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SOVEREIGN INVESTMENT AS A TOOL OF WAR: CAN INTERNATIONAL LAW ADDRESS FINANCIAL AGGRESSION BY STATE ACTORS?

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I

INTRODUCTION

In August 2008, then Treasury Secretary Henry Paulson attended the Summer Olympics in Beijing at the height of the financial crisis.[1] Two well-known Government Sponsored Enterprises (GSEs), Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), had been in turmoil for weeks. Days before Paulson's trip, Fannie and Freddie had announced $2.3 billion and $821 million dollar losses, respectively.[2] As the owners or guarantors of half of U.S. mortgages outstanding at the time, the subprime mortgage crisis had hit the GSEs hard.[3] For weeks Paulson's office had been receiving "nervous calls from officials of foreign countries that were invested heavily with Fannie and Freddie," who had purchased more than $1 trillion dollars of debt issued or guaranteed by the GSEs under the belief that they benefitted from an "explicit guarantee" from the U.S. Government.[4] In Beijing, Paulson learned from his Chinese counterpoints that top-level Russian officials had approached China with a plan to sell "big chunks of their GSE holdings" to force the U.S. to use its emergency authorities to prop up these companies."[5] China had declined the offer, but the "report was deeply troubling" for Paulson: "heavy selling could create a sudden loss of confidence in the GSEs and shake the capital markets."[6] The American financial system was in a precarious position, even without coordinated attempts by other governments to weaken American leadership and force an intervention in large U.S. businesses. In the (certainly dramatized) Home Box Office (HBO) movie version of Andrew Ross Sorkin's celebrated 2010 account of the financial crisis, Henry Paulson characterized what he had learned as "a friendly reminder that with a single phone call to Moscow, (China) can take down the entire U.S. economy."[7] By early September 2008, Fannie and Freddie were under the conservatorship of the Federal Housing Finance Agency (FHFA).[8]

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1. Henry M. Paulson, Jr., ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 159 (2010).

2. *Id.* at 158–159.

3. *See* Deborah Solomon, *The Fannie & Freddie Question*, WALL ST. J. (Aug. 30, 2008) https://www.wsj.com/articles/SB122005562753985195 ("The companies are crucial to the housing market, owning or guaranteeing nearly half of U.S. mortgages outstanding -- some $5.2 trillion -- and buying most of the new ones being made.").

4. Paulson, *supra* note 1, at 160–161.

5. *Id.* at 161; *see also* ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES 222 (2009) (discussing Chinese and Russian plans to sell Fannie and Freddie assets).

6. Paulson, *supra* note 1, at 161.

7. TOO BIG TO FAIL (HBO Films 2011).

8. Heidi N, Moore, Winners & Losers of the Fannie & Freddie Bailout, WALL ST. J. (Sep 7, 2008), https://blogs.wsj.com/deals/2008/09/07/winners-losers-in-the-fannie-freddie-bailout/.

Advanced economies have, for the most part, been on a steady path towards the liberalization of international markets for goods and capital for the last several decades.[9] Global Foreign Direct Investment (FDI) flows totaled $1.1 trillion in 2018.[10] Along with the financial value and economic growth facilitated by the increase in FDI, however, has come a set of corresponding concerns about the detrimental impact on developing nations' economic growth, the harmful working conditions of the global labor supply, and the proliferation of regulatory "races to the bottom" by developing governments hoping to attract foreign investment.[11]

For those working in national security, especially in countries with sophisticated financial markets, free capital movement has created a particular set of anxieties. The liberalization of the markets for goods and capital has armed some countries with "large publicly owned investment portfolios" that "make their home governments major players in the world capital markets."[12] As this diverse group of sovereign investors, "organizations that professionally manage capital transferred to them by governments according to specific objectives determined by the sovereign sponsor,"[13] become powerful forces in global financial markets, questions emerge as to what this financial power has purchased them on the geopolitical market.

The main concerns surrounding sovereign investment are the ways it can be leveraged by state actors to "seek control of strategically important industries, to extract technology or other proprietary knowledge, or to achieve a degree of direct or indirect influence over host governments."[14] This paper will examine the possibility that sovereign financial investments might be used to weaken host financial markets themselves and, by extension, the government regimes that are accountable for those markets' maintenance and health. Despite these concerns, host countries that are recipients of large amounts of FDI, such as the United States, have benefitted greatly from the growing pool of global investment capital and are legally compelled to maintain their longstanding commitment to open capital markets. The tradeoff between "safeguarding opportunities for productive international investment" and "defending the nation's security" colors every discussion of the regulation of sovereign investment.[15]

This paper will first provide an overview of the primary forms of sovereign investment, with an emphasis on sovereign wealth funds (SWFs) and state-owned enterprises (SOEs). The next section will highlight the national security questions raised

9. *See* Beth A. Simmons, *The Internationalization of Capital*, *in* CONTINUITY AND CHANGE IN CONTEMPORARY CAPITALISM 36, 36 (Herbert Kitschelt. Peter Lange, Gary Marks & John D. Stephens eds., 1999) ("The internationalization and integration of capital markets has been the most significant change in the political economy of the industrialized countries over the past three decades.").

10. FDI in Figures April 2019, OECD, http://www.oecd.org/investment/FDI-in-Figures-April-2019.pdf (last visited November 14th, 2019).

11. *See* Jeffrey Frankel, *Globalization of the Economy*, *in* INTERNATIONAL POLITICAL ECONOMY: PERSPECTIVES ON GLOBAL POWER AND WEALTH 63, 77 (Jeffry A. Frieden, David A. Lake & J. Lawrence Broz eds, 5th ed. 2010) ("Many who fear globalization concede that trade has a positive effect on aggregate national income but suspect that it has adverse effects on other highly valued goals such as labor rights, food safety, culture, and so forth.").

12. Benjamin J. Cohen, *Sovereign Wealth Funds and National Security: The Great Tradeoff*, 85 INT'L AFF. 713, 713 (2009).

13. Caroline Nowacki and Dr. Ashby Monk, *Sovereign Investors: Understanding the Giants of the Financial World*, Global Projects Center, Stanford University (May 2017), https://cdcicapital.fr/wp-content/uploads/2017/12/Sovereign_Investors_CDC_Stanford_05_2017.pdf.

14. Cohen, *supra* note 12, at 719.

15. Cohen, *supra* note 12, at 713.

by sovereign investment, with a particular focus on SWFs. Then the paper will discuss the existing international legal and regulatory scheme regarding FDI, with an emphasis on SWFs. Finally, the paper will consider potential national security challenges posed by SWFs in the future, examining them through more familiar and established national security paradigms in an effort to shine light on applicable international law, and frame a potential response by the United States.

