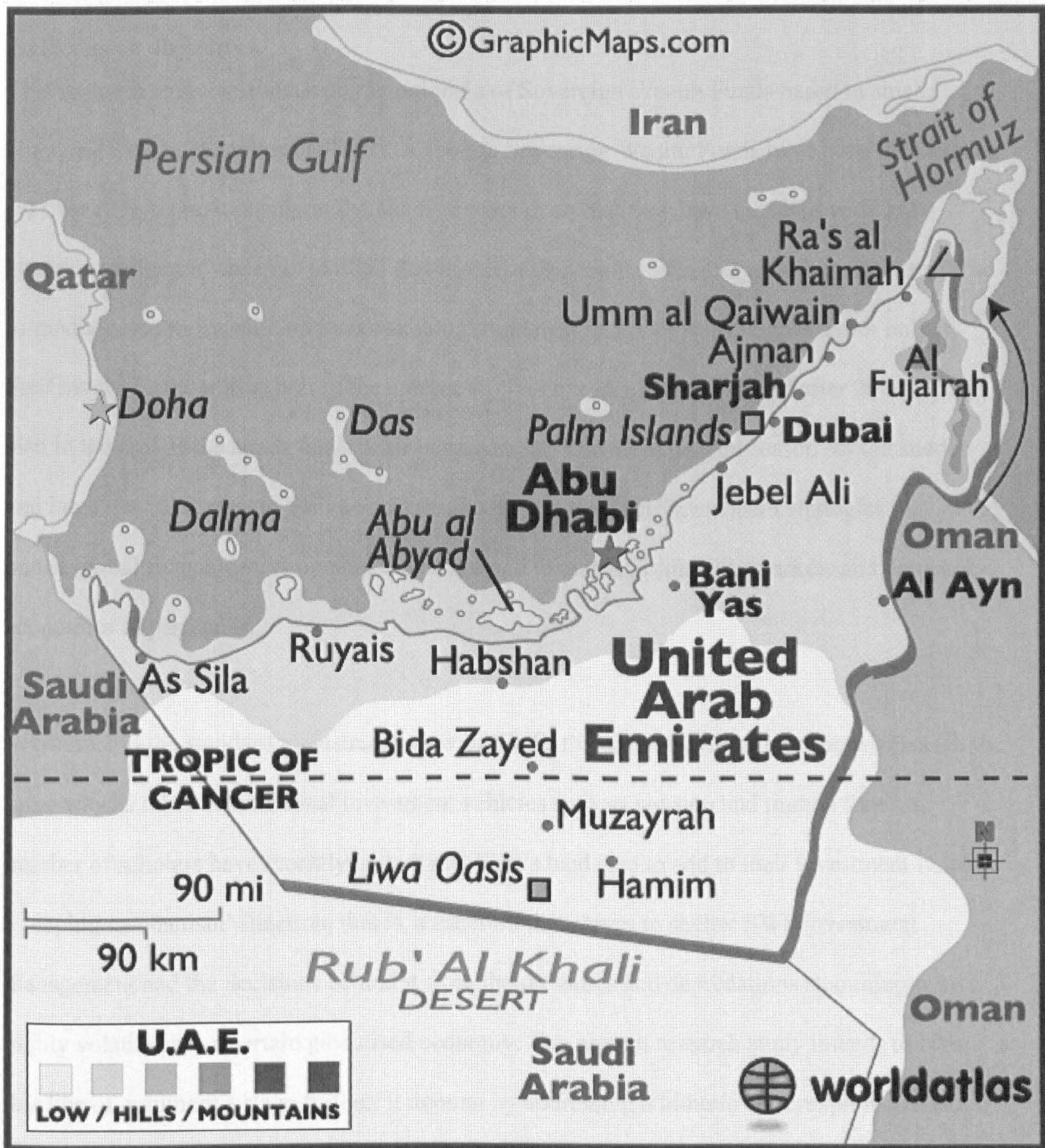
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Chapter One
Introduction

1.i Research objectives.

This research study will focus on the rationale of Sovereign Wealth Funds based in small, emerging market economies (EMEs). Although Sovereign Wealth Funds have been in existence for over fifty years, it is only in the last five years or so that they have attracted wide scale attention. In fact, it was only in 2005 that the term 'Sovereign Wealth Fund' was first used. The immediate reason for this sudden awakening of interest in SWFs was the growth not only in their number – more than half of the current 45 SWFs were only established after 2000 – but also in the size of the assets under their management. The more general reason for the sudden and huge rise in interest in SWFs concerns the impact that their investment strategies may have on the global financial environment in general and on national financial markets and domestic economies in particular.

In contrast to the standard mainstream view of SWFs that they should behave more or less in the same way as other conventional investment vehicles such as pension and mutual funds, a number of scholars have recently argued that SWFs tend also to add to their investment function a 'coping mechanism' function, that is, a function that serves to shelter SWF investment management and the decisions behind it from the pressures and depredations stemming from a highly volatile and uncertain globalised economy. The present research study intends to take this line of argument a stage further. It does so by addressing a hitherto underexplored research question, namely, how should our perception of the role of SWFS based in small, peripheral economies change once we relax not only the assumption that the global market economy is a self stabilising space but also the assumption that it is an equitably structured space? The answer given in this research thesis, and which constitutes the main contribution to the literature

on SWFs, is that it should recognise a 'dual coping mechanism' function'. The central contention of this thesis is that small, EME-based SWFs necessarily fulfil a double-sided coping function in today's globalised economy in the sense that they need to negotiate not only the pressures caused by the instability of the global economic space but also the pressures associated with the highly unequal, core-periphery structure of that space.

1.ii Research Strategy

To substantiate this contention three hypotheses are advanced all of which take as their point of reference, either directly or indirectly, the newly established 'voluntary' set of internationally agreed principles governing SWF conduct: the 'Santiago Principles'. The central hypothesis is that the net benefits of small EME based SWFs for their home countries are maximised when they conform to the Santiago principles because the voluntary nature of these principles allows SWFs to fulfil their coping function effectively. The preliminary hypothesis is that the net benefits will be lower when there are no internationally agreed principles of SWF conduct in place because of likely negative blocking actions on the part of foreign governments and regulators; however, the net benefits will still be positive inasmuch as SWFs can still fulfil their coping function. The third hypothesis is that the net benefits will be lower still, and possibly minimal, if SWFs are forced to comply with an alternative and more strict set of rules of conduct because of the constraints these will impose on their room for manoeuvre in the global economy thus undermining their coping function. To help verify these hypotheses, a combination of quantitative and qualitative research techniques is used with triangulation and the case study approach serving as the all-encompassing methodological framework. The three case studies chosen are Abu Dhabi's ADIA, one of the world's largest SWFS, Dubai's ICD, a medium sized SWF, and Fujairah's FIE, one of the world's youngest and smallest SWFs.

1.iii Structure of the research study

The structure of this research study is as follows. The next chapter presents an extensive and up to date review of the existing literature on Sovereign Wealth Funds, on their aims and objectives, on their distinctive organisational and managerial structures, on their potential threats to, or benefits for the global economy, and on the appropriate type of internationally agreed rules for their conduct. Chapter three introduces the broad theoretical framework against which the core hypotheses of this research study are formulated. Chapter four outlines the methodological approach that will be adopted to help substantiate the core hypotheses. Chapter five introduces the first of three case studies, Abu Dhabi's ADIA, and presents some results. Chapter six presents the second of the three case studies, Dubai's ICD and some results. Chapter seven presents the final case study, Fujairah's FIE and some results. Chapter eight presents a brief summary and conclusion.

Chapter 2.

Sovereign Wealth Funds: Literature Review

2.i Sovereign Wealth Funds: definition and background

This research dissertation will set up and assess certain hypotheses concerning the rationale for Sovereign Wealth Funds based in small emerging market economies (EMEs) such as those of the Gulf area in the Middle East. In doing so it will challenge many of the established ideas and preconceptions surrounding these investment vehicles that stand at the juncture between high politics and high finance. To clarify the radical nature of the hypotheses advanced here, it is necessary to review the existing literature on SWFS and identify not only the main points of argument and discussion but also the gaps in this discussion. As a preliminary exercise, it is first useful to begin with a definition of SWFs and provide some background information on these government owned institutions.

In the literature on Sovereign Wealth Funds, there are slight differences in how these government investment vehicles are defined but there is agreement that they can be broadly differentiated from the other three major forms in which government wealth is held[1]. These other forms are:

(i) international reserves: foreign currency assets held for use by a treasury department, finance ministry or central bank;

(ii) government pension funds: funds held by governments on behalf of their citizens;

[1] See Truman (2007); Balding (2008); Miracky et al (2008); IMF (2008)

(iii) state-owned corporations: corporations which are taken out of the private sector and managed by the government for reasons that could be political or economic in nature[2].

SWFs essentially differ from these other types of government wealth funds in that they represent pools of surplus capital which governments invest for profit, where the profit itself may in turn be used to attain broader objectives. The following definition of SWFs given by the International Monetary Fund when it established its 'Work Agenda' to study these government investment vehicles captures their distinctive nature:

"Sovereign Wealth Funds are special purpose public investment funds .. .that are owned or controlled by the government, and hold, manage or administer assets primarily for medium- to long-term macroeconomic and financial objectives. The funds are commonly established out of official foreign currency operation, the proceeds of privatizations, fiscal surpluses and/or receipts resulting from commodity exports. The funds employ a set of investment strategies which include investments in foreign financial assets"[3].

This broad definition of SWFs needs to be broken down into its individual constituent parts if their nature and function is to be analysed more closely, but before doing so something must be said about their history and present size. SWFs originated in the 1950s as the governments of Norway and Singapore and then later Kuwait sought to use their surplus foreign exchange earnings to buy income-generating assets in order to insulate their economies from exchange rate fluctuations. Over the past fifty years, and especially over the past decade, both the number of SWFs and the range and object of their investment strategies have grown considerably. Today there are 45 SWFs in operation with approximately $5 trillion under management. The vast majority of SWFs are now

[2] See Kimmitt (2008)
[3] IWG-SWF (2008, p.3)

operated by governments located in what are now termed Emerging Market Economies (EMEs), with the greatest concentration of SWFs and assets under management being in the Middle East – the Gulf Cooperation Council (GCC) countries in particular – and in Asia. This geographical spread broadly reflects the two main sources of the surplus revenues that are channelled into the SWFs: oil and gas exports on the one hand (the 'commodity' SWFs)- and foreign exchange reserves and other non-oil export revenues on the other (the 'non-commodity' SWFs). In 2008, assets managed by commodity SWFs totalled about $2,300 whereas assets managed by non-commodity SWFs totalled about $1500[4].

Although SWFs have been in existence for over fifty years, it is only in the last five years or so that they have attracted wide scale attention. In fact, it was only in 2005 that the term 'Sovereign Wealth Fund' was first used. The immediate reason for this sudden awakening of interest in SWFs was the growth not only in their number – more than half of the current 45 SWFs were only established after 2000 – but also in the size of the assets under their management. However, size in this context is relative. Assets in the region of $5 or $6 trillion look large when taken on their own but not when compared to the world's total stock of financial assets – these totalled $167 trillion at end 2007 or $122 trillion if bank deposit money is stripped out – or when compared to the assets held by other investment vehicles, such as pension and mutual funds (these institutional investors held approximately $50 trillion worth of assets at the end of 2007 (see Sovereign Wealth Fund Institute, 2008)). The more general reason for the sudden and huge rise in interest in SWFs concerns the impact that their investment strategies may have on the global financial environment in general and on national financial markets and domestic economies in particular. These investment strategies may have a political dimension to them, as well as strictly economic goals, a possibility that has given cause for alarm, as will be seen below. However, before taking up this matter it should first be noted that even if attention is restricted to the purely economic content of SWF investment

[4] See Maslakovic (2009); Jen and Andreopoulos (2009)

objectives and strategies, there are certain differences as well as similarities as compared with those of the other types of investment vehicle. To examine this, we shall begin with a review of the major objectives held by SWFs.

2.ii The Rationale for SWFs

As a matter of description it is correct to say that SWFs manage assets to generate profits. However, what also has to be explained are the deeper motives or strategic objectives behind this preoccupation with profits. In the literature, several such objectives have been identified[5] but, stripping out the various overlaps between them, these objectives basically divide into four major categories:

(a) Stabilisation.

A SWF can serve as a buffer that protects the domestic economy in general, and the government budget in particular, from economic volatility. This volatility arises either from swings in the global economic environment to which all EMEs are generally exposed or from swings in the prices of commodity exports to which those EMEs specialising in oil and gas exports are especially exposed. The fundamental rationale here is that in a boom period of the economic cycle when exports and/or commodity prices are rising, the SWF can accumulate the surplus pools of capital which, in turn, can be drawn upon in a recession phase of the cycle when exports and/or commodity prices are falling[6].

[5] See Razanov (2005); Lyons (2007); Gomes (2009)
[6] See Rozanov(2005)

(b) Savings.

A SWF can act as a wealth-conserving or inter-generational fund transfer mechanism. The stocks of income-yielding assets such as oil and gas that EMEs possess are neither limitless nor renewable, which means that were a country's government to spend all of the income flows from these assets on current consumption, the losers would be the future generations of that country. By investing a portion of current government income in an SWF, which can in turn invest this income in a variety of different financial and non-financial assets, the wealth of a country is thereby both preserved and augmented for the benefit of future generations[7].

(c) Diversification and development.

A SWF can act as an instrument for promoting economic diversification and, on that basis, economic growth. Many EMEs such as those of the Arabian Gulf have so far developed as single commodity producers and exporters. However, theory has shown that over-reliance on a single economic sector can impede the growth of a country either because it will be far less able to resist the pressures of economic volatility and/or because it will not be able to benefit from the various advantages – in terms of the synergies and positive externalities relating to human and non-human capital development – that arise from diversification across different economic sectors. To the extent that an SWF allocates an accumulating pool of capital placed under its management to different investment projects, so also does it help to reduce single commodity dependence[8].

(d) Asset management

A SWF can help a government to manage its exchange reserves on a more cost-efficient basis. Foreign currency reserves are held in order to help stabilise a domestic currency's rate against a

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[7] See Miracky et al (2008)
[8] See Butt et al (2008); Seznec (2008)

key currency such as the US dollar, an objective which is in turn essential for stabilising export and import prices. Due to considerations of safety and liquidity, most foreign reserves are held in the form of US treasury bonds, extremely safe securities, the market for which is the deepest and most liquid in the world. However, the down side to the fact that US treasuries are highly safe and liquid is that their yields are relatively low. The corollary is that while the build-up of large US treasury denominated reserves makes good economic sense up to a point (reserve holdings have to be large in the current era of financial globalisation where private speculators can bring huge financial fire power to bear when attacking a particular currency as was shown in the European monetary system crisis of 1992 and the Asian currency crisis of 1997), a continued build-up beyond that point of critical mass is simply wasteful and inefficient. By diverting that excess of reserve holdings into a SWF, which is an entirely separate investment entity, a government can reduce the holding costs of foreign exchange reserves while at the same time increasing investment returns[9].

This question of returns leads on to the next big issue which concerns the investment methods used by SWFs to achieve the strategic objectives listed above. To consider this issue, it is first useful to consider the basic investment strategies currently pursued by the world's big institutional asset managers (IAMs) such as pension funds, mutual funds and insurance companies who are now the dominant type of investor in the world's asset markets. The central function of IAMs is to use their advantages of size and expertise to generate higher returns subject to a given level of risk, than is possible for their individual clients[10]. To achieve this task on a consistent basis, IAMs tend to divide and arrange their investment portfolios along a risk-return continuum that begins with those portfolios that combine relatively low risk with relatively low returns (cash, government bonds). Next they then move on to portfolios that

[9] See Butt et al (2008)
[10] See Grahl and Lysandrou (2006)

combine average risk with average return (corporate bonds, equity), then further moves on to portfolios that combine high risk with high return (real estate) and then ending with investments in very high risk and return vehicles (hedge funds, private equity). For the large IAMS, hedge funds and private equity groups represent a class of 'alternative investments' which are characterised by the high risk-return ratio. The difference between these two investment vehicles is that where hedge funds tend to specialise in short term speculative trading, private equity firms tend to specialise in the long term management of corporate assets.

SWFs are not as transparent in their in their dealings as are IAMs, as we shall again have occasion to note below , but from the evidence that is available it is clear that they are beginning to simulate the basic IAM strategy of portfolio diversification and risk management. To quote one author: " *Most SWFs follow a traditional allocation approach that balances liquidity needs with a drive for greater returns. Various investment funds make allocations across the spectrum of asset classes, from the least to the most risky*"[11]. Having said this, it is also clear that there are variations in the manner and extent to which different SWFs diversify their investment portfolios in that these variations generally tie in with in the different weights that are assigned to the individual strategic objectives. For example, in the case of the Russian SWF, where, as its name of Russian Stabilisation Fund suggests, the primary objective is to insulate the government budget from the volatility of oil and gas earnings, most of its investments are channelled into foreign government bonds and other fixed income securities[12]. In the case of Norway's SWF, the Norwegian Government Pension Fund, where the two primary aims are savings and stabilisation, the bulk of investments are channelled into a mixture of fixed income securities and equity[13]. At the other end of the spectrum of examples as in the case of the SWFs of Abu Dhabi and Kuwait – the Abu Dhabi Investment Authority and Kuwait Investment

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[11] See Butt et al (2008, p.79)
[12] See Rozavov (2005)
[13] See Hamerman (2008)

Authority respectively – where there is a mixture of all the strategic objectives listed above, we find that investments are spread across the entire risk-return spectrum[14].

As is clear from the above, there are many similarities between SWFs and other investment vehicles but also significant differences. These differences regarding both investment objectives and the investment strategies used to achieve these objectives are basically summed up by the fact that where other investment funds occupy an intermediary position between 'clients' on the one hand and the financial markets on the other, SWFs do not occupy any such intermediary position. Consider the question of objectives. Institutions such as pension and mutual funds, in seeking to maximise returns subject to a given level of risk for their clients, can treat financial objectives such as return maximisation as an end in itself. By contrast, the fact that SWFs are owned by national governments and operated on their behalf, rather than on that of others, means that financial objectives such as return maximisation and/or risk control cannot be treated as ends in themselves but merely as means to secure wider macroeconomic objectives. This is a key point that comes out of the IMF definition of SWFs quoted above: other investment funds typically only have 'financial objectives' whereas SWFs tend to have a combination of 'macroeconomic and financial objectives'.

Now consider the question of strategies. The most important point here is that because pension and mutual funds and other institutional investors manage other peoples' money, they have to match assets with liabilities in terms of maturity and risk structure, a match that places tight constraints on their room for manoeuvre. By contrast, SWFs do not have any explicit liabilities and thus do not face similar tight constraints on the type or mix of assets in which they can invest. As will be seen below, this relative freedom from asset-liability matching constraints can have advantages insofar as it allows for more long-term investment horizons that in turn are conducive to certain macroeconomic objectives, such as domestic growth and development. However, it can also have

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[14] See Butt et al (2008)

potential disadvantages in that the absence of an outside constraint on the composition of assets can lead to laxity of investment behaviour that then results in substantial losses.

2. iii Costs and Benefits of SWFs: The Home Nation Case

Much of the controversy surrounding SWFs centres on the question of the potential threat they pose to the global economy in general and to the advanced market economies in particular, but before reviewing this part of the literature it may be first useful to briefly assess the SWF cost benefit ratio for the countries that are home to SWFs, as this will be important to our hypotheses advanced below. This ratio is invariably positive, for were it otherwise it is hardly likely that SWFs would have been established in the first place. As concerns the benefits side of the equation, these more or less coincide with the strategic investment objectives outlined above: namely those of stabilisation, intergenerational transfer, economic diversification and development and asset management. As concerns the costs side of the equation, these costs broadly divide into four categories.

The first is the potential loss of cultural identity as compared with a situation where surplus government revenues from commodity or non-commodity exports are held in investment vehicles that are directly managed and controlled, as well as directly owned, by the government in question. The advantage of a SWF that is staffed by foreign professional expert asset managers (who are given independent leeway for decision making) is that it is better placed to maximise the risk-weighted returns on global investments. The down side to foreign staffing is that some of the key investment decisions taken may not fit in with the owner's cultural and moral values and codes of conduct. The second potential cost relates to the sheer size of a SWF's assets and their consequent power of attraction for foreign institutions searching for outside funding sources. These costs refer to the possibility that SWFs are seduced into buying assets in Western economies - including real estate, equity stakes or other financial securities – at prices that are well above their market value. It

is not beyond reason to expect certain public or private institutions in the West, dazzled by the sight of the huge accumulating pools of capital in some EME investment funds, to do everything they possibly can to get these funds to invest in their direction on the most lucrative terms to themselves. A good example concerns the case of Qatar that purchased from the UK's Ministry of Defence the Chelsea Barracks, former home to the Coldstream Guards, for the substantial sum of $1.85 billion, a sum that was said to be more than three times the then market value of the 12.8 acre site[15]. A more recent and more general example is the case of the large volume of funds that have been channelled into the Western investment banks. Now the Western governments were more than happy to see these heavy investments happen in the wake of the financial crisis of 2007-8 because it helped to relieve them of the financial burden of supporting their banks[16]. However, it is far from clear that the SWFs, particularly those from the Arabian Gulf countries, will benefit from all of these investments given that many of the investment banks are sitting on huge amounts of subprime backed securities that are completely worthless. Although it is possible to suppose that the SWFs do eventually get back their money from the investment banks over the longer term, the fact that they may come out even after ten or twenty years or so is poor compensation for the loss of revenues that could have been generated through investments in more secure and profitable businesses[17].

The third cost represents the inverse of one of the benefits of SWFs, the stabilization benefit. Where diversified investments across global asset classes and geographies may help 'smooth out' the gyrations in commodity export prices and thus in the domestic government's budget revenues, the potential downside to global investments is that it exposes the asset portfolio to the gyrations of the global economy. That this is indeed a potentially serious cost has become recently clear given that the gyrations in the global economy have become particularly acute since the outbreak of the financial crisis in 2007. The fourth potential cost of SWFs overlaps with the second in that it again

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15 See Raphaeli and Gersten (2008)
16 See Epstein and Rose (2009) and Mezzacapo, (2009).
17 See Behrendt (2009)

comes down to a question of size of assets but this time linked in with the question of transparency. If on the one hand size of assets, coupled with the fact that unlike other private investment vehicles SWFs do not have liabilities that have to be matched with assets, makes SWFs attractive to foreign institutions seeking funds, on the other hand, these same considerations may make other foreign institutions, particularly regulators, so concerned about the impact of SWF investments that they adopt restrictive measures that then narrow down the SWF's room for manoeuvre. Transparency is a key issue here in that the greater the lack of transparency regarding a SWF's size of assets, investment strategy and so on, the greater the fear on the part of foreign regulators about SWF intentions and the greater the consequent backlash[18].

2.iv The Potential Global Costs of SWFs

As noted above, although SWFs have existed for decades it is only in the past few years that they have attracted a great deal of attention. While attention amongst academics and government politicians was gradually building up after 2002 in parallel with the growth of SWF assets and capital inflows from Emerging Market Economies into the US and West Europe, a portion of which had SWFs as their source, that attention reached a qualitatively new level after the publication of an article by Lawrence Summers in the Financial Times on July 30, 2007. This article aroused huge interest because Summers straddles the academic and political worlds: A Harvard economics professor, he has also been adviser to the Bush administration and more recently to the Obama administration. Although he claims that his article is not aimed to "*propose policy*" he does suggest that the "*risks*" posed by SWFs "*would be greatly mitigated if SWFs invested through intermediary asset managers, as is the case with most institutional pools of capital such as endowments and pension funds*". This suggestion seems strange as it fails to appreciate the fundamental distinction between SWFS and 'intermediary asset managers' in that the latter have purely financial objectives

[18] See Rose (2008); Nageswaran (2008); Schubert and Barenbaum (2009)

i.e to maximise risk-adjusted returns for clients, while the former have additional macroeconomic objectives such as growth and development: to ask governments, particularly those of EMEs, to behave like endowments and pensions funds and other client groups and place all their surplus funds with intermediaries, is to ask them to disconnect the vital link between these surplus funds and their wider macroeconomic objectives, which hardly seems a feasible request. However, the reason why Summers put forward his suggestion comes down not only to economic considerations, i.e to eliminate the differences between narrow financial objectives and broad macro ones, but also to political considerations. To quote Summers:

"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. They may want to see their national companies compete effectively, or to extract technology or to achieve influence".

This view concerning the potentially harmful risks posed by SWFs to the logic of the capitalist system has been echoed both by other academics and policy advisors[19], and indeed by many Western government leaders, but before reviewing some of these positions it is first useful to make clear and explicit the implicit assumptions about the nature of the current global capitalist system shared by the critics of SWFs.

There has recently much debate about what the 'globalisation' process witnessed over the past three decades or so actually involves[20]. However, there appears to be a consensus that at the very minimum it involves the closer interdependence between nationally embedded economic activities to the point where the world economy becomes a genuinely integrated economic space. Broadly speaking, the key drivers behind global integration fall into three categories: political-economic; technological; institutional. The first of these categories refers to the stretching and deepening of

[19] See Cox (2007); Garten (2007)
[20] For an overview of this debate see Held et. .al (1999) or Hirst and Thompson (1999).

capitalist market principles: stretching in the sense that with the collapse of the central planning systems in the former communist bloc countries, capitalist market relations have now become (with a few remaining exceptions) globalised in the geographical sense, and deepening in the sense that even in the capitalist countries the role of the interventionist state has been restructured ('hollowed out') so as to give more room to private activities and market principles (a restructuring manifested in particular in the wave of 'privatisations' that occurred in West Europe after 1980). The second category refers to the accelerating pace of technological change and innovation that has occurred in the areas of information and communication and of transportation and distribution with the result that the world has become a more compressed and accessible space[21]. The third category refers to the introduction and harmonisation of new rules and regulations, norms, codes and standards for behaviour introduced by governments in their domestic economies (from 'interventionist' states, nation states both East and West have become 'regulatory' states) and by supra-national or international bodies such as the IMF, OECD, and BIS at the global level.

As stated, the above developments in the political-economic, technological and institutional spheres have served to create a more closely integrated world market space both in terms of physical commodity space (it is estimated globally harmonised production standards cover about 70-80% of all material goods and services) and in terms of financial commodity space (globally harmonised standards for disclosure and transparency, and consequently for pricing of financial risk now cover most financial assets, which is one of the major reasons why the world stock of financial claims on output streams has been able to rise at rate several times higher than the rate of output growth in recent decades). However, there appears to be a widely held assumption that the capitalist world system constitutes not only an integrated economic and financial space in the sense of a convergence in behaviour patterns and in the rules and standards binding on behaviour but also an evenly balanced and neutral space in the sense that in the postcolonial and post-communist eras

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[21] See Harvey (1989)

there are no more divisions or inequalities between core and periphery, between centre and margins. Given this assumption that global capitalism approximates not only in the imagination but also in reality a smooth and undifferentiated space of equilibrium where all occupants act according to the same commercial criteria, to the same culturally unmarked and neutral rules of exchange, one can then understand why the entrance of SWFs into this space are viewed as eruptions, as disturbances that shake and undermine the prevailing equilibrium and even threaten the very existence of the capitalism system. To again quote Lawrence Summers:

"A signal event of the past quarter-century has been the sharp decline in the extent of direct state ownership of business as the private sector has taken ownership of what were once government-owned companies. Yet governments are now accumulating various kinds of stakes in what were once purely private companies through their cross-border investment activities....To the extent that SWFs pursue different approaches from other large pools of capital, the reasons have to be examined. The most plausible reasons – the pursuit of objectives other than maximising risk-adjusted returns and the ability to use government status to increase returns – are also most suspect from the viewpoint of the global system."

The concerns raised by Summers were subsequently treated at greater length by several other academic researchers and policy advisers including Edwin Truman of the Peterson Institute who has been influential in helping to shape international policy co-ordination in regard to SWFs, more on which below. In an article published in August 2007, Truman makes clear his acceptance of the notion that the global capitalist system is an integrated and evenly balanced space and that the entrance of SWFs into this space is potentially destabilising: as he puts it, " *Large cross-border holdings in official hands are at sharp variance with today's general conception of a market-based global economy and financial system in which decision making is largely in the hands of numerous*

private agents pursuing commercial objectives"[22]. Having made this statement, Truman goes on to note that the potential threat to the 'market-based global economy' posed by SWFs need not be a real one considering that they share many similarities with private investment institutions. To quote: *" Government foreign investment activities have many similarities in their objectives, management, and motivations with activities of private-sector entities. In particular, the objectives and activities of some sovereign wealth funds do not differ significantly from those of pension funds found in the private or public sector or investments by firms that manage private portfolios of assets that serve comparable purposes"*[23]. Given Truman's recognition of the various overlaps and similarities between SWFS and other investment vehicles such as pension funds, why then does he echo the alarm raised by Summers regarding SWFs? The answer is to be found in three interlinked issues that he raises: transparency and accountability; range and content of objectives; and impact on the global economy and global polity. Each of these issues is considered in turn.

a) Transparency

Truman has observed, as have several other commentators[24], that SWFs have an extremely poor record regarding transparency of their operations and governance structures, the principle reason being that unlike private-sector entities that are subject to national regulation SWFs are under no regulatory obligation to disclose information to shareholders or government agencies. Some evidence of the comparative lack of transparency of SWFs has been provided by the Sovereign Wealth Fund Institute which measures worldwide SWF transparency and investment strategy using the Linaburg-Maduell Index that ranks transparency from a scale of 1 (lowest transparency) to a scale of 10 (highest transparency) see figure 1 and by Standard Chartered bank that also ranks transparency according to a similar scale, see figure 2. Although, the results are generally the same,

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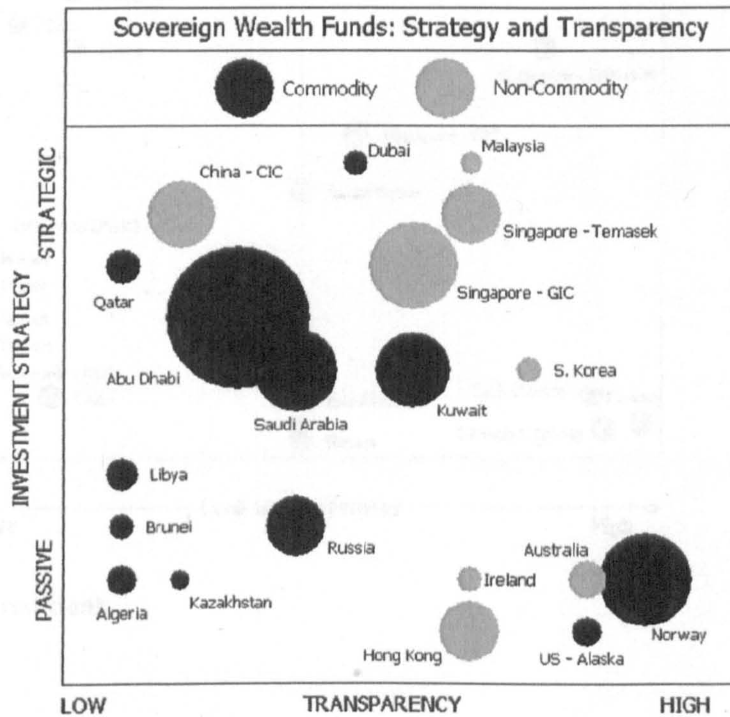
[22] Truman (2007, pp.3-4)
[23] Ibid.

[24] See Cox (2005); Garten (2007); Markheim (2008)

there are some differences, including, notably, that the UAE's SWFs appear to be more strategically inclined investors than China's CIC according to the Standard Chartered's index while the Sovereign Wealth Fund Institute's index shows the opposite.

