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The conditions for a positive contribution of sovereign wealth funds to the world economy

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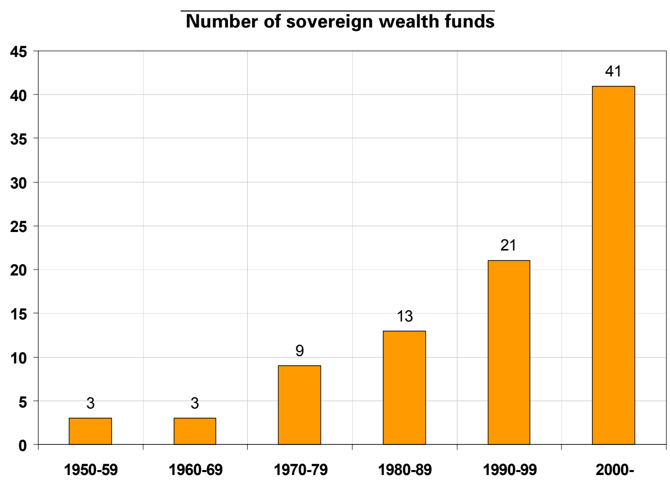
- The so-called Sovereign Wealth Funds (SWFs), set up by governments enjoying fast growing external revenues in order to manage sovereign wealth separately from official foreign reserves, are already surpassing the hedge fund industry in terms of assets under management. Their aggregate asset portfolio is still much lower than total assets under private management (2 to 3 trillion $ versus 53 trillion $) but, on current growth trends, it would exceed 10 trillion $ in the next few years.

- Traditionally, foreign reserves have been largely parked in passive investments, mostly in US Treasury bills and bonds, with central banks focusing on security and liquidity. Rising SWFs invest in a broader range of assets with the aim to raise the return of their portfolio. By increasing their holdings of risky assets, they would raise the demand for equities, emerging market assets and risky assets in general.

- Most of them have low levels of transparency, which might undermine financial market stability by exacerbating the volatility of some asset prices and prevent market participants from anticipating correctly relative asset price changes. Furthermore, their opacity, combined with their public ownership, spur concerns that they may actually operate to serve strategic interests.

- Nevertheless, sovereign wealth funds may contribute to stabilize the international financial system, provided that their management transparency is improved. From a technical standpoint, some solutions may be found: identifying best practices for index-driven management, investment rules or public accounting. A more ambitious objective would be to tackle the issue at its roots by moving away from the "non-cooperative equilibrium" of excess reserve accumulation, by aiming to reduce global current account imbalances and better insuring emerging countries against international financial risks.



Source: Deutsche Bank.

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DIRECTION GÉNÉRALE DU TRÉSOR ET DE LA POLITIQUE ÉCONOMIQUE

A growing number of countries flush with foreign assets set up investment funds labelled Sovereign Wealth Funds (SWFs), in order to manage the money drawn from foreign exchange reserves and natural resource payments separately from the official reserves of their monetary authorities. Current market estimates of SWFs'assets under management range from 2 to to 3 trillion \$. SWFs are already surpassing hedge funds (a mere 2 trillion \$ assets under management). They are set to grow rapidly and to invest in a broader range of asset classes. However, public disclosure of most SWFs' portfolio and investment strategy remains very limited. Given their public ownership, such characteristics spur concerns that SWFs may actually operate to serve non-financial objectives and threaten third countries strategic interests.

All these issues were on the agenda of the G-7 finance ministers and central bank governors meeting held on 19 October 2007 in Washington D.C. Upon this occasion, they also had a session with a group of SWF managers. The G-7 finance ministers and central bank governors finally "agreed that sovereign wealth funds (…) are increasingly important participants in the international financial system and that our economies can benefit from openness to SWF investment flows". They also asked the IMF, the World Bank, and the OECD to identify "best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability" and countries receiving SWFs investments "to build on principles such as non-discrimination, transparency, and predictability".

This paper seeks to review three dimensions of this work programme: the rise of SWFs and its underlying factors; their investment behaviour and its impact on asset prices and market dynamics; the risks relating to their action and how to deal with them.

