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Abstract

Since the early 2000s the number and size of sovereign wealth funds (SWFs) in the Gulf region and elsewhere have grown substantially. Their increasing impact on global financial markets has focused attention on these state-controlled investment vehicles. Some policymakers in Europe and the United States have raised concerns regarding the governability and transparency of these funds. This paper analyses the arguments for and against SWFs, their investment portfolios, and their role in addressing the global financial crisis in the late 2000s, in both holding and recipient countries. Rhetoric aside, the paper argues that the available evidence suggests that Gulf SWFs (and their Asian counterparts) have been a stabilizing force in the global financial system.

1. INTRODUCTION

From the early 2000s oil prices witnessed an unprecedented surge, reaching a peak of US$147.00 per barrel in mid-2008 before collapsing by the end of the year and later stabilizing between US$80.00 and US$90.00 per barrel by the end of the decade. Most oil-exporting countries, particularly the Gulf Cooperation Council (GCC) states (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates – UAE), continue to be heavily dependent on oil revenues as their main source of income. Thus, the rise in oil prices provided crude exporters with massive amounts of wealth. The relatively small size of their economies and concerns about fuelling inflation meant that their ability to absorb these oil revenues domestically was, and still is, limited. Thus, a large proportion of these revenues had to be invested abroad. A number of sovereign wealth funds (SWFs) were founded to initiate and manage these investments. It is important to point out that other fast-growing economies, particularly China and Singapore, have witnessed a similar development, accumulating massive current account surpluses and creating their own SWFs. The focus of this paper is on the oil funds created by the GCC states.

This is not the first time a set of SWFs has been created. A similar wave of SWF creation occurred in the 1970s following the jump in oil and gas prices. The most recently established funds, however, have substantially expanded the number and size of SWFs. The overall volume of assets under management by SWFs is still relatively small in comparison with total global financial assets. However, these assets are significant relative to hedge funds or private equity

(Santiso 2008: 2). Furthermore, their assets are projected to increase substantially over the next few years. Deutsche Bank predicts that SWF holdings will rise from US$3.6 trillion in 2008 to US$10 trillion by 2015 (Deutsche Bank 2008: 6) and JP Morgan researchers make a similar prediction, stating that SWFs' assets are likely to double from 2009 to 2015 (JP Morgan 2009: 4). Regardless of the accuracy of these projections, one important element in the changing global economy is the increasing prominence of SWFs from a wide range of home countries.

This increasing prominence of SWFs and the emergence of oil-exporting countries as major creditors to the world, and to industrialized countries in particular, have highlighted two fundamental changes in the international financial system. First, the progressive running of large current account surpluses in oil-exporting countries has been in parallel to current account deficits built by major industrial countries in Europe and the United States. Indeed, it can be argued that without the contribution of oil funds in bailing out major international financial institutions the global recession would have been deeper and would have lasted longer. In short, oil-exporting countries have increasingly resumed a prominent role as major creditors. Second, oil funds are owned by their home governments and are largely controlled by the state. This framework is at variance with the traditional private sector, market-oriented approach that is dominant in most Western countries (Truman 2008: 3)

The rapid expansion of petrodollar investments has fuelled anxiety regarding these new dynamics in the global financial system. In principle, most countries welcome foreign investments. However, when the money is owned and controlled by foreign governments, suspicion arises. Policymakers in receiving markets are concerned about possible political objectives behind these SWF investments. Following their capital injections into European and US banks that suffered big losses from the subprime mortgage crisis, oil funds have attracted heightened attention from policymakers, national legislatures and the media in the United States and several European countries. Meanwhile, these capital injections have been welcomed by the International Monetary Fund (IMF) and others because they have helped to stabilize markets.

This heightened attention and the lack of consensus on the role of SWFs underscore the fact that the structure, objectives and investment strategies of SWFs in general and those in the Gulf region in particular are poorly understood. This paper seeks to contribute to the growing systematic academic research on oil funds. In the next section I discuss the various definitions of

SWFs and highlight the differences and similarities between them. This will be followed by an analysis of the pros and cons of opening the door to foreign investments, including from the Middle East. The attempts to regulate foreign investment, including those made by oil countries, will be discussed as well as Gulf countries' responses. This will be followed by a close examination of two main funds created and owned by the Gulf states: the oldest fund (Kuwait Investment Authority) and the wealthiest fund (Abu Dhabi Investment Authority). References will also be made to SWFs in Bahrain, Oman, Qatar, and Saudi Arabia. In the concluding section I summarize the main findings of this paper.

2. Sovereign wealth fund: definition

SWFs have been around for more than half a century. The proliferation of SWFs since the early 2000s, however, has prompted academics, analysts and politicians to define what SWFs are and how to distinguish them from other investment vehicles. Davis and colleagues define an SWF as a mechanism designed to reduce the impact of volatile revenue on the government and the economy. Its objectives may also include supporting fiscal discipline and providing greater transparency in the spending of revenue (Davis, Ossowski, Daniel, and Barnett 2001: 8). Allen and Caruana see SWFs as government-owned funds, set up for a variety of macroeconomic purposes. They are commonly funded by the transfer of foreign exchange assets that are invested long-term, overseas. They allow for a greater portfolio diversification and focus on return than normal for central-bank-managed reserve assets (Allen and Caruana 2008: 4). Sun and Hesse state that SWFs are special-purpose investment funds owned by the general government. They are often established out of balance-of-payments surpluses, official foreign currency operations, proceeds of privatization, fiscal surpluses, or receipts resulting from commodity exports (Sun and Hesse 2009: 4). Finally, Das and colleagues argue that SWFs hold, manage or administer financial assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets (Das, Lu, Mulder, and Sy 2009: 5).

The US government's definition of SWFs focuses on the degree of their risk tolerance: SWF managers typically have a higher risk tolerance and higher expected return than traditional official reserve managers (United States Department of the Treasury 2007: 1). Meanwhile, the European Commission's definition concentrates on their sources of funding: the feature distinguishing SWFs from other investment vehicles is that they are state-funded (European

Commission 2008: 4). The Monitor Group, a financial consulting firm, identifies five qualifying characteristics of a SWF: it is owned directly by a sovereign government; it is managed independently of other state financial institutions; it does not have predominant explicit pension obligations; it invests in diverse asset classes in search of commercial return; and it makes a significant proportion of its publicly reported investments internationally (Barbary and Chin 2009: 17).

These definitions suggest a number of common characteristics of SWFs. First, they are owned and managed by governments and are commonly established out of balance-of-payments surpluses. In the case of oil-exporting countries, high oil prices for a prolonged period of time provide such surpluses. SWFs prefer to place their assets abroad, mainly to allay fears about appreciation of the domestic currency (Ter-Minassian 2007: 15). SWFs' holdings do not include the following: foreign currency reserve assets held by monetary authorities for the traditional balance-of-payments or monetary policy purposes; operations of state-owned enterprises in the traditional sense; government-employee pension funds; or assets managed for the benefit of individuals.

SWFs typically have a diversified investment strategy, with a higher level of risk accepted in search of higher returns. SWFs have various objectives, implying different investment horizons and risk/return trade-offs, which lead to different approaches in managing these funds. SWFs usually pursue multiple objectives. On the basis of the source of their assets SWFs can generally be divided into two categories: (1) commodity funds, which receive most of their holdings from exporting one or a few commodities that are largely owned by the government (e.g. oil funds), and (2) non-commodity funds, which are usually established through transfers of assets from official foreign exchange reserves (e.g. some Asian SWFs, such as those of China and Singapore). The goal of such transfers is to pursue higher returns. Finally, two broad types of SWFs can be identified on the basis of their main objectives: (1) stabilization funds, where the primary objective is to insulate the economy against commodity price swings; and (2) savings funds for future generations, which aim to share wealth with upcoming generations.

To sum up, SWFs are a heterogeneous group. They take many forms, pursue different strategies, and establish a variety of legal, institutional and governance structures.

2.1. Investment portfolios

SWFs from the Gulf region employ a wide range of investment strategies that seek to strike a balance between safe assets and high returns. Given these broad objectives, Gulf SWFs have allocated their holdings in a variety of investment vehicles, from conservative (relatively safe with low returns) ones such as debt and equity securities to riskier investments with potential for higher returns, such as private equity, real estate and hedge funds. By their nature, SWFs are expected to invest in more diversified portfolios and riskier assets than traditional reserve holdings.

