

## International Investment of Sovereign Wealth Funds (SWFs): Concerns Raised by Western Countries

Brian Sukianto<sup>1</sup>

### Abstract

SWFs are long-term investment vehicles that are owned by a sovereign State. However, many perceive that being State-owned simply means being State-directed and that often also means being political and non-commercial. Such perceptions have been more prevalent in Western countries, given that many SWFs have been established by Middle Eastern and Asian States, which often target acquisitions in Western countries. Those concerns were further heightened by the fact that many Asian SWFs have been non-transparent with respect to the objectives of their investment activities. Based on such concerns, many Western countries have adopted more stringent domestic-based regulations to control investments by SWFs and protect their national security. This paper discusses what is defined as SWFs, why Western countries are concerned about such funds, and domestic policies of Western countries to address SWF investments. This paper argues that regulation of SWFs through international instruments is a better strategy to monitor SWF investments.

**Keywords:** SWF, investment, state-owned, concerns, issues, western countries.

### Intisari

*SWFs merupakan kendaraan investasi jangka panjang yang dimiliki oleh suatu negara. Namun, banyak anggapan bahwa menjadi milik negara berarti diarahkan oleh negara dan seringkali juga bersifat politis dan non-komersial. Kekhawatiran seperti itu cenderung lebih banyak dikemukakan di negara Barat, mengingat bahwa SWF sebagian besar berasal dari negara Timur Tengah dan Asia yang seringkali menargetkan akuisisi di negara Barat. Kekhawatiran tersebut semakin diperparah oleh fakta bahwa banyak SWF Asia yang tidak bersifat transparan. Berdasarkan kekhawatiran tersebut, maka banyak negara Barat yang mengadopsi peraturan berbasis domestik yang lebih ketat untuk mengontrol investasi SWF dan melindungi keamanan nasional mereka. Penulisan ini membahas mengenai apa itu SWF, mengapa negara Barat mengkhawatirkan entitas tersebut dan kebijakan domestik negara Barat terhadap investasi SWF. Makalah ini berpendapat bahwa pengaturan SWF melalui instrumen internasional merupakan strategi yang lebih baik untuk memantau investasi SWF.*

**Kata kunci:** SWFs, investasi, milik pemerintah, masalah, isu, negara barat

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<sup>1</sup>\* Class of 2018, Bachelor of Law Candidate from International Law Department, Universitas Gadjah Mada's Faculty of Law

## A. Introduction

Sovereign Wealth Funds (“**SWFs**”) have only recently caught the public’s attention due to their rapid growth both in number and assets. Put simply, an SWF is a long-term government-controlled investment vehicle whose investment strategy typically includes the acquisition of international assets.<sup>1</sup> SWFs are owned and funded by their respective home countries.<sup>2</sup> Designated for specific financial objectives, SWFs incorporate distinct strategies to fulfill its respective objectives accordingly. Estimates in 2020 indicated that more than 115 SWFs are in operation, representing more than 68 nations.<sup>3</sup> In 2020, the Sovereign Wealth Fund Institute (“**SWFI**”), an organization that tracks SWFs, estimated that total assets under management of SWFs was more than US\$ 9,158 trillion.<sup>4</sup>

The fact that most of these SWFs are owned by non-Organization for Economic Co-operation and Development<sup>5</sup> (“**OECD**”) countries (i.e., Asian countries) has further heightened public attention towards SWFs. In fact, Asian SWFs currently account for about a quarter of total global SWF assets.<sup>6</sup> The 2008 World Bank Report noted that, “the emergence of the SWFs in Asia is largely a by-product of the strong economic development in Asia.”<sup>7</sup> As can be seen in the table below, of the six largest SWFs, only one SWF originated in a European country.

**Table 1.** Largest SWFs by Total Assets.<sup>8</sup>

<b>RANK</b>	<b>SWFs</b>	<b>ESTIMATED TOTAL ASSETS</b>	<b>REGION</b>
1	Government Pension Fund of Norway (Norway)	\$1,289,460,000,000	Europe
2	China Investment Corporation (China)	\$1,045,715,000,000	Asia
3	Kuwait Investment Authority	\$692,900,000,000	Asia

<sup>1</sup> International Monetary Fund, *Sovereign Wealth Funds Generally Accepted Principles and Practices*, (London: International Working Group of SWF, 2008), 1.

<sup>2</sup> *Ibid.*

<sup>3</sup> International Working Group of SWF, “Our Member,” Accessed July 20, 2021. <https://www.ifswf.org/our-members>.