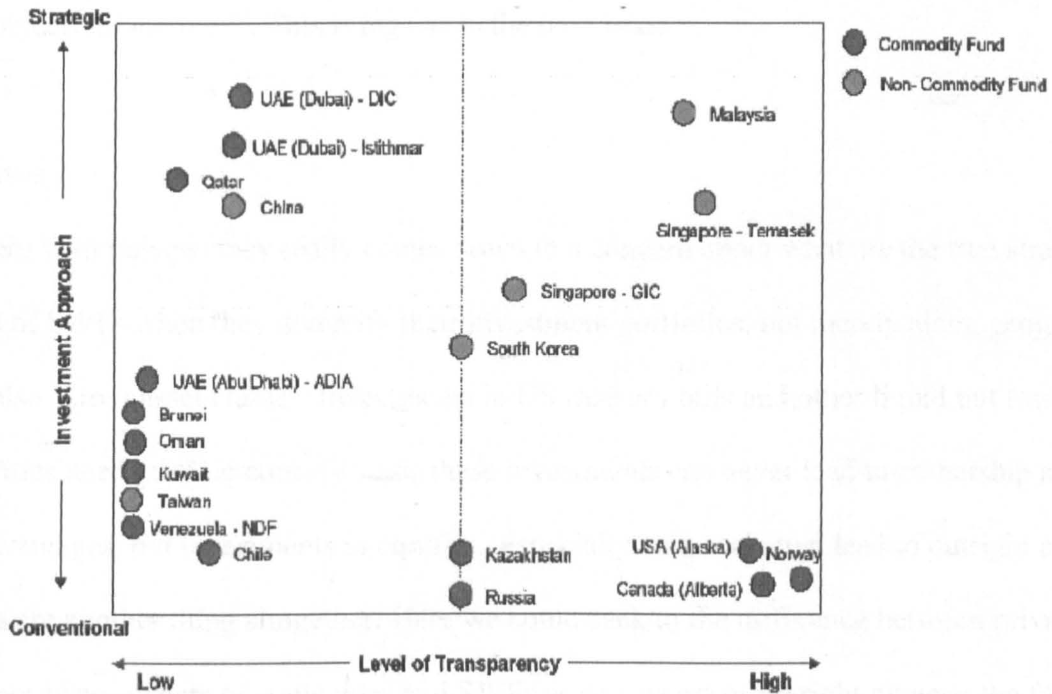
Figure 1



Source: Sovereign Wealth Fund institute

Figure 2

Sovereign Wealth Funds: Strategy and Transparency (2nd version)



Source: Standard Chartered Bank

Truman recognises that "*governments are understandably concerned about not compromising their room to manoeuvre their international investments. They want to protect their sovereignty, confidentiality and capacity to make strategic investments*", but, Truman goes on to say, *"once a government seeks to operate outside its national borders, then it no longer is 'sovereign' in most respects"*[25]. Several commentators have drawn attention to the fact that some types of private investment vehicles have also not been subject to strict demands for transparency and disclosure, and that therefore it is hypocrisy to target the SWFs alone in this respect[26]. However, this line of argument no longer holds because since the subprime crisis hedge funds and other alternative investment vehicles have been made subject to tougher transparency requirements[27]. In any case, as some commentators have argued, there is still a difference between hedge funds and SWFs in that

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25 Truman (2007, p.5)
26 See El Erian (2008); Avendano and Santiso (2009).
27 See Lysandrou (2011)

the former are always constrained to make profits for their clients while SWFs are under no such constraints and can afford to suffer losses even in the longer term provided other, non-political strategic objectives are met[28]. This brings us to the next issue.

b) Objectives

The concern with transparency really comes down to a concern about what are the true strategic objectives of SWFs when they diversify their investment portfolios, not merely along geographical lines but also across asset classes. Investments in US treasury bills and other liquid but low yield debt securities need raise no concern since these investments can never lead to ownership and control advantages, but investments in equities, especially on a scale that lead to outright control of companies are another thing altogether. Here we come back to the difference between private shareholders as co-owners of companies and SWFs as co-owners or outright owners: the former typically seek to maximise 'shareholder value', but the latter may have other criteria in its 'investment decision-making calculus'[29] . They may want to secure sensitive strategic assets in the infrastructure industries, such as media and telecommunications, seaports and energy and use these assets in a way that is contrary to the security of Western nations; [30]or they may want to obtain inside knowledge about how companies operate abroad and then use this knowledge to improve the competitive edge of their own national companies[31]; or they may use their position as shareholders to remove a corporation's management or put pressure on that management to make decisions that are conducive less to maximising the share value of that company than to maximising the competitive position of another of the SWFs' companies[32]; or, if prevented from investing in

28 See Rose (2008); Hemphill (2008)
29 Hemphill (2008, p10)
30 See Lyons (2008); Luft (2008);
31 See Teslik (2008)
32 ibid.

defence-related industries, they may want to invest in other forms of 'dual-use' (civilian and military) technologies and thus acquire military advantage[33].

c) Impact

Turning finally to the question of impact, Truman and others hypothesise that SWFs "potential to disrupt financial markets" links in directly with their size, their lack of transparency and "the risk that political objectives might influence their management". In elaborating on the channels through which SWFs might have a detrimental impact on the market-based global economy let us again revisit the main assumptions as to how this economy operates. In his testimony to the US Senate banking Committee in July 2008, Cox argued that:

"the combination of the growing governmental (and potentially political) influence over capital market flows that sovereign wealth funds portend, together with the funds' lack of transparency, provides challenges to a regulatory system premised on free markets, the free flow of information, and investor incentives based on profit and loss"[34].

Here the idea of a uniformly equal, neutral and unbiased economic space is posed in terms of 'efficient' capital markets theory, namely, the theory that if left to operate without outside interference[35], capital markets will allocate resources efficiently on the basis of price signals that reflect all publically available information. Transparency is presumed to be the key factor here in that it allows market participants to make investment decisions in a rational and consistent manner where these decisions in turn impact on prices, which then produce other investment decisions and so on in a continuous, feed-back loop process. The claim is that SWFs potentially disrupt this efficient process "*premised on free markets*" and " *the free flow of information*" because of their

[33] See Markheim (2008)
[34] Quoted in Badian and Harrington (2008, p.55)
[35] Kurlantzick (2008, p.65)

lack of transparency and mistrust of their actions by other agents operating in the system. Thus Kurlantzick states that:

"Because of their secretiveness and closed shop management style, the SWFS could buy up assets across the world without other investors knowing what they are doing, adding massive uncertainty and volatility to financial markets already struggling to understand investments by private equity, hedge funds, and other new actors".

In a survey conducted by the Norton Rose Group, many private-sector agents believe that SWFs are motivated by political and not profit- and loss criteria. To quote: "*A majority of SWFs regarded the "highest economic return" as their most important investment criterion; non-SWF respondents were divided as to whether SWFs are primarily driven by returns*"[36]. Even without ostensible political motives, SWFs may still disrupt financial markets simply because when making investment decisions, the opacity of these decisions may not be sufficiently or accurately taken into account by other agents. To quote Hemphill "*Since SWFs are often of significant monetary size, concentrated, and non-transparent, actual or perceived shifts in fund asset allocation can cause adverse market volatility*".[37] The problem of adverse impact, however, is compounded when there are political objectives attaching to fund allocations. To quote Badian and Harrington:

"Investments may be politically motivated, leading to market inefficiencies. government-controlled companies and investment funds may not always direct their affairs in furtherance of investment returns. If such funds use business resources in pursuit of other government interests, what will be the effect on the pricing of assets and allocation of resources in the domestic economies of other nations?"[38]

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[36] Norton Rose LLP (2008, p.3)
[37] Hemphill (2009, p.556).See also Dohner (2008)
[38] Badian and Harrington (2008, p.55)

2.iv The Potential Global Benefits of SWFs

In response to the alleged threat posed by SWFs to the economic interests of the US and other advanced market economies, some academics have proposed that certain tight restrictions be imposed on these investment vehicles. Thus Gilson and Milhaupt have proposed that the equity shares in companies held by SWFs be stripped of their voting rights; the result of this initiative, they go on to argue:

> *"is to separate control from investment value; the expected returns to a foreign sovereign equity investor remain identical to those of other shareholder, while losing direct influence over management through voting. Sovereign investors with purely financial motives will still invest; the proposal does not raise the cost of their investments. Sovereigns seeking strategic benefits from equity investments, however, will find SWFs to be a less attractive vehicle by which to achieve their ends"*[39].

Others, for example Lawrence Summers[40] , have proposed that SWFs not be allowed to invest directly in firms but only indirectly via professional asset managers. As the US SEC Chairman noted when also advancing this proposal *"to the extent that sovereign investing is conducted trough professional management of the funds, this could help to de-politicise the process both in practice and in perception"*[41]. Mezzacapao notes that *"the mandatory use of external asset managers may deliver additional advantages for SWFs(notably, through producing best risk-adjusted returns), without imposing significant compliance costs or disrupting their operations"*[42]. Another alternative proposal advanced by Aizenman and Glick is that SWFs be limited to investing in index funds, the idea here being that indexation presupposes dispersion of

[39] Gilson and Milhaupt (2008, pp.1345-6)
[40] See also Thoma (2008)
[41] Cox (2007p.4)
[42] See Mezzacapao p. 46 who quotes Keller (2008)

shareholdings across the companies that comprise the index and thus that there can be no concentration of shareholdings in any one company.

These various proposals have not received any substantial support, basically on the grounds that they all raise dangerous precedents that if followed through, could pose more problems than they resolve. For example, the Gilson –Milhaupt proposal to strip equities held by SWFs of their voting rights, which is portrayed as a 'minimalist' response to the 'new mercantilism', has been sharply criticised by Epstein and Rose as an 'extreme' measure. Paul Rose argues that this proposal *"negates the essential nature of equity investment"*,[43] while Edwin Truman, who is no friend to SWFs and has pressed for SWF regulation as will be elaborated on below, has pointed out that this proposal, if applied throughout the US, would *"disenfranchise as much as several trillion dollars of investments by US state and local government pension funds"*[44]. Epstein and Rose argue:

"against imposing any additional burdens on investments by SWFs in the United States...a policy of watchful waiting is preferable to any immediate effort to impose special restrictions on SWFs...the nightmare scenarios painted by SWF critics often involve activities that would be caught by existing laws, either as they relate to national security or to various forms of business regulation under the securities and antitrust laws"[45].

The overriding reason why the above proposals have not commanded substantial support is that they do not take sufficient account of the potential benefits of SWF investments. Other commentators have argued that the threat posed by SWFs has been grossly exaggerated and that on the contrary they can be an important stabilising force in the global financial and economic

[43] Rose (2008, p.139)
[44] Truman (2008, p.12))
[45] Epstein and Rose (2009, p.111)

system[46]. Tamara Gomes[47] has listed four major ways in which SWF can impart a stabilising influence:

1) Portfolio diversification and risk sharing: by diversifying out of customary reserve instruments as well as established reserve currencies, SWFs are accepting a higher level of risk than traditional foreign exchange reserve investments. This higher risk tolerance can facilitate international risk sharing, as SWFs move into different classes of assets.

2) Provision of liquidity: Large investors can play a stabilising role by providing liquidity to financial markets. One of the commonly cited advantages of SWFs is that, due to their large scale, they are able to inject liquidity into global capital markets, thereby supplying capital to those who require (or demand) it. At the same time, their increased risk-appetite allows them to provide capital to entities that risk-averse investors would shy away from.

3) Long term investment horizon: SWFS are focused on long term returns as well as other positive externalities that will arise from these investments, such as market access. Additionally, SWFs are not highly leveraged and have very little capital adequacy requirements, unlike other large institutional investors such as hedge funds. The focus on long-term returns and the lack of specific capital requirements will decrease the risk of a rapid liquidation of investments and the ensuing impact on financial instability.

4) Facilitate unwinding of global imbalances: US treasury yields were falling in the early to mid-2000s due to large inflows from the EMES and particularly from East Asia for reserve holding purposes; however, *"significant amounts of money that would normally be*

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[46] See, for example, Arreaza et.al (2009) and Avendano and Santiso (2009)
[47] Gomes (2008)

invested by the monetary authorities have been and will continue to be transferred to SWFs. Given that SWFs invest significantly more in equities and other assets than in fixed-income securities, their investments may contribute to a gradual reversal of this effect"[48]

Tamara Gomes goes on to concede that the activities of SWFs can potentially disrupt global financial stability in some cases by virtue of the very same characteristics of these activities as listed above:

1) Triggering herding behaviour: SWFs concentrate large sums in the hands of a very few players and invest in higher-risk assets than either a monetary authority or an average individual would do; thus the presence of a large player with a high-risk appetite can induce market behaviour that could lead to a negative outcome; that is, SWF investment actions such as the sudden sell-off of large amounts of stock can induce 'herding' behaviour which then has a destabilising impact on asset prices.

2) Lack of transparency and short term volatility: SWFs have the potential to destabilise small markets by inducing other traders to mimic their strategies, leading to greater buying or selling on one side of the market. The impact of this behaviour may be exacerbated by the lack of transparency surrounding the investments and strategies of SWFs. The lack of transparency about the holdings of SWFs introduces an element of uncertainty into markets.

3) Non-economic objectives and financial protectionism: while it is not necessarily a direct risk to international financial stability, some observers are concerned about a protectionist backlash against SWFs that would restrict cross-border investment and thus slow down economic growth. The reaction of Western states to SWF investments may lead to the adoption of barriers, preventing the free movement of capital. This policy response may affect not only SWFs but also other institutional investors, such as national pension funds. While the leading

[48] Gomes,ibid.p.9

SWFs have stated that they are long-term, passive investors, they offer little transparency concerning their investment strategies and corporate governance structures. This lack of transparency leads to concerns regarding political motives for investing. Increasing transparency would alleviate these concerns and provide for an atmosphere that is more conducive to foreign investment.

Gomes' conclusion is that the positive benefits that SWFs can confer on the global economic system outweigh any potential negative effects. This conclusion is shared by Epstein and Rose, by Arreaza, Castilla and Fernandez and by Shubert and Barenboim who state that *"generally speaking, Sovereign Wealth Funds bring far more in benefits, to all interested parties, than they are likely to bring in costs"*[49]. However, what is interesting to note is that while Gomes and others reject the claim that SWFs impose more costs than benefits on the global financial system, they all nevertheless believe that these government vehicles should be subject to certain internationally agreed rules and standards for behaviour. The principle reason that they do so is that they generally subscribe to the view that the global capitalist system does essentially represent a level playing field governed by a set of neutral and culturally unmarked rules of the game. It is because they accept this idea as their framework of analysis that, despite the fact that they do not believe that SWFs are in themselves a major or direct threat to global financial stability, they insist that SWFs be made to obey these same rules of the game. The key point, as made clear in Gomes' list of potential dangers posed by SWFs, is that their lack of transparency can provoke a protectionist backlash amongst Western governments which then in turn does even more damage to the stability and balance and openness of the global financial system. Ultimately, it is this 'indirect' threat to the system that runs via the negative reaction of Western governments rather than the 'direct' threat posed by SWFs, which is the single biggest driver

[49] Shubert and Barenboim (2009,p.) Similar conclusions have been reached by Kirchner (2009)

behind the establishment of a set of principles governing SWFs' behaviour. To Quote Arreaza et.al.:

" We believe that it is important for SWFs to follow sound corporate governance policies that generate an equal amount of confidence in countries of origin as well as in recipient countries, dispelling fears that may lead to undue financial protectionism. This will guarantee that these funds attain the goals they were created for and allow recipient nations to benefit from this new source of funding"[50].

There is ample evidence of Western governments' negative reaction to the growth of SWFs in recent years, and this is to be found in their own initiatives in monitoring and regulating the activities of SWFs in their domestic economies. For example, Canada undertook a review of its Investment Act in 2007 to see whether there should be an increased scrutiny of those takeovers that involve companies with "unclear corporate governance and reporting" and which use "non-commercial objectives" in their investment decisions. Germany's Chancellor has requested that the European Union "protect companies from unwanted foreign takeover[51]" while Germany's Finance Minister has stated that Germany will defend its companies from takeovers by SWFs that belong to governments whose "social and political systems are not exactly moderate[52]". France's President Sarkozy, speaking before the European parliament in October 2008, proposed that Europeans establish their own SWFs to protect strategic industries from foreign takeover[53]. In the US, concerns over the increasing presence of SWFs have led to calls to strengthen the monitoring and regulatory role of the Committee on Foreign Investments in the United States (CFIUS), an entity first established in 1975. The UK takes a relatively more relaxed and flexible position[54], but even so the Chancellor of the Exchequer argued recently that

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[50] Arreaza et.al. (2009,p.26)
[51] Quoted in Raphaeli and Gersten (2008, p.5)
[52] Quoted in Raphaeli and Gersten (ibid.)
[53] See Behrendt (2009, p.6)
[54] See, for example, Gieve (2008)

all investors, including SWFs, should respect the rules of the market in relation to transparency and governance and to the conditions of mutual reciprocity[55].

In view of the concerns regarding SWFs raised by politicians in the advanced market economies and the threats of protectionist actions, Benjamin Cohen has coined the now often used phrase the 'Great Tradeoff' to describe the stark choice between *"on the one hand, the world community's collective interest in sustaining the openness of capital markets; on the other hand, the legitimate national security concerns of individual host countries"*[56]. Cohen's phrase encapsulates the majority body of thinking regarding the current global capitalist system and the advent of SWFs as key players in that system: as we say, while the majority view is that the direct costs to the system arising out of SWF foreign investments activity are less than the direct benefits, the indirect costs arising out of recipient countries' national security concerns and threatened retaliatory protectionist actions are substantial indeed. This is why again and again we find commentators pressing SWFs to conform to certain international standards for transparency, governance and risk management when making their foreign investments simply in order to allay recipient countries' fears. Thus Gomes concludes her article on SWFs with the statement that *"a clear articulation of investment goals, greater transparency, improved financial reporting, and higher governance standards would go a long way to alleviate concerns regarding the non-commercial motivations of SWFs"*[57]. Similarly, Beck and Fidora conclude their survey of the costs and benefits of SWFs with the suggestion that *"SWFs be sufficiently transparent on their size, asset allocation and investment motives so as to assuage concerns about potentially distorting the effects of SWFs and to reduce uncertainty in financial markets"*[58].

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[55] See Behrendt (2009); Hamerman (2008)
[56] Cohen, 2009, p.
[57] Gomes (2008, p.15)
[58] Beck and Fidora (2008,p.358)

The various suggestions and proposals made by academics that the appropriate response to SWFs should be to make them subject less to specific bans and restrictions than to general and multilateral set standards for behaviour appear to have found favour with the governments of the leading market economies. A good example is the call made by the G-7 Finance Ministers at a summit in 2007 that SWFs comply with best practices in such areas as governance, risk management, transparency and accountability. One result of this call was the issuance in October 2008 of the OECD's " Declaration on Sovereign Wealth Funds and Recipient Country Policies". Another, and possibly more important result was the issuance, in 2008, of the Washington based International Monetary and Financial Committee's voluntary code of conduct: "Sovereign Wealth Funds: Generally Accepted Principles and Practices". These principles are known as the "Santiago Principles" named after the venue of the last meeting of the international working group that drew up the principles.

2.vi The Santiago Principles

On May 1st, 2008, an International Working Group of Sovereign Wealth Funds (IWG-SWF) comprising of 26 IMF member countries with SWFs was established to develop a voluntary code of conduct for SWFs. It should be noted that although the G-7 countries had asked the IMF as well as the OECD to draw up a code of conduct for SWFs, the IMF decided against unilateral action on this matter in favour of a more cooperative approach involving member IMF countries. The form of this approach, whereby the IMF facilitated and coordinated the work of the IWG-SWF rather than dictate terms to this body, ties in with the 'voluntary' spirit of the Santiago principles. The set of 24 Generally Accepted Principles and Practices (GAPP) adopted by the IWG-SWF in October 2008 basically divides into three parts: (1) the legal framework of SWFs, their objectives and coordination with macroeconomic policies; (2) institutional framework and

governance structure of SWFs; and (3) an investment and risk management framework. (See Appendix 1 for the full list of the principles)

According to Mezzacapo the Santiago principles represent a *"balanced and proportionate"*[59] international regulatory response to the advent of SWFs as important players in the global financial system. Recall the basic dilemma confronting national policy makers in the advanced economies: on the one hand, to impose 'hard' regulatory constraints on SWFs risks endangering the smooth and efficient operation of the global financial systems; on the other hand, not to impose any constraints means risking potential threats to national security and national economic interests more generally. For Mezzacapo, the Santiago principles resolve the dilemma through its *"two-layer regulatory approach" to SWFs of "self-regulation within a statutory framework"*. As he puts it, this regulatory framework, which is also broadly in line with the European commission's own approach to SWFS:

"appears to confirm the idea hereby suggested that most of the issues raised by SWFs (namely, misallocation of resources due to their lack of transparency, suspicions and uncertainty surrounding their strategies and investment motives) may be more efficiently tackled by market participants themselves through development of reasonable and appropriate 'soft law' measures (i.e. voluntary codes of conduct, guidelines and best practices for SWFs and recipient countries), if necessary complemented with a 'light' regulatory intervention aimed (and limited), at least in the first instance, at minimising transaction and 'bargaining costs between SWFs (interested in secure and liberal access to industrial-country markets for their capital) and other stakeholders(concerned about SWFs objectives and operations)"[60].

[59] Mezzacapo (2009,p.42)
[60] Ibid. p.64

Not all commentators agree that the Santiago principles necessarily represent an optimum solution to SWF regulation. Drezner makes the point that there is a real possibility *"that the Santiago meetings produced a 'sham standards' outcome in which principles are vaguely articulated but not codified or implemented"*[61]. He goes on to quote one official involved in the IMF-IWG negotiations who predicted that the GAPP would be *"toothless and devoid of anything other than motherhood and apple pie"*. While Drezner does not believe that the GAPP principles are necessarily a failure, he does warn that their voluntary or soft-law nature means that there is a possibility that they will be honoured only in the breach, in which case *"the outcome is a hypocritical regime in which sham standards are created*". In contrast to Drezner and other sceptics who question whether the GAPP are sufficiently stringent, other commentators criticise the GAPP for being too simplistic in their approach. Thus Backer (2009) argues that the existing "formally public/functionally private model" underpinning SWF regulation does not capture the multidimensional qualities of contemporary organisations such as SWFs and MNCs: where the latter can exert cross-border 'regulatory' power, the former participate in cross-border market transactions as 'private' actors. Similarly, Pistor (2009) contends that the current regulatory regime does not take sufficient account of the changed relationships in global finance that undermine clear regulatory distinctions "between public v private, regulation v firm level governance, and stakeholding v supervision." Gelpern also argues that current SWF regulation fails to adequately take account of the complex nature of these organisations and of their multiple governance concerns and, what is more, fails to rank the four axes of accountability characterising SWFs (public internal, private internal, public external, private external) in any order of hierarchy.

We shall broaden our assessment of the Santiago principles in later sections, but here we first want to take issue with the misleading ideas that they are either too soft or too simplistic.

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[61] Drezner, (2008, pp.15-16)

However SWFs are defined, the one fact that cannot be ignored is that they are government owned vehicles which ought to suggest that political considerations must enter somewhere into the equation. Simple logic dictates governments must have political motives because governments in the final analysis are political institutions. What this means is that the Santiago principles cannot be too soft or simplistic because they directly confront the above logic: they recognise that SWFs are government owned vehicles and they recommend that they be allowed to operate as such in the global financial system but only on the basis of pursuing purely commercial objectives and explicitly rejecting any 'political' or 'geo-political' objectives. Thus in the commentary explaining GAPP 2 - The policy purpose of the SWF should be clearly defined and publicly disclosed – the paragraph begins by stating that a clearly defined purpose facilitates formulation of appropriate investment strategies based on economic and financial objectives. However, it then goes to state that *"A clearly defined policy purpose will also ensure that the operational management of the SWF will conduct itself professionally and ensure that the SWF undertakes investments without any intention or obligation to fulfil, directly or indirectly, any geo-political agenda of the government"*[62] . Again, in the commentary explaining GAPP 6 – The governance framework for the SWF should be sound.._it is stated that *"the SWF's operational management should be conducted on an independent basis to ensure its investment decisions and operations are based on economic and financial considerations consistent with its investment policy and objectives, in effect free of political influence or interference"*[63]. Finally, in the commentary explaining GAPP 21 – the SWF's exercise of its ownership rights – it is stated that *"to dispel concerns about potential noneconomic or nonfinancial objectives, SWFs should disclose ex ante whether and how they exercise their*

[62] IWG-SWF (2008, p.12)
[63] ibid.p.15

voting rights...To demonstrate that their voting decisions continue to be based on economic and financial criteria, SWFs could also make appropriate ex post disclosures"[64].

As is clear from the above, it was the West, the G-7 countries in particular, that set the agenda for SWF regulation in 2008 onwards. Countries with SWFs may have been part of the IWG-SWF negotiations that led to the Santiago principles, and the IMF may have only played a co-ordinating or convening role, but the tone and content of the principles – repeatedly emphasising the point that SWFs operate only according to economic or financial criteria and expressly reject any political or other non-commercial objectives - indicate that these principles reflect G7 assumptions and priorities rather than those of the EMEs where most SWFs are based. Following the publication of the Santiago principles the International Working Group was succeeded by the International Forum of Sovereign Wealth Funds (IFSWF), a body which Gelpern (2010) describes as *"the soft institutional counterpart to the emphatically soft law of the Santiago Principles"*[65]. That these principles are not 'emphatically soft' but emphatically biased (favouring G7 concerns and priorities) and emphatically interventionist (requiring SWFs to deny their political nature as a precondition for operating in the global economy) would appear to be shown by the extreme reluctance on the part of many EMEs that are home to SWFs to adopt the Santiago principles in full. In a recent report outlining the current state of Santiago Principles implementation, Behrendt (2010) concludes that this process has been highly "uneven". To quote the conclusion in full :

" a small group of SWFs, predominantly from democratic countries, shows a high degree of commitment to the principles. A second group shows partial implementation, and a third group, mainly from the Gulf Arab region, has yet to reach satisfactory implementation levels. The Santiago Principles and the commitment of their sponsors – some of the biggest SWFs – is an

[64] ibid. p.23
[65] Gelpern (2010, p.5)

important test for the viability of new forms of global governance. However, their sluggish implementation risks devaluing the Principles, thereby increasing SWFs' political risk exposure". [66]

As already suggested, we will return to a broader assessment of the value of the Santiago principles below. However, for the present it should be stated while I recognise that the initiative for the principles came from the advanced market economies and their governments, and thus reflected their particular concerns and their overall agenda, the 'voluntary' form of the principles does reflect the fact that governments from the EMEs did have an important input that resulted in a compromise. One of the key government authorities was that of Abu Dhabi who gave permission to its Abu Dhabi Investment Authority (ADIA) to act as co-chair of the IWG-SWF meetings that drew up the Santiago principles in 2008. In its position as co-chair, ADIA more than any other EME-based SWF ensured that the principles were 'voluntary' in a double sense: not only could SWFs choose not to comply with these principles – although ADIA insisted that membership of the subsequently formed IFSWF was conditional on compliance – but they could choose how to interpret the degree to which they make information available about asset size, geographical allocation and certain other investment decisions. While the Santiago principles drew the criticisms that they are "*toothless and devoid of anything other than motherhood and apple pie*", their doubly voluntary nature nevertheless represented an important compromise in reaching an agreement on what was a Western initiated 'best practice' agenda for SWFs. How important that compromise was, will be seen below.

[66] Behrendt (2010, p.)

2.vii The 'Oxford' School of Thinking on SWFs.

So far in this survey of the current literature on SWFs, attention has been concentrated on the different views and opinions about the role, function and impact of SWFs that have nevertheless been expressed and developed within the same general analytical framework, namely, one that rests on certain shared points of departure and preliminary assumptions concerning the global economic environment. In the very recent period, a body of work on SWFs by researchers based primarily although not exclusively in Oxford University - Gordon Clark, Ashby Monk, Adam Dixon - has challenged this analytical framework. In what follows, we review the main features of this challenge before going on to indicate the principal ways we intend to build on this challenge as a first step towards establishing certain new hypotheses concerning SWFs and their operations, with particular reference to the SWFs based in the United Arab Emirates.

The central challenge, developed by Clark et al, concerns the 'form' and 'function' of SWFs: by 'form' they refer to the rules that relate to the organisational and governance structure of SWFs, in other words, *"to who is responsible for investment decision-making*", and by 'function' they refer to that set of rules that relate to the SWFs' objectives and methods of achieving those objectives, or, to put it more generally, that *"relate to the conceptual foundations of investment practice"*[67]. Their basic argument is that the form and function of SWFs as defined above: *"may not be stable over the long-term; the challenge facing SWFs is, in part, about transcending traditional forms of investment management in favour of a genuine commitment to long-term investment in the interest of both the SWF and the sovereign. We suggest, in fact, that transcending the current paradigm may necessitate the transformation of the 'form' of SWFs such that they become strategic investors rather than portfolio investors, knitting together their sponsors' geopolitical interests with investment management"*[68].

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[67] Clark and Monk (2010, p.4)
[68] ibid.

The reason given for the likely transformation of SWFs relate to certain pressures and constraints associated with the globalisation process, but before detailing these it should first be noted that Clark and Monk do accept that, as things stand, SWFs " *owe their form and functions to the hegemony of Anglo-American finance over the late 20th and early 21st centuries*"[69]. In more specific terms, the current SWF form, they contend, is "an intellectual edifice perched on three pillars":

i) modern portfolio theory: this theory holds that since risk divides into idiosyncratic or diversifiable risk and systematic or non-diversifiable risk, an efficiently managed investment portfolio in the sense that risk is minimised for a given level of returns will be one that includes a sufficient range of securities as to reduce diversifiable risk to zero leaving only systematic risk in the portfolio;

ii) efficient markets hypothesis: this hypothesis argues that markets are generally speaking efficient information processing systems and that therefore the prices of securities tend to reflect all publicly available information about corporations (this is in fact the semi-strong version of EMH);

iii) "asset allocation is deemed the crucial strategic decision when setting funds' investment programmes"; according to Clark and Monk, this third pillar reinforces the first two: if SWFs principal function is to maximise risk adjusted returns, then the appropriate way of fulfilling this function is to follow the guidelines as set by the neo-classical approach to investment management.

From the above discussion it is clear that Clark and Monks' description of the form and function of SWFs essentially coincides with the idealised types that have been promoted by Western dominated institutions such as the IMF and OECD. As already noted, a core objective of the Santiago principles was to ensure the 'de-politicisation' of SWFs by putting in place a set of

[69] ibid

rules that guarantees "the relative autonomy this type of institution enjoys from their political sponsors"; in other words, the core objective was to allow SWFs to operate in the global economy but only on condition that they behaved exactly liked other institutional investment vehicles such as pension and mutual funds. However, while Clark and Monk concede that SWFs were initially *"conceived to isolate or 'ring-fence' the management and investment of national assets from direct political interference"* (a point that appears to be confirmed by the fact that 26 SWF owning countries formally endorsed the Santiago principles in October, 2008) the global financial crisis that broke out in the summer of 2007 will likely see the transformation of SWFs from 'portfolio' investors into 'strategic' investors.

This prediction derives from an understanding of the global capitalism-nation state nexus that is very different from the conventional mainstream view: where the latter depicts global capitalism as a neutral, evenly-balanced market price space whose equilibrium is potentially threatened by the entry of national governments as market players, Clark and Monk put the opposite view that global capitalism is an uneven, volatile and unpredictable space that presents as many problems for nation states and imposes as many constraints on their actions as it offers enabling benefits and opportunities. In developing this view, Monk cites the work of Laura Weiss who in the course of her own analysis of the pressures of globalisation on nation states argued that the latter were forced to demand *"coping solutions to ease adjustment pressures"*. To quote Weiss more fully:

"The more countries become integrated into the global economy, the more exposed certain social sectors become to the risks and uncertainties of market fluctuations, and consequently the more vulnerable to economic and social dislocation. In this respect, globalization is enlisting governments in multi-faceted efforts to cope with increased economic vulnerability"[70].

[70] Weiss (2005,p.347)

In Monk's view, the coming transformation of SWFs into strategic investors exactly fits in with this idea that the national governments operating SWFs will henceforth use them as *"coping mechanisms"* to deal with the uncertainties and risks of the global economic and financial environment. As Clark and Monk put it: *"If 'trapped' by past commitments, necessitating the deepening of market relationships, SWFs may have to remake themselves to cope with the 'new' realities of global financial markets"*[71]. Of course, in the wake of the great financial crisis that first broke out in the very heartlands of global capitalism in 2007/8, the SWF owning countries certainly have the motive to use SWFs in this way. Contrary to the efficient markets hypothesis, the markets do not always manage, control and distribute risks efficiently; on the contrary, as the subprime crisis proved, in the current global context where 'financialisation' prevails (i.e where global financial markets are not only unregulated but allowed to grow to proportions where they completely dominate underlying product markets) the markets can also magnify risks even to the point of threatening the very foundations of the global market system. Against this background, argues Ashby Monk, *"SWFs are perceived by some policymakers to be a means of insulating completely against the outside world; the SWF is seen to be a tool to allow the state sponsor to continue with institutions, plans or policies that, in a totally open and competitive world would be sub-optimal. So, the SWF promises a powerful form of protection from the depredations of the global economy"*[72].