Table 1: main sovereign wealth funds (by decreasing order of size)

Country	Fund name	Inception year	Assets under management (billion \$)
United Arab Emirates	Abu Dhabi Investment Authority (ADIA)	1976	500-875
Singapore	Government of Singapore Corporation (GIC)	1981	100-330
Norway	Government Pension Fund – Global (GPF)	1990	300-322
Kuwait	Kuwait Investment Authority (KIA)	1953	213-250
China	China Investment Corporation	2007	200
Singapore	Temasek Holdings	1974	108-159
Russia	Stabilization Fund	2004	127-133
Qatar	Qatar Investment Authority (QIA)	2005	40-60
Libya	Oil Reserve Fund	2005	50
Algeria	Fonds de régulation des recettes	2000	25-43
United States of America	Alaska Permanent Reserve Fund	1976	38-40
Brunei	Brunei Investment Authority (BIA)	1983	30-35
Malaysia	Khazanah Nasional BHD	1993	18-26
South Korea	Korea Investment Corporation (KIC)	2005	20
Venezuela	National Development Fund	2005	15-18
Canada	Alberta Heritage Savings Trust Fund	1976	15-17

Sources: Deutsche Bank, Goldman Sachs, Morgan Stanley, Standard Chartered

1. The rise of sovereign wealth funds is a structural phenomenon

1.1 Economic and financial objectives

There is a debate in the literature on how sovereign assets should be managed and the need to have these assets invested in stand-alone funds. Some authors[1] argue that monetary authorities should take advantage of the opportunities offered by modern capital markets to improve the returns earned on reserve holdings, without increasing their risk exposure. Others[2] consider that a clear distinction should be made between foreign exchange reserves, which should be invested cautiously so as to be liquidated easily if necessary to protect domestic currencies and banks from crisis, and sovereign assets that accrue from the extraction of natural resources.

By establishing SWFs, that is separate institutions with long-term wealth-maximization objectives and distinct expertise in wealth management, countries aim to pursue several goals[3] :

- shield their economies from the volatility of the revenues stemming from commodity exports, which can exacerbate business cycle fluctuations;
- spread over successive generations the wealth extracted from commodities, which are exhaustible resources;
- limit the adverse effects of a high degree of dependence on natural resources. If the export of natural resources results in an appreciation of the real exchange rate, reducing the competitiveness of other tradable sectors, the dependence on natural resources can become entrenched. This leads to divert capital away from high-productivity sectors (the so-called "Dutch disease");
- the dramatic accumulation of reserves has triggered rising costs of sterilization in order to neutralize their inflationary impact as well as negative carrying costs, and it has focused attention on how these assets can be invested so as to increase their return or at least reduce their losses[4]. Traditionally, foreign reserves

(1) For instance, Summers (2007), "Opportunities in an era of large and growing official wealth", *Sovereign Wealth Management, Central banking Publications.*

(2) For instance, Hildebrand (2007), "Four tough questions on foreign reserve management", *Sovereign Wealth Management, Central banking Publications.*

(3) See Rietveld and Pringle (2007), "The evolution of sovereign wealth management", *Sovereign Wealth Management, Central banking Publications.*

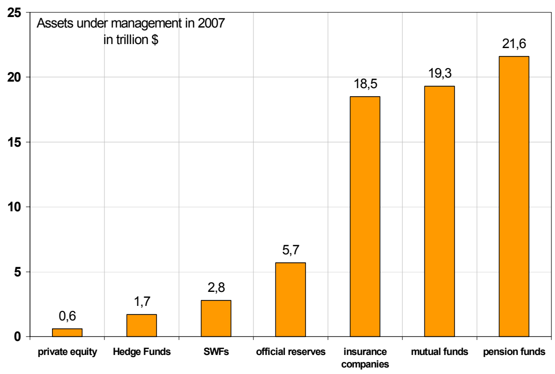
(4) The cost of carry is the spread between the financing cost of foreign reserves and their return. The cost of sterilisation is the spread between the return of the domestic assets that the central bank sells in order to offset the money stock increase resulting from the purchase of foreign reserves and the return of the latter. According to World Bank calculations, the probability of a negative return over a ten-year horizon is far greater for investment made according to standard central bank policies than for more aggressive investment strategies. See Summers (2007) op. cit.

