Sovereign Wealth Funds in an Evolving Global Financial System

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Open Capital Markets and Sovereign Wealth Funds, Pension Funds and State-Owned Enterprises

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1. Introduction

- Sovereign Wealth Funds (SWF) have been around for a long time, but have grown quickly in recent years due to high oil prices boosting oil-producer revenues, and in response to foreign exchange market intervention in the face of large capital inflows into emerging markets. They have now become too large to ignore.

- It is important to be clear at the outset that possible concerns about SWF's cannot plausibly be related to their causing financial market instability. On the contrary, SWF direct speculative risk taking in the current financial turmoil has been a stabilising influence, allowing western banks to raise some of the capital required to avoid bankruptcy. Furthermore, compared to central banks investing all of their foreign exchange reserves in US Treasuries—arguably a contributory factor to the too low cost of capital that caused the subprime crisis—SWF's provide a ready mechanism for governments with large foreign exchange reserves to diversify their portfolios. Extremely large concentrations of high-saving-country investments in Treasuries have long been a concern in respect to asset price (including exchange rate) stability.

- The concern voiced most often is that governments with SWF's may use their financial power to build strategic advantages that are against the national interest of host countries (recipients of foreign investment), typically in the areas of energy, telecommunications, high technology and materials, where national security issues are said sometimes to arise. But when one looks for examples of SWF investments in the past that have demonstrably compromised the national interests of the host country (however these are defined), the examples are sparse. One frequently suggested example of an investor that is potentially threatening is Gazprom—but Gazprom of course is not a SWF, it is a Russian State-Owned-Enterprise (SOE).

- The discussion of possible concerns about SWF's is frequently conducted around the issue of governance. In very broad terms, the presumption is that if any public pools of capital are managed in a *transparent* way, according to a set of principles that are consistent with international best practice, then it would be more likely SWF's and SOE's could be invest more freely in host country markets, except for investments which are reviewed and found to be inconsistent with a country's national security reservations.[1]

[1] Internationally accepted standards are the OECD Principles of Corporate Governance, OECD (2005), and 'reservations' refers to previously negotiated exceptions to the free movements of capital allowed in the OECD Code of Liberalisation of Capital Movements (1961) and the OECD Declaration on International Investment and Multinational Enterprises (1976) and (2000). In 2007 and 2008 the presumption has been explained by Truman (2007), Kimmitt (2007) and many others.

2. Government-Related Pools of (and Access to) Capital

- There are in fact 5 capital pools with meaningful distinctions where government ownership plays a role:

  (i) Social Security Reserve Funds (SSRF's): set up as part of the overall social security system, where the inflows are mainly surpluses of employee and/or employer contributions over current payouts, as well as government top-ups.

  (ii) Foreign Exchange Reserves: accumulated typically as a result of intervening in the foreign exchange market in the face of foreign capital inflow. These are typically invested in US treasuries or sub-managed by SWF's or Sovereign Pension Reserve Funds (SPRF's).

  (iii) Sovereign Pension Reserve Funds (SPRF's): are established by government separately from the social security system to fund pensions at a specified future date.

  (iv) SWF's: are pools of assets owned by governments to achieve broader national objectives—to diversify and improve the return on exchange reserves or oil revenue, to shield the domestic economy from commodity price fluctuations, or unspecified other objectives.

  (v) SOE's: are entities (separate from public administration) that have a commercial activity where the government has a controlling interest (full, majority or significant minority) whether listed or not on the stock exchange. The rationale is often industrial/regional policy and/or the supply of public goods (often in utilities and infrastructure—such as energy, transport and telecommunications).

- The SSRF's are shown in Figure 1, but will not be discussed very much in this paper. This is because fiduciary/prudential rules apply—a requirement of matching assets and liabilities over long time horizons and investing according to pre-specified benchmarks (often in domestic government bonds). Nor will any reference be made to the very large funds run by governments but where the assets are actually owned by the beneficiaries (e.g. Calpers).

- Similarly, the investment of a country's foreign exchange reserves will not be pursued in this paper. As noted above, these can create financial instability issues on a significant scale.[2] However that issue is not the concern of this paper. If reserves are not held in US Treasuries, and are sub-managed by SWF's or SPRF's—the governance and foreign investment issues are taken up in that context.

- Major SWF's, SPRF's and SSRF's are shown in Figure 1. At the time of writing SWF's had passed the $2.6trillion mark, and pension funds in total have grown to over

[2] See for example Blundell-Wignall and Atkinson (2008).

$4.2trillion. However, the SPRF part of this (most comparable to SWF's) is relatively small in comparison, at around only $295billion—though growing quickly. If Norway were included on the pension fund side this estimate would more than double. We have chosen not to do this as the Norway fund, notwithstanding the word 'pension' in its new formal name, may be used for purposes other than funding pensions liabilities. The founding act states that the fund: '*shall support central government saving to finance the National Insurance Scheme's expenditure on pensions and long-term considerations in the application of petroleum revenues*'.

Figure 1: Sovereign Wealth and Pension Funds 2008H1 (or most recent)

Sovereign Wealth Fund		**Sovereign Social Security & Pension Reserve Funds**			
	US$bn		**Country**	**Name of the fund/institution**	**US$bn**
UAE (abu Dhabi Invest Auth.)	688	**OECD: SSRF**	Canada	Canada Pension Plan	114.5
Norway (Gov. Pension Fund-Global)	357		Denmark	Social Security Fund	0.7
Singapore (GIC)	325		Japan	National Reserve Funds	1,217.6
Kuwait Investment Auth	250		Korea	National Pension Fund	228.7
Saudi Arabian Monetary Auth.	225		Mexico	IMSS Reserve	7.4
China Investment Corporation	200		Spain	Fondo de reserva de la seguridad social	44.9
Stabilisation Fund of Russian Fed.	108		USA	Social Security Trust Fund	2,238.5
Singapore (Temasek)	100	**OECD: SPRF**	Australia	Future Fund	49.1
Libya Reserve Fund	50		France	fond de reserve des retraites' (FRR)	42.3
Algeria Rev. Regulation Fund	43		Ireland	National Pensions Reserve Fund	26.5
Qatar Investment Auth.	40		New Zealand	New Zealand Superannuation Fund	10.6
USA Alaskan Permanent Reserve Fund	39		Norway	Government Pension Fund - Norway	20.4
Brunei Investment Auth.	30		Poland	Demographic Reserve Fund (DRF)	1.2
Korean Invest Corp	18		Portugal	Social Security Financial Stabilisation Fund	8.3
Kazakhstan National Oil Fund	18		Sweden	National Pension Funds (AP1-AP4 and AP6)	137.0
Malaysia Khazanagh Nasional	18	**OECD**	**Total**		**4,147.7**
Canada Albert Heritage TF	15	**Non-OECD: SSRF**	China	National reserve funds	94.6
ChineseTaipei National Stabilisation Fund	15		Jordan	Social Security Corporation	5.3
USA New Mexico SIO TF	15		Pakistan	Employees' Old-Age Benefits	2.4
Iran Foreign Exchange Reserve Fund	15		Saudi Arabia	General Organisation for Social Insurance	8.6
Other	50		Thailand	Social Security Office	11.6
		Non-OECD: SPRF	China	National Social Security Fund	57.8
			Russia	National Wealth Fund	32.4
Total	**2,619**	**Non-OECD**	**Total**		**212.7**

Source: OECD, National sources

- SOE's are not pools of investable capital as such, but they may finance investments via their earnings, fiscal appropriations from the government, or from debt markets at a (possibly) distorted low cost of capital. In some sense there is greater scope for financially less-constrained investment, and with strategic objectives very much in mind.

3. Governance Issues

- The G7 Finance Ministers have asked the IMF to prepare voluntary best practices for SWF's in terms of governance, and the OECD to prepare guidance for recipient country attitudes to investment from SWF's. The OECD published its response, and this was considered by ministers in April. [3]

- Some OECD work has drawn a distinction between SWF's and SPRF's. They have many characteristics in common: both are large pools of capital that can be invested with return and other objectives in mind; and government ownership is a factor in both cases. The reason for the distinction is that while a SPRF is not currently paying out pension liabilities, it has been earmarked to do so, bringing with it the transparency required where fiduciary responsibilities are present (future pensions) and where peer comparisons with private pension funds are made.

- As a result, some SPRFs have specific investment return targets and concomitant investment strategies that have been designed on purely financial grounds. It is relatively easy to find annual reports with objectives, benchmarks, returns, risk controls, etc.[4] In contrast, most SWFs have diffuse investment objectives, which can leave open the possibility of pursuing political objectives.

OECD pension fund guidelines

- The OECD Guidelines on Pension Fund Governance aim to ensure an appropriate division of operational and oversight responsibilities, and the suitable accountability of those with such responsibility.[5] The main elements of the pension guidelines are:

  (i) A governing body with clearly set out fiduciary duties, a specific measurable mandate, and members which must possess the relevant expertise to carry out their functions. Where the members don't possess sufficient knowledge to discharge their duties they should seek external advice. Segregation from government is preferred to avoid political interference.