The older Gulf SWFs such as the Kuwait Investment Authority (KIA), Abu Dhabi Investment Authority (ADIA) and Oman's State General Reserve Fund (SGRF), tend to be cautious, discreet and conservative investors. Meanwhile, the 'younger' funds (those founded since the early 2000s) tend to be more aggressive investors, reflecting the financial confidence of high oil prices throughout most of the decade. Many of the latter group have pursued attractive opportunities in all sectors across the world. Some of these newly created funds borrowed to invest in high-profile assets, instead of relying on their own capital accumulations. The collapse of oil prices in mid-2008 and the end of the era of cheap and easy credit have underscored the shortfalls of such a strategy.

The investment portfolios of the Gulf SWFs are not different from their counterparts in other countries. According to researchers at the Organization for Economic Cooperation and Development (OECD), SWFs invest on average 38 per cent in the financial sector, 14 per cent in the communication and transportation sectors and 6 per cent in the energy sector. Other sectors, with allocations below 5 per cent each, are consumer durables and non-durables, utilities and technology services (Avendano and Santiso 2009: 20). Other analysts (Bortolotti, Fotak, Megginson and Miracky, 2009: 18) give similar trends. From 1986 to 2008, 30.9 per cent of all SWF investments' deals by number and 54.6 per cent of the value of all acquisitions were in the financial sector. Other targets were real estate (11.9 per cent of deals, 15.3 per cent of value), information technology (7.5 per cent of deals, 7.7 per cent of value), industrials (9.1 per cent of deals, 5.3 per cent of value) and infrastructure (11.9 per cent of deals, 15.3 per cent of value).

Investments by Gulf SWFs have followed similar lines, with even more concentration on the financial and energy sectors. Other sectors include real estate, industrial, aerospace, healthcare and transportation. A close examination of Gulf SWFs' portfolios shows that they have disproportionately favoured financial companies, particularly since the early 2000s. At least two factors have contributed to this trend. First, large banks have continued to be regarded as having substantial growth and profitability potential in the medium and long terms. Second, investing in US and European financial institutions has improved SWFs' images. Shortly before the eruption of the subprime crisis and broad economic recession, many American and European policymakers and media outlets were suspicious of SWFs' motives and goals. Following their investments in financial institutions – at a time when some banks were facing serious problems regarding their capitalization – these same policymakers and pundits expressed appreciation for the helpful role SWFs played in a critical phase of market developments (Deutsche Bank 2008: 10).

Another large and growing target of SWF investments is the nascent market for investment products that comply with Islamic law (Sharia), which forbids interest on the grounds that money alone should not create profit. From profit-sharing accounts and crude products, Islamic finance spans derivatives, bonds, fund management, credit cards and car loans – all of which often use complex structures to circumvent the Islamic ban on interest. Thus, the challenge is how to replace conventional financial practices (deemed to be usury-based) with Islamic alternatives (a profit-and-loss-sharing partnership).

The rise of Islamic finance in the second half of the twentieth century coincided with the two oil shocks (1973–4 and 1979–80), which concentrated an immense amount of wealth in the Islamic world. Since then there has been a rapid growth of Islamic financial institutions and diversification of available products that comply with Sharia. The goal is to appeal to a growing population of rich, pious Muslims, particularly in the Gulf region. Some of the earliest Islamic banks of the modern era include the Dubai Islamic Bank, Faisal Islamic Bank, Al-Baraka Groups, Kuwait Finance House and Bahrain's First Islamic Investment Bank (El-Gamal 2006: 9).

Islamic finance represents a small but growing fraction of the global financial service industry. Even in countries where the industry is most developed, such as Saudi Arabia, Islamic assets are outstripped by conventional ones. As Islamic finance becomes more important to more people around the world, however, the sector will witness a convergence of products, standards and regulations, and there will be an increased acceptance of Islamic banking and investment worldwide. Indeed, in recent years companies such as Investment Dar in Kuwait and Bahrain's Arcapita and Gulf Finance House have been among the most profitable institutions in the Gulf and the rest of the Islamic world.

To sum up, SWF portfolios typically involve more diversified asset allocations than traditional reserves holdings, with considerable stakes in equities and a wide geographical dispersion.

Historically, Gulf SWFs have favoured investments in Western markets. This is because European and American capital markets traditionally offer the widest selection of investment opportunities and a high level of liquidity and are thus able to absorb the large volume of funds institutional investors typically seek to allocate. Within the OECD, most SWF investments have gone to just two countries: the United States and the United Kingdom. In fact, Gulf SWFs make more cross-border investments in US-headquartered companies than those in any other country. These heavy Gulf investments in the United States simultaneously reflect and cement the strategic relationship between the two sides.

Meanwhile, SWF investments in the United Kingdom have their roots in the establishment of the Kuwait Investment Office (KIO) in London in the early 1950s. Since then, the ups and downs of the British economy have not deterred Gulf SWF investments from coming to London. These strong financial ties are driven by two fundamental dynamics. First, long-standing political and economic relations have served as the glue in strengthening the partnership between Britain and the Gulf states. Second, London enjoys special characteristics which make it a leading global financial services hub, attracting businesses and traders not only from the Gulf region, but from all over the world. These include a legacy of internationalism, a tradition of economic openness and stability, and a broad and liquid market.

Despite these strong financial ties to Western markets, Gulf SWFs have shown great interest in investing in emerging markets in Asia as well, particularly those in China, Hong Kong, India, Indonesia, Malaysia, Singapore, Taiwan and Thailand. The underlying reason for investing in Asian markets is their miraculous economic performance over the last few decades. This astonishing performance means that SWF investments in Asia can earn a much higher profit rate than in OECD countries.

Finally, the global economic recession of the late 2000s prompted Gulf SWFs to invest a large proportion of their assets in their own home countries and the broader Middle East. Gulf states, like those in the rest of the world, could not escape the severe economic and financial crisis. They called on their SWFs to help address challenges such as low financial liquidity, high unemployment and overall stagnated economic systems. They also sought to play a role in helping overcome the economic crisis in the broader Middle East. As a leading Bahraini banker put it, 'True security comes with the stability of one's neighbors' (Kerr 2008). Developments in early 2011 have proved the strong adherence to such sentiment. In response to rising unrest in Bahrain and Oman, the GCC leaders pledged US$20 billion dollars to promote economic development and create jobs in these less fortunate Member States.

3. The debate: for and against SWFs

The large and growing size of SWFs has created an intense controversy in recipient countries, particularly the United States and Europe. The management of their assets has become a major focus of national and international economic and financial policy. Some Western policymakers and media outlets have expressed concern about SWFs' role in their countries. These concerns mainly focus on at least five overlapping issues.

1. *The economy may not have the capacity to absorb foreign resources efficiently.* SWF investments can lead to equity price bubbles and the related decline in demand for Treasury bonds. Thus high oil prices and large petrodollar investments might have the long-term impact of fuelling inflationary pressure and increasing the volatility of financial markets (Farrell and Lund 2008: 3).
2. *SWF investments can trigger defensive reactions from recipient countries.* Such reactions can provoke a wave of investment protectionism, which may undermine globalization and harm the global economy (McCormick 2007: 6).
3. *SWF assets are not private money, and are largely owned and managed by their home governments.* This raises concerns about the expanding role of governments in the economic system and broader international markets (IMF 2008).
4. *SWF investments might not be driven by purely commercial interests.* Rather they might seek to obtain technology and expertise that would serve the strategic goals of their home

countries. In short, they might have a political agenda that is not necessarily in line with the national interests of recipient countries (Truman 2007: 1).

5. Generally, *there is little published information about Gulf SWFs' assets, liabilities or investment strategies.* This lack of transparency has fuelled suspicion regarding their management practices and strategic goals. It is important to emphasize that the approach to disclosure of oil funds' assets and investments often mirrors general attitudes to public sector transparency. Accordingly, transparency and accountability practices for funds differ across oil-producing countries. Transparency can be defined in terms of (a) clarity of roles and responsibilities; (b) public availability of information; (c) open budget preparation, execution and reporting; and (d) assurances of integrity (IMF 2005: 8). A high degree of transparency is essential to be able to build and maintain support for the government's management of petroleum wealth. It also contributes to building trust with recipient markets and to the overall stability of the international financial system. However, demands for transparency should be balanced against legitimate business interests of investors and should run both ways. In other words, recipient governments should disclose their policies on SWF investments.