have been largely parked in passive investments, mostly in US Treasury bills and bonds, with central banks focusing on security and liquidity. Central banks such as the Swiss National Bank and the Eurosystem are taking a more active approach to investing. In this regard, leaving reserve management to central banks may pose agency problems: possible conflict between the central banks' primary objectives (the pursuit of price, exchange rate and financial stability) and reserve management functions; lack of incentives to pursue more aggressive investment policies; lack of performance-based compensation schemes; reputation risk in case of losses. Within this context and to resolve these potential conflicts, a number of countries have sought to establish separate institutions.

1.2 A rise set to strengthen

Focusing on the case of natural resource funds, econometric work by the IMF[5] suggests that improvements in terms of output stabilization and asset diversification can be achieved through SWFs. Thus, from both a theoretical and an empirical point of view, there seems to be a strong rational for government in situation of fast growing revenues to consider having sovereign wealth managed by separate funds. SWFs have grown fast. Current market estimates of SWFs' assets range from USD 1.9 to 3.2 trillion $[6].

Chart 1: main non-bank participants of the financial system

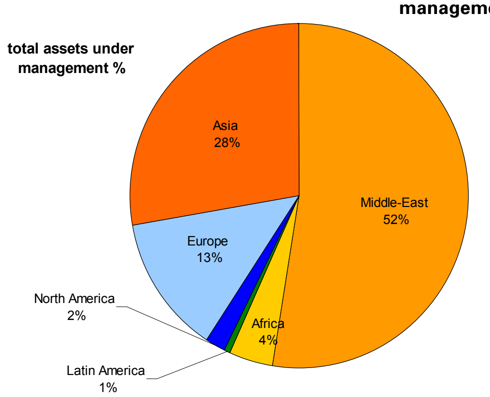


Source: McKinsey and Morgan Stanley.

This is almost half the amount of official reserves (5,6 trillion $) and 10 times less than assets under management of insurance companies, mutual funds and pension funds (53 trillion $), but SWFs are already surpassing the hedge fund industry which accounts for a mere 1.7 trillion $ of assets under management (see chat 1).

Besides, they seem to grow at a much faster pace than the private asset management industry and, on current trends, they could reach up to 12 trillion $ by 2015[7]. The strength of this upward trend is of course uncertain as it largely depends on the price of oil, oil production capacities and current account imbalances. But there are compelling reasons to believe that the accumulation of wealth under SWFs will continue at a strong pace: the value of proven oil reserves of the Gulf Cooperative Council (GCC) is around 44 trillion $ (28 times the size of SWFs emanating from the GCC)[8]; current account surpluses in Asia amount to roughly 400 billion $ a year, while countries already consider that their official reserves exceed the appropriate level for liquidity purposes[9].

Chart 2: regional breakdown of SWF assets under management (%)



Source: Morgan Stanley.

Available information indicates that these holdings are quite concentrated, among funds, with the top five funds accounting for about 70 percent of total assets, as well as among countries (see exhibit 2), half of total assets being held by Middle East countries. Yet, an increasing number of countries have established or consider the establishment of SWFs, including China, Japan, Russia, Saudi Arabia[10] or even Bolivia.

Finally, the rise of SWFs can actually be seen as one facet of the financial modernization that has taken place in

(5) Davis, Ossowski, Daniel and Barnett (2001), "Stabilisation and savings funds for non-renewable resources", *IMF Occasional Paper 205, International Monetary Fund.*

(6) Among others, International Monetary Fund (2007), "Sovereign Wealth Funds", *Global Financial Stability Report, Annex 1.2 of chapter 1, September*, Jen (2006), "Sovereign Wealth Funds and Official FX Reserves", *Morgan Stanley Research Global, 14 September*, Kern (2007), "Sovereign wealth funds - state investments on the rise", *Deutsche Bank research, 10 September* and Lyons (2007), "State Capitalism: The rise of sovereign wealth funds", *Standard Chartered Global Research.*

