Social Security Reform: Sovereign Wealth Funds as a Model for Increasing Trust Fund Returns

Benjamin A. Templin*
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INTRODUCTION

This Article addresses the question of whether non-US sovereign wealth funds ("SWFs") should serve as a model for the United States in managing the Social Security Trust Fund.

By law, the Social Security Trust Fund ("Trust Fund") is required to invest only in special issue US government bonds, which recently earned an annual nominal return of 4.6%. However, over the long term, the stock market has an annualized nominal return of around 7.9%. In contrast to the US approach, many countries have recognized that the stock market yields higher returns and have successfully used SWFs to diversify holdings out of bonds and partially into stocks to help prefund their social insurance programs. Some countries using

this approach have achieved annualized returns of over eight percent.4

This Article takes the view that the US should follow the lead of other countries and create an SWF to help prefund its social insurance obligations. Social Security is facing a funding crisis and the Trust Fund will be exhausted by 2036.5 Many reform proposals have been floated, yet most involve some sort of benefit cut or tax increase.6 In sharp contrast, investing the Trust Fund in equities could reduce the financing deficit by over thirty percent without increasing taxes or reducing benefits.7 President Bill Clinton backed the idea, as did long-time Social Security Commissioner Robert Ball.8

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5. Bd. of Trs., supra note 2, at 2–3. For the purposes of this Article, I focus only on the Old-Age and Survivors Insurance ("OASI") Trust Fund, which funds Social Security benefits. The Social Security Administration also runs the Disability Insurance ("DI") Trust Fund, which is facing a more imminent insolvency date of 2018. Both the Social Security Administration and policy analysts often combine the two programs and trust funds together and therefore report an insolvency date of 2036. Id.


7. See Provisions Affecting Trust Fund Investment in Marketable Securities, SOC. SEC. ADMIN., http://www.ssa.gov/oact/solvency/provisions/investequities.html (last visited Nov. 12, 2011). The projection assumes that forty percent of the Trust Fund would gradually be invested in stocks over a period from 2011 to 2025 and that the investment would yield a real return of 6.4%. That would reduce the long-range actuarial balance from 1.92% of taxable payroll to 1.30%, an improvement of over thirty percent. See id. (under the G1 Provision, click “Summary measures and graphs” hyperlink). Proposals for investing the Trust assume that the funds would be invested in a broad-based index such as the Wilshire 5000. See U.S. SENATE SPECIAL COMM. ON AGING, SOCIAL SECURITY MODERNIZATION: OPTIONS TO ADDRESS SOLVENCY AND BENEFIT ADEQUACY, S. Rep. No. 111–187, at 50–51 (2d Sess. 2010).

8. See President William Jefferson Clinton, Address before a Joint Session of the Congress on the State of the Union, 1 PUB. PAPERS 62, 63 (Jan. 19, 1999) (proposing a shift of up to sixty percent of the Social Security Trust Funds into index funds); Social Security at 75 Years: More Necessary Now than Ever: Hearing before the Subcomm. on Soc. Sec. of the H. Comm. on Ways & Means, 111th Cong. (2010) (statement of Nancy J. Altman, Co-Director, Social Security Works). Although Democrats introduced a bill in Congress to implement President Clinton’s proposal, it died in committee. See Social Security Act
Despite the economic logic behind diversifying the Trust Fund, policymakers and politicians have not considered diversification in the most recent round of discussions on how to address the imminent funding crisis.\textsuperscript{9} One concern voiced is that market volatility could lead to lower returns during some periods of time and this might result in some generations having to pay higher taxes in order to fund benefits.\textsuperscript{10} Additionally, conservatives oppose the proposal on philosophical grounds, arguing that government investment is a form of socialism, which may result in political interference in private enterprise.\textsuperscript{11}

\textsuperscript{9} In 2010, President Obama issued an executive order to create the bipartisan National Commission on Fiscal Responsibility and Reform (“Fiscal Commission”) for the purpose of recommending measures “to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run.” Exec. Order No. 13,531, 75 Fed. Reg. 7,927 (Feb. 23, 2010). Social Security reform was just one of the issues addressed by the Fiscal Commission’s December 2010 report. While the report included a number of proposals that would cut benefits and increase taxes, there was no discussion of Trust Fund investment. See generally NAT’L COMM’N ON FISCAL RESPONSIBILITY AND REFORM, THE MOMENT OF TRUTH (Dec. 2010), available at http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf (discussing various recommendations to achieve solvency).


This Article seeks to address whether the success of non-US SWFs will lend credibility to the diversification proposal. The Article uses the methodology of new institutionalism to discuss what forces might help create the political will necessary to adopt this policy proposal. Part I of this Article analyzes the political opposition to government investment of the Social Security Trust Fund. The focus is to define the philosophical and pragmatic reasons behind the opposition to the proposal. Part II discusses new institutionalism as it relates to government investment, in order to give a framework to analyze how certain political economies change and adapt. The next two Parts look at forces that may drive change in the U.S. political economy. Part III addresses the Social Security funding crisis and Part IV discusses the gradual adoption of government investment as a policy matter over the last thirty years. Part V addresses the historical development of SWFs as financial intermediaries and the changing perceptions over their role in global financial stability. Part VI discusses SWFs as a model for the U.S. Social Security Trust Fund.

I. POLITICAL OPPOSITION TO GOVERNMENT INVESTMENT

One of the most promising long-term reforms for the Social Security funding crisis is the full funding model, whereby social insurance would be funded not only by tax contributions but also by investments made by the government in a diversified portfolio of stocks, bonds, and other assets. Despite the financial crisis of 2007–2009, economists agree that over time, a diversified portfolio will outperform a bond-only portfolio. The obstacle in advancing a full-funding model is not in the economic realities but in the norms of a neo-liberal political economy.

From the inception of Social Security, conservative politicians have adamantly opposed government investment as a
funding mechanism. The opposition is rooted in political beliefs about the proper role of government in a market economy. The argument advanced is that, when the government participates as a shareholder in private enterprise, four distinct issues threaten to disrupt a market-based economy: (1) the government’s lack of expertise in managing assets will lead to waste; (2) political interference will result in a lack of wealth maximization; (3) the government will coercively interfere in corporate governance, thus affecting firm efficiency; and (4) it is impossible for the state to act as both a shareholder and a regulator, since those roles result in an inherent conflict of interest.

The fears of conservatives about government investment came true when the US Treasury made several investments through the Troubled Asset Relief Program (“TARP”) under the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009 during the financial crisis of 2007–2009. The Treasury paid more for assets than private investors, thereby lowering the eventual return on investment. Political influence was exerted in the investment decision, and the executive branch was actively involved in corporate governance. While government investment under TARP was soundly and justifiably criticized for failing to achieve its goals, many of the investments ended up in the black. In some respects, the mismanagement under TARP helped define the issues surrounding government investment so that proposals could be put forward to help limit political interference in the investment cycle.

15. See Templin, supra note 11, at 431–32.
16. See generally Templin, supra note 11 (documenting the numerous investments made under the Troubled Asset Relief Program (“TARP”)).
17. Id. at 1158–61.
18. Id. at 1163–70, 1184–96.
Some political actors and commentators contend that government investment is inconsistent with the neoliberal political economy that exists within the United States. In this view, government investment may occur successfully in other types of political economies, such as the state capitalism system found in China, but adopting those methods in the United States disrupts free market principles. However, recent work in comparative capitalism studies suggests political economies are flexible enough to change, adapt, and adopt methods used by states even if such methods have historically run counter to the character of a particular type of capitalism. The next section will discuss the new institutional framework for analyzing how a particular political economy changes its rules of the game—that is, its institutions.

II. POLITICAL ECONOMY AND INSTITUTIONAL CHANGE

Much of the opposition to government investment in a neoliberal economy rests on the belief that methods used in a state capitalist system would cause inefficiencies if applied in a free marketplace. The new institutionalism and comparative capitalism literature offers a framework to analyze the role of government investment in different types of market economies. The rise of the new institutionalism school of thought has done much in the area of comparative capitalism studies to address how and why different societies develop different laws and rules of the game.

Increasingly, legal scholars are drawing on interdisciplinary studies in order to gain an understanding of the forces which dictate how actors operate. New institutionalism concerns the development of rules of the game that limit the behavior of people and firms. Although economists have developed different definitions, there is general agreement that institutions include both formal and informal rules. Formal rules include statutes, regulations, court decisions, and, of course, constitutions; while informal rules consist of societal norms and

21. See id. at 1156–57.
22. See id. at 1152–98.
customs. If an actor breaks a formal rule, he may be subject to penalties. However, actors are not legally obligated to follow informal norms, though failure to do so may result in an unofficial penalty.\(^\text{24}\)

Economists disagree over the method in which an institution develops and changes over time.\(^\text{25}\) Path dependence is a leading theory that describes a process where rules of the game become so dominant in an economy and actors’ behavior that changing the rule becomes nearly impossible, even if it is economically rational to make a change.\(^\text{26}\) The political bargaining process influences the development of formal institutions, so that the development of a rule might reflect compromises between different interest groups.\(^\text{27}\) When an institution is used repeatedly in a political economy, it starts to dominate and evolve into the default rule. Any actors who attempt to use a different rule meet resistance since the entrenched rule has supporters who benefit from its application.\(^\text{28}\)

Economists Peter Hall and David Soskice adopt path dependence theory for their varieties of capitalism model.\(^\text{29}\) Hall and Soskice posit that political economies can generally be categorized according to two types—a liberal market economy (“LME”) or a coordinated market economy (“CME”).\(^\text{30}\) Hall and Soskice do not consider either type as superior.\(^\text{31}\) The development of an LME or CME is the result of culture and the historical choices made by actors within a region.\(^\text{32}\) Perhaps the most significant result of Hall and Soskice’s work was that it challenged the theory that globalization necessarily results in a


\(^{\text{25}}\) See Crouch, supra note 23, at 10–11.

\(^{\text{26}}\) See id. at 74–75 (noting the many scholars who have contributed to the path dependence theory).

\(^{\text{27}}\) See id. at 7 (providing US intellectual property law as an example of such compromises).

\(^{\text{28}}\) See id. at 1–2.

