Law at the End of the Day: Sovereign Investing in Times of Crisis: Global Regulation of SWFs, SOEs and the Chinese Experience--Part III, Complexity, Coordinationand the SOE

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Sovereign Investing in Times of Crisis: Global Regulation of SWFs, SOEs and the Chinese Experience--Part III, Complexity, Coordinationand the SOE

This is the THIRD of a multi-part series exploring the rise of a new form of integrated sovereign investing. The focus will be on the regulatory framework that is being developed in the West and the reality of innovative sovereign investing being implemented in China. A complete version of these materials will be published in the University of Iowa College of Law Journal, Transnational Law and Contemporary Problems. The manuscript of which may be accessed HERE.

The materials will be divided into the following parts:

Part I. Introduction

Part II. Projections of Public Economic Power in Private Form: Contextualizing Sovereign Wealth Funds--Form, Function and Policy.
A. Form in SWF Definition and Operation.
B. Function in Sovereign Investing.
C. Form and Function in the Policy Context on the Eve of Financial Crisis.

Part III. Complexity and Coordination in Sovereign Investing: The State Owned Enterprise as Sovereign Investment Vehicle.

Part IV. The Expression of Dissonance in Regulatory Responses.
A. National Approaches to Regulatory Reform.
1. The United States, Canada, Australia
2. Europe
B. Proposed Non-National Approaches to Regulatory Reform.
1. The European Union
2. American Bi-Lateralism
3. Santiago Principles.

4. OECD Soft Standard Setting

Part V. Coordination, Development, Opposition and the Challenges of Sovereign Investing in the Context of Global Economic Crisis: The Case of China.

A. "Go Global" Strategy and the Consolidation of Sovereign Investment

B. The Organization and Operation of Chinese Sovereign Investing.

C. Sovereign Investment as Cooperative Public-Private Networks: CIC and Its Subsidiaries.

D. Conformity to Current Regulatory Models and Policy Ramifications.

Part VI. Conclusion.

Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience

Abstract: The financial crisis of 2007 has brought into sharper focus a set of rising global financial actor—the sovereign investor. In the form of sovereign wealth funds (SWFs), sovereigns have become an important player in global financial markets and its stability. Over the last decade they have become more visible and more aggressive in the scope and form of their interventions in global finance. In the form of state owned enterprises, sovereigns have begun to operate indirectly through subordinate legal persons that operate like privately held multinational corporations. In that form, sovereigns are becoming a more significant presence in global markets as owners as well as investors. More importantly, sovereign owners have begun to coordinate their economic activities for economic and sovereign goals. Consequentially, crisis has produced a dynamic element in the evolution of the global economic system. These evolutionary elements now brought into sharper focus issues of law and policy that stretch current systemic conceptions into new and unchartered territory. If sovereign investors are understood as private actors participating in markets, then this might suggest the best case for the equal treatment of states with private entities, because it stands in the same shoes as a private investor. On the other hand, if sovereign investors, and their instrumentalities, are understood as an instrumentality of the state, then these entities can be understood as instruments projecting state power into the territory of other states, and a political solution becomes more likely. Yet, while governmental responses were at first wary—criticizing these funds as potentially dangerous to the sovereignty and independence of national markets, the increasing needs of national economic sectors quickly altered attitudes. Responses have focused on law and policy to protect the integrity and workings of the markets themselves—both domestically and internationally—by decentering the sovereign element of sovereign investment, but without much of a plausible conceptual center. This essay examines these fundamental issues of sovereign investing. Section I contextualizes the problem as a function of the character and control of large aggregations of wealth, Section II focuses on sovereign wealth funds as projections of public economic power in private form. It focuses on issues of the conceptual dissonance in the definition and operation of sovereign wealth funds. The section ends by connecting those issues to policy debates about sovereign investing, especially in the form of sovereign wealth fund activity. Section III then considers the expression of the conceptual dissonance of sovereign investment regulation. It considers national and supra national approaches to regulation and regulatory reform. Section IV considers state owned enterprises as another vehicle for sovereign investment abroad. It considers state

owned enterprises (SOEs) as a fundamental component of innovative multi-vehicle deployments of sovereign wealth outside the national territory as part of the implementation of coordinated national development goals. Section V critically examines these issues in context. It considers the approach of China in the use of its state wealth through SWFs and SOEs. The Chinese efforts to coordinate sovereign investing directly by the China Investment Corporation and its principal subsidiaries, and indirectly through its subsidiaries and supported SOEs investing abroad, suggest a more complex organization of sovereign investing in which profit maximization is blended with a pronounced set of political objectives, grounded in development goals. This presents a potentially substantial advance in the integration of programs of sovereign investing, public policy and private markets. A responsive regulatory framework has not followed. The rise of sovereign market participatory entities, operating as both sovereign and private actors, will require a responsive regulatory framework substantially different from those currently in gestation. The Chinese experience suggests that while there is fundamentally little to fear from well operating public-private constructs, that model requires a different regulatory approach, and one that recognizes and rethinks the relationship of public and private sectors and the limitations of the state's role in both in the context of protecting the integrity of global markets and the free movement of capital and economic activity.

III. Complexity and Coordination in Sovereign Investing: The State Owned Enterprise as Sovereign Investment Vehicle.

It is clear that sovereign wealth funds represent a multifaceted nexus point for the convergence of public and private law.214 On the one hand, it encompasses attempts by states to participate in global markets like private individuals. On the other hand, it also possesses the possibility of governance by other means--turning markets into another vector for regulation--the way that the privatization of surveillance and monitoring regimes (transparency) has increasingly been used.215 But there is more to it than that. The funds represent the convergence of public and private power—of politics through economic means, of the subversion of the private element of the global economic order through the participation of public entities as private participants.