(7) For underlying assumptions et detailed calculations, see "How big could sovereign wealth funds be by 2015?", *Morgan Stanley Research Global, 3 May 2007.*

(8) See Bindelli and Jen (2007), "Transforming oil into financial wealth", *Morgan Stanley Research Global, 15 November.*

(9) In China, such considerations have led to the decision to establish the *China Investment Corporation* (CIC) outside the People's Bank of China. See also Jen and St-Arnaud (2007), "Tracking the tectonic shift in foreign reserves and SWFs", *Morgan Stanley Research Global, 15 March.*

Emerging Market Economies (EMEs) over the past ten years[11]. A related aspect of this development is the international expansion of large state-owned companies from EMEs, including the growing importance of their foreign investment activity. Their position in world ranking has improved rapidly, either in terms of sales, market capitalization or total foreign assets[12]. 2006 became the highest year on record for cross-border mergers and acquisitions originated in non-OECD countries, reaching an estimated 115 billion $. More than half of this money flowed into OECD countries.

Today, the overall results posted by EMEs are rather impressive both in terms of macroeconomic performance and financial robustness. On the one hand, their fundamentals have improved significantly and substantial efforts to modernise the domestic financial sector have been undertaken in order to offer investors an increasingly wide and sophisticated range of financial instruments. On the other hand, their integration into the global economy and international financial markets has deepened. In 2005, the total outflow from EMEs was 133 billion $ (17% of world outward flows) and the value of the foreign direct investment stock from emerging economies was around 1.4 trillion $ (13% of the world total).

2. Their active management of foreign reserves may contribute to raise market efficiency

2.1 Active management of foreign reserves

Strictly speaking, SWFs may be defined as vehicles funded by foreign exchange assets and managing those assets separately from the official reserves of the monetary authorities. This leads to the distinction between commodity funds (approximately holding two thirds of the sector's assets under management), established through commodity exports owned, exploited or taxed by the government, and non-commodity funds, established through transfers of assets from official foreign exchange reserves.

The holding and the management of foreign assets by sovereigns can also take the form of Sovereign Pension Funds (SPFs) also denominated pension reserve funds. SPFs differ from SWFs in two main ways[13]: the former are in principle funded by domestic assets and have financial obligations they need to address in the future, while the latter are typically funded by foreign exchange assets and do not have pre-established future constraints. However, in some countries, the stand-alone funds managing government-sponsored investment have both SPF and SWF features. This is the case for instance for French FRR (*Fonds de Réserves des Retraites*), Norway's Government Pension Fund-Global (GPF) and the Government of Singapore Investment Corporation (GIC). In addition, like SWFs, SPFs tend to enhance their risk-return profile for two reasons: they aim to address better the fiscal burden arising from the ageing process; besides, financial globalisation facilitates a reduction in the home bias.

Such diversity entails a multiplicity of objectives: stabilization of fiscal revenues, balance of payment sterilization, intergenerational saving. Sovereign wealth funds - as well as sovereign pension funds - aim first to preserve a minimum amount of capital, in real terms, so that the funds' purchasing power is guaranteed. Yet, SWFs having typically no identified liabilities - unlike SPFs - are more able to focus on a return objective and an acceptable level of risk[14]. Among SWFs, stabilization funds are generally conservative in their strategic asset allocation, focusing on liquid and relatively secure assets, while saving funds, which pursue long-term objectives, may invest in a broader range of assets[15].

Since the beginning of the years 2000, countries, especially in Asia and the Middle-East, have been transferring an increasing part of growing foreign reserves to SWFs. In the meantime, the demand of SWFs for risky assets has been going up as a result of a management of foreign reserves apparently more prone to risk. Even long-established SWFs have announced that they would increase their exposure to risky assets. It is unclear if and how the ongoing credit crisis will affect this trend.