II

OVERVIEW OF SOVEREIGN INVESTMENT

Sovereign investments can generally be classified into four separate types: international reserves, public pension funds, SOEs, and SWFs.[16] International reserves are typically managed by governments and central banks to address any payment imbalances and execute monetary policy, while public pension funds tend to be held in local currency with "low exposure to foreign assets," constrained and guided by future liabilities to their pensioners.[17] This paper is more concerned with SOEs and SWFs, the "major manifestations of state capital in the international market," with a primary emphasis on SWFs.[18]

Despite evoking overlapping national security concerns, SOEs and SWFs differ significantly in "their sources of funding as well as…. their mandate(s)."[19] SOEs are companies over which the state exercises significant or total control.[20] SOEs can include a "wide variety of entities" across a diverse set of industries.[21] While SOEs can receive state subsidies, they are primarily "funded through the proceeds of their activities…and focused on their respective industry."[22] Global investments of SOEs represent a much larger portion of total sovereign investment than SWFs.[23] This is due in part to the global economic prominence of China who in 2019, for the first time since Fortune began publishing its Global 500 in 1990, had more companies (129) than the United States (121) on the list.[24] 82 of the 129 Chinese firms in the Global 500 are SOEs.[25] According to Schmitt et al., investment by SOEs outside of China may account for up to 80% up all Chinese FDI outflows.[26] SOEs are "more prone than their private sector competitors to goal ambiguity, and tend to have limited internal and external constraints on management."[27]

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16. Robert Kimmitt, *Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy*, FOREIGN AFFAIRS (Jan./Feb. 2008), https://www.foreignaffairs.com/articles/2008-01-01/public-footprints-private-markets.

17. *Id.*

18. Wouter P.F. Schmit Jongbloed, Lisa E. Sachs & Karl P. Sauvant, *Sovereign Investment: An Introduction*, *in* SOVEREIGN INVESTMENT 3, 4 (Wouter P.F. Schmit Jongbloed, Lisa E. Sachs & Karl P. Sauvant eds., 2012).

19. *Id.* at 9.

20. Kimmitt, *supra* note 16.

21. Schmit et al., *supra* note 18, at 9.

22. *Id.* at 9.

23. *Id.* at 9–10.

24. Geoff Colvin, *It's China's World*, FORTUNE (July 22, 2019), https://fortune.com/longform/fortune-global-500-china-companies/.

25. *Id.*

26. Schmit et al., *supra* note 18, at 10.

27. Schmit et al., *supra* note 18, at 9.

SWFs are a newer phenomenon: the first SWF, the Kuwait Investment Authority, was formed in Kuwait in 1953.[28] SWFs are state-owned and "government-funded investment vehicles,"[29] tasked with "manag(ing) some portion of the foreign exchange assets of a national government."[30] SWFs typically have no significant liabilities and are managed separately from other central bank reserves.[31] Funds are established for a number of different purposes, including the diversification of national wealth, the stabilization of national revenues, wealth distribution across generations, and other economic and social objectives.[32] As foreign exchange reserves accumulate, these countries wish to "deploy them strategically or at least earn higher returns than those available in US Treasury Bills or their foreign equivalents."[33] The International Monetary Fund (IMF) published a SWF "Taxonomy Based on Policy Objectives," outlining the different SWF policy orientations:

> *Stabilization funds* are set up by countries rich in natural resources to insulate the budget
> and economy from volatile commodity prices (usually oil). The funds build up assets during the years of ample fiscal revenues to prepare for leaner years.
> *Savings funds* are intended to share wealth across generations. For countries rich in natural resources, savings funds transfer nonrenewable assets into a diversified portfolio of international financial assets to provide for future generations, or other long-term objectives.
> *Reserve investment corporations* are funds established as a separate entity either to reduce the negative cost-of-carry of holding reserves or to pursue investment policies with higher returns. Often, the assets in such arrangements are still counted as reserves.
> *Development funds* allocate resources for funding priority socioeconomic projects, such as infrastructure.
> *Pension reserve funds* have identified pension and/or contingent-type liabilities on the government's balance sheet.[34]

The Kuwait Investment Authority is a paradigmatic example of a savings fund, "deliberately designed to provide for the day when the emirate's oil wells run dry."[35]

There is no one fund model, and they vary greatly in their governance, strategic objectives, appetite for risk, and operational transparency.[36] SWFs tend to fall into one of two categories based on their core funding source. Commodity SWFs are funded by

28. Salar Ghahramani, *Sovereign Wealth Funds, Transnational Law, and the New Paradigms of International Financial Relations*, 8 YALE J. INT'L AFF. 52, 53 (2013).

29. Schmit et al., *supra* note 18, at 4.

30. Cohen, *supra* note 12, at 715.

31. *Id.* at 715.

32. *See* Schmit et al., *supra* note 18, at 5 ("Sovereign wealth funds are established for a number of reasons.").

33. Lawrence Summers, *Funds that shake capitalist logic*, FINANCIAL TIMES (July 29, 2007), https://www.ft.com/content/bb8f50b8-3dcc-11dc-8f6a-0000779fd2ac.

34. Sovereign Wealth Funds: IMF Global Financial Stability Report (GFSR), INTERNATIONAL MONETARY FUND, https://www.imf.org/external/pubs/ft/gfsr/2007/02/pdf/annex12.pdf (last visited, December 13th, 2019).

35. Cohen, *supra* note 12, at 715.

36. *Id.* at 715–16.

commodity exports, almost always oil and gas revenues.[37] Other SWFs are capitalized by the transfers of official foreign exchange reserves by countries with built-up balance-of-payment surpluses.[38] Norway, Abu Dhabi, and Kuwait are prototypical oil-exporting SWFs, while China and Singapore have large investment vehicles funded through excess foreign reserves.[39] Total assets under management by SWFs were approaching eight trillion dollars in 2018,[40] certainly "large enough to be systemically significant."[41]

Figure 1 shows the largest SWFs by total assets.

Figure 1[42]

Fund	**Total Assets** (Billions USD)
Norway Government Pension Fund Global	$1,099
China Investment Corporation	$941
Abu Dhabi Investment Authority	$697
Kuwait Investment Authority	$592
Hong Kong Monetary Authority Investment Portfolio	$509
GIC Private Limited (Singapore)	$440
National Council for Social Security Fund (China)	$438
SAFE Investment Company (China)	$418
Temasek Holdings (Singapore)	$375
Qatar Investment Authority	$328

Note: As of November 2019

Because SWFs are financed by export revenues, their funding has been fueled by "the rise of commodity prices and global payments imbalances" in the last several decades.[43] Economist Raghuram Rajan tracks these trade imbalances between countries to "prior patterns of growth,"[44] where developing (and some developed) countries committed to an "export-led managed-growth strategy," considered to be "the primary path out of poverty in the post-war era."[45] Many SWFs were born out of this dynamic,