We have also seen that sovereign investment vehicles embrace a large and protean class of organs, entities and actions, whose principal point of commonality is the ownership, control or management by a sovereign.216 A sovereign wealth fund can serve as the single investment entity, organized as a corporation or similar enterprise under the general law of its sovereign owner217 or more typically organized pursuant to special legislation.218 But sovereign wealth funds can themselves serve as the holding company for any number of vertically or horizontally organized sub-funds, through which the actual operations of the entities are effects. These sovereign wealth enterprises can include any form of economic enterprise, from investment to operating entities.219 Indeed, as conventionally defined,

“sovereign wealth funds are not the only vector through which sovereign entities make foreign private investments. Another way through which countries invest in foreign entities is through purchases by state-owned enterprises. . . .. Additionally, governments can make foreign private investments directly through their existing foreign exchange stocks.”.220 Operating individually, in its various forms, and in tandem with other financial entities, “[t]hese new power brokers are here to stay, and they are increasingly venturing into each other's territory. Hedge funds are buying up companies. Asian central banks are starting to replicate the sovereign wealth funds of oil exporters. Oil exporters are creating more-sophisticated investment vehicles such as private-equity funds.”221 It is in this context that the nature of the state owned enterprise becomes more relevant and interesting.

Let us turn to the state owned industry as sovereign wealth fund in the context of these assumptions. In many critical respects, state owned enterprises are no longer little more than the outward projection of state power in centrally planned economies that was the hall mark of Marxist-Leninist States before the fall of the Soviet Union.222 These were thought extinct, or at least substantially discredited in the rush toward privatization which formed the last phase of the construction of global private economic markets.223 Likewise, state owned enterprises no longer resemble the remnants of socialist experimentation that marked much of Europe before the 1990s,224 and still appears from place to place in Latin America and Asia.225 “Over the last few decades however, globalisation of markets, technological changes and deregulation of previously monopolistic markets have called for readjustment and restructuring of the state-owned
sector.”226

The most dynamic development of SOEs,227 at least SOES that are being integrated into the modern global economy, are those being developed in China.228 Moreover, as SOEs continue to evolve, the issues of governance, and of reassurance for participation in private markets, begins to look substantially like those applicable to SWFs, and of these, principally, transparency.229 Chinese SOEs are sovereign, at least in the sense that their ownership is vested, directly or indirectly, in the state. However, in a way that parallels SWFs, direct state oversight has been increasingly reduced. “Since the 1980s, the Chinese government and the ruling party have followed a policy of zhengqi fenkai, which formally separates government functions from business operations.”230 This is viewed as good discipline by state authorities as well.231 However, as with SWFs, ownership oversight has not been reduced. SOEs, like SWFs operate to maximize benefits to their owners. Where the owner is the state, of course, there is a conflation of “private” welfare maximization, and public policy.232 But in places like China, even that separation must be contextualized within an economic system in which the factors of production are never entirely free of state oversight.233

> “In fact, the government’s pervasiveness in society gives China’s stateowned enterprises freer rein to confront these issues than their counterparts in more open societies enjoy: the Communist Party controls both labor and management, eliminating the overt tensions that make public-sector reform difficult elsewhere. Over the past decade, tens of millions of workers have been

> laid off by state-owned companies striving to become leaner organizations."234

In a sense, then, in China, the issue isn't so much ownership, but control. And in the case of economic enterprises, control, especially over outbound investment, is still strictly a matter of state policies.235 When that control relationship spills over borders, then SOEs, like SWFs, begin to blur the boundaries between pubic and private and between sovereign and commercial purposes.236

These notions are reflected in recent academic and industry attempts to distinguish between SWFs and SOEs. These efforts suggest that the current consensus sees to distinguish between SOEs and SWFs by a variety of factors. One basis for distinguishing between SWFs and SOEs is based on funding sources. This would suggest that SWFs and SOEs could engage in the same business, but their relationship to their owner, and to the sources from which the owner funds each, would be different. Thus, for example, Ping Xie, of Central Huijin Investment Company Limited,237 and Chao Chen, of China Investment Corporation,238 suggest that because of their common state ownership "SWFs are often confused with traditional government pension funds (GPF), monetary authorities and state-owned enterprises (SOE). SWF vs. SOE: the former is held by the central government and is funded by forex reserves and export revenues; the latter is held by the central or local government and is funded by the government grants and corporate profits."239 This is a view, shared in part by other bank analysts.240 Yet there is nothing that suggests that this distinction is invariably true, or, for that matter that funding SOEs from forex reserves and SWFs from the profits of its activities would necessarily reconstitute either.

