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REMARKS

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ABSTRACT

The Norwegian Sovereign Wealth Fund (SWF) has been offered as a global model for the organization and operation of such enterprises. The Norwegian SWF appears to incorporate the global consensus views of best practices for such entities, grounded in transparency and a clear separation between the political activities of states and their investment activities. These remarks critically assess those understandings. Focusing on Norway's SWF, these remarks suggest that these sovereign investment vehicles cannot avoid advancing the political policies of their sovereign owners in pursuing ostensibly economic investment objectives. The Norwegian funds provide a particularly useful case study of the issues that are now at the center of reconceptualizations of the relationships between state and corporation, economic and political regulation, national and transnational legal frameworks, and public and private legal regimes.

I want to thank the organizers of this conference for the invitation to join this group of exceptional experts who have been working on a wide variety of issues relating to sovereign investing in the form of sovereign wealth funds. My task today is fairly straightforward but somewhat critical. Let's start by identifying the main point I wish to address:[1] the constitution and operation of the Norwegian sovereign wealth fund (SWF), the Government Pension Fund—Global, suggests that the basis for current approaches to global regulation of such entities fail both as regulation and as a principled basis for understanding the way these funds work.

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1. A fuller exposition of the ideas introduced in these remarks will be published as *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment*, 41 GEO J. OF INT'L L. (forthcoming 2009).

I make the following argument in support of this position: Current regulation is based on a "formally public/functionally private" model. The touchstone for the model is the adoption of an "idealized private investor" model that can be distinguished from other types of investment activity and assumes that the essence of private economic activity can be distilled, and that, thus distilled, it is substantially non-political. Thus, the Norwegian SWF can be constituted to act no differently than other private participatory funds, and such behavior focuses principally on the maximization of financial advantage. But this idealized private investor standard at the heart of sovereign wealth fund regulation does not work, even as soft law. The macroeconomic and ethics based actions of Norway's SWF suggests that Norway is consciously pursuing state policy indirectly through its funds. Investment is clearly meant to project Norway's political power by other means, and to move policy in particular directions. But it also does not accurately describe the behavior of private funds. Many of them seek to use their investment power to effect changes in the behavior of governments, communities, and people in a way that can only be described as political in a broad sense.

The problem, then, isn't that sovereign wealth funds cannot mimic private wealth fund behavior. It is almost the opposite—the problem is that neither type of fund can function in a substantially apolitical way. While the political activities of private funds might be viewed benignly, those of states using their large capital positions to participate in private markets for policy ends are unlikely to be understood as harmless.

Let's start with the big picture and work our way to Norway. The twentieth century saw the construction of two parallel systems: one public and one private. The public system was made up of states and other public actors. It was grounded in rule of law concepts. Its essence was political and regulatory. The actors in this system did not make wealth or engage in economic activity, as such; they oversaw such activities. The private system was made up of everyone else—natural and legal persons, aggregations of wealth, people, and communities of interest. This system was grounded in contract and notions of interest maximization, whether measured in economic, social, religious, or other terms. The members of this system did not regulate so much as participate in the markets, communities, and other frameworks regulated and overseen by political bodies in accordance with laws.

The basic division between the systems was founded on the simplest of ideas—states governed and everyone else contracted within systems of governance overseen by the community of states. This framework served to confirm the monopoly of states (and international organizations in which they participated) over political activity. Economic actors, on the other hand, were expected to be non-political, focused on maximizing their aggregate wealth. Thus divided, a global system of markets could be created without frightening states or disturbing their monopoly over political power. This framework proved highly successful as the basis for the evolution of what we now understand as economic globalization and state-based internationalism.

But too much of a good thing can undo the very thing it creates. Modern global markets have given rise to aggregations of private economic power, whose actions have spilled over into the public sphere. Large corporations are increasingly regulating the markets in which they participate and are having political effect in the states in which they operate. Likewise, states, never totally absent from participation in those economic markets they sought to regulate, have reconstituted themselves as economic actors to participate in private economic global markets. States are increasingly projecting public power through participation in private markets outside their territory. Markets may become another front in the political engagement among states.