37. Kimmitt, *supra* note 16.
38. *Id.*
39. *See* Cohen, *supra* note 12, at 716 ("In simplest terms, the universe of SWFs may be said to be dominated by three classes of countries: seven Arab oil exporters (Abu Dhabi, Algeria, Dubai, Kuwait, Libya, Qatar, Saudi Arabia); two non-Arab oil exporters (Norway, Russia), and three emergent East Asian economies (China, Hong Kong and Singapore).").
40. Claire Milhench. *Global sovereign fund assets jump to $7.45 trillion: Preqin*, REUTERS (Apr. 12, 2018), https://www.reuters.com/article/us-global-swf-assets/global-sovereign-fund-assets-jump-to-7-45-trillion-preqin-idUSKBN1HJ2DG.
41. Kimmitt, *supra* note 16.
42. Top 87 Largest Sovereign Wealth Fund Rankings by Total Assets, SOVEREIGN WEALTH FUND INSTITUTE, https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund (last visited December 12th, 2019).
43. Cohen, *supra* note 12, at 715.
44. RAGHURAM RAJAN, FAULT LINES: HOW HIDDEN FRACTURES STILL THREATEN THE WORLD ECONOMY 7 (2010).
45. *Id.* at 47.

and act as one outlet for the investment capital accumulated by trade surplus countries. The global trade imbalance has therefore been a major "motor" behind sovereign funds,[46] with exporting "countries like China financing the unsustainable consumption of rich countries like the United States."[47] It was the U.S. financial sector's role as bridge "between an overconsuming and overstimulated United States and an underconsuming, understimulated rest of the world" that precipitated the events of the 2007–08 Financial Crisis,[48] and brought SWFs into a prominent role in the public discourse.[49]

During the financial crisis, as SWFs "flush with U.S. dollar-denominated cash from once-booming commodities prices and trade surpluses," stepped in to recapitalize fledgling financial institutions.[50] Between mid-2007 and January 2008, SWFs were involved in at least nineteen "headline-grabbing deals" involving once-venerable banks like UBS and Morgan Stanley.[51] Merrill Lynch, for example, sold a five billion dollars stake to Singapore's Temasek Holdings in December 2017, [52] and another almost seven billion stake to the Kuwait Investment Authority in January 2018.[53] Financial institutions suffering from severe and rapid declines in confidence were the beneficiaries of large, swift injections of capital, frequently with little or no governance or oversight requirements attached.[54]

The crisis experience highlighted clearly the positive effect of SWFs. For host countries, SWFs offered "access to sizeable inflows of capital….and stabilize[d] capital markets in moments of stress."[55] SWFs' long-term investing strategies, and relative insulation from "short-term volatility," make them appealing investors who are unlikely to "liquidate their positions quickly" due to regulatory pressure or investor dissatisfaction.[56] However the extent to which large American and European financial institutions, some at one-time among the most esteemed business entities on earth, relied on these funds "caused serious concern among some observers, calling for a rigorous regulation of the funds and their activities."[57] There was a belief at the time that 2007–08 foretold increased influence of SWF in global capital markets.[58] This has not happened, perhaps due in part to the backlash in host countries concerning the "risks and costs of such sovereign investment," or the painful economic realities these funds

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46. Sebastian Mallaby, *The Next Globalization Backlash: Wait Til the Kremlin Starts Buying Our Stocks*, WASH. POST (June 25, 2007).

47. RAJAN, *supra* note 44, at 7; *see also* JEFFREY A. FRIEDEN & MENZIE D. CHINN, LOST DECADES: THE MAKING OF AMERICA'S DEBT CRISIS AND THE LONG RECOVERY (2011) ("There have been tidal waves of international capital flows to and from borrowing nations for centuries. But there has rarely been a capital flow cycle quite so enormous in its upswing as the American borrowing boom of 2001–2007, and there has rarely been a crash quite so dramatic or so global as the American collapse of 2008").

48. RAJAN, *supra* note 44, at 6.

49. Ghahramani, *supra* note 28, at 57.

50. Mark Gordon & Sabastian v. Niles, *Sovereign Wealth Funds: An Overview, in* SOVEREIGN INVESTMENT 24, 24 (Wouter P.F. Schmit Jongbloed, Lisa E. Sachs & Karl P. Sauvant eds., 2012).

51. *Id.*

52. Eric Dash, *Merrill Lynch Sells Stake to Singapore Firm*, N.Y. TIMES (Dec. 25, 2007), https://www.nytimes.com/2007/12/25/business/25merrill.html.

53. *Kuwait Investment Authority Backs Merrill Lynch*, SOVEREIGN WEALTH FUND INSTITUTE (Jan. 25, 2008), https://www.swfinstitute.org/news/18278/kuwait-investment-authority-backs-merrill-lynch.

54. Gordon & Niles, *supra* note 50, at 24.

55. Cohen, *supra* note 12, at 717.

56. Kimmitt, *supra* note 16.

57. Ghahramani, *supra* note 28, at 57.

58. Gordon & Niles, *supra* note 50, at 24.

faced in the years of recession that followed the crisis.[59] The New York Times estimated in 2009 that Temasek had lost up to two billion dollars on its Merrill investment.[60] What did occur, however, was a reinvigoration of the discussion around host national security and sovereign investment.[61] The following section will examine more closely the conventional national security concerns associated with SOE and SWF investment, with a particular focus on the concerns around the growing role of SWF in global financial markets.

III

SOVEREIGN INVESTMENT, SOVEREIGN WEALTH FUNDS, AND NATIONAL SECURITY

Despite the long-held commitment by the United States and other Organisation for Economic Co-operation and Development (OECD) countries to the free flow of capital, host country governments have begun to approach FDI with more caution and an eye towards potential national security consequences. Two failed investments by SOEs shone a light on sovereign investment even before the national attention given SWFs during the financial crisis. In 2005, the government-owned China National Offshore Oil Corporation (CNOOC) made a failed attempt to acquire American oil company UNOCAL.[62] The deal faced significant public backlash and bipartisan political opposition rooted in anxiety about oil's central role to American national security.[63] For Chinese officials, the incident was political, and an indication that the US was not as open to foreign investment as its formal policies might suggest.[64] The following year, Congress again "hit the alarm button" in response to news that state-owned Dubai Ports World, through its acquisition of Peninsular & Oriental Steam Navigation, was "set to assume management of some terminals at five large U.S. ports."[65] The potential for the ports to be used to onload terrorist weapons and explosives from the Middle East, despite the unlikelihood and repeated security assurances from Dubai Ports, was more than U.S. officials could stomach.[66] In 2007, Congress passed the Foreign Investment

59. *Id.*

60. *See Tallying Up Temasek's Losses on Merrill*, N.Y. TIMES DEALBOOK (Jan. 8, 2009). https://dealbook.nytimes.com/2009/01/08/tallying-up-temaseks-losses-on-merrill/ ("After re-upping with an additional $900 million investment, Temasek spent a total of $5.9 billion in Merrill stock. With the recent conversion into BofA shares, it now holds Bank of America stock worth just $2.59 billion, based on Wednesday's closing price.").

61. *See Sovereign Wealth Funds: Foreign Policy Consequences in an Era of New Money: Hearing Before the Comm. on Foreign Relations*, 110th Cong. 2 (2008) ("Should we be concerned that the Governments of Russia and China control billions of dollars in assets and directly invest in U.S. institutions and companies?") (statement of Sen. Joseph Biden, Jr., Chairman, S. Comm. on Foreign Relations).

