CARNEGIE
PAPERS

Managing Arab Sovereign Wealth in Turbulent Times—and Beyond

Sven Behrendt and
Bassma Kodmani, Editors

The custodians of Arab sovereign wealth have found themselves in a precarious situation, having to respond, first, to an external audience when it appeared that their influence in the world of finance had substantially increased; and, later, to a domestic audience when it appeared that they might have overplayed their hands.

A joint initiative of

Arab Reform Initiative

CARNEGIE ENDOWMENT
FOR INTERNATIONAL PEACE
WASHINGTON DC ▪ MOSCOW ▪ BEIJING ▪ BEIRUT ▪ BRUSSELS

Carnegie Middle East Center

Number 16 ▪ April 2009

Carnegie Endowment for International Peace
Publications Department
1779 Massachusetts Avenue, NW
Washington, DC 20036
Phone: 202-483-7600
Fax: 202-483-1840
www.CarnegieEndowment.org

This publication can be downloaded at no cost at www.CarnegieEndowment.org/pubs. Limited print copies are also available. To request a copy, send an e-mail to pubs@CarnegieEndowment.org.

The Carnegie Middle East Center

The Carnegie Middle East Center is a public policy research center based in Beirut, Lebanon, established by the Carnegie Endowment for International Peace in 2006. The Middle East Center is concerned with the challenges facing political and economic development and reform in the Arab Middle East and aims to better inform the process of political change in the region and deepen understanding of the complex issues that affect it. The Center brings together senior researchers from the region, as well as collaborating with Carnegie scholars in Washington, Moscow, and Beijing and a wide variety of research centers in the Middle East and Europe, to work on in-depth, policy-relevant, empirical research relating to critical matters facing the countries and peoples of the region. This distinctive approach provides policy makers, practitioners, and activists in all countries with analysis and recommendations that are deeply informed by knowledge and views from the region, enhancing the prospects for effectively addressing key challenges.

Contents

Introduction 1

Chapter 1: An Update on Arab Sovereign Wealth Funds 3
Sven Behrendt

Chapter 2: Whose Sovereignty? Whose Wealth? 9
Rami G. Khouri

Chapter 3: Arab Wealth: Financial Versus Real Assets 13
Hazem El-Beblawi

Chapter 4: Sovereign Wealth Funds and the Politics of Boom and Bust 20
Ibrahim A. Warde

Chapter 5: The Global Financial Crisis and the Arab Sovereign Wealth Funds: Implications and Limitations 28
Atif Kubursi

Chapter 6: Arab Investments: An Instrument to Diversify National Economies? 33
Ghazi Hidouci

Chapter 7: Sovereign Wealth Funds: An Instrument Marked by Its Birth Conditions? 37
Samir Aita

Conclusions: Putting Arab Money on the Reform Agenda 43
Bassma Kodmani

Introduction

The debate about the role that sovereign wealth funds (SWFs) from Arab and other emerging economies play in international financial markets has been a highly cyclical one. Only twelve months ago, the Western public questioned the deeper rationales for sovereign investments in what were perceived to be strategic assets of Western economies. Commentators argued that these investments could harm the long-term competitiveness and national security of Western economies.

Today, the Arab world realizes that much of its sovereign wealth is exposed to the financial market crisis and that, as a result, the value of those assets in which SWFs invested have decreased substantially. This, in turn, has caused an intense discussion about the rationale for building the Arab financial nest egg on shaky foundations such as equity stakes in Western corporations.

In consequence, the custodians of Arab sovereign wealth have found themselves in a precarious situation, having to respond, first, to an external audience when it appeared that their influence in the world of finance had substantially increased; and, later, to a domestic audience when it appeared that they might have overplayed their hands. However, beyond these short-term challenges for Arab and other SWF managers and owners, the recent debates about SWFs have focused on what was to be done with Arab surplus capital in order to secure a viable future for Arab economies in a world of profound economic turbulence and at a time when the relationship between the state and the market is being fundamentally rethought.

This collection of essays seeks to contribute to this debate. It provides a platform for scholars and practitioners from or based in the Arab world to present their preliminary thoughts about the future management of Arab sovereign wealth, while taking into account the turbulences to which Arab SWFs have recently been exposed.

The volume is organized as follows. In chapter 1, Sven Behrendt provides a short overview of the rise of SWFs as a relevant investor class in international financial markets as well as the political pressures to which they were exposed in the most recent past.

In chapter 2, Rami Khouri argues that a broader Arab constituency needs to be involved in order to provide guidance on how and where Arab wealth is to be invested in the future.

In chapter 3, Hazem El-Beblawi highlights the mismatch between investments in financial and real assets and calls for a new vision and more imagination to enable the Arab region to benefit from a massive investment program.

In chapter 4, Ibrahim Warde argues that while the economic boom years were accompanied by the rise of influence of a technocratic financial expert elite, periods of bust pave the way for the return of politics in wealth management, which again becomes subject to domestic, regional, and international political considerations.

In chapter 5, Atif Kubursi argues that the objective criterion of policy makers in the Gulf should remain the preservation of real wealth per capita. This objective should override any attempts to maximize returns and accept undue risks.

In chapter 6, Ghazi Hidouci calls for the establishment of social capacity, so decisive for economic progress in Asia, linking public service, social organizations, and the economy to a purpose that is beneficial for all.

In chapter 7, Samir Aita argues that the key concerns for SWFs should be the social distribution of revenues and the transparency and accountability of state institutions, as well as their capacity to finance economic development founded on a strong industrial base, both within each Arab country and in the Middle East and North Africa.

In chapter 8, Bassma Kodmani concludes by putting the debate in the context of a reform agenda for the Arab world, arguing that delaying reforms might result in strengthening the appeal of a populist discourse and the influence of the forces that voice them.

We hope that this paper contributes to the further integration of Arab SWFs into the global financial architecture, to the debate within the Arab world about how best to put its wealth to work, and to the broader reform agenda in a region of the world that increasingly focuses on its sources of revenue beyond oil.

CHAPTER 1

An Update on Arab Sovereign Wealth Funds

Sven Behrendt

The rise of sovereign wealth funds (SWFs)—government-controlled pools of assets designed to engage primarily in foreign investment—and the transformation of SWFs into relevant players in the global economy have been driving an intense debate for the past two years in Europe and the United States about adequate policy responses. For the European and the American publics, SWFs from developing economies have been a stark reminder of the changing balance of power within the geo-economic system favoring the East at the expense of the West. SWFs were assumed to be diluting economic competitiveness or threatening the national security of the host countries through the aggressive implementation of comprehensive acquisition strategies. Being government-owned investment vehicles, they were also assumed to be undermining economic liberalism, the underlying doctrine of globalization.

For decades, SWFs existed at the periphery of global public attention. Only at the beginning of this decade did they appear on the radar screen of other financial market participants, and eventually a broader global audience. Because SWFs were a new and potentially very relevant investor class, the Western public sought to obtain more information about them. But SWFs, in particular those from emerging economies, did little to clarify the size of their assets or their investment strategies. Instead, many SWFs opted to remain secretive and opaque, which triggered considerable concerns and contributed to their "mystification."

The debate regarding SWFs' role in and impact on the global economy has been highly cyclical and tightly correlated to price developments in commodity markets, but also to the increasing economic strength of emerging economies. We argue that this debate can be segmented into five distinct phases.

The Emergence of Sovereign Wealth Funds

The first phase of the debate over SWFs was largely confined to developing the notion and understanding the elements that constituted the building blocks of an SWF. To be sure, the term "sovereign wealth fund" was not coined until 2005, when Andrew Rozanow, a financial markets analyst, asked "Who holds the wealth of nations?"[1]

Rozanow's article marked the preliminary end of the quiet ascent of SWFs and positioned SWFs as a relevant global investor class. SWFs had existed for a long time, but only at the middle of this decade did they move from being peripheral to central players in global finance and begin to be perceived as such.

In the 1950s, the first SWFs—the Kuwait Investment Authority (KIA), and the Revenue Equalization Reserve Fund of Kiribati—were established. Some might include the Saudi Arabian Monetary Agency (SAMA) as a part of this initial cohort; however, SAMA is the Central Bank of the Kingdom of Saudi Arabia, not a dedicated fund.

During the 1970s, a number of new SWFs were created, including the Abu Dhabi Investment Authority (ADIA). The 1980s and 1990s witnessed little activity with regard to SWF creation, with the notable exception of Abu Dhabi's International Petroleum Investment Company, established in 1984.

Only by the turn of the century did the number of SWFs grow substantially; in fact, of the forty-four nonpension SWFs existing by 2007, twenty-four, more than half, had been established during this period.[2]

Rapid Growth

At the beginning of this decade, the rise of demand for commodities driven by the dynamic economic growth of China, India, and other emerging economies, as well as the evolution of commodities as an attractive asset class, allowed Arab Gulf economies to benefit from a massive increase in the price of oil and natural gas. This windfall revenue provided the main source of funding for their SWFs.

Commentators have suggested that SWFs worldwide will likely continue to grow substantially in the medium-term future, and further solidify their position as relevant if not dominant players in the world of global finance. For example, analysts from Morgan Stanley have argued that the value of SWFs assets reached $3 trillion by 2007 and is bound to increase to $12 trillion by 2015.[3] The Arab countries of the Gulf were assumed to have become home to some of the biggest SWFs and were estimated to be managing around $1.5 trillion in SWF assets, including central bank reserves.

ADIA was assumed to be by far the largest global SWF, with assets estimated at between $500 billion and $875 billion. SAMA was assumed to manage $330 billion, followed by the KIA, with more than $200 billion, and the Qatar Investment Authority (QIA), with more than $60 billion. Smaller funds, such as the Mubadala Development Corporation and International Petroleum Investment Company, both based in Abu Dhabi, were estimated to have around $10 billion.[4]

SWFs did little to make their assets, the values of their holdings, or their investment strategies transparent. As a result, the debate about the size of SWFs was mostly driven by assumptions and attempts to combine disparate fragments of information in order to arrive at a more accurate assessment of the value of their assets.

Sovereign Wealth Funds Exposed to Political Pressure

By the summer of 2007 and throughout 2008, the public debate about SWFs was further intensified by the apparent shift of the geo-economic power equation from West to East, and thus the debate began to zoom in on SWFs from emerging economies. The starting point of this phase is perhaps best marked by a *Financial Times* contribution by Lawrence Summers, who argued that SWFs shake the logic of capitalism.[5] It peaked with Arab and other SWFs acquiring major stakes in Western financial institutions in the winter of 2007–2008. Although these acquisitions might have helped to prevent an accelerated decline of asset valuations at that time, they were also viewed by the general public with a great deal of concern.

This debate soon spilled over into the world of real politics, and governments in the developed world had to define their policy responses to the challenges that the rise of SWFs presumably posed. These responses were not consistent, however. The UK government rather actively courted SWFs to invest in its economy, particularly in its financial services sector. Conversely, French president Nicolas Sarkozy addressed the European Parliament and called on European governments to protect their industries by establishing their own SWFs. Germany revised its foreign trade law, which in effect would scrutinize foreign investments that targeted more than 25 percent of any major enterprise.

The Organisation for Economic Co-operation and Development, attempting to present a consistent approach for its member states toward sovereign foreign investors, worked out a "guidance" document that suggested maintaining an open investment regime toward foreign investors but acknowledged that national security concerns might cause individual governments to protect assets.[6]

In response to the political debates in industrial economies, SWFs formed their own body: the International Working Group of SWFs (IWG). Within a few months, in Santiago, the IWG worked out "Generally Accepted Principles and Practices," whose purpose was to identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements, as well as the conduct of investment practices by SWFs on a prudent and sound basis.[7] However, after a follow-up meeting in Kuwait in spring 2009, it remained unclear what exact direction the IWG would take toward implementing the "Santiago Principles."[8]

Sovereign Wealth Funds Hit by the Financial Crisis

By the second half of 2008, it became increasingly clear that the global financial and economic crisis would reach a severity not witnessed since the late

1920s. Arab and other SWFs, which in the past couple of years had decided to rebalance their portfolios in favor of higher-risk equity investments, were hit full force. The value of their assets decreased substantially; in addition, they were asked to provide liquidity to domestic financial markets.

