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Orwellian double-speak marks thinking about sovereign funds

Commentary: West should stop seeing SFs as bogeymen

By Darrell Delamaide

There's an Orwellian double-speak at work in much of the writing and thinking about sovereign funds.

Everyone wants these well-endowed government investment vehicles to be non-political, except when it's convenient to view them as political. The West on the whole wants them to make their investment decisions on strictly financial terms, except when it's useful to go outside accepted financial rules.

For instance, Greece would like China's sovereign funds to buy Greek government bonds, because these funds, unlike regulated mutual funds, can ignore the fact that these bonds are rated below investment grade. And besides, China is undertaking some significant investment in Greece. So Chinese Investment Corp. and the others should buy Greek bonds, right? And if the managers of these funds protest that they must make their investment decisions based on a hard calculation of risk and return, their protests fall on deaf ears.

When BP was down and out over the oil spill in the Gulf of Mexico, executives made the rounds of sovereign funds seeking capital to shore up the embattled oil giant. What a bargain, they said, as if sovereign funds, unlike other investors who had marked down BP shares in public trading, could afford to ignore the reputational risk and the enormous liability BP was incurring with the spill.

There's another wrinkle to this. While sovereign funds are working hard to implement the Santiago Principles and establish their non-political bona fides to a largely sceptical world, some participants on the international financial and corporate scene are tempted to use them as a convenient bogeyman to achieve entirely separate sets of political objectives.

Take the recent move by the board of the Italian bank Unicredit to eject chief executive Alessandro Profumo. The ostensible reason for the ousting was because Profumo had allowed Libya's sovereign fund to invest in the bank even though the Libyan central bank already had a stake just under 5%.

What the politicians from Umberto Bossi's Northern League who sit on the board *said* was that they feared political control by Libya, with its new total of about 7.5% of the bank's shares. What they *meant* was that they feared dilution of their own control, and what they

wanted was to get rid of Profumo under any pretext because he had a tendency to be a mite too independent.

In an OECD working paper last year, economists Rolando Avendano and Javier Santiso found that sovereign funds do not have radically different investment motives than mutual funds – in both cases the main influences tend to be financial rather than political. Moreover, while most sovereign funds are located in countries with less democratic regimes, they tend to invest without differentiation in jurisdictions with democratic or autocratic regimes - as do mutual funds. In other words, they are politically colour-blind.

In fact, as Tufts University professor Daniel Drezner has observed, the investing country must be significantly more powerful than the target country if it wants to exercise any political leverage. To influence policy through investments would require a panoply of flanking measures that is beyond the means of the small countries with the biggest sovereign funds. Many of these countries – Norway, Singapore, United Arab Emirates, Qatar, and Kuwait, for instance – are firmly allied to the West and would damage their own economies if they tried to inflict harm on countries in which they invested.

Of course China is a different story, and reports that CIC might be enlisted to join with Sinochem in a \$40bn bid for Canada's Potash Corp is creating some unease about the use of a sovereign fund to promote strategic objectives. This is especially the case as China is using its dominance of "rare earth" production as leverage in a territorial dispute with Japan.

The difference, of course, is that the potash resources would remain in Canada, where the national government could intervene in a political crisis, if it ever came to that.

The Santiago Principles pledging transparency and non-political motives for sovereign fund investment are a response to Western scepticism about the funds. The West is part of this process and has to keep its part in the bargain. Westerners – whether they are financiers, commentators, economists or politicians – would do well to honour the measures the sovereign funds are taking in good faith. Doing the opposite – by pillorying them as bogeymen for blatantly self-interested reasons – risks damaging not the funds' reputation, but that of the West.

Darrell Delamaide sits on the OMFIF Board of Contributing Editors.

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