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The Rise of Foreign State Ownership in East Asia: Domestic Political Determinants and Stabilizing Effects

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Abstract: Since the Asian Financial Crisis of 1997, the prevalence and transparency of state ownership – both domestic and foreign -- has exhibited considerable variance across the region. To explain this puzzle, I argue that a tight focus on two dimensions of politics yields a remarkable degree of analytic purchase: centralization of political control and a regime’s coordination commitments. The centralization of political control refers to whether the executive faces institutional checks on its decision-making power. Coordination commitments concern political leaders’ need to accommodate particularistic or encompassing interests. The theory leads to the expectation that state-owned firms in authoritarian regimes will exhibit greater stability in a period of heightened financial volatility. Tests conducted on 896 firms around the collapse of Lehman Brothers offer support for this expectation.
I. Introduction

State owned enterprises and the government agencies that control them have become a major focus of international interest.¹ This is due to their size, their potential to disrupt financial markets, and the risk that political objectives might influence their management, magnifying concerns about their transparency (Truman 2010). Recent work on East Asia demonstrates that foreign state ownership, in particular, has become increasingly common since the 1997 Asian Financial Crisis (Carney and Child 2013).²

Existing explanations have difficulty accounting for the rise of foreign state ownership. Work that focuses on the difference between concentrated and diffuse ownership cannot explain the rise of state ownership because concentrated ownership is usually characterized as family ownership (La Porta, Lopez-de-Silanes and Shleifer 2008; Roe and Siegel 2009), and the motivations for families to retain concentrated ownership fundamentally differ from those of the state. But existing explanations of state ownership also fail to explain its growing importance because they do not consider its use as a political mechanism by which regimes defend themselves from destabilizing pressures associated with financial globalization (Marshall 1920; Hirschman 1958; Gerschenkron 1962; Shirley and Nellis 1991; Krugman 1993; Shleifer and Vishny 1998; Netter and Megginson 2001; Lazzarini and Mussacchio 2014).

I argue that the power of global capital has increased the prevalence of state ownership as a counter-reaction for three reasons. First, heightened fear of a politically debilitating financial crisis has led to greater state ownership of strategically important firms. Second, easier access to foreign sources of funding for all firms, including those which are allied to political challengers of a regime, has pushed authoritarian leaders to acquire those firms. Third, the accumulation of foreign exchange reserves to enhance macroeconomic stability has enabled state agencies to purchase stakes in listed corporations.

Regimes respond differently to financial globalization’s destabilizing pressures. Some turn to state ownership and sovereign wealth funds more than others, and some do so with greater transparency than others. To explain these varied responses, I argue that a tight focus on two dimensions of politics yields a remarkable degree of analytic purchase: centralization of political control and a regime’s coordination commitments. The centralization of political control refers to whether the executive faces institutional checks on its decision-making power (Tsebelis 2002). Coordination commitments concern political leaders’ need to accommodate particularistic or encompassing interests (Acemoglu and Robinson 2012).

If we restrict our focus to the centralization of political control, we might predict state ownership to be more common in states where centralized control is high because such arrangements permit political leaders greater freedom to acquire and deploy large corporations for whatever political or personal aims they choose to pursue (e.g., Haggard 1999; MacIntyre 2002). While this approach explains incremental changes across countries and time (countries with fewer veto points are more likely to exhibit changes to state ownership positions; Carney et al 2015), it cannot account for persistent differences between countries with a comparable number of veto-points, such as Singapore and Brunei. SOEs are common and important to both, but Singapore’s SWFs and SOEs are far more transparent than Brunei’s.

¹ These agencies are commonly labelled sovereign wealth funds, but include a variety of organizations such as pension funds, foreign exchange reserve funds, savings funds, and development funds (Kunzel et al 2011; Al-Hassan et al 2013).
² Foreign state ownership is identified when a state owns at least 5% of a company’s outstanding shares.
The second dimension focuses on elites’ coordination commitments. In the context of East Asia, numerous scholars have pointed to the heterogeneity of coalitional size as a key factor driving institutional development and economic growth (e.g., Crone 1988; Campos and Root 1996; Waldner 1999; Doner, Ritchie, and Slater 2005). Coordination is more likely to occur in states that require leaders to make inclusive bargains than in states in which particularistic interests prevail. This perspective can explain differences between Singapore (encompassing) and Brunei (particularistic), but it fails to account for why two states with broad coalition commitments such as Singapore and South Korea, display varying levels of state ownership. Combining these two approaches offers a parsimonious explanation that can reconcile the varying prevalence and transparency of state ownership across these widely differing country contexts.

After developing and assessing the argument with regard to state ownership in domestic contexts, I apply it to foreign state ownership. East Asia is an ideal setting to examine the prevalence and transparency of SOEs and SWFs in response to the rising pressures of financial globalization because economies in the region have been increasingly exposed to international financial flows over the last two decades. They likewise exhibit considerable heterogeneity across the two political attributes postulated to be of importance to state ownership outcomes as well as the manifestation of state ownership.

An implication of the theory presented here is that authoritarian regimes (and by extension their investment agencies) will display a greater commitment to strategically valued ownership positions – both domestic and foreign. Hence, firms owned by these regimes should exhibit greater stability when financial volatility spikes for exogenous reasons.

The paper proceeds by delineating ownership patterns of SOEs and sovereign wealth funds in both domestic and foreign contexts. The subsequent section presents the theory, followed by analytic narratives of the cases in order to identify the causal mechanisms contributing to the varying manifestations of state ownership across the region. The penultimate section tests the stability-enhancing aspect of state ownership by authoritarian regimes. The final section summarily concludes.

II. Cross-National Patterns of State Ownership and SWFs

Determining the relative importance of the state as a corporate owner requires that our focus be restricted to those companies whose owners can be accurately identified – a country’s largest listed firms. These entities regularly supply information through annual reports and other publications to meet regulatory requirements to list on a stock exchange. While this approach is not perfect in that it excludes unlisted SOEs and private family-owned firms, it offers the most accurate method for determining the relative importance of the state as an owner in relation to other owners in most country contexts.

Data Collection
As the starting point for collecting ownership data, the names of the largest 200 publicly-traded firms (in terms of market capitalization) from nine country’s stock exchange are identified for the end of the calendar year 2008. The countries include Hong Kong, Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand. The names for the 200 largest firms for each country in 1996 are also reported and come from the Claessens et al dataset.\(^3\) The approach for identifying ultimate owners in 2008 mirrors that of

\(^3\) Claessens et al (2000) explain that their dataset always covers the largest 100 firms in terms of market capitalization, and is then supplemented with data for additional firms depending on the availability of the data. Hence, the paper’s analysis of their top 200 firms by country is
Claessens et al. so as to ensure methodological consistency. For each of the firms, identification of all shareholders owning more than five percent of the company’s shares came from Thomson Reuter’s Worldscope database. Where this information was not available through Worldscope, Bureau van Dijk’s OSIRIS database was used, or Gale’s Major Companies of Asia and Australasia 2008 handbook. Often, the corporations in the dataset are owned in turn by other companies. In order to trace ultimate ownership, the ownership structure of these intermediate shareholding companies had to be uncovered as well. Wherever these shareholding companies are publicly-traded corporations themselves, the above exercise was repeated using the Worldscope and OSIRIS databases to identify their ownership. Where these companies have not been publicly-traded, the process has been more arduous.

The intermediate non-publicly-traded firms present in the ownership data are state-owned, family-owned, employee-owned, or are subsidiaries of public or other non-public corporations. To resolve the ownership structure of these non-publicly-traded firms, the first resort has been to turn to the annual reports of the downstream publicly-traded firm whose ownership is ultimately trying to be revealed. Often times, through careful reading of this report, the ultimate owner of the intermediate firm may disclose this information. When the annual report has not been helpful in this regard, the website of the non-publicly traded firm sometimes discloses this information. Next, various stock exchange filings indicating the transfer of share ownership are used to identify ultimate owners. As a last resort, where none of the above has been informative, business reports and newspaper articles revealing the non-publicly-traded company’s owner, either explicitly or in passing, are used. These latter resources have been retrieved primarily through the LexisNexis and Alacra Store databases, as well as Bloomberg Businessweek online.

As a basis for inclusion in the dataset, it is a requirement that all shareholders above a given ownership threshold can be traced, provided their shares are held in blocks sizeable enough to be reported (typically around 5%). Some firms are included which are exceptional to this rule in either of two ways. The first is if there exists an owner whose identity cannot be traced, but detailed information on a larger owner who claims more than 50% of the company’s stock is available. The second is if there exists share blocks whose owners cannot be traced due to their being held via a nominee or trust account, but whose sum total is less than the proportion of shares held by a revealed owner whose identity is traceable. In either of these cases the largest shareholder can still be identified. Conversely, a company is excluded from the dataset if shares held in trust (or through a nominee account) amount to a greater proportion of outstanding shares than that which the largest revealed shareholder can be shown to control. A company is also excluded from the dataset if there exists a significant shareholder whose identity is not discernable due to a lack of information about the intermediate non-publicly-traded firm through which these shares are owned.

It is recognized that a bias is likely introduced by excluding firms whose largest owners hold shares through trust accounts, nominee accounts, or holding companies whose ownership structure is not discernable. In putting together their earlier dataset, Claessens et al. (2000) report the same problem regarding nominee accounts. By determining the group-affiliation of the problematic firms, they conclude the direction of their bias is against uncovering family ownership. Through the reading of annual reports and stock exchange data a useful reflection of each country’s largest firms in order to draw comparisons with a country’s 200 largest firms in 2008.

Companies that belong to the same business group are not treated or counted differently from firms that do not belong to a group when determining the relative ownership levels as reported in table two.
filings, most nominee account holders have also been found to be an individual or family where the information has been revealed. Hence, the direction of this bias is likely to be the same as that concluded by Claessens et al. – away from family ownership. Moreover, this is consistent with the stronger incentives for families and individuals to hide their control of a company through the use of trusts, nominee accounts, and shell holding companies. A related bias is introduced through the selection criterion used more generally. Widely-held corporations are most easily identifiable, while corporations who have outstanding share blocks greater than the ownership threshold immediately lend themselves to the possibility of exclusion noted above. Taken together, these biases suggest that the reported incidence of widely-held corporations is likely understated, with the incidence of family-ownership being overstated. The incidence of state ownership is likely to be the most accurate. In total, ultimate ownership is identified for 1,386 firms in 2008, with 210 firms being state-owned, and 68 firms having foreign state ownership.

