2011

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Recommended Citation
Kyle J. Hatton & Katharina Pistor, *Maximizing Autonomy in the Shadow of Great Powers: The Political Economy of Sovereign Wealth Funds*, Columbia Journal of Transnational Law, Vol. 50, p. 1, 2011; Columbia Law & Economics Working Paper No. 395 (2011).
Available at: https://scholarship.law.columbia.edu/faculty_scholarship/2431

Maximizing Autonomy in the Shadow of Great Powers: The Political Economy of Sovereign Wealth Funds

KYLE HATTON* & KATHARINA PISTOR**

Abstract:

Sovereign wealth funds ("SWFs") have received a great deal of attention since they appeared as critical investors during the global financial crisis. Reactions have ranged from fears of state intervention and mercantilism to hopes that SWFs will emerge as model long-term investors that will take on risky investments in green technology and infrastructure that few private investors are willing to touch. In this paper we argue that both of these reactions overlook the fact that SWFs are deeply embedded in the political economy of their respective sovereign sponsors. This paper focuses on four political entities that sponsor some of the largest SWFs worldwide: Kuwait, Abu Dhabi, Singapore and China. Each of them has been governed for decades by elites whose grip on power has been tied to the economic fortune of their respective economies and their ability to pacify, or at least balance against, foreign powers. We argue that for these four political entities, both the motives for establishing SWFs and the strategies they employ can best be explained by an "autonomy-maximization" theory.

In a world where uncertainty—both economic and political—looms larger as a concern in the wake of the global financial crisis and political upheavals, such as the revolutions in Tunisia, Libya and Egypt, elites use an increasingly diverse array of tools to protect their autonomy within the global system and hedge against unexpected turmoil. SWFs serve ruling elites by concentrating substantial resources, which can be used to pay off domestic adversaries, to insure the economy against major downturns and thereby mitigate public discontent, to signal cooperation to major foreign powers and to increase legitimacy in the global arena by presenting governance structures familiar to the West. We employ a comparative case study analysis to highlight the critical importance of these political economy

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The authors would like to thank participants at the conference on "Sovereign Wealth Funds and Other Long Term Investors: A New Form of Capitalism?" at Columbia University, Oct. 4–5, 2010 for helpful comments and suggestions. All remaining errors are ours.

dynamics in the establishment of SWFs, their governance structures and their behavior in both normal times and during times of crisis.

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I. Introduction

Sovereign wealth funds ("SWFs") have drawn increased scrutiny in recent years due to high-profile acquisitions of equity stakes in Western companies; however, most of these funds have quietly invested public wealth in diversified global portfolios for decades. Lately, heightened concerns about national security interests have led to increased filings and investigations by the Committee on Foreign Investment in the United States (CFIUS),[1] but the more common reaction to the expanded role of SWFs in the global financial system among the general public is a kind of collective unease. At the center of this unease is the opacity of SWFs' institutional structures, strategies and goals: it is difficult to rely comfortably on partners whose motives are unclear.

Accordingly, much debate in academic circles has emerged about the motives of SWFs. From the alarmist camp, some have sounded warnings that SWFs portend the return of mercantilism to the global economy while others have argued that they evidence the rise of a new form of socialism or imperialist-capitalism in emerging economies. This anxiety is fueled by the fact that many SWFs tend to come from countries that are non-democratic. On the other side, SWF apologists steadfastly maintain that these institutions are classic examples of rational market investors. We believe that these explanations are lacking, in no small part because they attempt to reduce SWFs to terms with which Western audiences are familiar in order to elicit either protectionist or free market policy responses.

In contrast, we characterize SWFs as autonomy-maximizing institutions.[2] In each of the countries analyzed herein, the ruling elite utilize SWFs to secure their domestic political dominance against both internal and external threats. While this interest is furthered by wealth-maximizing choices in most instances, SWFs are not wholly neutral market actors; however, neither are they bent on imposing the policies of their sovereign sponsors on the international system.

This article first summarizes and briefly explains the existing accounts of SWF motives along with the term "autonomy-maximizer," while showing that only the autonomy-maximizing story can fully explain SWF actions since their inception. Then, case studies of SWFs in Kuwait, Abu Dhabi, Singapore and China are presented to ground the autonomy-maximization theory in reality. These case studies confirm that SWFs are used to maximize the autonomy of their sovereign sponsor and that this objective is quite consistent with each country's behavior prior to its formation of SWFs. Finally, a theoretical argument is provided as to why SWFs are appropriate institutions for advancing this goal.

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1. From 2006 to 2008, filings increased by about forty percent from 111 to 155, and investigations increased from 7 to 23. COMM. ON FOREIGN INV. IN THE U.S., COMM. ON FOREIGN INV. IN THE U.S. ANNUAL REP. TO CONG. (Public/Unclassified Version) 3 (2009), *available at* http://www.ustreas.gov/offices/international-affairs/cfius/docs/2009%20CFIUS %20Annual%20Report.pdf.

2. The notion that SWFs are autonomy-maximizers is similar, but not identical to the argument made by Dixon and Monk that SWFs are used to maximize the sovereignty of the state sponsor. Adam Dixon & Ashby H.B. Monk, Rethinking the Sovereign in Sovereign Wealth Funds (Aug. 3, 2010) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1652701. Dixon and Monk argue that SWFs improve the "sovereignty deficit [of some states] vis-à-vis more powerful states," enhance "a [state's] international legal sovereignty" and further states' domestic "Westphalian sovereignty." *Id.* at 9, 11. We will distinguish these positions more carefully below under II.B.

II. THEORY

SWFs have been defined as "government owned and controlled (directly or indirectly) investment funds that have no outside beneficiaries or liabilities (beyond the government or the citizenry in abstract) and that invest their assets, either in the short or long term, according to the interests and objectives of the sovereign sponsor."[3] This definition is indicative in that it draws a clear connection between the actions of SWFs (investment) and the motives of the sovereign sponsor. SWFs have accumulated vast pools of capital, so identifying these interests and objectives is critical for other actors in the global economic governance system who need to determine whether SWFs are reliable partners. Accurately identifying sovereign goals and objectives is, however, problematic: any self-reported disclosure must be viewed skeptically, the well-documented historical opacity of SWFs tends to frustrate independent investigation and many investment decisions may be consistent with multiple characterizations of the underlying SWF motive.

Existing scholarly debate has attempted to explain SWF actions through several competing theoretical frameworks. Some have theorized that SWFs are rational market actors which maximize financial returns—and thus reliable partners—while others argue that SWFs are exploitative institutions—and thus not to be trusted—alternatively characterizing them as mercantilist, socialist-imperialist or capitalist-imperialist institutions. This is, however, a false dichotomy: it is possible to act in a manner that is neither financial-return-maximizing nor exploitative. Further, none of the existing characterizations can adequately explain the full range of observed SWF behavior. Based on detailed comparative analysis of the leading SWFs in the world and their role within the systems that sponsor them, we argue that SWFs are autonomy-maximizing institutions. Autonomy-maximization is consistent with the circumstances that led to the creation of SWFs in each of the case study countries and can explain SWFs' historically passive external investment strategy, the politicized nature of their domestic investments, the use of SWF revenues to pacify domestic constituencies, their dollar recycling function and the extraordinary investments made by SWFs during the recent financial crisis.

A brief explanation of each of the existing alternative theories is provided below, followed by an analysis of whether these theories can explain each of the behaviors listed above. We then provide an overview of our autonomy-maximizing theory, along with an analysis showing how it does explain each of these behaviors.

A. Existing Alternative Explanations

There are three primary existing theories of SWF objectives and motivations. The first

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3. Ashby H.B. Monk, Recasting the Sovereign Wealth Fund Debate: Trust, Legitimacy, and Governance 10 (May 1, 2008) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1134862. Of course, by extension, SWFs may be liable and responsive to the population at large insofar as the sovereign is accountable to the nation. Given that many SWFs are sponsored by non-democratic governments, however, even this indirect accountability is questionable.

theory is that SWFs are mercantilist (or neo-mercantilist) institutions. The second theory is that SWFs act as capitalist-imperialist (or socialist-imperialist) institutions. SWF apologists, in contrast, argue that they are rational market-based investors. None of these theories explains the full breadth of SWF behavior; indeed, some would predict behavior quite contrary to that actually observed over the last twenty years.

In the classic sense, mercantilism proceeds from an assumption that economic exchanges are a zero-sum game and that accumulation of capital marks the winner.[4] Between the sixteenth and seventeenth centuries, the governments of the emergent nation states in Europe believed that by regulating their economies they could enhance their geopolitical power. Adam Smith was highly skeptical of the concept and advocated free trade as a superior way to foster prosperity.[5] Professors Gilson and Milhaupt have characterized SWFs as neo-mercantilist institutions that use "company-level behavior" to maximize "country-level . . . economic, social, and political benefits."[6] According to this theory, SWF actions should be aimed at *country-level* maximization of these benefits. Gilson and Milhaupt present little concrete support for this characterization beyond a passing reference to the Chinese economy and an observation that SWFs constitute "state involvement in the economy."[7] While Chinese trade policy may have mercantilist tendencies,[8] this does not necessarily prove that all SWFs (or even the Chinese Investment Corporation) act out of mercantilist impulses. The analysis below shows that a significant portion of SWFs' behavior is not explainable by country-level economic, social and political benefit maximization.

Post-mercantilist state involvement in the economy has been alternatively explained by imperialist-capitalism. While capitalism is based on private ownership of the means of production, imperialist-capitalism means that governments become deeply involved in directing investments overseas in an attempt to marry their own interests with those of the economic elites. Essentially, the argument as developed by Max Weber is that higher profits are available outside of domestic markets and that by capturing these profits through the use of imperialist force, states can boost the expansion of their domestic economies more rapidly than through pacifist "free-trade" capitalism alone.[9] Heike Schweitzer explains that if SWFs are indeed imperialist-capitalist institutions, they should be trying to exploit the capitalist system for their own economic and political benefit.[10] Upon inspection, however, it is apparent that SWFs are neither "turning the tables" of imperialist force against Western economies nor engaging in imperialist behavior in developing states; further, the imperialist-capitalist theory does not explain several key categories of SWFs' historical actions.

The final existing theory on SWFs is that they are pure market-based rational investors.

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4. *See, e.g.*, THOMAS MUN, ENGLAND'S TREASURE BY FORRAIGN TRADE (1664); JAMES STEUART, AN INQUIRY INTO THE PRINCIPLES OF POLITICAL ECONOMY (1770); *see also* FRANK HALLIDAY, ARABIA WITHOUT SULTANS 464 (1974).

5. *See* ADAM SMITH, THE WEALTH OF NATIONS 488 (University of Chicago Press 1976) (1776).

6. Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345, 1346 (2008).

7. *Id.*

8. For an argument that China's policy is mercantilist, see Robert J. Samuelson, *China's Wrong Turn on Trade*, NEWSWEEK, May 14, 2007, at 55.

9. MAX WEBER, ECONOMY AND SOCIETY 918–20 (University of California Press 1978) (1921).

10. Heike Schweitzer, *Sovereign Wealth Funds: Market Investors or Imperialist-Capitalists*, 2 EUR. Y.B. INT'L ECON. L. 80 (2011).

In the neoclassical model of economic organization, rational actors seek to maximize their interests—primarily profits.[11] While most proponents of the market economy would argue that private actors are the agents best suited to the system, an argument can be made that in highly competitive markets, actors with different ownership structures or objective functions will largely converge in their outlook and behavior to conform to demands of the market economy.[12] This is uniformly the motivation SWFs themselves declare;[13] it is echoed by numerous commentators[14] and is presented by Epstein and Rose as a prudent default assumption due to the lack of contradictory evidence.[15] Under this theory, SWFs should act to maximize the financial gains accruing to the SWF—similarly to how a "normal" investor would structure its behavior. While the wealth-maximizing explanation explains certain SWF actions, it cannot explain others without assuming that SWFs are occasionally completely irrational or that they represent "dumb money" in the marketplace.

We believe that any theory of SWF motivation should be able to explain five particular courses of action that SWFs have undertaken in the past. The following table presents a summary of our analysis, which is detailed below.

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11. For a discussion of the *homo economicus* concept in historical perspective, see Bruce Carruthers, Homo Economicus *and* Homo Politicus*: Non-Economic Rationality in the Early 18th Century London Stock Market*, 37 ACTA SOCIOLOGICA 165 (1994).

12. This line of thinking has motivated the liberalization of markets in the former socialist world as a means to develop efficient markets even before privatization and other institutional reforms had been completed. For a discussion of the sequence of privatization and market reforms, see Andrzej Rapaczynski, *The Role of the State and the Market in Establishing Property Rights*, 10 J. ECON. PERSP. 87 (1996). *But see* Justin Y. Lin, *Viability, Economic Transition and Reflection on Neoclassical Economics*, 58 KYKLOS 239 (2005) (arguing that non-viable firms will not function in a competitive market economy).

13. *See, e.g.*, TEMASEK HOLDINGS, TEMASEK REPORT 2010: MAKING A DIFFERENCE 5 (2010) ("Temasek Holdings is an investment company managed on commercial principles to create and deliver sustainable long-term value for our stakeholders."), *available at* http://www.temasekholdings.com.sg/pdf/temasek_review/TR2010.pdf; *Mission and Principles*, KUWAIT INV. AUTH., http://www.kia.gov.kw/En/About_KIA/Mission_Principles/ Pages/default.aspx (last visited Sept. 16, 2011) ("[The Kuwait Investment Authority's ("KIA")] mission is to achieve long term investment returns on the financial reserves of the State of Kuwait . . . ."); CHINA INV. CORP., ANNUAL REP. 2010, at 1 (2010) ("[China Investment Corporation's] mission is to make long-term investments to maximize risk adjusted financial returns for the benefit of the shareholder."), *available at* http://www.china-inv.cn/cicen/include/resources/CIC_2010_annualreport_en.pdf; *Guiding Principles*, ABU DHABI INV. AUTH., http://www.adia.ae/en/About/Guiding_Principles.aspx (last visited Sept. 16, 2011) ("ADIA's decisions are based solely on its economic objectives of delivering sustained long-term financial returns.").

14. *See* Eric Langland, *Misplaced Fears Put to Rest: Financial Crisis Reveals the True Motives of Sovereign Wealth Funds*, 18 TUL. J. INT'L & COMP. L. 263 (Winter 2009).

15. Richard A. Epstein & Amanda M. Rose, *The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow*, 76 U. CHI. L. REV. 111, 113–14 (2009).

	Mercantilism	Imperialist-Capitalism	Market Investor
Passive outward investments	X	X	✓
Extraordinary outward investments	X	X	X
Dollar recycling	X	✓	X
Revenues used to pacify domestic constituencies	X	X	X
Politicized domestic investments	X	X	X

One of the trademarks of SWF behavior over the past thirty years has been passive foreign direct investment.[16] Certainly, SWFs have sought influence on the boards of some of their investment targets, but in the large majority of cases, SWF wealth is employed passively. This is not consistent with the pursuit of a mercantilist agenda. Passive investments in Western corporations allocate capital to corporations that maximize wealth at the company level; mercantilist SWFs would need either to successfully influence corporate boards to act in ways that benefit the sovereign sponsor at the expense of other investors (for which there is no evidence to date, and which is unlikely to occur in the future given strong penalties levied against directors who violate the duty of loyalty),[17] or to purchase large stakes in companies such that company-level wealth maximization results in de facto country-level wealth maximization. Mercantilism, therefore, does not explain why SWFs predominantly invest passively. Imperialist-capitalism, too, fails to provide an explanation for SWFs' historical passive investment strategy. Passive investment strategies simply do not fit with an "exploitative" agenda, nor do they serve to bend host-country industrial policy to benefit the SWF sovereign sponsor. The market-investor theory does explain SWFs' passive investment strategy, as the cost advantages of a passive strategy are well-documented.

SWFs' investments in Western financial institutions during the recent financial crisis were heavily publicized and caused great concern in many circles.[18] None of the existing theories, however, offers an adequate explanation for why SWFs made these investments. Almost uniformly, the investments included passivity clauses, specifying that the investments created "no special rights of ownership," "no role in the management of the company," "no right to des-

16. For a comprehensive study on past investment patterns of SWFs, see MONITOR GROUP, ASSESSING THE RISKS: THE BEHAVIORS OF SOVEREIGN WEALTH FUNDS IN THE GLOBAL ECONOMY (2008).

17. The duty of loyalty is part of the fiduciary duties in U.S. corporate law. However, other countries sanction conflicted transactions as well. For a comparative perspective, see Katharina Pistor & Chenggang Xu, *Fiduciary Duties in Transitional Civil Law Jurisdictions: Lessons from the Incompleteness of Law Theory*, *in* GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS 77 (Curtis Milhaupt ed., 2003).

18. Lawrence Summers, who later became economic advisor to the Obama administration, opined that the "logic of the capitalist system" of shareholders maximizing value is "far from obvious" in the case of SWF investments in foreign companies. Lawrence Summers, *Sovereign Funds Shake the Logic of Capitalism*, FIN. TIMES, July 30, 2007, at 9.

ignate a member . . . of the Board of Directors" or "[no] special governance rights."[19] This passivity, as noted above, is inconsistent with either a mercantilist or imperialist-capitalist agenda. Further, some of these investments (particularly those from Gulf states) were undertaken after U.S. officials visited political entities that sponsor SWFs to "persuade" them to contribute to the global bailout.[20] Clearly, imperialist pressure was not being exerted by the SWFs looking to exploit Western markets; it was more likely exerted against them to force the recapitalization of Western-controlled financial institutions using SWF cash. Therefore, the imperialist-capitalist theory cannot explain these extraordinary investments.

Mercantilism also fails to provide an explanation for extraordinary investments during the financial crisis. These recapitalizations were all made during a period of extreme uncertainty: conservative mercantilists would have disinvested from risky financial institutions fearing the loss of capital, while aggressive risk-taking mercantilists would have demanded large returns in exchange for their investments. The evidence, however, shows that SWFs did not disinvest—instead, they increased their investments in risky Western financials during the crisis.[21] While some have since cut back their investments, they did so only after the urgency of the global financial crisis had subsided.[22] They also did not extract disproportionate benefits: they tended to act like cooperative players in the global economic governance system. The convertible bonds they purchased were preferred relative to those purchased by other equity investors, but were subordinated to later investments made by the U.S. government; also, most SWFs converted their bonds to common shares early[23]—which is inconsistent with the country-level maximization story.

SWF investments in Western financial institutions during the crisis cannot be easily explained as the actions of a rational market investor. While some have argued that investing in vulnerable institutions and subsequent disinvestment in favor of more conservative instruments is perfectly consistent with the rational market investor theory,[24] this ignores the particulars of the investments themselves. When the SWFs invested in Western financial intermediaries, such as Morgan Stanley, Merrill Lynch ("Merrill"), Citigroup or UBS, share prices had already plummeted, and it was fairly clear among sophisticated investors that the bottom could not be identified because exposure to sub-prime mortgages was unknown.[25] Other large players in the

19. Paul Rose, *Sovereign Wealth Fund Investment in the Shadow of Regulation and Politics*, 40 GEO. J. INT'L L. 1207, 1231–35 (2009).

20. For a detailed account of one such bailout, see Katharina Pistor, *Global Network Finance: Institutional Innovation in the Global Financial Marketplace*, 37 J. COMP. ECON. 552, 565 (2009).

21. *Id.* at 558. For a more updated account, see Katharina Pistor, *Sovereign Wealth Funds and Global Financial Governance, in* SOVEREIGN WEALTH FUNDS AND FOREIGN DIRECT INVESTMENT (Karl Sauvant ed., forthcoming 2012).

22. Pistor, *supra* note 20, at 557.

23. *Id.* at 554, tbl.1. One example discussed is the additional capital injection China Investment Corporation gave Morgan Stanley to pay back the TARP money to the U.S. government.

24. Langland, *supra* note 14, at 265.

25. Indeed, the reason financial intermediaries turned to SWFs was that they were unable to secure sufficient funds to recapitalize at the time. Note also that Barclays, a bank that had largely escaped the problems associated with asset-backed securities, tried to launch a public offer in the summer of 2008. That offer was heavily undersubscribed. Only commitments secured from sovereign investors (e.g., Temasek, China Development Bank and Qatar Investment Authority) to acquire the unsubscribed share ensured that the capital increase succeeded. When Barclays needed more funds in the fall of 2008, it therefore went straight to sovereign investors. For details, see generally Pistor, *supra* note 20.

financial system were refusing to invest in the financials under any terms.[26] In this environment, SWFs made huge investments concentrated in particular Western financials rather than spreading the investment across the industry (contrary to their normal investment patterns) and made the investment decisions extremely quickly. For example, the Abu Dhabi Investment Authority ("ADIA") invested billions in Citigroup less than forty-eight hours after a visit from Robert Rubin—former U.S. Treasury Secretary and then-director at Citigroup. Further, the fact that all SWFs incurred large losses as the result of these investments weighs against the market investor theory: either they were easily misled "dumb money" or they had some other common reason to invest in Western financials beyond financial returns. Given that SWFs have historically performed well,[27] we reject the "dumb money" explanation and instead conclude that the SWFs are not always market investors.

Another important attribute of SWFs is that they recycle dollars from Eastern exporters to the West.[28] This is consistent with an imperialist-capitalist theory but inconsistent with the other two theories. Imperialist-capitalists should prefer equities in foreign markets to secure influence abroad and dollar recycling is consistent with this behavior. Mercantilism, however, favors the accumulation of capital inside national borders, so sending large quantities of the international reserve currency back to the West would be anathema to mercantilist goals. Market investors should invest in the highest-returning opportunities available and diversify against currency risks; SWFs, however, are heavily invested in dollar-denominated assets to the extent that they are overexposed to the dollar.[29] Therefore, neither the mercantilism theory nor the market investor theory provides an explanation for why SWFs so consistently recycle dollars to the West.

SWFs also use their funds to pacify domestic constituencies. In some countries, new SWFs have been established to expand the institutional space such that potential rivals for political authority are placated.[30] In other countries, the proceeds of investments have been used to fund current government expenditures during times of crisis.[31] None of the existing theories can explain this behavior. Mercantilist institutions should maximize country-level benefits—not allocate benefits within the country to preferred groups. The allocation of funds domestically is beyond the scope of imperialist-capitalist theory, but to the extent that these institutions should be seeking to maximize profit by taking advantage of opportunities outside the domestic econ-

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26. While SWFs do benefit from favorable tax treatment in the United States, *see* I.R.C. § 892 (2011), such that they should value U.S. equities more highly than either domestic investors or foreign private investors do, *see* Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440, 442 (2009), the complete lack of interest from non-sovereign sources suggests that a simple valuation gap was not the sole explanation.

27. It is difficult to get an accurate account of their performance because only a few SWFs make their performance data publicly available. However, a careful assessment of the performance of SWFs prior to the global financial crisis shows that SWFs have highly diversified portfolios, invest in the long term and frequently invest in slightly riskier assets than the average institutional investor. The assessment was conducted by Monitor, a Boston-based consulting group, and was based on transactions for which public information is available (i.e., when they invest in securities that are registered and reported on). *See* MONITOR GROUP, *supra* note 16, at 33, 35–40, 56, 70.

28. *See infra* Part III.C (discussing the SWFs of Singapore).

29. This follows largely from the fact that they use foreign exchange earnings from oil exports and consumer product exports to finance their investments. For details, see *infra* Part II (analyzing the origins and behavior of SWFs in case studies).

30. *See, e.g.*, *infra* Part III.B (analyzing SWFs in Abu Dhabi).

31. During the Arab uprising of 2011, for example, Saudi Arabia launched a $35 billion program for domestic investment to appease its population. *See* Abeer Allam, *Saudi 'Royal Gift' Fails to Woo Activists*, FIN. TIMES (Feb. 25, 2011), http://www.ft.com/ intl/cms/s/0/b02f1ffa-3f62-11e0-8e48-00144feabdc0.html#axzz1Y2YES2sX.

omy, the use of funds inside the SWF sovereign sponsor is inconsistent with expected behaviors. Lastly, the market investor theory does not explain this behavior either. Market investors would neither allocate fund-management responsibilities based on political concerns nor draw down capital to fund current expenditures.

Finally, SWFs' *domestic* investment decisions are sometimes heavily politicized. SWFs themselves admit that non-financial motivations influence domestic investment decisions.[32] Less publicly, SWFs often take large minority stakes in domestic companies controlled by members of the existing elite and their allies; SWF-owned domestic financial institutions also provide extremely favorable lending facilities to the local merchant class on a "name-basis."[33] These actions prey on existing wealth and fail to maximize either country-level benefits or financial returns accruing to the SWF.