\(^{\text{29}}\) See id. at 2.

\(^{\text{30}}\) Hall & Soskice, supra note 24, at 8.

\(^{\text{31}}\) Id. at 20–21.

\(^{\text{32}}\) Id. at 12–14.
gradual convergence among states towards global adoption of the neoliberal model.\textsuperscript{33}

Government investment for the purpose of funding social insurance can be seen as an institution that is consistent with CMEs, such as those found in Europe or Asia, rather than LMEs, such as in the United States. Assuming that path dependence theory is correct, then government investment of the US Social Security Trust Fund is unlikely to occur. Even though it might be economically rational to diversify the Trust Fund, political actors will resist changing the dominant rules of the game that limit government investment since to do so would be inconsistent with the US neoliberal political economy.\textsuperscript{34}

Not all socio-economists, however, agree with the theory of path dependence. Some contend that LMEs can and do adopt institutions from CMEs without experiencing inefficiencies.\textsuperscript{35} The process of institutional change may occur when a particular economy experiences a crisis.\textsuperscript{36} The 2007–2009 financial crisis illustrates how a crisis can change the rules of the game within the US economy. The US Treasury and Federal Reserve made massive investments in private financial institutions during the collapse of the credit markets.\textsuperscript{37} Government investment of this type was clearly an institution more likely to be used by a CME than an LME, and the intervention is still controversial even though the bailout of financial institutions under the Troubled Asset Relief Program yielded a better return for taxpayers than if the same amount had been invested in government bonds.\textsuperscript{38}

Institutions also change incrementally over time.\textsuperscript{39} The rate of change is a factor of the embeddedness of an institution—

\begin{footnotesize}
\begin{enumerate}
\item See CROUCH, supra note 23, at 24–25.
\item See Templin, supra note 11, at 1157–84.
\item See CROUCH, supra note 23, at 30.
\item See id. at 3.
\item See CROUCH, supra note 23, at 75 (noting scholars who developed this theory of cumulative change).
\end{enumerate}
\end{footnotesize}
that is, the degree to which a particular society has integrated that institution into its cultural, political, and economic systems.40 Some socio-economists have posited that rapid change occurs even without a crisis. Social and political scientist Colin Crouch has recently challenged new institutionalists with the notion of slow progressive change through a theory of recombinant governance. Under this approach, institutional entrepreneurs have recombined different elements of what are traditionally considered non-complementary—that is, duplicative institutions to address social and economic issues.41 Crouch criticizes the varieties of capitalism school for being one dimensional and not reflecting the more heterogeneous way in which political economies operate.42 Crouch challenges classic new institutional theory by positing that a society with “institutional heterogeneity” has more tools to address issues when a particular path is no longer working.43 In this view, institutional change occurs when the rule’s governance is changed.44 If the institution is no longer followed by the actors in an economy, then the enforcement or governance of that institution weakens.45

Crouch’s approach posits that both neoliberal and centralized political economies can share institutional norms and rules without experiencing disruption. This view of the development of governing institutions suggests the US could begin to shift the Trust Fund into a diversified portfolio without affecting the nature of the political economy.

This Article will next address three catalysts that may operate to change the institutions surrounding government investment of the Trust Fund: (1) the impending solvency crisis; (2) incremental change in belief systems on the role of government in the US political economy; and (3) the presence of non-US SWFs as models for reform.

40. See id. at 13 (noting the scholars who have contributed to this theory of embeddedness).
41. See id. at 3 (describing the analysis Crouch undertakes).
42. See id. at 22–23.
43. See id. at 71.
44. See id. at 24.
45. See id. at 22.
III. FUNDING CRISIS AS A CATALYST FOR CHANGE

The funding crisis facing Social Security has been a controversial policy issue for decades, yet little significant reform has been made since the 1983 Social Security Amendments, which established increases in the employment tax and raised the retirement age, among other changes. The well-accepted actuarial predictions of the Social Security Administration are that the Social Security Trust Fund will be insolvent by 2036. Yet, Congress has lacked the political will to address this issue, and conventional political theory contends that an imminent crisis will be necessary to move a bill on Social Security forward. This Part first considers the nature of the funding crisis and then details how Trust Fund diversification would reduce the funding deficit.

A. Social Security Funding Crisis

Social Security is widely acknowledged as the most important program in preventing poverty among elderly Americans, yet it faces insolvency because of demographic, economic, and structural problems. In its most recent annual report, the Social Security Administration reported that under its intermediate scenario the Trust Fund reserves will be exhausted by 2036.


47. See Bd. of Trs., supra note 2, at 2–3.


49. Kathryn L. Moore, The Privatization Process: Redistribution under a Partially Privatized Social Security System, 64 BROOK. L. REV. 969, 990 (1998) (stating that Social Security benefits prevent fifty percent of the elderly from living below the poverty line). Some scholars dispute these claims. See, e.g., SYLVESTER J. SCHIEBER & JOHN B. SHOVEN, THE REAL DEAL: THE HISTORY AND FUTURE OF SOCIAL SECURITY 208 (1999). Schieber and Shoven argue that the claims of the effectiveness of the program are exaggerated because the SSA does not include all sources of income for the elderly (such as payments from private pensions) in its calculation. Id.

50. Bd. of Trs., supra note 2, at 2–3.
The funding problems for Social Security arise from a system called pay as you go ("PAYGO"), which has proven inadequate as a financing tool in light of demographic changes. Under PAYGO, the employment tax from the current generation of workers pays the benefits of current retirees.51 Any excess is put into the Trust Fund.52 So long as there is a high worker to beneficiary ratio, such a system is sustainable. However, because of a population bulge as a result of the Baby Boom generation as well as longer life expectancies, the worker to beneficiary ratio is declining.53 This means there are fewer people paying into the system and more people receiving benefits.54

Other forces have also put pressure on the Trust Fund. Unemployment increased dramatically after the subprime financial crisis started in 2007, and the economic recovery has not proceeded as quickly as was originally predicted, resulting in lower predictions by the Social Security Administration as to the level of earnings and therefore revenue generated through the employment tax.55 In 2010, the revenue generated by the employment tax was less than the amount of benefits paid out,56 which meant the Social Security Administration had to use Trust Fund reserves to pay out benefits.57 Initially, in 2010, the Social Security Administration expected employment tax revenues to improve and generate enough revenue to cover 2012 benefits.58 However, by 2011, the Social Security Administration conceded

52. Id.
53. See BD. OF TRS., supra note 2, at 10.
54. See id.
56. See BD. OF TRS., supra note 2, at 143. The net benefits in 1983 were US$149.2 billion but only US$138.3 billion was collected in taxes. All net contributions for the period from 1984 to 2009 were greater than the benefits paid out. Id. at 142–43.
57. See id. at 2.
that the employment tax revenue would no longer by itself cover outgoing benefits in either the short- or long-term outlook.59

Since the Trust Fund investments are composed entirely of non-marketable, special issue US bonds, the Treasury has to pay interest to the Trust Fund in order for recipients to receive benefits.60 This has added an additional strain on Treasury’s general budget, since there have been increased net operating costs, shrinking tax revenues that resulted from the 2007–2009 recession, and tax cuts passed as part of a stimulus package.61

B. Trust Fund Diversified Portfolio Returns

Investing the Trust Fund in a diversified portfolio could reduce the funding deficit. In a 2010 report, the US Senate reported that investing a portion of the Trust Fund into securities that represented a broad based index, such as the Wilshire 5000, might eliminate as much as one-third of the deficit.62 Does the market for stocks really outperform a bond-

59. See id. at 36 (showing that net payroll tax contributions are not expected to exceed benefit payments under the intermediate assumptions).


61. See id. at iii, 14.

62. U.S. SENATE SPECIAL COMM. ON AGING, supra note 7, at 50–51. The predictions of the extent that portfolio diversification can improve the funding problem vary depending on, among other factors, the diversification model. Several studies have predicted a wide range of results. Other studies date back as far as the mid-1990s and make the assumption that the Trust Fund would have been diversified long ago. Consequently, estimates would have to be readjusted for an accurate estimate of the returns available in the post-subprime crisis environment. With that in mind, the older studies are illuminating. The Government Accounting Office (“GAO”) reported that shifting from bonds to stocks only would have bought the Trust Fund only another eleven years. See Solomon & Berson, supra note 14, at 136. Other studies were more conservative. Barry Bosworth and Gary Burtless created a model that shifted thirty percent of the Trust Fund from bonds into equities, then made other changes, such as increasing the employment tax, and were only able to delay the inevitable funding crisis for another sixteen years. Whereas, when they put seventy percent of the Trust into equities, the model predicted that the Trust Fund could last another fifty-three years. Barry Bosworth & Gary Burtless, The Effects of Social Security Reform on Saving, Investment, and the Level and Distribution of Worker Well-Being 6 (Ctr. for Ret. Research at Bos. Coll., Working Paper No.2002–02, 2002). The model also assumed that an immediate tax rate hike of two percent occurred in the year 2000, and thus these numbers may vary somewhat when applied to the current size of the trust and the current predictions on the rate of decline. See id. at 3. Yet another study predicted that
only portfolio? Can a publicly run investment fund achieve the same results as a privately managed hedge fund or mutual fund? This section will first examine market returns for stocks over the long-term and then analyze data for publicly-run government employee pension funds.

The benefits of a diversified portfolio are not controversial. A fully diversified portfolio of stocks, bonds, and other assets routinely outperforms a bond-only portfolio over long periods of time and it does so with less risk. Equities generate an average annualized return of approximately 7.9%, which is a 2.68% premium over risk-free US Treasury securities. The data also supports shorter holding periods. Professor Jeremy Siegel of the Wharton School of Business found that over thirty-year periods, stocks outperform bonds 99.4% of the time. Although bonds are generally perceived to be safer investments than securities, government treasuries are actually at-risk of losing value because of inflation over long periods of time. Using 200 years of data, Siegel showed that over seventeen-year periods, bonds are at-risk of the inflation rate exceeding the rate of return on the bonds, however, stocks have never had a negative return in the same periods.