The KIA, for example, declared that it lost $30.7 billion from March to December 2008.[9] The QIA stated in March 2009 that it had lost less than 20 percent of its value in 2008. It put buying on hold and announced a review of its investment strategy; and it will most probably focus on commodities, such as food, energy, and water, in the medium-term future.[10] Saudi Arabia's Public Investment Fund, established in 2008, was asked to step up its level of lending and to extend the growth of firms' loans by providing longer grace periods.[11]

At the same time, analysts developed more sophisticated models in an attempt to arrive at more accurate estimates of the size of Arab SWFs.[12] According to these estimates, the Gulf's external portfolio fell from about $1.3 trillion in 2007 to $1.2 trillion in 2008. The value of the foreign assets of the governments of Kuwait, Qatar, and the United Arab Emirates fell from about $1 trillion at the end of 2007 to $700 billion at the end of 2008.

The analysts also argued that the value of the assets held by ADIA and the Abu Dhabi Investment Council amounted to $450 billion by December 2007, not between $500 billion and $875 billion, as others had previously argued.[13] In addition, they assumed that the value of the investments of ADIA and the council had declined by up to $140 billion by the end of 2008. During the same period, the value of the KIA's assets fell from $262 billion to $228 billion, and those of the QIA from $65 billion to $58 billion.

SAMA, given its fairly conservative investment behavior, saw the value of its foreign assets and those that it managed for other government institutions rise from $385 billion at the end of 2007 to $501 billion toward the end of 2008.

To be sure, in all cases, negative capital gains were outbalanced by considerable net inflows, given that the average price of crude oil rose to around $100 in 2008. ADIA and the Abu Dhabi Investment Council benefited from an inflow of $59 billion; the KIA, of $57 billion; the QIA, of $28 billion; and SAMA, of $162 billion.

These figures indicate two things. First, they provide a stark indication of the risky bets that Arab fund managers have placed in financial markets. Second, they indicate how far off the international public has been in its attempt to assess the true value of Arab SWFs and other SWFs. Public opinion and politics in the West were shaped, among other factors, by reference to ADIA's estimated value of $875 billion, and not the still-significant but nevertheless more modest $328 billion estimate—a discrepancy of more than $500 billion.

Moving Forward

One lesson learned from the current global financial and economic crisis is that it is not helpful to expose sovereign investments to the volatilities of the global economy, when at the same time the most important source of national income is dependent on robust global economic growth. In recent months, the price of oil has fallen alongside the value of the assets that SWFs have held.

At the same time, it can be assumed that the Arab Gulf economies will continue to command substantial financial resources. These could stagnate if the price of oil remains at about $40 to $50 a barrel, with the effects of the recession still playing out and spare oil production capacities rising. They might grow modestly if the price of oil rises to $75 a barrel, which the Organization of the Petroleum Exporting Countries believes to be the "correct" price. They could rise considerably again if the price of oil moves back up to the $100 per barrel range and then exceeds $200 by 2030, based on the assumption of a swift recovery by the world economy, as the International Energy Agency argues.[14] Of course, sovereign wealth accumulation will significantly depend on the value of imports associated with domestic spending.

Given their most recent experiences as financial investors in volatile markets, but also the political response from Europe and the United States, sovereign investors from the Arab world and elsewhere will probably become more selective in making asset acquisitions. Arab investments in the future will most likely no longer be primarily focused on financial assets. The idea of replacing oil rent with a financial rent, within a couple of decades, is probably too risky to pursue.

The investment strategies of Arab SWFs will therefore most likely be based on a more holistic approach. Ideally, this would include taking into account the long-term financial needs of their societies, the long-term development and diversification strategies of their economies, and knowledge and technology transfers, as well as the long-term opportunities of select industries to serve in global markets in transition.

The investment themes that emerge from this formula include ensuring global energy security while simultaneously balancing the need to reduce greenhouse gas emissions; ensuring food security for the arid countries of the Gulf Arab region, while at the same time contributing to developing sustainable agrobusinesses that meet the demands of an increasingly affluent global population; addressing issues related to health and nutrition, given that the region's population suffers from the world's highest rates of diabetes; strengthening the region's position in the petrochemical industry, and extending the reach of its oil industry up the value chain; strengthening the region's position in the logistics and transportation sector, because the Arab world has traditionally played a major role as a global hub for trade and commerce; solidifying the region's position in the construction and real estate sectors; developing the region's position as a provider of sophisticated materials for high-end manufacturing industry players; and positioning the region as one of several global hubs for the financial services industry.

Above all, the interest of Arab sovereign investors in equity acquisitions in Western industrial economies will depend on the readiness of their Western counterparts to engage in mutually beneficial partnerships. At the same time, an increasingly educated public will continue to watch and comment on future SWF investment activity to ensure that it is correlated with public purposes.

Notes

1 Andrew Rozanov, "Who Holds the Wealth of Nations?" *Central Banking Journal* 15, no. 4, May 2005.

2 Edwin M. Truman, *A Blueprint for Sovereign Wealth Fund Best Practices*, Policy Brief 08-3 (Washington, D.C.: Peterson Institute for International Economics, 2008).

3 Steven Jen, "How Big Could Sovereign Wealth Funds Be by 2015?" Morgan Stanley Research, May 3, 2007.

4 Truman, *Blueprint*.

5 Lawrence Summers, "Funds That Shake Capitalist Logic," *Financial Times*, July 29, 2007.

6 OECD Investment Division, *Sovereign Wealth Funds and Recipient Countries: Working Together to Maintain and Expand Freedom of Investment* (Paris: Organisation for Economic Co-operation and Development, 2008).

7 International Working Group of Sovereign Wealth Funds, "Sovereign Wealth Funds: Generally Accepted Principles and Practices—Santiago Principles," October 2008.

8 Sven Behrendt, "The Santiago Principles of the International Working Group of Sovereign Wealth Funds: Blueprint for a 12-Point Action Plan," Carnegie Endowment for International Peace, January 2009.

9 "Kuwait, Singapore Funds Lose on Finance Bets International," *International Herald Tribune*, February 10, 2009.

10 Reuters, March 12, 2009.

11 "Saudi Fund Steps in to Boost Lending," *Financial Times*, March 13, 2009.

12 Brad Setser and Rachel Ziemba, "GCC Sovereign Funds: Reversal of Fortune," Council on Foreign Relations, January 2009.

13 The Abu Dhabi Investment Council was established by the government of Abu Dhabi in 2007 to invest part of the government's surplus financial resources inside the United Arab Emirates, in order to expand and develop the local economy.

14 "IEA Predicts Oil Price to Rebound to $100," *Financial Times*, November 5, 2008.

CHAPTER 2

Whose Sovereignty? Whose Wealth?

Rami G. Khouri

The role of sovereign wealth funds (SWFs) in assuring the future well-being of the energy-rich Arab states—and their neighbors and trading partners, by extension—has been highlighted by the impact of the current global financial and economic crisis. These accumulated oil and gas income surpluses are already being used by some Arab states to offset the sharp economic declines triggered by the global crisis, as all the major income sources of the region have declined simultaneously. Oil and gas export income is down by nearly two-thirds, income from funds invested abroad and at home is down by at least one-third, and remittances sent home by workers from non-oil-producing Arab states are already declining and will continue to do so in the coming few years. Tourism income and foreign direct investment are also likely to drop sharply in the short term.

As macroeconomic management and development policies assume a more central position in the public policy debates in the Arab world, we should expect to see more open discussions about how those countries that have SWFs actually put them to use in offsetting the current negative trends. While these SWFs have been growing in the past several decades, they have tended to generate more discussion and analysis abroad than in domestic public debates in the Arab world. The current financial and economic crisis and the possible role of the SWFs in alleviating some of the impact of the crisis should be a prime opportunity to discuss the full meaning of the "sovereign" in "sovereign wealth funds."

The blackout situation pertaining to analyzing SWFs in the Arab world has been slightly ameliorated with the recent publication of reports and articles on the subject. These new analyses have somewhat clarified the number, size, and nature of the Arab SWFs, their relative position globally vis-à-vis non-Arab SWFs, and the political dimensions of the discussions about SWFs, especially with respect to how major Western financial and political centers view these funds.

Sven Behrendt's recent paper reminds us that the estimated $1.5 trillion held by Arab SWFs in mid-2008 (United Arab Emirates, Saudi Arabia, Kuwait, and Qatar) may have dropped by around 20 percent since then.[1] He also notes that it is particularly important that these are modest amounts relative to the much larger pools of money managed by leading Western financial institutions (such as $21 trillion by investment companies and $15–16 trillion each by insurance companies and pension funds).

Yet in the context of domestic and regional Arab economies, these are enormous sums. They have generated public discussion primarily in the context of the often-testy interaction between Arab investors and Western political decision makers and regulators, in which Arab funds are either hailed as economic saviors or chided as dangerous security threats if they control strategic Western firms. Behrendt suggests that Arab public opinion, civil society, and the media should take more interest in these funds, and "demand a more transparent accounting of how their nations' funds are being invested. In particular, the Arab public could legitimately ask what social and economic goals are being served by the investments and to what degree they are serving broader regional objectives."[2]

The "sovereignty" dimension of the SWFs seems ripe for discussion, and perhaps activation on a wider scale through mechanisms that allow the citizens of these wealth-holding states to have a greater say in the strategic accumulation and deployment of the funds. If these SWFs represent the stored wealth of the citizens of these countries, it would seem appropriate to allow these citizens to have more information about how the funds are managed and invested, and perhaps to have greater say in these issues. These funds are likely to remain a feature of the Arab economic and fiscal landscape for decades to come. As their importance grows, they will inevitably generate questions that are as much political as economic.

The few Arab countries that control more than a trillion dollars in SWFs face challenging decisions about how to invest these funds in the most effective and prudent manner. Their own and neighboring Arab economies are not mature enough to absorb such large amounts, and investing in the West has resulted in political pushback and, in the past year, sharp financial losses. This would seem to be the moment for Arab SWF managers and their political leaders to take advantage of the leverage they enjoy, globally and regionally, to reevaluate some of their past practices, especially with respect to their domestic and regional dimensions. Two parallel and linked issues are ripe for more intense public debate and scrutiny in the Arab world: the domestic political management of the SWFs, and their potential regional economic impact.

The nature, use, and fate of the SWFs matter directly and primarily to the citizens of those energy-exporting countries that own them. The experience of recent decades suggests, however, that the development of these countries—including their investment abroad, in some cases—is closely linked to conditions in energy-poor Arab countries around them. On issues of labor movement, trade, food production and supplies, real estate and other investments, tourism, some aspects of security, and a few other fields, the wealthy and poorer Arab states are increasingly linked to one another. The brisk, sustained development of the Gulf states from the 1970s through the 1990s sparked economic growth in labor-exporting Arab countries, and the recent slowdown in the Gulf has similarly hit the lower-income Arab states hard by reducing job opportunities, remittance flows, and foreign direct investment. Labor and investment flows are two of the most impressive areas where inter-Arab cooperation and economic linkages have expanded and succeeded in the past four decades. Therefore, these two sectors should rank high in the minds of Arab officials and others who now might reconsider how SWFs are stored and deployed in the years ahead—especially in the wake of the sharp losses suffered due to the global financial and economic crisis.

This moment of economic reassessment should include a retrospective analysis of whether some SWFs could have been invested more productively in the Arab region, through joint ventures or foreign direct investment in fields that would benefit both the investing and recipient countries, and be less susceptible to losses in paper value than foreign equity investments. Agriculture, food processing, the water sector, education, and health care come to mind as prime examples of areas where demand will continue to grow in the entire Arab region, and Arab capital from the energy-rich countries could comfortably and profitably form partnerships with the labor- and land-and-water-rich assets of countries like Jordan, Lebanon, Syria, Morocco, and Sudan. Today, inter-Arab investments in truly strategic industries like food, water, health, and solar energy can be considered much more seriously than ten or twenty years ago, because the basic infrastructure required for efficient investments is in place in most Arab countries, which was not the case when the first oil boom hit in the early 1970s.

These are political decisions as much as they are economic ones. They can be made on the basis of long-term complementarities that benefit both sides of an investment venture, rather than only on the basis of medium-term return on equity. Considerable expertise throughout the banking and investment sectors of the energy-rich states could be tapped, alongside the political experience of some members of parliament and civil society advocates, to these basic questions on the ultimate ownership and use of the SWFs: How and where are these large amounts of money being invested? Who makes the investment decisions? How and by whom are these investment managers chosen? Should these funds be used to plug short-term gaps or to foster longer-term economic well-being? On what basis are decisions made related to investments at home, in the Arab region, and internationally? What criteria define these decisions? How can the citizens of the involved countries be appropriately informed about these issues and contribute to SWF investment policies? Who holds the investment managers accountable for their decisions? Do the investment managers report only to the top political leaders of their country, or do they also feel any obligation to report regularly to its citizens?