Norway's Government Pension Fund - Global has announced that it would increase its exposure to global equities from 40% to 60%. China's CIC is also expected to hold a substantial share of its assets in equities, after having acquired nearly 10% of the private equity fund Blackstone in May 2007. As evidenced by a recent Mc Kinsey Global Institute study[16], some SWFs have signalled

(10) According the Financial Times issue dated 22 December 2007, Saudi Arabia is considering the launch of a sovereign wealth fund likely to exceed the Abu Dhabi Investment Authority in terms of assets under management, which is the biggest known SWF (around 900 billion $) to date. For the time being, the Saudi foreign reserves are spread between the monetary authority, the *Saudi Arabian Authority* (SAMA), the *Public Investment Fund* in charge of investing part of the oil export revenues in the country exclusively, and many other funds belonging to the Royal family.

(11) See Bank of England (2005), "Capital flows to emerging market: recent trends and potential financial stability implications", *Financial Stability Review, December* ; Odonnat and Rahmouni (2006), "Are emerging countries still an homogenous asset class?", Banque de France, *Financial Stability Review*, December.

(12) Source: OECD (2007), "Trends and recent developments in foreign direct investment", *International Investment Perspectives*.

(13) Jen and St-Arnaud (2007), "Sovereign Pension Funds", *Morgan Stanley Research Global, 23 August*.

(14) Conversely, sovereign pension funds having explicit future liabilities typically design strategic asset allocation benchmarks that aim to preserve solvency.

(15) See International Monetary Fund (2007), op. cit.

their intent to shift from being largely passive investors to taking larger equity stakes in foreign companies. They have actually made significant steps in this direction over the last weeks of 2007, when they bought more than 30 billion $ convertible bonds issued by several large banks including Citigroup, Merril Lynch, Morgan Stanley, UBS, eager to raise fresh capital after posting larger than expected losses.

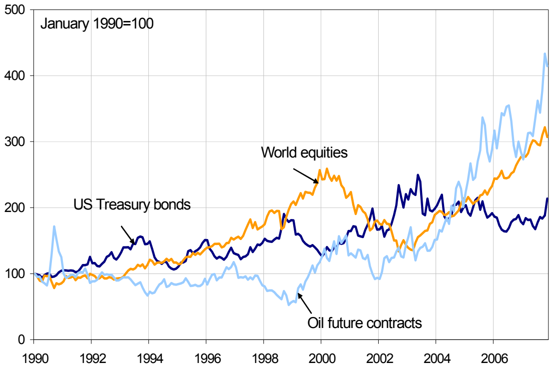
2.2 Stronger market efficiency

Given the already relatively large size of SWFs and their fast growing flows, changes in their investment behaviour or shifts in asset allocation could potentially influence financial asset prices. The mere expectation of SWFs changing their asset allocation can impact asset prices. As it happens, rumours of currency allocation shifts by Asian central banks regularly stir excitement in foreign exchange markets.

Market analysts consider that these portfolio shifts should be positive for equities, emerging market assets and risky assets in general[17]. The mere comparison of past performances of various asset classes (see chart 3) suggests that countries with a high level of foreign reserves would indeed gain from investment diversification, although in practice the assessment of investment choices also requires to account for each asset's risk.

The quantitative impact on these assets' pricing would depend among other things on changes in interest rates. There are, in the economic literature, several estimates that central bank buying of US Treasury bonds has depressed long-term yields. For instance, The US Federal reserve's calculations show that a one percentage-point increase in foreign purchases of US long-term bonds (expressed as a percent of GDP) decreases long-tem interest rates by 43 basis points[18]. If the buying of US government bonds eases as a consequence of the SWFs' investment strategies, bond yields could rise then.

Chart 3: performances of various financial investments



Source: Bloomberg.

A wholesale move from bonds to equities could also support the yen other things being equal, assuming that SWFs invest in equities in line with Japan's share in the world stock market capitalisation (more than 10%), while only 3.2% of the world's total official reserves are held in yens[19]. Conversely, the same reasoning applied to the US dollar and the euro would imply a weakening of these two currencies.

