Political Players?

Sovereign Wealth Funds' Investments in Central and Eastern Europe

Edited by
Tomasz Kamiński

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Tomasz Kamiński
(University of Łódź)

Introduction

Sovereign wealth funds (SWFs) are state-owned investment funds composed of financial assets such as stocks, bonds, property, precious metals or other financial instruments. SWFs invest globally and most of them are funded by foreign exchange assets. They may have their origin in commodities (created through commodity exports, either taxed or owned by the government) or assets transferred from official foreign exchange reserves.

SWFs have been present in the financial world since 1953, when the first of them, the Kuwait Investment Board, was set up. Nevertheless their rapid development and growth of prominence is a rather new phenomena. Their growing position in the world, in terms of asset value as well as number of funds, has been observed in the world since 2005.

Although there has been vivid academic debate as to what extent SWFs are motivated by political reasons (this topic is addressed in Chapter 2), it is rather clear that countries can use state-owned investment funds as a tool of their foreign policy. Such danger was addressed by the IMF and its Santiago Principles (the document that set out the common standards regarding transparency, independence, and governance of SWFs), noticed also by the EU as well as various academics and experts.

Therefore, in our study we made an assumption that SWFs are instruments of state policy, serving to their national interest. This is very much in line with realism, one of the most prominent theories of international relations, that focuses the attention of scholars on the concept of power and the notion that states pursue policies that maximize their power through various means. SWFs in this context are perceived as instruments of economic statecraft (see: Chapter 2).

The complementary theoretical approach focuses on the state and its role as an independent economic agent. As rational economic agents, states seek the best possible ways to maximize their wealth, they try to take advantage of available opportunities and invest their funds where the highest expected return can be found. Looking through this prism then we come to find that investor states employ their SWFs for commercial purposes, with special emphasis on the management of national wealth.

There are also other explanations for the behavior of SWFs (see: Chapter 2), but those two are the most important to conceptualize our theoretical approach. We would like also stress that taking into account the dynamic nature of SWFs and multiplicity of their goals, any single theoretical perspective would be inadequate to explain their behavior.

This book looks at SWF activities in Central and Eastern Europe (CEE). Since entering the European Union (EU) in 2004 the investment attractiveness of Poland and other countries in CEE has grown. Consequently, foreign investors have become increasingly interested in investing in the region than before. As such, it should not be surprising that, SWFs have also begunfinancial activities in CEE.

The main goal of this book is to determine the main motives for SWF presence in CEE. Are the potential financial gains the only reason behind their investments? Are SWF activities in the region dangerous for the stability and security of the CEE countries?

Our hypothesis was that SWF investments in CEE are not only financially driven, with the political motives of their investors, wishing to see reached, also being a factor. This could create potential security threats for Poland and other countries in the region.

Answering the abovementioned questions contributes to the academic discussion about SWF strategies and deeper understanding of the motives behind SWF operation. It is also part of the debate about security risks linked with the growth of global investment activities by states. We hope that this interdisciplinary work will contribute to two fields: political science (notably international relations) and economics (investment management). In particular, the following aspects will be dealt with:

Political science:

1. A better understanding of SWFs as a policy tool used by states in the era of globalization.
2. An insight into the mechanisms of foreign policy used by the global economic powers. The book will help understand the strategies, goals and foreign policy agendas of these countries.

Economics:

1. A review of SWF investment strategies, in particular regarding the balance between investment efficiency and the pursuit of political objectives.
2. Formulation of socioeconomic conclusions in the context of attracting SWFs whose investment strategies are perceived (by the host countries) as desirable and mitigating the outcomes of SWF investment and non-investment engagement, potentially detrimental to the interests of the CEE countries.

Given the qualitative and quantitative character of the research, the methodology will draw on both approaches. In essence, the methodology will enable a thorough and empirical-based testing of the primary research proposition as to the existence and significance of non-investment objectives in the activity of global SWFs operational in the selected CEE economies of: the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia.

In our research we covered seven EU member states. Originally we planned also to analyze two other CEE countries: Ukraine and Belarus. However, it turned out that those countries have not attracted any SWFs investments.

This research study is based on empirical data gleaned from the Sovereign Wealth Fund Institute Transaction Database – arguably the most comprehensive and authoritative resource tracking SWF investment behavior globally. In the database (till mid 2014) 11,633 SWF transactions were catalogued, including 1,118 domestic investments with a value USD 174.1 billion and 10,515 foreign investments with a value of USD 675.8 billion. Therefore, about 90% of the number of SWF investments and about 80% of the total value of SWF deals are cross-border transactions. Combining this database with additional media sources we selected 47 transaction in CEE, valued at USD 8.274 billion. The full list of transactions is presented in Annex 9.

Certainly, the outcome does not pretend to be fully comprehensive of all SWF activities in the region. SWFs are widely perceived as relatively opaque even among alternative investment managers. Due to this fact their investment activity is commensurately obscure. SWFs often operate through special purpose vehicles (SPVs), which complicates identification of their beneficial ownership or accurate and timely portfolio compositions. Moreover, the majority of sovereign wealth funds are notorious for inferior standards of transparency measured via the Linaburg-Maduell Transparency Index. Suffice it to say that only 4 out of the 12 biggest SWFs, managing 80% of total SWF assets, scored more than 6 out of a maximum of 10 points and can be perceived as relatively transparent. However, considering the aforementioned constraints and inevitable simplifications, it can be claimed that we managed to collect a sufficient probe to enable the postulation of academic conclusions.

Our research activities presented in the book were limited by a number of practical factors, such as:

- relative opacity: SWFs, as (largely) unregulated institutional investors do not offer lofty standards of institutional transparency, which is likely to complicate an in-depth and comprehensive analysis;
- limited history: SWFs are a relatively novel form of alternative investment management: this by definition limits the time horizon of empirical research and the scope for far-reaching systemic conclusions and policy recommendations;
- uniqueness: every SWF pursues its own strategy (a function of the political agenda set by its creators/contributors); due to the variations in SWF activity any aggregate conclusion could be precarious.

The book is a result of the research project "The Political Impact of Investments of Sovereign Wealth Funds in Central and Eastern Europe Political" financed by the (Polish) National Science Centre (Decision no. DEC-2012/07/B/HS5/03797). The project was implemented in the years 2013–2015 by a team of researchers engaged by the Faculty of International and Political Studies at the University of Łódź.

The team of authors involved on the creation of this book is composed of three political scientists and two economists of diverse ages and academic backgrounds. This makes a persuasive case for a well-rounded and balanced piece of research (between political science and economics) and will enable a comprehensive approach to the study.

The book is divided into seven chapters. Chapter 1 presents the SWFs from the economic point of view. It encapsulates the most recent findings on SWF investment activity globally. The author discusses the position of global SWFs among conventional and alternative asset managers, SWF allocation strategies, their recent investment behavior and its likely evolution in the foreseeable future. Chapter 2 conceptualizes the political significance of SWFs. The analysis starts from the concept of economic statecraft, its instruments and position of SWFs in this context. Then a review of the academic discussion concerning motives behind SWF activities is presented, with a central question about the importance of political ones being addressed. Finally, the list of risks that should be taken into account as long as SWF investments in the CEE are concerned are outlined. Chapter 3 looks at the problem of the global competitiveness of CEE financial markets. The assessment is made using quantitative and hybrid metrics of financial center development while placing particular emphasis on competitiveness drivers relevant to the activity of global SWFs in the CEE region. Chapter 4 offers an overview of SWF investments in CEE. This chapter also aims to inquire into the possible reasons for the relatively low investments by presenting them and analyzing their specificity.

The case study section starts from Chapter 5 that looks at the role of SWFs in China's policy toward CEE. Despite a visible growth of economic ties, Beijing presented a very limited will to use investments as a political instrument in the region. Chapter 6 presents the picture of portfolio and political implications of Norway's SWF investments in CEE. However, seeing as the Norwegian fund is the most transparent one, it is also probably the most politically biased. The final chapter gives insight into Gulf Cooperation Council (GCC) countries, which invest in CEE through their SWFs. It analyzes the main directions of these investments, political and economic interests behind them and finally concludes with the political risks analyses. A summary of all these findings and comparative analyses of all three cases studies are presented in the concluding section, at the end.

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Chapter 1

The Recent Investment Activity of Global Sovereign Wealth Funds

This chapter encapsulates the most recent findings on sovereign wealth fund (SWF) investment activity globally. The key research proposals addressed herein relate to the position of global SWFs among conventional and alternative asset managers, SWF allocation strategies, their recent investment behavior and its likely evolution in the foreseeable future.

1.1. Stylized Facts on Sovereign Wealth Funds' Contemporary Investment Strategies

Sovereign wealth funds have historically been viewed as conservative asset managers; however, the global financial crisis of 2007–2009 has materially affected their investment allocation behavior. On the one hand, numerous SWFs had to help recapitalize cash-strapped domestic sectors or companies (stirring up considerable controversy, cf. Gelb 2014), on the other hand, their numerous holdings (e.g. illiquid asset classes) suffered significant value erosion. Consequently, SWFs have been forced to rethink their investment strategies and map out plans to approach the investment process from a broader perspective (cf. Alsweilem 2015).

Among the key factors driving portfolio allocation decisions by worldwide SWFs since the last global financial crisis, have been (cf. Kunzel 2010):

- **SWF subtype**: global SWFs can broadly be classed as: macroeconomic stabilization funds, savings funds, pension reserve funds and reserve investment corporations, this classification has significant implications for portfolio allocation patterns (e.g. SWFs that – by virtue of their explicit or implicit mandate – do not need to preserve a substantial proportion of their assets in investments easily convertible into cash, have more latitude in selecting relatively illiquid and risky, i.e. volatile asset classes);
- **SWF time horizon**: longer-term (especially intergenerational) SWFs whose activity is projected for whole decades rather than single years can afford more exposure to illiquid and risky investments – such funds can extract illiquidity and anticyclical premia over asset managers that are constrained by the prospect of short-/medium-term withdrawals and the need to prove their performance in a relatively short time frame;
- **SWF funding base**: the investment policy of an SWF has to be a function of funding scale and stability, as the SWF's assets are primarily derived

from a single resource, limited, non-renewable or nearly depleted resources, the SWF's investment strategy has to account for implied volatility in the availability of such resources (commodity or otherwise based);

- **national policy toward SWFs**: the role of a given SWF must be reconciled with other SWFs originating from the same country (if the country operates more than one SWF) or other agencies playing similar roles to SWFs, furthermore political interference with the investment activity of an SWF can detract it from efficiency oriented investment management;
- **SWF maturity**: mature, experienced and fully fledged SWFs are more likely to apply broader diversification to their portfolios, are more inclined to seek exposure to nontraditional asset classes and employ sophisticated portfolio strategies, whereas recently founded SWFs need time to arrive at their predefined asset allocation;
- **reaction to the crisis**: the SWFs that suffered heavy losses during the last global financial meltdown have been compelled by their mandators to rearrange their portfolios toward a greater readiness to support the domestic economies, higher liquidity, broader diversification into alternative assets, emerging markets and advanced risk metrics (e.g. factor based investing, cf. Masih 2014).

1.2. Recent Investment Activity of Global SWFs

According to the latest available estimates (TheCityUK 2015), global SWFs rank at the top of the largest non-conventional (alternative) investment management institutions by aggregate assets under management and their scale is becoming significant even to mainstream (conventional) asset managers – whose record of activity is by far more established (Figure 1.1). Despite such prominence, global SWFs tend to keep a lower profile in the mass media than most other financial institutions, are not routinely obligated by law to perform publicly available information disclosures, and are thus considered relatively obscure to the point of being demonized in popular culture (Drezner 2008). Numerous fast growing SWFs come from emerging markets and derive their assets from the extraction of natural resources or non-commodity exportation (Appendix 1).

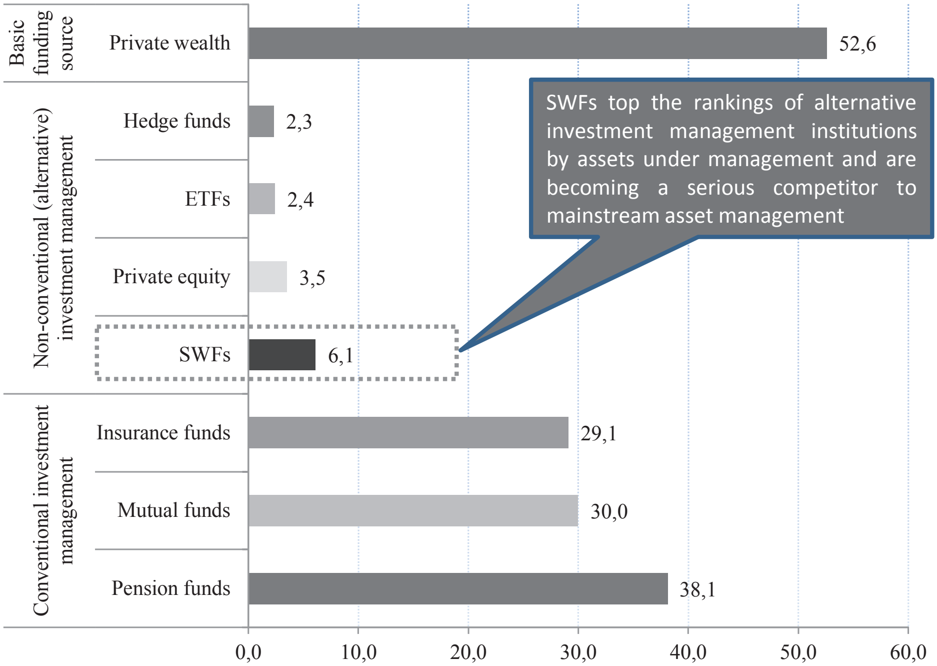

Figure 1.1. The Structure of the Global Fund Management Industry (Including Conventional and Non-Conventional Institutions) by Assets under Management at the end of 2013 (in USD in trillions)
Source: UK, The Leading Western Centre for Sovereign Wealth Funds, TheCityUk, June 2015, available at: http://www.thecityuk.com/research/our-work/reports-list/sovereign-wealth-funds-2015/ [accessed: 16.08.2015]. Note: about one-third of private wealth is incorporated in conventional investment management. Note: the SWFs' asset under management total differs from that contained in Appendix 1 due to a different time period under survey and different sources used.

Despite chronic inscrutability (the average Linaburg-Maduell transparency ratio, the most widely applied metric of SWF information disclosure standards, for the 79 largest global SWFs amounts to 6 on a scale from 1 to 10: see Appendix 1), the funds' assets have been conspicuous for exponential growth in defiance of the downward volatility plaguing numerous investment management institutions amid the global economic crisis of 2007–2009 (Figure 1.2). The SWF expansion has been driven both by continued funding from governments and capital gains accumulated in continued pursuit of superior returns at a time when international interest rates have been hovering close to zero (cf. Preqin 2015).

The unabated ascent of global SWFs, particularly driven by a proliferation of non-commodity funds, despite a number of systemic challenges persistent in the global asset management industry, can be attributed to the following SWF hallmarks:

- **stability**: state control over SWF assets makes them less susceptible to panic withdrawals triggered by shrinking rates of return (even amid economic crises);
- **long-termism**: the intergenerational character of SWFs helps them overcome interim pricing pressures in search of long-run returns (this feature is accompanied by the infrequent use of short/medium-term benchmarking by SWFs);
- **lack of short-terms liabilities**: SWFs' role as intergenerational asset managers is bolstered by the absence of short-term liabilities and the resultant leeway in asset allocation (although the recent crises have compelled some funds to recapitalize selected industries and companies);
- **portfolio structure**: although the diversification of SWF portfolios has been on the continued rise, they are still significantly exposed to illiquid asset classes (e.g. real estate, infrastructure and private equity) whose valuations are immune to short-term pricing changes;
- **growing role of emerging economies**: the global shift of geopolitical and economic gravity toward emerging markets has wide-ranging implications for the distribution of capital (i.e. burgeoning number of non-commodity SWFs established by export-pushed countries);
- **competence and experience lags**: numerous SWFs are gradually embracing sophisticated investment management techniques such as the so-called "smart beta" (Wiśniewski 2015), yet their overall commitment to state-of-the-art risk-adjusted investment management is still limited (this factor has practical implications for the complexity of portfolio strategies).

As displayed in Figure 1.3, the growth of global SWFs has been broad-based, as the vast majority of SWFs either expanded or maintained asset sizes in 2013–2015. The dynamics of the SWFs industry attests to spectacular resilience amid the mixed fortunes of the global asset management industry since the advent of the new millennium. It has also been a function of the aforementioned SWF specific traits. Last year saw a slowdown in new SWF startups, as only one fund was de facto remodeled (Ireland's Strategic Investment Fund reestablishment from the assets of the National Pension Reserve Fund whose activity dates back to 2001, see Appendix 1).

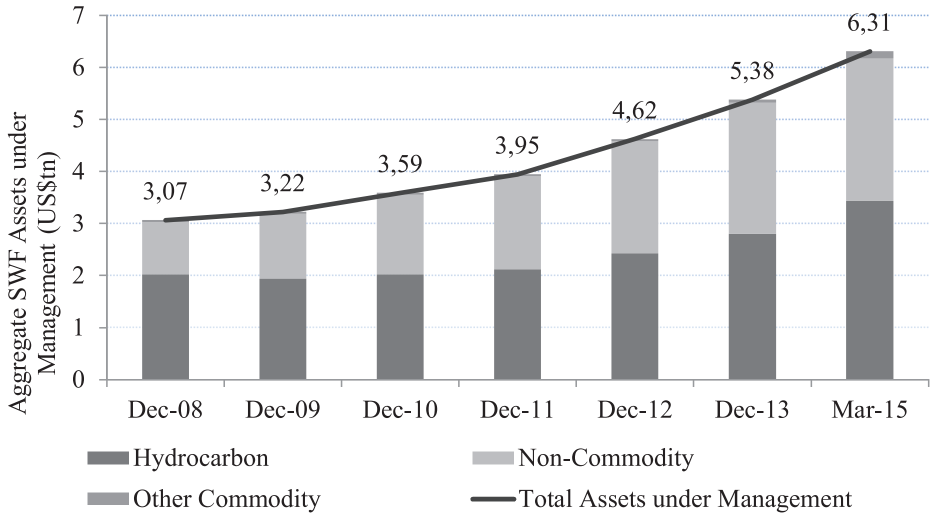

Figure 1.2. Aggregate Sovereign Wealth Fund Assets Under Management (USD in trillions), 2008–2015
Source: 2015 Preqin Sovereign Wealth Fund Review: Exclusive Extract available at: https://www.preqin.com/docs/reports/2015-Preqin-Sovereign-Wealth-Fund-Review-Exclusive-Extract-June-2015.pdf [accessed: 12.08.2015]. Note: the SWFs' asset under management total differs from that contained in Appendix 1 due to a different time period under survey and different sources used.

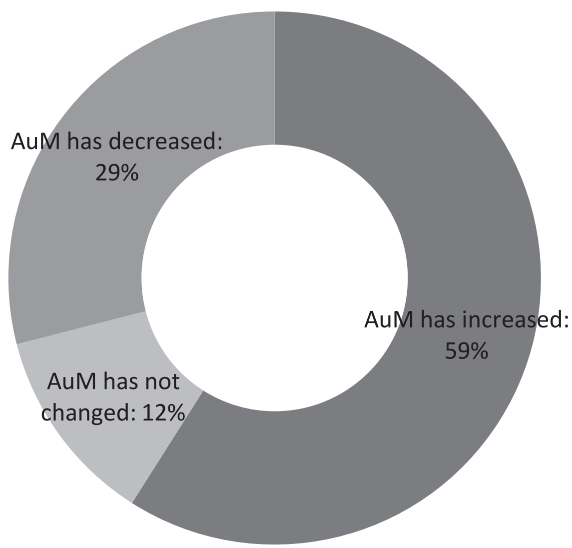

Figure 1.3. Change in Sovereign Wealth Fund Assets Under Management (AuM) 2013–2015
Source: 2015 Preqin Sovereign Wealth Fund Review: Exclusive Extract available at: https://www.preqin.com/docs/reports/2015-Preqin-Sovereign-Wealth-Fund-Review-Exclusive-Extract-June-2015.pdf [accessed: 12.08.2015].

Beyond the sheer scale of asset growth, it is by far more intriguing to examine the structural and regional compositions of global SWF investment activity (Appendix 2). Evidently, the investment portfolios of global SWFs are still dominated by traditional assets. Public equity (81%) and fixed income (86%) figure prominently in an average SWF's portfolio globally, however, "brick-and-mortar" alternatives, i.e. infrastructure (60%), real estate (59%) and private equity (47%) also account for large proportions of the holdings.

International disparities in the compositions of SWF portfolios manifest the following characteristics (Appendices 1 and 2):

- **North American SWFs are the most diversified** in their investment allocations (including substantial exposure to alternative assets), which attests to their expertise and pursuit of investment efficiency;
- **recently established SWFs** (Latin American and African) are relatively **risk averse** and centered on fixed income and public equity instruments with visibly lower (than global averages) emphasis on nontraditional assets;
- despite proximity to several globally competitive financial centers, **European SWFs** tend to be relatively **conservative** (concentrated around public equity and fixed income instruments) and show limited diversification (especially with regard to alternative assets);
- **Asian and Middle Eastern SWFs** are beginning to **emulate** their **North American** peers in respect to portfolio heterogeneity (with Asian SWFs displaying a slightly more pronounced affinity for hedge funds);
- given only a handful **Australasian SWFs** currently in operation, any far-reaching interpretations of their portfolio patterns would be unwarranted, yet the distribution of investment per asset class demonstrates a certain **routinization** of investment behavior (equal shares of all alternative asset categories).

The role of commodity importing emerging countries as SWF sponsors is rising in line with the general shift of power from West to East and is being accompanied by spectacular volatility in commodity prices: they have contracted across the board since April 2011 (Figure 1.4) and their growth prospects seem bleak (World Bank 2015).

Despite the aforementioned evolution of the SWF industry, hydrocarbon based funds still dominate the SWF scene (both in total asset under management and the number of fund operations). Non-hydrocarbon commodity SWFs

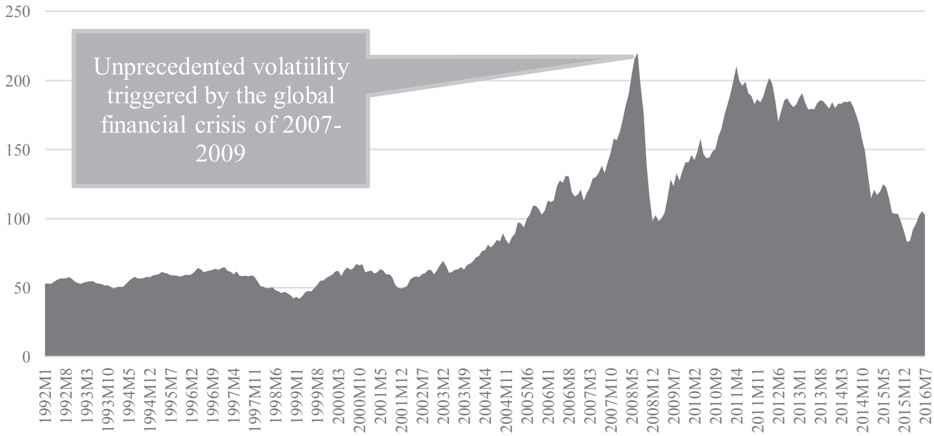

Figure 1.4. International Monetary Fund (IMF) Commodity Price Indices in January 2010January 2015
Source: IMF datasets available at: http://www.imf.org/external/np/res/commod/images/chart_lg.jpg [accessed: 31.08.2015].

remain negligible in global terms, especially by total asset volumes (Figure 1.5). Extrapolating from historical and current trends, it is safe to predict that non-commodity SWFs will outnumber and outweigh commodity based ones in the following decades, which will have widespread repercussions for the shape of SWF investment policies (the ebb and flow of new SWF assets will follow the economics of export capacity rather than commodity extraction).

SWFs reap plenty of economic benefits related to scale (e.g. revenue and cost synergies in a business where fixed, e.g. regulatory costs are soaring) thus their assets under management routinely outstrip USD 1 billion, although the asset accumulation process is usually protracted and follows the varying dynamics of export receipts (in view of the recent volatility of commodity prices). Contemporary financial markets are placing a large premium on hefty players in the asset management arena, yet according to our empirical findings in the case of global SWF assets there appears to be a “sweet spot” (between USD 1 billion and USD 9 billion) enabling the combined accrual of scale related benefits as well as mitigation of operating (investment due diligence, portfolio selection, political compliance) and industry specific (liquidity, regulatory, asset diversity) constraints (Figure 1.6).

Heavyweights from Asia dominate the global SWF landscape in respect to assets under management (coming out second only to SWFs from the Middle East and North Africa by the number of active fund

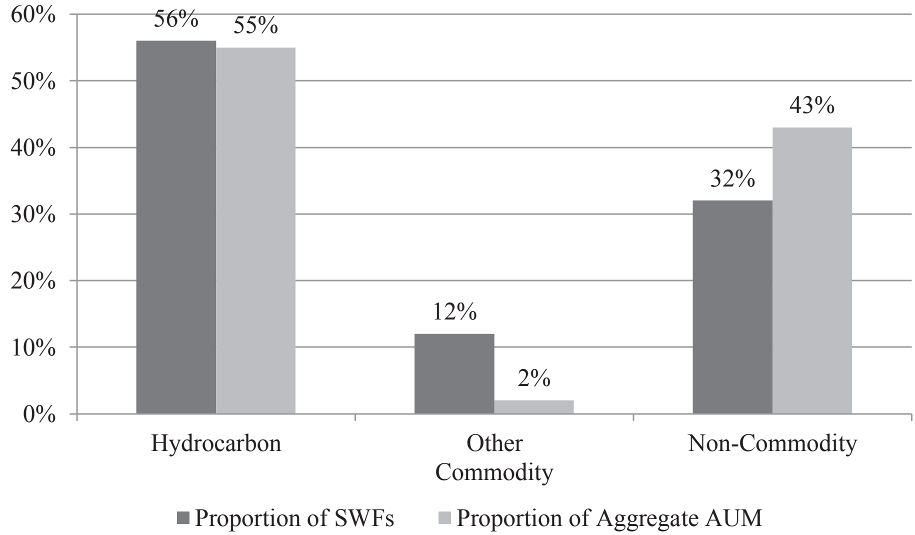

Figure 1.5. Breakdown of Sovereign Wealth Funds by Source of Capital in 2014
Source: 2015 Preqin Sovereign Wealth Fund Review: Exclusive Extract available at: https://www.preqin.com/docs/reports/2015-Preqin-Sovereign-Wealth-Fund-Review-Exclusive-Extract-June-2015.pdf [accessed: 12.08.2015].