On the home front, the ultimate owners of the SWFs—the citizens of the energy-producing states—should be provided with more information on how the funds are accumulated, stored, and invested, rather than leaving this task in the hands of small groups of specialists. The oil-rich Arab states have developed political systems that reflect their unique circumstances of having relatively small populations that are socially conservative and patriarchal, and that have accumulated immense wealth in a short period of time. In these states, decision making reflects tribal and monarchic systems in which small groups of men at the top of the power structure make strategic decisions after consulting widely and informally with their fellow citizens.

Formal parliamentary systems have not generated much credibility, with the possible exception of the occasionally robust Kuwaiti parliament, but even that body is routinely dismissed or suspended when it becomes too pesky. What might work well in the Gulf states is a combination of more oversight of SWFs by the existing constitutional structures along with new councils that could be established purely to review and advise the SWFs' managers and to act as a first line of accountability. Such councils could include respected, proficient individuals from the government, civil society, the financial sector, academia, and the research or media sectors.

In analyzing the role of SWFs in the energy-rich Arab states, the two dimensions of "sovereignty" and "wealth" now need to be reconsidered, with equal weight being given to both sides of the equation. Preserving the value of capital is an important consideration, but equally important in the long run is the issue of exercising genuine sovereignty by making an effort to ensure that the excess funds held in the name of the citizenry are actually managed in a manner that benefits their long-term best interests. This is a moment when Arabs should be thinking more in terms of enhancing the wealth of their sovereignty, rather than merely bemoaning the erratic performance of their sovereign wealth. This could be a historic opportunity for the energy-rich Gulf countries with considerable stored wealth to pioneer decision-making and accountability mechanisms for managing their wealth that will set a standard of innovation, excellence, and political accountability for all the other Arab countries.

Notes

1 Sven Behrendt, "The Santiago Principles of the International Working Group of Sovereign Wealth Funds: Blueprint for a 12-Point Action Plan," Carnegie Endowment for International Peace, January 2009.

2 Ibid., 21.

CHAPTER 3

Arab Wealth: Financial Versus Real Assets

Hazem El-Beblawi

With the advent of the first oil price shock (1973–1974), a new term, "petrodollars," emerged to denote the Arab financial wealth placed in the major financial markets. Now, more than three decades later, the new term "sovereign wealth funds" (SWFs) has been coined to refer to the same essential phenomenon.

In both cases, these government-owned funds attracted much attention and were subject to heated debate in the media and elsewhere. The declared objective of the debate in 1973–1974 was to ensure the "recycling" of petrodollars to the financial markets with minimum disturbance, while today the debate has become a sign of the growing concerns about SWFs' political risks and nontransparencies.

With the eruption of the financial and economic crisis in late 2008 and the prompt support given by Arab money to ailing financial institutions in the West, the whole topic of the SWFs has virtually faded out in the media. SWFs' contributions to bail out some financial institutions were highly praised as a positive factor for international financial stability.

In both 1973–1974 and 2008, the issue was debated from the viewpoint of the Western countries. The Arab interests were hardly voiced. More than two decades ago, I published an essay on the subject in which I claimed that placing these surplus funds—petrodollars—in *financial assets* rather than investing them in *real assets* was not in the best interest of the Arab oil-producing countries.[1] I would add today that investing these funds in real assets would also be beneficial to the global world economy.

Real and/or Financial Facts

Notwithstanding the vital role of finance in modern economies, in the final analysis, the real economy determines economic outcomes. Financial institutions help facilitate and encourage—or their absence could obstruct—the movements of the real economy. Yet it remains true that finance is subservient to the real economy. Finance is but a mirror of the real economy—perhaps a little more than just a mirror.

The emergence of petrodollars, and now SWFs, is only a financial phenomenon. Unless such funds are transformed into real assets, sooner or later they would be bound to disappear through various financial mechanisms.

Given the recent history of oil price increases and, accordingly, the emergence of petrodollars and SWFs, we can distinguish three cycles:

- From 1974 to 1978
- From 1979 to 1985
- From 2004 to 2008

In all three cycles, there was a surge of oil surplus funds and, four or five years later, a substantial erosion of these funds.

In the first cycle, high global inflation followed the first oil price shock of 1974. By late 1978, there was enormous shrinkage both in surpluses in the states of the Organization of the Petroleum Exporting Countries (OPEC) and in deficits of the member states of the Organisation for Economic Co-operation and Development.

In the second cycle, the Iranian Revolution gave rise to a second oil price shock in 1979, and oil surpluses reemerged. The Iran–Iraq War in 1980 consumed a major part of these funds. In 1986, the world witnessed a shock in reverse, with oil prices decreasing and stagnating through the end of the century. During the same period, the first and the second Gulf wars exhausted a major chunk of the remaining oil surpluses.

Finally, in the third cycle, oil prices surged sharply again in 2004, only to come to a halt in 2008 after the eruption of a major global financial and economic crisis. How can these developments be explained?

New Savers

The increase in oil prices over the last three decades amounts to a redistribution of world income in favor of the oil-producing countries. The transfer of wealth from oil-consuming to oil-producing countries is, perhaps, the most significant consequence of the oil price increases. The sustainability of this newfound wealth will depend on how the funds are put to use.

The principal oil-exporting countries, mainly on the Arabian Peninsula and on the Gulf, were thinly populated and already enjoying relatively high per capita income. With oil price increases, the Gulf oil-producing countries have increased their share of world income, but more fundamentally this has led to an increase in their propensity to save. The emergence of new savers—the oil-producing countries—is probably among the most important change among recent economic developments.

The increase in the Gulf states' share of world income permitted them to boost their domestic spending spectacularly, both in consumption and investment. However, because of the limitation on their domestic absorption capacity, their excess savings remained unabsorbed domestically and were reflected in huge balance-of-payments surpluses.

A new phenomenon, oil surplus funds, became a feature of the world economy: excess savings in the form of balance-of-payments surpluses held by the Gulf countries. Moreover, these new savings introduced a disturbing factor to external global equilibria.

Placement—Not Investment

Perhaps the great merit of the ideas of John Maynard Keynes was to help build macroeconomic models and to emphasize the importance of the ex post equality between savings and investment. This is an accounting equality or, rather, an identity, which holds true for every economic system regardless of the economic forces behind it. One need not be a Keynesian to use this accounting identity as a tool for analysis. For whatever determines savings and investment, at the end of the day there must be an equality between *realized savings* and *realized investment*. Theories may and do differ as to what influences both investment and savings, yet all agree that the equality must hold ex post between them.

With the oil price shocks, the global economic system had to accommodate the new savings (oil surplus funds) to the iron accounting equality *savings* = *investment*. Economic forces should operate in such a way as to reconcile two facts: the emergence of new savings, and the maintenance of the accounting equality *savings* = *investment*.

Three possible scenarios can logically satisfy this requirement; thus, in the face of the emerging oil surplus funds, there could be

- a parallel increase in the rate of *real investment* in the world;
- a nominal *dis*savings elsewhere in the world to offset the increase in the Gulf states' savings; or
- an increase in financial assets, giving rise to increased nominal investment (placement).

We therefore must distinguish between two kinds of transactions related to financial assets according to their effect on the world economy's productive system: between *investment* and *placement* cases. By investment is meant the use of finance to add to capital goods. The French term *placement* designates the purchase of titles and shares that does not add to the productive capacity of the economy. *Placement* adds only to financial assets.[2]

A combination of elements from the three scenarios outlined above is always possible—and, indeed, is likely. Experience has shown that the third scenario represented, to a great extent, the world's response to the increase in its savings (petrodollars). This does not preclude sporadic increases in real investments (especially within the Gulf states themselves), nor a few cases of the transfer of property titles (dissavings) to OPEC surplus countries. It remains true that, by and large, the rate of investment has not shown any perceptible increase with the emergence of oil surplus funds. In fact, world real investment rates were showing signs of slackening. Also, the transfer of wealth in the form of property titles was the exception rather than the rule. On the contrary, financial assets, particularly debt instruments (deposits, certificates of deposit, bonds, bills, notes, loans, papers, etc.), soared dramatically in the aftermath of the oil price shocks.

It seems to me that oil surplus funds were, to a great extent, used for placement rather than for investment. The real question here, then, is how the equality of ex post savings and investment could be brought about in this *placement* case. The increase in financial assets, particularly debt instruments, in the world economy triggered various economic forces that ultimately increased the nominal investment (in value terms) to match the increase in the Gulf states' savings. It followed, then, that the Gulf states' savings underwent a continuous erosion until their virtual disappearance in 1978 after the first oil price shock, and once again in 1985, after the second one. Finally, with the collapse of the financial markets in 2008, a major part of the Gulf Arab states' accumulated wealth evaporated.

To understand the workings of the economic forces that brought about the required ex post equality in the "placement case," it is helpful to recapitulate the assumptions outlined above:

- No major worldwide reallocation between consumption and investment has taken place, so that the old structure remained, by and large, unchanged following the oil price shocks.
- OPEC's new savings were not accompanied by a major nominal dispossession of wealth elsewhere, so there was no substantial dissavings outside the Gulf states.
- OPEC's financial investments were largely added to—not subtracted from—the total stock of financial assets.

Increasing financial assets without corresponding increases in real investment contributed to the emergence of inflation in the late 1970s and early 1980s, and eventually to the collapse of the financial markets in 2008.

The Mirage of Security

It follows from the above discussion that the Gulf states' savings placed with the international financial markets amounted to an implicit, yet crucial, choice: to place these savings with the industrial countries rather than with the less-developed ones. Injecting new financial funds (Gulf states' savings) into the industrial countries through international financial institutions would not, by itself, increase real investment. The availability of financial resources does not guarantee that real investment will be boosted in the industrial countries. Nothing seems to augur a change in their effective demand toward more capital goods.

The Gulf states' savings were not, to be sure, voluntary savings acquiesced to by industrial societies to finance new investment opportunities; they were savings imposed on them by exogenous factors. If the proceeds of such external savings were reinjected into the system, they would be immediately absorbed with little real change in consumption patterns to restore the previous state, the status quo ante. In these circumstances, it is not hard to understand that the Gulf states' new savings brought about a surge in financial assets without much impact on the real economy.

It would, however, be farfetched to think that the profusion of the financial assets and the proliferation of the financial markets came about merely due to the emergence of the oil surplus funds. Far from that, various other factors have contributed to this end. It remains true, nonetheless, that the oil funds were an important element in this development.

Paradoxically, the Gulf states' search for security, which led them to place their savings in the most robust financial institutions, triggered a more menacing danger that finally led to the erosion of these same savings. Shying away from the hazards of investing in less-developed countries (LDCs) and preferring more "secure" investments in advanced countries brought about much more redoubtable risks.

Real Investment in and Partnership With LDCs

It would appear from the above that without increasing real investment to match the increase in the Gulf states' savings, the economic forces of the market would, one way or another, work to erode the value of the new savings (financial assets). This result was reached through general inflation, thus increasing the nominal value of the financial assets owned by the new savers. This was the case for the world economy in the late 1970s and early 1980s. Subsequently, the same result came about through the collapse of the financial markets themselves and the evaporation of a substantial part of the value of the financial wealth. This is what we are witnessing in 2009.

Another crucial element that comes up here is the fact that the potential for increasing real investment can mainly be realized in the developing world. Only in the poor developing countries, the LDCs, is there a genuine need for massive real investment. It seems paradoxical that the long-run viability of the oil surplus funds is bound to the success of LDCs' efforts to undertake massive investment programs.

A New Economic Order: A Dream?

Reshaping the international order and erasing world poverty have always been the goals of the international community. Can the Gulf oil surplus countries play a role in bringing about such a "New Economic Order"?

It would have been asking too much to expect that the Gulf oil surplus countries would alone assume the whole responsibility for reshaping the world economic order by investing their earned additional surpluses in the LDCs. This is also highly idealistic.

The Gulf states' new savings, it has been shown, cannot be maintained in real terms without a parallel increase in real investment. And here emerges the crucial role of the LDCs as potential partners for the Gulf states' new savings. Given structural demand limitations in industrial countries, only capital-hungry poor countries would provide much-needed investment opportunities to match the Gulf states' newly available finance. This may sound too simplistic, because investment in the LDCs is not only a question of finance—the LDCs' institutional, human, and material shortcomings are too well known to warrant any further elaboration.

Regardless of the formidable obstacles for enabling the developing world to advance, there remains a basic difference between industrial and developing countries with regard to the absorption of the oil surplus funds. In the industrial countries, real investment will not increase without a corresponding change in the domestic demand structure. In developing countries, on the contrary, investment may increase—given the availability of OPEC finance—without further need for a structural change in demand.

