EVENT SUMMARY

A Blueprint for Sovereign Wealth Fund Best Practices

Edwin M. Truman, Peterson Institute

Peterson Institute, Washington, DC

April 1, 2008

The rapid expansion of sovereign wealth funds (SWFs) has been a source of tension in the international financial system because they represent two relatively new developments: the redistribution of wealth from industrial to developing countries and the shift of a large portion of this new wealth from private to public hands.

For these reasons, SWFs present several major concerns for both the investor countries and the countries that are on the receiving end of SWF investment. Some of these concerns include the mismanagement of funds and the potential for corruption, the politicization of SWF investment including potential conflicts of interest for investing countries and the threat of financial protectionism from receiving countries, and the worry that SWF investment may create unnecessary financial-market turmoil.

To address these concerns, government officials have called for the establishment of a set of best practices for SWFs. Proposals for such a standard from the G-7, the International Monetary Fund (IMF), the European Union, and the US Treasury have included guidelines for institutional structure or governance, transparency or disclosure, accountability, and risk management practices. While some of these proposed guidelines are especially valuable, including the principle of establishing accountability, others are largely superficial and have little practical content.

Peterson Institute Senior Fellow Edwin M. Truman has created a blueprint for SWF best practices based on a scoreboard that measures the performance of existing SWFs on 33 criteria. The elements of the scoreboard cover structure, governance, accountability and transparency, and behavior. He uses this scoreboard to score 44 SWFs including 34 non-pension funds and a sample of 10 sovereign pension funds.

Truman presented this blueprint at an Institute meeting on April 1, 2008. He argued that the IMF-sponsored initiative on best practices for SWFs should be judged according to three tests. First, all of the elements in his scoreboard should be included. Second, compliance should be voluntary but funds that do not comply with certain criteria should explain why they choose not to do so. Third, compliance should be rigorous and testable by the general public—details about compliance with best practices are more important than simply paying lip service to general principles. He also recommended that compliance be enforced through “naming and shaming” as this would bring about results more quickly than legislation.

The overarching principle of this blueprint for SWF best practices is accountability. The blueprint includes the principles set forth by G-7, US, and EU authorities in their proposals for SWF best practices and can be used to evaluate the IMF-sponsored dialogue. This dialogue if successful will help to demystify SWFs and also help to build confidence in the sound operation of these funds.

Question and Answer Session

During the question and answer session, Truman argued that the biggest concern should not be with sovereign wealth funds, but rather with other government owned entities such as banks and utilities. Echoing a point made previously by his colleague Anders Åslund, Truman said that one should be more wary of the Russian energy giant Gazprom for being opaque and monopolistic than Russia’s two SWFs, which are generally considered to be transparent and accountable.

On the role of the IMF in overseeing sovereign wealth funds and their investment activities, Truman argued that the goal should be for the countries involved to engage in a mutual effort where they see it in their common interest to cooperate. He also pointed out that IMF surveillance of SWFs may not necessarily be a popular proposal in light of recent experience with IMF exchange rate surveillance. On the question of whether the IMF or World Bank should be involved in managing sovereign wealth fund assets, Truman said that while there is debate on this issue, “fundamentally, I don’t think the Fund and the Bank should be in this business quite frankly.”

Truman added that the recent revelation by Angel Gurria that the OECD does not plan on issuing new recommendations for host countries that address the issue of sovereign wealth funds will be “a problem” because G-8 countries and other countries are expecting a quid pro quo.

When asked why some funds that are recognized as experienced and sophisticated investors score poorly on his scoreboard, Truman explained that recognition by market players that these funds are professional is not sufficient. “Having a good reputation in the investment community is not enough when you are managing these large amounts of money which are viewed as threatening in the countries in which you are investing.”

When asked about the “fairness” of allowing governments to subsidize overseas investment, Truman responded that this criticism is misplaced because there is no subsidy involved in the action of a sovereign wealth fund. SWFs manage assets that are held outside the country. “You can disapprove of how those assets were accumulated” for example through foreign exchange market intervention, but once they are accumulated “they have to be invested in something.”