Once SWFs are seen to be organisations that not only enable their government owners to 'engage' in the global economic system but also to 'resist' the various pressures emanating from that system, it is only logical that one should then postulate that the form and function of SWFs should vary across places as well as across time. Recall that in the mainstream literature, SWFs are generally categorised according to their sources of funding: 'commodity' SWFs as distinct

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[71] Clark and Monk (2010, p.15)
[72] Monk (2010, p.21)

from 'non-commodity' SWFs. In some cases, as in that of the work of the IWG-SWF in preparing the Santiago principles, SWFs can be differentiated according to their chief objective e.g 'stabilisation' SWFS versus reserve-management SWFs and so on. In addition to these two conventional typologies of SWFS, Dixon and Monk propose a further "stylised typology of SWFs in relation to the state and its sovereignty" that "comprises five idealised types: postcolonialist, rentier, productivist, territorialist and moralist". As these authors point out, this "inductive typology" does not seek to replace the conventional typologies, *"rather, it is historical shorthand designed to provide further understanding to the potential long-term significance of SWFs and the factors that might underpin further development of new SWFs in different countries"*[73]. The following provides a brief description of the five idealised types as provided by Dixon and Monk:

i) Postcolonial SWF

This type of SWF is *" a means of increasing a state's capacity to engage, thus partially improving the country's perceived sovereignty deficit"*. As Dixon and Monk explain, *" in a global system of 195 countries, postcolonial states, particularly small ones, can be easily overshadowed and homogenised within their broader cohort. As a result, postcolonial states may seek to separate themselves and gain wider reception from more powerful cohorts of states"*...in this context they go on to argue *"the SWF can provide a state with increased capacity to a)engage with more powerful states through investments in the latter, and b)engage with institutions such as multinational firms or other non-governmental organization that may possess significant if not implicit power in the global economy and thus the political sphere"*[74]

[73] Dixon and Monk (2009, p. 12)
[74] ibid. p13-14

ii) Rentier SWF

For a rentier state – defined as one in which external rents accrue to the government (e.g sale of natural resources on the global market) and only a small proportion of the population is engaged in the generation of these rents – the SWF "*is the institution that is used to provide long-term assurance that domestic sovereignty can be maintained, and, more importantly, enhanced*" The SWFs of Kuwait and Brunei are cited as examples of 'rentier' SWFS.

iii) Productivist SWF

Most national economies today form part of complex global production networks that "*characterise the production, distribution and consumption of goods and services in an increasingly globalized economy*". According to Dixon and Monk the two chief functions characterising the rationale driving the 'productivist' SWFs are a) the attempt to extract a larger part of the value generated in the global value chains thereby reducing the extant asymmetries in the global networks and b) to make strategic investments in certain activities (e.g. R&D, distribution) that can partially reshape the global networks. According to Dixon and Monk, productivist SWFs are most associated with high-growth Asian countries, with the best example being the China Investment Corporation (CIC).

iv) Territorialist SWF

In introducing this type of SWF, Dixon and Monk first explain that "*despite major advances in free trade policies, governments across the globe are eternally concerned with the competitive pressures these place on their firms and their economies. Most governments try to play a balancing act of appeasing local interests while remaining committed to free trade*". Territorialist SWFs are an example of the type of instrument used by governments to help them play this balancing act. As Dixon and Monk explain: "*the stated or implicit rationale behind these funds is to to support the competiveness of local firms, both at home and abroad*". They

cite as a good example of this type of SWF the new French SWF the Fonds strategique d'investissement (FSI) created by the French government in 2008.

v) Moralist SWF

Dixon and Monk single out 'intergenerational justice' as the major rationale behind this type of SWF. As they explain: "*The two most prominent intergenerational justice issues facing contemporary advanced democracies are environmental degradation and demographic ageing, which together can have caustic implications for domestic sovereignty over the long term; failure to plan for these intractable problems could result in a loss of domestic authority and control. As such, confronting these issues has become a source of legitimacy for several SWFs. We define these SWFS as moralist".*[75] Dixon and Monk cite the Norwegian Government Pension Fund Global (GPF-G) as an example of the moralist SWF.

We believe that Dixon and Monk's attempt to provide an unconventional typology of SWFs that contrasts with, as well as supplements, the mainstream versions, is very valuable in its own right. This said, we have serious reservations about the nature of their typology. The problem is not that it is descriptively inaccurate: on the contrary, the characterisations of the different types of SWFs are more or less in accordance with the different concerns and priorities of the different countries that are host to these vehicles. Rather, some of the idealised types that are presented appear to lack any real substance or explanatory power. Thus we cannot see how describing Norway's SWF as a 'moralist' SWF adds any real new depth to the standard characterisation of this SWF as essentially nothing other than a government owned pension fund with the same type of social, environmental and other moralist concerns that are held by many of the large private pension funds of the US, UK and Europe. Nor can we see how describing the CIC as a 'productivist' SWF is telling us anything that is not already said in the comprehensive set of

[75] ibid.p.16

SWF objectives as listed by the IWG-SWF. Only in respect of the 'postcolonial' SWF category do we see Dixon and Monk attempting to say something profoundly new, for nowhere in the current literature on SWFs is there really any mention of the colonial legacy of many of the countries that own SWFs and this even applies to that small section of the literature that looks at SWFs specifically in the context of the 'development' of emerging market economies[76]. However, while Dixon and Monk make several interesting observations about 'postcolonial' SWFs they do not in our view go far enough in clarifying the lines that demarcate these SWFs from other types. The particular reasons for holding this view will be made clearer in the next chapter, but here in concluding this survey chapter we want to indicate the ways in which we want to build on the challenge to the existing SWF theoretical framework recently mounted by Clark, Monk and the Oxford School of critique.

2.vii An Expanded View of SWFs as Coping Mechanisms

The Oxford School's contribution to the SWF debate clearly shows the timing of its introduction to the debate. In contrast to Lawrence Summer's FT letter and Edwin Truman's articles for the Petersen Institute that first launched the debate and appeared just before the outbreak of the great financial crisis, the Oxford School critique was introduced well after the effects of the crisis became clear. The timing of Summer's letter is unfortunate. Up to that point in August 2007, the capitalist world economy had enjoyed a relatively long period of growth and prosperity. Cyclical swings were still common but these were muted and were nothing of the scale that had been seen in earlier decades, and nothing indeed on the scale of the 1930's. So stable was the capitalist world economy, from the early 1990s to the mid 2000's, that this period began to be called the 'great moderation' in the US and the 'great stability' in the UK. It seemed as if economists and other government policy advisors had finally found a way of defeating

[76] See, for example, Griffith-Jones and Ocampo (2008)

severe economic instability. As Gordon Brown put it in a speech before the British House of Commons : "no more boom or bust". Unfortunately for Brown his words were premature, for soon after making this speech the capitalist global economy went into the most severe crisis since the Great Depression, and with it went all the assumptions that economic equilibrium and stability were the norm rather than the occasional exception.

Following the onset of the global economic crisis, the Oxford School could now justifiably introduce the concept of SWFs as coping mechanisms on a systematic basis and not just as a passing fanciful idea. However, while we totally agree with its 'coping mechanism' line of interpretation of SWFs, we also believe that it suffers from a serious omission. This is that although it challenges the first mainstream assumption concerning the stability of the global economy it fails even to address, let alone challenge, the second crucial assumption concerning the equitable structure of the global economy. This omission is extremely serious because it leaves a gaping hole in the fundamental rationale for SWFs to act as coping mechanisms. The logic is straightforward. If the global economy is inherently unstable because it is continuously subjected to new and unforeseen developments (population explosion, rapid political change, ecological and environmental shifts, new technologies and communications systems etc), and if at crucial junctions it can reach a point of near collapse, then it follows that all national governments without exception have to find ways of 'coping' with the pressures arising out of this instability and potentially catastrophic collapse. However, this very same point then leads to the next question as to why it is that some governments should have the right to use SWFs as coping mechanisms even while other governments seem able or content to use other methods and policy measures for coping with economic instability. Our contention is that the only way to give a meaningful answer to this question is by meaningfully questioning the underlying assumption that the global economy represents an equitably structured space.

All governments pursue 'geo-political' objectives – they have to by virtue of their very function – but if there are some governments who can do so without recourse to SWFs, it is in large part because their countries occupy a position in the global economy of such weight and importance that they simply do not need to use SWFs. By contrast, if there are other governments who do need to rely on SWFs, in order to pursue their geo-political objectives in the face of continuing economic change and turbulence , it is in many instances because their countries occupy such a small, peripheral position in the global economy that they have few, if any, alternative means of doing so. In short, our contention is that the most basic rationale for the sudden proliferation and growth of SWFs in the very recent period has to do not merely with the growth in the surpluses in many small EME countries and therefore with the need to decide on how best to invest these surpluses to maximise returns. It also has to do with the realisation on the part of the governments of these EMES that only through the use of SWFs can they hope to overcome and balance out the disadvantages of small country size and peripheral status and thereby be able to participate in the global economy on more equitable terms. The difficulty in giving substance to this contention is, of course, to explain how exactly the contemporary global market place can still be characterised as a space that is unequally divided into cores and peripheries. The next chapter outlines just why this is a difficulty and indicates one way of resolving it.

Chapter 3

Sovereign Wealth Funds as Coping Mechanisms

3.i. Neo-colonialism and post-colonialism.

If we go back one hundred years it is not difficult to visualise the structure of global inequality existing in that period just prior to the First World War. It marked the high point of colonialism, the system under which the major European countries headed by Britain and France controlled – through a variety of forms – vast tracts of the world's land surface populated by an equally vast array of native peoples. That system of colonialism, which represented a system of core-periphery relations in their most open and coercive form, began to disintegrate after the Second World War. Starting in the late 1940s and early 1950s, the process of decolonisation gathered such rapid momentum that by the late 1960s to early 1970s virtually the entire planet was now covered by formally independent nation states. In short, the last quarter of the last century saw the globalisation of the 'Westphalian' state; the principle, first established in 1648 by the Treaty of Westphalia which ended the European 30 Years War, that all nations shall have the right to self-determination in all matters, religious as well as secular.

The end of formal colonialism did not signify the end of relations of inequality, of domination of one set of countries by another set of countries. If this seems clear simply by looking at the current state of international relations what is difficult to theorise is exactly how this current system of inequality operates. One line of argument that became popular in the 1960s was that 'colonialism' had given way to 'neo-colonialism' or 'economic colonialism': where the former system was a complete and open system of coercion in the sense that it operated in all spheres and walks of life – political, military, social and cultural as well as economic – the latter system is more narrow and less open in that formal political, social and cultural independence coexist

side by side with economic dependence and/or outright economic coercion. To quote from the Third All-African People's Conference held in Cairo in 1961: *"This Conference considers that neo-colonialism, which is the survival of the colonial system in spite of formal recognition of political independence...is the greatest threat to African counties that have newly won independence"*[77].

The problem with this argument is that while it may have local and occasional applicability –for example, the way that the US has periodically exercised its dominant economic power over its close Central and South American neighbours – it does not appear to have systematic, global applicability. In the final analysis, neo-colonialism implies some form of coercion exercised on a direct, face to face relation between countries and this form simply does not apply today on any systematic basis as opposed to an occasional one. Instead, what we see operating at the global and systematic level is an array of arm's length and apparently 'neutral' interrelations coordinated by a variety of international organisations such as the IMF, the BIS, the OECD and the World Bank through whose authorities various rules and codes of conduct for both governments and private corporations are drawn up and implemented. Indeed, with the collapse of communism in the late 1980s and early 1990s and the subsequent globalisation of capitalist market relations, even the tripartite division of the world between 'First' (capitalist), 'Second' (socialist) and 'Third' (developing) countries, which had formed a crucial component of the 'neo-colonial' theory, began to lose its meaning. As Aijaz Ahmad, a leading literary and social theorist put it: *"Those categories and debates that were once centred on a tripartite division of the world may well appear antiquated after the global restructuring in past few years"*[78].

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[77] AAPC, Cairo (1961)
[78] (1998, p.27)

A new theorisation of the persistence of global inequality in the contemporary era, which took root in the 1980s and gained wide prominence in the 1990s is that summed up by the term 'post colonialism'. Curiously, this new line of theory did not originate in the fields of economics or political science but in the field of literary studies and criticism. This is to a great extent understandable because in analysing the literary texts that came out of newly independent countries –or out of authors who had settled in places such as Britain but whose parents were emigrants from newly independent countries- what became clear in many of these texts is that alongside the 'celebratory' aspects of gaining independence there were also the darker, more fraught and antagonistic aspects of 'writing back', of interrogating and challenging the 'master narratives' of the former colonial powers, of 'resisting' the continuing domination of established Western cultural norms. As Ashcroft et.al put it in their introduction to a post colonial studies reader published in 1995 " *Post-colonial as we define it does not mean 'post-independence', or 'after colonialism', for this would be to falsely ascribe an end to the colonial process...it is the discourse of opposionality which colonialism brings into being*[79] ".

However, the problem with the close association of post-colonial theory with post-colonial literary criticism is that while there is a recognition that even after the general termination of formal colonialism there still persists a new form of colonialism, a new version of 'core-periphery' or 'centre-margin' relations, there has really been no successful attempt at explaining the content of this new post-colonial system of inequality. One of the direct results of this failure is that post-colonial theory has come to be largely dominated by – and hence largely equated with in the minds of many – 'post-structuralism': the theory that holds that the world today has no 'centre-margin' dichotomy or indeed any form of hierarchical structure and that, on the contrary, it now represents a 'decentred', unstructured and potentially chaotic space

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[79] (1995, p.5)

whose future development is unclear and certainly not one that is bound to conform to any 'grand narrative' of historical development. To quote from Homi Bhabha's book, The Location of Culture, which has done much to position postcolonial theory in the post structuralist camp: *" As a mode of analysis (post colonialism) attempts to revise those nationalist or 'nativist' pedagogies that set up the relation of Third World and First World in a binary structure of opposition. The postcolonial perspective resists the attempt at holistic forms of social explanation[80]"*.

The sum result of the above observations is that it is difficult to explain global inequality in the current era as something that is structured and systematic. On the one hand, if the contemporary era is one characterised by the absence of structured hierarchies and core-periphery relations as the post-structuralists maintain, how can one talk of relations of domination and subordination? On the other hand, if such relations do persist as some postcolonial theorists maintain, how can one explain these relations in the absence of obvious, country to country relations of domination and subordination? One recent attempt to resolve this difficult question uses what has been called a 'two-space theoretic approach'.

3.ii Two-space theory

What follows is a brief outline of two-space theory as developed in a series of papers by Lysandrou and Lysandrou (2000;2003) and Lysandrou (2005). By 'two-space' these authors refer to two different domains or locations of human activity, but what is unusual about their classification is that the differences between these two spaces of activity are not so much defined by differences in the 'functions' of activities –the 'economic' function versus the

[80] (1994, p.17)

'political', 'social' or 'cultural' functions for example –as by the difference between the 'capacity' for activity and the 'outcomes' of activity. Thus 'physical' space is where individuals use their various capacities for activity e.g labour, management, governance and control etc. while 'price' or 'commodity' space is where the outcomes of activities are mapped as commodities carrying prices set by some standard. In physical space, individuals relate to each other as possessors of particular skills, attributes or capabilities while in 'price' space they relate to each other as possessors or exchangers of comparable entities, commodities. This distinction between spaces is, to quote Lysandrou and Lysandrou,

"given added weight by allowing for the fact that physical space includes a diverse array of political, social and cultural institutions and practices which support, overlap with or envelop the economic practices whose outcomes are mapped into price space. Thus physical space is recognized to be a heterogeneous one in the sense that agents relate to each with certain beliefs and ideals, as voters with certain rights and responsibilities and so on. This rich heterogeneity of physical space contrasts with the stark homogeneity of price space where it remains the case that, whatever the range and volume of commodified entities filling that space, agents always relate to each other here merely as commodity holders[81]".

Having defined two space theory, a theory which holds that countries exist both as containers of people in physical space and as containers of commodities in price space, it is now possible to see why inequality and the perpetuation of centre-margin relations both exist and do not exist at one and the same time. On the one hand, they do not exist in physical space where, as a general rule, the modern nation states not only have formal but also essential independence and the right to self determination in most important matters; on the other hand, they do exist in commodity

[81] (2003,p.6)

price space where the differences in the respective sizes of countries as 'commodity masses' is key to the perpetuation of inequality and dependency relations. The most usual visualisation of commodity-based country size is in material commodity terms, that is, terms of the annual flow of goods and services (annual GDP). As is well known, country size differences in GDP terms often bear little relation to the differences between countries as measured in physical terms, i.e land mass, population size etc. For example, the annual output flow of the US is approximately 28% of world GDP even while its population is only about 5% of the world population while China, with over 20% of the world' population ranks third in gross GDP. However these differences in GDP 'flow' terms become even more stark when we consider the differences between countries in capital market 'stock' terms, that is, in terms of the percentage shares of the total volumes of debt and equity securities outstanding at any one point in time. As Lysandrou (2005) puts it, where goods and services are 'material commodities', the past outcomes of corporate or government activity, debt and equity securities are 'financial commodities', tradable claims on the future expected outcomes of corporate and government activity. Financial commodities, as defined above, are today the dominant matter in global commodity space as is exemplified by the fact that in 2010 the world's total financial stock came to approximately $215 trillion as compared with $62 trillion for world GDP, a ratio of about 3.5 to 1 whereas in 1980 the ratio was 1 to 1 (approximately $10 trillion for both world GDP and world financial stock). Further, the percentage share of the G-7 countries in capital market terms is massive, accounting for 75% of all stocks in 2010, while the rest of the OECD countries account for 15% and all the rest i.e all EMES account for a mere 10%[82].

The large size differences between countries in capital market terms become even larger when we bring national or regional currencies into the picture. As can be seen in figure 1 , the US dollar mass of assets is huge, rivalled only by the euro, yen and sterling masses, while all other

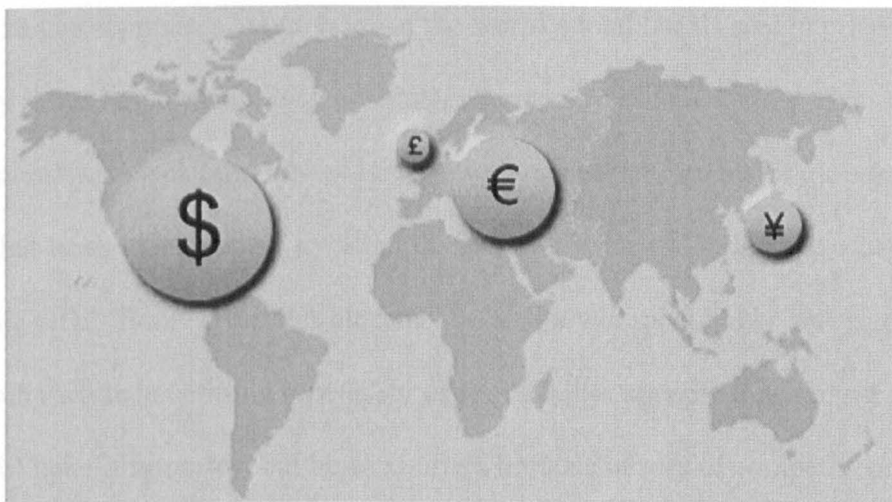
[82] BIS (2011)

countries collapse into small fragments in currency-capital market stock terms. The reason for illustrating country currency masses in terms of securities is not just that these represent stocks as opposed to GDP figures which represent annual flows of output, but also because trade and foreign direct investment related currency exchanges only constitute about 1-2% of all the $4 trillion daily turnover on the forex markets while securities-related exchanges account for the remainder. In fact, it is in the currency markets –where exchanges of material products coincide with exchanges of financial instruments – that the domination of financial commodities over material commodities becomes absolutely clear. However, to return to the main point, just as financial commodities dominate material commodities, so do the countries where the stock of financial securities looms large, dominate the countries where securities stocks are either much smaller or virtually non-existent. In currency-commodity price space, as figure 1 makes clear, there has been a reconstitution of the type of core-periphery relations that have been dismantled in physical space.

Figure 1

Capital Markets, 2006

(currency terms)



3.iii Control at a distance

It is with this reconstitution that we can now begin to understand how the exercise of domination by the core economy governments over periphery economy governments continues albeit with a change in form. Where previously domination was exercised in physical space on a relational basis involving some form of direct coercion and pressure, today domination is exercised in commodity space on an arm's length, distanced basis, one that involves not so much direct coercion as the gravitational pull of giant commodity masses over the smaller orbiting masses. The crux of the matter is control at a distance: while governments of large commodity masses can adopt actions without reference to the actions of other governments, the reverse is not true: governments of countries that occupy a relatively small presence in commodity price space always have to ensure that their actions fit in with the actions of core economy governments. To help illustrate the mechanics of this new gravitational pull form of control and dependency, we need only look at currency exchange rate volatility and of the different abilities of currency masses to cope with this volatility.

Let us compare two countries, say the US and an EME country. As noted, the US has a population size that represents about 4-5% of the world's total but its size in price-commodity space is many times larger than this in percentage terms: 28% in GDP flow terms and nearly 50% in capital market stock terms. Now let us assume that there is a major global economic disturbance that leads to a potential gyration in the value of the dollar against other currencies. At the material GDP 'floor' level, this currency volatility will most likely hurt some sectors of the US economy while benefitting others; for example dollar appreciation against other currencies will benefit importers but hurt exporters because of loss of competiveness, while dollar deprecation against other currencies will benefit exporters because it will improve their competiveness while hurting importers because of a rise in import prices. These differences in sectoral impact will be reflected in the risk-return characteristics and hence in the prices of the

debt and equity securities issued by the different US corporations and this reflection will cause investment shifts in the 'upper' floor US capital level. In other words, investors will make portfolio changes, shifting assets out of one sector into another, according to their expectations regarding the impact of currency volatility on underlying economic fundamentals and business prospects. However, the crucial point here is that these investor portfolio shifts across assets are in the end shifts across dollar assets, in other words, asset shifts that occur within the same currency framework and not across different currency frameworks. What this in turn means is that the underlying shifts in the GDP domain caused by an initial currency disturbance are not further magnified by additional currency disturbances triggered by capital market shifts; on the contrary, the fact that these shifts occur within the dollar regime means that the size and diversity of the US dollar capital markets allow them to act as a shock absorber or dampener to the original underlying economic disturbance.

Now consider the opposite case of a country that may have a reasonably significant position in commodity space in GDP terms but a very small position in capital market terms. Currency volatility will again affect import and export related sectors differently, and these differential effects will then cause investors to shift from one asset class to another according to their expectations concerning the impact of currency volatility on business conditions. But the difference here is that if the capital market is thin, then it is likely that any asset shift will also lead to a shift into assets belonging to other currency regimes. In other words an asset shift will be accompanied by a movement of funds across currencies, which will in turn cause further currency exchange rate movements. In this case, the initial disturbance caused by the initial currency volatility will now be amplified by further currency volatility caused by asset market shifts. This is not all. All prices, the prices of output, the interest rate (the price of money), the exchange rate (the international price of a country's money) and security prices, all interlock and are mutually dependent. Thus if, say, a steep currency depreciation causes high inflationary

expectations which may then cause output falls, this may cause a fall in share and bond prices, which may then fall even further if these price falls lead to even more asset shifts that cause even more downward currency depreciation. This was precisely the experience of South Korea and other East Asian economies during the Asian financial crisis of 1997-8. But to return to the overall point here, in the case of a small commodity mass in capital market terms, its capital market does not act as a shock absorber or dampener as in the US case, but as a shock amplifier.

These differences in the ability of 'commodity masses' to act as shock absorbers or as shock amplifiers, that relate to their differences in size, help to explain not only the differences in the degree of independence with which national governments can pursue their domestic macroeconomic policies but also the new relations of control and dependency between governments. Take first the case of a government of a large commodity mass such as that of the US. Suppose this government, faced with the prospect of rising inflation, implements a restrictive macro policy such as a combination of monetary tightening, which leads to an interest rate rise, and government spending cuts, which lead one way or other via the effect on domestic consumption to a reduction in imports. As a result of the fact that all prices interconnect (product prices, interest rate, prices of securities,) these effects of government macro policy will inevitably have an impact on the most general price of all, the US dollar's international exchange rate, which in turn will react back on the other prices such as prices of US securities thus causing portfolio shifts. However because of the depth and diversity of the US capital markets, and the knowledge therefore that portfolio shifts will mostly take place within the dollar universe, the US government can afford to take a lax, benign, view of the impact of their actions on the US dollar's exchange rate against other currencies. What this in effect means is that the US government can take independent actions without having to consider the actions or reactions of other governments.

By contrast, the governments of countries that represent small commodity masses cannot be indifferent to the effects caused by their macro policy actions. Any action that causes a disturbance to domestic prices may then lead to a disturbance in the prices of domestic money (interest rate) or of domestic securities (bond and equity prices), an event which then may cause cross-currency portfolio shifts that in turn may cause the country's currency exchange rate to gyrate wildly, thereby having a hugely negative impact on the domestic economy. Too low an exchange rate may lead to huge domestic inflationary pressures via the impact on import prices, while too high an exchange rate may lead to a loss of competiveness via the impact on export prices. It is here now that we can see a relation of domination and control of one set of governments over another set, but a relation of control not based on a direct, face to face connection but on a distanced, impersonal connection. The key to the matter is that all prices interconnect not just on a domestic context but also in a global one: if the government of a large commodity mass undertakes macro policy actions for domestic stability purposes that then cause a disruption to prices, the fact that we now have a globalised and highly interdependent world market means that the government of small commodity masses have immediately to undertake macro policy actions to maintain domestic stability in the face of pressures, possibly initiated by the governments of the large commodity masses.

It is this fundamental symmetry between governments, that some can conduct macro policies independently of the actions of other governments, while the majority of other governments cannot do so but on the contrary must pursue their macro policies partly if not totally with an eye on the actions of the 'core' governments that goes a long way to explain the 'euro' project first initiated by France and Germany and supported by a number of other European union countries but not by the UK. The usual view as to the reasons for European currency integration is that this process simply represents the culminating stage of the Single European Market project, namely, that which aims at the elimination of all possible barriers – tariff and non-tariff

barriers – to the free flow of goods, people and capital between the European union member countries. While this view is certainly correct in some senses, others (e.g. Lysandrou, 2000) have argued that another reason for the euro project is not just to unify markets at the GDP level but also to unify the capital markets into one giant euro-denominated capital market and thereby give it a mass and weight that can rival the US dollar mass. The euro project is often said to be a 'politically 'driven project because the size of the eurozone does not correspond to strict economic criteria (the so-called 'optimum currency area' criteria) underlying this size. However, it has been argued that while the role of politics cannot be denied – successive French governments in particular have never denied that their overriding aim is to have a voice on the international stage that at least equals that of the US government – there was a strong economic rationale behind this political criterion, namely, that only by unifying the European capital markets into one giant euro-denominated mass could the French and German governments conduct macro policies (including interest rate and monetary policies) independently of US government actions. Of course, the eurozone project meant that small peripheral countries like Greece and Ireland had almost total loss of control over monetary and interest rate policies which were largely dictated by France and Germany – in other words the core-periphery relation that exists globally was replicated on a European regional basis – but the point still remains that the eurozone project manifests the attempt on the part of some former 'core' governments to maintain their 'core' status under the new conditions of globalised markets and commodity relations by unifying their capital markets as well product markets in order to create mass on a sufficient scale as to enable it to resist the gravitational pull of the US dollar.

While the French and German governments, supported by a number of other EU countries, have succeeded in creating a European currency union, other governments around the world have not. The reason is that monetary and exchange rate union can only really work if there is also a certain degree of fiscal union – i.e harmony in tax and spend policies but also a system of intra-

regional fund transfers from surplus to deficit regions – and fiscal union presupposes political union, which is an extremely difficult task to achieve given the sheer weight of historically shaped differences in cultures and social systems and codes of values and moral standards. Just how difficult is now being shown by the present eurozone crisis which threatens to destroy the whole euro project. In the Middle East region, the plan to create a pan-regional dinar – the Gulf dinar – comprising the six member countries of the Gulf Cooperation Council (Saudi Arabia, United Arab Emirates, Oman, Kuwait, Qatar and Bahrain) has all but been shelved because of the differences between the GCC six in how to operate a single currency and monetary policy in the absence of political and fiscal union. Thus the fall-back position that most peripheral countries in the world economy have resorted to is to align their currency exchange rates to a key currency, most notably the US dollar, where the form of alignment differs from country to country. In the most extreme cases – dollarisation and currency boards – any pretence at maintaining currency sovereignty is dropped entirely: dollarisation as in the case of some central American republics (Ecuador, El Salvador) is an open declaration of willingness to be a 'currency (dollar) colony' subservient to US decision making (the US Federal reserve has made it absolutely clear that no outside government that has dollarised its economy will have a seat on the board of governors), while a currency board is almost similar in its effects in that the attempt to restrict the amount of domestic currency in circulation in accordance with the volume of dollars held, presupposes that domestic monetary and interest policy is exactly in line with US policy actions. In most other cases, the preferred form of currency alignment is to keep the national currency and a certain amount of monetary independence but then keep the domestic currency's exchange rate against the US dollar within a pre set target range, an objective which of course requires the build up of substantial dollar reserves.

3.iv SWFS as coping mechanisms

It is here that we come back to the subject of SWFs. Recall from the previous chapter that while SWFs first made their appearance as far back as the 1950s it is only in the past decade and a half at most that their size and numbers have exploded, a development that clearly links in with the explosion in the volumes of surplus funds generated through oil or non-oil export surpluses and with the fact that while much of these surpluses continue to be used as reserve funds to help maintain the national currency's exchange rate against the US dollar within a target range an increasing proportion of these funds are being diverted into special investment vehicles. Recall also that the diversion of increasing amounts into SWFs has caused concern amongst leading academics and policy makers in the largest of the Western economies, notably the US but also some West European economies, the cause being the suspicion that these government owned investment vehicles will not restrict their objectives and ambitions to purely commercial ones. As also noted, behind these concerns was the 'neo-liberal' ideological position that the new globally integrated capitalist economy represented an essentially self-equilibrating space whose efficiency was maximised when governments did not interfere with the pricing mechanisms and played only a 'light touch' regulatory role. Given this position, one can see why the intrusions of government owned vehicles such as SWFs into the global capitalist market economy were generally interpreted as potential 'eruptions' to the smooth and efficient functioning of that economy. However, this neo-liberal view of the capitalist economy has been thoroughly discredited by the great financial crisis in that it did not break out in countries such as China where there was too much government control over market relations but in the USA and certain other advanced market economies where on the contrary where was too little control over, or regulation of, the banking and financial sector.

As we have also seen, this crisis provided the impetus for the Oxford School's new line of thinking on SWFs as coping mechanisms, investment vehicles charged not merely with keeping

to conventional financial and commercial objectives but also with developing a strategic objective of absorbing, filtering or managing the pressures emanating from a highly unstable and uncertain global economic environment. The gap, as already noted, in this otherwise correct line of argument is that it fails to address the second major assumption underpinning the conventional mainstream position on SWFs, namely, that the global economy is an equitably structured space. Those who warn of the dangers of SWFs as politically-motivated investment vehicles start out from the position that there are no core-peripheral constellations in global economic space and thus can maintain that all governments are on a par when dealing with the pressures and strains of global economic instability. If this is so then the question logically arises as to why some governments should be allowed to resort to the use of SWFs as coping mechanisms when other governments do not. This is a question that the Oxford school of critique finds difficult to answer precisely because in its preoccupation with economic instability it fails to consider in depth the accompanying issue of economic inequality. Although there are specific references to unequal relations between nation states there is no general and consistent attempt to theorise the unequal structure of contemporary global capitalism. Dixon and Monk accurately describe how "postcolonial states are portrayed as weak"..and how " many postcolonial states occupy marginal positions within the global division of labour", but they do not go on to give a more encompassing and in-depth explanation of the current unequal structure of global postcolonial space.

The reality is that there has been a perpetuation of core-periphery relations, although these have been reconstituted in what has been called above as commodity-price space, which means that governments are not in the same position when dealing with instability: governments such as that of the US that are situated in a large commodity mass such as the dollar mass of securities can conduct their domestic macro policies to cope with instability without needing to resort to any extra instruments because of the absorbing, dampening effects of the mass and diversity of

dollar denominated securities; on the contrary, governments situated in small commodity masses do need to rely on the use of extra instruments such as SWFs to cope and manage the effects of instability given that the smallness or thinness of their commodity masses are likely to play a more amplifying rather than absorbing role in the transmission of instability. It is precisely because these centre-margin relations continue to exist in our own era that the indiscriminate demand for the de-politicisation of all SWFs, regardless of the size of their country of origin, can be a source of more harm than of more good, of more unfairness than of more fairness.

To illustrate the point, consider the standard rules in boxing. These rules are supposed to ensure that fights are fair and give boxers an equal chance of winning; but they only yield this outcome if individual boxers are grouped into different weight categories: 'heavyweight', 'middleweight' and so on. Remove the weight divisions, and the standard rules, far from giving equal advantage to all boxers, will on the contrary give unfair advantage to heavy weight boxers over middleweight boxers, the latter over lightweight boxers and so on. Now if we turn to the global postcolonial economy, we find that even while there are huge size disparities between the 195 or so countries participating in it the interactions between these countries do not take place in segmented, size-determined sub-domains but in the same undifferentiated global domain. Given that this postcolonial domain is not equitably structured, it follows that if small countries participate in this domain on the same terms and rules of engagement as do the large countries they will potentially lose more than they will gain. Just as lightweight boxers need to fight according to different, unorthodox rules if they are to survive any contest with heavy weight boxers, so small countries need in certain instances to be allowed to follow different rules of engagement in the global economy if they are to ensure that the pressures and constraints on them emanating from the core regions of the economy are to be managed as much in their own interests as in the interests of the core. This line of argument extends to the case of the SWFs

that belong to small EMES such as the UAE. Given the current unequal structure of the global postcolonial space, the demand that even these SWFs should be completely 'de-politicised' is tantamount to disarming these SWFS, rendering them ineffective as a means of coping with the current system of inequality. On the contrary, only if the political element of small country-based SWFs is openly acknowledged, can those SWFs act as a 'coping mechanism', a mechanism for managing and controlling global pressures.