<sup>4</sup> SWFI, “Sovereign Wealth Fund Rankings”, Accessed July 20, 2021. <https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund>.

<sup>5</sup> Members of OECD countries include: Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Iran, Ireland, Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad & Tobago, the United Arab Emirates, the United States.

<sup>6</sup> Sudarshan Grooptu, *Sovereign Wealth Fund in East Asia*, (Timor Leste: World Bank, 2008), 6.

<sup>7</sup> *Ibid*, 3.

<sup>8</sup> International Working Group of SWF, “Our Member”.

	(Kuwait)		
4	Abu Dhabi Investment Authority (UAE)	\$649,175,654,400	Asia
5	Hong Kong Monetary Authority Investment Portfolio (Hongkong)	\$580,535,000,000	Asia
6	Temasek Holdings (Singapore)	\$484,441,000,000	Asia

Source: *The Sovereign Wealth Fund Institute*.

The emergence of these Asian SWFs has signalled a major reshaping of the world's economy, where Asian countries dominate the global economy.<sup>9</sup> As proof, Western countries are only now becoming the key recipients (host countries) of SWFs investments.<sup>10</sup> This is due to several reasons, not least because of Western countries' steady economies and low investment risks.<sup>11</sup> Specific examples include SWFs of China and South Korea investing in two of the biggest U.S. financial institutions, Morgan Stanley and Merrill Lynch, for \$5 billion and \$2 billion respectively.<sup>12</sup>

Despite the headlines, many Western countries are convinced that SWFs tend to be politically motivated, particularly Asian SWFs. These concerns were emboldened by the fact that many Asian SWFs are non-transparent and therefore it is hard for Western countries to assess whether or not their investment activities are based on non-commercial motives.<sup>13</sup> Western countries also perceived SWFs as destabilizing the investment market in situations where SWFs suddenly move their significant investments from any specific Western country.<sup>14</sup>

In response to those concerns, there has been a push by Western countries (e.g., the U.S., Canada, Australia) to regulate SWFs through their domestic laws as a form of regulatory control over the investments of SWFs in their countries. In the U.S., such concerns have led to the strengthening of the powers of the Committee on Foreign Investment in the United States ("**CFIUS**"), which is in

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<sup>9</sup> OECD countries, which five decades ago concentrated 75% of world GDP, today only account for less than 55% of global wealth.

<sup>10</sup> Javier Santiso, *OECD Emerging Markets Network Working Paper: Sovereign Development Funds: Financial Actors of the Shifting Wealth of Nations* (Paris: OECD, 2008), 6.

<sup>11</sup> *Ibid.*

<sup>12</sup> Donghyun Park, *ADB Briefs October 2008 No. 1: Developing Asia's New Sovereign Wealth Funds and Global Financial Stability*, (Asian Development Bank, 2008), 1.

<sup>13</sup> *Ibid.*

<sup>14</sup> Evaritius Oshionebo. "Managing Resource Revenues: Sovereign Wealth Funds in Developing Countries," *Asper Review of International Business and Trade Law* XV (2015), 248-250.

charge of reviewing foreign acquisitions.<sup>15</sup> U.S. laws further enable the CFIUS to reject investments deemed a threat to the U.S. national security.<sup>16</sup> Australia and Canada also adopted new rules purporting to control the acquisition of domestic companies by foreign state investors.<sup>17</sup> This paper further discusses the general overview of SWFs and issues raised by Western countries as recipient countries of SWF investment. Finally, this article suggests that, contrary to the clamor for more domestic-based regulation of SWFs investment in the respective Western countries, a better strategy would be to regulate SWFs through international regulation. It is also worth noting that for the purposes of this paper, “western countries” refers to developed countries; that is, OECD member countries, such as the U.S., Canada, and Australia.

## **B. General Overview of SWFs**

### a. What are SWFs?

SWFs are *foreign-government-controlled investors* (“**FGCI**”).<sup>18</sup> SWFs are owned and funded by the governments of their home countries. Sources of funding and objectives of SWFs vary widely from one country to another. Typically, they are established through funds raised from balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.<sup>19</sup> In regards to their objectives, the International Monetary Fund (“**IMF**”) has classified five types of SWFs, which will be elaborated in detail in the table below.