**State Ownership Patterns**

Figure one shows cross-country patterns for the extent of state ownership of a country’s largest enterprises in 1996 and 2008. 1996 is a useful moment to gauge the relative importance of state ownership because it is just prior to the onset of the Asian Financial Crisis. The AFC dramatically illustrated the perils of financial globalization to the region’s political elite, as they witnessed economic turmoil lead to regime change in Indonesia and Thailand. 2008 is an opportune time to re-examine ownership arrangements as new patterns had consolidated their position in the wake of the crisis by this point. Brunei was not included in the ownership dataset because it does not have a stock exchange. It is included here because of its theoretical importance as an extreme case in which the state dominates ownership of the corporate sector.

The figure clearly shows that state ownership is highest for Brunei and Singapore in 1996. Following the AFC, Malaysia joins their ranks; but state ownership remains relatively low for the remaining countries notwithstanding marginal changes. Although state ownership displays a notable decline in Singapore, this is not a reflection of the withdrawal of the state from the corporate sector; rather, this change reflects the consolidation of the state’s ownership of strategically important firms and industries.
Figure 1. Cross-National Patterns of State Ownership

![Bar chart showing state ownership across countries over time](chart.png)

Note: State ownership includes firms with a state agency/ministry controlling at least 10% of the voting stock. Data are for each country’s 200 largest publicly listed firms at the end of 1996 and 2008, except for Brunei.

Source: Carney and Child (2013), except for Brunei.

Figure two displays foreign state ownership positions by country of origin based on the 2008 dataset. It is noteworthy that in 1996, no ownership positions were identified as being held by a foreign state in the Claessens et al (2000) dataset. Foreign state ownership only appears in the wake of the Asian Financial Crisis. A number of countries from outside East Asia also hold a small number of ownership positions. I restrict the reporting of foreign state ownership to those countries located in the East Asia region both because they are of intrinsic interest and because they hold the largest number of ownership stakes. After taking these data reporting considerations into account, three East Asian countries stand out for their high levels of foreign ownership, including Singapore, followed by Malaysia, and then China. The governments of Taiwan and Thailand also have a small number of ownership positions. Interestingly, the data reveal that only the SWFs of Singapore (Temasek) and Malaysia (Khazanah) have ownership stakes large enough to permit their identification, and to therefore potentially wield influence over the management of the target company.
Figure 2. Foreign State Ownership Positions by Country of Origin, 2008

Note: Sample includes 200 largest firms by market capitalization for 9 East Asian Countries
Source: Carney and Child 2013

Figure three shows foreign state ownership positions by host country in 2008. Indonesia, followed by Thailand, and then Singapore have the highest number. Likewise, SWF ownership is highest for Thailand and Indonesia (again, Temasek and Khazanah), and these two dominate SWF ownership positions throughout the region.
Sovereign Wealth Funds

As the data in figures two and three show, sovereign wealth funds have become increasingly important intermediaries through which states initiate and manage corporate ownership positions. But the extent to which these funds can pursue political aims is restricted by their funding source as well as their purpose. Funding sources may include pension savings, foreign exchange reserves, sales of commodities and fiscal surpluses. The purpose of a SWF may include the following categories: pension reserves, reserve investments, macroeconomic stability, and saving for the future. Pension funds, for example, generally face strong oversight and tight restrictions on their investment strategies due to their pension payments obligations. They may engage in ownership positions through equities purchases, as displayed in figure four, but are unlikely to pursue political objectives at the expense of prudent portfolio allocation. Data from Turner and Bagnall (2013), for example, demonstrates that pension funds exhibit the highest levels of transparency and compliance with the Santiago Principles concerning SWF best practices in comparison to other types of sovereign wealth funds.

Figure 3. Foreign State Ownership Positions by Host Country, 2008

Note: Sample includes 200 largest firms by market capitalization for 9 East Asian Countries
Source: Carney and Child 2013
Governments with a surplus of foreign exchange reserves face pressures to invest these funds overseas in order to reduce upward pressure on the exchange rate stemming from persistent current account surpluses. Additionally, reserve funds seek to reduce the negative carry costs of holding reserves or to earn higher returns through sizeable allocations to equities and alternative investments (e.g., up to 50 percent in South Korea and 75 percent for Singapore’s GIC). But investing overseas introduces pressures to abide by international norms and rules, thereby reducing the capacity for states to use these funds for strategic investments. Usually the funds are invested in a passive, diversified manner that maintains a low ownership stake in any one company in order to meet foreign investment regulations and to quell concerns about political influence.

SWFs that are funded by fiscal surpluses and commodities sales can more easily engage in long-term, strategic investments. Indeed, these funds offer the greatest insight into how politics may influence sovereign wealth behaviour, and in turn, the state’s motivations for owning select corporations. But these funds also exhibit variation in the extent to which they can be directed toward owning corporations depending on their purpose.

Stabilization funds are the least likely type of fund to engage in ownership of listed companies. Because they seek to buffer the economy from commodity price volatility and external shocks, they primarily invest in a highly liquid portfolio of assets, such as fixed income and government securities. The IMF Global Stability Report (2012) indicates that these investments occupy 70 to 80 percent of the portfolio, as displayed in figure four, leaving little room for equities investments.

Saving funds, by contrast, face the fewest restrictions on their capacity to initiate corporate ownership positions. Their aim to share wealth across generations leads to investments via a high risk-return profile including a high proportion of equities and other
investments that commonly exceeds 70 percent (Al-Hassan et al 2013). Thus, SWFs that are funded by commodities sales or fiscal surpluses in conjunction with the purpose of saving for the future offer the greatest opportunities for the state to initiate significant, long-term ownership positions.

With these characteristics of sovereign wealth funds in mind, we can now turn to an overview of them for East Asia. Table one categorizes the region’s SWFs by their funding source, with the major purpose of each fund identified on the right side of the table. SWFs with the combination of commodities sales/fiscal surpluses and saving are located in the following countries: Brunei, Indonesia, Malaysia, and Singapore. Taiwan has a fund that relies on fiscal surpluses, but its primary purpose is macro-stability, making it unlikely to invest substantially in equities. Although Indonesia’s fund engages in saving, it has so few assets that it is not an influential investor. Thus, the funds of greatest interest, and those most likely to initiate and manage sizeable, long-term corporate ownership positions are those located in Brunei (Brunei Investment Authority), Malaysia (Khazanah), and Singapore (Temasek). An additional feature of note is the dual or even multiple purposes that some funds fulfill. Brunei’s BIA fulfills all four purposes, while Malaysia’s Khazanah serves dual purposes. By contrast, none of the other funds aside from Indonesia’s serve more than one purpose. That these funds serve multiple purposes is indicative of the high fungibility of resources for these funds, and is also compatible with their low levels of transparency as indicated by the Truman and Santiago Principles scores. The global sample of these funds indicates that pension funds have the highest scores for these two measures, followed by reserve funds, and then commodity funded and fiscal surplus funds. The East Asian funds listed here mirror that global pattern.

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5 Development funds are another class of SWF established to allocate resources to priority socio-economic projects, usually infrastructure. I follow Al-Hassan et al (2013) in grouping them together with saving funds.
Table 1. East Asian Sovereign Wealth Funds

<table>
<thead>
<tr>
<th>Country</th>
<th>Fund Name</th>
<th>Year Founded</th>
<th>SWF Assets 1996 (Bill USD)</th>
<th>SWF Assets 2008 (Bill USD)</th>
<th>SWF Assets over GDP 1996</th>
<th>SWF Assets over GDP 2008</th>
<th>SWF Assets over GDP 2012</th>
<th>Foreign Assets as % of Total</th>
<th>Truman Score 2012</th>
<th>Compliance with Santiago Principles 2012</th>
<th>Purpose: Macro stability</th>
<th>Purpose: Saving</th>
<th>Purpose: Pension Reserve</th>
<th>Purpose: Reserve Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brunei</td>
<td>Brunei Investment Agency</td>
<td>1983</td>
<td>15</td>
<td>30</td>
<td>40</td>
<td>2.94</td>
<td>2.1</td>
<td>100</td>
<td>21</td>
<td>28</td>
<td>X</td>
<td>X8</td>
<td>X9</td>
<td>X10</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Government Investment Unit</td>
<td>2006</td>
<td>--</td>
<td>0.30</td>
<td>--</td>
<td>0.0006</td>
<td>0.0002</td>
<td>100</td>
<td>NA</td>
<td>NA</td>
<td>X11</td>
<td>X12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>Khazanah Nasional</td>
<td>1993</td>
<td>3</td>
<td>19</td>
<td>39.1</td>
<td>0.03</td>
<td>0.08</td>
<td>10</td>
<td>59</td>
<td>64</td>
<td>X13</td>
<td>X14</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>Temasek</td>
<td>1974</td>
<td>75</td>
<td>159</td>
<td>173.3</td>
<td>0.4</td>
<td>70</td>
<td>76</td>
<td>82</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>Taiwan Stabilisation Fund</td>
<td>2000</td>
<td>--</td>
<td>15</td>
<td>17.2</td>
<td>--</td>
<td>0.04</td>
<td>0.02</td>
<td>NA</td>
<td>NA</td>
<td>X15</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Funding Source: Oil

Funding Source: Fiscal Surpluses

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6 Truman and Bagnall 2013
7 https://openknowledge.worldbank.org/bitstream/handle/10986/12639/705770ESW0P1110NAL00310July020080v2.txt?sequence=2
9 http://en.wikipedia.org/wiki/Brunei_Investment_Agency; BIA manages funds from the Worker’s Provident Fund.
10 http://www.sovereignwealthfundsnews.com/bruneiinvestmentagency.php
11 http://www.swfinstitute.org/swfs/government-investment-unit/
12 http://www.swfinstitute.org/swfs/government-investment-unit/
### Funding Source: FX Reserves

<table>
<thead>
<tr>
<th>Country</th>
<th>Funding Source</th>
<th>Year</th>
<th>Funding</th>
<th>Exchange Rate</th>
<th>Current Value</th>
<th>5-Year Average</th>
<th>10-Year Average</th>
<th>15-Year Average</th>
<th>20-Year Average</th>
<th>40-Year Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Korea</td>
<td>Korea Investment Corporation</td>
<td>2005</td>
<td>--</td>
<td>30</td>
<td>56.6</td>
<td>0.03</td>
<td>0.03</td>
<td>100</td>
<td>69</td>
<td>76</td>
</tr>
<tr>
<td>Singapore</td>
<td>Government Investment Corporation</td>
<td>1981</td>
<td>110</td>
<td>220</td>
<td>247.5</td>
<td>1.97</td>
<td>2.13</td>
<td>1.29</td>
<td>100</td>
<td>66</td>
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</tbody>
</table>

### Funding Source: Pension Contributions

<table>
<thead>
<tr>
<th>Country</th>
<th>Funding Source</th>
<th>Year</th>
<th>Exchange Rate</th>
<th>Current Value</th>
<th>5-Year Average</th>
<th>10-Year Average</th>
<th>15-Year Average</th>
<th>20-Year Average</th>
<th>40-Year Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>National Social Security System</td>
<td>2014</td>
<td>--</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Korea</td>
<td>National Pension Service</td>
<td></td>
<td>368</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>Employees Provident Fund</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>Social Security System</td>
<td>1957</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>Central Provident Fund</td>
<td>1955</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>Gov Pension Fund</td>
<td>1997</td>
<td>--</td>
<td>17</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>18</td>
<td>80</td>
</tr>
</tbody>
</table>

Sources: Foreign exchange reserves excluding gold: World Bank; Sovereign Wealth Fund data: SWF Institute and Sauvant, Sachs, and Jongbloed (2012); IMF (2011).
Compliance with Santiago Principles and Truman Scoreboard come from Bagnall and Truman (2013).

