

# Sovereign Wealth Funds and Social Arrears: Should Debts to Citizens be Treated Differently than Debts to Other Creditors?

PATRICK J. KEENAN\*

---

Introduction.....	432
I. The Problem: Sovereign Wealth Funds, Concentrated Wealth, and Social Welfare.....	438
A. States as Aid Recipients and Capital Exporters .....	439
B. Conventional Justifications for Development Assistance and Sovereign Wealth Funds.....	442
1. Development Assistance .....	443
2. Sovereign Wealth Funds.....	444
C. Connecting Concentrated Sovereign Wealth and Social Welfare .....	446
II. Benefits for Those in Debt to Others: An Analogy to the IMF's Policy on Lending into Arrears .....	448
A. Early Policy: Safeguarding the IMF's Resources .....	452
B. Recent Policy: Influencing Negotiations and Internal Policies .....	453
III. Social Arrears: A Theory of Domestic Obligations .....	453
A. State Obligations .....	455
1. Sources of State Obligations .....	456
2. Substantive Obligations.....	458

---

\* Associate Professor of Law & Corman Faculty Scholar, University of Illinois College of Law. For helpful comments and conversations, I am grateful to Amitai Aviram, William Davey, Margareth Etienne, Victor Fleischer, Anna Gelpern, Tom Ginsburg, Christiana Ochoa, Paul Rose, Tom Ulen, and Timothy Waters. I am also grateful to participants in workshops at the University of Chicago Law School and Indiana University Law School-Bloomington.

B.	Tardiness .....	461
C.	Capacity .....	463
IV.	Implementation and Possible Complications .....	464
A.	Including Social Arrears as a Condition of Access in the United States.....	465
1.	Broadening the Scope of Review by CFIUS .....	466
2.	Expanding the President's Authority under IEEPA.....	468
3.	Policy Coherence.....	468
B.	Implementation Issues .....	469
C.	Possible Objections .....	471
	Conclusion .....	472

## INTRODUCTION

The recent emergence of sovereign wealth funds (SWFs) as active and important players in international financial markets has raised a host of questions about their likely effect on markets and states.<sup>1</sup> SWFs are investment vehicles through which governments invest foreign currency reserves or the windfall earnings from profitable trade in commodities. In recent years, these funds have become important sources of capital for the financial markets, and they appear likely to become even more powerful if the liquidity crisis sparked by problems in the mortgage industry continues or spreads.<sup>2</sup>

SWFs create a regulatory and theoretical challenge because they serve two masters with very different agendas. On the one hand, when

---

1. One study of the total size of sovereign wealth estimates that fifty-four of the largest SWFs control approximately \$5.3 trillion in assets. See Edwin M. Truman, *A Blueprint for Sovereign Wealth Fund Best Practices* 1 (Peterson Inst. for Int'l Econ., Policy Brief No. PB08-3, 2008), available at <http://www.iie.com/publications/pb/pb08-3.pdf>. In response to recent financial crises in the United States and Europe, these funds have become more active. See *The Invasion of the Sovereign-Wealth Funds*, *ECONOMIST*, Jan. 19, 2008, at 11 (reporting that SWFs had invested a total of \$69 billion in investment banks in the months after the subprime mortgage crisis began in 2007).

2. For example, in 2007, Temasek, one of Singapore's SWFs, took a \$5 billion stake in Merrill Lynch. See Eric Dash, *Merrill Lynch Sells a \$5 Billion Stake to Singapore Firm*, *N.Y. TIMES*, Dec. 25, 2007, at C1. Merrill Lynch needed the infusion of capital to help it deal with the subprime mortgage crisis. *Id.* And Merrill Lynch was not alone in receiving an infusion of capital from an SWF. In November 2007, Citigroup raised \$7.5 billion from the Abu Dhabi Investment Authority. David Wighton, *Abu Dhabi's Big Place in the Citi*, *FIN. TIMES*, Jan. 24, 2008, at 2. UBS received \$9 billion from the Government of Singapore Investment Corporation. *Id.*

SWFs participate in the financial markets, they are expected to behave as private actors, motivated only by profits.<sup>3</sup> Among scholars and policymakers, the most prominent concern about SWFs is that they could operate in the market as tools of state policy. For example, if an SWF took a controlling stake in a corporation in a vital industry, the managers of the SWF could use that stake to advance the strategic interests of the government that controlled it, rather than seeking profits without a strategic objective.<sup>4</sup> In conventional accounts, the response to this concern is that SWFs should be treated as a benign force so long as they act as ordinary market participants. It remains to be seen whether there is legitimacy to the claim that SWFs will be used to advance state policy in an inappropriate way, though the limited evidence available so far suggests that most SWFs are profit maximizing rather than strategically focused.<sup>5</sup>

On the other hand, to citizens in the state that created the SWF, they are purely an instrument of public policy whose chief justification is to improve social welfare in the state. To citizens, a well-run SWF should become a reliable source of income that drives economic and social development.<sup>6</sup> Many of the states benefiting from high oil prices, for example, are states in the developing world. These states have received substantial oil revenues in the last five years, and especially in the last two years.<sup>7</sup> They now face an unusual problem, at least for them: what

---

3. See Roland Beck & Michael Fidora, *The Impact of Sovereign Wealth Funds on Global Financial Markets* 5 (Eur. Cent. Bank, Occasional Paper No. 91, 2008) (“Over the longer run, any impact of SWFs . . . will depend critically on the motives underlying the investment decisions of such funds. While fully return and risk-motivated investments may affect financial stability rather positively . . . non-commercial motives might have a negative impact on financial stability.”).

4. This kind of concern undermined an attempt by China’s national oil company, the China National Offshore Oil Corporation (CNOOC), to purchase the American oil company Unocal. See Stephanie Kirchgaessner, “Congressional Angst” Scuppers Chinese Bid, *FIN. TIMES*, Aug. 3, 2005, at 22 (reporting that members of Congress feared that CNOOC’s investment would amount to giving control of Unocal to the Chinese government).

5. See WILLIAM MIRACKY ET AL., *MONITOR GROUP, ASSESSING THE RISKS: THE BEHAVIORS OF SOVEREIGN WEALTH FUNDS IN THE GLOBAL ECONOMY* 35 (2008) (arguing, based on a study of public transactions involving SWFs, that instead of “investing in potentially sensitive sectors SWF’s have avoided sensitive sectors and industries”).

6. Consider the case of Kiribati, whose experience is perhaps the best that citizens could hope for: “Kiribati, a Pacific island country that mined guano for fertilizer, set up the Kiribati Revenue Equalisation Reserve Fund in 1956. Today the guano is long gone, but the pile of money remains. If it manages a yield of 10% a year, the \$400m fund stands to boost the island’s GDP by a sixth.” *Asset-Backed Insecurity*, *ECONOMIST*, Jan. 19, 2008, at 78, 79.

7. See Jędrzej George Frynas & Manuel Paulo, *A New Scramble for African Oil? Historical, Political, and Business Perspectives*, 106 *AFR. AFF.* 229, 230–32 (2007) (describing revenue associated with oil-related development in Africa).

should they do with all the cash? Many of these states have embraced SWFs as a means to transform short-term wealth from the commodities boom into long-term development.<sup>8</sup> Under the right circumstances this can be an entirely sensible strategy. It can allow the state to diversify its portfolio by creating multiple income streams from a single income stream and make the economy less vulnerable to swings in commodity prices. This explains why one argument commonly made in favor of SWFs is that they are a better means to improve a state's social welfare than the available alternatives.<sup>9</sup>

But in many other states, increasing the amount and concentration of resources controlled by the government is not likely to improve or even sustain current levels of social welfare but instead is likely to reduce it. Part of the reason for this is that rulers in states that receive windfalls from resources or other sources often attempt to consolidate their control over access to those resources.<sup>10</sup> The widespread emergence of SWFs creates a risk that such rulers will further insulate themselves from political accountability by moving even more of the state's resources outside the typical channels of domestic political control.<sup>11</sup> This potential negative externality associated with SWFs runs directly counter to the typical objection to such funds—that they will be used to further political aims of the state rather than simply pursuing purely economic returns.<sup>12</sup>

---

8. See Helmet Reisen, *How to Spend It: Sovereign Wealth Funds and the Wealth of Nations* 1–2 (Org. Econ. for Cooperation and Dev., Dev. Ctr. Policy Insights, No. 59, 2008) (arguing that oil-rich countries should either keep the oil in the ground, in which case its value is the expected future price of oil, or sell the oil and invest the proceeds in a way that will earn a market rate of return).

9. For a description of the various justifications for SWFs, see INT'L MONETARY FUND, *SOVEREIGN WEALTH FUNDS—A WORK AGENDA* 5–6 (2008).

10. See Elissaios Papyrakis & Reyer Gerlaugh, *The Resource Curse Hypothesis and Its Transmission Channels*, 32 J. COMP. ECON. 181, 188 (2004) (arguing that empirical analysis suggests that in states in which natural resources are the primary source of revenue the desire to gain access to the resources can “promote rent-seeking competition” and “induce economic agents to bribe the administration in order to gain access” to the rents).

11. See Aaron Tornell & Philip R. Lane, *The Voracity Effect*, 89 AM. ECON. REV. 22, 42 (1999) (arguing that, where political and legal institutions are weak, competition for resource rents can produce “a more-than-proportional increase in redistribution” of wealth from resource rents).

12. For a limited exception, see Anders Aslund, *The Truth About Sovereign Wealth Funds*, FOREIGN POL'Y, Dec. 2007, at [http://www.foreignpolicy.com/story/cms.php?story\\_id=4056](http://www.foreignpolicy.com/story/cms.php?story_id=4056) (arguing that SWFs are often an inappropriate policy tool because they centralize economic decision making in the government rather than permitting citizens to make their own investment decisions).

What is missing from the current debate about SWFs is a theory that makes sense of their dual public/private missions in a way that fully accounts for their domestic effects.<sup>13</sup> Without such a theory, there is no coherent account of how and why to regulate SWFs. For example, regulations that create incentives for SWFs to behave as private players may well make them less accountable to the citizens of the home country. Regulations that encourage SWFs to be accountable to citizens risk encouraging strategic behavior that might disrupt financial markets (and reduce returns).

To illustrate the problem, consider that some states with large SWFs are also the recipients of development assistance from other states. For example, in 2006, Algeria received just over \$208 million in development assistance from foreign governments.<sup>14</sup> During the same period, the government of Algeria controlled an SWF worth \$47 billion.<sup>15</sup> In 2006, Libya also received \$37 million in development assistance while controlling an SWF worth \$50 billion,<sup>16</sup> and Nigeria received \$11 billion in development assistance and controlled an SWF worth \$17 billion.<sup>17</sup>

The aid recipient/capital exporter anomaly shows the complicated nature of SWFs and the need for more scholarly attention to their dual roles as instruments of public policy and participants in private markets. First, consider the perspective of citizens of the aid recipient state. To them, such aid is both an indication that social problems exist and that their government is unable to meet those needs on its own. States traditionally accept development assistance reluctantly, and only to meet real

---

13. Anna Gelpern has proposed a taxonomy of issues relevant to the regulation of SWFs, including what she calls “[p]ublic internal accountability,” which she describes as the available domestic mechanisms to ensure that SWFs “further [a] domestic public purpose.” Anna Gelpern, *A Sovereign Wealth Turn* 6 (Rutgers Sch. of Law-Newark, Research Papers Series Paper No. 25, 2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1272395](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1272395).

14. Organisation for Economic Cooperation and Development, OECD.Stat Extracts, at <http://stats.oecd.org/wbos/index.aspx?datasetcode=table2a> (select “All Donors, total” under “Donor” menu; see “2006” column) (last visited Nov. 22, 2008) [hereinafter OECD Aid Statistics]. The dataset of aid statistics that I use throughout this Article comprises official development assistance provided in 2006 by members of the Development Assistance Committee, a forum of bilateral donors. See Organisation for Economic Cooperation and Development, Glossary of Statistical Terms, Development Assistance Committee (DAC), at <http://stats.oecd.org/glossary/detail.asp?ID=608> (last visited Sept. 12, 2008) [hereinafter OECD Glossary].