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[3] See OECD (2008).

[4] See the discussion in Blundell-Wignall, Yermo and Hu (2008).

[5] See OECD (2005)

(ii) Ring-fencing legislation to ensure that the assets of the fund are to be used exclusively for the payment of pensions.

(iii) An investment committee which advises the board on investment strategy and an executive body that is in charge of operational management including asset management—the latter may be delegated externally, but in this case the governing body should retain fiduciary responsibility for the fund.

(iv) Full public disclosure, normally through an independent audited annual report' while also meeting all requirements to report to government. Accountability relies on this as the assets are owned by the government and therefore the governing body (unlike a private pension fund) is not independent of it. Disclosure is a particularly sensitive topic for both SWFs and SPRFs. Commercial considerations argue against detailed disclosure of investments by both SWFs and PPRFs. At the same time, there is a need to promote the transparency of the funds' investment policy. Public disclosure of asset allocation and investment performance at sufficiently long intervals (*e.g.* one year) and with prudent delays (a few months) can help meeting the goal of transparency without jeopardising the fund's confidentiality regarding some aspects of its investment management.

(v) Appointment of a custodian.

(vi) A code of conduct.

(vii) Mechanisms to address conflict of interest situations and complaints from the public.

- Most SPRFs are set up with these principles in mind. Good examples include: the independent committee structure of the National Pensions Reserve Fund Commission in Ireland; the independent legal entity of the Board of the Guardians of the New Zealand Superannuation Fund (one of the strictest eligibility requirements for board members is in place in New Zealand, where all board members must have experience and expertise in investment management, and at least four must be qualified as investment professionals); and the Australian Future Fund, operated by a board of professionals independent of government (the board approves investment policies and makes critical operational decisions, such as the hiring of the president and chief executive officer and the setting of executive compensation). Such governance structures ensure a high degree of protection against political interference in the management of the reserve fund.

OECD guidelines for state owned enterprises

- SOE's are very active in international investment, and their activities can give rise to concerns. One reason for this is that while SPRF's and SWF's often (though not always) invest in financial assets to meet a return objective (frequently with concentration limits) SOE's often attempt to obtain strategic commercial positions—such as broader distribution, better returns by applying better management expertise, secure supply often via vertical integration (for example, to sure up resource inputs). Governance issues are therefore just as pressing as they are for SWF's, if not more so. The OECD Corporate Governance Working Party on State Owned Enterprises has agreed a set principles for running SOE's, the main over-arching components of which are:[6]

1. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises. The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.

2. The State Acting as an Owner. The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.

3. Equitable Treatment of Shareholders. The state and state-owned enterprises should recognise the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.

4. Relations with Stakeholders. The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.

5. Transparency and Disclosure. State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

6. The Responsibilities of the Boards of State-Owned Enterprises. The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

- Drawing out Guidelines I.C, I.D and I.F:

  "Any obligations and responsibilities that an SOE is required to undertake in terms of public services …should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public…"

  "SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated"

[6] See OECD (2005).

"SOEs should face competitive conditions regarding the access to finance…"

These "framework conditions" are at the heart of some of the main regulatory concerns that have been raised against SOEs operating outside their home jurisdictions.

4. SWF's, SPRF's and SOE Investments in Host Countries

- The International Working Group of Sovereign Wealth Funds, being managed by the IMF is developing Generally Agreed Principles and Practices for SWF's that should be of great value as a benchmark. Some issues could of course remain, due to the less precise nature of the SWF investment mandate, which does not constrain the use of assets for specific purposes (and thereby leaves open the possibility of political objectives).

- But even if governance issues can be solved and full transparency achieved, the issue remains on the table as to what legitimate objections there might still be to the free flow of investment from these pools of capital (and/or state funding and debt). That is: even if 'the window is cleaned' and full transparency is achieved; and even if governance practices move into line with appropriate guidelines, would there still be some legitimate objections to the free flow of capital left on the window sill? The answer in practice for most OECD countries is 'yes'; and these objections most often take the form of concerns about 'national security' and essential security interests.

OECD investment instruments[7]and principles

- The OECD Investment Committee report on SWFs and Recipient Country Policies, which represents the consensus view among OECD countries and also reflects inputs from emerging economies, was published in April 2008.[8] Based on this Report, Ministers endorsed the following policy principles for countries receiving SWF investments. These principles reflect long-standing OECD commitments that promote an open global investment environment applying to all investments: private, SOE, SWF and SPRF. They are consistent with OECD countries' rights and obligations under the OECD investment instruments. These are the OECD Code of Liberalisation of Capital Movements, adopted in 1961, and the OECD Declaration on International Investment and Multinational Enterprises of 1976, as revised in 2000. There are broad procedures for notification and multilateral surveillance under the oversight of the OECD's governing Council (to ensure observance). The instruments embody the following principles:

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7 See (OECD (2008)

8 See OECD (2008)

(1) *Non-Discrimination*. Foreign investors are to be treated not less favourably than domestic investors in like situations. While the OECD instruments protect directly the investment freedoms of those SWF's established in OECD member countries, they also commit members to extend benefits of liberalisation to all members of the IMF. Experience has shown that, in practice, OECD governments nearly always adopt liberalisation measures without discriminating against non-OECD countries—investors from non-member countries reap the same benefits of free market access as OECD residents. Outright discrimination against non-OECD based investors would be a major departure from OECD tradition. The important point here is that recipient countries should not discriminate among investors in like circumstances.

(2) *Transparency*: Information on restrictions on foreign investment should be comprehensive and accessible to everyone. In other words, it is important they be consistent and predictable.

(3) *Progressive liberalisation*: Members commit to the gradual elimination of restrictions on capital movements across their countries.

(4) *Standstill*: Members commit to not introducing new restrictions (other than for national security and public order).

(5) *Unilateral liberalisation*: Members also commit to allowing all other members to benefit from the liberalisation measures they take and not to condition them on liberalisation measures taken by other countries. Avoidance of reciprocity is an important OECD policy tradition. The OECD instruments are based on the philosophy that liberalisation is beneficial to all, especially the country which undertakes the liberalisation.

National Security

The OECD Investment Committee's project on "**Freedom of Investment, National Security and 'Strategic Industries'"** has, since early 2006, provided a forum for intergovernmental dialogue on how governments can reconcile the need to preserve and expand an open international investment environment with their duty to safeguard the essential security interests of their people.

Dialogue has taken place in a series of discussions involving the 30 OECD members, the 10 non-member adherents to the Declaration and other major non-member countries. The "Freedom of Investment" (FOI) project carries on a tradition of OECD dialogue on investment issues that has been framed by the OECD investment instruments.

The FOI discussions have confirmed the continuing relevance of the basic principles underpinning these instruments: transparency, liberalisation and non-discrimination. They have focused on clarifying, in the current security context, the one exception to open investment policies provided for in these instruments: that governments may take measures they "consider necessary to protect essential security interests".

The FOI discussions include peer monitoring sessions through tours d'horizon of national developments, in-depth policy discussions of selected national security topics, and identification of good investment policy practices. The Investment Committee has issued a report summarising these discussions. A key finding of these discussions is that any restrictions designed to protect national security should be transparent, subject to accountability and proportional to the objective pursued. To the extent possible, other policy remedies to the problem should be used before considering new restrictions. In other words, any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors (e.g. competition policy, licensing, taxation, royalties and financial regulation) are inadequate to address legitimate national security concerns.

A considerable amount of analytical work has been done on national security under the FOI project over the last 2.5 years. The review of critical infrastructure policies, for example, shows that countries (i) are using broad definitions of critical infrastructure within their national security strategies, often including the financial sector, health care, etc. (ii) use a wide array of policy tools to protect critical infrastructure (e.g. law enforcement, defense, domestic and international intelligence, sector-specific policies); (iii) assign varying places to discriminatory investment policy in protecting critical infrastructure.

Here the concern that sometimes arises is that if foreign governments control the distribution of essential products and services they might be able to use them to achieve foreign policy aims. Other issues include foreign government control and/or access to defense-related technology: Such investments could provide a channel for the acquisition of dual-use technologies (civilian or military) by the acquiring country; could be used to deny access of such assets to the host country; or could be used for military intelligence purposes against the host country. But peer review of restrictive investment measures and transparency of those measures is absolutely necessary to ensure that this does not become a mechanism to pander to nationalism and domestic rent-seeking behavior in the sectors concerned.

OECD member countries have agreed that the national security clause of the OECD investment instruments should not be used as a general escape clause from their commitments to open investment policies. However, much more work needs to be done to achieve better consistency in practice; and the OECD Investment Committee is in the midst of work to achieve better consistency. There is particular interest in government controlled-investors in this work.

Competition

- Foreign investment (including sometimes from governments) is generally regarded as a powerful competitive mechanism for host countries—it can contribute to lower and more stable prices and to the stability of supply.

- On the other hand, government-related investment may at times undermine economic efficiency if it directly interferes with the ability of a country to achieve a 'level playing field'. This is a particular concern where SOE investments are involved. For example, an SOE may obtain state funding at a cost of capital unavailable to other players—both at the takeover phase and at the subsequent operating level.