**Table 2.** Types of SWFs and Their Objectives.<sup>20</sup>

<b>Types</b>	<b>Objectives</b>	<b>Example of SWFs</b>
Fiscal Stabilization Funds	“Set up to insulate the budget and economy from commodity price volatility and external shocks. Their investment horizons and liquidity objectives resemble that of central banks' reserve managers, in view of their role in	Iran’s Oil Stabilization Fund, Taiwan’s National Stabilization Fund

<sup>15</sup> *Ibid.*

<sup>16</sup> Edwin M. Truman, “The Rise of Sovereign Wealth Funds: Impacts on US Foreign Policy and Economic Interest,” accessed July 27, 2021. <https://www.piie.com/sites/default/files/publications/testimony/truman0508.pdf>.

<sup>17</sup> Steffen Kern, “SWF and Foreign Investment Policies – an Update,” *Deutsche Bank Research* October 22 (2008): 26-30.

<sup>18</sup> Organisation for Economic Co-operation and Development. *Foreign Government-Controlled Investors and Recipient Country Investment Policies: A Scoping Paper* (Paris: Organisation for Economic Co-operation and Development, 2009), 6.

<sup>19</sup> International Monetary Fund, “Sovereign Wealth Funds – A Work Agenda,” *IMF*, accessed July 27, 2021. <https://www.imf.org/external/np/pp/eng/2008/022908.pdf>.

<sup>20</sup> *Ibid.*

	countercyclical fiscal policies to smooth boom/bust cycles.”	
Savings Funds	“Set up to share wealth across generations by transforming non-renewable assets into diversified financial assets. Their investment mandates typically reflect a higher tolerance for volatility and a focus on long-term returns.”	Kuwait Investment Authority (KIA)
Development Funds	“Set up to allocate resources to priority socioeconomic projects, usually infrastructure”	India’s National Infrastructure Fund (NIIF), Nigeria Sovereign Investment Authority (NSIA)
Pension-Reserve Funds	“Set up to meet identified outflows in the future with respect to pension-related contingent-type liabilities on the government’s balance sheet”	Japan’s Government Pension Investment Fund (GPIF), Chile’s Pension Reserve Fund
Reserve Investment Funds	“Set up to reduce the negative carry costs of holding reserves or to earn higher return on ample reserves, while the assets in the funds are still counted as reserves”	Russia’s Reserve Fund, Kiribati’s Revenue Equalization Fund, Oman’s State General Reserve Fund.

Source: *The International Monetary Fund (IMF)*.

In relation to their legal structure, SWFs are also a non-homogenous group. Their legal structure and governance vary significantly from country to country. The IFSWF has classified three types of legal structures of SWFs:

**Table 3.** The Legal Structures of SWFs.<sup>21</sup>

Legal Structures of SWFs	Example of SWFs
“SWFs established as independent legal entities governed by a specific constitutive law.”	Kuwait Investment Authority (KIA), the Korea Investment Corporation (KIC) and the State Oil Fund of the Republic of Azerbaijan (SOFAZ)

<sup>21</sup> International Working Group of SWF, *Santiago Principles: 15 Case Studies*, (Doha: IFSWF’s 6<sup>th</sup> Annual Meeting, 2014), 16.

“SWFs set up as state-owned corporations governed by company law”	China Investment Corporation (CIC), Government of Singapore Investment Corporation (GIC), National Investment Infrastructure Fund (NIIF), and Singapore’s Temasek Holdings
“SWFs made up from a pool of assets owned by the state (national or sub-national governments) or the central bank”	Botswana Pula Fund (PF) and Chile’s Economic and Social Stabilization Fund (ESSF)

Source: *The International Forum for Sovereign Wealth Fund (IFSFW)*.

#### b. Significance of SWFs?

SWFs are significant due to the size of their asset holdings. Initially, most SWFs were passive investors,<sup>22</sup> but as time has gone by, SWFs have become active investors.<sup>23</sup> Significantly, SWFs have grown rapidly throughout the past decade, surpassing \$9 trillion in assets.<sup>24</sup> In fact, SWFs headquartered in Asian economies are the most active investors.<sup>25</sup> Steffen Kern stated that “Asian SWFs is contributing 66% of the transactions of the funds.”<sup>26</sup> Due to the size of their asset holdings, it is very likely that SWFs are able to affect market prices for the investments they target.<sup>27</sup> This is why SWFs are significant and must not be disregarded, particularly by Western countries, given that Western countries are now the primary host countries for SWF investments.

### C. Issues Involving SWFs

The significant emergence of SWFs raises various policy issues and concerns for host countries, especially Western countries. Of these concerns, lack of transparency, non-commercial investment motives, and market distortions are at the forefront of the debate.