The limited number of case studies and problems with data collection complicate a comprehensive evaluation of the operations of Gulf SWFs, their overall performance and the legitimacy of the aforementioned Western concerns. In recent years domestic and international pressure has intensified on SWFs to improve their governance and accountability practices. In response there have been some small but significant changes. Since the late 2000s several Gulf SWFs have introduced measures to comply with international financial norms and IMF guidelines. SWFs from Bahrain, Kuwait and the UAE have published information on their assets and established websites to inform the public on their management practices and financial goals.

On the other side, proponents of SWFs argue that these investment funds have already proved themselves crucial to economic prosperity in both their home and recipient countries as well as to the stability of the international financial system. These proponents call for the elimination of restrictions on foreign investments and, instead, the provision of more incentives to facilitate and encourage cross-border movement of capital. Their argument is based on five pillars:

1. *Extracting and selling oil amounts to running down capital.* Preventing, or imposing strict restrictions on, investments by SWFs from oil-exporting countries would make it harder for them to diversify their economies and to maximize their profits. Under such a scenario, it would make economic sense to keep oil underground. This would lead to a global shortage of oil supplies and higher prices, which would harm the interests of oil-consuming countries and add pressure on the international financial system (Reisen 2008: 11).
2. *SWFs tend to have long-term horizons*, with no commercial liabilities that they are obligated to pay out on and no external investors able to withdraw capital at short notice. These characteristics enable them to withstand market pressures in times of crises, dampen volatility and serve as a stabilizing force.
3. *SWFs are a way to help recycle petrodollar surpluses internationally*, as the economic recession of the late 2000s demonstrated. Gulf SWFs were able to inject badly needed capital into several US and European financial institutions when public confidence in these institutions was low and the world was drawing deeper into economic crisis.
4. *SWFs provide new sources of liquidity to recipient countries and help to spread technology and know-how among home countries.* As a result, SWFs help all parties to adjust to global economic imbalances and should be seen as a win-win institution.
5. In addition to these financial benefits, *SWFs have significant strategic implications*. SWF investments bind peoples together and reinforce bonds of mutual dependence among countries, therefore increasing the costs of international conflict. They mean that SWF home and recipient countries develop direct stakes in the economic prosperity and political stability of each other.

SWFs represent a large and rapidly growing stock of government-controlled assets, invested more aggressively than traditional reserves. Attention to SWFs is inevitable given that their rise clearly has implications for the international financial system. The funds bring benefits to the system, but also raise potential concerns. The experience of the last several years suggests that more information and accurate data about them are needed. In the end, though, it can be said that the free flow of capital contributes to efficient allocation of risks and resources. This freedom of capital movement should continue within a set of rules agreed by both sides – the SWF home countries and the recipient markets.

4. Attempts to regulate SWFs

Cross-border investments are generally seen as a contributor to global prosperity. However, some policymakers in the United States and Europe worry about the potential implications of letting state-controlled funds acquire stakes in powerful companies and critical economic and strategic sectors. Consequently, many Western leaders have called on SWFs to be more open and demanded restrictions on their investments. It is important to point out that almost without exception all counties in the world have rules in place regulating the entry of foreign capital and investment into their domestic economies. Such rules can take the form of outright prohibition or quantitative and qualitative limitations on foreign investments, capital controls and vetting mechanisms. In addition, many countries implement policies that leave foreign owners at a competitive disadvantage with nationals. These policies include restrictions on foreign ownership of land and other assets, discriminatory taxation and trade rules and restrictive licensing processes. Finally, foreigners are usually not allowed to invest in industries deemed strategically sensitive.

At the peak of the global recession (2008–9), hostility towards SWFs lessened considerably as several Gulf SWFs (and their Asian counterparts) participated in bailing out major financial institutions in the United States and Europe. It is uncertain whether the hostility and suspicion towards SWFs will wane or will be reactivated when the global economy rebounds. What is clear, though, is that SWFs will remain controversial, arousing concerns for governments around the world. Within this context, the United States, the European Union, the OECD and the IMF have sought to articulate new policies to strike a balance between protecting sensitive sectors and industries on national security grounds and ensuring a free flow of capital through transparent and stable rules.

4.1. United States

Generally, the United States welcomes all kinds of foreign investments including those from SWFs. Washington has long been open and receptive to foreign investments, as has been demonstrated by the statutory frameworks, policy measures and international agreements of several US administrations. In the last half century the United States has entered into several treaties with other countries and international organizations that acknowledge its commitment to free-market principles and openness to foreign investment.

The Department of the Treasury collects data on foreign portfolio investment in the United States through surveys of US financial institutions and others. These surveys provide data on ownership of US assets by foreign residents and foreign official institutions. Officials from the Treasury use this data to compute the US balance-of-payments accounts, assess the US's international investment position, and formulate international economic and financial policies. The data is also used to provide aggregate information to the public on foreign portfolio investments. SWF investment holdings are included in the foreign investment data collected by the Treasury, but cannot be specifically identified because of data collection limitations and restraints on revealing the identity of reporting persons and investors.

There are no federal laws that specifically target SWFs investing in the United States. However, some laws specifically target foreign investments, which include those of SWFs. These laws regulate foreign investments regardless of the economic sector. They are mainly driven by national security considerations and the desire to protect the nation's industry. In 1975 President Gerald Ford issued Executive Order (EO) 11858 establishing the Committee on Foreign Investment in the United States (CFIUS), mainly to monitor and evaluate the impact of foreign investment in the United States. The EO emphasizes that international investment in the United States promotes economic growth, productivity, competitiveness and job creation. The EO further underscores that it is the policy of the United States to support unequivocally such investment, consistent with the protection of its national security. The EO authorizes the CFIUS to undertake an investigation of any transaction that might threaten or impair the national security of the United States and send a report to the president. The CFIUS may seek to mitigate any national security risk posed by a transaction that is not adequately addressed by other provisions of law by entering into a mitigation agreement with the parties to a transaction or by imposing conditions on such parties (National Archives 1975).

The formal CFIUS process generally begins when parties to a proposed or pending transaction jointly file a voluntary notice with the CFIUS. Upon receiving the notice, the CFIUS chairperson determines whether the notice is complete and satisfies the requirement stated in the regulations. Then, a review period of up to 30 days begins. During the review period, CFIUS members examine the transaction in order to identify and address any national security concerns that arise as a result of the transaction. During the review period, CFIUS members may request additional information from the parties, who may respond to such follow-up requests.

Most of the time, CFIUS concludes the review process during or at the end of the initial 30-day review period. In certain circumstances, however, CFIUS may initiate a subsequent investigation, which must be completed within 45 days. Parties to a transaction may request withdrawal of their notice at any time during the review or investigation stages. Such a request must be approved by the CFIUS and may include conditions on the parties, such as requirements that they keep CFIUS informed of the status of the transaction or that they re-file the transaction at a later time.

If CFIUS finds that the covered transaction does not present a national security risk or that other provisions of law provide adequate and appropriate authority to address the risk, then CFIUS advises the parties in writing that it has concluded all actions with respect to the transaction. On the other hand, if CFIUS finds that a covered transaction presents a national security risk and that other provisions of law do not provide adequate authority to address the risk, then CFIUS may enter into an agreement with, or impose conditions on, parties to mitigate the risks or may refer the case to the president for action. Where CFIUS has completed all action with respect to a covered transaction, or the president has announced a decision not to exercise his authority, then the parties receive a 'safe harbour' with respect to the transaction (United States Department of the Treasury 2009).

In October 2007, the Foreign Investment and National Security Act (FINSA), Public Law 110-49, became effective. FINSA further scrutinizes foreign investments in the United States and ensures that they do not pose a threat to national security, while simultaneously underscoring the general US stance of welcoming foreign investment. In short, FINSA seeks to improve CFIUS procedures further. The 2007 law requires CFIUS to conduct an investigation into the effect of a transaction on national security if it is a transaction controlled by a foreign government, threatens to impair national security, or results in the control of a critical piece of US infrastructure by a foreign person (Government Track 2007).

FINSA requires CFIUS to submit a report of all investigations to Congress and allows it to negotiate, impose and enforce any agreement or condition with any party to the covered transaction in order to mitigate any threat to the national security of the United States that arises as a result of the covered transaction. FINSA also requires the president to determine a course of action regarding a covered transaction within 15 days after the investigation is completed.