As shown above, none of the existing theories about SWF objectives and motivations explains the breadth of their documented behavior. SWFs generally adopt a passive and diversified investment strategy in foreign markets, but they made extraordinary and highly risky investments in Western financial institutions during the financial crisis.[34] They also recycle dollars to the West,[35] make politicized domestic investments and use funds to pacify domestic constituencies.[36] Since none of the existing theories can explain all of these behaviors, a full understanding of SWFs requires a new theory about their institutional interests.

B. Autonomy Maximization

We offer a new theory of SWF objectives and motivations. We argue that SWFs act to maximize the domestic autonomy of the ruling elite in the sovereign sponsor. As mentioned above, SWFs are government-owned and controlled and have no outside beneficiaries or liabilities beyond the government itself, so they are responsive to the expressed interests and objectives of the government. There are competing conceptions of what constitutes "governmental interest" in a democratic society, but a discussion of public choice versus public interest politics is beyond the scope of this article. In political entities without representative democracy or where the institutions of democracy are clearly subordinate to authoritarian rule, such as China, Singa-

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32. Economic diversification, creation of employment opportunities for nationals and economic development all play into domestic investments. Even the lauded Norwegian Government Pension Fund explicitly invests according to a political agenda: it will not invest in weapons manufacturers, alcohol or tobacco producers, or firms that do not meet its labor relations standards. NORWEGIAN GOV'T PENSION FUND, GUIDELINES FOR THE OBSERVATION AND EXCLUSION OF COMPANIES FROM THE GOVERNMENT PENSION FUND GLOBAL'S INVESTMENT UNIVERSE § 2 (2010), *available at* http://www.regjeringen.no/en/sub /styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.

33. For an example of the consequences of loose lending policies like "name-lending," see the massive write-downs by numerous SWF-controlled Middle Eastern banking institutions occasioned by the collapse of the Saad Group in 2009, *Defaults: Islamic Finance in Uncharted Territory*, REUTERS, Nov. 5, 2009, *available at* http://www.reuters.com/article/2009/11/05/islamic-defaults-idUSKLR44503820091105, and the subsequent backstopping of those banks by SWF sovereign sponsors' deposits, particularly by increasing the level of government cash deposited in troubled banks. *See Government Deposits with Banks up Dh15bn*, EMIRATES 24/7 (Sept. 28, 2010), http://www.emirates247.com/business/economy-finance/government-deposits-with-banks-up-dh15bn-2010-09-28-1.296464.

34. *See* discussion *infra* pp. 21, 31, 45, 53.

35. *See* discussion *infra* p. 24.

36. *See infra* pp. 19, 23, 26, 29, 31, 37 n.185, 43, 52.

pore,[37] Kuwait[38] and Abu Dhabi, the government is comprised of ruling elites who are not directly accountable to the public in general; it is easy to see how "governmental interest" becomes tied to the personal interests of the ruling elite. Indeed, the internal governance structures of the SWFs themselves ensure that SWF management is directly accountable to the ruling elite in each sovereign sponsor.[39] Consequently, it is unsurprising that SWFs can be, and are, wielded to advance the interests of those elites. First and foremost among these interests is the maintenance of their privileged position, which is characterized by autonomy within the sovereign sponsor. We argue that SWF actions that are inconsistent with existing theories can be explained under our autonomy-maximization theory.

	Mercantilism	**Imperialist-Capitalism**	**Market Investor**	**Autonomy-Maximization**
Passive outward investments	X	X	✓	✓
Extraordinary outward investments	X	X	X	✓
Dollar recycling	X	✓	X	✓
Revenues used to pacify domestic constituencies	X	X	X	✓
Politicized domestic investments	X	X	X	✓

A passive outward investment strategy is consistent with autonomy-maximizing behavior. First, passive investments are less likely to incur the ire of "more powerful" states—either in the form of protectionist regulation against foreign investment or more active interventions into SWF sovereign sponsors—ensuring that Western capital markets remain open to future SWF investment. Further, insofar as generating wealth is conducive to increasing domestic autonomy,[40] the ability of a passive investment strategy to maximize wealth is consistent with autonomy-maximization.

The extraordinary investments made by SWFs during the financial crisis are also consistent with the behavior of autonomy-maximizing institutions. Among the elite in the Gulf States, there is an implicit understanding that the security umbrella provided by the United States is not completely free. Therefore, in order to secure their continued control over the state in the long term (i.e., to protect their domestic autonomy), the ruling elite act to meet American demands

37. While Singapore's government structure is that of a parliamentary democracy, functionally it combines authoritarian and democratic institutions to form a hybrid system of governance sometimes referred to as "non-representative democracy."

38. In Kuwait, the Parliament is formally subordinate to the Emir.

39. See *infra* notes 77–79, 138–141, 205–222, 264–276 and accompanying discussion.

40. Increased wealth provides the existing elites with a greater capacity to buy out potential rivals and reward their supporters, ensuring their continued autonomy in the domestic sphere.

from time to time.[41] Directing SWF investment toward the rescue of Western financial institutions is quite consistent with protecting long-term autonomy in this sense.[42] Further, if the SWFs had refused to assist in recapitalizing Western financial institutions, they might have been rejected as partners in the system of global economic governance, which would have reduced policy options for the elite in the future.

Dollar recycling, too, is part of a commitment to Western states, but it is also critical for sustaining the domestic industrial policy choices that the elite in SWF sovereign sponsors have adopted. For both export and commodity-funded SWFs, a failure to recycle dollars would reduce Western purchasing power and erode their own funding streams as export values decline. In the smaller SWF sovereign sponsors, a failure to recycle dollars may even result in Western-backed regime change.[43] Therefore, SWFs' decisions to concentrate investments in dollar-denominated assets is consistent with autonomy-maximization.

Autonomy-maximization also explains the use of revenues to pacify domestic constituencies. The multiplication of SWFs in some sovereign sponsors provides potentially rivalrous actors within the sovereign sponsor with large capital pools of their own, aligning their interests with those of the ruling elite. This improves the security of the ruling elite, increasing their autonomy, as remaining political rivals will have fewer allies. Further, a drawdown on capital assets during times of crisis is consistent with autonomy-maximization; by spending money to meet government payrolls even during emergencies, the ruling elites are able to buy the continued loyalty of the population, improving their own ability to act freely after the end of the emergency.

Similarly, the politicized nature of domestic investments can be explained by autonomy-maximization. Favorable loans and large minority investments function to buy out potential political rivals, ensuring that they do not enter politics. This ensures that existing elites have little competition for political power and increases the range of domestic policy choices that are available without causing political unrest. Investing domestically in businesses that are labor-intensive tends to reduce political opposition among the masses. Taking a controlling stake in domestic financial institutions ensures that the existing elite will structure the economic development of the sovereign sponsor (protecting their autonomy in this area of domestic policy).

Overall, we argue SWF behavior can be explained by our autonomy-maximization theory. Our theory is related to but distinguishable from the sovereignty-maximization theory ad-

41. Consider that even the 1970s oil embargo was, as Halliday puts it, "lifted before any of the original conditions for its being ended had been met: not an inch of Palestinian soil had been returned." FRED HALLIDAY, ARABIA WITHOUT SULTANS 20–21 (1974). He goes on to describe how relations between the Gulf States and the West had moved past the posturing, and a compromise was apparently struck in which OPEC was allowed to maintain higher oil prices, but the oil-producing states of the Arabian Peninsula tacitly committed to investing in the West, purchasing significant amounts of western military equipment and paying for economic and military assistance from the United States. *Id.* at 39. For a detailed account of explicit bargaining between Arab tribal leaders and western powers during World War I and during the inter-war period, see generally ASKAR H. AL-ENAZY, THE CREATION OF SAUDI ARABIA: IBN SAUD AND BRITISH IMPERIAL POLICY, 1914–1927 (2010).

42. Indeed, military exports to non-Chinese SWF sovereign sponsors increased after the recapitalizations. *See SIPRI Arms Transfer Database*, STOCKHOLM INT'L PEACE RESEARCH INST., http://armstrade.sipri.org/armstrade/page/trade_register.php (last visited Oct. 14, 2011) (recipient register used to generate data).

43. In Abu Dhabi, Sheikh Shakbout's obsession with hoarding gold and refusal to recycle the proceeds of oil exports back into the global economy led the British to provide support for the 1966 coup led by his brother, Sheikh Zayed al Nahyan. HALLIDAY, *supra* note 41, at 464.

vanced by Dixon and Monk.[44] While their theory, like ours, acknowledges that SWFs are tools that can be used to advance the interests of their sponsors,[45] in our view they fall somewhat short in completing this chain of analysis by resting on the "state" as the sponsor. We argue that the true stakeholders in the SWFs analyzed in this paper are the ruling elites in the sovereign sponsor, and that as such, it is the interests of these elites that SWFs advance. To these elites, SWFs serve as a valuable tool for protecting their interests. Limiting the interests of the ruling elite to state sovereignty, as would be necessary to justify a singular focus on sovereignty-maximization, appears to miss the complex geopolitical and geoeconomic conditions to which these elites feel compelled to respond. In fact, one can point to instances where the elites have been quite willing to compromise on their monopoly on the legitimate use of force within state borders (the key aspect of Westphalian sovereignty) but not control over SWFs.[46]

III. CASE STUDIES

In this section we offer more detailed evidence in support of our theory drawing on the history and operation of SWFs from the Gulf States (Abu Dhabi and Kuwait) and the Far East (Singapore and China). The Sovereign Wealth Fund Institute, an organization that tracks SWFs,[47] currently estimates these entities' SWFs account for more than half of the assets managed by SWFs worldwide—or about $2.8 trillion.[48] They also comprise four of the six top SWF sovereign sponsors as measured by fund size.[49] Saudi Arabia is listed as sponsoring the third-largest SWF, but the Saudi Arabian Monetary Authority holds a substantial portion of its funds in low-risk assets, such as sovereign debt instruments.[50] All four political entities selected are less than fully democratic[51] and as such are representative of the majority of countries that have sponsored SWFs to date. Indeed, the only fully democratic country among those sponsoring one of the ten largest SWFs is Norway.[52] The political entities selected also exemplify the core funding mechanisms for SWFs: the accumulation of vast foreign exchange reserves as a result of substantial trade surplus and/or commodity exports.

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44. Dixon & Monk, *supra* note 2.

45. *Id.*

46. The most obvious example is the establishment of both semi-permanent military bases and forward operating locations for the U.S. military in Kuwait, the U.A.E. and Singapore. *See Military Bases Directory*, MILITARY AVIATION—U.S AIR FORCE, NAVY, MARINES, ARMY, MILITARY BASES (Feb. 13, 2011), http://www.globemaster.de/ regbases.html. Even as Kuwait's al Sabah family pleaded for international forces to restore it to power in Kuwait during the Gulf War, it retained total control of KIA assets.

47. *See Sovereign Wealth Fund Rankings*, SOVEREIGN WEALTH FUND INST., http:// www.swfinstitute.org/fund-rankings/ (last visited Feb. 15, 2012).

48. *Sovereign Wealth Fund Rankings*, SWF INST., http://www.swfinstitute.org/fund-rankings/ (last updated Dec. 2011).

49. *Id.*

50. *SAMA Foreign Holdings*, SWF INST., http://www.swfinstitute.org/swfs/sama-foreign-holdings/ (last visited Jan. 17, 2012).

51. *See supra* notes 37, 38.

52. *Sovereign Wealth Fund Rankings*, *supra* note 48.

A. Kuwait

For hundreds of years, autonomy has been a concern for the rulers of Kuwait. Situated as it is on the best natural harbor in the Persian Gulf and surrounded by Saudi Arabia, Iraq and Iran, the implicit threat of invasion has always loomed large.[53] Further, the royal position of the al Sabah was secured only by support from tribal leaders and the merchant class, which significantly constrained royal privileges since both tribes and merchants in the historical Gulf were highly mobile.[54] Whereas the al Sabah Emir once sent tributary payments to the Ottomans,[55] guaranteed the safety of British trade ships[56] and privately bestowed gifts on tribal allies and merchants to secure royal autonomy,[57] the modern bargain revolves around the allocation of oil revenues.

The creation of a sovereign wealth fund in Kuwait served to increase the autonomy of the al Sabah family, as did the replacement of the Kuwait Investment Board with the Kuwait Investment Office and its later supersession by the Kuwait Investment Authority ("KIA"). The KIA's subsequent actions reflect an objective of autonomy-maximization. The drawdown on KIA funds during the Persian Gulf War, domestic investments in companies owned by the merchant class and the investments in Citigroup and Merrill Lynch are all autonomy-maximizing activities.

The Kuwait Investment Authority is the primary sovereign wealth fund in Kuwait and manages both the Future Generations Fund ("FGF") and General Revenue Fund ("GRF") for the state. Both the KIA and its funding are statutorily decreed. Kuwait's FGF was established by Kuwait's Crown Prince and Finance Minister in Law Decree Number 106 of 1976, which permanently allocated ten percent of Kuwait's annual general revenues to the FGF and prohibited any reduction of this percentage or withdrawal of funds from the account.[58] In 1984, the KIA was created by another royal decree to manage the FGF and GRF.[59] Both of these decisions were autonomy maximizing.

The FGF was created in 1976, though the concept of a SWF in Kuwait can be traced back to 1953 when the Kuwait Investment Board ("KIB") was established.[60] The KIB was replaced

53. The al Sabah have proven that their preferred strategy is seeking out protection from a Great Power, which provides for effective deterrence while leaving domestic autonomy basically untouched. For example, this was the bargain that was expressly struck with the Ottoman and British Empires. *See infra* notes 55–57 and accompanying discussion.

54. If the Emir acted against the tribes or merchants, they would simply pack up and move to the territory of another Emir within the Gulf region—thereby depriving the Emir of tax revenues and military strength.

55. *See* ALAN RUSH, AL SABAH: HISTORY & GENEALOGY OF KUWAIT'S RULING FAMILY, 1754–1987, at 176 n.10 (1987); *see also* ROBIN BIDWELL, THE AFFAIRS OF KUWAIT: 1896–1905, at 8 (1971).

56. *See* GÖKHAN BACIK, HYBRID SOVEREIGNTY IN THE ARAB MIDDLE EAST: THE CASES OF KUWAIT, JORDAN, AND IRAQ 65 (2008).

57. *See* MICHAEL S. CASEY, THE HISTORY OF KUWAIT 41 (2007).

58. See the translation of Law Decree No. 106 for the year 1976 concerning the Reserves for Future Generations, Arts. 1–3 (1976), *Overview of Funds*, KUWAIT INV. AUTH., http://www.kia.gov.kw/En/About_KIA/Overview_of_Funds/Pages/default.aspx (last visited Sept. 16, 2011).

59. *See History of the KIO*, KUWAIT INV. AUTH., http://www.kia.gov.kw/En/KIO/ About/Pages/default.aspx (last visited Jan. 20, 2012). KIA is the parent company of the Kuwait Investment Office (KIO).

60. *Kuwait Investment Authority*, SWF INSTITUTE, http://www.swfinstitute.org/swfs/ kuwait-investment-authority/ (last visited Sept. 18, 2011).

by the Kuwait Investment Office ("KIO") after Kuwaiti independence in 1961.[61] The KIO was created to manage surplus oil revenues, and the FGF was designed for the same function.[62]

One might ask why Kuwait was extracting oil at levels that would create a budget surplus, but this is outside the scope of this paper.[63] Regardless of the motive, oil revenues must be allocated in some fashion. It is likely that the fledgling nation of Kuwait would have happily gone along with the status quo (in which the Emir funded the state apparatus out of his personal coffers, bribed prominent merchants to stay out of politics and directly collected oil concession revenues from Western oil companies). The creation of a sovereign wealth fund, however, maximized the autonomy of the al Sabah relative to other options.

First, separating the private affairs of the ruling family and the public affairs of the state is a strong signaling mechanism in the formation of the modern nation-state. If the al Sabah family had continued to deposit oil revenues into their personal bank accounts, then the international community would not have seen the oil reserves as "sovereign." Consequently, nationalization of oil reserves would have been labeled more accurately as private theft and the recognition of the "statehood" of Kuwait, both internationally and domestically, might have been called into question, increasing the likelihood of foreign invasion or a democratic revolution.[64]

Second, while the al Sabah could have separated the public and private spheres by transferring natural resource wealth to their subjects, it would not have been acceptable to the individuals within the royal family to transfer "their" oil wealth to the public at large. It would essentially have converted a royally-controlled and monopolized resource (oil) into a resource freely distributable among the nation (cash). This likely would have shifted the domestic balance of power in Kuwait and Abu Dhabi toward the merchant class, which would have benefited dramatically from the increased demand for tradable goods. Thus, the only option that protected

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61. *See* NIGEL ANDREW CHALK ET AL., INT'L MONETARY FUND, KUWAIT: FROM RECONSTRUCTION TO ACCUMULATION FOR FUTURE GENERATIONS 29 (1997); *History of the KIO*, *supra* note 59.

62. *See History of the KIO*, *supra* note 59.

63. As Halliday points out, it is "irrational for states that [are] unable to absorb their revenues to produce above a certain level" because oil reserves increase in value as global supplies diminish—enabling later producers to capture higher profits. FRANK HALLIDAY, ARABIA WITHOUT SULTANS 421 (1974). For small Gulf States like Kuwait and the U.A.E., the oil surplus could not possibly be fully allocated to the government's current accounts because there was simply not enough to spend it on. It is probably sufficient to note that the fiscal surpluses enjoyed by the Gulf States are the result of production policies designed to keep global oil prices low, and that once created, these surpluses must be allocated to something. Whether these policies are the result of Western political pressure or self-interested choices aimed at disincentivizing the development of hydrocarbon alternatives is best left for analysis elsewhere. Today, given high production rates, efficiency concerns mandate that states' returns on extractive revenues at least equal the projected capital gains on oil reserves minus the net of marginal extraction costs. *See* Frederick Van der Ploeg, *Why Do Many Resource-Rich Countries Have Negative Genuine Saving? Anticipation of Better Times or Rapacious Rent Seeking*, at 5–7 (Centre for Economic Policy Research Discussion Paper No. DP7021, Oct. 2008), *available at* http://ssrn.com/paper=1311145.

64. In light of recent events in North Africa, the salience of this point is even more apparent. The Tunisian and Egyptian revolutions have prompted Swiss authorities to freeze the Swiss personal bank accounts of Zine al-Abidine Ben Ali and Hosni Mubarak, respectively, over concerns about corruption. Adam Levine, *Mubarak Assets Frozen by Swiss Government*, CNN (Feb. 11, 2011), http://money.cnn.com/2011/02/11/news/ international/swiss_banks_mubarak/index.htm; *Switzerland Freezes Assets of Zine Al-Abidine Ben Ali and Laurent Gbagbo*, GUARDIAN (Jan. 19, 2011), http://www.guardian.co.uk /world/2011/jan/19/switzerland-freezes-assets-ben-ali-gbagbo. By concentrating wealth in personal accounts, these former leaders compromised internal legitimacy (illustrated by the widespread domestic belief that their regimes were corrupt) and made the funds they had amassed dependent on continued control of the state. Although no situation has presented itself to test the resilience of elite control of SWFs in the context of regime change, it stands to reason that the formalities of corporate governance would provide at least some temporary buffer against asset seizure.

both the international security and domestic power of the royal family was to dedicate oil revenues to the public sector.

There was, however, a secondary decision to be made on the ratio of public spending to public savings. It was immediately clear in Kuwait that very high savings rates were not likely to be accepted by opposition groups; at least some portion of oil revenues was needed to buy off the merchant class. High public spending levels could have potentially increased buy-in to the national identity and loyalty to the al Sabah family if expansive government institutions were created to provide civil service positions, welfare payments and subsidized services to citizens. Indeed, in Kuwait and other Gulf states, large bureaucracies were created;[65] however, as soon as public funds are spent, even through "loyalty-building" civil service structures and subsidies, royal control dissipates. Further, oil reserves are not unlimited, so public spending is not a sustainable model for ensuring the continuous provision of "loyalty-building" services and subsidies.

In contrast, public savings are still controlled by the state, which is dominated by the royal family and its agents. Therefore, the royal influence and control created by public ownership of oil is preserved when oil revenues are allocated to a SWF. The KIA essentially transforms a natural resource monopoly into an "effective monopoly on capital."[66] When Kuwait's oil reserves eventually stop producing, the al Sabah will still have control over the most important wealth-generating asset in the country. This will leave the royal family financially autonomous; it will not have to rely on the merchant class or the general public for taxes, ensuring that these groups do not gain political leverage. It will also ensure that the general public remains mostly dependent on the state for income. Given investment income from the SWF, it will remain possible to continue paying citizens high wages to work for a few hours a day in the civil service and making direct cash subsidies. Thus, the decision to create a SWF is consistent with the royal interest in protecting its position of financial and political privilege (i.e., its domestic autonomy).

In choosing to create a SWF rather than simply sitting on a horde of dollars, Kuwait also satisfied Western powers that were concerned about their balance of payments. As early as the 1950s, the KIB played a significant role in the Eurodollar market,[67] and investments by the KIB, KIO and KIA have been critical to managing the balance of payments between Kuwait and the West.[68] Investing dollars abroad is fundamentally opposed to a mercantilist agenda[69] but is quite

65. *Kuwait Country Report*, BERTELSMANN TRANSFORMATION INDEX 2010, http://www. bertelsmann-transformation-index.de/1397.0.html (last visited Sept. 16, 2011) ("The state bureaucracy is functional, but bloated; many positions were created to provide employment for Kuwaiti citizens.").

66. To be sure, public spending does shift some wealth to the private sector, but the sheer size of the KIA's reserves and the strategic positions it holds in domestic financial institutions tend to ensure that it will remain the dominant player in the Kuwaiti economy (after the Kuwait Oil Company, of course). Further, unlike other institutional investment managers, SWFs like the KIA are not subject to the threat of asset withdrawal; therefore, the KIA is not as sensitive to demands for market returns. This enables the KIA to invest in projects with below-market financial returns (which are addressed below), providing cheap capital to political allies domestically and abroad.

67. *See* JEAN FRANCOIS SEZNEC, THE FINANCIAL MARKETS OF THE ARABIAN GULF 61 (1987).

68. *See Provisional Balance of Payments Statistics of the State of Kuwait for Year 2005*, CENTRAL BANK OF KUWAIT, http://www.cbk.gov.kw/cbkweb/servlet/cbkNewsMain? Action=newsdisp&id=1022 (last visited Oct. 14, 2011) (see especially the line item "Financial Account" in the table).

69. Reinvesting dollars abroad exchanges capital reserves for legal rights governed by foreign law and thus runs counter to the mercantilist goal of accumulating capital assets. *See* MUN *supra* note 4 and accompanying text.

consistent with an autonomy-seeking goal. Without a sovereign wealth fund to invest in oil surpluses outside Kuwait, there likely would have been a severe backlash by the West against both Kuwait's independence and its nationalization of the oil sector.

The transformation of the KIB to the KIO, then to the FGF and eventually to the KIA also increased the autonomy of the al Sabah. Regarding the transition between the KIB and KIO, it is clear that replacing the British-controlled KIB with the Kuwaiti-controlled KIO was essential to increasing Kuwait's autonomy. After gaining independence, seeking to control all of Kuwait's accumulated surplus capital (rather than leaving it in a pseudo-trust administered by the British) was only natural. The FGF was established in 1976 when the Kuwait Oil Company was nationalized;[70] thus, dramatically increased revenues were expected to pour into the state coffers. By forming the FGF, the al Sabah deflected the inevitable pressure to increase public spending by dedicating half of all accumulated assets and ten percent of all future oil revenues to the sovereign wealth fund. This protected royal autonomy on public spending decisions. It also legitimized the decision to allocate oil revenues to the public sector by justifying the fund as being created to benefit future generations of Kuwaiti citizens, rather than simply "Kuwait."

The FGF was, however, mostly focused on investments outside of Kuwait. When the 1982 Souk al Manakh stock market crash threatened the survival of almost every large company in Kuwait, the government stepped in to purchase shares in the traded companies from the public,[71] and a new entity was needed to manage these companies. Thus, the KIA was born. While the KIA has since partially privatized or reduced its holdings in these companies,[72] it is clear that it was formed to facilitate the transfer of funds that had been dedicated to international investments to a program designed to prop up the domestic economy (and stabilize the resulting political unrest). Housing both international and domestic investment management functions within the KIA ensured that potential future domestic crises could be averted more quietly. Interestingly, the legislation that created the KIA in 1982 prohibits the disclosure of any information about the organization or its performance to the public—at the penalty of up to three years in prison[73]—cementing the autonomy of the al Sabah to direct the KIA as they please.