Among the more visible manifestations of these tectonic changes in the organization of the global order are sovereign wealth funds, nicely defined by Clay Lowery as "a government investment vehicle which is funded by foreign exchange assets, and which manages these assets separately from official reserves."[2] Over the last decade they have been transformed from a simple and relatively benign sovereign vehicle for the investment of excess wealth in a discrete way, to an important force in global finance. We have been told about the size of SWFs and their growth on the eve of the great financial crisis of 2008. In its 2009 Report, the Government Accounting Office reported that forty-eight SWFs operated by thirty-four countries had been identified,[3] managing between $1.9 and $2.9 trillion.[4]

The response of investment host states—usually, but not inevitably, developed states with sizeable economic wealth in financial markets—has been a cautious alarm. The great fear, of course, is the use of

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2. Stephen Jen, *The Definition of Sovereign Wealth Fund*, GLOBAL ECON. F., MORGAN STANLEY, Oct. 26, 2007, *available at* http://www.morganstanley.com/views/gef/archive/2007/20071026-Fri.html (accessed Jan, 9, 2009) (Quoting Undersecretary Lowery).

3. U.S. GOV'T ACCOUNTING OFFICE, SOVEREIGN WEALTH FUNDS, REPORT TO THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS 5, U.S. SENATE, GAO-09-608 (2009).

4. CONG. RES. SERVICE, SOVEREIGN WEALTH FUNDS: BACKGROUND AND POLICY ISSUES FOR CONGRESS (2008), *available at* http://opencrs.com/document/RL34336.

sovereign investing through economic markets to achieve political aims beyond the borders of the investing state. The response of the international community to the rise of these sovereign investment vehicles has been something like a "divide and assimilate" policy. The recently adopted Santiago Principles, a collective effort backed by states with large and active SWFs,[5] is grounded in a measure of transparency, some minimum amount of institutionalization of funds and their activities, so that they exist separate from the political and administrative ministries of a state, and with a strict limit on objectives of investment. The objectives are to ensure that host states do not feel threatened by these investment vehicles, and can approach their governance (and acceptability) in the same way that they approach the regulation of private aggregations of investment capital. For that purpose, the objectives of investment take on an important role. Critical to that role is an understanding that SWFs ought to strive to adhere to a private investor model of investment. The object of SWFs should not be to project state power. Rather, it is to "maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds."[6] And so the deal: if a sovereign wealth fund appears to assimilate to the culture of a hypothetical non-sovereign investment entity, if it ceases to exercise its authority as a regulator rather than a participant, then the sovereign might be deemed declawed. Now benign, it can be viewed as an instrument useful to the development of global financial markets, and regulated as such.

This consensus is grounded in a set of core beliefs about the way funds of these sort work. The first is that private funds act to maximize financial returns without much regard for other concerns—especially political ones. The second is that it is possible to distill the essence of this financial-returns-privileging behavior and impose it on political organizations seeking to enter financial markets. Thus framed, the regulatory issues facing states confronting sovereign wealth funds is simplified and made manageable. One worries only about details—how much transparency, how to manifest separation from the political organs of the state, and the like.

In many respects the Norwegian SWF, its Government Pension Fund-Global—serves as a poster child of this global movement toward behavior norm consensus. Norway's Government Pension Fund—

5. *See* INT'L WORKING GROUP OF SOVEREIGN WEALTH FUNDS, SOVEREIGN WEALTH FUNDS: GEN. ACCEPTED PRINCIPLES AND PRAC.: SANTIAGO PRINCIPLES (2008), *available at* http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf (accessed Feb. 1, 2009) (hereinafter "the Santiago Principles").

6. Santiago Principles, *supra* note 5, Principle 19.

Global, funded for the most part from income from the exploitation of Norway's natural resources, is enormous, even after the disastrous results attendant on the financial crisis of 2008.[7] Even better, like an increasing number of private funds, the Government Pension Fund—Global, is organized to invest in a socially conscious manner. It conflates state action in private form and the more advanced elements of economic social responsibility.

The origins of Norway's SWF can be traced back to 1990 when the Norwegian state established the Petroleum Fund as a fiscal policy tool to support a long-term management of the petroleum revenues, acquiring state funds in 1996 and investing in foreign equities only a little more than a decade ago, in 1998.[8] The Petroleum Fund was not set up as a separate legal person but was instead organized as a department of government apparatus, to be managed by the Norwegian Central Bank.[9] It was renamed the Government Pension Fund in 2006.