<sup>22</sup> Paul Rose, “Sovereign as Shareholder”. *North Carolina Law Review* 87(1) (2008): 86.

<sup>23</sup> *Ibid*, 87.

<sup>24</sup> SWFI. “Sovereign Wealth Funds Surpass \$9 Trillion in Assets,” accessed October 21, 2021. <https://www.swfinstitute.org/news/88265/sovereign-wealth-funds-surpass-9-trillion-in-assets>.

<sup>25</sup> Steffen Kern, “SWF and Foreign Investment Policies”.

<sup>26</sup> *Ibid*.

<sup>27</sup> Kathryn Gordon, “Sovereign Wealth Funds and Recipient-Country Investment Policies: OECD Perspectives” in *Economic of Sovereign Wealth Funds: Issues for Policymakers* ed. Udaibir S. Das et. al. (Washington DC: Monetary Fund, 2010), 1-299.

a. Lack of Transparency

Currently, many western countries deem SWFs as non-transparent investment entities. This is also shown in the Linaburg-Maduell Transparency Index, a method of rating transparency of SWFs developed by Carl Linaburg and Michael Maduell, where many Asian SWFs (particularly those of the Middle East and China) are placed in the lowest rank.<sup>28</sup> The lack of transparency in SWFs happens because transparency for SWFs, as for any other large investor, is a dual-edged sword. On one side, it is perceived that excessive disclosure with respect to SWFs would negatively affect their investment performance and strategy. This concerns how disclosure over short-term performance metrics may ultimately harm long-term investment as the investments would be allocated towards short-term performance.<sup>29</sup> On the other hand, lack of disclosure has led to host countries perceiving SWFs as political investors. Fears were prevalent among western countries that SWFs may potentially be misused by authoritarian governments to weaken western economy. Nevertheless, limited evidence exists to support the presence of politically driven investments. The following is supported by a data by the IMF indicating that authoritarian governments were inclined to avoid investment prone to political influence.<sup>30</sup>

However, given the recent and projected growth of SWFs, the transparency of SWFs is a crucial factor. As stated by Steffen Kern, transparency of SWF is important due to two reasons: <sup>31</sup> “First, without insight into SWF activity, it is difficult to assess systemic risks or to determine whether SWFs are in fact pursuing strategic, non-commercial investment strategies (which will be discussed further below). Second, limited disclosure makes it difficult to assess the management and governance of the funds and, therefore, difficult to identify mismanagement or corruption by fund managers.”

Unfortunately, there are no legally binding regulations or disclosure requirements for SWFs. The only current international instrument that calls for higher transparency of SWFs is the Santiago Principle—non-binding guidance

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<sup>28</sup> SWFI. “Linaburg-Maduell Transparency Index (LMTI),” accessed April 20, 2021. <https://www.swfinstitute.org/research/linaburg-maduell-transparency-index>.

<sup>29</sup> Adam D. Dixon, “Enhancing the Transparency Dialogue in the “Santiago Principles” for Sovereign Wealth Funds”. *Seattle University Law Review* 37 No. 581, (2010): 584.

<sup>30</sup> Victoria Barbary, Bernado Bortolotti, “Sovereign Wealth Funds and Political Risk: New Challenges in the Regulation of Foreign Investment” World Scientific Book Chapters, in *Regulation of Foreign Investment Challenges to International Harmonization*, ed. Zdenek Drabek & Petros Mavroidis, (World Studies in International Economics: Volume 21, 2013), 317-318.

<sup>31</sup> Anthony Wong, “Sovereign Wealth Funds and the Problem of Asymmetric Information: The Santiago Principles and International Regulations,” *Brooklyn Journal of International Law* 34(3) (2009): 1096.

established by IFSWF, which will be discussed in detail below.

#### b. Politically-Based Investment

This section explores the issue of the political versus commercial objectives of SWFs. The OECD differentiates between political and commercial objectives as follows:<sup>32</sup> “A political objective, in its broadest possible sense, refers to any goal related to the implementation of any aspect of public policy. Whereas a commercial objective refers to economic transactions motivated by the desire to earn money or reduce costs.”