62. Matt Pottinger, Russell Gold, Michael M. Phillips & Kate Linebaugh, *Cnooc Drops Offer for Unocal, Exposing U.S.-Chinese Tensions: Delay Imposed by Fierce Foes In Congress*, Plus Missteps By Bidder, Doomed Move, WALL ST. J. (Aug. 3, 2005), https://www.wsj.com/articles/SB112295744495102393.

63. *See* Steve Lohr, *Unocal Bid Opens Up New Issues of Security* (July 13, 2005) https://www.nytimes.com/2005/07/13/business/worldbusiness/unocal-bid-opens-up-new-issues-of-security.html ("The takeover offer has prompted a gathering groundswell in Congress to make sure oil is defined as a product vital to America's national security.").

64. Gordon & Niles, *supra* note 50, at 34.

65. Bill Spindle, Neil King Jr. & Glenn *R.* Simpson, *In Ports Furor, a Clash Over Dubai: Where Bush Sees an Ally, Foes in Congress See Links to Terrorism*, (Feb. 23, 2006) https://www.wsj.com/articles/SB114066714703481063.

66. *Id.*

Security Act of 2007 (FINSA),[67] "enhanc(ing) the scope of authority of the U.S. government's Committee on Foreign Investment in the United States (CFIUS), an oversight agency of the U.S. Department of the Treasury."[68] CFIUS reviews any FDIs that implicate national security concerns, and can "recommend to the President blockage of foreign government investments that are deemed to have potentially adverse national security implications."[69] Though CNOOC and Dubai Ports were SOE transactions, concerns provoked are similar to the worries many hold over SWF interests in host companies.[70] It also highlighted the "U.S. Government's commitment to close scrutiny of foreign investment in critical U.S. industries."[71]

So why has much of the focus recently been on SWFs? SWFs are not the only sovereign investment vehicle that raises national security questions, but they are perhaps the most useful lens through which to discuss the topics. SWFs have grown substantially in the last few decades, and, despite the caution they have exercised post-crisis, will continue to be a growing presence in global financial markets.[72] Further, "SWFs raise issues that also bear on other types of sovereign investment -- financial-market issues, which also relate to international reserves and public pension funds, and investment issues, which also relate to SOEs."[73] A general lack of transparency is worrisome for observers, given that many funds are "highly secretive."[74] The fact that fund managers are only accountable to their governments may make their decision-making more nimble. A further "turning point" was the formation of SWFs in China and Russia in the mid-2000s, "two countries with unmistakable geopolitical ambitions."[75] The introduction of "two major powers with pockets deep enough to make a real impact" further prompted a reconsideration of "the role of big Arab oil exporters, whose strategic interests also could not always be expected to coincide precisely with those of the US or other western nations."[76] The SWF-focused considerations discussed in the rest of the paper may overlap significantly with corresponding concerns about other forms of sovereign investments.

For this discussion, national security concerns surrounding SWFs can be categorized intro three main buckets. The first is concerned with use of state-controlled SWFs "to seek control of strategically important industries,"[77] such as telecommunications, news and media, energy, seaport, financial services, and other dual use industries.[78] The worry is this control can be leveraged to further the military positions of the funds' state backers, or, in the case of escalating tensions, fund assets could be used directly against the host country.[79] The second concern surrounds state actors gaining, through the fund, access to sensitive or proprietary technology or

67. *CFIUS Reform: The Foreign Investment & National Security Act of 2007* (FINSA), DEPARTMENT OF TREASURY, https://www.treasury.gov/resource-center/international/foreign-investment/Documents/Summary-FINSA.pdf.

68. Thomas A. Hemphill, *Sovereign Wealth Funds: National Security Risks in a Global Free Trade Environment*, 52 THUNDERBIRD INT. BUS. REV. 551, 556 (2010).

69. *Id.* at 556–557.

70. *Id.*

71. Gordon & Niles, *supra* note 50, at 37.

72. Kimmitt, *supra* note 16.

73. *Id.*

74. Cohen, *supra* note 12, at 716.

75. Cohen, *supra* note 12, at 719.

76. *Id.*

77. *Id.*

78. Ghahramani, *supra* note 28, at 57–58.

79. *Id.*

information.[80] "Corporate intelligence" only available to insiders could be transferred to "a rival company in (the SWF's) own country," or even to the military and other defense industries, to increase domestic competitiveness.[81] One of the issues raised during the failed CNOOC Unocal deal was Unocal's "underwater terrain-mapping technology used for offshore oil exploration that might also be useful in navigation for the Chinese military's growing fleet of submarines."[82]

The third concern raised is that SWFs' financial power can be used to disrupt or distort financial markets themselves via direct investment in equity, or even debt, markets. This can be done to generally weaken or destabilize a country, harm the reputation and legitimacy of elected leaders, or to induce a preferred action by a host country. The stability of financial markets is in and of itself a "sensitive national competitiveness issue."[83] "Since SWFs are an outgrowth of domestic and international economic and financial policies, it makes sense to consider them in terms of their potential impact on financial stability."[84] One indisputable lesson from the 2007–08 crisis is that the American financial system, and therefore the global financial system, is susceptible to rapid declines in confidence and great instability.[85] Further, the innovation and complexity, and associated risks, of financial products and machinations outpaced what existing administrative and regulatory regimes were equipped to effectively track, understand, and mitigate.[86]

The asset classes in which SWFs may invest in are "theoretically unlimited," constrained only by their own imposed restrictions of regulations in the host country.[87] SWFs can perform the same functions as other investment funds, and "even 'short' a market, an asset, or a company."[88] This sort of threat seems at the same time the most confusing to imagine, and perhaps the most difficult to anticipate and detect. State orchestrated geopolitical SWF investing activities, towards a geopolitical or even military objective, would be more nebulous and complex than an attempt to control physical assets or acquire trade or defense secrets.

Conceding that there are many details missing in Paulson's account, it is into this third bucket that the Treasury Secretary's story from the 2008 Beijing Olympics seems to fall. Russia saw how the crisis had shaken the confidence not only of investors in the American financial markets, but also of American voters in the Bush Administration and the federal government itself. If Russia's intention was in fact to force the U.S. to intervene in Fannie and Freddie, it is an example of sovereign investors using their financial holdings in other countries for a geopolitical purpose. It is also representative of how much discretion governments can exercise over their sovereign investment vehicles when they are the only key stakeholder. While the 2007–08 facts can seem idiosyncratic, and China has trillions of reasons not to sabotage the U.S. financial systems, the concerns are emblematic of the political objectives that may color

80. Cohen, *supra* note 12, at 719.

81. Ghahramani, *supra* note 28, at 58.

82. Lohr, *supra* note 63.

83. Hemphill, *supra* note 68, at 556.

84. Kimmitt, *supra* note 16.

85. *See e.g.*, Paulson, *supra* # at xiii ("The pace of events during the financial crisis of 2008 was truly breathtaking"); *see also* SORKIN, supra note 5, at 88 ("…confidence in the global financial system was rapidly eroding, and liquidity was evaporating.")

86. See RAJAN, *supra* note 44, at 155 ("There is substantial evidence that government intervention and regulatory failure had as much of a role to play in this crisis as private-sector failure . . .")

