BORROW MY PENSION

THE NORWEGIAN GOVERNMENT PENSION FUND – GLOBAL: A RESPONSIBLE LENDER?

SLUG
SLETT U-LANDSGJELDA

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CONTENTS

ABBREVIATIONS

CAC	Collective Action Clauses
CSO	Civil Society Organisation
GDP	Gross Domestic Product
GPFG	(Norwegian) Government Pension Fund - Global
HIPC	Heavily Indebted Poor Countries (Initiative)
IFIs	International Financial Institutions
IMF	International Monetary Fund
LIC	Low-Income Country
MIC	Middle-Income Country
NBIM	Norges Bank Investment Management
NGO	Non-Governmental Organisation
NOK	Norwegian kroner (Norwegian currency)
SWF	Sovereign Wealth Fund

Norges Bank	The Norwegian Central Bank
Storting	The Norwegian Parliament

TECHNICAL TERMS

Equity: Investments in equities are investments in stocks.
Fixed security: Financial asset which yields fixed and regular income. In this regard: Bonds which earn fixed interest rates.
Fungibility: Something that is interchangeable. Some would argue, for instance, that lending money to an illegitimate regime is legitimate as long as the loan is supposed to finance the building of schools. However, the loan releases funds that can be used for oppressive actions.
Paris Club: An informal group of financial officials, a creditor club, from 19 of the world's richest countries. Meets in Paris to negotiate debt restructuring, debt relief and debt cancellation to indebted countries.
Sovereign bond: Bond (explained in box page 8) issued by a national government and which is denominated in foreign currency.
Government bond: Bond (explained in box page 8) issued by a national government and which is denominated in the country's own currency.
NB! Usage of the terms 'sovereign' and 'government' bond seem to not always be consistent with this definition. In this report, 'government bond' is normally used when referring to bonds issued by a national government, denominated in local or foreign currency.
Sovereign wealth fund: Investment funds owned by governments, many of which raise their capital from natural resources.
Vulture fund: Private investors who specialize in making profits on poor countries' debt. The 'vultures' buy up developing countries' debt at a cheap price in the secondary market. Subsequently, they seek to recover the full amount, meaning the full face value of the debt plus interest and penalties, through negotiations or even litigation.

INTRODUCTION

Borrow My Pension explores the ethical implications of the Norwegian Government Pension Fund - Global's (GPFG) lending policies. The report aims to merge two discussions, both of which are prioritized by the Norwegian government and frequently subject to public debate. These are the discussion on ethical and social responsible investments and the discussion on responsible lending and illegitimate debt. The intersection between the two, which the GPFG's investments in government bonds represents has, however, not received much attention.

Despite a fairly comprehensive ethical framework for the GPFG's investments in companies, the Fund's investments in government bonds are not subject to ethical guidelines. To invest in bonds is a means of lending money. About one fourth of the fund's holdings is invested in government bonds, making the GPFG a lender to countries around the world. The only restriction put on the government bond investments, is a prohibition against investing in bonds issued by Burma. We find this highly inconsistent, provided Norway's progressive policies on other issues related to responsible lending. The report argues that the weak framework for government bond investments also contradicts the fund's ethical foundation. A more comprehensive mechanism is needed for the GPFG to act as a responsible investor and to ensure that future generations of Norwegians will not earn their pensions on investments in illegitimate debt.

The Norwegian government does not intend to change the existing mechanism. The argument used to defend the status quo is based on the principle of non-interference into foreign policy. This means the basis for investments should be purely financial. According to the Government, an expansion of the ethical framework for investments in government bonds would constitute a threat to the stated policy of non-interference. To exclude a country's government bonds from the portfolio could be perceived as a boycott of the country in question and thus harm diplomatic relations.

This is a valid concern which should not be understated. Nevertheless, we believe a mechanism could be established to ensure ethical investments and responsible lending, also taking the above-mentioned concerns into account. A more comprehensive ethical framework for these investments is crucial to ensure that lending through the GPFG is in line with the ethical foundation of the fund and does not contradict with the moral conviction of the public. This report suggests a checklist for government bond investments is established to ensure responsible investments. Such a checklist should be derived from commonly accepted ethical principles such as respect for human rights and international law, and transparent procedural arrangements.

The aim of this report is first and foremost to fuel a constructive debate on how the ethical framework for the GPFG could be expanded to cover all its investments. So far the government has seemed reluctant to enter into such a debate. We hope this initiative will be helpful in taking the debate one step further in the direction of establishing an ethical framework that truly corresponds with the label 'responsible investor'.