Any fund is, however, only as good as its investment strategy. One question that arises with the introduction of such massive wealth into the equity markets is whether any given fund that large can yield similar returns. Can a government-run Social Security fund achieve the same returns as a private pension plan? Public employee pension plans provide some data points. A Wilshire Trust Universe Comparison Service reported that publicly-run employee pension funds in the United States shifting forty percent of the Trust Fund out of bonds and into stocks, along with other changes, would keep Social Security funded for another seventy-five years. Theodore J. Angelis, Investing Public Money in Private Markets: What are the Right Questions?, in FRAMING THE SOCIAL SECURITY DEBATE: VALUES, POLITICS, AND ECONOMICS 287, 288 (R. Douglas Arnold et al. eds., 1998).

63. See SIEGEL, supra note 13, at 24–36.
64. See IMANEN, supra note 3, at 122–23.
65. See SIEGEL, supra note 13, at 26.
66. See id. at 24–27.
slightly outperformed other funds for the first quarter of 2011 and the preceding twelve months. The anecdotal evidence also shows that some public employee funds achieve competitive returns when they invest with large equity positions. The Oklahoma Public Employees Retirement System rose 21.23% in 2010 due largely to the fact that sixty-four percent of its portfolio is invested in both domestic and international stocks. Annualized averages for some public funds outperform market returns. Florida’s Retirement System’s defined benefit plan investments have an 8.79% annualized return over the last twenty years, compared with an average market return of 7.9%.

Indeed, most public employee and private pension funds invest at least a portion of their assets in the stock market. As of the first quarter of 2011, private pension plans had US$2.1 trillion invested in corporate equities, and public employee pensions plans (including federal, state and local plans) had US$2 trillion invested in stocks. Together, private and public pensions account for about seventeen percent of all direct investments in corporate equities. Given the prevalence of pension funds investing in stocks, Congress would likely have


70. See id.

71. See Barry B. Burt, Florida Pension Plan Returns 22%, PENSIONS & INVESTMENTS (July 20, 2011, 3:34 PM), http://www.pionline.com/article/20110720/DAILYREG/110729988/-1/TOPIC (describing the annualized rate of the Florida Retirement System’s benefit plan investments over the last twenty years); ILMANEN, supra note 3, at 123 (noting the average market return over the last twenty years).


73. See id.


75. See id.
already approved Trust Fund diversification if it were not for concerns about political investment.76

IV. GRADUAL ADOPTION OF GOVERNMENT INVESTMENT AS A POLICY INITIATIVE

Despite political rhetoric to the contrary, US economic policy has incrementally changed over the last thirty years to the point that government investment in private enterprise occurs frequently even if the political rhetoric suggests otherwise. From an institutional change perspective, the previous constraints on government investment have slowly faded as the governance of the institution changed.77

Even before the financial crisis surfaced, the United States has increasingly been an investor in private enterprise for the purposes of economic development. Sociologist Fred Block argues that despite political rhetoric to the contrary, the United States actually started pursuing a government-led investment policy on a major scale as early as the 1980s, and that this state-guided investment for policy-driven research and development projects has changed the US national innovation system such that most research and development now has some sort of government support and investment behind it.78

In describing initiatives to promote economic development in each of the fifty states, scholar Peter Eisinger distinguished the supply-side market policies of the Reagan era with a state-driven demand-side model where the state actively formed partnerships with business. Since Eisinger’s study is focused on the competition among the fifty states, it holds possible

77. See CROUCH, supra note 23, at 24.
implications for how non-US states compete in investment. In the demand-side model, there is an acceptance that investors may not be aware of some economic opportunities or be risk averse when “there is no immediately apparent, easily accessible market.” Consequently, the state seeks to ferret out or create those opportunities and then find investors to fund the ventures.

The entrepreneurial state fosters opportunity for businesses through “efforts to encourage small business participation in export trade, to subsidize technology transfer from university laboratories to the market, and to underwrite research and production in technologically advanced fields....” Sometimes, the role of the entrepreneurial state is as matchmaker and other times as investor. When the capital markets are insufficient to fund a business opportunity, the state might take on the role of venture capitalist (“VC”)—providing start-up capital, financing research and funding export ventures. State investment is critical when there is market failure or high-risk and promising ventures that cannot attract adequate capital. For example, state-run venture capital funds intervened to finance technology start-ups after the dot-com bubble burst and private VC funding had dissipated.

Yet, within the demand-side model that Eisinger lays out, the investment opportunities are less market-driven and more policy-driven. The investments documented by Eisinger are those typically benefiting a region with an aim towards job creation rather than wealth creation. Normatively, Eisinger’s entrepreneurial state should in fact pursue such policy goals. Eisinger is not against wealth creation; rather his assumption is

79. See id. at 150 (“Interjurisdictional competition is one of the abiding principles of American federalism.”).
81. See id.
82. See id.
83. See id.
84. See id.
86. See EISINGER, supra note 80, at 257.
that it is a natural function of the state to invest only when there is some other policy-driven goal related to the actual investment.\footnote{87}

The evidence of whether investment by the entrepreneurial state realizes a financial return is inconclusive, though some programs show “not only a positive employment effect for firms using the program, but also a net fiscal gain for the state government.”\footnote{88} Reports on the success of such funds often focus on jobs created or some other performance benchmark as well as net return.\footnote{89} Some regional focused funds have done extraordinarily well. Maryland Venture Fund, run by the Maryland Department of Business and Economic Development, produced a whopping substantial annual rate of return of thirty percent over its first ten years of operation, whereas the average rate of return for the venture capital industry is twenty to twenty-five percent.\footnote{90} While small-scale grant projects, such as those found in the biotech industry, have been successful, the entrepreneurial-state-financed public-private technology infrastructure projects, such as household high-speed broadband, have failed, leaving the United States strong in some areas and weak in others.\footnote{91}

The largest program of government investment came about during the financial crisis of 2007–2009 when the government invested US$512.3 billion in private enterprise through a variety of programs.\footnote{92} Two pieces of emergency legislation drove the investments—the Emergency Economic Stabilization Act of 2008 (EESA) and the American Recovery and Reinvestment Act of 2009.\footnote{93} The bulk of the funds invested were through the EESA, which authorized TARP and other investments, and were justified by a theory of Keynesian economics.\footnote{94} While Keynesian

\footnote{87. See id.  
89. See, e.g., Koprowski, supra note 85.  
90. See id.  
91. See Block, supra note 78, at 193.  
92. Templin, supra note 11, at 1129. For a breakdown of the investments and the programs under which they were made, see id. at 1129 n.4.  
94. See Templin, supra note 11, at 1148–52.
economics has been used by US policymakers before this, there had been a shift to less interventionist policies during the Ronald Reagan presidency when monetarism and Milton Friedman’s laissez-faire theories dominated US policy. Although the change to a Keynesian approach was driven partially by crisis, the shift towards government investment was at an unprecedented level, suggesting greater acceptance of such an approach among the polity. Interestingly, the investments made under TARP were initiated by President George W. Bush. Although President Bush opposed government investment for the purpose of the Social Security Trust Fund, he was able to adopt the tool in another crisis.

While much has been written about waste, mismanagement, and political interference with the TARP investments, the program is widely considered to have been successful in resolving the financial crisis, and it did so while turning a small profit for taxpayers on some of the investments. However, as of July 2011, the Treasury still holds investments made during the crisis, such as its stock in AIG, and the ultimate return to the taxpayer will depend on external factors such as the general health of the economy and the performance of the insurance industry in general.

Interestingly, some subtle shifts occurred during the financial crisis in the rules of the game that constrain government investment. One institutional constraint is the preference for short holding periods, even if it means that the government does not recoup the full value of an investment. However, some government investments made during the financial crisis are purposefully being held longer than originally contemplated in order to more fully recoup the cost to taxpayers. While initially it was contemplated that AIG would sell various assets and divisions in initial public offerings by 2010, in order to try and repay the US government investment, a

95. See id. at 1150–51.
96. See President’s Comm’n to Strengthen Soc. Sec., supra note 11, at 13.
97. See Dennis, supra note 19, at A18.
99. See Templin, supra note 11, at 1176–78.
new board and chief executive officer changed course stating it
time to get a fair price. The direction was clearly
towards maximizing the price of the assets in order to repay the
government in full. This approach stands in stark contrast to
prior institutional norms, which constrained the government in
terms of holding periods. This is not to say that an early exit is
no longer a goal of such investments. In contemplating the sale
of its stake in General Motors and Chrysler, the Treasury has to
balance its competing goals of an early exit with recouping the
cost, which would require holding onto the stock until the share
price rises.

While problems with political interference in government
investment occurred under the TARP program, proposals have
been made to create legal boundaries and norms to reduce, if
not eliminate, political influence in government investment.

Some excellent models already exist in the management of
existing SWFs.

V. SOVEREIGN WEALTH FUNDS: PRE– AND POST–FINANCIAL
CRISIS

The rapid growth, size, and success of investments in non-
US SWFs for the purpose of financing social insurance may also
provide a model for a diversified Trust Fund.

SWFs have attracted increased attention and concern in the
last five years. Given the increase in numbers as well as the size
of some funds, commentators have noted that SWFs are a new
class of financial intermediary with the potential to threaten
global macroeconomic stability and sustainability. Global and
national responses to the threat posed by non-US SWFs have
varied between “hard law” approaches, such as national laws
prohibiting or deterring international investment and binding

100. See id. at 1173.
101. See id.
102. See U.S. Gov’t Accountability Office, GAO-11-471, TARP: Treasury’s
Exit from GM and Chrysler Highlights Competing Goals, and Results of
Support to Auto Communities Are Unclear 19 (2011).
103. See generally Templin, supra note 11 (describing several proposals).
104. See Vittas et al., supra note 4, at 1.
105. See, e.g., Edwin M. Truman, Peterson Inst. for Int’l Econ., Sovereign
Wealth Funds: Threat or Salvation? 46–51 (2010)
international treaties, and “soft law” approaches, such as non-binding voluntary codes of conduct. Hard law approaches involving restrictions may result in protectionism that damages global trade, yet soft, voluntary standards, by definition, lack any form of enforcement mechanism.