- In general, the sense of the OECD investment principles is that restrictions on particular investments should be a last resort in cases where general competition policy (and other policy) cannot be used adequately to address the issue. If investment review or sector bans on foreign and of sector-specific contracting and restriction is required then the above principles should apply where relevant. OECD countries should not impose standards on foreign SOE's that are greater than those they apply or expect from their own SOE's. In principle, if a foreign country follows the OECD guidelines for SOE's in their corporate governance and competition laws and guidelines, then this can go a long way in allaying fears over the investment strategies of its SOE's.

- Allowing a foreign-government-controlled entity to take over a private domestic company needs particular scrutiny—it is a form of nationalization (where a controlling interest is obtained); or worse, renationalization if the private domestic company had previously been privatized by the domestic government. The whole reason for the OECD guidelines on SOE's is to try to obtain outcomes as close as possible to what they would be under private ownership—but in practice it is difficult to achieve.

Natural resources policy.

- Most countries have a variety of objectives in relation to exhaustible resources. Consuming nations want a reasonable (preferably lower) price trajectory and reasonable price and supply stability. Producing nations will generally want to adopt a strategy that maximises the net present value of their natural resource assets and will wish to manage economic shocks relating to variability of resource revenues. They pursue these objectives with a variety of policy tools, of which investment policy is only a small part (tax policy, SOEs, property law, foreign policy, etc.). This section looks at the issue of resource rents, assuming the broad policy framework is well designed around market principles.

- Much public policy in globally traded exhaustible resources reflects a face-off between consuming and producing nations as they try to meet price and supply stability (and foreign policy) goals while also attempting to siphon off as much rents from one another as possible. Among other things, this implies that producing nations that are successful in this game share an interest in both generating and accruing natural resource rents.

- Australia does have the legislation in place to use investment restrictions as a tool in this and other areas. The Foreign Acquisitions and Takeovers Act 1975 (FATA) states that non-residents need prior approval for: investments in Australian companies that exceed certain thresholds ($100m gross assets—but $105m for US investors in sensitive sectors only), portfolio investments in media of 5% or more and all non portfolio investment (for the US the thresholds for sensitive sectors and government entities apply); takeovers of offshore companies whose Australian subsidiaries' gross assets exceed $200m ($913m for US investors except in sensitive sectors where $210m threshold applies); direct investments by foreign governments and their agencies irrespective of size; and all urban land. '*Sensitive sectors'* include: urban land, banking, civil aviation, airports, shipping, media, and telecommunications. The mechanism has been used occasionally to block significant takeovers of energy/resource companies (e.g. Shell's takeover of Woodside in 2001 was not in the 'national interest').

- As noted earlier, energy supply and distribution can be regarded as a national security issue. **Nuclear non-proliferation** is a good example—and Australia has used sector-specific bans in this area. But its use FATA to restrict resource investment has been relatively infrequent. The question addressed here is whether there is a case for using investment powers in the process of appropriating economic rent—looking at the concept of **'national interest' as opposed to 'national security'** in this context, but from the prior that openness is first-best policy in most circumstances.

The exhaustible resource rent issue and the Hotelling rule

- The world economy can be thought of as being made up of *produced* and *scarce* commodities, where the latter are comprised of exhaustible resources with differential costs of extraction depending on the location. A fundamental economic distinction arises between these two groups: for exhaustible resources a form of economic (or Ricardian) rent applies arising from differential costs of extraction and the overall scarcity factor, whereas this is not the case for produce commodities, like manufactures, where in competitive markets super profits can only arise out of market failures of some form.

- If a few simplifying assumptions are made the concept of rent for exhaustible resources can be expressed simply in a diagram at a point in time (Figure 2).[9] Assets such as natural gas, oil, coal, iron ore, and base metals are not reproducible in the ground, and have no marginal product return, nor depreciation: so the return on a unit of the resource is its flow price when extracted. This entails costs, and a low cost producer of a resource—for example Australian in iron ore—will earn a rent (that can't be competed away) shown in the shaded area, at a price set by the marginal producer of the resource. If the few major producers can restrict output in the face of strong inelastic demand (think of Chinese demand currently) a further scarcity rent can be extracted as shown.

- Over time the country should run down its exhaustible resource according to the Hotelling rule:

  $d\pi(t)/\pi(t)=r$

  Where π is the net price (unit price less cost) and r is the long-term equilibrium rate of interest.

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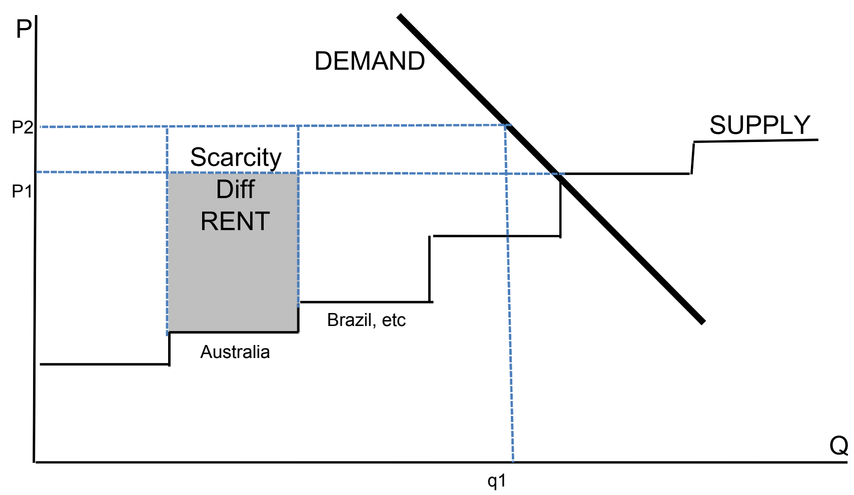
[9] Each country has constant returns to scale and a different (accessibility-determined)cost structure.

It states that the net price in asset market equilibrium should grow at the rate of interest. Costs may vary according to technical progress (declining prices) and the rate of extraction (rising prices). Prices will be determined by global demand and supply conditions and by the nature of market structure (monopoly or oligopoly). In iron ore the structure is something like a cartel with a fringe of smaller players. Depending on the interaction of supply, demand and market structure factors, the flow-net-price of the resource may fall for extended periods and then rise with the possibility of strong rents being earned in both cases (for low cost producers). But the important point is that restricting output to take advantage of scarcity is not at all a bad thing in terms of maximizing total returns from the asset by achieving Hotelling optimality. Restricting output today (e.g. not expanding at a rate and price that a China-type economy might prefer) may be essential to take advantage of the Hotelling condition, and hence may be in the national interest of a country like Australia, Canada, Brazil; or South Africa.

Figure 2: Economic (Ricardian) Rent

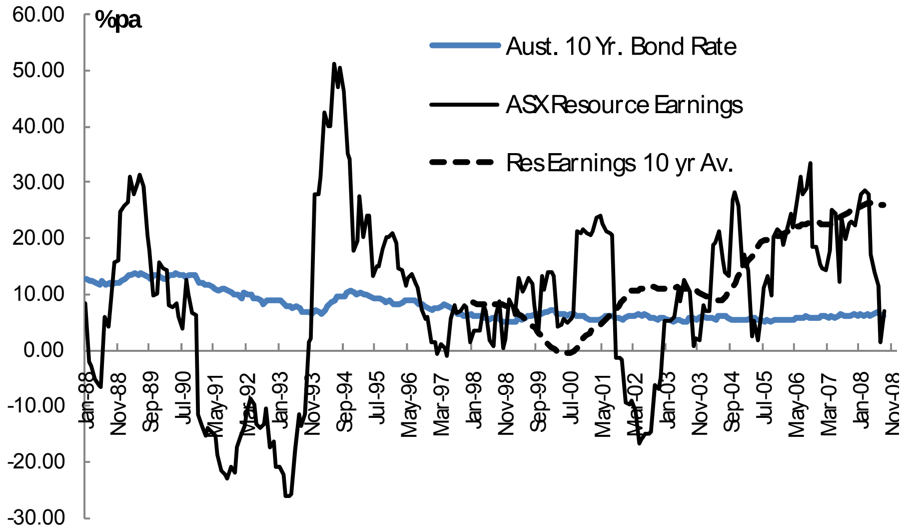


Source: OECD

- Figure 3 shows the percent change in the ASX200 Resources Earnings versus the Australian 10-year bond rate. The Resource earnings % change is also shown as a 10-year average to smooth out volatility. As this is an EBIT (before interest and tax) concept, it should sit well above the bond yield.

- There have been extended periods in the past when the annual return on resources has been less than the bond yield. Currently the EBIT return is in line with the bond yield, while the 10-year average return has over the last 8 years been sitting well above the risk free bond return. That is to say, investing in resource extraction has allowed sales at a profit well over the alternative use of investing in a risk free bond allowing for taxation and rent sharing.

Figure 3: Hotellings Rule, Australia ASX 200 Resources



Source: Datastream, OECD

- Economic rent accrues to a country due to its natural endowments, and because they will be depleted over time, the endowments and the rents will eventually disappear. A country's economic welfare therefore depends on capturing those rents for its citizens.

