

Онопко М.О.*

ETHICAL DIMENSIONS OF THE SOVEREIGN WEALTH FUNDS OPERATIONS: CASE OF THE NORWEGIAN GOVERNMENT PENSION FUND (GLOBAL)

Анотація. Стаття присвячена дослідженню етичних питань у діяльності фондів суверенного багатства. Визначено різні точки зору в дослідженні даного питання. Розглянуто практику Норвезького державного пенсійного фонду (глобального) як приклад застосування етичного підходу з боку суверенних фондів.

Ключові слова: фонди суверенного багатства, моральні теорії, легітимність, етичні проблеми.

Annotation. The article is devoted to investigation of the ethical issues in sovereign wealth funds operations. Different perspectives on this matter are discussed. The case of the Norwegian Government Pension Fund (Global) is depicted as an example of ethical approach implementation by sovereign wealth funds.

Key words: sovereign wealth funds, moral theories, legitimacy, ethical issues.

Аннотация. Статья посвящена исследованию этических вопросов в деятельности фондов суверенного богатства. Определены различные точки зрения в исследовании данного вопроса. Рассмотрена практика Норвежского государственного пенсионного фонда (глобального) как пример применения этического подхода со стороны суверенных фондов.

Ключевые слова: фонды суверенного богатства, моральные теории, легитимность, этические проблемы

Problem statement. Investigation of the changes in the global financial system brought by the sovereign wealth funds within the framework of the institutional theory provides a reflection of the significance of emerging markets economies not only in terms of economics, but also as a growing centre of power in a broader social and cultural context.

Review of recent publications. Sovereign wealth funds draw attention of scholars around the world and their development is highlighted in works of R. Beck, C. Chen, M. Fidora, O. Listhaug, R. Milne, A. Monk depicting various aspects of the phenomena.

Description of the unresolved issues within broader problem. The main problem is what ethical issues are involved and most relevant to access the development of the sovereign wealth funds as institutional innovation. The case of the Norwegian Government Pension Fund (Global) is chosen due to the high level of transparency and ethical standards both in governance of the Fund and in Norwegian society.

* аспірант кафедри міжнародних фінансів Інституту міжнародних відносин Київського національного університету імені Тараса Шевченка
Науковий керівник: професор Рогач О.І.

Purpose of the paper. The paper is aimed to provide exploration of reasons prompting states to establish sovereign wealth funds and the issues that are connected to management of financial resources contained in these investment vehicles. The secondary data was used to get a broader understanding of the research questions.

This research is based on a case study method. There is a single case study to investigate situation in particular settings. Case study provides us with picture of perception of actors within organization and within its real-life context. On the other hand, the results acquired through this method cannot be generalized to explain behavior of all the sovereign wealth funds but we can still add to existing knowledge.

Sovereign wealth funds are pools of capital that belong to sovereign nations, but display same behaviour as other, but privately owned funds. This is the prerequisite for the choice of approach to analysis of the issues arising in their operations.

For the purpose of the study we need to distinguish characteristics of the sovereign wealth funds that make them a subject of inquiry of the present paper and lead to the need to discuss the agency relations in these particular settings. They are the state ownership of the sovereign wealth funds, absence (or limited degree) of explicit liabilities (regular fixed payments to pensioners or other domestic constituents) and separate management from the official foreign reserve of home country [1, p. 352].

The following research questions are formulated to carry out research of the issues of development of sovereign wealth funds under global integration: What ethical issues are connected to operations of the sovereign wealth funds? How the ethical principles are met in the Norwegian Government Pension Fund (Global)?

Sovereign wealth funds present a much diversified group of entities that brings up the issues concerning their evolution and possible impact over national global economy. The international political economy presents approach to this issue from three main theoretical perspectives: realism, liberalism and Marxism.

Realism presents the point of view that the state is the most important actor in international system, thus the logics in operations of the sovereign wealth funds creates adversity in other states. On the other hand, if we take liberalism perspective, it will mean that these actors are entering the markets and if the state role is minimized eventually markets will adjust to these changes, even though recent development of the global economy has shown that liberal approach is not the best way to ensure development and establish order and that states are indeed important actors in international economy.