After the role they played in the financial crisis of 2007–2009, SWFs are, however, beginning to be perceived as less threatening and as financial intermediaries. In particular, SWFs focused on funding social insurance programs are considered to not pose the threat to global stability that strategic funds might pose. This Part first discusses concerns raised about SWFs by the International Monetary Fund (“IMF”) and the responses that have developed to address those concerns. This Part then addresses how the attitudes towards SWFs have shifted, given the role that some SWFs played as investors adding liquidity during the financial crisis of 2007–2009.

A. New Class of Financial Intermediary

Although SWFs have existed since the 1950s, policy analysts raised the alarm in 2007 about potential manipulation as SWFs grew in size. Projections originally suggested the funds would grow to US$10 trillion by 2012. In a widely quoted study at the time, Morgan Stanley predicted similar results with an estimated US$12 trillion in assets by 2015. However, those estimates are now considered inaccurate. At the start of 2011, SWFs held an

106. International law scholars use “soft law” to mean “norms that are not thought of as law per se but compel a law-like sense of obligation in states.” Allison Christians, Hard Law, Soft Law, and International Taxation, 25 Wis. Int’l L.J. 325, 331 (2007). In contrast, “hard law” includes “customary law” and binding treaties in the international context. Id. at 328 n.15.


108. See id. at 56.

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estimated US$3.98 trillion in assets. Although SWFs lost an estimated US$200 billion during the financial crisis of 2007–2009, most of those losses are expected to be recovered since SWFs are generally long-term investors. Additionally, new money flowed into some SWFs as a result of increases in commodity prices and those assets will need to be invested.

Some funds are controlled by oil rich nations such as the United Arab Emirates, Kuwait, and Russia. However, China has also placed reserves in its funds. Not all SWFs are controlled by countries that are sometimes at political odds with the United States on the international stage. Norway controls one of the largest funds. Indeed, the state of Alaska appears on most lists of SWFs because of the Alaska Permanent Fund—a state-owned investment vehicle for oil and mineral licensing fees.

Three trends help explain the wealth creation of SWFs: (1) dependence on oil; (2) low-cost manufacturing in Asia; and (3) smart money management of public pension funds by forward-thinking developed countries—for example, Canada and Norway. Oil rich nations, such as Dubai, Kuwait, Qatar, and Russia, gained wealth through western dependence, high consumption, and rising prices. In contrast, low labor costs in Asia, as well as monetary policies pegging local currencies to the

114. Id. at 214.
116. See id. (providing a representative list of SWFs that includes the Alaska Permanent Fund); see also Alaska Permanent Fund Corporation, SWF INSTITUTE, http://www.swfinstitute.org/swds/alaska-permanent-fund-corporation (last visited Nov. 7, 2011) (detailing information about Alaska’s Permanent Fund, including information about oil and gas licensing fees).
dollar, have transformed the region into the world’s manufacturing center, which has led to a trade surplus and growth in sovereign economic wealth. Some countries, such as Canada and Norway, established funds for the purpose of funding social programs—for example, public pension and health programs.

There have been many attempts to create different classification systems for SWFs. For the purposes of this Article, the IMF classification works best since it breaks SWFs into five different types according to the objective of the fund:

1. **Stabilization Funds** are used primarily by oil rich nations “to insulate the budget and the economy from volatile commodity prices.”

2. **Savings Funds for Future Generations** convert assets from the sale of natural resources into a “diversified portfolio of international financial assets to provide for future generations.”

3. **Reserve Investment Corporations** are state-owned entities that are designed to increase the rate of return on currency reserves.

4. **Development Funds** are created to fund “priority socioeconomic projects, such as infrastructure.”

5. **Contingent Pension Reserves** are created to help fund commitment by governments to provide pensions.

Naturally, different types of funds have different objectives, risk levels, and motivations behind the investment. Generally,

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117. See Adam Dixon & Ashby H.B. Monk, Rethinking the Sovereign in Sovereign Wealth Funds 11 (Aug. 3, 2010) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1652701. Some typologies classify SWFs according to the funding source, while others use objective to distinguish types of funds. Adam Dixon and Ashby Monk propose a unique system that classifies “according to the role they play in sovereignty and what underlies their claims to legitimacy without their respective nation state.” Id. at 12.


119. Id.

120. Id.

121. Id.

122. Id.

123. Id.
countries have gradually moved their investments from bonds to a more diversified portfolio that includes the securities of American corporations.

B. Global Macroeconomic Stability and Sustainability

The international community first expressed anxiety that non-US SWFs might invest for political rather than economic purposes in 2007; the topic has been the subject of many law review articles since then.\textsuperscript{124} Citing a lack of transparency and accountability in some funds (e.g., Chile, China, Dubai, Kuwait, Qatar, Taiwan, and Venezuela),\textsuperscript{125} the IMF feared that some investments might be made for strategic purposes rather than for wealth creation. Legal and economic scholars Ronald Gilson and Curtis Milhaupt identified the phenomenon of SWFs with a political agenda as the “new mercantilism.”\textsuperscript{126} Under this conception, developing countries with wealthy SWFs may seek to invest in companies in order to gain some degree of corporate control and then use that control to “maximize economic, social, and political benefits” for that country.\textsuperscript{127}

Investments might be strategic either geopolitically or by industry/technology.\textsuperscript{128} Economist Gerard Lyons predicts that SWFs will “boost strategic links with countries that have not shared fully in globalization or which have been shunned by the West; and to take more strategic stakes in sensitive areas within developed countries.”\textsuperscript{129} For example, a non-US power could


\textsuperscript{126} Id. at 1346.

\textsuperscript{127} See id.

\textsuperscript{128} See Lyons, supra note 113, at 192–94.

\textsuperscript{129} Id. at 179.
make an investment in order to get competitive market information for the purpose of improving a state-owned enterprise. More nefariously, a country’s investment could be made in order to transfer technology in violation of intellectual property or state security laws. Such potentially strategic investments include companies in the telecom, energy, media, financial, and technology arenas. Alternatively, a SWF may try to dominate the economy of a poorer country by gaining ownership to the country’s national resources or other assets.

In addition to fears over strategic investments, there is also fear over the ease with which markets can be manipulated through financial leverage. In 2007, US Securities and Exchange Commission Chairman Christopher Cox expressed concern over the lack of transparency in SWF transactions and the ability to manipulate the market through insider trading. Given the lack of transparency in disclosing portfolio holdings, there is no way to monitor how a SWF may exercise its shareholder voting rights. Moreover, SWFs gain an advantage over private players in the market given that their borrowing costs are lower and SWFs have “security and intelligence apparatus that may offer them access to information not available to other market participants.”

The risk of SWFs being used by corrupt heads of state to funnel money out of the country also became an issue in February 2011 when a revolt to overthrow Col. Muammar el-Qaddafi started in Libya. Assets of the Libyan Investment

131. See Johnson, supra note 107, at 56.
Authority were frozen in order to prevent Col. el-Qaddafi from using the money. Some companies that had sought investments from the Libyan Investment Authority were embarrassed by the association with the dictator, and speculation rose that firms may rethink how they approach SWFs in the future. After the fall of the el-Qaddafi regime, a new director of the Libyan Investment Authority sought to investigate the entity’s investments through the creation of an independent committee. The US Securities and Exchange Commission also investigated allegations of bribery by US-based investment banks in their dealings with the entity.

C. Regulation, Voluntary Standards, and the Dangers of Protectionism

A number of constraints already serve to monitor SWF investment in US companies. Official US policy is to encourage free trade and globalization, including cross-border investment, while still protecting national security interests. In order to accomplish these goals, the United States uses a combination of federal laws governing foreign investment, bilateral treaties, and monitoring through organizations such as the IMF. This Section will examine those methods of constraint and also examine recent proposals to further restrict SWF investment.

1. Existing US Regulations

The Committee on Foreign Investment in the United States (“CFIUS”) is the US governmental body charged with monitoring the national security implications of foreign investment. CFIUS consists of fourteen members from the executive branch who have the ability to recommend that an
investment by non-US investors, including SWFs, be blocked or to set conditions on the investment if the committee determines that the transaction threatens national security.\textsuperscript{141}

Some concern arose in Congress when CFIUS determined that the purchase of leases to manage several major US ports by a United Arab Emirates (“UAE”) entity was not a threat to national security.\textsuperscript{142} The UAE entity backed off, but Congress later passed legislation that, through reporting requirements, attempts to hold CFIUS accountable to Congress prior to approving a transaction.\textsuperscript{143} Since then, commentators mostly agree that CFIUS adequately protects US interests without hindering global investment, though some scholars have called for increased scrutiny.\textsuperscript{144} Legal scholar Joel Slawotsky makes the point that some countries, such as Singapore, UAE, and Venezuela, have multiple SWFs making simultaneous investments in the same industry sector or even company.\textsuperscript{145} Slawotsky maintains that for such nations “there must be a rebuttable presumption that the home state is ultimately in control of the investment decisions for each of the SWFs . . . [and a]ny holdings such funds have in the same company should be aggregated.”\textsuperscript{146} Interestingly, the mere fact that CFIUS exists has led to investment patterns by SWFs to try to avoid investigation by CFIUS. By staying away from sensitive industries and keeping investments small, SWFs avoid the gaze of CFIUS.\textsuperscript{147}

Like any investment funds, SWFs are also subject to the regulatory framework and mandatory disclosures required by

\begin{itemize}
\item \textsuperscript{141} See 31 C.F.R. § 800.506(b) (2008).
\item \textsuperscript{142} See JAMES K. JACKSON, CONG. RESEARCH SERV., RL 33388, THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS) 12-13 (2006).
\item \textsuperscript{143} See Adam Gutin, Regulating Sovereign Wealth Funds in the U.S.: A Primer on SWFs and CFIUS, 5 FLA. INT’L U. L. REV. 745, 769 (2010).
\item \textsuperscript{144} See id. at 779; see also Bruce Winfield Bean, Attack of the Sovereign Wealth Funds: Defending the Republic from the Threat of Sovereign Wealth Funds?, 18 MICH. ST. J. INT’L L. 65, 94–96 (2009).
\item \textsuperscript{145} See Joel Slawotsky, The Regulation of Sovereign Wealth Fund Investments in the United States, BANKING & FIN. SERVICES POL’Y REP., Oct. 2010, at 10.
\item \textsuperscript{146} Id.
\item \textsuperscript{147} See Rose, supra note 124, at 99–100.
\end{itemize}
state and federal securities laws. The securities laws lead to more transparency when SWFs gain a degree of control over a corporation. The Securities Exchange Act of 1934 Section 13(d) requires that any investor holding five percent of a public company’s securities disclose the investment as well as disclosing any plans to acquire further control or liquidation. The Bank Holding Company Act requires approval by the Federal Reserve if an entity seeks to acquire a twenty-five percent ownership in any bank or bank holding company.