The picture can still be made brighter. Increased real investment in the LDCs would imply more imports of capital goods from the industrial countries, and hence a larger volume of international trade. The industrial countries could thus increase their capital good exports to the LDCs to compensate for their higher oil bills from OPEC (thus practicing trilateralism). The world as a whole would become thriftier, yet more capital accumulation would also be forthcoming. We could witness a higher growth path for the world economy as a whole.

This, of course, is an idealized world. Real life is less attractive. The LDCs are disappointingly mismanaged, lack skilled labor, and are deficient in infrastructure. These are enormous problems and cannot simply be removed by a stroke of the pen. However, the alternative has proved to be as depressing, if not more so.

Additionally, even a hypothetical role for the Gulf states in establishing a "New Order" will need a massive transfer of resources to the LDCs. It is only by concentrating their investment effort in a particular region that tangible results could be expected. Since the Gulf surplus countries are mainly

Arab states, a privileged region for a concentrated regional investment program could have ideally been the Arab region. An *Arab regional development plan* would thus appear, in theory, to be most promising.

Conclusion: Wealth Cannot Simply Be Created by Financial Devices

Petrodollars and SWFs are no more than additions to financial wealth placed in the financial markets in the form of financial assets. The increased savings of the Gulf states did not bring about corresponding increases in real investment. The emergence of these new funds was confined to the financial sphere and barely touched the real economy. The failure to increase real investment to match the increase in the Arab Gulf states' savings triggered economic forces in the market to work toward the erosion of these states' accumulated wealth.

This is not a conspiracy theory, but it is the result of an obvious fact: Wealth cannot simply be created by financial and/or monetary devices. Wealth can only be created by adding to the real assets on the ground.

The mismatch between the *financial* and *real* aggregates led to financial turbulence—first inflation, and subsequently the meltdown of the financial markets. The Arab Gulf states can help themselves and the world at large if they achieve a state of mind that focuses on real investments rather than obsessing about financial wealth. The Arab region could become a promising land for a massive program of investment. But it will take more than an academic exercise to actualize such a dream. The Arab region needs a new vision, and more imagination.

Notes

1 Hazem El-Beblawi, "The Predicament of the Arab Gulf Oil States: Individual Gains and Collective Losses," in *Rich and Poor States in the Middle East*, ed. M. Kerr and S. Yessin (Boulder, Colo.: Westview Press, 1982).

2 Joan Robinson, *The Accumulation of Capital* (New York: Macmillan, 1956).

CHAPTER 4

Sovereign Wealth Funds and the Politics of Boom and Bust

Ibrahim A. Warde

Sovereign wealth funds (SWFs) burst upon the global scene, seemingly out of nowhere, in late 2007 when they acquired in just a few months more than $60 billion worth of shares in major global financial institutions. In the fad-driven world of finance, SWFs were the new stars. Latecomers such as Russia and Saudi Arabia rushed to create their own SWFs—in essence redirecting part of their foreign exchange reserves into a private equity arm that would seek high returns on the international equity markets.

Much of the debate has focused on the concerns, the fears, and the hopes of recipient countries: What do SWFs *really* want, and what is their impact on the host countries? As will be discussed below, the concept of governance, vague as it is, has been useful to placate critics and justify needed policies of openness or protectionism, but it does not explain much. To unlock the mysteries of SWFs, one needs to look at the changing political-economic context of the SWF-holding countries. Rather than having an unchanging essence, SWFs change with the ups and downs of oil prices.

The argument developed here is that in times of rapid rises in the price of oil, such as the periods 1973–1981 and 2003–2008, "technocrats" (experts in charge of making investment decisions) enjoy some autonomy, whereas in periods of stagnation and decline, such as the years between 1981 and 2003, and likely the post-2008 era, politics trumps technocracy. In the boom years, a financial logic prevails. Yet as soon as boom turns to bust, technocrats come under attack for their bad investments, and the politicians have to respond to myriad domestic and international demands.

As I have discussed elsewhere, there is a great deal of diversity among SWFs in general.[1] Those belonging to the states in the Gulf region do, however, have a few things in common: Their wealth depends directly or indirectly on oil and other sources of energy, and they evolve in an environment sharing political, religious, cultural, and geostrategic characteristics. A dynamic approach is essential, because the very peculiar circumstances of late 2007 and early 2008 have led to beliefs and generalizations that have taken on a life of their own, despite the fact that they are no longer warranted or relevant.

Governance: A Red Herring

There are striking parallels between the oil price shocks of the 1970s and the 2003–2008 rise in oil prices.[2] In both cases, the sudden rise of "Arab money" stoked fears while whetting appetites. In the 1970s, business magazines were wondering how long it would take before Arab money would be able to buy all of Wall Street. In recent months, analysts have engaged in similarly wild extrapolations. Morgan Stanley analysts have predicted that SWFs will increase from $3 trillion in 2008 to $12 trillion in 2015. This guesstimate has been endlessly repeated, leading some to speculate that by 2015, SWFs "could be bigger than the U.S. economy."[3]

In the 1970s, Hans Morgenthau, then the best-known international relations specialist, expressed his outrage: "The control of oil, the lifeblood of an advanced industrial state, by potentates who have no other instrument of power and who are accountable to nobody, morally, politically, or legally, is in itself a perversity. It is a perversity in the sense that it defies all rational principles by which the affairs of state and the affairs of humanity ought to be regulated to put into a few irresponsible hands power over life and death of a whole civilization."[4] At the time, to avoid a protectionist backlash, managers of Arab wealth had to show that they were "responsible" in the "recycling of the petrodollars." The outcry was mitigated by economic recession in the West and the fact that, in addition to a few high-profile investments, much of the newfound wealth was placed in large international banks or was used to purchase U.S. Treasury bills.

In the years preceding the recent banking crisis, a system of "gated finance" based on de facto exclusion had come into existence. As in those gated residential communities where a small number of privileged people are protected from the surrounding often-chaotic environment, the major financial institutions enjoyed a great deal of freedom added to the privileges of self-regulation; but this came at the price of greater vigilance toward the outside world.[5] Despite the rhetoric of free enterprise and open capital flows, the system's flagships were not to be sold to outsiders. In 2005 the attempt by the China National Offshore Oil Corporation to acquire the oil company Unocal was foiled. The following year the prospect that Dubai Ports World could gain control of six American ports met with a great deal of resistance in the U.S. Congress and the media. Then came the current financial and economic crisis, and with it new attitudes toward certain foreign investors.

In 2008, as investors from China and the Gulf region started buying bank stocks, Jim Cramer, the star analyst of the CNBC financial news cable television network asked, "Do we want the communists to own the banks or the terrorists?" before answering "I'll take any of it, I guess, because we're so desperate."[6] The new attitude was, in the words of Kristin Halvorsen, the minister of finance of Norway, which is home to the second-largest SWF: "They don't like us, but they want our money."

Such contradictions would be resolved with talk of governance and codes of good behavior. The new consensus was that SWFs would be welcome, provided they were committed to good governance. The Organisation for Economic Co-operation and Development, the International Monetary Fund, the World

Bank, and other international organizations started devising codes stressing transparency, accountability, and responsible investing. SWFs would also commit to restraining from investing for strategic or political reasons.

Despite the fact that investments by SWFs have slowed considerably, the rush to adopt such codes has not. In October 2008, the Abu Dhabi Investment Authority, the world's largest SWF, took the lead in issuing a statement of investment principles stressing transparency, accountability, and good governance.[7] Many other unilateral and multilateral declarations of good governance have since followed.

All this is somewhat ironic—considering, first, that the guiding lights of global finance on Wall Street and elsewhere have not been, as recent developments have amply shown, paragons of good governance; and, second, that with the growing intervention by governments, the world of finance is being increasingly politicized. In this respect, it is revealing that one of the newest SWFs in the developed world, created by France, is primarily designed to protect national industries from foreign SWFs.[8]

It should be said that the concept of good governance, though heartily endorsed, is increasingly fuzzy. Indeed, a 2008 survey of corporate governance practices in the Middle East and North Africa found that while the vast majority of publicly listed banks and companies believed corporate governance to be vitally important, more than half—53 percent—of the participants did not know what the expression meant.[9]

Between Technocracy and Politics

There are two main characteristics to the technocratic phase observed in the boom years. One is that a significant part of surpluses is invested overseas; the other is that wealth managers are likely to be professionals somewhat insulated from politics. The focus on foreign investment and the quest for high returns are based on the view that local Gulf markets are too small to absorb sudden financial windfalls, and that wealth should be husbanded for the benefit of future generations.

In both periods of rising oil prices, the investment technocracy, much courted and much feted, had its day in the limelight. In the 1970s, the extent of mismanagement of oil wealth was not immediately clear. Boom times often have a self-fulfilling element: Growth feeds upon itself, and short-term gains are often interpreted as proof of the talent of the managers and the justification for their relative autonomy. But as the saying goes, one should not confuse brains and a bull market. Inevitably, disappointment sets in. In 2007 and early 2008, the consensus was that the move by SWFs to buy financial stocks at the bottom of the market was clever—until it became clear that the market was far from hitting bottom.[10]

The technocratic logic becomes unsustainable when recession hits. Investment funds hunker down. Foreign investment and private equity deals become less significant, and new priorities appear. Policies that once seemed logical show their limits. In the early 1980s, as in late 2008, the oil-producing countries were hit with sudden global economic downturns, which affected them in multiple ways. In addition to the double whammies of sharp drops in oil revenues and losses from foreign investment, new demands appeared, first as a result of the recession at home, but also as a result of commitments made and expectations built up in the boom years.

In the context of the current recession, investments in shares of global financial institutions have quickly become an embarrassment.[11] SWFs are first and foremost funds for future generations, whose duty is to help fructify the national capital or at the very least preserve it. Because charity begins at home, the idea of rescuing foreign companies when national firms need rescuing musters little domestic support. Thus, as national economies have been hit by the recession, a number of SWFs have announced a reorientation of priorities toward the home (or at least the regional) market, in particular toward local infrastructure projects.[12] The Kuwait Investment Authority and the Qatar Investment Authority have been called upon to inject liquidity in collapsing stock markets, recapitalize banks, finance stimulus plans, and more generally make up for the decline in the value of oil exports.[13] In Dubai, the recession has caused a massive reorganization and scaling back of SWFs.[14] Two of Dubai's SWFs—Dubai International Capital and the Dubai Group—were merged, as Abu Dhabi came to the rescue of Dubai. In Kuwait, the question of mismanagement and the squandering of public money was behind the resignation of the cabinet, the dissolution of Parliament, and the subsequent paralysis of political institutions.

Given the opacity of Gulf politics, the multitude of politically driven deals will only start to be known when future historians look back at the contemporary period. It is nonetheless useful to consider three dimensions—domestic, regional, and international. At the domestic level, governments must respond to the demands of various constituencies, and dwindling resources must still somehow finance big projects launched in euphoric days—whether in development, educational, or media projects—not to mention stepped-up efforts at public diplomacy.[15] Such challenges are exacerbated by underlying tensions (succession battles, sectarian conflicts, restless and often jobless youth, yearnings for democracy, and so on). At the regional and international levels, there is the ubiquitous question of "checkbook diplomacy," justified by the wealth—real or perceived—of the Gulf nations. Against a backdrop of geostrategic threats (the Arab–Israeli conflict, Iran and Sunni/Shi'i tensions, nuclear issues, the "war on terror," and so on) and political and military dependence on the United States, these countries are called on to pay for war and peace, purchase weapons, and help pay for the maintenance of the international order.

A striking illustration of the speed with which boom can turn to bust can be found in Kuwait at the beginning of the 1980s. With its vast oil production and small population, Kuwait looked immune to economic trouble and was poised for an era of great prosperity. It was also regarded as a pioneer of what were not yet known as SWFs. In the summer of 1981, after years of a seemingly unstoppable flow of oil revenues, another outlet for Kuwait's new oil wealth appeared—an informal financial market known as the Souk Al-Manakh, which listed fifty-four recently formed Gulf companies (mostly from Bahrain and the United Arab Emirates). Unlike the staid official market, the unregulated Souk Al-Manakh, with its skyrocketing values, looked like the place where instant fortunes could be made. At its peak, its market capitalization was said to be the third highest in the world, behind only the United States and Japan.

The incredible rise in the value of these fifty-four companies was fueled in large part by the common practice of postdated checks, as thousands of investors drew against funds they did not have. Investors would routinely write such checks for twice or three times the price of the stock. It took only a year for this seemingly unstoppable bull run—which had the entire country caught in a speculative fever—to end, when one of the postdated checks was presented to a bank and bounced. In August 1982, the Kuwaiti government ordered all such dubious checks to be turned in for clearance. According to the official investigation, the total of such checks was $94 billion.