Overall, the growing demand by SWFs for financial assets should be positive for the world economy. SWFs typically have a high foreign currency exposure, no explicit liabilities that trigger leverage or funding liquidity pressures. **These funds have then a greater capacity than many other large investors to take long-term views on investments, namely to follow buy-and-hold strategies**. Like other long-term investors, such funds are willing to step in when asset prices fall and therefore may be able to accommodate short term volatility in asset returns and lower liquidity risk premia. This is likely to contribute to the long-term development of financial markets, especially in emerging countries and to exert a stabilizing influence on the world's financial system.

3. Their lack of transparency generates risks that must be put under control

3.1 Low degree of transparency

In principle, managing sovereign assets *via* a separate entity can contribute to a more transparent management of national wealth. There are some cases (the Government Pension Fund - Global in Norway or the Alberta Heritage Savings Trust Fund in Canada) where the setting up of SWFs has enhanced the transparency and accountability with which the revenues from natural resources are managed, by increasing public scrutiny of public finances. In those examples, transparency has been an important driver, not only of the fund success, but also of better fiscal control[20].

Going further, some funds provide detailed information on their size, performs returns and portfolio composition[21], yet most of them have low levels of transparency in this regard. Many of the largest -and also older- SWFs do

(16) Mc Kinsey Global Institute (2007), "The new power brokers: how oil, Asia, hedge funds and private equity are shaping global capital markets", *October.*

(17) Some market participants report an additional feed-back effect: the investors' sentiment that SWFs will support the price of risky assets feeds back into today's market prices and creates the possibility that SWFs end up paying a higher price than otherwise. See Merrill Lynch (2007), "The overflowing bathtub, the running tap and SWFs", Global Economics, 5 *October.*

(18) Warnock and Warnock (2005), "International capital flows and US interest rates", *Board of Governors of the Federal Reserve System, International finance discussion papers, n°840, September.*

(19) See Jen and St-Arnaud (2007), "Global official reserves just breached US$6.0 trillion", *Morgan Stanley Research Global, 8 November.*

(20) See Rietveld and Pringle (2007), op. cit.

not give details of their operations, performance, investment strategy and organisational features[22].

One may argue that the lack of well-defined obligations for SWFs and their ability to retain funds over a long period, while not having to reveal results, are an investment advantage as the funds can get the benefits of volatility and illiquidity. Namely, this is precisely being not very transparent that enables them to intervene as contrarians when prices move and provide the additional liquidity that helps stabilize financial markets. However, for SWFs, disclosing the value and the evolution of the assets under management as well as the overall investment strategy would be just in line with standard market practices[23].

3.2 Risks for financial stability

SWFs are becoming a significant unregulated set of intermediaries, which are rather opaque for many of them as regards their institutional structure and their investment policy[24]. More specifically, it is not always clear that SWF assets actually differ from official reserve assets by their liquidity and marketability, as well as whether there is any guidance that would preclude the SWF assets to be readily available to the monetary authorities and be a liquid claim in foreign currency on non residents. For instance, in the case of some commodity funds, it is often difficult to determine on which institution's balance sheet (the SWF or the central bank) the assets are registered.

The funds may take advantage of this blurriness to briskly alter their governance structures in the event of losses, which in turn could lead to sharp changes in investment policies, possibly exacerbating market volatility in some asset classes. As SWFs grow in importance, even slight SWF portfolio reallocations can lead to sharp volatility on narrow and illiquid markets, such as emerging ones or even some segments of more mature financial markets including private equity and real estate.

Finally, in the context of low interest rates, SWFs may be tempted to search for yield. They may try to achieve extra returns by investing part of their portfolio in alternative assets with high leverage and low liquidity (private equity, hedge funds, commodities, credit derivatives and infrastructure)[25]. Given their already relatively large size, this would have a bearing on a variety of asset prices. For instance, an increase in their asset allocations in favour of hedge funds would indirectly impact the pricing of assets targeted by hedge funds, like emerging market bonds, commodities, or high-yield corporate bonds. Available information, although partial and mainly qualitative (McKinsey Global Institute, IMF), suggests that many SWFs are already increasing their exposure to alternative assets, without prejudice of the consequences of the ongoing credit market.