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18 [https://www.gpf.or.th/eng2012/about_gpf.asp](https://www.gpf.or.th/eng2012/about_gpf.asp)
III. Theory

I argue that state ownership is increasingly used by authoritarian regimes as a mechanism to protect incumbent leaders from regime threats. Since the 1990s, a “major explosion” in financial globalization among emerging economies has occurred (Rodrik 2008), posing an increasingly significant threat to the political control of incumbent leaders in two ways. First, it magnifies the risk of a financial crisis that could cause political turmoil. Second, financial globalization expands access to resources, denying an important tool by which an incumbent regime may control and weaken political challengers. The policy options chosen in response to these threats, and the manner by which these options are implemented, correspond to varying state ownership arrangements.

I argue that the manner by which varying forms of state ownership are implemented can be largely explained by the combination of two regime attributes: centralization of control and coordination commitments. Centralization of control refers to the lack of formal institutional checks on executive decision-making, or veto-points (MacIntyre 2001; Tsebelis 2002). Coordination commitments concern whether political elites must tend to particularistic or broad coalitional needs to sustain their rule (Evans 1995; Campos and Root 1996; Waldner 1999; Doner, Ritchie, and Slater 2005). The composition of coalitions and the relative importance of actors within the coalition influence the specific manner by which state ownership initiatives are implemented. In prior work, these two theoretical approaches have been used in isolation to offer compelling explanations for East Asian political economy phenomena. Combining them yields novel and intriguing insights. I begin with an overview of the threats that regimes face from financial globalization before turning to potential responses.

Regime Threats

State ownership is increasingly used as a tool by authoritarian regimes to protect political incumbents from regime threats. In recent times, the greatest source of instability is due to financial globalization, via two specific threats. Financial globalization poses a first threat to regime stability by heightening the potential for an exogenously induced shock. Governments may implement a range of policy options to mitigate their vulnerability, such as exchange controls, managed exchange rates, domestic ownership regulations, responsive welfare state policies, and the accumulation of foreign exchange reserves. But it is the last option – the accumulation of foreign exchange reserves -- which enables the creation of a sovereign wealth fund that could lead to a rise in state ownership.

Financial globalization’s second threat occurs via the expanded access to resources outside of a regime’s control. Financial globalization expands access to resources via greater inward capital flows such as foreign direct investment and portfolio flows, as well as by easing domestic firms’ access to international capital markets and/or foreign financial institutions. Whereas the first threat affects all regimes, the second threat primarily affects those regimes which seek to deny resources to political challengers -- authoritarian regimes. There are several options by which these regimes can address this threat. One option is to do nothing. This may occur if a regime is confident that it can crush political challengers without provoking a backlash. A second option is to close the economy and prevent firms from accessing international markets. This option will likely blunt economic growth, which may

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19 The speed and volume of these flows have grown in recent times due, in part, to the global diffusion of liberalizing standards governing capital accounts, financial markets, exchange rates, accounting systems, and banking (Elkins and Simmons, 2004; Simmons, Dobbin and Garrett, 2006; Walter 2008; Büthe and Mattli, 2010; Bach and Newman, 2010).
backfire if a regime’s legitimacy depends on economic performance. A third option is for the state to acquire ownership of firms allied to political challengers. This is attractive not only because it will deny resources to political challengers, but also because it can be used to reward loyal supporters and create a new revenue stream for the regime.

Regime Attributes and Responses

I argue that the transparency and relative size/extent of SOEs and SWFs depend on the joint effect of a regime’s centralization of control and coordination commitments. Before examining their joint effects, it is necessary to enumerate their individual effects.

Centralization of Control

Highly centralized control refers to unchecked decision-making power, as in authoritarian regimes. While authoritarian rule depends on the support of allied groups, ultimate decision-making authority rests in leaders’ hands. To preserve their power, control over the state’s most valuable resources is essential, including the economy’s largest corporations. Threats to the regime will prompt a defensive reaction that heightens the state’s control over these valuable assets, and deny their use to political challengers.

The first threat associated with financial globalization – an exogenous shock – may cause a sufficient economic and political rupture to grant an opportunity to political challengers to overthrow the regime. The accumulation of foreign exchange reserves is one of several policy tools to dampen such a shock, and it permits the state to purchase corporate ownership stakes. But these purchases are likely to be concentrated in foreign markets due to the need to alleviate the “Dutch disease” phenomenon, ensure macroeconomic stability, and diversify investments across markets. Likewise, ownership stakes will usually remain at low levels as a result of the diversification of the fund’s portfolio and to remain below key regulatory thresholds.

The second threat -- access to foreign financing for political challengers -- is magnified when accompanied by a financial crisis. Authoritarian regimes therefore have strong incentives to deny resources to political challengers as financial globalization grows, and state acquisitions are an effective means by which to accomplish this. The absence of veto points in authoritarian regimes eases state acquisitions of private firms by denying a veto to opposing groups. Opposition to state purchases would arise not only from the targeted firms and their political backers, but also from the business community more widely out of fear that state encroachments on private property may go unchecked (North and Weingast 1989).

Regimes with low centralization of control, or numerous veto-points, are usually democracies. Financial globalization’s first threat – an exogenous shock – is also a concern to these regimes, although the survival of the regime is usually not at stake; rather, the incumbent party’s success at the next election is the main concern. But because their electoral success turns on their ability to deliver good economic performance, political leaders must

20 In resource-based economies, upward swings in commodity prices tend to result in a boom in aggregate domestic demand, inflationary pressures, and thus an appreciation of the real exchange rate vis-à-vis trading partners. Those conditions, in turn, make the non-commodity sector less competitive in international markets—a phenomenon known as the Dutch Disease. By augmenting the country’s net external asset position in a way consistent with economic structure and fundamentals, the SWF would help maintain external stability over the long term.
insure against an exogenous shock. The accumulation of foreign exchange reserves is one possible response, and this may contribute to state purchases of listed corporations, though they will primarily be located in foreign jurisdictions for the same reasons mentioned above.

The second threat – political challengers accessing foreign resources – is not addressed by stable democratic regimes because of commitments to protect the democratic process which usually entail access to financing for political candidates from their supporters. Again, the survival of the regime is not at stake, only the incumbent party’s success at the next election. Additionally, democracies decentralize political power and thereby grant business owners the potential to block state acquisition initiatives. More veto points make state initiatives slower to occur, if they occur at all, and to be more incremental in their consequences. Because democracies grant more power to business owners, state owned enterprises are likely to be fewer and SWFs will be less easily manipulated for political leaders’ narrow objectives. Hence, the extent of state ownership is likely to be lower in regimes with less centralized control.

While centralization of control can explain the extent of state ownership, it cannot account for how that control is exercised; in other words, the level of transparency. For example, in Singapore and Brunei, two countries with comparably centralized control and extensive ownership of the private sector, SWFs and SOEs in the former are far more transparent than those in the latter. To explain this puzzle, it is necessary to also consider regimes’ coordination commitments.

**Coordination Commitments**

Broad coordination commitments emerge from the need to implement policies that require accommodation among multiple parties. In the context of developmental states, leaders with broad commitments are often pressed to “redistribute assets, such as land, identify areas for new investments, establish education and training programs that upgrade skills valued by the market, and set up manufacturing and agricultural extension programs that improve the competitiveness of firms” (Doner, Ritchie, and Slater 2005). Such policies require reliable and substantial amounts of specialized information, as well as the willingness of actors to wait for benefits to appear long after costs are incurred. The complexity of these policies in conjunction with the uncertainty of their payoffs requires the active “buy-in” of numerous parties. This requires mechanisms that facilitate information flows between state agencies and private actors regarding market conditions as well as credible commitments that the policies will be faithfully implemented and side-payments delivered. These public-private mechanisms may emerge as formal “deliberation councils” and joint statutory boards or more ad hoc advisory councils. While these mechanisms produce greater transparency about the regime and more confidence that it will fulfill its commitments, they do not equate to the regime relinquishing control over key resources and assets. Hence, broad coordination commitments will have greater influence on transparency than on the extent of state ownership.

By comparison, regimes with particularistic coordination commitments refrain from engaging in such information-sharing mechanisms designed to enhance confidence in the regime’s policy initiatives. Regimes with particularistic coordination exist in one of two different forms. The first type is governed by a narrow elite which has the power to implement policies unilaterally. Monarchies such as Saudi Arabia and Brunei are clear examples. The second type arises when a country has a fragmented society in which the executive lacks the power to implement substantive policies (Migdal 1988). The Philippines, which is ruled by powerful local families, is a clear example.
The threat of an exogenous shock as well as the threat of political challengers is of grave concern to regimes with the first form of particularistic coordination. In this case, a narrow elite governs the country, and their hold on power may be precarious depending on the resources at their disposal. There are strong pressures for the state to control the country’s most valuable resources – often the largest corporations – and to do so in a nontransparent manner. Lack of transparency allows for the fungibility of resources so leaders can both line their pockets as well as allocate resources for political reasons despite the potentially negative consequences for other actors.

These threats are also of concern to regimes with the second form of particularistic coordination; however, the capacity to address these threats is hampered by the weakness of the state relative to society. Local “bosses” will prevent state intervention over local resources and assets, thereby denying the capacity to initiate state acquisitions. Thus, transparency is less of an issue than the actual capacity to initiate state acquisitions in the first place.