Despite the burdens of this massive bailout, funding demands—domestic, regional, and international—did not abate. All things being relative, the outside world had a hard time believing that Kuwait was broke, or even that it was facing a liquidity crisis. One pressing financial demand that was impossible for Kuwait to turn down was that presented by Iraq, at war with Iran between 1980 and 1988, as the powerful neighbor argued that the war was also protecting Kuwait and indeed the entire Gulf region from Iranian-style fundamentalism. The Gulf War was also the occasion for embarrassing revelations about the Kuwait Investment Office (later to be known as the Kuwait Investment Authority), the first of those institutions that were not yet called SWFs, which was then highly regarded yet nonetheless was depleted by 60 to 80 percent from a prewar total of $100 billion, as a result of politically driven expenditures, mismanagement, and fraud.[16] It is a cautionary tale about the ease with which the coffers of an SWF can be emptied.

In the current global financial and economic crisis, the greatest demands are likely to be placed on Saudi Arabia, the world's largest exporter of oil. As of this writing, Saudi Arabia has embarked on a massive economic recovery program worth $400 billion, which the International Monetary Fund considers as the largest in the countries belonging to the Group of Twenty.[17] Like the other Gulf countries, Saudi Arabia is also expected to make significant contributions to the International Monetary Fund. It is too early to know about other handouts to regional and international causes, but if recent history is any indication, they are likely to be substantial. Much is known about the Saudi role in financing the Afghan jihad, and about the Saudi agreement (in 1980) to match American expenditures in Afghanistan dollar for dollar.[18] But Saudi checkbook diplomacy has extended much farther, all the way to places such as Angola or Nicaragua.[19] In the Saudi-bashing climate of the post–September 11, 2001, period, Prince Turki Al Faisal, the former Saudi chief of intelligence, reminded his Georgetown University audience in February 2002 of the role played by his country when the United States was hobbled by political and economic constraints:

> In 1976, after the Watergate matters took place here, your intelligence community was literally tied up by Congress. It could not do anything. It could not send spies, it could not write reports, and it could not pay money. In order to compensate for that, a group of countries got together in the hope of fighting communism and established what was called the Safari Club. The Safari Club included France, Egypt, Saudi Arabia, Morocco, and Iran …. The main concern of everybody was that the spread of communism was taking place while the main country that would oppose communism was tied up. Congress had literally paralyzed the work of not only the U.S. intelligence community, but of its foreign service as well. And so, the Kingdom, with these countries, helped in some way, I believe, to keep the world safe at the time when the United States was not able to do that.[20]

Charles Freeman, who was the American ambassador in Saudi Arabia between 1989 and 1992, also recalls the incessant financial requests he had to make—the largest one being the $65 billion Saudi contribution to the 1990–1991 Gulf war—as well as a running dispute with the Saudis about the true state of their finances. In his words, "There was simply disbelief [in Washington] that Saudi Arabia could be cash poor."[21]

This analysis has sought to show that the conventional wisdom on SWFs is flawed. It is based on a simple extrapolation of recent trends that disregards likely cycles of boom and bust; it is based on a private equity logic that leaves politics out; and it looks at governance and codes of good behavior as panaceas. The question of how the excess wealth of oil-producing countries is spent is a complex one. In times of boom, a private equity logic may be a good approximation of investment strategies. In times of bust, however, such a logic is trumped by political factors. The use of SWFs thus can only be understood in relation to the collision of countless claims on oil revenues made at the domestic, regional, and international levels—and how governments choose to adjudicate among these claims.

Notes

1 Ibrahim Warde, "Sovereign Wealth Funds to the Rescue: Are They Saviours, Predators or Dupes?" *Le Monde diplomatique*, April 2008.

2 There were two distinct oil price shocks. The first, at the time of the October 1973 Arab-Israeli war, resulted in a quadrupling of the price of oil over a four-month period. The second, in 1978–1979, resulted in a doubling of the price of oil as a result of the Iranian upheavals that led to the Islamic Revolution.

3 Kathryn Hopkins, "Sovereign Wealth Funds 'Could Be Bigger Than US Economy by 2015,'" *Guardian*, April 28, 2008.

4 Quoted by Jack Anderson and James Boyd, *Fiasco: The Real Story Behind the Disastrous Worldwide Energy Crisis—Richard Nixon's "Oilgate"* (New York: Times Books, 1983), 256.

5 Ibrahim A. Warde, *The Price of Fear: The Truth behind the Financial War on Terror* (Berkeley, Calif.: University of California Press, 2007), 107–125.

6 Peter S. Goodman and Louise Story, "Foreigners Buy Stakes in the U.S. at a Record Pace," *New York Times*, January 20, 2008.

7 "A Bid for Trust," *Financial Times*, September 4, 2008.

8 Philippe Ricard, "La France propose des fonds souverains en Europe pour protéger le capital des entreprises," *Le Monde*, October 23, 2008.

9 "Time for Transparency: What Will It Take to Improve Corporate Governance in the Middle East?" Knowledge@Wharton, March 11, 2009, http://knowledge.wharton.upenn.edu/article.cfm?articleid=2178.

10 Heather Connon, "Why Sovereign Wealth Funds Can't Get Enough Bank Shares," *Observer*, June 22, 2008.

11 Stanley Reed, "Sovereign Wealth Funds Taste Bitter Losses," *Business Week*, December 11, 2008.

12 Marc Roche, "Les fonds souverains du Moyen-Orient battent en retraite," *Le Monde*, November 30, 2008. Also see Simeon Kerr, "Istithmar Set to Launch Fresh Asset Sales," *Financial Times*, March 8, 2009.

13 Antoine Reverchon, "Des investisseurs financiers provisoirement affaiblis," *Le Monde*, November 11, 2008.

14 Simeon Kerr, "DIC Cuts Workforce in Rare Arab Redundancies," *Financial Times*, October 1, 2008.

15 One example is the efforts of the Qatari government to sponsor an agreement among feuding Lebanese factions.

16 Youssef M. Ibrahim, "Financial Scandal Is Shaking Kuwait," *New York Times*, January 10, 1993. See also Marc Roche, "L'éclipse du KIO: Victime de la guerre er des difficultés du Koweit le puissant bureau d'investissement de l'émirat n'est plus que l'ombre de lui-même, " *Le Monde*, May 26, 1992.

17 P. K. Abdul Ghafour, "Kingdom's Recovery Program Largest in G-20: Al-Assaf," *Arab News*, April 4, 2009.

18 Robert Gates, *From the Shadows: The Ultimate Insider's Story of Five Presidents and How They Won the Cold War* (New York: Simon & Schuster, 1996), 148–149.

19 George Crile, *Charlie Wilson's War: The Extraordinary Story of the Largest Covert Operation in History* (New York: Atlantic Monthly Press, 2003), 236.

20 Prince Turki Al Faisal, special address, Center for Contemporary Arab Studies, Georgetown University, February 3, 2002. See also John Cooley, *Unholy Wars: Afghanistan, America and International Terrorism* (London: Pluto Press, 2002), 15–18.

21 David B. Ottaway, *The King's Messenger: Prince Bandar Bin Sultan and America's Tangled Relationship with Saudi Arabia* (New York: Walker, 2008), 104–105.

CHAPTER 5

The Global Financial Crisis and the Arab Sovereign Wealth Funds: Implications and Limitations

Atif Kubursi

It may be convenient to dismiss the current international financial and economic crisis as another blip in the financial markets. The seriousness, depth, and uniqueness of the crisis, however, suggest that this may not be the case. Several distinguishing features make this crisis different from many preceding difficulties, suggesting that its effects are going to be more profound and that its consequences may last longer than any of the previous minor crises in the 1980s and 1990s.[1] There are also early indications that this crisis, unlike many others before it, may finally shake the present economic structures, institutions, and orthodoxy as it calls into question some of the fundamental tenets of neoliberal economics, the efficacy of current regulations, and confidence in the working of national and international economic institutions and mechanisms.

What started as a real estate collapse, with housing prices falling over 30 percent in less than a year in the United States (the early estimates put the losses so far at $2 trillion in America alone), further imploded as the subprime lending debacle led to widespread foreclosures as high-risk lending to groups without sufficient resources to support their mortgage payments dragged several banks into insolvency, spreading over many countries, and sank giant mortgage guarantors such as Freddie Mac and Fannie Mae when mortgagees abandoned homes whose prices had fallen below their mortgaged value.

This real estate crisis could have been restricted to the balance sheets of mortgage lenders and guarantors, but banks and investment banks bundled their risky (toxic) mortgages with other good assets, trying to hide the true risk content of these mortgages. Other financial institutions the world over—such as giant insurance corporations, investment banks, hedge funds, and other financial institutions—also fell into bankruptcy. Corporations with assets in the trillion-dollar range saw their assets evaporate in days, if not hours. The liquidation of assets flooded the stock exchanges, precipitating continuous large declines in stocks' values, with the contagion soon spreading far beyond financial stocks. Ripples and hiccups in the financial sector turned into tidal waves, engulfing the real economy and almost all countries of the world. This is perhaps the second time in eighty years that the major economies of the world are on the same sinking ship.

Some countries have been more affected by the current crisis than others; these are the countries that are deeply integrated into the global economy.

The Arab Gulf countries are flagrant examples of this deep and lopsided integration, which has become a dominant characteristic of the current global economic system. The countries belonging to the Gulf Cooperation Council (GCC) export almost exclusively large quantities of oil and derive huge rents on these exports that exceed the absorptive capacity of their small and disarticulated economies. Without exception, they have "invested" large proportions of their surpluses in advanced Western economies.

These investments have traditionally been allocated to highly liquid assets, but they recently came to include a limited range of less secure and liquid industries, primarily financial and commercial in nature. This meant that their rates of return were lower but have increasingly moved into higher-risk assets to improve their rates of return and to capitalize on the stock boom that characterized the previous few years. Unfortunately, the returns were incommensurate with the high risks on account of their limited diversification and, in the case of real estate investments, of their limited liquidity.

The sovereign wealth funds (SWFs) in the four dominant GCC countries (United Arab Emirates, Saudi Arabia, Kuwait, and Qatar) are estimated to have had assets in excess of $1.5 trillion before the start of the crisis in August 2008, with the United Arab Emirates' SWF accounting for $875 billion; Saudi Arabia's, $300 billion; Kuwait's, $250 billion; and Qatar's, $40 billion. These estimates of assets are only for the SWFs and do not include the investments of individuals and private institutions.[2] When the latter are added, a reasonable estimate would put their value at over $3 trillion.

Early estimates of the losses of the Arab Gulf countries in the first few months of the crisis vary. On January 19, 2009, Mohamad Al Sabah, the foreign minister of Kuwait, stated that his rough estimates show that the GCC countries had lost, in less than four months of the crisis, more than $2.5 trillion. These losses include about $600 billion in the value of the SWFs' assets (equal to two years' average gross revenue from oil for the region), an equivalent amount in private investments abroad, $200 billion in oil revenues as oil prices collapsed from a high of $147 a barrel to less than $35, and the rest spread over domestic stock markets (for instance, Saudi stocks lost 60 percent of their value in less than three months), dwindling tourism incomes (particularly in Dubai), rents, dividends, and new obligations to support international institutions (for example, the International Monetary Fund) to help several countries cope with the crisis and lost growth.[3] These figures could also underestimate the true magnitudes of the losses, given the fact that the SWFs' holdings have continuously been replenished as long as the oil price remained high.

The British prime minister, Gordon Brown, is known to have asked the GCC countries during a trip to the region in November 2008 if its surplus countries could advance $250 billion to the International Monetary Fund to support a new facility to help countries that have suffered from the global crisis. The list of countries includes Hungary, Iceland, Ukraine, and a host of others.

The GCC countries were expected to grow at an annual real rate of 5.7 percent in 2009. This has been scaled down to 4.2 percent. In the United Arab Emirates, the real rate of growth has been scaled down from 7.5 to 3 percent. These represent major declines and a setback from the average rates of growth registered in the past few years. These declines are the direct result of oil revenue losses, because oil still accounts for more than 75 percent of government revenues in the region. Almost all, if not all, the countries in the region will sustain large deficits in their operational budgets, and most have reduced development expenditures or eliminated them. Early estimates suggest that more than 60 percent of new projects in the region have been shelved or scaled down.[4]

There are rumors of widespread closures of businesses and wholesale layoffs of workers in several GCC countries. There are also unconfirmed reports that the parking lots of Dubai International Airport are congested with parked cars, with their keys in them left by workers who lost their jobs and cannot afford the high rents in the emirate.