Others favor distinguishing between SWFs and SOEs on the basis of organization. Thus, for example, it has been suggested that SWFs are asset pools owned by governments and operated to meet national policy objectives, while SOEs are separate legal persons constituted to engage in commercial activities.241 Yet again, the definition seeks too much. The Chinese SWF is itself constituted as a separate legal personality under generally applicable Chinese corporate law, yet it cannot be said that such a constitution converts it from SWF to SOE.242 Moreover, as the Santiago Principles efforts suggests, SWFs are increasingly seen as grounded in commercial purposes objectives.243

What these efforts suggest is that formal distinctions between SOEs and SWFs can mask effective convergences of function. Thus, there is much to commend the insight that while on a "superficial level, the difference between SWFs and SOEs is obvious: It is the same as that between any type of investment fund and any type of company. But in reality the difference is not that obvious, and is to some extent misleading, since there are SOEs that are used as a conduit for their respective state's sovereign wealth, as part either of a longer channel involving an SWF or of a shorter channel between the foreign reserve manager and the target company."244 At the same time, it is clear that at the edges, SWFs and SOEs can be very different vehicles. The difference is tied to funtion. SWFs are creatures whose ordinary course business is investment. SOEs are not necessarily constituted to engage, in the ordinary course, in investment. Yet, SOEs can invest, and SWFs can acquire controlling

The investment and regulatory consequences by SOEs whose business is not investment, then, presents issues similar to those of the typical SWF, from a functional perspective, though retaining potentially significant differences from a formal or constitutive perspective. From a functional perspective, centered on the state as ultimate owner, there may be little difference between a state owned hotel corporation purchasing a large hotel corporation with principle offices in Chicago and incorporated in Delaware, and a SWF purchasing a controlling interest in the same firm. In both cases the target company is controlled by an enterprise whose ultimate owner is a state. In both cases, the state, as ultimate shareholder, can assert a power of control over the entity that may or may not reflect the sort of values a private shareholder might be expected to assert. Thus, states might be tempted to use their ownership for political purposes--that is to maximize their national interests through their ownership of foreign entities--even if those entities suffer financially as a result. Thus, for example, if the state owned hotel corporation of State A wanted to ruin the competing hotel business of State B, it might cause State A Hotel Corp to purchase State B Hotel Corp for the purpose of either shutting it down or causing State B to make concessions that would preserve the business of the hotels in State A. But this scenario is not necessarily logical, realistic, or peculiar to public entities. First, unless the target entity is wholly owned, the public shareholder would be subject to suit for breaches of duty or abuse of power by the minority shareholders in many jurisdictions (but not all to be sure). Second, all shareholders seek to maximize their personal interest in their investments. It stands to reason that a public shareholder would measure its interests (and its maximization) on a scale distinct from that of an individual or legal person that is not a state. Third, the sort of predatory behavior suggested by the example is usually actionable under the domestic law of the state where it occurs. The evil or disruptive potential of such behavior is only troublesome to the extent that states, as owners of entities that invest in foreign jurisdictions, may evade local (host state) law or may avoid treatment as a shareholder like any other.

However, where a state coordinates the outbound investment activities of multiple SOEs, the effects can be more profound—at its limit testing the integrity of markets and serving as an indirect method of projecting public power through ostensibly private and commercially motivated activity. That may be the direction in which the systematization and coordination of direct and indirect Chinese overseas sovereign investment is heading,245 a subject taken up in more detail in Section V.246 Under this model, the state can maximize the effect of its private sector participation by fracturing its sovereign investment along conventional lines—reserves driven, sovereign wealth fund, state owned enterprises in various sectors—and then influence investment choices. These choices would be driven not necessarily by an individual entity's determination of its own profit maximizing choices, but by the aggregate welfare maximization (to the state) of all state owned entities. Thus, determinations of sector investment, of targeting particular host states and the like, would be set, at least at a general level, as a political matter. Within the framework of the overall policy objectives, individual enterprises would then operate within those policy parameters. Profit maximizing coordinated political objectives could then be possible.

The state would then serve as the supervisory headquarters of a conglomerate with significant internal regulatory power, and external participatory power.247 And those objectives could permeate the system so that, at its point of contact with host states or in foreign markets, the transactions appear substantially private.248 Yet private enterprises test those limits as well. Large private enterprises also coordinate global operations and operate politically to enhance their overall welfare as a going concern,249 and thus also test the integrity of markets. A functional analysis does raise some of those concerns. Principal among them is that a large corporation may order its operations so that it effectively regulates itself.250

> Any enterprise that can disperse its assets among a large enough number of regulatory units will transform the relationship between regulator and enterprise. For the traditional relationship that is both singular and hierarchical, globalization permits the enterprise to treat regulation as another factor in the production of wealth. The enterprise, now in a position to shop for regulatory regimes, or even bargain for domestication within the territory of a regulatory territory, can take advantage of the limitations of the territorial principle to minimize the effects of regulation to inhibit enterprise activity. The principle of regulatory hierarchy can then be turned on its head.251

Able to achieve a measure of self-regulation, the largest private enterprises can assert regulatory and political power. There may be little functional difference between a large multinational corporation targeting a small state and a large state operating significant SOEs targeting the economic infrastructure of a third country.252 Economic activity, then, can have political, regulatory and economic effect, whether undertaken by public or private concerns. Still, the, political effect is substantially more pronounced when participatory activity is used by states as a tool of their political relations with each other, than when they result from the interactions of private enterprises, or between them and states.253

It is in this context that a state owned enterprise, one bent on aggressive investment in other entities abroad, might pose a danger of the sort against which states are now seeking protection—when the activities are generated by sovereign wealth funds. It is not just that such entities are owned and perhaps managed in the ultimate interests of a state, but it is that such enterprises, if managed well enough, might also be able to evade local control and project home state policies into host state, sometimes in ways inconsistent with host state public policy.254

For all that, even within a functional orientation, SWFs and SOEs can be distinguished at least at the margins. Most SWFs are investment vehicles—their object is to invest in more or less liquid markets for securities, now including equities. Most SOEs are operating enterprises. To the extent that both invest in the securities of other enterprises, and do so abroad, there is a functional conflation in objective. These objectives are also similar to those of similarly constituted private actors. Their principal objects are consonant with those of private actors. Yet like private actors, they might seek to aggressively insert themselves in the economic life of other states where that has the effect of enhancing their

own financial condition, increasing its market share or reducing competitive pressures, among the usual "reasonable actor" objectives. But that very conduct can produce the sorts of interventions that might make states quite nervous where the entity is owned by a state, both in terms of disguising political intervention through SOE activity and of negatively impacting the integrity of private economic markets.255 But generally while SWFs are in the business of investment, SOEs are not. In that respect, at least, many SWFs can be distinguished from many SOEs, but not from all of either.