Generally, the US regulatory system has sought to achieve four broad goals: (1) *Ensure adequate consumer protections.* US regulators seek to address informational disadvantages that consumers and investors may face, ensure consumers and investors have sufficient information to make appropriate decisions, and oversee business conduct and sales practices to prevent fraud and abuse. (2**)** *Ensure the integrity and fairness of markets.* US regulators monitor markets to prevent fraud and manipulation and to ensure efficient market activities. (3) *Monitor the safety and soundness of institutions.* Because markets sometimes lead economic institutions to take on excessive risks that can have significant negative impacts on consumers, investors and taxpayers, regulators oversee risk-taking activities to promote the safety and soundness of economic institutions. (4) *Ensure the stability of the overall economic system.* Regulators act to reduce systemic risk in various ways, such as providing emergency funding to troubled financial institutions (United States Government Accountability Office 2009a).

In 2008 the Department of the Treasury reached an agreement on principles for SWF investment with Abu Dhabi (and Singapore). This agreement identified the policy principles for both SWFs and receiving countries. Those for the former state that SWF investment decisions should be based solely on commercial grounds; greater information disclosure by SWFs can help reduce uncertainty in financial markets and build trust in recipient countries; SWFs should have in place a strong governance structure; SWFs and the private sector should compete fairly; and SWFs should respect host-country rules. Those for the latter state that recipient countries should not erect protectionist barriers to portfolios of foreign direct investment; they should ensure predictable investment frameworks; they should not discriminate among investors; and they should make sure that any restrictions imposed on investments for national security reasons are proportional to genuine national security risks raised by the transactions (United States Department of the Treasury 2008).

The financial crisis of 2008–9 dramatically illustrated the ineffectiveness of the US regulatory system in overseeing the increasingly complex markets, institutions and products that have rapidly evolved over the last several decades. The regulatory system, developed in a piecemeal fashion over the past 150 years, with some parts of the system created in response to previous financial crises, lacks the comprehensive framework needed to regulate today's highly complex, ever-changing global marketplace (United States Government Accountability Office 2009b).

Since the subprime crisis of 2008–9 it has become more difficult to finance the US deficit. In contrast to their behaviour during the stock market boom of the 1990s and the post-2001 real estate bonanza, foreign private investors have become reluctant to enter the market. Instead, financing mainly relies on inflows from central banks and SWFs. In 2008, nearly half of all US Treasuries were owned by foreigners. Moreover, according to Ben Bernanke, Federal Reserve chairman, about a third of recent emergency funding for Western financial institutions has come from Asian and Arab SWFs (Woertz 2008). Despite a rise in political sensitivity and a growing suspicion of SWFs' investments, the United States has continued to attract the bulk of these investments.

Some analysts argue that the United States is stuck in a box. By running up large trade deficits and tolerating foreign government intervention in currency markets, the United States contributed to a large dollar overhang abroad – much of it in the hands of sovereign funds. Investments by those funds in Treasury securities, in turn, helped keep long-term interest rates artificially low. This facilitated the growth of the real estate bubble and eventually contributed to the subprime crisis (Morici 2008). There is legitimate concern that the United States is still following the same destructive pattern.

Foreign investments – governmental or non-governmental – in US financial or non-financial institutions are likely to continue their historical rise. SWF holders and the US market need each other. The challenge facing the United States is how to find the right balance between making itself safe and attractive to SWFs and simultaneously maintaining its open, market-based regime in which private sector actors are the dominant players. The challenge facing SWFs is how to address and mitigate growing private and public political suspicion of their operations. For several decades SWFs and the United States have engaged in a multidimensional and multibillion-dollar partnership. This complicated partnership is likely to grow further in the foreseeable future. The economic and financial wellbeing of the United States is in the best interest of SWFs. Meanwhile, the continuing rise of SWFs is good for the US market.

4.2. European Union

The European Union's stance on SWFs has some similarities with and some differences from that of the United States. An openness to investment and a commitment to the free movement of capital have been long standing principles of the European Union. Joaquin Almunia, European Commissioner for economic and monetary policy, asserts that the EU Member States are well aware that investment and openness 'are the elements that drive our economy forward and without them we cannot advance' (Almunia 2008).

With regard to SWFs, what worries European leaders is not only that governments are taking a leading role in allocating huge financial resources, but also that many of these governments do not adhere to either the democratic and free-market principles that drive European societies or their vision for the international system (Barysch, Tilford, and Whyte 2009: 5). The EU leaders nevertheless acknowledge the positive role SWFs have played. As José Manuel Barroso, the European Commission's president, asserts, SWFs are 'not a big bad wolf at the door. They have injected liquidity and helped stabilize financial markets' (Barber 2008). In the light of the above, European leaders have sought to articulate a common EU stance on the rise of SWFs. In early 2008 the European Commission adopted a communication that was later endorsed by the EU heads of state and government during the European Council meeting. This communication calls on SWFs to commit to good governance practices, adequate accountability and a sufficient level of transparency.

Unlike in the United States, there is no agency in the European Union responsible for vetting foreign investments at the Union level. Rather, individual Member States, subject to EU law provisions on the free movement of capital, retain authority to restrict capital inflows into their countries where justified on the basis of public policy or public security. In Europe, both collectively at the EU level and individually at the Member State level, there exists a comprehensive regime to regulate the actions of foreign investors, which covers SWFs in exactly the same way as any other foreign investor.

Thus, instead of seeking to regulate SWFs, the European approach relies heavily on constructive dialogue and cooperative effort between recipient countries on one side and SWFs and their sponsor countries on the other. Accordingly, there are few, if any, high-profile cases of an EU government blocking an SWF investment. Usually, recipient countries and investors try to avoid public controversies.

The global economic recession of the late 2000s has introduced new dynamics into the European Union's perception of SWFs. On the one hand, in an environment where capital is extremely scarce, SWF investments are considered an important component of European efforts to overcome the financial crisis and to initiate and consolidate economic recovery. On the other hand, the collapse in market valuations has raised concerns that foreign investors, including SWFs, may acquire significant stocks in major European companies at very low prices. Thus, a number of political leaders and some media outlets have sounded the alarm against SWF investments. The French president, Nicolas Sarkozy, argued that falling share prices meant that big industries were in imminent danger of being taken over by non-European investors. He was quoted as saying, 'I don't want European citizens to wake up in several months and find European companies belonging to non-European capital, which bought them at the share price's lowest point' (Charter 2008). The French president called on EU Member States to launch national SWFs to take stakes in key industries in order to stop them from falling into foreign hands. Similarly, the Italian government set up a national interests committee to establish rules about SWF investments. The foreign minister, Franco Frattini, called for the imposition of a 5 per cent stake ceiling on foreign investment in any individual Italian company (Dinmore 2008).

Despite rising concern and calls to protect national industries and companies, the European Union is likely to remain committed to its tradition of openness to capital investments. Foreign investors have always played a significant role in European economies. Meanwhile, European leaders have continued their efforts to engage SWFs in a cooperative partnership to enhance their governance standards and allow for more transparency.

4.3. Organization for Economic Cooperation and Development

The fact that the United States and several EU Member States are also members of the OECD means that the latter's stance on SWF investments is similar to those of Washington and Brussels. Angel Gurria, the OECD's secretary general, asserts that the organization's findings ‘show that these funds (SWFs) bring benefits to home and host countries’ (Gurria 2008) A recent OECD Ministerial Council Meeting concluded that protectionist barriers to foreign investment would hamper growth. Far from being a threat to OECD financial systems, SWFs could be ‘allies in the struggle to stimulate development and support donors as development finance partners’ (OECD 2008a).

Like the United States and European Union, the OECD has repeatedly issued statements confirming its adherence to an open-door investment policy in which it accommodates foreign capital from all sources, including governments. Most OECD Member States have developed guidelines aimed at striking a balance between welcoming SWF investments and protecting their own economic interests and national security. For example, in late 2007 Canada issued guidelines under which Ottawa examines the corporate governance and reporting structure of non-Canadian investors. This examination includes whether the non-Canadian companies follow Canadian standards of corporate governance (including commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders) and to Canadian laws and practices (OECD 2009a). Similarly, Australia indicated that investments by funds controlled by foreign governments are examined in the same way as those by private investors, but noted that its screening regime applies to all proposed direct investment by companies controlled by foreign governments. In February 2008, Australia issued ‘Principles Guiding Consideration of Foreign Government Related Investment in Australia’ in order to enhance the transparency of its review procedure (Treasurer of the Commonwealth of Australia 2008).