From the board of directors to its funding mechanisms, the institutional structure of the KIA functions to protect royal autonomy. The KIA is led by Managing Director Bader Mohammad al Sa'ad, Executive Director of Operations and Administration Othman al Essa and Bader al Ajeel, Executive Director of General Reserves.[74] It is overseen by a board of directors that is chaired by Mustafa Jassem al Shimali and also includes Sheikh Salem Abdulaziz al Sabah, Bader Mohammad al Sa'ad, Khalid al Rowaieh and Khalifa Musaad Hamada.[75] Board member-

70. *Background Note: Kuwait*, U.S. DEP'T OF STATE: BUREAU OF NEAR E. AFF. (Mar. 17, 2011), http://www.state.gov/r/pa/ei/bgn/35876.htm ("In 1976, the Kuwaiti Government nationalized KOC.").

71. John F. Wilson & Alexei P. Kireyev, *The Kuwaiti Financial System: Structure and Experience*, *in* KUWAIT: FROM RECONSTRUCTION TO ACCUMULATION FOR FUTURE GENERATIONS, *supra* note 61, at 29.

72. *Id.*

73. Kuwait Law No. 47 of 1982.

74. *Executive Management*, KUWAIT INV. AUTH., http://www.kia.gov.kw/En/About_KIA/OrganizationalStructure/Org_Str_EM/Pages/default.aspx (last visited Sept. 16, 2011).

75. *Board of Directors*, KUWAIT INV. AUTH., http://www.kia.gov.kw/En/About_KIA/OrganizationalStructure/Org_Str_BOD/Pages/default.aspx (last visited Jan. 20, 2012); *Executive Management*, KUWAIT INV. AUTH., http://www.kia.gov.kw/En/About_KIA/ OrganizationalStructure/Org_Str_EM/Pages/default.aspx (last visited Jan. 20, 2012); *Kuwait Investment Authority: Board Members*, BLOOMBERG BUS. WEEK, http://investing

ship is allocated on an *ex officio* basis to the Governor of the Central Bank, the Minister of Finance (who holds the Chairmanship), the undersecretary of the Ministry of Finance and customarily to the Minister of Oil. Additional seats are filled by prominent Kuwaitis with experience in investment management, at least three of whom must not concurrently hold a government position. The majority of the KIA's directors must be from the private sector.[76]

Thus, the KIA board of directors lacks the prominent royal membership that characterizes SWFs in Abu Dhabi. However, this does not necessarily indicate any large degree of independence from the royal family. The Governor of the Central Bank, Minister of Finance, Minister of Oil and Undersecretary of the Ministry of Finance are all appointed by the Emir and the Prime Minister (who is generally also the Crown Prince). Even the requirement for a "majority-private sector" board is tempered by the appointment process, which the al Sabahs control; appointment of Board Members is executed through an Emiri decree.[77]

Thus, despite a thin veneer of independence provided by the presence of non-royal directors, the fact that directors are appointed by the Emir and Prime Minister indicates that, in Western parlance, the true shareholder in the KIA is the al Sabah family.[78] Further, since there is no need to engage in any kind of proxy fight or to even call a general shareholder meeting to effect the will of this shareholder, the directors can be fired at any time. Similarly, there is no "for cause" restriction on termination in the organizing documents of the KIA.[79] Thus, the Emir maintains unqualified and instantaneous control over the KIA and the power to direct KIA investment choices if necessary.

In Kuwait, funding to the KIA is statutorily decreed. The GRF was created in 1960 with funding to be drawn from budget surpluses.[80] Article 2 of Law 106 of 1976 dedicated fifty percent of the GRF as seed capital to the FGF. Article 1 additionally permanently allocated ten percent of Kuwait's annual general revenues to the FGF and prohibited any reduction of this percentage or withdrawal of funds from the account.[81] This may seem to reduce royal control over funding; however, given that the Emir retains a veto over all new legislation, he has the power to propose legislation himself and can dissolve the Assembly, the future of Law 106 of 1976 effectively rests in the hands of the Emir (and thus the al Sabah family). Further, the Emir may

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.businessweek.com/businessweek/research/stocks/private/board.asp?privcapId=21922514 (last visited Nov. 21, 2011).

76. *Governance at KIA*, KUWAIT INV. AUTH., http://www.kia.gov.kw/En/About_KIA/ Governance/Pages/default.aspx (last visited Sept. 16, 2011).

77. *Board of Directors, supra* note 75.

78. Even if one were to deem the KIA a subsidiary of the state, the fact that the royal family appoints the KIA directors and has a monopoly on executive power as a matter of right (rather than through an election by the public at large) indicates that the "directors" (the al Sabahs) of the "parent company" (Kuwait) cannot be replaced. *See id.* Thus, the shareholders whose interests are represented in the KIA are simply the al Sabahs.

79. Note that whereas it is theoretically possible under the corporate law of Delaware—the leading place of incorporation for U.S. firms—to fire directors, *see* DEL. CODE ANN. tit. 8, § 141 (2011), it is in practice rather difficult due to the widely diffused ownership base of most public corporations, the associated collective action problems and the array of defenses available to the Board, including staggered boards. For a recent empirical analysis of the effects of these devices on shareholder wealth, see generally Lucian A. Bebchuck, et al., *Staggered Boards and the Wealth of Shareholders: Evidence from Two Natural Experiments*, *in* HARVARD LAW AND ECONOMICS DISCUSSION PAPER NO. 697, 2010, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1706806.

80. Robert Bacon & Silvana Tordo, *Experiences with Oil Funds: Institutional and Financial Aspects, Report 321/06*, ENERGY SECTOR MGMT. ASSIST. PROGRAM (June 2006), http://www.earthrights.net/docs/World BankResourceRentFunds.pdf.

81. Kuwait Law No. 106 of 1976.

promulgate a royal decree pursuant to the law without Assembly approval. Here, regulatory decrees are rather important, as the ban on "withdrawal of funds" has been narrowly interpreted in the past.

This brings up one of the clearest examples of the KIA acting to maximize autonomy: the drawdown on FGF funds that occurred during the Persian Gulf War. At the time of the Iraqi invasion of Kuwait, Kuwait's Assembly had been dissolved for four years—so it could not possibly have approved any withdrawals from the FGF during the war. However, accumulated savings from the FGF were used to provide short-term financing required by the heavy strain placed on the economy by the Gulf War.[82] The al Sabah additionally paid millions to American public relations firms to drum up support for a U.S.-led invasion of Kuwait to expel Iraq's army.[83] Additionally, after the allied coalition defeated the Iraqi forces and reinstalled the al Sabah family, the FGF was used to fund reconstruction efforts and provide direct subsidies to Kuwaiti citizens.[84] Granted, an invasion is an extraordinary circumstance, but Sheikh Jaber's actions in utilizing FGF funds were contrary to the express restrictions in Article 1 of Law 106 of 1976 because the Assembly did not approve them. Furthermore, none of these actions were consistent with the KIA's professed mission of "achiev[ing] long term investment returns on the financial reserves of the State of Kuwait."[85] They were, however, consistent with autonomy-maximization.

Using FGF funds to continue payments to the civil service was a remarkably astute way to ensure the loyalty of the bureaucracy during the exile. Absent these payments, support for the al Sabah regime could easily have waned in favor of establishing a more powerful legislature since tensions had been running high prior to the invasion. Similarly, buying up the debt of Kuwaiti citizens (and eventually forgiving most of it) ensured that citizens would not lose their homes due to non-payment of their obligations. While an argument could be made that using FGF funds to pay for the reconstruction of Kuwait's oil infrastructure was consistent with achieving long-term investment returns (because oil production is Kuwait's most profitable investment[86]), given the availability of extensive international loans at the time, Kuwait probably could have borrowed money at rates below the returns on its international portfolio. Spending from the FGF, however, emphasized the competence (and "generosity") of the al Sabahs, while borrowing from the international community would have been a signal of weakness to the Kuwaiti population. As a consequence of using FGF funds, the legitimacy of the al Sabahs was protected, thereby securing their domestic autonomy in the long term.

Domestically, the KIA invests in a manner that effectively buys out the political ambitions of the merchant class. The KIA has a history of investing in the businesses of prominent

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82. Bacon & Tordo, *supra* note 80, at 118.

83. *See* JOHN STAUBER & SHELDON RAMPTON, TOXIC SLUDGE IS GOOD FOR YOU: LIES, DAMN LIES, AND THE PUBLIC RELATIONS INDUSTRY § 10 (2002).

84. FED. RESEARCH DIV., KUWAIT: A COUNTRY STUDY 122 (1993).

85. *Mission and Principles*, KUWAIT INVESTMENT AUTHORITY 6–7, http://www.kia.gov.kw/En/About_KIA/Mission_Principles/Pages/default.aspx (last visited Oct. 29, 2011).

86. However, oil is not its biggest revenue producer: by the mid-1980s, the KIA's foreign investments had already surpassed oil exports as Kuwait's primary source of revenues. *Kuwait*, ENCYCLOPEDIA BRITANNICA, *available at* http://www.britannica.com/ EBchecked/topic/325644/Kuwait/45147/Economy ("This oil income and the investment income it generated—the latter surpassed direct sales of oil revenues by the 1980s—gave Kuwait one of the highest per capita incomes in the world.").

merchant families within Kuwait. While this kind of investment would not normally reflect a non-financial motive, it does suggest autonomy-maximization in the Kuwaiti context. As discussed earlier, the merchant class is a potential rival for political power in Kuwait. As early as 1950, Sheikh Abdullah al Sabah "bought out" the political ambitions of the merchant class by granting preferential monopolies, dealerships, extending personal loans and withdrawing the al Sabah family from Kuwaiti commercial activity.[87] The continued allocation of oil revenues to the merchant class through KIA's domestic investment reflects the ongoing arrangement between the al Sabahs and Kuwait's merchants: KIA funds are invested, few demands are made for dividends (as long as the family remains pliant) and shares are rarely sold. When this politicized domestic investment activity slowed during the 1980s as a result of depressed oil prices, Kuwait's merchants re-entered the political scene. In 1989, prominent members of the merchant class began meeting in secret with members of the dissolved Assembly—worrying the al Sabahs enough that the Emir established a replacement for the Assembly (though the crisis was ultimately rendered moot by the Iraqi invasion).[88] Therefore, it is clear that KIA's domestic investment strategy increases the autonomy of the al Sabah family by preventing the emergence of serious challengers to royal legitimacy.

In the international arena, the KIA has generally followed a conservative strategy by investing in a diversified portfolio while remaining below reporting requirements in most of its investments. To be sure, most of its international investments are profit-driven. This is not, however, inconsistent with autonomy-maximization, as building wealth increases the range of policy options available to the al Sabah family and preserves their ability to continue making these policy decisions after Kuwait's oil reserves are eventually depleted.

On the subject of investment levels themselves, prior to its Citigroup investment, the KIA held stakes larger than 5% in only three publicly traded Western corporations: approximately a 24% stake in Swiss hotelier Victoria Jungfrau Collection AG and approximately an 8% stake in GEA AG,[89] as well as a 5.3% share in Daimler AG.[90] Remaining below the reporting threshold defined in domestic securities legislation is quite consistent with autonomy-maximization, as it allows SWFs to avoid public scrutiny.[91] First, the KIA is well aware of the political firestorm that could result if its international investments were publicized. When British Petroleum's IPO floundered in 1987, the KIA purchased a substantial stake in the company, acquiring 21.6% by March 1988, only to be ordered by the British Monopolies and Mergers Commission to divest down to 9.9%.[92] The British government also pressured the KIA to sell off even more, which it

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87. JILL CRYSTAL, OIL AND POLITICS IN THE GULF: RULERS AND MERCHANTS IN KUWAIT AND QATAR 75–77 (1995).

88. FED. RESEARCH DIV., KUWAIT: A COUNTRY STUDY 106 (2004), *available at* http://lcweb2.loc.gov/frd/cs/kwtoc.html (last visited Sept. 16, 2011).

89. *See Kuwait Investment Authority*, SOVEREIGN WEALTH FUND NEWS, http://www.sovereignwealthfundsnews.com/kuwaitinvestmentauthority.php (last visited Oct. 12, 2011).

90. *Extraordinary Report*, DAIMLER AG (Apr. 30, 2010), http://www.daimler.com/Projects/c2c/channel/documents/1840573_Extraord_Rep_Renault_Nissan_100430.pdf.

91. The reporting threshold varies from country to country. In the United States, for example, it is five percent. *See* Securities Exchange Act of 1934 § 13(g)(1), 15 U.S.C. § 78m(g)(1) (2006). In Switzerland, however, the reporting threshold is three percent. *See* BUNDESGESETZ VOM 24 MÄRZ 1995 ÜBER DIE BÖRSEN UND DEN EFFEKTENHANDEL [BEHG] [Swiss Federal Act on Stock Exchanges and Securities Trading of Mar. 24, 1995], SR 954.1, art. 31, *available at* http://www.admin.ch/ch/d/sr/c954_1.html, *translated in* http://www.six-exchange-regulation.com/download/admission/regulation/federal_acts/sesta_en.pdf.

92. Eric V. Thompson, *A Brief History of Major Oil Companies in the Gulf Region*, UNIV. OF VA. PETROLEUM ARCHIVES

did, leaving the KIA with the estimated 1.75% of BP that it still holds today.[93] Second, crossing key investment thresholds subjects even SWFs to an increased regulatory burden in Western countries. By remaining below these thresholds, the KIA ensures that the additional duties that these regimes impose do not restrain its investment. Finally, keeping investment levels below these reporting thresholds ensures that the CFIUS will not review the KIA's investments, as only "control" transactions are subject to review.[94] Therefore, by avoiding large investments and activist interventions in the management of companies, the KIA preserves its ability to invest in a wider array of businesses while avoiding regulatory scrutiny and protectionist countermeasures—thereby maximizing its autonomy in financial markets.

The KIA's extraordinary investments in Western financial institutions during December 2007 and January 2008 also reflect autonomy-maximizing behavior. While Bear Stearns and Lehman Brothers had not yet collapsed, it was fairly clear that subprime mortgages posed a substantial risk to Western financial institutions. In that environment, the KIA purchased three billion dollars[95] in Citigroup convertible preferred shares bearing 7% interest and convertible at a 20% premium to the then-current share price.[96] At the time, the federal overnight rate was about 4.25%,[97] so the preferred shares presumably would yield a 2.75% premium; however, as preferred shares, the securities were not principal protected. It is hard to understand why the KIA would have put such a large sum at risk when the decline in Citigroup's share price showed no signs of slowing and had already reduced the company's valuation by 37% in the last six months, with no end in sight. Simply put, something else must have been going on.[98]

The KIA's investment into Merrill Lynch was on similar terms: two billion dollars for convertible preferred shares bearing nine percent interest, although these had a mandatory conversion feature after 2.75 years.[99] Similarly to the Citigroup investment, this was a large risk to

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PROJECT, http://www.virginia.edu/igpr/APAG/apagoil history.html (last visited Sept. 16, 2011).

93. Anna Shiryaevskaya & Ayesha Daya, *Kuwait Raising Stake in BP Depends on Market Conditions, Oil Minister Says*, BLOOMBERG NEWS (Aug. 3, 2010), http://www.bloom berg.com/news/2010-08-03/kuwait-raising-stake-in-bp-depends-on-market-conditions-oil-minister-says.html.

94. Ivan A. Schlager & Warren G. Lavey, *Treasury Department Issues Final Regulations Reforming U.S. National Security Reviews of Foreign Investments*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES 1–3 (Nov. 21, 2008), http://www.skadden.com/content/Publications/Publications1567_0.pdf.

95. Souhail Karam & Ulf Laessing, *Kuwait Steps in To Sure Up* [sic] *Citigroup and Merrill*, ARABIAN BUSINESS (Jan. 16, 2008), *available at* http://www.arabianbusiness.com/ property/article/508312-kuwait-step-in-to-sure-up-citigroup-and-merrill.

96. *See* Peter Thal Larsen, *Sovereign Funds Win Beneficial Deal Terms*, FIN. TIMES (Jan. 15, 2008), *available at* http://www.ft.com/intl/cms/s/0/6cd48d84-c3a6-11dc-b083-0000779fd2ac.html#axzz1YnHrpIc0.

97. Press Release, Bd. of Governors of the Fed. Reserve (Jan. 22, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20080122b.htm.

98. While the KIA was eventually able to sell its preferred shares for $4.1 billion, yielding a profit of 36.7%, *Kuwaiti Sovereign Wealth Fund Sells Stake in Citigroup for $1.1bn Profit*, IRISH TIMES, Dec. 7, 2009, at 18, *available at* http://www.irishtimes.com/news paper/finance/2009/1207/1224260241159.html, that deal seems to have been politicized and there was no way to predict when the KIA initially purchased the preferred shares that Citigroup would adjust the conversion price on the preferred shares down to $3.25 per share, *see* Press Release, Citigroup, Inc., Citi to Exchange Preferred Securities for Common, Increasing Tangible Common Equity to as Much as $81 Billion (Feb. 27, 2009), *available at* http://www.citigroup.com/citi/press/2009/090227a.htm, to induce an early conversion under a plan to increase tangible common equity. It was only this adjustment that enabled the KIA to profit from the deal. If the preferred shares had been either held or converted at the original conversion price, the transaction would have resulted in substantial losses to the KIA.

99. Tom Bawden, *Citigroup is Staring at a Further Writedown of £3bn, Analyst Says*, TIMES (London) (Jan. 16, 2008), http://business.timesonline.co.uk/tol/business/ industry_sectors/banking_and_finance/article3193312.ece.

undertake given the uncertainty surrounding the magnitude of exposure to mortgage-backed securities and the valuation of those securities. Although the conversion price was not initially disclosed, given that Merrill Lynch was trading at fifty-four dollars per share at the time, and based on comparisons with the publicly disclosed investment in similar securities by the New Jersey Investment Council, the KIA's preferred shares were probably supposed to convert to two percent of Merrill's common stock. Again, these shares were not principal protected, so the large risk taken by the KIA does not make much intuitive sense.[100] Either the KIA was irrational, or there was something else going on in the transaction.

The investments into Citigroup and Merrill Lynch involved the KIA taking on substantial downside risks to stabilize two Western financial institutions in return for less-than-certain returns. By making these investments so quickly in a troubled market, the KIA improved Kuwait's reputation as a trustworthy and responsible player in the global financial system. This reputational boost should improve the KIA's autonomy relative to Western financial regulators in the future, as the KIA should be seen as less threatening. It also can be viewed as part of the security bargain between the United States and Kuwait. In the two years following these investments, U.S. firms have announced weapons sales and military base construction projects in Kuwait valued at over $1.9 billion.[101] The security guarantee provided by the United States is not unique. The al Sabahs secured Ottoman support by sending tributary payments,[102] and British protection from the 1930s through the 1960s was secured by the provision of access to Kuwaiti oil fields.[103] In either case, the result of the KIA's investments in Western financial firms during the crisis was an increase in autonomy.

The KIA was also deeply involved in bailing out the domestic Kuwaiti financial and industrial sectors. Law Decree No. 2 of 2009, entitled "Enhancing the State Economic Security," authorized the KIA to recapitalize domestic banks through convertible bonds, shares or sukuk

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100. Eventually, when Merrill Lynch ("Merrill") sought to induce the conversion of these shares, the conversion price was dropped to $27.68 per share (and potentially even lower if the New Jersey Investment Council's ("NJIC") complaint against Merrill was valid and the KIA was the undisclosed "other investment group" that received a better conversion price than the NJIC). *See New Jersey Sues Merrill Lynch, Claims Deception*, CONSUMER AFFAIRS (July 29, 2009), http://www.consumeraffairs.com/news04/2009/07/nj_merrill _lynch.html. The KIA's common shares in Merrill were eventually exchanged for 0.8595 shares in Bank of America ("BoA") during the Merrill-BoA merger. *See Update 1: Kuwait to Keep Merrill, Citi Stakes for Now*, REUTERS (Sept. 6, 2009), http://uk.reuters.com/article/idUKL672397020090906?sp=true. Assuming that the initial conversion into Merrill common stock was at $27.68, this would have given the KIA about 72.25 million shares in Merrill, and 62.1 million shares in Bank of America. At the March 15, 2010 price of $16.75 per share, this means that the KIA's initial principal investment of $2 billion has declined in value to about $1 billion—even after the adjusted conversion price on Merrill. Adding in an assumed six quarters of interest payments on the preferred shares, the KIA would have earned another $275 million, but the overall result of this investment was rather disastrous. Interestingly, adding together the KIA's loss on this transaction and its gain on the Citigroup transactions results in a net gain of $416.2 million—equivalent to an annualized 4.1% return, which is roughly equal to the targeted Federal Funds Overnight Rate of 4.25% when these investments were originally made.

101. *See Up in Arms*, *CNNMONEY*, http://money.cnn.com/magazines/fortune/ storysupplement/up_in_arms/ (showing $854 million in sales agreements from the US to Kuwait for 2008–2009) (last visited Nov. 21, 2011); *Arms Transfers Database*, *STOCKHOLM INT'L PEACE RESEARCH INST.*, http://armstrade.sipri.org/armstrade/page /trade_register.php (select "USA" as the supplier and "Kuwait" as the recipient and the year range of 2008–2009, and then click on the "download" icon) (showing an additional $1.1 billion agreement for the sale of three KC 130J Hercules tanker/transport planes in 2009) (last visited Nov. 21, 2011).

102. *See* BIDWELL *supra* note 55 at 8.

103. *See* Richard A. Mobley, *Gauging the Iraqi Threat to Kuwait in the 1960s*, 45 STUD. IN INTELLIGENCE 19, 20–21 (2011), *available at* http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA529668.

bonds,[104] and extend subordinated loans to, or purchase convertible bonds, sukuks or preferred shares in, domestic businesses in the productive sector.[105] It also authorized the Central Bank of Kuwait to guarantee domestic banks' investment portfolios and real estate debt obligations,[106] and to guarantee up to fifty percent of new[107] or refinanced[108] commercial loans made to domestic businesses in the productive sector.

Pursuant to this law, the KIA intervened dramatically in the domestic private sector. In April of 2009, the KIA made a $1.4 billion investment into companies traded on the Kuwait Stock Exchange ("KSE") to fight off a regional stock market rout.[109] This is not an investment that a profit-maximizing fund would make—higher profits could be made by investing after a large run on the market than by stabilizing it—nor would a mercantilist institution make the investment, as it puts precious capital at risk. Similarly, investing domestically does not serve imperialist motives.

The investment was, however, a strong move toward protecting the autonomy of the ruling elite. During the previous bull market on the KSE, Kuwaiti citizens invested heavily into KSE-traded companies. If their investments had collapsed, political turmoil might have followed, especially since the KIA had already acted to stabilize Western financial institutions. By stabilizing the KSE, the KIA rescued panicked small investors and stabilized the value of large merchant-controlled companies, thereby preventing the spread of political unrest and ensuring the continued autonomy of the ruling elite. The level of private financing provided under Law Decree No. 2 of 2009 is unknown, but it is almost certain that the KIA purchased convertible bonds and sukuks on terms favorable to equity holders. These mechanisms provided another protection against political unrest—this time by pacifying the owners of privately held companies (which are generally members of prominent merchant families or tribal leaders). There were even rumors that KIA bailout funds were being selectively directed to the companies owned by the al Sabahs' political allies—a charge that the KIA denied,[110] but the truth of which would be consistent with previous KIA investment behavior.

In summary, the formation of the KIA and its predecessor SWFs in Kuwait were autonomy-maximizing events aimed at ensuring international recognition of Kuwait's statehood and the al Sabah family as its legitimate rulers. In light of the geopolitical context in which Kuwait finds itself, the general strategy of investing internationally for profit in a mostly passive fashion furthers the same goal. By quietly recycling foreign exchange earnings from oil exports through the KIA, Kuwait essentially cements the implicit security bargain it has with the United States. Additionally, several extraordinary events support our argument that the KIA serves primarily autonomy-maximizing goals. First, the drawdown on KIA assets during the Persian Gulf War

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104. Kuwait Law Decree No. 2 of 2009 on Enhancing the State Economic Stability, art. 6 (2009), *translation available at* http://www.bakertillykuwait.com/PDF/Law-Decree-No-2-of-2009-Eng.pdf.

105. *Id.* art. 12.

106. *Id.* art. 3.

107. *Id.* art. 8.

108. *Id.* art. 12.

109. *Kuwait's KIA pumps $1.4bn in Bourse Fund*, TRADE ARABIA (Apr. 27, 2009), http://www.tradearabia.com/news/CM_160338.html.