15. Truman, *supra* note 1, at 2 tbl. 1.

16. OECD Aid Statistics, *supra* note 14; Truman, *supra* note 1, at 2 tbl. 1.

17. OECD Aid Statistics, *supra* note 14; Truman, *supra* note 1, at 2 tbl. 1. A current estimate for the value of Nigeria’s SWF is \$11 billion. See Sovereign Wealth Fund Institute, Fund Rankings, Largest Funds by Assets Under Management, at <http://www.swfinstitute.org/funds.php> (last visited Nov. 22, 2008).

needs. For many poor states, particularly those with a history as a colony, the acceptance of development aid comes at a cost that is difficult to measure, but is often discussed in terms of eroded sovereignty or as a reduction in national pride.<sup>18</sup> That the state accepts development assistance is evidence that those in power recognize that there are unmet social needs.

Next, consider the perspective of aid donors. For donors, a state's acceptance of development aid is an indication that the recipient cannot, on its own, afford to meet the needs of its citizens. When the recipient of this largesse is also the steward of a multibillion dollar investment fund, donors may well ask whether their dollars would be better spent elsewhere. One way to interpret a state's decision to create a sovereign investment vehicle despite being the recipient of development aid is that the state's own government thinks that its development is a bad bet. If a government has decided that it is a better long-term investment to buy shares in foreign corporations than to build roads, provide basic education, or improve health care for its people, then why should foreign donors conclude that development aid is a good investment?

To this point, the debate regarding regulation of SWFs has mostly involved scholars focused on tax issues, corporate law, and national security.<sup>19</sup> But there is much that scholars of human rights and economic development can contribute to account for the impact of SWFs on recalcitrant regimes and vulnerable populations, which requires a focus on the domestic effects of SWFs on developing countries.

To fill this gap in the literature, I develop a theory of social arrears, defined as what a state owes its citizens and to determine whether an SWF is being used to pay this debt. I argue that to reconcile the dual public/private missions of SWFs, a government's unmet obligations to its citizens should be treated like unpaid debts to other creditors, which typically would constrain the government's investment options until the creditors are satisfied. By "social arrears," I mean the unmet social development needs that a state apparently has the resources to address but

---

18. See David N. Plank, *Aid, Debt, and the End of Sovereignty: Mozambique and its Donors*, 31 J. MOD. AFR. STUD. 407 (1993) (arguing that reliance on foreign aid has undermined the state's authority and sovereignty); see also PAUL NUGENT, *AFRICA SINCE INDEPENDENCE: A COMPARATIVE HISTORY* 326–35 (2004) (describing the reaction in Africa to the erosion of sovereignty associated with development programs).

19. See, e.g., Shams Butt et al., *Sovereign Wealth Funds: A Growing Global Force in Corporate Finance*, 19 J. APPLIED CORP. FIN. 73 (2007); Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. (forthcoming 2008), available at <http://ssrn.com/abstract=1234410>; David D. Stewart, *Sovereign Wealth Funds Take Advantage of IRS Ruling*, 49 TAX NOTES INT'L 829 (2008).

chooses not to. To help define social arrears and demonstrate the usefulness of the concept, I draw an analogy from the International Monetary Fund (IMF) policy regarding lending into arrears. This policy regulates the IMF's engagement with states that wish to borrow money from the IMF but are behind in their payments to other lenders. The IMF takes a policy position that its aid should go to development projects, not to servicing other debts. This policy does not amount to an outright ban on any engagement with states which are behind in their payments to other lenders, but it certainly creates an incentive for states to resolve their debt problems with other lenders if they want to receive assistance from the IMF.

With a theory of social arrears in place, I explore how the theory could inform public policy. I argue that before states with substantial social arrears are permitted to use international financial markets, those states should be required to pay their debts to their own citizens. If they do not do so, then those regimes should not be permitted to invest state money in the financial markets in London or New York while other states or international institutions provide development or humanitarian assistance to meet the social needs of citizens.

This theoretical approach and the specific policy measures I propose to implement it are consistent with current policies and regulations relating to financial markets. Despite rhetoric about the openness of financial markets and the increased mobility of capital, the United States and the European Union (EU) both treat access to financial markets as conditional, not obligatory. For example, entities that wish to use markets in the United States or the EU may do so only if their non-market behavior is consistent with the national interest of the state in question. In the United States, two categories of investors have been barred: those whose past actions demonstrate that they threaten national security and those who are associated with regimes accused of gross abuses of human rights. For example, Osama bin Laden's investments would be barred because he represents a threat to national security. Charles Taylor, the former president of Liberia who is accused of widespread human rights abuses in neighboring Sierra Leone, is barred from investing in U.S. markets because of his human rights record. In the EU, states are permitted by EU directive to define the conditions for themselves as long as the conditions fall under the national interest rubric.

This Article proceeds in four parts. In Part I, I lay out the empirical case showing that there are a number of states receiving windfall profits from the sale of commodities while also receiving development assis-

tance. I consider this anomaly and explore briefly whether this inconsistency among aid, investment, and security policies might be justifiable. I argue next that this inconsistency—whatever other justifications it might have—is easily addressed. In Part II, I consider three precedents from similar contexts that show ways in which states or international institutions have successfully regulated aid or foreign investments. To do this, I draw an analogy to the IMF's policy regarding lending into arrears, and I present and critique the various justifications for development assistance. In Part III, I develop a theory of social arrears to help identify when states are failing their citizens to such an extent that other states should take steps to reduce the harm. In Part IV, I describe how my proposal might be implemented in practical terms, including the legal mechanisms through which this proposal could be put into force. In addition, I anticipate and address several possible objections to the theory of social arrears.

#### I. THE PROBLEM: SOVEREIGN WEALTH FUNDS, CONCENTRATED WEALTH, AND SOCIAL WELFARE

One of the principal reasons that SWFs have sparked concern among scholars and policymakers is their perceived lack of transparency,<sup>20</sup> though the arguments in favor of transparency sometimes vary. Some scholars have argued that the failure of most SWFs to disclose their investment strategies and the metrics by which they will measure performance makes it difficult for central bankers, investors, and other market participants to make informed decisions.<sup>21</sup> For example, if an SWF measures performance using both economic and political metrics, the SWF's interest in a corporation may stem from the government's desire to control that corporation even if it loses money. A separate concern regarding transparency is that the lack of transparency may cause states fearing market forces are insufficient to discipline SWFs to adopt unnecessarily stringent regulations.<sup>22</sup> Such regulations might have the effect of artificially reducing the capital available to corporations and entrepreneurs, thereby slowing growth or reducing the ability of the fi-

---

20. See, e.g., Stewart, *supra* note 19, at 829 (2008) (reporting a wide range of transparency concerns among members of Congress).

21. See INT'L MONETARY FUND, *supra* note 9, at 16–17 (“[A]bsence of SWF data can hinder economic analysis and potentially mislead policymakers, market participants, and other commentators about a country's economic performance.”).

22. See Butt et al., *supra* note 19, at 82–83 (2007) (noting that some in the financial community fear an increase in protectionist policies in response to transparency and security concerns).

financial markets to recover from a liquidity crisis (such as the current mortgage-related crisis in the United States).

Regardless of whether these concerns turn out to be reasonable, they ignore the risk that SWFs will become a source of what I have previously called “unconditioned wealth.”<sup>23</sup> As I use the term, unconditioned wealth is wealth received by states unaccompanied by strong political or market requirements. Unconditioned wealth has several characteristics.<sup>24</sup> First, it is concentrated in the hands of a small number of people. For example, in Angola, a small coterie of elites receives and has almost complete control over that country’s vast oil wealth.<sup>25</sup> The second condition depends in part on the first: those who control the wealth are not politically accountable to an engaged, informed electorate. In some states, the lack of political accountability is both a cause and an effect of unconditioned wealth.<sup>26</sup> In states where the only way to accumulate wealth is through politics, unconditioned wealth can provide politicians with the resources they need to hold onto power against their challengers. Third, unconditioned wealth is not subject to the discipline that the financial markets impose on other forms of wealth.<sup>27</sup> This is, of course, a form of a common principal-agent problem. When those who manage wealth know that the principals on whose behalf they manage it have no means to hold them accountable, it should come as no surprise that the managers act in their own interests and not in the interests of the supposed principals.

#### A. *States as Aid Recipients and Capital Exporters*

States whose citizens need development and humanitarian assistance even while their leaders invest abroad via SWFs highlights the gulf that

---

23. See Patrick J. Keenan, *Curse or Cure? China, Africa, and the Effects of Unconditioned Wealth*, 27 BERKELEY J. INT’L L. (forthcoming 2008), available at [http://works.bepress.com/cgi/viewcontent.cgi?article=1003&context=patrick\\_keenan](http://works.bepress.com/cgi/viewcontent.cgi?article=1003&context=patrick_keenan).

24. *Id.*

25. See HUMAN RIGHTS WATCH, *SOME TRANSPARENCY, NO ACCOUNTABILITY: THE USE OF OIL REVENUE IN ANGOLA AND ITS IMPACT ON HUMAN RIGHTS* 16–17 (2004) (describing centralization of control over oil revenue and failures to account for the revenue). The Human Rights Watch report was based on data uncovered by the IMF during its 2002 and 2003 consultations with Angola. *Id.* at 36 n.76.

26. See HUMAN RIGHTS WATCH, *WORLD REPORT* 76–81 (2008) (describing the Angolan government’s attempts to retain power through political violence and press restrictions, among other means).

27. See Ian Taylor, *China’s Relations with Nigeria*, 96 ROUND TABLE: COMMONWEALTH J. INT’L AFF. 631, 635 (2007) (describing production sharing contracts, which often permit host country governments to avoid market scrutiny or discipline).

often lies between those in power and citizens in poor states. In this Section, I show that there are states that are simultaneously capital exporters and aid recipients. For example, in 2006, Nigeria received \$11 billion in official development assistance.<sup>28</sup> At the same time, Nigeria's Excess Crude Account, a government-controlled fund created to invest the country's vast oil revenue, has approximately \$17 billion in assets under its management.<sup>29</sup> As Table 1 shows, Nigeria is not alone. A number of states both receive official development assistance and, at the same time, possess millions or billions of dollars in their SWFs.

---

28. OECD Aid Statistics, *supra* note 14.

29. Truman, *supra* note 1, at 2 tbl. 1.

TABLE 1

Country	Official Development Assistance <sup>30</sup> (current dollars, in millions)	SWF Assets under Management <sup>31</sup> (current dollars, in millions)
Algeria	208.3	47,000
Angola	170.7	1,000
Azerbaijan	205.6	10,200
Botswana	65.6	6,900
Chile	83	21,300
China	1,237.6	585,600
Iran	121	12,900
Kazakhstan	171.8	38,000
Libya	37.3	50,000
Malaysia	240.2	25,700
Mauritania	190.2	300
Nigeria	11,431.8	11,000
Oman	34.6	8,200
São Tomé & Príncipe	21.5	20
Timor-Leste	209.3	3,200
Trinidad and Tobago	13.4	2,400
Venezuela	56.7	800
Vietnam	1,845.5	2,100

Before moving on, it is important to make two brief observations about the data presented in Table 1. The second column contains the figures for official development assistance, which is just one kind of aid that states provide to other states.<sup>32</sup> Official development assistance is a useful indicator in this context because it is money ostensibly dedicated

30. OECD Aid Statistics, *supra* note 14.

31. The figures in this column come from Sovereign Wealth Fund Institute, *supra* note 17, with the exception of the figures for Angola and São Tomé & Príncipe. The figure for China does not include the China-Africa Development Fund or the Hong Kong Monetary Authority Investment Portfolio. The figure for Angola comes from JPMORGAN RESEARCH, SOVEREIGN WEALTH FUNDS: A BOTTOM-UP PRIMER 69 (2008), available at [http://www.econ.puc-rio.br/Seminario/textos\\_preliminares/SWF22May08.pdf](http://www.econ.puc-rio.br/Seminario/textos_preliminares/SWF22May08.pdf). The figure for São Tomé & Príncipe comes from Truman, *supra* note 1, at 2 tbl. 1.