But the emerging regulatory framework for SWFs distinguishes between SOEs and SWFs on formal grounds. Because SOEs tend to be defined as distinct from SWFs, their investment activities might not fall within the limitations of the Santiago Principles256 and similar mechanisms, even when their investment activities are functionally the same. Where SWFs invest in or through SOEs that invest abroad, the problem of regulatory irrelevance becomes more acute.257

Thus, the state owned enterprise presents a unique variant on the SWF. Though it is neither a fund, nor was it created for the purpose of investing in other entities, a state owned enterprise might naturally engage in such activities. But it does so in the context of maximizing its own business operations rather than as an end in itself. Yet those business operations, as classically understood, are themselves undertaken to maximize the interests of the entity (and its shareholders). If there is a unity between shareholder and corporate interests (for example where the entity's shares are wholly owned by the state, then it would be logical to assume that the maximization of state value in such enterprises includes the political value of that enterprise's operations. On the other hand, even if that is the case, at least with respect to its global operations, such an entity (and its state owner) would be liable in host jurisdictions, for breaches of duty, abuse of power, looting and the like in its relationships with its foreign owned subsidiaries. Consequently, the similarities in result mask significant differences between states as owners of SWFs and states as sole shareholders of operating entities that may also invest in foreign undertakings.

State owned enterprises also present its own set of unique regulatory problems. As suggested above, the regulatory approaches of the Santiago Principles258 and other efforts designed to control enterprises in the business of investing have little relevance to enterprises that constitute operating units in other industries but which (like their privately owned counterparts) also engage in investment activities or in the development of a global network of operations grounded in ownership of enterprises in a variety of host states.259 Indeed, the problem of control is different, and the ability to distinguish between behaviors of state owned enterprises and others much more difficult. The regulatory tools are also cruder--resort to foreign direct investment regimes, and the construction of baroque exemptions for state owned enterprises from free movement provisions available to others. But these probably do more harm than good. And a state owned enterprise version of the Santiago Principles260--a “reasonable private company investment model" would be difficult to articulate and harder to apply with any degree of consistency. Indeed, in the case of state owned enterprises investing abroad, even more so than with SWF, the host states might be tempted to use the difference in ownership for its own purposes. Thus, and

perversely, state owned enterprises investing abroad for legitimate purposes, might be subject to regulatory hurdles as a method by host states to manipulate the competitive environment internally
in ways that would be irregular if the regulating state had sought to distinguish among privately owned forms.

As a consequence, states as market participants acting outside their territories, especially when operating through wholly owned or controlled state owned enterprises present a unique problem. They are entities that are not formally constituted as entities in the business of investment, yet they might make such investments in the course of their economic activities—like virtually every other privately owned enterprise. Functionally, then, aggressively operated state owned enterprises can project state power abroad as effectively as a traditional sovereign wealth fund. The regulatory approaches to such enterprises are unlikely to be found in the control mechanics being developed for SWFs.

Indeed, the principles of regulation ought to be based on a different framework.261 On the one hand, such regulations ought to be strengthened to permit minority shareholders of foreign subsidiaries to protect their interests against actions of state owned enterprises and their owners--including actions against the state owners of the stated owned enterprise, and national laws that ensure that state owned enterprises, acting as shareholders of subsidiaries, must act solely in the interests of the company they control (at least when they act as corporate directors, or when they exercise shareholder power in self dealing transactions). On the other, the host state might take for itself additional power to intervene in the actions of enterprises over which it has regulatory control. Many corporate statutes confer a power on the state to bring an action to dissolve a corporation that exceeds or abuses the authority conferred on it by law.262 Moreover, the state is usually granted a right to administratively dissolve a corporation.263 Both of those concepts could be used, broadened to fit the context of subsidiaries of foreign state owned corporations, to give a state the power to intervene in such subsidiaries where it might be clear that those who own or control a domestically chartered enterprise are using that enterprise for purposes other than those for which the enterprise was chartered (for example "to engage in any lawful business."264

But a difficulty arises where a state owned enterprise is owned by a sovereign wealth fund, or better put, when a sovereign wealth fund is organized to include control of sovereign wealth enterprises that include operating companies. When operating companies organized as sovereign wealth enterprises are a part of the controlled enterprises of a sovereign wealth fund, then the differences between the two forms of sovereign investment become more complicated, and may merge. In that context, it may not be realistic to assume either differences in purpose or methods. On the other hand, the better regulatory model might be a multinational enterprise controlling a number of operating companies in which it invests and interests in which it might buy and sell, rather than a state entity fixated on maximizing the value of sovereign reserves.