- Companies involved in exploration and development of natural resource projects often require tax incentives to undertake the heavy capital expenditure involved, given the significant risks with upstream exploration and development.[10] In principle this should later be followed by increasing government involvement with the rising share of economic rent. Sharing in the economic rent often can take the form of royalty/production taxes, resource rent taxes and production sharing/equity participation. In principle such approaches are to be favoured over investment policies.

Appropriating and investing resource rents: SWF paradox

- The basic problem for a country rich in natural but exhaustible resources is that living standards of all future generations will fall as the resource runs out, unless the rents can be appropriated and invested (in infrastructure, human capital and knowledge) to maintain a sustainable consumption path indefinitely into the future (see Solow (1974) and Hartwick (1977)). This very process has led to the creation of SWF's. It is the reason

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[10] For example, in Australia there is a !50% uplift of cost deductions for offshore natural gas exploration.

why there will be clear policy differences between these countries and others. Countries with SWF’s want open markets to invest the rents in global markets, but before they can do this they must be able to appropriate the rents.

- The question arises as to whether this can be done efficiently independently of whom owns the resources: the government, a private company, a foreign company or a foreign government-related entity. If ownership by a foreign entity including SWF’s and SOE’s reduces the rent obtainable under Hotelling, then a paradox would emerge where natural resource countries would have concerns about foreign investment in their resources, but would want open markets for their own investments. This paradox would constitute a difficult issue in the context of international negotiations.

- The appropriation of rents from exhaustible resources in principle can involve 4 broadly different types of policies:

  (1) State ownership and development of the resources locally;

  (2) Private (domestic or foreign) ownership and a taxation regime to capture the rents.

  (3) Foreign government-related ownership and a domestic tax regime.

  (4) Selling the assets at a market price which correctly discounts all future rent-income streams to any buyer and investing it in global assets..

  In each case the potential relevance of investment restrictions will be touched on, with emphasis on whether there is anything specific to foreign government as opposed to generic issues relevant to all potential owners.

1. State ownership production sharing and equity participation

- This has been most common in oil and gas. In Norway Statoil is over 70% owned by the government. In Saudi Arabia ARAMCO is owned by the government; and this is common throughout the Middle East. In Russia Gazprom is an SOE, and so forth. Russia has moved further towards this approach in recent years—for example the nationalisation of Yukos.

- Nationalisation leaves little to chance—the rents accrue directly to the government. It avoids the issue of OECD investment instrument issues being breached quite neatly—there are no foreign takeover issues that can lead to concerns about to whom the economic rent accrues: the government owns the companies developing the resources. This is less common in Western countries (other than Norway).

- Production sharing and equity participation is less common in hard-rock mining, where all of the same issues apply. This illustrates that nationalization is not necessary to capture exhaustible resource rents. The current Australian government has a proposal for a **resource rent tax** in the hard rock mining sector under discussion with the states.

2. Resource rent taxation and private owners

- In Australia a resource rent tax (RRT) applies to Liquid Natural Gas (LNG) development by private companies, (where the offshore nature of the resource falls in the Commonwealth domain except in the North-West Shelf where licensing areas are subject to excise and royalties). State government licensing and royalties are more common for onshore mining. For the LNG RRT a cost plus calculation is made for the natural gas production process, including capital expenditure. This defines the minimum price for the upstream producer. Then a netback price can be calculated for the downstream (integrated) producer where all upstream and downstream costs are deducted from the revenue achieved by selling at the LNG price. The rent to be shared comes from the difference in these 2 prices-some of the rent accrues to the company and some to the country, the proportions being determined as a part of the normal political process.

- The main attraction of a resource rent tax is that it applies only to the rent necessary to keep the factor in its current production—the rent is shared between the producer and the government. Investors require a certain rate of return to undertake a project, and any return above that threshold results in investors receiving rent—so the tax applies after all costs associated with exploration, development and production have been deducted; i.e. tying it to the profitability of the project. Given that the payback period of the non-production factors can be quite long, the **tax may be back-loaded.** This can be quite long in the case of developing countries, where infrastructure (ports, rail, expensive pipelines, etc) are more limited.

- **Three potential disadvantages** of private ownership combined with a RRT are:

  (1) That rent appropriation could be undermined by **aggressive tax accounting**;

  (2) The netback price calculation becomes difficult to administer in the case of complex natural resource projects. For iron ore, for example, the cost side would involve: prospecting, remote area development (towns, schools, shops) and quarrying, housing and labour facilities, skilled-labour shortages (engineers); specialized equipment and explosives (ammonium nitrate demand and supply factor), crushing and screening hematite' in remote areas, disposing of tailings and meeting environmental and land right issues, road transport from remote areas, giant tipper trucks tyre shortages with 4-year waiting lists, rail and port infrastructure requirements, shipping delays and penalties; highly variable shipping freight rates (availability of cape-size vessels), etc.

  (3) Most importantly, unlike LNG price taking, a producer country may have **monopoly power in the global price setting process**. Bulk commodities (e.g. iron ore) are frequently characterized as having cartel-versus-fringe structures where the few big players settle a price, and take into account the impact (price taking and production

decisions) that it will have on the fringe—like a Stackelberg leader. The stronger the cartel the higher is the price that can be set for downstream users (e.g. steel mills).

This is the case for iron ore in Australia. The annual iron ore price settlement is not independent of the ownership of the main suppliers. The net-back price could be a crucial factor in a direct conflict of interest with downstream producers (e.g. the steel mills for upstream iron ore). It is difficult to see how this input into a RRT could be handled by tax policy, because ownership and the incentives of the owner are the critical variables.

Vertical integration with some influence on oligopoly price setting could impact the size and share of the rent unfavourably for the host country—a foreign steel company would buy a stake in exhaustible resources where scarcity rents apply to ensure better pricing for itself (that scarcity rents are not extracted against them), and use transfer pricing to impact the taxation take. The host country objective is to achieve the Hotelling condition; the exercise of market power to achieve this condition is not a necessarily a bad thing where exhaustible resources are concerned. The question arises as to how the host country government can reconcile competing interests without resorting to investment restrictions—which may lead to reciprocity measures in other countries and adverse consequences for its SWF investments.

Differential rent and exploitation issues

- Foreign investment review rejections of takeovers have occurred where a government believes that the acquirer will not develop the license for the resource project concerned. The theoretical case arises when multi-national companies buy exhaustible resource companies when differential rents are present.
- Differential economic rent arises out of accessibility and extraction costs in different locations. Costs therefore vary with the rate of exploitation—typically as the rate of extraction advances at a particular site the resource becomes less easily accessible. If Figure 2 referred to a single site, one would move up the cost curve, exploiting cheapest deposits first, but causing all future costs to rise as the low-hanging fruit is taken away.
- Hotelling's rule can be rewritten as:[11]

  $d\pi(t)/\pi(t)-c(t, X(t))=r$

  Where $c(t, X(t))$ is a cost function dependent on technical progress over time t and the rate at which the stock of known reserves $X(t)$ is being depleted. Exploitation with rising endogenous cost should be driven to the point where the Hotelling condition is achieved.
- However, most major resource companies (BHP, RIO, Shell, Xstrata, etc) operate globally at multiple locations at the same time, and conduct exploration and mergers and

[11] See Gaudet (2007).

acquisitions to sure up future production possibilities. Economic efficiency requires that the lowest cost deposits are exploited before higher cost ones. So a multinational may invest in exploration rights or in another company in a national jurisdiction and hold onto it until its low cost deposits elsewhere are exploited first. If the host country is looking to develop the resources, this may be dealt with through financial penalties or via foreign investment review and restriction—in this case financial penalties would have the same effect as a restriction where other investors were not present. This case applies to all foreign investors (private, SOE and SWF's).

3. Foreign government SWF and SOE investment

- If a foreign government-related entity attempts to buy a domestic exhaustible resource (in the ground or a company) where economic, differential and scarcity rents are present do any new issues arise in addition to the above generic ones? This is a very difficult area to discuss because OECD countries are committed to openness, as discussed above, and national security does not encompass resource rent (economic) issues. The above economic issues would better be described as falling within the domain of 'national interest', rather than 'national security'. However, the purpose of this section is to raise issues that affect policy in practice rather than ignore them.

- If we consider **nationlisation** (point (1) above) many countries with a private enterprise culture have gone through a fairly systematic privatisation process for good reason (efficiency, level playing fields, competition). Such governments may find it odd to allow foreign governments to reverse the process in general, and to do so in industries with rents that can't be competed away in particular.

- In the general case is difficult to accept that **aggressive tax accounting** or **complexity** is sufficient reason to justify foreign investment restrictions to better capture rent. Taxation can be an efficient instrument where the project concerned is a price taker in global markets and self assessment on costs is policed and enforced. However, in the case of a SWF or an SOE the problem of aggressive tax accounting has the added dimension that 'property rights' are not even between countries, and were disputes to arise with SOE's and SWF's they would be very difficult to pursue in the courts (**sovereign immunity issues**). If there were concerns with respect to ultimate owners within specific country jurisdictions, the case for investment restrictions would be increased—or at least the threat of such restrictions could be used to achieve a more effective sharing of the rent.