32. See OECD Glossary, *supra* note 14. The OECD describes official development assistance as grants or loans “administered with the promotion of the economic development and welfare of developing countries as the main objective.” *Id.*

to improving social welfare in the recipient state. It does not include military assistance or private sector investments, for example. Although there is robust scholarly debate about the many motivations that might explain the provision of development assistance, one important reason is to help the recipient state develop its economy and society.<sup>33</sup> Particularly because the amount of development assistance does not include other forms of aid, it can be interpreted as a rough approximation of the amount of help a state needs. Put more bluntly, it is a form of charity—perhaps provided for selfish reasons and put to inefficient uses—and states that do not need it typically do not accept it.

The third column shows the amount of money, in dollars, that is controlled by the SWFs for each state. The term “sovereign wealth fund” captures a variety of investment vehicles that may pursue different investment strategies, raise funds from different sources, and be subject to differing levels of oversight. Scholars are devoting considerable attention to sorting out these issues, but to date there is not a single agreed upon definition of the term. Nonetheless, the broad outlines of the term are clear. SWFs are investment vehicles set up by a state, funded with state resources, and managed with the goal of achieving a market rate of return.<sup>34</sup> The data in the third column were collected according to this broad definition of SWFs.

#### *B. Conventional Justifications for Development Assistance and Sovereign Wealth Funds*

The purpose of a theory of social arrears is to define when states are failing their own citizens, even when they have the means to do better. Identifying when this situation occurs should help policymakers determine when SWFs should be encouraged or discouraged. I argue that when states are in arrears to their own citizens, it should be difficult for the ruling regime to create an investment vehicle to further concentrate wealth in its own hands. To the extent that my argument can be interpreted as an argument in favor of constraining a state’s ability to set its own path toward economic development, it is important have a coherent account of the reasons that states provide development assistance and the reasons that states create SWFs. At their most basic, the justifications for accepting development assistance and for creating SWFs are the same: to improve the welfare of the citizens of the recipient state.

---

33. See *infra* Part I.B.1.

34. See Beck & Fidora, *supra* note 3, at 6 (noting the lack of a “commonly accepted definition” but providing a list of characteristics that help to describe an SWF).

My theory and the means I propose to implement it are at least theoretically justified, because it would create an incentive for poor country governments to invest in their own countries and remove incentives for the leaders of commodity-rich states to act in ways that benefit themselves but not the nation.

### 1. *Development Assistance*

Scholars and policymakers typically advance one of two general arguments to explain why wealthy states provide development assistance to poorer states. The first is that aid is provided as a form of state policy with the goal of influencing the recipient state. This account—sometimes stated normatively, sometimes descriptively—holds that states simply cannot justify intentionally reducing their own short-term welfare by giving away money without at least the hope of improving their long-term welfare by advancing strategic or economic objectives.<sup>35</sup> President Richard Nixon perhaps stated the normative argument most clearly: “[R]emember that the main purpose of American aid is not to help other nations but to help ourselves.”<sup>36</sup> Alberto Alesina and David Dollar, among others, have found empirical support for the descriptive claim.<sup>37</sup> In a study of the distribution of foreign assistance, they found that political considerations are more predictive of the allocation of development assistance than economic considerations.<sup>38</sup> For example, they found that “a non-democratic former colony gets about twice as much aid as a democratic non-colony” and that considerations such as “voting patterns in the United Nations explain more of the distribution of aid than the political institutions or economic policy of recipients.”<sup>39</sup>

The second justification for providing development assistance is typically stated in terms of morality or beneficence.<sup>40</sup> Under this ap-

---

35. See NICHOLAS EBERSTADT, *FOREIGN AID AND AMERICAN PURPOSE* 135 (1988) (arguing that the purposes of American foreign aid are “to augment American political power throughout the world” and to “support the postwar liberal international economic order that the United States helped create and is committed to preserving”).

36. Brian R. Opeskin, *The Moral Foundations of Foreign Aid*, 24 *WORLD DEV.* 21, 21 (1996) (quoting TERESA HAYTER, *THE CREATION OF WORLD POVERTY* 83–84 (1990)).

37. See generally Alberto Alesina & David Dollar, *Who Gives Foreign Aid to Whom and Why?*, 5 *J. ECON. GROWTH* 33, 33 (2000) (“We find considerable evidence that the pattern of aid giving is dictated by political and strategic considerations.”).

38. *Id.* at 55 (finding that aid allocations “may be very effective at promoting strategic interests, but the result is that bilateral aid has only a weak association with poverty, democracy, and good policy”).

39. *Id.*

40. There is, of course disagreement among philosophers about whether the provision of for-

proach, wealthy states should provide assistance to poor states or their inhabitants simply because the needs of the poor are great and the costs to the wealthy are relatively insignificant.<sup>41</sup> Regardless of which justification for the provision of aid is more powerful, there is broad consensus on what recipient states should do with the aid they receive. Realists and humanitarians alike expect that, at the very least, development assistance will be used to improve the welfare of the inhabitants of the recipient state. They may well have different predictions or expectations regarding the additional effects of aid, but aid providers expect that it will be used to improve welfare.<sup>42</sup>

## 2. *Sovereign Wealth Funds*

Investment vehicles that are funded and controlled by states are not a new phenomenon, but their recent growth has been nothing short of staggering,<sup>43</sup> driven in large measure by current account surpluses and increasing commodity prices.<sup>44</sup> As scholars and policymakers have begun to examine sovereign investments more closely, they have developed a number of ways to categorize state-controlled investment vehicles. Robert Kimmitt proposes a taxonomy based on the source of funds and the entity's investment strategy.<sup>45</sup> Kimmitt identifies four types of state-controlled entities: "international reserves, public pension funds, state-owned enterprises, and [sovereign wealth funds]."<sup>46</sup> On this account, SWFs are funded by excess foreign exchange reserves (beyond the amount the state needs as insurance against a currency crisis or a steep drop in demand for its exports) or from revenue from commodities. Typically, SWFs are managed with a greater tolerance for risk than would be true for a pension fund or traditional currency reserve.<sup>47</sup>

---

eign aid constitutes a moral duty, based in ideas of justice, or an act of charity, which is praiseworthy but not required. See Opeskin, *supra* note 36, at 23 (describing at least four principal approaches to understand the moral dimensions of foreign assistance).

41. See JOHN DEGNBOL-MARTINUSSEN & POUL ENGBERG-PEDERSEN, *AID: UNDERSTANDING INTERNATIONAL DEVELOPMENT COOPERATION* 10–12 (2003) (describing various moral and humanitarian arguments in favor of foreign assistance).

42. See generally Carl-Johan Dalgaard et al., *On the Empirics of Foreign Aid and Growth*, 114 *ECON. J.* F191, F193–97 (2004) (surveying theories of growth and aid).

43. See MIRACKY ET AL., *supra* note 5, at 7 (noting that, in 2007, SWFs "invested \$92 billion in publicly-recorded equity transactions, compared with just \$3 billion in 2000").

44. See Butt et al., *supra* note 19, at 73 ("[G]lobal foreign-exchange reserves have [increased] by 140% over the past five years . . .").

45. See Robert M. Kimmitt, *Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy*, *FOREIGN AFF.*, Jan.–Feb. 2008, at 119.

46. *Id.* at 120.

47. See Butt et al., *supra* note 19, at 74 ("SWFs . . . are generally managed with a higher risk

The principal argument in favor of SWFs is that they permit governments with large pools of capital to earn a higher return than would be available if they invested solely in, for example, U.S. Treasury bonds. For resource-rich states, two possible benefits are particularly salient. The first is that SWFs have the potential to “help ensure continued prosperity for citizens” even after a nonrenewable resource such as oil has been fully exploited.<sup>48</sup> SWFs can also help resource-dependent states avoid the economic consequences of fluctuations in commodity prices. Although it has appeared recently that oil and other commodity prices are a one-way ratchet, there have been a number of commodity busts in recent decades that had devastating effects on the domestic economies of producer nations.<sup>49</sup> By diversifying the state’s portfolio, an SWF can help smooth out the bumps that will inevitably arise in single-source economies. In the end, the arguments in favor of SWFs all focus on their potential to improve the lives of people living in the states that create such funds.

The emergence of SWFs has sparked lively discussion among scholars and policymakers regarding the likely effects of SWFs on the global economy, states on the receiving ends of their investments, and states that control SWFs.<sup>50</sup> For most observers, the principal concern is that SWFs will make investments in pursuit of political, not economic, goals. Part of the reason for this concern is that most SWFs do not fully disclose their holdings, investment criteria, and management rules. In the absence of information, it is possible to imagine that a state might create an SWF with multiple objectives, both strategic and economic. In this context it is perhaps not surprising that when Dubai Ports World (DPW) sought to take a controlling interest in the company that operates most of the ports in the United States, there was great public outcry. DPW’s protestations notwithstanding, many observers feared that the purchase might have been pursued for political and economic reasons.<sup>51</sup>

---

tolerance than official foreign exchange reserves . . .”).

48. *Id.* at 78.

49. See generally Mohammad A. Razzaque et al., *The Problem of Commodity Dependence*, in COMMODITY PRICES AND DEVELOPMENT 7, 11–13 (Roman Grynberg & Samantha Newton eds., 2007).

50. See generally INT’L MONETARY FUND, *supra* note 9 (summarizing the issues raised by the emergence of SWFs); MICHAEL F. MARTIN, CHINA’S SOVEREIGN WEALTH FUND (Cong. Research Serv., CRS Report for Congress Order Code RL 34337, Jan. 22, 2008), available at <http://www.fas.org/sgp/crs/row/RL34337.pdf> (summarizing issues relating to SWFs and possible areas of Congressional action).

51. See David E. Sanger, *Under Pressure, Dubai Company Drops Port Deal*, N.Y. TIMES, Mar. 10, 2006, at A1.

Although the concern that states will use economic means to achieve strategic ends remains a central theme of the debate about whether, how, and why to regulate SWFs, it is not the only worry.

A related concern is that states will use SWFs to manipulate their currency or engage in some other mischief in global financial markets. Lawrence Summers, for one, has indicated that one reason that SWFs have garnered so much attention is that, given their increasing size, they might be used to “assert political pressure on a government to rescue a bank they have invested in” or launch a “‘speculative attack’ on another country’s currency.”<sup>52</sup> A final area of concern arises due to the opaque nature of most SWFs. Because they do not release the same types and quantity of information as other investment entities, the “absence of SWF data can hinder economic analysis and potentially mislead policymakers [and] market participants.”<sup>53</sup>

### C. *Connecting Concentrated Sovereign Wealth and Social Welfare*

SWFs are a mechanism by which states with a single source of income can convert that income into long-term development.<sup>54</sup> One problem faced by any country that derives the majority or more of its income from the sale of a single commodity is finding a way to convert that income into long-term, more secure wealth before the commodity runs out.<sup>55</sup> For example, if a country depends on the sale of timber as its primary source of income, the managers of that commodity know that sooner or later the timber industry will slow down or the country’s supply of timber will start to contract. The same is true for countries that derive most of their income from the sale of oil, natural gas, diamonds, or any other nonrenewable commodity. Converting a single source of income into long-term development is the goal of many states in the Persian Gulf, for example. Dubai is perhaps the most prominent example, with its strategy of diversifying its economy from an oil-reliant

---

52. Steven R. Weisman, *Sovereign Wealth Funds Resist IMF Attempts to Draft Code of Conduct*, INT’L HERALD TRIB., Feb. 9, 2008, at 11, available at <http://www.iht.com/articles/2008/02/09/business/fund.4-219755.php>.

53. INT’L MONETARY FUND, *supra* note 9, at 16.

54. See, e.g., *id.* (arguing that SWFs can “facilitate the saving and intergenerational transfer of proceeds from nonrenewable resources and help reduce boom and bust cycles driven by changes in commodity export prices”).