The discussion of the placement of state owned enterprises within or beyond the definition

of sovereign wealth funds highlights the way in which the definitions of sovereign wealth funds incorporate its critique. None are descriptive—all suggest the special character of the object and its deviation from the regulatory standard model. It suggests the limited range of utility and the dangers from nonconformity to the standard investment model. Sovereign wealth funds are a problem because they deviate from the behavior patterns that are associated with and required of the instrumentalities of states seeking to protect and invest their reserves as part of their regulatory and sovereign obligations. As a consequence, the definitions also imply the need for specific approach to regulatory responses, and the character of that response.

ENDNOTES:

214 Larry Catá Backer, The Private Law of Public Law: Public Authorities As Shareholders, Golden Shares, Sovereign Wealth Funds, And The Public Law Element In Private Choice of Law, 82(5) TULANE LAW REVIEW 1801 (2008).

215 See Larry Catá Backer, Global Panopticism: States, Corporations and the Governance Effects of Monitoring Regimes, 15 INDIANA JOURNAL OF GLOBAL LEGAL STUDIES 101 (2008).

216 "Sovereign wealth funds are simply the latest manifestation of the explosive growth in official assets ranging from currency reserves to state-owned enterprises." Daniel W. Dezner , Sovereign Wealth Funds and the (In)security of Global Finance, Testimony Before the U.S: House of Representatives, September 10, 2008, at 3, available at , at 9.

217 For example, , Qatar Investment Authority (QIA) was incorporated in 2005 as the primary vehicle for strategic and direct investments by the State of Qatar, QATAR INVESTMENT AUTHORITY WEBSITE, available at http://www.qia.qa/qia/faq.html. Also, "According to its constitutive instrument, QIA's objectives are to develop, invest, and manage the state reserve funds and other property assigned to it by the Government via the Supreme Council of Economic Affairs and Investments", Sovereign Wealth Funds Institute, available http://www.swfinstitute.org/fund/qatar.php.

218 Both the Norwegian and the two Singapore funds were created in this manner. See, e.g., text and notes, supra, at ---.

219 Some have, for example, identified the China National Offshore Oil Corporation and the Dubai DP World as sovereign wealth enterprises. See KPMG, Sovereign Wealth Funds—The New Global Investors, Oct. 1, 2008. See also SWF Institute, Sovereign Wealth Enterprise (suggesting that SWEs may be created for flexibility. "A sovereign wealth fund could have a strict investment mandate in place; however, the sovereign wealth enterprise has its own rules. For instance, many public pension funds are unable to short stocks. To get around this they can hire an external manager to manage a portfolio that could have a long-short

strategy. A second reason could be transparency. If a sovereign wealth fund has hundreds of sovereign wealth enterprises, it is harder to track their holdings. Lastly, is to avoid being lumped into the same category as a sovereign wealth fund and avoid the public spotlight." Id). On the China National Offshore Oil Corp., see Company Description, TradeBig.com, available http://www.7621.tradebig.com/ ;
China National Offshore Oil Corp., available http://www.cnooc.com.cn/yyww/default.shtml.

220 Bryan J. Balin, Sovereign Wealth Funds: A Critical Analysis, The John Hopkins University School of Advanced International Studies (SAIS), March 21, 2008 (approved) ("Examples of this method [investment through state owned enterprises] include the attempted acquisition of the Peninsular and Oriental Steam Navigation Company (P&O) by the state-owned Dubai Ports World Corporation, and the purchase of IBM's computing business by the Chinese government-controlled Lenovo Group. . . [E]xample[s of purchases through foreign exchange stocks include that of] the governments of India, Thailand, and Indonesia [which] have either investigated or implemented plans to diversify their foreign exchange holdings into private fixed income products or liquid international equity securities")

221 Diana Farrell and Susan Lund, Power Brokers, Newsweek International, Oct. 20, 2007, available http://www.mckinsey.com/mgi/mginews/powerbrokers.asp

222 For a discussion of traditional state owned enterprises and the law applicable in home and host states, especially before 1989, see, e.g., Bernard Fensterwald, Jr., Sovereign Immunity and Soviet Trading, 63 HARV. L. REV. 614 (1950).

223 On Eastern European privatization, once the focus of a tremendous amount of academic consideration, see, e.g., George Bogdan, The Economic and Political Logic of Mass Privatization in Czechoslovakia and Poland, 4 CARDOZO J. INT'L & COMP. L. 43 (1996).

224 For a discussion of state owned enterprises in Western Europe, and their critique, see e.g., Carol M. Rose, Privatization--The Road to Democracy?, 50 ST. LOUIS U. L.J. 691 (2006); John N. Drobak, A Comment on Privatization and Democratization, 50 ST. LOUIS U. L.J. 783 (2006).

225 For a discussion of state owned enterprises outside of Western Europe, and their critique, see, e.g., Amy L. Chua, The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries, 95 COLUM. L. REV. 223 (1995); Lawrence Sáez & Joy Yang, The Deregulation of State-Owned Enterprises in India and China, 43 COMP. ECON. STUD. 69, 76 (2001).

226 "Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries", OECD, 2005 and "Privatising State-Owned Enterprise, An Overview of Policies and Practices in OECD Countries", OECD, 2003.

227 See id.

228 See, e.g., George Steven Swan, The PoliticalEconomy of the Rule of Law in C hina, 5 HASTINGS BUS. L.J. 309 (2009); H. Stephen Harris, Jr., Legal Implications of a Rising China: The Making of an Antitrust Law: The Pending Anti-Monopoly Law of the People's Republic of China, 7 CHI. J. INT'L L. 169, 173 (2006); See Deborah Kay Johns, Reforming the State-Enterprise Property Relationship in the People's Republic of China: The Corporatization of State-Owned Enterprises, 16 MICH. J. INT'L L. 911, 923-27 (1995); Xinqiang Sun, Reform of China's State-Owned Enterprises: A Legal Perspective, 31 ST. MARY'S L.J. 19, 21 (1999). For a history of the transformation of Chinese SOEs, see, e.g., Donald Hay, Derek Morris, Guy Liu & Shujie Yao, Economic Reform and State-Owned Enterprises in China 1979-1987, at 5 (1994).