The Fund is actually two funds; one, the Government Pension Fund—Global, invests abroad, and the other, the Government Pension Fund—Norway, is a domestic investment vehicle. According to Norway's official site in the United States, the GPF does not seek to control companies through buy-outs. Rather, "by its own rules the fund restricts its ownership in any company it invests in to five percent of shares. The investment objectives are purely financial in nature, safeguarding assets for the long term."[10]

Administration of the Fund is divided into three parts. The responsibility for overall policy is vested in the Ministry of Finance. Control over management is vested in the Norwegian Central Bank. Lastly, ethical issues involved in the application of the investment strategy by the Central Bank though its management apparatus are to be overseen by an autonomous ethics council. In addition, the Storting (the Norwegian Parliament) established an advisory Council on investment strategy in 2005 to assist the Ministry of Finance in setting the guidelines

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7. *See* MINISTRY OF FINANCE, NORWAY, REP. NO. 20 TO THE STORTING: ON THE MGM'T OF THE GOVERNMENT PENSION FUND IN 2008, *available at* http://www.regjeringen.no/pages/2185603/PDFS/STM200820090020000EN_PDFS.pdf (accessed May 10, 2009).

8. Norwegian Ministry of Finance, *Fact Sheet Pension Fund—Global* (2008), *available at* http://www.regjeringen.no/upload/FIN/Statens%20pensjonsfond/PF-summary-aug08.pdf.

9. *See* MINISTRY OF FINANCE, NORWAY, THE MGM'T OF THE GOVERNMENT PENSION FUND—GLOBAL, *available at* http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund/The-Management-Model.html?id=429362 (accessed March 30, 2009).

10. Norway's official site in the United States, Transparency and Trust: Keys to the Norwegian Pension Fund, *available at* http://www.norway.org/misc/print.aspx?article={f7a4696e-21f9-42d2-a8a0-3fc48197df6f}.

within which the SWFs are operated.[11]

There is some effort to separate the SWF investment functions from the political functions of the state organs that have oversight responsibility. The division of authority between the Ministry of Finance and Norges Bank is governed by a Management Agreement. Norges Bank's management established the Norges Bank Investment Management ("NBIM") on January 1, 1998 as an operational investment management unit for the Global Fund, which hires outside managers to direct some of its investment activities.[12] The Norges Bank Executive Board supervises the operations of NBIM.

The Ministry of Finance has taken the position that "there is a broad political consensus that the Pension Fund should be managed with a view to achieving the maximum possible return within a moderate level of risk."[13] The Fund's investment strategy is implemented through a benchmark portfolio.[14] The investment strategy of the Fund is critically grounded on the principle that markets do not always function efficiently and that the conventional financially driven benchmark portfolio investment strategy of the Fund will not maximize Fund values. The result is the application of what are referred to as principles of responsible investment and active management. Both are grounded in notions of market inefficiencies, but each focuses on different consequences that might flow from perceptions of inefficiency. Responsible investing focuses on good corporate governance and ethics as a basis for developing portfolio and investment strategies. "Active management provides an opportunity to achieve exposure to systematic risk factors that it can be difficult to represent properly in the benchmark portfolio."[15] Unlike responsible investing that targets values, active management targets financial inefficiencies and more aggressive use of investment and shareholder power to exploit these market failures and the generation of "excess" return.[16]

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11. THE MINISTRY OF FINANCE, NORWAY, THE INVESTMENT STRATEGY COUNCIL, *available at* http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund/The-Investment-Stategy-Council.html?id=434880 (accessed April 4, 2009).

12. NORGES BANK, TEN YEARS OF NBIM, *available at* http://www.norges-bank.no/upload/nbim/reports/2007%20feature1.pdf; *see also* NORGES BANK INVESTMENT MANAGEMENT, GOVERNMENT PENSION FUND—GOLBAL ANNUAL REPORT 2008, at 8, *available at* http://www.norges-bank.no/upload/73979/nbim_annualreport08_rev.pdf.

