

Gulf Investments in the United States

Unwelcome Money

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DESPITE THE FACT that Arab Gulf investment abroad is nothing new, recent developments have given these investments unforeseen dimensions. As Gulf investments abroad – and specifically in the West – have come into focus, economic and even political relations for countries of the Gulf region have been affected. The first experiment in the field of foreign investment for Gulf countries occurred in the 1970s when monetary surpluses from oil exceeded their ability to absorb the increased revenue. The majority of these investments took the shape of indirect investment via the buying and selling of stocks and bonds in Western countries, specifically in the United States and Europe. This occurred especially because Arab economies at the time were culture-oriented and largely unfriendly to outside investments, whether Arab or foreign.

Gulf investment trends

With the impact of the new oil boom at the beginning of the 21st century several factors have emerged that have markedly changed the nature of Gulf investments abroad. The first of these developments is that growing fiscal surpluses led to a significant increase in the volume of investments in general, and foreign investment in particular. Similarly, the recent increase in fiscal surpluses encouraged most countries in the region – if not all – to create what is known as “financial stability funds,” aimed primarily at diversification of sources of income to ensure continuing revenue for future

generations. Ultimately, these funds represent large sums earmarked for investment, especially foreign investment.

Also among the factors changing the nature of Gulf investments abroad is an improvement in the investment climate in Arab countries as a result of economic reforms undertaken during the 1980s and '90s. These reforms have encouraged Gulf countries to direct an increasing proportion of their investment to projects within Arab countries, whether in real estate or tourism, or in direct and indirect financial investment.

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Likewise, globalization and the growing interdependence of economies have clearly impacted the distribution of Gulf investments abroad. Despite that Western countries have retained the lion's share, developing regions, especially Arab and Asian countries, have begun to attract more Gulf investment. According to relevant international institutions, Gulf investments abroad today are distributed geographically as follows: approximately 55 percent in American investment tools; approximately 19 percent in European investments; approximately 11 percent in Arab countries; 11 percent in Asian countries; and an estimated 4 percent in other regions.

In addition, the preferred investment tools for Gulf investments have changed over the past few years. There is now an increasing tendency toward direct investment, rising to a rate of more than 15 percent of investments compared with approximately 11 percent only four to five years ago. At the same time, there has been a noted decline in the rate of bank deposits in the Gulf investment portfolio, from 45 percent in 2001 to approximately 27 percent at the end of last year.

Yet the most important development related to Gulf investments abroad, particularly during the past few years, is the new trend of Gulf acquisition of large global companies and organizations. Such acquisitions have recently provoked rancor among Western countries, often based on unjustified fears and arguments. Indeed, the conservative attitude of Western countries towards the investment of "sovereign wealth funds," in particular from the Gulf, seems inconsistent with the call by said Western countries for the free movement of capital and the opening of markets. By the same token, it also appears contrary to Western calls for petroleum-rich states to increase their investments to help resolve the fiscal imbalances that plague key Western economies.

That said, media outcry and Western conservative attitudes might be attributed to the latest trend in Gulf investments of focusing on a number of companies that are national symbols in some Western countries. There are, of course, other arguments

put forward by Western countries to justify their reservations about these investments, including the fact that these investments come from governments and therefore may not be purely investment-driven. Other contentions include that such investments lack transparency, as there is neither sufficient data on them nor information about their policies and strategies. This, critics believe, could affect the state of financial markets in the case of a sudden shift in investments, considering the magnitude of these investments. Regardless of whether or not such arguments are justified, such attitudes and their potential impact on Gulf investments cannot be underestimated.

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The not-so-free investment market

In this context, the approval of such investments within the United States is subject to strict procedures and extraordinary review. Within the European Union, regulators are currently setting controls – where once there were no restrictions – on the movement of this money. This is in addition to the tasking of the International Monetary Fund (IMF) to set laws that govern such investments.