229 Thus, recent analysis in the popular business press has rightly suggested that "as the Chinese economy evolves, it is no longer so easy or desirable to pigeonhole state-owned enterprises. The line between them and private-sector companies has blurred considerably. Over the next five years, as the economy and business climate continue to shift, the ownership structure of state-owned companies will matter much less than the degree of openness they show in their business practices and management—that is, their transparency and receptiveness to new ideas." Jonathan R. Woetzel, Reassessing China's State Owned Enterprises, McKinsey Quarterly (July 2008).

230 Id.

231 For an interesting internal perspective, see, e.g., Zhang Wenkui, Dev. Research Ctr. of the State Council (P.R.C.), The Role of China's Securities Market in SOE Reform and Private Sector Development, at 1, available at http://www.tcf.or.jp/data/20020307-08_Wengkui_Zhang.pdf (accessed July 23, 2009).

232 As one commentator recently noted, "because the central or local government "perform[s] contributor's duties, and enjoy[s] the owner's rights and interests" in Chinese SOEs, the government's role should never be neglected or underestimated." Catherine (Xiaoying) Zhang, Business Negotiation Between Westerners and Chinese State Owned Enterprises, 42 INT'L LAW. 1303, 1306 (2008).

233 "Chinese SOEs have much more complicated incentive systems, combined with the government's significant role in Chinese SOEs, as mentioned above. The motivations of Chinese SOEs' executives in business negotiations are far greater than merely profit-making. Other factors, such as the overall political environment, compliance with policy guidelines, and even the deal's impact on the executive's personal political career path, will have an inevitable impact on the Chinese SOEs' business negotiations with Western firms. Furthermore, these various motivations are generally interlinked." Id., at 1308.

234 Id.

235 "As the distinction between a state-owned and private enterprise blurs, the challenges that both face are
converging. Chinese companies, in the public or private sector, must gain approval from government officials for cross-border M&A and other global activities. Even the top-tier state-owned companies—those reporting directly to the central government—struggle with many of the same problems confronting their private-sector counterparts as they move beyond China's borders." Id.

236 See OECD INVESTMENT NEWS, China's Outward FDI Faces Challenges as it Continues to Expand, June 2009, Issue 10, ("In recent years, several major acquisitions by Chinese MNEs of target companies in developed countries have been discontinued in the face of strong opposition from host country publics, in some cases after having been approved by the authorities. Because these MNEs are often closely held or listed state owned enterprises (SOEs), concerns have been voiced about acquisitions that might be politically-motivated perhaps even a representing a potential threat to the national security of host countries. Another priority in host countries has been maintaining a level playing field among foreign SOEs and privately owned companies – not least in respect of their access to, and cost of, financing. Much of the public criticism of Chinese-led takeover bids has focused on the perception that the bids were facilitated by subsidized government financing. A key step that Chinese authorities might take to alleviate such fears is the upgrading of corporate governance standards in SOEs in order to entrench the commercial orientation of these enterprises and strengthen governance mechanisms to raise the credibility of the commercial orientation.").

237 This entity is a subsidiary of the Chinese SWF, China Investment Company (CIC). See discussion below at text and notes ---.

238 China Investment Corporation is the entity through which China engages in SWF activity. See discussion at text and notes ---.

239 Ping Xie (Central Huijin Investment Company Limited), Chao Chen (China Investment Corporation),The Theoretical Logic of Sovereign Wealth Funds, (June 16, 2009). Preliminary study report of the 2008 National Natural Science Contingent Project "Sovereign Wealth Funds: operation and Impact Analysis" (No.09110421A1), available at SSRN (last accessed July 21, 2009) ("In terms of legal structures, SOEs are corporations regulated by the general company law while SWFs may take three forms: a pool of assets, a legal entity under a specific public law, or a legal entity under the general company law. Most SWFs take the third form and act strictly as a business entity").

240 In establishing the difference between Sovereign Wealth Funds and State-Owned Enterprises, an October 2008 research paper by the Deutsche Bank puts in perspective the role of SWFs with respect to SOEs: "SWFs are government-owned investment funds which are commonly funded by the transfer of foreign exchange assets, and which are set up to serve the objectives of a stabilisation fund, a savings fund for future generations, a reserve investment corporation, a development fund, or a contingent pension reserve fund by

investing the funds on a long term basis, often overseas." Deutsche Bank Research, SWFs and foreign investment policies – an update, October 22, 2008 ("In doing so, SWFs fulfill functions complementary to other state-operated entities, such as central banks, development banks and pension funds, and to other state-owned assets, like state-owned enterprises, and other public entities." Id.).