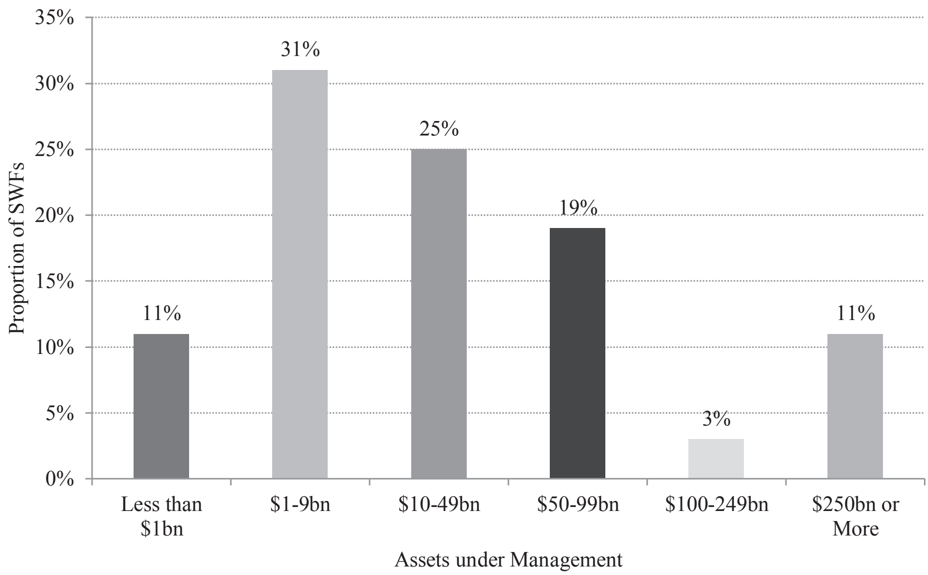

Figure 1.6. Breakdown of Sovereign Wealth Funds by Assets under Management in 2014
Source: 2015 Preqin Sovereign Wealth Fund Review: Exclusive Extract available at: https://www.preqin.com/docs/reports/2015-Preqin-Sovereign-Wealth-Fund-Review-Exclusive-Extract-June-2015.pdf [accessed: 12.08.2015].

operations). Europe, rallied around three major funds and spearheaded by the world's largest SWF (Norway's Government Pension Fund – Global), represents another significant area of SWF activity. North American SWFs (propelled by oil and gas revenues) rank at the bottom of the list of the world's leading SWFs (Figure 1.6).

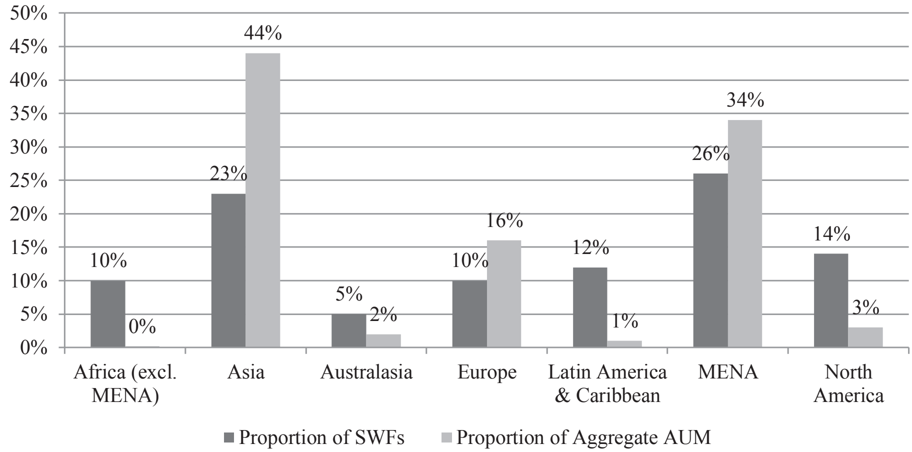

Figure 1.7. Breakdown of Sovereign Wealth Funds by Region in 2014
Source: 2015 Preqin Sovereign Wealth Fund Review: Exclusive Extract available at: https://www.preqin.com/docs/reports/2015-Preqin-Sovereign-Wealth-Fund-Review-Exclusive-Extract-June-2015.pdf [accessed: 12.08.2015].

Although global SWFs are not at the forefront of investment innovation (hedge funds or even certain mutual funds betray by far more ingenuity in asset allocation), they will be forced to adapt to the continued evolution of the asset management industry as well as to the increasingly unstable socioeconomic environment of their business. The following game-changers are likely to define the SWF industry for the years to come (cf. Preqin 2015):

- **declining commodity prices**: as mentioned previously, by varying estimates the prices of hydrocarbons are headed for long-term stagnation or moderate shrinkage, which will complicate SWF funding and put additional pressure on the ability to realize capital gains;
- **depletion of natural resources**: nonrenewable natural resources (still the predominant origin of SWF assets) will become harder or more expensive to exploit, which will also reduce SWF financing capacity;

- **liquidity constraints**: it is fair to assume that SWFs will be increasingly used to bail out distressed industries or companies in their home countries – to enable such aid, SWFs will have to preserve a liquidity margin (a share of assets easily convertible into cash – at the expense of risky and illiquid asset classes);
- **long-termism**: numerous recently founded SWFs are only beginning to formulate their default investment strategies. Once the socioeconomic and political underpinnings of their creation take their final shape, these SWFs will have the ability to take a longer view of their investment policy;
- **contrarianism**: the inherent long-termism of SWF investment activity offers them the unique advantage of breaking out of pro-cyclicality – a practical challenge to numerous asset managers benchmarked against single economic or stock market cycles;
- **use of alternative assets**: rising inter- and intra-asset correlations on global investment markets (Kolanovic 2011) make a persuasive case for a more vigorous approach to investment diversification: within and across asset classes – this trend will increasingly affect SWF asset allocation practices;
- **amalgamation and concentration**: evidently, the global SWF landscape is dominated by a handful of institutions (the top ten largest funds account for almost 75% of the total global assets managed by SWFs) – their future activity will gain momentum at the expense of smaller funds (which will most likely fall prey to business combinations and varying forms of integration).

Conclusions

At present, global SWFs represent the most powerful institutions among alternative asset managers. Their chronical opacity and ambiguous motives complicate any in-depth analysis of investment behavior and cast doubt on socioeconomic outcomes. Despite such limitations, it is clear that the global SWF industry is evolving toward less dependence on natural resource extraction, more interaction with domestic economies, intergenerational awareness, out-of-the-box investment strategy and market consolidation. Differences in portfolio allocation decisions by global SWFs are primarily driven by expertise and scale related factors and are liable to change as the competence and impact of newly established funds evolves. Transparency remains the primary objective of worldwide initiatives aimed at tracking the activity of global SWFs.

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Chapter 2

Political Significance of Sovereign Wealth Funds

Reflecting on sovereign wealth funds (SWFs) from the perspective of political science, one can perceive them as state-controlled entities that are instruments of state-sponsored foreign policy. As Gilpin (2001) noted, even in the context of "a highly integrated global economy, states continue to use their power […] to channel economic forces in ways favorable to their own national interests." SWFs, as investment arms of countries, can be obviously perceived as instruments of a statecraft.

The main aim of this chapter is to conceptualize the political significance of SWFs. The analysis starts from the concept of statecraft and its instruments. For the purpose of this work, the analysis is concentrated on foreign policy as an international dimension of the statecraft and explanation of the role of SWFs in this context. In the next part, the review of the academic discussion concerning motives behind the SWFs' activities with a central question about the importance of political ones is presented. Concluding that states through SWF investments can pursue their policy objectives both domestically and internationally, a review of concerns regarding SWF investments follows. Finally, the list of risks is presented that should be taken into account as long as SWF investments in the Central and Eastern Europe (CEE) are concerned.

2.1. Statecraft and the economic instruments of foreign policy

Statecraft has traditionally been defined as the art of conducting state affairs or all the activities by which statesman strive to protect cherished values and to attain desired objectives vis-à-vis other nations and/or international organizations (Sprout 1971). Generally, all agree that statecraft includes the domestic and international actions of a state and development as well as implementation of policy (Ping 2005, p. 13–17). However, the theoretical discussion about statecraft was vivid and different researchers employed different perspectives to describe "statecraft."

Baldwin (1985) in his classical "Economic statecraft" claims that in international relations statecraft could be understood as governmental influence attempts directed at other actors (both state and non-state) in the international system. In other words, it refers to "the selection of means for the pursuit of foreign policy goals." The techniques of statecraft are usually labelled as “tools,” “means” or “instruments” and all of these terms could be used interchangeably. In his approach, there is not much difference between instruments of economic foreign policy and economic statecraft.

The instruments of statecraft have been subjected to the taxonomies of numerous scholars. Hans Morgenthau (1964) reduced the tools of statecraft to two categories: diplomacy and war. However, it is hard not to agree with Ping (2005) who said that this dichotomy is too simplified to explain the breadth of possible alternatives within peace and war, nor does it acknowledge the fundamental difference between domestic and foreign statecraft.

Much more useful, a four-way taxonomy of the statecraft was presented by Baldwin (1985). He distinguishes propaganda (“influence attempts relying primarily on the deliberate manipulation of verbal symbols”), diplomacy (“influence attempts relying primarily on negotiations”), military statecraft (“influence attempts relying primarily on violence, weapons and force”) and economic statecraft that refers to “influence attempts relying on resources which have a reasonable semblance of market price in terms of money.”

The Baldwin classification, like any other, has its deficiencies. For instance, it is not clear how to classify the sale of military equipment. Should it be considered as economic or military statecraft? Depending on the particular case, circumstances or analytical approach one might decide to classify them either way. Due to the fact that each taxonomy has its “borderline cases” we should agree with Baldwin, who claims that their existence does not do serious harm to the value of the whole concept.

Following Baldwin’s approach we could define instruments of economic statecraft as all of the economic means by which foreign policy makers might try to influence other international actors. In this definition the focus is put on the implementation of state’s foreign policy, so consequently, the international dimension of economic statecraft could also be called “economic instruments of foreign policy.”

Analyzing instruments of economic instruments of foreign policy we can divide them into positive and negative or, in other words, persuasive and coercive. The former (collected in Table 2.1) are associated with attempts to promise or provide rewards, the latter (Table 2.2) with an attempt to threaten or punish.

Table 2.1. Examples of positive instruments of Economic Statecraft

Trade related	Capital related
Tariff discrimination (favorable)	Providing aid
Granting "most-favorable-nation" treatment	Investment guarantees
Tariff reduction	Encouragement of private capital exports or imports
Direct purchase	Taxation (favorable)
Subsidies to exports or imports	Promises of the above
Granting licenses (import or export)	
Promises of the above	

Source: (Baldwin 1985, p. 42).

Table 2.2. Examples of negative instruments of Economic Statecraft

Trade related	Capital related
Embargo	Freezing assets
Boycott	Controls on import and export
Tariff increase	Aid suspension
Tariff discrimination (unfavourable)	Deprivation of ownership (expropriation)
Withdrawal of "most-favored-nation" treatment	Taxation (unfavorable)
Blacklists	Withholding due to international organization
Quotas (import or export)	Threats of the above
License denial (import or export)	
Dumping	
Preclusive buying	
Threats of the above	

Source: (Baldwin 1985, p. 41).

The classification presented above is obviously not comprehensive. One of the elements that have to be added are foreign investments, both greenfield and capital. Nowadays, states, usually through state-owned entities such as SWFs or state-owned enterprises, invest abroad heavily. Consequently, acquisitions of foreign assets, or even promises of acquisition, are important positive economic instruments of foreign policy and the withdrawal of money or promises of withdrawal are negative instruments. SWFs, employed to use these tools, can be classified as "providers" of some instruments of economic statecraft.

2.2. Sovereign wealth funds and the foreign policy of the state

Sovereign wealth funds have attracted a lot of attention of economists but relatively little of political scientist. Even new and widely acclaimed books on foreign policy do not mention SWF (Alden, Aran 2011) or discuss it one sentence (Hill 2016). Among the very few works that presented SWFs as instruments of foreign policy, the book of William Norris (2016) seems to be the most comprehensive, however it is focused on China only. Therefore, one can say that SWFs have not been yet conceptualized as instrument of foreign policy or economic statecraft.

We should have in mind, that "sovereign wealth fund" is an umbrella term – the breadth and depth of differences in fund organization, management and strategic asset allocation make it probably impossible to establish a standard for the relationships across the whole industry. A fund's objectives could be as diverse as SWFs are, and varied from strategic and highly-politicized to purely financial ones. Murphy (2012) called it a "double bottom line" that manifests in two ways. In addition to earning excess financial return, funds benefit from increased political influence or furthering strategic interests of the sponsor's citizens.

Some SWFs own statements support this view, admitting that non-financial motivations influence their investment decisions (Hatton, Pistor 2012). Norway's Government Pension Fund – Global, the largest SWF to operate globally (SWFI Rankings, 2014) is the best example. The fund is permitted to invest in targets as long as they will satisfy predefined environmental, labor or transparency standards (Chesterman 2008; Clark, Dixon, Monk 2013). So a form of "ethical screening" is needed prior to the investment, which obviously can be classified as politically-biased and not market-driven behavior.

However, as convincing as the above presented way of thinking is, answering the question if SWFs pursue strategic goals along with financial ones has become one of the fundamental issues that has been examined by various researchers. Many scholars have endeavored to assess to what extent SWFs follow investment strategies driven primarily by financial efficiencies and to what degree they respond to political agendas. Interestingly, depending on methodologies and time periods applied, varying conclusions come to the fore.

In Balding's (2008) analysis of foreign and private equity transactions undertaken by flagship SWFs, pointed to an absence of non-economic investment motives. Balding thus construed SWFs' policies to follow the path of expected investment efficiency. However, he admitted that "while the evidence that sovereign wealth funds have acted historically as instruments of state power or in collaboration remains thin, the logic behind the fear is not irrational." Lixia Loh (2010) strongly argued that anti-SWF concerns arise mainly from the lack of understanding the role of SWFs and Loh's research showed no clear evidence of funds acting out of purely political motives. Epstein and Rose (2009) even advised to make a prudent default assumption that SWFs are market-driven, due to the lack of contradictory evidence. Such voices are, however, in the minority.

Most of the other researchers argue that SWF investment policies are not entirely driven by profit maximizing objectives but they give different explanations. Chhaochharia and Laeven (2008), analyzing SWF investment strategies, found that funds largely invest to diversify away from industries at home and predominantly in countries that share the same culture. That suggested that their investment rules are not entirely driven by profit maximizing objectives but have some political motivations behind them.

Knill, Lee and Mauck (2012) agreed that political relations play a role in SWF decision making. In their empirical study they claim that contrary to predictions based on the foreign direct investment (FDI) and political relations literature, SWFs prefer to invest in nations with which they have weaker political relations and behave differently than rational investors who maximize return while minimizing risk.

Clark and Monk (2012) defined SWFs as "long-term investors, whose holdings are selected on the basis of their strategic interests (fund and nation) rather than the principles of modern portfolio theory." In this definition they made an important distinction between the owner and the fund itself suggesting that sometimes the ruling elites of a country and its fund managers might have conflicting interests.

Hatton and Pistor (2012) in their very interesting paper also put attention on the role of ruling elites. In their work they observed that in political entities without electoral democracy, such as China, Singapore, Kuwait and Abu Dhabi, the overriding objective of SWFs is to maximize the gains of the politicians. They claim that SWF behavior can be explained by the "autonomy-maximization theory." In accordance with this theory the true stakeholders in SWFs are the ruling elites in the sovereign sponsor, and that as such, it is the interests of these elites that SWFs advance. To these elites, SWFs "serve as a valuable tool for protecting their interests." The first and foremost among these interests is maintaining their privileged position. Obviously this position is often very much dependent on domestic stability or the security of the state, so the activities of SWFs may serve a state's interests as well.

None of the existing characterizations can adequately explain the full range of observed SWF behaviors and there is no clear consensus in academic literature as far as the explanation of SWF investment strategies is concerned. Presumably any pan-industrial conclusions would be highly precarious to draw and the level of politicization is highly fund specific. The most convincing argument is presented by Manda Shemirani (2011), who claims that we should simply apply three different perspectives to the study of SWFs and that help us to explain the differences with respect to a funds' behavior. Firstly, SWFs can act as a tool in a state's foreign policy. Secondly, funds are a "metamorphosis of state-run business" and together with other state-owned or state-controlled entities they are instruments of states acting as a entrepreneur e.g. increase earnings and manage political risks. Lastly, SWFs serve for various types of "domestic compensation." A political leader might need, for instance, to provide compensation for their voters or supporters of the political regime in order to ensure continuity of their government. Another example is the need to manage macroeconomic deficiencies or bail-out some troubled institutions.

Following Shemirani's way of thinking we can assume that a behavior of a particular SWF is always a mix of those three motives. They are mixed in different proportions depending on the fund and may change over time. As she noted: "The SWF's goals can be multiple, changing, or even overlapping, in which case the critical question to ask is how the owner balances their various goals against each other." For example, states are faced with extreme external pressures, for example global recession may result in the abandonment of the main goal of a SWF and divert the fund's resources for coping with economic problems at home. This was the case with Russia. The economic troubles resulting from falling oil prices and the sanctions imposed on this country after its aggression on Ukraine, forced the Kremlin to fall back on the SWF's assets to shore up the cash-strapped national budget and wobbly Russian Ruble (Flood 2015).

Keynes said years ago that "international cash-flows are always political" (Keynes 1933) which today can support the view that when analyzing SWFs activities one has to presume there are political motives behind them. As Truman (2010) rightly observed "SWFs are political by virtue of how they are established, and by their nature are influenced to some degree by political considerations." This conclusion has resulted in distrust by Western policymakers about SWF intentions and implementing new, protectionist policies designed to minimize perceived SWF threats (Monk 2008). The types of concerns Western countries have are analyzed in the following subchapter.

2.3. Concerns regarding SWF activities

Concerns over SWF activities have been publicly voiced since 2007. In May 2007 information about the acquisition of stakes in Blackstone, an American investment fund, by Chinese SWF China Investment Corporation hit the headlines of all major newspapers (Arnold et al. 2007). The size of the transaction (USD 3 billion), provenance of the capital and rumors that the new Chinese fund is going to invest abroad USD 300 billion, made Westerners nervous and started a vigorous debate about the potential consequences of capital expansion by SWFs.

The most interesting observation, as far as consequences of SWFs rise in prominence are concerned, was made by Lawrence Summers who wrote in the Financial Times that funds "shake logic of capitalism" that used to be based on ongoing privatization (Summers 2007):

> The question is profound and goes to the nature of global capitalism. A signal event of the past quarter-century has been the sharp decline in the extent of direct state ownership of business as the private sector has taken ownership of what were once government-owned companies. Yet governments are now accumulating various kinds of stakes in what were once purely private companies through their cross-border investment activities.

His observation was later supported by Professors Gilson and Milhaupt (2008) who have characterized SWFs as "neo-mercantilist" institutions that use "company-level behavior" to maximize "country-level [...] economic, social, and political benefits."

That narration has been particularly widespread in the United States, where almost all agree that, as state sponsored actors, SWFs can be used by their mandators for politically driven purposes, potentially harmful for the US. Even Barack Obama, during his initial presidential campaign in 2008 commented: "I am obviously concerned if these... sovereign wealth funds are motivated by more than just market consideration and that's obviously a possibility" (Loh 2010).

However, just what are the main threats related to SWF activities? Truman (2010) enumerates five types of concerns, though some of them are shared by all government-sponsored institutions and do not exclusively relate to sovereign funds.

1. Mismanagement of investments by SWFs to the economic and financial detriment of the country with the fund.
2. Pursuit of political and economic power objectives via SWFs.
3. Exacerbation of financial protectionism inspired by SWFs.
4. The potential for financial turmoil and uncertainty associated with SWF activities.
5. Conflicts of interests between countries with SWFs and countries in which they invest.

The first concern primarily involves countries that are home to SWFs, so it is beyond the scope of our interests, but the other four deserve closer investigation.

Pursuit of political and economic power objectives via SWFs

Governments may use their SWFs to implement various political goals. Firstly, thanks to SWF investments states can increase their political influence in foreign countries. For example, the People's Republic of China using promises of SWF investment convinced the government of Costa Rica to sever diplomatic ties with Taiwan and establishing them with Beijing. According to La Nación, Costa Rica's largest newspaper, China's SAFE Investment Company bought USD 300 million in Costa Rican government bonds in two lots in January 2008 and January 2009 in return for this diplomatic move. That was kept in secret, however, the newspaper revealed this case and even won the lawsuit, defending their right to publish this information (Anderlini 2008; Norris 2016).

Another example of rising political influence comes from Europe. SWFs money started to be extremely attractive to European countries seeking investment in times of Eurozone crisis. Italy's finance minister, Giulio Tremonti, who was at first skeptical to what he called the "reverse colonization of Europe," in 2011 turned to cash-rich Beijing in the hope that Chinese SWFs would help rescue his country from financial crisis by making "significant" purchases of Italian bonds and investments in strategic companies (Dinmore 2011). Such behavior obviously put Italy in an unfavorable position vis-à-vis China.

The more SWFs invest in a particular country, the bigger the "threat of disinvestment" as a political tool. An announcement about the possible withdrawal of money from a particular market could be very useful to pressure foreign partners. In early 2008, Muammar Gaddafi threatened to withdraw Libyan SWF investment from African nations resistant to his idea of strengthening the African Union (Drezner 2008). In 2010, during the G20 meeting in the Korean city of Busan, Eurozone officials met powerful Asian investment groups and government officials who expressed concerns about Europe's financial woes and according to the "Financial Times" said "they would reduce or halt future purchases of Eurozone bonds unless something was done to allay the fears about Europe's banks." This declaration had an impact on European officials as in that very difficult moment the last thing that any debt-laden European government wanted were problems with selling bonds (Tett 2010).

Secondly, there is a threat that through SWFs foreign governments could take control over strategic industries or critical infrastructure. Alan Tonelson articulated this concern in his testimony in American Congress in 2008: "If, for example, the Chinese government held significant stakes in a large number of big American financial institutions, especially market-makers, and if our nation's current period of financial weakness persists, how willing would Washington be to stand up to Beijing in a Taiwan Straits crisis?" (Drezner 2008).

Not only the Chinese threaten Western analysts. For example, in 2007 an investment company owned by the Abu Dhabi government picked up an 8.1% stake in the American-based and second-largest maker of computer microprocessors. This investment has raised worries among politicians in Washington over increasing Arab-nation involvement in potentially crucial intellectual property in sensitive areas such as defense and technology (Wray 2007).

Another particularly vulnerable sector is energy. For such SWFs owners like China, foreign acquisition of energy companies is perceived as a strategic national interest and key issue for the energy security of a country. Host countries are naturally cautious about such investments (Sun et al. 2014).

Financial protectionism

Concerns associated with SWF activities stimulate many countries to impose new barriers to capital flows. New or improved regulations were introduced by such countries as the US (Lovery 2012), Canada (Safarian 2012) and Germany (Jost 2012). The European Union decided to avoid bringing legislative action at the EU level but proclaimed a special document (European Commission 2008) in which they recommend soft measures, such as non-binding guidelines, as a more appropriate response to the rising SWF activity in Europe. Consequently, the EU strongly supports the International Monetary Fund (IMF) initiative to prepare a set of rules that were voluntary agreed upon by owners of SWFs in 2008 and are known as "the Santiago Principles."

Protectionism is perceived by many observers as something principally negative because capital markets should remain open to foreign capital flows and direct investments. In the opinion of Robert Dohner, an American official from the Treasury, it is the most pressing concern that the proliferation of SWFs "could provoke a new wave of investment protectionism, which would be very harmful to the global economy" (USCC 2008). Kratsas and Truby (2015) presented academic proof that regulatory responses on SWFs are associated with the risk of becoming overtly protectionist and imposing unwanted costs on the global financial system.

Nevertheless, the author found no evidence that these newly erected barriers really cause harm to the financial system or stop the flow of SWF capital. We can presume that the relatively low number of SWF investments in Germany and comparatively large ones in the United Kingdom, is to some extent linked to the more open attitude of the British government and liberal law environment. Obviously the German law that allows the government to block SWF acquisition of large stakes in German companies that could "threaten

Germany's interests" may seems discouragingly arbitrary, but there is no proof that this is a reason behind the lower attractiveness of the German market for SWFs.

To conclude – the threat of protectionism is so far much more potential than real. For instance, Thatcher's (2013) comparison of German, Italian and French policy toward SWFs even proved that although all three countries have passed legislation regulating foreign equity investment, the provisions remain limited, and direct actions against have almost never been used.

Financial turmoil and uncertainty

The next concern related to SWFs is linked to their impact on financial market stability. There is a vivid academic discussion over the question whether SWFs contribute to capital market volatility or if they can act as market stabilizers. A few stylized facts can be derived from this ongoing debate (Wiśniewski, Kamiński, Obroniecki 2015).

Firstly, some SWF features make them natural market stabilizers. They are relatively large, highly liquid, long term orientated, not significantly leveraged, with a substantial appetite for risk, less sensitive to market conditions (than other institutional investors) and focused on global portfolio diversification in search for superior returns (Mezzcapo 2009). Due to such characteristics, SWFs can promote stability in the global financial market.

Secondly, companies tend to profit from SWF investments. Fernandes's (2009) research on SWF portfolio activities in 2002–2007 demonstrated that capital markets had placed a high premium on SWF co-investment (such a premium had reached 20%). Such favorable market reaction to SWF entry announcements confirm the findings of Kotter and Lel (2008), who found that SWF investments have a positive effect on a target firms' stock prices around the announcement date, although not in the long run.

Thirdly, SWFs generally follow investment practices of other established classes of institutional investors (such as public pension-, mutual- or hedge funds). Kotter and Lel (2011) suggested that SWF behavior mirrors that of other institutional investors in their preference for target characteristics and in their impact on target firm performance. Similarities to mutual funds were proved by Avendaño and Santiso (2012) who claimed that despite contrasts in portfolio allocation, the two types of collective investment schemes do not radically differ in their investment routines. These may suggest that SWFs behaviors are no riskier than other market players.

Fourthly, SWFs have the potential to play a stabilizing role on worldwide capital markets because they serve as the "buyers-of-last-resort" when markets are falling. Despite their heavy losses sustained during the global financial crisis (Kunzel et al. 2010), and the fact that during the liquidity crunch SWFs were used to provide liquidity for their home markets, the funds did not refrain from international lending. For certain cash-strapped companies in the West, they turned out to be veritable "white knights" – friendly investors that despite high risks moved to salvage distressed companies. Couturier et al. (2009) cite the example of Bank Barclay, which being on the verge of bankruptcy managed to attract funding from three Gulf SWFs (albeit on premium terms). In a broader context, the SWFs' readiness to invest counter-cyclically is per se a stabilizing factor.

Finally, there is no evidence of their destabilizing activities on the markets. Sun and Hesse (2009) even tried to prove the opposite – in their study they tried to prove that there was a significant destabilizing effect of SWFs on equity markets, at least in short-term perspectives. Obviously, they stressed that the assessment of the longer-term impact of SWF investments and their potentially stabilizing role will require more research but thus far SWFs have behaved responsibly.

The above mentioned arguments seems to prove that SWFs are not destabilizing as such. Their potential contribution to market turmoil depends on sponsoring states. In one set of circumstances a given SWF can contribute to financial stability but in another the very same SWF can foment the hostile political strategy of its state.