The consequences of these adjustments will not be restricted to the GCC countries, where nationals sometimes do not represent more than 10 percent of the labor force. The ripples will expand and will affect many other poorer Arab countries—particularly Lebanon, Egypt, Jordan, and Palestine—and several South Asian countries that depend on remittances sent by their nationals working in the Gulf and on tourism and investment flows from the region.

A few questions naturally arise: Was it possible to anticipate this crisis? Why have its effects been so severe, particularly for the GCC countries? Would it have been possible to mitigate or minimize its negative consequences? Did the GCC states' fund managers employ reasonable or acceptable risk management strategies that might have reduced their losses? What prevented the use of these risk management techniques? Are there governance standards that could have been employed or could be employed to ward off similar investment losses in the future?

These are critical questions that could and should be raised in the hope that the lessons of this crisis will not be lost. In this regard, three basic observations need to be made.

First, the magnitudes of the losses are larger than the average losses shown by various Western market indices. This may suggest that the GCC states' SWF investments were on average riskier than the typical stock market indices. Or could it be that these SWFs have been restricted to a narrower range of allocations, given Western pushback and increased resistance to their operations in Western societies?[5]

Second, a cursory (the investments are not typically transparent) review of the range of assets held by the SWFs suggests that they are not well diversified (by assets, countries, and liquidity). This may not be the fault of the SWFs' management, but it may also reflect the constrained and scrutinized environment in which the SWFs operate (for instance, the tempest created about Dubai Ports World's proposed investment in the United States last year). Regardless of the circumstances, the fact remains that the range of assets held by these SWFs is not sufficiently diversified.

Third, there are no hard data on the rates of return realized by the SWFs' investments. But given their nature and their narrow range, it is possible to suggest that, given their risk structure, their returns are not commensurate.

Many lessons can be learned from the current crisis, and although its consequences are still unfolding, it may be more prudent to wait until we see the final outcomes. Yet it is worth reviewing the parameters of required changes that could help avert future difficulties and exposures.

It is true that as long as the price of oil is likely to remain higher than the average cost of producing it, the Arab Gulf region will realize large rents. As far as we can foresee, these rents will be denominated in U.S. dollars, which makes investing them in the United States more likely and smoother.

These surpluses can be spent domestically on current private and public consumption or on imports, or they could be invested domestically or abroad. It has been the case that the domestic absorptive capacity was lower than the realized surpluses and, out of necessity, a large share of these surplus funds has been invested abroad. Domestic absorptive capacity pertains not only to the capacity of domestic economies to absorb productive investments; it also pertains to their capacity to absorb these investments without exposing the domestic economies to unnecessary and intolerable inflation rates.

But domestic absorptive capacity is not an exogenous and immutable value. It can be expanded wisely and through coordinated investments within a broader geographic context (for example, in the GCC as a whole rather than in each country alone, or even in the Arab context). It is quite clear that this level of coordinated investments has not been tried on a regional basis. There are some regional investments, particularly in Dubai, but these have not been conceived at a higher level of deliberate utilization to expand the region's absorptive capacity. Some wider Arab investments have also been made by the Gulf countries in other Arab countries, but these have been on a smaller scale than those in Western markets and at an individual and uncoordinated level.

If investing in foreign assets and markets is necessary, and one assumes that diversification is a wise investment policy, then there are many avenues to widen this diversification perspective across countries, across currencies, and across assets. The mean-variance principle or the contours of the rates of return and risk of the present allocations do not seem to reveal that diversification and the trade-offs between returns and risks have been well managed. The magnitudes of the losses are too large compared with what a few alternative portfolios could have generated.

The fact that the losses have been so large and immediate also suggests that there were missing links and functions in the overall management of these portfolios. If anything, the capacity to adjust investment strategies at short notice and to continuously monitor and rebalance portfolios should have been more pronounced.

The nature of property rights and the system of governance in the Gulf region have shielded these investments from scrutiny and accountability. As long as oil revenues flow directly to the region's rulers, independent of any major contribution of the ruled, the accountability links go missing. The dominance of oil in the region has been blamed for reversing the natural links between subjects and rulers that prevail in democratic societies. Thus, the insulation of the region's SWFs from public scrutiny and oversight is symptomatic of a broader and more serious malaise in the region—the dependence of the ruled on the ruler, instead of the reverse. As long as this is the case, and in the absence of taxation, it is likely that representation of the citizenry will remain weak if not absent. In such circumstances, the population must devise a mechanism to gain their voice that the system does not provide.

Finally, the objective criterion of the policy makers in the Gulf should remain the preservation of real wealth per capita. As oil stocks are drawn down, other forms of wealth should replace declining oil assets. This effort to preserve real wealth should override any attempts to maximize returns and accept undue risks. After all, determining this outcome should be left to the citizens of the Gulf states.

Notes

1 Atif Kubursi, "Financial Meltdown or an Economic Collapse: The Limits of Ideological Prescriptions," McMaster University, 2009.

2 See the chapter by Sven Behrendt in this volume and Jasem Husein, "The Economic Consequences of the International Financial Crisis on GCC Countries," Aljazeera Reports, 2009.

3 There are many estimates of these losses. Some of these estimates can be found in "Kuwait, Singapore Funds Lose Financial Bets," *International Herald Tribune*, February 10, 2009; Brad Setser and Rachel Ziemba "GCC Sovereign Funds: Reversal of Fortune," Council on Foreign Relations, January 2009; and Stanley Reed, "Sovereign Wealth Funds Taste Bitter Losses," *Business Week*, December 11, 2008.

4 Husein, "Economic Consequences."

5 Katherine Hopkins, "Sovereign Wealth Funds 'Could Be Bigger Than the US Economy in 2015,'" *Guardian*, April 28, 2008.

CHAPTER 6

Arab Investments: An Instrument to Diversify National Economies?

Ghazi Hidouci

The current global financial and economic turmoil requires the Arab world to fundamentally rethink the strategic orientation of its investments with the objective of making Arab economies more resilient against the currents of the global economy. Arab states should devise a way to more rigorously diversify their investments both geographically and through different industrial sectors. They should also enhance their thinking about investment strategies that put the economic interests of the Arab region first and promote its economic development. They also need to look at how the Arab world chooses to regulate the vehicles through which these investments are realized in the future.

When developing a regional investment perspective, we have to be aware that the Arab countries in the most recent past have witnessed very different patterns of economic development.

The citizens of the Gulf Cooperation Council (GCC) countries have benefited from increasing income levels financed by the global boom in commodities. At the same time, surplus capital has been invested though Gulf Arab Sovereign Wealth Funds (SWFs) in international assets and has allowed Gulf Arab economies to establish a presence in international markets and major corporations. The rise of Arab SWFs as meaningful actors on the global scene has been an impressive example of Arab economic ambitions. At the same time, the fall in the value of SWF assets has raised serious concerns about the direction that SWFs have taken in allocating their investments, and if these investments will be sustainable.

Other Arab nations, particularly in the Maghreb, have accomplished less. The incomes of citizens in this region did not rise as much as those of the GCC; the assets are much less geographically diversified. The reasons for this are obvious: the countries of the Maghreb face much different demographic realities; at the same time, their investment approach is based on overly cautious financial policies that echo the period prior to the structural adjustment policies of the more recent past.

What the Arab regions have in common are economies that are tightly linked to the world's monetary, financial, and trade fluctuations, and as a result are deeply affected by the volatilities of the global economy. The region suffers from a lack of vigor in managing its own internal monetary, financial, and economic markets. In addition, geopolitical instability drives ever increasing expenditures for security. Consumerism and commercialism reinforce the rentierism of the entire region.

While the current economic crisis has not spared the Arab world from economic hardship, considerable financial resources remain at the disposal of Arab governments. The task now is to set in motion a positive dynamic based on strategic knowhow, the political will of national governments, and the leadership of regional institutions. This dynamic will help Arab states to fundamentally redesign their economic strategies, both on the national and regional levels.

A Common Project Toward Regional Integration

It should be obvious that the fragility of Arab economies does not allow Arab policy makers to merely respond to the economic crisis by implementing financial response strategies. Any strategy based on making a short-term impact will fail to address the longer-term economic deficits that many of the Arab economies suffer from. Therefore, a broader and more comprehensive vision of economic development is required. This new vision needs to serve as the basis for long-term, sustainable economic growth. It will need to be based on three pillars:

The first pillar involves addressing the wasteful consumption of natural resources, whether water, energy, or land. The region for much too long has not seriously taken into account the scarcity of natural resources. Any regional development strategy must be based on the understanding that natural resources are finite and have an ever increasing price. Economic and ecological objectives must converge. Lowering energy consumption and limiting greenhouse gas emissions are some elements of this strategy. Scarce resources must also be managed on the basis of sound economic fundamentals, in the most efficient way possible, and in the most sustainable way possible. Although technologies that might help the region to eventually realize this objective have not yet reached the stage at which they are economically viable, the region should make an effort to find innovative approaches. The redirection of financial surpluses towards cutting-edge sectors could set Arab states on a new path toward a healthy regional economy. A large part of regional incomes could potentially be shifted away from consumerism and property speculation and directed toward investment in development projects that are based on the principles of sustainable development.

The second pillar is to seriously reconsider the monetary and fiscal affairs of the Arab region. The collateral transmission of financial tensions from failed operators to operators that are in principle healthy triggers a cascade of financial distress. Market turbulence places general liquidity under high tension. Having been taken hostage, central banks, government treasuries, and taxpayers have inevitably been forced to socialize the losses. The region needs to rethink ways of bolstering local trade that are based on a joint monetary policy, depending less on risky and costly international currencies. The current market drift should push the region to act collectively and with other partners to create a stable monetary and financial system, promoting production without over-remunerating money or taking damaging speculative risks. Establishing a regional financial zone with adequate regulation will address the risk of capital flight and ensure the inflow of external capital, provided that development and guarantees are attractive in terms of the return/risk ratio.

The third pillar is state management and governance at the regional and national levels. Development from top to bottom, as exercised in the past, should be abandoned. To ensure success, citizens themselves and investors in particular must get involved. Economies in the Arab world must be based on a bottom-up approach that fosters entrepreneurship and innovation. Arab economies need to be organized horizontally, not vertically and autocratically. A more efficient regional economy cannot be envisaged without emancipating Arab citizens. This emancipation ultimately would have a spill-over effect into the organization of the body politic in the Arab world. The economic transformation that we propose will ultimately result in the increased democratic participation of Arab citizens and entrepreneurs in political decision making. It will also result in rethinking much more vigorously the foundations upon which Arab economies have been built—the ideologies that support these foundations reach back to the past century. The stunning failure of economic policies since independence has shown that a new concept is needed to ensure that Arab states do not always reproduce the same elites who are supposed to work for the people while they abuse their powers. Governments are at a crossroads—they can either switch from minimalism, commercialism, and consumerism to complete the construction of capable and benevolent democratic states, or they can head for chaos.

The Role of SWFs

To avert a catastrophe, it is vital to create a collective understanding of regional solidarity. Despite a tradition rooted in academic arguments about the weakness if not absence of links among the countries in the Arab zone, the long common regional history since independence illustrates without doubt the cultural solidity of human and economic links that surface, particularly at times of crisis. Rich and poor countries share a common strategic destiny in the face of adversity. Language and customs foster human and material exchanges whenever possible. Pressure from the poor for solidarity from the rich is politically strong. Questions of security are, in part, viewed as transversal.

This is the foundation upon which Arab investments in the future must be based. These investments, either managed by SWFs or other investment vehicles, will help the Arab world reach a more sustainable future. The investments will help the Arab world move beyond its dependence on scarce natural resources and enable it to manage these resources more efficiently. They will also make the Arab economies less vulnerable to the whims of the global economy by developing a genuine Arab economic space that facilitates investment and growth. Finally, they can support the bottom-up approach in regional economic development that is so much needed in this part of the world.

This plan provides a creative space for SWFs to rethink their investment policies and consider a regional dimension in their future strategies. By doing so, they will become part of a larger project that has the economic progress of the Arab world at its core.

CHAPTER 7

Sovereign Wealth Funds: An Instrument Marked by Its Birth Conditions?

Samir Aita

As in old feudal societies, everyone is marked by his or her birth conditions in the financial markets of capitalism. And thus this is the case for sovereign wealth funds (SWFs). No one can choose how they were born.

