



CELIS Issue Note on Strategic Considerations for Sovereign Investment and Investment Control

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Introduction

The liberal world order is in flux. While financial and economic integration have for a long time been considered the basis for peace, democracy and freedom, pro-liberal market principles such as the optimal allocation of capital are under pressure by national and economic security considerations. The introduction and strengthening of investment screening mechanisms on grounds of national security and public order in EU member states exemplify this evolving repositioning vis-à-vis unconditioned financial integration.

State-led investments, such as those channeled through *Sovereign Wealth and Pension Funds*, has increasingly been associated with the potential to pursue geo-political agendas. Given their capacity to move substantial capital on a global scale across industry sectors, the rapid advancement of these government-owned funds since the Financial Crisis of 2007/08 presents unprecedented challenges for investment regulation authorities. While increasingly being perceived as a risk to national security, state-owned funds also offer significant benefits. Their substantial resources and long-term investment horizons benefit host states by providing essential capital and fostering sustainable growth, as they typically avoid the need for a quick exit unlike some private equity funds. This dual nature of sovereign investment highlights the need for a focused discussion on the most pressing strategic issues at the intersection of sovereign investment and investment control during CFIS 2024.

All red but not the same: lumps apples, lobsters, and bliss potatoes

Issue

Sovereign Wealth and Pension Funds differ in their purpose, management structures, and investment strategy.

Why it matters



Sovereign investment vehicles serve different purposes. Some are designed to function as intergenerational saving mechanisms. Others, however, also serve the purposes of stabilisation, regional or economic development. Yet others fulfil political objectives for the home country.

Increasingly, investment screening frameworks establish state ownership as a criterion for screening transactions. While sovereign investment vehicles are essentially state-owned entities, their management structures vary in terms of control exercised by national executives over the fund's daily operations. Accordingly, state-owned investment vehicles may be in possession of a sovereign state but not state controlled.

Sovereign investors employ various strategies, including portfolio, controlling, and mixed approaches. The investment profile can serve as an indicator of a fund's broader motives. While majority investments often prioritize strategic gains over financial returns, non-controlling or portfolio investments typically focus on maximizing financial returns. However, it remains highly difficult to distinguish financial from political objectives.

The rapidly evolving landscape and differences of sovereign investors appear to require investment screening/controlling authorities to qualify the individual risk profiles of individual investment vehicles and transactions. To ensure market openness and the essential security interests of investment-hosting countries, a dialogue is necessary to clarify how such qualification is done when screening sovereign investments. Sovereign investors should explore designs and management structures of investment vehicles that reduce the perception of pursuing objectives beyond financial returns on investment.

Points for discussion

- According to which criteria is governmental control of sovereign investment assessed in investment screening decisions?
- How can screening mechanisms differentiate between strategic and non-strategic investments by sovereign funds?
- What measures can ensure transparency in the operations of sovereign investment vehicles?



Third wheeling: The sovereign investors, the host country and the strategic competitor

Issue

The financial relationship to China of several sovereign investors that seek investment in Europe and the US has raised national security considerations.

Why it matters

Sovereign investment vehicles have become an essential instrument of global financial integration. In particular, the relationships of Gulf Arab sovereign investment vehicles with Beijing—exemplified by their involvement in the Digital Silk Road—are increasingly seen as potential channels for the transfer of data and technology to China.

Points for discussion

- How can screening mechanisms address the risks posed by the financial integration of individual sovereign investment vehicles?
- What measures can be implemented to monitor and regulate the relationships between sovereign investors and third-party countries?
- What frameworks can be established to ensure transparency and accountability in the operations of sovereign investment vehicles?