110. Jamal Yali, *Finance Minister Denies Giving Halt to KIA Studies Presented by Companies*, KUWAIT NEWS AGENCY (July 6, 2009), http://www.kuna.net.kw/News AgenciesPublicSite/ArticleDetails.aspx?id=2012434&Language=en.

demonstrates that Kuwait's elite have used KIA accounts as a backup source of funds to prevent any disruption in payments to important allies (both domestic and international) on whom they rely for security and legitimacy—one that remains viable even if access to oil revenues has been compromised. Second, politicized domestic investments demonstrate how KIA investments have been used to pay off potential challengers to the ruling elite. Furthermore, the KIA's large investments into Citigroup and Merrill Lynch during the financial crisis illustrate how SWF assets are used to meet Kuwait's political obligations during times of international turmoil. Lastly, the bailout of the Kuwaiti economy in the aftermath of the 2008 crisis reinforces this theme: the KIA is used to deflect calls for political autonomy, revealing autonomy-maximizing motives.

B. Abu Dhabi

Much of the story in Abu Dhabi mirrors that in Kuwait. The creation of ADIA and other Abu Dhabi SWFs, their general investment strategy and their extraordinary actions all reflect autonomy-maximizing behavior. It is useful, however, to delve into the particulars. First, Abu Dhabi's SWFs exist at a sub-national level, which presents an interesting story of domestic autonomy-maximization relative to other ruling Emirati families. Second, the evolution of SWFs in Abu Dhabi is peculiarly linked to issues of succession and royal power sharing. Finally, the "grand bargain" with the merchant class is especially obvious in the context of the domestic banking sector.

In Abu Dhabi, four distinct sovereign wealth funds coexist, the oldest of which, ADIA, dates back to 1976 and the newest of which, Mubadala, was created in 2002. The same general argument applies to the creation of SWFs to manage oil revenues in Abu Dhabi as in Kuwait. Allocating revenues to a public-sector savings vehicle transforms the royal family's monopoly on oil reserves into a virtual monopoly on capital. Thus, the creation of a SWF maximizes royal autonomy comparatively more than distributing revenues to the private sector, keeping revenues in private bank accounts or allocating them more substantially toward public spending.

The creation of a SWF also maximizes autonomy relative to Western powers. As mentioned in the Kuwait case study above, Western powers have been concerned about the balance of payments resulting from oil sales since the Gulf States first assumed any degree of control over the revenues. In Abu Dhabi in particular, the consequences of refusing to recycle currency to the West are vividly apparent. When the former Emir Sheikh Shakhbout bin Sultan ruled over Abu Dhabi, he pursued an aggressively mercantilist strategy: "he insisted on keeping his reserves in gold and on inspecting them in the bank each week" and "hid himself on his yacht in Abu Dhabi harbour, where he kept his sheep and his gold bars."[111] In 1966, development spending was only £1.75 million out of over £200 million in revenues,[112] creating a large imbalance in international payments. Consequently, he was deposed by his brother Zayed, who relied on British backing and the support of credibly neutral members of the al Nahyan family. Understandably, the subsequent rulers in Abu Dhabi have been careful to maintain their implicit obligations

111. HALLIDAY, *supra* note 4, at 464.

112. For development spending, see *id.* For total revenues, see *1966: Kuwait*, ASTHEYSAWIT.COM, http://astheysawit.com/9200-1966-kuwait.html (last visited Nov. 21, 2011) (listing 1965–1966 oil revenues at $605 million). The exchange rate for U.S. dollars to pounds sterling in 1966 was 1 USD to 0.35714 GBP. *Foreign Currency Units Per 1 U.S. Dollar, 1948–2009*, PACIFIC EXCHANGE RATE SERVICE, http://fx.sauder.ubc.ca/etc /USDpages.pdf (last visited Nov. 21, 2011).

to recycle currency to the West in order to prevent Western interventions in the domestic political realm—thereby protecting the al Nahyan family's domestic autonomy.

Another prominent attribute of the SWFs in Abu Dhabi is that they are controlled at the sub-national level. This can be explained as a consequence of the circumstances surrounding the creation of the U.A.E., but it also maximizes the autonomy of the al Nahyan family within the national context. The formation of the U.A.E. was an ambitious political endeavor that was particularly precarious because it sought to subordinate the previously sovereign powers of seven emirates ruled by six families to a national superstructure. Given that Abu Dhabi possessed the vast majority of oil reserves in the U.A.E. but only a minority of the population, Sheikh Zayed al Nahyan would have insisted on reserving control of oil deposits to the emirate in which they were located.[113] Indeed, Article 23 of the U.A.E. constitution provides that "the natural resources and wealth in each Emirate shall be considered to be the public property of that Emirate."[114] The inclusion of "wealth" in this constitutional provision indicates that retaining sub-national autonomy over the use of oil revenues was critically important to the political bargain that created the U.A.E. By reserving oil revenues to the individual emirates, the U.A.E. Constitution ensured that SWFs would be owned, controlled and administered at the sub-national level. This in turn ensured that investment and spending decisions remained a local matter, thereby maximizing the autonomy of Abu Dhabi (and thus the al Nahyan family).

Other emirates, particularly Dubai, have tried to establish independent wealth-generating assets to increase their ability to resist the influence of Abu Dhabi's oil revenues in the federal political system. While Dubai's rapid expansion has been impressive, particularly in its evolution into a global transshipment and distribution center, its aggressive leveraging strategy put its progress in jeopardy when the financial crisis hit. When it looked like Dubai's repayment obligations on a large sukuk issued by Nakheel could not be met, a bailout from Abu Dhabi seemed likely—but was not assured. While Abu Dhabi reversed from its initial position that it would not backstop Dubai's debt, the subtext was that Dubai's ambitions on influence within the federal system would be curtailed. Indeed, in January of 2010, the Burj Dubai—which was supposed to be a symbol of Dubai's achievement—was renamed the Burj Khalifah, in honor of Sheikh Khalifah bin Zayed al Nahyan of Abu Dhabi.[115] The world's tallest tower now stands in the middle of Dubai as a reminder that it is Abu Dhabi, and thus the al Nahyan family, that has control and autonomy within the U.A.E.[116]

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113. At one point, the Union aspired to encompass the entire Trucial Coast, including Bahrain and Qatar. It was this very divide between wealth and population, along with disagreements on the locus of authority over the incipient military, that drove Bahrain and Qatar to drop out of the proposed union. *See id.* at 469–71. Following their withdrawal, although Abu Dhabi's bargaining position in the negotiations to create the U.A.E. improved relative to the smaller emirates because the availability of potential alternative funding sources for the government declined significantly, the other sheikhs outnumbered the al Nahyans and could have co-opted Abu Dhabi's resources through the Executive Council of the U.A.E. if ownership had not been reserved to the sub-national political units. Since it would have been difficult for the smaller, poorer emirates to offer concessions to the al Nahyans in exchange for truly national ownership of oil, it is little wonder that ownership was reserved to the individual emirates.

114. Although the U.A.E. Constitution in force today was formally adopted in 1996, it varies little from the "interim" Constitution drafted and adopted in 1971.

115. *See* Andy Sambidge & Andrew White, *World's tallest tower hits 828m, renamed Burj Khalifa*, ARABIANBUSINESS.COM (Jan. 4, 2010), http://www.arabianbusiness.com /world-s-tallest-tower-hits-828m-renamed-burj-khalifa-27406.html; *World's tallest building opens in Dubai*, BBC NEWS (Jan. 4, 2010), http://news.bbc.co.uk/2/hi/8439618.stm.

116. The bailout of Dubai's debt was funded by $10 billion in bond purchases by the U.A.E. Central Bank (which is overwhelmingly funded by Abu Dhabi) and $10 billion in bond purchases made directly by the government of Abu Dhabi; these

Another unique feature in the history of SWFs in Abu Dhabi is the proliferation of different funds. The creation of these new funds could probably be explained in a number of ways, such as increasing efficiency through specialization, but it is probably best understood through the lens of royal succession.[117] Between 1909 and 1928, a series of fratricides and early deaths plunged Abu Dhabi's political system into chaos. It was only the intervention of the eldest son of Sheikh Zayed the Great,[118] Khalifah bin Zayed bin Sultan al Nahyan (who had refused the position of Emir several times), that created the stability necessary to install Shakbout bin Sultan bin Zayed al Nahyan as Emir for thirty-eight years. Khalifah's sons, collectively known as the Bani Khalifa, were also critical in the coup that deposed Shakbout in favor of his younger brother Zayed in 1966. In light of this legacy of fratricide and instability, the proliferation of SWFs in Abu Dhabi is best understood as the expansion of institutional space. By opening new spaces within a controlled area of the economy in which non-ruling royals may pursue their ambitions, the creation of new SWFs lowers the stakes in royal succession and creates a common interest among royals in preserving the status quo—thereby reducing the likelihood of intra-familial fractures and increasing the autonomy of the royal family.

After ADIA was established in 1976, Sheikh Zayed al Nahyan quickly created the Abu Dhabi Investment Company ("ADIC") in 1977 to focus on domestic investments. The ADIC was initially almost wholly owned by ADIA. Setting up the ADIC as a virtual subsidiary reflects a distinct decision by Sheikh Zayed al Nahyan to separate domestic and foreign investment decision-making. This decision expanded the political space available to accommodate allies and potential rivals. By placing different factions of the royal family on the board of directors at each SWF, the Emir could reward his allies and pacify potential rivals without allowing any individual to accumulate enough power to pose a serious political threat. For instance, directors and officers at the domestically-focused ADIC could presumably gain considerable domestic influence in the merchant and industrial communities but could not access the larger assets at the parent-fund level. On the opposite side, ADIA directors and officers control massive amounts of capital but do not interact with the local business community on a daily basis. Therefore, separating domestic and international investment functions decreased the likelihood of conflicts within the royal family or political unrest from tribal allies. Both objectives are consistent with autonomy-maximization.

In 1984, Sheikh Zayed established the International Petroleum Investment Company

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transactions coincide with a forecasted $23 billion deficit in Abu Dhabi's budget—which was in turn covered by transfers from ADIA and ADICU to the general budget. Camilla Hall & Vivian Salama, *Abu Dhabi Forecasts $23 Billion Budget Deficit in 2010, Prospectus Shows*, BLOOMBERG NEWS (July 20, 2010), http://www.bloomberg.com/news/2010-07-20/abu-dhabi-forecasts-23-billion-budget-deficit-in-2010-prospectus-shows.html.

117. The following paragraph is largely drawn from Davidson's account in Christopher Davidson, *After Sheikh Zayed: The Politics of Succession in Abu Dhabi and the U.A.E.*, 13 MIDDLE EAST POLICY 42, 42–59 (Spring 2006). It is also important to note that the merchant class was not as influential in Abu Dhabi as in Kuwait. Abu Dhabi was not a natural transshipment point for trade, *see* DONALD HAWLEY, THE TRUCIAL STATES 197 (1970), so the 1920s collapse of the pearling market eroded merchant influence to a far greater extent in Abu Dhabi than in Kuwait. Further, Abu Dhabi had been effectively demilitarized since the late 1800s after Britain guaranteed its security, so merchant influence over the tribal levies was not as important. *See Emirates History—British Era*, GLOBALSECURITY, http://www. globalsecurity.org/military/world/gulf/uae-history-british.htm (last updated Sept. 7, 2011).

118. Sheikh Zayed the Great ruled from 1855 through 1909 and signed the treaty with the British that recognized Abu Dhabi's sovereignty (and handed the conduct of its international affairs over to Britain). *A Walk Through Time: Zayed the Great*, UAE INTERACT, http://www.uaeinteract.com/history/e_walk/con_2/con2_1.asp (last visited Oct. 12, 2011).

("IPIC") as a fifty-fifty joint venture between ADIA and the Abu Dhabi National Oil Company ("ADNOC"), giving it a mandate to focus on investments in the petrochemical sector.[119] The IPIC was essentially a forum in which ADNOC and ADIA could arrive at a consensus on investments in the petroleum sector after balancing financial returns against Abu Dhabi's strategic needs related to oil.[120] ADIA representatives on the IPIC board typically judged the financial merits of acquisitions, while ADNOC officials reviewed their strategic value to Abu Dhabi's oil sector.[121] Still, the Supreme Petroleum Council retained the ultimate decision-making authority over IPIC investments[122] to ensure that they conformed to the IPIC's mandate of securing high-quality upstream services and downstream markets for Abu Dhabi's primary export.[123] The creation of the IPIC created additional institutional space within the realm of SWFs, allowing Sheikh Zayed to accommodate the political ambitions of additional family members and political allies.

Initially, Sheikh Zayed delegated supervisory roles at the SWFs, ADNOC, the *diwan* (Council of State) and many ministries to his Bani Khalifa allies, thereby shoring up support against loyalists to the deposed Sheikh Shakbout and increasing Sheikh Zayed's policy-making autonomy in other areas. As the senior members of the Bani Khalifah grew older and his own sons came of age, Sheikh Zayed shifted control of the SWFs and government agencies to his own sons to satisfy their political ambitions and smooth the way for an eventual succession. Prior to his death, Sheikh Zayed had placed ADIA under the influence of a younger son, Ahmed (generally seen as being allied with Khalifa bin Zayed and not a succession challenger), while retaining the chairmanship for himself; IPIC was the province of Mansour (another younger son), and ADIC was placed under the control of key tribal allies. However, none of these appointees were politically ambitious. Sheikh Zayed's eldest son, and then-Crown Prince, Khalifa, was appointed to lead the Supreme Petroleum Council and Executive Council. Mohammed was given a leadership position in the United Defense Forces, the U.A.E. military.[124]

Sheikh Zayed bin Sultan al Nahyan's death in 2004 prompted the first succession in Abu Dhabi since independence. It also marked the first uncontested transfer of power since the death of Zayed the Great in 1909. Despite his position as Crown Prince, it was not certain that Khalifa would succeed to his father's position over Mohammed, because Mohammed's political status had grown tremendously due to his position as the eldest brother within the Bani Fatima.[125]

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119. *Abu Dhabi—The International Petroleum Investment Co.*, APS REVIEW DOWNSTREAM TRENDS (Jan. 27, 2003), http://goliath.ecnext.com/coms2/gi_0199-2473603/ ABU-DHABI-The-International-Petroleum.html.

120. Without this cooperation, ADIA and ADNOC could have found themselves pursuing contradictory petrochemical investment strategies or duplicating investments resulting in overexposure.

121. *Abu Dhabi—The International Petroleum Investment Co.*, *supra* note 119.

122. *Id*.

123. *Abu Dhabi—Overseas Investments*, APS REVIEW DOWNSTREAM TRENDS (Jan. 18, 1999), http://www.thefreelibrary.com/Abu+Dhabi+-+Overseas+Investments.-a053639875.

124. For a discussion of the position of Sheikh Zayed's sons and tribal allies prior to his death, along with the succession options then in play, see John Duke Anthony, *Succession in the Emirate of Abu Dhabi and the UAE: An Assessment of the Players and the Likely Possibilities*, GULFWIRE (2001), *available at* http://www.ncusar.org/publications/ Publications/1999-08-30-Succession-In-Abu-Dhabi-and-The-UAE.pdf.

125. Fatima was Sheikh Zayed's favorite wife and the mother of six sons. CHRISTOPHER M. DAVIDSON, ABU DHABI: OIL AND BEYOND 98, 99 (2009). In contrast, Khalifa's mother, Sheika Hassa bint Mohammed bin Khalifa al Nahyan, bore only one son: Khalifa. *Family Feeling Behind the Football*, THE ECONOMIST, Sept. 27, 2008, at 64, *available at* http://www.economist.com/node/12305389.

While Khalifa had secured the support of the Bani Khalifa, the tribal hinterland and most of his brothers outside the Bani Fatima, Mohammed could have made the succession difficult. Consequently, upon his appointment as Emir, Sheikh Khalifa bin Zayed al Nahyan immediately enacted measures designed to reward his supporters and mollify the Bani Fatima.

Khalifa first upheld the accession of Mohammed as Crown Prince[126] and appointed him as Chairman of the Abu Dhabi municipal government.[127] He then decreed the creation of Mubadala (another SWF) in 2002,[128] transferred ADIA's interest in IPIC to ADNOC, spun off the Abu Dhabi Investment Council ("ADICU") from ADIA and transferred ADIA's domestic assets (including ADIC, the National Bank of Abu Dhabi ("NBAD") and the Abu Dhabi Commercial Bank ("ADCB")) to the newly independent ADICU.[129] The historical, transitional and current institutional structure of Abu Dhabi's SWFs is shown in the Annex, Figure 1.

The dramatic 2004 reorganization not only decentralized control of Abu Dhabi's SWFs, but also divided control between powerful political players within the Emirate. Mubadala's very existence is owed to Sheikh Mohammed's political influence. Without a fund of his own, Mohammed would have been more likely to make a serious challenge to the succession rather than to rally behind Khalifa. Similarly, Mansour gained increased control over IPIC after ADIA's shares were transferred to ADNOC. Without the supervisory role that ADIA-aligned directors had played in IPIC, Mansour would have had greater freedom to pursue investments of his own choosing. Operational control of the new ADICU has been effectively delegated to al Nahyan tribal allies (the al Kindi and al Suwaidi).[130]

The consequences of separating the SWFs are not merely theoretical. ADICU expanded its original "domestic" mandate to become an international investment vehicle.[131] In buying up New York's Chrysler building in 2008,[132] ADICU seems to be treading into territory traditionally covered by ADIA. Financially speaking, there is little reason that ADICU should have been investing in New York real estate. The Council's mandate was domestic, its employees have focused on domestic investing for some forty years and if the investment opportunity was attractive, there is no reason that ADIA would not be the appropriate vehicle. The absence of any response by ADICU's al Nahyan directors suggests that a distinct decision has been made to

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126. *Khalifa Consolidates Alliances for the Post-Zayed Era*, GULF STATES NEWSLETTER (Nov. 12, 2004), http://www.gsn-online.com/HTML/Public/GSNs_World/Free_Content/ Free_content_63.html.

127. *Khalifa Names Mohammed Chairman of Exec. Council*, KHALEEJ TIMES (Dec. 9, 2004), http://www.khaleejtimes.com/DisplayArticle.asp?xfile=data/theuae/2004/December/ theuae_December208.xml&section=theuae.

128. *The Mubadala Story*, MUBADALA, http://mubadala.ae/about/history/ (last visited Oct. 15, 2011).

129. *Abu Dhabi Investment Council*, SOVEREIGN WEALTH FUND INST., http://www. swfinstitute.org/swfs/abu-dhabi-investment-council/ (last visited Oct. 15, 2011); *Abu Dhabi Investment Authority*, TAIGHDE, http://taighde.com/w/Abu_Dhabi_Investment_Authority (last visited Oct. 15, 2011); *Investment Strategy*, ABU DHABI INV. COUNCIL, http://www. adcouncil.ae/AboutUs/InvestmentStrategy/tabid/63/Default.aspx (last visited Oct. 15, 2011) (showing equity stakes in prominent Abu Dhabi businesses).

130. ADICU is ultimately supervised by a collection of royal family members who serve on the board of directors, including Khalifa and his brothers Mohammed, Mansour, Hamed and Sultan bin Tahnun of the Bani Khalifa. *See Board of Directors*, ABU DHABI INV. COUNCIL, http://www.adcouncil.ae/AboutUs/BoardofDirectors/tabid/57/Default.aspx (last visited Oct. 15, 2011).

131. *See History*, ABU DHABI INV. COUNCIL, http://www.adcouncil.ae/AboutUs/ History/tabid/92/Default.aspx (last visited Oct. 15, 2011); *see also supra* page 28 (discussing the fact that ADICU was created from ADIA and capitalized with ADIA's domestic assets—indicating its original domestic mandate).

132. Landon Thomas Jr., *A Growing Trophy Case: Foreign Investors Acquire More Pieces of Americana*, N.Y. TIMES, July 10, 2008, at C1.

accept the actions of their tribal allies at the helm of ADICU—at least as long as they remain pliant allies.

In a similar fashion, IPIC, moving far beyond its "petrochemical" mandate under Mansour's direction, acquired a 16.3% stake in Barclays in 2008 through a deal that sidestepped the supervision of Sheikh Khalifa and was probably brokered through Mansour's Dubai connections.[133] The transaction was rather murky, as it was reported that Mansour agreed to the deal in both a personal capacity and as the chairman of the IPIC board. Although much publicity accompanied IPIC's subsequent disinvestment in June 2009, IPIC retained a 5% stake in Barclays.[134] Apparently, IPIC is still in the banking business. The decision to allow Mansour to push for these kinds of non-petrochemical investments seems to be a conciliatory measure designed to mitigate any friction with Khalifa.[135]

The very creation of Mubadala seems to be designed to pacify Mohammed bin Zayed by allowing him to pursue his own vision for developing Abu Dhabi, which tends to be more aggressive and modernizing than that of Khalifa or their father Zayed. Thus, Mohammed's Mubadala has moved aggressively to take significant stakes in high-profile foreign companies (e.g., Rolls-Royce, AMD Computing, the Carlyle Group and Ferrari, among others). Mubadala also invests domestically in numerous firms in various sectors, including health services, aerospace and large-scale aluminum smelting.[136] Perhaps most surprisingly, however, Mubadala has acquired large stakes in some domestic petroleum services companies and has even bought significant stakes in oil blocs around the world through its wholly owned subsidiary, Liwa Energy.[137] It is clear that Mubadala's mandate is not geographically limited, nor is it limited by sector (as it has moved into IPIC's traditional realm). There seems to be little financial rationale behind creating an entire new SWF rather than creating a fund for aggressive investments under ADIA. Politically, however, creating space for Mohammed to pursue his own aims was important to ensuring an uncontested succession for Khalifa.

Overall, the proliferation of multiple SWFs in Abu Dhabi has increased the institutional space available for members of the royal family, increasing their individual autonomy and creating a more stable political environment in which dissent is less likely (thereby increasing Sheikh Khalifa bin Zayed bin Sultan's autonomy as Emir in a broader sense). This strategy was pursued by Sheikh Zayed bin Sultan and was expanded during the succession that led to his son Khalifah bin Zayed bin Sultan ascending to the position of Emir.

It is equally important to recognize that the al Nahyan family retains control over the management of each SWF in Abu Dhabi. At ADIA, the board of directors is composed of six royal family members and four close tribal allies.[138] As the largest of Abu Dhabi's SWFs, it is

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133. Mansour is tied to Dubai through marriage, *see HH Sheikha Manal Bint Mohammed bin Rashid Al Maktoum Will Be Honored by CITYarts*, AMEINFO (Apr. 27, 2009, 1:54 PM), http://www.ameinfo.com/194238.html.

134. Joanna Hartley, *Abu Dhabi's IPIC Sells 11% Stake in Barclays*, ARABIANBUSINESS.COM (June 2, 2009, 11:07 AM), http://www.arabianbusiness.com/abu-dhabi-s-ipic-sells-11-stake-in-barclays-17720.html.

135. The support of Mansour is key to diffusing any potential opposition to Khalifa from the Bani Fatima bloc of the al Nahyan family.

136. *See Sectors*, MUBADALA, http://mubadala.ae/sectors/ (last visited Oct. 29, 2011).

137. *Energy: Assets*, MUBADALA, http://mubadala.ae/sectors/energy/assets/ (last visited Oct. 15, 2011).

138. *Board of Directors*, ABU DHABI INV. AUTH., http://www.adia.ae/En/People/Board_ Of_Directors.aspx (last visited Oct. 1, 2010).

considered the third most powerful institution in Abu Dhabi. Accordingly, the Emir directly holds the position of Chairman and his younger brother Ahmed (who is not a political rival in any sense) directly manages the operations of ADIA through his position as managing director. At ADICU, while the Executive Council and management positions are dominated by tribal allies rather than the al Nahyans, five of eight board seats are held by the al Nahyan family, ensuring ultimate royal control.[139] At IPIC, non-royals hold the majority of board seats, but the fund is now a wholly owned subsidiary of ADNOC, thereby placing it under ultimate royal control. In practice, IPIC is dominated by Sheikh Mansour bin Zayed al Nahyan, even though the managing director is not a member of the al Nahyan family. Sheikh Mohammed bin Zayed al Nahyan is the chairman of the board at Mubadala; he has surrounded himself with allies who have worked alongside him for decades and technocrats.[140] In all of these SWFs, the al Nahyan family controls the nomination and removal processes for directors—ensuring that when push comes to shove, these SWFs will serve the interests of the royal family and thus ensure its autonomy from political competition at home and abroad.

In addition to maintaining royal control over the SWFs' boards of directors, the autonomy of the royal family is assured through SWF funding mechanisms. For Abu Dhabi's SWFs, it is difficult to confirm exactly when and how funding decisions are made with respect to state revenue stream allocation, as there is no controlling public law like that in Kuwait. It is, however, fairly certain that the Supreme Petroleum Council (SPC) must clear all decisions on changes in the allocation of oil revenues. Since the chair of the SPC is the Emir, and al Nahyans and Emiri-appointed tribal allies hold the other seats, it is apparent that funding remains a fail-safe tool to ensure SWF loyalty to the royal family.