Additionally, bilateral investment treaties also establish more transparency and accountability. By 2008, the United States had entered into nine bilateral investment treaties with countries that have SWFs. In March 2008, Abu Dhabi and Singapore agreed to bilateral treaties that included provisions as to investment and governance standards. In such bilateral treaties, the United States agrees that it will not engage in protectionist policies in regard to SWF investments.

2. Proposals–Decoupling Voting Rights

Ronald Gilson and Curtis Milhaupt suggest that voting rights be temporarily decoupled from stock purchased by SWFs. Gilson and Milhaupt propose that the suspension of voting rights would only last as long as the SWF held the shares so that the resale value of the stock would not be affected. Under this model, SWFs with a political or strategic agenda might not purchase shares, since they would have no voting rights to exercise control over a corporation. Only SWFs with a profit motive would purchase such shares, or so the theory

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150. Slawotsky, supra note 145, at 8.
151. See Backer, supra note 148, at 91.
153. See Backer, supra note 148 at 92.
154. See Gilson & Milhaupt, supra note 125, at 1352.
155. Id. at 1364.
The Gilson and Milhaupt idea is compelling; however, such passive investing (i.e., investment without shareholder control) creates corporate governance problems. If too many shareholders are removed from the governance process, then boards and executives may engage in corporate waste.\textsuperscript{157} Moreover, investors with a wealth maximization motive have legitimate, non-political motives for exercising voting rights.

The Gilson and Milhaupt proposal has been criticized as overly reactionary and possibly harmful to domestic interests.\textsuperscript{158} One difficulty with controls specific to SWFs is that restrictions will likely inhibit economic interdependence, which has been argued to help ease tensions in global conflict.\textsuperscript{159} On the other hand, there are legitimate national security and economic fears. It would be naïve to think that a non-US government would not manipulate the US economy for its own political aims. No single solution is likely to negate the dangers posed by SWFs engaged in economic hegemony. Increased regulation of investment will interrupt the free flow of capital and depress financial markets at a time when US bank liquidity is at risk.

3. Codes of Conduct

Through a joint IMF and World Bank initiative, twenty-six countries with SWFs developed a voluntary “best practices” code of conduct to allay fears that SWFs are seeking to exert political influence.\textsuperscript{160} The IMF international working group met three times during 2008 and eventually agreed upon “a set of generally accepted principles and practices (GAPP) that properly reflects their investment practices and objectives.”

\begin{footnotes}
\footnotetext[156]{Id. at 1365.}
\footnotetext[159]{See, e.g., id. at 132 (maintaining that “[t]he greater the number of nations in which SWFs invest, the more beholden they become financially to an open and peaceful world economy”).}
\end{footnotes}
meeting in Santiago, Chile. The principles, which have come to be known as “The Santiago Principles” have the following objectives:

“i. To help maintain a stable global financial system and free flow of capital and investment;

ii. To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;

iii. To invest on the basis of economic and financial risk and return-related considerations; and

iv. To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability.”

Reaction to the Santiago Principles was cautiously optimistic; yet concern still lingers about challenges in accountability. The Santiago Principles help “demystify the methodology of sovereign wealth funds and how they invest.”

The working group adopted twenty-four guiding principles that included detailed explanatory notes to give guidance on matters of disclosure, investment intent, and governance standards. By adopting the principles, the working group hoped also to “contribute to the stability of the global financial system, reduce protectionist pressures, and help maintain an open and stable investment climate.”

One follow-up to the 2008 Santiago Principles was the establishment, in 2009, of the International Forum of Sovereign Wealth Funds (“IFSWF”)—a voluntary group of representatives from SWFs that meets periodically and “exchanges views on issues of common interest, and facilitates an understanding of

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162. Id. at 4.


164. See Norton, supra note 124, at 648–51.

165. See id. at 657 (internal quotation marks omitted).
the Santiago Principles and SWFs’ activities.” While voluntary codes of conduct might create a norm, there is no accountability if and when an SWF violates such a code. At best the IFSWF brings together “a ‘global community’ of SWFs” where the enforcement of norms is through “internal peer review and other forms of periodic assessment . . . .”

Some western countries are skeptical of voluntary agreements given the lack of accountability. Scholars have suggested “striking a careful balance between the need for foreign capital and the danger of foreign governments interfering in sensitive sectors of the economy,” and that voluntary norms such as the Santiago Principles are just a first step “to achieve some consensus in the controversial global economic realm.”

4. Increased Regulation and Protectionism

Economist Gerard Lyons predicts that Western nations are likely to implement protectionist policies to restrict SWF investment in their countries. In fact, protectionist policies were considered after the alarm was raised in 2007 by Australia, Canada, the European Union, France, Germany, Italy, and the United States. After the IMF report was released, Germany increased its controls, and the United States considered whether to tighten rules by requiring passive investments. Yet

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167. Norton, supra note 124, at 657 (internal quotation marks omitted).


172. Germany Moves to Block Takeovers by Sovereign Wealth Funds, supra note 168.

protectionism will hurt global trade.\textsuperscript{174} Notwithstanding restrictions on foreign investment, US public opinion has generally turned away from free trade in recent years, and America’s allies fear there could be a cascading effect on global gross domestic product (“GDP”) that could result in a long recession if the United States begins to disfavor free trade.\textsuperscript{175}

Additionally, there has been a political backlash against SWFs given that many countries receive favorable tax treatment on investments under a theory of sovereign immunity. Given the recent growth in funds as a result of increased prices in commodities, analysts have begun to question whether gains by non-US SWFs should be taxed.\textsuperscript{176} Some scholars have gone so far as to suggest that prohibitions be made on SWF investments if the host country has “failed to provide adequate health care, access to education, or some assurance of personal security to its citizens.”\textsuperscript{177}

\section*{D. Post–Financial Crisis Shifts in Attitude}

A recent study from the Brookings Institution suggests the fears about SWFs are unfounded given the behavior and motives of many funds.\textsuperscript{178} Moreover, the study suggests that given the objectives of SWFs, foreign capital from sovereigns can be an

\begin{flushleft}
\begin{itemize}
\item \textsuperscript{174} Lyons, supra note 113, at 180.
\item \textsuperscript{175} Stefan Theil, \textit{Adam Smith’s Return}, NEWSWEEK, Dec. 8, 2008.
\item \textsuperscript{176} Melone, supra note 133, at 145. Professor Matthew Melone argues against taxing SWFs and preserving the sovereign immunity exception for tax. \textit{See id.} In contrast, Victor Fleischer maintains that the exemption is a subsidy for sovereign wealth and that SWFs should be taxed in the same way as a private foreign investor. \textit{See Victor Fleischer, A Theory of Taxing Sovereign Wealth, 84 N.Y.U. L. REV. 440, 443 (2009).}
\item \textsuperscript{177} Patrick J. Keenan, \textit{Sovereign Wealth Funds and Social Arrears: Should Debts to Citizens be Treated Differently than Debts to Other Creditors?}, 49 VA. J. INT’L L. 431, 471–72 (2009).
\item \textsuperscript{178} See Darrell M. West et al., Brookings Inst., \textit{Rebuilding America: The Role of Foreign Capital and Global Public Investors 2} (2011), available at http://www.brookings.edu/~/media/Files/rc/papers/2011/0311_sovereign_ wealth_funds/0311_sovereign_wealth_funds.pdf. The Brookings study uses the term Global Public Investors (“GPIs”) to include SWFs as well as other types of government investing entities. \textit{Id.} at 1. The conclusions of the Brookings study on GPIs are also relevant for SWFs since the most prevalent type of GPI is the SWF. \textit{Id.} at 6. For consistency, this Article uses the term SWFs.
\end{itemize}
\end{flushleft}
important source of development funds for both the private and public sectors.179

In contrast to fears raised in the media, Brookings found that most SWFs “are inherently cautious, focused on capital preservation, asset diversification, predictable returns, and the mitigation of political risk.”180 Rather than seeking complete control of a company, “most limit their equity ownership stake in public companies, financial institutions and private businesses to minority status and eschew direct management responsibility.”181 SWFs with the objective to fund national pension programs were singled out as exemplars of conservative and conventional portfolio management.182 Countries vary widely on the investment constraints for its national pension funds.183 Some, such as Norway, limit the investment in equities to thirty-five percent of the fund’s assets; whereas, Australia has no limits on any asset class.184

SWFs are historically long-term investors whose goal is to maximize wealth.185 Professional money managers trained in western investment principles typically manage the funds.186 SWF investments appear to be apolitical, according to the Brookings study.187 China’s investments might be termed strategic, since many are focused on the energy and natural resource sectors, though those investments are thought to be made for economic purposes, since China lacks many of the resources it needs to maintain its position as the world’s leading manufacturer.188

179. Id. at 3–4.
180. Id. at 2.
181. Id.
182. Id. at 6.
183. Id. (citing ORG. FOR ECON. COOPERATION AND DEV., SURVEY OF INVESTMENT REGULATION OF PENSION FUNDS (2010)).
184. ORG. FOR ECON. COOPERATION AND DEV., SURVEY OF INVESTMENT REGULATION OF PENSION FUNDS 11 (2010) (discussing Norway’s limits on investment in equities); id. at 4 (stating that while Australia has no asset class limits, “[l]oans or financial assistance to members is not permitted”).
185. Bean, supra note 144, at 106.
187. See id.
188. Id. (discussing China’s focused investments in the energy and natural resource sectors); see Alex Cree, Managing China’s Sovereign Wealth Fund Development: An American Strategy for Setting Rules and Norms, 9 J. INT’L POL’Y SOLUTIONS 27, 29 (2008),
SWFs also favor minority stakes and do not seek out board seats. There may be some disincentives for a SWF to seek out controlling shares, since the public entity would then need to hold directors accountable for poor performance. In another study, researchers confirmed that SWFs acquired a seat on a company’s board of directors in less than fifteen percent of the investments studied. If SWFs are incentivized to increase returns, then it might be in its own interest to be a passive investor. The study found that “abnormal performance worsens the larger the stake acquired . . . and if the SWF takes a seat on the board of directors.”

