

The Ambachtsheer Letter

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SOVEREIGN WEALTH FUNDS: FRIENDS OR FOES?

“What is distinct is that SWFs involve a sharp rise in the role of government in the ownership and management of international assets. It calls into question our most basic assumptions about the structure and functioning of our economies and the international financial system...”

Edwin Truman
Institute for International Economics
November 2007

“Many economists argue they make global capital markets safer. The SWFs don’t have to worry about panicky investors withdrawing their money when markets tank, helping stabilize prices of the stocks and bonds they own. So far the record shows they move carefully...”

Jack Ewing
Business Week
November 2007

A Roundtable Discussion

We led off a roundtable discussion on the ‘SWFs: Friends or Foes?’ question at the University of Toronto’s Rotman School of Management last week. As over 200 people showed up, things got a little crowded around the table. Nevertheless, the topic was given a thorough going-over during the 2-hour event. This *Letter* sets out the framework for discussion we proposed at the forum, and reports on the apparently opposing majority (‘friends’) and minority (‘foes’) participant views expressed. However, rather than leaving the question suspended in an ‘either-or’ decision situation, we suggest in this *Letter* how the apparently opposable views can be converted into a ‘not either-or but both’ outcome, superior to either alternative (see Rotman Dean Roger Martin’s new book “The Opposable Mind” for more on this powerful idea).

A Brief History of Capitalism

The last 200 years of capitalism can be summarized briefly as follows:

- Adam Smith Capitalism was the micro-capitalism of the butcher, the baker, and the candlestick maker. While Smith’s “Wealth of Nations” (1776) with its ‘enlightened self-interest’ doctrine received all the glory, his earlier “Theory of Moral Sentiments” (1759) was equally important. Enlightened self-interest must always be guided by strong moral values and a strong sense of the public interest.
- Industrial Revolution Capitalism emerged when the steam engine and related inventions led to large productivity gains and scale economies. Despite Karl Marx’s dire predictions, the Carnegies, Rockefellers, Vanderbilts, Morgans, Fords became the new owner-operator giants of capitalism.

- Managerial Capitalism followed with the deaths of these giants, and with the advent of anti-trust legislation to curb their power. So corporate ownership became more diffused through society. In their “Modern Corporation and Private Property” (1932), Berle and Means pointed out that this ownership diffusion had agency costs of its own, with managers now pursuing their own interests, rather than their shareholders’. In his “General Theory” (1936), Keynes went one step further by observing that investment managers could also pursue their own interests by charging clients fees for engaging in non-productive portfolio ‘beauty contests’.
- Institutional Capitalism was foreseen by Drucker in his “Unseen Revolution” (1976). Demographic forces would produce a flood of retirement savings in the decades ahead. Drucker worried that this huge pool of financial capital would be co-opted by outside agent forces (e.g., governments, business, organized labor). Drucker urged the creation of arms-length, expert investment agencies to ensure it would be invested in the best interest of its owners. Thirty years later, Davis, Lukomnik, Pit-Watson would proclaim victory in “The New Capitalists” (2006), arguing that a new class of Drucker-inspired investment institutions is indeed creating a superior form of capitalism as we enter the 21st century.

Are they right? Has the battle for a progressive, responsible form of capitalism been won? To address these questions, we need to better understand the structure of the \$30T global pool of accumulated retirement savings. As Drucker foresaw, it is here that the sharp end of ‘institutional capitalism’ operates today.