241 Mr. Adrian Blundell-Wignall (Deputy Director, Financial and Enterprise Affairs, OECD) and Mr. Gert Wehinger (Economist OECD) provides a definition of SOEs with respect to SWFs:

> "SWF's: are pools of assets owned by governments to achieve broader national objectives—to diversify and improve the return on exchange reserves or oil revenue, to shield the domestic economy from commodity price fluctuations, or unspecified other objectives.
> SOE's: are entities (separate from public administration) that have a commercial activity where the government has a controlling interest (full, majority or significant minority) whether listed or not on the stock exchange. The rationale is often industrial/regional policy and/or the supply of public goods (often in utilities and infrastructure—such as energy, transport and telecommunications)...
> SOE's are not pools of investable capital as such, but they may finance investments via their earnings, fiscal appropriations from the government, or from debt markets at a (possibly) distorted low cost of capital. In some sense there is greater scope for financially less-constrained investment, and with strategic objectives very much in mind"

Adrien Blundell-Wignall and Gert Wehinger, Open Capital Markets and Sovereign Wealth Funds, Pension Funds and State-Owned Enterprises, Sydney 25-26 September 2008 (hosted by Centre for Applied Macroeconomic Analysis in the ANU College of Business Economics And the Lowy Institute for International Policy), available (last accessed July 21, 2009).

242 See text and discussion, infra at notes ---. Philippe Gugler, and Julien Chaisse, Sovereign Wealth Funds in the European Union: General Trust Despite Concerns, SWISS NATIONAL CENTRE FOR COMPETENCE IN RESEARCH, Working Paper No. 2009/4 (January 2009).

243 See, e.g., Santiago Principles, supra, note --, at GAPP 19.

244 Philippe Gugler, and Julien Chaisse, Sovereign Wealth Funds in the European Union: General Trust Despite Concerns, SWISS NATIONAL CENTRE FOR COMPETENCE IN RESEARCH, Working Paper No. 2009/4 (January 2009).

245 For example see Ken Davies, While global FDI falls, China's outward FDI doubles, Columbia FDI Perspectives, VALE COLUMBIA CENTER ON SUSTAINABLE INTERNATIONAL INVESTMENT, No. 5, May 26, 2009 ("China's worries are not unfounded. While there are those who welcome Chinese investment, for example in African countries

happy to receive accompanying unconditional aid, there are also widespread suspicions of China's intentions. The predominance of SOEs in China's OFDI has raised fears that such investment may not be governed by normal commercial considerations and may even be an arm of the country's foreign and defense policy.")

246 See text and notes, infra, at Section V (Coordination, Development, Opposition and the Challenges of Sovereign Investing in the Context of Global Economic Crisis: The Case of China).

247 See, e.g., Ronald J. Gilson & Curtis J. Milhaupt, Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism, 60 Stan. L. Rev. 1345, 1346-47 (2008) ("In this form, the country is the unit whose value is to be maximized, with a corresponding increase in the role of the national government as a direct participant in and coordinator of the effort." Id., at 1346). For a comparison with traditional mercantilism, at leats in the judicial conception, see Standard Brands v. Smidler, 151 F.2d 34, 66 U.S.P.Q. (BNA) 337 (C.C.A. 2d Cir. 1945) (Franks, J., concurring). For a popular press account, see, e.g., Robert J. Samuelson, Mercantilism Is Making a Comeback, INVESTOR'S BUS. DAILY, Dec. 26, 2007, at A11

248 Consider, for example, the lending activities of a bank, controlled by a subsidiary of a state sovereign wealth fund, whose lending and acquisition activities might serve to further overall state objectives, but the transactions—loans, acquisitions of foreign banks, foreign joint ventures—might not appear to have a sovereign element. Even something as simple as determining to which economic sector loans might be targeted (and of what purposes) could both reflect state policy to foster a particular sector, and especially its overseas activities, and provide as conventional basis for wealth maximizing commercial activity. For a discussion, see, For example, China's State-owned enterprises are allegedly by far the largest Chinese players in the African continent (See Chen Jialu, China SOEs move to fill African investment gap, CHINAdaily.com June 16, 2009).

249 For a discussion, see, e.g., Donna E. Arzt and Anna G. Kaminska, From Soviets To Saddam: Introduction To The Thirtieth Anniversary Symposium, 30 Syracuse J. Int'l L. & Com. 181 (2003). For extended discussion, see PETER MUCHLINSKI, MULTINATIONAL ENTERPRISES AND THE LAW (2nd ed, 2007).

250 See Larry Catá Backer, The Autonomous Global Enterprise: On the Role of Organizational Law Beyond Asset Partitioning and Legal Personality, 41 TULSA LAW JOURNAL (2006).

251 Id. Thus, "The ability to commodify regulation makes it at least theoretically possible to construct an economic entity which, through careful planning can take advantage of asset partitioning, cross holdings, and global dispersion of assets to avoid effective regulation by any one political community." Id.

252 An excellent example of this is the creation of large and effective systems of

transnational governance within an integrated production, distribution and sales system of large multinational enterprises. In this case, the multinational enterprise, through systems of contract that now assume a regulatory purpose, can harmonize behavior among its global supply chain as well as within any other segment of its operations. This harmonization occurs below and beyond state regulatory provisions in host countries. For a discussion of the theory and implementation of these private law based commercial transnational systems, see, Larry Catá Backer, Multinational Corporations as Objects and Sources of Transnational Regulation, 14 ILSA JOURNAL OF INTERNATIONAL & COMPARATIVE LAW 499 (2008); Larry Catá Backer, Economic Globalization and the Rise of Efficient Systems of Global Private Law Making: Wal-Mart as Global Legislator, 39(4) UNIVERSITY OF CONNECTICUT LAW REVIEW 1739 (2007). Li-Wen Lin has recently argued that these private transnational law systems might well leak into the law of host and home states as well, and as such, ought to be an object of comparative law study. See Li-Wen Lin, Legal Transplants through Private Contracting: Codes of Vendor Conduct in Global Supply Chains as an Example, 57(3) AMERICAN JOURNAL OF COMPARATIVE LAW 711 (2009).