The Washington Consensus presents an approach towards regulation of the global economy from the point of liberalism and based upon the faith in the role of markets, and assumption that the process of adjustment is causal. J. Stiglitz [15, p. 7] points out that the capital market liberalization had an adverse effect for economic stability and created obstacles for growth in a long-run perspective.

As it is pointed by M. Rupert and S. Solomon [13, p. 10] interaction of state and market involves both conflict and cooperation. Interstate politic is a system of sovereign states and governments of the states are acting according to the interests they have. This situation is leading to the situation when states are prompted to act as rivals. The market interaction in neoliberal world is supposed to eliminate the influence of the range of factors that affect the way interstate politics is formed by following the Smithian logic of market-based cooperation.

From the Moral Theory Prospective freedom is the ontological condition for decision-making process in any setting, but the decisions are made in accordance with certain moral rules. L. Treviño, G. Weaver, & S. Reynolds [16, p. 953] presented the framework for the exploration of

the individual-level ethical decision making that includes distinction between moral awareness, moral judgment, moral motivation and moral behavior. Moral awareness is the process of identification of moral issues. Moral judgments are deemed to be highly influenced by external factors and individuals can be more attentive to information concerning the ends in ethical decision making (utilitarians) or they can focus on means (formalists). Organizations have ethical infrastructure containing ethics code and policies, communications, training, monitoring systems, sanctions, rewards (formal side) and attention to ethical climates and organizational cultures on the informal side, and each individual involved in decision-making process within organization is influential on organizational morality. Organizational morality is established, institutionalized and reproduced within and through relations of power [17, p. 471].

C. Chen has made a distinction between SWF and other institutions in public ownership and employs the “National Economic Man” model based on assumption that there are certain stages of development of every national economy and establishment of sovereign wealth fund is a result of rational choice for the state as rational individual with rational expectations [2].

Utilitarianism is one of the most influential moral concepts rooted in social theory that puts utility or happiness on the first place when one should make judgments about moral issues. The utilitarian moral theory provides possible explanation of the way to cope with issues in interstate interaction. According to the Greatest Happiness Principle, interests of every nation should be equally important when we make judgments about the moral issues. If there is a difference in levels of happiness that each decision produces the one that will produce the most utility should be chosen [12, p. 61]. In reality, the countries do not act as equal in the global economy and decisions are based on the set of different. In case of sovereign wealth funds we can say that ethical issue appears even when we have to detect the measure for utility that is accepted in all situations, since there are too many different interests involved. If we take the highest possible profit as a measure for utility in transactions of sovereign wealth funds then there will be no way to explain why some of potentially profitable investments are not made. From the point of view of utilitarian theory, there should not be any other motivation but profit. On the other hand, when sovereign wealth fund withdraw investment from some enterprise, it may prevent possible losses in future due to the bad governance or sanctions imposed by governments. That brings us to conclusion that utilitarian moral theory is applicable in most cases to find a solution for ethical dilemmas arising in the operations of sovereign wealth funds, even though there are some issues that can hardly be addressed within its framework.

Taking Ethical Subjectivism perspective there is nothing wrong with investments made in any kind of endeavor for as long as those who make decision do not perceive them as immoral [11, p. 74].

The social contract theory presents the approach that helps to explain morality as a precondition for social living and government as an institution enforcing moral rules. In this regard, sovereign wealth funds as state-owned pools of capital should represent the interests of the nation. The rational choice is the choice that will be beneficial both for national economy and for the world. On the other hand, if we follow the logics of Thomas Hobbes, we can find roots of morality in an attempt of self-interested actors to reach agreement about the issues in interaction between actors in social life [11, p. 101]. Cooperation is important for global economy to be viable and to provide opportunities for development of each state. In global economy independent states have different interests, but each of the states needs something from others, there is also scarcity of resources that prompt international trade as a form of cooperation. On the other hand, there are problems that need to be addressed by all the countries. In case of sovereign wealth fund investments the social contract theory is applicable to detect whether withdrawal of investments is motivated by existence of issues or by other motives.