55. See, e.g., John Rowse, *Using the Wrong Discount Rate to Allocate an Exhaustible Resource*, 72 AM. J. AGRIC. ECON. 121 (1990) (describing the management challenges associated with the extraction of nonrenewable resources).

economy to an economy that depends on financial services, tourism, and other sectors.<sup>56</sup>

Under certain conditions, SWFs have the potential to be a form of unconditioned wealth and one that Western governments and market participants sustain unintentionally. The wealth created from SWFs can be compared with the revenues that come from the sale of natural resources.<sup>57</sup> In resource-rich states, particularly those with weak domestic political institutions, citizens rarely benefit from the state's resources. Other things equal, states that rely heavily on oil or mineral revenue tend to be less democratic than other states,<sup>58</sup> because resource wealth can lead to an increase in rent-seeking behavior in the form of attempts to bribe those in power.<sup>59</sup> Resource-rich states are thus less likely to become democratic and more likely to have sustained autocratic rule.<sup>60</sup> Underlying this is the fact that the presence of resource wealth (as opposed to other forms of wealth) increases the payoff from holding power.<sup>61</sup> Politician-managers have a strong incentive to use wealth to hold onto power rather than to develop the state.<sup>62</sup>

With very few exceptions,<sup>63</sup> the concerns raised about SWFs all relate to the potential for these funds to disrupt the global financial mar-

---

56. See generally UGO FASANO & ZUBAIR IQBAL, *GCC COUNTRIES: FROM OIL DEPENDENCE TO DIVERSIFICATION* (2003) (surveying attempts by Bahrain, Dubai, and other states in the United Arab Emirates to diversify their economies away from oil).

57. I present a much fuller version of this argument in Keenan, *supra* note 23.

58. See Michael L. Ross, *Does Oil Hinder Democracy?*, 53 *WORLD POL.* 325, 346 (2001) (arguing, based on empirical study, that "a state's reliance on either oil or mineral exports tends to make it less democratic").

59. See Elissaios Papyrakis & Reyer Gerlaugh, *The Resource Curse Hypothesis and Its Transmission Channels*, 32 *J. COMP. POL.* 181, 188 (2004) (arguing that the presence of natural resources and weak domestic institutions creates incentives for people to attempt to bribe those in power to gain access to the resource revenue).

60. See Jay Ulfelder, *Natural-Resource Wealth and the Survival of Autocracy*, 40 *COMP. POL. STUD.* 995, 996 (2007) (arguing, based on empirical study, that resource wealth is positively associated with autocratic forms of government and negatively associated with transition to democracy).

61. See Silje Aslaksen & Ragnar Torvik, *A Theory of Civil Conflict and Democracy in Rentier States*, 108 *SCANDINAVIAN J. ECON.* 571, 584 (2006) (showing that the presence of resource wealth increases the payoff associated with holding power).

62. See Aaron Tornell & Phillip R. Lane, *The Voracity Effect*, 89 *AM. ECON. REV.* 22, 42 (1999) (arguing that where domestic institutions are weak, resource wealth is associated with greater redistributions of wealth from economically efficient activities to economically inefficient but politically useful activities).

63. The most notable exceptions are Gelpern and Truman. In her taxonomy of accountability concerns for SWFs, Gelpern notes, "Public internal accountability . . . must be achieved within the political system of the capital-exporting state." Gelpern, *supra* note 13, at 6. Truman notes that one concern about SWFs should be the risk that "governments may mismanage their international investments to their own economic and financial detriment." Truman, *supra* note 1, at 3.

kets or the states on the receiving end of investments.<sup>64</sup> What is left out is a fully developed recognition of the potential domestic effects of SWFs. I discuss this notion in the following Parts II and III.

## II. BENEFITS FOR THOSE IN DEBT TO OTHERS: AN ANALOGY TO THE IMF'S POLICY ON LENDING INTO ARREARS

SWFs serve both public and private purposes, and they answer to public and private masters. On the private side, SWFs are similar to many other investment funds: their purpose is to maximize the return to shareholders and serve as a source of capital in the markets. They answer to regulators in the markets in which they do business and to the shareholders and managers of the enterprises in which they invest. On the public side, the most compelling purpose of SWFs is to improve social welfare in their home states; their public-side masters are the people for whose benefit they exist. The current literature on SWFs is largely devoted to consideration of private-side issues, such as the likely effect on the capital markets of one form of regulation or another, or the justifications for taxing (or not taxing) SWFs in host states.<sup>65</sup> One weakness of the current literature is that there is no coherent account of public-side issues. How can people in states with SWFs ensure that such funds actually improve domestic social welfare? Another weakness of the current literature is that it lacks a coherent account of how the potential for public-side regulation might help accomplish private-side objectives. Put another way, is there a way to use private-side regulation to make it more likely that SWFs will fulfill their domestic obligations?

To get some traction on these issues, I draw an analogy to the IMF's policy on lending into arrears, which regulates the circumstances under which a state may benefit from the assistance of the IMF if that state is in debt to private creditors.<sup>66</sup> The IMF's policy attempts to balance its goals of assisting states in distress (and stabilizing these states' economies) with its desire not to pour money into states that have defaulted

---

Even while suggesting this concern, Truman notes that the harm from such behavior is likely to be "negative consequences for the global economic and financial system, including large-scale corruption in handling the huge amounts of money involved." *Id.*

64. See, e.g., Truman, *supra* note 1; *The Invasion of the Sovereign-Wealth Funds*, *supra* note 1; Peter Navarro, Op-Ed., *Sovereign Wealth Funds: China's Potent Economic Weapon*, CHRISTIAN SCI. MONITOR, Feb. 8, 2008, at 9; Beck & Fidora, *supra* note 3.

65. See Fleischer, *supra* note 19 (arguing that SWFs should not receive the preferential tax treatment afforded to other state economic activity).

66. See generally International Monetary Fund, IMF Policy on Lending into Arrears to Private Creditors (1999), at <http://www.imf.org/external/pubs/ft/privcred/lending.pdf>.

on their obligations to other creditors. By monitoring arrears, the IMF has the ability to determine whether its beneficiaries are fulfilling their domestic obligations.

Examining the evolution of the IMF's policy yields important lessons about ways to address arrears, which, taken together, can point the way toward a workable approach to handling arrears in other contexts. The first and most basic lesson to draw from the IMF's experience is that defining arrears is more difficult than it might initially seem. The evolution of the IMF's policy shows flexibility on each element of arrears: obligation and tardiness. A workable policy on arrears must consider *to whom* debts are owed, not simply whether there are debts. At first, the policy covered only arrears to private creditors.<sup>67</sup> Today the policy covers arrears to private creditors and on bonded debt.<sup>68</sup> The second lesson is that the decision whether to lend into arrears—regardless of how the term is defined—does not depend solely on whether a state is creditworthy. The history of the IMF's policy shows an increasing interest in the process by which debtor states resolve their credit problems. The IMF requires states that seek loans notwithstanding arrears to private creditors to demonstrate not only that they are working toward a resolution of the private debt but that they are operating in “good faith” as they work out their credit problems. Third and finally, the IMF's support depends on the results of the debtor state's negotiations with its private creditors and on the state's willingness to make necessary changes to its financial and economic policies. In practice, this means that the IMF is able to exercise more influence over the debtor state's internal policies than would otherwise be possible.

The basic concept of arrears is simple. For example, the IMF defines “arrears” as “debt, either domestic or external, resulting from payments not being made when due.”<sup>69</sup> This definition incorporates two important

---

67. See Int'l Monetary Fund [IMF], *Arrears to Creditors and Debt Strategy*, Dec. No. 3153–(70–95) (Oct. 26, 1970), reprinted in Lee C. Buchheit & Rosa M. Lastra, *Lending into Arrears—A Policy Adrift*, 41 INT'L LAW. 939, 940 n.2 (2007) (defining IMF policy regarding lending to states in default to private creditors).

68. See International Monetary Fund, *supra* note 66, at 6–7 (presenting the rationale for the IMF's decision to include bonded debt in the lending into arrears policy).

69. International Monetary Fund, Glossary of Selected Financial Terms, Arrears, at <http://www.imf.org/external/np/exr/glossary/showTerm.asp#95> (last visited Sept. 25, 2008). The full definition reads as follows: “Arrears: A stock of outstanding debt, either domestic or external, resulting from payments not being made when due. Arrears of the government may arise, for example, from a failure to pay interest or amortization obligations when due or when there is a delay in paying bills to contractors, wages to civil servants, or retirement benefits to pensioners beyond the date that these payments are legally obligated to be made.” *Id.*

elements that are uncontroversial in most contexts but require some consideration to be useful for my purposes. The first element is that there is some obligation to make the payment. Arrears arise when required payments are not made. Absent some other consideration, the failure to make some other kind of transfer—relief from foreign debt, for example—would not give rise to arrears. The second element is that the payment is past due. Not all debts qualify; only those that remain owed after their due date amount to arrears. Much of international economic law is concerned with managing, resolving, or avoiding the myriad disputes that might arise when states, firms, and individuals incur and collect debts, including past due debts.<sup>70</sup> Most important for my theory, however, is the law and policy relating to the provision of benefits to entities that are in arrears to others.

Before moving on, it is useful to preview how the IMF analogy relates to my theory, partly to show its utility and partly to acknowledge that it is an imperfect comparison. The IMF's policy regarding lending into arrears is primarily a means to avoid harm to the IMF. As I show below, the original legal basis for the IMF's policy was the provision of its charter requiring it to safeguard its resources. To be sure, the policy has evolved significantly since then, but the basic goal remains: avoid lending money to states that appear unlikely to repay it.<sup>71</sup> Consider an example from Argentina. In 2001, after several attempts to restructure its debt to private creditors to avoid default, Argentina was unable to service its foreign bonds and the IMF cut off further distributions.<sup>72</sup> One of the IMF's stated goals was to protect its resources—to avoid pouring more money into Argentina without some indication that the money would be repaid. Standing in the way of repayment were Argentina's debts to private creditors, which were treated as constraining obligations. The IMF did not suggest that Argentina ignore these debts or treat

---

70. The issues surrounding sovereign debt are not new, despite the work done by the IMF and other institutions, and not fully resolved. For a useful history of sovereign debt crises, see Ross P. Buckley, *Why are Developing Nations So Slow to Play the Default Card in Renegotiating their Sovereign Indebtedness?*, 6 CHI. J. INT'L L. 345, 346–52 (2005) (tracing the history of sovereign defaults from the sixteenth century to the early years of the twenty-first century). For an analysis of many of the policy questions relating to sovereign debt and default, see generally Prasanna Gai et al., *Crisis Costs and Debtor Discipline: The Efficacy of Public Policy in Sovereign Debt Crises*, 62 J. INT'L ECON. 245 (2004) (developing an econometric model to identify optimal policy responses to sovereign debt crises).

71. See International Monetary Fund, *supra* note 66, at vii (stating that, despite the need for changes in policy, the new policy must provide “adequate safeguards for the use of the Fund's resources”).

72. Anna Gelper, *After Argentina* 2–3 (Rutgers Sch. of Law-Newark, Research Paper No. 011, 2005), available at <http://www.ssrn.com/abstract=880794>.

their repayment as virtuous but not required. Instead, the IMF recognized that Argentina could not avoid accounting for the debts as it sorted out its credit problems. To be clear, I do not suggest that the IMF insisted that Argentina repay every dollar that it owed. The reasons that the IMF and others gave such weight to Argentina's private debts were complicated and surely were grounded as much in raw political economic calculus as in the law of contract. But regardless of the reasons that the private debts were accorded such importance, the fact remains that they were and accounting for them was an important part of Argentina's recovery.

The IMF's treatment of arrears helps to show how existing obligations can operate as useful constraints on behavior. A hypothetical example shows how this concept can be extended in the case of a country that uses SWFs. Imagine that Argentina has a surplus of currency reserves that it wishes to invest abroad through an SWF. Simultaneously, most people in Argentina are impoverished, there are few paved roads, and the majority of people lack access to potable water and basic health care. Political institutions are sufficiently weak that there is little that citizens can do to influence government policy. Under my theory, these conditions would amount to arrears, and a prohibition on the provision of benefits to sovereigns in the face of social arrears would prohibit Argentina's SWF from investing abroad. The goal of the policy would be to protect the interest of the people of Argentina by requiring the government to attempt to satisfy basic domestic needs before investing abroad. With respect to social arrears, what is missing is a reason to treat them as constraining obligations—factors that must be addressed as part of any program of recovery or development.