The one area that still gives pause to those concerned about SWFs is that which concerns accountability and transparency. The implementation of the Santiago Principles has been “highly uneven,” with some countries fulfilling the mandates only partially. The Brookings study suggests that “[p]ositive feedback loops through transparency ratings from trusted brands would encourage [SWFs] to be more open about their actions.” Another study found that target firms and SWFs prefer to “structure transactions in a way that matches up with recipient country ideals” and then disclose the terms in order to reduce transaction costs. Not only does such disclosure have an immediate effect of easing public concern, it also “conditions the market for future transactions, which may reduce transaction costs for transactions with other SWFs and for subsequent investments by the same SWF.”

What is most interesting about the Brookings study is the shift in attitude towards SWFs. Their findings acknowledge that both public and private entities rely on foreign capital. Given available at http://irps.ucsd.edu/assets/017/7165.pdf (discussing China’s economic motivation for investing).

189. See WEST ET AL., supra note 178, at 14.
190. See id.
192. Id. at 1.
194. Id.
196. Id.
the rising government deficit as well as a crumbling infrastructure, some US projects may not get funded if not through SWF investments. Since the report concludes SWFs are generally non-political conservative investors, it recommends policies that would encourage SWF investment—a sharp turnaround from the generally held view, only four years earlier, that SWFs posed a threat. 197 The study was driven partially because SWF investments in the United States dropped as a result of the financial crisis, as these funds turned towards funding projects in their respective home countries.198

SWFs serve as an interesting example of government investment funds that have successfully invested in order to build pension reserves without incurring significant political interference in private enterprise.

VI. SWFS AS A MODEL FOR THE SOCIAL SECURITY TRUST FUND

The following Part examines some of the most successful SWFs that manage social insurance fund assets and the methods used by such funds to keep investment decision-making apolitical while still maintaining accountability. In the last fifteen years, countries have increasingly incorporated social insurance reserve funds that employ modern portfolio theory into their pay-as-you-go financing systems.199 Countries that have diversified their public pension reserve funds include Australia, Canada, China, Denmark, France, Ireland, Japan, Jordan, Korea, New Zealand, Norway, Pakistan, Poland, Portugal, Sweden, and Thailand.200 Such funds allow the countries to partially pre-fund their programs in order to “mitigate financial issues raised by changing demographics, balance intergenerational fairness,

199. Vittas et al., supra note 4, at 1.
improve adequacy, and better ensure the sustainability of the schemes.”

Comparing the different funds presents difficulties in part because of differing legal systems, objectives, and reporting schemes among the funds. The OECD classifies the group of SWFs under consideration in this Article as Public Pension Reserve Funds and breaks it into two subcategories: Social Security Reserve Funds, where the source of funds is the surplus from employment taxes; and Sovereign Pension Reserve Funds, where the government provides funds for the trust. For the purpose of this Article, funds include both categories provided that the fund invests in a diversified portfolio.

Some confusion may arise in the use of the term “public pension,” which in the United States usually refers to a program such as the National Railroad Retirement Investment Trust—a pension plan set up for the benefit of a group of government employees. For the purposes of this Section, the term “public pensions” will also refer to funds that exist to finance social insurance programs. This Section first examines the performance of diversified funds that have good governance attributes, and then examines the characteristics that foster apolitical, wealth-oriented investment.

A. SWF Public Pension Performance

Well-managed SWFs that invest in diversified portfolios for the purpose of funding public pensions can outperform bond-only portfolios over the long-term. This Section examines the performance of some of the most successful funds. As noted


202. Blundell-Wignall et al., supra note 200, at 4–5. (distinguishing how the source of a SWF’s funds may have a bearing on the degree to which a particular governance structure is effective at remaining apolitical). In Social Security Reserve Funds, taxpayers, as stakeholders in the fund, would have an interest to urge politicians to not interfere since political interference could lead to abnormally negative returns. See id. at 18.


204. Vittas et al., supra note 4, at 1–3.
above, comparing performance data between international funds is problematic. Many factors affect performance, such as asset allocations. A fund that is heavily weighted in bonds will not do as well in the long-term as a more diversified fund.\textsuperscript{205} New Zealand’s SWF reflects this fact. With over sixty percent of its assets invested in equities, the New Zealand Superannuation Fund is among the best performing funds, showing an annualized nominal return of 7.83\% between 2003 and 2011.\textsuperscript{206}

Other factors that affect performance include the length of time that a fund has been in existence. Funds that have existed for longer than ten years show less of an impact from the 2007–2009 financial crisis on the average rate of return than funds that were investing for only a short time. For example, the Australian Future Fund has an annualized average return of only 3.5\%; however, the fund started in 2006—right on the cusp of the financial crisis and stock market decline.\textsuperscript{207} The effect of the financial crisis has skewed annualized returns even for funds with a ten-year track record. The Canadian Pension Plan Investment Board has an annualized rate of return of 5.9\% since it began investing in 2001.\textsuperscript{208} While the return is not as robust as some other funds, some of the assets are invested in longer-term investments such as real estate and infrastructure, which are just beginning to regain value after the economic downturn of 2007–2009.\textsuperscript{209}

One fund that successfully employed market timing by selling equities before the financial crisis was China’s National Social Security Fund (NSSF), which reported an annualized

\textsuperscript{205} Id. at 1–3.

\textsuperscript{206} NEW ZEALAND SUPERANNUATION FUND, PERFORMANCE AND PORTFOLIO UPDATE TO 30 JUNE 2011 1 (2011), http://www.nzsuperfund.co.nz/files/Fund_performance_to_30_June_2011.pdf; see also Vittas et al., supra note 4, at 55 (explaining that the New Zealand Superannuation Fund, formed in 2001, is expected to partially fund the country’s universal public pension benefit starting in 2020).


\textsuperscript{209} See id.
return of 9.17% from 2000 through 2010. The NSSF is the country’s largest pension fund, and was set up to be the safety net for provinces that could not meet their future national pension obligations. Equity investments comprised about fifty-three percent of assets as of December 2009. When first formed, investment returns “were modest” given that the portfolio consisted of mostly government bonds and cash. However, China’s NSSF yielded high returns in 2006–2007 as it began to increase equity investments in China’s volatile stock market. Unlike most buy and hold pension fund investors, China’s NSSF benefited from a bull market in 2006 and the first half of 2007, but then sold off a large percentage of its equity investments as the market began to turn in 2007 and 2008. The excellent returns in 2006 and 2007 of 29.01% and 43.19% more than offset the modest returns of earlier years. Moreover, the lack of significant exposure to equities during the financial crisis of 2007–2009 put the NSSF in a much better position than similar funds. The track record alone, however, is not justification for the NSSF to be a model for the US Social Security Trust Fund. Commentators have expressed concern over China’s lack of transparency and disclosure in running the


213. Leckie & Pan, supra note 212 (explaining that the portfolio’s equity investments consisted of 25.91% in domestic stocks, 6.54% global stocks, and 20.54% in equity assets).

214. Id.

215. See id.

216. Id. at 9, 14.

217. Id. at 14.

218. See Nat’l Council for Soc. Sec. Fund, supra note 212; see also Leckie & Pan, supra note 212.
The objectives and purpose of the fund are unclear, leading some to speculate that political pressure could result in a “misuse of the funds.”

Returns suffer when the government interferes in the management of a fund and forces the board to make politically motivated investments. For example, the Irish National Pension Reserve Fund was established in 2000 with the goal to partially fund payments for “social welfare pensions and public service pensions” starting in 2025. From 2001 to 2010, the fund’s Discretionary Portfolio had a modest annualized return of 3.5%. The substandard performance, when compared to its peers, may be partially explained by the 2009 Irish government intervention, which forced the fund to invest in failing Irish banks—an investment that has drawn down the performance of the fund.

B. Fund Governance Characteristics

In a recent study, Kevin Whitman, of the Social Security Administration, identified five governance characteristics that could be used to evaluate a proposal to diversify the Social Security Trust Fund. These characteristics are: 1) legal status; 2) mandate; 3) governing board characteristics; 4) investment policy and management; and 5) oversight.

By analyzing the structure and governance of the National Railroad Retirement Investment Trust, Whitman establishes the factors in government employee pension trusts that “shape program investment operations, define their level of independence, and determine the manner in which they engage

219. Leckie & Pan, supra note 212.
220. Id.
221. Vittas et al., supra note 4, at 46.
224. Whitman, supra note 203, at 78.
225. Id.
with political actors.”

Using these characteristics, this Section analyzes best practices for SWF governance using case studies done by the World Bank and OECD, as well as guidelines produced by the OECD and the International Social Security Association on good governance for managing pension and social security trusts.

1. Legal Status

Legal status refers to the nature of the fund as a legal entity—that is, the extent to which it is independent from existing government agencies and the political arm of the government. In a 2008 report, the World Bank identified an independent institutional structure as an important element in insulating financial operations from political influence. If the government has direct control over the fund, then there is a temptation to use the funds for purposes other than social insurance. Establishing a segregated model not only lessens the possibility of political interference, it also affects the nature of the other characteristics by allowing for “greater clarity in mandate and objectives” and better oversight because of “greater transparency and accountability of a segregated fund’s governing body.”

The legal structure of a separate fund also impacts investment policy and management, since investment professionals are more easily recruited to a fund than to a government agency.