In further developing and clarifying the above line of argument one should take a closer look at the meaning of 'geo-political' interests and at the bearing that the size of countries in economic and financial terms has on government execution of these geo-political interests. All governments have such strategic interests which necessarily overlap in one way or other with purely economic macro policy objectives, but only some governments have the luxury of pursuing these interdependent strategic interests and macro policy objectives without having to rely on some extra instruments such as SWFs. A case in point is the US government's pursuit of its overseas foreign and military policies. In the 1960s the US government financed its war in Vietnam largely by printing dollars, a process that eventually led to high domestic inflation, a development that had severe wider macroeconomic implications which necessitated corrective, anti-inflationary policies, and which helped to contribute to the breakdown of the Bretton Woods system of fixed exchange rates. Learning from this experience, later US governments financed its wars –e.g the first Iraq war under George Bush senior and the second Iraq war under George Bush junior – not so much by printing dollars as by issuing treasury bonds, a form of debt financing that had less inflationary consequences and, as already mentioned, allowed the US government to finance its wars without having to raise domestic taxes given that it was largely foreigners who were buying the Treasury bonds. Now the US governments had the options to pursue this line of action because foreigners and in particular foreign governments were, and continue to be, willing to hold large volumes of US treasuries and the reason for this

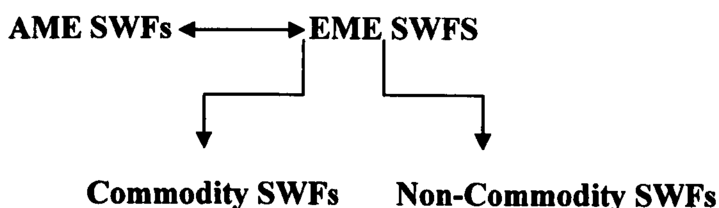
in turn is the knowledge that treasuries are highly liquid –easily transferable into assets without loss of value – and that there is a huge mass of other dollar securities into which treasuries can be converted without loss of exchange rate-related value. Given all this, of course the US governments along with other governments of core currency masses do not need to use SWFs as strategic instruments (the case of the French government is the exception that proves the rule) but in the case of governments of countries that represent small currency denominated commodity masses there is a necessary use of SWFs as strategic instruments that can help manage and deflect global financial pressures in the course of managing domestic macro objectives and pursuing geo-political interests.

Having made the distinction between countries that do not need to use SWFs and those that do, let me now turn to a second distinction between the countries in the latter, SWF-using, category. In this connection I think it useful to present an alternative typology of SWFs where the 'size' of the home country of origin is made an explicit factor (as opposed to being merely an implicit factor as in the Dixon and Monk characterisation of the 'postcolonial' SWF), the rationale being that in this way one get a better handle on the 'political' dimension of SWFs and its ramifications. Before elaborating on this point, I should first point out that a number of authors have introduced typologies of SWFs where these basically concern the 'motivation' behind the creation of SWFs. Thus in parallel with the Oxford School's typology that was described in the previous chapter we also have Mandy Sherimani's (2011) typology that classifies SWFs as government instruments created for purposes of 'economic statecraft' or 'state entrepreneurship' or 'domestic compensation', while Hatton and Pistor (2011) classify SWFs according to whether their objective is 'mercantilism', 'imperialist-capitalism', 'market investment' or 'autonomy-maximisation'. However, while these classification systems differ in the description of the motivations behind SWFs or in the different weightings given to these motivations, none of them bring into focus the question of the differences in the size of SWFs. In other words, they

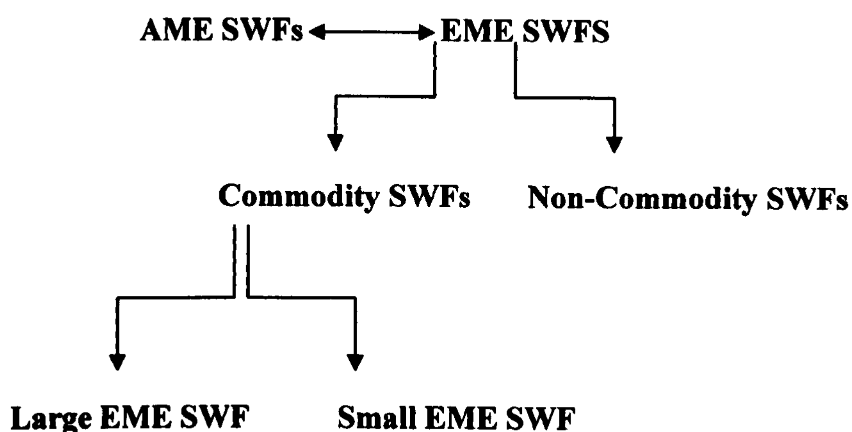
all take as their basic framework the conventional two-layer differentiation of SWFs according to geography (advanced market economy SWFs such as that of Norway are generally differentiated from emerging market economy SWFs) and according to source of funds ('commodity' SWFs - oil or gas exports are the chief source of funds- are generally differentiated from 'non-commodity' SWFs where trade surpluses are the chief source of funds). See figure 2a. However, as shown in figure 2b, SWFs can also be grouped along a third dimension, namely, country size (measured in population and GDP terms). This third dimension of country size differences is applied only to EMEs with 'commodity' SWFs because only here is the large-small distinction significant: EMEs that have a trade surplus with AMEs tend to be large (e.g China) while EMES that rely on oil or gas exports can either be very small (e.g the UAE, Kuwait and Qatar) or very large (e.g Russia).

Figure 2

a) Conventional Typology of SWFs



b) Modified Typology of SWFS



This third layer distinction in country size has a crucial bearing on the question of the 'political' as opposed to strictly 'economic' or 'commercial' nature of SWFs. In the majority of the current

literature on SWFs, the 'political' nature of SWFs is essentially treated as a single, undifferentiated issue; that is to say, there is no recognition that the political aspect of SWFs can mean different things in different contexts. By contrast, I advance the contrary view here that there are fundamentally two different types of SWF politics that correspond to the difference between 'large' and 'small' countries of origin. In the case of large countries that own SWFs such as Russia or China, politics can be interpreted in the sense that the governments of these countries may seek to use their SWFs as a means of leveraging up their diplomatic or military power. We shall call this the PDM model of politics (politics with a diplomatic-military angle). In the case of very small countries that own SWFs such as the UAE, where there is very little if any possibility that such countries can gain any diplomatic or military advantage over the Western countries, politics can be interpreted in the sense that the governments of these countries seek to use their SWFs as a means of providing effective institutional support to their broader social and economic goals. We call this the PSE model of politics (politics with a socio-economic angle).

As argued, in the mainstream literature on SWFs no distinction is made between the above two different aspects of the political dimension of SWFs: the fact that SWFS are government owned vehicles is enough to lead most commentators to characterise them as potentially dangerous instruments inasmuch as they can potentially be used to gain unfair advantage in the global market and in global affairs more generally; this characterisation then leads to the demand for the complete 'de-politicisation' of SWFs. In my view, this fear of SWFs can only be justified, and the demand for their de-politicisation consequently sustained, in the case of the large EME countries such as China and Russia that have the military and technological capacity to pose a genuine threat to Western security in particular or to Western interests more generally. On the contrary, this fear cannot be justified in connection with the small EMEs such as the UAE that simply do not have the military or technological capacity to pose any such threat to the West. In

the case of these small EMEs, the demand for the complete de-politicisation of their SWFs, far from serving as a means of maintaining balance in the relations between the different participants in the global economy, will instead be a means of further accentuating the existing imbalances in these relations.

3.v The Santiago Principles Revisited

The characterisation of the global market economy as not only an inherently unstable space but also as a highly unequal space helps to put into proper perspective the importance of what we have previously described as the 'doubly voluntary' nature of the internationally agreed principles of conduct for SWFs, the so-called Santiago principles adopted in late 2008. Recall that the first sense in which these principles are voluntary is that they were not unilaterally drawn up by Western dominated institutions such as the IMF and then imposed on SWFs, but rather that a large group of the latter, lead by the SWFs of Singapore and Abu Dhabi, voluntarily agreed to co-chair a working group charged with drawing up a list of principles to which SWFS can then voluntarily sign up to. Recall also, that the rationale behind this voluntary decision to draw up and conform to internationally agreed principles of SWF transparency and conduct was that only in this way could the SWFs help to calm Western governments and regulators' fears about SWF investment intentions in Western economies and thereby help to reduce the threat of retaliatory actions that could then block or constrain SWF investments. However, the second sense in which the Santiago principles are 'voluntary' in nature is that SWFs can choose how much information they disclose and on which areas of investment decision making they disclose information. As we have seen above, it is this second sense in which the principles are voluntary, this 'soft law' nature of the principles, which has drawn the heaviest criticism.

This criticism ultimately reflects two assumptions about countries and their governments in the global economy. First that all the latter, regardless of whether they belong to the advanced or emerging market economy categories, are equal in status and position, which means that the operation of SWFs by some governments can be potentially unfair when other governments do not resort to the use of such investment vehicles. This assumption is in our opinion wrong for the reasons already given. Second that all SWFs, regardless of the size of the home country base in question, are treated as equivalent government owned-vehicles that pose equivalent types of potential threats. This assumption is also in our view wrong because the point bears repeating that SWFs from small EMEs can only have political interests in the PSE sense as described above in contrast to SWFs from large EMES that can have political interests in the PDM sense as described above. What this means is that while calls to replace the 'voluntary' Santiago principles with a mandatory and much stronger set of internationally agreed principles –i.e principles that force all SWFs to disclose all detailed information about their investment strategies – may have some sense with regard to large EME-based SWFS that can have diplomatic and military related intentions, they make little sense with regard to small EME-based SWFS that can only have socio-economic related intentions. On the contrary, given that the global economic space is not only unstable but also unequal, any attempt to take away from small EME-based SWFs their right to discretion and flexibility over the amount and range of information they disclose about their foreign investment activities – and thus their ability to negotiate and manage the pressures of the global economy - will only disadvantage them at the expense of the institutions based in the core economies.

With the above comments in mind it is now possible to move towards not only a clear position regarding the role of small-EME based SWFs in the contemporary globalised economy but also towards a testable set of hypotheses in connection with this position. The latter put simply is that small EME based SWFS act as 'coping mechanisms' in a dual sense in that they serve to

shelter EME government foreign investment strategies not only from the pressures emanating from a highly unstable globalised economy but also from the pressures associated with the highly unequal structure of the contemporary globalised economy. To verify this position, we advance three hypotheses common to which is the idea that the net benefits of SWFs to the home country are positive. From the previous chapter, recall that the four main benefits are those of stabilisation (B1), intergenerational transfer (B2), economic diversification and development (B3) and asset management (B4). Recall also that the four main potential costs are loss of cultural identity (C1), unwanted attraction from foreign governments (C2), exposure to the gyrations of the global economy (C3) and instigation of protective restrictive measures by foreign governments and regulators (C4). The fact that SWFs developed prior to the adoption of the Santiago principles would indicate that the net benefit ratio is positive (i.e. $B-C > 0$) even in the absence of any internationally agreed principles. While this proposition is intuitively plausible, it is worthwhile formulating it as a hypothesis to be tested on the grounds that it can serve as the benchmark for two other hypotheses that can take us by degrees towards full confirmation of the central proposition being advanced here.

Thus:

H1: The net benefits of a SWF to a small-EME based country are positive even when there are no internationally agreed principles of SWF conduct.

Given the fact that the globalised economy is a highly integrated and interdependent one, it follows that the ability of any SWF to take strategic portfolio diversification decisions on an international basis presupposes the free flow of cross border investments, in other words, the absence of restrictive and protectionist measures on the part of foreign governments and regulators. However, since such restrictive actions are likely to be less prevalent the more that SWFs are seen to conform to internationally agreed principles regarding transparency,

governance and other institutionally related matters, it follows that conformity with such principles as exemplified by the current Santiago principles will lead to a higher positive net benefit ratio. Thus:

H2: The net benefits of a SWF to a small EME based country will be even higher when the SWF conforms to the Santiago principles.

Given the unequal structure of the integrated global economy, it follows that any demand to replace the voluntary Santiago principles with an alternative and much stricture set of principles regarding transparency and information disclosure will disadvantage small EME based SWFs by restricting their room for flexibility and range of manoeuvre in coping with the pressures of the globalised economy. Thus:

H3: The net benefits of a SWF to a small EME based country, were it forced to conform to a 'mandatory' set of principles of conduct, would be less as compared with the net benefits arising out of conformity with the Santiago principles.

As one of the supervisors of this research has said, everything comes in threes. Having put forward three hypotheses, we shall look at three case studies in order to try and substantiate these hypotheses. However, before doing so we first outline the methodology that will be used. A central element of this methodology, as will be seen, is triangulation. Everything does indeed come in threes.

Chapter 4

Research Methodology.

4.i. Research Design

The previous chapter concluded with the hypothesis that PSE type SWFs run by governments of small emerging market economies need to explicitly retain rather than renounce their geo-political aims and interests if these investment vehicles are to serve effectively as coping mechanisms in today's highly unstable and unequally structured global economy. The purpose of this chapter is to sketch out the research methodology used to substantiate this central hypothesis. In doing so, we begin with the question of research design.

Research design has to be the starting point in any programme of research in that it represents the strategic plan of action, the general 'blueprint', for the implementation of that programme. To quote Kerlinger (1986): *"Research design is the plan and structure of investigation so conceived as to obtain answers to research questions. The plan is the overall scheme or programme of the research. It includes an outline of what the investigator will do from writing hypotheses and their operational implications to the final analysis of data"*[83]. For each of the many steps in the chain linking the writing of hypotheses to the final analysis of the data hard decisions have to be made regarding the precise techniques used for data collection and organisation. There are two reasons for this need to make choices. The first and more general reason comes down to the efficiency of resource allocation. To quote Phillips (1971): *"Research design aids the researcher in the allocation of limited resources by posing crucial choices in*

[83] 1986, p.78

methodology" [84]The second and more specific reason comes down to the individual characteristics of the phenomenon being investigated. It is possible that these characteristics impose certain constraints on the data collection and organisation techniques such that the particular ones finally used have been adopted less as a matter of choice than as a matter of necessity. In the case of SWFs that are the object of research here, we will argue that amongst the constraints that dictate the design and structure of the research programme are those of 'time' – SWFs have only recently grown in importance, a fact which severely limits the use of any time series data – and 'information' – SWFs are less transparent than other investment vehicles, a fact which restricts the use of secondary data for example.

To summarise, a research design, as Yin (2009) puts it, *"is much more than a work plan. The main purpose of the design is to help to avoid the situation in which the evidence does not address the initial research questions. In this sense, a research design deals with a logical problem and not a logistical problem"*[85].With the above arguments and concluding summary in mind, the present research programme was structured around the following themes:

- location and scale of research: this section briefly looks at the reasons for the choice of three Emirati based SWFs as the object of inquiry;

- quantitative versus qualitative methods of enquiry: this section explains the reasons for selecting a primarily qualitative based research method;

- the case study: this section explains the preference of this approach over alternative qualitative based approaches;

- the interview: this section explains the rationale both for the choice of the interview approach as the preferred method of accessing primary information and for the choice of the problem-centred interview approach over alternative semi-structured approaches;

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[84] 1971,p.11.
[85] 2009, p.27

- triangulation: this section explains how in order to reduce *"the frictional loss in decisions between research perspectives"* (Flick), the questionnaire-based approach was used in conjunction with the problem-centred interview;

- the questionnaire: this section describes the set of questions that comprised the questionnaire and the method of weighting interviewee responses to the questions.

4.ii Location and scale of research

This research study focuses on three SWFs, all based in the United Arab Emirates, the Abu Dhabi Investment Authority (ADIA), the Investment Corporation of Dubai (ICD) and the Fujairah Investment Establishment (FIE). Case studies drawn from outside the UAE context may possibly further deepen the original findings but only at the cost of thinning the amount of attention paid to each, whereas these findings should be sufficiently robust if attention is concentrated in depth on three case studies that have both strong overlapping characteristics and also some distinct differences. The overlapping characteristics clearly pertain to the fact that all three SWFs are based in a country that shares a common Arab culture, language and history. The distinct differences pertain not only to the fact that each Emirate has a fair degree of autonomy within the UAE federal structure but also to the fact that the three SWFs examined are very different in terms of size, organisational structure and length of history. Thus at one end of the scale ADIA represents not only one of the world's largest SWFs in terms of assets under management and numbers of people employed but also one of the world's oldest SWFs. In stark contrast, FIE represents not only one of the world' smallest SWFs but also one of the world's youngest SWFs.

4.iii Quantitative versus qualitative research methods.

Methods of research inquiry are typically classified as either quantitative or qualitative. A combination of both methods will be used in relation to the subject of SWFs under investigation here for reasons that will become clear after briefly summarising some of the major differences between the two methods .

The first major difference concerns the path of reasoning that links the 'general' with the 'specific'. Quantitative methods of enquiry follow a 'deductive' or 'top-down' line of enquiry in the sense that they begin with a study of a general phenomenon and then proceed to form a more specific theory or hypothesis about the phenomenon which can then be tested. Quantitative methods are also characterised as 'positivist' in the sense that it holds to a version of reality that contends that *"there is a reality out there to be studied, captured and understood"*[86] . Qualitative methods of enquiry by contrast follow an 'inductive' 'bottom-up' approach that moves from specific observations to broader generalisation and theories. Qualitative methods do not typically begin with a theory or hypothesis about what is general which is then tested or falsified as in positive, quantitative approaches. Rather, qualitative methods are more associated with postpositivist methods which *"argue that reality can never be fully apprehended, only approximated*[87]*"* Instead of beginning with a hypothesis, which presupposes some prior knowledge of reality, the qualitative mode of enquiry is a more open and flexible one which arrives at certain generalisations and conclusions.

This difference in the modes of enquiry overlaps with the difference in the nature of the data which are used as evidence to back up certain positions. The data in quantitative methods typically involve numbers and statistics which are the basis for testing and verifying or

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[86] (Denzin and Lincoln, 2008, p.14).
[87] (Denzin and Lincoln, 2008, p.14).

falsifying hypotheses. Saunders, Lewis and Thornhill (2000) define quantitative methods as being based on *"meanings derived from numbers"*[88] Cooper and Schindler (2008) state that *"quantitative research is often used for theory testing"*[89] and they make the general point that this is because this research method "*attempts precise measurement of something. In business research, quantitative methodologies answer questions related to how much, how often, how many, when, and who*". Elspeth McFadzean puts over the nature and purpose of quantitative data more forcefully when she states that these data "*are analysed using statistical techniques which can range from very simple methods such as calculating means and standard deviations to complex techniques such as analysis of variance or the use of non-parametric methods. In addition, quantitative methods tend to reduce phenomena down to their basic elements and investigate the causal relationships between these elements. The basic belief is that variables are objective, hard and tangib*le." [90](p.3) By contrast, the data in qualitative methods are not 'objective, hard or tangible'. Qualitative data typically involve words which, unlike numbers, do not take on any standardised form. As a result of this fact qualitative data collection requires classification into categories and data analysis requires the use of conceptualisation. To again quote Elspeth McFadzean " *qualitative methods.. tend to be more subjective. Researchers using these methods are inclined to explore a more holistic picture. Rather than investigate the causal relationship between basic elements, they want to understand how these phenomena, as a whole, work. Moreover, they are interested in the thoughts, feelings and ideas of the people who use and/or develop the phenomena. Thus the data that is collected is subjective and internal. In other words, researchers are collecting data that are socially constructed by their subjects. Their aim is to understand the meaning of the phenomena rather than how one element affects another*" [91].

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[88] 2000, p23.
[89] 2008,p.164
[90] 2005, p.3
[91] Ibid. p.5

A third major difference between the research methodologies concerns the variety of perspectives on the phenomenon under investigation. Quantitative approaches typically adopt a single perspective on reality, a fact that follows on from its positivistic emphasis on causality: a hypothesis is constructed about an aspect of reality and the hypothesis is then tested using a data set of numbers. Providing that the data set is properly constructed, there is no need to adopt a second, alternative perspective on the phenomenon or aspect of reality being tested. In other words, there is no need for triangulation. To quote Elspeth Mcfadzen: " *there is no need to triangulate quantitative methods as these should be accurate if undertaken properly*"[92] . By contrast, qualitative methods rely on multiple perspectives as a way of capturing as much of reality as is possible. These perspectives will not just rely on observations of events or facts but also on observations of individuals and on interpretations of their views and feelings. In this situation, triangulation is needed in order to ensure some measure of accuracy. To again quote Elspeth McFadzean: "*Qualitative methods...do not rely on large numbers, information is socially constructed by the interviewees and the data is interpreted by the researcher. Therefore accuracy must be ensured by triangulating people and/or sources*"[93].

A final major difference between the two research strategies that can be summarised here is that concerning the relation between the researcher and the object being researched. Quantitative approaches typically involve distance or separation between the researcher and the object. In the natural sciences this is easy to appreciate as researchers can have no social or emotional involvement with the natural phenomena that they study. However, even in the social sciences such as economics, where the objects are not natural but social phenomena, and where these social phenomena ultimately come down to the actions and decisions of individuals, the quantitative method of analysis still involves distance between the researcher and the

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[92] ibid.p.7
[93] ibid.

individuals being studied. By contrast, there is a view that the qualitative method of inquiry presupposes involvement, closeness between the researcher and the individuals being observed. As Carson, Gilmore, Perry,and Gronhaug (2001) put it, qualitative methodology is based on "*researcher immersion in the phenomenon to be studied, gathering data which provide a detailed description of events, situations and interaction between people and things, providing depth and detail*" [94].

Traditionally, the two research methods have been associated with different branches of knowledge; the quantitative approach with natural sciences such as physics and chemistry and some social sciences such as economics while the qualitative approach has tended more to be associated with social and cultural studies. However there are many areas of knowledge where a choice between the two methods can be made or where elements of both methods can be used in combination. It is these possibilities that explain why advocates of the two different approaches have traded criticisms, not to say insults down the years. Critics of the qualitative approach dismiss it as one which is imprecise, inaccurate, subjective and therefore not a genuine science. To quote Denzin and Lincoln (2008): " *Politicians and 'hard' scientists sometimes call qualitative researchers journalists or soft scientists. The work of qualitative scholars is termed unscientific, or only exploratory, or subjective. It is called criticism rather than theory or science, or it is interpreted politically, as a disguised version of Marxism or secular humanism... Positivists further allege that the so-called new experimental qualitative researchers write fiction, not science, and that these researchers have no way of verifying their truth statements*"[95] (p.21). Where critics of the qualitative approach emphasise the loss of accuracy due to imprecision critics of the quantitative approach emphasise the loss of accuracy due to too much precision. Reality is not simple but complex, and social reality is not only complex like

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[94] 2001, p.165
[95] 2008, p.21.

much of nature but also, unlike much of nature, is very fast changing. This is why quantitative methods used for purposes of isolating causes and effects can be too narrow and restrictive. To quote Flick (2002): " *Rapid social change and the resulting diversification of life worlds are increasingly confronting social researchers with new social contexts and perspectives...traditional deductive methodologies .. are failing...thus research is increasingly forced to make use of inductive strategies instead of starting from theories and testing them*"[96] Denzin and Lincoln, who also quote these passages from Flick approvingly, go on to argue that amongst the key factors that give qualitative methods an advantage over quantitative methods are the '*recognition of constraints of everyday life*' and the '*securing of rich descriptions*'[97] .

While quantitative and qualitative research methods are often posed as mutually exclusive, each with their own distinct advantages, a number of theorists have argued that the two methods can be used in combination according to the particular phenomenon or process being studied.(see e.g Mcfadzean, 2007; Yin, 2009) This was the intention here, although it has to be also said that the balance in the combination was weighted in favour of the qualitative side of the equation. The quantitative element comes from the fact that a deductive, top-down line of analysis is pursued in this research thesis: having surveyed the literature on SWFs and identified certain biases in favour of a particular interpretation of their role and function in the contemporary era, an alternative hypothesis concerning the latter questions is then put forward. However, this quantitative-type of hypothesis construction could not be tested in the standard quantitative-type way because of the lack of 'large numbers', the absence of any time series data due to the comparatively recent appearance and growth of SWFs and the absence of any substantial amount of cross-sectional data due to the relative opacity of SWFs (a feature that, as is argued here, is not as negative as is made out). These constraints necessarily dictated a greater,

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[96] 2002, p.56
[97] 2008, p.35

although not exclusive, reliance on qualitative methods for assessing the central hypothesis of this present study.

4.iv Reasons for the Case Study Approach

The need to use a mix of quantitative and qualitative research methods in this present inquiry is one reason for the choice of the case study as the appropriate framework for organising the various materials and data into a coherent analysis. Before elaborating on this point we first begin with looking at a definition of the case study approach and how it can be distinguished from other major forms of inquiry. According to Cresswell (2007) case study research as a methodology is "*a type of design in qualitative research, or an object of study, as well as a product of the inquiry. Case study research is a qualitative approach in which the investigator explores a bounded system (a case) or multiple bounded systems (cases) over time, through detailed, in-depth data collection involving multiple sources of information (e.g observations, interviews, audio-visual material, and documents and reports), and reports a case description and case based themes*"[98].

Cresswell argues that the case study represents one of five main qualitative methods of enquiry (others e.g Denzin and Lincoln (2008) give longer lists, while yet others e.g Miles and Huberman (1986) give shorter lists) and so to appreciate why the case study approach is better suited to the purpose of this study of SWFs than are the other approaches it is as well that the latter are briefly summarised. The first of these is the 'narrative' research, a method that concentrates on studying on one or two individuals, where the study makes use of their life stories, experiences and memories and chronologically arranging the meaning of those experiences. The second approach is 'phenomenological' research which differs from the

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[98] 2007, p.73

narrative mode in that it concentrates on the lived experiences of several individuals and describes the meaning of a concept or phenomenon to those individuals that comes out of their experiences. Where the first two approaches rely on description of experiences, the third approach, grounded theory, tries to theorise the meanings of the experiences of individuals, in other words it tries to extract some general conclusions, or generate some abstract analytical schema, from the collection of individual experiences. Where grounded theory looks at many individuals, these are not typically located in one place, sharing a similar language or culture and similar patterns of behaviour. Ethnographic research, the fourth approach, by contrast, does focus on an entire cultural group when trying to extract a theory or analytical schema from studying the experiences of the individuals comprising this group.

When going from narrative research to ethnographic research as outlined in the above sequence, the progression is a smooth and continuous one in that the emphasis is on individuals and their experiences, from one to many, from description to theory extraction, but always the emphasis is on understanding individuals and their experiences. With the case study, the fifth approach, there is a definite leap in that here the issue is how to understand or theorise a particular issue or problem and then look at a particular case as a means of illustrating that problem. The following quotation from Cresswell (2007) indicates this leap in analytical approach: "*The entire culture-sharing group in ethnography may be considered a case, but the intent in ethnography is to determine how the culture works rather than to understand an issue or problem using the case as a specific illustration. Thus case study research involves the study of an issue explored through one or more cases within a bounded system (i.e., a setting, a context)*"[99] Here, then, the relevance of the case study approach to this inquiry into SWFs can be seen: having formulated a particular hypothesis regarding the function of PSE-type SWFs in the current globalised era, namely that an explicit recognition of their 'political' character as government owned

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[99] 2007, p.73

investment vehicles allows them to function more effectively as 'coping mechanisms', it follows that a case study approach was the appropriate method for trying to substantiate this hypothesis precisely because it is an approach that looks at the general issue at stake from the perspective of the individual representative entity or entities within a set context.

Having decided that the case study approach was appropriate to the research problem here, the next question that had to be resolved concerned the type of case study to use. Cresswel distinguishes between types of case studies according to differences in size of the bounded case (whether the case involves an individual or group of individuals) and according to differences in the intent of the case analysis. In terms of intent, the three variations are 'instrumental' case study, 'collective' case study and 'intrinsic' case study. This third type was discarded here because the focus was on the case itself inasmuch as it represented an unusual situation. In an instrumental case study the researcher focuses on an issue or concern and then selects one bounded case to illustrate the point. The collective case study is the same except that the researcher selects multiple studies to illustrate the issue. This last approach was preferred here, first because the focus is on the issue and not the case itself which is merely the illustration of the issue, and second, because the selection of multiple cases to illustrate the issue can add depth to the illustration by virtue of providing different perspectives. The basic logic here is that of 'replication'. As Yin (2009) explains, the results extracted from one case study will be more robust if similar results can be extracted from other case studies that more or less duplicate the circumstances or context of the first case study. This type of replication is called 'literal replication', a form in which two to three cases are sufficient to supplement the original case. The alternative type of replication is 'theoretical replication', a form in which six to ten cases are used to see if contrasting but anticipatable results can be reached. In this research study, a literal replication study was used because it focussed on three SWFs, all based in the United

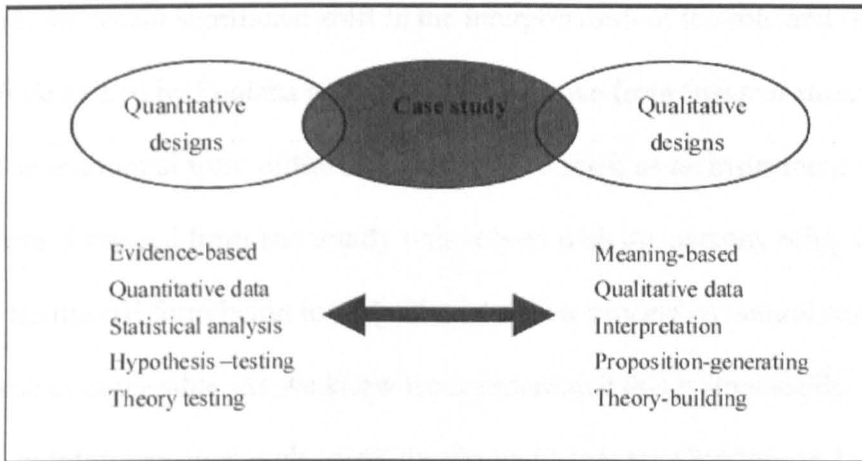
Arab Emirates, the Abu Dhabi Investment Authority, the Investment Corporation of Dubai and the Fujairah Investment Establishment.

To summarise, this research study used a 'case study' approach because this looks at a general issue from the perspective of the individual representative entities within that context; it used a 'collective' case study variation principally because the selection of multiple cases to illustrate the issue could add depth to the illustration by virtue of providing different perspectives; and, finally, it used a 'literal replication' form of case study because it focussed on three SWFs.

4.v Reasons for the semi-structured interview

At this point, we come back to the question of combining quantitative and qualitative research methods. Creswell, as noted above, sees the case study as representative of a qualitative research method. However, a number of research theorists, for example Maylor and Blackmon (2005), argue that a case study research design in actual fact offers a suitable framework for combining these two methods, an argument that is illustrated in figure 1. As can be seen in the figure 1, hypothesis-construction represents a key feature of the quantitative aspect of the research design. This was also the key feature of the present dissertation, but its expansion to the point of assessing or substantiating the hypothesis could not essentially rely on quantitative data for the reasons given above. This meant that resort had to be made to qualitative data, the use of which represents a defining feature of the qualitative side of research design.

Figure 1



Source: Maylor and Blackmon (2005)

Qualitative data can be divided into both primary data and secondary data. Primary data involve direct access to the respondents or subjects being studied. Secondary data, by contrast, "*are usually historical, already assembled, and do not require access to respondents or subjects*[100]". The great advantages of secondary data are that "*researchers are able to build on past research and body of business knowledge*" and that the use of this data is far more time and money saving as compared with the use of primary data which is more time and money consuming[101] (Zykmund, 1997, p.11). However, the great disadvantage of secondary data is the problem of inadequacy: even if such data is available, there may not be a sufficient amount as to enable proper tests to be made and proper conclusions to be drawn. This problem applies also to Sovereign Wealth Funds, which is why secondary data was heavily supplemented with primary data. This point brings us to the use of the interview.

[100] Zykmund, (1997, p.10)
[101] ibib.p.11

Before outlining the form of interview that was adopted here, it is first useful to note, as a background point, the recent significant shift in the interpretation of the role and function of the interview, a shift described by Fontana and Frey (2008) as one from '*neutral stance to political involvement*'. The traditional form of the interview was to see it as an instrument of analysis where the interviewer was distanced from and totally uninvolved with the persons being interviewed; the idea behind this traditional form being to make the interview process as neutral and as close to a scientific approach as is possible. As we know from experience this is impossible. The 'objects' being studied in an interview are not physical, inanimate phenomena but human beings with feelings, ideas, religious and cultural values and occupy the same social and political space as the people doing the interviewing. Therefore the interview cannot, by definition, be 'neutral' or 'scientific' and to pretend otherwise is to do more harm than good. As Fontana and Frey (2008) put it, interviewing *"is inextricably and unavoidably historically, politically, and contextually bound. This boundedness refutes the whole tradition of the interview of gathering objective data to be used neutrally for scientific purposes"*[102]. The modern approach to interviewing is one that explicitly recognises 'empathy', the removal of barriers between interviewer and interviewee so that the former not only becomes involved in the interview but also takes up a position, a stance. Given that the people that will be interviewed in the course of this inquiry are involved in various ways in the operation of SWFs and given the political nature both of the general interview framework and of the specific questions that will form the basis of the interviews it is only correct to recognise from the outset that the "*language of scientific neutrality and the techniques to achieve it*' are, as Fontana and Frey say, goals that are "*largely mythical*". Myths can have their uses, but in the present case of the interview, they serve to get in the way.