13. *See* MINISTRY OF FINANCE, *supra* note 15, Chapter 5: The Management of the Government Pension Fund.

14. *See* MINISTRY OF FINANCE, *supra* note 7, at 16-19.

15. *Id.* at 15.

16. *Id.*

The most important and controversial aspects of the application of the Global Fund's investment principles are bound up in Ethical Guidelines for Investment.[17] These Ethical Guidelines and their enforcement mechanisms are said to exist separately from the investment work overseen directly by Norges Bank.[18] The Ethical Guidelines are based on two premises. The first is that the Fund must be managed to extract a "sound return in the long term."[19] The second is that the first objective is contingent on a number of policy factors, including "sustainable development in the economic, environmental and social sense."[20] The policy nature of these contingencies is clearly articulated as well. The Fund is to be used not merely to protect and increase the value of the Fund itself, but to influence behaviors among the pool of potential targets of investment. The Ethical Guidelines are implemented in three ways—through the exercise of ownership rights, negative screening of companies, and exclusion of companies from the investment pool.[21]

The Ethics Guidelines are overseen by a Council of Ethics, established by Royal decree in 2004 and revised in 2005. The Council was constituted as an independent advisory body, with authority to screen companies for conformity to ethics principles and to recommend exclusion of non-conforming companies from the pool of entities in which the Fund will invest.[22] The Ministry of Finance, though, makes exclusion decisions.

The governance and activities of the Norwegian SWF produces a curious tension. Though it is constituted as a substantially autonomous unit with a wealth maximization mission, its organization also introduces a political element into the heart of the formal organization of the management of the Global Fund, particularly in the form of the Ethics Council. This produces a certain ambiguity in Fund behavior—it operates like a private investment fund to the extent that it seeks to maximize shareholder value, but the maximization of shareholder

17. STYRER, RAD OG UTVALG, ETHICAL GUIDELINES, NORWEGIAN GOVERNMENT PENSION FUND—GLOBAL, *available at* http://www.regjeringen.no/en/sub/Styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277 (accessed March 25, 2009).

18. Ministry of Finance, *supra* note 7, at 139.

19. *Id.* at ¶ 1.

20. *Id.*

21. *Id.*

22. ETHICAL GUIDELINES, NORWEGIAN GOVERNMENT PENSION FUND—GLOBAL (issued Dec. 22, 2005 pursuant to regulation on the Management of the Government Pension Fund—Global; former regulation on the Management of the Government Petroleum Fund issued Nov. 19, 2004), *available at* http://www.regjeringen.no/en/sub/Styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277 (accessed March 25, 2009).

value in this case requires the Fund be used to affect the global governance goals of the Norwegian state. That ambiguity is nicely evidenced in the way in which investment policy is driven by political interests. I note three examples: (1) corporate social responsibility; (2) sanctions against Israel; and (3) investment in Burma. The three suggest the way in which public and private interest may merge, and the way in which, as some critics fear, public policy can be deployed within markets.

Corporate social responsibility, in the form of exercising shareholder rights, is an important element of the investment strategy of the Norwegian Funds. The Fund management has focused on a few specific areas of corporate governance, which it has raised with entities whose equities they hold (as well as with the governments that have chartered those entities). With respect to corporate governance, the Global Fund asserted shareholder power in two ways—by voting and through direct communications with companies. In addition, Norges Bank has begun to work in concert with other funds, both public and private, to effect changes in the ways that governments approach environmental issues. Importantly, the Fund also focuses on state-to-state dialog, in an attempt to obtain legal reform for targeted corporate governance issues—for example, meeting with American government officials in their role as an agency of the Norwegian State to discuss changes in American securities law.[23]

A more political use of investment power involved the entanglement of the Norwegian SWF with the efforts to boycott Israeli firms or firms that do business with Israel. The most recent genesis of this strategy has been repeated efforts to seek to exclude Israeli companies and companies that do business in Israel from the investment portfolios of the Norway Funds. While the determination to check those companies has not produced a blanket recommendation to exclude investment in any class of companies, or companies engaging in activities in areas controlled or within conflict zones in Israel/Palestine, the Ethics Counsel had begun to report conclusions with respect to individual companies. In one such case, the Ethics Committee considered a complaint against the Israel Electric Corporation.[24] In a similar vein, the Norwegian SWF