Beyond the creation and institutional structures of Abu Dhabi's SWFs, their investment decisions also reflect an autonomy-maximizing objective. In the international sphere, ADIA's trademark has been its tendency to purchase small stakes in companies below the threshold for mandatory reporting requirements. ADIA's head of strategy Jean-Paul Villain, a Frenchman who has held top positions at ADIA for most of the past two decades, noted that keeping ADIA's stake below this threshold eliminates the headaches associated with being a named shareholder.[141] As noted in the Kuwait case study above, this strategy is autonomy-maximizing because it maximizes the number of investment opportunities that ADIA can pursue without triggering a political backlash. As in the case of the KIA, Abu Dhabi's SWFs do not follow this "small investment" strategy inside the Middle East (including inside Abu Dhabi itself) where political reactions are less likely. For instance, ADIA holds large shares in the Arab Banking Corporation, the Arab International Bank, U.A.E.'s Union Cement Company, Qatar Telecom and Egypt's EFG Hermes Holding.[142] Similarly, ADIA does not nominate directors for Western companies but does nominate and elect directors onto the boards of Middle Eastern companies. It is therefore apparent that ADIA's general strategy is autonomy-maximizing.

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139. *Id.* *See also Executive Committee*, ABU DHABI INV. COUNCIL, http://www.adcouncil.ae/AboutUs/ExecutiveCommittee/tabid/93/Default.aspx (last visited Jan. 6, 2011).

140. *See* CHRISTOPHER M. DAVIDSON, DUBAI: THE VULNERABILITY OF SUCCESS 157 (2008).

141. Sudip Roy, *Money and Mystery: ADIA Unveils Its Secrets*, EUROMONEY, Apr. 2006, at 70–76 (Apr. 2006). While Villain also attributed this strategy to increases in market efficiency that have made it more difficult and expensive to make big bets, he emphasized that ADIA's secrecy (which would be impossible if investments were made above the reporting threshold) is critical to reducing the risk of political objections to ADIA investments.

142. MANDA SHEMIRANI, SOVEREIGN WEALTH FUNDS AND THE INTERNATIONAL POLITICAL ECONOMY 79–80 (2011).

ADIA's extraordinary investment in Citigroup can also best be explained as autonomy-maximizing. First, the investment fits with ADIA's aversion to exceeding reporting requirements: the convertible bonds convert to no more than 4.9% of Citigroup Inc.'s equity.[143] It was not, however, secretive. This is in large part because the investment was not made through the normal Villain-led strategy-setting and opportunity-identifying regime. In this transaction, former Treasury Secretary and Citigroup's then-Chairman Robert Rubin (whose political linkages to the American government were not unnoticed) traveled to Abu Dhabi and met and shook hands with Sheikh Ahmed bin Zayed and Sheikh Mohammed bin Zayed. Two days later, the money was wired to a Citigroup account.[144] This transaction's departure from almost all of ADIA's traditional investing patterns makes it look suspiciously like a political investment—one that is, in fact, autonomy-maximizing. By supporting the recapitalization of Citigroup, ADIA conveyed that it is a cooperative player within the system of global economic governance,[145] which should open more investment opportunities in the future. Despite its size and political nature, nothing in the deal suggests that it was mercantilist; ADIA acquired only convertible debt and remained a passive investor. As in Kuwait, large arms sales to the U.A.E. were announced in 2009 through 2010, which may have been part of the implicit political bargain in the transaction.

Outside of ADIA, Abu Dhabi's SWFs are more aggressive. ADICU invests primarily within Abu Dhabi and is not averse to taking large stakes in companies targeted for investment. ADICU owns majority shares in the NBAD,[146] the ADCB,[147] Union National Bank[148] and Al Hilal Bank,[149] and large stakes in numerous other domestic companies.[150] The majority stakes in

143. Eric Dash & Andrew Ross Sorkin, *Fund in Abu Dhabi to Pay $7.5 Billion for 4.9% of Bank*, N.Y. TIMES, Nov. 28, 2007, at C1.

144. Emily Thornton & Stanton Reed, *Inside the Abu Dhabi Investment Authority*, BUSINESSWEEK (June 6, 2008), http://www.businessweek.com/globalbiz/content/jun2008/ gb2008065_742165.htm. Although Jean-Paul Villain indicated that the investment was in line with existing strategy (because ADIA was underweight in U.S. equities, large companies and credit, and was already looking to acquire five or six smaller one billion dollar stakes in large U.S. financial institutions when Citigroup came calling), *id.*, concentrating the full investment into a single company whose financial future was tenuous (and investing about fifty percent more into the asset class than they had anticipated) does not fit ADIA's traditional conservative strategy.

145. ADIA's current arbitration claim against Citigroup seeks damages of 4 billion dollars, Chris Dade, *Abu Dhabi to Sue Citigroup for $4 Billion*, DIGITAL JOURNAL (Dec. 16, 2009), http://digitaljournal.com/article/283935, which would bring the overall value of the investment to $8.06 billion, including $3.12 billion in interest payments (assuming that ADIA exercises the one-year extension option, making the conversion date March 2011 and implying a holding period of forty months), and a market price for common shares of $4.01 per share on December 7, 2009 (not reflecting the impact of a later 1:10 reverse stock split), *see Citigroup, Inc., New Common Stock Chart*, YAHOO! FINANCE, http://finance.yahoo.com /echarts?s=C+Interactive#chart7:symbol=c;range=20091203,20101203;indicator=split+volume;charttype=line;crosshair=on;ohlc values=0;logscale=on;source=undefined (last visited Oct. 15, 2011) (indicating an 87.4% decline in value relative to the conversion price of $31.83 per share). This would make the annualized return on the investment about two percent. In all likelihood, the suit is a negotiating tactic designed to prompt a renegotiation of the conversion price in a manner similar to the conversion rate reset on the KIA's preferred shares.

146. *Shareholding Pattern*, NAT'L BANK OF ABU DHABI, http://www.nbad.com/investor/ stock/ownership.php (last visited Oct. 15, 2011).

147. *Abu Dhabi Commercial Bank*, ARABIAN BUS., http://www.arabianbusiness.com/ companies/abu-dhabi-commercial-bank-66462.html (last visited Oct. 15, 2011).

148. *Union National Bank*, GULFBASE, *available at* http://www.gulfbase.com/site/ interface/CompanyProfileSummary.aspx?c=186 (last visited Oct. 29, 2011) (indicating that the Abu Dhabi Investment Council owns a 50.1% share).

149. *Abu Dhabi to Launch Al Hilal Bank*, ARABIAN BUS. (Aug. 1, 2007), http://www.arabianbusiness.com/abu-dhabi-launch-

domestic banks are particularly relevant because they guarantee that the domestic financial sector is ultimately responsible to the state (and thus to the al Nahyan family). Through these intermediary financial institutions, it is possible to carefully manage the development of Abu Dhabi's economy, ensuring that political allies are more easily able to access credit markets. The scandal involving the Saad Group and Algosaibi & Brothers Company is illustrative of the kind of name-based lending that occurs on a regular basis throughout the Middle East.[151] Further, the provision of mortgage loans based on the reputation of the owner of the target property, rather than the creditworthiness of the borrower, was very common.[152] Overall, Abu Dhabi has used the subsidiaries of its SWFs to provide easy credit and cash payments to domestic political allies. This behavior is autonomy-maximizing because it incentivizes loyalty to the royal family, thereby increasing the range of actions that the royal family can undertake without leading to political resistance.

In a similar vein, IPIC has traditionally made large investments in the petrochemicals sector.[153] This strategy is consistent with autonomy-maximization. By purchasing large or controlling stakes in downstream petrochemical companies,[154] IPIC secures markets for Abu Dhabi's oil exports. This decreases Abu Dhabi's vulnerability to oil price shocks and potentially creates channels for oil sales higher than OPEC quota levels. Similarly, by purchasing large or control-

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al-hilal-bank-199340.html.

150. *Direct Investments*, ABU DHABI INV. COUNCIL, http://www.adcouncil.ae/BusinessFunctions/DirectInvestments/tabid/67/Default.aspx (last visited Oct. 15, 2011) ("legacy portfolio consisting of 12 investments in local financial institutions and other prominent companies").

151. Saad Group defaulted on a $1 billion debt in May 2009, forcing regulators across the Middle East to ask numerous banks to mark down overall loans to the groups (which were approximately ten billion dollars) by fifty to seventy-five percent. In the aftermath, almost every bank in the Gulf saw an increase in debt renegotiation and restructuring by family-owned businesses, reflecting widespread concern. As was noted in the Arabic press, banks simply made lending decisions based on reputation rather than the underlying business. As a measure of how integral these loans are to the political bargain in the region, the U.A.E. Central Bank gave exposed banks access to lending facilities to resolve any liquidity problems caused by the markdown, effectively backstopping the bad loans, since both the Central Bank and the commercial banks are government-controlled. *GCC—The Saad-Algosaibi Disaster*, EXEC. MAGAZINE (Sept. 2009), *available at* http://executive-magazine.com/getarticle.php?article=12201; Mark Townsend, *Saudi Scandal Lifts Veil on Gulf Finance*, INSTITUTIONAL INVESTOR (Oct. 1, 2009), http://www.institutionalinvestor.com/Popups/ PrintArticle.aspx?ArticleID=2307525.

152. Information obtained from personal interviews with company owners in Abu Dhabi between November 17 and 25, 2006 and January 21 and 23, 2008. For post-crisis independent confirmation that name lending was common, see *ME Lending Slumps to 5-Year Low*, TRADEARABIA (Dec. 18, 2009), http://www.tradearabia.com/news/bank_172003.html; *IPRA-GC Conference 2011 Opens in Abu Dhabi*, AL BAWABA (Apr. 14, 2011), http://www.albawaba.com/ipra-gc-conference-2011-opens-abu-dhabi ("through practices such as 'name lending,' many businesses used to get by on reputation alone").

153. IPIC has made some extraordinary investments—most notably in acquiring a 16.3% stake in Barclays. This investment is probably best explained as an exercise of Sheikh Mansour's personal autonomy, the limits of which were made clearer when pressure from within Abu Dhabi led IPIC to reduce its stake to a more traditional five percent. The reasons for acquiring a stake in a western financial institution at all probably mirror those that led to investments in Citigroup by ADIA and the KIA, and in Merrill Lynch by the KIA.

154. Such companies include OMV AG, Borealis, CEPSA, PAK Arab Refinery and Oman Polypropylene, among others. *Moody's Publishes Credit Opinion on International Petroleum Investment*, AMEINFO (Apr. 28, 2009), http://www.ameinfo.com/194324.html; PAK-ARAB REFINERY LIMITED (PARCO), http://www.parco.com.pk/ (last accessed Oct. 29, 2011) ("40% of the shares are held by Emirate of Abu Dhabi through its Abu Dhabi Petroleum Investment Company L.L.C. ("ADPI"), a subsidiary group of International Petroleum Investment Company"); Prema Viswanthan, *Oman PP Reduces OP Rates at PP Plant on Feedstock Shortage*, ICIS ONLINE, http://www.icis.com/Articles/ 2010/06/11/9366972/corrected-oman-pp-reduces-op-rates-at-pp-plant-on-feedstock-shortage.html (last visited Oct. 29, 2011) ("International Petroleum Investment Co (IPIC) . . . hold[s] a 20% stake in Oman Polypropylene.").

ling shares in upstream service providers like Oil Search and Arab Petroleum Pipelines Co., among others, IPIC ensures that Abu Dhabi will have access to the technology and human resources needed to keep oil production levels high as existing reserves decline. So, by purchasing petrochemical sector companies, IPIC increases Abu Dhabi's ability to sustain oil sales and production autonomously.

Mubadala also pursues an aggressive investment strategy. It has taken a share greater than five percent in some sixty-three companies, many of which are Western corporations. Some of these companies even operate in traditionally sensitive industrial sectors like aviation[155] and electronics.[156] Mubadala's investments follow exactly the kind of activist investment pattern that worries many Western investors. The investments are explicitly made to steer future expansion by those companies to Abu Dhabi.[157] Acquisitions in the aviation and aerospace sector were made in conjunction with the construction of a new airport terminal and airport free trade zone[158] and all fit within an expressed public policy goal.[159] Investments in the Guinea Alumina Corporation, the Emirates Aluminum Company[160] and Spyker Cars[161] were all made to develop a seamless supply chain for aluminum that would create thousands of new jobs in Abu Dhabi.[162] Developing and diversifying the economy inside Abu Dhabi simply does not make sense for a SWF that is looking to maximize profits because Abu Dhabi's sole competitive advantages are access to petroleum and subsidized energy.[163] However, in developing state-owned "private sector" industries, Mubadala is expanding the "private sector" opportunities for future generations of Abu Dhabi's citizens. Eventually, this should enable reductions in civil service positions

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155. Seventy percent of SR Technics and thirty-two percent of Piaggio Aero Industries. MUBADALA, ANNUAL REPORT 2010, at 42 (2010), available at mubadala.ae/images/uploads/ Mubadala_AR10_English.pdf.

156. A twenty percent share in Advanced Micro Devices, Inc. *Id*.

157. *Id*.

158. *See Abu Dhabi International Airport*, ABU DHABI GOVERNMENT—BUSINESS, http://business.abudhabi.ae/egovPoolPortal_WAR/appmanager/ADeGP/Business?_nfpb=true&_pageLabel=P6800317491243425964701&did=124726&lang=en (last visited Oct. 29, 2011). Competition with Dubai's new Jebel Ali Airport City was almost certainly an additional factor in these investment decisions, as maximizing future policy options that would accrue to the emirate whose airport was more successful required activist investments in western companies. For a view of inter-emirate competition manifested in aviation, see *Rulers of the New Silk Road*, THE ECONOMIST (June 3, 2010), *available at* http://www.economist.com/ node/16271573 (last visited Oct. 29, 2011).

159. *See* THE EXEC. COUNCIL, POLICY AGENDA 2007–2008: THE EMIRATE OF ABU DHABI 50–51, *available at* http://mubadala.ae/images/uploads/Policy_Agenda_2007_-_20 08.pdf (last visited Oct. 29, 2011).

160. Asa Fitch, *UAE Rises in Ranks of Aluminium Majors*, THE NATIONAL (Apr. 24, 2011), http://www.thenational.ae/business/economy/uae-rises-in-ranks-of-aluminium-majors (last visited Oct. 29, 2011).

161. Spyker automobiles are primarily manufactured from aluminum. *See Craftsmanship*, SPYKERCARS, http://www.spykercars.nl/?pag=26 (last visited Oct. 29, 2011).

162. *See* Soren Billing, *Mubadala Will Grow Asset Base Threefold in 5 Years*, ARABIAN BUSINESS (Apr. 29, 2009), http://www.arabianbusiness.com/property/article/554074-mubad ala-will-grow-asset-base-threefold-in-5-years-.

163. Abu Dhabi has a small workforce and relies on temporary immigrant workers for its labor supply, its fresh water is created by energy-intensive desalination plants and, with the sizeable exception of petroleum, it has no natural resources. The Emirate's "Economic Vision: 2030" lists its competitive advantages as petroleum and natural gas reserves, low energy costs, a world-class transport system, relatively affordable skilled labor and its geographical position. *See Section 3: Engines of Abu Dhabi's Future Economic Growth in* ECONOMIC VISION: 2030, *available at* http://www.masdarcity.ae/userfiles/files/economic-vision-2030-section-3.pdf (last visited Oct. 29, 2011). Suffice it to say that the ability to import labor is not traditionally thought of as an economic advantage and the emirate's geographic position is not particularly distinguishable from any number of other emirates and countries located in the Middle East.

while retaining royal control over citizens' employment.[164] Mubadala has also taken large stakes in non-oil energy companies[165] in order to ensure continued state control over energy in Abu Dhabi. Thus, overall, it is clear that Mubadala's investment activity is autonomy-maximizing. Further, by separating these aggressive strategies from ADIA, any political backlash against Mubadala's investments will not restrict ADIA's ability to invest Abu Dhabi's primary reserves.

In summary, the formation of ADIA, placing control at the sub-national level and the proliferation of new SWFs can best be described as choices made to ensure the autonomy of the ruling family. ADIA's general strategy of investing internationally for profit is not inconsistent with this goal. Indeed, its tendency to invest below reporting thresholds lends credence to an autonomy-maximizing strategy rather than a mercantilist one. While some commentators have suggested that ADIA's extraordinary investment in Citigroup during the financial crisis points to a mercantilist strategy,[166] our analysis suggests that it too can best be explained in autonomy-maximizing terms. The size and nature of the transactions need to be viewed in the context of the global crisis and the relationship between the United States and Abu Dhabi. Living up to the commitments implied by its relationship with a great power is essential for a small ruling elite that is vulnerable to internal and external threats. Finally, the more aggressive investment strategies of IPIC, ADICU (including the provision of favorable loans to political allies) and Mubadala also fit this explanation. They are meant to stabilize the current balance of power within the royal family and maintain the unified front presented by existing elites, thereby preventing vulnerability to demands made by other segments of society and protecting the autonomy of the ruling elite.

C. Singapore

Unlike the governments in both Kuwait and Abu Dhabi, Singapore is not a hereditary monarchy. Further, unlike those political entities' SWFs, Singapore's Temasek Holdings ("Temasek") and Government of Singapore Investment Corporation ("GIC") are not funded by natural resource revenues. Despite these differences in local conditions, the creation, structure and actions of Singapore's SWFs are best explained by autonomy-maximization. Indeed, no other country has so openly embraced economic management as a means to protect the autonomy of the ruling elite both internally and externally. The initial creation of SWFs in Singapore increased the autonomy of Singapore's People's Action Party ("PAP");[167] so, too, has the evolution of Temasek and the GIC. Just as with KIA and Abu Dhabi's SWFs, the normal investment

164. If these companies are privatized at some point in the future, the process will likely result in disproportionate benefits for political allies. Even if privatization is executed such that all citizens benefit equally, this would have the autonomy-boosting effect of reducing demands on ADIA funds. Offering citizens ownership of observable large domestic companies would likely eliminate demands on the more substantial assets held by ADIA.

165. Including Dolphin Energy and the Abu Dhabi Future Energy Company (Masdar). MUBADALA ANNUAL REPORT 2010, *supra* note 155, at 42.

166. *See* Gilson & Milhaupt, *supra* note 6, at 1348–50.

167. The PAP has held power in Singapore since the creation of the state due to the country's pluralist voting system. As a sign of its dominance, the party held every seat in the legislature from 1968 until 1980. *See Party Milestones*, PEOPLE'S ACTION PARTY (Oct. 15, 2011), http://www.pap.org.sg/partyhistory.php. The PAP currently holds all but six seats. Shamim Adam & Weiyi Lim, *Singapore's Lee Retains Power With Smallest Margin Since 1965*, BLOOMBERG NEWS (May 7, 2011), http://www.bloomberg.com/news/2011-05-07/singapore-s-people-s-action-party-keeps-parliamentary-majority-state-says.html.

patterns of these SWFs, as well as their extraordinary actions (interventions in the domestic stock market, purchases of large stakes in Chinese and American banks, providing assurance for the Barclays IPO and recapitalizing CAO) fit the pattern of autonomy-maximization but cannot be explained with any of the other theories we explored above.

Singapore's elites have always been conscious of the issue of external autonomy, and it is not hard to see why. Singapore's political history has been marked by British colonization, Japanese military occupation and other turmoil since its very creation. Other than the brief reign of a puppet sultan in the nineteenth century, Singapore had been controlled by or subsumed within some foreign power from its inception until it gained independence in 1965.[168] An independent republic, Singapore is wedged between Malaysia and Indonesia. Although over seventy-five percent of the population is ethnic Chinese,[169] the presence of a substantial Malay minority has prompted its neighbors to express their desire to see regional "ethnic solidarity" from time to time, ensuring that stability is never certain. For example, Indonesia sponsored terrorist attacks in Singapore during the 1960s to foment racial riots as part of its bet to prevent the unification of the Malaysian peninsula. Relations with Malaysia, the country from which Singapore separated, have also remained tense. Malaysia disputed Singapore's maritime claims until 1995,[170] and Singapore is also completely reliant on the Malaysian state of Johor for its drinking water.[171] It is therefore unsurprising that Singapore's elites have approached politics with a rather realist interpretation.[172]

Given that Singapore is, however, a tiny country relative to its neighbors (much less relative to whatever global power has been ascendant at a given time), it has never been able to rely strictly on military power to secure its existence. Relying on a sense of historical legitimacy within the region was an equally untenable plan given Singapore's origins as an imperialist outpost.

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168. Singapore was originally carved out of Malay territory when the British installed and recognized the exiled elder brother of the Sultan of Johor as the ruler of Singapore to provide a base for British activity in the otherwise Dutch-controlled straits. *See* Barbara Leitch LePoer, *Chapter 1: Historical Setting*, *in* LIBRARY OF CONG. FED. RESEARCH DIV., SINGAPORE: A COUNTRY STUDY (1989), *available at* lcweb2.loc.gov/frd/cs/sgtoc.html. After the British East India Company deposed the Sultan and took full control five years later, the British ruled Singapore until 1939. With Britain's naval forces engaged in defending the home islands against Germany, Japanese forces quickly defeated the skeleton British defenses and imposed a brutal occupation regime in which Chinese civilians were massacred in retaliation for ongoing resistance against Japan in mainland China. The British reassumed control of Singapore after the end of the war and set Singapore on a path to independence. After securing full internal self-government in 1959, Singapore temporarily merged into Malaysia in 1963 (becoming independent of the U.K.) but was expelled in 1965 and forced to fend for itself as an independent state. MICHAEL LEIFER, SINGAPORE'S FOREIGN POLICY: COPING WITH VULNERABILITY 4 (2000); LePoer, *supra*.

169. *See* LEIFER, *supra* note 168, at 1.

170. *Id.* at 2.

171. *Id.* at 4.

172. As early as 1966, Singapore's first prime minister (and still the dominant figure in Singaporean politics), Lee Kuan Yew, said, "in the last resort it is power which decides what happens and, therefore, it behoves [sic] us to ensure that we always have overwhelming power on our side." *Id.* at 5.

At independence, the domestic situation was equally tenuous. The country's per capita GDP was under $400 and unemployment was high. Singapore's entrepôt-based economy could not provide enough jobs to defuse racial tensions over employment, and industrial infrastructure was minimal;[173] a concerted industrial development policy was urgently needed.[174] As others have commented, the only way to "wean the native Malay population from ethnic politics was through the appeal of social democratic policies,"[175] but full socialism was impossible absent a union with the Malay hinterland. Therefore, when the merger experiment between Singapore and Malaysia failed, the PAP was forced to embark on an alternate path.

As Lee Kuan Yew, the first Prime Minister of the Republic of Singapore, would later explain, the PAP "decided soon after independence to link Singapore up with the advanced countries and make [them]selves a hub or nodal point for the expansion and extension of their activities."[176] This initial industrial policy was carried out through substantial investments and subsidized loans made by the Economic Development Board into domestic and foreign companies. The twin tactics served the dual purposes of creating vested foreign interests in the continued viability of Singapore as an autonomous state and creating employment for the working class to quiet ethnic tensions.[177]

By requiring private savings to be paid into the Central Provident Fund ("CPF") and incentivizing additional private purchases of government bonds, Singapore managed to co-opt a substantial pool of private capital into the service of the government.[178] Critically, given Singapore's young population at the time, the CPF's liabilities would not come due for decades. The allocation of assets, however, would be specifically approved by government bureaucrats according to current policy goals.[179] Therefore, the move can be interpreted as serving two goals.

173. RAJ VASIL, GOVERNING SINGAPORE: A HISTORY OF NATIONAL DEVELOPMENT AND DEMOCRACY 5 (2000).

174. *Id.* at 6.

175. A political party is essentially in the business of acquiring and maintaining power. In older Western democracies, because of the nature of the citizenry and the open and competitive political environment, power is seen as a means to implementing policies, preferences and priorities. However, in newly independent states, power was tied more directly to the exploitation of primordial loyalties and the distribution of patronage: policy success could not be relied on as voters were not sufficiently educated to make rational choices based on evidence. *Id.* at 8–9.