Overall, Western countries appear keen to limit the acquisition of what they consider strategic foundations or sectors. In particular, they are moving towards disallowing, for this type of investment, greater than 20 percent ownership of any company or institution absent a special permit. In all cases, these Western states will try to ensure that these investments do not buy the right to vote in a way that can influence the management of companies they seek to own.

In other words, Western countries seek to attract the funds of Gulf investments but without necessarily affording Gulf countries the right to choose the kind of companies to invest in or have a voice in the management of these companies.

What, therefore, can be done with Gulf investments? In general, with the steady accumulation of monetary surpluses, states in the region will not have many options but to invest abroad, especially in Western states. But to avoid any problems with Western countries, it might be wise to study how best to not incite rancor in these countries relative to Gulf investments. What follows are some modest observations on this matter.

The first question that may be asked: Is the acquisition of large international companies that have become national symbols the most profitable option for Gulf in-

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vestors, not only in terms of the high costs associated with such acquisitions but also in terms of the political sensitivity of such acquisitions? Answering this question is the first step on the part of the investor.

Diversifying sources of income, which Gulf countries seek to achieve through investment abroad, must take into account the need to create vertical and horizontal linkages among firms Gulf countries seek to invest in, in addition to the needs of their region's economies. Such an assessment may make investment in large Western companies, which often raise the sensitivity level of Western public opinion towards investments by certain countries, unfavorable.

In addition, as long as many investments will not be permitted to translate to votes commensurate with their share in the company, why insist on having a number of shares significant enough to raise the fears of Western countries?

Further, at a time when the region suffers from a lack of qualified personnel, it is necessary to inquire about the feasibility of guaranteeing proper management of these large investments, especially in the case of possessing significant portions of companies and global institutions that have complex and intricate markets and operations.

In general, with growing fiscal surpluses for the Arab Gulf, it seems that the subject of Gulf investments abroad will continue to attract the world's attention, which may generate reactions that may not be in the interest of the countries of the region. This calls for moving quickly to set an appropriate strategy for dealing with global trends, to preserve the interests of Gulf countries on the one hand, and ease negative attitudes towards Gulf investments abroad on the other.

Western attitudes: revisions and fears

Despite continued Western fears towards sovereign wealth funds, recent developments in the global economy – especially in the aftermath of the mortgage crisis in the United States and enormous resulting losses for many American and European financial institutions, as well as the trend toward general recession – seem to have led to a revision of Western attitudes toward such funds. Hopefully this is neither a temporary revision nor an opportunistic effort to save Western financial institutions in difficult circumstances.

Recently, large Western banks have been exposed to huge losses estimated at hundreds of billions of dollars because of the mortgage crisis, including Citigroup, Merrill Lynch and recently Credit Suisse. Sovereign wealth funds moved quickly to save these Western banks, even in comparison with IMF movements to save poor nations in crisis. Some might say that these funds were not acting to save the banks, but to achieve large returns as a result of reduced costs of shares amid the crisis. Of course,

achieving investment returns must be, in the end, the aim of these funds. However, the reality is that sovereign funds have suffered losses in saving these banks, although these losses are so far only on the books. It is the hope of investors that these losses turn into profits soon.

To picture the size of the sacrifices incurred by sovereign funds from investments in Western countries, some examples follow. Citigroup saw a sovereign fund investment input estimated at \$7.5 billion but whose value today is not more than \$6 billion. Similarly, sovereign fund investments in Merrill Lynch, estimated at about \$6.6 billion, have now decreased in value by eight percent. This scenario also applies to a third case, that of Credit Suisse, where sovereign fund investments have already lost the equivalent of eight percent of their value in only a few weeks.

While it is true that investments are exposed to temporary market fluctuations, it is also true that economic indicators in the American economy in particular and the global economy in general do not appear optimistic. Investments, therefore, may suffer greater degradation before they are able to turn profitable or even recover their original value.