The World Bank study examined public pension SWFs in Canada, Ireland, New Zealand, and Norway. In the first three of those countries, the public pension SWFs were created as “separate state entities with their own board of directors.” The Canadian Public Pension Investment Board (CPPIB) is a

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226. Id.
228. See Vittas et al., supra note 4, at 1–2.
229. Yermo, supra, at 10.
230. Id. at 11.
231. Id. at 11–12.
232. Vittas et al., supra note 4, at 2.
government corporation and, therefore, a separate legal entity, which operates outside of the federal and provincial government agency structure in Canada. Although deemed to be a government entity, the status as a corporation allows the CPPIB to operate in the same manner as a private investment entity. Similarly, the New Zealand Superannuation Fund and the Irish National Pensions Reserve Fund were formed as separate entities with independent boards.

In Norway, no separate entity exists though other controls keep the fund functionally immune from massive political manipulation. The Government Pension Fund-Global (GPF-G) is managed by the Ministry of Finance, “which makes all strategic decisions, formulates investment policy objectives, and sets the strategic asset allocation and benchmarks.” The Ministry appointed Norges Bank, Norway’s central bank, to manage the assets of the trust, which removes day-to-day operations away from the government. However, the agreement can be terminated by either party with only one year’s notice. Despite its lack of independence, Norway’s GPF-G has avoided political interference in part because of a law that limits public spending from oil revenue—the source of funds for the trust—so “that the annual structural budget deficit should not exceed [four] percent of Fund assets.”

If the United States were to diversify the Social Security Trust Fund, the most important first step would be to establish a separate entity outside of the usual agency structure. Federal government corporations would likely be the best model since they are a step removed from the political process and allow the

233. *Id.* at 37. The Canadian Pension Plan Investment Board (CPPIB) was created in 1997 to address the transition from an unsustainable pay-as-you-go system to a partially pre-funded program. *Id.* at 35–36.

234. *Id.* at 37.

235. *Id.* at 2. Unfortunately, the independence of the Irish fund was short-lived. See infra notes 295-98.

236. Vittas et al., *supra* note 4, at 27. Two funds exist in Norway to manage public pension money—the Government Pension Fund–Global, which invests internationally, and the Government Pension Fund–Norway, which invests in domestic assets. *Id.* at 26. The focus in this Article is on the global fund.

237. *Id.* at 27.

238. *Id.*

239. *Id.* at 33.
government to operate using business methods not normally available to agencies.\textsuperscript{240}

2. Mandate

The World Bank recommends that public pension funds be given a “clear and unequivocal commercial mandate . . . to maximize investment returns, subject to a prudent level of risk, and after taking fully into account the structure of its liabilities and the length of its investment horizon.”\textsuperscript{241} If the US Social Security Trust Fund is diversified, then creating a clear mandate would be critical to its success, since the size of the trust “makes political interference more likely.”\textsuperscript{242}

Canada’s public pension trust is a good example of the successful implementation the World Bank recommendation. The CPPIB Act provides that the object of the fund is to achieve “a maximum rate of return, without undue risk of loss.”\textsuperscript{243} The New Zealand fund has a similar mandate and its board is charged with “investing the fund on a commercial and prudent basis in order to maximize investment returns without incurring undue risks.”\textsuperscript{244} The goal of maximizing returns is often tempered by other requirements. The CCPIB must also take into account “the factors that may affect the funding of the Canada Pension Plan and the ability of the Canada Pension Plan to meet its financial obligations on any given business day.”\textsuperscript{245} The New Zealand fund must also invest assets in such a way as to “avoid[] prejudice to New Zealand’s reputation as a responsible member of the world community.”\textsuperscript{246}

Despite their mandate to maximize returns, public pension funds have sometimes come under pressure from politicians and


\textsuperscript{241}. Vittas et al., \textit{supra} note 4, at 22.

\textsuperscript{242}. Whitman, \textit{supra} note 203, at 81.

\textsuperscript{243}. Canada Pension Plan Investment Board Act, S.C. 1997, c. 40, § 5(c) (Can.).

\textsuperscript{244}. Vittas et al., \textit{supra} note 4, at 56.

\textsuperscript{245}. Canada Pension Plan Investment Board Act § 4.

\textsuperscript{246}. NEW ZEALAND SUPERANNUATION FUND, \textit{supra} note 206, at 3.
activist groups for investing in controversial firms. For example, the CPPIB has been criticized by activist groups for, among other things, its investments in arms manufacturers and tobacco companies.\textsuperscript{247} The CPPIB response has been to adopt the United Nations Principles on Responsible Investment, which are also endorsed by the other three nations.\textsuperscript{248} The principles state that “responsible corporate behavior with respect to environmental, social and governance [“ESG”] factors can have a positive influence on financial performance over time.”\textsuperscript{249} However, CPPIB maintains investments that achieve its mandate of maximizing risk adjusted returns and stops short of divesting itself in tobacco and munitions companies. Rather, the CPPIB seeks to engage in a dialogue with companies on ESG issues in order to seek corporate practices that will maximize long-term financial gain.\textsuperscript{250}

Norway’s GPF-G is likely the largest of the public pension plans that has become more aggressively activist in the application of ESG issues to its investments. In 2004, Norway mandated that the GPF-G establish an Advisory Council on Ethics and divest itself of companies that produced certain types of weapons or otherwise engaged in activities that violated environmental, social, and governance factors, such as human rights abuses, pollution, etc.\textsuperscript{251} As a result, Norway divested itself of investments in Wal-Mart on the basis of “human rights and labour rights,” including the employment of child labor.\textsuperscript{252} The manager of the GPF-G, Norges Bank, maintains that application of environmental, social, and governance factors is distinguished from political pressure because of “the relationship that exists between well-regulated and morally legitimate markets and companies on the one hand, and long-term returns for

\textsuperscript{248.} See Vittas et al., supra note 4, at 14.
\textsuperscript{249.} CAN. PENSION PLAN INV. BD., REPORT ON RESPONSIBLE INVESTING 1 (2010).
\textsuperscript{250.} See id. at 2–3.
\textsuperscript{252.} Id. at 12.
diversified investors on the other." Although the Norwegian fund’s annualized return of 7.9% suggests that the fund is managed for the purpose of wealth creation, “the macroeconomic and ethics based actions of the funds suggest that Norway is consciously pursuing state policy indirectly through its funds.”

Given its funding problems, the mandate for a diversified Social Security Trust Fund should follow the lead of other countries and specify that the fund should maximize risk adjusted returns allowing for the necessary liquidity to honor future obligations. If the Social Security Trust Fund were to diversify, a great deal of pressure would no doubt be exercised to require that the fund not invest in companies or industries that are not deemed socially responsible. One solution that would avoid the decision over whether a company is ethical enough for the investment would be to invest entirely through broad-based index funds, such as the Wilshire 5000. Even if it takes that approach, the Trust Fund should certainly adopt—at a minimum—the United Nations Principles on Responsible Investment. To the extent that the Trust Fund owns shares in companies directly, it could effectively follow the example of the CPPIB by actively engaging the company in a dialogue and voting its shares for responsible corporate behavior.

3. Governing Board Characteristics

The term governing board characteristics refers to the procedures by which board members are appointed and the requisite qualifications. While a fund may be a separate legal entity, politicians might be able to exert political influence over


investment policy through the appointment process. Consequently, safeguards against political influence are important in the vetting process for directors if the fund is to stay independent.

In Canada, the appointment process for the CPPIB’s twelve-member board of directors is structured to achieve a managing body that has both financial expertise and is representative of the different provinces. Appointing a director is a two-step process. First, a committee that includes representatives from each province creates a list of candidates. Second, the federal finance minister with the recommendation of the provincial finance ministers then selects the final directors. The board of directors in turn appoints the day-to-day professional money managers; thereby removing the investment decision further away from the political influence.

A two-step process also exists in New Zealand. Although the New Zealand Superannuation Fund board is ultimately appointed by the government, an independent nominating committee first proposes recommendations. The New Zealand Superannuation Fund Act of 2001 requires that board members “in the opinion of the minister, have substantial experience, training and expertise in the management of financial investments.” The board appointed a chief executive officer, and the fund is run on a day to day basis by a staff of professional money managers.

The Irish government does not use a nominating committee like Canada and New Zealand, it directly appoints seven commissioners to run the National Pensions Reserve Fund. The terms are staggered and each commissioner has to meet certain qualifications, such as having “substantial expertise and experience at a senior level in a broad range of areas.”

256. Id.
257. Id.
258. Vittas et al., supra note 4, at 13.
259. Id. at 56.
260. Id. at 58.
261. Id. at 47.
which could include the financial industry, but might be in another area, such as consumer protection or the civil service.\textsuperscript{262}

The required financial expertise of directors differs among funds with New Zealand likely having the strictest requirements that every member have substantial investment knowledge and experience.\textsuperscript{263} The World Bank study notes, however, that it is an issue that none of the funds studied requires that board members “have adequate knowledge of modern financial instruments and strategies.”\textsuperscript{264} Given the increase in the use of derivatives and absolute return strategies, this may be an important qualification to consider adding to the requirements.

In order to foster an environment where investment returns are maximized and apolitical, the Social Security Trust Fund would likely benefit from being run by a small—no more than ten-person— independent board composed solely of financial professionals.\textsuperscript{265} There should be fixed terms that are staggered, and the appointment process should include a non-political nominating committee that creates a short-list of qualified volunteers. The expertise on the board should include a significant number of members who are skilled in complex financial instruments, such as derivatives.

4. Investment Policy and Management

The investment policy of a fund should, naturally, be structured in order to achieve its mandate. The policy should include guidelines and strategies on issues such as asset allocation, international investment, time horizon, target return, and similar financial metrics. For many funds, policy is normally set at the board level and then implemented by managers.\textsuperscript{266} However, in the case of Norway, policy decisions are decided by the Ministry of Finance.\textsuperscript{267} Funds typically have a long horizon for investments given the wealth maximization mandate.\textsuperscript{268}

\textsuperscript{262} Id.
\textsuperscript{263} Id.
\textsuperscript{264} Id. at 13.
\textsuperscript{265} The World Bank makes these recommendations generally rather than specifically to the Social Security Trust Fund. See id. at 23.
\textsuperscript{266} See id. at 2.
\textsuperscript{267} Id.
\textsuperscript{268} Id. at 3.
Funds are highly diversified with investments spread out over bonds, public equities, real estate, private equity, emerging markets, and hedge funds. Some funds build large internal staffs of investment professionals while others rely on outside managers.