With that in mind, there are growing fears raised by western countries that SWFs will be used by their home countries’ governments to achieve non-commercial (political) goals, in addition to commercial goals.<sup>33</sup> In other words, western countries fear that political relations may play a role in SWF decision-making. Such notion is heightened by the fact that SWFs usually have direct control from their home countries’ governments. For example, the appointment and removal of an SWF’s governing body typically requires the consent of the government controlling the relevant entity. In many cases, key positions are also conferred to individuals with close ties to the State, such as a present or former minister. The ruler of Abu Dhabi, for example, serves as chairman of the ADIA (Abu Dhabi’s SWF), with other family members acting as managing directors.<sup>34</sup> The Chairman of the KIA (Kuwait’s SWF), Mariam Al-Aqeel have previously served as the country’s Minister of Finance.<sup>35</sup> In China, the Chairman and Chief Executive Officer of GIC, Lou Jiwei, had a ministerial position within the State Council.<sup>36</sup>

Due to those perceived political influences, many commentators are also concerned that home countries will use their SWFs to support what one analyst has called “state capitalism,” using government-controlled assets to secure stakes around the world in strategic areas such as telecommunications, energy and mineral resources, and financial services, among other sectors.<sup>37</sup> Nevertheless, many countries enforce foreign investment laws to filter such concerns through rejecting investments in certain sectors deemed strategic or sensitive. Moreover,

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<sup>32</sup> Organisation for Economic Co-operation and Development, *Foreign Government-Controlled Investors*, 10.

<sup>33</sup> *Ibid.*

<sup>34</sup> ADIA, “Board of Director,” accessed July 23, 2021, <https://www.adia.ae/en/investments/governance/board-of-directors>.

<sup>35</sup> New Kuwait Summit 2019, “H.E. MRS. MARIAM AL AQEEL,” Accessed 22 October 2021, <https://newkuwaitsummit.com/user-profile/he-mrs-mariam-al-aeel>.

<sup>36</sup> Martin A. Weiss, “Sovereign Wealth Funds: Background and Policy Issues for Congress,” *Congressional Research Service* (2009).

<sup>37</sup> *Ibid.*

many fear that SWFs may use their influence through portfolio companies to gain access to natural resources, know-how, confidential information or to gain competitive advantage.<sup>38</sup> Relatedly, many also fear that such sensitive information so acquired would then be used by the SWFs (or their governments) for insider-trading purposes.<sup>39</sup>

In the end, although these political influences in investment may lead to poor financial performance and inefficiency in target firms (from a strictly economic perspective), as SWFs would have additional objectives besides return maximization, such as achieving political and social goals.

### c. Market Distortion

SWFs investments in western countries are equally alleged to be capable of destabilizing the investment market in situations where SWFs might suddenly withdraw or divest (for economic or non-economic reasons) their large investments from any particular Western country. This can be so, because SWFs already hold a significant amount of assets and if they are carelessly managed, there will be broad consequences for the whole market.<sup>40</sup> Moreover, whether financial stability would be impacted is heavily dependent on the motives behind the investments. When driven by ulterior motives such as political motives, SWFs may potentially create market distortion. For example, particular SWFs are inclined to a sudden selling of assets which would ultimately lead to market volatility.<sup>41</sup>

As stated by Anthony Wong, “in addition to the risk of market shock and stability, the risk of sudden movement by SWFs will also cause a rise in interest rates because an interest rate is an aggregate of the real interest rate, inflation expectation, risk premium, and liquidity preference”.<sup>42</sup> An increase in risk will require borrowers to offer additional risk premiums to compensate the investors. Altogether, an increase in risk will cause an increase in interest rates.<sup>43</sup> In the end, investment prices may be artificially inflated and misrepresent the true relative market value.

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<sup>38</sup> European Economy, “The so-called ‘Sovereign Wealth Funds’: Regulatory Issues, Financial Stability and Prudential Supervision,” *European Economy Economic Papers* 378 April, (2009), 30.

<sup>39</sup> Richard A. Epstein and Amanda M. Rose, “The Regulation of Sovereign Wealth Funds: The Virtue of Going Slow,” *The University of Chicago Law Review* 76(1) (2018), 123.

<sup>40</sup> Anthony Wong, “Sovereign Wealth Funds”, 1094.

<sup>41</sup> Roland Beck, Michael Fidora, “The Impact of Sovereign Wealth Funds on Global Financial Markets”, *European Central Bank, Occasional Paper Series No. 91*, July 2008, 24.

<sup>42</sup> Anthony Wong, “Sovereign Wealth Funds”, 1101.

