

Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Merchantilism

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Abstract:

Sovereign wealth funds (SWFs) have increased dramatically in size as a result of increased commodity prices and the increase in the foreign currency reserves of Asian trading countries. SWF assets now roughly equal those in hedge and private equity funds combined. This growth, and the shift of SWF investment strategy toward equities and increasingly high profile investments like capital infusions into U.S. financial institutions following the subprime mortgage problem, have generated calls for domestic and international regulation. The U.S. and other western economies already regulate the foreign acquisition of control of domestic corporations. However, acquisitions of significant but non-controlling positions are not regulated. The danger is that new regulation will compromise the beneficial recycling of trade surpluses accomplished by SWF investments.

In this paper, we situate the controversy over SWF investments in the increasing global trend toward direct governmental involvement in corporate activity, a phenomenon we label the New Merchantilism. We explain why increased transparency of SWF investment portfolios and strategy, the most commonly advanced policy recommendation, does not respond to the chief concern that SWF investments have engendered. We offer a regulatory minimalist response to fears that SWFs will make portfolio investments for strategic rather than economic reasons. Under our proposal, voting rights of SWF equity investments in U.S. corporations would be suspended but reinstated on sale. Thus, SWFs would buy and sell fully voting rights, thereby assuring that the incentives to make non-strategic investments would be unaffected, while the capacity to exercise influence for strategic motives would be constrained. The paper concludes by assessing the extent to which even a regulatory minimalist response remains both over and under inclusive; however, the limited imprecision does not undermine the effectiveness of the response.