176. LEIFER, *supra* note 168, at 12.

177. Interestingly, these investments were largely funded by mandatory contributions from Singapore's work force to Singapore's Central Provident Fund, which was established in 1955. *See* Mukul G. Asher, COMPULSORY SAVINGS IN SINGAPORE: AN ALTERNATIVE TO THE WELFARE STATE 1 (Nat'l Ctr. for Policy Analysis, Policy Rep. No. 198, 1995), *available at* http://portal.jnu.edu.cn/publish/uploadFile/2970/eWebEditor/20100713084009226.pdf; *Looking Back*, CENTRAL PROVIDENT FUND BOARD, http://mycpf.cpf.gov.sg/CPF/About-Us/HistoryofCPF.htm (last updated June 30, 2011). This imposition of a mandatory savings regime on the labor force, combined with Singapore's welcoming attitude toward labor-intensive industries, LePoer, *supra* note 168 ("A four-year development plan, launched under Minister of Finance Goh Keng Swee in 1961 . . . set aside a large area of swamp wasteland as an industrial estate in the Jurong area and emphasized labor-intensive industries . . . ."), created a substantial pool of capital for the government to redeploy toward additional industries. Conservative fiscal policies, *see Country Watch: Singapore*, ASIAN FINANCE, Sept. 15, 1989, at 83, also discouraged local consumption, further accelerating the accumulation of capital. Finally, through the EDB's efforts to ensure diversification via selective deployment of this cheap capital, the effects of Dutch Disease were mostly avoided. *See* SINGAPORE INFLATION RATE, http://www.tradingeconomics.com/singapore/ inflation-cpi (indicating that Singapore's average annual inflation from 1962 to 2010 was 2.73 percent).

178. *See* GEORGE A. AKERLOF & ROBERT J. SHILLER, ANIMAL SPIRITS: HOW HUMAN PSYCHOLOGY DRIVES THE ECONOMY, AND WHY IT MATTERS FOR GLOBAL CAPITALISM 125 (2009) (discussing Lee Kuan Yew's policies of mandatory pension contributions and other policies to boost domestic saving rates).

179. The CPF is a provident fund, so in addition to paying out a single lump sum to pensioners upon retirement, it also gives

First, it created a public perception that the PAP was critically responsible for the country's new private sector growth. Second, it created a financial cushion to ward off economic downturns. This, in turn, assured that the PAP would be able to provide continued economic growth and stability even during times of economic shocks—thereby protecting the autonomy of the ruling elite.

In addition, the country pursued an active industrial policy to accelerate growth and position Singapore as a critical economy in the Far East. According to Suppiah Dhanabalan, the longtime Chairman of Temasek, Singapore incentivized capital investments in manufacturing from both local and foreign sources by taking minority stakes in companies and making subsidized loans through the Economic Development Board ("EDB").[180] In an effort to separate regulatory and business functions, the government transferred EDB's industrial loan portfolio to DBS Bank in 1968 and transferred EDB's equity holdings to the Ministry of Finance.[181] During this early period, a special department within the Ministry of Finance managed these holdings.[182] However, in 1974 the department was reorganized into Temasek, a limited liability company owned by the Ministry.[183] This raises questions as to why a special entity was needed and whether this reorganization served primarily administrative functions or other goals.

The official story is, of course, that the creation of Temasek was simply a decision made to separate the business and regulatory functions of the government to increase efficiency.[184] Given that the transfer of the EDB's equities to the Ministry of Finance was supposed to achieve this same goal, however, Temasek seems a bit redundant. Additionally, the timing was somewhat suspect, as one would have anticipated that Temasek would have been created at the same time that the EDB's loan portfolio was used to capitalize DBS Bank six years earlier. Finally, the fact that Singapore's regulatory bodies continued to protect monopolies held by Temasek-controlled companies[185] suggests that the separation of regulatory and equity interests does not initially seem to have caused any tangible changes in regulatory policy.

Mercantilist theory offers little insight on the creation of a separate government-owned corporation: the distinction between channeling capital accumulation through a Ministry or a Ministry-owned corporation is irrelevant because either can be used to ensure that capital stays within the country. Creating Temasek as an independent entity does not support the account that

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citizens the ability to withdraw some funds for specifically approved purposes such as housing, tertiary education and health care costs. *See* ARMANDO BARRIENTOS, COMPARING PENSION SCHEMES IN CHILE, SINGAPORE, BRAZIL, AND SOUTH AFRICA 8–10 (IDPM Discussion Series, Paper No. 67, 2002).

180. Suppiah Dhanabalan, Chairman, Temasek Holdings, Governance and Sustainable Institution: A Personal Perspective, Remarks at the 6th Mizuho Global Seminar in Tokyo (May 17, 2010), ¶ 14 (transcript available at http://www.temasek.com.sg/mediacentre/ speeches?detailid=8598).

181. Dhanabalan, *supra* note 180.

182. *Id.*

183. *Id.* ¶¶ 14–17.

184. Dhanabalan has said that "Temasek was formed simply to take a load off a Government which had other priorities and by forming Temasek, the government could be sure that there could be an independently focused, professionally managed and commercially disciplined approach to investments and managing businesses." *Id.* ¶ 19.

185. Burton Ong, who discusses the likely impact of Singapore's new competition law on government affiliated companies, calls such companies "large Singapore companies who [sic] shares are held, entirely or substantially, by Temasek Holdings." *See* Burton Ong, *The Origins, Objectives and Structure of Competition Law in Singapore*, 29 WORLD COMPETITION 269, 272 n.8 (2006).

Singapore's SWFs are imperialist-capitalists either. When a country is trying to capture above-market rents through the imposition of imperial force, it would seem to be beneficial to keep a direct link between its equity investments and the state. That way, investment targets would be more compliant for fear of the political consequences of resisting the SWF. Rather, the creation of Temasek is consistent with the actions of a rational market-based investor: vesting investment decisions in an autonomous company should increase returns over those generated by officials within a politicized Ministry of Finance.

The creation of Temasek is also consistent with the autonomy-maximization theory advanced in this paper, especially when considering the timing of the creation of this sovereign wealth fund within its broader geopolitical context. Temasek was incorporated in the same year that American forces withdrew from Vietnam. This threatened to disrupt the tenuous balance of power in Southeast Asia that Singapore had worked carefully to create.[186] By shifting its portfolio of equities to a formal corporation separated from the government, Singapore signaled to the West that it was committed to capitalist principles while the Ministry of Finance's retention of the equity interest in Temasek (and the fact that the new company was largely staffed by civil servants)[187] signaled to the socialist world that Singapore was not fully in the pocket of Western interests. By adopting corporate formalities while retaining certain socialist aspects, Singapore was able to chart a middle ground that kept all sides interested in Singapore's continued viability and protected the autonomy of the PAP.

Funding is another mechanism by which Singapore's government, and thus the PAP, retains control over Temasek. Despite occasional protests that Temasek should not be considered a conventional SWF because it receives only small capital injections from the government from time to time rather than on a regular basis,[188] Singapore's capital injection in 2008 of close to S$21 billion[189] was equal to more than ten percent of Temasek's portfolio value at the time.[190] While this occurred in the midst of the global financial crisis, it serves to illustrate the central role of Temasek in Singapore's economic policy. Further, as a Fifth Schedule Company,[191] Te-

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186. During the 1960s and 1970s, Singapore's leaders promoted trade relations with Moscow, believing that a Soviet role in Southeast Asia would ensure the permanent interest of the United States in the region. By involving both the Soviet Union and the United States as counterweights to China (the presumptive regional power), Singapore managed to carve out a fair amount of autonomy for itself rather than being captured under any particular power's "sphere of influence." *See* LePoer, *supra* note 168. Interestingly, by avoiding any commitment to a neutral foreign policy, while remaining part of the Non-Aligned Movement, Singapore also managed to keep each of these larger powers interested in the continued security of Singapore—which lent some protection against regional threats coming from Indonesia and Malaysia. *Id.*

187. Temasek was initially staffed by seconded and retired civil servants. Dhanabalan, *supra* note 180, ¶ 20.

188. Suppiah Dhanabalan, Chairman, Temasek Holdings, The Role of Sovereign Funds in Today's Globalization, Speech at The Indus Entrepreneurs Event (Aug. 21, 2008), ¶¶ 27–28 (transcript available at http://www.temasekholdings.com.sg/media_centre_news_ speeches_210808.htm).

189. *Apres Ho Ching, Le Deluge?*, ASIA SENTINEL (Feb. 9, 2009), http://www.asiasentinel.com/index.php?option=com_content&task=view&id=1710&Itemid=233&limit=1&limitstart=1 ("[L]ast financial year its portfolio value rose by thirteen percent to S$185 billion but much of this was apparently accounted for by an official injection.").

190. *See Our Portfolio Value Since Inception*, TEMASEK (2010), http://www.temasekreport.com/2010/portfolio/inception.html.

191. Fifth Schedule companies are designated by Singapore's Constitution as government-affiliated companies. They need special approval from the President on certain matters of governance. Other Fifth Schedule entities include the Central Provident Fund Board, Government of Singapore Investment Corporation and the Monetary Authority of Singapore. *See* CONSTITUTION OF THE REPUBLIC OF SINGAPORE, July 1, 1999, Fifth Schedule, arts. 22A, 22C.

masek must obtain the approval of the Singaporean President if the value of its portfolio falls below what it was when the current government took office.[192] Since the PAP ensured that its nominee for president ran unopposed by any viable alternative candidate from Singapore's independence through 2011, the presidential approval requirement ensured that the PAP would have a veto right over Temasek's annual budget for a full election cycle even if the party were to lose its majority in Parliament.[193] In the 2011 presidential race, the PAP did not officially endorse a candidate for the presidency and allowed four candidates to qualify. Of the four, however, three were former PAP members, and the winner, Tony Tan Keng Yam, was the PAP's favored candidate and a long-serving PAP cabinet member, former deputy Prime Minister and the former head of GIC.[194] The implications of the 2011 election are unclear, but for the moment the PAP retains control of both Parliament and the presidency.[195]

Temasek's sister fund, GIC, was established more recently in 1981. It serves as another illustration of how small states use economic resources to placate major powers on whose goodwill they ultimately depend. By 1981, Singapore's economy had developed significantly and had emerged as one of the Asian tigers and dragons (alongside Hong Kong, Taiwan and South Korea) due at least in part to an aggressive export-led growth strategy.[196] In addition, the economy was generating both persistent positive cash flows (through Temasek's investment in domestic companies[197]) and new low-cost capital (from individual savings in the Central Provident Fund).[198] There was simply too much money available to invest solely within Singapore. Moreover, there was increasing international pressure on Singapore and other countries with substantial accumulations of excess reserves to recycle them for the benefit of the global economy, especially in the aftermath of the oil crisis, which had exposed vulnerabilities in the Western export markets.[199] Thus, it was fairly apparent that international investment opportunities should be pursued. However, investments into foreign public corporations by a holding company for what were essentially state-owned enterprises probably would not have been warmly received in Western democracies. Establishing a separate institution to manage Singapore's excess revenues allowed for a distinction to be made between the hands-on domestic economic policies of the

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192. *Id.*

193. The PAP has used the government's election board to disqualify opposition candidates for president since constitutional amendments first required direct elections of the president in 1991. *See Presidential Election 1999*, SINGAPORE ELECTIONS, http://www.singapore-elections.com/pres-elec/1999.html (last visited Jan. 7, 2011); *Presidential Election 2005*, SINGAPORE ELECTIONS, http://www.singapore-elections.com /pres-elec/2005.html (last visited Jan. 7, 2011).

194. Chun Han Wong, *Tony Tan Elected President of Singapore*, WALL ST. J. (Aug. 28, 2011), http://online.wsj.com/article/SB10001424053111904787404576534873643392148 .html.

195. *Id.*

196. The deeper reasons for the East Asian "miracle" continue to be debated. While some attribute it primarily to export-led growth, *see, e.g.*, ASIAN DEV. BANK, EMERGING ASIA: CHANGES AND CHALLENGES (1997), others emphasize broader industrial policies, *see, e.g.*, ROBERT WADE, GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EAST ASIAN INDUSTRIALIZATION (1990); THE WORLD BANK, THE EAST ASIAN MIRACLE: ECONOMIC GROWTH AND PUBLIC POLICY (1993).

197. *See supra* note 185 and accompanying text.

198. *See* Margaret Sullivan, *Chapter 3: The Economy*, *in* SINGAPORE: A COUNTRY STUDY, *supra* note 168 ("Every employed Singaporean or permanent resident was automatically a member of Central Provident Fund, although some self-employed people were not. Membership grew from 180,000 in 1955 to 2.08 million in 1989. At the end of 1988, the 2.06 million members of the Central Provident Fund had S$32.5 billion to their credit.").

199. Bela Balassa, *The Newly-Industrializing Developing Countries After the Oil Crisis*, 117 WELTWIRTSCHAFTLICHES ARCHIVE 142, 165 (1981).

PAP implemented through Temasek and the country's international investments. Thus, establishing the GIC enabled Singapore to access a broader range of investment opportunities without triggering a political backlash.

As discussed in the Abu Dhabi case study, creating a separate SWF for domestic and foreign investments also prevents management or employees at either fund from establishing a powerful competing locus of authority with ties to both domestic businesses and international actors. This approach protects the existing privileged position and autonomy of local elites. In the case of Singapore, the political importance of controlling SWFs and the investment opportunities they provide is illustrated by the fact that Lee Kuan Yew became chairman of GIC at a time when he was still serving as the country's prime minister and has retained this position ever since.[200] Further, establishing a second SWF expands the institutional space available to reward allies or sideline potential rivals and ensures their loyalty to the ruling elite.[201]

Specializing investment functions is, of course, also perfectly consistent with profit maximization. Moreover, the shift to international investments is a move capitalist or socialist imperialist accounts predict.[202] However, closer inspection of GIC's financial resources and their management strongly point towards autonomy-maximization. GIC receives money from the public budget. However, because part of the CPF's portfolio is Singaporean government bonds, the CPF functions to mobilize the mandatory contributions by Singaporean employees—a cheap source of captive capital—to facilitate GIC's activities abroad.[203] This ingratiates the PAP with the international community, signaling that it is a cooperative player in rebalancing global currency accounts. It also allows the PAP to increase the size of Singapore's reserves relatively easily since its cost of capital is so low. (This increase serves as propaganda each year to boost popular domestic support for the PAP.) These easy returns are also used to justify high salaries for GIC employees—even those who serve in *ex officio* positions[204]—which serves to increase the attractiveness of remaining on good terms with the PAP rather than mounting a political challenge.

So far we have argued that the establishment of separate entities to manage funds that could be invested to boost domestic development or to invest internationally supports the autonomy maximization theory advanced in this article. We now extend this argument and suggest that the governance structure of both funds lends further credence to our theory.

Temasek's formal governance structure is the same as that of conventional limited liability companies found in the West.[205] Senior management is selected and overseen by a board of

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200. Note that Lee Kuan Yew served as prime minister of Singapore for thirty-one years, from 1959 until 1990. *See Not Fade Away*, THE ECONOMIST (May 16, 2011), http://www.economist.com/blogs/banyan/2011/05/singapore_politics.

201. *See infra* note 209 (discussing the career patterns of management personnel at the two funds).

202. *See supra* note 9 and accompanying discussion.

203. The CPF guarantees pensioners a return of 3.5%, and GIC's average returns are reported to be about 9%. *See* Shawn Crispin, *Cracks Appear in Lee's Mantle*, ASIA TIMES ONLINE (Mar. 20, 2009), http://www.atimes.com/atimes/Southeast_Asia/KC20Ae02.html. The GIC is then able to retain these excess profits to boost its balance sheet.

204. Singapore's government ministers earn average salaries of $1.2 million—and Lee Hsien Loong earns more than $2 million. *Id.*

205. The Singapore Companies Act applies to closely held as well as publicly traded corporations. Its core governance provision mirrors, for example, Section 141 of the Delaware General Corporate Law by stating that the company is managed by or under the direction of the board of directors. For a summary of the key aspects of Singapore's company law, see *Company*

directors, which is in turn elected by shareholders.[206] The official line is that the Board is independent of the government because a majority of its directors are "non-executive independent private sector business leaders."[207] However, Temasek's sole shareholder is the Ministry of Finance, making it questionable how effective the presence of a Board is in separating Temasek from the government. Clearly, in the event of any substantial disagreement between the party and the Board over Temasek's strategy or actions, it would be relatively simple for the Ministry of Finance to call a shareholder meeting to replace the entire slate of directors. Further, the appointment or removal of directors to Fifth Schedule Companies like Temasek requires Presidential approval under Singapore's Constitution.[208] Additional evidence comes from the staffing of top positions at Temasek, which are filled by PAP insiders, ensuring PAP influence on Temasek's day-to-day activities. Most obviously, the CEO of Temasek, Ho Ching, is the wife of Lee Hsien Loong, Singapore's current prime minister and the son of Lee Kuan Yew. Further, Ho Ching was nominated to be CEO shortly after her husband was elected Prime Minister, suggesting that her selection is part of a strategy to transfer power to the next generation of the Lee Kuan Yew cartel.[209] The Chairman of the Board, Suppiah Dhanabalan, is another example. He worked at the EDB prior to its funds being transferred to Temasek, was a prominent PAP politician during the 1980s,[210] held numerous ministerial portfolios and remains a key member of the Lee Kuan Yew inner circle.[211]

In defense of the rather clubby (and somewhat nepotistic) appointments, Lee Hsien Loong has said that Singapore is "such a small society if you want everybody to be disconnected from everybody else, we just don't have the bodies."[212] Perhaps this is true on some level, but it would certainly be possible to find non-family and even non-party members to fill these positions. Temasek's governance structure therefore allows the PAP to maintain control over Temasek which in turn facilitates the PAP's ongoing efforts to guide Singapore's economy and retain control of the government.

The Chip Goodyear fiasco at Temasek provides a good example of how its governance structure does not actually isolate the Board from political considerations. In February 2009, Temasek announced that Chip Goodyear would become Temasek's new CEO, replacing Ms. Ho as of October 2009.[213] However, the transfer of power never materialized and Goodyear left the company in the summer of 2009. Officially, there was a conflict in management style and strat-

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Law, SINGAPORE LAW, http://www.singaporelaw.sg/content /CompanyLaw.html (last updated Apr. 30, 2009).

206. *Relating to Our Stakeholders*, TEMASEK (2010), http://www.temasekreport.com/ 2010/governance/shareholders.html. Temasek also maintains an "International Panel" comprised of international business leaders. This panel does not exercise any supervisory or direct authority over Temasek and generally serves as an advisory panel for the Board. *See* Dhanabalan, *supra* note 188, ¶¶ 37–38.

207. *Relating to Our Stakeholders*, *supra* note 206.

208. CONSTITUTION OF THE REPUBLIC OF SINGAPORE, July 1, 1999, Fifth Schedule, arts. 22A, 22C.

209. Wilson Ng, *The Evolution of Sovereign Wealth Funds: Singapore's Temasek Holdings*, 18 J. FIN. REG. & COMPLIANCE 6 (2010).

210. SUNANDA K. DATTA-RAY, LOOKING EAST TO LOOK WEST: LEE KUAN YEW'S MISSION INDIA 24 (2009).

211. Anne Hyland, *Singapore's Mr. Buffet*, AUSTL. FIN. REV. (May 24, 2002), http://www.singapore-window.org/sw02/020524af.htm.

212. *Id.*

213. *Mr. Charles "Chip" Goodyear to Succeed as CEO of Temasek*, STEEL GURU (Feb. 8, 2009), http://www.steelguru.com/sfTCPDF/getPDF/ODE3MjI=/Mr_Charles_Chip_Good year_to_succeed_as_CEO_of_Temasek.html.

egy.[214] It was, perhaps, a pleasant way to state that Goodyear had proven unexpectedly resistant to suggestions from the political elite notwithstanding an extended search to fill the position and a longstanding relationship between Temasek's chairman and Goodyear. Others speculated that Goodyear's previous position at BHP Billiton might have made his appointment a rather poor signal to China in light of its battle with another Australian mining company, Rio Tinto, at the time.[215] In any event, the Board's attempt to replace Ho Ching failed.

The governance structure of the GIC is, perhaps, even more revealing of the importance of Singapore's SWFs to the ruling elite. Similar to Temasek, the GIC is organized as a formal corporation with management that reports to a board of directors who are, in turn, elected by shareholders. As with Temasek, however, the sole shareholder is the Ministry of Finance.[216] Thus, as long as the PAP retains control of the government, it has the power to select all directors. Additionally, like Temasek, GIC is a Fifth Schedule Company, implying that no director may be appointed or removed without Presidential approval.[217] This "safeguard" also ensures that in the event of an unexpected loss of parliamentary control, the PAP would still control the board of GIC for at least the remainder of the President's term.[218]

As can be seen by the current Board's composition, the PAP closely supervises the GIC. Lee Kuan Yew served as the Chairman of GIC from 1981 through 2011 (and still retains a position as a "senior advisor"); he was succeeded by his son Lee Hsien Loong.[219] Among the other eleven directors are the current Ministers of Finance, Trade and Industry, Home Affairs and Education, along with a former Minister of Finance who had served in that position for sixteen years and the former second minister of Foreign Affairs.[220] Five seats are held by current senior managers within GIC and two are held by senior managers of Temasek-controlled companies.[221] Ang Kong Hua is the only director with no ties to the PAP who is not currently working for a

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214. James Thompson, *Temasek Reveals Surprise Departure of Goodyear*, INDEP. (July 22, 2009), http://www.independent.co.uk/news/business/news/temasek-reveals-surprise-de parture-of-goodyear-1755896.html (quoting the official statement of Temasek that the board and Mr. Goodyear have "concluded and accepted there are differences regarding certain strategic issues that could not be resolved").

215. In 2009, China arrested executives of Rio Tinto on charges of corruption in the wake of Rio's refusal to engage in a $23 billion joint venture with China's Cinalco. Given the importance of China for Singapore's long-term economic prospects, even a remote association with the Australian mining industry may have damaged Temasek's standing in China to an unacceptable extent. Mr. Goodyear was, according to some, suddenly an "unacceptable face of Singapore business." Ian Verrender, *Singapore Sling for Chip*, SYDNEY MORNING HERALD (July 29, 2009), http://www.smh.com.au/business/singapore-sling-for-chip-20090724-dw51.html.

216. GIC, REPORT ON THE MANAGEMENT OF THE GOVERNMENT'S PORTFOLIO FOR THE YEAR 2008/09, at 24 (2009), *available at* http://www.gic.com.sg/data/pdf/GIC_Report_ 2009.pdf.

217. *Id.* at 25.

218. *See supra* note 193 and accompanying discussion.

219. Lars Klemming, *Lee Hsien Loong Named Chairman of GIC*, BLOOMBERG NEWS (May 30, 2011), http://www.bloomberg.com/news/2011-05-31/lee-hsien-loong-named-chairman-of-gic.html.

220. *GIC Board of Directors*, GIC, http://www.gic.com.sg/about/board-of-directors (last visited Jan 7, 2011) (Lim Hng Kiang, Tharman Shanmugaratnam, Teo Chee Hean and Heng Swee Keat are currently ministers; Richard Hu Tsu Tau is the former long-serving Minister of Finance; Raymond Lim Siang Keat is the former second minister of Foreign Affairs; follow links for information about each individual member).

221. *Id.* Temasek owns large stakes in DBS Group Holdings Ltd. (twenty-seven percent) and Singapore Airlines Ltd. (fifty-five percent). *See Major Portfolio Companies: Financial Services*, TEMASEK REVIEW 2011 (2011), http://www.temasekreview.com.sg /portfolio/major_financial.html; *Major Portfolio Companies: Transportation and Industrials*, TEMASEK REVIEW 2011 (2011), http://www.temasekreview.com.sg /portfolio/major_transport.html.

company controlled by one of Singapore's SWFs. Overall, eleven of the twelve directors are strongly connected to the PAP or work for a company the government owns.[222] The career patterns leave the impression that a board position at GIC is a reward for outstanding (and loyal) services in business or government. This also ensures that GIC's strategies are aligned with the interests of Singapore's elites.

More than governance structures and personnel decisions, however, the controversy surrounding SWFs and their motives and strategies is concerned with their actual investment behavior. Temasek has traditionally taken controlling stakes in domestic companies and large minority stakes in regional companies. As discussed, Temasek's strategy has allowed the PAP to pick winners in the domestic market and foster the development of specific industrial sectors. Temasek began to develop an international profile only over the past decade. Closer inspection of its regional investments suggests a similar pattern.

Temasek is highly selective in its choice of regional investments and tends to take relatively large stakes. In fact, governments in the region often seek out Temasek to become a core investor in industries that require a stable shareholder or to defuse political tension in their own countries. These investments arguably serve the dual purposes of generating profits and aligning the interests of potential regional political rivals (and former enemies).

For example, Temasek invested in several Indonesian banks in the aftermath of the Asian financial crisis when the recapitalization of banks was of paramount importance to regional political stability. It now holds substantial minority positions in Alliance Bank (Malaysia) and Bank Danamon (Indonesia),[223] and the host government has invited it to take positions in Indonesian and Thai telecommunications companies. While Temasek was eventually forced to divest its stakes in Indonesian telecoms Telkomsel and Indosat due to a controversial anti-trust ruling,[224] the fact remains that the Indonesian government specifically invited the initial investment.