In addition to these guidelines developed by individual OECD Member States to attract SWF investments without jeopardizing their national security and strategic interests, the organization has reached a consensus on a number of rules and regulations to pursue a similar balance. The key OECD investment rules are the OECD Code of Liberalization of Capital Movements, adopted in 1961 (OECD 2010a), and the OECD Declaration on International Investment and Multinational Enterprises of 1976, as revised in 2000 (OECD 2010b). They institute procedures for notification and multilateral surveillance under the broad oversight of the OECD’s Governing Council to ensure their observance. The two documents are regularly updated by decisions of the OECD Council. They serve as a reference manual about the obligations of Member States to the degree of liberalization achieved by each one in regard to capital movements. Together, they embody the following principles:

- *Non-discrimination*: Foreign investors are to be treated the same as domestic investors in like situations. The two measures commit OECD Member States to extending the benefits of liberalization and free-market principles to all foreign investors.
- *Transparency*: Information about restrictions on foreign investment should be comprehensive and accessible to all parties.
- *Progressive liberalization*:- Members must commit to the gradual elimination of restrictions on capital movements across their countries.
- *'Standstill'*: Members must commit to not introducing new restrictions.
- *Unilateral liberalization*: Members must commit to allowing all other members to benefit from the liberalization measures they take and not to make them conditional on liberalization measures taken by other countries. Avoidance of reciprocity is an important OECD policy tradition.

In 2006 the OECD launched the Freedom of Investment (FOI) process under the auspices of the OECD Investment Committee, which for decades has been in charge of discussing all issues related to foreign investment. The FOI provides a unique multilateral forum for investment policy. It includes a process of peer surveillance to ensure that international commitments to openness are respected (OECD 2008b). The goal is to help OECD member and non-member governments preserve and expand an open environment for international investment while also safeguarding essential security interests. In the late 2000s participants in the FOI process agreed on a set of guidelines to contribute to confidence-building between SWFs and host countries and facilitate the free movement of foreign capital. These guidelines underscore several themes, including the following:

- *Transparency/predictability*: While it is in investors' and governments' interests to maintain the confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes.

- *Codification and publication*: Primary and subordinate laws should be codified and made available to the public in a convenient form (e.g. in a public register or over the internet).
- *Regulatory proportionality*: Restrictions on investment, or conditions on transactions, should not be greater than needed to protect national security, and they should be avoided when other existing measures are adequate and appropriate to address a national security concern.
- *Last resort*: Restrictive investment measures should be used, if at all, as a last resort when other policies cannot be used to eliminate security-related concerns (OECD 2009b).

It is important to point out that these OECD efforts to strike a balance between attracting foreign investments and ensuring national security interests should be seen as a complement to similar attempts by the IMF and other international financial institutions.

4.4. International Monetary Fund

Recognizing the growing importance of SWFs and the role of the IMF in monitoring the health of its member countries' economies and the global financial system, the IMF's ministerial guidance body – the International Monetary and Financial Committee – called on the Fund to engage in a dialogue with countries to arrive at a voluntary set of best practices in the management of SWFs. The IMF had developed similar guidelines in the past, particularly in the areas of fiscal transparency and foreign exchange reserves management. In response, representatives of SWFs met at the IMF Headquarters in Washington, DC, in late April 2008. The meeting saw a useful exchange of views among SWFs, recipient countries, and representatives from both the Organization of Petroleum Exporting Countries (OPEC) and the European Commission. It formally established an International Working Group of SWFs (IWG) to reach a consensus on a set of principles that properly reflects the SWF investment practices and objectives.

The IWG was co-chaired by Hamad al-Suwaidi, undersecretary of the Abu Dhabi Department of Finance and a director of the ADIA, and Jaime Caruana, counsellor and director of the IMF's Monetary and Capital Markets Department (IWG 2008a). It was comprised of representatives from 26 IMF member countries. In 2008 alone, it held meetings in Washington, DC (30 April to 1 May), Singapore (9–10 July), and Santiago (1–2 September). In their third and final meeting of the year, representatives reached an agreement on the Generally Accepted Principles and Practices for Sovereign Wealth Funds (GAPP), also known as the Santiago Principles. These principles provide a voluntary framework for appropriate governance and accountability arrangements, as well as appropriate investment practices by SWFs.

The IWG's work was guided by four main objectives: (1) to help maintain a stable global financial system and free flow of capital and investment; (2) to comply with all applicable regulatory and disclosure requirements in the countries where SWFs invest; (3) to invest on the basis of economic and financial risk and return-related considerations; and (4) to have in place a transparent governance structure that provides for adequate risk management and accountability (IWG, 2008b).

The GAPP cover three main areas: legal framework and objectives; institutional framework and governance structure; and investment and risk management. The 26 participants agreed on 24 principles to guide their investment strategies and operations. The implementation of these 24 principles is on a voluntary basis and subject to home countries' laws and regulations. These 24 principles underscore the need for clear and publicly disclosed investment policies, sound and effective accountability procedures, auditing regimes in accordance with recognized international auditing standards, and compliance with all the laws and regulations of host countries (IWG 2008b).

The work of the IWG and the publication of the GAPP should be seen as an important step in establishing and consolidating dialogue and understanding between SWFs and recipient countries. Other steps in this direction include the founding of the International Forum of SWFs and the issuing of the Kuwait Declaration. In April 2009 SWF representatives who participated in the IWG and endorsed the Santiago Principles met in Kuwait City. The meeting was hosted by the KIA, and agreed to establish the Forum as a permanent organization. The purpose of this organization is to meet, exchange views on issues of common interest, and facilitate an understanding of the Santiago Principles and SWF activities.

The Forum was not created to serve as a formal supranational authority and its work does not carry any legal force. Rather, it acts as an informal platform to facilitate the exchange of ideas and views among SWFs and with other relevant parties, share views on the application of the Santiago Principles, and encourage cooperation with investment recipient countries and relevant international organizations (IWG 2009). In order to pursue and advance these goals the Forum members held another meeting in Sydney, Australia (May 2010), hosted by Australia's Future Fund. A third meeting was held in Beijing, China (May 2011), hosted by the China Investment Corporation. The Forum members discussed risk management issues relating to the emerging environment for global asset allocation, reviewed progress on the application of the Santiago Principles, and reviewed the funding of the future work of the Forum, including a permanent secretariat. The Forum's next meetings will be held in Mexico (2012) and Norway (2013).

It is important neither to overestimate nor to underestimate the impact of the IWG and the Forum. It is still too early to provide any accurate assessment of their work and general compliance with the Santiago Principles. Sceptics point out that the Santiago Principles are voluntary guidelines and that, since there is no enforcement mechanism, compliance is bound to be low.

5. Gulf SWFs

The GCC was established in 1981 by Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE to promote their economic and financial integration. The total population of GCC states – including expatriates – is estimated at just 38 million. Nevertheless, in 2008, these states boasted a combined GDP of US$1.1 trillion. This is because the six GCC countries possess 40 per cent of the world's proven oil reserves and are responsible for 23 per cent of the world's total oil production. At the same time, they have 25 per cent of the world's proven natural gas reserves and are responsible for 24 per cent of global production (British Petroleum 2010: 6, 22). Furthermore, the GCC states' spare capacity for oil production accounts for the bulk of the world's total. All these figures illustrate the leading role the region plays in global energy markets.

There is another side to these energy riches, however. Despite persistent efforts to diversify their economies and reduce their heavy dependency on hydrocarbon resources, the GCC states are still deeply dependent on oil revenues. Oil accounts for about 50 per cent of the region's GDP and 80 per cent of fiscal and export revenues (Khamis and Senhadji 2010: 1). This provides the context within which we can understand the creation of Gulf SWFs.

The GCC states are home to some of the largest and oldest SWFs, with estimated assets between US$600 billion and US$1 trillion at the end of 2008 (Friedman and Meakin 2009: 65). The main reason for the growth of these SWFs was the high oil prices up to 2008. Through most of the 2000s, the GCC states were the largest source of net global capital flows in the world, rivalling China as a 'new financial superpower' (Economist 2008: 2).