Having recognised that interviewing is not a detached process merely signifying the neutral exchange of asking questions and getting answers but a collaborative effort that *"leads to a*

[102] 2008, p.115

contextually bound and mutually created story",[103] there was still the question of which form of collaborative effort to choose from. According to the contemporary literature on the interview, there are basically there generic forms of the interview: structured, semi-structured and unstructured. In the case of the structured interview we are brought back to a position that is close to, although not identical with, the traditional view of the interview as a neutral, detached and scientific process. This is because a structured interview is quite rigid in its form and leaves little room for flexibility and room for manoeuvre. To quote Fontana and Frey (2008), "*in structured interviewing, the interviewer asks all respondents the same series of pre-established questions with a limited set of response categories. The interviewer records the responses according to a coding scheme that has already been established by the project director or research supervisor. The interviewer controls the pace of the interview by treating the questionnaire as if it were a theatrical script to be followed in a standardised and straightforward manner... There is very little flexibility in the way in which questions are asked or answered in the structured interview setting*"[104].

This approach has not been used here because the type of questions that were put to SWF personnel were necessarily of a type that needed to allow for nuanced differences and multiple perspectives and opinions. There was an ordered set of questions, but the procedure in getting responses had to allow room for flexibility, for the element of surprise and contingency and the voicing of alternative views. This point raises the question as to why it was not intended to go to the other extreme interview approach, the unstructured approach. As Fontana and Frey note, this approach is 'open – ended' rather than 'close-ended'. There is no formal interview framework; no pre-set list of questions around which the interview can be organised. The open-ended interview can have the advantage in that it can achieve a certain depth of understanding because of the freewheeling line of discussion that can allow for the contingent and the unexpected. However, its disadvantage, which

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[103] Fontana and Frey, 2008,p.116
[104] 2008, p.117

is the reason that it was not adopted here, is that its lack of organisation prevents reaching an assessment of a basic theory or hypothesis which was the intention of the present inquiry. In putting forward a body of unusual propositions regarding the rationale for small EME-based SWFs in the contemporary global era, the only feasible way of estimating how far these propositions have substance or depth is to extract responses from the key people being interviewed in a certain organised and systematic manner. Of course, the interview could not be so rigidly structured as to prevent flexibility of responses, but neither could it be so open and free that the individual responses received could not be compared in a way that could allow for some definite conclusions regarding the hypothesis put forward.

It is clear from the above that the preferred mode of interview here was one that mixed elements of both structured and unstructured approaches: the semi-structured interview. As Uwe Flick (2002) notes, the defining "*characteristic of the semi-structured interview is that more or less open questions are brought to the interview situation in the form of an interview guide. Thus it is hoped that these questions will be answered freely by the interviewee*"[105]. Note here that there is not open-endedness as the questions set form a guide, an organisational framework for the interview, while on the other hand there is no intention to close down the scope for discretion in the manner in which questions are answered.

Although the semi-structured interview was for the purpose of the present investigation of SWFs the appropriate form of interview, there are according to Flick a number of sub-branches of this form from which it was possible to choose. These include the 'focussed', 'semi-standardized', 'problem-centred', 'expert' and 'ethnographic' forms. All of these versions of semi-structured interviews have their strengths and weaknesses according to Flick, and therefore the final choice of approach has to depend on the particular line of inquiry that the interview is supposed to support

[105] 2002, p249

and the particular aim or purpose of the enquiry that the results of the interview are supposed to help achieve. Going by this criterion, it seemed that the 'problem-centred' approach was the one that was most fit for purpose in the context here. According to Flick, this interview approach is characterised by three central criteria: 'problem centring' i.e. the researchers' orientation to the relevant social problem; object orientation i.e. methods are developed or modified with respect to an object of research and process orientation i.e. adjustment in the research process and in the understanding of the object of research. All these elements applied here with regard to the present inquiry into SWFs: central to the inquiry was the problem of the political nature of SWFs and whether this nature should be explicitly recognised or subdued and hidden in the course of their operation; the method of interview was balanced between formal and informal approaches so as to get as close as is possible an authentic response to the question of the political nature of SWFs; there was a need for constant adjustment in the interview process so as to allow for sufficiently flexibility in the manner in which different interviewees could bring their particular experiences and opinions to bear on the subject being investigated and the questions being asked.

To summarise, the preferred form of interview that has been used here in discussion with senior personnel from ADIA, ICD and FIE was be the 'problem-centred semi-structured interview' : semi-structured in that it involved 'open' rather than 'closed' questions to the interviewees, a form of questioning that in turn encouraged free answering, and problem-centred in that, as stated, this form of the interview seemed particularly well suited to the problem of the political nature of SWFs. A list of the types of 'open' form questions presented to the interviewees is given in the appendix (see appendix 2).

4.vi Reasons for triangulation

It has been said that because of the nature of the subject under investigation here, the recent emergence of SWFs and the controversy surrounding the politics of these vehicles, qualitative methods of research have to predominate over quantitative methods even though these are by no means going to be excluded. However, the problem with qualitative research approaches is that because of the intangible, non-measurable nature of the materials relating to the subject under study, or because of difficulties in deciding which materials or aspects to include (the essential, the manageable, the relevant) and which to exclude (the less important, the secondary) there is more of a possibility of gaps in the analysis. Put another way, there is more of a possibility of what Flick (2002) calls "*frictional loss*" or "*loss of authenticity*" than is the case in quantitative research approaches. One way of reducing, if not entirely resolving, this problem of frictional loss is through triangulation. To quote Flick (2002): "*the frictional loss in decisions between research perspectives can be reduced by the approach of systematic triangulation of perspectives. This refers to the combination of appropriate research perspectives and methods that are suitable for taking into account as many different aspects of a problem as possible*" [106].

Triangulation was originally imported into qualitative research studies from land surveying (see FlicK, 2004), but the person who did much to popularise its use as a qualitative research tool was Denzin. For him the inspiration for the triangulation concept came from Greek mathematics: "*The concept of triangulation, as in the action of making a triangle, may be traced to the Greeks, and the origins of mathematics*"[107] In his original use of the triangulation method, Denzin argued that its rationale was to 'validate' a certain proposition or field of enquiry by adopting multiple perspectives as opposed to a single perspective: "*methodological triangulation involves a complex process of playing each method off against the other so as to maximise the validity of field*

[106] 2002, p.254.
[107] 1989, p.234.

efforts"[108] As Flick also points out (2002): "*Triangulation was first conceptualised as a strategy for validating results obtained with the individual methods*"[109]. However, this interpretation of the purpose of triangulation was subsequently criticised by a number of theorists including Fielding and Fielding (1986) who argued that "*we should combine theories and methods carefully and purposefully with the intention of adding breadth or depth to our analysis but not for the purpose of pursuing 'objective' truth*"[110]. This criticism was taken on board by Denzin who now accepts that "*triangulation is less a validation strategy within qualitative research and more a strategy for justifying and underpinning knowledge by gaining more knowledge*"[111]. Flick similarly states that "*triangulation is less a strategy for validating results and procedures than an alternative to validation which increases scope, depth and consistency in methodological proceedings*"[112].

As regards the hypothesis put forward here concerning the contemporary function of PSE type SWFs, it was not of course intended to attempt anything like a complete validation, an objective, cast-iron and scientific proof of the hypothesis simply because of the nature of the phenomenon under investigation. However, it was possible to assess whether the hypothesis did have some degree of substance and authenticity; in other words to assess whether the hypothesis being advanced was not an entirely fanciful one. This point brings us to the next issue, that of procedure. Having generally decided that the triangulation strategy was necessary for substantiating, deepening the authenticity of, the results regarding the hypothesis put forward here concerning SWFs, the next step was to decide the particular type or combination of types of triangulation method that is best suited to this subject. Denzin distinguishes four types of triangulation; 'data' triangulation; 'investigator' triangulation; 'theory' triangulation; 'methodological' triangulation.

[108] 1978, p.304
[109] 2002, p.253
[110] 1986, p.33
[111] Denzin and Lincoln, 2008, p.17.
[112] 2002, p.253

Data triangulation refers to the use of different data sources rather than the use of different methods of producing data. This triangulation method figured in the hypothesis assessment conducted below in that there was a mixture of reliance both on primary data, information extracted directly from interviews with key personnel in the SWFs that were chosen for case study, and on secondary data, including materials from journal articles, bulletins, annual reports and public statements. By investigator triangulation Denzin means the employment of different observers or interviewers in order to minimise bias on the part of the researcher. This type has not been used here because the hypothesis that is presented in this thesis already involves a clear and coherent statement of the position of the researcher; in other words, the bias of the researcher regarding the political nature of SWFs is made explicit from the outset and indeed that bias is part of the whole point of the hypothesis and of attempts to evaluate the responses of the interviewees to that hypothesis. Denzin defines theory triangulation as a method of approach where "*the starting point is approaching data with multiple perspectives and hypotheses in mind..various theoretical points of view could be placed side by side to assess their utility and power*"[113]. This third triangulation type has not been used here as the point of the hypothesis advanced here regarding the political nature of SWFs is expressly formulated as a counter-position to the mainstream views on the subject. These views are already well known because, as has been seen, they have been well publicised at every level - academic , political and diplomatic - and hence the point is not to evaluate their validity as to question their validity by putting forward and assessing a counter view.

The last generic form of triangulation and the one that Denzin most values is methodological triangulation. There are two sub-types of this form: 'within-method' triangulation, whereby the investigator takes one method and employs multiple strategies within that method to examine data, and 'between-method' triangulation whereby dissimilar methods are combined to illuminate the same class of phenomenon. Denzin considers this a much more satisfactory form of triangulation

[113] 1989, pp239-240.

method in that the "*rationale for this strategy is that the flaws of one method are often the strengths of another; and by combining methods, observers can achieve the best of each while overcoming their unique deficiencies*"[114]. Denzin states that between-method triangulation can take many forms but does not give examples. This is left to Flick who, interestingly, gives as an example of between-method triangulation the combination of "the questionnaire with a semi-structured interview". This is an interesting example, because it was precisely the form of between-method triangulation that has been used in this thesis.

To summarise, having first formulated the basic hypothesis that small country, PSE-type SWFs are better able to negotiate the pressures and upheavals of the global economy when they explicitly retain rather than renounce their 'political' character, the intention was not only to substantiate this hypothesis but also to enrich and complete it by combining the following three approaches:

(i) extraction of references from written material (secondary data):

(ii) semi-structured interviews using a set of problem-centred questions as a general framework for discussion (primary data);

(iii) a questionnaire where the questions are more specific and the responses are quantified using a simple standard of measure.

4.vii Reasons for the questionnaire

While the main burden of substantiating the present hypothesis regarding the role of PSE type SWFs in the modern global era relied on qualitative data, a questionnaire format served to bring in a more quantitative element insofar as responses to the set questions that were ranked according to the observed measure of agreement with the questions. Before elaborating on this point, we need first to distinguish between the use of 'nominal' and 'ordinal' data. Nominal data refers to the

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[114] ibid.p.244

labelling or coding of information into categories. This approach has been used in the semi-structured interview where each of the personnel occupying a particular senior position was assigned a number. By contrast, ordinal data refers to the ordering or ranking of data based on a scale. This approach was used in the questionnaire where, in the interests of simplicity, the weight range was from 1 to 5, where 1= zero or little agreement and 5 = maximum agreement. Note that the numbers in this scale did not measure precisely the amount of agreement with a particular question; rather they ranked the answers into an order of relative strength of agreement.

Before turning to the content of the questionnaire that will be discussed below, we first need to discuss data sampling. About 120 copies of the questionnaire were distributed in ADIA which employs approximately about 1300 personnel. The copies were evenly distributed across ADIA's seven departments. Approximately 100 copies were distributed in ICD, which employs approximately 800 personnel. These were evenly distributed across five of the subsidiary corporations of ICD. As the FIE is very small and only employs 37 personnel, copies of the questionnaire were distributed to all of them. As will be further noted in the next chapters, the response ratio was satisfactory, particularly in the case of FIE which recorded a 100% response ratio.

The questionnaire, as shown in figure 2, comprised of two sets of questions, one regarding the potential 'benefits' of a SWF to its home country and the other regarding the potential 'costs' of a SWF to that country.

Figure 2

Benefits and Costs of SWFs

(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization **B2**Facilitate inter-generational transfers **B3**Promote economic diversification **B4**Improve reserve fund management		**C1**Loss of cultural identity **C2**Losses due to unwanted attraction of investees **C3**Losses due to exposure to global gyrations **C4**Losses due to foreign restrictive measures	
Total		**Total**	

Before elaborating on how the questionnaire was used to help 'ground' the hypothesis regarding the role of SWFs as 'coping mechanisms', it is first useful to briefly recap the potential benefits and costs of SWFs to their home nations as given in the literature review chapter. The four main benefits of SWFs are:

Stabilisation; many EMEs are exposed to the swings and gyrations in the global economy, thus by diverting substantial amounts of their oil or non-oil export earnings into SWFs these can these be used as buffers or shock absorbers that can help to protect the domestic economy and the government budget from volatility in export earnings.

Intergenerational transfers; the need to conserve wealth for future generations is especially important for the oil and gas producing EMEs because these commodities are non-renewable and therefore by diverting current export revenues into SWFs these can then be invested in projects that can ensure a steady and permanent stream of income into the future.

Economic diversification; stable and high economic growth is more likely to be secured over the longer term when a country's economy is more diversified because different

sectors react differently to different phases of the global economic cycle, hence oil and gas dependent countries are likely to benefit highly from the potential diversification opportunities opened up by their SWFs.

Reserve fund management; to help minimise exchange rate volatility all small currency economies hold reserves, typically in the form of US treasury bonds. While these types of reserve instrument are safe and highly liquid, their downside is that they yield a relatively low return and thus a major benefit of SWFs is that they help to resolve this dilemma by allowing governments to divert a portion of their low yielding reserves into a more broadly diversified investment portfolio that can generate higher future returns subject to an acceptable level of risk.

Turning to the potential costs of SWFs for home nations, these broadly divide into four categories:

Loss of cultural identity as compared with a situation where surplus export revenues are held in investment vehicles that are directly managed and controlled by the government in question;

Losses due to the sheer size of a SWF's assets and their consequent power of attraction for foreign institutions searching for outside funding sources;

Losses due to the enhanced exposure of the asset portfolio to the gyrations of the global economy;

Losses due to the lack of transparency that may make other foreign governments and regulators so concerned about the impact of SWF investments that they adopt restrictive measures that then narrow down the SWF's room for manoeuvre.

The fact that the benefits of SWFs to home nations typically outweigh any potential costs should be self-evident: SWFS are hardly likely to survive let alone grow and flourish were it the other way round and the costs outweighed the benefits. However, the point of the questionnaire

was not only to establish that the net benefit ratio is positive (B>C) but also to quantify the degree to which it is positive through the simple system of weighting the responses. This aspect is important because the whole rationale behind the questionnaire was to use it to triangulate the interview responses concerning the political nature of SWFs. In the semi-structured interview, the discussion ranged around fairly open questions concerning the 'coping mechanism' hypothesis, but the responses certainly could not be quantified in a way that could establish the degree to which the hypothesis has depth or authenticity. This could be achieved through a three-step use of the questionnaire. On the first occasion, the respondents were asked to weigh the benefits and costs of the SWF in a context where there are no internationally agreed principles governing SWF conduct. On the second occasion the respondents were asked to weigh the same benefits and costs but this time in a context where the 'voluntary' Santiago principles do govern SWF conduct. On the third occasion respondents were asked to weigh the benefits and cost of the SWF in a context where they are forced to comply with an alternative, much stricter set of agreed principles regarding SWF conduct.

We point out the following reasons for the use of a three-step questionnaire developed around the central theme of the Santiago principles. We have said that PSE type SWFs maximise their potential as coping mechanisms when their 'political' nature is in some way acknowledged. Now in the Santiago principles it is repeatedly stated that SWFs should not have 'geo-political' motives but only financial and economic ones. In our view, this is because nowhere is there a distinction drawn between 'geo-political' interests in the PDM sense, that is, in the sense that large EME based SWFs such as those of Russia and China can pursue strategic interests for diplomatic or military related reasons, and the PSE sense. Hence, to allay fears on the part of Western governments and regulators, all SWFs, including those of small EMES, have to appear to conform to non-strategic political positions in order to be able to carry out their function efficiently. However, the fact that the Santiago principles do allow SWFs a substantial degree of

discretion of over what amount and what type of information to provide is an indirect concession to the 'political' nature of SWFs in that few if any private investment vehicles now have such discretion. Hence, by taking the net benefits of a SWF in the context where it conforms to the Santiago principles we could use this as a benchmark against which we could compare the net benefits arising out of alternative scenarios. Thus if there are no generally agreed principles in place, Western fears about SWF 'geo-political strategic' intentions would be greater and hence the ability of small EME based SWFs to carry out their coping mechanism role would be restricted. Similarly, the restrictions would also be great, and possibly be even greater, in the opposite case where the 'voluntary' Santiago principles are replaced by an alternative and more stringent set of generally agreed rules for SWF conduct because the demand for total transparency would be tantamount to reducing the 'political' nature and hence room for manoeuvre of small EME based SWFs.

Chapter 5

Case Study 1: Abu Dhabi Investment Authority

5.i Introduction

In this chapter we begin to look at three SWFs based in the UAE, a federation of seven emirates that gained full independence from the UK in 1971. Abu Dhabi is by far the largest emirate in terms of land space (87% of the UAE) and in terms of the country's natural resources, although not in terms of local population size where it is second to Dubai. Although the emirs choose two of their members to be the single president and vice president of the UAE respectively, thus confirming the UAE's status as a sovereign Gulf state, this does not in any way weaken the importance of the fact that the unity between the seven emirates is ultimately based on the recognition that each continues to be governed by its hereditary ruling family. This political point finds its economic reflection in the fact that the natural resources located in each of the individual emirates belong to those emirates and not to the UAE as a whole. This explains why we take as our first case study the Abu Dhabi Investment Authority (ADIA) because the major sources of its finance are the oil and gas revenues of Abu Dhabi that in turn owns and controls about 90% of the UAE's oil reserves and about 85% of its gas reserves. Before testing for the three hypotheses in relation to ADIA, it is first useful to look at Abu Dhabi's general economic strategy and at how ADIA is expected to fit in with and help promote this strategy.

5.ii The Abu Dhabi Economic Vision

Up to the mid-20th century, the economy of Abu Dhabi continued to be sustained mainly by camel herding, production of dates and vegetables and fishing and pearl diving. In 1939, Sheikh

Shakhbut Bin Sultan Al Nahyuan granted petroleum concessions, and oil was first found in 1958. Uncertain whether the oil royalties would last, Sheikh Shakbut was extremely cautious as to how to use these royalties and preferred instead to save the revenue rather than invest it in development. His brother Sheikh Zayed bin Sultan Al Nahyan, who became ruler in 1966 and who was the main driving force behind the formation of the UAE when the UK announced in 1968 that it would withdraw from the Arabian Gulf by 1971, took a completely different view and saw that oil wealth had the potential to transform and modernize Abu Dhabi and the country more generally. Indeed, after the Emirates gained full independence in 1971, oil and gas production and exports became by far the main source of exchange earnings and fiscal revenue for the government (between 1991 and 2007 the average percentage share of oil and gas earnings in the Federal government's fiscal revenue was 62% while the average percentage share was 73% in the case of Abu Dhabi's fiscal revenue (Shemirani, 2011, p.70)).

As argued previously, while oil and gas revenues present considerable advantages for a country that aims to use them to begin the process of economic and social development and transformation into a modern state, the downside is that over-dependence on this exhaustible source of revenue can at some point create difficulties. The most significant difficulty is the susceptibility of domestic fiscal revenues and of domestic economic growth to the gyrations in the export prices of oil and gas. Recognising the full force of the argument that balanced and sustainable economic development requires in the first place the diversification of the domestic economic base, the Abu Dhabi government launched, as a key element of its 2007-8 Policy Agenda, the *Abu Dhabi Economic Vision 2030*. Developed in consultation with the private sector, the ADEV represents a long term road map aimed at laying out the strategic requirements for ensuring the emirate's economic development. What is most interesting is that the ADEV repeatedly points out the need for 'diversification'. Thus at the outset of the executive summary it is stated that *"Economic diversification is common and fundamental to*

the government's other stated priority areas and the policy agenda as a whole". (ADEV, p.5) Later in the ADEV where the Economic Vision Imperatives are listed it is explained that *"The Emirate's drive for a more sustainable and diversified economy is intended to reduce the relatively high dependence on oil and the cyclical swings that accompany it"* (ADEV, p.7).

Once the primary aim of economic diversification for the reasons stated is understood, it then becomes possible to understand how all the domestic and international prerequisites for achieving this aim fall into place. On the domestic front, there are basically five key prerequisites. The first is the need to identify what new economic and business sectors to develop keeping in mind the characteristics that are specific to Abu Dhabi as well as its potentialities. To this end, the ADEV has given priority to developing various high valued added technology and knowledge based sectors. In so doing, it takes three countries in particular as benchmark role models: Norway, because *"it has comparable oil outputs to Abu Dhabi"* and is successfully *"channelling oil revenues for local economic development";* Ireland, because of *"the success in developing a diversified knowledge based economy"*; and New Zealand because of its success *"in building a relatively large export base" (*ADEV, p.10). The second prerequisite that follows on from the first is the need to invest in secondary and higher education so as to create a highly skilled and motivated workforce. The third prerequisite is that along with investments in human capital there also needs to be heavy investments in the country's transportation and communication and buildings infrastructure. The fourth prerequisite is that there needs to be a strengthening of the Emirate's governance and legal institutions so as to encourage a dynamic, competitive and entrepreneurial business sector. Finally, this ties in with the fifth domestic prerequisite which is to ensure a more efficient and effective partnership between public institutions and private firms.

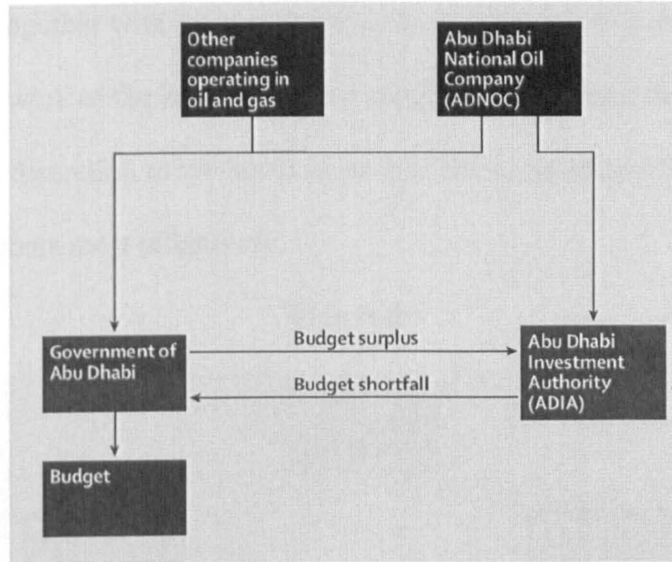
On the external front, there is basically one key prerequisite and this has all to do with international linkages. It is worth quoting the following passage from the ADEV at some length: *"Faced with the prospects of a more globalised economy, the emirate can rely on its established network of international relationships and friendships to respond to the many challenges of increasing globalisation. Moreover Abu Dhabi's geo-political status can help the Emirate to respond to the pace of technological change and harness the capabilities of research and development for future competiveness"* (p.13). Two things are made very clear here. On the one hand, Abu Dhabi's economy needs to integrate more closely into the global economy if it is to successfully tap into the latest technological developments and occupy a position in the global division of labour that is worthy of its potential; on the other hand, the process of global integration poses challenges that have to be handled carefully if Abu Dhabi is to successfully integrate on terms that are beneficial rather than harmful to it. It is here that we come to the importance of the Abu Dhabi investment authority ADIA. If successful economic integration into the global system is to be achieved, there have to exist organisations that can serve as the instruments for achieving integration, that can act as both the conduits for passing new technologies and business practices into Abu Dhabi's domestic economy and at the same help to shield that economy from the potentially destabilising shocks emanating from the global system. Before elaborating on this point, it is first useful to describe some background facts about ADIA.

5.iii The Abu Dhabi Investment Authority

The origins of ADIA go back to 1967 when the government of Abu Dhabi created the Financial Investments Board under the Department of Finance with the aim of investing oil revenues more profitably as opposed to merely keeping surplus oil revenues in Western bank accounts. Only later in 1976 did Sheikh Zayed take the decision to establish ADIA as an investment vehicle that was organisationally and managerially separate from the Abu Dhabi government while still

ultimately owned by the government. This change in organisational status did not change one of the major objectives of ADIA, which is to help smooth the government's revenues over the course of the business and economic cycle. As shown in the figure 1, taken from ADIA's first published annual review, ADIA's main source of funds are shares of the oil revenues from the Abu Dhabi National Oil Company (ADNOC) and shares in the budget surpluses of the Government of Abu Dhabi (whose main sources of funds are also oil and gas revenues). As also shown, ADIA is expected at times of economic downturn and fall in oil revenues to return funds back to the Government to make up for any budget shortfall. Given Abu Dhabi's small tax base, and given the Emirate's exposure to the swings in oil prices and therefore oil revenues the importance of ADIA as a budget smoothing instrument cannot be overstated. A measure of this importance can be gauged by the share of investment income as a proportion of total Abu Dhabi government revenue that averaged about 20% between 1999 and 2007 (Sherimani, 2011, p.61). Of course, ADIA is not the only investment vehicle that has contributed to this source of fiscal revenue to the government as there now exist alongside ADIA, which concentrates solely on foreign investments, two other important SWFs that concentrate primarily on domestic investment portfolios (ADICU and Mubadala). However, it is most probably the case that ADIA continues to be the major contributor to the government budget when this is required.

Figure 1

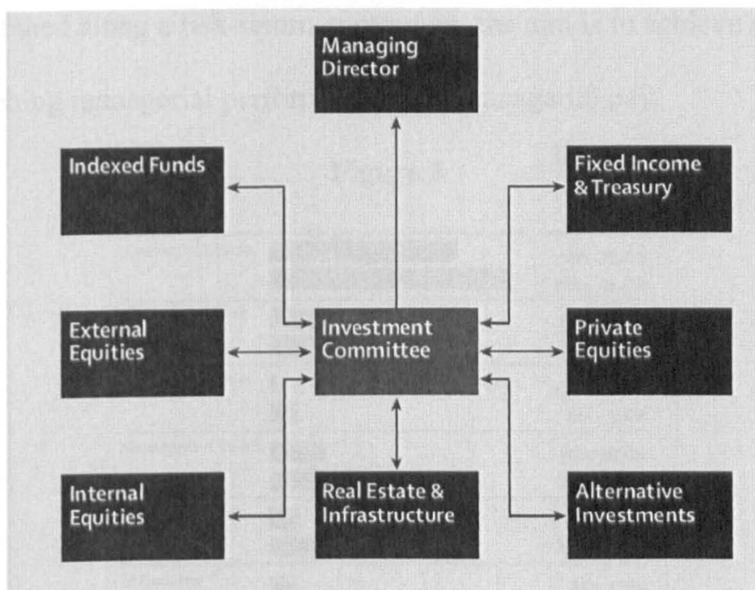


Source: ADIA (2009)

ADIA's story since 1976 is one of growth and sophistication both in terms of personnel, organisational structure and investment strategy. As concerns personnel the changes have been reflected not only in numbers – from about 200 in 1976 these had increased to 500 in 1988, to over 1000 in 1993 and to some 1,300 today – but also in terms of ethnic background. While almost all of the fund mangers employed by ADIA in 1976 were of foreign origin, today local people account for some 40% of the total, while of the remaining 60% this is now much more widely dispersed in terms of regional and ethnic backgrounds as compared with 1976 when most foreigners came from the US or West Europe. The Abu Dhabi government and the management of ADIA has always been concerned with the lack of local talent and so have invested heavily in training and recruitment programmes to try and boost the share of locally born employees in ADIA's total employment. As concerns organisational structure, the guiding principle here is to achieve a balanced coordination between control and discipline on the one hand with flexibility and room for discretionary decision making on the other. As can be seen in figure 2, the board of directors, which is appointed by the ruler of the emirate, has overall responsibility for the implementation of ADIA's investment strategy, but it does not involve

itself in ADIA's day to day investment and operational decisions that are the province of the Managing Director. Together with the assistance of the Investment Committee, the Managing Director overseas the work of the investment and support departments, that are illustrated in figure 2, while giving discretion to the heads of each of these departments to achieve the established strategic goals most effectively.

Figure 2

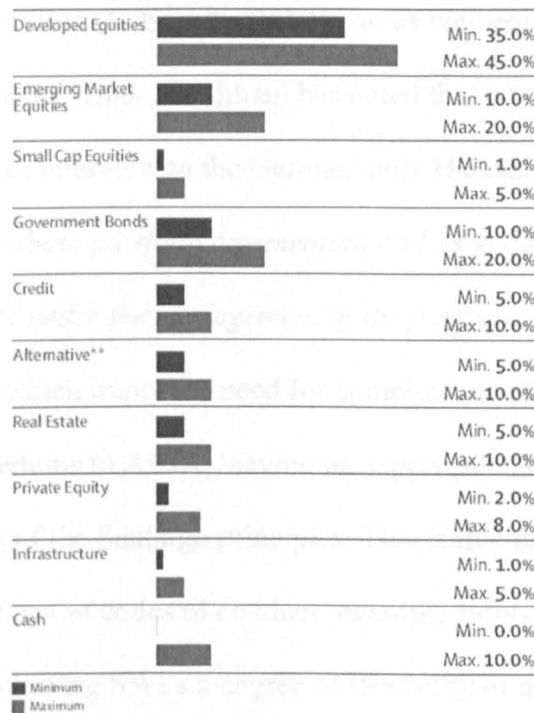


(Source: ADIA (2011)

ADIA's growing sophistication is above all reflected in the evolution of its investment strategies. At its beginning in 1976, ADIA invested in a few products, such as US treasury and other Western government bonds, and in a few foreign localities. It now currently manages a much more sophisticated global investment portfolio diversified across more than two dozen asset classes and sub-categories. Figure 3 gives a list of the major asset classes. Alongside the growth in the range of asset classes, the equally important strategic change is the growing shift towards index-replication strategies. In contrast to ADIA's early days when the typical portfolio was a broad based portfolio discretionally run by a single manager, more typical today is the narrow portfolio run to a specified risk-return ratio. Thus portfolios that track an equity or bond market

index closely and accept small tracking errors are expected to yield average market returns combined with average risk, while portfolios that have larger tracking error limits are expected to generate above average return at the cost of accepting above average risk. Alongside these 'core' portfolios that track market indexes, which account for about 60% of all ADIA's assets, there are the various 'satellite' portfolios such as private equity, hedge funds and infrastructure that aim to generate much higher returns albeit with a great deal more risk. By allocating funds in portfolios distributed along a risk-return continuum, the aim is to achieve maximum cost efficiency by matching managerial performance with managerial pay.

Figure 3



(Source: ADIA (2011))

The reason we now know more about ADIA' s investment strategies has all to do with the "Generally Accepted Principles and Practices of Sovereign Wealth Funds", the Santiago principles that were discussed at length previously. In 2008 ADIA had reached an agreement with the US Department of the Treasury (along with the Singapore Government's SWF) to help

lay core international policy principles and standards governing SWF investments. Following the agreement later that same year ADIA assumed the role of co-chair of the International Working Group of 26 SWFs that subsequently agreed the Santiago principles. Having helped lead the initiative to promote greater transparency on the part of SWF's and their investment activities, it was only logical that ADIA would then also put into practice its commitment to this transparency principle by issuing its first annual review in 2009. This said, however, ADIA has still come under criticism for not disclosing enough information about itself in either the annual reviews of which there have been three to date – or on its website. The main criticisms relate to such facts as concern the overall size of the assets under ADIA's management –estimates range from $300 billion to $800 billion (Behrendts, 2010) – or as concerns the precise regional and country location of investments. Thus Sherimani has noted that when Sheikh Ahmed bin Zayed Al Nahyan gave an exclusive interview to the German daily Handelsblat in January 2010, *"he disclosed little information about portfolio composition and its geographical distribution, while leaving the size of the assets under the management of the fund undisclosed*" (2011, p.62). However, these criticisms, which imply the need for complete, mandatory disclosure of every piece of information that pertains to ADIA, leaving no aspect private or public undisclosed, seem to miss the very point of the Santiago principles. This is that they are in the end a 'voluntary' not 'mandatory' set of codes of conduct regarding information disclosure so as to ensure a balance between allowing SWFs a degree of flexibility of manoeuvre in regard to their global investments while at the same assuring Western governments that they have nothing to fear in geo-political strategic terms from SWF investments.

5.iv Triangulation: Method 1

Having provided some background information on ADIA we now turn to the triangulation technique discussed in the previous chapter to assess the three hypotheses regarding the

importance of small country SWFs as coping mechanisms in a globalised world. In this section we begin with the first leg of triangulation, which is a close scrutiny of published information about ADIA. Most of this is contained in the annual ADIA Review that was first introduced in 2009 when Sheikh Ahmed bin Zayed Al Nehyaun was Managing Director of ADIA.

Hypothesis One states that the net benefits of a SWF such as ADIA to its home country and government are positive even when abstraction is made from any declared commitment to a set of internationally agreed principles regarding SWF conduct. To evaluate this first hypothesis we look at statements regarding first the benefits of ADIA and then regarding any potential costs.