Considering SWFs first involves the question of the "nature" of public money in hard currencies—"public," in the sense that SWFs' resources come from the surpluses of central banks, which are state institutions, from a country's foreign trade and transfers. This money thus belongs to the citizens of this country, and it is managed by a state-owned institution that should be accountable first and above all to them. However, because this money was born in "foreign" currencies—say, dollars—it cannot be used directly in the country, unless the country is "dollarized"—that is, it internally uses two currencies, its local one and the dollar. This is rarely the case, as it is, for example, in Lebanon. So the SWFs were born from the start marked by a dilemma: How to use public money outside the country, in assets more beneficial for the country's current and future generations than U.S. (or other highly indebted developed countries') Treasury bills? And, as we are talking of surpluses: How could this public money be placed in the long term for the benefit of a country's citizens?

The question of birth is also that of the country of origin, because most SWFs were born in developing countries—Arab, Asian, or others. The Norwegian SWF had grown for decades and was allowed its place "under the sun" of the financial markets, without polemics. It is only when these "strangers" came to play on the ground that the furors about "invasion"[1] and "worrisomeness"[2] with regard to national securities were raised in the media and by political players in developed countries. And at this level also, the birth was marked by other dilemmas—why SWF investments from developing countries should be dormant and nonstrategic, only available to save companies and financial institutions facing bankruptcy in the developed world, while the developing countries should open their companies and utilities, strategic even if less technologically advanced, freely to foreign capital and multinationals. Or is it, as in international politics, "two weights, two measures"? The issue here is clearly the legitimacy of SWFs playing a role in their countries' industrial policies in a globalized world—why their investments should not follow any logic, contrary to a classical multinational.

SWFs as Institutional Investors

SWFs (presently managing $2.5–4.0 trillion[3]) are not the most important institutional investors acting in the world's financial markets. Pension funds and mutual funds, as well as insurance companies, have already been and will continue to be the major global players (each accounting for managing $18 trillion to $22 trillion). The extent to which their investments are transparent and free from their respective government's interventions, or that of national-champion multinationals, is a real question in political-economy terms. Some of them were even created and grew as public entities, like the SWFs—namely, the public pension reserve funds (PRFs).[4] These PRFs account for $4 trillion to $4.5 trillion, the biggest being those of the United States (around $2 trillion) and Japan ($1.2 trillion)—much bigger than SWFs. The difference, as the Organisation for Economic Co-operation and Development (OECD) states it,

> brings to light the geopolitics of SWFs: most SWFs are located in non-OECD countries and are dependent on global trade and exchange rates; all PRFs are based within the OECD and are dependent on demographic change and ageing societies…. SWF pools…are expected to grow rapidly in the coming years, [whereas] PRF pools (as well as other private pension funds) should begin to cash out between 2010 and 2025…. The requirements of accountability, suitability and transparency are broadly met by these reserve funds. However, some specific details of the funds' governance and investment management could be improved in a few countries, such as enhancing the expertise in the funds' governing boards and constraining discretionary interventions by government.[5]

These governance concerns, mildly stated by the OECD, have now evolved with the perspective of the current world crisis, as some governments, like France, have created their own state-financed strategic investment funds, which are dedicated to reinforcing and stabilizing the capital of French companies.[6] The question of governance and the accountability of public funds to their owner-citizens, and that of national interest, are intricate, and are becoming even more intricate with the global crisis.

These issues are continuously evolving, and they have reached a turning point with the current crisis. Before the crisis, who dared, in fact, to point a finger at the "bad children" of financial capitalism—the hedge funds? Their size was similar to that of the SWFs; they hid—and are still hiding—behind tax havens; and they were specializing in speculation, the aggressive acquisition and dismantling of industrial ventures, and glamorizing bad assets and distributing them in the world financial system, with some tricky games with rating agencies. These hedge funds were, however, well born—the legitimate children of major banks and insurance companies, and other institutional investors based in developed countries. And such birth conditions influenced even angry world leaders at the recent London meeting of the Group of Twenty (G20) to mildly agree that "it is necessary to extend regulation and oversight . . . for the first time, systematically on important hedge funds."[7] However, as after the Washington G20 meeting, these new recommendations were "music to the ears of many (hedge) fund managers."[8]

Arab SWFs: Governance, Transparency, and Industrial Policies

In the developed countries, the media turmoil over SWFs went along with the emergence of public concerns about the adverse consequences of globalization—the delocalization of jobs, protectionism,[9] and the national interest—despite the OECD's calls for freedom of investment and the fair treatment of SWFs.[10] The case of Dubai Ports World's tentative acquisition of P&O, including its operation of some U.S. ports, which was accepted by the Committee on Foreign Investment in the United States but blocked by the U.S. Congress,[11] had clearly shown that the issue goes far beyond "fair" protectionist measures. Things have changed only relatively with the current major global crisis, as the SWFs were called to save and to behave responsibly as part of the global financial system.[12]

In the Arab world, the major concerns were at another level. In fact, the media turmoil about Arab SWFs had first shed light on a long-standing concern of Arab citizens: the social distribution of oil revenues (and of revenues from other natural resources). In fact, it is worth noting that the first Arab SWF was created by Kuwait, a country with a relatively democratic public life, and that the second one was created by the Emirate of Abu Dhabi, whose leader was sincerely concerned about public policies, industrial as well as geopolitical. From the point of view of the citizens of Arab countries, the creation of Arab SWFs was then seen as a positive step: The countries' oil surpluses would go to a public institution and not be distributed among princes or other members of the "power system."[13] Public money in hard currencies would serve public policies and not private interests. And it should be noted that a major transparency and governance concern in many Arab countries with respect to the revenues of exported natural resources is still to have the share devoted to the "power system," and not in SWFs, under citizens' scrutiny.

With the development of Arab SWFs, a second issue arose concerning their institutional governance and accountability as state institutions. In those PRFs in OECD countries with the best governance practices, such as social security funds, the governing bodies typically include members nominated by the government and representatives of employers, as well as representatives of workers (generally trade unions). The same situation exists for the PRFs' investment committees, even if independent audits and public disclosure are sometimes not up to OECD guidelines.[14] Some PRFs are also directly accountable to national legislatures. Such practices only rarely exist for Arab SWFs, as with many other public institutions in the Arab countries, including social security and other funds operating in local currencies. For instance, the board of directors of the Abu Dhabi Investment Authority is recruited from—only—senior government officials. The Kuwaiti Investment Authority is accountable beforehand to the Council of Ministers. And Saudi Arabia's nontreasury-bill public investments are managed directly by the Saudi Arabian Monetary Agency, which avoids putting the issue of accountability on the table.

However, the major concern from an Arab citizen's perspective is with SWFs' investment policies and objectives. In fact, SWFs represent about twice the total gross domestic product of the Arab countries, for which remittances from foreign workers (roughly $50 billion yearly) constitute the major incoming capital flow to sustain non-oil-producing economies (and are their real social safety net) and are far more important than foreign direct investment.[15] A significant share of Arab SWFs' investments went to other Arab countries, but mostly in Arab stock markets, which bubbled up recently also to more than the size of the total gross domestic product of Arab countries, with only around a thousand companies in the market. Not only have Arab stock markets experienced two severe corrections—respectively, in 2006 and more recently and more severely with the global crisis in the autumn of 2008—but half these stock markets' capitalization has been made up of financial and real estate companies, a quarter of telecommunications firms, and the remaining quarter of all other service, agricultural, and industrial companies, oil industries included. With the current crisis, SWFs are assumed to have experienced severe losses, both in regional and international markets, amounting to $450 billion to $600 billion,[16] yet they are being called to intervene to save regional banks and real estate companies from bankruptcy.

It is the comparison between the size of these investments, especially the losses, and the development investment needs of the Arab countries that shock Arab public opinion. Even in the countries belonging to the Gulf Cooperation Council, infrastructure and public services are much below capacities.[17] Also, the non-oil-producing Arab countries are experiencing the highest unemployment rate in the world and one of the highest poverty rates;[18] and all are moving toward deindustrialization—calling into question the efficiency of SWFs' investments for fostering development in their own countries. This disappointment comes along with that about the Madrid peace process, which instead of launching a major "Marshall Plan" for the Arab countries ended with controversial Euro-Mediterranean and other free trade (and free investment) agreements. And the meager $2 billion fund to promote small and medium-sized enterprises, put forth by the last Arab League Kuwait summit, will not alleviate disappointed Arab public opinion.

Perspectives

From a global perspective, the issue of SWFs is not really that of their behavior toward a responsible global financial system; it is mainly the regulation of such a financial system that the current crisis has shown to be going crazy at many levels (hedge funds, rating agencies, conflicts of interest, tax havens, and so on), with no real perspective that an agreement could be reached soon for sound and fair global regulation. Taxpayers and unemployed people in the OECD countries are currently paying the price for such deregulation. And there are also the issues of protectionism and national security, given the destructive results (for jobs and welfare, and, in the OECD countries, also for technology investments) of global financial capitalism. Can anyone expect these to decline with this crisis?

From the perspective of the Arab countries, the issues of SWFs are those of the social distribution of revenues, the transparency and accountability of state-owned institutions, and investment policies for economic development and industrialization, on the levels of both each country and Arab complementarities. In short, these issues are precisely those of state building, democracy, and development. As one says in Arabic, you have to care first about your parents to be able to be good with others.

Notes

1 "Invasion of the Sovereign-Wealth Funds," *Economist*, January 19, 2008.

2 See, for example, the debates of the Council on Foreign Relations at http://www.cfr.org/publication/15484/mckinsey_executive_roundtable_series_in_international_economics.html.

3 Morgan Stanley Research, "Currencies: How Big Could Sovereign Wealth Funds Be by 2015?" May 3, 2007.

4 See Juan Yermo, *Governance and Investment of Public Reserve Funds in Selected OECD Countries*, OECD Working Paper on Insurance and Private Pensions 15 (Paris: Organisation for Economic Co-operation and Development, 2008).

5 OECD Investment Committee, "Consultation on Sovereign Wealth Funds: Comments by TUAC," Organisation for Economic Co-operation and Development, December 13, 2007.

6 See http://www.caissedesdepots.fr/IMG/pdf_CP_FSI_CDC_201108.pdf.

7 The London Summit 2009, "Global plan for recovery and reform: the Communiqué from the London Summit," April 2, 2009, see http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/.

8 "For Hedge Funds, Little News from G20 Is Good News, So Far," *Hedge Week*, November 17, 2008.

9 "Thinktank Calls for EU Laws to Curb Sovereign Wealth Funds," *Guardian*, November 10, 2008.

10 OECD Investment Committee, "Sovereign Wealth Funds and Recipient Countries' Policies," Organisation for Economic Co-operation and Development, April 4, 2008.

11 Like many similar entities in other OECD countries, such government entities as this OECD committee can block any foreign investment in the United States, if contrary to national interests and security; what the OECD answers is that "national security is a legitimate concern but should not be a cover for protectionist policies." OECD Investment Committee, "Sovereign Wealth Funds."

12 "Gordon Brown Asks Gulf Wealth Funds to Invest in U.K.," Bloomberg, November 2, 2008.

13 The term "power system" is preferred here to "regime," because it refers, in republican or royal regimes, to rulers who are not accountable to the public, that is, to state institutions and citizens. See Samir Aita, "Reforms, State and Politics in Syria," in *The Changing Role of the State*, ed. S. Radwan and M. Riesco (Cairo: Economic Research Forum, 2007).

14 See Yermo, *Governance and Investment*.

15 Samir Aita, *Towards Reinforcing the Role of Capital and Investment in Arab Social and Economic Integration* (in Arabic), background paper for the Arab Development Summit of Kuwait, January 2009 (Cairo: Economic Research Forum, 2008).

16 For different estimations, see www.sovereignwealthfundwatch.com.

17 See, for example, the debates in the Arab press on the "scandal" of the Jeddah sewage system.

18 See, for example, World Bank, *Unlocking the Employment Potential in the Middle East and North Africa: Towards a New Social Contract* (Washington, D.C.: World Bank, 2008).

CONCLUSIONS

Putting Arab Money on the Reform Agenda

Bassma Kodmani

The image of Arab public finance as it transpires from comments in the Arab media and public debate is first and foremost one of opacity, which in turn inspires a host of vaguely formulated suspicions—punctuated with periodic revelations that tend most often to confirm several suspicions: Arab public finances suffer from imprudent or unwise management; the boundaries between public and private wealth are blurred at best; and investment decisions are often motivated by political and security considerations (money that buys the regimes foreign protection). In this regard, sovereign wealth funds (SWFs) epitomize the nontransparent and non-accountable management of public finance by authoritarian governments, whose objectives are seen as necessarily questionable by the mere fact that information about them is lacking.