The CCPIB has an actively managed portfolio where the focus is on a long-term global investment strategy. The fund is managed by a chief executive officer, who is appointed by the board, and a team of investment professionals. Canadian assets account for only 48.3% of its portfolio, and many investments, such as infrastructure and real estate, are made with a long horizon of fifteen to over twenty years in order to realize the full return. The aspirational reference portfolio requires sixty-five percent equity and thirty-five percent debt. In the actual portfolio, bonds, money market investments, and other debt make up only 32.8% of the asset allocation. Equities—both foreign and domestic—account for 53.5%, and infrastructure and real estate comprise the remaining 13.7% of the portfolio. The highly diversified Canadian fund has required an expansion of the staff in recent years as it began to more actively manage its portfolio. This has increased the management costs of the portfolio, though the overall costs are within reason. That said, commentators maintain that the strategy and cost of active management will need to be monitored in coming years.

The New Zealand Superannuation Fund board is obligated by law to employ “best practice portfolio management.” After consulting outside investment advisors, the board adopted an asset allocation that was broadly diversified across classes,
sectors, and location.\textsuperscript{280} New Zealand equities accounted for only 7.5\% of assets according to a 2005 review.\textsuperscript{281} The fund is managed on a day-to-day level by a chief executive officer and a small staff. However, external managers, who are appointed by the board after a rigorous review process, manage the day-to-day investments.\textsuperscript{282}

Many funds—Canada, Ireland, Norway, and New Zealand—started out as passive investors and have since transitioned to active investing in order to “raise expected returns while keeping risks under control.”\textsuperscript{283} The activist investment policies of mature funds are not likely to be immediately appropriate for the US Social Security Trust Fund. Even successfully managed activist funds like Canada’s transitioned over time from a passive approach to an activist approach.\textsuperscript{284}

As a practical matter, in order for the United States to diversify Social Security Trust Fund assets, Congress would first have to pass legislation that transforms the special-issue government bonds into marketable instruments so that the Trust Fund could then resell the securities into the secondary market.\textsuperscript{285} It is uncertain, however, how well the secondary market would absorb the sale of these securities. Demand for US government bonds was still high in August 2011, even as Standard & Poors downgraded the US credit rating.\textsuperscript{286} Bond yields were at historic lows since the US debt was seen as a safe haven given uncertainty over European sovereign debt and continued economic growth.\textsuperscript{287} If demand continues to remain high, then the securities could be more easily sold into the secondary market. One plan to diversify calls for investing forty

\textsuperscript{280} Id. at 57.
\textsuperscript{281} Id.
\textsuperscript{282} See id. at 58.
\textsuperscript{283} Id. at 61.
\textsuperscript{284} See id. at 42–45.
\textsuperscript{285} Id. at 7. The Canadian Pension Plan provides a precedent for diversifying out of a bond-only portfolio. When it adopted the diversified investment strategy, the Canadian system had financing problems similar to those that the US Social Security system currently faces. See CAN. PENSION PLAN INV. BD., supra note 271, at 6.
\textsuperscript{287} Id.
percent of the US$2.6 trillion Trust Fund—just over US$1 trillion—into equities. That would increase the US debt held by the public by about ten percent to US$10.9 trillion. In devising a plan to diversify, government economists will need to gradually sell the bonds in the secondary market so as not to produce significant adverse effects on the government’s ability to issue new bonds.

5. Oversight

Given the amount of money at stake, the independence of a public pension fund has to be balanced by a system of oversight that holds the fund accountable to the government and the contributors to the system. Oversight measures may involve review by government agencies and political entities, timely reporting requirements, independent auditing of financial statements, and the possibility of legal action to enjoin the trust. In addition to oversight by outside entities, the board may have oversight measures to monitor the activities of managers, such as audit committees.

The purpose of reporting requirements is to heighten the degree of transparency and therefore accountability. The CPPIB Act requires that the Canadian fund publish an annual report that includes audited financial statements—an annual and quarterly—and to hold public meetings in each member province every two years. In contrast, the New Zealand Superannuation Fund Board is subject to an independent review of its performance only once every five years. The New Zealand Treasury is expected to “monitor its activities on a regular basis.” In the case of Norway, the Ministry of Finance has to report to Parliament on fund performance, and the manager,

288. In August 2011, the amount of US debt held by the public was about US$9.9 trillion; while intragovernmental holdings were approximately US$4.7 trillion. The Debt to the Penny and Who Holds It, TREASURY DIRECT (Aug. 11, 2011), http://www.treasurydirect.gov/NP/BPDLogin?application=np (enter August 11, 2011 in “Enter Beginning Date” field).

289. Whitman discusses each of these methods of oversight for the National Railroad Retirement Investment Trust. Whitman, supra note 203, at 80–81.

290. Vittas et al., supra note 4, at 38–39.

291. Id. at 56.
Norges Bank, reports on holdings and performance through a website.\textsuperscript{292}

The Canadian, Irish, and New Zealand funds have all set up standard corporate control including audit committees, standard-setting on issues like valuations, outside auditors to monitor performance, and use outside advisors to help the board determine key policy decisions such as asset allocations.\textsuperscript{293}

Oversight for a diversified Social Security Trust Fund should follow the best practices of other countries and publicly publish audited quarterly and annual reports. It should also be obligated to report to Congress on a regular basis. The Treasury would likely be vested with additional oversight responsibilities; however, to prevent political interference, the Treasury’s ability to act might be limited to bringing a lawsuit to prevent an \textit{ultra vires} act not authorized by the Trust’s mandate.\textsuperscript{294}

6. The Threat of Government Legislation

Even though a country may adopt the best practices to foster board independence and avoid political intrusion, most funds are not immune from the possibility of the government passing new legislation to thwart the goals of the fund. As Irish citizens discovered, the government can easily suspend the independence of a fund it creates. In 2009, the Irish government forced the originally independent National Pension Reserve Fund to purchase €7 billion in stock in order to bolster the capital of Irish banks.\textsuperscript{295} The fund was, in effect, forced to go against its original mandate to maximize returns, since the investment in the Irish banks was not one that a fiduciary would normally make.\textsuperscript{296} The investment has proven costly for the Irish National Pension Reserve Fund. While the fund’s regular portfolio has garnered a twenty percent return in 2009, the

\textsuperscript{292} Id. at 27–28.

\textsuperscript{293} Id. at 14.

\textsuperscript{294} This could be structured in a way that is similar to the oversight provisions of the National Railroad Retirement Investment Trust where the overseeing agency of the Trust, the Railroad Retirement Board, has a statutory right to seek injunctive relief if the trust, the board, or its employees violate the provisions of the enabling legislation. See Whitman, \textit{supra} note 203, at 80.

\textsuperscript{295} Waki, \textit{supra} note 223.

\textsuperscript{296} Id.
investment in the banks lost €400 million by November 2010. In May 2011, the Allied Irish Banks announced that it could not pay a €280 million dividend owed to the fund and offered additional stock in lieu of the payment.

Similar threats exist for other funds. The French Parliament passed legislation in 2010 that requires the country’s Pension Reserve Fund to sell assets in order to repay the short-term debt needs of the country’s welfare system. Originally, the fund was given a much longer investment horizon so that disbursements could not be made until 2020; however, now the politically motivated legislation requires the fund to reduce its forty percent asset allocation in stocks, which will likely result in a much lower long-term return. The potential for government intervention in New Zealand does not even require an act of Parliament. The Minister of Finance is authorized to direct the trust fund to undertake a certain action; thereby cutting off the independent nature of the New Zealand Superannuation Fund. However, any directive has to be in writing, presented to the New Zealand Parliament, and published.

Some potential controls on government intervention exist through the political process and potentially as a constitutional mandate. For example, an irate electorate would be a check on politicians who interfere with a fund. However, the greatest protection for a trust fund would be a constitutional amendment that explicitly bans political meddling and preserves the board’s independence.

Although the recent events in Ireland and France are unfortunate, the success in other countries indicates that public pension SWFs can be successful provided that they are

297. Id.
300. Verno, supra note 227, at 17.
301. See Coats, supra note 299.
302. Vitas et al., supra note 4, at 13 n.9.
303. See Templin, supra note 240, at 442–43.
organized to exhibit the following characteristics: (1) political neutrality; (2) transparency; (3) accountability; (4) strong governance; (5) a mandate to maximize returns as adjusted for risk; (6) long-term horizons for investments; and (7) adequate resources.  

**CONCLUSION**

The last ten years have seen a significant shift in the way countries manage public pension and social insurance reserve funds. Rather than invest solely in government bonds, countries now employ modern portfolio techniques to diversify assets and earn a higher rate of return. Even after considering the losses incurred during the 2007–2009 financial crisis, non-US sovereign wealth funds that have managed to remain apolitical have competitive returns and sometimes outperform the market.

Curiously, the United States has not followed suit even though the long-term benefits of a diversified portfolio are well-known. The reasons for this economically irrational behavior likely stem from beliefs underlying the country’s neoliberal political economy, specifically regarding the role of government as an owner of private enterprise. Institutional studies suggest that the rules constraining government investment are not likely to change rapidly given the constraints of path dependence theory. However, the United States has seen incremental changes of attitudes towards government ownership. Many states that run venture capital funds and government employee pension funds have been successful as apolitical state investment entities. Moreover, attitudes towards SWFs have shifted from fear and anxiety over politically motivated investments, to a greater acceptance of the sovereign investors as wealth-maximizing entities. Crisis also drives change. The Social Security Trust Fund is now expected to be depleted by 2036. Diversifying the Trust Fund could eliminate as much as thirty percent of Social Security’s funding deficit, without raising taxes or reducing benefits.

Sovereign wealth funds that were created for the purpose of funding national pension systems provide a model for the

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304. Vittas et al., supra note 4, at 2.
United States to form an independent entity that is apolitical yet able to be held accountable for its actions. As US politicians grasp for solutions to Social Security’s funding problems, they should consider adopting the successful SWF models used in Australia, Canada, and New Zealand in order to help partially prefund future benefits.