It is important to emphasize here the necessity of changing the negative image painted by Western media of Gulf investment funds, which have been portrayed as an attempt to invade Western economies – as indicated recently on the front cover of one of the most important Western magazines – though the funds have gone to significant lengths to rescue some Western financial institutions. Such a revision of attitudes would serve the interests of both sides and underline the positive aspects of such funds, which without a doubt represent, at least in cases such as those mentioned, common interests.

Until now, unfortunately, acceptance of sovereign fund investors appears at best forced. Experience in both Western and Eastern states shows that attitudes towards sovereign funds are not fixed but are governed by conditions that may be temporary, attitudes changing when and if circumstances change. It is the author's assessment that the fears of Western countries towards sovereign wealth funds do not stem from rational justification; rather they often seem to be affected by political protectionist tendencies, which may unintentionally work against the interests of these countries themselves.

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Certainly these fears become more surprising after recognizing the many distinguishing characteristics associated with sovereign wealth fund investments. First, there have not been any negative ramifications in the record of these funds so far. Therefore, prevailing fears seem mostly based on expectations rather than on actual experience. Second, what these funds represent at the present time does not amount

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to more than two percent of the approximately \$165 trillion that make up the volume of shares traded globally. In other words, even assuming that these funds wanted to move their investments suddenly, it would have little influence. Thus fears of such a move are exaggerated to a great extent.

In fact, there are many benefits to these funds, the most important of which is that long-term investors appear willing to bear the costs of short-term market fluctuations, which acts as a stabilizing force in financial markets, in addition to being benign investors

who provide substantial funds without insisting on having influence over the management of given companies and institutions, either in the medium or long term or in their daily operations.

In addition, the funds, in that they represent substantial monies, are a helpful factor in addressing fiscal imbalances at the global level through the transfer of funds from countries with surpluses to countries suffering from fiscal deficits and that require such funds. This is in addition to being an important factor in increasing the integration of the world economy in increased partnership and linking common interests.

For these reasons, the sensitivity and fears shown by Western countries toward these funds do not seem justified. Nor do Western countries need new restrictions or laws to govern the workings of these funds. Western states have enough laws to govern foreign investments. For example, there are limits on the ownership of banks by virtue of the fact that the state is often the guarantor of bank deposits. This limitation applies even more in the case of defense technology, and even utility companies. Therefore, there is no need to develop a new guide to determine the entry and movement of sovereign wealth fund investments. It is not necessary to discriminate against the activity of these investments since they will necessarily be subject to the same laws that apply to other investments without distinction.

The task of building trust

All this does not mean that sovereign wealth funds should be passive when it comes to aforementioned issues. Previously we indicated that these funds themselves should not underestimate the fear and sensitivity of Western countries, and must also work to take measures to alleviate these fears, demonstrate the positive aspects of the activity of these funds and promote them in a way that reinforces their position. By the same token, they should emphasize the common interests represented by the investment of these funds.

It appears that the first thing that must be done is to undertake a campaign to raise awareness of the positive role these funds play at the global economic level. Second, there must be an emphasis on transparency and disclosure in the workings of these funds. This does not mean that they must reveal details of investment deals; rather they should disclose objectives and general policies, not only in the broad plan but even at the local level. Obtaining support and assistance must be based on communication and disclosure.

Similarly in the interest of transparency, sovereign funds need to identify the responsibilities of partners and management. Disclosure and transparency on the part of the management of these funds would reassure and stabilize financial markets, in addition to creating the discipline required for effective management overall. Sovereign funds should also work to avoid outcry over companies that double as national symbols. Thus it may be safer to avoid owning strategic levels of shares by favoring modest investments in a greater number of companies and broader sectors, which will also achieve diversity of the investment portfolio and reduce the concentration of risk.

In reality, the issue of sovereign wealth funds has widened beyond investment-related or purely economic considerations. It has been politicized and become a phenomenon of international concern. Dealing with the issue, therefore, should not be limited to investment professionals, but include the best expertise available in the areas of international political and economic relations as well. ■

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