87. Ghahramani, supra note 28, at 52.

88. *Id.* at 53.

sovereign investment strategies, and the mechanisms that could be employed towards non-financial ends.

These key national security concerns are exacerbated by the lack of transparency and unclear corporate governance that obscures SWF activities and shields insight into their management and operations. SWFs, with some exceptions, tend to suffer from a general lack of transparency, often foregoing any disclosures related to their investment strategy or balance sheet.[89] This lack of transparency "impedes an understanding of their market efficiency and regulatory compliance and thus gives rise to an information disparity that as a general matter makes it harder for any interested person to allay suspicions of secretive investment strategies.[90] Without the kind of disclosures often compelled by host country domestic corporate or securities law, it is difficult to obtain clarity regarding SWF operations, understand the motivations of their key stakeholders and sponsors, and the operational involvement of the central government. Thus, "suspicions surrounding their activities abound."[91]

Unlike the private investment vehicles in host countries that are likewise seeking high yields, such as private equity and hedge funds, "SWFs are not necessarily driven by a need to generate a profit."[92] They are also not tied to the same three, five, or ten year time horizons that constrain typical private funds and drive their investment strategies. Further, SWF operators and managers answer primarily to a single key stakeholder, rather than a dispersed set of investors to whom they might owe a legally binding duty. "The government as a shareholder, by means of investments through SWFs, distinguishes itself from other shareholders because the government may draw benefits from its participation in ways that other shareholders cannot."[93] In other words, "a government-owned investment fund may be motivated by strategic, noncommercial considerations in its investment decision-making calculus,"[94] and the investment strategies they can employ are "unlimited."[95] As Larry Summers summarized in 2007, writing for the Financial Times,

> The logic of the capitalist system depends on shareholders causing companies to act so as to maximise the value of their shares. It is far from obvious that this will over time be the only motivation of governments as shareholders. They may want to see their national companies compete effectively, or to extract technology or to achieve influence.[96]

Given the opaqueness surrounding the goals and operations of these funds, particular concern has been expressed regarding their equity investments,[97] especially when SWFs

89. Hemphill, *supra* note 68, at 553.
90. Schmit et al., *supra* note 18, at 12–14.
91. Ghahramani, *supra* note 28, at 62.
92. Hemphill, *supra* note 68, at 556.
93. Bart De Meester, *International Legal Aspects of Sovereign Wealth Funds: Reconciling International Economic Law and the Law of State Immunities with a New Role of the State*, LEUVEN CENTRE FOR GLOBAL GOVERNANCE STUDIES, https://ghum.kuleuven.be/ggs/publications/working_papers/2009/20demeester.
94. Hemphill, *supra* note 68, at 556.
95. Ghahramani, *supra* note 28, at 52.
96. Summers, *supra* note 33.
97. Ghahramani, *supra* note 28, at 62 ("There are, of course, legitimate policy questions to be asked…. Should SWFs be prohibited from short-selling? Should SWFs be able to become majority shareholders or have a controlling stake in the host countries' companies?").

are attempting to purchase controlling equity stakes in host corporations.[98] SWFs themselves have acknowledged that "as a result of the SWFs' increasing level of assets invested in public and private equity holdings, they are exercising greater influence on corporate governance practices."[99] Commenters therefore see less risk when SWFs, rather than directly purchase securitized assets directly, invest through intermediary asset managers who are subject to host country oversight, like Blackstone.[100]

Most discussions of SWFs and national security acknowledge the many reasons to be skeptical about the potential for SWFs to be used as tools of geopolitics of war, identifying "no proof at this point suggesting the SWFs make equity investment decisions based on malicious intent or geopolitics."[101] SWF countries certainly have strong incentives to maintain good relationships with the host countries.[102] "While the OECD economies…might need SWF investment, it is equally true that capital exporters need America and Europe to keep their jurisdictions open to capital inflows."[103] However unlikely it is that any of these national security fears manifest, it is still prudent to evaluate how the United States might be constrained in its response. Since the bulk of scholarship written about SWFs in the years following the crisis, tensions with big players like China and Russia deteriorated.[104] The discussion going forward will not attempt to forecast the likelihood of these occurrence, but instead focus on how the international regulatory regime currently treats sovereign investment, and the way that law might structure any strategic, geopolitical, or military actions by SWFs.

IV

INTERNATIONAL LAW AND SOVEREIGN INVESTMENT

SWFs pose a significant "regulatory challenge" for global monetary governance.[105] Domestic law and institutions are perhaps the simplest measure a host country can take to quell concerns about the national security threat of SWFs. Under FINSA, the United States Treasury's CFIUS, for example, can review any "merger, acquisition of takeover" by a "foreign person" that might result in foreign control of a U.S.-based entity.[106] Investing parties can voluntarily submit any transaction for review, or an investment will be reviewed if any CFIUS committee member believes that it may have "adverse impacts on the national security."[107] Other host countries have similar domestic regulatory schemes: the UK, Germany, Canada, and Japan have also enacted restrictions on foreign ownership.[108] However domestic law cannot come close to

98. De Meester, *supra* note 93, at 8.

99. *Sovereign Wealth Funds Generally Accepted Principles and Practices, "Santiago Principles"*, INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS, 3 (Oct. 2008) [hereinafter *Santiago Principles*].

100. Summers, *supra* note 33.

101. Ghahramani, *supra* note 28, at 62.

102. Cohen, *supra* note 12, at 724.

103. *Sovereign Wealth Funds: Foreign Policy Consequences in an Era of New Money: Hearing Before the Comm. on Foreign Relations*, 110th Cong. 17 (2008) (statement of Daniel W. Drezner, Jr., Professor of International Politics, Tufts University).

104. *See* Holly Ellyatt, *Are Russia and China the best of friends now? It's complicated, analysts say*, CNBC (Sep. 27, 2019), https://www.cnbc.com/2019/09/27/russia-and-chinas-relationship--how-deep-does-it-go.html.

105. Cohen, *supra* note 12, at 731.

106. Ghahramani, *supra* note 28, at 59.

107. *Id.*

108. *Id.* at 61.

mitigating all national security anxieties. Bart De Meester summarizes nicely in his article *International Legal Aspects of Sovereign Wealth Funds:* "While preventive measures are definitely useful, the real challenge occurs at the moment investments that passed preventive scrutiny turn out to be problematic."[109]

However all of these domestic law efforts, and any potential international laws concerning FDI and SWFs, are constrained by the guidelines of the World Trade Organization's (WTO) General Agreement on Trade in Service (GATS), to which all WTO members are parties.[110] The GATS is the only multilateral agreement that has binding rules for investment.[111] Its stated purpose was to "establish a multilateral framework of principles and rules for trade in services….conditions of transparency and progressive liberalization."[112] Part of the motivation for promoting "progressively higher levels of liberalization of trade in services," was the "increasing participation of developing countries in trade in services and the expansion of their service exports."[113]