The IMF analogy, in addition to showing the potential value of treating existing obligations as constraints on behavior, is useful in another way as well. One way to frame the IMF's involvement with a state is that it is conferring a benefit on the recipient state. Its concern for arrears is grounded in its interest in ensuring that the benefit is not wasted. Another reason for its attention to arrears—one which, as I show below, has become increasingly prominent—is its interest in policy coherence. If the goal of IMF involvement is to help states improve domestic social welfare, then the IMF must have some way to determine if this is occurring and how the IMF's policies have affected the state's behavior. Similarly, when a state allows other states access to its capital markets or to invest in its corporations, that state is conferring a benefit on other states. If the proceeds of such investments provide the ruling regime

with tools to hold onto power illegitimately or to abuse its citizens, then the benefits have been wasted. This is particularly important for those states that provide development assistance. Their goal is to improve welfare in aid recipient states, and any evidence that their money is being wasted should be a cause for concern. When there is systematic waste—or the potential for it—then the donor state’s policy is incoherent and unlikely to succeed.

A. *Early Policy: Safeguarding the IMF’s Resources*

When the IMF promulgated its first policy regarding arrears in 1970, it permitted loans to states in arrears only in very limited circumstances and only if the state had in place a program to eliminate the arrears within a fixed period of time.<sup>73</sup> The policy had two principal objectives. The first was to protect the IMF’s resources, consistent with Article V of the IMF’s Articles of Agreement, which required the IMF to adequately safeguard its resources.<sup>74</sup> From a banking standpoint, the IMF’s policy was entirely rational—“IMF lending to a member country with arrears was considered inconsistent” with the requirement that the IMF establish adequate mechanisms to safeguard its resources.<sup>75</sup> The second objective of the policy was to ensure that states did not impose inappropriate currency restrictions because of their potential to undermine the state’s “perceived creditworthiness”<sup>76</sup> and because of the potential to interfere with “the smooth functioning of the international payments system.”<sup>77</sup>

In 1980, the IMF modified its policy to lengthen the time during which debtor states would be permitted to eliminate arrears (and still qualify for IMF loans) and to acknowledge that some states might need to renegotiate their outstanding debts.<sup>78</sup> The IMF’s early policy proved inadequate to respond to the Latin American debt crisis of the 1980s, as

---

73. Throughout this Section, my discussion of the evolution of the IMF’s policy on lending into arrears draws on the comprehensive history and thorough analysis in Buchheit & Lastra, *supra* note 67, at 939. Lee Buchheit and Rosa Lastra argue that the IMF’s rules regarding arrears has drifted away from the original purposes of the IMF and the arrears policy. *Id.* at 952.

74. Articles of Agreement of the International Monetary Fund art. V, Dec. 27, 1945, 60 Stat. 1401, 2 U.N.T.S. 39, available at <http://www.imf.org/external/pubs/ft/aa/aa.pdf>.

75. Buchheit & Lastra, *supra* note 67, at 941.

76. *Id.*

77. IMF, *supra* note 67, at 940 n.2.

78. IMF Executive Board Meeting 80/154, Oct. 17, 1980, *Review of Fund Policies and Procedure on Payments Arrears* (June 30, 2006), available at <http://www.imf.org/external/pubs/ft/sd/index.asp?decision=EBM/80/154>; see also Buchheit & Lastra, *supra* note 67, at 942 (discussing the implications of the 1980 modifications).

states in desperate need of assistance had accrued substantial debts and arrears. Part of the problem was that the IMF's arrears policy had the effect of "pressuring sovereign debtors to settle with private creditors to gain access to IMF funds."<sup>79</sup> Thus the unintended consequence of the IMF's desire to safeguard its funds and assist states in crisis was to make those states even more vulnerable to the vicissitudes of the private markets.

*B. Recent Policy: Influencing Negotiations and Internal Policies*

After the debt crisis in Latin America exposed important weaknesses in its arrears policy, the IMF modified the policy. In 1989, the IMF adopted a policy that would permit it to provide loans to states if they were in arrears to commercial banks.<sup>80</sup> This shift in policy was intended to reduce the leverage that commercial banks had over sovereign debtors by preventing banks from negotiating unfairly with states desperate for assistance from the IMF. The new policy amounted to a move toward influencing the conduct of negotiations between debtor states and creditor banks by shifting bargaining power from banks to states.<sup>81</sup> In 1998, the IMF modified its arrears policy again, this time permitting lending into arrears only when there was evidence that the debtor state and the creditor bank were negotiating in "good faith."<sup>82</sup> As it now stands, the IMF's policy requires it to judge the fairness of the negotiations as a precondition to providing assistance to states in distress.<sup>83</sup> This shows that the IMF approach has as much to do with shaping policy that affects the welfare of states in need of assistance as with protecting the IMF's assets.

### III. SOCIAL ARREARS: A THEORY OF DOMESTIC OBLIGATIONS

What do states owe their citizens? Arriving at an answer to this question can help sort out the public and private claims on SWFs. When the

---

79. Gelpert, *supra* note 72, at 9 box 3.

80. See International Monetary Fund, *supra* note 66, at 1 (describing 1989 changes in arrears policy).

81. See Buchheit & Lastra, *supra* note 67, at 945 ("[T]he primary motivation of the 1989 shift in LIA [lending into arrears] policy was to neutralize the ability of private creditors to use the IMF's 'no arrears' rule as negotiating leverage over sovereign debtors.").

82. International Monetary Fund, *supra* note 66, at 1 (describing 1998 changes in arrears policy).

83. See Gelpert, *supra* note 72, at 9 (arguing that the new policy puts the IMF in the position of "evaluating the quality of a country's dialogue with its creditors").

IMF assesses the creditworthiness of a state seeking its assistance, one factor it must consider is the state's indebtedness to other creditors. In the conventional model, the issue of arrears becomes relevant when a state cannot fulfill its obligations to private creditors but nonetheless wishes to receive further benefits. My aim is to use this basic framework to fashion a theory that accounts for a new reality, where states are sufficiently wealthy to export capital, but whose citizens live in such poverty and deprivation that other states provide charitable assistance. In the conventional model of arrears—most fully developed by the IMF—the foundational elements are obligation and tardiness. The debtor must be obligated to repay, and the agreed upon period for repayment must have passed. In my theory of social arrears, I include these elements and add the element of capacity, by which I mean that the state in question must have the resources to address the social needs of its citizens. In this Part, I argue that the elements of obligation, tardiness, and capacity can form the basis of a theory of social arrears. In addition, I show that all three elements have solid foundations in international law. My goal in doing so is not to show that my theory of social arrears is somehow mandated by existing law. Instead, my goal is to show that my theory is not inconsistent with existing law for much more pragmatic reasons. Other things equal, a new theory is likely to be more palatable if it is made up of commonly understood elements. In addition, it is useful to show that policymakers have addressed similar issues in the past, suggesting that such problems can be solved without a radical overhaul of existing law or policy.

Before moving on, it is important to acknowledge that the taxonomic approach I take in this Part, although useful as a way to identify and articulate the elements of my theory, risks obscuring the syncretic nature of social arrears. For example, a useful theory of social arrears must distinguish between unmet needs and genuine arrears. This means showing more than that a state has unmet development needs, because this is surely true of every country in the world. Even among the richest economies of the world, including, for example, the United States and Japan, it is possible to find pockets of deep poverty and compelling evidence of other unmet social needs. Instead, a useful theory of social arrears must show that there are unmet social needs and that the state has not fulfilled such needs. Thus, for example, unmet needs should include basic obligations such as health, education, access to food and water, and personal security. It would not be sufficient to identify unmet demand for broadband Internet service or inadequate but nonetheless func-

tional transportation. In addition, the arrears must be reasonably pervasive; that is to say, the needs must be present in widespread areas or felt across a substantial segment of the population. For these reasons, Part IV presents several mechanisms through which social arrears might be addressed and considers a number of possible objections to the theory.

The objective of this Part is to specify the content of a theory of social arrears. I identify legal sources for each of the elements—obligation, tardiness, and capacity—and give each content. In addition, I argue that the content of the obligation element should include the provision of health care, education, and security. Although much of this material is framed in the language of rights, I do not argue that the implementation of a theory of social arrears is somehow compelled by existing international law. In Part IV, where I address implementation issues, I argue that the recent increase in commercial activity by state entities provides a new and potentially powerful means to facilitate development, even in states in which domestic political accountability is limited or nonexistent. In this Part, however, my objective is simply to show that the elements of the theory are supported by international law.

#### A. *State Obligations*

In the financial model of arrears, the element of obligation is simple enough. In it, the notion of obligation is contractarian: the debtor state has explicitly agreed to the terms that the creditor bank is attempting to enforce.<sup>84</sup> When the state fails to fulfill that explicit agreement, the state's debts become arrears. With social arrears, the element of obligation requires more elaboration. The concept of obligation contains within it two elements: *why* do states owe their citizens something and *what* is owed?<sup>85</sup>

---

84. For a basic definition of debt and default, see International Monetary Fund, Glossary of Selected Financial Terms, Debt, at <http://www.imf.org/external/np/exr/glossary/showTerm.asp#95> (last visited Sept. 25, 2008) and International Monetary Fund, Glossary of Selected Financial Terms, Default, at <http://www.imf.org/external/np/exr/glossary/showTerm.asp#118> (last visited Sept. 25, 2008).

85. There is one potential additional issue to consider: to whom duties are owed. Largely because the substantive obligations I have identified are well-established (even if not universally accepted), I have chosen not to address this issue in any depth. To be sure, there are many thorny debates regarding this question. For example, although there are certainly arguments to the contrary, it is relatively uncontroversial to claim that basic education should be provided to all persons. Because my theory is an attempt to address only the most severe deprivations, it is not necessary to consider whether all persons should receive a free post-secondary education, or if that benefit should be reserved for citizens or some other group.

Although the bases for arguing that states owe their citizens something (i.e., the *why* issue) are contested, there are three approaches that support the claim. All of these approaches depend in part on a theory of statehood, an issue to which I devote some attention. First, under the duty to protect, a doctrine with deep roots in international law, states are required to take steps to protect citizens (and others, under the right circumstances) from a range of threats.<sup>86</sup> Second, the very concept of human rights—the idea that individuals have rights that states and others must respect—supports the claims that states owe something to their citizens. The third theory provides somewhat weaker support, but is nonetheless important. Under international law, there is a notion that, along with the perquisites of sovereignty, statehood comes with a set of obligations or burdens.

The content of a state's obligations (i.e., the *what* question) has been the subject of debate in the human rights literature for decades, and many questions remain unresolved. For example, must states provide free education to all citizens through a certain minimum age? Must states provide Western-style health care for all citizens, or would community-based clinics staffed by nurses suffice? There is broad consensus that states must provide access to health care and education and take steps to ensure personal security.<sup>87</sup>

### 1. *Sources of State Obligations*

Debating the bases for the intuition that states owe *something* to the people living within their territory has been a preoccupation of international law scholarship. In this Section, I consider in some detail the concept of statehood, including its legal definition and recent debates over the concept of failed states. Other scholars have written about what they call “failed states,”<sup>88</sup> entities in which the governments, for a variety of reasons, have effectively ceased to function. These scholars have written about the failure of governments, and most have mentioned in passing the concept of statehood and its legal definition. Both of these areas help to illuminate what a state owes its citizens by helping to define what a state is and how an entity can cease to be considered a state by virtue of its failure to meet certain domestic obligations.

---

86. See generally DINAH SHELTON, REMEDIES IN INTERNATIONAL HUMAN RIGHTS LAW 47–54 (1999) (describing the history of the state duty to protect individuals from human rights violations).