Temasek's purchase of a 49.6% stake in Thai telecom company Shin Corporation was supposed to demonstrate Singapore's ability to assist regional allies by helping then-Prime Minister Thaksin Shinawatra defuse allegations that his investment and telecommunications policies were aimed at benefiting a company his family owned.[225] Unfortunately for Temasek and Singapore, this acquisition sparked a "wave of unrest" that eventually resulted in a military coup and the ouster of Thaksin.[226] This episode demonstrates that even regional investments bear addi-

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222. *See* GIC, REPORT ON THE MANAGEMENT OF THE GOVERNMENT'S PORTFOLIO FOR THE YEAR 2009/10, at 30–37 (2010), *available at* http://www.gic.com.sg/data/pdf /GIC_Report_2010.pdf.

223. Ben Bland, *Temasek's Malaysian Governance Problem: What Happened Next*, ASIAN CORRESPONDENT (Mar. 12, 2010), http://asiancorrespondent.com/the-asia-file/temasek-s-malaysian-governance-problem-what-happened-next.

224. On November 19, 2007, Indonesia's Commission for the Supervision of Business Competition (KPPU) announced that it had found Temasek guilty of violating Article 27 of Indonesia's Competition Law Number 5 of 1999, which prohibits any company from owning a "majority" of shares in two or more companies that together have more than half of the market share in any industry. KPPU did so despite the fact that Temasek's subsidiaries actually held less than half of the shares in each company. *See Temasek to Appeal to Indonesia's Supreme Court*, TEMASEK (May 2009), http://www.temasek.com.sg /pdf/kppu_09may.pdf. The ruling was upheld on appeal to Indonesia's Supreme Court. Harry Suhartono, *Indonesia Court Upholds Anti-Trust Body Ruling on Temasek*, REUTERS (May 9, 2008), *available at* http://in.reuters.com/article/2008/05/09/temasek-indonesia-verdict-idINJKB9857020080509.

225. *Thaksin Cashes in his Chips*, ECONOMIST (Jan. 24, 2006), http://www.economist. com/node/5433987.

226. Wayne Arnold, *Ouster of Thaksin Exposes Temasek*, INT'L HERALD TRIB. (Sept. 20, 2006), *available at* http://www.nytimes.com/2006/09/20/business/worldbusiness/20iht-sing.2875492.html.

tional political risks relative to domestic investments. Whereas Temasek benefits from complete political support inside Singapore, it has little control over changes in the political winds in other countries. Not surprisingly, Temasek has treaded more carefully in recent years when investing regionally.

While Temasek's actions are regularly publicized, the GIC has largely avoided public scrutiny despite managing a larger portfolio.[227] This is fairly comparable to the situation in Abu Dhabi. The SWF tasked with investing globally (here, GIC) takes small stakes that are well below thresholds that would invite scrutiny or trigger disclosure requirements imposed by foreign regulators. Even on its own website, GIC discloses only highly aggregated figures describing its portfolio.[228] As mentioned in the previous case studies, this strategy is autonomy-maximizing because it maximizes the number of investment opportunities that GIC can pursue without triggering a political backlash.

It is, of course, true that the general investment patterns of both Temasek and GIC are consistent with autonomy maximization or profit maximization. True preferences, however, are often revealed in a crisis.[229] Crises are extreme events that may prompt actors to make unusual and economically irrational decisions. Sometimes, however, these decisions reveal deep-seated priorities that are difficult to discern in normal times when wealth maximization neatly coincides with political interests. Examining the reactions of Temasek and GIC to several crises over the past decade thus helps to shed light on their underlying motives.

The first example dates back to 2004, when China Aviation Oil ("CAO"), a subsidiary of China Aviation Oil Holding Company ("CAOHC"), a large company trading on Singapore's SGX exchange, collapsed.[230] CAO had taken substantial short positions on oil at a time when prices were increasing relentlessly. Consequently, it was forced to file for bankruptcy but was reorganized and eventually relisted on the SGX. A closer look at this fairly innocuous chain of events reveals, however, a complex sequence of interactions between the Chinese and Singaporean governments in which Temasek played a central role. In a last-minute attempt to rescue CAO, its parent company, CAOHC, engaged in insider trading under Singapore's laws.[231] Temasek and the other investors were wiped out when CAO filed for bankruptcy only weeks later. Singapore's Monetary Authority faced the stark choice of enforcing its insider trading rules (and

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227. Temasek reported that the market value of its portfolio has recovered from the financial crisis and rose to a new high of $183 billion in March 2010. Netty Ismail, *Temasek's Assets Set to Reclaim Peak as Asia Pays Off*, BUS. WEEK (July 7, 2010), *available at* http://www.theedgesingapore.com/component/content/17550/17550.html?task=view& showall=1. GIC does not disclose its portfolio's value, but it was speculated to be about $200 billion as of March 31, 2009. Costas Paris and P.R. Venkat, *Singapore's GIC's Portfolio Suffers Loss In Fiscal 2009*, DOW JONES NEWSWIRES (Sept. 29, 2009), http://singaporeelection.blogspot.com/2011/04/wsj-singapores-gic-suffers-416-billion.html.

228. *Supra* note 216, at 11–12.

229. For a discussion on using crisis moments to analyze governance regimes, see generally CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD (2008).

230. For a detailed account of this case, see *id.* at 125.

231. Two months before CAO filed for bankruptcy, it offered fifteen percent of its shares in CAO to investors in a private placement but failed to disclose that the funds raised would be lent to CAO to meet its obligations to the counterparties on its oil futures and creditors who had provided short-term liquidity. *See id.* Temasek was one of the lead investors buying shares in this placement, which was read by other market participants as a signal of safety despite rumors that CAO was troubled. John Burton, *BP and Temasek to Buy Stake into CAO*, FIN. TIMES (Nov. 22, 2005), http://www.ft.com/intl/cms/s/0/3d629ef2-5b4c-11da-b221-0000779e2340.html#axzz1abh5SfOH.

assuring foreign investors in particular of its commitment to strong investor protection) or soft-pedaling in order to protect its relations with China.[232] In nothing less than a coordinated approach, the Monetary Authority levied a substantial fine on CAO, but Temasek recapitalized CAO within the week, thereby ensuring CAO's re-listing on the Singapore stock exchange—an entity in which Temasek indirectly holds a twenty-four percent stake.[233] The events were quickly followed by an announcement that Temasek had been chosen as one of two initial investors in the China Construction Bank (CCB)—a highly anticipated opportunity, given that it was the first of China's four largest banks to go public.[234] Evidently, by choosing a middle ground, Temasek preserved its ability to invest in Chinese companies, thereby maximizing its future range of investment options and its autonomy.

In line with the behavior of KIA and ADIA described above, both Temasek and GIC took major stakes in struggling banks and investment banks in the midst of the global financial crisis and invested repeatedly even after booking losses on their original investments. Temasek acquired a 13.7 percent stake in Merrill Lynch through substantial investments in late 2007 and the fall of 2008.[235] While Temasek has always maintained that it was investing in Merrill Lynch because it thought that the company was undervalued (thus protecting its "profit-maximizing" credentials), skepticism is warranted. Temasek's initial $6 billion investment in December 2007 occurred at a time when many suspected that western banks were facing substantial impending losses on their subprime loan portfolios. Perhaps Temasek simply misjudged Merrill's exposure. However, when it became clearer that Merrill was, in fact, facing massive write-downs, Temasek followed its paper losses with another $6.6 billion to shore up Merrill's balance sheet.[236] Temasek again stepped into the breach with *another* $3.4 billion in the fall of 2008 (part of which, however, was from a $2.5 billion reset payment that was triggered under the earlier investments when Merrill sold additional shares to other investors at prices below those for which it had sold to Temasek).[237] After its shares in Merrill were converted to Bank of America shares as part of that merger, Temasek closed out its position in early 2009, resulting in an estimated $4.6 billion loss.[238] Temasek's loss-chasing behavior cannot be explained by profit-maximizing motivations. It did, however, help to support the health of the international financial system, thereby helping

232. The importance of China is underscored by the fact that Chinese companies represent over forty percent of foreign listings on the SGX, Lynette Khoo, *China moves pose IPO challenge for SGX*, ASIA ONE BUSINESS (Nov. 4, 2009), http://www.asiaone.com /Business/News/My+Money/Story/A1Story20091102-177410.html, and represented the greatest opportunity for continued SGX growth.

233. *See* MILHAUPT & PISTOR, *supra* note 229, at 125.

234. *Temasek to Invest 1 Billion USD in China Construction Bank*, PEOPLE'S DAILY ONLINE (July 5, 2005), http://english.peopledaily.com.cn/200507/05/eng20050705 _194016.html. On the sequence of bank privatization in China, *see* Katharina Pistor, *Banking Reforms and Bank Bail Outs in the Chinese Mirror, in* CHINA'S TRANSITION TO A MARKET ECONOMY (Joseph Stiglitz ed., forthcoming 2012) (manuscript available at http://policydialogue.org/files/events/Pistor_banking_reform_bail_outs.pdf).

235. Elinor Comlay, *Singapore's Temasek Holdings TEM.UL Has Increased its Stake in Merrill Lynch & Co Inc MER.N to 13.7% from 9.4%, According to a U.S. Regulatory Filing*, REUTERS (Sept. 30, 2008), *available at* http://www.reuters.com/article /idUSTRE48T4FE20080930.

236. Jason Simpkins, *Merrill Lynch Turns to Temasek for Another Stock Purchase, Unloads $31 Billion in CDOs*, MONEY MORNING (July 29, 2008), http://moneymorning.com/ 2008/07/29/merrill-lynch/.

237. *Id.*

238. Costas Paris, *Temasek Counts the Cost of Merrill Stake*, WALL STREET J. ASIA (May 18, 2009), http://online.wsj.com/article/SB124236495798923123.html.

to protect the value of Singapore's U.S. dollar-denominated reserves, and demonstrated that Singapore is a cooperative player in the global financial system.

GIC's contributions to the recapitalizations of UBS and Citigroup during the financial crisis gave it stakes of about eight percent and eleven percent, respectively, in the companies.[239] This, of course, seems somewhat contrary to its usual low-profile investment pattern. However, it seems likely that GIC did not expect to actually take such a substantial stake—or even convert its preferred shares. Even when the preferred shares dropped in value by eighty percent, GIC held onto them. However, when the U.S. government indicated that Citigroup needed to increase its tier one capital reserves, but that converting its own preferred stock was contingent on other investors following suit,[240] the writing was on the wall. The U.S. government was implicitly providing support for SWFs to take large stakes in Citigroup. Conversion of the preferred shares to common shares was the only viable option for salvaging Citigroup's total common equity ratio. This also had the benefit of converting GIC's paper loss from eighty percent to twenty-four percent,[241] but it eliminated GIC's claim to a seven percent dividend payment. A profit-maximizing investor responsive to short-term shareholders would have either converted or sold off its preferred shares earlier to minimize its paper losses and the accompanying criticism. A rational long-term investor (which GIC purports to be) should have continued to hold its preferred shares despite the suspension of dividend payments in order to eventually benefit from the seven percent dividend, which was temporarily being paid to a trust. GIC, however, delayed the conversion until it had the tacit support of the U.S. government, thereby signaling its cooperative posture in the global financial system and protecting its future ability to invest in the United States. To avoid ongoing American regulatory scrutiny, a prompt sell-off to bring ownership below five percent was required and it occurred.[242] This entire sequence of events is neither consistent with profit maximization nor with mercantilist theories. Instead, it demonstrates the use of these funds for autonomy maximizing purposes: they are used for highly risky investments to signal cooperation and maintain stability, even when this comes at a substantial economic loss. And contrary to predictions that would follow from mercantilist arguments, they are not retained to exert future control.

In addition to making stabilizing investments in western banks, Singapore's SWFs are deeply involved in the Chinese market. The rise of China is arguably the greatest threat to Singapore's role as a major economic hub in the Far East and its role as a bridge between East and West. As China has asserted its own central place in global finance with the rise of the Shanghai and Shenzhen stock exchanges, Hong Kong and Shanghai are competing over their share in the listing of firms from mainland China.[243]

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239. *See* Pistor, *supra* note 20, at 554 tbl.1, 564.

240. FEDERAL RESERVE BANK OF ST. LOUIS, THE FINANCIAL CRISIS: A TIMELINE OF EVENTS AND POLICY ACTIONS 20, *available at* http://timeline.stlouisfed.org/pdf/CrisisTime line.pdf (last visited Jan. 7, 2011) ("The conversion is contingent on the willingness of private investors to convert a similar amount of preferred shares into common equity.").

241. Conrad Tan, *GIC Cuts Loss in One Fell Swop* [sic], ASIA ONE BUS. (Mar. 2, 2009), http://www.asiaone.com/Business/News/My%2BMoney/Story/A1Story20090301-125407 .html.

242. Costas Paris & P.R. Venkat, *Singapore's GIC's Portfolio Suffers Loss in Fiscal 2009*, DOW JONES NEWSWIRES, Sept. 29, 2009, *available at* Factiva, Doc. No. DJ00000020090929e59t00069.

243. For a discussion of the CAO case to illustrate Singapore's relation to China and how this relation affects its governance of financial markets, see MILHAUPT & PISTOR, *supra* note 229.

A striking example of this is when the CCB, the Bank of China and the Industrial and Commercial Bank of China ("ICBC") were partially privatized in 2005 and 2006. Between them, these banks attracted substantial investments from western institutions like Bank of America, RBS and Goldman Sachs.[244] However, when these institutions came under pressure at home to improve their tier one capital base, they chose to generate cash by selling off their stakes in the Chinese banks. As the initial investments were subject to a three-year lock-in period that expired in early 2009, it looked as if shares in China's banks would be flooding the market precisely when financial markets were down, with likely negative repercussions for China's financial institutions. Government-linked Chinese institutional investors picked up most of the shares western banks sold. This could have looked like western investors were selling off their low-quality assets, thereby damaging the value of the Chinese banks.[245]

However, one major foreign investor, Temasek, also participated.[246] At a time when private investors were shying away from investing in financial institutions, including those in China, Temasek shouldered the risk once more and signaled to external capital markets that the Chinese banks were still valuable (and not simply being propped up by the Chinese government through a back channel). Last, but not least, Temasek also appeared as one of the core investors that backed the IPO in 2010 of the Agricultural Bank of China, the last of the four major Chinese banks that had been slated for partial privatization.[247] Our theory suggests that Temasek made these investments in the Chinese financial sector to signal that an independent and largely autonomous PAP is a useful friend for China, which, in turn, should provide a rationale for China to avoid impinging on the PAP's autonomy.

To summarize, the creation, internal governance structures and investment patterns of Singapore's SWFs fit our autonomy-maximizing theory. Creating the institutions made the government, rather than individuals, the primary beneficiary of high domestic savings rates, ensuring that the PAP would remain firmly in control of Singapore's economic development. As discussed, each institution is clearly controlled by members of the PAP inner circle, and their governance structures ensure that this will remain the case. Extraordinary investments into key foreign financial institutions in both Asia and the West demonstrated Singapore's value in the international financial system, thereby ensuring that global players will remain engaged in Singapore to provide an implicit security guarantee against any regional threats. Parallel support for the Chinese and western financial sectors helps to ensure that both will continue to engage with Singapore rather than leaving it to the other's sphere of influence. Singapore's SWFs also sometimes act to soften the impact of policies or actions undertaken by Singapore's government that would adversely affect the interests of these more powerful global actors. The strategy has proven successful, as Singapore and the PAP have been able to weather financial crises without incurring any obligations to outside countries or institutions—all while steadily improving their own regional security situation.

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244. *See* Pistor, *supra* note 20, at 557.

245. For details on these transactions, see generally Pistor, *supra* note 234.

246. *Id.*

247. Saeed Azhar & Michael Flaherty, *Temasek Offers $300 Million to Invest in ABC July IPO*, CHINA DAILY (June 14, 2006), http://www.chinadaily.com.cn/bizchina/2010-06/14/content_9976381.htm.

D. China

In some, but not all, respects, China is an outlier among the political entities surveyed in this paper. Unlike the Gulf States or Singapore, China is big—home to the largest population in the world—and is an emerging global power. Consequently, security motives do not play such a large role in motivating China's establishment of SWFs. Yet even in this case, the basic argument that SWFs are instruments designed to maximize the autonomy of ruling elites both domestically and internationally has substantial traction.

We would like to acknowledge at the outset that among the political entities discussed herein, China comes closest to acting like a mercantilist.[248] This fact is apparent in natural resource investments that SWFs and other state-controlled entities in China have made across the globe.[249] These investments, which are frequently paired with aid to support infrastructure development, are clearly meant to secure China's access to resources that are indispensable for the continuing growth of its economy. Nonetheless, not all investments have this overtone. Specifically, the entities that invest China's large foreign exchange reserves, the State Administration for Foreign Exchange ("SAFE") and China Investment Corporation ("CIC"), seem to pursue a much broader strategy, in which resource acquisition may play only a minor role.

The continued importance of the government as owner and manager of economic entities in China makes drawing a clear distinction between what counts as a SWF and what is simply a state-owned enterprise exceedingly difficult. In fact, the generic definition of SWFs in the literature, which we have endorsed as well, does not facilitate such a distinction. Some sources list a number of state sponsored funds, including SAFE and CIC as well as China's National Social Security Fund, as SWFs, which is entirely consistent with the above definition.[250]

Nonetheless, we will focus for the most part on CIC for two reasons. First, it is the only entity that has been officially designated by China as a SWF.[251] It is also the most transparent institution, which makes an assessment of China's SWF governance structure and investment strategies much easier. Second, CIC invests both domestically and internationally. SAFE has also been reported to invest globally, but as an administrative agency, it can do so only through special investment entities. Apparently, SAFE has established such entities in Hong Kong and has used them to invest in a series of companies that are listed on the London Stock Exchange.[252] However, very little is known about how much and where SAFE invests China's foreign exchange reserves.

248. *See generally* Gilson & Milhaupt, *supra* note 6.

249. This includes major investments in the financial, infrastructure and natural resource sectors by the Industrial and Commercial Bank of China ("ICBC"), which is indirectly owned by CIC (through Hui Jin). *See* Tom Burgis, *China to Extend Africa Acquisitions*, FIN. TIMES (July 30, 2008), http://www.ft.com/intl/cms/s/0/1f7ab242-5e5c-11dd-b354-000077b07658.html#axzz1ZjCi8Quj.

250. *See* Mark Konyn, *Eyes Stay Focused on China's SWFs*, FIN. TIMES (Nov. 9, 2009), http://www.ft.com/cms/s/0/11a93d82-cb07-11de-97e0-00144feabdc0.html#axzz1FOVi0zJl. The article also lists the National Social Security Fund ("NSSF") and the China-Africa Development Fund (Cad-Fund) as SWFs.

251. The term "sovereign wealth fund" is, of course, a general label of government-owned investment vehicles. *See* discussion *supra* Part II (Theory). The point is that CIC is a government-owned entity that is designated to invest for the purpose of maximizing returns for the benefit of its shareholder, i.e., the Chinese government. *See* CHINA INV. CORP., http://www.china-inv.cn/cicen/about_cic/aboutcic_overview.html (last visited Jan. 7, 2011).

252. Philip Stafford & Alida Smith, *Paper Trail Leads to London Top Stocks*, FIN. TIMES (Sept. 12, 2008), http://www.ft.com/intl/cms/s/0/a9e41266-8062-11dd-99a9-000077 b07658.html#axzz1ZjCi8Quj.

CIC was officially established in the fall of 2007 in response to growing pressures from the international community, in particular the United States, to reinvest the rapidly increasing foreign exchange reserves the country had accumulated.[253] This is highly reminiscent of the international pressure that triggered the creation of Singapore's GIC.[254] As it happened, CIC was established at the very moment that the global financial crisis began to unfold. This was almost certainly not planned but has left its marks on CIC's early investments abroad.

Formally, CIC is directly under the control of the State Council, China's executive branch of government. Its most powerful stakeholder, however, is the Ministry of Finance. It provided CIC with its start-up capital by issuing bonds to the public and handing over the proceeds so that CIC could acquire foreign exchange from the People's Bank of China ("PBoC"), China's central bank for its foreign exchange reserves.[255] Thus, CIC was initially entirely debt financed. This created a heavy burden on CIC to generate substantial return on its investments in order to meet monthly interest payments. This structure proved to be unsustainable, especially in light of the global financial crisis. By August of 2009, an agreement was struck to recharacterize the initial capital contribution as equity rather than debt, thereby eliminating CIC's need to make regular interest payments[256] and establishing it as an entity with no external liabilities.

CIC's official mission is "to make long-term investments that maximize risk-adjusted financial returns for the benefit of the State, our shareholder."[257] In an attempt to reassure the global public that this does not entail state control akin to the old socialist model, the report goes on to state:

> Our legal framework and governance model require us to operate as an independent commercial entity in an environment of sound corporate governance. We are committed to maintaining excellent professional and ethical standards in corporate governance, transparency and accountability. We have the full support of our shareholder to achieve our mission and attain these goals.[258]

This statement is obviously meant to assure the global community about CIC's objectives but does not necessarily give an accurate account of how the entity operates. We therefore scrutinize the formal governance structure of CIC, the identities of those charged with running the fund and its investment strategy (or at least as much of CIC's strategy as can be gleaned from its investments during its short existence to date). In analyzing the CIC, we find only limited sup-

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253. *See China's Trillion-Dollar Kitty is Ready*, ASIA TIMES (Oct. 2, 2007), http://www.atimes.com/atimes/China_Business/IJ02Cb01.html (referring to the huge foreign exchange reserves China had already accumulated at that time). China's foreign exchange reserves have become a contentious issue with the United States, and Treasury Secretary Timothy Geithner has repeatedly warned that China should work on reducing the reserves to overcome global imbalances. *See, e.g.*, Timothy Geithner, United States Treasury Secretary, G-20 Statement (Feb. 2, 2011) (transcipt available at http://www.treasury.gov/press-ce nter/press-releases/Pages/TG1073.aspx).

254. *See* Pistor, *supra* note 20.

255. For a detailed account of CIC's establishment and early investment strategies, see generally MICHAEL MARTIN, CONG. RESEARCH SERV., RL3433, CHINA'S SOVEREIGN WEALTH FUND (2008); Michael H. Cognato, *China Investment Corporation: Threat or Opportunity?*, NBR ANALYSIS, July 2008, at 9.

256. Ouyang Xiaohong & Liu Peng, *CIC No Longer to Pay Interest to the State*, ECON. OBSERVER (Aug. 26, 2009), http://www.eeo.com.cn/ens/homepage/briefs/2009/08/26/1493 95.shtml.

257. CHINA INV. CORP., ANNUAL REPORT 2008, at 4 (2008), *available at* http://www.china-inv.cn/cicen/include/resources/CIC_2008_annualreport_en.pdf.

258. *Id.*

port for a mercantilist argument and similarly limited support for CIC's self-proclamation that it is completely driven by risk-adjusted returns. Many of CIC's international investments are small and passive, indicating that mercantilism is not the driving force behind CIC. CIC's larger acquisitions can best be explained as reactions to the global financial crisis—and indicate motives that are not aligned with maximizing risk-adjusted returns. CIC's refusal to turn its stakes in global financial institutions into mechanisms of control also indicates that mercantilism and imperialism are not its primary drivers.

We argue that CIC's investments in global financial institutions during the crisis served to assure other major stakeholders in the global financial system (especially the United States) that China is a cooperative player and that it is not using its growing economic and financial power to control international markets. China's actions at the time were critical to deflating, at least temporarily, the pressure on China to abandon its efforts to subsidize export-driven growth through an undervalued exchange rate.

At present, China's leadership does not see an alternative to this strategy and is acutely aware of the fact that continued economic growth is critical for maintaining its hold on power. In fact, during the crisis, CIC was being used to infuse capital into China's major financial institutions so that they could expand their credit facilities and prop up the domestic economy, thereby protecting Chinese jobs. This closely resembles similar practices in Singapore, where Temasek and GIC were also used to insure against a more severe economic downturn that could have put domestic political pressure on the country's leadership. It also shows that CIC has been used as an instrument of monetary policy—which is not exactly within the purview of an investor looking to maximize risk-adjusted returns.