Conflicts of interests

Investments by SWFs also create clear possibilities of conflicts of interests between the funds, owners or managers of targeted companies as well as governments of the host countries. It is easy to imagine that a politically motivated fund invests in a company to be able to influence the management or gain access to privileged technological or military know-how. Sensitive information could be stolen and transferred to, for example, a state-owned enterprise that is a direct competitor. From the investor state point-of-view, losses from the investment in a foreign company can be balanced by additional gains in the domestic company. Apart from industrial espionage a hostile fund can also facilitate sabotage of critical infrastructure such as aqueducts or electric plants.

The above mentioned concerns are usually refuted by SWFs and some researchers on the basis of observation that funds tend to concentrate on long-term profits, buy minority stakes and are not interested in having some impact on the management of a company. In other words, SWFs are usually passive and not active investors (Fotak et al. 2013). However, this is not always the case. China Investment Corporation (CIC), for instance, whose president publicly said in 2008 that the fund does not want board seats and has instructions to take passive roles in its investments, has gained influence on the boards of four prominent companies (Koch-Weser, Hacke 2013). Some of them are operating in sectors perceived as sensitive or strategic.

On the board of the AES Corporation, a global power company, CIC installed Zhang Guobao, who was a high-level Chinese government official, former vice-chairman of the National Development and Reform Commission, the main planning agency. Such an appointment has to raise doubts about potential political motivations behind his activities.

Other companies with CIC representatives on the board were: Canadian Teck Resources, Shanduka Group from South Africa and Heathrow Ltd., the operator of London's biggest airport. Nobody has been caught red-handed but potential conflicts of interests between a foreign country, to which a member of board is subordinate to, the interests of the company and host country are clear. The absence of negative experiences does not remove concerns that the occurrence of abuses will only be a matter of time.

Conclusions

Diplomacy can and should be viewed through lenses of political interests of actors. SWFs are not independent political actors but only investment arms that a state can instrumentally use to pursue political and economic power. Therefore, the political significance of SWFs, its stabilizing or destabilizing inclinations, are a function of their sponsoring states. In one set of circumstances a given SWF can contribute to financial stability but in another the very same SWF can implement the hostile political strategy of its state. Consequently, it is instructive to analyze the manifest or covert interests and political strategies of countries exerting control over specific SWFs – and not funds as such.

SWF activities in the region could be potentially harmful only when the donor state were to demonstrate explainable interests in destabilizing the CEE states and when the scale of involvement were to be big enough. Unless the SWF owner does not have vital national interests in the region. The risk of hostile maneuvering via SWFs is limited. Due to this fact, all analyses of fund activities have to include an assessment of the political interest of their owners in a particular state or region.

As far as types of risks regarding usage of SWFs by sponsoring states are concerned we could point out three that seem to be particularly important from the perspective of CEE countries. Firstly, SWFs are convenient to use leverage on a host country. In fact, all CEE states have to actively search for foreign capital and investment promises from foreign financial institutions are very much welcomed. It provides space for political pressure from states behind potential investors. Secondly, SWFs could be used to exercise control over strategic resources or critical infrastructure. Taking into consideration many security threats for the countries in the region that come from energy or economic dependency from foreign countries (most notably Russia), further losing control over sensitive assets may be risky. Thirdly, through SWFs foreign countries could search for access to privileged technological and military know-how, facilitate espionage or sabotage sensitive enterprises. Market valuation of "crown jewels enterprises" of CEE states are usually relatively low, in comparison with the enormous capital gathered in the SWFs. Many of them are already privatized, with only minority stakes in governmental hands. That is why, they are vulnerable for hostile take overs.

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Chapter 3

The Competitiveness of Central and Eastern European (CEE) Financial Markets

The research seeks to gauge the global competitiveness of Central and Eastern European (CEE) financial markets. The assessment is made using quantitative and hybrid metrics of financial centre development while placing particular emphasis on competitiveness drivers relevant to the activity of global sovereign wealth funds (SWFs) in the CEE region.

Besides an introduction, the study contains sections dealing with: research methodology and objectives; quantitative, quantitative and hybrid metrics of financial market competitiveness and their significance for investment by global SWFs in CEE as well as initiatives aimed at securities market consolidation in the region. The findings lead to conclusions regarding the allure of CEE financial industries to global SWFs. The stylized facts contained in the research are appended by case studies based on selective CEE listed financial markets for which comparable datasets have been available.

Despite continued progress, the financial centres of CEE remain marginal from the pan-European (let alone global) perspective. Their peripheral stance is a legacy of communism which has stifled free enterprise (including capital markets) for almost half a century. Another constraint relates to scale and expertise – the fragmented securities markets of CEE find it difficult to rival their seasoned Western peers bolstered by larger, robust economies and drawing on extensive hands-on experience.

From the viewpoint of a single financial centre, the Warsaw Stock Exchange (WSE) stands out as the most diversified and liquid market, although its days as an independent entity might be numbered – amid a growing trend towards stock market consolidation. The stunted growth of CEE financial centres appears to be a major constraint in wooing global SWFs into the region. One of the remedies is consolidation via merger and acquisition (M&A) activity – already attempted under the auspices of the CEE Stock Exchange Group (CEESEG) and validated by close links (qualitative and quantitative) among CEE markets. Besides consolidating, the CEE financial markets should strive to upgrade the quality of socioeconomic environments in which their financial industries operate and to prioritize the advancement of technical and human infrastructure (prerequisites for attracting high-quality global investment institutions – including SWFs).

3.1. Research methodology and objectives

The methodology of the research combines the use of quantitative and qualitative competitiveness metrics. The former focus on trading magnitude and intensity in key market segments (equity, fixed income, financial derivatives), whereas the latter seek to synthetize instrumental factors (a selection of socioeconomic competitiveness rankings) and financial centre assessments (gleaned from external respondents). Numerous caveats should be attached to both approaches. They relate to the growing prominence of trading in over-the-counter (OTC) financial instruments (unaccounted for or underreported in official statistics), subjective biases in surveys (based on a sample of responses), misinterpretation of (positive or negative) synergies existing among the market segments, as well as idiosyncrasies affecting the activity of a single financial centre (difficult to benchmark across a peer group).

The ultimate objective of the study is to assess the "friendliness" of CEE financial centres to global SWF investments and to produce policy recommendations aimed at improving the investment climate of the CEE economies to global SWFs. Both goals have not been adequately addressed by scholars and policymakers to date – thus the study is a pioneering effort in this regard.

3.2. Quantitative drivers of a globally competitive financial centre

Financial centres can be judged in multiple ways. Traditionally, their competitiveness has been assessed using metrics embodying the breadth (diversity, heterogeneity, product selection (cf. Michie, Oughton 2013) and depth (volume, liquidity, capacity, cf. Sarr, Lybek 2002) of trading activity. In line with such assumptions, a globally competitive financial centre should offer a rich and comprehensive selection of investment opportunities needed to construct an efficient portfolio (Choueifaty, Coignard 2008d) while on the other hand, it should maximize the likelihood of seamless trade execution (both goals are of paramount importance to SWFs whose investment holdings are bulky, dispersed globally, and increasingly diversified by asset class and financial instrument). Such an approach, although intuitive in interpretation and methodology, has a few serious practical drawbacks:

- statistical misrepresentation: as over-the-counter (OTC) (usually unregulated and relatively opaque) markets gain traction in global finance, the magnitude of their activity (vs. listed markets) can be understated due to information scarcity (Nystedt 2004) – this constraint is particularly relevant to emerging economies where the bulk of trading is done on an OTC basis (owing to the relative underdevelopment of local public exchanges);
- globalization: the competitiveness of a single financial centre is critical, however, in view of the rising degree of globalization it is by far more important how a local financial system can interact with and leverage the functionality of other centres (cf. Walter 1998) – such a reservation applies directly to emerging markets whose socioeconomic progress is to a large extent a function of their openness to the external world;
- scale effects: small economies are at a clear disadvantage, as the broad infrastructure necessary to help nurture an internationally competitive financial centre is so significant that it can disproportionately favour large countries (World Economic Forum 2016) – this issue is further complicated by CEE's ongoing integration with the European Union (itself commanding several globally competitive financial centres operating across national borders);
- synergies (classical and reverse): the sheer size of segments making up a financial centre does not account for their linkage and the collective value (created or destroyed) in the process – there is no single metric that would adequately capture investment activity in any of the market segments (furthermore – their boundaries have blurred in recent decades).

In view of such limitations, a quantitative analysis of financial centre competitiveness should, ideally, encompass all major investment asset classes (group of investments that display similar characteristics) and their specific metrics. Among asset types routinely used by institutional investors are categories considered traditional (equity, bonds, cash and cash equivalents) and those deemed alternative (all non-traditional investments including: natural resources, commodities, real estate, infrastructure, intellectual property, financial derivatives, structured products, artworks, antiques, collectibles as well as hedge, private equity- and exchange traded funds) (CAIA 2016; Investopedia 2016).

In practice, however, information disclosure standards prevalent internationally further restrict the selection to the following publicly tradable categories:

- equity (turnover, number of trades, market capitalization, and number of listings) – this category demonstrates the extent and quality of global investors' commitment to corporate co-ownership (which can imply active or passive strategies with regard to company stock);
- bonds (turnover, number of trades, number of listings) – as a quasi-lending form of financing, the scale of investments in debt instruments underlies the perception of investors as to a favourable interplay between yields and creditworthiness with regard to corporate, municipal and sovereign debt;
- financial derivatives (notional turnover, number of contracts traded) – three major strategies predominate among investors in financial derivatives: speculation (seeking capital gains via active risk taking), hedging (mitigating the risk of volatility in asset prices) and arbitrage (exploiting pricing inefficiencies for particular assets or their combinations).

In the SWF context, the aforementioned asset classes can be entered into directly or through financial intermediaries (i.e. other asset management institutions). No matter how convoluted the investment strategies employed, the proposed quantitative assessment offers a snapshot of the financial centres covered.

Appendices 3–8 contain the aforementioned metrics for selective CEE markets (the Bucharest Stock Exchange, the Bulgarian Stock Exchange – Sofia, the Budapest Stock Exchange, the Ljubljana Stock Exchange, the Prague Stock Exchange and the Warsaw Stock Exchange). The appendices contain quantitative data on the three major asset classes (market segments): equity, bonds and derivatives with further specifics on order handling routines (e.g. electronic or manual) and collective investment schemes (e.g. Undertakings for Collective Investment in Transferable Securities, UCITS; Exchange Traded Funds, ETFs) used by the markets. The trading datasets also comprise information on market size, turnover and listing numbers for the specific segments covered. The following takeaways can be gleaned from the appendices:

- peripheral significance: despite lofty aspirations, the CEE market remain local in their outreach and are struggling to develop a supranational presence (internationalization of capital flows, attracting foreign issuers, supplying complex, multipartite professional services) – the fragmentation of CEE's markets does not seem to be working to the region's overall advantage;

- limited breadth and depth: the CEE economies have made great strides in cultivating their financial centres, yet most of them remain relatively undiversified and illiquid (the post-communist transition is lengthy) – additionally, the region's markets exhibit low penetration by modern and flourishing financial instruments (financial derivatives, ETFs and UCITS);
- consolidation: M&A activity is afoot (e.g. CEESEG) to improve the increasingly fragile economics of financial centres in the face of rising regulatory costs and rigor, falling fees as well as stiffening competition from non-CEE exchanges and multilateral trading facilities (MTFs) – consolidation among securities markets can occur both de jure (formal M&A alliances) and de facto (intense trading activity between or among individual markets);
- Warsaw's pre-eminence: the Warsaw Stock Exchange outranks the other CEE financial centres by most quantitative counts and exhibits unparalleled breadth of activity (cf. Gál 2015) – the Polish bourse is reaping scale-related and first-mover advantages (the largest EU member in the CEE peer group and a CEE pioneer to have embraced a liberally mined "shock therapy").

Judging by the quantitative metrics reviewed in this research, the CEE financial centres in general fail to deliver the diversity and liquidity necessary to accommodate large-scale investments of the world's leading SWFs – whose assets for the top ten institutions range between US$ 236.0 billion and 847.6 billion as at 30 April 2016 (SWFI 2016).

3.3. Qualitative and hybrid drivers of a globally competitive financial centre

As previously mentioned, quantitative metrics of financial centre competitiveness based on the intensity of financial activity do not fully capture the holistic aspect of what underpins a globally recognizable financial environment. Usually, qualitative (or hybrid) competitiveness drivers are incorporated to demonstrate a more comprehensive approach. Numerous variables make up such methodologies, yet their essence comes down to effective, albeit nonintrusive, regulations, ease of doing business and the existence of investment friendly social factors (Securities Industry Association 2008).

Open and fair financial markets with particular emphasis on legal remedies available to minority stockholders in the event of abuse, are of paramount importance as financial institutions, let alone individuals, usually play this role (cf. Rose 2014).

Free flow of capital and a convertible currency matter to financial investors as they facilitate effective investment repatriation by international institutions and individuals and help minimize transaction costs (cf. Odonnat 2008).

The availability of a skilled workforce and flexible labour laws help supply local talent and downsize hire/fire costs. It is noteworthy that emerging markets globally face a shortage of adequately trained staff while the complexity of financial products and services continues to grow. For some emerging markets it is possible to reclaim some of the foreign-educated talent to their own advantage (Giannetti, Liao 2013).

The use of a globally familiar language simplifies business interaction; clearly, countries where English serves as an official language or where it is widely spoken have an edge over those whose official tongue is of merely local or regional significance (Madden, Wan Nursofiza 2015).

A fair, transparent, efficient legal and regulatory regime, on the one hand, offering remedies in the event of contractual breaches, while, on the other hand, not materially distorting commercial activity, sets the stage for a predictable and well-oiled corporate governance environment.

Not only do sound and fair tax levies represent a sizable cost of doing business, yet the need to mollify a fickle fiscal regime results in risk exposure which is difficult to quantify, mitigate and can undermine commercial rationalism. With the leeway existing in the European Union regarding national tax systems, fiscal competition plays a particularly vital role.

Implementation of international standards and best practices (e.g. IOSCO and BIS): in an era of rising corporate, social responsibility and transparency shows the extent to which financial institutions and sectors are able to demonstrate compliance with international best practices, which can be viewed as a precious intangible.

A low cost of doing business (minimal "red tape" and bureaucratic inertia, etc.) helps preserve a healthy balance between requisite regulatory rigour and friendliness to businesses and businesspeople.

Although standards of technical infrastructure only indirectly affect financial businesses and individuals, they can often prove decisive in decisions to undertake or maintain financial activity in a given locality. Besides any infrastructural improvement needs lasting financial commitments which is hardly achievable by emerging economies.

Any volatility in government political and economic decision-making complicates current and future activity in the financial space, especially if such decision-making strays from rationality. That is precisely why the political environment of financial markets ranks atop of the competitiveness criteria vital for global supremacy among such centres.

Although valuable insights can be derived from a cross-sectional analysis of quantitative measures showing financial competitiveness, there is infinitely more to the competitive power of a financial centre than the sheer scale of its business. In practical terms, some centres can be viewed less favourably than their proven financial fundamentals, while some can punch far above their weight. This phenomenon tells us that competitive factors surrounding a financial centre are often difficult to categorize and quantify. Arguably, the Global Financial Centres Index (GFCI) pioneered by the British think tank Z/Yen (Z/Yen 2015) stands out as the most comprehensive and advanced way of integrating quantitative and qualitative competitive factors into a synthetic metric of financial centre competitiveness.

The GFCI's methodology is based on a "factor assessment model" that uses two distinct sets of input (Z/Yen 2015):

- "instrumental factors: objective evidence of competitiveness was sought from a wide variety of comparable sources. For example, evidence about a just and reliable business environment was drawn from a corruption perception index (supplied by Transparency International), an ease of doing business index (from the World Bank) and an operational risk rating (from the EIU). A total of 105 instrumental factors were used in GFCI 16. And all financial centres are represented in all the external sources, and the statistical model takes account of these gaps.

- financial centre assessments: by means of an online questionnaire, running continuously since 2007. In GFCI 16, 29,226 financial centre assessments were drawn from 3,633 respondents."

It is noteworthy that several CEE financial centres were ignored by the GFCI for a variety of reasons (the most important of them are limited institutional transparency and inadequate statistical significance – a function of negligible impact on worldwide financial markets). The six CEE markets making up GFCI 16 comprised: Prague (the Czech Republic), Warsaw (Poland), St. Petersburg and Moscow (Russia), Budapest (Hungary), and Tallinn (Estonia).

Figure 3.1 illustrates the fortunes of the selected CEE emerging markets throughout the surveyed period (March 2007–September 2014), which corresponds to the 16 editions of the study. Several conclusions can be drawn from the trajectory of competitiveness for the CEE financial markets, however, among the most striking features are:

- intra-CEE correlations: all the CEE financial centres under survey demonstrate an astonishing degree of correlation, which argues for homogeneity in the approach to the region from the perspective of financial industry competitiveness – despite disparate tempos of macroeconomic growth and convergence with more established EU members, most CEE economies continue to be put in the "emerging Europe" investment basket (MSCI 2016);
- high volatility (especially mid-crisis): the CEE financial centres exhibit heightened risk (measured by GFCI score volatility), which spiked far above the worldwide GFCI average during the global financial crisis of 2007–2009 (cf. Kern 2010) – the CEE emerging economies are still viewed as risky bets and in times of global economic turbulence suffer a flight of speculative capital (Kurnyaeva 2012);
- role of non-quantitative ("soft") factors: as with other global financial centres, quantitative drivers of financial centre competitiveness only partially explain the standings of individual centres, as qualitative determinants play a pivotal role (Bourse Consult 2013) – e.g. Warsaw's rankings are held back by such factors – many CEE economies continue to benefit from sustained investments in diverse elements of technical and human infrastructure accomplished in the communist era and their subsequent commercialization following the fall of communism;

- global underperformance: despite ongoing convergence with modern financial industries worldwide, CEE GFCI scores are still lagging behind the global average, which is a legacy of backwardness from the communist era and the high tempo of growth by financial capitalism globally (often labelled as "financialization").

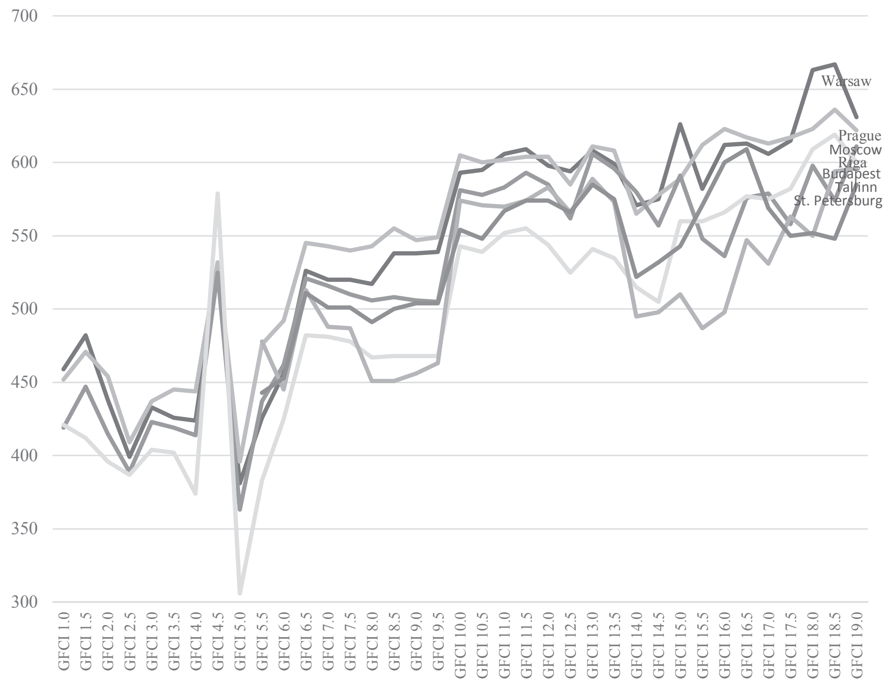

Figure 3.1. Global Financial Centre Index (GFCI) Scores for: Prague, St. Petersburg, Budapest, Moscow, Tallinn and the Average (worldwide) GFCI Score for March 2007 (GFCI 1)–September 2014 (GFCI 16) Source: Long Finance website (the GFCI Over Time online interface): http://www.longfinance.net/programmes/financial-centre-futures/gfcigraph.html [accessed: 1.09.2015]. Note: GFCI Editions 1–16 covered the 84 most representative financial centres worldwide.

3.4. The competitiveness of CEE financial centres and its significance for SWF investment activity

Given the limited clout of the existing Russian SWFs in global terms (US$ 152.20 bn of aggregate assets under management shared among three funds, thereby representing 2.09% of the global SWF asset total as of April 2016) and their recent self-absorption (the SWFs have been compelled to prop up the increasingly frail Russian economy in the wake of international sanctions imposed after the Russian military intervention in Ukraine), the activity of global SWFs in CEE can be narrowed to foreign i.e. non-CEE SWFs' investment allocations to the region. Therefore, CEE's ability to offer a globally competitive socioeconomic environment is instrumental in wooing further inward investment by SWFs into CEE.

In this context, it is worth revisiting the hallmarks of SWFs investment activity:

- scale: SWFs top the rankings of global alternative investment institutions by assets under management – followed by private equity-, exchange traded-, and hedge funds (Bardalai et al. 2015), as such they have to allocate their portfolios in a way that would safeguard enough liquidity to accommodate large-scale transactions;
- long-termism: SWFs are long-term investors whose competitive edge lies in their ability to wait out protracted macroeconomic cyclicality in the pricing of asset classes (Bolton et al. 2012) – this trait implies exposure to macroeconomic and political risks in the host countries and the need to mitigate them (through pre-transaction due diligence and hands-on portfolio management);
- diversification: in an era of soaring inter- and intra-asset correlations, SWFs need to diversify their investment portfolios more vigorously across an ever broader array of asset classes and individual instruments (Aït-Sahalia, Xiu 2015) – this necessity sways SWFs towards financial markets offering sufficient investment variety;
- risk adjusted efficiency: as the current yields of fixed-income instruments are at record lows and the outlook for other (traditional and alternative) asset classes remains mixed, SWFs are increasingly inclined to pursue investments providing a favourable risk/reward mix (Wiśniewski 2015) – this pursuit is even more important for fuel-based SWFs (squeezed by the price erosion of their exports).

It is to what extent the CEE financial markets are able to deliver on these priorities related to the activity of global SWFs that will determine the future course of investment by this largest class of alternative investment management in the region.

3.5. CEE Stock Exchange Group as an example of business amalgamation

The CEE Stock Exchange Group (CEESEG) is a holding company currently comprising the stock exchanges of Vienna (Austria) and Prague (Czechia). The holding company, emerged as the outcome of business combinations of CEE stock exchanges by the Vienna Stock Exchange after the collapse of communism in CEE. The group is the largest stock exchange alliance to emerge thus far in all CEE and its strategy is aimed at deriving regional synergies from the individual CEE markets (whose independent expansion might be hampered by scale-related constraints). Among synergies envisaged as part of the consolidation drive is the home-market principle whereby the needs of small and medium capitalization issuers are best met by local exchanges.

While each member continues to support its local market under independent management, at the international level, the alliance acts as CEE Stock Exchange Group v all major professional market participants (which provides more bargaining power in cost negotiations). Additionally, both CEESEG members are engaged in numerous initiatives to raise the visibility of the alliance and to attract the attention of institutional investors, trading participants, data vendors and index licensees to CEE. Both exchanges profit from close cooperation and know-how transfers as well as from joint coverage of the CEE region.

The bipartite bloc has emerged as a result of complex M&A activity in CEE. In 2015, CEESEG adapted its business model to the changed market environment and disposed of its former stakes in the Budapest and Ljubljana stock exchanges. In order to ensure sustainable competitiveness, the group decided to shift from direct investment to co-operation in data vending, index licensing and information technology services spanning twelve other stock exchanges in CEE. These synergy effects and the common brand make it possible for the local markets to enhance networking with international customers.

3.6. CEE financial centres' reform agenda

Plenty needs to be done to upgrade the economic environments in which the CEE financial industries operate. Such reforms need to embrace both aspects directly relevant to the process of allocating investments and broader settings of the financial marketplaces. Among the reform initiatives that would help to raise the competitiveness of the CEE financial centres are: smart deregulation, globalization, improvements in infrastructure and a stronger domestic capital base.

The CEE financial industries have been erected on the ashes of communism, however, vestiges of the command economy linger on (they are usually tied to state interventionism) – the CEE financial jurisdictions should strike a delicate balance between the need to safeguard a responsible and transparent doing-business environment and much-needed liberalization. A gentle, yet persuasive regulatory touch appears to be the answer.

The CEE economies and financial industries would benefit enormously from increased exposure to global capital flows – this can be achieved via deregulation and openness to foreign capital (both of which are hallmarks of intense globalization).

Despite an extended payback, advanced infrastructure is a sine qua non for developing an internationally competitive financial centre – infrastructural investments are exceptionally cumbersome for emerging markets whose budgets often operate on a shoestring, however, lasting and material commitments to this area are considered particularly beneficial for the breadth and depth of financial markets.

Finally, the strength of domestic financial institutions determines financial market stability in the event of foreign capital flight and helps reduce market volatility (systemic risks). This is the reason why even globally minded financial centres need to nurture their home capital base – not only to provide easily accessible investment opportunities to local clients, but also to render the domestic financial market more competitive in risk-adjusted terms.

Conclusions

Despite brisk expansion, successful restructuring and ongoing convergence with developed European countries, the financial markets of CEE continue to trail their more experienced European peers. Besides the lingering legacy of communism, the CEE financial industries face other serious challenges related to limited scale, inadequate globalization, lack of domestic financial resources and institutions as well as obsolete infrastructure.

These weaknesses constrict the potential for more SWF investment in the region. SWFs, as the most powerful player among alternative asset managers, seek efficient, abundant and liquid capital markets to accommodate their increasingly sizable and diversified portfolios. Given the interdependence of global financial markets, investment exposure to CEE investment assets can be developed indirectly: using more advanced financial centres, which is the case for most SWFs involved in CEE.

To overcome such constraints and attract a high-quality, value-adding institutional investor base (including a more conspicuous SWF presence), the CEE financial centres need to work out strategies consistent with national priorities, which will help ensure the commitment to and continuity of further socioeconomic reforms.

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Chapter 4

An overview of Sovereign Wealth Funds' (SWF) investments in Central and Eastern Europe (CEE)

This chapter presents an overview of the investments made by Sovereign Wealth Funds (SWF) in Central and Eastern Europe (CEE), defined in this paper as the region encompassing the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia. The following analysis considers all investments made by the funds as of the end of July 2014 and is based on data from the Sovereign Wealth Fund Institute Transaction Database, the Sovereign Wealth Center and government official information. The aim of the chapter is to make an introduction to the following parts of this paper and to allow to estimate the potential political risks stemming from SWF investments.

The chapter presents first the total value of the SWF investments in CEE as calculated based on available information together with an estimate of the value of the investments whose values remained undisclosed as of the writing of this paper. Second, it outlines which countries' SWFs have invested in CEE in order to see the main geographical origins of the investments. Third, it presents the countries targeted by the funds in order to see the directions of the investments. Fourth, it analyses the sectors targeted by SWFs in CEE and provides a broad comparison with the funds' global preferences in terms of sectors.