As concerns the four listed benefits of SWF discussed above, it appears that the second one regarding intergenerational transfers is the most important given that securing the future welfare of Abu Dhabi is explicitly declared to be the overriding priority of ADIA. Thus at the very beginning of Sheikh Ahmed's Managing Director's letter in the first ever ADIA Review he states that *"For more than three decades, the Abu Dhabi investment authority has played a central role in safeguarding the current and future welfare of the Emirate of Abu Dhabi and its people".* (p.6) In Sheik Hamed bin Zayed Al Nehyan's Managing Director's letter in the 2010 ADIA Review , this commitment to the welfare of Abu Dhabi is made even more explicit as he states that *"With over 1200 employees, ADIA's mission has always been to secure and protect the future welfare of the Emirate of Abu Dhabi"* (p.5). The commitment to this central mission was again reaffirmed in Sheikh Hamed's 2011 ADIA Review Managing Director's letter.

If safeguarding the future welfare of Abu Dhabi is the overriding goal of ADIA, then according to its annual published statements its fund management strategy is the central instrumental means of achieving this goal. In other words, the advantages of efficient allocation and use of surplus oil revenues in investments is the second most important in the list of benefits conferred

by ADIA on its government and people. Thus to go back to the 2009 Managing Director's letter, Sheikh Ahmed states that *"We have carried out our mission by prudently investing funds allocated by the Government of Abu Dhabi through a strategy focussed on long-term value creation .. What began as a small operation with just a few people investing in fixed income securities is now a globally recognised investing institution with more than 1200 employees and a highly diversified portfolio of assets spanning multiple geographies and asset classes".*(p.6) This statement, and very similar ones made in the two successive ADIA Annual Reviews, clearly show that having ADIA as a large, independent investment organisation, employing a large number of highly qualified investment managers, enables the government to pursue a more beneficial and cost effective fund management strategy than would be the case if its surplus oil and gas revenues were simply kept in official reserves or invested through a directly managed government investment arm.

Contrary to what the established literature maintains as regards budget revenue smoothing to counter the cyclical gyrations in oil and gas prices, ADIA appears to give this potential benefit lesser, albeit positive, importance. Thus in the 2009 review it is stated in the section dealing with ADIA's relationship with the government of Abu Dhabi that *" ADIA is required to make available to the Government of Abu Dhabi, as needed, the financial resources to secure and maintain the future welfare of the Emirate. In practice, such withdrawals have occurred infrequently and usually during periods of extreme or prolonged weakness in commodity prices"* (p.6). What is rather strange here is that the second half of this paragraph clearly refers to budget smoothing, but the first half refers instead to the more general mission of securing the future welfare of Abu Dhabi. Taken together, the two halves of this paragraph, and the form of their presentation, clearly indicate that ADIA attaches only residual importance to budget smoothing. That it continues to do so is made clear by the fact that the above paragraph is reproduced word for word in both the 2010 and 2011 Annual reviews.

What ranks more highly than budget smoothing is the final listed benefit of SWFs, namely, regarding the promotion of economic growth and diversification. It is probable that the other Abu Dhabi SWFs such as ADICU and Mubadala by virtue of being more domestically focussed in their investment strategies play a more important role than does ADIA in facilitating these goals of growth and diversification. However, the supplementary importance of ADIA in this regard should not be underestimated as its training of 'home grown' talent in various financial and other institutional skills and its deployment of this talent alongside highly trained professionals drawn from over forty countries can have positive spill over effects for the rest of the domestic economy. Thus in the 2009 Review it is stated that *"we honour our employees commitment to this mission* (securing the future welfare of the Emirate) *by providing a stimulating work environment and opportunities to develop their skills in order to build a rewarding, long term career".* (p.11) Further on it is stated that *"ADIA plays a key role in developing future leaders, both to drive its own success and that of the Emirate*". (p.11) In the 2011 Review, this point is reiterated even more firmly: *"We are also firmly committed to developing local talent. Our scholarship programme reaches back into local schools to identify, develop and track students at an early age who we believe have the potential to be the leaders of the future"* (p.13). While affirming the importance of training local talent, the Reviews continually make clear that it is also through working in an environment where locals can mix with foreign professionals that the full benefits of skill and expertise externalities can be fully reaped.

Turning to the potential costs to Abu Dhabi posed by ADIA, the first of these represents the reverse side of the last of the above benefits, namely as regards the preponderance of foreign professionals and managers in the organisational structure of ADIA. Too much reliance on foreign talent may still be beneficial for ADIA's own investment operations but can also have a negative 'crowding out' effect in the sense that local talent is not nurtured and developed with

consequent beneficial spill over effects for the wider Abu Dhabi economy. It is because of the awareness that overreliance on foreign personnel may have long term negative cultural and economic disbenefits that in the very first Annual review of 2009 considerable emphasis was placed on the importance of identifying and nurturing local talent from a very young age. As Sheikh Ahmed, the then Managing Director stated in his letter: " *we attach the highest importance to nurturing both 'home grown' talent and international talent, as demonstrated by our significant ongoing investment in learning and development programs*" (p.6). Again, in the 2010 Annual Review, the new Managing Director, Sheikh Hamed, reaffirmed that *"we are also firmly committed to developing local talent"* (p.7). These repeated assurances that ADIA tries to strike a balance between international and home grown talent in the make up of its personnel is in our view clear indication that any disturbance to that balance can pose costs to the long term cultural and material well being of Abu Dhabi.

We turn now to the second potential cost of ADIA, which concerns the potential for incurring losses that are in some way linked to the size and attraction of ADIA's assets to foreign governments and private corporations. The most notable case in this context concerns ADIA's ill-fated investments in the US Citigroup Corporation in 2007, more on which below. For the present, we draw attention to a statement made in the Annual review of 2009 that was not subsequently repeated in either the 2010 or 2011 Reviews. In the section headed 'Commitment to building understanding' in the 2009 Review, the opening paragraph reads as follows: " *As a long-term investor with a purely economic focus, we believe ADIA plays a role in providing stability to international financial markets, especially during times of economic weakness when others with shorter-term strategies or liquidity needs may have to reduce their holdings"* (p.9). Now what is interesting here is that it was some Western commentators who in the course of the debate on SWFs that began seriously just before the outbreak of the financial crisis in 2007 argued that the plus side of SWFs is that they act as 'long term' and therefore stabilising

investors in contrast to other investment vehicles with more short terms needs. However, for Western commentators to say this as part of forming an overall balanced and objective picture of the role of SWFs in the global economy is one thing, but for ADIA or any other SWF to consciously take on this long term stabilising role as part of its investment strategy is quite another. Why should it be the duty of ADIA to provide stability to the international financial markets? The point here is that by getting ADIA to act in this way it was possible for Western governments, such as the US, to help lesson the burden on their taxpayers' money needed to bail out the banks. By investing heavily in Citigroup bank in 2007 ADIA may have helped to inject stability in the US economy but that investment subsequently incurred huge losses for ADIA.

What is interesting is that in the subsequent Reviews of 2010 and 2011 there is no section titled 'commitment to building understanding' but rather a section dealing with 'investment strategy'. In this re-titled section there is still a commitment to *"looking beyond individual economic cycles and focussing on strategies aimed at capturing secular trends to generate long-term, sustainable returns"* (p.8). And throughout the 2010 and 2011 there are still repeated assurances of a continuing commitment to maintain good relations with overseas government regulators and corporations based on trust and mutual understanding. However, there are absolutely no references to the idea that a central rationale behind ADIA's long term investment strategy is to help stabilise the international financial markets. On the contrary, what is now made explicit is that ADIA's duty, and its core rationale for devising long terms strategies that look beyond individual economic cycles, is to help shield Abu Dhabi's economy and government revenues from the sharp and potentially harmful effects of global economy gyrations.

This last point links up, albeit from a different angle, with the third potential cost of ADIA, which concerns losses due to over- exposure to the global economy. The irony here is that while ADIA exists in order to facilitate a globally diversified investment portfolio and thus help Abu

Dhabi's economy escape the limitations and drawbacks of overdependence on oil and gas revenues, the fact that the global economy itself can be subject to huge gyrations as has been proved by the experience following the outbreak of the financial crisis means that ADIA can inadvertently act as a conduit through which those gyrations and uncertainties can be fed through into the domestic economy. It is because the senior management teams of ADIA are fully aware of this danger that they have sought to ensure the widest possible spread of investments across regions and asset classes so as to a achieve a globally 'neutral' benchmark. In other words, the central idea is that up or down movements in the risk- return ratios in one group of regions or asset classes are counterbalanced by opposite movements in other groups of regions or asset classes. To quote from the investment strategy section of the 2010 Review when summing up its basic investment philosophy: *"The result is a recommended portfolio mix that contains more than two dozen asset classes and sub-categories, each with a fixed weighting, which together form ADIA's shared, long term view of the world, or "neutral benchmark"* (p.12).

The fourth and final potential cost of ADIA again owes its existence to the size of its assets. Where size allows ADIA to diversify across multiple asset classes and geographies and thus efficiently manage the overall risk and return targets, size also appears to foreign constituencies as posing a potential threat to their interests either because a build up of substantial investments in a foreign corporation can enable ADIA to exercise control or because sizable shifts of funds across asset classes can cause asset price volatility. This sense of threat can of course rebound on ADIA and its foreign investment strategy because of the retaliatory or other protectionist measures that can be raised against ADIA. The threat to foreign interests may be imaginary rather than real, but the degree to which ADIA lacks transparency regarding its investment intentions can help fuel the sense of threat and thus the degree of protectionism mounted against ADIA. It is because the senior management of ADIA understands this problem all too well that

the Annual Reviews since 2009 have all repeatedly emphasised the point that foreign companies have nothing to fear from ADIA's investments insofar as they are all entirely motivated by portfolio diversification motives without any geo-political overlays. Thus as in the 2009 Review Sheikh Ahmed stated in his letter that *"Our investment decisions have always been driven solely by economic objectives"*(p.5). Further on he goes on to emphasise, as is done in other sections of the 2009 review, ADIA's complete independence of the Abu Dhabi government as regards its portfolio investment. Finally, the Review emphasises that one of its guiding principles is that *"ADIA does not seek active management of the companies in which it invests"*(p.5). Interestingly, in the 2010 review there is not only a reaffirmation of this guiding principle but it is also taken a step further by including a reference to a general abstention from voting. To quote: *"ADIA does not seek to manage or be represented on the boards of the public companies in which we invest. In practice, this means that we usually abstain from exercising our voting rights, except in certain circumstances to protect ADIA's financial interests or to oppose motions that may be detrimental to shareholders as a body"*(p.5). This same paragraph was reproduced in its entirety in the 2011 review. Clearly, the repeated emphases on ADIA being a politically neutral investment vehicle that has only economic priorities and no ambitions to control foreign companies in which they invest is aimed at securing the free-flow of ADIA's investments across regions and asset classes. However, the equally important point is that these repeated assurances about transparency and sole commitment to economic and financial priorities indicate the potential costs arising out of ADIA's size and financial strength and the backlash amongst foreign corporations and government regulators that the fears of that strength can give rise to.

In sum, the anecdotal evidence that can be extracted from ADIA's published reports strongly suggest that Hypothesis One is valid: the net benefits of ADIA for the government and Emirate of Abu Dhabi are positive even while abstracting from any commitment to internationally

agreed principles regarding SWF conduct. Although there are potential costs as itemised above, the strength of the benefits appears to be sufficient enough to outweigh the costs. However, there is one complication concerning Hypothesis One that needs to be addressed. This is that on the one hand the hypothesis states that the net benefits of a SWF are positive even in the absence of the Santiago principles while on the other hand the evidence for this hypothesis could only be drawn from reports that only owe their very existence to the adoption of the Santiago principles in 2008. To get round this complication we use the power of inference: that is to say, from the information extracted from 2009 to 2011 Reviews we work backwards to infer the degree of net benefits without the commitment to any such 'voluntary' principles, while for Hypothesis Three we work forwards to infer the degree of net benefits arising out of a commitment to an alternative, 'mandatory' set of agreed principles. Before going on to discuss this third hypothesis we now turn to Hypothesis Two that states that the net benefits of ADIA to Abu Dhabi will be even higher with a commitment to the Santiago principles as compared with no such commitment.

In characterising SWFs as coping mechanisms that facilitate their core function as investment vehicles operating in a globalised economy, we identified two major characterising features of the latter that justify the need for SWFs to serve as coping mechanisms: namely, that it is both an unstable and unequally structured space. The second of these characterising features does not figure in any way in the published materials issued by ADIA, so we deal with this point below. However, the first of these features does on the contrary feature prominently in the Annual Review and above all in the Managing Director's Letter. The reason for this, of course, is that the starting date of publication of the ADIA Annual Review not only coincides with the adoption of the Santiago principles at the end of 2008 but also with the height of the great financial crisis signalled by the collapse of Lehman Brothers. When Lawrence Summers had written his famous article on the perceived threats of SWFs to the global economy in the

summer of 2007 he could not have known that the years of the so-called 'great moderation' were about to be rudely ended by the worst financial and economic crisis since the Great Depression, and so he could afford to assume that the Western Governments had finally found a way of maintaining a stable global economic landscape that could only be threatened by the eruptions caused by the appearance of SWFs. That illusion of stability was finally ripped apart by the crisis and so it was that the idea that SWFs act as mechanisms that could help shield small economy foreign investments from the worst effects of global instability came to the fore. Thus in his 2009 Letter Sheikh Ahmed stated that *"considerable uncertainty remains about the outlook for 2010 ..but economic turbulence is a fact of life. This is why we, at ADIA, have an investing philosophy that aims to diversify our exposure to known market risks while capturing long term trends...finally, in what has been a demanding environment, I would like to close by thanking my colleagues..their dedication and composure has ensured that ADIA continues to be well-positioned for the long term".* (p.6)

At an earlier point in his 2009 Letter, Sheikh Ahmed announced the importance of the Santiago principles that ADIA in its role as co-chair of the IWG-SWFS had helped to get accepted in October 2008 and confirmed ADIA's compliance with these principles. The link between compliance with the Santiago principles and the ability of ADIA to act as a coping mechanism in a turbulent economic world is clear: for the latter function to be successfully fulfilled ADIA needs to be flexible in its investment placements so as to be able to ride the sharp economic swings and their asymmetric negative effects in different regions and asset classes; however, flexibility presupposes an absence of retaliatory and restrictive actions on the part of foreign governments and corporations, and this in turn presupposes an atmosphere of openness and mutual trust. As Sheikh Ahmed stated *"We also understand that trust must both be earned over time and maintained through ongoing actions. So with the publication of this, our first Annual review, we aim to enhance understanding of ADIA in key areas such as governance, investment*

strategy, portfolio structure, our approach to risk and –the lifeblood of our organisation – our people". (p.7) In his 2010 letter, Sheik Hamed reaffirmed this link between ADIA's essential role to invest flexibly in an uncertain and volatile world and the need for transparency and mutual trust in order to ensure the 'free flow of capital' and hence ADIA's ability to invest flexibly: *" as a member of the global investment community we have always been conscious of the role that we, together with other investors, must play in building understanding and maintaining trust with governments and regulators around the world. This is essential to ensure the continued free flow of capital, which is in everyone's best interest especially during times of market disruption and uncertainty such as those experienced in recent years."* (p.8) What is particularly significant is that after making clear this link between the need for the free flow of capital (i.e the need to allow ADIA, along with other foreign investors, the ability to freely manoeuvre in a volatile world) on the one hand and mutual trust and openness on the other, the Sheikh then goes on to reaffirm the importance of compliance with the Santiago principles as had been done a year earlier by his predecessor: *"It is for this reason that ADIA was proud to play a leading role in the development of the Santiago principles.. Last year, we took this a step further by launching our first annual Review and re-launching our website ...in this 2010 Review we have added further information, including market overviews for each of the asset classes in which we invest, as well as key developments within our investing departments"* (p.9)

Given the above observations it seems reasonable to infer from them that Hypothesis Two is fully valid: the net benefits of ADIA for Abu Dhabi are greater when ADIA complies with the Santiago principles than is the case were ADIA not to comply with such principles. The key elements in the net benefit calculation that are most effected are the third and fourth listed potential costs of SWFs. As regards C3, through enhancing Abu Dhabi's investment exposure to the global economy ADIA can potentially incur heavy losses due to the turbulence in global economic conditions; but this is precisely the reason why ADIA needs not only to maintain a

highly diversified portfolio but also to react instantly and flexibly to changing market conditions by constantly changing the overall make up of its portfolio. However, as regards C4, flexibility requires the lowering of barriers that can be raised by foreign governments and regulators and this requires mutual trust and openness. Thus the degree to which compliance with the Santiago principles can achieve these latter conditions, so can this compliance help to reduce the potential costs of its actions. ADIA's management in 2009 was categorical on this point in the section "Commitment to building understanding" in the Annual review of that year for in explaining its reason for ADIA's central role in the process of establishing the Santiago principles it stated that *" a key element of this process was the expectation that if SWFS complied with the Santiago Principles, recipient countries would recognise and respect their compliance, and would not subject SWFs to any requirement, obligation, restriction, or regulatory action exceeding that of other investors"* (p.13) As we say, the clear implication here is that without the adoption of the Santiago Principles, that sends out an unambiguous message that SWFs *"had robust internal frameworks and governance practices and that their investments were made only on an economic and financial basis"* (p.12), foreign governments were more likely to subject SWFS to tighter regulatory constraints and obligations thus interfering with their coping mechanism role in an uncertain and turbulent global economy.

Turning finally to Hypothesis Three, let us first begin by recalling some definitions. The Santiago principles are 'voluntary' in a double sense: first, that SWFs are not compelled by any agency or authority to adopt them(although, as stated in ADIA's 2009 review, a condition of membership of the International Forum of SWFs is that with regard to the Santiago Principles SWFs "*are expected to support them and either implement them or aspire to implement them*") and, second, that SWFs are given leeway as to how much detailed information about their investment activities and strategies should be disclosed. Thus as already previously noted, ADIA itself has come under criticism for not divulging information about the size of its assets

or about the respective percentage shares of its funds that are distributed across specific asset classes or geographies. The key question here is whether the net benefits of ADIA were it to be bound by mandatory rules regarding information disclosure – i.e rules stipulating not only the principle of transparency and disclosure but also the precise amount of detail in the information given - would be greater or less than is the case when it 'voluntarily' complies with a more voluntary i.e discretionary system of information disclosure. Although it is difficult to answer this question based on any direct references to ADIA's published materials, it is safe to infer from the repeated references to the 'voluntary' nature of the Santiago principles that the answer would most likely be a reduced level of net benefits. The reason is that just as a total absence of transparency would lead to a higher level of the third and fourth costs of SWFs as listed above, the opposite case of mandatory full disclosure, thus inhibiting discretion and flexibility of action, would lead to a higher level of the second and fourth costs. As regards C2, it is likely that if ADIA were to constantly remind the outside world of the size of its assets and the degree to which these compare with the amounts held by other investment vehicles, this could lead it to come under more unwanted pressure by foreign government or private entities to make investments that, while beneficial to the latter, may be costly to ADIA itself. As regards C4, it is possible that if ADIA fully discloses the geographical size distribution of its assets, the governments in the areas where ADIA is relatively underweighted could take retaliatory action in the sense that they could give privileges to other investment vehicles that are seen to be giving them greater weight in their portfolios.

5.v Triangulation: Method 2

As argued in the methodology chapter, the usefulness of triangulation is that only by evaluation hypotheses from varying perspectives can the resulting conclusions be given any weight as the limitations associated with any one perspective are counteracted by the strengths of an

alternative perspective. This is very relevant in this case concerning ADIA where it was possible to ascertain from the materials extracted from ADIA's Annual Reviews that the three hypotheses regarding the net benefits of a SWF have validity. However, there are two sets of limitations. The first is that while it is possible to affirm that the net benefits of ADIA are greatest when it subscribes to the voluntary Santiago principles, it is difficult to assess the degree to which the net benefits in this case exceed the net benefits were ADIA not to subscribe to these principles or were ADIA compelled to subscribe to much tighter principles regarding SWF transparency and information disclosure. The second limitation concerns the proposition regarding an inequitably structured global economy and ADIA's place within it. While there was much that could be deduced from ADIA's published materials regarding its potential role as a coping mechanism in an unstable and uncertain global economy, nothing similar could be deduced regarding its coping mechanism role in an unevenly structured global economy. As will now be seen, both of these limitations are to a substantial degree rectified by the use of the second triangulation method as described previously, namely, the semi-structured interview.

Five senior personnel in ADIA were interviewed over the course of two mornings in Abu Dhabi. The personnel were drawn from the following five departments: External Equities (Deputy Manager, classified as N=1); Indexed Funds (Manager, classified as N=2); Fixed income &Treasury, Manager, classified as N=3); Alternative Investments (Manager, classified as N=4); Finance (Assistant Manager, classified as N=5). Before putting the specific questions concerning the benefits and potential costs of ADIA in an attempt to further evaluate the validity of our three hypotheses, we first outlined to the interviewees the broad context of the questions and the rationale behind the hypotheses. In other words, the interview was 'semi-structured' in the sense that we wanted to see how the interviewees would respond to our central claims that ADIA's role as a small country government owned investment vehicle could only be fully realised if it also acted as a coping mechanism helping to shield investments and the

decisions behind them from the pressures arising out of a highly unstable and highly unequal globalised economy.

In opening the discussion, reference was made to the Lawrence Summers famous 2007 article in the Financial Times and to the writings of Edwin Truman, all of which suggested that the sudden rise in the numbers and sizes of SWFs represented potential eruptions to an otherwise stable and evenly balanced global capitalist economy. All of the interviewees were familiar with the Summers article, while only three (N1, N2 and N4) were familiar with Truman's pronouncements, and they all concurred that Summers was unfortunate in the timing of publication of his article, appearing just before the full effects of the financial crisis were beginning to be felt. They made it clear that while a number of prominent US and other Western economists and policy makers were convinced that the period of the 'great moderation' was set to last for some time and that stability would from now on be the norm, they themselves had doubts that this would be the case considering the rapid structural changes to the global economy brought about by such events as the collapse of communism and the entry of China as a major world player amongst other things. Certainly, the global economy was now characterized by a more or less uniform commitment to the principles of capitalism and the profit principle, if not necessarily to Western political ideals, but uniformity in this sense did not necessarily mean a stable economic structure. On the contrary, the very process of integrating very diverse countries and peoples into a single capitalist system was bound to bring with it new risks and uncertainties in addition to new opportunities, although of course, no one could predict the depth or scale of the financial crisis that erupted over 2007-8.

While there was no need for clarification as to what was meant when we took issue with the notion that the global economy was generally self-stabilising, there was need for further elaboration as to what was meant by challenging the accompanying notion of an equitably

structured global space. The argument was put that while there was formal political equality between nations and governments in the general sense that no one of the latter could exercise direct or open control over others (although there still remained instances to the contrary) there was another sense in which core-periphery relations still held, notably in the economic and financial spheres, albeit that the power exerted by core economies and financial systems over smaller, peripheral ones was exercised from a distance and in an impersonal form rather than on any direct, relational basis. The interviewees, particularly N1 and N5, appeared to like the phrase of 'gravitational pull', the attraction of smaller financial systems to the larger core systems by the power of gravity rather than through the medium of personal or political control. It is, they said, in the nature of the current global reality that the US financial markets – the dollar money markets and the dollar securities markets –are by far the largest, deepest and most mature in the world. Thus it stands to reason that when deciding on asset and geographical locations for portfolio choices, there is no option but to weight portfolios heavily in the direction of these markets simply because the scale of all other currency-denominated markets (with the exception of the eurozone markets) pale in comparison. This asymmetry does give the US markets gravitational pull, especially when one considers that investment vehicles from all over the world are essentially competing to gain access to the US markets just to achieve globally balanced portfolios. This was the crucial point according to the interviewees, namely, that of asymmetry: while one had to have significant amount of US dollar-denominated assets even to begin to construct a global 'neutral' benchmark, one could potentially leave out this or that particular small-currency denominated set of asserts and still remain with a neutral benchmark. It is possibly because the US government and other regulatory authorities are fully aware of this asymmetry that puts them in a strong position vis a vis foreign investors even though they do not have to visibly demonstrate the strength of that position.

At this point we raised the controversial issue of ADIA's decision in November 2007 to purchase some $7.5 billion worth of convertible bonds issued by Citigroup, an investment that turned out to be extremely unwise as these bonds dramatically collapsed in value in the following months as the financial crisis deepened. Indeed, the losses were so extensive that in early 2009 ADIA brought an arbitration claim against Citigroup seeking damages of $4 billion. Now it is well known that the US government, faced with bailing out many other crisis stricken US financial institutions with taxpayers money during this period, was keen to get outside foreign assistance to help recapitalise Citigroup, one of the designated 'too big too fail' banking groups in the US. So the obvious question that arose was whether ADIA came under any direct US government pressure to invest in Citigroup on so large a scale, a question that was made even more obvious by the fact that shortly before the investment was made Richard Rubin, Citigroup's then Chairman but also a former US Treasury Secretary, travelled to Abu Dhabi. The answer was that there was no pressure in any direct, open sense.

The investment was a mistake because it departed from ADIA's traditional diversification strategy: although the convertible bonds it had bought converted to no more than 4.9% of Citigroup's equity –in line with the average ADIA stakes in corporations – the investment was in absolute terms too heavily concentrated in a single entity when what would normally have happened is to disperse funds across a number of US entities and financial instruments. That it was a mistake has to be admitted given that that ADIA subsequently sought damages, but that it happened was due to two contrasting factors. On the one side, the history and reputation of Citigroup made it seem unlikely that the fall in the value of its securities would have been as sharp as it turned out. On the other side, the feeling was communicated to ADIA that, given the size of its assets principally financed by its oil revenues much of which had come from sales to the US, ADIA had a duty of care to act as a cooperative player in the global financial system helping to rebalance financial imbalances. In so doing, the appreciation shown would materially

translate into giving ADIA more helpful investment opportunities elsewhere in the US financial system. Whether the communication of this sentiment amounts to pressure is debatable, but the notion of gravitational pull from a distance is certainly apposite in that it captures the way in which ADIA was led into making the investment.

The most interesting and most significant point that came of our discussion at this juncture was the observation that the Citigroup investment was not made secretively and that it was not made through the normal internal portfolio selection channels involving ADIA's professional investment managers. Instead, and as N2 particularly stressed, the investment was highly publicised and went through as a direct transaction between the Chairman of Citigroup and the Managing Director of ADIA. Several of the interviewees, particularly N2 and N3, noted that this one observation possibly gives indirect credence to the idea that SWFs do in fact act as coping mechanisms, as shields helping to protect investments from pressures arising out of the currently unevenly structured global economy; for had the investment in Citigroup gone through the normal ADIA channels, the likelihood is that the scale of that particular investment would not have been as large and would have been accompanied by several other investments in other US institutions and instruments.

With the above general context set in place, the discussion with the five interviewees turned to the specific questions concerning the benefits and potential costs to the Abu Dhabi government and country from having ADIA as an independently managed global investment vehicle as opposed to a vehicle directly managed by the Abu Dhabi government. Starting with the benefits side of the balance sheet, there was unanimity among the interviewees that the second and fourth benefits were on a par as being the most important. In fact, as they made clear, these two benefits were not independent in that while securing the future welfare of the Emirate was the central mission of ADIA, the execution of a balanced global investment strategy that combined

discipline and flexibility represented the means of achieving that mission on a consistent basis. Not far behind in terms of importance was the third benefit of helping to promote the domestic institutions that are essential to the continued development of the Abu Dhabi economy. While it was conceded that the other Abu Dhabi SWFs were also important in this regard by virtue of being more domestically focussed in their investment strategies, the special contribution that the more outward looking and globally focussed ADIA makes is that by allowing domestic talent to mix with foreign professionals drawn from over forty countries it enables the more rapid transfer of managerial skills and institutional knowledge necessary to the further development and modernisation of the economy. Fourth in importance, but still not to be underestimated, is the stabilizing function of ADIA's investments. All the interviewees, and particularly N5 from ADIA's Finance Department, agreed that at the end of the day as long as Abu Dhabi still relies on oil and gas revenues as its major source of income, the government budget will continue to be exposed to the cyclical swings in energy prices. For this reason, a continuing significant part of ADIA's overall function is indeed to help smooth out these budget revenue swings as and when necessary.

Turning to the potentials costs of ADIA, the first reaction of the interviewees was to point to the sheer size of ADIA's assets. Size was a potential source of problems associated with the second and fourth costs as listed above. In regard to C2, the interviewees emphasised the point that the general knowledge that a)ADIA was a globally focussed investment organisation and b)had relatively large sums at its disposal made it a target for anyone and everyone wanting investments in their organisation, a pressure that could lead ADIA into incurring losses due to restrictions in its room for manoeuvre, restrictions that are particularly acute when there is a fear of insulting foreign organisations when investments are not made in their direction. Size and global focus are also at the root of C4, albeit in this case for the opposite reason that foreign governments and regulators fear that ADIA's investments in local companies are motivated by

geo-political strategic goals and are aimed at gaining control in order to realise these goals. It was pointed out that it is precisely in order to put such fears to rest that explains why ADIA pursues a policy of never investing in equity that amounts to more than 5% of a corporation's total capital. This average ratio is maintained not only because of diversification considerations associated with the benchmarking of portfolios against market indexes but also because it is typically below the threshold for mandatory reporting requirements. If ADIA acquires a large enough stake that does trigger reporting requirements, this then tends to lead to protracted negotiations the essence of which is to ensure that there is no threat of corporate control and hence a potential threat to the host nation's security. As concerns the first and third costs of a SWF, the interviewees did not see either of these as being particularly significant. Of course, there was an acknowledgment that were ADIA's staff and senior management to be completely dominated by foreign nationals, then the question of a certain loss of cultural identity would become relevant. However, it is precisely to safeguard against this type of problem that ADIA has as a major priority a programme for recruiting and training local talent to ensure that a significant proportion – typically 30-35% - of ADIA's personnel are Abu Dhabi nationals. Similarly, there is acknowledgement that tying ADIA's portfolio to the global economy can run the risk of exposure to the gyrations of that economy. However, this is precisely why ADIA's central investment strategy is to keep its overall portfolio tied to a globally 'neutral' benchmark: as is constantly stated in ADIA's Annual Reviews, and as was again emphasised in the interviews, the whole point of diversifying across asset classes and geographies, and doing so in a way that combines discipline with flexibility, is to try and capture the return potentials of global investments while at the same time controlling for the risks.

On balance, it is clear from the interviews that Hypothesis One is affirmed: the net benefits of ADIA to Abu Dhabi are unambiguously positive. The next question of course is whether Hypothesis Two is also true, namely, the that net benefits of ADIA are even greater, and

possibly at their maximum, when ADIA adheres to the Santiago principles. When this question was put, the reaction was surprisingly quick and emphatic: all five of the interviewees were adamant that adherence to the Santiago principles was absolutely vital to ADIA's ability to carry out its core functions efficiently. For this reason they all paid respect to Sheik Ahmed's vision and willingness to take the lead and agree to co-chair the IWG-SWF forum that established the Santiago Principles in 2008. As to the reasons for this conclusion, the central point of focus was on B4 and C4: on the one hand, the benefits of portfolio management and diversification in a globally integrated world are likely to be maximised when there are fewer foreign government and regulatory barriers placed in the way of investments; on the other hand, there is less likely to be political opposition to ADIA's foreign investments when its intentions are clearly demonstrated to be non-political in any strategic sense and purely motivated by economic and financial interests. Of course, prior to the adoption of the Santiago Principles every effort was made to communicate to foreign regulators –via letters, texts, official documents and even by informal exchanges in one to one meetings – that ADIA's investment strategy was economic and financial in content and motivation and that there were no ulterior geo-political objectives at stake. However, all of this was not only time consuming and laborious but the very format of these messages and communications did not do enough to instil full confidence in foreign regulators. By contrast, the Santiago principles and ADIA's repeated assurances that it intends to comply with these principles as shown in practice by its published materials and website documents appear to give foreign regulators a greater sense of confidence because of the way that these principles codify and make more systematic the assurances of non-political motives provided by ADIA and the other SWFs who sign up to the principles.

Turning finally to Hypothesis Three, namely, that the net benefits of ADIA to Abu Dhabi would be less if ADIA were forced to comply with a stricter set of generally agreed principles as compared with the Santiago principles, the strength of reaction on this issue was surprising. All

the interviewees were adamant in their opinion that to replace the Santiago principles (which incidentally were not easy to get put into practice with over 25 SWFs signing up to them) with an alternative and less flexible set of principles would completely impair ADIA's ability for room for manoeuvre in a volatile and fast changing global economy. In other words, the net benefits of ADIA would certainly be much lower under a mandatory set of rules as opposed to a voluntary set. In regard to the specific reasons for this conclusion, most of the interviewees immediately focussed on the second of the four listed potential costs, namely, that to do with unwanted foreign attraction. It was argued that even before the financial crisis, it was important to keep the exact size of funds under management a secret so as not to give encouragement to foreign companies or governments to come seeking for investment funds of the type or of the amount that ran contrary to ADIA's own preferred and balanced investment strategy. It was asked what would now happen given the advent of the crisis when so many governments and corporations are cash strapped and desperate for outside funding. For ADIA to fully disclose all details regarding size and geographical allocation of funds would bring it under more pressure to make the kinds of investments that, while beneficial to others, would be detrimental to ADIA's long terms strategy of maintaining its portfolio to a global 'neutral' benchmark.