As a limited liability company, CIC's formal governance structure is similar to the conventional Western corporation. It has a board of directors that selects and supervises a management team, and there is some overlap between the two.[259] However, when looking at the actual personnel, it is clear that there is an additional governance system in place that is decidedly "Chinese." Those serving on CIC's board or as executives were drawn from China's financial elite—a cohort of financial cadres that has been groomed by the Communist Party, which ultimately controls their career path. CIC's chairman of the board of directors and CEO is Lou Jiwei, and the vice chairman, president and chief investment officer is Gao Xiqing.[260] Both men come with extensive experience in government services, including in the financial sector. Mr. Lou has previously held several positions, including those at the State Council, the Ministry of Finance and the State Commission for Restructuring the Economic Systems.[261] Likewise, Mr. Gao has served in the general counsel's office of China's Securities Regulatory Commission

259. In addition, following the German corporate governance model, Chinese law also requires a board of supervisors, the members of which may not be executives. For a comprehensive overview of China's system of corporate governance, see JING LENG, CORPORATE GOVERNANCE AND FINANCIAL REFORM IN CHINA'S TRANSITION ECONOMY (2009). China is indeed conventionally classified as a civil law country of German origin. The reasons are largely historical, as in the late nineteenth and early twentieth centuries China copied Japanese law, which, in turn, was borrowed primarily from Germany. However, China's recent legal reforms have been more eclectic and include sourcing from the United States, Taiwan (itself a German civil law country) and the European Union. For a summary of the law governing corporate law and securities listings, see generally Howard Gensler, *Company Formation and Securities Listing in the People's Republic of China*, 17 HOUS. J. INT'L L. 400 (1995).

260. *Board of Directors*, CHINA INV. CORP., http://www.china-inv.cn/cicen/governance/ governing_bod.html (last visited Jan. 21, 2012).

261. *Id.*

("SRC") as well as at the National Council for the Social Security Fund.[262] Indeed, inspection reveals that without exception, every member of CIC's board of directors, every executive and every member of its supervisory board has held or concurrently holds key positions in government, including positions at the PBoC, SAFE, the Ministry of Finance, regulatory bodies overseeing banking, finance and securities and at government-controlled financial intermediaries like Hui Jin Corporation, which holds the government's stakes in China's major banks and is a subsidiary of CIC.[263]

The ubiquity of such cross-placements suggests that the formal governance structure of CIC is deeply embedded in a dense network of personal ties. In contrast to the Gulf states, where personal ties are formed by kinship relations, or Singapore, where the small size of the country and its elite facilitates a combination of kinship and meritocracy, in China the network is maintained by the Organizational Committee of the Communist Party (OCCP). The OCCP has the power to appoint and dismiss key cadres within China's system of governance not only in politics, but also in the economy and finance. It governs by controlling human capital. The CCP regularly updates a rulebook that lists the positions over which it commands control,[264] which include positions in top financial intermediaries.[265]

The role of the CCP in governing China's financial system is consistent with our autonomy-maximization theory. The CCP has asserted its control over the financial sector by way of controlling appointments to key positions at the very moment that China began to open the state-controlled sector to private and foreign investors. As part of China's WTO agreement, it committed to open the financial sector fully to foreign investment by the end of 2006.[266] The likely repercussions of financial liberalization (i.e., the threat to state control of the economy) were mitigated by two strategies. First, China invited strategic investors to acquire large stakes in major banks prior to the liberalization deadline in 2006, thereby ensuring that it controlled who would acquire such stakes and on what terms.[267] These investors entered into three-year lock-up agreements, which ensured that these arrangements would extend well beyond the liberalization deadline of 2006. Second, the CCP asserted its control rights over the financial sector by creating the OCCP to oversee the recruitment of financial cadres to key positions in finance—including at large banks that had just been partially privatized.[268]

These strategies can be interpreted as mercantilist, but they also reflect an attempt by the CCP to control a sector that is vital for managing the economy and ensuring continuous growth.

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262. *Id.*

263. *See* Katharina Pistor, *Governing China's Finance*, *in* CAPITALIZING CHINA (Randall K. Morck & Henry Wai-chung Yeung eds., forthcoming 2012) (manuscript at 16–23) (available at http://www.nber.org/chapters/c12073.pdf) (presenting data on personal networks that link executives and board members of China's financial institutions to key government agencies and/or other state-controlled entities).

264. For a detailed account of the emergence of this committee, see generally Sebastian Heilmann, *Regulatory Innovation by Leninist Means: Communist Party Supervision in China's Financial Industry*, CHINA Q., Mar. 2005, at 1. An earlier version of this rulebook was translated into English. *See generally* John P. Burns, *Strengthening Central CCP Control of Leadership Selection: The 1990 Nomenklatura*, CHINA Q., June 1994, at 458.

265. *See* Pistor, *supra* note 20, at 554 tbl. 1.

266. For an early prediction of the likely impact of financial liberalization, see John P. Bonin & Yiping Huang, *Foreign Entry into Chinese Banking: Does WTO Membership Threaten Domestic Banks?*, 25 WORLD ECON. 1077 (2001).

267. For details of the bank privatization strategy in China, see generally Pistor, *supra* note 234.

268. *See* Heilmann, *supra* note 264.

In a country where political accountability is absent, delivering growth has become the most important source of the ruling elite's legitimacy. China has become adept at camouflaging its real governance structure by adopting elements of "good governance" from the West. Incorporating CIC as a limited liability company was the first step in this direction. In addition, CIC has assembled an international advisory board that includes former World Bank president Jim Wolfenson, former chief economist at the World Bank Nicholas Stern, former member of the WTO's appellate body and professor at Columbia's School of International Public Affairs ("SIPA") Merit Janow and Vice Chancellor of the Chinese University of Hong Kong Lawrence Lau. The only member with a specific financial background is Taizo Nishimuro of Japan, who heads the Tokyo Stock Exchange Group.[269] Clearly, the recruitment of these international dignitaries[270] is meant to assure outsiders that CIC is playing by the rules of international corporate governance and to deflect demands for the actual allocation of control rights, which in China lie mostly beyond formal legal structures.[271]

CIC's investment strategy is bifurcated into domestic and international investments with slightly more than fifty percent of its initial capital of U.S.$200 billion assigned for foreign investment.[272] A large chunk of the capital designated for domestic acquisition was spent on the acquisition of Hui Jin Investment Corporation, a government-owned entity that was previously established to manage the government's controlling stakes in China's largest banks.[273]

Although CIC is the parent of Hui Jin, it does not have the authority to appoint Hui Jin's board. The State Council—subject to the approval of the OCCP—makes appointments to the Hui Jin Board.[274] Moreover, management operations of the two entities are strictly separated. The picture that emerges from these interlocking (rather than hierarchical) boards of directors is one where a central agent—here, the CCP and its OCCP—controls the most important resource for the financial sector: human capital. With the help of party organs[275] that ensure that top management personnel at partially privatized banks have spent at least some time working for the Ministry of Finance, the People's Bank of China or another state agency, the CCP maintains

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269. For details of all members of CIC's International Advisory Council, see CHINA INV. CORP. ANNUAL REPORT 2008, *supra* note 257, at 24–25.

270. The practice of recruiting dignitaries to company boards in fact resembles that of newly formed corporations in nineteenth century England, when members of the aristocracy were recruited to serve on company boards. *See* RANDE W. KOSTAL, LAW AND ENGLISH RAILWAY CAPITALISM (1994) (describing corporate governance practices in the 1830s and '40s).

271. *See generally* Pistor, *supra* note 263 (comparing formal and informal means of governing China's financial system).

272. MICHAEL MARTIN, CHINA'S SOVEREIGN WEALTH FUND (2008). Note, however, that according to recent press reports, two separate entities may be formed—one for domestic and one for international investments. *See* Chen Dujuan, *China Plans To Restructure its Sovereign Wealth Fund*, GLOBAL TIMES (Sept. 2, 2011), http://www.globaltimes.cn/NEWS/tabid/99/ID/673705/China-plans-to-restructure-its-sovereign-wealth-fund.aspx.

273. *See* Pistor, *supra* note 263 (manuscript at 9). Hui Jin is now apparently slated to become an independent entity again. *See* Chen, *supra* note 272.

274. *See* Pistor, *supra* note 263 (manuscript at 9). *See also* Hui Jin's description of its governance structure on its web page:

> The Company shall establish its Board of Directors, which shall consist of not less than five (5) directors. The Board shall have one Chairman, who shall be the Company's legal representative. *All directors shall be appointed by the State Council*. The term of office of a director is three (3) years, and a director may be re-appointed.

Articles of Association (Abstract), CENTRAL HUIJIN INV. LTD. (Oct. 1, 2011), http://www.huijin-inv.cn/hjen/governance/governance_2008.html?var1=Governance (emphasis added).

275. *See generally* Heilmann, *supra* note 264.

its grip on the financial sector, and CIC is a central part of this regime.[276]

This background is also critical when assessing CIC's international investments. CIC made its first major international investment in May 2007, months before the SWF was officially launched. It acquired a ten percent stake in Blackstone, which reorganized into a limited partnership structure and launched its IPO just before the onset of the global financial crisis. The units CIC acquired confer no voting rights, and CIC opted not to appoint any representatives to the board.[277] The investment suffered a substantial loss when the financial crisis unfolded, as the price of Blackstone's units plummeted. Nonetheless, CIC has held on to these shares and in fact has elected Blackstone to be one of the key managers of its own assets.[278] This suggests that CIC invested in Blackstone not primarily to earn profits but rather to secure access to expertise and human capital. By securing a successful IPO of Blackstone, they created a long-term relationship that gives CIC access to management expertise and builds loyalty with one of the most sophisticated groups of financial experts from the West. These relational ties can be interpreted as an extension of China's domestic governance regime for finance: control through human resource management rather than formal ownership rights with the goal of stabilizing the system and the powers that control it.

CIC's second major investment occurred later in 2007, at a time when the global financial system already showed serious signs of distress. In December of 2007, CIC acquired the equivalent of a nine percent stake in Morgan Stanley in the form of convertible units at a nine percent interest rate.[279] The difference in the structure of this investment as compared to the one in Blackstone six months earlier suggests that by late 2007, the riskiness of investing in prominent financial intermediaries from the West was apparent to all investors, including CIC. This does not mean that CIC could have foreseen the scale of the crisis, but it does suggest that it was not a naïve, inexperienced investor that simply made a bad investment decision. Not only was the nine percent interest rate above prevailing market rates, but it had also become apparent that private investors had lost interest in these financial intermediaries.[280] Just like other SWFs, CIC assumed a critical role as an investor of penultimate resort (the final resort investment was duly left to the financial intermediaries' home central banks). Indeed, CIC stood ready for another rescue operation of Morgan Stanley in September of 2008, when the company found itself on the verge of collapse following the bankruptcy of Lehman Brothers. Press reports at the time revealed that CIC considered buying as much as a forty-nine percent stake in the company.[281] In the end, the transaction did not come through—most likely because both sides feared political obstacles, which would have delayed the rescue operation. Indeed, the investments SWFs had made in 2007 and early 2008 had created a political backlash in the United States and triggered a

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276. *See also* Pistor, *supra* note 263 (manuscript at 18–19) (describing the dense network and the central role of the CCP in this network).

277. *See id.*

278. Rick Carew & Jenny Strasbourg, *CIC Turns to Friends: Morgan, Blackstone*, WALL ST. J., July 31, 2009, at 20.

279. *China's CIC Ploughing $1.2 Billion into Morgan Stanley* (CNBC television broadcast June 3, 2009).

280. *See generally* Pistor, *supra* note 20 (discussing how private investors fled markets at the onset of the global financial crisis).

281. James Quinn, *Morgan Stanley Talks to Suitors but Goldman Says It's Business as Usual*, TELEGRAPH (Sept. 18, 2008), http://www.telegraph.co.uk/finance/newsbysector/ banksandfinance/2985030/Morgan-Stanley-talks-to-suitors-but-Goldman-says-its-business-as-usual.html.

review of rules governing the political review of foreign investments.[282] Similarly, CIC faced major criticism at home for its substantial losses on its earlier investments in Blackstone and Morgan Stanley.[283] In the end, Mitsubishi UFJ of Japan acquired a twenty percent stake, and subsequently the U.S. government acquired another twenty-five percent stake. However, less than a year later, CIC acquired another forty-seven million shares (at an undisclosed price) to help Morgan Stanley repay the funds it had received from the U.S. government, thereby regaining its status as a fully private entity (if one discounts the fact that these stakes were now held by a SWF).[284] Interestingly, Morgan Stanley was later selected as another key asset manager for managing CIC's overseas investments.[285]

Comparing CIC's investments in Blackstone and Morgan Stanley suggests an emergent pattern. There is little indication that CIC is seeking to control foreign financial intermediaries it invests in (i.e. engaging in mercantilism or imperialism in the financial sector). Instead, it is building long-term, reciprocal relations. At this point in time, CIC still needs foreign expertise to confront the vagaries of global financial markets. The foreign intermediaries were, in turn, dependent on capital that few private investors, if any, were supplying during the global financial crisis. By extending domestic patterns of control over human capital to global markets, CIC is creating a critical bridge between China's domestic financial governance regime and its relation to global markets. The motive for this strategy is not primarily financial. In fact, the very purpose of investing globally is to reduce China's current holdings of foreign exchange reserves, and in light of the magnitude of these holdings (over 3 trillion dollars as of June 30, 2011),[286] the return on any of CIC's investments is likely to be trivial. Instead, the bridge serves the critical function of ensuring that the CCP has some tools at its disposal to manage global financial markets and mitigate any shocks that might emanate from them and create a challenge to its hold on power.

Outside the financial sector, CIC has invested extensively in sectors that supply China with critical resources. They include a twenty percent stake in GCL-Poly Energy Holdings Limited,[287] a seventeen percent stake in the Canadian mining company Teck Resources,[288] a fifteen

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282. The rules, finalized in November 2008, already cast a shadow on ongoing transactions. Most important was the Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons; Final Rule, 31 C.F.R. § 800 (2008). The rules broadened the definition of "control" by a foreign entity, which was expanded to mean,

> the power, direct or indirect, whether or not exercised, and whether or not exercised or exercisable through the ownership of a majority or a dominant minority of the total outstanding voting securities of an issuer, or by proxy voting, contractual arrangements or other means, to determine, direct or decide matters affecting an entity; in particular, but without limitation, to determine, direct, take, reach or cause decisions regarding (1) The sale, lease, mortgage, pledge or other transfer of any or all of the principal assets of the entity, whether or not in the ordinary course of business; (2) The dissolution of the entity; (3) The closing and/or relocation of the production or research and development facilities of the entity; (4) The termination or non-fulfillment of contracts of the entity; or (5) The amendment of the Articles of Incorporation or constituent agreement of the entity with respect to the matters described at paragraph (a) (1) through (4) of this section.

Id. at § 800.204.

283. Bill Powell, *Why China Won't Come to the Rescue*, TIME (Sept. 19, 2008), http://www.time.com/time/business/article/0,8599,1842754,00.html.

[284]284. Wang Xu, *CIC Increases Stake in Morgan Stanley*, CHINA DAILY (June 3, 2009), http://www.chinadaily.com.cn/china/2009-06/03/content_7978689.htm.

285. *See* Carew & Strasbourg, *supra* note 278.

286. *FAQ on Foreign Exchange Reserves*, STATE ADMIN. OF FOREIGN EXCH. (July 28, 2011), http://www.safe.gov.cn/model_safe_en/news_en/new_detail_en.jsp?ID=3010000000 0000000,313&id=2.

287. *China Investment Corporation Invests in GCL-Poly Energy Holdings Limited,* SOVEREIGN WEALTH FUND INST. (Nov.

percent stake in AES (U.S.)[289] and an eleven percent stake in the Kazakh gas company KazMunaiGas.[290] These investments are consistent with a mercantilist interpretation but also fit our theory. Since the future of the CCP as China's ruling party is directly linked to its ability to deliver growth and ensure employment for an additional six million people who enter the Chinese workforce on an annual basis,[291] securing natural resources is a means to serve both ends: external and internal control.

In general, filings with the SEC show that CIC has invested in numerous companies in the United States and elsewhere, but in most cases has only taken small minority stakes. They offer little evidence for the proposition that CIC is on an acquisition spree with the intent of controlling major companies in the United States.[292]

In interpreting CIC's investment strategies, it is important to realize that China itself has become deeply dependent on the global financial system. This implies that China has become vulnerable to the volatility of global markets, which in and of itself is a threat to a system that is poised to maintain political and economic stability. Against this background, CIC's actions appear less as an aggressive foreign acquisition strategy and instead as an attempt to help buffer the impact of global markets. It does so by using its resources to help mitigate the fallout from the global financial crisis and to limit the impact of vast fluctuations in the price of resources and commodities that are critical to the Chinese economy. As the CCP's legitimacy inside China (and perhaps even in the international context) is largely dependent on its ability to ensure continued economic growth, CIC's efforts to mitigate China's vulnerability to the international marketplace (and thereby sustain its economy in times of crisis) can be viewed as maximizing the autonomy of the CCP. Within China, if the economy is stable (as the CIC is trying to ensure), there are fewer competing claims against the party for political influence. In the international context, cooperation from the CIC in stabilizing financial markets (and in rebalancing currency reserves) demonstrates that the CCP is a potentially trustworthy counterparty and reduces the salience of competing accounts of the CCP's merit in the international system (such as criticisms of its role in human rights abuses, etc.). Viewed in this light, China's preeminent SWF also fits our autonomy maximization theory.

19, 2009), http://www.swfinstitute.org/sovereign-wea lth-funds/china-investment-corporation-invests-in-gcl-poly-energy-holdings-limited/.

288. *Teck Resources Announces C$1.74 Billion Private Placement*, SOVEREIGN WEALTH FUND INST. (July 3, 2009), http://www.swfinstitute.org/sovereign-wealth-funds/teck-resou rces-announces-c1-74-billion-private-placement/.

289. *China Investment Corporation Invests in AES Corporation*, SOVEREIGN WEALTH FUND INST. (Nov. 8, 2009), http://www.swfinstitute.org/sovereign-wealth-funds/china-invest ment-corporation-invests-in-aes-corporation/.

290. *See China Investment Corporation*, SOVEREIGN WEALTH FUND INST. (Oct. 1, 2011), http://www.swfinstitute.org/swfs/china-investment-corporation/.

291. The number was suggested to one of us in a private conversation with a top official at CIC. Confidential notes from meeting with CIC official (on file with the authors).

292. *See* Rick Carew, *What CIC Disclosures Say About Its Strategy*, WALL ST. J. (Feb. 9, 2010), http://online.wsj.com/article/SB10001424052748704182004575054903625520956.html. *But see* Steven Mofson, *In SEC Filing, China Reveals Vast U.S. Holdings*, WASH. POST, Feb. 9, 2010, at A13, for a more alarmist view on CIC's disclosures.

IV. Conclusion

A widely accepted definition of SWFs holds that these entities are government-owned and -controlled, and have no outside beneficiaries or liabilities beyond the government itself, so they are responsive to the expressed interests and objectives of the government. There are competing conceptions of what constitutes "governmental interest" in a democratic society, but a discussion of public choice vs. public interest politics is beyond the scope of this article. This article suggests that in political entities without electoral democracy, such as China, Singapore, Kuwait and Abu Dhabi, the government is comprised of ruling elites who are not directly accountable to the public in general: it is easy to see how "governmental interest" becomes tied to the interests of the ruling elite. Indeed, the internal governance structures of the SWFs themselves ensure that SWF management is directly accountable to the ruling elite in each sovereign sponsor. Consequently, it is unsurprising that SWFs can be, and are, wielded to advance the interests of those elites. First and foremost among these interests is the maintenance of their privileged position.

The task of maximizing autonomy is, however, complex. The privileged position of ruling elites in non-democratic countries is dependent on domestic stability, security of the state against foreign rivals and the maintenance of substantial autonomy relative to superpowers to which they might otherwise be vulnerable. Without domestic stability, elite status is fragile and will last only until the next coup or mass uprising; a foreign invasion would topple existing elites or at least subsume them into a hierarchy with foreigners at the top. Finally, as autonomy relative to superpowers decreases, the ability to direct state action towards benefiting the elite is restricted and domestic legitimacy may be threatened.

As is revealed by the detailed case studies presented in this paper, SWFs are well suited to serving an autonomy-maximizing function in the domestic arena. The creation of a SWF ensures that wealth stays under the control of the ruling elite rather than passing into the hands of the population as a whole. In the Gulf, the extraction and sale of oil could transform a royally monopolized resource into dispersed wealth, but concentrating the resultant revenues into a SWF ensures continued royal control. In Asia, export-led growth could increase the purchasing power of the domestic population, but sterilizing the returns by concentrating them in a SWF protects against destabilizing currency crises and the rise of new wealthy classes that might challenge the existing elite for political control of the state. Further, once accumulated in a SWF, wealth can be strategically deployed in the domestic market to protect the status of elites. It can be used to "buy off" potential political rivals, expand the institutional space for political allies (increasing the benefits of aligning oneself with the existing elite) and to fund social programs that satisfy the needs of the population as a whole for the foreseeable future. Finally, SWFs ensure that domestic stabilization strategies can be maintained even in the face of shocks to the system like oil price or production declines or falling trade volumes. Collectively, these effects substantially improve domestic stability. Indeed, as we have shown, several SWFs have used their resources in the global crisis and subsequently in the political uprisings in the Middle East to appease potential opponents at home.

SWFs are equally well suited to maximizing autonomy in the international context by improving state security and mitigating the impact of volatile global markets on the domestic economy. First, administering wealth through the public sector rather than funneling it to the private bank accounts of the ruling class (as is done in a substantial number of resource-rich countries) legitimizes the sovereign sponsor government in the eyes of the international community. In terms of the particulars of administering the fund, SWF investment decisions can also be made to directly induce potential threats to state security not to attack or to convince a third party to guarantee the security of the state. Even without such a direct bargain, deploying capital in other countries creates economic ties that discourage confrontation and creates relationships that provide leverage in times of crisis.

SWFs can also be used to maintain substantial autonomy relative to superpowers—whether the United States, as discussed in the case of the Gulf States in particular, or China in the case of Singapore—that might otherwise exert pressure to limit the sovereign sponsor's range of viable domestic policy choices. This is relevant in particular for small countries that cannot effectively maintain their own external security. First, SWFs diversify the revenue stream of the sovereign sponsor, insulating against the effects of changes in the terms of trade or other exogenous shocks, such as commodity price fluctuations. Maintaining foreign-currency-denominated assets also decreases vulnerability to currency crises, which effectively increases the range of available domestic policy choices in the long term. Further, SWF investments can be directed toward injecting capital or liquidity into the economies of superpowers during their own periods of crisis, with the expectation that this assistance will be remembered during future interactions. SWFs can also be used to fulfill unspoken "dollar-recycling" obligations that, if unmet, might lead to interventions by Western countries. Finally, SWFs can also be used to secure access to natural resources or markets for primary exports, ensuring the long-term viability of current industrial policy in sovereign sponsors and providing insurance against protectionism in developed countries.

More recently, SWFs have become an important force in global financial relations, not primarily because of their size, which is still dwarfed by private investment vehicles, but because of their ability and willingness to invest at times when private investors take flight. These investments have given rise to a series of interpretations. Some have stressed the potential danger that these "neo-mercantilist" organizations may pose to the capitalist system. Others have painted a more positive picture by suggesting that SWFs could help enhance global social welfare by investing their resources to spur development in less-developed countries, or to invest in green technology in an attempt to save the planet from climate change.[293] In contrast, this paper suggests that these investments, too, are best understood as part of a general strategy aimed at autonomy maximization. SWFs have invested widely in the global financial system and are as such dependent on it. Their willingness to step in when private investors took flight is therefore not without self-interest. In addition, by helping to stabilize global finance they were able to either confirm existing relations of reciprocity or establish similar relations. As discussed in the case studies, the financial crisis created an opportunity for the Gulf States to reciprocate the security umbrella the United States has offered them in the past. For China, the crisis created an opening to position itself not only as a challenge to U.S. dominance, but as a relational player.

The actual context in which SWFs were established and operate, we suggest, is crucial

293. For a discussion of SWFs as potential agents of development, see Javier Santiso, *Sovereign Development Funds: Financial Actors in the Shifting Wealth of Nations*, *in* NEW PERSPECTIVES ON SOVEREIGN ASSET MANAGEMENT 173 (Malan Reitveld ed., 2008); for a discussion of their potential role in green technology, see James Lamont, *Norwegian State Fund in $4bn Green Push*, FIN. TIMES, Sept. 1, 2009, at 20.

for understanding their role and the attractiveness of various investment opportunities at any given point in time. Modeling SWFs according to the standard accounts of state control over economic activities, which are derived primarily from the historical experience of the West, misses these critical aspects, and is therefore bound to miss the critical determinants of SWF behavior both domestically and internationally.

ANNEX—FIGURES AND CHARTS

Figure 1: Equity Transitions among Abu Dhabi's SWFs