The institutional theory is employed in the study to explore agency conflict and legitimacy issues within sovereign wealth funds. One of the most important issues in investigation of sovereign wealth funds is legitimacy both on international and national level. Legitimacy is a term that means practices in accordance with law, both in legal system and social laws, norms accepted in certain society. D. Deephouse [3, p. 1024] explored the connection between “legitimate” behavior of institutions and the legitimate status conferred by social actors (society and others). Organizational legitimacy is gained through a process of legitimation: approval from main stakeholders [5, p. 362]. J. Dowling and J. Pfeffer defined organizational legitimacy as a status when value system of organization is congruous with social system and any disparity between the two is threatening entity’s legitimacy [4, p. 123]. The possibility to make proactive choice in changing environment gives the firm an opportunity to take into account interests of different stakeholders and create more legitimacy for main stakeholders [9, p. 439]. There seems to be a certain “social contract” between the company and society in which it operates, as stated by A. Shocker and S. Sethi organization as social institution has to deliver some merit goods for society and serve interests of groups that empower organization to exist [14, p. 99]. Organization seeks to create certain perception of relevant groups of society, that is why sometimes organizations may pretend to act in some way to gain legitimacy from the group in society that is influential enough for organization to involve in legitimization activity [5, p. 364]. In our study legitimacy issues are explored in sovereign wealth funds as an institutional paradox because of ongoing search of domestic legitimacy that entails further politicization of the investment decisions.

The research is aimed to carry out analytical study of the sovereign wealth funds and their strategy in the global integration. Global integration is a process of shifting global economic power towards emerging economies leading to the need to establish new mechanisms to regulate the global economics. Using data concerning the Norway SWF the Government Pension Fund (Global) we can come up with general assumptions about the sovereign wealth funds and their impact on global economy and local development.

The Norwegian Government Pension Fund (Global) is a part of public sector in Norway, but mostly operates overseas on private markets. There are many ethical limitations for investments, as well as political factors affecting investment decisions. This clearly creates challenges in management control, from point of view of contingency theory and new public management. Using data from the media, official site it can be seen if there is cooperation between the Fund and external managers, such cooperation would create the principal-agent problem. As we know to date, the Fund has offices overseas in New York, London, Shanghai and Singapore and it makes it a government-owned multinational enterprise.

The performance management of the Norwegian Government Pension Fund Global is critical for future development of economy of Norway, because it provides welfare redistribution between generations, thus investment strategy has to be changed in accordance with the current needs of the domestic economic development. Another important aspect is a need to inform shareholders – meaning all the Norwegians – about short-term performance when the Fund is a long-term investor. Losses in short-term can produce higher return in the long-run, but from the point of view of the shareholders this is a failure of the government, because the government revenues from export of petroleum are transferred to the fund and the Fund is integrated into central government budgets and accounts. This clearly can be viewed through approach of the institutional theory as a way of further institutional development of the public sector.

R. Milne has stated that a rapid growth of assets under management will eventually prompt fund to alter benchmark and implement more active investment strategy [7], A. Monk underlines

that the Fund presents a kind of institutional paradox, because of its ongoing search of domestic legitimacy and this will lead to further “politicization” of the investment decisions [10]. O. Listhaug points out that locking up the wealth of nation in a fund is one of the reasons for decline of political trust [6, p. 836]. These studies have shown that there is a need to further studies of operations of the Norwegian Government Pension Fund Global and its influence on the domestic economy and how economic and political situation shape the Funds strategy.

The Government Pension Fund (Global) is accumulating resources both from oil revenues and proceedings from investments. The government of Norway considers it a tool to show the world the intentions of Norway to contribute to sustainable development [8, p. 14]. The Ethical Guidelines state that Fund has to be managed in order to achieve high returns, at the same time it is stated that Norway as investor is responsible for unethical actions of the firms that the Fund have invested. It is stated, that the way fund is managed will become increasingly important in light of ethical issues connected with the investment activities of the fund. The government encourages all the companies to be sustainable and implement the best practices in their business process and this is considered as an important part of Norway’s Strategy for Sustainable Development.