<sup>43</sup> *Ibid.*

## **D. Response of Western Countries**

Based on the several issues mentioned, SWFs are presumed to be offenders until proven innocent.<sup>44</sup> Therefore, to protect their national security interest from such investment, many Western countries have enacted laws that restrict or prevent sovereign investment funds from purchasing or acquiring a controlling stake in their respective countries. Below, we will see the regulatory measures taken by Canada, the U.S., and Australia over government-owned investments, including SWFs, in their countries.

### a. Canada

In Canada, for example, the Investment Canada Act empowers the Canadian government to review state foreign investments that are potentially injurious to national security.<sup>45</sup> The Act also empowers the government to prevent the acquisition of a controlling stake in Canadian companies by foreign state investors. Pursuant to section 14 of the Act, the Canadian government has the authority to review any investment by foreign investors that acquire control of a Canadian business where the assets of the Canadian business exceed the prescribed threshold.<sup>46</sup> For the government-controlled investors, including SWFs, the threshold for review is C\$369 million (Canadian dollars) in asset value.<sup>47</sup> As a result, investment by an SWF to acquire control of a Canadian company whose asset value is at least C\$369 million is subject to review by the government of Canada. A notable instance is the acquisition of Aecon Group Inc. (Canadian construction company) by China Communications Construction Company Ltd. (Chinese state-owned engineering and construction company) valued to be C\$1.5 billion. This was subject to review by the government of Canada in accordance with the *Act* which subsequently was blocked to safeguard Canada's national security.<sup>48</sup>

### b. The U.S.

Different from Canada that authorizes its government to review potentially injurious transactions of an SWF, in the U.S. the authority to review such transactions is conferred on a specific institution, which is the Committee on Foreign Investments in the United States (“**CFIUS**”). In the U.S., the Foreign Investment and National Security Act of 2007 (“**FINSA**”) empowers the CFIUS

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<sup>44</sup> Investment Canada Act (R.S.C., 1985, c. 28 (1<sup>st</sup> Supp.)), Justice Laws § 25.

<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*

<sup>47</sup> *Ibid.*

<sup>48</sup> CBC News, “Federal government blocks sale of construction giant Aecon to Chinese interests”, *CBC News*, Accessed 23 October 2021, <https://www.cbc.ca/news/politics/canada-blocks-aecon-sale-china-1.4675353>.

to review any state foreign acquisition transactions and make recommendations to the President regarding whether or not the President should veto the foreign acquisition transactions.<sup>49</sup> Therefore, the President of the U.S. has the power to veto or block any proposed or pending acquisition of a U.S. company by foreign state investors if the President considers that the acquisition transaction is a threat to national security.<sup>50</sup> In 1990, for example, the CFIUS's review of the acquisition of MAMCO Manufacturing, a U.S. company engaged in the manufacturing of airplane components and parts, by the China National Aero-Technology Import & Export Corporation led President George H.W. Bush to veto the acquisition.<sup>51</sup> More recently, on 2017, following a review by the CFIUS of the potential threat to the U.S. national security, President Trump have ordered the blockage of \$1.3 billion acquisition of Lattice Semiconductor Corporation, a U.S. company engaged in semiconductor manufacturing by Canyon Bridge Capital, a Chinese private equity firm backed by its government.<sup>52</sup>

Unlike Canada that sets a threshold for a transaction subject to review, the CFIUS review process can be applied whenever control of a U.S. business is acquired, without any specific threshold. As stipulated under FINSA, reviewable transactions include a "covered transaction", defined as "any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States."<sup>53</sup> By this extensive review authority, many experts deem CFIUS as "one of the most demanding foreign investment processes among the industrialized economies—not least for sovereign investors."<sup>54</sup>

### c. Australia

Foreign state investment control in Australia is regulated under the Foreign Acquisitions and Take-overs Act, Act No. 92 of 1975. foreign state investment control aims to ensure that foreign state investment does not run against Australia's national interest.<sup>55</sup> The control process requires a foreign

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<sup>49</sup> Evaritius Oshionebo. "Managing Resource Revenues: Sovereign Wealth Funds in Developing Countries," *Asper Review of International Business and Trade Law* 217 (2015): 253.

<sup>50</sup> Anthony Wong. "Sovereign Wealth Funds", 1088.

<sup>51</sup> Jared T. Brown and Daniel H. Else, "The Defense Production Act of 1950: History, Authorities, and Reauthorization," *Congressional Research Service* (2014): 21.