This last point overlaps (as three of the interviewees, N1, N2 and N4, pointed out) with the third of the four costs, namely, that to do with exposure to the gyrations of the global economy. Given that since the crisis cyclical swings in regional economies have become more prominent, with the emphases on the downward slopes of the cycles, it is now important than ever that ADIA sticks to its global neutral benchmark strategy so as to balance out the risks against returns, and for this objective to be efficiently maintained ADIA needs to minimise as far as is possible unwanted attentions from heavily indebted governments, corporations or banks. The other interviewees (N1 and N5) at this point intervened to argue that the third and fourth potential costs were closely intertwined because of the problems posed by the threat of

retaliatory and protectionist measures to the ability to maintain a global neutral portfolio strategy. Under the circumstances where there is no transparency, foreign governments and regulators hold up the threat of restrictive actions on the grounds that investments may be conducted for political-strategic reasons. By contrast, under the opposite situation where SWFS are forced to give complete and detailed information about all of their activities, foreign governments may threaten retaliatory restrictive action if they see preference given to other corporations based in other countries and not to their own corporations. Interestingly, in the course of this particular discussion one of the interviewees (N3) brought in the point about the strong gravitational pull of the US dollar market. Look he said, the largest US corporations are closely linked through personalities, party donations, lobbying power and so on with top US government officials, so if a particular US corporation or bank needs outside financial injection and they see that we might have plenty of money they will lean on US government officials who in turn will lean on us and make the injection. Now the pressure will be distant, not open or direct, because it will be made clear that if we play ball in this or that particular instance they will make it easier for us to make investments in other US economic sectors. Now of course the point is that we need to make heavy investments in the US dollar markets just to keep to a globally neutral portfolio simply because the dollar markets are so huge and dominant in the global economy. So yes, it is agreed that the US capital markets, and the US players within it, do collectively exert massive gravitational pull and if we are to manage the pressures of that pulling power in a way that is at least mutually beneficial then we need to retain certain discretion over the amount of information we supply regarding our fund size and its geographical and asset allocation.

To summarise, the interviewees certainly confirmed all three hypotheses concerning SWFs as coping mechanisms in an integrated but also uncertain and unequal global economy. While this result is generally in line with the results obtained from ADIA's published materials, what is

noticeably different is that the net benefits in the case were the Santiago principles replaced by an alternative set of principles would be so much lowered as to place these on a level that is below that in the case where no generally agreed principles are in place. In other words, the interviewees were clear in their view that if ADIA is to maximise its potential as a coping mechanism this could only be on the basis of 'soft law' principles allowing for discretion and flexibility, while the introduction of 'hard law' principles that gave no room for discretion and flexibility would be so counterproductive that it would possibly be better to have no internationally agreed principles at all.

5.vi Triangulation: Method 3

We now come finally to the third leg of triangulation, namely, the use of a questionnaire. While in the two previous legs it was possible to ascertain the validity of all three hypotheses, it was not possible to quantify the degree to which the net benefits of a SWF are maximised when it conforms to the Santiago principles or to quantify the differences between the net benefits when there are no principles in place and when such principles as are in place take on a more mandatory form. The questionnaire allows us to rectify these drawbacks to some, if not to a complete, extent.

Approximately 120 copies of the three-stage questionnaire were sent to a sample of ADIA staff drawn from seven different departments. 83 copies were returned. To inform respondents as to the context of the questionnaire, it was prefaced with an introductory note that briefly explained the background to the four potential benefits and four potential costs of a SWF. However, so as not to prejudice the responses, nothing was said about the three hypotheses. The result averages are reported below.

Questionnaire 1

Benefits and Costs of SWFs: No International Principles

(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization	4.3	**C1**Loss of cultural identity	1.9
B2Facilitate inter-generational transfers	4.9	**C2**Losses due to unwanted attraction of investees	2.5
B3Promote economic diversification	4.6	**C3**Losses due to exposure to global gyrations	2.3
B4Improve reserve fund management	4.7	**C4**Losses due to foreign restrictive measures	2.9
Total	18.5	**Total**	9.6

As expected, Hypothesis One is confirmed: the net benefit ratio is positive (i.e B-C =8.9) even when no internationally agreed principles for SWF conduct are in place.

Questionnaire 2

Benefits and Costs of SWFs: Santiago Principles

(1=Zero or little agreement, 5= maximum agreement)

Benefits	**1-5**	**Costs**	**1-5**
B1Facilitate stabilization	4.3	**C1**Loss of cultural identity	1.9
B2Facilitate inter-generational transfers	4.9	**C2**Losses due to unwanted attraction of investees	1.5
B3Promote economic diversification	4.9	**C3**Losses due to exposure to global gyrations	1.9
B4Improve reserve fund management	4.7	**C4**Losses due to foreign restrictive measures	1.8
Total	18.8	**Total**	7.1

As also expected, Hypothesis Two is confirmed: the net benefit ratio is higher (i.e B-C=11.7) when a SWF conforms to the Santiago principles. Interestingly, the impact on B3 is positive but less so as compared with the strength of opinions expressed in the interviews, while most of the positive impact comes from the reduction in the costs, C2 to C4.

Questionnaire 3

Benefits and Costs of SWFs: Alternative Principles

(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization	4.2	**C1**Loss of cultural identity	1.9
B2Facilitate inter-generational transfers	4.7	**C2**Losses due to unwanted attraction of investees	3.2
B3Promote economic diversification	4.2	**C3**Losses due to exposure to global gyrations	2.6
B4Improve reserve fund management	3.9	**C4**Losses due to foreign restrictive measures	2.9
Total	17.0	**Total**	10.6

Finally, as also expected, Hypothesis Three is confirmed: the net benefits of a SWF are lower (i.e B-C = 7.6) when a SWF is forced to conform to more stringent rules of conduct as compared with the Santiago principles. Indeed, the result gives further confirmation to what was already apparent from the interviews, namely, that forcing a SWF to give complete information about all its activities will impair its investment function far more than would be the case were there to be no internationally agreed rules of conduct.

5.vii Summary of results

The results of our first case study, ADIA, confirm the three hypotheses put forward concerning the coping function of SWFs for small EME-based economies. What is particularly interesting in this first case is that strong confirmation of the coping function hypotheses was provided by

all three legs of the triangulation method, the information gained from published materials, the conclusions drawn from the problem-centred, semi-structured interview and the results of ordinal data contained in the three stage questionnaires.

Chapter 6

Case Study Two: Investment Corporation of Dubai

6.i Introduction

Although Dubai is the second largest Emirate in land size, it is the largest in population terms with over two million in 2011. However, what is even more striking than the size of this figure is its composition. First, approximately 80% are non-Emirati residents, foreign guest workers mainly drawn from the Indian subcontinent, Europe and other Arab countries. Second, 77% of the population are male (23% female), a fact that reflects the temporary guest nature of foreign workers who tend to remit large proportions of their salaries back to their families. Third, and perhaps most striking, is the very young nature of the population, with more than half of all individuals (54% in 2010) being between the ages of 25 and 39.

This last characteristic ties in with the dynamic, fast changing nature of the Dubai economy. Apart from Abu Dhabi, Dubai was the only other of the seven Emirates that had a significant amount of oil reserves. However, these stocks are diminishing at such a rapid rate that Dubai's oil reserves are expected to run out by 2020. Thus one can understand why Dubai's ruling family and government have been even more urgently preoccupied with diversifying Dubai's economy away from oil dependence in order to secure its continued future economic growth. In this context the central overarching strategy over the past two to three decades has been to transform Dubai into the region's major service-based economy, with the key sectors being tourism and hotel and leisure services, construction and real estate, trade related services (wholesale and retail) and financial and banking services. Prior to the crisis, Dubai's economic growth rate averaged 6% between the mid 1990s and 2006, with tourism, foreign trade and

construction being among the key drivers. The crisis did have a significant negative impact on growth, with Dubai's economy contracting in 2008 and 2009 – the main sectors affected being construction and real estate – but growth resumed in 2010, albeit at a lower rate compared with the pre-crisis trend.

Dubai's government has made no secret of the fact that in developing its economic diversification strategy over the past recent decades it has taken Singapore as its role model. In this regard, the comparisons with the Singaporean growth model are notably striking in three areas in particular. First, there is a conscious embrace of 'globalisation' in the sense that only by opening up the domestic economy completely to both inward and outward economic flows (investment and capital, trade, tourism and labour flows, financial service flows) can it successfully integrate into the global economy as a major regional service hub. This strategy explains the creation of special economic zones characterised by the absence of tariffs, profit repatriation taxes, low administrative barriers etc and the sustained investments in the emirate's physical, legal and governance infrastructure aimed at facilitating the inward and outward economic flows. Second, there is an emphasis on targeting the high-quality end of particular service sectors rather than simply relying on a broad based average quality spread, the aim being to build up Dubai's competitive advantage over other regional service hubs such as Bahrain or Qatar in the way that was achieved by Singapore in the South East Asian region. Thus in financial services there has been heavy investment in developing top quality banking, legal and insurance support services. In construction and real estate the emphasis has been on developing top quality office space with a complete back up of top quality infrastructure support (e.g telecommunications, transportation linkages to the airport and sea port). Perhaps most striking of all in this regard, is the concentration of investments in the very high quality end of the hotel and restaurant sectors. As in the case of Singapore, Dubai has decided to target the above-median tourist income groups as part of its global tourism strategy with the result that it has the

highest proportion of 5 star hotels in the Middle East region. Indeed, the number of new 5 star hotels grew more rapidly than the rest of the industry in 2009 and 2010 (17%)[115], indicating that they are at the heart of Dubai's hospitality industry's orientation toward luxury tourism (apart from hosting Dubai's nightlife with restaurants and bars, they are also linked in with other luxury end items including jewellery, haute couture clothes and other luxury products and services).

Third, there has been a conscious attempt to emulate Singapore's service based growth development model in its evolutionary, multi-period sense as much as in its one-period aspect. When Singapore became independent of the Malaysian Federation in 1965 and was left to economically succeed on its own, it began life as an 'entrepot' economy, that is, as a simple trading, warehousing and shipping hub, before moving on to become a major location for the regional headquarters of multinational corporations and a high quality tourist resort and, finally, a major financial service sector with the creation of the Singapore International Monetary Exchange (SIMEX) in 1984. Of course, the major idea behind this evolution up the service ladder, from low-skill intensive sectors such as warehousing and shipping to high-skill and high-tech intensive sectors such as banking, insurance and financial services is to create multiple positive synergies and externality effects that could help improve the overall skill quality of the local population. This too, we find, is also the Dubai's government vision, that only by incrementally developing its service sector in both a quantitative sense (new sectors such as insurance, legal services etc. developed in conjunction with the established core service sectors such as banking and tourism) and in a qualitative sense (a greater concentration on the high tech and high quality end of particular service sectors) can it successfully maintain a competitive edge as a major regional service hub.

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[115] Lindback and Hultbeg, (2008)

Having said all of the above, there is one crucial respect in which Dubai's growth trajectory along a service development spiral differs from that of Singapore's, and this concerns time scale. Where Singapore developed its growth model over four decades starting in 1965 – from the basic trade oriented 'entrepot' model right through to the finance oriented model begun in the 1980s and fully operational by the 1990s – Dubai has rushed to develop its similar growth model in less than half of that time. In this regard, one could say that Dubai is like South Korea in the sense that where the latter country took the Japanese industrial-oriented growth model and compressed into what came to be the archetypal 'developmental state' model, so has Dubai taken the Singaporean service-oriented growth model and compressed it. The analogy can be taken further in that just as South Korea incurred a great deal of foreign debt in the way that Japan has never done in the course of promoting its high growth but also high risk strategy so has Dubai – in the rush to speedily transform itself into a regional financial, tourist and trading hub – taken on a great deal of foreign debt to help finance the various construction and other infrastructure projects that form the material basis for this transformation. This high risk strategy may have paid off had it not been for the great financial crisis and its subsequent devastating fall–out which caused enormous damage to Dubai's domestic economy, and thus its income generating capacity, in 2008-9. While one could argue that Dubai's government should not have taken on this big gamble in the rush to re-orientate Dubai's economy away from oil dependence, one could also put the counter-argument that no one could have foreseen the depth and intensity of the great financial crisis and that of its subsequent global ramifications.

It is here that we come to the importance of the contribution made by Dubai's Sovereign Wealth Fund, the Investment Corporation of Dubai (ICD). While Dubai's government incurred a substantial amount of foreign debt over the immediate pre-crisis period (estimates put the figure

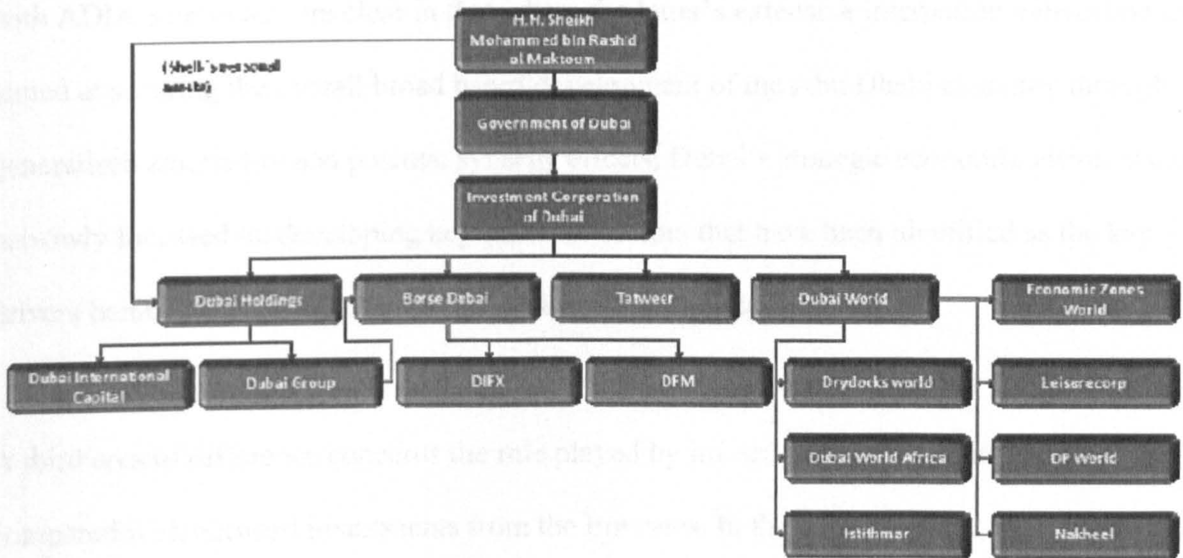
at $110 billion in 2008)[116] a sizable proportion of this debt has since been paid off with a major contribution to this effort being the contributions originating out of the profits generated by many of the subsidiary companies of ICD. Dubai's SWF is very young indeed, only have been established in 2006. Prior to that, government oil revenues and other sources of government income were managed in an assortment of investment vehicles directly managed as well as directly owned by the government. With the establishment of ICD, the ruling family and government of Dubai still own the investment assets, but these are now independently managed by professional investment advisers. Having finally decided to follow Abu Dhabi and ADIA's example, the Dubai ruling family saw that only by creating an independent and professionally managed investment body could it achieve one of the primary goals of investment, namely to achieve superior returns, at a given level of risk, through disciplined and efficiently managed portfolio diversification. While this aspect of diversification is very much in line with ADIA's philosophy, there are several significant differences between ADIA and ICD that need to be noted.

The first concerns organisational structure. Where ADIA is one of several Abu Dhabi SWFs and is quite independent of the others in terms of investment objectives as well as of investment management, ICD is the sole government owned SWF in Dubai that controls, through a system of subsidiaries, all of the other 'crown jewel' corporations of Dubai (see figure 1). Each of the subsidiaries has a specific function, which in turn fits in with a specific area of development. Thus Dubai World is mainly responsible either directly – or through Economic Zones World – for developing Dubai's' Duty Free Economic Zones and the commercial, transportation and communications infrastructures also geared to supporting Dubai's' role as a major trading and shipping area. For our purpose the main subsidiaries of interest and which hold the majority of the ruling government' assets are Dubai Holdings and its two subsidiaries Dubai International

[116] ibid.

Capital and Dubai Group, for these are the primary investment vehicles responsible for making overseas investments.

Figure 1



(Source: Lindback and Hultbeg, 2008)

Here we come to the second important difference between ICD and ADIA, which concerns the range of geographical and asset class diversification. Where ADIA engages in the broadest possible diversification along these two axes in the pursuit of maintaining a 'global neutral' portfolio, with the result that ADIA rarely holds more than 5% of any one company's total share capital, ICD by contrast engages in a much narrower investment target range, preferring to build up substantial shareholdings in a few, strategically placed corporations. Example cases include NASDAQ OMX group (44%), Travelodge (100%) and Mauser (100%). The reasons for this approach are that this represents an excellent means of securing access to the range of technology, knowledge and managerial skills required to develop the particular sector being given priority. Thus if the aim is to transform Dubai into a high quality tourist resort, the links with Mauser and Travelodge, through which the process of knowledge and skill transfers in this particular business area can be speeded up, makes good economic sense. Similarly, if another

major objective is to promote Dubai as a major regional financial centre, the tie up with NASDAQ OMX Group, as also the investment in the London Stock Exchange, represents a good way of securing the kind of expertise needed to achieve this objective. The differences with ADIA's approach are clear in that where the latter's extensive international investments are aimed at securing the overall broad based development of the Abu Dhabi economy through generalised externality and positive synergy effects, Dubai's strategic economic vision is more narrowly focussed on developing key business sectors that have been identified as the key drivers behind Dubai's rapid reorientation away from oil dependence.

A third area of difference concerns the role played by inward foreign direct investments as compared with outward investments from the Emirates. In the case of ADIA, this aspect of the matter has virtually no significance for two reasons, one being that the amount of inward FDI is relatively small as compared with domestically sourced investments in Abu Dhabi's economy most of which come either directly from Abu Dhabi's oil revenues or from Abu Dhabi's domestically focussed SWFs such as IDIC and Mubadala, and the other reason being that any foreign inward investments that do occur are generally managed in partnerships with the latter named SWFs rather than with ADIA. In the case of Dubai and ICD, by contrast, inward FDI plays a very significant role in helping to develop the domestic economy and its infrastructure speedily and one of ICD's major assigned objectives is to help coordinate inward FDI flows and manage them in conjunction with the investments made by domestic corporations.

The final area of difference between IDC and ADIA concerns transparency and information disclosure. Although ICD has signed up to the Santiago Principles and is now a member of the International Forum of SWFs, its transparency rating remains low as compared with that of

other SWFS including ADIA[117]. In contrast to ADIA, the ICD issues no public annual report as such and gives no information regarding assets under management, the geographical allocation of assets or about the returns on investments. However, what it does do on its website is to present a clear statement of intent –its general position regarding the aim of its portfolio investment strategy – and a list of the major corporations that come under the ICD umbrella. The differences between ADIA and ICD concerning transparency cannot, in my view, be the result of societal or cultural differences. This standard argument may apply to transparency differences between Middle Eastern SWFS in general and, say, a SWF such as that of Norway's. However, given that ADIA and ICD belong to two ruling families and governments that are tied together on several levels – national, family, religion, history – the role of cultural difference cannot apply in any meaningful sense. Nor can the transparency difference be due to the differences in portfolio investment, as the ICD's preference for a narrower and more concentrated spread of investments should logically be accompanied by more, not less, transparency in order to avoid any backlash (retaliatory) actions on the part of foreign governments and regulators. Instead, the most plausible explanation for the transparency difference has in my view to do with the relative young age of ICD. After all, ADIA was in existence for over three decades before adopting the Santiago Principles in 2008 and issuing its first annual review in 2009. ICD by contrast, was only formed in 2006 and so it is only to be expected that it will take some time before it can reach ADIA's standards regarding transparency and information disclosure.

6.ii. Triangulation: First Method

Having provided some background information on Dubai's growth trajectory and ICD I now turn to the triangulation technique discussed previously to assess the three hypotheses regarding

[117] SWF Institute (2010)

the importance of small country SWFs as coping mechanisms in a globalised world. In this section I begin with the first leg of triangulation, which will inevitably be a short one given the small amount of published information about ICD. As noted above, ICD's website does provide a brief outline of its structure and of its main subsidiaries but little other detailed information. However, what are significant in that they help shed light on ICD's overall aims are the following two statements published on ICD's website, the first a general one and the second a statement given by the Ruler of Dubai and Chairman of the Board of Governors of ICD, Sheikh Mohammed bin Rashid Al Maktoum:

(1) "*Investment Corporation of Dubai's investment portfolio is comprised of wholly and partly owned government businesses. ICD's mandate is to generate a superior return on investment, in a way that will benefit the regional financial community. We have achieved this through strategic investments in companies that have achieved global excellence and have defined the industrial, retail and financial landscape of Dubai.*"[118]

2) "*ICD is a vital and key initiative of the Government of Dubai to streamline and coordinate its various assets. As Dubai continues its untiring mission for excellence, ICD has an important role to play as the principal investment arm for the Government of Dubai. The portfolio companies that currently reside under the ICD are symbols of Dubai's successes in achieving excellence in the sectors in which we have chosen to participate. These companies will be the engine of Dubai's future growth under the stewardship of ICD's board of directors. We have a desire to build on the confidence placed in Dubai by the international investment community and we accord great importance to transparency and ethics. ICD will be at the forefront of these initiatives and will lead by example in its dealings with all its stakeholders*".[119]

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[118] ICD (2012)
[119] ICD (2012).

Hypothesis One states that the net benefits of a SWF such as ICD to its home country and government are positive even when abstraction is made from any declared commitment to a set of internationally agreed principles regarding SWF conduct. From the above two statements we can safely assume this hypothesis to be substantiated, principally through the references to the third and fourth benefits of SWFs: B3, the positive effects bestowed on the domestic economy through the SWF's global portfolio investments and B4, the improvement in asset management through the transfers of assets out of a directly managed government investment vehicle into an independently and professionally managed vehicle. As is mentioned in the first of the above statements, ICD's principal rationale is to help generate '*superior return on investment*' (B4) which in turn will help contribute to the '*excellence*' of the '*industrial, retail and financial landscape of Dubai.*' (B3). Similarly, the Chairman's statement to the effect that 'ICD is a vital and key initiative of the Government of Dubai to streamline and coordinate its various assets', gives a clear-cut confirmation of B4, while equally clear confirmation of B3 is given in the subsequent reference to the fact that 'the portfolio companies that currently reside under the ICD are symbols of Dubai's successes in achieving excellence in the sectors in which we have chosen to participate'. Recall that the Dubai's government emulation of Singapore is such that not only is the intention to develop particular sectors that are identified as the growth engine of the domestic economy but also to concentrate on the high quality end of those particular sectors in order to maintain competitive advantage in an increasingly competitive world. The repeated references to ICD being an instrument to help coordinate and achieve this excellence in specific areas shows the importance of ICD's contribution to Dubai's economy.

We now turn to Hypothesis Two that states that the net benefits of ICD to Dubai will be even higher with a commitment to the Santiago principles as compared with no such commitment. While no direct support for H2 can be derived from the first of the above statements, some strong support can on the contrary be derived from the last part of the chairman's statement. To

recall that part: '*We have a desire to build on the confidence placed in Dubai by the international investment community and we accord great importance to transparency and ethics. ICD will be at the forefront of these initiatives and will lead by example in its dealings with all its stakeholders*'. What is clear here is that a declared commitment to 'transparency and ethics' is aimed at building 'confidence' in the international investment community, an objective which is in turn crucial to allowing ICD to carry out its strategic portfolio investments. In this regard it should also be noted that transparency serves a two way purpose, namely, that by promoting openness and transparency with regard to inward foreign direct investments, this may help to pave the way for ICD's overseas investments; in other words, ICD can gain better access to foreign company shareholdings not only by being itself transparent in its investment objectives but also because of the transparency of the Dubai government's dealings with foreign companies investments in Dubai.

Finally, as regards Hypothesis Three, all that can be done is to use the power of inference to claim that it has some validity. The fact that despite the emphasis in the Chairman's statement on '*transparency and ethics*' and on the proposition that '*ICD will be at the forefront of these initiatives and will lead by example in its dealings with all its stakeholders*', the ICD provides comparatively few details concerning its global investment strategy would suggest that this strategy might be hampered and made more difficult were ICD forced to comply with a set of more strict rules regarding transparency and information disclosure.

6.iv Triangulation: Method Two

Let us begin this section by again repeating the point that the usefulness of triangulation is that only by evaluation hypotheses from varying perspectives can the resulting conclusions be given any weight as the limitations associated with any one perspective are counteracted by the

strengths of an alternative perspective. If this was true in relation to ADIA, it is many times more true in relation to ICD given the relative paucity of its published materials. Hence, if any successful attempt at substantiating our three core hypotheses is to be made, it will have to rely more strongly than before on the second and third methods of triangulation. In relation to the second of these, the structured interview, we shall see that its importance in affirming our three hypotheses cannot be overestimated.

As in the case of ADIA, we managed to interview five senior personnel from ICD over the course of a morning. Three of the personnel were from Dubai International Capital (Director, External Equities, classified as N=1; Director, Fixed Income Securities, classified as N=3, and Director, Global Mixed Securities, classified as N=3); one was from Dubai Holdings (Deputy Director of Finance, classified as N-4) and one from Dubai Group (Director, Real Estate and infrastructure, classified as N-5). Again as in the case of the ADIA structured interview, I began by outlining the standard mainstream view of the role and potential benefits and disbenefits of SWFs in the global economy and the counter-posing hypotheses about small EME-based SWFS as 'coping mechanisms' in that economy. Far from being a stable and equal space as was often presumed prior to the financial crisis, the global economy, we put it to the interviewees, is on the contrary a highly unstable and highly unequal space. The immediate response of the interviewees to this opening set of observations was that they very much liked the idea –which they had never heard of before – of SWFs serving as 'coping mechanisms' in a globalised world. The substance of the idea they were familiar with, but not the phrase itself, which, they said, accurately captured what ICD was really all about. In this connection, they raised the issue of Temasek, Singapore's chief SWF, arguing that if Singapore was Dubai's chief inspiration and role model for generating economic growth for a small service based economy in an integrated but highly competitive global market economy, so was Temasek –along with ADIA - one of ICD's chief role models as a SWF. They noted how Temasek has indeed acted as Singapore's

coping mechanism, particularly after the Asian crisis of 1997 which hit Singapore's domestic economy very badly in the subsequent fall-out effects in the course of 1998, helping to soften the impact of those effects through its regional and global investment diversification strategies. The key point they emphasised, particularly by N3 and N5, was that just as Temasek's role is to help develop Singapore's key domestic sectors of finance, trade and tourism – and at the same time help to shelter these sectors from the gyrations of the global economy - through its strategic linkages to foreign companies operating in similar or supporting sectors, so is ICD's role very much in the same vein. Of course, there is also much to learn from ADIA, especially given its closeness, but where it provides a more general contribution in helping with Abu Dhabi's economic development, ICD's contribution to Dubai has to be more focussed. In this latter connection, the interviewees, notably N4, made an interesting comparison with Singapore and Temasek, namely, one that concerns absence of domestic financial resources and hence speed and urgency of growth and development. Abu Dhabi is still rich in oil reserves, and can be assured of huge oil revenues for years to come, and for this reason ADIA can take a relatively more relaxed and therefore more broad-based approach to the aim of aiding and promoting Abu Dhabi's domestic economic growth. Dubai by contrast has no such luxury as its oil reserves will run out and so finds itself in a position similar to that of Singapore in the 1960's when it was forced to leave the Malaysian Federation and survive on its own. Having no oil or gas or other natural resources how did Singapore survive? By punching a hole for itself in the global economy and making itself indispensable to the South East Asian region as a high quality service hub; in other words, Singapore did not simply sit back and bemoan its fate or rely on the resources given to it by nature or by God but consciously went out to create a competitive advantage in its chosen areas of specialisation, eventually using Temasek as one of its key investment instruments, and this is what Dubai and ICD are also now doing.

Turning the discussion to a more specific focus on the idea of the global capitalist economy being one that had now entered into an era of 'great stability', all of the interviewees stated categorically that they had never been particularly impressed by this notion. In this regard the experience of South East Asia in 1997-8, of Russia in 1999, of Argentina in 2000-2001, and of certain other regions over recent decades all appeared to falsify any notion of the global economic market as being an inherently self-stabilising space. Of course, one could argue that all of the above cited examples represent regions that are on the periphery of the globalised economy, and so are bound to exhibit more gyrations and instability as compared with the core economies but from the vantage point of the Emirates, also a peripheral EME, how else can one view the global economy as a whole except as one that is always prone to instability in the absence of concerted government actions. This said, however, the interviewees nevertheless also believed that the core economies themselves could not generally be characterised as inherently self-stabilising. Japan, it was pointed out by N1, is a major G7 economy and yet went fifteen years, from 1990 to the mid 2000s, through a period of zero or stagnant growth. If the US and European economies appeared to fare better over this same period, thus giving rise to the notion of the 'great stability', the interesting point made here by the interviewees is that this had more to do with the absorption of the Chinese and former Soviet bloc labour forces into the global market – thus helping to keep down labour costs and inflation rates even while there was high growth – rather than through the inherent abilities of the G7 economies to self-stabilise. Once this set of external factors had become fully absorbed into the US and European growth models, the contradictions associated with the development of a fully integrated market economy began to make themselves felt as, for example, through the rise of global imbalances (the surpluses of China and other low wage export economies counterbalanced by the deficits of the US) and the rise of private debt levels (the reliance of increasing numbers of US households on credit to make up the shortfall of stagnant wages partly caused by global labour market competition). As a final point here, while all of the interviewees were adamant that while the US and other

Western economies were never in their view free of the threat of instability- they all smiled when reference was made to Gordon Brown's 'no more boom or boost' phrase' – they at the same never believed that a crisis of the scale witnessed in 2007 could have broken out in the US. The fact that it did, they concluded, is all the more reason why a key mission of the ICD is to help attain a balanced geographical spread of investments in the sense that while some focus still inevitably remains on US and EU investments, there is also need for room to make investments in an assortment of other geographical areas.

Moving on to the question of inequality between countries and nation states in the globally integrated economy, the ICD interviewees, like those of ADIA, very much warmed to the idea of gravitational pull and control at a distance. They agreed that not all nation states and their governments are equal, even if there is formal equality, and that this inequality is generally not exercised on any direct, one to one basis, although they all knew of particular circumstance where such types of control and exploitation of inequality has happened. The interesting point they made here, and notably by N3 and N5, in this connection with 'distanced' and 'impersonalised' control related to the question of 'standards'. The West led by the US, tend to introduce standards in such areas as governance, banking, accounting, financial disclosure and so on that are billed as 'globally neutral' but many of which in actual practice reflect the past historical experience and present cultural values of the West itself. Now inequality enters the picture here in that non-West countries are obliged to adhere to standards that are set by the West and that have involved little if any input from themselves. Now while one could argue that some areas of business and market activity can involve notions of technical neutrality, other areas such as the question of transparency and the amount of information disclosure quite clearly do not. Different countries, drawing on different cultural traditions, have different notions of what is meant by transparency and so for the US and other Western countries to present their notion as something that is globally or technically neutral to which all other

countries must aspire is an example of control at a distance: subscribe to the US' notion of transparency or face the prospect of being blocked from full access to the US capital market. The dilemma this poses for small EME based economies is clear: if full access to the US and other Western economies is blocked, this will certainly the limit the opportunities for EME based economies and their governments to build and maintain balanced international portfolios, while fully accepting Western standards of transparency to keep open investment opportunities in the West will on the other hand possibly be more in the interests of the Western governments and corporations than in the interests of the EME governments themselves. Are SWFs a useful coping mechanism in the sense of trying to resolve this particular dilemma? Yes, it was concluded by the interviewees. The whole point of the ICD's formation was not just to streamline the Dubai government's assets and their management, but to create an overarching umbrella institution that could negotiate key issues such as to do with transparency and ethics, accountancy and legal standards etc., on terms that are mutually acceptable to both the Dubai government and to foreign governments and regulators. Yes, it was agreed, ICD's role can indeed be said to provide a mechanism for absorbing, managing and on occasion deflecting the various pressures emanating from the global economy.

At this point in the interview the discussion with the five interviewees turned to the specific questions concerning the benefits and potential costs to the Dubai government and country in having ICD as an independently managed investment vehicle as distinct to a vehicle directly managed by the Dubai government. As concerns the benefits side of the balance sheet, the interviewees agreed that the third and fourth benefits were the most important: more specifically, they agreed with the Chairman's statement that the overriding aim in establishing ICD was to streamline and make more efficient the management of portfolio assets (i.e B4), an aim that is in turn designed to give material support to the type of outward and inward investment flows that can benefit the overall economic profile and growth potential of Dubai (i.e B3). Certainly, the

underlying and more general rationale behind ICD was to help secure the future welfare of Dubai and its people (i.e B2), but as concerns the budget stabilisation function of ICD (i.e B1), this was ranked less in importance given that Dubai's economy was no longer as reliant on oil exports as it once was and hence no longer as sharply exposed to the gyrations in oil prices. This is not to say that the budget support function was irrelevant, because as shown by recent events surrounding Dubai's debt problems, ICD's revenue and profit streams have made an important contribution to servicing the debt as well to reducing its overall size. Rather, the point is that ICD's more important aim is to help speed up Dubai's reorientation away from any one sector-reliance and thereby give a give a more solid and broad-based economic foundation for Dubai's public revenues. As to the costs side of the equation, the interviewees were ready to concede that the second of the four listed costs was possibly significant: the bringing together of all of Dubai's major corporations under the ICD umbrella made this SWF seem all the more attractive to financially strapped foreign governments and corporation. Indeed, it was precisely the fear that any full revelation of the value of ICD's total assets under management would bring forward a multitude of unwanted foreign suitors that explains why ICD's management is extremely reluctant to provide this information on any regular basis. In sum, it became clear from the interview that Hypothesis One is affirmed: the net benefits of ICD to Dubai are positive even in the absence of any adherence to internationally agreed rules of SWF conduct.