87. See *infra* Part III.A.2.

88. See *infra* notes 94–95.

The 1933 Montevideo Convention formalized a definition of statehood that continues to define what it means to be a state.<sup>89</sup> Under the Montevideo Convention definition, states should “possess the following qualifications: a) a permanent population; b) a defined territory; c) government; and d) capacity to enter into relations with the other states.”<sup>90</sup> This definition came not from centuries of consistent thinking about the parameters of statehood; instead, it represented contemporary conceptions of what statehood entailed.<sup>91</sup> The Restatement (Third) of Foreign Relations Law defines a state as having a “defined territory,” a “permanent population,” a “government,” and the “capacity to conduct international relations.”<sup>92</sup> In a comment, the Restatement explains: “A state need not have any particular form of government, but there must be some authority exercising governmental functions and able to represent the entity in international relations.”<sup>93</sup> Within the short phrase “some authority exercising governmental functions” is almost the entire range of activity that matters to the citizens of a state. For example, a functioning state must have a government that can protect its citizens and other people within its borders from violence, whether caused by internal or external sources. This does not mean that a high crime rate dooms a state or that a state that suffers an attack from without ceases to be a state. Rather, to be a state, an entity must have in place mechanisms to respond to internal or external violence, such as criminal laws and a criminal justice apparatus. It is not the effectiveness of the apparatus that matters; what matters most is that the apparatus exists.

Proposals to address “failed states” fall into two camps. Some propose that the United Nations or another international institution put a failed state under a sort of trusteeship or guardianship, taking over governmental functions until the local people are again in a position to govern themselves.<sup>94</sup> The other camp rejects the “failed state” concept, and

89. See Convention on the Rights and Duties of States, Dec. 26, 1933, T.S. No. 881, 165 L.N.T.S. 19.

90. *Id.* art. 1.

91. For a thorough history of the concept of statehood, see Thomas D. Grant, *Defining Statehood: The Montevideo Convention and its Discontents*, 37 COLUM. J. TRANSNAT'L L. 403 (1999).

92. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 201 (1987).

93. *Id.* § 201 cmt. d.

94. Perhaps the most prominent article in this vein was Gerald B. Helman & Steven R. Ratner, *Saving Failed States*, FOREIGN POL'Y, Winter 1992–93, at 3. In it, they argued in favor of intervention by the United Nations to forestall state failure or rebuild failed states. See *id.* Their proposals sparked debate among scholars and policymakers that has not yet abated. See, e.g., Stephen D. Krasner, *Sharing Sovereignty: New Institutions for Collapsed and Failing States*, 29 INT'L SECURITY, Fall 2004, at 85 (arguing in favor of creating new institutions to administer

with it the trusteeship solution, as neocolonial.<sup>95</sup> This camp argues that an appropriate response must be based on the local people's right to self-determination.

Despite the many differences of opinion about how to define a state, and how best to respond to state failure (and, indeed, if such an idea is coherent), these varied approaches are consistent in many regards. We expect a functioning government to have control over at least most of its territory, to maintain the rule of law, to protect its citizens from violence from internal and external sources, to have some role in regulating the commerce that takes place within its borders and between its enterprises and the rest of the world, and to provide an administrative structure that permits the people living within its borders access to basic services. This list of functions is deliberately vague; not all governments provide the same set of services or perform the same functions, or perform them all efficiently or effectively. The government of a poor state can be described as functioning reasonably well even though it does not provide the generous welfare benefits available in many countries in Western Europe, for example. Even without arriving at a precise definition of the set of functions that a state government must perform, one can see why scholars have concluded that an entity whose government fulfills virtually none of those functions is no longer a state. More important than this conclusion, however, are the reasons for it. To be a state is to be capable of meeting the basic needs of people living in the state. Entities that do not or cannot perform this function may cease to be states.

## 2. *Substantive Obligations*

In the human rights literature, rights are often roughly divided into two categories: civil and political rights on the one hand, and economic, social, and cultural rights on the other hand. This division is reflected perhaps most clearly in two documents that form what is sometimes referred to as the "International Bill of Rights":<sup>96</sup> the International Covenant on Civil and Political Rights<sup>97</sup> and the International Covenant on

---

states that are unable to undertake basic functions).

95. See Ruth Gordon, *Saving Failed States: Sometimes a Neocolonialist Notion*, 12 AM. U. J. INT'L L. & POL'Y 903 (1997). In her seminal article, Ruth Gordon analyzes the problem of state implosion in the context of the needs and constraints of local communities.

96. Thomas Buergenthal, *The Normative and Institutional Evolution of International Human Rights*, 19 HUM. RTS. Q. 703, 708 (1997).

97. International Covenant on Civil and Political Rights, Dec. 16, 1966, S. EXEC. DOC. E, 95-2 (1978), 999 U.N.T.S. 171.

Economic, Social, and Cultural Rights.<sup>98</sup> Since the dawn of the UN system, scholars and policymakers have debated the relative importance of the two sets of rights, rehearsing what have become familiar arguments. One camp maintains that civil and political rights are more important because their exercise permits individuals to act as a collective to determine the best course toward the realization of the other rights. The other camp argues that greater emphasis should be placed on the realization of economic and social rights to ensure that individuals have their basic biological and social needs met. Without addressing these needs, the argument goes, it is impossible for individuals to exercise meaningfully their other rights. This disjunction, although the subject of much discussion, may not be relevant when confronted by real-world problems. To bring some coherence to the debate, Amartya Sen, among others, has argued for an approach that places more emphasis on the combined effect of the failure to realize a range of rights.<sup>99</sup> This approach, even if not universally accepted, has the virtue of recognizing and attempting to account for the layered and contingent nature of individual achievement and experience.

I focus on three areas which, taken together, go a long way toward defining the quality of an individual's life. Adequate health care, access to education, and some assurance of personal security are all central to individual and collective welfare. Beyond the theoretical arguments in favor of focusing on these issues, there are two pragmatic reasons to select them. First, much of development assistance that flows to poor countries is targeted at these problems. Put another way, it is a state's failure to provide or ensure these amenities, and the individual suffering that flows from this failure, that prompts other states to provide development assistance. The second pragmatic argument in favor of these three issues is that they are relatively uncontroversial. Virtually no serious scholars argue that states have absolutely no obligations in these areas.

In the rest of this Section, I briefly survey the vast literature supporting my claim that these three issues are widely considered state obligations. Before moving on, it is useful to recall that I do not argue that international law compels the approach that I advocate. Instead, I argue that, as a matter of policy, there are sound reasons to treat these issues

---

98. International Covenant on Economic, Social, and Cultural Rights, Dec. 16, 1966, 993 U.N.T.S. 3.

99. See AMARTYA SEN, DEVELOPMENT AS FREEDOM 10–11 (1999) (arguing that the realization of different forms of rights is essential to, and constitutive of, development).

as a state's obligation and for other states to respond to the failure to fulfill these obligations as a defaulted debt that must be resolved before the state with social arrears is permitted to receive further benefits.

A state's obligations to ensure adequate health care and education are specified in the International Covenant on Economic, Social and Cultural Rights. Article 12 recognizes the right to "the highest attainable standard of physical and mental health"; Article 13 recognizes the "right of everyone to education."<sup>100</sup> In addition to international agreements, some states have begun to guarantee these rights in domestic constitutions.<sup>101</sup> Further evidence of the importance and legitimacy of the rights to health care and education comes from the discourse regarding the right to development.<sup>102</sup> In general terms, this right is usually taken to mean a process of development with the goal of realizing other human rights.<sup>103</sup> More specifically, it requires that states ensure "equality of opportunity for all in their access to basic resources, education, health services, food, housing, employment and the fair distribution of income."<sup>104</sup>

International law is less clear with respect to personal security, but there is a growing consensus that states must ensure some measure of domestic stability. First, international law has long recognized that, under appropriate circumstances, states bear responsibility for injuries to noncitizens suffered in the state.<sup>105</sup> Under this doctrine, a state could seek compensation for an injury suffered by one of its citizens abroad.<sup>106</sup> This doctrine eventually came to mean that host states bear responsibility for injuries suffered by individuals within the state, re-

---

100. International Covenant on Economic, Social, and Cultural Rights, *supra* note 98, arts. 12, 13.

101. See, e.g., Varun Gauri, *Social Rights and Economics: Claims to Health Care and Education in Developing Countries*, 32 *WORLD DEV.* 465, 465 (2004) ("Of the 165 countries with available written constitutions, 116 made reference to a right to education and 73 to a right to health care. Ninety-five, moreover, stipulated free education and 29 free health care for at least some population subgroups and services.").

102. See generally Declaration on the Right to Development, G.A. Res. 41/128, U.N. Doc. A/Res/41/128/Annex (Dec. 4, 1986).

103. See Arjun Sengupta, *On the Theory and Practice of the Rights to Development*, 24 *HUM. RTS. Q.* 837, 846 (2002) (arguing that the right to development "refers to a process of development which leads to the realization of each human right and all of them together").

104. Declaration on the Right to Development, *supra* note 102, art. 8.

105. See Philip C. Jessup, *Responsibility of States for Injuries to Individuals*, 46 *COLUM. L. REV.* 903, 904 (1946) (noting that the "law governing the responsibility of states for injuries to aliens is one of the most highly developed branches" of international law).

106. See HENRY J. STEINER & PHILIP ALSTON, *INTERNATIONAL HUMAN RIGHTS IN CONTEXT* 82 (2000) (tracing the history of the rights of states to compensation for injuries done to their citizens by other states).

ardless of the nationality of the injured party or whether her state (assuming she was a citizen of another state) was willing to seek compensation on her behalf.<sup>107</sup> The most protective version of this doctrine is a generalized state responsibility to protect. Those who advocate this doctrine argue that the duty of states to protect individuals is sufficiently strong to compel other states to intervene in states where individuals face conditions of extreme “violence, deprivation and abuse.”<sup>108</sup>

### B. *Tardiness*

Determining when a debt payment is late is often straightforward. Typically, the loan agreement includes a timetable for repayment and provides a formula for determining when late payments become actionable arrears. With social arrears, the question is more complicated. The most useful approach to the issue comes from the jurisprudence that has developed in South Africa regarding that country’s constitutional obligation to protect economic, social, and cultural rights.<sup>109</sup> South Africa’s Constitution guarantees to each citizen the right to education, health care, and access to adequate housing, among many other rights.<sup>110</sup> Under the South African Constitution, the government is required to ensure the “progressive realization” of these rights in light of “available resources,” among other considerations.<sup>111</sup>

107. See generally Jessup, *supra* note 105 (arguing that a more generalized doctrine of responsibility has emerged from the practice of states).

108. Louise Arbour, *The Responsibility to Protect as a Duty of Care in International Law and Practice*, 34 REV. INT’L STUD. 445, 445 (2008).

109. A focus on South Africa should come as no surprise. Since its post-apartheid constitution went into effect in 1996, it has become a laboratory of constitutional theory. In part, this is because the South African Constitution is perhaps the most comprehensive and specific in the world. Consider just the Bill of Rights, which guarantees rights in twenty-seven separate substantive areas, sometimes in extraordinary detail. For example, under Section 28(1)(a), children have a constitutional right to a “name and a nationality from birth.” S. AFR. CONST. 1996 § 28(1)(a). Section 33, which guarantees “just administrative action,” provides individuals with a right to “written reasons” if their “rights have been adversely affected by administrative action.” *Id.* § 33(2). For a more detailed analysis of the development of South African constitutional theory, see John Dugard, *International Law and the South African Constitution*, 8 EUR. J. INT’L L. 77 (1997) (describing the role of international law in South African constitutionalism) and Jeremy Sarkin, *The Drafting of South Africa’s Final Constitution from a Human-Rights Perspective*, 47 AM. J. COMP. L. 67, 69 (1999) (evaluating the “human rights commitment of the drafters” of the South African Constitution).

110. See S. AFR. CONST. 1996 §§ 26, 27, 29 (guaranteeing the rights to housing, healthcare, and education, respectively).

111. In the South African Constitution, the provisions guaranteeing access to adequate housing, access to health care, and education are all subject to similar limitations. Section 26, which covers housing, provides that the “state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of this right.” *Id.* § 26(2).