In the context of a regime with broad-based coordination commitments, the widespread consequences of an exogenous shock will press leaders to create a SWF if sufficient reserves are available. The second threat – access to resources by opposition political groups – is of primary concern to authoritarian regimes and leaders in these regimes will implement state ownership to control resources and deny them to challengers. At the same time, the incumbent regime may engage in privatization initiatives to co-opt the populace and gain their support for the incumbent regime. Likewise, both policy options (creating a SWF and the strategic use of SOEs) will be pursued in a fairly transparent manner as the state depends on the cooperation and support of numerous socioeconomic groups.

The problem with this perspective is that countries with similar coordination commitments can have vastly different levels of state ownership despite having comparable levels of transparency. Consider Korea and Singapore, for example. Both regimes maintain broad coordination commitments. Likewise, the Korean Investment Corporation displays a nearly equivalent level of transparency to Singapore’s Government Investment Corporation (see table 1). However, Singapore has far more extensive state ownership than Korea. To explain this puzzle, as well as the puzzle of why countries with comparable levels of centralized control differ in their levels of transparency, I now turn to an integrated framework.

An Integrated Framework

Combining the two approaches into a single unified framework yields intriguing insights. In figure 5, the y-axis on the left indicates the centralization of political control; the y-axis on the right indicates the extent of state ownership. The bottom x-axis indicates the state’s coordination commitments; the top x-axis indicates the level of transparency. Clear predictions result in the form of a sideways parabola that opens to the left.
Note: Centralization of control corresponds to the number of institutional checks that the executive faces which constrain its decision-making power. A higher centralization of control is postulated to correspond to more extensive state ownership. Coordination commitments concern political leaders’ need to accommodate particularistic or encompassing interests. Encompassing governance arrangements correspond to high levels of transparency and accountability.

Figure five depicts six regime types that correspond to varying combinations of the regime attributes. I proceed along the parabola starting with the upper left case of oligarchy.

**Oligarchy.** The upper left portion of the parabola corresponds to high centralization of political control and particularistic coordination commitments. This is indicative of an authoritarian regime with power concentrated among a narrow elite, such as a monarchy. Because these authoritarian regimes depend on a narrow base of support, they are at the greatest risk of succumbing to regime threats. As a result, they are likely to accumulate foreign exchange reserves to buffer an exogenous shock, and these reserves may be deployed towards state ownership of corporations. This regime is also likely to turn to state ownership in order to control the major resources of the state and to deny their use by political challengers. Implementation of such policies by a narrow elite requires opacity so as to avoid provoking an outcry. Thus, the extent of state ownership will be high and transparency low.
Divided Nondemocracy. A divided nondemocracy is characterized by a split between two rival groups. State elites divert resources from the excluded group to the in-group which political leaders can rely on to support the regime. This is likely to occur via the distribution of political patronage such as subsidized loans and preferential access to government-funded projects. Over time, however, the danger of a political faction gaining sufficient influence and access to resources may emerge and pose a credible threat to the incumbent leaders. To stifle this threat, leaders may buy out or simply expropriate the large corporations that political challengers rely on to provide them with resources. To accomplish this without provoking a backlash, opacity is necessary. However, reliance on support from members of the in-group requires some measure of transparency to preserve their “buy-in” for regime policies. Likewise, partial privatization may occur, with shares sold to members of the in-group to preserve their loyalty, but with control remaining in the hands of the state. These conflicting needs yield transparency levels that lie between those found in regimes with broad and narrow coalition commitments, although state ownership will be extensive.

Encompassing Nondemocracy. Although political control is centralized, the regime’s leaders must accommodate the interests of the wider community as a result of the state’s high coordination commitments. The result is state ownership of the largest enterprises and control over sovereign wealth funds as important mechanisms by which the party maintains control and buffers against exogenous shocks, but state ownership will be less extensive than in regimes that depend on a narrow base of support or have more divided politics. This type of authoritarian rule will therefore have the highest level of transparency due to its broad coalition commitments. Likewise, partial privatization is likely to be used as a mechanism by which to co-opt the population to supporting the incumbent regime, but with the regime retaining ultimate control.

Encompassing Democracy. High coordination commitments in conjunction with low centralization of control correspond to this regime type. In this more democratic context, business owners will have greater influence over the policymaking process. They are unlikely to favor state ownership because it may deny commercial opportunities to them, it may lead to crowding out of investment, and it could lead to competition with SOEs. As a result, there are likely to be fewer SOEs than in an authoritarian regime. The main threat to this regime is an exogenous shock that could lead to a change in the ruling party at the next election; if sufficient reserves are available, a SWF may be created. The regime’s high coordination commitments will also yield transparent management of SWFs and SOEs.

Divided Democracy. Where the populace is divided, there is perpetual concern that the next party to take office will undo the policies of the previous one. The uncertainty of holding on to power beyond the next election hampers the capacity to make long-term commitments. While a particular group or party may pursue what it regards as the nation’s aggregate welfare, this will invariably differ from the vision held by the opposing party. As a result, the creation of a sovereign wealth fund that could have distributionally unequal benefits makes its creation difficult to begin with. This is not to say that it will not occur; if responsibility for its administration is delegated to an independent agency in a manner similar to that of an independent central bank, then such an entity could exist and thrive. But this is difficult to accomplish and sustain. Transparency is likely to be high so long as democratic processes are respected and corruption contained. Additionally, as a democratic regime in which politicians are beholden to powerful constituents such as business owners, the state is unlikely to maintain extensive ownership stakes in commercial enterprises.
Fragmented Democracy. Fragmented democracies often arise when political leaders’ credibility to deliver on electoral promises has not yet been established and they must therefore deliver goods to a loyal base of supporters (Keefer 2007; Keefer and Vlaicu 2008). Fragmented coordination is therefore especially common among young democracies and those in which corruption remains a persistent problem (Migdal 1988; Sidel 1999). Corruption commonly coincides with a lack of transparency, enabling special interests to benefit at the expense of the aggregate welfare. But, in these regimes, political leaders lack the political capacity to use public funds to bolster the regime’s control through SOEs. Often, the political system degenerates into rent-seeking of state resources by particularistic interests, with political representatives acting on behalf of those interests. The incapacity for coordination among political and business elites in deciding the allocation of public finances also stymies the creation of a SWF that could offer non-targeted benefits such as macroeconomic stabilization. As a result, formal government initiatives to enhance state ownership and/or investments by a SWF face difficulties.

IV. East Asian Cases

Financial globalization has become a particularly acute threat to political leaders in East Asia, many of whom experienced unprecedented economic and financial shocks in 1997 in addition to witnessing the fall of both the Indonesian and Thai regimes. The argument contends that countries implement state ownership in accordance with their domestic political arrangements. If authoritarian regimes did not already intervene extensively in the private sector, and even for those which did, the 97 crisis jolted authoritarian leaders into reassessing and potentially enhancing the state’s role. In figure 6, East Asian countries are placed on a parabola at their approximate location corresponding to the two political attributes.
Figure 6. East Asian Cases

Centralization of Control

Low

High

Coordination Commitments

Particularistic

Encompassing

Transparency & Accountability

Low

High

Oligarchy: Brunei

Divided Nondemocracy: Malaysia

Encompassing Nondemocracy: Singapore

Divided Democracy: Thailand

Encompassing Democracy: South Korea

Fragmented Democracy: Philippines

Note: Centralization of control corresponds to the number of institutional checks that the executive faces which constrain its decision-making power. A higher centralization of control is postulated to correspond to more extensive state ownership. Coordination commitments concern political leaders’ need to accommodate particularistic or encompassing interests. Encompassing governance arrangements correspond to high levels of transparency and accountability.

I examine each case in detail except for Thailand. Thailand is excluded from the current study because it represents the weakest test for the theory (i.e., it is not an extreme case nor does it have fiscally-funded SWFs or significant state ownership levels). I begin with an overview of each of the remaining country’s regime attributes followed by how these have impacted state ownership and SWF (where relevant) dynamics. After assessing state ownership/SWF arrangements for the domestic context, I turn to an examination of their foreign state ownership dynamics. I expect that foreign state ownership dynamics will exhibit patterns corresponding to the country’s domestic political attributes.

**Brunei**

*Regime Attributes*

Since independence in 1983, Brunei has remained a monarchy with a high degree of centralized control and a narrow base of political support. In effect, the sultan wields the only veto. The regime also maintains narrow coordination commitments because 80% of the country’s wealth comes from the hydrocarbons industry, and the participating firms are privately owned by the monarchy. Businesses not directly involved with hydrocarbons are
almost completely dependent on the income generated by that industry, weakening the need for the regime to coordinate with business. Moreover, 70 percent of those employed in the private sector are foreigners who are issued work permits only for periods of 2 years or less. The government regulates the immigration of foreign labor out of concern it might disrupt Brunei’s society. And unlike Malaysia, where government patronage has led to the emergence of a class of Malay entrepreneurs, a genuine Brunei Malay business class remains embryonic with well-educated Bruneians preferring to work for the government. As a result, there is almost no coordination between the government and private business owners.

**Regime Defense via Narrowly Controlled State Ownership**

Threats to the monarchy’s reign from financial globalization arrived through the collapse of its largest conglomerate, Amedeo, in 1998. The collapse was triggered by the Asian Financial Crisis and the plunging price of oil. Amedeo was founded about four years earlier by the Sultan’s younger brother, Jefri Bolkiah, who was the Finance Minister and head of Brunei’s sovereign wealth fund, the Brunei Investment Authority. Prior to this crisis, BIA’s assets were estimated at US$60 billion, but Amedeo was estimated to have left debts of around US$16 billion, in addition to US$14.8 billion that Jefri was personally accused of squandering, thus depleting BIA assets by the same amount. Amedeo’s demise resulted in the immediate repatriation of 20,000 foreign workers, equivalent to nearly 20 percent of the workforce, causing havoc in Brunei’s retail sector. Additionally, private construction companies that worked with Amedeo faced bankruptcies, a significant rise in unemployment ensued, and tensions between fundamentalist and liberal Muslims increased.

Amedeo’s collapse led to a crisis of regime legitimacy. Action to the scandal was handled solely by the Sultan. The Sultan brought a lawsuit against Jefri, accusing him of stealing and misusing BIA funds. For example, the vast majority of Amedeo’s projects were for the prince and his family (Gunn 2009). These included numerous multi-million dollar projects such as the Prince’s private office, the now abandoned private mosque in Jefri’s office grounds, and the Jerudong Hotel. Only about 10 percent of the total funds (US$4.4 billion) injected into Amedeo from the BIA and others were spent on infrastructure improvements.