- **The exercise of market power**, where it exists, is one potential reason why governments in a resource-rich country may opt for the investment restrictions approach. Does the case become stronger where SOE/SWF investments occur? Consider the following cases:

  (1) A foreign private resource extraction company like Xstrata buys a small resource company, like Oz minerals or a fringe iron ore producer with no global pricing power. No investment restriction issue should arise.

(2) A foreign private resource extraction company like Vale Inco buys a large Australian resource company with market power (like RIO), still no issues should arise as the company will use its market power to maximize price for shareholders and will be subject to taxation, which can be invested for the host country via a SWF.

(3) A foreign downstream company (e.g. a private steel mill) buys a small resource extraction company in a vertically integrated structure. Aggressive tax accounting issues may arise, but should be handled via tax policy. If the company is an SOE/SWF this issue may be compounded by sovereign immunity issues. It is possible that the threat (but not use) of foreign investment policy may help achieve better outcomes.

(4) A foreign company buys share of an exhaustible resource company which has market power. If the use of that market power is in the national interest, then some governments may be unwise to allow downstream companies or government-related entities to buy blocking stakes that might adversely impact the use of that market power. If this is an SOE or a SWF then national strategic objectives come more directly into play—there may be divergent national interest issues when deciding on global pricing strategy and how the economic and scarcity rent is shared. The National interest issue here certainly deserves further study.

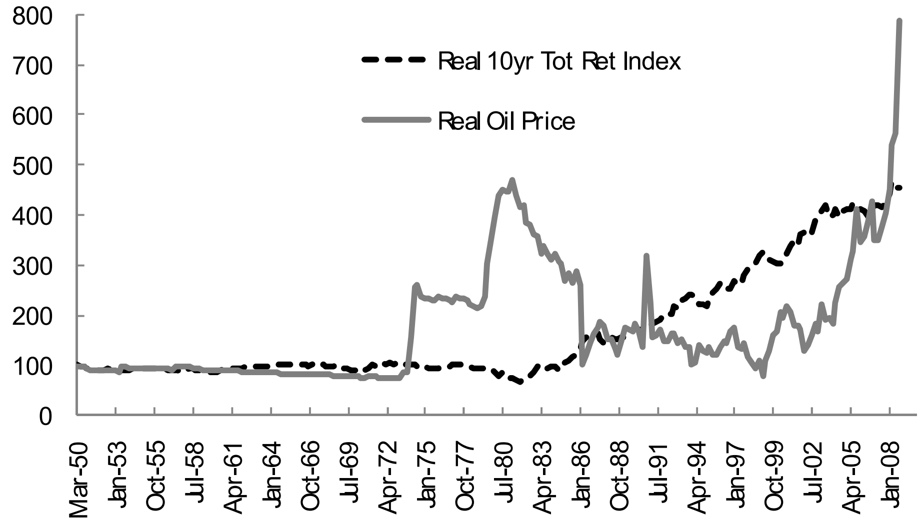
- If governments carry out policies in the national interest (a concept that has not been analysed in OECD committee meetings) as opposed to national security a host of new economic as opposed to security issues arise.

4. Selling the asset in a global auction

- Pricing a company (public or private) that owns a natural resource asset or license is different than pricing the natural resource product itself (the question that Hotelling deals with). In an efficient asset market, the original owner of a natural resource would accrue all available resource rents generated by future production because the seller would include the present value of these future rents in the minimum price he would accept for the asset. Subsequent owners would operate to ensure that product prices are set to make enough money on the operation to ensure that they cover the rent-related price premium they paid when they bought the natural resource asset from its original owners. The proceeds would be invested via a SWF to ensure that the Solow/Hartwick condition is met.
- The oil price stayed between \$2.57-\$3 p/bl. From 1950-1967. After 1973 the cartel began to share the rent in a different way. If the Saudi had sold all of its oil reserves in 1950 using \$2.57 as the long-run price in its NPV, it would undoubtedly have under-priced the asset in a global auction.
- Looked at another way, Figure 4 shows \$100 1950 dollars invested in oil production, and that \$100 dollars from a sale of the oil reserve to a company invested in bonds. Aside from the great disinflation bond rally from 1991 to 2002 it was better to invest in oil by 2008. A sale in 1950 would not have discounted the 8 times increase in real oil prices. It would have made more sense to lease the resource, tax it with a RRT, and

invest the proceeds and adjust policy as required over the depletion period of the resource.

Figure 4: Real Oil Price and Real 10 Year US Bond Total Return Index



Source: Datasteam, OECD

5. Foreign Investment Deal Flow: SOE's, SWF's and SPF's

- A time series of global deal flow from SOE's, SWF's and SPRF's is shown in Figures 3. The numbers refer to all deals involving foreign direct investment by the entity concerned. Three observations stand out:

  (1) The concern about SWF investment during the course of 2007, when international consulting firm studies raised the level of alarm, was not uncorrelated with the sudden pick up in the deal flow in this sector.

  (2) SOE's, which have not been the subject of inquiry and reports by the OECD and the IMF in 2007 and 2008, have traditionally been much stronger foreign direct investors for a longer period of time than SWF's. It is intriguing that the SWF's have had more attention than SOE investments over the period.

  (3) SPRF's are miniscule in the area of foreign investment—reflecting their preference for a portfolio approach to investment (mostly in exchange-traded instruments and with portfolio diversification limits in place) and with a strong home-country bias (sometimes mandated at 100% in domestic bonds).

SOE and SWF deal flow: changing patterns

- The 50 biggest SOE foreign investment deals since 1990 are shown in Figure 6, and those for SWF's are shown in Figure 7.

- Both OECD and non-OECD countries are both strongly involved in SOE foreign investment. This may help explain why it has been very difficult for OECD countries to raise concern about SOE foreign investment issues in contrast with SWF concerns. Of the 50 largest SWF deals since 1990, no OECD country figures in the list. It is consequently more understandable that individual OECD countries would feel more comfortable raising issues about SWF investment when it began to pick up in 2006 and particularly in 2007.

- Insofar as concerns about national security and the national interest are concerned, the main sectors with an a priori claim to potential issues, in term of the above discussion would be:

  (1) Energy and power: security of infrastructure; rent/exhaustible resources

  (2) Telecommunications: security of infrastructure and military.

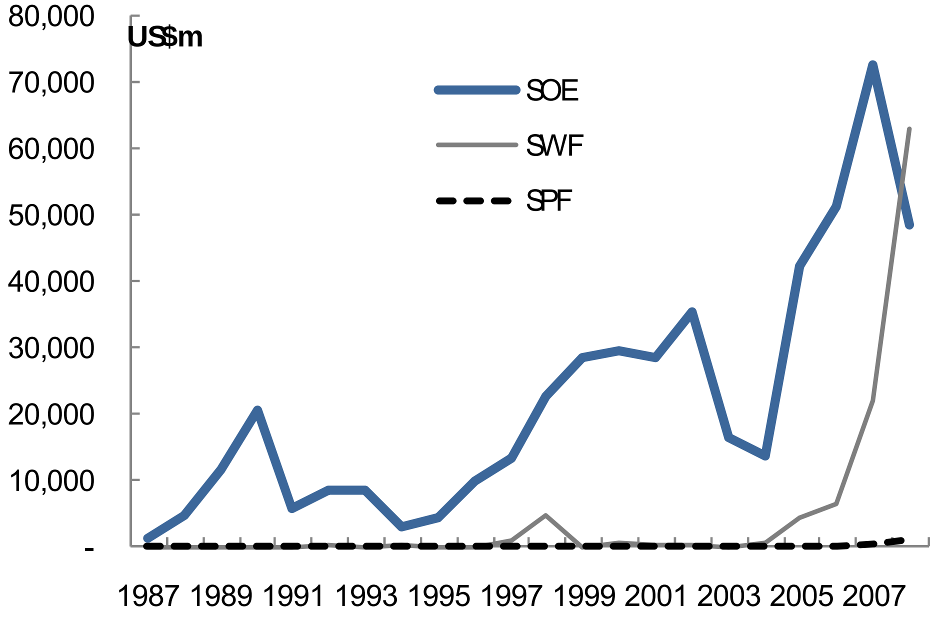
  (3) Materials: rent/exhaustible resources.

  (4) High technology: military use.

- About 68% of the target firms for SOE deals are in these 4 (national interest) sectors. Prior to 2006, 24 of the 30 largest SOE acquirers had OECD country ultimate owners (around 68%). Of the targeted firms, 27 were also in OECD countries. That is to say, it was more-or-less an intra-OECD activity to buy into such industries. From 2007, however, the pattern has changed quite noticeably. 15 of the 20 top deals shown, (about 75%), were non-OECD acquiring countries, and 50% of the target nations were OECD countries.

- All SWF acquirers in the top 50 deals are from non-OECD countries and target firms are almost always from the OECD, only 4 of the top 50 deals were in the areas most associated with strategic concerns (see Figure 7).