South Africa's Constitutional Court has considered this provision on a number of occasions and in so doing provided a useful model for a theory of tardiness (and for a general theory of social arrears). The court's most thoughtful treatment of the issue came in *South Africa v. Grootboom*, decided in 2001.<sup>112</sup> In that case, the plaintiffs had been forcibly evicted from their dwellings (they were illegally squatting in a township) and they sued the government, claiming that its failure to provide them with emergency housing violated the constitution's guarantee of adequate housing and they sought immediate assistance with housing. The court held that the plaintiffs were not entitled to housing "upon demand," thereby denying them immediate relief.<sup>113</sup> Instead, the court held that the constitution required the government to "devise and implement a coherent, co-ordinated programme designed to meet its" constitutional obligations<sup>114</sup> and that the government had failed to meet this standard.<sup>115</sup> The court's focus was on whether the government had set its priorities in a rational way—having considered their effects and costs—not whether a particular person was experiencing unconstitutional conditions.<sup>116</sup>

---

Section 27(2) contains an identical limitation with respect to health care. *Id.* § 27(2). Section 29, covering education, deviates slightly from this approach: "Everyone has the right (a) to a basic education, including adult basic education; and (b) to further education, which the state, through reasonable measures, must make progressively available and accessible." *Id.* § 29.

112. *South Africa v Grootboom* 2001 (1) SA 46 (CC) (S. Afr.). The South African Constitutional Court's opinions from three cases are particularly relevant. While *Grootboom* is the most salient for the purposes of this Article, others merit note as well. In *Soobramoney v Minister of Health, Kwa-Zulu Natal* 1999 (1) SA 765 (CC) (S. Afr.), the court held that a provincial hospital's refusal to provide free kidney dialysis to the plaintiff did not violate the constitutional guarantee of access to adequate health care. *Id.* at 776. Central to the court's analysis was its conclusion that the government's decision—regarding which medical services it would subsidize—was "rational" and "taken in good faith." *Id.* The court noted that the government had identified its funding priorities, mindful of the fact that there were simply not enough resources to meet every need and that the state's priority is to help as many people as possible. *Id.* In *Minister of Health v Treatment Action Campaign* 2002 (5) SA 721 (CC) (S. Afr.), the Constitutional Court held that the government's refusal to provide the drug Nevirapine to pregnant women to prevent mother-to-child transmission of HIV violated the right to adequate health care. *Id.* at 750. The court found that the government's refusal to provide the drug was unreasonable because it had received the drug virtually free from pharmaceutical companies, and there were no real questions as to the effectiveness or safety of the drug. *Id.* at 740, 745.

113. *Grootboom*, 2001(1) SA 46 (CC) at 66.

114. *Id.*

115. *Id.* Specifically, the Constitutional Court found that the government's housing program could reasonably be broken into three components: long-, medium-, and short-term plans to address the country's housing problems. The court found that the long- and medium-term components of the plan were adequate, but that the short-term component was inadequate because it did not provide assistance for people like Ms. Grootboom, "those in desperate need." *Id.*

116. For a thorough analysis of the South African Constitutional Court's jurisprudence in this

In the context of a theory of social arrears, this approach would mean that determining whether a state's debts to its citizens were past due would call for an assessment of the state's plan to deliver relevant services. It would not depend on whether, at a given moment, some citizens were experiencing inadequate conditions. To be sure, evidence that such conditions were widespread would be an important factor in the decision. But the primary focus of the decision would be on a state's policies designed to improve domestic conditions.

### C. Capacity

The element of capacity is less analytically distinct than the other two elements, and therefore requires less elaboration. It is entirely possible that the considerations important to this factor are subsumed in the other factors. Nonetheless, it is useful to identify capacity as a separate element even if only as a form of affirmative defense. Before a state can be said to be in social arrears, it must have the financial wherewithal to address at least some of the unmet needs. Thus, to pick an easy example, I would not argue that the government of Somalia faces social arrears. It has virtually no money and no realistic possibility of meeting the development needs of its population.<sup>117</sup> That is not to suggest that the government of Somalia does not bear responsibility for the social conditions

---

area, see Karin Lehmann, *In Defense of the Constitutional Court: Litigating Socio-Economic Rights and the Myth of the Minimum Core*, 22 AM. U. INT'L L. REV. 163 (2006). Karin Lehmann's comprehensive history of post-apartheid constitutional litigation considers two jurisprudential approaches to litigation regarding economic and social rights. Consider a case involving, for example, a claim that the state's failure to provide access to adequate housing or education violates the South African Constitution. Under one model, which she labels the "reasonableness approach," when courts are faced with such a claim, the court's duty is to determine whether the state's approach to the problem is reasonable. If so, then the court does not examine the details of the government's spending priorities. *Id.* at 165. The second model, labeled the "minimum core" approach, would require the court to identify "the minimum core of each of the rights that have come before it." *Id.* (citation omitted). The minimum core approach would allow courts to determine those elements of a social program, without which the program would be unconstitutional. For my purposes, it is not necessary to resolve this issue for two reasons. First, the lively scholarly debate notwithstanding, each approach necessarily incorporates elements of the other. It really is not possible to assess the reasonableness of a social program without some notion of what basic elements must be included. Similarly, it would be difficult to specify the minimum core of a particular right with no regard for what the government could actually provide. Second, the analytical models that Lehmann and others have identified are most salient with respect to judicial decision making, when judges are confronted with competing sets of demands. In contrast, my approach is an attempt to bring some theoretical coherence to policy. In this context, an element of each analytical model will surely be necessary.

117. See, e.g., World Bank, Somalia, at <http://www.worldbank.org/Somalia> (last visited Nov. 22, 2008) ("Somalia is one of the poorest countries in the world, a situation aggravated by the civil war and the absence of a functioning national government for over a decade.").

within the country, just that it is difficult to argue reasonably that the government of Somalia could, but has chosen not to, meet the social development needs of the population. Instead, I focus on those states in which there is—or appears to be—sufficient wealth to meet many of the social needs of the population, but where the government has apparently chosen not to meet those needs. The reasons for this are more practical than theoretical. Indeed, it might be entirely consistent with my approach to hold even the very poorest states accountable for the conditions in which their citizens live.

The issue is not whether a state's budget has a particular ratio of education spending to defense spending, for example. Instead, the issue is whether the state's leaders have chosen to invest state funds abroad in the face of deprivation at home. For my purposes, the most important element of this calculation is whether there are substantial state-controlled investment vehicles that are active internationally. From the perspective of citizens, when leaders decide there is sufficient money in the state's coffers to invest abroad, it would be difficult not to conclude that the coffers contain enough money to provide access to basic services.

#### IV. IMPLEMENTATION AND POSSIBLE COMPLICATIONS

The goal of my theory is to put the debts that states owe to their citizens on the same footing as the debts owed to other creditors. The increasing popularity of SWFs has made this issue even more salient, because it now appears that some of the states with the poorest populations actually have substantial resources that the regimes in power have chosen not to invest internally. To give effect to this normative goal, it is important to recognize the hybrid nature of SWFs. They attempt to increase a state's wealth by investing it in the same way a private investor would. They must answer to financial regulators—as private investors must—and to the citizens who own the money the SWF invests. My policy proposals attempt to harness some of the tools of financial market regulation to bring some coherence to the policy goals of recipient and donor states.

In this Part, I advance two specific proposals that would build on existing law and policy to better ensure that SWFs are used for their intended purposes. First, I propose that the Committee on Foreign Investment in the United States (CFIUS) include social arrears as a factor in its review of potential investments. CFIUS, a body created by statute to

review foreign investment for various national security issues, plays an important (though limited) role in shaping the kinds of investments that foreign corporations may make in the United States. My proposals would broaden the range of investments that CFIUS would be required to review and add one additional factor for it to consider. Second, I propose a similar change to the implementation of the U.S. president's authority under the International Emergency Economic Powers Act (IEEPA). Under that statute, the president has the power to prohibit or restrict the financial transactions of foreign persons or entities. I propose that the president consider social arrears as a factor when exercising this authority.

Before moving on, it is important to acknowledge that my proposals amount to second-best solutions. They call for the imposition of new rules or restrictions on investments from SWFs. These new rules would be enforced by regulators in investment destination states. Of course, it would be far simpler for the states that own SWFs to pursue the normative goals that I have identified as principal justifications for SWFs. For example, regimes in control of SWFs might divide the wealth into shares and distribute those shares to citizens. Alaska has just such a system for the distribution of its oil revenue.<sup>118</sup> Oil dividends are paid individually to citizens, thereby increasing the sense of ownership that citizens feel about the resource and providing an incentive for citizens to exercise oversight of those who control the revenue.<sup>119</sup> This approach is potentially effective in places with strong institutions of political accountability, but not especially promising in states that do not already have such institutions.<sup>120</sup> For this reason, my approach targets the actors with the greatest potential to enforce the changes I propose, the regulators in the states in which SWFs invest.

A. *Including Social Arrears as a Condition of Access in the United States*

All states place some kind of restriction on access to their financial markets. In the United States, for example, the list of people and entities whose access to U.S. financial markets is either blocked or restricted

---

118. See Martin E. Sandbu, *Natural Wealth Accounts: A Proposal for Alleviating the Natural Resource Curse*, 34 *WORLD DEV.* 1153, 1159–60 (2006) (describing the effects on citizens of the distribution of revenue from resource exploitation).

119. *Id.*

120. For a thorough discussion of the benefits of natural wealth accounts, see *id.* at 1156–59 (describing the potential for natural wealth accounts to increase citizen oversight of political leaders by harnessing behavioral biases).

runs 394 single-spaced pages and includes individuals and businesses<sup>121</sup> whose activities are subject to sanctions under a wide range of programs.<sup>122</sup> In the United States, there are two principal tools—CFIUS, which reviews foreign investments,<sup>123</sup> and the president’s authority to bar investments under IEEPA<sup>124</sup>—that permit the government to reject inward investment if it would be contrary to the interests of the United States. My proposals would modify existing policy to recognize social arrears as a legitimate reason to reject investment from an SWF. Although I focus on the United States, similar measures could be implemented in other markets, such as that of the EU, and could be modeled on U.S. policy tools.

In the United States it would be possible to prohibit investments from states with substantial social arrears by modifying existing statutes. In this Section, I show how to do so, and I argue that doing so would be consistent with current U.S. policy and would not require a major reworking of U.S. law. The official policy of the United States, as stated by President George W. Bush, is to “support unequivocally” international investment because of its potential to promote “economic growth, productivity, competitiveness, and job creation.”<sup>125</sup> Foreign investment is therefore not only permitted, it is encouraged. There are, however, restrictions on foreign investment. Such restrictions are typically enforced in one of two ways, both of which nominally focus on national security concerns but actually focus on national interests more broadly.

### 1. *Broadening the Scope of Review by CFIUS*

Certain investments from abroad are reviewed to determine “the effects of the transaction on the national security of the United States.”<sup>126</sup> The review can result in a restructuring of the proposed transaction or a

---

121. See U.S. Department of the Treasury, Office of Foreign Assets Control, Specially Designated Nationals and Blocked Persons, at <http://www.treas.gov/offices/enforcement/ofac/sdn/index.shtml> (last visited Sept. 12, 2008).

122. The Office of Foreign Assets Control is part of the U.S. Treasury Department and is charged with maintaining a comprehensive list of people and entities whose assets and activities are subject to sanctions of some sort. See U.S. Department of the Treasury, Office of Foreign Assets Control, Our History, at <http://www.treas.gov/offices/enforcement/ofac/mission.shtml> (last visited Oct. 17, 2008).

123. See Foreign Investment and National Security Act of 2007, Pub. L. 110–49, 121 Stat. 246 (codified at 50 U.S.C. app. § 2170). The statutory provision creating CFIUS is found at 50 U.S.C. § 2170(k), which designates the members of the committee and outlines its duties.