The Sultan took action through an unprecedented lawsuit which accused Jefri of squandering more than US$28.8 billion in state funds. In addition to the lavish projects mentioned above, Jefri reportedly also spent US$2 billion over a ten year period on 2,000 cars, 17 airplanes, including a private Airbus A310, several yachts, quantities of jewellery, and more than a dozen homes and other “trophy” investments. Jefri’s overseas assets mirrored his Bruneian investments with their lavish price tags, including the British jeweler Asprey, The New York Palace Hotel, Hotel Bel-Air in Los Angeles and Plaza Athénée in Paris.

After Brunei’s High Court ruled against Jefri, the case was referred to the Privy Council in London, the highest court of review for Brunei. In the end, an out-of-court settlement was reached in which Jefri would return all funds taken from the BIA. The private

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23 These included a Power Station, a communications tower, and an international school.
24 Civil Suit No. 31 of 21 February 2000 filed in the High Court of Brunei Darussalam.
26 Kay, Richard (September 28, 2009). “Sultan of Brunei buries the hatchet with his playboy brother”. Mail Online.
settlement solution was optimum for the Sultan because it maintained the privacy of the royal family’s wealth and privileges while placing blame on Jefri individually.

Since the scandal, the Sultan has remained the Finance Minister and therefore has retained direct authority over the BIA. But the secrecy governing the BIA’s investments and the lack of a clear line between the state’s and the Sultan’s personal funds has persisted. BIA’s founding legislation continues to make it one of a small group of sovereign wealth funds (including Kuwait Investment Authority and Oman’s SWFs) whose officers have an explicit legal obligation to keep its activities secret. It is not a member of the International Forum of Sovereign Wealth Funds and has resisted moves toward greater transparency. Likewise, the largest corporations remain firmly in the hands of the monarchy, and there are no definite plans for a stock exchange that would require disclosures to shareholders. Brunei’s reaction is notable for how it differed from its neighbors at the time. Across the region, major initiatives were launched to improve listed firms’ corporate governance rules, accounting standards, and information dissemination (Walter 2008). While implementation varied, efforts were made to at least give the appearance of greater transparency and accountability. But in Brunei, these could not occur because it did not have, and still does not have, a stock exchange. The case illustrates that where political control is highly centralized at the same time that there is very little coordination with private business, state ownership and secrecy remain paramount and uncontested.

Malaysia

Regime Attributes

Since independence in 1957, Malaysia has been dominated by a single major political coalition – Barisan Nasional. Barisan is dominated by one political party, the United Malays National organization (UMNO), which coordinates with about a dozen smaller ethnic and regional parties. Cooperation in the division of the electoral map before elections has allowed these parties to maintain continuing dominance over Malaysian politics and allowed Barisan to sustain its position as a unitary actor.27 UMNO’s dominance within Barisan grants it disproportionate control over key cabinet posts.28 Because the cabinet is dominated by UMNO, effective veto power is controlled by the UMNO leadership. Despite declining support at the voting booth since 1999, Barisan Nasional has held onto its majority control in parliament, preserving UMNO’s control over the appointment of cabinet posts and its veto power.

The regime’s coordination commitments are characterized by state-led discriminatory and redistributive policies that benefit bumiputeras primarily at the expense of the Chinese and Indian communities. This state-led coordination was entrenched following the New Economic Policy in 1971 which instituted, among other measures, programs designed to place 30% of the ownership of the corporate sector into the hands of Muslim Malays. A number of government agencies have been created to achieve these aims, including government-controlled pension funds (e.g., the Employment Provident Fund), trusteeships designed to hold corporate assets for the benefit of ethnic Malays (e.g., Amanah Raya), and investment holding companies (e.g., Khazanah Nasional).

The influx of funds to state coffers as a result of the oil boom that followed the creation of the NEP originally propelled this arrangement, especially through the allocation of public sector contracts to bumiputera firms. Because public investment is usually the most important component of total investment, these government business relationships magnified the power of the federal government, and UMNO in particular, both politically and

28 See Gomez and Jomo 1999.
The federal government’s monopoly over revenue collection and disbursement has made regional development highly dependent on federal allocation (Woo 2009). Hence, inter-company relations and business-government coordination are generally state-led and state-mediated, with the exception of ethnic Chinese businesses (Gomez 1994; Rasiah 2003).

**Regime Defense via Redistributively-Oriented State Ownership**

From independence in 1957 until 1998, the opposition was fragmented and weak. The first transformation of political party opposition began at the height of the Asian financial crisis when Mahathir sacked Anwar as Finance Minister and Deputy PM due to ‘moral impropriety’. After numerous mass protests an alliance of opposition parties was formed, the Barisan Alternatif (BA) (Alternative Front), ahead of the 1999 elections. For the first time since 1959 UMNO won fewer votes than its coalition partners combined. UMNO’s legitimacy was decisively shaken.

In response to these domestic economic and political crises as well as those of its neighbours in Indonesia and Thailand, UMNO’s leadership implemented stronger controls over budgetary purse strings and economic policy. The first of three actions to this end occurred when control of the Ministry of Finance was taken over by Mahathir. After a brief period when Mahathir’s ally Daim was in charge, control was transferred back to the PM where it has remained ever since. Second, Mahathir created the National Economic Action Council (NEAC) in late 1997, a super-constitutional organ designed to find a solution to the country’s economic crisis. At the head of its Executive Committee sat the Prime Minister, the Deputy Prime Minister, and an executive chair who also serves as Minister in the Prime Minister’s Department (Pepinsky 2008). Although the crisis had long since passed, the NEAC continued to exist as a body up through 2006 with wide discretionary authority over economic management, superseding that of economic ministries such as Trade and Industry, Public Works, Finance, and others. Third, Khazanah assumed a more active and prominent role in both domestic and foreign investments, reporting directly to the Prime Minister. Khazanah has played a central role in the regime’s bolstering of state ownership of the corporate sector both at home and abroad.

Although it was started in 1994, Khazanah’s active involvement in Malaysia’s corporate sector first occurred during the Asian Financial Crisis. Its role was often to assist (bail-out) select cronies under the guise of rescuing the economy. This occurred in three ways. First, loans were made to Danaharta, an asset management company established by the government in 1998, to isolate poor quality debt and remove them from the books of financial institutions. Danaharta borrowed a total of MYR1.3 billion from the Employees Provident Fund (EPF) and Khazanah (Business Times 2003). Second, Khazanah also directly injected capital into ailing firms in exchange for equity, a move that has been interpreted as bailouts to politically connected firms (Halim 2004). For example, Bank Bumiputra, a financial institution that had been repeatedly rescued by the government (Jomo 1988), received MYR1.1 billion from Khazanah in exchange for an 18% stake in the bank (Gabriel 1998). More controversially, Khazanah invested about MYR4 billion to take over the Renong-

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29 Anwar was held responsible for a number of unproductive megaprojects and refused to subsidize the troubled Renong Group as well as the shipping company owned by Mirzan Mahathir, the prime minister’s son. There are even indications that Anwar and his supporters tried to overthrow Mahathir, his former mentor, as party leader at the UMNO general assembly in June 1998.

30 Daim ostensibly resigned of his own accord, but political observers have noted that Daim’s business interests had come into conflict with the business interests of Mahathir’s son Mokhzani Mahathir.
United Engineers Malaysia (UEM) group (Toh 2001). The investment in Renong-UEM was Khazanah’s biggest at the time. It subsequently privatised the conglomerate to restructure the group. In so doing, Khazanah was accused of expropriating minority shareholders (Gunasegaram 2001). Third, Khazanah issued MYR3 billion worth of bonds as part of its contribution to a special fund set up to support the stock market. The fund was used to ‘buy shares from Malaysians at a premium while those sold by foreigners [were] purchased at market value’ (Business Times 1997). Khazanah also bought stocks directly in order to push up the index (Asian Wall Street Journal 1997).

Despite its active role during the Asian financial crisis, Khazanah generally managed its investments in a relatively passive manner during its first decade of existence (Halim 2004; Lord 2004). However, in 2004 Khazanah’s activities changed significantly as it was called upon to revive the competitiveness of the national economy.

One of the key links in this process was the transformation of the GLCs. But Khazanah’s close identification with the government has compromised Khazanah’s ability to make decisions on its investments and activities on purely commercial grounds. Indeed, Khazanah’s CEO, Azman Mokhtar, regards Khazanah as a ‘strategic investment arm of the government of Malaysia’ (Fong 2010). A revealing document is the Ninth Malaysia Plan (Government of Malaysia 2006), Malaysia’s first five-year development plan issued under Abdullah. The Plan, like its predecessors, placed heavy emphasis on the government’s role in coordinating the redistribution of wealth and equity in favor of bumiputera.31 And in the public debate on the most recent iteration of the Malaysian Government’s national economic management plan, the Economic Transformation Programme (ETP), launched by the current Prime Minister, Najib Tun Razak, in September 2010, full meritocracy and purely market-driven outcomes were explicitly ruled out as a means through which the nation’s economic goals would be achieved (Boo 2011). Instead, the government had to reassure the bumiputra community that they would not be marginalised.