The GATS compels host countries to allow a "service supplier" from another Member country to become a supplier of services by establishing "a commercial presence."[114] A "commercial presence" is "any type of business or professional establishment."[115] In other words, "a foreign service provider can establish itself in a host country to offer services by means of acquiring an existing juridical person,"[116] with "juridical person" defined as "any legal entity….under applicable law."[117] Members cannot forbid a foreign company from becoming a service provider in a host country through the acquisition of an existing supplier of services in that country. Crucially, however, the GATS only applies if a SWF obtains "control" over an existing corporations.[118] Therefore, any domestic laws that regulate minority investments do not fall under the GATS unless an entity is acquired and is controlled by a new (foreign) investor.[119] Further, target corporation must provide "services," as defined by the GATS.[120]

Within the GATS are some exceptions that permit the limit of some forms of sovereign investment by host nations where national security is concerned. Article XIV outlines the "essential security" exception:

> 1. Nothing in this Agreement shall be construed:
>   a. to require any Member to furnish any information, the disclosure of which it considers contrary to its essential security interests; or
>   b. to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:

109. De Meester, *supra* note 93, at 2.
110. GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994) [hereinafter GATS].
111. De Meester, *supra* note 93, at 2.
112. GATS, preamble.
113. *Id.*
114. GATS, Part 1, Article 1.
115. GATS, Part VI, Article XXVIII.
116. De Meester, *supra* note 93, at 22.
117. GATS, Part VI, Article XXVIII.
118. *Id.*
119. De Meester, *supra* note 93, at 22.
120. *Id.*

i. relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;

ii. relating to fissionable and fusionable materials or the materials from which they are derived;

iii. taken in time of war or other emergency in international relations; or

c. to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.[121]

The exception allows host states to comply with the GATS while insulating domestic corporations and industries in sectors strategically important to national security. However the discussion about how much latitude the "it considers" language gives host states is ongoing, and it is not settled to what extent the WTO can question a state's determination that investment is contrary to an "essential security interests."[122]

The GATS imposes restrictions, however, only on host countries as part of its effort to preserve openness.[123] "No supranational entities currently regulate SWFs, despite calls for SWF activities to be regulated by a single transnational entity or a joint venture of two or more international organizations."[124] The lack of international regulation, or even some formal guidelines for behavior, was particularly concerning to host countries when they watched SWFs take large stakes in giant financial institutions. At the June 2007 "Group of Eight" meeting in Heiligendamm, Germany, participants discussed the need for coordinating a response to the "regulatory challenge" posed by SWF investment.[125] The International Working Group of Sovereign Wealth Funds (IWG),[126] coordinated by the International Monetary Fund (IMF), began discussions as early as November 2007 about common standards relating to transparency, independence, and governance.[127] Understandably, some of the fund-owning governments resented being "singled out" in this way, having never demonstrated themselves to be anything but profit-seeking.[128] Moreover, many funds admitted to participating only to avoid the political backlash and bad press associated with refusing to comply with the request of

121. De Meester, *supra* note 93, at 25–26.

122. *See* James Mendenhall, *Essential Security Exception in U.S. Trade and Investment Agreements*, *in* SOVEREIGN INVESTMENT 310, 315–316 (Wouter P.F. Schmit Jongbloed, Lisa E. Sachs & Karl P. Sauvant eds., 2012) ("…it would appear that actions taken by CFIUS are unreviewable in most cases, at least as a practical matter and perhaps a legal matter").

123. De Meester, *supra* note 93, at 2.

124. Ghahramani, *supra* note 28, at 61.

125. Cohen, *supra* note 12, at 723.

126. IWG countries included are 2IWG member countries are Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Islamic Republic of Iran, Ireland, Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad and Tobago, the United Arab Emirates, and the United States. Permanent observers of the IWG are Oman, Saudi Arabia, Vietnam, the OECD, and the World Bank. *Santiago Principles* at 1 n. 2.

127. Cohen, *supra* note 12, at 723.

128. See *id.* ("Typical were the remarks of the managing director of the Kuwait Investment Authority (KIA) at the Davos World Economic Forum in February 2008. 'The KIA has been operating for fifty-five years,' he pointed out, 'and has never made a political decision. We look to the bottom line.' At times, the language was anything but diplomatic. The proposed code of conduct was outright 'unfair', complained the executive vice-president of the newly formed China Investment Corporation in March 2008.").

the US and its host country partners.[129] Nevertheless, in less than a year, the IWG produced The Santiago Principles, named for the city in which the group reached agreement.[130] The principles were presented in October 2008.[131]

The Santiago Principles outline 24 Generally Accepted Principles and Practices (GAPP) for the SWFs.[132] In its report, the IWG identified the need "to continue to demonstrate—to home and recipient countries, and the international financial markets—that the SWF arrangements are properly set up and investments are made on an economic and financial basis." The GAPP principles are divided into three sections: (i) legal framework, objectives, and coordination with macroeconomic policies; (ii) institutional framework and governance structure; and (iii) investment and risk management framework.[133] In drafting the GAPP, the group was driven by a set of guiding objectives:

i. Have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability;
ii. Ensure compliance with applicable regulatory and disclosure requirements in the countries in which SWFs invest;
iii. Ensure SWFs invest on the basis of economic and financial risk and return-related considerations; and
iv. Help maintain a stable global financial system and free flow of capital and investment[134]

The Santiago Principles encourage transparency, accountability, and predictability. The report also emphasizes the desire for SWF countries to demonstrate their exclusively financial and economic orientation.[135] By building understanding, the SWFs "aim to contribute to the stability of the global financial system, reduce protectionist pressures, and help maintain an open and stable investment climate."[136] Interestingly, De Meester notes that "the Principles do not exclude that SWFs pursue other than economic or financial objectives, but that these need to be clearly set out in the investment policy and be publicly disclosed."[137]

"Ultimately, the Santiago Principles are a series of non-binding principles forming the only international law instrument currently affecting SWF behavior in the equity markets."[138] There are certainly reasons to wonder how effective a voluntary set of principles might be, especially given the "even less impressive" attempt at reciprocity made by the OECD host countries to commit to keeping capital markets open,

129. *See id.* ("Some fund managers indicated that they had agreed to participate in the IWG talks only because of a fear of political backlash in the US and other recipient countries had they refused.").
130. *Id.*
131. *Santiago Principles* at 2.
132. *Id.* at 1.
133. *Id.* at 5.
134. *Id.* at 4.
135. *Id.*
136. *Id.*
137. De Meester, *supra* note 93, at 19–20.
138. Ghahramani, *supra* note 28, at 62.

effectively only affirming the status quo.[139] However they are a step in the right direction towards setting up international norms. SWF investors need the sophisticated, relatively safe, financial markets and products made available by host countries and will likely be conscious of any potential reputational damage caused by a failure to comply with even voluntary international principles of conduct. Without international regulations directly addressing SWFs, some inference is required to try and predict how any noneconomic or non-financial sovereign investment activity might be treated under the current legal regime.