4.1. The relatively insubstantial value of SWF investments in CEE

Based on the above-mentioned sources, the total value of SWF investments in CEE may be set at around USD 8.5 billion. This value would therefore amount to around 1.0% of global SWF investments since the 1970's (as reported by the Sovereign Wealth Fund Institute). However, it may be justified to exclude investments in treasury bonds from this calculation: first, because these are not taken into account by the Institute in its database and second, because there is no publicly available information regarding other SWF investments in these assets in CEE, which makes the comparison less accurate. Taking this under consideration, SWF investments in CEE would amount to less (as the Database does not take into account some of Norway's Government Pension Fund – Global equity investments, while the analysis in the present chapter takes into account all the funds' recorded investments in CEE) than 0.4% of their global investments in the above-mentioned period. Annex 1 lists sovereign wealth funds' investments in CEE over time.

The above-mentioned value of SWF investments in CEE does not take into account investments whose values have not been disclosed. In order to estimate the funds' total exposure to the region it is possible to make the following assumption. First, Abu Dhabi Investments Authority's (ADIA) total investments in CEE amount to USD 307 million (the missing value of one of the investments is estimated at USD 51 million, the average of the fund's other investments in CEE). Second, China State Administration of Foreign Exchange's (SAFE) and Qatar Investment Authority's (QIA) investments in the real estate sector are each considered equal to the median value of SWF investments in real estate in CEE (around USD 39.5 million). Third, the value of the Government of Singapore Investment Corporation's (GIC) investment in the financial sector is estimated at the median value of investments of other SWFs in this sector in CEE (approximately USD 49 million). Finally, in the case where an information aggregates broadly a fund's investments in a variety of sectors (without providing tangible information as to the fund's exposure to each of these sectors) the value of the investment is divided by the number of sectors. Taking into account these estimates, the total value of SWF investments in CEE would amount to around USD 8.9 billion.

SWF exposure to CEE may be well considered as relatively insubstantial (Wiśniewski, Kamiński, Obroniecki 2005). In fact, based on the World Bank's data, the share of the gross domestic product of only the region's biggest economies (the Czech Republic, Hungary and Poland) in the world's gross domestic product in 2014 is bigger (around 1.1%) than the share of SWF investments directed toward CEE countries (around 0.4% excluding the investments in Treasury bonds, as mentioned above). Furthermore, the value of SWF investments in CEE may also seem relatively limited considering that the region has been very dynamic from an economic point of view with growth rates significantly exceeding the growth rates of other European economies in the last decade. This chapter will therefore aim to inquire into the possible reasons for these relatively low investments by presenting them and analyzing their specificity.

4.2. The specificity of SWF investments in CEE

An analysis of the list of investments shows that Norway's Government Pension Fund – Global's (GPFG) has accounted for 72.4% of all SWF investments ever made in CEE, with almost three-fourths of the funds being invested in governments' treasury bonds. Excluding the investments in Treasury bonds, Norway's SWF would still account for almost half of all SWFs investments in CEE. In terms of investment value and based on available data, Chinese funds would rank second with approximately 18% of the investments, followed by Kuwait, Singapore, the United Arab Emirates, Oman and Qatar (there is no data regarding the value of the latter's SWF investments in CEE).

The disproportion between the level of Norway's SWF's and other funds' investments raises the question whether it is due to the high interest of GPFG in CEE or rather to a lack of interest of other SWFs in the region. It is also necessary to bear in mind that such a disproportion may skew the analysis of SWF investments in the region (for example concerning the geographical and sectorial preferences of SWFs in CEE, analysed further in this paper). Table 4.1 below presents a breakdown of SWF investments in CEE by geographical origin of the funds.

Table 4.1. Geographical breakdown of SWF investments in CEE

Country of the Acquirer Entity	Value of investments (USD m)	Value of investments (excluding investments in T-bonds, USD m)	Share of total SWF investments in CEE (%)	Share of total SWF investments in CEE (excluding investments in T-bonds, %)
Norway	6,160	1,629	72.4	44.7
China*	1,000	667	12.1	18.3
Kuwait	421	421	5.1	11.6
Singapore*	563.22	563.22	4.0	15.5
United Arab Emirates*	255.73	255.73	3.1	7.0
Oman	108	108	1.3	3.0
Qatar	n/a	n/a	n/a	n/a
sum	**8,507.95**	**3,643.95**		

* Excluding investments whose value and nature were not disclosed.

Source: own calculation based on sources listed in Annex 1.

In terms of the geographical destination of SWFs investments in CEE, around two-thirds of the investments were directed toward Poland, the biggest economy in the region, almost a third of the assets was invested in the Czech Republic and Hungary and only around 5% of the assets was invested in Slovakia, Lithuania and Estonia (with no investments in Latvia). Such a focus on the biggest economies in the region is even more obvious after excluding investments in treasury bonds: Poland, Hungary and the Czech Republic taken together were the target of almost the entirety of the investments. It is also worth to underline that besides Norway's fund, other SWFs did almost not invest outside the three above-mentioned biggest CEE economies. As a matter of fact, GPFG is the only SWF that has invested in both Lithuania and Estonia. This may help to answer the above-mentioned question regarding the reason for the low investments of SWFs other than GPFG: SWFs may prefer to settle with investing in only the biggest and the most liquid markets in the region, namely Poland, Hungary and the Czech Republic and avoid investing in the relatively less liquid markets, most probably due to a risk aversion toward the region. This is summed up in Table 4.2 below, which presents the values of SWF investments in CEE by country.

Table 4.2. SWF investments in CEE by targeted country

Country of the Target Entity	Value of investments (USD m)	Value of investments (excluding investments in T-bonds, USD m)	Share of total SWF investments in CEE (%)	Share of total SWF investments in CEE (excluding investments in T-bonds, %)
Poland*	5455	2296	64.1	63.0
Hungary	1,330.22	1,007.22	15.6	27.6
Czech Republic	1,325	321	15.6	8.8
Slovakia	287.73	0.73	3.4	0.0
Lithuania	94	3	1.1	0.1
Estonia	16	16	0.2	0.4
Latvia	0	0	0.0	0.0
sum	**8,507.95**	**3,643.95**		

* Excluding investments whose value and nature were not disclosed.

Source: own calculation based on sources listed in Annex 1.

Concerning the sectors most frequently targeted by SWF investments in CEE, the financial, real estate, energy, telecommunication and infrastructure sectors have accounted for ca. 70.5% of all SWFs' investments in CEE. This corresponds broadly to the funds' top preferences in their global investments (based on the Sovereign Wealth Fund Institute data, the above-mentioned sectors' share in the total investments amounted to around 69% of the global investments), thereby proving that SWFs have kept an overall similar investment strategy both in their CEE and in their global investments. This is also confirmed when looking at the investments in the real estate sector alone. However, one may notice some important differences when looking at the exposure to some individual sectors. On the one hand, although the financial sector was the most solicited in the case of both the global and the CEE investments, the share of the investments in this sector in the total CEE investments was significantly lower than the share of these investments in the global investments. In their CEE investments SWFs have also invested proportionally less of their funds in the consumer product, industrial and materials sectors than they have globally. On the other hand, SWFs have invested proportionally more of their funds in the telecommunication and healthcare sectors in CEE than globally. This is summed up in Table 4.3 below, which presents and compares the breakdown of the funds' investments both globally and in CEE in terms of targeted sectors.

Table 4.3. Breakdown of SWF investments by sector, globally and in CEE (excluding investments in T-bonds)

Target sector	Share of SWF total investments in CEE (excl. investments in T-bonds) (%)	Share of SWF global investments (%)
Financials*	17.3	29.0
Real Estate*	14.5	14.5
Energy	12.3	10.3
Telecommunication and satellite communication	10.3	4.3
Infrastructure	16.1	10.5
Healthcare	10.0	3.2
Industrials	4.2	7.0
Consumer products	4.0	8.9
Materials	1.4	7
Other	9.9	6.0
Standard deviation	**5.3**	**7.4**

* Excluding investments whose value and nature were not disclosed.

Source: own calculation based on sources listed in Annex 1 and the Sovereign Wealth Fund Institute Transaction Database.

An important point to underline is the fact that the standard deviation of the share of each of the sectors in the total value of investment is even higher in the case of the global investments (7,4%) than in the case of the CEE investments (5.3%), which means that the SWF investments in CEE are more equally distributed in terms of sectors than the SWF global investments. However, it is once again important to bear in mind that the analysis may be skewed by the high proportion of Norway's fund's investments in CEE, especially as based on the list of the investments in Annex 1 GPFG is also the fund whose investments are the most diversified in terms of sectors.

Conclusions

SWFs remained relatively cautious toward investments in CEE and saw relatively few attractive investments opportunities in the region. This may be attributed to a risk aversion toward the region and an unwillingness to invest in relatively less liquid markets.

First, as the analysis above has shown, in the analysed period Norway's SWF was responsible for the bulk of SWF investments in CEE (even excluding the fund's investments in Treasury bonds), while the level of investments of other countries' funds in the region was significantly lower. The analysis of SWF investments in CEE must therefore take under consideration this predominance of GPFG investments.

Second, concerning the geographical destination of their investments in CEE, SWFs did not diversify much their investments and focused mostly on investments in the Czech Republic, Hungary and Poland, the region's biggest economies. This concerns also Norway's SWF, although it is important to mention that GPFG is the SWF that has invested in the largest number of CEE countries among all SWFs.

Third, although SWFs demonstrated an overall more equal sectorial distribution in their CEE investments than in their global activity (they focused less on specific sectors and, for example, devoted proportionally much less of their funds to the financial sector), besides Norway's fund many SWFs did not diversify much their investments and some of the SWFs (especially some Middle East funds) have focused almost exclusively on investments in the real estate sector.

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Chapter 5

Untapped Instrument.
Sovereign Wealth Funds and Chinese policy toward the Central and Eastern European countries

This chapter aims at looking at the role of Sovereign wealth funds (SWFs) in China's policy toward Central and Eastern European (CEE) countries in the 21st century, especially since the enlargement of the European Union (EU) in 2004. During this time, we could observe an increase of Chinese interest in the region resulting in growing trade, investments and number of contacts on all levels. China has used a wide array of different instruments to achieve its goals in the region: from a big political project such as the "16+1 format" to an unprecedented frequency of contacts between Chinese provinces and their European counterparts (Kaczmarski, Jakóbowski 2015). Despite a visible growth of economic ties, Beijing presented a very limited will to use investments as a political instrument. Even if Chinese investments in CEE are booming, they are possibly less politically biased and more market-driven than those in other developing countries, like African ones.

The Chinese investment pattern is also different than in the old EU member states (EU-15). Although, similarly to the Western Europe, China's strategy mainly involves purchasing existing companies, rather than making large greenfield investments (Jakóbowski 2015), Chinese foreign direct investments (FDI) are more greenfield than merger and acquisition (M&A)-oriented. Also strategic alliances have been much rarer in CEE than in the EU-15. Jacoby (2014) claims that this may prove that the Chinese in CEE are motivated more often by market access and less often by gaining access to technology and management practices, both of which are more available through M&A and/or strategic alliances with local firms. Such an approach of the Chinese could explain the very limited engagement of SWFs, which obviously are not interested in greenfield investments. This, however, raises the question about the role of the Chinese SWFs in CEE? Are they going to increase their engagement in the region together with maturing economic ties between China and the region? Could they serve as a convenient instrument of political pressure on CEE countries?

This chapter starts with an overview of Chinese policy toward CEE, its motivations, goals and methods. Then Chinese SWFs investments in CEE are presented against a background of their activities in the whole EU and the fact, that they are perceived as politically-biased. At the end, an analysis of the potential role of Chinese SWFs in the region and the risks linked with it is conducted.

5.1. Background of China-CEEC relations

While China traditionally has had friendly relations with Central and Eastern European countries, dating back to the establishment of the People's Republic of China in 1949, they were highly dependent on the overall state of China-Soviet relations. This resulted in almost three decades of practically frozen cooperation after a period of intensified and comprehensive relations during the 1950s. This fact, as well as internal difficulties in China, i.e. the Cultural Revolution, meant that the full potential of China-CEE relations could not be realized during the Cold War period. On the Chinese side, this historical legacy was also visible in the fact that CEE affairs were treated by state agencies together with Soviet issues, and geographically put together as Eurasian Affairs.

The end of the Cold War, the democratization and economic transformation of CEE countries opened new chapter in China's relations with the region. Unfortunately, the abovementioned processes coincided with internal problems in China. 9 June 1989 became a symbol in this matter, as it marked the subversion of the student protest in Tiananmen Square and the first semi-free parliamentary elections in Poland since World War Two. Although mutual interest did not disappear completely, the period immediately after 1989 was marked by a lack of trust between China and the newly democratized Central European countries.

China first tried to build its position in the region in the 1990s, but at that time cooperation with China was often used in internal political disputes. Many former democratic opposition members in CEE countries criticized, on moral grounds, post-Communist politicians who at that time were more eager to develop friendly relations with Beijing. On the other hand, one has to remember that in the last decade of the 20th century both sides had other political priorities than the development of China-CEE relations. Notably, in the CEE countries it was the EU and NATO accession that occupied their minds and used resources. Economically, both China and Central European countries were westwards oriented, and therefore generally did not perceive each other as attractive partners. Moreover, to a certain extent they became competitors among emerging markets (Zhu 2012).

It was not until the beginning of 21st century that China changed its perception of Central Europe. The EU enlargement in 2004 and the Eurozone crisis became major factors behind the change. The importance of the EU enlargement in 2004 for China-Central Europe relations rested both on Chinese recognition of the positive impact of the process, and on the Central European countries' realization of strategic diplomatic goals regarding their entrance into the EU and NATO. This new situation opened space for cooperation as the new EU members had more resources to develop relations with more distant countries, and the economic benefits of EU membership brought new opportunities for cooperation with China. A report by the renowned China Institute of Contemporary International Relations published in November 2003 clearly stresses respect for the political choices made by CEE countries, acknowledging as well that both sides politically will not be strategic partners for each other (CICIR 2003). From this point CEE countries were also firmly treated by China as part of Europe (as opposed to Eurasia during the Cold War), and a new channel for conducting relations with them was opened. On the other hand, at that point China seemed to not have a specific policy for dealing with the whole region, although intensified interest was clearly visible.

It was only by the end of the decade that the second of the abovementioned factors took into effect. As states whose development are dependent on foreign investments and export, after 2008 CEE countries started to look for new markets and sources of capital. This new situation was also reflected in their stance on issues regarding EU-China relations, in general, they became more positive toward loosening protectionist measures (Cui 2013). By that time, China was also experiencing new challenges in its development strategy, as well as political relations with its neighbors. All this prompted China to develop a more structuralized approach to CEE, seen in Beijing as an area of new opportunity.

In the period after the first CEE countries entered the EU, economic and trade cooperation of the 16 CEE countries with China sped up, with the trade volume growing from USD 8.7 billion in 2003 to USD 55.1 billion in 2013. China's investment in CEEC[1] increased from less than 100 million USD to about 5 billion USD. CEE investment in China grew from USD 420 million to USD 1.2 billion (MoC PRC 2014). However, due to lack of reliable statistical data[2],

1 China treats the following 16 countries as Central and Eastern Europe: Albania, Bosnia and Hercegovina (BiH), Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia.

2 „Measurements of the flow of China's foreign direct investments are severely hampered by the significant involvement of offshore financial centres in these

estimations can noticeably differ in terms of actual size of Chinese investments (Jakóbowski 2015)

Although the overall volume of trade, investment as well as rapidly growing contacts, it is asymmetry that defines China-CEE relations. On one hand, it is trade asymmetry, as China became a major import partner for CEE countries, but one with which they have a huge trade imbalance. Although it has to be taken into consideration that after 2004, as CEE has been integrated with the global value chains of multinational firms that have also been developing rapidly in China as well, trade deficit with China is also linked with the transfer of productive factors within the mentioned chains. Nevertheless, trade deficit is often raised by CEE countries during high level political talks. Apart from economic issues, asymmetry is also clearly visible when it comes to overall potential of the interested countries. It can also be observed within CEE itself, where Poland is by far the largest country, and all four Visegrad Group countries dominate the rest (Kong 2014).

5.2. Goals of Chinese policy toward Central Europe

China's policy toward CEE needs to be put into a broader context of overall contemporary Chinese foreign policy, with serving national development of China as its main task since 1978. One of the major means of it was to forge strong links with the world economy as the internationalization of Chinese economy was seen as the key to the revival of China's position in international relations. While the "Go Out" strategy (more commonly known in the West as "Going Global") became part of the 10th Five-Year Plan (2000–2005) in 2001, it was not until the mid-2000s that Chinese companies, organizations and localities began to follow the government's encouragement to internationalize, whilst intensifying soft power initiatives (Shambaugh 2013). This was also evident in the rising interest in CEE that followed general trends of Chinese politics and economy, as it was not until the 11th plan for 2006–2010 that China's investment began to rise in CEE. At that time Chinese investors began to realize the investment potential of the region that was further

type of transactions, by cases of by-passing administrative restrictions imposed on capital flows using unofficial channels, and by deficiencies in statistical methodologies used" (Jakóbowski 2015).

strengthened by economic problems in the Eurozone. In terms of investment opportunities some observers in China began to use the term "window of opportunity" (Liu 2013).

More recent initiatives also seem to follow the common pattern. Since 2013 the new Chinese leadership under Xi Jinping started to actively promote the creation of "the Silk Road Economic Belt" and "21st Century Maritime Silk Road" (often described as "One Belt, One Road") that would help in economic policy coordination, building transport links, free trade, use of local currencies and friendly people-to-people relations. These proposals, while targeted at foreign partners essentially seem to address the need for a change of the Chinese economic growth model and the development of Western China. Given their location, CEE countries can play an important role since the overland routes pass through Poland, while the maritime route from the Greek port of Piraeus could take a land passage through the Balkans and Hungary. Moreover, the areas of cooperation preferred by CEE countries, especially infrastructure development, are also priorities of the One Belt, One Road strategy (Liu 2014a). The role of CEE countries in the Silk Road Economic Belt is still being discussed, but it is already clear that at least for CEE many proposals were planned and announced much earlier and are being put into the Silk Road framework ex post (Li, Zhou 2014).

Politically, CEE's role for Chinese foreign policy increased after the enlargement of the EU. Already in June 2004 during a state visit to Poland, Hungary and Romania Hu Jintao acknowledged the need to strengthen political dialogue and cooperation with new or soon to be EU members, as these countries by being part of the EU will have influence over issues all around the world (Zhu 2012). This is especially true for the Visegrad Group members, as it has been noticed in China that they possess "an intra-European Union voting weight equal to France and Germany combined" (Liu 2014). It also has to be noted that during the Crimean crisis in March 2014, Chinese foreign minister has a telephone consultation with his Polish counterpart.

To sum up, China's actions in CEE are motivated by the national development of China. Because of this the goals set for Chinese policy reflect the current stage of domestic reforms as well as broader international initiatives. Therefore, in recent years the discussed countries started being considered as an entry point for Chinese investment in Europe and simultaneously a passage area on routes from China to Western Europe, both needed for the outward movement of Chinese companies. Apart from direct effects visible in bilateral relations, the indirect influence on EU policy toward China can also be traced back in China-CEE interactions.

According to Chinese sources pragmatism, defined by the Chinese as focus on economic cooperation beneficial to all parties (often described in official documents as a "win-win situation") is the main point of Chinese policy toward Central Europe, while risk avoidance and adhering to market rules are guiding principles (Liu 2013). Therefore, China looks for stable and predictable partners for cooperation. The size of the economy and overall potential also seem to play an important role. Very informative in this matter is a look at the "The rank and rating of CEECs' investment environment" prepared at the Chinese Academy of Social Science, a leading Chinese think tank that also deals with the CEE issues (Table 5.1)[3]. Described as a "new designed framework for investment environment indicators from Chinese perspective" (Liu 2014) it emphasizes China's specific requirements and investment preferences, notably weighing political factors highly (especially bilateral relations).

Comparing China's relations with Hungary and Poland present an interesting case when it comes to political factors in Chinese considerations. Hungary has a long history of good relations with China, even in the 1990s the government was more open to cooperation with China, than in the neighboring countries, and is also home to the largest Chinese community in Central Europe. Especially since 2003 Hungarian authorities actively seek to enhance their relations with China and with the Viktor Orban coming to power in 2010 these were further intensified. Hungary was willing to become not only a Chinese economic hub in the region but also explored possibilities of very close comprehensive cooperation that to a certain extent could counterweight strained relations with Brussels. Poland on the contrary, was not only politically very distant from China, often bringing up issues sensitive to Beijing i.e. Tibet, but also relatively protectionist in economic matters as well (Fox, Godement 2009). Nevertheless, it was Poland that has practically been chosen as the most important partner which was evidenced by both the signing of strategic

3 Since the time of writing this book the position of some of the countries has most probably changed, i.e. the Czech Republic might have overtaken Hungary after the President of the Czech Republic Milos Zeman's state visit to China in November 2014, which will possibly give rise to a relatively low mark for bilateral relations.

Table 5.1. The rank and rating of CEE countries investment environment (100 points)

Rank	Country	Score	Political environment	Economic environment	Social environment	Bilateral relations	Rating
1	Poland	88	24	18	18	28	Very good
2	Hungary	79	20	16	16	27	Good
3	Czech Republic	78	24	18	18	18	
4	Slovakia	77	24	16	16	21	
5	Romania	76	18	16	16	26	
6	Serbia	76	18	14	16	28	
7	Estonia	70	20	16	16	18	Not Bad
8	Latvia	70	20	16	16	18	
9	Lithuania	70	20	16	16	18	
10	Croatia	68	20	14	16	18	
11	Bulgaria	67	18	14	15	20	
12	Slovenia	66	20	12	16	18	
13	Montenegro	65	18	14	15	18	
14	Macedonia	65	18	14	15	18	
15	Albania	64	17	14	15	18	Not Good
16	BiH	62	15	14	15	18	

Source: (Liu 2014).

partnership in 2011, as well as hosting the first China-CEE Cooperation Forum in Warsaw, 2012.

China chose Poland due to the size of its economy, good conditions during the Eurozone crisis and political stability. All of these mentioned elements helped to strengthen Poland's role in the EU as well, a fact that was not insignificant for China. Hungary under President Orban was perceived as too uncertain, both economically and politically, to become a strategic partner. Specifically, relations between the Hungarian government and EU institutions could potentially put at risk Chinese interests. Internal difficulties in administrative coordination also might have played a role (Kałan 2012).

5.2.1. European and regional look (16+1 format)

Apart from the abovementioned focus on economic cooperation, pragmatism as understood by China is also a combination of the "European point of view" (*Ouzhou shijiao*) and "Central and Eastern Europe regional pattern" (*Zhongdongou diqu fangshi*). The former refers to the already mentioned acknowledgement of CEE orientation in the EU, and the subsequent treatment of this region by Beijing as part of its broader European policy. The latter is more often described in the West as the "16+1 format" according to which China is willing to conduct its relations together with the 16 CEE countries. By doing so China shows that CEE countries are not only considered part of Europe, but a part of Europe that deserves special attention so that Chinese policies and initiatives could catch up with those developed earlier with other parts of the EU (Scandinavia, West and South Europe). It also appears that China realizes that those among the 16 CEE countries that are currently not part of the EU eventually will become members, or at least there policies will continue to be Brussels oriented.

The "16+1 format" deserves special attention as it became the first comprehensive Chinese strategy aimed at all of the countries in that the region. The first signs of China's new approach and introduction of the "16+1 format" could be observed in June 2011 when the China-Central and Eastern European Countries Economic and Trade Forum was organized in Budapest. During the event the former Chinese Premier Wen Jiabao made five proposals on increasing bilateral trade, increasing two-way investments, enhancing infrastructure construction cooperation, deepening fiscal and financial cooperation, as well as expanding people-to-people and cultural exchanges. Although the Premier opened the Budapest event personally, it was not until 2012 in Warsaw that it took the form of a summit attended by the heads of government. At that point it was already clear that China had chosen the so-called "16+1" format when dealing with the region.

In 2012 original proposals made by Wen in Budapest were developed into the so-called 12 cooperation measures for China-Central Europe cooperation. This list of initiatives, mostly in the economic sphere, was to put a new dynamic in it. Among them were pledges to open a USD 10 billion credit line for cooperation projects as well as a USD 500 million investment fund. It is important to note that the measures were formally a one-side declaration by China, and while welcomed by the 16 countries, they did not fully reflect their expectations. This divergence became evident soon after the meeting as more details were disclosed. And only were some of the proposed measures not attractive for a few countries (notably the EU members who were not allowed to provide special treatment for Chinese companies), but the overall development raised concerns in Brussels that the new initiative was undermining EU's policy toward China.

The new Chinese Premier Li Keqiang confirmed the previously taken path in Bucharest, in November 2013. At the meeting, "The Bucharest Guidelines for Cooperation between China and Central and Eastern European Countries" were signed by all 17 parties and proposals of both China and CEE countries were put on agenda. This shows that the new platform improved and used the experiences of the previous year, as well as the fact that it is also used for bilateral relations between individual states and China. The guidelines, apart from outlining several specific initiatives to be taken up during 2014, focused on creating joint mechanisms of cooperation in particular fields and further learning about possible cooperation and expectations. Out of 8 points, 6 were related to the economic sphere. The guidelines also addressed concerns related to the EU by committing to follow EU law.

It was also in 2014 that one of the proposals raised by Wen Jiabao in Warsaw, namely the establishment of the China-CEE Investment Cooperation Fund with the initial capital of USD 500 million, was finalized. The Fund was eventually established by China Exim Bank in partnership with other institutional investors from CEE, and Warsaw based CEE-Equity Partners Ltd became the investment advisor. It is interested in projects typically requiring USD 25–75 million of equity with larger transactions also financed with partners or with bank debt. The first investment was announced in September 2014 and together with two partners was aimed at three wind power projects in Poland (CEE Equity Partners).

In December 2014 the third meeting took place in Belgrade. Like in Bucharest, the meeting resulted in signing the Belgrade guidelines for cooperation. Further developing ideas announced a year before, economy still dominated with improving connectivity and logistics on top of the list. This, together with the declaration that a medium-term cooperation agenda will be discussed in 2015 showed that the format is evolving into a more matured form, with a growing number of common initiatives (Belgrade Guidelines 2014). Apart from the guidelines, Premier Li Keqiang pledged that China will establish a new investment fund worth USD 3 billion, that will take advantage of public-private partnerships and leasing, forms of investment that CEE countries seek but are not so appealing to China (Tanjug 2014a). "Despite the general success of the Meeting, there were setbacks as well. The signing of the two agreements on HSR [Belgrade-Budapest High-Speed Railway] appear to be a face-saving exercise: the final contract – previously expected to be signed in Belgrade – did not materialize since the involved parties could not reach an agreement on the modality of financing" (Pavlićević 2014).

In general, the "16+1 format" was also seen in China as a means toward overcoming the asymmetry problem by conducting relations with a single bloc. The problem is that while China treats these 16 countries together, those countries do not constitute a unified group. Moreover, even in their relations with China under the "16+1 format" these countries perceive each other rather as competitors for Chinese investment and business opportunities. Even with mechanism developed in 2014 "there is also reluctance to institutionalize the 16+1 format. For CEE, it is 16 bilateral dialogues, while new mechanisms are instruments facilitating contacts rather than institutions, as they do not have internal structure or budget" (Szczudlik-Tatar 2014). The Chinese are already aware of the fact that because of the differences among the 16 countries future relations would be more like "one country toward many sides" (*yiguo dui duobian*) rather than one country toward a single bloc (Liu 2013).