<sup>52</sup> Liana B. Baker, "Trump bars Chinese-backed firm from buying U.S. chipmaker Lattice", *Reuters*, September 14, 2017. Accessed October 24, 2021, <https://www.reuters.com/article/us-lattice-m-a-canyonbridge-trump-idUSKCN1BO2ME>.

<sup>53</sup> Foreign Investment and National Security Act of 2007, H.R. 556 (110<sup>th</sup>) (2007).

<sup>54</sup> Steffen Kern, "Control Mechanism for Sovereign Wealth Funds in Selected Countries," *CESifo DICE Report* 06 (4) (2008): 44.

<sup>55</sup> Steffen Kern, "SWF and Foreign Investment", 26.

government investment to identify itself to the government and the Foreign Investment Review Board (“**FIRB**”) will examine the investment.<sup>56</sup> The FIRB plays an advisory role in this process while final authority rests with the federal Treasurer, who can reject proposals deemed contrary to the national interest or impose conditions on them to address national interest concerns.<sup>57</sup>

The FIRB is mandated to ensure that investments are consistent with any specific legislation in areas such as transport and telecommunications.<sup>58</sup> It also examines whether proposals have implications for other government policies, competition, or the operation of Australian businesses.<sup>59</sup> This intervention mandate clearly sets the tone that Australia was, and still is, particularly concerned about the entry of foreign State investors.

#### **D. Criticism Toward Western Countries’ Responses**

Prominently, regulations enacted by Western countries are deemed insufficient to address the concerns about national security and control of Western companies by SWFs.<sup>60</sup> Rather, those investment measures targeted at state investors often have negative spill-over effects for a commercially motivated foreign state investors,<sup>61</sup> and it is therefore also likely that it will harm the country’s competitive position in terms of market openness by international standards.

Moreover, such stringent regulatory measures enacted by Western countries are also likely to run counter to the free market principles promulgated by the OECD in 2009.<sup>62</sup> Even though the OECD acknowledges the host countries’ rights to take such actions as they consider necessary to protect national security, such restrictions, however, should be guided by the principles of proportionality, regulatory transparency, and predictability.<sup>63</sup> Unfortunately, there is no clear

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<sup>56</sup> *Ibid.*

<sup>57</sup> *Ibid.*

<sup>58</sup> Steffen Kern, “Control Mechanism for Sovereign Wealth Funds in Selected Countries”, 44.

<sup>59</sup> *Ibid.*

<sup>60</sup> Joel Slawotsky, “Sovereign Wealth Funds as Emerging Financial Superpowers: How U.S. Regulation Should Respond,” *Georgetown Journal of International Law* 4(40) (2009): 1249.

<sup>61</sup> Edward F. Greene and Brian A. Yeager, “Sovereign Wealth Fund- A Measured Assessment,” *Capital Market Law Journal* 3 (3) (2008): 247.

<sup>62</sup> Organisation for Economic Co-operation and Development, “International Investment of Sovereign Wealth Fund: Are New Rules Needed,” accessed July 26, 2021. <https://www.oecd.org/daf/inv/investment-policy/39979894.pdf>.

<sup>63</sup> Organisation for Economic Co-operation and Development, “Sovereign Wealth Fund and Recipient Countries – Working Together to Maintain and expand Freedom of Investment,” accessed July 26, 2021. <https://search.oecd.org/daf/inv/investment-policy/41456730.pdf>.

guidance on constituting “transparent, proportional, and predictable”. In addition, security and commercial interests may conflict one another since if investments are rejected for reasons of security, transparency as to why the investment was rejected may not always be feasible. Therefore, the applications of such principles vary widely from one country to another.<sup>64</sup> With such a lack of guidance, it is very likely that restrictions on foreign state investment performed by Western countries would undermine the Western countries’ commitment to open investment. As stated by Jeffrey Garten (2008), professor of finance at Yale School of Management, “while prudent regulation in selected areas can be justified, the current Western countries’ governments action is likely to produce too much government intervention.”<sup>65</sup>

### **E. The Ways Forward**

As stated by Anthony Wong: “international regulation and monitoring of SWFs is preferable to domestic regulations and monitoring”.<sup>66</sup> In particular, such a forum is attractive because of its ability to alleviate many of the concerns discussed above. Moreover, there are also several additional benefits of international regulation compared to domestic-based regulations as follows:<sup>67</sup>