Several examples highlight the role of politics in Khazanah’s investment decisions. The first is Malaysia’s national car manufacturer, Proton. To restore competitiveness, a partnership with Volkswagen was negotiated by Khazanah as the principal shareholder in 2007. However, this deal was cancelled at the last minute due to the negative implications for

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31 A number of bumiputra-only unit trusts have been used to this end via heavy involvement in the KLSE, such as Amanah Saham Nasional and Amanah Saham Bumiputra. To increase the wealth flowing to Malays in the wake of the country’s financial crisis, Mahathir directed the expansion of government participation in the stock market in the late 1990s and early 2000s. The government subsidiary Permodalan Nasional Berhad (PNB) also launched two more unit trusts in 2000 and 2001. Additionally, PNB manages four unit trusts open to all Malaysians, three of which were opened between 2000 and 2003; however, these still reserve many shares for bumiputera at discounted prices. Another means by which the government promotes bumiputera corporate interests is through Perbadanan Nasional Berhad (PNS), which facilitates the growth of a “bumiputera commercial and industrial community” by investing in bumiputera-controlled start-ups and distributing franchises to bumiputeras. Perbadanan Usahawan Nasional Berhad (PUNB), a wholly owned subsidiary of Yayasan Pelaburan Bumiputra (of which PNB is another subsidiary), has since 1991 complemented PNS in nurturing bumiputera entrepreneurs. PUNB’s role in promoting bumiputera franchisees and businesses owners expanded considerably in the Ninth Malaysia Plan. Below the federal level, State Economic Development Corporations perform similar functions within most Malaysian states. A wide array of government linked coordinating bodies and policy development organizations support these efforts both at the Federal level and among the Malaysian states.
a large network of bumiputera-owned SMEs that supplied parts to Proton (Barrock 2007). A second example is Iskandar Malaysia – an initiative launched in 2006 to develop the region bordering Singapore. It was projected to take 20 to 30 years and would involve the creation of a new state administrative centre, an education hub, a biotechnology hub, and various tourism projects. The key motivation for the project was political. Mega projects have offered an effective means for the Malaysian government to disburse large contracts to favoured business allies. The project offered a way for Prime Minister Abdullah to answer critics who pointed to an absence of mega-projects during his administration (Reme 2006). Khazanah has had overall responsibility for the execution of the project as well as being a major investor. A third example is Tenaga Nasional, Malaysia’s power generator and distributor. Despite Khazanah’s efforts to improve profitability, the strong political opposition of business owners on the demand side has prevented price increases, while the political influence of power producers has prevented increases in supply.

Political influence occurs partly because of Malaysia’s weak regulatory apparatus which enables nontransparency and corruption to cloud business-government relations. As measured by Transparency International, for example, Malaysia was almost precisely as corrupt in 2014 as it was in 1995. Regulatory weaknesses are due to the vulnerability of supervisory agencies to political interference. For example, agencies of public accountability such as the Anti-Corruption Agency (ACA), and the Federal Courts remain subordinate to high UMNO office holders. The ACA has the statutory authority to investigate and prosecute a wide number of offenses among public servants, but in practice, it is successful against only low-level functionaries. The Malaysian judiciary, stripped of independent authority by Mahathir in the late 1980s has faced continuing accusations of bowing to political pressure and bribery.

Although Khazanah started off with six companies that were listed on the KLSE in 1994, by September 1999 Khazanah owned stakes in eight publicly quoted companies in Malaysia that together comprised approximately 5% of KLSE’s total market capitalisation (Business Times Singapore 1999). From an initial endowment of approximately MYR7 billion, Khazanah’s investment portfolio rose to about MYR51 billion in 2004. By 2011, this had ballooned to about MYR113 billion, with investments in over 50 companies, both in Malaysia and abroad.

**Foreign State Ownership**

Reflecting its activist role domestically, Khazanah has also exhibited activist investing behaviour in foreign markets. Its mission has been the promotion of select SOEs as “regional champions” by acting as a partner in foreign markets (Taing and Siow 2008). Its overseas investments have spanned a range of sectors, but most of its activities have focused on financial services and healthcare. Despite the new focus on foreign investments, no more than about 12% of its total equities portfolio were located overseas as of 2012.

Khazanah’s activist intervention in the financial services sector can be seen from its investments in the Indonesian financial sector. In 2006, Indonesia passed a law preventing dominant ownership in more than one commercial entity by a single foreign entity. Khazanah was in violation of the new law because it had dominant direct ownership in Bank

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32 It acquired a 60% equity stake in the agency, Iskandar Investment, responsible for the development of catalyst projects. Khazanah was also the parent company of UEM, an unlisted holding company that owned about two-thirds of the land where the development would occur.

33 Single Presence Policy.
Lippo and indirectly dominant ownership in PT Bank Niaga, through Bumiputera-Commerce Holdings Berhad (BCHB) which in turn owns Malaysian bank, CIMB Berhad.

Khazanah could either reduce its holdings in one of the banks, merge them, or create a holding company to control the banks. It ultimately chose the most activist route, merging them. The new bank is known as PT Bank CIMB Niaga, and it is the fifth largest bank in Indonesia by asset size (as of 2012). The merger also helped CIMB become Southeast Asia’s largest banking group (based on the number of retail branches), thereby fulfilling the Malaysian government’s goal of developing regional champions. Additionally, BCHB became the largest single holding in Khazanah’s portfolio, and one of the largest companies in Malaysia (by market capitalization).

Khazanah’s other foreign investments in the financial sector have been in the Middle East and in Islamic finance, consistent with the Malaysian government’s goal of promoting Malaysia as an international Islamic financial centre. To this end, it bought a 10% stake in Jadwan Investment, based in Saudi Arabia in 2008, a 25% stake in Dubai-based Islamic investment firm, Fajr Capital Limited in 2009, and invested in Singapore-based Asia Capital Reinsurance Group in 2006, with which it later established an Islamic reinsurance company in Malaysia in 2008.

Khazanah’s activist investment strategy can also be seen from its activities in the healthcare sector. Building on its pre-existing joint venture with Parkway Holdings (a Singapore-based healthcare provider with the largest regional network of private hospitals and healthcare facilities), Khazanah became the second largest shareholder in Parkway Holdings in 2008. The largest shareholder at the time was the US private equity firm, TPG. But in March 2010, TPG sold its stake in Parkway to Fortis Healthcare, an India-based corporation. Fortis’s post-acquisition behaviour was regarded as “aggressive” by Khazanah, leading to Khazanah’s announcement in May that it wanted to take control of Parkway through a partial offer (Ramchandani 2010). This led to a two-month long takeover battle between Khazanah and Fortis that has been cited as a “rare example of a hostile move by a sovereign wealth fund” (Venkat et al. 2010). Khazanah eventually won and by the end of 2010 had acquired all of Parkway’s shares, which were subsequently consolidated with those in Pantai (a Khazanah-owned Malaysian healthcare provider), and two other healthcare providers to produce “Asia’s premium regional healthcare platform” (Business Times 2010).

Singapore

Regime Attributes

Singaporean politics have been dominated by the People’s Action Party (PAP) since the 1959 general election when Lee Kuan Yew became Singapore’s first prime minister. The PAP has been in government and won every General Election since then leading many to conclude that Singapore is a de facto one-party state. While the political system includes formal separation of powers, in practice there is almost no mechanism by which to effectively oppose PAP policies. This has contributed to the PAP’s unitary veto power.

At the same time, Singapore’s political leaders consult extensively with business (both domestic and foreign) and labour. With a lack of natural resources in conjunction with a

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34 This claim is bolstered by the lack of an independent media to foster political awareness among its citizens -- all the papers and broadcast stations are controlled by the ruling party. The use of defamation and bankruptcy actions against government critics has further contributed to an environment lacking in free and open political debate and the difficulty of forming political and civic organizations that are free of state interference and surveillance (Bryan 2007).
threatening regional security environment, PAP leaders have required broad-based support to sustain the legitimacy of their rule.

With promises of economic redistribution as an antidote to the spike in labour militancy in the years following World War II, LKY’s PAP won Singapore’s first popular elections in 1959. But Singapore’s forced separation from Malaysia in 1965 “threw Singapore into geopolitical limbo, creating a ‘sense of vulnerability’ and shared hardship among the population” (Doner et al. 2005). Severe Malay-Chinese racial riots in 1964 heightened this sense of vulnerability, which was magnified by Britain’s 1967 decision to accelerate military withdrawal from Singapore by 1971.

In response, the PAP implemented an export-led development strategy that would bypass unfriendly regional markets and export directly to international markets. But the success of this strategy depended on the support of a broad coalition of labour and business without raising exporter’s costs. This strategy led to the creation of a series of institutions and programs to attract foreign investment while simultaneously balancing rising wages with rising labour productivity. It began with the creation of the Economic Development Board in 1961 to attract foreign investment, followed by the National Wage Council in 1972 to reduce upward wage pressure. This was followed by the Skills Development Fund in 1979 to bring higher skills jobs to Singapore, followed in turn by the Productivity and Standards Board and the Institutes for Technical Education in the 1980s to moderate wage increases with productivity improvements. Finally, the Local Industry Upgrading Program was initiated in the 1990s in conjunction with 13 institutes to encourage research in new markets such as data storage.

In sum, the PAP’s political legitimacy rested upon growing the economy through export-led development that required the participation of labour and business, both local and foreign. This ongoing collaboration demanded the support of a broad-based coalition in exchange for improvements in the quality of life and the business environment.

Regime Defence via State Ownership with Inclusive Characteristics

Following independence, major state-run initiatives were launched in order to spur the provision of public infrastructure as well as revitalize industrial assets formerly managed by the British colonial government (Huff 1994; Low 1998; Rodan 1989; Tsui-Auch 2005; Worthington 2003; Yeung 2005). Many state-controlled statutory boards were established to oversee the provision of roads, electricity, housing, transport, and communication services. State-owned enterprises spun off from these statutory boards evolved into some of the government-linked companies (GLCs) that dominate key sectors of today’s economy. One of these statutory boards, the EDB, was charged with overseeing public investment in the industry sector starting in 1963 when seven public enterprises in manufacturing were established. S. Dhanabalan (2001), Chairman of Temasek Holdings, recollected that the “EDB was not only invited to take equity interest in these projects, but many of these projects would not have started if EDB had not been prepared to share in the risk.”

Due to their virtual monopoly, the state’s commitment to operating its GLCs on a strictly commercial basis, and its sound finance policies in the public sector, these corporate entities were profitable and contributed earnings to the state. After eight years of operation, the EDB was restructured in 1968 to focus on inward investment promotion; its equity investments in public enterprises were taken over by the Ministry of Finance (MoF) (Dhanabalan 2001). Equity investments in 35 companies directly owned by the MoF were later transferred in 1974 to a separate company – Temasek Holdings – that was created to oversee and monitor these companies.

During its first few years, Temasek Holdings served as a holding company to monitor activities of its companies, and to keep the Minister for Finance and the Cabinet informed
about their performance. Its present chairman, S. Dhanabalan, who was a former Cabinet minister, recalled that “there was no supervisory function [for Temasek Holdings]. Each company had its own management who were accountable to its own board . . . The Government’s main interest was to make sure the right people were in charge and after that the management was to chart its own course. That approach carried on in Temasek.”

By 1979, Temasek Holdings had adopted a new and more active approach to provide focus and direction to its companies to pursue national development objectives and by 1983 the state had directly invested in 58 companies. These companies in turn wholly owned or partially owned around 490 Singaporean firms (Huff 1995: 1428).