V

ANTICIPATING POTENTIAL LEGAL ISSUES

Given the relatively new role of SWFs in global financial markets, and in national security conversations, there are few data points to use to evaluate the efficacy and applicability of international norms and laws. In an attempt to anticipate the use of sovereign investments, particularly SWFs, towards diplomatic or military means, it seems useful to analogize to other areas of national security law that are more established. In doing so, this paper hopes to shed light on whether a deliberate attempt by a SWF to harm the United States on behalf of its state manager would be a per se violation of international law. Conclusions about what SWF actions, if any, would constitute a prohibited use of force inform what would be a lawful and appropriate response by the United States or any other targeted host country.

A. Sovereign Investment and Sanctions

The United Nations Security Council (UNSC) is empowered to identify and respond to any "threat to peace, breach of the peace, or act of aggression,"[140] and determine "what measures not involving the use of armed force are to be employed to give effect to its decisions," including "complete or partial interruption of economic relations."[141] Unilateral sanctions, however, imposed by an individual state, present a more complicated question of legality. While Article 2(4) of the United Nations Charter "clearly prohibits the use of force, there is no provision which clearly prohibits coercive economic measures under the UN Charter."[142] Many believe that the economic coercion is excluded from the prohibition on a "use of force" in Article 2(4),[143] and that "economic pressure and psychological operations are generally considered lawful."[144] Not all observers, however, would agree that sanctions effects fall short of the use of force. Subscribers to an alternative view evaluate economic sanctions based on their effects, arguing that "comprehensive and long term economic sanctions can be as severe as the use of force."[145] Therefore "a broadening of the definition of force or aggression

139. Gordon & Niles, *supra* note 50, at 39–41 (discussing efforts for host countries to organize and make commitments to openness).

140. U.N. Charter art. 39.

141. U.N. Charter art. 41.

142. Syed Ali Akhtar, *Do Sanctions Violate International Law?* ECON. AND POL. WEEKLY (Apr. 9, 2018) https://www.epw.in/engage/article/do-sanctions-violate-international-law //.

143. Michael N. Schmitt, *The Use of Cyber Force and International Law* at 1113.

144. *Id.* at 1115.

145. Cassandra LaRae-Perez, *Economic Sanctions as a Use of Force: Re-evaluating the Legality of Sanctions from an Effects-Based Perspective*, 20 B.U. INTL' L. J. 161, 163 (2002).

to capture extensive unilateral sanctions" is proper,[146] as "economic sanctions appear to be closer to the use of force than the U.N. has been prepared to admit."[147]

Based on contemporary practice and understanding, even if sanctions are "more than an act of international diplomacy," they are likely not considered uses of force.[148] It does seem possible that in the future, perhaps in the face of a certain set of facts, the severity of the humanitarian effects on civilian populations by a unilateral economic sanction or coercion will cause an evolution in the consensus interpretation of international law.

Despite a likely per se legality under the UN Charter, economic coercion in the form of sanctions tends to be used in practice only as a reaction to perceived provocative actions by other states. "That fact that…a[n] operation directed against a state does not rise to the level of an armed attack does not leave that state without response options."[149] They are often categorized as countermeasures, only appropriately taken against a state "responsible for an internationally wrongful act,"[150] in an attempt to "convince the offering state to desist."[151] Said differently, "countermeasures are otherwise unlawful actions taken by one state in response to the unlawful actions of another."[152] A recent example was the Trump administration's sanctions on the Central Bank of Iran and the National Development Fund of Iran., the Iran's SWF, following the attack on Saudi Arabian oil facilities.[153] The sanctions were implemented on the grounds that those entities provide material support to the country's Islamic Revolutionary Guard Corps (IRGC), a Foreign Terrorist Organization (FTO) from which American law permits the seizure of assets.[154] Countermeasures in the forms of sanction are often considered preferable and more lawful than any kinetic actions.

So what does the analysis of the legality of unilateral sanctions tell us about SWFs? If SWFs actions adverse to a host country are treated like sanctions, or traditional economic coercion, than a SWF action is unlikely to fall into the category of a "use of force" prohibited by Article 2(4) of the UN Charter. If the action does not rise to that level, then Article 51 self-defense rights are not necessarily invoked for the host country, even if the US policy is to consider any use of force "an armed attack."[155] A host country would not be able to respond to a hostile SWF action by using force itself. That does not mean, however, that a host country has no recourse in response to an adverse SWF action.

A host country may still be permitted to take countermeasures in response to an economic activity that the host considers unlawful. Given the lack of directly applicable binding law on SWF action, it may be difficult for a host country to characterize a

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146. *Id.* at 188.

147. *Id.* at 181.

148. *Id.*

149. Michael N. Schmitt, *The Use of Cyber Force and International Law*, *in* THE OXFORD HANDBOOK OF THE USE OF FORCE IN INTERNATIONAL LAW 1110, 1128 (Marc Weller ed., 2015).

150. Akhtar, *supra* note 142.

151. Schmitt, *supra* note 149, at 1128.

152. *Id.*

153. Mario Mancuso, Sanjay Mullick, Anthony Rapa, & Abigail Cotterill, *Insight: Economic Sanctions and Export Controls Update Q3 2019*, BLOOMBERG LAW (Nov 21, 2019), https://news.bloomberglaw.com/white-collar-and-criminal-law/insight-economic-sanctions-and-export-controls-update-q3-2019.

154. *Id.*

155. Ryan Goodman, *Cyber Operations and the U.S. Definition of "Armed Attack"*, JUST SECURITY (Mar. 8, 2018), https://www.justsecurity.org/53495/cyber-operations-u-s-definition-armed-attack/.

specific SWF action as unlawful. The United States or other host country might argue a violation of the Santiago Principles is 'unlawful' and grounds for countermeasures short of a use of force as self-defense. In that case, the U.S. could be justified in violating any applicable international legal commitments, such as the GATS, as a host country into which FDI flows. The result would be tighter capital controls on money coming from sovereign sources who have engaged in adverse geopolitical financial action.

Sanctions and SWF actions however seem to differ significantly in the speed of their implementation and the ability of a host country to prepare and fend off potential negative effects. With that in mind, sanctions may not be the most helpful parallel, especially to the SWF activities that could be designed to weaken financial systems and governments in host countries. Putting sanctions in place takes time, and their execution necessitates an announcement of the terms and disclosure regarding the rationale. This gives targeted countries, institutions, and business entities some time to plan and anticipate the effects on their operations. The fact that sanctions and other potentially coercive economic measures often impact the cross-border flow of goods and services, lengthens the time those measures will take to be felt by entities operating in the targeted country. Sanctions also tend to have some clarity in purpose, usually compelling "compliance with some international obligation that the target State has failed to observe."[156] If the target complies, sanctions are designed to be removed with pretty anticipatable consequences.

Traditional economic sanctions seem quite different from the scenario Paulson described, where the health of financial institutions and systems was changing almost hourly and any adverse financial actions could have significant negative effects. Efforts to harm financial market participants, or the market functions and health themselves, can be executed quickly, and have dispersed effects that are difficult to anticipate, characterize, and quantify. As evidenced during the subprime crisis, financial products available in sophisticated host countries have grown complex and innovative.[157] In these scenarios it may not always be clear what an appropriate response would look like, or what actions might appease the adverse party. This is particularly true if the action is designed to exacerbate a recession, further destabilize capital markets, or worsen confidence in a specific asset class or industry. A strategic action, like a sale of a type of an asset class, or the dumping of shares in a specific industry, could have ripple effects that may not initially be identifiable. SWF actions, particularly exacerbating existing market stressors, can therefore have as or more severe effects as economic sanctions, and it can take time to untangle what the effects may be. Because of their speed, ambiguity of purpose, unanticipated consequences, and comparable potential severity, SWF actions certainly look more like uses of force than traditional economic sanctions.