The next question is whether Hypothesis Two is also true, that net benefits of ICD are greater when it does adhere to internationally agreed rules as typified by the Santiago Principles. The reaction to this question was somewhat muted as compared with the reaction expressed by the ADIA senior personnel. However, this said, all five of the ICD interviewees were in agreement that adherence to the Santiago principles was helpful to ICD's mission to execute its global investment functions efficiently. The reasons given for this conclusion were essentially similar to those given by the ADIA interviewees inasmuch as the central focus was again on B4 and C4:

the benefits of global portfolio management are more likely to be maximised when there are fewer foreign government and regulatory barriers placed in the way of investments, and there is less likely to be political opposition to ICD's foreign investments when its intentions are clearly demonstrated to be non-strategic in any military or diplomatic sense and solely motivated by economic and financial interests. In this connection the interviewees raised the issue of the ill-fated attempt by Dubai World (and more specifically, its subsidiary the DP World) to take over the management of six American ports including those in New York, in 2005. Although there were several reasons why members of the US Senate and Republican Party were fiercely opposed to the takeover deal, even though it had the full support of the Republican President Gorge Bush, it is possible that the absence of any formal declaration of commitment to the principles of transparency and ethics on the part of Dubai World may not have helped matters. It was partly with this experience in mind that when ICD was formed a year later in 2006, it lost no time in signing up to the Santiago Principles and, through its Chairman no less, issued a clear statement of intent regarding commitment to transparency and ethics in all its dealings with all its stakeholders. At this juncture, we took the discussion back to hypothesis one and pointed out that as regards this hypothesis the interviewees had only mentioned C2 and not C4, which should have been the case considering the fact that if the potential costs due to any blocking or retaliatory action by foreign governments and regulators is lowered with formal declarations of adherence to transparency and non-strategic objectives then it must follow that those same potential costs are likely to be higher in the absence of any such declarations. The interviewees conceded this argument and agreed that on balance the net benefits of ICD to Dubai are higher with adherence to the Santiago principles as compared with non-adherence.

As regards Hypothesis Three, that the net benefits of ICD to Dubai would be less if ICD was forced to comply with a stricter set of internationally agreed principles as compared with the Santiago principles, the reaction to this proposition was as equally fierce as was the case in the

ADIA interview. On this occasion, we were not surprised given the warning signs as conveyed both in the short published materials and in the preliminary part of the interview. All the interviewees were as adamant as their ADIA counterparts in the view that to replace the 'voluntary' Santiago principles with a 'mandatory' set of principles would totally undermine ICD's for room for manoeuvre in the global economy. In contrast to the ADIA interviewees who were primarily concerned with the costs side of the net benefits equation (particularly C2), the ICD personnel were more concerned with the benefits side of the equation, and most importantly with B3 and B4. Their argument was that while it was one thing to be asked to give a broad commitment to transparency regarding general investment objectives and investment philosophy, a position that they understand and fully accept, it was quite another thing to be asked to give full information about every single detail of their investment plans.

In connection with this line of argument several of the interviewees raised an interesting point that echoed the proposition concerning the distinction between large-EME based SWFs that could have strategic intentions in the military-diplomatic sense and small-EME based SWFs that could only realistically pursue strategic intentions in the socio-economic sense. Now we had not put this distinction (between the PDM type SWFs and the PSE type SWFs) to the interviewees in the course of describing our version of the 'coping mechanism' role of SWFs, but here they were putting forward essentially the same distinction in the course of describing their reactions to the need for full transparency and information disclosure. Now they could understand this type of demand as put, say, to the Russian government's SWF in that this investment vehicle could potentially use its investment policies as part of a strategic initiative to access foreign military technology or, indeed, to lever up diplomatic pressure on a particular issue or political problem. What they could not understand is why this same demand should be indiscriminately made of ICD when it is quite clear that the whole of the United Arab Emirates, let alone Dubai on its own, simply has not the potential to pose any kind of military, technological or diplomatic

threat to Western interests. Any strategic interests of the ICD are purely of the socio-economic kind, but if they are to be successfully realised in a highly unstable and uneven, and at the same time highly competitive, global market economy then ICD has to retain a substantial degree of discretion regarding its portfolio investments. The key phrase emphasized here in this connection is 'opportunity investing': if ICD is to successfully manage a foreign asset portfolio that contributes to the continued development of major sectors of the Dubai economy, then it has to keep a constant look out for good investment opportunities. Given that such opportunities are not that easy to come by and given the fiercely competitive nature of the global economic environment, it follows that ICD has to retain a certain amount of discretion regarding information disclosure if it is to be able to manoeuvre flexibly and efficiently so as to snap up the good opportunities that do arise.

6.v Triangulation: Method Three

We now come finally to the third leg of triangulation, namely, the use of a questionnaire. While in the two previous legs it was possible to ascertain the validity of all three hypotheses, it was not possible to quantify the degree to which the net benefits of a SWF are maximised when it conforms to the Santiago principles or to quantify the differences between the net benefits when there are no principles in place and when such principles as are in place take on a more mandatory form. As in the ADIA case, the questionnaire allows us to rectify these drawbacks to some extent.

Approximately 100 copies of the three-stage questionnaire were sent to a sample of ICD staff drawn from four different departments. 62 copies were returned. As in the ADIA case, to inform respondents as to the context of the questionnaire, it was prefaced with an introductory note that briefly explained the background to the four potential benefits and four potential costs of a SWF.

However, so as not to prejudice the responses, nothing was said about the three hypotheses. The result averages are reported below.

Questionnaire 1

Benefits and Costs of SWFs: No International Principles

(1=Zero or little agreement, 5= maximum agreement)

Benefits	**1-5**	**Costs**	**1-5**
B1Facilitate stabilization	3.8	**C1**Loss of cultural identity	1.2
B2Facilitate inter-generational transfers	4.2	**C2**Losses due to unwanted attraction of investees	2.8
B3Promote economic diversification	4.8	**C3**Losses due to exposure to global gyrations	2.1
B4Improve reserve fund management	4.9	**C4**Losses due to foreign restrictive measures	2.9
Total	17.7	**Total**	9.0

As expected, Hypothesis One is confirmed: the net benefit ratio is positive (i.e B-C =8.7) even when no internationally agreed principles for SWF conduct are in place.

Questionnaire 2

Benefits and Costs of SWFs: Santiago Principles

(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization	3.9	**C1**Loss of cultural identity	1.2
B2Facilitate inter-generational transfers	4.2	**C2**Losses due to unwanted attraction of investees	2.8
B3Promote economic diversification	4.9	**C3**Losses due to exposure to global gyrations	2.1
B4Improve reserve fund management	4.9	**C4**Losses due to foreign restrictive measures	2.2
Total	17.9	**Total**	8.3

As also expected, Hypothesis Two is confirmed: the net benefit ratio is slightly higher (i.e B-C=9.6) when a SWF conforms to the Santiago principles. Interestingly, the positive impact on the benefits is only slightly different, while most of the positive impact comes from the reduction in the costs due to foreign restrictive measure, C4.

Questionnaire 3

Benefits and Costs of SWFs: Alternative Principles

(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization	3.9	**C1**Loss of cultural identity	1.2
B2Facilitate inter-generational transfers	3.7	**C2**Losses due to unwanted attraction of investees	3.0
B3Promote economic diversification	3.5	**C3**Losses due to exposure to global gyrations	2.9
B4Improve reserve fund management	3.8	**C4**Losses due to foreign restrictive measures	2.4
Total	16.9	**Total**	9.5

Finally, as also expected, Hypothesis Three is confirmed: the net benefits of a SWF are lower (i.e B-C = 7.4) when a SWF is forced to conform to more stringent rules of conduct as compared with the Santiago principles. As in the ADIA case, but perhaps also a little more strongly, the result gives confirmation to what was apparent from the interviews, namely, that forcing a SWF to give complete information about all its activities will impair its investment function far more than would be the case were there to be no internationally agreed rules of conduct.

6.vi Summary of results

The results of our second case study, ICD, confirm the three hypotheses put forward concerning the coping function of SWFs for small EME-based economies. However, what differentiates this second case from the first case study of ADIA is that strong confirmation of the coping

function hypotheses was only really provided by two of three legs of the triangulation method, namely, by the conclusions drawn from the problem-centred, semi-structured interview and the results of ordinal data contained in the three stage questionnaires. Some confirmation was provided by the first of the three legs, the use of published materials, but not on the same scale as was the case with ADIA.

Chapter 7

Case Study Three: Fujairah Investment Establishment

7.i Introduction

Fujairah is often, and understandably, described as the "Jewel of the Middle East". Beautiful beaches, a majestic mountain range (the Hajar range), lush greenery and an all-year sunny climate all combine to make Fujairah an exotic land that is welcoming to every type of visitor, tourists and business people alike. In addition to these natural conditions, another factor that is key to Fujairah's growth and development is its unique geographical position within the UAE. It is the only emirate that is situated on the eastern side of the UAE, along the Arabian Sea in contrast to the Arabian Gulf where the other six Emirates are situated. Thanks to this strategic location outside the Strait of Hormuz and facing the wide open Arabian Sea, Fujairah has won international importance as a trade and shipping link between the Far East, the Indian subcontinent, the Middle East and Africa. Thus the Dolphin Energy pipeline, completed in 2007, is the only multinational gas grid in the Gulf, linking Fujairah to Qatar's North Field, the world's biggest gas field. Similarly, the Abu Dhabi government has recently completed a $3.3 billion crude oil pipeline that will carry one and a half million barrels a day to Fujairah's port. In 2014, the Abu Dhabi government intends to build a liquid natural gas pipeline also terminating at Fujairah's port. As we say, these developments that allow ships to load and offload in Fujairah have huge significance in that Fujairah's geographical position provides a much safer passage for the shipments of crude oil as compared with the passage through the six mile wide Strait of Hormuz that can be cut off by Iran at will.

Fujairah is not only relatively small in land space terms but also in population terms, as the local population only totals about 130,000 with another 40,000 foreign individuals. Although this latter figure is expected to rise over the next few years, possibly to a maximum of 100, 000, it is unlikely to reach levels which exceed the total of native individuals as in Dubai's case. Fujairah has few oil reserves or any form of mineral wealth as compared with some of the other Emirates and has therefore traditionally relied more on its geographical or locational advantages. Given its strategic position on the Arabian Sea and its deep-water facilities which allow giant super-tankers from China and the Far East to use the Fujairah port as an important transit point to Africa and to other parts of the Middle East, the key to the Fujairah development strategy is a combination of further expanding this existing and important shipping sector and diversification into new sectors and industries. In this sense there is a difference with some other UAE economies as with some economies in the GCC region more generally, for where the latter have as their key strategy diversification away from over-dependence on one, non-renewable, asset such as oil, Fujairah by contrast has as its key strategy the further expansion and modernisation of its most valuable asset – its strategically located sea port – while also diversifying into other interlinked projects such as transport and real estate infrastructure. As concerns its sea port, it should be noted that Fujairah is the world's second largest supplier of bunkering services, fuelling ships at sea on a scale only slightly lower than Singapore. It is estimated that by 2015, Fujairah's fuel storage capacity will triple, with 360 units holding more than 13 million cubic meters of oil, three quarters of the amount that currently passes through the Strait of Hormuz. As concerns real estate and infrastructure development, it is intended to relocate Fujairah's airport onto a spur of reclaimed land thus freeing up additional coastal frontage. Three international-class shopping malls have recently opened and several five star hotels are currently being built to accommodate the overspill of tourists from Dubai who will now be able to travel to Fujairah along a new $1.7 billion highway in just forty minutes.

This development and diversification strategy is mutually coextensive with the stabilization strategy – the insulation of the Fujairah economy from economic cyclical swings - in the sense that while shipping freight volumes can vary according to global economic conditions, a core constant volume can be achieved to the degree that the Fujairah sea port is modernised to handle all types and sizes of cargo ships from all international regions. Similarly, to the degree that other sectors are developed to international standards of excellence – the Fujairah International Airport, prestige hotels and office blocks, first class shopping malls, high quality tourism, restaurant and other consumer services – export earnings can be smoothed both across different periods of the year over the short term and across different phases of the business cycle over the longer term.

The ruling family and government of Fujairah have been instrumental in the commissioning and establishment of several new economic projects with the aim of putting Fujairah's economy growth trajectory on a secure, long term and sustainable basis. However, looking to the examples set by Abu Dhabi and Dubai and realising that the growth and development aims can only be fully achieved with the help of a government investment vehicle that could coordinate investments across the different economic sectors, the government of Fujairah took the initiative in recently creating the Fujairah Investment Establishment (FIE). Compared with other SWFs in the UAE, the FIE is still small in size in terms of assets under management and number of departments and personnel. This fact, together with the fact that the FIE is still a very young organisation, helps to explain the decision to link the FIE together with Dubai Investments in launching a joint venture company in 2007, Al Taif Investments. Although this joint venture is headquartered in Fujairah, its investments are, and will continue to be, diversified across different projects both within the local region and internationally. The important word here is 'leverage'; the ability to extra give boost and power to a range of actions. The scale and structure of SWFs is important to their ability to leverage up their power and influence and

hence their ability to achieve their strategic goals. As will be further noted below, the link up between the FIE and Dubai Investments is designed to give the former this extra leverage necessary to the promotion of its strategic objectives.

7.ii. Triangulation: First Method

Having provided some background information on Fujairah's growth trajectory and FIE we now turn to the triangulation technique to assess the three hypotheses regarding the importance of small country SWFs as coping mechanisms in a globalised world. In this section we begin with the first leg of triangulation, which, as in the case of Dubai's ICD, will inevitably be a short one given the small amount of published information about FIE. In its communiqués it does provide a very brief outline of its main portfolio strategy and of the motives behind it. However, what is more significant is the following statement of FIE's Chairman:

The Fujairah Investment Establishment's major aim is to protect the long term economic and social welfare of the Emirate of Fujairah and its people. To help achieve this aim FIE will direct investments towards those companies that have a proven record of global excellence in their respective fields of operation. The FIE is fully committed to the Santiago Principles that will be taken as one of the foundations for building sound international and national business links based on transparency and consistent ethical behaviour.[120]"

Hypothesis One states that the net benefits of a SWF such as FIE to its home country and government are positive even when abstraction is made from any commitment to a set of internationally agreed principles regarding SWF conduct. From the first half of the above statement we can assume this hypothesis to be substantiated, principally through the reference to the second and third benefits of SWFs: B2, the positive effects bestowed on the domestic

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[120] FIE (2011)

country through intergenerational transfers, and B3, the assistance to domestic economic diversification and growth that comes through investment linkages with world class foreign companies.

Hypothesis Two states that the net benefits of FIE to Fujairah will be even higher with a commitment to the Santiago principles as compared with no such commitment. Direct support for H2 can be derived from the second half of the above statement that makes explicit reference to the Santiago principles. What is clear in the reference to '*building sound international and national business links based on transparency and consistent ethical behaviour*' is that FIE is more likely to be able to carry out its core investment missions effectively if it can earn the trust of foreign corporations through its commitment to transparency. In other words, the net benefits of FIE are higher not only because of the impact of the commitment to the Santiago principles on B4, efficient investment management, but also because of the impact on C4, the reduction in the potential for retaliatory actions on the part of foreign public agencies.

Finally, as regards Hypothesis Three, once again and as in the case of Dubai and ICD, all that can be done is to use the power of inference to claim that it has some validity. The fact that despite the references in the FIE Chairman's statement to the Santiago principles the FIE still provides few details concerning its investment strategy would suggest that this strategy might be made more difficult if FIE was forced to comply with stricter rules regarding transparency and information disclosure.

7.iv Triangulation: Method Two

Let us begin this section by again repeating the point that the usefulness of triangulation is that only by evaluation hypotheses from varying perspectives can the resulting conclusions be given

any weight as the limitations associated with any one perspective are counteracted by the strengths of an alternative perspective. As in the case of ICD, this is also particularly true of FIE given the paucity of its published materials. Thus, once again, if any successful attempt at substantiating our three core hypotheses is to be made, it will have to rely very strongly on the second and third methods of triangulation. Here we begin with the semi-structured interview.

We managed to interview two senior personnel from FIE in the course of a morning. As in the case of the two previous structured interviews with ADIA and ICD, we began by outlining the standard interpretation of the role and impact of SWFs in the global economy and the counter-posing hypotheses about small EME-based SWFS as 'coping mechanisms' in that economy. Once again, we put it to the FIE personnel that far from being a stable and equal space as was typically assumed prior to the financial crisis, the global economy is on the contrary a highly unstable and highly unequal space. The coping mechanism function of SWFs, particularly in regard to small country based SWFS, therefore was all the more important in helping to absorb and manage the pressures of the global economy in a way that could benefit the home country. The response to this line of argument was favourable, as was the case before, although there were also some new interesting points that were made.

The first concerns the need for coping with instability. Both of the interviewees stressed the fact that they never really believed in the concept of equilibrium, the ideal of a decentralised market economy as being inherently self-stabilising. One of the interviewees was a trained economist and he stated that while the equilibrium concept was useful as a theoretical tool, it was dangerous to simplistically apply it to the real world economy. That potential danger, he went on to say, was finally exposed with the financial crisis that has since seen an extreme degree of global economic instability and uncertainty. At this point, both interviewees came in to support the argument that SWFs, and certainly in the case of small peripheral economies, do need to

fulfil a 'coping' role if the external global pressures are to be successfully managed. However, the further argument stressed by both interviewees is that if a SWF is to fulfil this role effectively it has to be of a sufficient size in terms of assets under management as to be able to diversify across different asset classes in order to balance out the various swings in different sectors. This explains the tie up between FIE and Dubai Investments to create Al Taif Investments: it was explained that this tie was not just about obtaining access to the investment skills and professional knowledge of their Dubai partners; it was also about creating a sufficient enough scale of investments assets as to be able to diversify across different sectors in a cost-efficient manner, an objective that was in turn as vital to shielding Fujairah's economy from the gyrations in the global economy as it was to allowing Fujairah to benefit from closer integration in that economy.

Turning to the subject of inequality between countries and nation states in the globally integrated economy, the FIE interviewees were supportive of the idea of a reconstitution of core-periphery relations in the world market price space, even though these same types of relations may have nearly disappeared in the political space, a reconstitution that has lead to a new type of control, control at a distance. In almost the exact same line of argument as put by the ICD interviewees, the main preoccupation of the FIE interviewees in connection with this point of distant, impersonalised, control was again related to the question of standards. They too believed that the West led by the US tend to take an essentially, if not openly, biased stand on standards in areas such as financial disclosure and governance. They agreed that far from being 'neutral' many of these standards reflect the priorities and values of the West itself rather than of the global community of nations in general. As in the case of their ICD counterparts, the FIE interviewees also believed that inequality between core and periphery in the global market place comes down to the fact that the non-core countries are obliged to adhere to standards that are set by the core countries and that have involved little input from themselves. This applies above all

to the notion of transparency: different histories and cultures lead to different views on what exactly is meant by transparency at, say, government or firm level, and while there has to be some convergence in transparency standards to allow for efficient global market integration based on free flows of capital investments and trade goods, convergence should surely be a two-way process that involves give and take on all sides. However, far from being based on such a process, convergence has virtually been all one-way, and so the idea of gravitational pull and control from a distance by the core over the periphery is true in this sense that peripheral economies must abide by standards set by core economies or face exclusion from full participation in the core economy sectors. At this point in the discussion, we again raised the dilemma posed for small economies: if full access to the core economies is blocked on account of non-compliance with core country notions of transparency, this will reduce the opportunities for small economies and their governments to build balanced international portfolios, while fully accepting core country notions of transparency to keep open global investment opportunities will on the other hand be more in the interests of the core country governments and corporations than in the interests of the small country governments themselves. In answer to the question of whether the FIE and Al Taif investment vehicles were useful coping mechanisms to help resolve this particular dilemma both interviewees said yes. They totally agreed, as did their ADIA and ICD counterparts, that SWFs do provide an important protective mechanism for absorbing and managing the various strong pressures emanating from the unequally structured global economy.

At this point in the interview the discussion with the two FIE interviewees turned to the specific questions concerning the benefits and potential costs to the Fujairah government and economy in having FIE as an independently managed investment vehicle. As concerns the benefits side of the balance sheet, the interviewees agreed that while all four were of importance, probably the first and second benefits – promoting revenue stability and securing the futures welfare of the

emirate – on balance had the edge over the third and fourth benefits although the latter, it was again reiterated, were not to be underestimated. As to the costs side, the interviewees felt that there could be a small potential cost in relation to C1, the problem of cultural loss. As Fujairah is a very small emirate in population terms, there is a more keen sense to preserve the national cultural integrity of the emirate, and this general priority certainly spills over into the question concerning the personnel composition of FIE. Indeed, it was also partly due to the concern to preserve the cultural identity of FIE while tapping into foreign skills and managerial expertise that explains the tie-up with Dubai Investments in creating the joint Al Taif Investments company. In sum, Hypothesis One was confirmed: the net benefits of FIE are positive even when abstraction is made from any mention of adherence to internationally agreed SWF principles.

The next specific topic of discussion is whether Hypothesis Two is also true, that the net benefits of FIE are greater when it does adhere to internationally agreed rules as typified by the Santiago Principles. The reaction to this question was generally positive. Both of the FIE interviewees were in agreement that compliance with the Santiago principles –which they acknowledged as having brought about partly on the initiative of ADIA - was helpful to FIE's investment management goals. The reasons given for this conclusion are by now familiar in that yet again the emphasis was on B4 and C4: the benefits of international portfolio diversification are more likely to be greater when there are fewer foreign government barriers placed in the way of investments, and there is less likely to be political opposition to FIE's foreign investments when its intentions are demonstrated to be non-strategic in the military or diplomatic sense and solely motivated by economic and financial interests.

Finally, as regards Hypothesis Three, that the net benefits of FIE to Fujairah would be less if ICD was forced to comply with a stricter set of internationally agreed principles as compared

with the Santiago principles, the reaction to this proposition was strongly affirmative. Both of the interviewees were absolutely clear that to substitute the voluntary and thus more flexible Santiago principles with a compulsory and thus inflexible set of principles would seriously weaken FIE's ability to fulfil its global investment functions efficiently and effectively. As in the case of the ICD personnel, and in contrast to the ADIA personnel, the FIE interviewees were primarily concerned with the benefits side of the equation and with B3 and B4 in particular. They thought it totally inappropriate and indeed unfair that in addition to providing a general commitment to transparency regarding general investment objectives, SWFs should also be bound to give detailed information about all of their investment plans. Any such compulsion would, in their view, make it extremely difficult to execute portfolio management on terms that were as beneficial to domestic economic goals and priorities as to foreign interests and priorities.

7.v Triangulation: Method Three

We now come finally to third leg of triangulation, the questionnaire. We repeat the point that while in the two previous legs it was possible to ascertain the validity of all three hypotheses, it was not possible to quantify the degree to which the net benefits of a SWF are maximised when it conforms to the Santiago principles or to quantify the differences between the net benefits when there are no principles in place and when such principles as are in place take on a more closed, inflexible and compulsory form. The questionnaire allows us to rectify these drawbacks to some extent.

Copies of the three-stage questionnaire were sent out to all thirty seven FIE staff and all thirty seven copies were completed and returned. Once again, to inform respondents as to the context of the questionnaire, it was prefaced with an introductory note that briefly explained the background to the four potential benefits and four potential costs of a SWF. However, so as not

to prejudice the responses, nothing was said about the three hypotheses. The result averages are reported below.

Questionnaire 1

Benefits and Costs of SWFs: No International Principles
(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization	4.0	**C1**Loss of cultural identity	1.9
B2Facilitate inter-generational transfers	4.9	**C2**Losses due to unwanted attraction of investees	2.3
B3Promote economic diversification	4.6	**C3**Losses due to exposure to global gyrations	1.3
B4Improve reserve fund management	4.2	**C4**Losses due to foreign restrictive measures	1.9
Total	17.7	**Total**	7.4

As expected, Hypothesis One is confirmed: the net benefit ratio is positive (i.e B-C =10.3) even when no internationally agreed principles for SWF conduct are in place.

Questionnaire 2

Benefits and Costs of SWFs: Santiago Principles
(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization	4.1	**C1**Loss of cultural identity	1.9
B2Facilitate inter-generational transfers	4.9	**C2**Losses due to unwanted attraction of investees	2.5
B3Promote economic diversification	4.8	**C3**Losses due to exposure to global gyrations	1.3
B4Improve reserve fund management	4.8	**C4**Losses due to foreign restrictive measures	1.5
Total	18.8	**Total**	7.2

As also expected, Hypothesis Two is confirmed: the net benefit ratio is higher (i.e B-C=11.6) when a SWF conforms to the Santiago principles. Interestingly, the impact on B3 and B4 is positive and more or less compares with the strength of opinions expressed in the interviews, while most of the positive impact comes from the reduction in the cost C4.

Questionnaire 3

Benefits and Costs of SWFs: Alternative Principles
(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization	3.8	**C1**Loss of cultural identity	1.9
B2Facilitate inter-generational transfers	3.7	**C2**Losses due to unwanted attraction of investees	3.2
B3Promote economic diversification	3.7	**C3**Losses due to exposure to global gyrations	2.6
B4Improve reserve fund management	3.4	**C4**Losses due to foreign restrictive measures	9.4
Total	14.6	**Total**	10.1

Finally, as also expected, Hypothesis Three is confirmed: the net benefits of a SWF are lower (i.e B-C = 4.5) when a SWF is forced to conform to more stringent rules of conduct as compared with the Santiago principles. Indeed, the result give further confirmation to what was already apparent from the interviews, namely, that forcing a SWF to give complete information about all its activities will impair its investment function far more than would be the case were there to be no internationally agreed rules of conduct.

7.vi Summary of results

The results of our third case study, FIE, confirm the three hypotheses put forward concerning the coping function of SWFs for small EME-based economies. However, as in the case of ICD, what also differentiates this third case from the first case study of ADIA is that strong confirmation of the coping function hypotheses was only really provided by two of three legs of

the triangulation method, namely, by the conclusions drawn from the problem-centred, semi-structured interview and the results of ordinal data contained in the three stage questionnaires. Unlike in the case of ICD, very little confirmation came from the use of published materials, which meant that there had to be here an even greater reliance on the interview and questionnaire legs of triangulation.

Chapter Eight

Summary and Conclusion

8.i Summary of research contribution

Although Sovereign Wealth Funds have been in existence since the mid-1950s, it is only over the past decade or so that the literature on this phenomenon has really grown in volume and scope. This thesis has sought to contribute to this literature by arguing that SWFs based in small emerging market economies with substantial oil or non-oil resources fulfil two essential coping functions in the contemporary global economy. For EMEs to diversify away from oil or other single resource dependence they have to integrate into the global division of labour but such integration can pose substantial problems given that the global economy is neither a stable space nor an equitably structured one. Thus the role played by SWFs for the governments and peoples of small oil or non-oil dependent EMEs is not merely one of ensuring the maximisation of risk-adjusted returns on diversified asset portfolios, as is the case with conventional investment management vehicles such as pension and mutual funds; rather, for that role to be effectively fulfilled it is also necessary for such SWFS to act as coping mechanisms helping to absorb, filter and consequently manage the pressures emanating from the global economy.

In giving flesh to this basic line of argument, this thesis has advanced three hypotheses, the central one being that small EME based SWFs can fulfil their coping function most successfully when they adhere to the Santiago principles. Given the doubly voluntary nature of these principles, SWFs can fulfil their portfolio investment function most efficiently because on the one hand the commitment to transparency helps to reduce the threat of retaliatory or blocking actions by foreign governments and regulators, while on the other hand the flexible 'soft law'

nature of the Santiago principles allows these SWFs some degree of manoeuvre in carrying out their investment choices. By contrast, the net gains of small EME based SWFs will be less, albeit still positive, if no internationally agreed principles of SWF conduct are in place because of the potential impediments raised by foreign governments and regulators who fear SWF motives that are shrouded by SWF opacity. Furthermore, the net gains of small EME based SWFS will be less, and on this occasion possibly minimal, if these vehicles are compelled to adhere to a stricter set of internationally imposed rules of SWF conduct because of the constraints thereby imposed on these vehicles' room for manoeuvre in the globalised economy characterised both by instability and by the perpetuation of core-periphery relations.

8.ii Limitations of this research study

To help verify these three hypotheses we have taken as our case studies three Emirati based SWFS, ADIA of Abu Dhabi, one of the world's largest SWFS, ICD of Dubai, a medium sized SWF, and FIE of Fujairah, one of the world's youngest and smallest SWFS. Although all three SWFS are based in the United Arab Emirates, the federal nature of the country, combined with obvious differences between these SWFs as regards size, history and experience amongst other factors, mean that each of the three cases has something new and different, as well as something similar, to contribute to the overall attempt to confirm the three hypotheses. However, it is admitted that confirmation cannot be watertight (hence a better word than confirmation may be substantiation) given the relative infancy of SWFs as an established, global phenomenon and hence given the inability to use any time series data in any systematic way. To help compensate for this limitation, the combined uses of quantitative and qualitative research techniques, taking triangulation and the case study approach as the overarching methodological framework, have, it is believed, enabled us to give some strong support to the three hypotheses that have been advanced.

8.iii Future research

At the present time of writing, the global debate on SWFs is fairly muted. The reason, quite simply, is that the recent great financial crisis and its after effects, including the problem of sovereign debt, have temporarily deflected attention away from SWFs. What attention has remained has generally been positive, given that SWFs are seen as possible lucrative sources of much-needed long term investment funds. However, once normality resumes it is quite possible, we would say even likely, that SWFs will again come to the centre of attention of Western governments as they were in the immediate pre-crisis period. If they do so, the strong likelihood is that the calls for tighter rules regarding transparency and information disclosure and other areas of SWF conduct will be resumed. The view here is that the Santiago principles that were negotiated in 2008 represented a balanced and sensible solution for ensuring that the interests of both advanced market economies and small emerging market economies were served on a mutually advantageous basis. However, given that these principles have also been criticised by some as being too 'soft', it is possible, and as we say also very likely, that once normal business is resumed in the global economy there will again be resumed the calls for a more strict, mandatory or 'hard law' set of rules for SWF conduct. Were this to happen, it would only disturb the current balance of interests and tip it firmly in the direction of the advanced market economies and their governments. If this is not to happen – and there are many reasons why it should not – then strong arguments in favour of supporting the existing Santiago principles need to be put forward. While this task can only be fully fulfilled as more detailed information and quantitative data about SWFs become available, it must begin now. The central purpose of this thesis has been to contribute to this beginning.

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Appendix 1

Sovereign Wealth Funds: Generally Accepted Principles and Practices. "Santiago Principles"

GAPP 1. Principle: The legal framework for the SWF should be sound, and support its effective operation and the achievement of its stated objective(s).

GAPP 2. Principle: The policy purpose of the SWF should be clearly defined and publicly disclosed.

GAPP 3. Principle: Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle: There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations

GAPP 5. Principle: The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

GAPP 6. Principle: The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate

accountability and operational independence in the management of the SWF to pursue its objectives.

GAPP 7. Principle: The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

GAPP 8. Principle: The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

GAPP 9. Principle: The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities

GAPP 10. Principle: The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

GAPP 11. Principle: An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

GAPP 12. Principle: The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a

consistent manner

GAPP 13. Principle: Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

GAPP 14. Principle: Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

GAPP 15. Principle: SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

GAPP 16. Principle: The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

GAPP 17. Principle: Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAPP 18. Principle: The SWF's investment policy should be clear and consistent with its defined objectives, risktolerance, and investment strategy, as set by the owner or the governing body(ies),

and be based on sound portfolio management principles.

GAPP 19. Principle: The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

GAPP 20. Principle: The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAPP 21. Principle: SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

GAPP 22. Principle: The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

GAPP 23. Principle: The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

GAPP 24. Principle: A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

Appendix 2

Questions used in the semi-structured interviews

Q.1 Of the four main benefits of SWFs to a home nation, how would you rank them in order of importance?

Q.2 Of the four main listed costs of SWFs to a home nation, how would you rank them in order of importance?

Q.3 Given that the net benefits of SWFs to a home nation are positive even in the absence of internally agreed principles of SWF conduct, do these benefits in your opinion increase, stay the same or diminish when SWFs comply with the Santiago Principles?

Q.4 Would the net benefits of SWFs to a home nation in your opinion increase, stay the same or diminish if SWFs were obliged to comply with a more strict set of internationally agreed rules of SWF conduct as compared with the Santiago Principles?

Appendix 3

The Questionnaire

Benefits and Costs of SWFs

(1=Zero or little agreement, 5= maximum agreement)

Benefits	1-5	Costs	1-5
B1Facilitate stabilization **B2**Facilitate inter-generational transfers **B3**Promote economic diversification **B4**Improve reserve fund management		**C1**Loss of cultural identity **C2**Losses due to unwanted attraction of investees **C3**Losses due to exposure to global gyrations **C4**Losses due to foreign restrictive measures	
Total		**Total**	