Countries such as the GCC states that rely on oil and other non-renewable resources for a substantial share of their revenue face two key problems: the revenue stream is uncertain and volatile, and the supply of the resource is exhaustible. Stated differently, government revenue derived from the exploitation of non-renewable resources differs from other revenue in that it partly represents a depletion of wealth. This suggests that some of this wealth should be saved – both to help stabilize financial markets and for intergenerational equity (Davis et al. 2001: 4). These two objectives, stabilization and saving, are further reinforced by a third: most oil-producing countries cannot absorb the amount of wealth they generate when oil prices are high

The combination of all the above factors drove the creation and growth of a large number of SWFs in the Gulf. Indeed, each jump in oil and gas prices increased the number and size of SWFs in the region. Thus it is no coincidence that the majority of Gulf SWFs were founded in the 2000s, when oil prices started their inexorable climb to their peak of July 2008, reflecting the confidence of a Gulf flooded with cash. The region now boasts the highest concentration of SWF assets worldwide. In 2008, analysts at the Deutsche Bank estimated assets under management by Gulf SWFs at US$1.6 trillion, representing 46 per cent of total global SWF assets (Deutsche Bank 2008: 4). Other analysts believe the GCC's share of total assets is closer to 60 per cent (Friedman and Meakin 2009: 6). The uncertainty in these figures is due to the fact that most SWFs in the Gulf and elsewhere do not publish official figures of their assets.

The availability of substantial financial resources proved crucial to the ability of the Gulf SWFs to play a significant role not only in overcoming the recent global financial crisis in their own home countries but also in continuing their investments, albeit at a much lower level, in troubled Western banks and corporations. According to one source, the market value of the Gulf's foreign portfolio fell by an estimated US$350 billion over the course of 2008 (Setser 2009: 1). Another source estimated that Gulf SWFs lost on average between 20 and 25 per cent of the value of their known equity portfolios (Barbary and Chin 2009: 4). After all, the IMF estimates that the GCC states' combined current account surplus fell to US$53 billion in 2009, after having risen more than tenfold in the previous decade to US$362 billion in 2008 (IMF 2010: 1). This was because, as the global financial crisis deepened, the demand for oil, and consequently oil prices, declined. At the same time, stock and real estate markets plunged and external funding for the financial and corporate sectors tightened.

Despite huge losses, however, Gulf SWFs have managed to maintain their financial leverage. This relative success is due to the execution of comprehensive economic strategies prior to the global financial crisis. The GCC states grew on average by a robust 5.75 per cent a year between 2005 and 2008 (IMF 2009: 6). They launched huge investment projects to pursue economic diversification and human capital development through investments in oil and gas and infrastructure, as well as in petrochemicals, tourism, financial services and education. In addition they saved and invested a significant portion of their oil revenues.

This strong economic base has enabled the GCC states to address the severe global financial crisis from a better stance than most other countries. Governments have used their strong international reserve positions to maintain high spending and introduce exceptional financial measures. Saudi Arabia adopted a US$400 billion public investment package (equivalent to 110 per cent of its annual GDP, the largest fiscal stimulus package relative to GDP among the G20 for 2009–10) to be implemented over five years. Increased spending on social sectors and infrastructure in 2009 cushioned the downturn. Countercyclical fiscal policy in the UAE also played a key role in avoiding a major disruption in economic activity. Abu Dhabi's support of Dubai regarding its debt crisis has limited contagion to the rest of the economy and the banking system not only in the UAE, but in the rest of the Gulf region. Meanwhile, in Qatar, the government's pre-emptive intervention in the banking sector was equivalent to 6.6 per cent of GDP, mainly in the form of equity injections and asset purchases by the Qatar Investment Authority (QIA). As for Kuwait, the Kuwaiti authorities' response to the financial crisis was complicated by prolonged negotiations between the government and the parliament. In early 2010, however, the parliament approved a four-year, US$105 billion spending package (95 per cent of GDP). Finally, the Omani and Bahraini authorities introduced liquidity and prudential measures that helped mitigate the adverse effects of the crisis, particularly on the banking system (Institute of International Finance 2010: 5).

These huge financial reserves have proved crucial in preventing the spread of the so-called 'Arab Spring' to the Gulf monarchies. In order to contain the popular uprisings that toppled and challenged several Arab governments, the authorities in Kuwait, Qatar, Saudi Arabia and the UAE offered generous welfare packages to their populations. These packages included new education and housing subsidies, creation of thousands of jobs, unemployment compensation, and a pay rise for government employees and retirees.

In short, the GCC authorities' response to the global financial crisis focused on restoring liquidity by providing capital injections into the banking system, supplemented by deposits from government institutions. To shore up investor confidence, Kuwait, Saudi Arabia and the UAE provided guarantees for deposits at commercial banks and asked SWFs to support domestic asset prices and to provide capital injections for banks. SWF resources in Bahrain, Kuwait, Oman and Qatar were used to set up funds investing in local equity markets. Furthermore, the KIA and the QIA bought domestic bank shares to help boost bank capitalization and confidence. Thus, the experience of the late 2000s demonstrates that in times of financial stress and political unrest, SWF domestic investments may temporarily deviate from pure profit maximization to support broader macroeconomic and financial/political stabilization objectives.

The role Gulf SWFs have played in addressing and mitigating the impact of the global financial crisis in their home countries was crucial. On the other hand, with regard to foreign markets, the Gulf SWFs have, on the whole, weathered the financial storm fairly well, outperforming their Asian counterparts in some cases. Generally, older funds with large and diversified portfolios were somewhat protected from critical damage, while younger funds that pursued aggressive investment strategies fared much worse. For example, after buying stocks in Western banks at the height of the global financial crisis, the KIA sold a large portion of its stake in Citigroup, and the ADIA and the QIA did the same with their portions of the British bank Barclays PLC. The three Gulf SWFs made huge profits in these transactions. These transactions underscore the fact that the Gulf SWFs, like most other investors, are largely driven by financial profit, not political or ideological considerations.

The experience of the last several years has helped respond to the criticism and reservations about SWFs expressed by some Western policymakers and media outlets. Indeed, as their profile rose in recent years, Gulf SWFs were ill-prepared to counter the negative coverage they received in some European countries and the United States. Officials from the Gulf SWFs have repeatedly argued that their record shows that their investment decisions are driven exclusively by economic and financial interests and that they do not have any political agenda. They can now rightly challenge politicians in the United States and Europe to name a single Gulf investment that was made for political rather than commercial reasons (Khalaf 2008). It is important to point out that the lines separating political and commercial motives are occasionally blurred.

Gulf investors accept the need for increased scrutiny from recipient countries when their investments have potential national security implications, so long as the process is clear, fair and timely. In return, they call on the entire world community (SWF home and recipient countries) to ensure that financial markets remain open, that investors (private or government) playing by the rules are not discriminated against, and that the regulatory process remain transparent and predictable (Al-Otaiba 2008).

Gulf investors argue that Western suspicions of their SWFs are unwarranted. These investors say that efforts to regulate SWF investment operations are unjustified given that there are no similar guidelines for private equity or hedge funds. They assert that SWFs tend to be passive rather than active investors. In other words, they play a minimum role in drawing the broad strategy in the firms where they invest. On average, an SWF takes less than 5 per cent of the shares outstanding in a company, not a controlling stake. With such a small share, SWFs can hardly be viewed as possessing control over companies (Avendano and Santiso 2009: 12). Furthermore, the majority of the Gulf SWFs use external managers to run their funds, partly to compensate for their relative shortage of indigenous professional financial experts.

Three conclusions can be drawn from this discussion of Gulf SWFs. First, while the GCC states' short-term economic outlook is clouded by the global economic slowdown and by the credit crisis in Dubai, the region's medium-term outlook seems broadly positive. This projection is based on substantial investments in both economic and human capital. All over the region new cities have been built, economic projects and financial centres have opened, and new schools and universities have been established. In short, it can be argued that the Gulf governments have managed their massive petrodollars in the first decade of the twenty-first century better and more wisely than they did in the 1970s (following the jump in oil prices). Not surprisingly, analysts at the McKinsey Global Institute conclude that petrodollar investors are 'poised for future growth in almost any scenario. Their foreign assets reach nearly $9 trillion by 2013 in our base case, and more than $13 trillion if the economy recovers more quickly' (Roxburgh, Lund, Lippert, White, and Zhao 2009: 12).