It also appears that a very important part of the "16+1 format" was policy coordination on the Chinese side. In 2012 the Secretariat for Cooperation between China and Central and Eastern European Countries was established in Beijing[4]. It is "mainly responsible for coordinating Chinese institutions, implementing the outcome of the leaders' meeting through the collaboration with the authorities of the 16 CEE countries, planning key directions and priorities for future cooperation between China and CEE countries, and organizing and promoting the work of the Secretariat." The creation of such a body not only helped in the abovementioned areas but also gave a clear sign to central government ministries and agencies, local governments and state owned companies that development of relations with CEE partners is accepted by the highest authorities.

It has to be mentioned that cooperation is not only conducted on the central level as Chinese local governments are also playing an increasingly important role. Interestingly their behavior often follow the patterns of relations on the central level (i.e. they initiate projects that Central European partners respond to). The "16+1 format" has been used at this level as well, notably with the Local Leaders Forum organized in Chongqing and Prague. Relations between cities, CEE regions and China are a fast growing phenomenon but their potential has not been yet fully realized.

The "16+1 format" did raise suspicion in Brussels though, with the EU worrying that China wants to divide its members. It seems that, among others, it was a matter of communication as after the initial discussions on that issue in 2012 it appears to have been solved. Both Bucharest and Belgrade guidelines addressed this issue explicitly by both declaring that the cooperation is contributing to the EU-China partnership, and in the case of EU members it will be conducted with respect to EU laws and regulations. In Belgrade Premier Li Keqiang specifically mentioned that "China supports the European

4 The Secretariat consists of 18 member units and they are: the Ministry of Foreign Affairs; International Liaison Department of the Central Committee of the Communist Party of China; National Development and Reform Commission; Ministry of Education; Ministry of Science and Technology; Ministry of Finance; Ministry of Transport (including National Railway Administration); Ministry of Agriculture; Ministry of Commerce; Ministry of Culture; People's Bank; General Administration of Press and Publication, Radio, Film and Television; National Tourism Administration; Civil Aviation Administration; Central Committee of the Communist Youth League of China; Council for the Promotion of International Trade; Development Bank; and Export-Import Bank. The Secretariat office is located in the department of European Affairs of China's Foreign Ministry to handle daily affairs.

integration process," "China's cooperation with the 16 CEECs will not result in fragmenting the European Union […] it will help deepen cooperation between China and the European Union," and "China-CEEC cooperation is undoubtedly part and parcel of China-Europe cooperation, and the two could naturally go in parallel and be mutually reinforcing" (Tanjug 2014b).

Addressing the needs brought up by CEECs, China has already announced a series of measures to facilitate trade relations with the region i.e. the hosting of round table meetings with commerce ministers, exhibition CEE products in China and running of an agricultural and trade forum. However, these kind of actions will take some time to bear fruit, reflecting the issue of trade imbalances brought by the CEE countries.

* * *

After a period of mutual disengagement, the EU Eastwards expansion as well the Eurozone crisis opened new perspectives for China-CEE relations that resulted in high dynamics of cooperation. A gradual and rather cautious Chinese policy, meant to learn the new situation and explore opportunities, has been the major factor of the change. China had the initiating role, including decisions on key partners and methods (16+1) with CEECs initially only responding to it, and then gradually putting forward their own proposals. The "16+1 format" revealed more structured approach to the region, being firmly a part of broader European policy.

Consequently, especially since 2011, Central Europe has experienced China's comprehensive offensive into the region. It was focused mainly on the Visegrad Group members, Romania and Serbia, with economic cooperation being the major area of interaction and political and public diplomacy aspects playing a supportive role. It has to be stressed though that China's internal development plays an important role as well, which is also clearly visible in new Chinese proposals like the Silk Road Economic Belt and 21st Century Maritime Silk Road. It is yet hard to decide on the effects of Chinese policy toward the region, mostly because at the time of writing this piece there were few examples of visible impact. However, expectations, especially on the side of the new export market and investment seeking CEECs, are high.

Finally, a particular aspect of Chinese policy toward CEECs should also be noted. One can argue that better mutual understanding can also be an important goal of the policy. Given the fact that for many years there have been very little working level contacts, and the general understanding expectations is low, then this could have a profound impact on China's policy in the future. Special coordination mechanisms for Chinese institutions engaged in contacts with CEECs, as well as sectorial China-CEEC cooperation mechanisms that follow the "16+1 format" bring forward some new potential for development.

5.3. Chinese SWFs' investments in Europe

The People's Republic of China has several public investment vehicles but among them two major SWFs can be indicated. The first is China Investment Corporation (CIC) formally established in September 2007 to manage and diversify Chinese foreign exchange reserves beyond its traditional investments in dollar-denominated bonds. This is a flagship fund, officially acknowledged as a SWF. The second is SAFE Investment Company (SIC), a Hong Kong based subsidiary of the State Administration for Foreign Exchange (SAFE). This institution is primarily responsible for the management of Chinese foreign exchange. On the contrary to CIC, SIC is much more obscure, and China has repeatedly refused to acknowledge its existence until it was confronted with incontrovertible evidence collected amid a media probe in 2008 (Anderlini 2008). Both funds have a total of USD 1.2 trillion under management (SWF Institute 2014).

The characteristics of investment patterns and performance of the two largest Chinese SWFs indicate that they are tools of the state's "Go Global" strategy and the politics of maintaining raw materials and energy security. Through SWFs, China invests in projects related to its political goals (Norris 2016; Cieślik 2014). Therefore, they are widely viewed as highly politicized and run in an obscure fashion, which has triggered a debate in Western countries as to whether the SWFs might serve as a source of market stability or as a potential threat to Europe (Bu 2010).

The debate about these SWFs has been echoed in a wider debate on rising Chinese investment and its potential consequences for the European Union. The problem has attracted the attention of business consultants (Hanemann, Rosen 2012) as well as academics (Meunier 2014; Zhang, v.d. Buckle 2014) and finally politicians – e.g. research studies on this topic have been ordered by the European Commission (Apoteker 2012; Clegg, Voss 2012). The majority of voices in the debate sounds rather soothing. Despite growing concerns among EU member states over the rising Chinese presence in Europe, there is no evidence that it threatens security in any way. Chinese investments activities are still limited in number and value and have a rather positive (if any) influence on the European economy and markets (Kamiński 2014).

As far as SWF investments in the EU are concerned, it is noticeable that their value has also remained rather low. After a buying spree in 2008 when China snapped up USD 8.4 billion worth of European "troubled assets," annual exposure in the subsequent years has hovered below USD 5 billion (Figure 5.1).

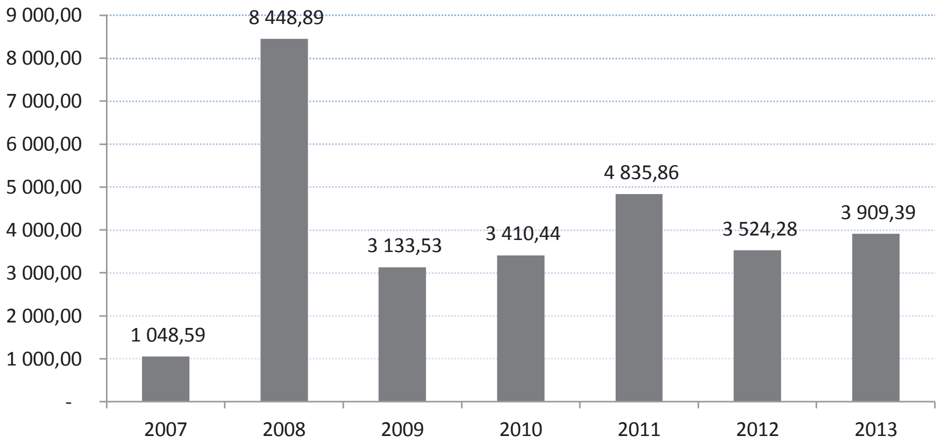

Figure 5.1. The value of Chinese SWF investments in the EU in 2007–2013 (in USD million)
Source: own calculations based on SWF Institute Transaction Database and SWF Center Transaction Database [accessed: 20.08.2014].

The value seems particularly unassuming, relative to the size of all SWF investments allocated to Europe. From 2007 to August 2014 they have totaled approximately USD 248 billion. This is significant if compared to other alternative investors (e.g. private equity funds whose routine investment strategy also involves acquisitions of shares or stakes in companies). Private equity vehicles allocated about USD 401 billion in 2007–2013 (EVCA Yearbook 2013). Chinese funds, with slightly more than USD 29 billion, are responsible for less than 12% of the value of SWF investments, on a par with Singapore (about USD 33 billion) and the United Arab Emirates (UAE) (about USD 29 billion).

As shown in Table 5.2, the United Kingdom (UK) attracted more than 60% of Chinese SWF investments. When combined with France, we see the vast majority (more than 90%) of SWF activity revolves around those two economies. Interestingly, Germany has managed to lure a relatively puny proportion of Chinese SWF commitments, given its undisputable status as the most powerful economy in Europe. Perhaps it is due to the relatively lukewarm approach to SWFs adopted so far by Chancellor Angela Merkel's cabinet. In 2009, Germany passed a law authorizing the government to bar non-EU investments in German companies greater than 25% if deemed a "public order and security" risk (Chaisse 2012). Although this regulation is broadly in line with similar rules already in force in the UK and France – Germany enacted it in a knee-jerk reaction to the rapid proliferation of SWFs.

Table 5.2. Chinese SWFs' investments in the EU member states (2007–Aug 2014) USD million

Country	Value	Share in total
UK	18,905.08	64.00%
Netherlands	1,517.88	5.14%
Germany	484.97	1.64%
France	8,391.75	28.41%
Other states	241.15	0.82%
Total	29,540.83	100.00%

Source: own calculations based on SWF Institute Transaction Database and SWF Center Transaction Database [accessed: 20.08.2014].

Due to the limited magnitude of Chinese SWF investments in comparison with all SWF acquisitions undertaken so far in the EU, the resultant share in the overall SWF portfolio allocated to Europe has remained low. In none of the member states, except for France, China has ranked as a major SWF investor (Table 5.2).

Chinese SWFs invest in Europe directly or through subsidiaries (sometimes in the form of Special Purposes Vehicles). For example, CIC has set up subsidiaries such as Best Investment Corporation or Stable Investment Corporation. Behind some of SAFE's investments in Europe stands Gingko Tree Investment Ltd. a subsidiary specializing in real estate acquisitions and registered in London. However, Gingko does not always invest directly, moving to set up its own subsidiaries. Such a practice makes monitoring Chinese SWF investments a highly complex effort (MacMahon, Wei 2013).

Table 5.3. Chinese SWF investments in EU member states in comparison with all SWF investments (2007–Aug 2014) in USD million

Country	All SWFs	China	Chinese share
UK	11,9202.5	18,905.08	15.86%
Spain	16,416.48	0.00	0.00%
Netherlands	9,489.79	1,517.88	15.99%
Italy	10,232.17	0.00	0.00%
Germany	50,661.46	484.97	0.96%
France	28,142.72	8391.75	29.82%
Others	14,047.96	241.15	1.72%
Total	248,193.08	29,540.83	11.90%

Source: own calculations based on SWF Institute Transaction Database and SWF Center Transaction Database [accessed: 20.08.2014].

There is obviously a question to what extent are Chinese investment activities subordinated to a state's foreign policy goals. Academics tend to agree that the link between Chinese outward investments and the political objectives is close and that Chinese companies are often instruments used to implement Beijing's foreign policy (Norris 2016; Pietrasiak et al. 2014; Freeman 2013). The best examples are large infrastructure projects that are included in Chinese foreign aid in third world countries. They are usually financed by Chinese banks and constructed by Chinese companies.

However, the aforementioned studies on Chinese investment in Europe seem to demonstrate that, so far, their political dimension has not been significant and none of the EU countries is seen as being "in China's pocket." Primarily, the scale of Chinese investment in Europe is still rather limited. Even if the growth of the volume of Chinese investment might be impressive, the share of Chinese firms in the European market remains marginal. Obviously, if the rapid growth of the investments turns out to be sustainable, the political pressure on Europe will grow.

5.4. Chinese SWFs in CEEC and potential methods of their political use

As far as CEE is concerned, very little is known about the Chinese SWF investments in those countries. There were a few official announcements and declaration of interests, but not many transactions materialized. For example, according to Reuters (2012) CIC has signed a deal with Poland's investment body, the Polish Information and Foreign Investment Agency (PAIiIZ), that could see China's SWF snap up assets in the coming years. "As for the size of their investments, the sky is the limit," PAIiIZ chief Slawomir Majman commented to Reuters. But two years later, in November 2014, according to a PAIiIZ official communicate on the website, a CIC representative stated that they had only "explored" the potential of Poland during his meeting with Mr Majman. Hitherto, there has been no single CIC acquisition in Poland revealed, however, Gao Xiqing, the former president of CIC, admitted in May 2013 that the fund had already invested around USD 1 billion in Polish listed companies (Rożyński 2013). The executive did not give any more precise data concerning these investments and this information has not been confirmed by other sources.

The largest transaction in CEE, with participation of a Chinese SWF, was the sale of the Silesia City Center shopping mall in southern Poland's industrial city of Katowice for EUR 412 million. It was bought by a consortium headed by Germany's Allianz Real Estate, which also includes Chinese Gingko, the subsidiary of Chinese SAFE (Property Investor Europe 2015; Cienski 2014).

Even if we do not know the exact value of Chinese SWF investments in CEE, we can estimate that it is low in comparison to Western Europe. The whole region has not managed to attract much Chinese money, even if particular countries have tried. Apart from the already mentioned case of Poland, a Czech minister has also met with the head of the CIC (Richter 2014) but with no effect so far.

This situation can change in the near future. CIC, or precisely its subsidiary CIC Capital, may have received USD 100 billion from a Ministry of Finance (MOF) bond issued in part for overseas direct investment in the framework of the One Belt, One Road initiative (Hsu 2015). CEECs are an important part of this Chinese program and due to this fact may attract some SWFs investments.

Even if until now the Chinese SWFs investments in CEE are not significant in terms of value, we could easily point out at least four methods of potential political usage of SWFs in the future. First of all, China could directly exploit its SWFs in so-called "chequebook diplomacy," aiming at pressuring a CEEC to behave in a way that is in line with Chinese interests. As Costa Rica's case has shown, described in Chapter 2, China is able to use its foreign exchange reserves to reach political goals. Small countries of CEE are particularly vulnerable to such a pressure.

Secondly, China could pressure CEE countries with the threats of disinvestment from the region. Due to the fact, that real value of SWFs pocket investments are not really known, Beijing could politically use this method even without great financial involvement. The announcement of disinvestment, refraining from investing in CEE or simply a lack of confidence in CEE markets, could entail great financial losses. Therefore, governments could be vulnerable to pressures from the Chinese side.

Thirdly, Chinese SWFs could take stakes in companies that are strategically important for the CEE states. Even if unable to control them, they could have enough shares to install their representatives on boards. That would give them an opportunity to have access to company secrets. Those secrets could then be passed on to Chinese competitors or used in any other way in line with the Chinas's interests.

Finally, SWFs could be valuable tool in building a positive image of China. For the purposes of public diplomacy, it is very profitable to present China as an engaged and responsible investor, ready to salvage in case of crisis (Godemont, Parello-Plesner 2011). The above mentioned, unverifiable claims of Gao Xiqing about the USD 1 billion investment in Poland could serve as a good example of such a behavior.

Conclusions

Central and Eastern Europe is playing a more and more important role in Chinese policy. After decades of a mutual lack of interest, as well as lack of trust, China-CEEC relations have not only seen increased and deepened contacts, but also institutionalization and development of new cooperation formats. However, the relative novelty, as well as high dynamics in the creation of new initiatives, make it hard to provide any final judgments. Trends seem to be undisputable, but the mentioned deficits in knowledge and experience result in policies not always suitable for particular countries. It has to be mentioned though, that Chinese decision makers already started to take into consideration the variety of conditions in all 16 CEECs.

Beijing tries to use a variety of political instruments to reach their goals in CEE. Until now, the state's capital pooled in SWFs belongs to the group of the tools that are not frequently used in the region. However, assets of Chinese SWFs are rising and one can expect that in future they will more often explore investment opportunities in CEECs. Increased engagement in the region gives China a convenient instrument of political pressure on the states in the region. That is going to be a great challenge for CEE governments due to the fact that today it is in principle impossible to close the doors on the capital market for Chinese funds. Their money is needed and their long term investment perspective can serve as a stabilizer for unstable stock exchanges and provide them with the necessary liquidity. On the other hand, so long as it is the state's capital one has to remember that behind this capital stands a powerful country with its interests and ambitions.

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Chapter 6

The Political Implications of Norway's Sovereign Wealth Fund investments in Eastern and Central Europe

Privatization as a core government policy is not only well documented in economic and political literature, but has also been a key component of the transformation process in many countries, which have been changing their economic format from one that is centrally planned to one that is market oriented. Moreover, looking at the large number of developing countries during the last decades we can observe a massive retreat process of states from many areas previously regarded *a priori* as state-owned and state-regulated. Privatization, along with deregulations in many sectors, has been the first answer and the main antidote given by leading global financial institutions to developing economies experiencing budget, financial or economic difficulties (Urban 2015).

However, looking at the global picture as a whole, we can find evidence that over the 2001–2012 period governments acquired more assets through stock purchases than they sold through share issue privatizations and direct sales. The key factor that seems to explain these obvious contradictions is that the government purchases of equity have recently been conducted mostly by state entities acting as investors rather than owners. Much of this state investment was channeled through special investment vehicles – sovereign wealth funds (SWFs), and the vast bulk of stock purchases have been cross border transactions (Bortolotti, Fotak, Megginson 2014).

Given the fact that according to Keynes international capital allocation is always politically motivated, questions arise to whether and to what extent this is true for Government Pension Fund Global (GPFG), a sovereign wealth fund operating from Norway. The main goal of this chapter is to analyze investment policy of this state-controlled entity and provide the picture of its portfolio investment in Eastern and Central Europe Countries. For this purpose, the remainder of the chapter is organized in the following manner: in the next part facts and figures about the fund are presented, than the investment policy of the fund is described, after that the holdings of GPFG in Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia are analyzed, and finally the political implications of these investments are discussed with particular emphasis on the issue of risks. The chapter ends with conclusions.

6.1. Government Pension Fund Global – facts and figures

The rise and growth of the Norwegian sovereign wealth fund is strongly associated with the exploitation of petroleum resources in the North Sea. Petroleum was discovered there in 1969 and oil production started soon thereafter in 1971. Throughout an almost two decade-long period, a sizeable income from the exploitation of this resource had accumulated and in response thereto, Norway's Parliament passed the Government Petroleum Fund Law. As a result, to support the long-term management of the petroleum revenues the Petroleum Fund was established and since its inception the fund has been a tool of fiscal policy. At the beginning the fund did not operate as an independent entity but constituted a department of the government apparatus, managed by the Norwegian Central Bank (Baker 2009, p. 132).

In 1996 the fund received the first capital transfer from the Ministry of Finance (NOK 46 billion), which was invested in the same way as foreign exchange reserves held by the Norwegian central bank. In the following year the decision was made to diversify the portfolio and invest 40% of the assets in equities instead of holding solely government bonds. In 1998, when the total value of the fund was NOK 172 billion, Norges Bank Investment Management was set up to manage the fund on behalf of the Ministry of Finance. Two years later, five emerging markets were added to the fund's benchmark equity index; by that time the value of the fund was calculated to be NOK 386 billion. In 2002 the fund started investing in corporate and securitized bonds. In 2004 with the fund's value amounted to over NOK 1 billion, the ethical guidelines for the fund were established. The Government Petroleum Fund changed its name to Government Pension Fund Global (GPFG) in 2006. In the next year the Ministry of Finance decided to increase the fund's share of equity investment from 40% to 60% and also to add small-cap companies to the benchmark portfolio. In 2008 real estate was included in the fund's investment universe, with a maximum share of 5% of total assets. By that year the total value of the fund was NOK 2.275 billion and the reference equity index of the fund included all emerging markets. In 2009 the fund's share of equity in its asset portfolio reached 60% and the fund's ethical guidelines were evaluated. By 2010 a mandate to the investment policy of the fund was introduced to invest as much as 5% of the fund in real estate through a corresponding reduction in the fixed-income holdings. In 2012 the Ministry of Finance announced a plan to gradually reduce the share of European holdings to 40% of the fund and increase its investments in emerging markets up to 10% (http://www.nbim.no/en/the-fund/history/ [accessed: 3.09.2015]; Canner and Green 2010).

Nowadays, GPFG is the single largest sovereign wealth fund with USD 882 billion worth of assets under management (http://www.swfinstitute.org/sovereign-wealth-fund-rankings/ [accessed: 3.09.2015]). At the end of 2014 GPFG's portfolio consisted of 9124 equity investments, accounting for 62.3% of the portfolio 4,256 fixed-income investments (36.5%) and real investment accounting for 2.2% of the portfolio (http://www.nbim.no/en/the-fund/holdings/ [accessed: 3.09.2015]). As regard to geographical location of the investments (see Figure 1) 39.9% take place in Europe, 38% in North America and 15.5% in Asia.

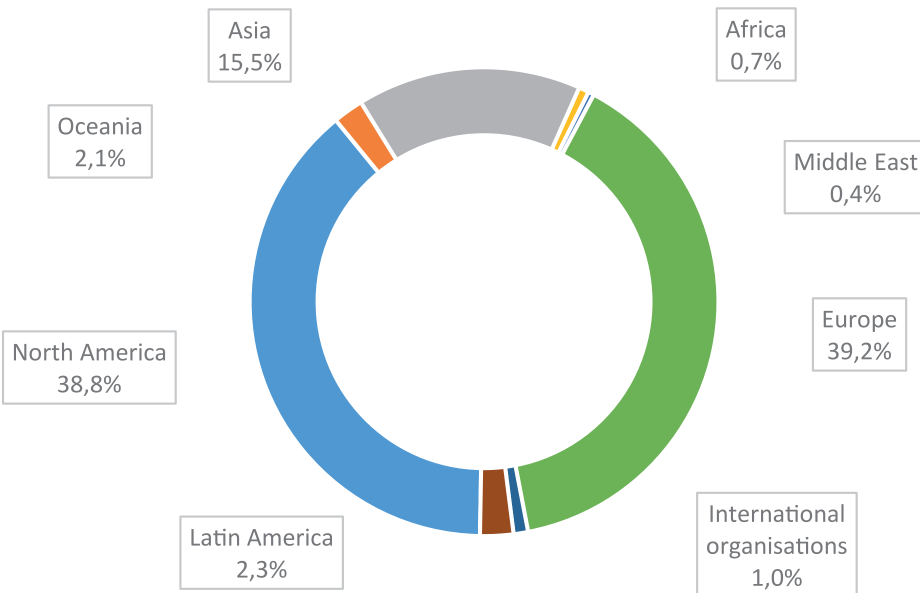

Figure 6.1. Government Pension Fund Global investments by region at the end of 2014
Source: http://www.nbim.no/en/the-fund/holdings/ [accessed: 3.09.2015].

The fund's annual return ranges from -23.32% to +25.62%, with a 5.9% annualized return since 1998, 6.12% in the last 10 years and 6.92% in the last 12 months (Norges Bank Investment Management, Government Pension Fund

Global Quarterly Report 2015, p. 15). GPFG is a commodity-based sovereign wealth fund with a high level of transparency (10 points in the Linaburg-Maduell Transparency Index – http://www.swfinstitute.org/sovereign-wealth-fund-rankings/ [accessed: 4.09.2015]).

Besides being the tool for the transfer of the country's wealth for future generations, GPFG insulates the domestic economy from the resource curse, known as the "Dutch disease." The experiences of other countries have shown that the sudden inflow of capital to the economy can rapidly inflate domestic prices and the exchange rate, decrease international competitiveness of the economy and result in de-industrialization (Chambers et al. 2012). Due to capital allocation on foreign markets via the use of the special investment vehicles that are SWFs, governments can improve resource allocation (Gieve 2008, p. 199) and for economies having a surplus of foreign exchange inflow, investing through SWFs gives an opportunity to sterilize this capital, avoid price bubbles and high inflation (Heyward 2008, p. 21). Another economic benefit that GPFG offers is that it helps to reduce the opportunity cost of reserve holdings due to greater portfolio diversification of reserve-assets and reduce the volatility driven by changes in commodity export prices (IMF 2008b, p. 4).

Holding over 1% of the total shares from different regional markets all around the world, GPFG is a leading example of a universal owner (Kiernan 2007; Gjessing, Syse 2007). The universal owner hypothesis states that although a large, long-term investor with diverse investment holdings can initially benefit from a company externalizing cost, the investor might ultimately experience a reduction in overall return due to these externalities adversely affecting returns from other assets. Thus, universal owners have an incentive to reduce negative externalities created by companies from their portfolios, such as pollution emission, corruption and increase positive externalities such as sound corporate governance and good human capital practices across their investment portfolios (Hawley, Williams 2000). For universal owners, overall economic performance will have an influence on the future value of their holdings more than the performance of individual companies or sectors, suggesting that universal owners will support the goal of sustainable growth and well-functioning financial markets. Consequently, a universal owner will view its goals holistically and seek ways to reduce externalities that produce economy-wide efficiency losses (Urwin 2011, p. 26; Nagell 2011, p. 81).

Summing up, GPFG is the largest SWF as well as important institutional investor in global financial markets. But is not the size of the fund that prompt the attentions; it is the investment policy of the fund. Generally speaking, the fund is allowed to invest in targeted companies only if they meet certain corporate governance, social and environmental criteria. Clark and Monk (2010) argue that GPFG has been at the forefront of ethical and socially responsible investment initiatives. As a result, the fund appears to have become an expression of Norwegian commitment to global justice.

6.2. The investment policy of the fund

The investment policy of GPFG has been evolving along with the growth of assets under its management. In 2004 Ethical Guidelines of investment were adopted. The premises for the Ethical Guidelines were two ethical obligations pointed out by the Graver Committee and then discussed and debated by the Norwegian Parliament. The first of them was the obligation to ensure financial returns so that future generations will benefit from the oil wealth, contingent on sustainable development. The second was to respect fundamental rights for those who are affected by the companies in which GPFG invests (Halvorssen 2011, p. 3). Thus, on the one hand it seems to be an expression of the belief that besides intergenerational justice, a sovereign wealth fund should contribute to the implementation of universally accepted values and norms (Reiche 2010, p. 3570).

On the other hand, given the fact that "nothing is external to a global shareowner" (Monks 2001, p. 105) the acceptance of ethical restrictions on investment occurs as a natural consequence of the awareness that arises regarding the role of externalities in portfolio management. The large equity positions, usually held in the form of minor ownership stakes across hundreds and thousands of companies scattered across the globe means that portfolios of such universal investors are exposed to costs linked to negative externalities. For example, a portfolio holding causing excessive greenhouse gasses, overusing water and making unsustainable use of natural resources may affect the ability of another company held in the portfolio to operate profitably. Consequently, it undermines the long term risk adjusted return of the universal owner. Thus, ethical guidelines are the tool that socially responsible investors use to actively engage with corporations in order to minimize negative externalities (Létourneau 2013).