253 That, of course, is the foundational assumption of projects such as the OECD's principles and guidelines for SWFs and SOEs. See discussion, infra, at text and notes ---.

254 See Larry Catá Backer, Extraterritoriality and Corporate Social Responsibility: Governing Corporations, Governing Developing States, LAW AT THE END OF THE DAY, March 27, 2008. These interventions can be motivated by the loftiest as well as the basest of motives. The ethics framework of the Norwegian Fund reminds us that economic aggression can occur for the best of all reasons—the attainment of welfare. But the valuation of such measure remains that of the projecting state and not that of the host state or its electorate.

255 Suma Athreye and Sandeep Kapur, Introduction: The internationalization of Chinese and Indian firms—trends, motivations and strategy, INDUSTRIAL AND CORPORATE CHANGE, Volume 18, Number 2, pp. 209–221, ("In the Chinese case, state-owned enterprises have been most active abroad, while in India private sector firms have led the drive to internationalization...Consider the growing unease with the entry of large sovereign wealth funds, and the concerns that these are largely instruments of an overbearing Chinese state. Of course, the dominance of state-owned enterprises in Chinese internationalization may be structural: unlike Indian business houses, a poorly developed domestic capital market might imply that state sponsorship is critical for Chinese firms' overseas ventures. But at the same time it creates the perception that these firms are beneficiaries of "unfair state aid," an argument that resonates with old debates about strategic trade policy.").

256 The Santiago Principles are specifically grounded in the nature of SWFs as engaged in the business of
investment.

> The principles and practices laid out in the GAPP, along with their explanatory notes, can be expected to guide existing and future SWFs in various aspects of their activities—most importantly investing professionally in accordance with

> their investment policy objectives—and to help inform any associated legal and institutional reform. As investment institutions, SWFs operate on a good faith basis, and invest on the basis of economic and financial risk and return-related considerations.

International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices; "Santiago Principles, (October 2008), at 5. For a discussion, see infra at text and notes ---.

257 This is in essence the problem of regulation in the context of the emerging structure of Chinese state investments discussed infra at Part V.

258 For a short discussion on the regulatory problems with respect to state-owned enterprises, see, Anna Gelpern, Sovereign Self-regulation (Guest Blogger), LAW AND DEVELOPMENT BLOG (A member of the law professor blog network), September 27, 2008. For a general discussion on the Santiago Principles see DELOITTE TOUCHE TOHMATSU, Minding the GAPP Sovereign wealth, transparency, and the "Santiago Principles" (November 2008), available at . (last accessed July 21, 2009).

259 Those principles, whether as articulated through the Santiago Principles, those developed by the U.S. Treasury Department, those articulated by the E.U. or the OECD focus on the investment activities of entities. For the Santiago Principles, see, (see International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices; "Santiago Principles, (October 2008). For the principles developed by the U.S: Treasury, (The U.S. Treasury Department, on behalf of the Committee on Foreign Investment in the United States (CFIUS), issued final regulations governing CFIUS on November 14, 2008- See 31 C.F.R. Part 800 (2008). The regulations implement Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (Section 721) –See, Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, 121 Stat. 246 (effective October 24, 2007). The regulations also codify improvements to the CFIUS process). For those articulated by the European Union, see, provisions governing the freedom of capital movements in Articles 56 to 60 of the EC Treaty. Corresponding guidance provided by Directive 88/361/EEC on the definition of capital movements, and Article 43 on freedom of establishment –see, EU internal market principles. For a complete report on special rights or "golden shares", including rulings by European Court of Justice, see COMMISSION OF THE EUROPEAN COMMUNITIES, Commission Staff Working Document Special rights in privatised companies in the enlarged Union–a decade full of developments, Brussels (July 25, 2005), available at http://ec.europa.eu/internal_market/capital/docs/privcompanies_en.pdf. For the OECD principles, see, Organisation for Economic Co-operation and Development, OECD Guidelines on Corporate Governance of State-Owned Enterprises, (2005). Also, OECD Guidance on Sovereign Wealth Funds. They impose something that is beginning to sound like a manifesto of formally constituted principles of private party investing (though its relationship to the objectives of private parties remains at best untested and at worst irrelevant). But these guidelines do not focus on the behaviors of operating entities engaged in economic activities

that seek to invest in other entities abroad. The reasons for such investment can be quite aggressive and destructive—to obliterate competition, to increase market share, to prevent a competitor from acquiring potentially useful assets, to vertically or horizontally integrate operations and the like—but these are the same objectives that private parties indulge in ordering their own economic activities. The separation of sovereign objectives from private equivalent objectives would involve the creation of another standard—something like a reasonable operating company investment policies standard. But there is nothing like that available.

260 According to The Santiago Principles SOEs are excluded from the definition of SWF ("These exclude, inter alia, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.") See International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices; "Santiago Principles, (October 2008).

261 I have discussed an alternative based on a participatory-regulatory distinction applied equally to sovereign and private actors in Larry Catá Backer, Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment, 41(2) GEORGETOWN JOURNAL OF INTERNATIONAL LAW – (forthcoming 2009).

262 Revised Model Business Corporation Act, Section 14.30.

263 Id., at Section 14.20)

264 Revised Model Business Corporation Act Section 3.01(a).

Posted by Larry Catá Backer

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