3.3 Risks for the free flow of capital

Growing equity investments by SWFs means that foreign governments are indirectly taking stakes in private companies of third countries. Such an indirect government implication may be seen as a reversal of the trend towards privatisation experienced in many countries over the past 25 years, including Europe, which might bring shortcomings in the corporate governance system and undermine the control of potential conflicts of interests.

However, sovereign wealth funds are like any other investor in this matter. Existing financial capital regulation and other corporate governance rules, applicable to any shareholder in the recipient country, would also apply to SWFs and their rigorous implementation should suffice to avoid market abuse. Besides, investments by SWFs, which seek to maximize their their portfolio value like any other institutional investor, should be welcome just as any other insofar that they both provide the capital needed by companies and exert pressure on the management to increase profitability.

Another fear seems more substantiated, **that investments made by SWFs in third countries' private firms may also serve non-financial motivations.** Two strategic objectives seem actually prominent: securing access to natural resources; facilitating access of domestic firms to foreign technologies and know-how[26]. Given their sheer size, SWFs could go on a buying spree of corporate assets in third countries that could well induce nationalistic sentiment if they are able to buy shares of companies seen locally as having strategic importance, in particular those operating in the defence and energy sectors. Such risk is exemplified by the debate around several recent major transactions. For instance, the Thai

(21) Norway's GPF provides information quarterly on its investment strategy and performance, and annually on its holdings of securities of individual issuers.

(22) See Lyons (2007), op. cit.

(23) See also Truman (2007), "Sovereign wealth funds: the need for greater transparency and accountability", *Peterson Institute for International Economics, Policy brief, August.*

(24) See US Treasury Department (2007), "Sovereign wealth funds", *Report to Congress on international economic and exchange rate policies, Appendix 3", June.*

(25) Bank for International Settlements (2007), "Institutional investors, global savings and asset allocation", *CGFS Papers n°27, February.*

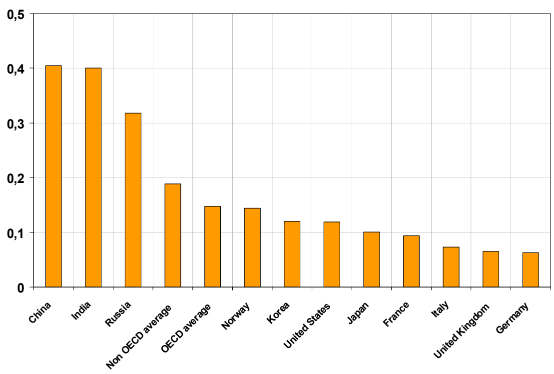
(26) Norway's Government Pension Fund - Global instead puts forward ethical and environmental concerns and excludes investments in arms production industries and polluting sectors. See Noyer (2007), "Foreign reserve accumulation: some systemic implications", *speech to the Salzburg global seminar, 1 October.*

authorities rejected the investment by Singapore's Temasek in their telecommunications company; Dubai Ports World had to abandon their attempt to buy Peninsular and Oriental Steam Navigation Company (P&O) who runs many US cities' port facilities, including the port of New-York; China National Offshore Oil Corporation (CNOOC) bid for the oil company Unocal was also blocked by the American authorities.

The fact that many countries, in which SWFs are domiciled, are significantly more restrictive in their foreign investment policies than recipient countries, especially the US and European countries, do not allay these suspicions (see chart 4). According to the OECD, China and Russia are among the most restrictive economies in this regard.

Since the main recipient countries already have national security rules that allow them to evaluate and prohibit foreign investments considered as against national security, *i.e.* in the defence sector, how to deal with SWF investment in the energy sector seems to be currently the most pressing issue[27].

Chart 4: foreign direct investment restriction index



Source: OECD.

Note: the index measure foreign investment discriminations (as of April 2006). It has been calculated for 29 OECD countries and 13 non OECD countries, but covers no Middle-East country).

Such concerns could generate foreign political pressure seeking to impede the free flow of capital, with possible capital account restrictions initiated in recipient countries. If questionable practices are numerous enough, they could stress the political system, which then may react in a way that would have systemic consequences[28].