During the 1980s and up to the early 1990s, Temasek Holdings began to exit its stakes in nonstrategic and viable companies through public listing and other forms of divestment. The privatization plan was announced by Tony Tan, the then Finance Minister, in Parliament on 8 March 1985. The initiative could be seen partly as a response to the 1984 election during which the PAP lost two elected seats in the Parliament to the opposition party for the first time in its history. Sikorski (1989: 89), for example, argued that “[i]f the December 1984 election can be seen as a precipitant for the privatization policy announced in March 1985, the government may have reasoned that the population would inevitably demand more politics at the expense of economic rationality.”

On the one hand, corporatizing and privatizing state-owned enterprises would reduce pressure from the private sector that had been calling for greater involvement in the domestic economy. On the other hand, the initiative would allow more ordinary Singaporeans to have greater stakes in the Singapore economy through their acquisition of shares of these former state-owned enterprises, often at a discount, as in the case of SingTel’s public offering in 1993. This political strategy of increasing the stake-holding of Singaporeans in national firms created a scenario of mutual dependence that favoured the ruling PAP. While Singaporeans could benefit from the rising value of their stakes in most of these publicly-listed GLCs (e.g. at an all-time high just before the Asian Financial Crisis starting in August 1997), the state had a vested interest in ensuring the continual growth and profitability of these GLCs so that their financial contributions to the state (through Temasek Holdings as the controlling shareholder) and ordinary Singaporean shareholders could be sustained. In short, as long as Temasek Holdings-controlled GLCs prospered and grew under the PAP government, the ruling party would be assured of its political legitimacy and popular votes.

This process of corporatization also led to the separation of regulatory functions and business activity thereby reducing any perceived conflict of interest. For example, Singapore Telecom (SingTel) emerged from the Telecommunication Authority of Singapore (TAS) and was incorporated and publicly listed in 1993. The TAS was subsequently merged with the National Computer Board on 1 December 1999 to form the Infocomm Development Authority of Singapore, a statutory board serving as the regulator of information technology and telephony in Singapore. The same separation of business and regulation also occurred to the Port Singapore Authority (PSA) when its business activity was incorporated as PSA Corporation in October 1997 and its regulatory function was transferred to the Maritime Authority of Singapore (established in February 1996). The low level of corruption has bolstered confidence in the commercial priorities of the Singapore government and its GLCs. At the same, however, Tsui-Auch and Yoshikawa (2010) observe that the state’s strong presence in the corporate sector reflects its fundamental belief that GLCs are “safeguards of national security.”

Foreign State Ownership

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In line with maintaining accountability to its shareholders (including the government -- by extension labour and business, both domestic and foreign), Temasek (and GIC) adopted voluntary investment principles that would enhance transparency, as prescribed in the Santiago Principles. While Temasek maintains that its approach to asset management is fully predicated on a commercial basis with no direct involvement from the Singapore government, the significant role of its Chairman (a former Cabinet minister) and CEO (wife of current Prime Minister), suggest that its investment approach likely aligns with the state’s broader economic strategies.

This ‘double bottomline’ mentality of maximizing profits and taking care of national interests has not necessarily led to political interference in the conduct of corporate strategy. But it suggests that it chooses its investments with both considerations in mind, Temasek has distanced itself from direct intervention in newly acquired foreign entities by delegating its corporate governance role to the top executives and managers of its subsidiaries. Temasek’s hands-off approach is also evident in its foreign investment strategy – it typically acquires minority equity stakes in almost all its overseas investments, with the exception of those in Indonesian banks, where it is focusing mainly on enhancing market value, rather than seeking to exercise control. Temasek’s approach contrasts with that of Khazanah, which prefers to take a majority stake in its overseas investments so that it can have adequate board representation to influence business direction and safeguard its interests.

The GIC, by comparison, deliberately takes a low profile in its foreign investments, taking small stakes of typically below 0.5% and avoiding direct intervention in management. Although GIC fully adopted the Santiago Principles and exhibits high transparency and accountability scores, it nevertheless faces criticism for its lack of transparency in comparison to Temasek. In May 2008, its Chairman, Minister Mentor Lee Kuan Yew, defended the GIC’s (lack of) transparency on the basis of the need for the GIC to be insulated from domestic political pressures in its allocation of investment funds and to protect the integrity of its global investment strategy from its competitors (see also Elson 2008: 91; Wu 2008: 120). But with 13 out of 15 board members directly linked to the Singapore government as of April 2010 (including four preceding and the present finance ministers), the GIC’s full independence from the Singapore government is questionable, particularly with respect to its nominal ‘parent’, the Ministry of Finance. To maintain domestic legitimacy, the Government of Singapore has taken steps to ensure that the GIC’s purpose, mandate, and accountability structure, which are crucial components of institutional legitimacy, are enshrined in the country’s Constitution. Clark and Monk (2012) report that reserves are accumulated in the key Statutory Boards and Government Companies (SBGCs) listed under the Fifth Schedule (such as the GIC) of the Singapore Constitution. There are various checks and balances by the Singaporean Constitution that safeguard these reserves from misuse. In fact, Singapore’s Constitution actually ties the hands of all future governments with respect to using reserves, allowing them to draw down on only the reserves accumulated during the term of office of the government. In this way, Singapore is stricter with its reserves than Australia, which holds to the principle that the current Parliament cannot tie the hands of future Parliaments (Clark and Monk 2010).

South Korea
Regime Attributes

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The Santiago Principles were developed by the International Working Group of the Sovereign Wealth Funds, which was first established at a meeting of countries with SWFs in Washington, DC, in 2008.
Korean democratic institutions consist of a presidential system with an executive, a unicameral legislature with multiple parties, and a judicial branch, each with veto power. Historically, the chaebol have wielded substantial influence in the Korean political process (Kang 2002); for example, Korea’s president in 2008 was a former chaebol CEO. Hence, legislation is unlikely to be passed without the chaebols’ blessing, although accommodation with other groups is often necessary due to its democratic institutions, corresponding to its low centralization of control.

With regard to its coordination commitments, Korea has long maintained broad-based arrangements out of necessity to upgrade its economy in the face of persistent external threats in conjunction with a paucity of natural resources (Doner, Ritchie, and Slater 2005). To counter external threats without abundant sources of revenue, elites were forced to engage in rapid, sustained economic growth. But this demanded the active support of a wide segment of society, including farmers, labor, and business. This began with rural development and import substitution in the early to mid-1950s. Support to the rural sector occurred via an extensive land reform initiative, the dissemination of seeds for higher yield varieties of rice, subsidized loans to improve farmers’ housing, technical training, expanded irrigation and access to fertilizer, as well as the introduction of universal primary education (Wade 1982). A shift toward labor-intensive exports occurred in the late 1950s and early 1960s, coinciding with improved bureaucratic expertise, and links with a private sector represented by large business groups and federations (Fields 1997, 136). In the 1970s, labor-intensive manufactured exports faced competition from cheaper rivals, pushing state elites to upgrade workers’ skills and training and pursue more sophisticated exports. This strategy gained labor’s support via rising wages and cheaper education. To promote skill- and capital-intensive exports, public-private agencies were established to assist the private sector throughout the 1980s and into the 90s.37

State Ownership Implications
Korea’s democratic institutions, which grant chaebols significant influence, have restrained encroachments by the state beyond what business owners and other important socio-economic actors permit. They have kept SOEs confined to areas of the economy in which they could effectively correct market failures such as the construction of large infrastructure vital to the economy, assisting a disadvantaged sector in a free market operation such as the distribution of staples like rice and sugar, spurring the development of strategic activities with wide-ranging impact (e.g., R&D centers), or the management of natural monopolies to protect consumers.

State ownership increased immediately following the 1997 crisis as a result of the government’s efforts to rescue firms from bankruptcy (and the economy from collapse), but many of these positions persisted for the following decade as political gridlock and changing administrations prevented concerted moves to reduce the state’s positions. A decade later, state owned enterprises constituted a greater proportion of the nation’s largest listed firms, but not as a result of state initiatives to increase state ownership; rather, these were due to larger market valuations (Carney and Child 2013).

37 “Organizations such as South Korea’s Institute of (Advanced) Science and Technology and Institute of Electronic Technology (1) mediated between industry and bureaucracy; (2) monitored new technologies, products, and processes of international competitors; (3) organized technology transfers; and (4) coordinated new projects in alliance with local firms” (Doner et al 2005).
For example, major fears arose with regard to the bankruptcy of highly leveraged major chaebol, notably Daewoo and Hyundai, in the first two years or so after the crisis. They were the two largest conglomerates at the time and without government intervention their collapse would have significantly worsened the economic impact of the crisis. Government ownership of the two groups persisted for the next decade due to start-and-stop efforts at privatization and accounts for the majority of state-initiated purchases in 2008.

Privatization of SOEs was a core policy promoted by Kim Dae-jung following his 1998 election. Those that entered the privatization process were often fully privatized without the government retaining an ownership stake (Kim and Kim, 2001; Nam, 2004). However, many on the initial list failed to be privatized (even partially) due to legislative maneuvers by conservative party members to block their sale to foreign investors (Nam, 2004; Walter, 2008; Lee, 2011). The possibility for privatization was further delayed after the election of the labor-friendly government of Roh Moo-hyun in 2003 who sought to prevent the layoffs associated with such actions (Harvie and Oh, 2004, 130). In 2008, the conservative party leader and former chaebol CEO Lee Myung-bak sought to reintroduce privatization (Kim, 2008). However, the financial crisis in 2008 halted these efforts and state ownership persisted.

South Korea therefore illustrates the dynamics in a democracy where state elites have had little scope to increase state ownership except as an emergency response to a crisis. Instead, state ownership has persisted because democratic institutions have enabled political opponents of the ruling party to slow efforts at change.

Foreign State Ownership
Like Singapore’s GIC, the Korean Investment Corporation (KIC) keeps a low profile with its overseas investments. It does not engage in large ownership positions, and its transparency scores, according to Truman, are comparable to those of GIC. Likewise, institutional mechanisms maintain its accountability to the government and prevent the misuse of funds. See Kim (2011) for an overview of the political debates and institutional rules for the governance of the KIC.

Philippines
Regime Attributes
The Philippines’ democratic arrangements exhibit the characteristics indicative of a regime with low centralization of control. Political power is distributed among the executive and a bicameral legislature. The multiparty system has resulted in roughly six incohesive parties gaining representation in Congress in recent times. But because there is no stable majority of disciplined parties, presidents can construct any coalition they can to get legislation passed. Hence, each legislative chamber can be seen as wielding a single veto. The Supreme Court also enjoys and exercises powers of judicial review, and occasionally serves as an additional veto player, overturning actions approved by the president and the Congress. Altogether, these institutional arrangements yield four veto points.