GPFG's asset holdings are mainly invested in accordance with a benchmark index determined by the Norwegian Ministry of Finance. This is a list that shows how much capital should initially be placed in each individual security the fund invests in. The benchmark index consists of 60% equities and 40% fixed income, however, gradually 5% of the assets will be invested in real estate. Norges Bank, delegated by the Ministry of Finance to manage the fund, is permitted to deviate slightly, within limits, from this list (Norwegian Ministry of Finance 2010, p. 8).

As a responsible investor GFFG is meant to:

- promote good corporate governance and greater awareness of social and environmental issues among companies in which it has holdings;
- help companies in its portfolio to respect fundamental ethical norms;
- promote sustainable development in an economic, social and environmental sense;
- promote good corporate governance as well as organization of financial markets;
- preclude the Fund from having investments that conflict with Norway's obligations under international law;
- avoid investments in companies that are engaged in grossly unethical activities (Norwegian Ministry of Finance 2010, p. 14).

The responsibility for executing the investment policy of the fund is divided among The Ministry of Finance, Norges Bank and Council of Ethics. The first is responsible for establishing underlying principles for the exercise of ownership rights as well as for criteria regarding the exclusion of companies. It also makes the decision whether or not the company should be excluded. The second exercises the ownership rights in individual cases and also reports quarterly on active ownership activities. The last gives advice on the exclusion of companies from the fund's holdings (Norwegian Ministry of Finance 2010, p. 14).

The investment policy of GPFG states the active ownership to safeguard the fund's financial values by contributing to good governance and by striving to achieve higher ethical, social and environmental standards in the companies. Norges Bank's activity is concentrated in certain key areas of significance to the portfolio of the fund. One of them is equal treatment of shareholders, which is especially important since the fund is mostly a small shareholder in many of the companies. Norges Bank also promotes better regulations and better corporate governance for financial markets, providing regular input of work on new regulations for the financial market of many countries as well as global principles for corporate governance. Another key area of the interest is the protection of children's rights and given the fact that in many companies and markets there is high risk of child labor, Norges Bank promotes the governance structure and reporting system to address this issue. Since the portfolios of the Fund are exposed to the risk of adverse economic effects of climate change, companies from it are expected to have strategies for managing physical and economic effects of climate change. Additionally, it is to set clear targets for reducing greenhouse gas emissions, to explore opportunities to develop new products and services that will help the transition to a low-carbon economy. Another important component of the Fund's investment policy is the exclusion of companies from the portfolio. Most of the instances of exclusion concern companies that produce certain products, such as key components for weapons that violate fundamental humanitarian principles through their normal use (nuclear weapons, cluster munitions, anti-personnel land mines). Individual companies may also be excluded from the Fund if it is determined that they run an unacceptable risk of contributing to grossly unethical activities (Norwegian Ministry of Finance 2010, p. 22–30).

Summing up, GPFG with globally diversified holdings, is a leading example of an institutional investor with social, governance and environmental components deeply tied with the core values of the investment policy. GPFG's activities prove the possibility of combining ethical values with financial expectations regarding the rate of return. At the same time, the Fund is a political tool of the state, used to promote the globally underlying values of the Norwegian people. The stream of capital provided to companies as well as to other governments via the purchase of bonds is conditioned by political factors. Such restrictions on investment are communicated directly, leaving no room for suspicions or suppositions.

6.3. GPFG holdings in Central and Eastern Europe

A lack of data along with low transparency make it almost impossible to perform an investment analysis of most SWFs. Against this background GPFG is a prominent exception; the Fund provides comprehensive information about it activities, allowing researchers to evaluate the objectives and performance of the fund. Despite of that empirical research concerning GPFG investment activity in Eastern and Central Europe Countries is very limited in numbers and provides more of a country rather than regional picture of the issue. Due to that fact an analysis of the GPFG's investment activities in these markets is needed.

Table 6.1. Holdings of GPFG in selected Eastern and Central Europe Countries at the end of 2014 (USD)

Country	Equities	Fixed-income	Total
Bulgaria	–	125,293,517	125,293,517
Czech Republic	83,730,658	957,119,917	1,040,850,575
Estonia	–	14,688,058	14,688,058
Hungary	117,137,959	399,014,626	516,152,585
Latvia	–	33,524,729	33,524,729
Lithuania	2,690,878	94,782,942	97,473,820
Poland	1,163,857,654	2,799,211,006	3,963,068,660
Romania	128,717,213	–	128,717,213
Slovakia	–	261,870,110	261,870,110

Source: http://www.nbim.no/en/the-fund/holdings/ [accessed: 4.09.2015].

At the end of 2014, GPFG had holdings in the following countries from the Central and Europe region: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia. The portfolio of assets in these countries consists of two categories: equities and fixed-income assets. Table 6.1 presents the basic information regarding the Fund's holdings in this region.

The data suggests that the highest capital allocation from GPFG is taking place in Poland, followed by the Czech Republic and Hungary. At the end of that list there are the Baltic states. In all countries the Fund has investments in fixed-income assets, excluding Romania. The Fund had not invested in equities in Bulgaria, Estonia, Latvia and Slovakia. However, due to the difference in size of the country, a comparison between economies based on this data does not provide the full picture of the issue. Figure 6.2 presents the capital allocations from the Fund normalized by country GDP, as a proxy for the size of the economy.

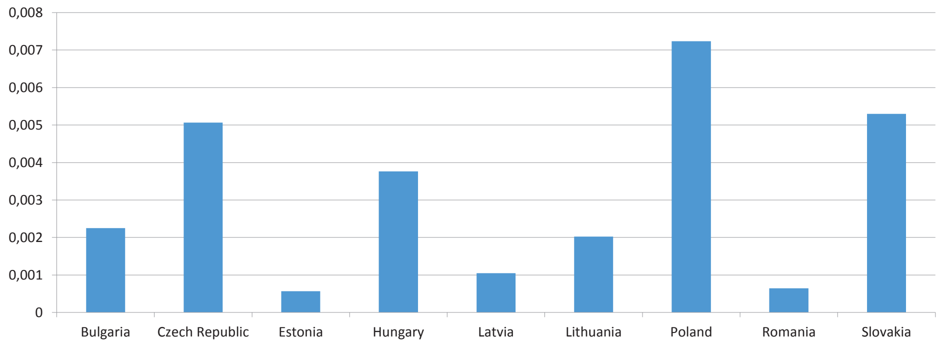

Figure 6.2. Capital allocations of GPFG scaled to country's GDP at the end of 2014 (USD)
Explanation: values on the Y axis are a ratio of capital allocation from the Fund to a country's GDP.
Source: own calculations based on the data from Fund's webpage http://www.nbim.no/en/the-fund/holdings/ [accessed: 4.09.2015] and World Bank http://data.worldbank.org/indicator [accessed: 4.09.2015].

Given the size of the economy measured by country's GDP, a conclusion can be drawn that the Norwegian SWF had invested the most in Poland, with Slovakia taking second place and Czech Republic third. What is worth mentioning is that a relatively low capital inflow from GPFG has been directed to Romania.

As regard portfolio investment, the issue of diversifications versus home bias is often the subject of analysis. According to the portfolio theory, a rational investor should allocate its capital taking into account the share of particular assets in the overall market as well as the share of that market globally. Several authors argue that the behavior of investors is in contradiction with these assumptions. The home-bias hypothesis states that due to the cost of information, similarities in terms of religion, geographical location, etc., investors increase the share of some assets from one market while decreasing the share of the assets from another in their overall portfolio. In order to validate the home-bias preferences of GPFG, using GDP we compared the share of the single economies in the overall GDP of 8 countries with a similar share of capital allocation. The results are presented in Figure 6.3. Two things seem to be clear, Poland is the market flooded by the fund while Romania garners the least interest, given the total portfolio of assets held by GPFG in this group of countries. However, taking the market capitalization of listed companies as a benchmark (Figure 6.4), for these two countries an opposite conclusion can be drawn. In the case of other countries the picture seems to be relatively clear, the capital allocation from the fund is consistent with the share of the country within the group, measured by GDP or market capitalization of listed companies.

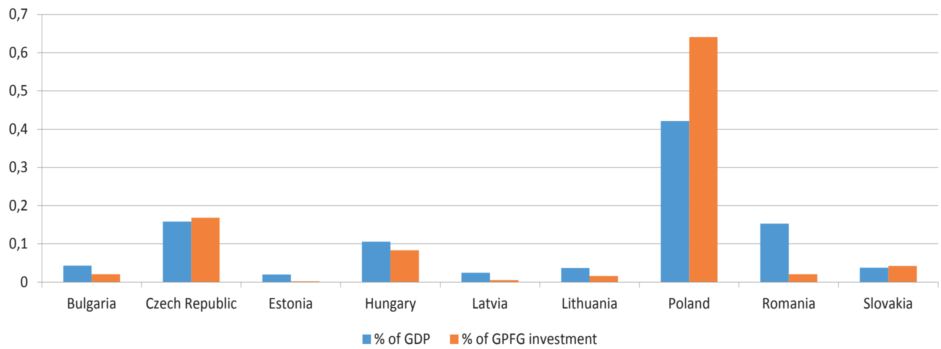

Figure 6.3. Share of a country's GDP versus share of capital allocation from GPFG
Source: own calculations based on the data from GPDG's webpage http://www.nbim.no/en/the-fund/holdings/ [accessed: 4.09.2015] and World Bank http://data.worldbank.org/indicator [accessed: 4.09.2015].

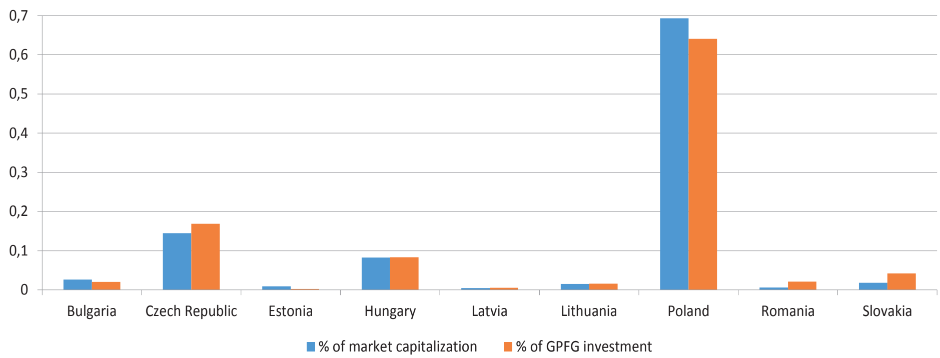

Figure 6.4. Share of market capitalization of listed companies versus share of capital allocation from GPFG
Source: own calculations based on the data from GPFG's webpage http://www.nbim.no/en/the-fund/holdings/ [accessed: 4.09.2015] and World Bank http://data.worldbank.org/indicator [accessed: 4.09.2015].

GPFG's investments in Central and Eastern Europe differ not only in terms of the total value of capital allocated in each economy, but also in terms of the number of portfolio holdings. The fund has 92 equity holdings in Poland, 9 in Romania as well as in Hungary, 4 in the Czech Republic and 1 in Lithuania. The fixed-income investments of the fund consist of national government bond holdings, with the exception of the Czech Republic where there are also 3 holdings in government related companies.

Given the fact that the majority of equity investments in Central and Eastern Europe is allocated in Poland, previous studies have focused on analyzing investment behavior of the Fund in this particular country. Urban (2015) using the financial data from companies listed on the Warsaw Stock Exchange employed the logit model to analyze the investment attractiveness of companies for the Norwegian sovereign wealth fund. The empirical findings of this research suggest that the likelihood of GPFG investment in a company listed on the Warsaw Stock Exchange is associated with a statistically significant level of total operating revenue, total assets, earnings per share, enterprise value and market capitalization of the firm. These results are to some extent similar to those obtained by Kotter and Lel (2011) suggesting that GPFG prefers investing in large companies. The findings of this study also suggest that not only the growth of earnings per share increases the probability of such investments, but also a company with GPFG as an investor has on average a higher level of earnings per share than companies not targeted for investment by GPFG. As to further research issue the author suggests to search for other motives for investment than financial ones, which is justified because of the relatively low predictive power of the models.

In another study Urban (2015) examined the impact of SWF ownership on the financial performance of firms. Empirical findings of this research based on regression models and financial data of Polish companies listed on the Warsaw Stock Exchange and targeted by the GPFG suggest that SWF ownership has a positive impact on the price to book value of the firm. In case of ROA and ROE as left hand variables the coefficients of GPFG's variable is not statistically significant, however positive. The author points out the need for conducting a comparative study for industry specific issues based on a larger data set and use of panel data.

The current holdings of GPFG on the Warsaw Stock Exchange by industry are presented in Figure 6.5. It suggests that listed companies from the financial sector have the highest share in the overall portfolio holdings of the Fund (38.9%), with industrials taking second place (15.7%) and basic materials third (12.22%). The share of oil & gas companies in the portfolio is 9.38%, consumer goods and consumer services 7.18% and 6.78% respectively. For the remaining industries it is less than 5%. In the case of equity holdings in Romania, 42.99% are listed companies from the financial sector, 32.45% from the oil & gas industry and 24.55% from utilities. The Fund's portfolio in Hungary is overwhelmed by companies from the financial sector with a share of over 90%. GPFG has also shares of 3 listed companies from the Czech Republic (utility, financial, telecommunications) and 1 from Lithuania (industrials).

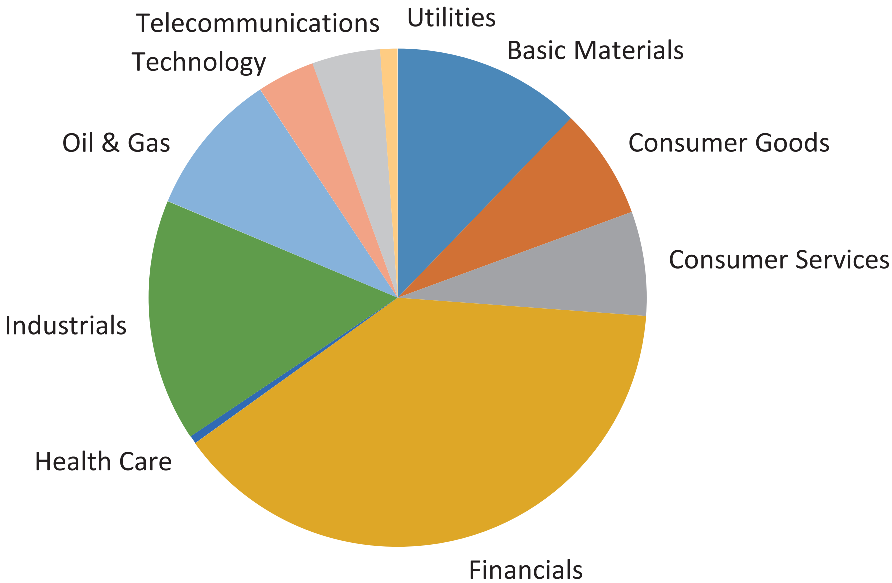

Figure 6.5. Holdings of GPFG on the Warsaw Stock Exchange by industry at the end of 2014
Source: own calculations based on the data from GPFG's webpage http://www.nbim.no/en/the-fund/holdings/ [accessed: 4.09.2015].

As for as the average ownership in companies from the Warsaw Stock Exchange is concerned, it ranges from 0.13% in utilities, 0.92% in telecommunications, through to 1.81% in financials and 2.15% in consumer services, and finally 3.18% in industrials and 3.60% in health care. The average ownership in the Polish companies is 2.15%, on the Hungarian stock market it is 0.96% and in Romania 1.23%.

The investment activity of the GPFG in Eastern and Central European is dominated by holdings in just one market – Poland. This concentration seems to be justified by the size of the economy and the capacity of the Warsaw Stock Exchange. However, to fully understand the investment preferences of the fund in this region, the global holdings of GPFG should be analyzed, which, given the size of the portfolio, seems to be a task for further research. In this context comparative analysis of GPFG's portfolio holdings from different emerging markets would be an interesting avenue for future research. Further studies should also focus on other than only financial characteristics of firms and take into account environmental, social and governance factors that could possibly determine the capital allocation of the largest SWF and socially responsible investor – Government Pension Fund Global.

6.4. Political implications of GPFG's capital allocation

SWFs, as it was pointed out earlier in this book, are a heterogeneous group of investors, with different objectives, changing over the time. The hybrid nature of these entities implies not only methodological difficulties in defining which state run fund is and which is not a SWF, but also makes it difficult or even impossible to draw conclusions that can be generalized to the entire group. Moreover, the lack of transparency about strategic asset allocation and the absence of a robust model describing it hinders in many cases the analysis on whether SWFs pursue political goals, rather than purely financial objectives (Bertoni, Lugo 2012). Against the majority of funds, GPFG is a unique case. The high transparency of its activities allow one to verify a hypothesis about financial as well as political motives of its investments. In this sub-chapter we address the issue of risk or concerns related to the activity of the Norwegian state-run fund.

Looking at the list of potential treats, bearing in mind the characteristics of GPFG, it is difficult to clearly point out a particular one. As regard to the pursuit of political and economic power objectives via SWFs, it seems to be very limited, probably due to the relatively low purely economic as well as political influence of Norway on other countries from the region and globally. SWFs can be use to support or complement other tools of political influence rather than replace them. Future studies should analyze the relationship between economic and political power of the SWF's host country and the level of political engagement of the funds. Given the fact that GPDF investments are fully transparent and there is no sign of concentration in sensitive industries of the countries, it is unlikely that the activity of this fund will stimulate financial protectionism in countries from the region. Contrary, promoting better regulations and corporate governance for financial markets along with providing regular input of work on new regulations for the financial market of many countries as well as globally, which the fund does, in the author's opinion affects markets in the opposite direction. However, GPFG can have a negative impact on the selected group of companies from the region. The political decision of the Norwegian Parliament to stop investing in coal-industry companies and withdraw the money previously invested in this sector, might affect the value of the shares and valuation of the companies. Due to the fact that the Norwegian fund has relatively low stakes in companies listed on stock exchanges, such a threat is rather limited. On the other side it is likely that in the future Norway will use its capital transferred to the economy as a bargaining chip to encourage a particular country to reduce its CO_2 emissions. Finally, addressing the issue of a conflict of interests between countries with SWFs and countries in which they invest, it is worth reminding that ethical guidelines for investment preclude capital allocation that conflict Norway's obligation under international as well as a given state's law. As a consequence of that, such risk is relatively low.

To sum up, the abovementioned analysis does not support the hypothesis that the investment activity of GPFG poses a significant and real threat to targeted companies or countries, however, it seem to be clear that the Fund has been used as a political tool. In the case of countries from Eastern and Central Europe, political use of the fund is rather limited, most likely due to the fact that this group of countries share the same canon of values, rules and principles as Norway does.

Conclusions

With USD 882 billion of assets under its management and 2.4% of holdings of total shares of companies in Europe, the Norwegian Government Pension Fund Global proves to be an important institutional investor with possible implications for asset prices. The latest decision of the fund to reduce its holdings in companies engaged in coal mining along with low prices of natural resources might have an influence on company valuations, located not only in Central and Eastern Europe. At the same time this political decision sends a clear signal to the public opinion that deeper and faster action needs to be taken to address the issue of global warming and climate change. Large institutional investors often have sufficient financial as well as political power to become drivers of change; GPFG's investment activity is clear evidence of that. Along with others institutional investors, GPFG can use capital allocation as a tool of political pressure, depending on the economies and companies it allocates capital to. However, without obligations regarding climate change on the global level, the influence of the Fund in this issue is rather limited.

Good corporate governance practices, sensitivity regarding human, social and environmental issues, and the ability to promote the canon of values professed by the Norwegian society are the key characteristics of GPFG, and have been the subject of analysis in this chapter. The growing capital engagement and high transparency standards give premise for further empirical studies not only about the impact of investments on financial performance of targeted companies but also on the political aspects of capital allocation.

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Chapter 7

The Political Significance of the Gulf Cooperation Countries' Sovereign Wealth Funds' Investments in Central and Eastern Europe

This chapter analyzes the potential political risks associated with the investment activity of the Gulf Cooperation Council (GCC), a "political and economic alliance" (Encyclopedia Britannica's website) consisting of the following member states: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates, hence almost the entire Arabian Peninsula.

The GCC funds rank third in terms of the value of investments (excluding investments in treasury bonds) in Central and Eastern Europe (CEE), behind Norway's and Asian funds, as they have been the origin of around a fourth of all SWF investments in the region. Consequently, it is necessary to analyze whether these investments do not pose political risks, understood as a threat to national security and political stability of each of the countries.

This chapter starts with an analysis of the importance of the GCC SWFs in terms of their global investments. It then analyzes the main directions of these investments, both in terms of targeted countries and targeted sectors, before outlining the GCC funds' investment activity in CEE and providing a comparison with these funds' global investment activity in order to estimate their interest in the studied region. Then, the chapter presents GCC countries' political and economic interests, both at the global scale and in CEE. Finally, the conclusion intends to answer the question regarding the political risks involved with GCC SWFs' investments in CEE.

7.1. The global importance of GCC countries' SWFs

The GCC countries' funds account for the most important group of SWFs in terms of assets under management. According to data available on the Sovereign Wealth Fund Institute's website, as of October 2014 the Middle East's (of which GCC SWFs form a significant part) SWFs' assets represented ca. 37.1% of global SWF assets, less than their Asian counterparts (which accounted for approximately 39.1% of the global SWF assets). However, an analysis of only the world's 10 biggest SWFs (which accounted for around 75% of all SWF assets as of September 2015 puts GCC SWFs in the first place (with 43.3% of the assets), before Asian funds (with 40.4% of the assets). Table 7.1 below presents the major SWFs from GCC countries with some of their key characteristics.

Table 7.1. Major SWFs from GCC countries

SWF	Country	Assets under Management (USD billion)	Linaburg-Maduell Transparency Index
Abu Dhabi Investment Authority (ADIA)	United Arab Emirates	773	6
SAMA Foreign Holdings	Saudi Arabia	671.8	4
Kuwait Investment Authority (KIA)	Kuwait	592	6
Qatar Investment Authority (QIA)	Qatar	256	5
Investment Corporation of Dubai (ICD)	United Arab Emirates	183	5
Abu Dhabi Investment Council (ADIC)	United Arab Emirates	110	n/a

Source: Sovereign Wealth Fund Institute website, http://www.swfinstitute.org/sovereign-wealth-fund-rankings/ [accessed: 01.09.2015].

GCC SWFs present some key characteristics (besides the obvious geographical criterion), which may allow to class them as a distinct group among SWFs. First, they are almost uniformly funded by commodity (mostly oil) revenues, unlike for example Asian funds, which are much more frequently funded by non-commodity revenues (mostly state foreign exchange reserves). Second, the fact that they are funded by commodity revenues may also have a direct impact on their investment behaviour. According to Bazoobandi (2011), GCC funds have a "higher risk appetite" and adopt a longer-term investment policy than SWFs funded by non-commodity revenues. Third, SWFs are generally considered as relatively opaque investors (Truman 2007; Kotter, Lel 2008) compared to other global financial institutions, unwilling to provide much information regarding the size of their assets under management or their overall investment motives. However, a comparison of the values of the Linaburg-Maduell Index for GCC SWFs (included in Table 7.1 above, with values from 0 to 10 – 0 meaning opacity and 10 meaning transparency) with the value of the Index in the case of other major SWFs (an average of 5.2

for GCC SWFs and 7.3 for non-GCC SWFs) may lead to the conclusion that Gulf funds are even more opaque than their peers from other parts of the world. This is confirmed by an analysis of the results achieved by SWFs funded by receipts from the sales of oil in the Truman fund scoreboard (Aizenman, Glick 2008).

7.2. The directions of GCC SWFs' global investments

Based on data available in the transaction database of the Sovereign Wealth Fund Institute, the total value of GCC SWF transactions closed between the years 1974 and the third quarter of 2014 may be set at around USD 233 billion. However, there is no common investment pattern for Gulf SWFs (and, in fact, there are sometimes significant differences between the behaviours of each Gulf SWF, some of them being a consequence of government mandates to invest in given sectors, as it is in the case of the International Petroleum Investment Company (IPIC), founded by the Abu Dhabi government "to invest in the energy and related sectors across the globe," as mentioned on the fund's website). Nevertheless, almost 48% of these investments were directed toward countries forming part of the European Union (EU) as of August 2014, with the United Kingdom (UK) alone accounting for 23.5% of all Gulf funds' investments, and so nearly half of the European investments. The other two major destinations were the United States (US) (which accounted for 16.6% of the investments) and Asian countries (which accounted for 10.4% of the investments, of which over three-fourths were directed solely to China and Taiwan). This is summed up in Chart 7.1 below.

Concerning the recipient industries, the financial, real estate, energy, infrastructure and industrial sectors have accounted for 82% of all GCC SWF investments since 1974. Some of the investments in the infrastructure sector have caught the attention of the media and politicians, especially at the height of the crisis in 2008 and 2009. In fact, GCC SWFs have invested some of their funds into companies managing airports, ports or water facilities, which, along with the funds already mentioned opacity, brought doubts whether these investments would not be dangerous for the recipient countries from a national security point of view. However, it is interesting to note that according to the Sovereign Wealth Fund Institute Transaction Database, the totality of the investments in the infrastructure sector has been carried out after 2007, and so during times when these investments were much more attractive in terms of price. This could mean that these investments were economically motivated. In fact, should these investments be politically motivated, it is most probable that the transactions would be carried out irrespective of the price. Chart 7.2 below presents a breakdown of GCC SWF global investments by sector.

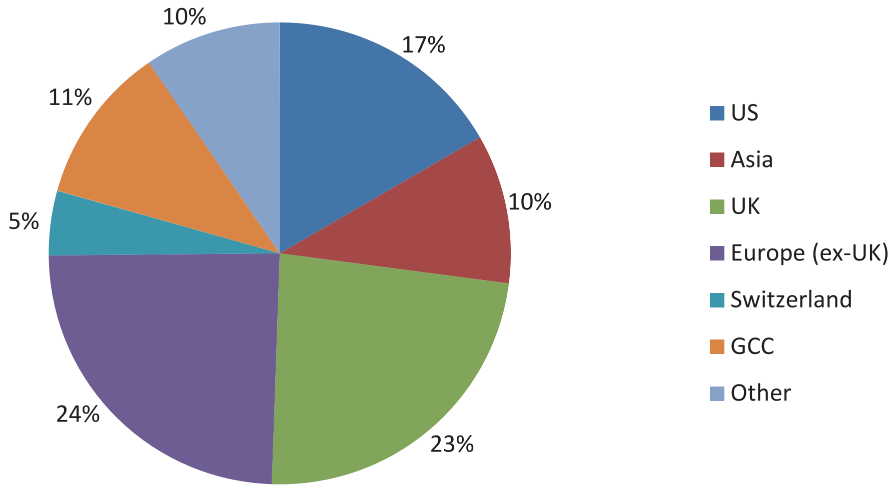


Chart 7.1. The geographical destinations of GCC SWFs' global investments since 1974 (% of total)
Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.