Second, it is true that the GCC states have amassed immense financial reserves and accordingly managed to weather the global economic crisis much better than countries in many other regions, and their outlook in the medium and long terms looks promising. But their prosperity is still largely linked to oil prices. Efforts to diversify the region's economies away from oil and create other sources of national income have achieved only modest success.

Third, the above broad generalizations about the GCC economies and SWFs should not give the impression that they are all identical. Gulf SWFs differ in their age, size and investment strategies. They have also adopted diverse stances on transparency, governance and other issues. In the following I briefly discuss the outlooks of SWFs in Bahrain, Oman, Qatar and Saudi Arabia. A more detailed examination of the oldest fund – the KIA – and the richest one – the ADIA – is provided.

5.1. SWFs in Bahrain, Oman, Qatar and Saudi Arabia

Mumtalakat is the investment arm of the government of Bahrain, established in 2006, with stakes primarily in Bahraini state companies. In addition, it has made investments directly in firms in foreign countries and has also invested in publicly listed companies. Most of the investments outside Bahrain have been concentrated in the Middle East. In general, Mumtalakat targets investments in air transportation, airports, aluminium, banks, construction, fishing and seafood, glass manufacturing, healthcare services, insurance, marine transportation, ports, real estate, renewable energy, telecommunication, tourism and hotels, transportation services, utilities and water desalination and supply. Mumtalakat's investments, both at home and abroad, are meant to promote Bahrain as a major commercial and financial hub in the Gulf region. The widespread political upheaval since early 2011 has raised doubts of Mumtalakat's reaching this objective.

Established in 1980, the Omani SGRF acts as a fund for future generations. However, it has also acted as a stabilization fund for government budget purposes during years of weak oil prices. Initially, the SGRF received 15 per cent of Oman's oil revenues. Since 1998, revenues of the government in excess of the budgeted prices for oil and gas are accumulated in the SGRF to be utilized if there is a budget shortfall in subsequent years. In 2006 the Oman Investment Fund (OIF) was established. It invests in a wide variety of asset classes including private equity, real estate, infrastructure and equities. Since its inception, the OIF has diversified its portfolio, including holdings in China, India, the UAE and the United States.

The QIA was established in 2005 as an independent government investment institution and went into operation in early 2006. The QIA's prime objective is to pursue revenue diversification. In order to achieve this goal the fund invests in international markets (United States, Europe and Asia) and within Qatar outside the energy sector. The fund focuses on four investment types: public equity, real estate, private equity and investment funds. The QIA's major investments include Four Seasons Healthcare in the UK, European Aeronautic, Defense & Space CO (EADS), the London Stock Exchange, Sainsbury PLC, Barclays PLC, Credit Suisse, Volkswagen AG and the Commercial Bank of China. The QIA initially favoured investments in Western markets, but since the late 2000s has shown greater interest in Asia and Latin America.

In Saudi Arabia the Public Investment Fund (PIF) was established in 1973 to provide financing for certain productive projects that are of 'a commercial nature and have a significant importance in developing the national economy, which the private sector cannot undertake either due to insufficient experience or inadequate capital or both' (Ministry of Finance, Saudi Arabia 2008). In 2008 the Saudi government established the country's first SWF – Sanabil. It is managed and fully owned by the PIF, and oil revenues are the primary source of funding. The plan is to invest a large proportion of its capital in equities and pursue higher returns. This objective can be achieved by investing in alternative asset classes such as private equity, real estate, infrastructure and hedge funds.

5.2. The Kuwait Investment Authority

Kuwait was the first oil-producing country to establish an SWF – the KIA. Sheikh Abdullah al-Salem al-Sabah, the ruler of Kuwait from 1950 to 1965, decided in 1953 to establish the Kuwait Investment Board (KIB) with the aim of investing Kuwait's surplus oil revenue in order to provide a fund for the future and reduce reliance on a single finite resource. The KIO in London was set up to pursue these objectives. Preparing for independence from the United Kingdom, the Kuwaiti government established the General Reserve Fund (GRF) in 1960. The GRF is the main treasurer for the government and receives all revenues (including all oil revenues) from which all state budgetary expenditures are paid. It also holds all government assets.

In 1976 Jaber al-Ahmed al-Jaber al-Sabah, then deputy emir of Kuwait and crown prince, issued Law No. 106, under which the Future Generations Fund (FGF) was established. Article 1 stated: ‘An amount of 10 percent shall be allocated from the state’s general revenues every year.’ Article 2 stated: ‘A special account shall be opened for creating a reserve that would act as an alternative to oil wealth. An amount of 50 percent of the available state’s GRF is to be added to this account.’ Finally, the law stipulated that the Ministry of Finance shoul invest these funds, and the profits accruing from them should go into this account (KIA 2009a).

Finally, in 1982 Jaber al-Ahmed al-Jaber al-Sabah, who became emir on 31 December 1977, issued Law No. 47, establishing the Public Investment Authority, now known as the KIA. The law stated that the objective of the KIA is to ‘undertake the management of the GRF, the monies allocated to the FGF, as well as such other monies that the Minister of Finance may entrust the KIA with its management’ (KIA 2008). The KIA’s mission is to achieve a long-term investment return on financial reserves, providing an economic alternative to exploiting its oil resources. In 1986 the KIA’s revenues from investments exceeded revenue from exporting oil.

The degree of transparency of the KIA cannot be understood in isolation from the broader socioeconomic and political system in Kuwait. Many Kuwaitis take pride in the fact that in 1962 their country was the first Gulf state to adopt a parliamentary democracy and a constitution. For many years the Kuwaiti press was among the most open in the Gulf region and the broader Middle East. Furthermore, the Kuwaiti General Assembly (parliament) has enjoyed real power in supervising public policy. This parliamentary power was clearly demonstrated in 2006 when a succession crisis erupted and the parliament members voted Sheikh Sa’ad al-Abdullah al-Sabah, the then emir, out of office on health grounds.

Members of the KIA’s Board of Directors and employees of the KIA are banned from disclosing data or information about their work or the KIA’s invested assets without written permission from the chairman of the Board of Directors. While its activities are therefore secretive, they are reviewed by multiple external and internal auditors and overseers. The Board of Directors appoints an external auditor, who reviews the FGF and GRF as well as the funds managed by the KIA. The KIA also has an independent Audit Department that reports to the chairman of the board. In addition, the State Audit Bureau has on-site personnel to monitor the KIA's activities on an ongoing basis. Finally, the KIA makes annual closed-door presentations on the full details of all funds under its management, including its strategic asset allocation, benchmarks and rates of return, to the Council of Ministers and to the National Assembly (KIA 2009b).

Like many other SWFs, the KIA does not disclose information about its assets, its rates of return or the allocation of its investments. However, in the last few years some data has become available. In 2007 the Kuwaiti finance minister, Bader Mishari al-Humaidhi, announced that the KIA's assets had reached US$213 billion, the largest in the country's history. Due to the global financial crisis, however, the KIA, like other SWFs, has indubitably lost a proportion of these assets.

Investment guidelines prohibit the KIA from investing in the following: (1) share ownership in companies whose principal business involves gambling, liquor or adult entertainment; (2) private placements and venture capitalization; and (3) single issuer/issues in excess of 5 per cent of the portfolio at the time of the purchase (KIA 2009c). In the late 1980s the KIA acquired 20 per cent of British Petroleum (BP) shares, becoming the largest shareholders. Upon review, the UK Monopoly and Mergers Commission decided that the KIA might exercise influence over BP and constrain it from acting competitively. The KIA responded by reducing its shareholding.

Historically, the KIA pursued a conservative investment strategy aimed at preserving capital. Accordingly, the bulk of the KIA's assets were invested in US Treasury bonds. With a new management since the mid-2000s, however, the KIA has moved away from safe but low-return bonds and started to invest in alternative assets, such as private equity, real estate, hedge funds and commodities. Like other Gulf SWFs, the KIA has also been attracted to Islamic finance and thus purchased stakes in Islamic financial institutions and the securities they issued. Other major investments were allocated to Daimler AG (the owner of Mercedes-Benz) and BP.