- a. The first benefit is that international regulations would protect the host and recipient countries’ interests equally, create a level playing field, and avoid over-regulation due to nationalist and protectionist pressures. This can be so, because the drafting of international regulations creates an opportunity for both the home country and host country to have a meaningful dialog over how SWFs should be regulated. If left solely to domestic regulations, there is a risk that only recipient countries’ concerns will be addressed, as SWFs and their host countries will not have an opportunity to voice their concerns.
- b. The second benefit is that international regulations will create uniform regulations governing SWFs. A uniform or even a mostly uniform regulatory system will have the additional benefit of lower compliance cost and redundancy. This approach also discharges the problem and possibility of conflicting regulations. However, it is important to consider that creating a uniform regulation on SWFs may pose difficulties in its negotiation process for particular governments to give up discretion, particularly on matters concerning security or are

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<sup>64</sup> *Ibid.*

<sup>65</sup> T.T. Ram Moham, “Sovereign Wealth Funds: Western Fears,” *Economic and Political Weekly* 43(15) (2018): 8-12.

<sup>66</sup> Anthony Wong, “Sovereign Wealth Funds”, 1099.

<sup>67</sup> *Ibid*, 1100.

strategically sensitive.

Unfortunately, currently, specific international legal instruments governing SWFs are very limited in quality and quantity. In terms of quality and quantity, only Generally Accepted Principle and Practice (GAPP) of SWFs (known as Santiago Principles) provide meaningful guidance for the organization and implementation of SWFs internationally. The Santiago Principles were drafted by the International Working Group of SWF (IWG).<sup>68</sup> They are comprised of 24 principles that call for more transparency of SWF activities and offer important guidelines for the structure, governance, and management of SWFs, which aim to allay all the concerns brought by host countries.<sup>69</sup>

Even though the Santiago Principles offer a guidance for SWFs, they have several flaws that constrain their effectiveness in achieving their stated objectives, most notably because of their non-binding nature as a set of voluntary principles. As a result, even if the Santiago Principles are enacted, such principles will be no more than just that, principles, effectively leaving political application to national governments, so that the degrees of commitment and the ways of implementation and enforcement are likely to vary.<sup>70</sup> Therefore, to alleviate all issues raised by Western countries mentioned above, it is advisable for the IWG to create an expanded and binding list of guiding principles, or regulations, of SWF investment.

While waiting for a more stringent international regulation of SWF, to fulfill such a legal vacuum, bilateral options through Bilateral Investment Treaties (BITs) could also be explored. BITs have their own advantages in regulating SWFs, one of which is flexibility to tailor their standards to the unique concerns raised by each potential investor. For example, more non-transparent SWFs may be subjected to more stringent transparency regulation, but already transparent SWFs may be subjected to less stringent transparency regulation through BITs. Moreover, BITs also contain dispute resolution provisions that will provide a mechanism to enhance effective enforcement of the agreements.

## **F. Conclusion**

SWFs have raised concerns, triggered in part due to their rapid growth in both size and number. These concerns have especially been raised by Western countries, given that they are now the target of SWFs investment, as follows: (i)

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<sup>68</sup> International Monetary Fund, *Generally Accepted Principles and Practices*, 5.

<sup>69</sup> Udaibir. S. Das, Adnan Mazarei, and Alison Stuart, "Sovereign Wealth Fund and the Santiago Principles" in *Economic of Sovereign Wealth Funds: Issues for Policymakers* ed. Udaibir S. Das et. al. (Washington DC: Monetary Fund, 2010).

<sup>70</sup> *Ibid*, 60.

SWF lack of transparency; (ii) SWF politically-based investment; and (iii) SWF potential to distort the market.

Because of such concerns, many Western countries have adopted a more stringent domestic-based regulation to control SWF investment in their respective countries. For instance, in Canada, state foreign investments are subject to government review. In the U.S., any state foreign acquisition transactions are subject to CFIUS review. Moreover, the president of the U.S. also has power to veto state foreign acquisition transactions. In Australia, any state foreign government investment is to be notified to the government and examined by the FIRB.

Some scholars have stressed that the laws and regulation thus far enacted by Western countries do not adequately address concerns about national security and control of Western companies or investment targets by SWFs. Rather, it is argued that those investment measures targeted at foreign State-investors might have negative spill-over effects for the commercially-motivated foreign state investors who have not been assessed as such. Therefore, some scholars argue that international regulation of SWFs is more beneficial and preferable to domestic regulations. However, currently, specific international legal instruments governing SWFs are very limited in quality and quantity. Therefore, while waiting for a more stringent international regulation of SWF, to fulfill such a legal vacuum, bilateral action option through BITs could be explored.

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