B. Sovereign Investment and Cyber Warfare

The use of cyber force in international law can also inform the analysis of sovereign investment. While some try to argue that cyber is not covered by current law, most scholars conclude that *jus ad bellum* does extend to the world of cyber.[158] This consensus is "based on the International Court of Justice's (ICJ) Nuclear Weapons

156. Paul Szasz, *The Law of Economic Sanctions*, 71 INT'L L. STUD. 455, 456 (1998).
157. *See* RAJAN, *supra* note 44, at 159–60 ("So, as with many things, financial innovations span the range from the good to the positively dangerous.").
158. Schmitt, *supra* note 149, at 1112.

advisory opinion, in which the Court held that the law on the use of force, including in cases of self-defence, governs 'any use of force, regardless of the weapons employed.'"[159]

There have been earnest and robust efforts to understand how international law applies to cyber law. The most notable example of this is the Tallinn Manual, an effort to "foster sophisticated analysis of law governing cyber conflict" in response to cyber operations against Estonia in 2008.[160] The North Atlantic Treaty Organization (NATO) brought together a group of experts to consider cyber force in *jus in bello* and *jus ad bellum* contexts.[161] The Tallinn Manual describes eight factors that "lie at the heart of the approach" to determining whether an action is a use of force: severity, immediacy, directness, invasiveness, measurability of effects, military character, state involvement, and presumptive legality.[162] Severity is the "most determinative factor," according to Michael Schmitt. Therefore, "an act not causing physical harm or injury *may*, as in the case of training and arming cyber activists to target another state, amount to a use of force depending upon its scope, duration, and intensity, when considered in light of, inter alia, the factors set forth later."[163] While economic coercions or actions have had a presumption of legality, Schmitt suggests a "cyber operation resulting in massive economic losses may nevertheless be styled by the international community as a use of force."[164] At the same time, the group of Tallinn experts "concluded that. . . 'non-destructive cyber psychological operations intended solely to undermine confidence in a government or economy'" would *not* qualify as a use of force.[165]

The eight factors recommended by the Tallinn manual are useful, suggesting a fact-based use of force analysis for actions that are not inherently physical or kinetic. While Schmitt and the Tallinn experts were most concerned with the "question of whether cyber operations having severe consequences can qualify as armed attacks in the absence of physical effects,"[166] the factors are the same one would use to substantively evaluate the effect SWF actions would have on a host country. Of particular importance to the determination in the SWF context would be severity, military character, and state involvement. When evaluating the legality of a SWF action, a host country would surely consider the planning and coordination SWF managers had with an adverse party's centralized military decision-making. Understanding the extent to which an operation was planned like a military action would shine light on the underlying motivations for investment decisions. It also seems logical to apply the same kind of "case-by-case" approach taken by the Tallinn experts to SWF actions, as opposed to making any presumptive determinations whether economic activities are or are not uses of force under international law.

C. Towards A New Paradigm

Though economic actions have enjoyed a presumption of legality, that presumption should not extend to the kind of adverse financial attacks by SWFs with which this

159. *Id.*
160. *Id.* at 1111.
161. *Id.*
162. *Id.* at 1114.
163. Schmitt, *supra* note 149, at 1114 (emphasis added).
164. *See id.* at 1115 ("The hypothetical case of a devastating attack on a state's stock market is often offered as the paradigmatic example.")
165. *Id.* at 1113 (emphasis added).
166. *Id.* at 1120.

paper is most concerned. The potential SWF actions discussed do not resemble economic sanctions: they would be speedy, unpredictable, and undertaken with indefinite objectives outside of causing harm. Like sanctions, SWF actions could have devastating effects not only on personal and institutional wealth and operations in the target country, but also everyday citizens who may suffer the humanitarian consequences of deep recession or global financial instability. Unlike sanctions, however, financial actions cannot be "undone" the way a restriction on trade might be. SWF actions are also differentiated from sanctions by the speed with which they are implemented and the rate at which consequences are felt by the targeted parties.

The best approach to SWFs, rather, is one more similar to the factually-rich inquiries made under the Tallinn Manual. While some factors in Tallinn remain extremely relevant, an approach to evaluating whether SWF is unlawful under international law could consider additional financial factors. For example, when dealing with financial markets, timing and information availability are additional crucial factors to understanding the intent and level of coordination underlined a financial transaction. By refusing to make any categorical determinations, and instead evaluating SWF actions on a case-by-case basis, a host country like the U.S. leaves itself the most options to respond to any financial actions that it deems unlawful.

VI

CONCLUSION

Sovereign investment will continue to be a major force on international capital markets. This seems especially true as large global trade imbalances seem to have become entrenched, rather than corrected, after the financial crisis.[167] State-owned investment vehicles, most notably SWFs, present a new set of challenges in the arena of national security. When a fund has only the government as its stakeholder and few or no liabilities, it may adopt investment strategies and objectives that are not purely economic, and maintain the flexibility in governance and operation to execute those objectives. The 2007–08 crisis revealed the instability of even the most sophisticated financial markets, and the highlighted influence sovereign investors can have on market stability and global economic health.

There are many reasons to be optimistic that SWFs and other forms of sovereign investment will not be used for non-economic purposes. As export countries continue to build up massive foreign exchange reserves, they have a clear stake in maintaining their access to developed financial products in host capital markets. However, the financial system is also more complicated than ever, both in the technology it employs and the diversity of financial products that exist, and the crisis demonstrated that sometimes financial machinations are beyond regulators' ability to anticipate.[168] Another reason to be prepared to address these issues is the United States' deteriorating relationship both with China and Russia in recent years.[169] These countries have demonstrated a willingness to asset their power in new and unconventional ways, and

167. *See* FRIEDEN & CHINN, *supra* note 47, at 225–26 ("If Americans, and their leaders, do not pay careful attention to these considerations, the nation risks losing another decade to stagnation and social conflict.").

168. *See* RAJAN, *supra* note 44, at 159 (discussing the constant process of financial innovation in sophisticated markets").

169. Ellyatt, *supra* note 104.

it would be naïve to assume that they have no plans in place to utilize their ascendant (especially in the case of China) financial power.

Though it can be tempting to view national security concerns about SWF and other sovereign investments as a different version of unilateral economic sanctions, it seems instead helpful to consider these risks through a new paradigm, influenced significantly by use of force approach advocated in the Tallinn manual. A fact-based analysis of an action by a SWF, pairing financial considerations with Tallinn factors like severity, state involvement, and military character, is the best way to evaluate whether an action by a SWF is a prohibited use of force under international law. Once an initial action is categorized, a host country can determinate what an appropriate and lawful response might be.