23. Ministry of Finance, *supra* note 7, at 24.

24. *See* Letter from Council on Ethics, Norwegian Government Pension Fund—Global to the Ministry of Finance 1 (Apr. 18, 2008) (Council on Ethics' assessment on investments in Israel Electric Corporation), *available at* http://www.regjeringen.no/en/sub/Styrer-rad-utvalg/ethics_council/Recommendations/Other-documents/letter-dated-april-18-2008-on-the-counci.html?id=524431 (accessed March 23, 2009).

has been involved in considering the ethics of investing in Myanmar (formerly Burma).[25] Here again, the political factors that motivated the approach to the Israeli issues underlie the relationship between the Norwegian state, the Global Fund and the objects of its investment.

So is the Norwegian SWF operated like a private fund, or is it a means through which Norway may leverage its political authority well beyond its territory? Norway's position appears to be that a SWF is functionally private if it maintains a separation of ownership from control of the fund. As long as the political branches are not directly in control, the SWF is sufficiently insulated to be treated like a private fund.[26] SWFs are quite political in their objectives—but that does not make them different from other private funds.[27] It makes them different from the ideal private investor behavior model that has been put forward to make them seem non-threatening.

They are threatening, but only in the same way that large private funds are threatening to national economies. Private funds have developed investment strategies to bring social, political or environmental change in targeted sectors. Socially responsible funds have been active in modern form from the 1970s, when they were used to try to put pressure on corporations that were contributing to the American war effort in Vietnam, and gained more prominence in private efforts to help undermine the South African Apartheid regime in the 1980s. There are a host of private socially responsible investment funds currently controlling a growing amount of investment capital.[28]

Socially responsible private funds resemble SWFs like that of Norway, with a focus on ethics, aggressively applied. This is particularly the case in the way in which these funds stress the combination of financial and political interests. The point is not that these funds exist, but that they operate in ways that would be considered political, and suspect under the Santiago Principles, were they operated like this by a sovereign. The problem is not that the Norwegian SWF advances political agendas

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25. COUNCIL ON ETHICS GOVERNMENT PENSION FUND—GLOBAL, NORWAY, ANNUAL REPORT 2007, 5 (2007), *available at* http://www.regjeringen.no/pages/1957930/Annual%20Report%20 2007.pdf (accessed March 25, 2009).

26. *See* MINISTRY OF FINANCE, NORWAY, REPORT NO. 16 TO THE SORTING: ON THE MGM'T OF THE GOVERNMENT PENSION FUND IN 2007, 139 (2008), *available at* http://www.regjeringen.no/pages/ 2064594/PDFS/STM200720080016000EN_PDFS.pdf (accessed March 27, 2009).

27. *See id.*, at 60, Part II, Box 2.5; *see also id.*, at 77, 100, 109 (focusing on the behavior of other large funds).

28. SOC. INVESTMENT FORUM, 2007 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES, *available at* http://www.socialinvest.org/resources/pubs/documents/ FINALExecSummary_2007_SIF_Trends_wlinks.pdf (accessed May 22, 2009).

through interventions in private markets (while seeking to maximize returns as they understand the meaning of that notion)—they do. The problem is that private investors engage in substantially similar conduct.

It is clear that the Norwegian Global SWF acts in a sovereign capacity. It deliberately seeks to project Norwegian policy preferences on a host of private actors otherwise beyond its reach. It seeks to use its investment strategies as a doorway to negotiate changes in foreign law, especially with respect to corporate social responsibility. But that Norway is acting as a sovereign through its Global Fund and in private markets, and is doing so aggressively, does not mean that SWFs ought to be viewed as a threat any greater than large private investment vehicles that also aggressively intervene in regulatory matters. The issue is the regulatory effect of interventions in private markets by public or private entities seeking to project power. The Norwegian SWF suggests that the emerging framework of SWF governance, grounded on an assumption that a state organization formally public but functionally private, acting like an idealized private investor, does not work either for private investors who seek to use investment for political ends or state investment entities that purport to refrain from that sort of activity.