However, the state is widely recognized for its weakness relative to the overwhelming power of large, diversified conglomerates and the families that own them. Many regard the legislature as being controlled by elite families that engage in pork barrel politics who wield considerable influence over almost all aspects of state functions (McCoy 1993, 433; Kondo 2014). This has directly contributed to the country’s highly fragmented politics; it has one of the highest scores on the factionalized elites index (8) according to the Fragile States Index.

38 Lee’s privatization policies differed from those of Kim’s because Lee would not place restrictions on their sale to domestic buyers which would allow the chaebol to acquire them.
In the wake of the AFC, few reforms were initiated to improve corporate governance standards, and the state did not take a leading role in the recovery. In light of the regime's political attributes, it is also not surprising that state ownership of major companies is often supplanted by the conglomerates. Usually, key business sectors, such as transportation, energy, telecommunications, and the financial sector are controlled by a limited number of corporations which are part of family-owned conglomerates (World Bank 2008). Hence, state ownership is low among listed companies, as displayed in figure one.

In recent times, the Philippines has accumulated record high international reserves, yet the government has remained unwilling to set up a SWF (Marella 2012). Deputy Governor of the Banco Sentral of the Philippines, Diva Guinigundo, has stated that the reason is that the bank is restricted by its charter RA 7653, the Central Bank Act, from investing in instruments other than triple-A rated bonds of foreign governments (Santos 2012). But this law was instituted in an environment of chronic balance of payment deficits; the law says nothing about what to do if the Bank were to have more than adequate reserves. Indeed, in March 2013, the BSP offered to sell US dollars to the National Government to capitalize the proposed SWF; BSP Governor, Amando V. Tetangco Jr, said the Finance Secretary, Cesar Purisima, was proposing to establish a SWF since legal constraints prevent the BSP from directly overseeing the proposed fund. But observers point out that such a SWF could bolster prospects for economic growth, particularly in infrastructure investment, following in the footsteps of Malaysia's Khazanah. But two key obstacles, as to compared to Malaysia, include the weakness of the state to overcome particularistic interests over how the funds would be distributed, as well as the more extensively fragmented nature of Filipino businesses who have a notoriously difficult history in overcoming their individually rational, but collectively counterproductive, interests.

39 Hutchcroft (1991) cites an interview with Wilhelm G. Ortaliz, former director of the Bureau of Industrial Coordination, Ministry of Industry. Ortaliz described the preeminent business association, the Philippine Chamber of Commerce and Industries as a “mere post office of diverse concerns, very personality oriented, and unable to formulate common positions on major issues.”

40 This is also partly due to the relative health of the Philippines banking sector (in 1996 the ratio of bad loans to total loans was only 3%) [FT, 10/8/97]. In contrast to elsewhere in the region, bank closures were not a part of the Philippine bailout plan offered by the IMF.
V. Stabilizing Effects of State Ownership

An implication of the theory is that regimes with sovereign wealth funds that can make long-term, strategic investments – savings funds – will confer stabilizing benefits to corporations in times of heightened financial volatility. This implication not only pertains to firms owned via savings funds, but also to the state-owned enterprises owned by these regimes in general. In the dataset used for this study, such corporations belong to the regimes of Singapore and Malaysia. To test this hypothesis, I examine share price movements around the collapse of Lehman Brothers on September 12, 2008. Estimates for share price volatility are constructed using idiosyncratic volatility. The measurement of idiosyncratic volatility is based on the standard deviation of the daily abnormal return adjusted for Fama-French three factors (Fama and French, 1993). Under the Fama-French three-factor model, the expected return is given by:

\[ E[R_{i,t}] = r_{f,t} + \beta_i(E[R_{m,t}] - r_{f,t}) + s_iSMB_t + h_iHML_t. \] (1)

SMB and HML are the size and value premium. \( E[R_{m,t}] - r_{f,t} \) is the market premium.\(^{41}\) Under the Fama-French three-factor model, the abnormal return is:

\[ AR_{i,t} = R_{i,t} - r_{f,t} - \hat{\beta}_i(R_{m,t} - r_{f,t}) - \hat{s}_iSMB_t - \hat{h}_iHML_t \] (2)

Abnormal return is used because it removes the systematic components of return that are attributed to variations in the market return and variations due to size and value premiums. Rather than applying the standard replication technique to form the Fama-French factors, I use commercially-available size and style indices on equities generated by MSCI to estimate the premiums. This approach is used by Elton, Gruber and Blake (1996). Specifically, the size premium, SMB, is the return differential between the MSCI Asia ex-Japan APEX 200 Index and MSCI Asia ex-Japan APEX 50 Index on day \( t \). The value factor, HML, is the return differential between the MSCI Asia ex-Japan Value Index and the MSCI Asia ex-Japan Growth Index on day \( t \). For the market premium, I use the MSCI Asia ex-Japan Index to proxy for the market return. For reasons of consistency, all index values are converted to local currency. Country-specific annualized yields of money market instruments (such as treasury bills or treasury bonds) are used as proxies for risk-free rates.

In order to calculate the daily abnormal return of stock \( i \) in month \( \tau \), I first estimate betas (\( \beta \), \( s \) and \( h \)) using 36 months data from month \( \tau - 37 \) to month \( \tau - 1 \). I then use the estimated betas to obtain the expected return for each stock on each day in month \( \tau \). The abnormal return is defined as the difference between the expected return and the realized return.

Table 2 reports results relating to the hypothesis that state-owned firms in Malaysia or Singapore will exhibit less share price volatility during a financial crisis. The table reports regression results for (monthly) idiosyncratic volatility (IV) around the collapse of Lehman Brothers for firms that are state-owned and in one-party regimes. Controls for return on equity (profitability), leverage (ratio of debt to assets), and size (equity capitalization) are included.\(^{42}\) Data come from Datastream. Columns (1) and (2) present results based on the

\(^{41}\) The subscripts \( m \) and \( f \) refer to the market rate and risk-free rate, respectively.

\(^{42}\) These are standard controls for idiosyncratic volatility tests based on a survey of the literature on this topic. See, for example, Ferreira and Laux (2007). Data availability
second quarter prior to the collapse, while Columns (9) and (10) present results based on the second quarter after the collapse. The results show that state-owned firms, on average, have a statistically significant lower IV in the first and second quarters prior to the collapse of Lehman Brothers. Two quarters prior to the crisis (Q = -2), firms with the state having an ownership stake have, on average, 1.4% (≈ 0.0004×121/2) lower annualized IV than non-state-owned peers, as shown in column (1). The even columns (2, 4, 6, 8, and 10) display the interactive effect of state-owned firms with the Singapore and Malaysian regimes; the expectation is that this variable will display a stronger negative relationship than state owned firms alone. The results validate this expectation for every quarter except the two quarters prior to the crisis. Overall, the results are consistent with the hypothesis that state-owned firms owned by the Malaysian and Singaporean regimes should exhibit lower share price volatility during a financial shock.43

43 The results are substantively the same when tests are conducted with clustered standard errors by firm and by industry.
Table 2. Idiosyncratic Volatility Implications during the Collapse of Lehman Brothers

This table presents results from the least squares estimation on firm’s idiosyncratic volatility (adjusted for Fama-French 3-Factors) two quarters prior to and after the collapse of Lehman Brothers Holding, Inc. The independent variables are: (1) “State Ownership 08”, an indicator variable = 1 if the firm is owned by the state in 2008, (2) “Mal & Sing”, an indicator variable = 1 if the country is either Malaysia or Singapore, (3) an interacted variable of state ownership and Mal & Sing, (4) the firm’s return on equity (profitability), (5) the firm’s leverage ratio (ratio of total liabilities over assets), and (6) size (equity capitalization). Robust (clustered standard errors by country) t-statistics are reported in parentheses. *, ** and *** represent significance levels of 10%, 5% and 1%, respectively.

<table>
<thead>
<tr>
<th></th>
<th>Q = -2</th>
<th>Q = -1</th>
<th>Q = 0</th>
<th>Q = +1</th>
<th>Q = +2</th>
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<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
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<tr>
<td>State Ownership 08</td>
<td>-0.4**</td>
<td>-0.35*</td>
<td>-0.57*</td>
<td>-0.13</td>
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<td></td>
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<tr>
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<td>1.5*</td>
<td>1.9</td>
<td>1.1*</td>
</tr>
<tr>
<td></td>
<td>(1.4)</td>
<td>(0.75)</td>
<td>(1.9)</td>
<td>(2.07)</td>
<td>(2.1)</td>
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<tr>
<td>State Ownership 08 * Mal &amp; Sing</td>
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<td></td>
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<td>2.8**</td>
<td>2.4</td>
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<td>(1.4)</td>
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<td>19,955</td>
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<td>0.04</td>
<td>0.02</td>
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VI. Conclusions

Since the Asian Financial Crisis of 1997, state ownership has increased across the globe. On the one hand, this is due to an increase in portfolio flows available to government agencies such as pension funds, reserve funds, and, to a lesser extent, macroeconomic stabilization funds. Because these ownership stakes tend to be small in size, they do not raise concerns about their influence on corporate ownership in foreign countries. However, savings funds are the exception. These funds allow governments to engage in long-term strategic investments with sizeable ownership stakes. The sample from East Asia has identified three that are located in authoritarian regimes – Brunei, Malaysia and Singapore. But because Brunei’s monarchy has chosen to maintain a low profile with its investments so as to avoid drawing unwanted attention to its investment allocation, there is no evidence for it to engage in significant foreign ownership positions. However, Khazanah and Temasek both exhibit rising levels of foreign ownership over the past decade.

To explain the extent and transparency of state ownership across these, and other regimes in East Asia, the paper proposes a novel framework that combines two political attributes: centralization of control and coordination commitments. According to these criteria, Malaysia’s regime is expected to engage in less transparent investments, but to also exhibit high levels of state ownership in relation to Singapore. The evidence supports this contention.

Finally, an extension of the argument is that authoritarian regimes (and by extension their investment agencies) will display a greater commitment to strategically valued ownership positions – both domestic and foreign. Hence, firms owned by these regimes should exhibit greater stability when financial volatility spikes for exogenous reasons. Initial tests from the period when Lehman Brothers collapsed support this conjecture.

Overall, the framework provides a novel perspective with which to explain the extent and transparency of state ownership, and SWFs, across regimes as they search for appropriate tools with which to defend the status quo from the rising pressures associated with financial globalization.

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