To avoid the risk of possible excessive political reaction and preserve the benefits of free market access, SWFs and their home countries themselves should address these issues. In this regard, reciprocity of investment protection rules must be ensured. In other words, for SWFs to be able to invest abroad, equivalent market access should be granted in their home country. Reciprocity in the field of investments is one of the objectives of multilateral organisations and bilateral agreements between countries.

3.4 The way forward

From an economic standpoint, the funds built up by non-renewable resources exporters in preparation of bad days may look more legitimate than those recently built up out of excess foreign reserves accruing through global financial imbalances. Indeed, the former reflect genuine wealth stemming from a permanent shock on commodity prices while the latter mainly take advantage of foreign exchange undervaluation.

Questions raised by SWFs in terms of transparency and corporate governance are not much different from those related to the growing role of hedge funds and private equity funds in the international financial system[29]. The way forward suggested by the G7 is to identify best practices for SWFs in terms of institutional structure, risk management, transparency, and accountability. It has asked the IMF, the World Bank and the OECD to examine these issues. However, at a time when EMEs are asking for more voting rights and an increased voice within the Bretton Woods institutions, some observers argue that these organizations may not be the most legitimate fora to engage a fruitful discussion with SWFs and their home countries[30]. There is no doubt that this discussion should be held in a consistent way with the reform of the international organisations, specifically of the IMF where a reform is underway to enhance the participation of emerging and low-income countries.

How to proceed in practice in order to facilitate fair treatment of SWFs by recipients? In order to begin a constructive discussion, the IMF[31] suggests "to determine what information countries are willing to share, what informa-

(27) One may argue that Western governments should actually encourage SWFs to purchase stakes in their energy companies in order to facilitate the increase in production capacities. See Currie (2007), "The energy problem is related to the savings problem", *Global Economics Weekly, Goldman Sachs, 7 November.*

(28) The broader emergence of new non bank intermediaries, including hedge funds, on financial markets may trigger negative political reactions. See Rajan (2007), "Financial conditions, alternative asset management and political risks: trying to make sense of our times", The broader emergence of new non bank intermediaries, including hedge funds, on financial markets may trigger negative political reactions. See Rajan (2007), "Financial conditions, alternative asset management and political risks: trying to make sense of our times", *Banque de France, Financial Stability Review, n°10, April.*

(29) OECD (2007), "The role of private pools of capital in corporate governance", *Financial Markets Trends, n° 92.*

(30) O'Neill J. (2007), "Sovereign Wealth Funds highlight the changing world-and the need for more", *Global Economics Weekly, Goldman Sachs, 7 November.*

(31) Johnson S. (2007), "The rise of Sovereign Wealth Funds", *Finance & Development, September.*

tion it makes sense to ask for, and what information can be used in our global economic and financial analysis". The examination of some funds such as Norway's GPF or France's FRR which disclose each year their investment portfolios and returns may provide some indication on how to enhance SWFs' transparency practices. More generally and with no prejudice of the international organisations' recommendations which are not known yet, existing best practices in the field of asset management could be used to draft a code of conduct for SWFs, based on the following principles:

– target a strict long-term maximisation of the portfolio value;

– insulate the investment process from political pressures, for instance by favouring index-driven strategies (consisting of tracking the performance of a given market index) or by setting up independent decision bodies;

– achieve adequate diversification of assets and dispersion of risks (through the reference to investment ratios specifying investment limits by financial instrument category or by nature of counter-party);

– disclose the management style (through mandates or using in-house resources), the process of awarding management mandates, the asset pricing methods, the amount and the growth of assets under management, or even investment limits and detailed composition of the portfolio.

Finally, a more ambitious approach would be is to tackle the issue at its roots by moving away from the "non-cooperative equilibrium of excess reserve accumulation". Some authors have suggested to set up internationally managed pools of international reserves[32]. A preferable objective would be to aim at improving how the international financial system operates, in order to contain the volatility of international financial markets against which emerging countries seek to hedge.

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(32) See Summers (2007), op. cit.

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