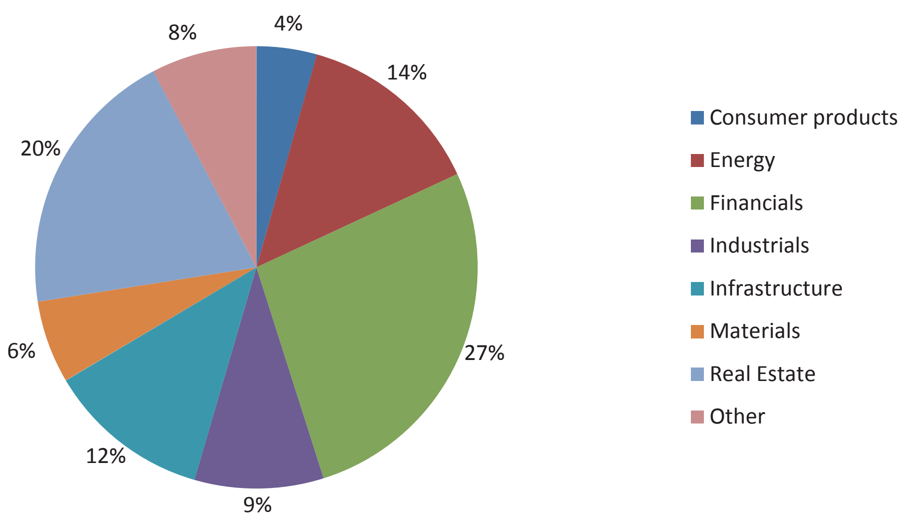
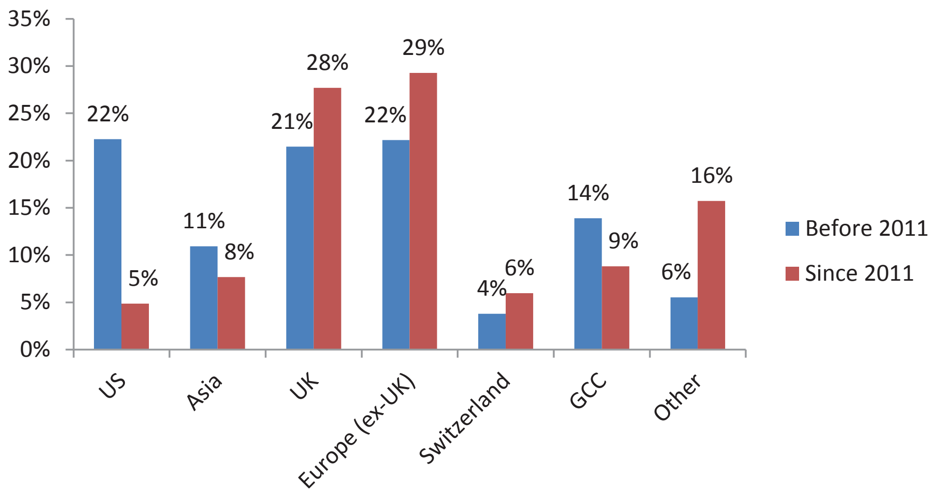


Chart 7.2. GCC SWF global investments by sector since 1974 (% of total)
Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.

GCC SWFs' investment policy has been significantly changing over time, which is especially visible in the analysis of the evolution of their geographical asset allocation policy. In fact, a comparison of the funds' investments between the years 1974 and 2010 with the investments made between 2011 and the third quarter of 2014 shows that with time, GCC SWFs have significantly decreased their investments in the US. While these investments made up around 22.2% of the investments before 2011, their share decreased to only 4.9% in the years since 2011. On the contrary, an analysis of the same two periods shows that there has been a significant increase in the share of the investments directed toward the EU (43.6% of the investments before 2011, and 56.5% of the investments since 2011).



Graph 7.1. Share of GCC SWF investments by region before and since 2011 (% of total)
Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.

7.3. GCC SWF investments in CEE

While Gulf SWFs seem to have increased the share of the European investments in their total investments over time, no such trend may be observed in the case of their CEE investments. Based on data from the Sovereign Wealth Fund Institute Database, the Sovereign Wealth Center and government official information, the total value of GCC SWF investments in CEE may be estimated at around USD 785 million. However, considering that the transaction values of some of the investments have not been disclosed, the total value of GCC

SWFs' exposure to the region, based on the estimations presented in the fourth chapter of this paper, could be set at ca. USD 875.5 million.

Both relative to the share of CEE in their total investments and to the share of their investments in the sum of SWF investments in CEE, the region seems to be underinvested by GCC SWF funds. The following calculations include only the investments whose value has been disclosed. First, investments in CEE countries make up only ca. 0.38% of Gulf funds' total investments (while, as it has been mentioned, investments in the EU accounted for ca. 48% of the total investments). Second, GCC SWF investments in CEE made up around 21,5% of all (excluding investments in treasury bonds) SWF investments in the region. In turn, the share of GCC SWF total transactions in global SWF transactions (based on the Sovereign Wealth Fund Institute Transaction Database) amounted to ca. 27.4%. It is therefore possible to conclude that while globally CEE countries have been only a minor destination for global SWF investments, the region has been an even less important destination for Gulf funds. Table 7.2 below presents the exposures of each of the Gulf funds to CEE, excluding the estimates of the undisclosed investments.

Table 7.2. Gulf funds' investments in CEE

SWF	Investments in CEE value (USD million)	% of total SWF investments in CEE (excluding investments in T-bonds)	Major targeted sectors	Targeted countries
Abu Dhabi Investment Authority	256	7.5	Real Estate	Czech Republic, Poland, Slovakia
Kuwait Investment Authority	421	12.3	Real Estate	Poland
Qatar Investment Authority	n/a	n/a	Real Estate	Poland
Oman State General Reserve Fund	108	3.2	Real Estate	Hungary
Total	785	23.0		

Source: own calculation based on sources listed in Annex 1.

As it is well shown by Table 7.2 above, in their investments in CEE countries, GCC SWFs have primarily been interested in the real estate sector. The targeted assets included mainly office buildings, real estate management companies and shopping malls. Such a preference for the sector is in accordance with the global evolution of GCC SWF investment policy – taken alone it has been the target of almost a third of all GCC SWF investments since 2011, up from around 14.3% of the investments before 2011, which demonstrates well the growing interest of Gulf funds for real estate assets. However, the financial, real estate, energy, infrastructure and industrial sectors still remain among the preferred sectors of Gulf funds (although their share in the total investments have decreased, and in general one may note that the funds have gradually distributed their investments more equally among industries). The question is therefore why Gulf funds invest so little (relative to other SWFs) in CEE and once they invest in the region why do they barely invest in sectors other than real estate. The following two subchapters will analyze whether a possible reason is not the low level of political and economic interests of GCC states in the region.

7.4. GCC countries' global political and economic interests

Despite the fact that one of GCC's main founding aims was to "achieve coordination and integration among Member States in all fields, including coordination of their policies and trade relations with the other countries and regional and international blocs" (Gulf Cooperation Council's website), there is currently no foreign policy common to all the GCC member states (Chatham House 2014). Nevertheless, there seem to be some similarities among the Gulf states' foreign policy strategic goals. An essential similarity in this respect is the traditional political competition with Iran: as a matter of fact, the desire to unite against Iran was one of the primary ambitions behind the establishment of the GCC itself in 1981 (Ulrichsen 2009).

The absence of a common GCC foreign policy may be a reflection of the fact that the Middle East region "still remains one of the least integrated in the world," which might be a consequence of the "lack of strong states" (Council on Foreign Relations 2012). Such a lack of strong states could stimulate political competition between the countries. This phenomenon could have in turn been reinforced by the political instability that the region has witnessed in the past years, with the so-called Arab Spring, the growth in power of the Islamic State or the Yemeni civil war to name only the major events. Therefore, all this may have led the GCC states to focus especially on the regional developments in their foreign policies and put a relatively lower emphasis on extra-regional affairs. As an example of such focus on the regional level it is worth to quote the official website of the Qatari Ministry of Foreign Affairs, which states that in terms of international cooperation, Qatar will aim to "enhance the regional role of Qatar on the economic, political, and cultural levels especially within the framework of the Gulf Cooperation Council, the Arab League, and the Islamic Cooperation Organization" (Qatar"s Ministry of Foreign Affairs" official website).

Regarding economic goals, one needs to consider the relative dependence of Gulf economies on revenues from sales of commodities, which makes these economies vulnerable to changes in global commodity prices. This is perhaps why the energy sector is among the most frequently targeted by the Gulf funds globally. At least one of them, the IPIC, has a clear mandate to invest in energy companies (the fund"s investments in the sector account for over 41% of its total investments). In order to decrease the mentioned financial dependence from the sales of commodities, it has become fundamental for Gulf states to diversify their revenues (which, in particular, means moving revenue streams to foreign economies, and, at best, to more remote parts of the world).

Such a need for revenue diversification used to be a major justification for the creation of SWFs in most of the Gulf countries. A proof of the fact that Gulf SWFs are (at least, in part) meeting this commitment is that compared to other SWFs, GCC funds have made few domestic investments: the share of the domestic investments in the total value of their investments as of August 2014 stood at ca. 11% versus 20.5% for SWFs globally. However, in the years 1974–2006 this share has amounted to only 0.44%, which means that almost the totality of their investments were directed abroad (and outside of the Arabian peninsula, as there were no investments in other GCC countries).

At the same time, as it has already been mentioned, in terms of geographic asset allocation policy, many Gulf SWFs have strongly focused on investments in the UK. This was especially significant in the years 1974–2006, when investments in this country accounted for ca. 46% of all GCC SWF investments, while investments in other European countries accounted for only 10%, as it is shown by Chart 7.3 below.

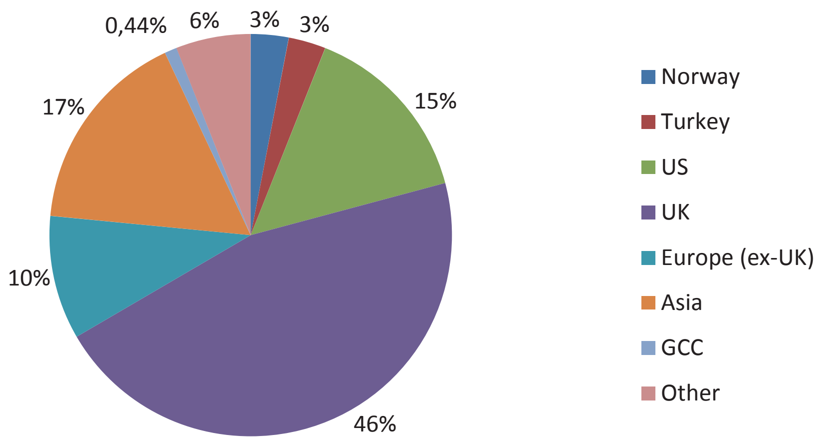


Chart 7.3. The geographical asset allocation of Gulf SWFs' investments in 1974–2007 (% of the investments
Source: own calculation based on the Sovereign Wealth Fund Institute Transaction Database.

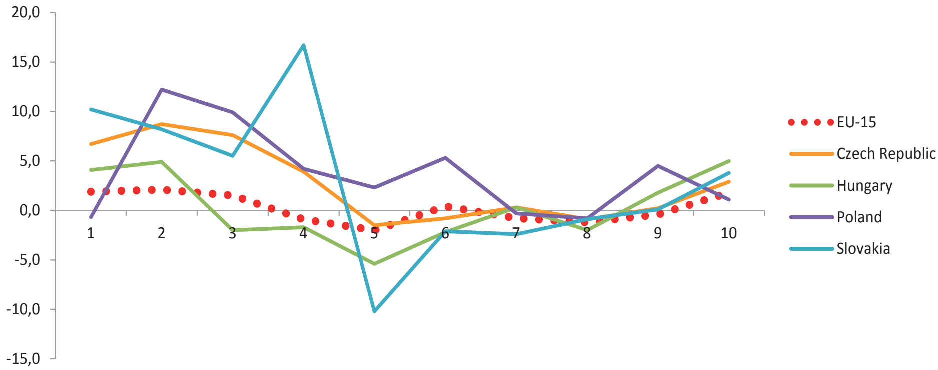
A potential explanation for this strong focus on the British economy is that Gulf funds chose long-term growth and stability over short-term profitability. They invested significantly more in the UK or the US than in the CEE economies (on a relative basis), despite the fact that the latter have been offering more attractive rates of economic growth in the past years. This policy may be also exemplified in Gulf funds' highly notorious investments in some of the most prestigious Western companies and brands. Finally, it is also essential to stress that besides long-term stability and the development of the economy, the UK has strong historical ties and the US have strong political ties with many GCC countries – this may be also an important decision-factor for Gulf SWFs.

7.5. GCC countries political and economic interests in CEE

In line with what has been said regarding the fact that Gulf countries have so far focused mostly on the Arab world and less on extra-regional affairs in their foreign policies, it is important to see that CEE countries are almost nonexistent in the policies of GCC countries. A good illustration of this lack of interest is the limited diplomatic network that these countries have in CEE countries: for example, Oman and Bahrain do not have any diplomatic mission in any of the CEE countries; Qatar does not have an embassy in the Czech Republic, Slovakia, nor in any of the Baltic countries although it does have an embassy in most Western European countries. Qatar is a good proxy in this respect, as the country "has been engaging in an ever-expanding foreign policy" (Khatib 2013) since 1995. It may be assumed that the lack of an expanded network of diplomatic missions may usually be, in turn, a disadvantage for companies or funds that aim to invest in a foreign country.

The economic interests of GCC countries in CEE seem also to be limited. Trade ties between GCC and CEE countries remain very limited as they "account for less than 1% of the GCC's total" (The Economist Intelligence Unit 2011). However, it is worth to note that trade between Asian and GCC countries has significantly increased in the last decades, while at the same time Asia has become an increasingly less and less important destination for GCC SWF investments (16.6% of GCC's investments before 2007 and only 8.2% of GCC's investments since 2011). This shows that trade may be not the best proxy for SWFs' investments' geographical directions. Therefore, perhaps a more accurate explanation for the low investments in CEE may be found in GCC countries' above-mentioned revenue diversification policy. Here it is interesting to note that, for example, in 2014 Poland started to import gas from Qatar with around 1.5 billion cubic meters of annual imports of liquefied natural gas (The International Energy Agency 2014). However, these imports represent only around 1.5% of Qatar's annual gas exports. Overall, comparing with other emerging and developed economies, CEE economies do not seem to be an attractive destination. As Bazoobandi notes it, "in contrast to the decline in investment in the Western markets, higher expected returns have become a key incentive for the Gulf governments to invest in emerging markets" (Bazoobandi 2011). However, although CEE countries' growth rates have proven to be especially high in comparison with other European countries, they still remained less attractive than the rates achieved by some of the fastest growing Asian economies.

This search for extra profitability in the emerging markets may also help to explain why Gulf SWFs dedicated their CEE investments almost entirely to the real estate sector and rather avoided investing in other sectors: for example, it is worth to note that some of the investments in CEE's real estate were directed toward shopping centers (which is for example the case of Abu Dhabi Investment Authority's investments in Slovakia). As a matter of fact, owing mainly to high retail sales before the crisis of 2008, shopping malls were very dynamic sectors in the CEE economies. Graph 7.2 below compares retail sales annual growth in CEE's major economies and in the 15 EU members from before the EU's enlargement in May 2004.



Graph 7.2. Retail sales' annual growth in the main CEE countries and in EU-15 (%)
Source: Eurostat.

Gulf funds may have been investing mainly in CEE's real estate because of the sectors' high business potential (relatively higher than the potential of other sectors). In other words, Gulf funds agreed to invest in CEE's peripheral economies only on the condition of higher expected returns, seeing these potential returns as a compensation for not investing in the European so-called core markets.

7.6. Conclusion: Are there political risks stemming from GCC SWF investments in CEE?

The previous subchapter mentioned the fact that Gulf SWFs are, overall, acting consistently with their governments' policy of diversifying state revenues. Furthermore, although, as it has been already underlined, investment patterns may vary significantly from one Gulf SWF to another, the geographical preference for investments in the UK, a country with close historical ties with many Gulf countries, proves that the latter are not evaluating their investments only in terms of economic factors but are also putting emphasis on political factors. These elements could mean that Gulf funds are not formulating their investment strategy independently from the government or based solely on economic and financial criteria and that they could be considered as tools used by Gulf states to reach their political goals. GCC SWFs have also invested globally in some fragile industries, such as infrastructure. All these elements could be considered as factors of political risk for recipient economies.

However, an analysis of GCC SWFs' global investment behaviour shows that ca. 70% of the investments have been directed toward the finance, real estate, energy and industrials sectors, all relatively safe from a political stability perspective (investments in the energy sector could be potentially considered as a threat to the national security of recipient economies, however, the bulk of these investments were minority holdings in global oil and gas companies), with investments in the infrastructure sector accounting for around 12% of the investments. As this chapter has specified earlier, these investments in the infrastructure sector must also have been economically motivated at least to some extent, as they have all been carried out after 2007, when global asset prices were falling significantly due to the financial crisis. Finally, apparently none of the political risks involved with the mentioned investments in the infrastructure sector have materialized so far.

In the case of CEE countries, political risks associated with GCC SWF investments seem to be even more limited. Referring to the classification of the ways through which SWFs may pose political risks for recipient countries as presented in Chapter 2 of this book, it is first important to note that GCC countries have no specific political interests in CEE, which is well proven inter alia by the Gulf countries' scant diplomatic network in the region. Second, most SWF investments in the region have so far been directed toward real estate and other assets safe from a political risk perspective, with the investments having been most probably targeted owing to their attractiveness in terms of expected financial returns. Most importantly, contrary to some of the countries most targeted by Gulf funds in their investments, based on available information CEE countries have not been until recently the target of significant investments in sectors deemed sensitive from a national security point of view, such as, for example, energy or infrastructure. Third, also due to the fact that GCC SWFs have been mostly interested in real estate in their CEE investments the risk that some investments might be carried out in order to gain access to some technologies seems to be insignificant.

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Conclusions

The main purpose of our research was to determine the main motives for SWF investments in CEE countries. We considered if commercial goals are the only reason behind their entering regional markets or there are other, political motives. If they are politically biased, do they pose any threat for the stability and security of the CEE countries?

The main conclusion of our work could be summarized in five points presented below:

1. SWFs were in analysed period of time not very active in the region

Despite ongoing convergence with western European countries, the financial markets of CEE still remains underdeveloped. It results primarily with their limited size that made them illiquid and more vulnerable foe external shocks. These weaknesses seem to lay behind the law level of financial engagement of SWFs in the region. SWFs seek efficient, abundant and liquid capital markets to accommodate their rising assets. The CEE markets are much less attractive than Western European.

For the bulk of SWF investments in the region has been responsible Norway's fund. Other funds have been relatively cautious towards investing in the CEE economies. Taking into consideration announcements of some SWFs owners (e.g. China) we can suppose that those situation is probably going to change in the future.

2. SWFs are political instruments of states

SWFs are not independent political actors but rather states' investment arms that can be instrumentally use to pursue political and economic power. Therefore, the political significance of SWFs, its stabilising or destabilising inclinations, are a function of their sponsoring states. In one set of circumstances a given SWF can be steered only by commercial motives, but in another the very same SWF can realise the political strategy of its state. Moreover, those two motives can coexist in the same time. In consequence, it is no sense in analysing the SWFs behaviours separate from the political interests of states that control them. In this context also making any strong conclusions about the motives of the SWFs, seems to be not possible. They are as diverse and changing in time as policies of the owner states.

SWF activities in the particular country or region could be potentially harmful only when the donor state have interests in it. Unless the SWF owner does not have vital national interests in the region. the risk of hostile manoeuvring via SWFs is limited. Due to this fact, all analyses of funds activities have to include an assessment of the political interest of their owners in a particular state or region.

3. There are some risks related to the SWFs activities in the CEE

We have found three types of risks regarding usage of SWFs by sponsoring states, that seem to be particularly important from the perspective of CEE countries. Firstly, SWFs are convenient to use leverage on a host country. All CEE states have to actively search for foreign capital and investment promises from foreign financial institutions are very much welcomed. It provides space for political pressure from states behind potential investors. Secondly, SWFs could be used to exercise control over strategic resources or critical infrastructure. Thirdly, through SWFs foreign countries could search for hostile take overs and getting access to privileged technological and military know-how.

4. There is no evidence of any hostile actions of the SWFs in the CEE

Neither SWFs investment record in the CEE, nor in-depth case studies analyses of three major SWFs holders active in the region, give grounds to corroborate the hypothesis about potential security threats linked with the SWFs. Hitherto, SWFs investments in the CEE were mainly financially motivated and did not pose any major political problem for Poland and other countries in the region. Any from the three above mentioned risks related to the SWFs operations has materialised. The only one case, when political motivation of investments is possible to prove is Norwegian GPF Global. That fund officially incorporated non-commercial motives into its decision-making process, however in a way that hardly can be perceived as “hostile” for the recipients of their investments. Through its SWF the Norwegian government try to promote good corporate governance practices, human rights or environmental issues, what is rather beneficial for the CEE countries.

5. Concerns over SWF activity are legitimate

This monograph has demonstrated that the bulk of concerns regarding SWF investments in the CEE is rather unfounded. However, from the fact that something has not occurred in the past, one should not infer that it impossible in the future. Quite the contrary, we have argued that SWFs, being political instruments of in the hands of their creators, may be potentially dangerous. Therefore, CEE countries should employ political strategies to monitor SWFs investments. It will permit them to react whenever SWFs should act in a way that threatens national security.

In this vein, the need to upgrade SWF transparency outweighs any other goals to be pursued by host countries with regard to policy choices pertinent to SWF investments. Ultimately, an international regulatory initiative designed to improve SWF disclosure standards needs to be launched (accompanied by a catalogue of regulatory responses if such standards are not met).

It is an open question if relatively small CEE countries are capable of implementing an effective monitoring regime on an individual or even regional basis. As aforementioned, wider international cooperation, perhaps at pan-EU level, is requisite to ensure that benefits from capital inflows are not to be squandered through disruptive practises followed by SWFs.

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Appendices

Appendix 1. The Largest Global SWFs [Their Assets under Management (AuM), Origins and Transparency (L-M index)] as of August 14, 2015

Country	Sovereign Wealth Fund Name	AuM (USD in billion)	Est.	Origin	L-M* Index
Norway	Government Pension Fund – Global	882.0	1990	Oil	10
UAE – Abu Dhabi	Abu Dhabi Investment Authority	773.0	1976	Oil	6
China	China Investment Corporation	746.7	2007	Non-Commodity	8
Saudi Arabia	SAMA Foreign Holdings	671.8	n/a	Oil	4
Kuwait	Kuwait Investment Authority	592.0	1953	Oil	6
China	SAFE Investment Company	547.0	1997	Non-Commodity	4
China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	400.2	1993	Non-Commodity	8
Singapore	Government of Singapore Investment Corporation	344.0	1981	Non-Commodity	6
Qatar	Qatar Investment Authority	256.0	2005	Oil & Gas	5
China	National Social Security Fund	236.0	2000	Non-Commodity	5
Singapore	Temasek Holdings	193.6	1974	Non-Commodity	10
UAE – Dubai	Investment Corporation of Dubai	183.0	2006	Non-Commodity	5
UAE – Abu Dhabi	Abu Dhabi Investment Council	110.0	2007	Oil	n/a
Australia	Australian Future Fund	95.0	2006	Non-Commodity	10
Russia	Reserve Fund	88.9	2008	Oil	5
South Korea	Korea Investment Corporation	84.7	2005	Non-Commodity	9
Russia	National Welfare Fund	79.9	2008	Oil	5
Kazakhstan	Samruk-Kazyna JSC	77.5	2008	Non-Commodity	n/a

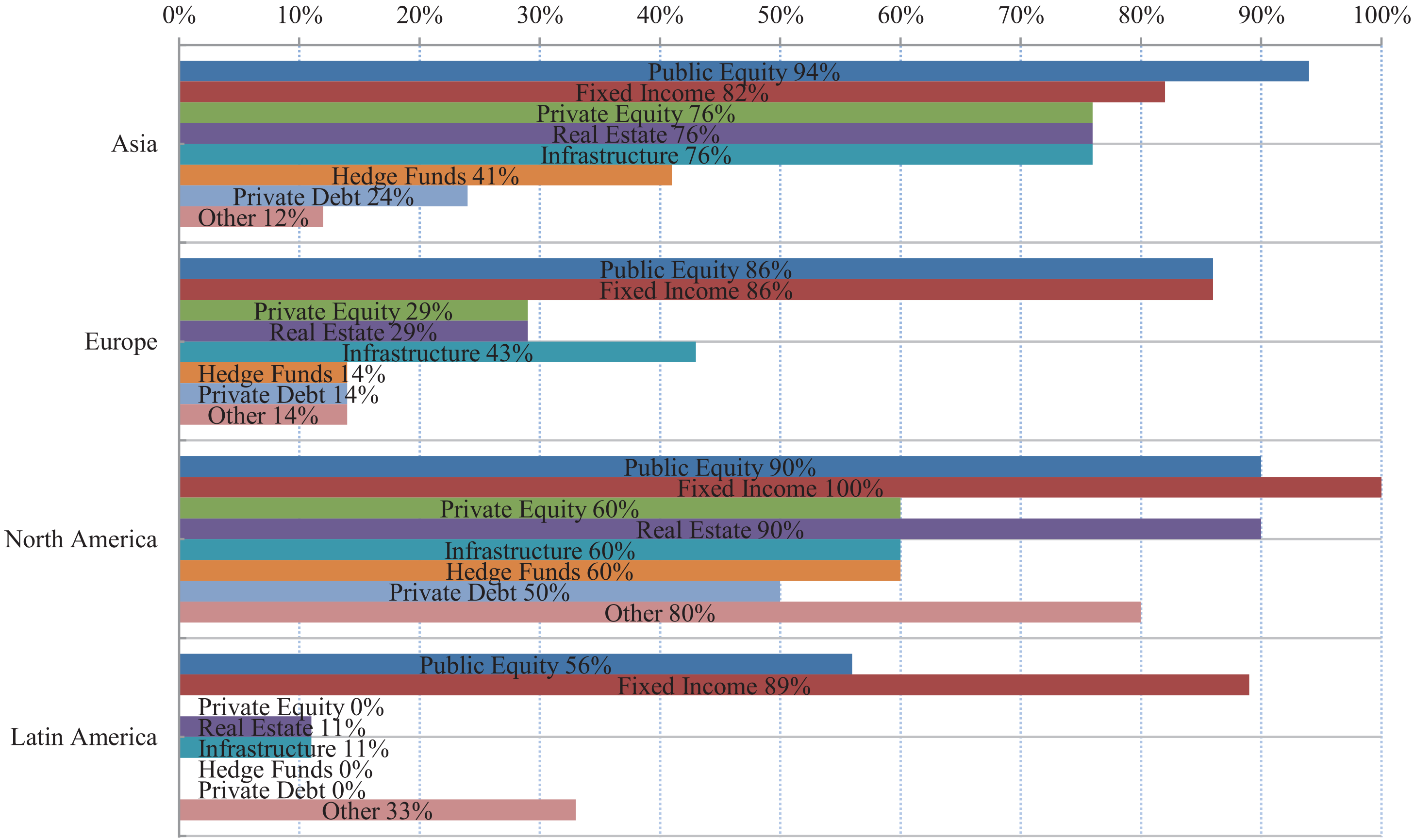
Kazakhstan	Kazakhstan National Fund	77.0	2000	Oil	2
UAE – Abu Dhabi	International Petroleum Investment Company	66.3	1984	Oil	9
UAE – Abu Dhabi	Mubadala Development Company	66.3	2002	Oil	10
Libya	Libyan Investment Authority	66.0	2006	Oil	1
Iran	National Development Fund of Iran	62.0	2011	Oil & Gas	5
US – Alaska	Alaska Permanent Fund	53.9	1976	Oil	10
Algeria	Revenue Regulation Fund	50.0	2000	Oil & Gas	1
Malaysia	Khazanah Nasional	41.6	1993	Non-Commodity	9
Brunei	Brunei Investment Agency	40.0	1983	Oil	1
US – Texas	Texas Permanent School Fund	37.7	1854	Oil & Other	9
Azerbaijan	State Oil Fund	37.3	1999	Oil	10
Ireland	National Pensions Reserve Fund	27.4	2001	Non-Commodity	10
France	Strategic Investment Fund	25.5	2008	Non-Commodity	9
New Zealand	New Zealand Superannuation Fund	21.8	2003	Non-Commodity	10
US – New Mexico	New Mexico State Investment Council	19.8	1958	Oil & Gas	9
Iraq	Development Fund for Iraq	18.0	2003	Oil	n/a
Canada	Alberta's Heritage Fund	17.5	1976	Oil	9
US – Texas	Permanent University Fund	17.2	1876	Oil & Gas	n/a
East Timor	Timor-Leste Petroleum Fund	16.6	2005	Oil & Gas	8
Chile	Social and Economic Stabilization Fund	15.2	2007	Copper	10
UAE – Federal	Emirates Investment Authority	15.0	2007	Oil	3
Russia	Russian Direct Investment Fund	13.0	2011	Non-Commodity	n/a
Oman	State General Reserve Fund	13.0	1980	Oil & Gas	4
Bahrain	Mumtalakat Holding Company	10.5	2006	Non-Commodity	10