We know that Arab investments have been met with a different set of suspicions on the international scene. When the issue of the transparency of SWFs was raised by international organizations and the idea of devising a code of ethics emerged, a key concern of Western institutions and governments was to get Arab countries to commit to refraining from investing for strategic or political reasons. Such a commitment would certainly reassure a number of countries, mainly Western ones, but it would have no impact on Arab public opinion because there is no reason why Arab citizens would be interested in seeing their leaders commit to refraining from investing in Western economies for strategic or political reasons.

How Relevant Is the Arab Space?

Another set of critics in the Arab region, and one that all the contributors to this volume discuss in their chapters, relates to the issue of absorptive capacity. Gulf countries have a limited absorption capacity, if this capacity is measured according to their strictly domestic needs. It is therefore natural that they seek to invest their surpluses in the global market. But if this wealth is to be considered Arab, then the whole issue of needs and of absorption capacity needs to be questioned.

From the perspective of non-oil-producing Arab countries, the debate on national versus global investments of the countries that belong to the Gulf Cooperation Council (GCC) ignores the regional level. Indeed, if Arab countries are considered as the natural environment with which the GCC countries share interests and have a common future, then the needs are considerable and the absorptive capacity is huge. The GCC countries, the argument goes, should consider the rest of the Arab world as their backyard in terms of economic and financial space for action and should seek to promote regional development, both economic and human, as part of preparing for future Arab generations. This debate over the distribution of oil wealth reflects a tension between the haves and have-nots that dates back to the 1970s. It was partially diffused by the massive movement of migrant workers from the labor-rich countries to the low-populated, oil-rich ones. Migrants became the key vehicle for fulfilling the GCC countries' priority of pursuing national development while transferring some wealth to the migrants' home countries. But solidarity was never allowed to take precedence over the objective of maximizing returns from investments and preserving the social and political stability of the Gulf's conservative societies. Whenever the have-nots posed the question of whose wealth the Gulf oil is, the answer from Gulf elites was always blunt: In the name of what should we be sharing our wealth? Gulf rulers can be immensely generous toward their neighbors but should not be made to feel guilty about their wealth in the name of Arabism.

It is quite clear that the broader Arab geographic context was never a level at which the GCC countries sought to coordinate their investments, as Kubursi indicates. Once their strictly national development needs were satisfied, the tendency has often been to launch megaprojects of questionable relevance. Thus, when the financial crisis hit the Gulf economies in the fall of 2008 and astounding projects were suspended, one common reaction among public opinion was "What use were these projects anyway?" But for all those who work in the Gulf and for their families living on remittances, the halt meant the loss of jobs and of income for millions of Arabs in the have-not societies.

El-Beblawi uses purely economic arguments to advocate for investments in the Arab countries. Only in the poor developing countries, he says, is there a genuine need for massive real investment and a potential for increasing capital. Cash-hungry poor countries, he argues, would provide much-needed investment opportunities to the GCC countries, and those poor countries happen to be the Arab ones in the immediate vicinity of the Gulf. Investing in them is therefore the best choice possible from a rational economic calculus.

The reality is that in the 1970s, when the oil-producing countries tested their ability to pressure industrial countries through the quadrupling of oil prices, they quickly came to realize that they needed to show good intentions in recycling their petrodollars, as Warde points out, lest Western governments provoke a protectionist backlash. Since then, the Arab Gulf countries have settled into a solid partnership with the Western countries, whereby their assets and their SWFs are placed in large international banks and financial institutions, and they thus see their interests as strongly depending on the well-being of the Western economies.

It Is the Institutions (Stupid)

For many experts, both Arab and non-Arab, the major weakness and a key reason for the mismanagement of Arab assets is the lack of professionally managed institutions with efficient and equitable governance structures. Over the last thirty-five years, Arab wealth has served to train individuals with outstanding skills. Many of the best and the brightest work in international institutions where the rules, lines of authority, and responsibilities are clearly set, making them reliable, trusted institutions. Conversely, Arab institutions continue to lack the ultimate guarantee of a responsible, fair, transparent process for decision making and a clear chain of authority.

It is precisely because of this deficit of trust in their own institutions that Arab governments look to Western institutions as the reliable, serious places in which wealth can be safely husbanded for the benefit of future generations. At least such was the belief until the magnitude of the current global financial and economic crisis revealed the gaps we now see.

As Kubursi indicates, the loss by the GCC countries of the equivalent of two years of average gross revenue from oil in a span of four months at the beginning of the current global crisis further calls into question the legitimacy of past investment choices and risk management strategies, and suggests that investing in the international market and Western financial institutions is in no way safer than doing so at home.

This discussion on the relevant geographic space notwithstanding, it is natural that oil-rich countries seek to be players in the global financial market. Arab and Western economists who advise Gulf financial institutions advocate for defining policies that aim at transforming oil revenue into strategic rather than purely financial international investments. Yet even in this context, they suggest that the Gulf countries are not engaging in the necessary institutional reforms to transform their oil revenues from purely financial into industrial capital. The GCC countries need to establish national corporations of global significance with strong strategic planning if they want to become key players in strategic industries at the global level. Only then will the image of volatile money at risk of being rapidly consumed be mitigated. For the GCC countries, reforming the structures of governance for their financial institutions is a prior condition; namely, principles of authority and responsibility need to be clearly identified.

Democratizing Arab Wealth

Although the suggestions and recommendations offered in the preceding chapters would go some way toward promoting the good governance of Arab financial institutions through reforms initiated from above, a necessary parallel agenda is a bottom-up strategy of pressure from society. The lack of transparency is a feature common to all Arab countries, not only the oil-producing Gulf monarchies. This democratizing agenda is therefore one that can be promoted across the region. The agenda includes three main items.

The first item on the democratizing agenda is the right to know. The Gulf region needs to wage a battle to gain access to information. The region's societies have only started to consider access to information as a necessity in order to be equipped to hold governments accountable and start developing participatory mechanisms. No Arab country has so far enacted a freedom-of-information law. Other countries of the global South are leading this struggle. India, South Africa, and several countries in Latin America are designing campaigns with specific steps for a comprehensive strategy. In the Arab world, the issue deserves a similar effort, because societies live in ignorance of basic information about their collective condition.

The opacity that surrounds certain sectors is remarkable. On public finance, it is particularly noteworthy. Researchers gather scattered information from non-Arab sources and have failed so far to find a breakdown of assets held by investment institutions. As long as these are not publicly available, a discussion of the appropriateness of the choices made is not possible.

The second item on the democratizing agenda is public scrutiny. Only a small number of watchdogs have been created in the Arab world to monitor the role and practices of the state since governments have begun to engage in large schemes of economic and institutional reform. Such independent entities are badly needed. Although many of them have been failures in other countries—particularly in Eastern Europe, because they were set up by aid agencies from the West and generated terrible corruption—others have been very useful when initiated through indigenous efforts. Nongovernmental organizations focusing on transparency and public integrity have emerged in several Arab countries where the space exists for them to work, such as in Morocco, Lebanon, Palestine, Jordan, and Yemen.

But democratic oversight of public finance is a huge area to tackle. Its opacity is equal to that of the security sector. Good progress has been achieved on promoting human rights as a central value in public debate. Human rights organizations have registered concrete achievements in exposing abuses and practices, particularly of the security institutions. There has also been significant progress on freedom of expression, freedom of association, and the right to demonstrate. Everywhere, the movements advocating for change have shifted from purely political demands to also pressing social and economic demands.

But the one area that has remained largely outside the sphere of public scrutiny is public finance and the way in which national assets are managed.

Societies are not equipped with adequate capacities to engage in this difficult task. There are a few examples, such as a growing number of questions addressed to ministers by Islamist members of parliament in Egypt, and efforts by Moroccan nongovernmental organizations to demand a right to bring under public scrutiny the king and the *makhzen*'s actions and decisions on the use of national assets. But rarely do issues of mismanagement or the squandering of public money lead to any consequences in the form of ministers leaving office or of a vote of no confidence against the government by parliament. Though most parliaments have finance committees whose role is to question the government, they are often ineffective, not only because the executive wants to keep them weak but also because they lack either the necessary information or the motivation and do not believe in their capacity to hold the government accountable. Therefore, they do not even bother to document the issues or prepare challenging questions for their leaders, because they feel they would be contributing to the facade of democracy that regimes are eager to promote (as in Algeria). The one exception to this is Kuwait, where the cabinet was forced to resign and parliament was dissolved following the collapse of the local stock market and allegations of corruption against the prime minister—although, here again, members of parliament decided to resign and accept general elections to protect the prime minister from questioning and from the risk of impeachment. In general, public finance remains the monarchical or presidential protected domain.

The third item on the democratizing agenda is the question of who stands to benefit from this situation. As reforms develop in areas where governments do not see a serious challenge to their vital interests, it is becoming clear that public finance, perhaps more than the security sector, is a minefield that ruling elites attempt to seal from the public eye and for which they are determined to fight to preserve their privileges.

In this area, as in many others on which democracy activists focus their advocacy efforts, delaying reforms might result in strengthening the appeal of populist discourse and the influence of the forces that voice them. As the global economic and financial crisis unravels and announcements of the dizzying amounts lost multiply, Islamic banks have found that they can use the situation to their advantage. Religious figures and the leaders of Islamic financial institutions are developing a discourse on the ethics of Islamic economics and on the accountability of Muslim finance, which is presented as infallible because it is governed by Shari'a law. In the face of the prevailing greed and rush toward Western financial institutions, whose "rogue practices" have been unmasked, Muslim morality, they claim, is the best protection to shield society from the dangers of secular finance.

About the Authors

Samir Aita is an economist, editor-in-chief, and general manager of *Le Monde Diplomatique* éditions arabes, Paris, and chairman of A Concept Mafhoum.

Sven Behrendt is a visiting scholar at the Carnegie Middle East Center of the Carnegie Endowment for International Peace, Beirut.

Hazem El-Beblawi is adviser to the Arab Monetary Fund, Abu Dhabi.

Ghazi Hidouci is a former minister of economy of Algeria, now based in Paris.

Rami G. Khouri is director of the Issam Fares Institute for Public Policy and International Affairs at the American University of Beirut.

Bassma Kodmani is executive director of the Arab Reform Initiative, Paris.

Atif Kubursi is professor of economics at McMaster University.

Ibrahim A. Warde is adjunct professor of international business at the Fletcher School, Tufts University, and is a Carnegie Scholar.

About the Carnegie Endowment

The Carnegie Endowment for International Peace is a private, nonprofit organization dedicated to advancing cooperation among nations and promoting active international engagement by the United States. Founded in 1910, Carnegie is nonpartisan and dedicated to achieving practical results. Through research, publishing, convening, and, on occasion, creating new institutions and international networks, Endowment associates shape fresh policy approaches. Their interests span geographic regions and the relations among governments, business, international organizations, and civil society, focusing on the economic, political, and technological forces driving global change.

Building on the successful establishment of the Carnegie Moscow Center, the Endowment has added operations in Beijing, Beirut, and Brussels to its existing offices in Washington and Moscow, pioneering the idea that a think tank whose mission is to contribute to global security, stability, and prosperity requires a permanent international presence and a multinational outlook at the core of its operations.

Carnegie Papers

From the Carnegie Middle East Center

2009

Managing Arab Sovereign Wealth in Turbulent Times—and Beyond
(S. Behrendt and B. Kodmani, eds.)
The Oil Boom in the GCC Countries, 2002–2008: Old Challenges, Changing Dynamics
(I. Saif)
European Conflict Management in the Middle East: Toward a More Effective Approach
(M. Asseburg)

2008

In the Shadow of the Brothers: The Women of the Egyptian Muslim Brotherhood
(O. Abdel-Latif)
When Money Talks: Arab Sovereign Wealth Funds in the Gobal Public Policy Discourse
(S. Behrendt)
Turkey's Middle East Policies: Between Neo-Ottomanism and Kemalism (Ö. Taspinar)
The Middle East: Evolution of a Broken Regional Order (P. Salem)
EU and U.S. Free Trade Agreements in the Middle East and North Africa (R. al Khouri)
Algeria Under Bouteflika: Civil Strife and National Reconciliation (R. Tlemçani)

2007

Lebanon's Sunni Islamists—A Growing Force (O. Abdel-Latif)
The Political Economy of Reform in Egypt: Understanding the Role of Institutions (S. Alissa)
Rethinking Economic Reform in Jordan: Confronting Socioeconomic Realities (S. Alissa)
Kuwait: Politics in a Participatory Emirate (P. Salem)
Women in Islamist Movements: Toward an Islamist Model of Women's Activism
(O. Abdel-Latif and M. Ottaway)
The Challenge of Economic Reform in the Arab World: Toward More Productive Economies
(S. Alissa)

For a complete list of Carnegie Papers, go to www.CarnegieEndowment.org/pubs.