In addition to the above changes in the KIA portfolio, the fund has sought to diversify its investments across various geographic locations. Due to strong historic and strategic ties with Europe and the United States, KIA's holdings in these two markets are significant. This geographical allocation, however, has witnessed fundamental changes in recent years. The KIA management has expressed strong interest in investing in emerging markets in Asia. The drive behind this shift is commercial. As Bader al-Sa'ad, managing director of the KIA, argued, 'Why invest in 2 per cent growth economies when you can invest in 8 per cent growth economies' (Sender 2007).

Finally, at the peak of the global financial crisis many Kuwaitis and the parliament called on the government to spend more of its wealth at home to stabilize the country's economy. The KIA pumped US$418 million into the Gulf Bank, Kuwait's fourth-largest traded lender, after it suffered heavy derivatives trading losses. The KIA also invested US$5.2 billion as part of a government fund to stabilize the stock market. Despite this scale-back on investments overseas and focus on the local economy, the KIA managers have been aware of the fact that the global economic crisis offers some investment opportunities abroad and have sought to take advantage of certain 'bargains'.

5.3. The Abu Dhabi Investment Authority

The ADIA is one of the wealthiest and oldest SWFs. It was established in 1976 by Sheikh Zayed bin Sultan al-Nahyan, the founder of the UAE and then ruler of Abu Dhabi. The ADIA replaced the Financial Investment Board, created in 1967 as part of the Abu Dhabi Ministry of Finance. The ADIA's current constitutive document is Law No. (5) of 1981, which delineates the roles and responsibilities of the Abu Dhabi government and the ADIA management. The main objective of the ADIA is to invest funds on behalf of the government of the Emirate of Abu Dhabi to make available the necessary financial resources and maintain the future welfare of the Emirate (ADIA 2010a).

The ADIA is not the only SWF in Abu Dhabi and the UAE. Since the early 2000s a number of SWFs have been established. The creation of several funds reflects the accumulation of massive wealth due to the rise of oil prices up to July 2008 and Emirati interest in pursuing several financial strategies. For example, the International Petroleum Investment Company (established in 1984) is responsible for all foreign investment in the oil and chemicals sector. Its portfolio includes investments in downstream hydrocarbon operations, petrochemical plants, pipelines, power utilities and shipping. The Mubadala Development Company was established in 2002 with a key goal of implementing a long-term economic diversification strategy. It invests in energy, industry, aerospace, information and communication technology, services ventures, real estate and hospitality, infrastructure and healthcare. In 2007 the Emirates Investment Authority was formed with a mandate to manage the sovereign wealth of the UAE federal government. One of its main goals is to diversify the government's asset exposure. These funds underscore two important characteristics of the UAE broad economic systems. First, the Emirates' leaders are aware that oil is a finite source and accordingly have pursued an economic diversification strategy. In other words, they are trying to create other sources of income and employment to supplement the country's dominant oil industry. Second, most of the newly established funds pursue a more assertive and aggressive investments than the older funds.

Some analysts suggest that the existence of several funds illustrates the influence of various members of the royal family. For example, Sheikh Khalifa bin Zayed al-Nahyan, president of the UAE and ruler of Abu Dhabi, is the chairman of the Board of Directors of the ADIA. Crown Prince Sheikh Mohamed bin Zayed al-Nahyan is the chairman of Mubadala. His full brother Sheikh Mansour bin Zayed al-Nahyan is the chairman of the International Petroleum Investment Company (England and Khalaf 2009). Despite the proliferation of new SWFs, the ADIA is the largest SWF in Abu Dhabi and the UAE.

The ADIA's Board of Directors and managing director (Sheikh Khalifa bin Zayed al-Nahyan) appoint other board members by royal decree. The Board holds primary responsibility for implementation of the ADIA's strategy. It also oversees the ADIA's financial performance and the activities of its management. The Board does not involve itself in the ADIA's investment and operational decisions, for which the managing director is responsible. Several committees provide assistance to the Board of Directors, including Investment, Strategy and Guideline Committees as well as an Evaluation and Follow-Up Department (ADIA 2010b). The ADIA management depends heavily on foreign experts. UAE nationals make up around 30 per cent of its total analysts (ADIA 2010c).

Until the late 1980s, the ADIA invested in mostly low-profile, conservative havens like US Treasury securities and government bonds. However, in recent years it has altered its asset allocation substantially and become a more risk-tolerant investor. (The US$7.5 investment in Citigroup is a case in point.) The ADIA has always sought to have a diversified portfolio across both asset classes and regions, as Tables 1 and 2 illustrate.

Table 1. *Portfolio overview by asset class*

Asset class	Minimum (%)	Maximum (%)
Developed equities	35	45
Emerging market equities	10	20
Small cap equities	1	5
Government bonds	10	20
Credit	5	10
Alternative	5	10
Real estate	5	10
Private equity	2	8
Infrastructure	1	5
Cash	0	10

Source: ADIA (2010c).

Table 2. *Portfolio overview by region*

Region	Minimum (%)	Maximum (%)
North America	35	50
Europe	25	35
Developed Asia	10	20
Emerging Asia	15	25

Source: ADIA (2010c).

The ADIA usually does not invest in the UAE or in the Gulf region except in instances where such investments constitute part of an index. Like other Gulf SWFs, the ADIA has recently taken a closer interest in emerging markets, particularly China and India. The ADIA has pursued investment opportunities in the insurance, financial, infrastructure and energy sectors.

In March 2010, ADIA published its first annual review, marking the first performance disclosure of any sort since the fund was established in 1976. The review states that the ADIA's

20-year and 30-year annualized rates of return to the end of 2009 were 6.5 per cent and 8 per cent respectively. The fund, however, declined to divulge its total assets. Whatever these assets are, it is likely that the ADIA, like other SWFs, has suffered significant losses as a result of the global financial crisis.

6. Conclusion

The global financial crisis in the late 2000s and the constructive role Gulf SWFs have played in efforts to overcome this crisis have partly reduced the intensity of controversy surrounding SWFs. It is uncertain what direction the controversy might take in coming years, though. Will sceptics in the United States and Europe accept these government-controlled investment vehicles? Or will they seek more regulations on their activities? The experience of the last several years offers a few lessons. First, the financial muscle and leverage Gulf SWFs will have in coming years will largely depend on future oil prices and the scale of Gulf governments' domestic spending. The higher the price of oil and the less domestic spending, the more assets they will have to invest overseas.

Second, while some information on Gulf SWF assets, strategies, management and governance is available, there is no uniform public disclosure of their activities by SWFs. As the KIA's and the ADIA's experiences suggest, a number of SWFs have come to accept the need for transparency and accountability in recent years. This acceptance might be driven by pressure from domestic public opinion or the desire to adhere to the Santiago Principles. Still, though, their actions leave much to be desired. Third, SWF host and recipient countries have a mutual interest in maintaining an open international investment climate in which all participants have confidence. Sensible management of oil-producing countries' petroleum wealth in well-functioning financial markets is in everyone's interest.

Fourth, the record of Gulf SWFs and indeed most SWFs demonstrates that they are generally passive investors with no desire to impact company decisions by actively using their voting rights, purchasing controlling shares, replacing old management or using any other means. Furthermore, there is no evidence that SWF investments are motivated and driven by political objectives. Like other investors, Gulf SWFs seek simply to maximize their profits.

Finally, in the last several years there have been many political and academic arguments put forth regarding the potential positive and negative effects of SWFs on global financial markets. Despite the hyperventilation of some actors about the activities of SWFs, a close examination suggests that these funds are not threatening to the established financial system. Rather, the evidence suggests that they can be, and have been, a stabilizing force.

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APPENDIX: ACRONYMS AND ABBREVIATIONS

ADIA	Abu Dhabi Investment Authority
BP	British Petroleum
CFIUS	Committee on Foreign Investment in the United States
EO	Executive Order
FGF	Future Generations Fund
FINSA	Foreign Investment and National Security Act
FOI	Freedom of Investment
GAPP	Generally Accepted Principles and Practices
GCC	Gulf Cooperation Council
GRF	General Reserve Fund
IMF	International Monetary Fund
IWG	International Working Group
KIA	Kuwait Investment Authority
KIB	Kuwait Investment Board
KIO	Kuwait Investment Office
OECD	Organization for Economic Cooperation and Development
OIF	Oman Investment Fund
OPEC	Organization of Petroleum Exporting Countries
PIF	Public Investment Fund
QIA	Qatar Investment Authority
SGRF	State General Reserve Fund
SWF	sovereign wealth funds
UAE	United Arab Emirates

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