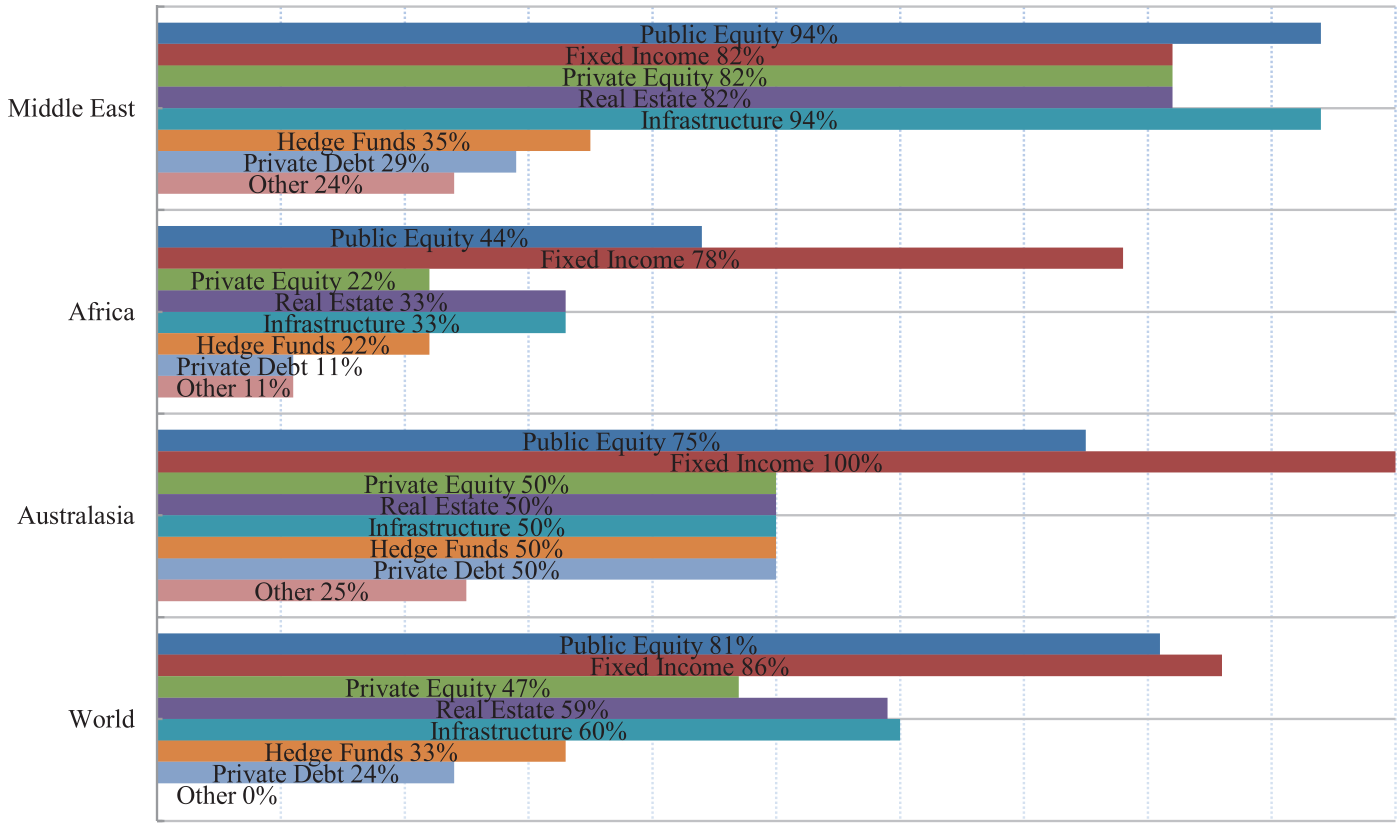
Country	Sovereign Wealth Fund Name	AuM (USD in billion)	Est.	Origin	L-M* Index
Peru	Fiscal Stabilization Fund	9.2	1999	Non-Commodity	n/a
Chile	Pension Reserve Fund	7.9	2006	Copper	10
Mexico	Oil Revenues Stabilization Fund of Mexico	6.0	2000	Oil	4
Oman	Oman Investment Fund	6.0	2006	Oil	4
Italy	Italian Strategic Fund	6.0	2011	Non-Commodity	n/a
Botswana	Pula Fund	5.7	1994	Diamonds & Minerals	6
US – Wyoming	Permanent Wyoming Mineral Trust Fund	5.6	1974	Minerals	9
Trinidad & Tobago	Heritage and Stabilization Fund	5.5	2000	Oil	8
Brazil	Sovereign Fund of Brazil	5.3	2008	Non-Commodity	9
Saudi Arabia	Public Investment Fund	5.3	2008	Oil	4
China	China-Africa Development Fund	5.0	2007	Non-Commodity	5
Angola	Fundo Soberano de Angola	5.0	2012	Oil	8
US – North Dakota	North Dakota Legacy Fund	3.2	2011	Oil & Gas	n/a
US – Alabama	Alabama Trust Fund	2.5	1985	Oil & Gas	9
Kazakhstan	National Investment Corporation	2.0	2012	Oil	n/a
Nigeria – Bayelsa	Bayelsa Development and Investment Corporation	1.5	2012	Non-Commodity	N/A
Nigeria	Nigerian Sovereign Investment Authority	1.4	2012	Oil	9
US – Louisiana	Louisiana Education Quality Trust Fund	1.3	1986	Oil & Gas	n/a
Panama	Fondo de Ahorro de Panamá	1.2	2012	Non-Commodity	n/a
UAE – Ras Al Khaimah	RAK Investment Authority	1.2	2005	Oil	3
Bolivia	FINPRO	1.2	2012	Non-Commodity	n/a

Senegal	Senegal FONSIS	1.0	2012	Non-Commodity	n/a
Palestine	Palestine Investment Fund	0.8	2003	Non-Commodity	n/a
Venezuela	FEM	0.8	1998	Oil	1
Kiribati	Revenue Equalization Reserve Fund	0.6	1956	Phosphates	1
Vietnam	State Capital Investment Corporation	0.5	2006	Non-Commodity	4
Gabon	Gabon Sovereign Wealth Fund	0.4	1998	Oil	n/a
Ghana	Ghana Petroleum Funds	0.5	2011	Oil	n/a
Indonesia	Government Investment Unit	0.3	2006	Non-Commodity	n/a
Mauritania	National Fund for Hydrocarbon Reserves	0.3	2006	Oil & Gas	1
Australia	Western Australian Future Fund	0.3	2012	Minerals	n/a
Mongolia	Fiscal Stability Fund	0.3	2011	Minerals	n/a
Equatorial Guinea	Fund for Future Generations	0.1	2002	Oil	n/a
Papua New Guinea	Papua New Guinea Sovereign Wealth Fund	n/a	2011	Gas	n/a
Turkmenistan	Turkmenistan Stabilization Fund	n/a	2008	Oil & Gas	n/a
US – West Virginia	West Virginia Future Fund	n/a	2014	Oil & Gas	n/a
Mexico	Fondo Mexicano del Petroleo	n/a	2014	Oil & Gas	n/a
	Total Oil & Gas Related	**4,168.6**			
	Total Other	**3,115.1**			
	TOTAL	**7,283.7**			

Source: SWF Institute Fund Rankings: http://www.swfinstitute.org/fund-rankings/ [accessed: 14.08.2015]. Note the Linaburg-Maduell (L-M) SWF transparency index methodology is summed up on the Sovereign Wealth Fund Institute website: http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/ [accessed: 15.09.2015].

Appendix 2. Proportions of Global and Regionally Based Sovereign Wealth Funds Investing in Each Asset Class as of the end of 2014





Source: 2015 Preqin Sovereign Wealth Fund Review: Exclusive Extract available at: https://www.preqin.com/docs/reports/2015-Preqin-Sovereign-Wealth-Fund-Review-Exclusive-Extract-June-2015.pdf [accessed: 12.08.2015].

Appendix 3. Bucharest Stock Exchange

Profile: Although the origins of the Bucharest Stock Exchange date back to 1882, the market was re-established in April 1997 and the first trading session took place later that year. Ownership of the Bucharest Stock Exchange is dispersed among domestic and international financial institutions and the bourse has aspirations to become a regionally competitive and diversified emerging market. The exchange's strategy is designed to complete the privatization process, enhance market breadth and depth, improve visibility and elevate the bourse to emerging market status.

Source: Bucharest Stock Exchange website available at: http://www.bvb.ro/AboutUs/Overview [accessed: 31.08.2015].

Table A3.1. Equity trading figures as of 2014

Category	Shares			Sec. Derivatives		ETFs		UCITS	
	EOB	Off EOB	Reporting Trades	EOB	Off EOB	EOB	Off EOB	EOB	Off EOB
Turnover (EUR m)	1,334	857	–						
Trades	763,115	1,350	–	197,174	–	1,624	–	1,946	–
Market Cap. (EUR m)	18,385			–		–		10	
Listings	83			113		1		3	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27. Abbreviations used: UCITS = Undertakings for Collective Investment in Transferable Securities, ETFs = Exchange Traded Funds, EOB = Electronic Order Book.

Table A3.2. Bonds trading figures as of 2014

Category	EOB	Off EOB
Turnover (EUR m)	14	21
Trades	305	20
Listings	71	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Table A3.3. Derivatives trading figures as of 2014

Category	Stock/Index Options and Futures	Bond Options and Futures	Commodities
Notional turnover (EUR m)	-	-	-
Contracts Traded	-	-	-

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Appendix 4. Bulgarian Stock Exchange – Sofia

Profile: Bulgarian Stock Exchange – Sofia was officially licensed by the State Securities and Exchange Commission to operate as a stock exchange on October 9, 1997 and is currently the only active stock exchange in Bulgaria. The scope of its activity comprises: organizing trading in securities and other financial instruments, operation and maintenance of information systems for securities trading, establishment and maintenance of a clearing system guaranteeing the settlement of obligations assumed under securities transactions executed on the Exchange. The Exchange is 50.05% owned by the State (via a stake held by the Bulgarian Ministry of Finance), other shareholders include local and foreign companies and private individuals.

Source: Bulgarian Stock Exchange-Sofia website available at: http://www.bse-sofia.bg/?page=Profile [accessed: 31.08.2015].

Table A4.1. Equity trading figures as of 2014

Category	Shares			Sec. Derivatives		ETFs		UCITS	
	EOB	Off EOB	Reporting Trades	EOB	Off EOB	EOB	Off EOB	EOB	Off EOB
Turnover (EUR m)	299	–	309	0	0	–	–	0	0
Trades	107,428	–	1,814	46	2	–	–	2	1
Market Cap. (EUR m)	4,988			–		–		2	
Listings	372			3		–		2	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27. Abbreviations used: UCITS = Undertakings for Collective Investment in Transferable Securities, ETFs = Exchange Traded Funds, EOB = Electronic Order Book.

Table A4.2. Bonds trading figures as of 2014

Category	EOB	Off EOB
Turnover (EUR m)	75	18
Trades	411	22
Listings	59	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Table A4.3. Derivatives trading figures as of 2014

Category	Stock/Index Options and Futures	Bond Options and Futures	Commodities
Notional turnover (EUR m)	–	–	–
Contracts Traded	–	–	–

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Appendix 5. CEESEG – Budapest Stock Exchange

Profile: The predecessor of today's Budapest Stock Exchange (BSE) commenced its operation on January 18, 1864 in Pest (the eastern part of what today's Budapest). The exchange is trying to develop a transparent and liquid market for its listed securities issued either in Hungary or abroad. It is also striving to offer a comprehensive array of financing and investment opportunities. A majority stake (50.45%) of BSE's equity is held by CEESEG AG.

Source: CEESEG – Budapest Stock Exchange website available at: https://www.bse.hu/ [access: 31.08.2015].

Table A5.1. Equity trading figures as of 2014

Category	Shares			Sec. Derivatives		ETFs		UCITS	
	EOB	Off EOB	Reporting Trades	EOB	Off EOB	EOB	Off EOB	EOB	Off EOB
Turnover (EUR m)	5,997	69	11	175	–	1	0	26	0
Trades	1,187,216	110	221	169,806	–	180	0	13,254	0
Market Cap. (EUR m)	12,012			437		7		2,672	
Listings	48			–		1		133	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27. Abbreviations used: UCITS = Undertakings for Collective Investment in Transferable Securities, ETFs = Exchange Traded Funds, EOB = Electronic Order Book.

Table A5.2. Bonds trading figures as of 2014

Category	EOB	Off EOB
Turnover (EUR m)	6	–
Trades	180	–
Listings	77	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Table A5.3. Derivatives trading figures as of 2014

Category	Stock/Index Options and Futures	Bond Options and Futures	Commodities
Notional turnover (EUR m)	1,716	–	70
Contracts Traded	908,483	–	3,930

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Appendix 6. CEESEG – Ljubljana Stock Exchange

Profile: The principal business of the Ljubljana Stock Exchange (LJSE) is to ensure proper conditions for the matching of supply and demand in the trading in securities and other financial instruments, and for organized, transparent, liquid, and effective trading in securities, in accordance with the law and other regulations. CEESEG AG is the LJSE's sole shareholder. Besides operating the stock market, the LJSE provides quotation dissemination, market research and analysis and auxiliary services.

Source: CEESEG – Ljubljana Stock Exchange website available at: http://www.ljse.si/cgi-bin/jve.cgi?doc=1468 [accessed: 31.08.2015].

Table A6.1. Equity trading figures as of 2014

Category	Shares			Sec. Derivatives		ETFs		UCITS	
	EOB	Off EOB	Reporting Trades	EOB	Off EOB	EOB	Off EOB	EOB	Off EOB
Turnover (EUR m)	608	–	161	–	–	–	–	–	–
Trades	73,630	–	31	–	–	–	–	–	–
Market Cap. (EUR m)	6,214			–		–		–	
Listings	51			–		–		–	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27. Abbreviations used: UCITS = Undertakings for Collective Investment in Transferable Securities, ETFs = Exchange Traded Funds, EOB = Electronic Order Book.

Table A6.2. Bonds trading figures as of 2014

Category	EOB	Off EOB
Turnover (EUR m)	69	–
Trades	1,099	–
Listings	45	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Table A6.3. Derivatives trading figures as of 2014

Category	Stock/Index Options and Futures	Bond Options and Futures	Commodities
Notional turnover (EUR m)	–	–	–
Contracts Traded	–	–	–

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Appendix 7. CEESEG – Prague Stock Exchange

Profile: Prague Stock Exchange (PSE), dating back to a commodity marketplace founded in 1871, is the largest and oldest organizer of securities trading in the Czech Republic (reestablished in 1993 following a fifty-year break caused by World War II and communism). Trading on PSE is conducted via licensed securities traders which are PSE members (primarily major banks and brokerages). The PSE's stock is ultimately controlled by CEESEG, whereas the bourse and its subsidiaries form part of PX Group (also comprising a power exchange and a securities depository).

Source: CEESEG – Prague Stock Exchange website available at: https://www.pse.cz/ [accessed: 31.08.2015].

Table A7.1. Equity trading figures as of 2014

Category	Shares			Sec. Derivatives		ETFs		UCITS	
	EOB	Off EOB	Reporting Trades	EOB	Off EOB	EOB	Off EOB	EOB	Off EOB
Turnover (EUR m)	5,572	–	–	21	–	–	–	–	–
Trades	629,507	–	–	3,813	–	–	–	–	–
Market Cap. (EUR m)	22,644			–		–		–	
Listings	23			68		–		–	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27. Abbreviations used: UCITS = Undertakings for Collective Investment in Transferable Securities, ETFs = Exchange Traded Funds, EOB = Electronic Order Book.

Table A7.2. Bonds trading figures as of 2014

Category	EOB	Off EOB
Turnover (EUR m)	296	–
Trades	1,857	–
Listings	116	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Table A7.3. Derivatives trading figures as of 2014

Category	Stock/Index Options and Futures	Bond Options and Futures	Commodities
Notional turnover (EUR m)	–	–	–
Contracts Traded	–	–	–

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Appendix 8. Warsaw Stock Exchange

Profile: The Warsaw Stock Exchange (WSE), originally set up as a mercantile exchange in 1817, was remodeled in 1989 following the overthrow of Poland's former communist regime. The bourse is incorporated as a joint-stock company and aspires to leadership among CEE securities exchanges. Besides equity trading, the securities market provides trading activity in derivatives and structured products, as well as information dissemination services. Close to 25 years of experience, high reliability of trading, operational security and a broad range of products make the WSE a hallmark of Poland's financial transition since 1989. The WSE is majority owned (51.76% of votes) by the Polish State Treasury.

Source: Warsaw Stock Exchange website available at: http://gpw.pl/root_en [accessed: 31.08.2015].

Table A8.1. Equity trading figures as of 2014

Category	Shares			Sec. Derivatives		ETFs		UCITS	
	EOB	Off EOB	Reporting Trades	EOB	Off EOB	EOB	Off EOB	EOB	Off EOB
Turnover (EUR m)	49,349	8,148	–	134	0	25	0	17	1
Trades	14,688,869	11,377	–	58,718	0	10,322	1	9,092	6
Market Cap. (EUR m)	139,069			–		–		616	
Listings	902			824		68		31	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27. Abbreviations used: UCITS = Undertakings for Collective Investment in Transferable Securities, ETFs = Exchange Traded Funds, EOB = Electronic Order Book.

Table A8.2. Bonds trading figures as of 2014

Category	EOB	Off EOB
Turnover (EUR m)	563	188
Trades	64,411	269
Listings	517	

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, p. 1–27.

Table A8.3. Derivatives trading figures as of 2014

Category	Stock/Index Options and Futures	Bond Options and Futures	Commodities
Notional turnover (EUR m)	55,591	71	–
Contracts Traded	7,222,687	3,025	–

Source: D. Somers, *European Exchange Report*, Federation of European Securities Exchanges (FESE) Economics and Statistics Committee (ESC), Brussels, Belgium, August 2015, pp. 1–27.

Annex 9. Sovereign Wealth Fund investments in Central and Eastern Europe

Country of the Target Entity	Acquirer Entity (country)	Transaction Date	Investment Type	Transaction Amount (in USD million)	% stake acquired	Target Industry
Czech Republic	Government Pension Fund – Global (Norway)	n/a	bonds	23	–	Infrastructure
Czech Republic	Government Pension Fund – Global (Norway)	n/a	bonds	69	–	Energy
Czech Republic	Government Pension Fund – Global (Norway)	n/a	listed equity	71	0.49%	Energy
Czech Republic	Government Pension Fund – Global (Norway)	n/a	T–bonds	1004	–	–
Czech Republic	Government Pension Fund – Global (Norway)	n/a	listed equity	36	0.42%	Financials
Czech Republic	Government Pension Fund – Global (Norway)	31.12.2013	listed equity	2	0.54%	Telecommunication Services
Czech Republic	Abu Dhabi Investment Authority (United Arab Emirates)	n/a	real estate	120	50.00%	Real Estate
Estonia	Government Pension Fund – Global (Norway)	n/a	bonds	16	–	Energy
Hungary	State General Reserve Fund	11.21.2011	real estate	108	100%	Real Estate
Hungary	Abu Dhabi Investment Authority (United Arab Emirates)	n/a	n/a	100	n/a	n/a

Hungary	Government of Singapore Investment Corporation (Singapore)	07.06.2007	unlisted equity	330.22	17.38%	Infrastructure
Hungary	Government Pension Fund – Global (Norway)	n/a	T–bonds	323	–	–
Hungary	Government Pension Fund – Global (Norway)	n/a	bonds	49	–	Financials
Hungary	Government Pension Fund – Global (Norway)	31.12.2013	listed equity	1	2.59%	Industrials
Hungary	Government Pension Fund – Global (Norway)	31.12.2013	listed equity	19	1.94%	Telecommunication Services
Hungary	Government Pension Fund – Global (Norway)	31.12.2013	listed equity	27	0.72%	Healthcare
Hungary	Government Pension Fund – Global (Norway)	n/a	listed equity	0.7	0.94%	Financials
Hungary	Government Pension Fund – Global (Norway)	n/a	listed equity	0.1	0.18%	Information Technology
Hungary	Government Pension Fund – Global (Norway)	n/a	listed equity	71	0.97%	Energy
Hungary	Government Pension Fund – Global (Norway)	n/a	listed equity	68	1.24%	Financials
Hungary	Government Pension Fund – Global (Norway)	n/a	listed equity	0.2	0.29%	Consumer Discretionary
Lithuania	Government Pension Fund – Global (Norway)	n/a	listed equity	3	2.77%	Aerospace

Country of the Target Entity	Acquirer Entity (country)	Transaction Date	Investment Type	Transaction Amount (in USD million)	% stake acquired	Target Industry
Lithuania	Government Pension Fund – Global (Norway)	n/a	T–bonds	91	–	–
Poland	Abu Dhabi Investment Authority (United Arab Emirates)	n/a	listed equity	n/a	n/a	n/a
Poland	Kuwait Investment Authority (Kuwait)	n/a	listed. real estate	400	n/a	n/a. Real Estate
Poland	Government of Singapore Investment Corporation (Singapore)	n/a	n/a	n/a	n/a	Financials
Poland	Abu Dhabi Investment Authority (United Arab Emirates)	5.22.2013	credit granting	35	–	Real Estate
Poland	Government Pension Fund – Global (Norway)	n/a	T–bonds	2826	–	–
Poland	Qatar Investment Authority (Qatar)	November 2013	real estate	n/a	n/a	Real Estate
Poland	State Administration of Foreign Exchange (China)	September 2013	real estate	n/a	n/a	Real Estate
Poland	Kuwait Investment Authority (Kuwait)	10.18.2007	real estate	21	n/a	Real Estate

Poland	China Investment Corporation (China)	n/a	listed equity	1000	n/a	Healthcare. Satellite Communications and T–bonds
Poland	Government Pension Fund – Global (Norway)	–	listed equity	476	–	Financials
Poland	Government Pension Fund – Global (Norway)	–	listed equity	127	–	Consumer Discretionary
Poland	Government Pension Fund – Global (Norway)	–	listed equity	20	–	Consumer Staples
Poland	Government Pension Fund – Global (Norway)	–	listed equity	223	–	Energy
Poland	Government Pension Fund – Global (Norway)	–	listed equity	7	–	Healthcare
Poland	Government Pension Fund – Global (Norway)	–	listed equity	152	–	Industrials
Poland	Government Pension Fund – Global (Norway)	–	listed equity	38	–	Information Technology
Poland	Government Pension Fund – Global (Norway)	–	listed equity	50	–	Materials
Poland	Government Pension Fund – Global (Norway)	–	listed equity	21	–	Telecommunication Services
Poland	Government Pension Fund – Global (Norway)	–	real estate	44	–	Real Estate
Poland	Government Pension Fund – Global (Norway)	–	listed equity	15	–	Utilities

Country of the Target Entity	Acquirer Entity (country)	Transaction Date	Investment Type	Transaction Amount (in USD million)	% stake acquired	Target Industry
Slovakia	Government Pension Fund – Global (Norway)	n/a	T–bonds	287	–	–
Slovakia	Abu Dhabi Investment Authority (United Arab Emirates)	9.28.2006	real estate	0.7	–	Real Estate
Slovakia	Abu Dhabi Investment Authority (United Arab Emirates)	8.17.2009	real estate	0.03	–	Real Estate
			Total	8,274.95		

Source: Sovereign Wealth Fund Institute Database, government and media reports.

Notes about authors

Tomasz Kamiński – Ph.D. in humanities, Assistant Professor at the University of Lodz. His research activities are concentrated mainly on various aspects of the EU-China relations. Recently, he has been working on the problem of "new actors" in the political relations: the Sovereign Wealth Funds and regional/local authorities who develop paradiplomatical relations with foreign partners. He is also an active blogger and regular contributor to the magazine "Liberté!," leading Polish political quarterly. His publications can be find at academia.edu or researchgate.net. Contact at tkaminski@uni.lodz.pl.

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Marcin Obroniecki is an advisor to the Ministry of Economic Development of Poland. Before working at the Ministry he worked several years at Bank Zachodni WBK in the Market Analysis Office, where he specialized in macroeconomic research and market intelligence. He then co-founded DobryPrad.pl, a Polish start-up comparison website for energy prices, where he was Vice-Chairman responsible for search engine optimization and increasing the site's client-acquisition potential. Heholds M.A. degrees in Finance and Strategy from Sciences Po Paris and the Warsaw School of Economics, with his graduate thesis being one of the very first papers about Sovereign Wealth Funds written in Polish. His research focuses on Sovereign Wealth Funds' role in the development of emerging market economies.

Tomasz Jurczyk is a researcher with focus on Chinese foreign policy, especially the role of local governments play in it and policy towards Central and Eastern Europe. He is also interested in Cross-Taiwan Strait relations. As a recipient of scholarship programs he has spent 3 years in Mainland China and Taiwan. Currently Ph.D. candidate at the University of Lodz, apart from academic activities he is also actively engaged in development of relations between Lodz and its Chinese partners.