124. See International Emergency Economic Powers Act, 50 U.S.C. §§ 1701–07 (2000).

125. Exec. Order No. 13,456, 73 Fed. Reg. 4675 (Jan. 25, 2008).

126. Defense Production Act of 1950, 50 U.S.C. app. § 2170(b)(1)(A)(i) (2007).

rejection of the transaction altogether. The purpose of the statute is to ensure that foreign states are not able to obtain control of companies or industries essential to U.S. national security. CFIUS, which conducts the review, was formed in 1975 by an executive order executed by President Gerald Ford and has since been authorized by statute.<sup>127</sup> Since September 11, 2001, the scrutiny to which foreign investments are subjected has increased,<sup>128</sup> and the scope of the statute was broadened in 2007.<sup>129</sup>

As the statute now exists, CFIUS must first determine if a transaction falls within its purview; if so, it must investigate the transaction. Two types of transactions come in for review: (a) “covered transactions,” which are those that would result “in foreign control of any person engaged in interstate commerce,”<sup>130</sup> and (b) transactions in which “foreign control” would be exercised by or on behalf of a foreign government.<sup>131</sup> Although the exact extent of CFIUS’s review is determined by the type of transaction—foreign-government controlled transactions are subject to greater scrutiny—both types are evaluated to determine the likely effect of the transaction on national security. To make this determination, CFIUS is required to consider a number of specified factors<sup>132</sup> and is permitted to consider “such other factors” as it or the president finds appropriate.<sup>133</sup>

Expanding the scope of CFIUS review to include consideration of social arrears would be consistent with the statute’s purpose and structure. In its current form, the statute gives CFIUS great authority to influence the investment decisions made by foreign entities. CFIUS review of a covered transaction includes a period during which the parties to the transaction can negotiate with the committee and with each other to arrive at a structure for the deal (and for the entity that will result from the deal) that will satisfy the committee’s security concerns. This

---

127. *Id.* at app. § 2170(k).

128. Jonathan C. Stagg, Note, *Scrutinizing Foreign Investment: How Much Congressional Involvement Is Too Much?*, 93 IOWA L. REV. 325, 341–42 (2007) (summarizing changes in the way CFIUS has conducted reviews since September 11, 2001).

129. See U.S. Department of the Treasury, CFIUS Reform: The Foreign Investment & National Security Act of 2007 (FINSAs), at <http://www.treas.gov/offices/international-affairs/cfius/docs/Summary-FINSA.pdf> (last visited Nov. 22, 2008).

130. 50 U.S.C. app. § 2170(a)(3). In the language of the statute, such transactions are “covered transactions.” *Id.*

131. *Id.* app. § 2170(a)(4). The statute refers to such transactions as “foreign government-controlled transactions.” *Id.*

132. *Id.* app. §§ 2170(f)(1)–(10).

133. *Id.* app. § 2170(f)(11).

suggests that, as the committee balances the value of open markets and foreign investment in the United States and national security, one of the tools available to it is to determine ownership structures and investment decisions made by foreign corporations and foreign governments.

In addition, CFIUS and IEEPA, discussed below, show that, as a matter of policy, the United States is willing to forgo at least some potential economic benefits in the pursuit of other objectives, including policies aimed at improving the human rights situation in foreign countries. Both statutes impose some barriers to U.S. financial markets. This means that some transactions that might make economic sense can be prevented entirely or restructured in a way that the market did not initially consider optimal when doing so advances the national interest.

## 2. *Expanding the President's Authority under IEEPA*

In addition to CFIUS review, there is a separate mechanism by which the U.S. government can restrict or prohibit foreign investment. The president has the power, under IEEPA, to prohibit or scrutinize a wide range of financial transactions involving foreign corporations, governments, or citizens.<sup>134</sup> The purpose of the statute is to give the President the tools “to deal with any unusual and extraordinary threat . . . to the national security, foreign policy, or economy of the United States.”<sup>135</sup> To exercise this authority, the president must declare a national emergency with respect to the threat.<sup>136</sup> Presidents have used this authority to restrict financial transactions involving people or corporations associated with the rebel movement in Angola and crises in Belarus, Ivory Coast, Democratic Republic of the Congo (DRC), Liberia, Sudan, Syria, and Zimbabwe.<sup>137</sup>

## 3. *Policy Coherence*

IEEPA allows the President broad latitude to determine what constitutes a threat to U.S. interests. For example, the executive order imposing sanctions on persons associated with the conflict in the DRC found

---

134. See International Emergency Economic Powers Act, 50 U.S.C. § 1701 (2000).

135. *Id.* § 1701(a).

136. *Id.* § 1701(b).

137. U.S. Department of the Treasury, Office of Foreign Asset Control, OFAC Country Sanctions Programs, at <http://www.treas.gov/offices/enforcement/ofac/programs/> (last visited Sept. 12, 2008). The situations listed are in addition to restrictions placed with respect to situations that might appear more obvious, such as the wars in Afghanistan, the Balkans, and Iraq, and individuals associated with Iran. *Id.*

that the “widespread violence and atrocities that continue to threaten regional stability . . . constitute[] an unusual and extraordinary threat to the foreign policy of the United States.”<sup>138</sup> There was no evidence of a threat to U.S. national security. Instead, the sole basis upon which President Bush declared a national emergency was violence that occurred in the DRC. To be clear, I do not argue that this designation was incorrect or should in any way be modified. The conflict in the DRC inflicted, and continues to inflict, a deadly and tragic toll on the people of that country. Instead, I use this situation to illustrate the broader point that the United States has imposed market restrictions as a response to humanitarian crises that posed no direct threat to the United States.

At the broadest level of generality, the dominant principle is that access to U.S. markets is a privilege that can be lost or revoked if the party seeking access acts in a way that is contrary to U.S. interests. Under my proposal, CFIUS and IEEPA would be modified to empower the relevant authority to include social arrears among the factors that could lead to restrictions on access to U.S. financial markets. Doing so would be consistent with existing policy and could be implemented through existing statutes.

### *B. Implementation Issues*

One difficulty with giving effect to the policies that I propose has to do with how to determine whether a state has social arrears, and if so, whether it has a plan to remedy those arrears. One way to accomplish this would be on a case-by-case basis, as the United States currently does under CFIUS. Such an approach has the benefit of allowing for nuanced and case-specific consideration of each transaction and its relationship to a state’s social deficits. But such investigations could become burdensome and could produce inconsistent results.

Another way to accomplish this goal would be to borrow from the model used by the Africa Growth and Opportunity Act (AGOA), which permits corporations from African states that meet certain requirements to export their goods to the United States under preferential conditions.<sup>139</sup> Under the AGOA model, states are certified annually by the president, based on specific written criteria that are set in the statute.<sup>140</sup> Under this model, the determination as to whether there are substantial social arrears need only be made once for each state, which would make

138. Exec. Order No. 13,413, 3 C.F.R. 247 (2006).

139. See Africa Growth and Opportunity Act (AGOA), 19 U.S.C. § 3701 (2000).

140. *Id.* § 3703 (describing the certification process and criteria).

the investment process much more efficient than if each deal was required to be scrutinized for its social implications.

Another potential implementation issue is one that arises when any new regulation is proposed. Regulations, regardless of whatever benefits they may produce, also impose costs. As a general rule, if it is possible to achieve the same benefits, or nearly so, without incurring the costs of the regulation, then that course should be followed. With this in mind, one potential mechanism by which to implement a social arrears policy would be reputational. Under this approach, there would be no legally enforceable penalty imposed on states that had substantial outward investments in the face of social arrears at home. Instead, the only legal obligation imposed on investing states (or on all states) by states receiving investments would be disclosure requirements. Thus the state wishing to make the outward investment would be required to do no more than provide data regarding specified social conditions in the country. Consider a hypothetical example. Imagine that Nigeria's SWF wishes to invest in Microsoft. Under a reputational approach, the SWF would be required to disclose to Microsoft (and its other shareholders) information about Nigeria's social arrears. Then, Microsoft would weigh the possible reputational harm it might suffer through an association with such an SWF against its need for capital.

Despite the potential potency of such reputational factors, there is little evidence that these alone would be sufficient to change state behavior. Indeed, recent empirical work has shown that economic considerations are the most effective tools for shaping state behavior. The most persuasive study is Emilie Hafner-Burton's 2005 article on the effect of preferential trade agreements and human rights agreements.<sup>141</sup> Preferential trade agreements govern market access and often include human rights conditions. Human rights agreements commit states to comply with certain norms but do not contain financial rewards or penalties.<sup>142</sup> Based on an econometric analysis of the uses of such agreements and the incidence of repression and other human rights violations, Hafner-Burton shows that agreements lacking economic conditions *do not* decrease human rights violations, while agreements conditioning benefits on improvements in human rights practices *do* decrease violations.<sup>143</sup>

---

141. Emilie M. Hafner-Burton, *Trading Human Rights: How Preferential Trade Agreements Influence Government Repression*, 59 INT'L ORG. 593 (2005).

142. *Id.* at 594 (describing the scope of agreements).

143. *Id.* at 619 (finding that conditional agreements "are systematically more likely to decrease repression" than agreements without such conditions).

### *C. Possible Objections*

One possible objection to my theory of social arrears and the mechanisms I propose to implement it is that, if applied across the board, the theory may reduce welfare rather than increase it. Surely there are some investments that even the most committed social activists would want a government to make. After all, the theory behind sovereign investment funds is that governments that find themselves flush with cash from sources that might not last should come up with some way to transform this short-term wealth into long-term development. And investments outside of the country are one way to accomplish this. At the same time, it is not at all clear that outward investment by governments in the face of substantial social arrears is the best way to increase the welfare of a country's people. The optimal implementation of the social arrears policy might be to impose a kind of penalty on investments abroad made by governments faced with substantial social arrears. On this model, states would be permitted to make investments but might, for example, be required to match the market investments with social investments at home. In this way, the controllers of the SWFs would still gain access to the benefits of investments in foreign firms, but only if they were willing to pay a premium in the form of required social investment.

Another plausible objection to my approach is that the difference in specificity between social arrears and financial arrears is sufficiently great as to render the analogy meaningless. Recall the IMF's policy regarding arrears. The IMF requires states with arrears to private creditors to negotiate in good faith to arrive at a settlement. Despite the complexity of the transactions that may be used to eliminate the arrears, in the end it is possible to know with reasonable certainty that all of the affected creditors have been included in the process and that the arrears have been (or are being) repaid. To simplify greatly, typical arrears negotiations result in a settlement involving easily identified participants, a specific dollar amount that must be repaid, and the deadline by which the repayment must occur. Although this is not the case with social arrears, this objection misses the point of my theory. My aim is to create a theoretical framework for regulating SWFs that accounts for their domestic effects in poor countries. To do this, it is necessary to put domestic obligations on an equal footing with other kinds of obligations. Once the policy framework accounts for this theoretical change, then it will be possible to identify the metric by which to measure social arrears.

Implementing rules regarding the measurement of social arrears might be more complicated, particularly with respect to the magnitude

of the arrears, the identity of the “creditors,” and whether those creditors are satisfied. The increasing importance of the good faith requirement shows that the IMF considers its loans to be a benefaction in two distinct ways. Most obviously, states benefit from the fact that funds are provided on terms more favorable than would otherwise be available from private lenders. This is the mission of the IMF, and it is intended to benefit states in financial or economic crisis. But the provision of funds in the first place hinges not solely on financial or economic factors but on the way the state negotiates with its private creditors. It is not enough that states need the IMF’s help because of a crisis—that merely makes them eligible for assistance. In addition, states must also behave in a way that is satisfactory to the IMF.

#### CONCLUSION

SWFs are a way for states to invest in international financial markets in order to pursue investments with higher yields than would otherwise be available. When states choose this path despite widespread poverty or deprivation at home, they are doing one of two things: either deliberately ignoring their debts to their own citizens, or pursuing a master plan to make as much money as possible to help their people for the long term. If it is the latter, then evidence of that plan should be enough to keep them out of social arrears. But when donor states permit sovereign investments without such evidence, they perpetuate social arrears.

I have proposed in this Article a theory of social arrears. I argue that a state should not be permitted to invest abroad through an SWF if it is in social arrears. I argue that to be in social arrears a state must have failed to provide adequate health care, access to education, or some assurance of personal security to its citizens; must be past due on one or more of these obligations to its citizens; and must have the capacity to provide such obligations. This theory of social arrears and the policies I have proposed to implement the theory would go a long way toward creating a coherent regulatory approach to SWFs that would account for their international *and* domestic roles.