Figure 5: SOE, SWF, SPRF Global Deal Flow



Source: Thompson One Banker, OECD.

- SPRF's seem to have North America ultimate owners with interests in mixed sectors (see Figure 8).

SWF as risk taking investors in the global financial crisis

- Since 2007 SWF's have invested $38billion into the troubled subprime crisis firms Citi, Merrill Lynch, UBS and Morgan Stanley (see Figure 6). The global financial system is desperately short of capital and few domestic investors have been willing to take a long view and invest in the institutions to enable them to recapitalize and to avoid deleveraging (with its potentially devastating implications on growth through credit crunch mechanisms).

- These beneficial risk-taking investments in 2007and 2008 constitute over 60% of the $60.6billion in large deals shown for this period in Figure 6.

Australia as a target nation

- Australia's 50 large foreign government-related investments are shown in Figure 9.

- Since 1990 most (76%) of the acquisitions have been non-OECD government-related investors. The 3 most frequent investors have been Singapore (18 of the 50 shown), China (11 of the 50) and New Zealand (6 of the 50). Of the target names about half have been in the areas where economic rent is an issue (materials and energy and power).

Figure 6: SOE Foreign Investment Deal Flow: 50 Largest Deals

Date Effective	Acquiror Name	Acquiror Nation	Acquiror Macro Description	AcquirorUltimateParent	Target Name	Target Nation	Target TF Macro Description	Deal Transaction value ($m)	Deal Val/Ent Val %
31/07/2008	Qatari Diar RE Invest Co	Qatar	Real Estate	Qatar	Cegelec SA	France	Industrials	2,963.7	..
21/07/2008	Saudi Telecommunications Co	Saudi Arabia	Telecommunications	Saudi Arabia	Oger Telecom	Utd Arab Em	Telecommunications	2,850.0	..
24/03/2008	SinoSing Power Pte Ltd	Singapore	Energy and Power	China	Tuas Power Ltd	Singapore	Energy and Power	3,072.18	..
14/03/2008	Fortum Oyj	Finland	Energy and Power	Finland	TGC-10	Russian Fed	Energy and Power	3,188.10	..
16/01/2008	Abu Dhabi Natl Energy PJSC	Utd Arab Em	Financials	Utd Arab Em	PrimeWest Energy Trust	Canada	Energy and Power	3,963.84	128%
15/11/2007	Infinity World Investments	Utd Arab Em	Financials	Utd Arab Em	CityCenter Holdings LLC	United States	Media and Entertainment	2,700.00	..
04/09/2007	CFMM Developpement	France	Materials	France	UraMin Inc	South Africa	Materials	2,034.60	123%
31/08/2007	SABIC	Saudi Arabia	Energy and Power	Saudi Arabia	GE Plastics	United States	Materials	11,600.00	..
14/08/2007	Abu Dhabi Natl Energy PJSC	Utd Arab Em	Financials	Utd Arab Em	Northrock Resources Ltd	Canada	Energy and Power	2,000.00	..
14/08/2007	China Development Bank	China	Financials	China	Barclays PLC	United Kingdom	Financials	2,980.07	0%
30/05/2007	OAO Gazprom	Russian Fed	Energy and Power	Russian Fed	Beltransgaz	Belarus	Energy and Power	2,500.00	..
15/05/2007	Swisscom AG	Switzerland	Telecommunications	Switzerland	FASTWEB SpA	Italy	High Technology	5,483.49	87%
18/04/2007	JTI(UK)Management Ltd	United Kingdom	Financials	Japan	Gallaher Group PLC	United Kingdom	Consumer Staples	14,683.56	78%
31/12/2006	CITIC Group Ltd	China	Financials	China	Nations Energy Co Ltd	Canada	Energy and Power	1,955.61	..
31/08/2006	Telenor ASA	Norway	Telecommunications	Norway	Mobi63	Serbia & Mont.	Telecommunications	1,931.65	..
10/08/2006	Sinopec Corp Qingdao Br,China	China	Energy and Power	China	OAO Udmurtneft	Russian Fed	Energy and Power	3,500.00	..
01/05/2006	PSA Corp Ltd	Singapore	Industrials	Singapore	Hutchison Port Holdings Ltd	Hong Kong	Industrials	4,388.00	..
19/04/2006	CNOOC Ltd	China	Energy and Power	China	NNPC-OML 130	Nigeria	Energy and Power	2,692.00	..
12/03/2006	ETISALAT	Utd Arab Em	Telecommunications	Utd Arab Em	Pakistan Telecom Co Ltd	Pakistan	Telecommunications	2,598.96	25%
09/03/2006	Thunder FZE	Utd Arab Em	Industrials	Utd Arab Em	Peninsular & Oriental Steam	United Kingdom	Industrials	6,899.27	79%
26/10/2005	CNPC International Ltd	China	Energy and Power	China	PetroKazakhstan Inc	United Kingdom	Energy and Power	4,141.18	105%
26/10/2005	Transalpina di Energia SpA	Italy	Energy and Power	France	Edison SpA	Italy	Energy and Power	4,503.65	28%
16/09/2005	Transalpina di Energia SpA	Italy	Energy and Power	France	Edison SpA	Italy	Energy and Power	4,925.30	33%
22/06/2005	IPIC	Utd Arab Em	Financials	Utd Arab Em	Kuokwang Petrochemical Co Ltd	Taiwan	Energy and Power	2,359.34	..
22/12/2004	Cassa Depositi & Prestiti SpA	Italy	Financials	Italy	STMicroelectronics NV	Switzerland	High Technology	1,882.34	10%
30/07/2004	Singapore Power Ltd	Singapore	Energy and Power	Singapore	TXU Australia Ltd	Australia	Energy and Power	3,720.00	..
09/12/2002	Telia AB	Sweden	Telecommunications	Sweden	Sonera Oyj	Finland	Telecommunications	6,329.89	..
29/07/2002	LE Group Plc	United Kingdom	Energy and Power	France	Seeboard PLC	United Kingdom	Energy and Power	2,056.96	..
28/06/2002	SABIC	Saudi Arabia	Energy and Power	Saudi Arabia	DSM Petrochemicals	Netherlands	Materials	1,977.53	..
15/03/2002	Norsk Hydro ASA	Norway	Energy and Power	Norway	VAW Aluminium AG	Germany	Materials	2,764.76	..
27/02/2002	Fortum Oyj	Finland	Energy and Power	Finland	NYA Birka Energi	Sweden	Energy and Power	3,052.18	..
18/01/2002	London Electricity(EdF)	United Kingdom	Energy and Power	France	TXU-Eastern Electricity	United Kingdom	Energy and Power	1,870.94	..
08/01/2002	Ente Nazionale per l'Energia	Italy	Energy and Power	Italy	Viesgo	Spain	Energy and Power	1,946.04	..
17/09/2001	SingTel	Singapore	Telecommunications	Singapore	Cable & Wireless Optus Lt	Australia	Telecommunications	8,491.12	89%
07/02/2001	EDF	France	Energy and Power	France	ENBW AG	Germany	Energy and Power	2,480.40	..
30/10/2000	CDC Asset Management Europe	France	Financials	France	NVEST LP	United States	Financials	2,185.85	631%
10/08/2000	Telenor AS	Norway	Government and Agenci	Norway	Sonofon S/A	Denmark	Telecommunications	1,875.72	..
06/12/1999	Tabacalera SA	Spain	Consumer Staples	Spain	Seita	France	Consumer Staples	3,029.43	121%
01/11/1999	ALITALIA-Passenger and Cargo	Italy	Consumer Products and	Italy	KLM Royal Dutch-Passenger	Netherlands	Consumer Products and Se	4,547.32	..
12/05/1999	Japan Tobacco Inc	Japan	Consumer Staples	Japan	RJ Reynolds International	Netherlands	Consumer Staples	7,831.82	..
04/12/1998	EDF	France	Energy and Power	France	London Electricity(Entergy)	United Kingdom	Energy and Power	3,204.77	..
13/10/1998	Framatome Connectors Intl	France	High Technology	France	Berg Electronics Corp	United States	High Technology	1,877.01	104%
07/09/1998	Gullspangs Kraft(Imatran Voim)	Sweden	Energy and Power	Finland	Stockholm Energi(Stockholm)	Sweden	Energy and Power	1,951.16	..
01/04/1998	Nordbanken(Venantius/Sweden)	Sweden	Financials	Sweden	Merita Oy	Finland	Real Estate	4,292.00	..
07/03/1997	CITIC Pacific Ltd	Hong Kong	Financials	China	China Light & Power Co Ltd	Hong Kong	Financials	2,099.89	21%
31/12/1993	UAP	France	Financials	France	Vinci BV	Netherlands	Financials	2,553.12	..
03/03/1992	Altus Finance SA	France	Financials	France	Executive Life Ins-Junk Bond	United States	Financials	3,250.00	..
08/11/1990	Nortel Inversora SA	Argentina	Financials	Italy	Telecom Argentina STET-France	Argentina	Telecommunications	2,578.00	..
27/09/1990	Renault SA	France	Industrials	France	Volvo AB	Sweden	Industrials	2,661.66	..
31/07/1990	Rhone-Poulenc SA	France	Materials	France	Rorer Group Inc	United States	Healthcare	3,476.00	60%