Table 1.
Reasons for Exclusion of the Investment Universe

| Reason for Exclusion | Number of Companies |
|---|----------------------------|
| Production of weapons that through their normal use may violate fundamental humanitarian principles | 18 |
| Production of tobacco | 21 |
| Serious or systematic human rights violations | 2 |
| Severe environmental damages | 10 |
| Other particularly serious violations of fundamental ethical norms | 2 |
| Serious violations of the rights of individuals in situations of war or conflict | 2 |

Source: Ministry of Finance of Norway <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/companies-excluded-from-the-investment-u.html?id=447122>

There is The Council on Ethics that is responsible for ensuring that the investments are made in companies that stick to ethical way of doing business. The companies involved in production of certain kinds of weapons, tobacco, sell of weapons to certain states, also violations of human rights, corruption, causing severe environmental damage and other violations of ethical norms. Table 1 shows the reasons for exclusion from the investment universe. There is a following procedure to exclude the company from investment universe of the Government Pension Fund (Global). The Ministry of Finance makes a decision to observe certain company based on information delivered by the Council of Ethics and come up with the ways to mitigate adverse effects or recommend withdrawing investments. Norges Bank is informing the companies about the issues detected by the Council on Ethics.

These practices are harming other states interests, but the government of Norway is concerned about being involved in this kind of activity. Altruism is a moral precondition for withdrawal of investments. On the other hand, investments can not be totally ethical, since every

company has something to hide and the sovereign wealth fund may be involved in unethical way of doing business through activities of partners and subsidiaries.

There are several options for companies that get notification about being monitored. They can work out the way to cope with problem or decline to change the way they act. The decision depends on the wide range of factors such as the stake owned by the Fund, importance of image for share price and risks connected to the withdrawal of investments. We can refer to two distinctive cases to address the issue of relations between Government Pension Fund (Global) and the companies it invested in. Siemens AG was recommended to be excluded by the Council on Ethics and was put under observation in 2009 and after the set of measures was implemented in 2013 the decision was made to stop observations due to a great progress in fighting corruption. Council of Ethics and Norges Bank published the reports about their observations in 2010 and 2011 about progress in fighting corruption and it was stated that the new monitoring and compliance system was designed and the requirements of the Ethical Guidelines were met.

Conclusion. The research is aimed to provide insight in the issues of establishment of sovereign wealth funds, influence of their activities on national economies and issues connected with their presence in the global economy. The research relies upon the mix of qualitative and interpretative techniques, particularly case study and content analysis. Data was obtained and reinforced from the different sources that gave us an opportunity to assume that we obtained relevant data and can reach the goal of research as well as to provide possible development of present research.

Concerning the first research question, there are several issues detected in operations of sovereign wealth funds. The first one is an issue of interrelation of the interests of sovereign states and their interaction with market. Since governments are representing the interests of the citizens, they should act as rational individuals according to mainstream economics, but in reality the interaction between actor is much more complicated and entails more ethical issues. Legitimacy is crucial issue for sovereign wealth funds and they have to gain it through the set of “contracts” between the funds and stakeholders.

The moral theories can be employed to explore the ethical issues in sovereign wealth funds practice, even though there is an extensive set of assumptions that should be made to employ utilitarian and ethical subjectivism approach. The social contract theory presents the most applicable approach to ethical issues in sovereign wealth funds practices, since existence of these institutions is partly a result of cooperation between government and society, as well as cooperation between sovereign states.

In case of the Norwegian Government Pension Fund Global, there are the same issues presented above, but the distinguishing characteristics of this case is the fact that the state who owns this pool of capital has one of the most sophisticated ethical principles system in modern world. Thus, coping with ethical issues are one of the most important parts of the strategy of the Norwegian Government Pension Fund Global. The Ministry of Finance is responsible for the final decisions concerning investments, while Council on Ethics and Norges Bank are ensuring monitoring of possibly harmful situations in operations of the Norwegian Government Pension Fund Global

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