Source: Thomson One Banker, OECD

Figure 7: SWF Foreign Investment Deal Flow: 50 Largest Deals

Date Effective	Acquiror Name	Acquirer (ult.) Nation	Target Name	Target Nation	Target TF Macro Description	Deal Transaction value ($m)	Transac Val/Ent. Val. %
06/06/2008	Abu Dhabi Investment Authority	Utd Arab Em	Citigroup Inc	United States	Financials	7,500.0	..
22/05/2008	Mubadala Development Co	Utd Arab Em	Pearl Energy Ltd	Singapore	Energy and Power	877.5	..
14/05/2008	Khazanah Nasional Bhd	Malaysia	Parkway Holdings Ltd	Singapore	Healthcare	391.9	13%
05/03/2008	GIC	Singapore	UBS AG	Switzerland	Financials	9,760.4	..
29/02/2008	DIFC	Utd Arab Em	OMX AB	Sweden	Financials	3,396.8	67%
26/02/2008	GIC Real Estate Pte Ltd	Singapore	Westin Tokyo	Japan	Media and Entertainment	721.8	..
14/02/2008	DIFC	Utd Arab Em	OMX AB	Sweden	Financials	1,182.8	23%
05/02/2008	Temasek Holdings(Pte)Ltd	Singapore	Merrill Lynch & Co Inc	United States	Financials	600.0	0%
01/02/2008	Korea Investment Corp	South Korea	Merrill Lynch & Co Inc	United States	Financials	2,000.0	..
31/01/2008	KIA	Kuwait	Merrill Lynch & Co Inc	United States	Financials	2,000.0	..
28/01/2008	GIC	Singapore	Citigroup Inc	United States	Financials	6,880.0	..
11/01/2008	Temasek Holdings(Pte)Ltd	Singapore	Merrill Lynch & Co Inc	United States	Financials	4,400.0	1%
31/12/2007	Dubai International Capital	Utd Arab Em	Alliance Medical Ltd	United Kingdom	Healthcare	1,248.7	..
28/12/2007	China Investment Corp	China	Morgan Stanley	United States	Financials	5,000.0	..
30/11/2007	Dubai International Capital	Utd Arab Em	Och-Ziff Cap Mgmt Grp LLC	United States	Financials	1,258.6	..
16/11/2007	Mubadala Development Co	Utd Arab Em	Advanced Micro Devices Inc	United States	High Technology	622.3	6%
23/09/2007	Mubadala Development Co	Utd Arab Em	Carlyle Group LLC	United States	Financials	1,350.0	..
20/09/2007	DIFC	Utd Arab Em	London Stock Exchange PLC	United Kingdom	Financials	1,648.0	23%
07/09/2007	Istithmar PJSC	Utd Arab Em	Barneys New York Inc	United States	Retail	942.3	..
31/08/2007	GIC Real Estate Pte Ltd	Singapore	InterContinental Chicago	United States	Media and Entertainment	450.0	..
17/07/2007	GIC Real Estate Pte Ltd	Singapore	WestQuay Shopping Center	United Kingdom	Real Estate	612.0	..
06/07/2007	Temasek Holdings(Pte)Ltd	Singapore	ABC Learning Centres Ltd	Australia	Consumer Products and Services	329.0	13%
27/06/2007	China Investment Corp	China	Blackstone Group LP	United States	Financials	3,000.0	..
20/06/2007	GIC Real Estate Pte Ltd	Singapore	Chapterhouse Holdings Ltd	United Kingdom	Real Estate	954.2	..
01/06/2007	Dubai International Capital	Utd Arab Em	Mauser AG	Germany	Materials	1,159.8	..
16/05/2007	GIC Real Estate Pte Ltd	Singapore	CSC-MetroCentre	United Kingdom	Real Estate	821.5	..
30/04/2007	GIC Real Estate Pte Ltd	Singapore	Westfield Parramatta	Australia	Real Estate	595.6	..
08/03/2007	GIC	Singapore	Hawks Town Corp	Japan	Retail	862.2	..
	Istithmar PJSC	Utd Arab Em	Undisclosed Business Parks(2)	United Kingdom	Real Estate	386.3	..
01/12/2006	Istithmar PJSC	Utd Arab Em	Adelphi	United Kingdom	Real Estate	594.1	..
11/10/2006	Istithmar PJSC	Utd Arab Em	W Hotel Union Square,NY	United States	Media and Entertainment	285.0	..
07/09/2006	Dubai International Capital	Utd Arab Em	Travelodge Hotels Ltd	United Kingdom	Media and Entertainment	1,270.0	..
02/08/2006	GIC Real Estate Pte Ltd	Singapore	Hines-Office Properties(2)	Germany	Real Estate	383.7	..
17/07/2006	Istithmar PJSC	Utd Arab Em	Loehmanns Holdings Inc	United States	Retail	300.0	..
06/06/2006	Istithmar PJSC	Utd Arab Em	280 Park Ave,New York,NY	United States	Real Estate	1,200.0	..
17/03/2006	Temasek Holdings(Pte)Ltd	Singapore	E Sun Financial Holding Co Ltd	Taiwan	Financials	400.0	..
24/01/2006	Istithmar PJSC	Utd Arab Em	Inchcape Shipping Services	United Kingdom	Industrials	289.4	..
03/01/2006	Dubai International Capital	Utd Arab Em	Doncasters PLC	United Kingdom	Industrials	1,240.6	..
06/10/2005	Khazanah Nasional Bhd	Malaysia	Lippo Bank Tbk PT	Indonesia	Financials	336.6	..
08/09/2005	Temasek Holdings(Pte)Ltd	Singapore	China Construction Bank Corp	China	Financials	1,400.0	..
19/07/2005	Dubai International Capital	Utd Arab Em	Tussauds Group Ltd	United Kingdom	Media and Entertainment	1,495.2	..
27/04/2005	GIC Real Estate Pte Ltd	Singapore	30 Gresham Street	United Kingdom	Real Estate	524.6	..
24/03/2005	GIC Real Estate Pte Ltd	Singapore	Bluewater Shopping Centre	United Kingdom	Real Estate	594.3	..
10/09/2004	Istithmar PJSC	Utd Arab Em	Kerzner International Ltd	Bahamas	Media and Entertainment	227.8	9%
02/03/2004	Temasek Holdings(Pte)Ltd	Singapore	Telekom Malaysia Bhd	Malaysia	Telecommunications	421.6	1%
23/06/2000	GIC Real Estate Pte Ltd	Singapore	Seoul Finance Centre	South Korea	Real Estate	400.0	..
03/09/1998	Hong Kong Monetary Authority	Hong Kong	HSBC Holdings PLC{HSBC}	United Kingdom	Financials	4,688.9	..
29/04/1998	GIC	Singapore	Thai Farmers Bank PCL	Thailand	Financials	265.6	1%
20/08/1997	Temasek Holdings(Pte)Ltd	Singapore	Shanghai Investment and Trust	China	Financials	762.1	32%
31/12/1994	Abu Dhabi Investment Authority	Utd Arab Em	No 1 OConnell Street,Sydney	Australia	Real Estate	219.0	..

Source: Thomson One Banker, OECD

Figure 8: SPRF Foreign Investment Deal Flow: Some Large Deals

Date Effective	Acquiror Name	Acquiror (Ult.) Nation	Target Name	Target Nation	Target TF Macro Description	Deal Transaction value (mio USD)	Deal Val./Ent. Val. %
31/03/2008	New York Common Retirement	United States	Shurgard Self Storage Europe	Belgium	Industrials	604.1	..
22/06/2007	Caisse de Depot et Placement	Canada	Interconnector(UK)Ltd	United Kingdom	Energy and Power	329.9	..
25/04/2006	Caisse de Depot et Placement	Canada	Aviza Technology Inc	United States	High Technology	15.0	..
25/01/2006	Caisse de Depot et Placement	Canada	Shanghai Forte Land Co Ltd-For	China	Real Estate	1.0	..
02/12/2005	Caisse de Depot et Placement	Canada	Airport Partners Hungary	Hungary	Industrials	..	..
23/03/2005	Caisse de Depot et Placement	Canada	Travelpro International Inc	United States	Consumer Staples	..	..
03/11/2004	Caisse de Depot et Placement	Canada	Constellation Copper Corp	United States	Materials	3.2	..
28/06/2000	Caisse de Depot et Placement	Canada	Putnam Lovell Group Inc	United States	Financials	25.0	..
08/01/1998	Caisse de Depot et Placement	Canada	Cie Generale des Eaux-Office	France	Real Estate	..	..
21/11/1997	Caisse de Depot et Placement	Canada	Walbro Corp	United States	Industrials	3.0	1%
12/01/1994	Caisse de Depot et Placement	Canada	Schroder Buy-Out Fund II	United Kingdom	Financials	..	..
14/09/1993	Caisse de Depot et Placement	Canada	Total Petroleum(North Amer)Ltd	United States	Energy and Power	3.1	..

Source: Thomson One Banker, OECD

Figure 9: Foreign Government-Related Investment Flow Into Australian Companies: 50 Largest Deals

Date Effective	Acquiror Name	Acquiror Nation	Acquiror Macro Description	Target Name	Target TF Macro Description	Deal Transaction value (mill USD)	Deal val % Ent val.
06/08/2008	China Metallurgical Constr	China	Industrials	Cape Lambert Iron Ore Ltd-Cape	Materials	373.44	..
28/07/2008	Areva NC	France	Energy and Power	Murchison United NL	Materials	2.46	6%
18/06/2008	Sinopec Intl Petro Expl,Prodn	China	Energy and Power	AED Oil-Expl Permits(3)	Energy and Power	555.96	..
21/04/2008	SINOCHEM Petro Expl & Prodn	China	Energy and Power	SOCO Yemen Pty Ltd	Energy and Power	465.00	..
17/04/2008	Hunan Nonferrous Metals Hldg	China	Materials	Abra Mining Ltd	Materials	3.15	14%
28/03/2008	Upper Horn Investments Ltd	Hong Kong	Financials	Whitehaven Coal-Narrabri Coal	Materials	63.48	..
24/01/2008	Nakheel Co PJSC	Utd Arab Em	Real Estate	Mirvac Group	Real Estate	300.00	..
31/12/2007	Yunnan Chihong Zinc	China	Materials	Chihong Intl Mining Co Ltd	Materials	13.50	..
24/12/2007	Nakheel Co PJSC	Utd Arab Em	Real Estate	Mirvac Group	Real Estate	348.56	..
04/09/2007	Angang Group Hong Kong Co Ltd	Hong Kong	Financials	Gindalbie Metals Ltd	Materials	32.54	..
06/07/2007	Temasek Holdings(Pte)Ltd	Singapore	Financials	ABC Learning Centres Ltd	Consum. Prod. & Serv.	328.99	13%
07/06/2007	Sinosteel Corp	China	Materials	PepinNini Minerals-Curnamona	Materials	23.27	..
30/04/2007	GIC Real Estate Pte Ltd	Singapore	Financials	Westfield Parramatta	Real Estate	595.60	..
26/04/2007	AREVA SA	France	Energy and Power	Summit Resources Ltd	Materials	115.90	12%
01/02/2007	BBC Worldwide Ltd	United Kingdom	High Technology	Freehand Group Pty Ltd	Media and Ent.	1.96	..
20/12/2006	China Railway Materials Coml	China	Government & Agen.	Yilgarn Infrastructure Ltd	Industrials	7.84	..
01/08/2006	Hunan Nonferrous Metals Corp	China	Materials	Compass Resources NL	Materials	23.06	18%
31/01/2006	OMX AB	Sweden	Financials	Computershare-Markets Tech Bus	High Technology	30.79	..
30/04/2005	Korea Resources Corp	South Korea	Materials	BHP AU-Wyong Coal Project,NSW	Materials	12.67	..
29/12/2004	Yanzhou Coal Mining Co Ltd	China	Materials	Gympie-Southland Coal Asts	Materials	23.45	..
18/12/2004	CNOOC Ltd	China	Energy and Power	North West Shelf Gas Pty Ltd	Energy and Power	537.31	..
30/07/2004	Singapore Power Ltd	Singapore	Energy and Power	TXU Australia Ltd	Energy and Power	3,720.00	..
10/08/2003	GIC Real Estate Pte Ltd	Singapore	Financials	Park Hyatt,Melbourne	Media and Ent.	82.01	..
30/04/2003	Meridian Energy Ltd	New Zealand	Energy and Power	Southern Hydro Ltd	Energy and Power	350.00	..
11/04/2003	Seletar Invest Pte Ltd	Singapore	Financials	Autron Corp Ltd	Consum. Prod. & Serv.	5.90	..
08/04/2003	Ascendas Land Invest Pte Ltd	Singapore	Real Estate	Colonial First State	Real Estate	75.20	..
06/12/2002	PSA Marine(Pte)Ltd	Singapore	Industrials	Mermaid Marine Australia Ltd	Industrials	3.88	13%
04/09/2002	GIC Real Estate Pte Ltd	Singapore	Financials	ANA Harbour Grand Hotel	Media and Ent.	109.45	..
10/08/2002	GIC Real Estate Pte Ltd	Singapore	Financials	Westin Sydney Hotel	Media and Ent.	89.01	..
25/07/2002	Orion New Zealand Ltd	New Zealand	Energy and Power	Energy Developments Ltd	Energy and Power	9.41	..
19/11/2001	GIC Real Estate Pte Ltd	Singapore	Financials	Ipoh Ltd	Real Estate	97.88	..
17/09/2001	SingTel	Singapore	Telecommunications	Cable & Wireless Optus Lt	Telecommunications	8,491.12	39%
23/05/2001	Meridian Energy Ltd	New Zealand	Energy and Power	Power Facilities Pty Ltd-Hydro	Energy and Power	42.66	89%
08/05/2001	New Zealand Dairy Board	New Zealand	Consumer Staples	Bonlac Foods Ltd	Consumer Staples	151.76	..
19/12/2000	New Zealand Dairy Group	New Zealand	Consumer Staples	National Foods Ltd	Consumer Staples	41.56	..
15/08/2000	SembCorp Energy Pte Ltd	Singapore	Energy and Power	Kwinana Co-Generation Plant	Energy and Power	14.56	..
30/06/2000	Singapore Power Ltd	Singapore	Energy and Power	GPU PowerNet Pty Ltd	Energy and Power	1,264.20	..
19/11/1999	GIC	Singapore	Financials	214 Adelaide Street,Brisbane	Real Estate	54.89	..
02/02/1999	Electricity Corp of NZ	New Zealand	Energy and Power	Northpower-Energy Retail Busn	Energy and Power	13.73	..
27/02/1998	Reco Park Pty Ltd	Singapore	Financials	Ipoh Ltd	Real Estate	13.58	..
25/11/1996	Brunei Investment(Brunei)	Brunei	Financials	Macquarie Bank Ltd	Financials	122.82	..
12/06/1996	GIC	Singapore	Financials	National Foods Ltd	Consumer Staples	14.05	3%
24/01/1996	GIC	Singapore	Financials	Thakral Holdings Group	Real Estate	28.30	3%
29/06/1995	Singapore Telecom Intl Pte Ltd	Singapore	Financials	AAPT Ltd	Telecommunications	39.65	9%
31/12/1994	Abu Dhabi Investment Authority	Utd Arab Em	Financials	No 1 OConnell Street,Sydney	Real Estate	219.04	..
13/04/1994	Sarthe Pty Ltd(CITIC/China)	China	Media and Ent.	Success Wings AU-Chat Melb Htl	Media and Ent.	8.66	..
08/07/1993	Abu Dhabi Investment Authority	Utd Arab Em	Financials	Pancontinental Mining Ltd	Energy and Power	12.58	..
19/03/1992	GD Net(Deutsche Bundespost)	Germany	Consum. Prod. & Serv.	TNT Express Worldwide(TNT Ltd)	Consum. Prod. and Serv.	292.71	4%
04/05/1990	Cogema	France	Materials	Pancontinental Mining Ltd	Energy and Power	2.64	..

Source: Thomson One Banker., OECD

6. Conclusions

- Governance regimes are of critical importance in terms of how government-related investors are perceived in host countries, and the OECD guidelines for Sovereign pension and SOE's are a good example of what is expected for most players. Closeness to government in both governance and investments is not a good model for existing and newly-emerging pools of capital.

- OECD investment guidelines are very important for maintaining an open global investment regime to enhance productivity and growth. Country reservations in the OECD codes relate to national security.

- Other economic rationale sometimes mentioned in the context of restrictions on other grounds include:

  (1) Competition and level playing field issues—but these are best handled by competition policy, not foreign investment restrictions.

  (2) Natural Resources Policy, including exhaustible resource rent issues required to achieve the Hotelling condition where national interests may diverge.

  While there are practical difficulties on the supply side in measuring costs for rent sharing via resource rent taxation, this approach is to be preferred to foreign investment restrictions where possible.

  The case for foreign investment restriction becomes stronger where a foreign downstream producer may buy the upstream producer with aim to block the use of market power in price negotiations, or where a purchase by another producer results in resource development delays because differential rent is present in the context of multinational enterprises. However, in both cases this would only apply in the case of relatively large investment deals (certainly not for small fringe companies).

  (3) Particular problems associated with foreign SOE's and SWF's include: (i) sovereign immunity and the difficulty of pursuing foreign governments in the courts; and (ii) SOE and SWF investments where the ultimate government owner is likely to pursue objectives in its own national interest at the expense of the host country.

  The best example here is where the foreign government stake in a domestic exhaustible resource company is intended to block the use of market power in international price negotiations. At a broader level countries that have adopted a market-based development route may not wish to see industries nationalized by foreign governments for a variety of reasons.

- Most major government-related investment deals in areas of strategic concern during the past 10 years have been from SOE's rather than SWF's, suggesting the need for the debate to move into this area for both OECD and non-OECD countries.

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