The intersection between responsible investments and responsible lending has been subject to little attention. Because the issues dealt with in this report are not frequently debated and do not represent common knowledge, a major part of the report is devoted to explaining the basic functioning of government bonds and how these could represent ethical challenges to investors. Chapter one provides an introduction to the issue of government bonds, how bond debt is linked to the debt crisis and to illegitimate debt. Chapter two presents the GPFG, its investments in government bonds and the ethical framework. Chapter three discusses bond investments in the light of principles for responsible finance. The Eurodad Charter on Responsible Financing is used as a benchmark for what should be considered responsible lending and borrowing.[1]

[1] Hurley, Gail, 2008: *Eurodad Charter on Responsible Financing*. Eurodad. http://www.eurodad.org/whatsnew/reports.aspx?id=2060

1

1. GOVERNMENT BONDS AND THE DEBT CRISIS

It is estimated that about 80 percent of developing countries' sovereign debt consists of loans to private creditors, such as private banks and bond holders like the Norwegian Government Pension Fund - Global (GPFG).[2] Over the last decade issuing bonds has become an increasingly important way for developing countries to borrow funds in the international capital market. Over the past five years, ten emerging economies and low-income countries have been added to the list of bond issuers.[3] Some bonds are issued to finance general government expenditure, others to finance large projects or to pay off existing debts. Bonds are also used as an instrument to restructure loans.

In 2008 the GPFG invested about 555 billion Norwegian kroner (about $86 billion) in government bonds in 45 countries. 19 of these were classified as developing countries.[4] As is the case with all types of lending and borrowing, bond financing requires the borrower and the lender to act in due diligence in order to ensure the legitimacy of the loan transaction. However, this does not always happen. History has shown various examples of irresponsible, dubious and illegitimate bond financing. Little attention has been paid to the need for responsible behaviour by lenders and borrowers in the bond market.

This report mainly draws attention to bonds issued by low- and middle-income countries, though an ethical framework must apply to all government bond investments.

Basics about Bonds
A bond is a loan: To issue bonds is a way of borrowing money. The GPFG invests in bonds issued by governments and thus lends money to countries. It is worth noticing that investments in bonds are often referred to as investments in debts; reflecting the fact that bond issuance is a borrowing/lending mechanism.

Bond: a financial security issued by business and by the government as a means of borrowing long-term funds.[5] Bonds are normally issued for periods of several years, with a fixed interest rate which reflects the market interest rate at the moment the bond is issued. Interest is paid on designated dates, often once or twice a year. On maturity, the end of the agreed period for which the bond was issued, the issuer will repay the bond holder the agreed value of the bond.

Example: You issue a $1000 bond at a 5% interest rate, with a 5 year maturity and interest payments every year. You will then pay $50 in interest payments annually for five years. The fifth year, in addition to paying the $50, you will also pay the bond holder the $1000, i.e. the face value or the nominal value of the bond.

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2 Millet and Toussaint, 2009: *Figures Relating to the Debt for 2009*. CADTM.
http://www.cadtm.org/IMG/pdf/DEF_Figures_relating_to_the_Debt_Vademecum_2009_FEB_2009-2.pdf
3 Eurodad, 2008: *North-South Financial flows: trends and status* (p.2) Eurodad report for ActionAid.
4 NBIM, 2009: *Government Pension Fund – Global Annual Report 2008*, Holdings Fixed Income.
http://www.nbim.no/upload/73982/fi_holdings_spu_sorted.pdf
Developing countries defined according to the World Bank.
World Bank website: Country Classification http://go.worldbank.org/K2CKM78CC0
5 Pass, Ch. and Lowes, Br. 1993: *Collins dictionary of economics* (p.42) Second edition, Harper Collins Publishers.

Bond auctions: Government bonds are issued by central banks and are typically sold at auctions. Investors participate in the auctions which represent the primary market for bonds. After having purchased bonds, the investors have the possibility of selling the bonds on to other investors in the secondary market.

Determining the interest rate: The interest rate reflects the expected return on the bond, and is set according to the associated risk. The interest rate on US Treasury Bonds is typically used as a benchmark. If the risk associated with the bond issued is high, for example due to high debt distress or political unrest, the investor will not be willing to buy the bond unless the interest rate and hence the expected return is sufficiently high.

The issuers: Governments, municipalities, private companies and international organisations can issue bonds. This report will solely focus on bonds issued by national authorities, although the GPFG also invests in bonds issued by corporations, international organisations and local authorities in various countries.

1.1. History: From Bank Loans to Bond Debt

1970s and 1980s: Bank Lending and Debt Crisis

From the beginning of the twentieth century until the 1970s, issuing bonds was the most important way for countries to borrow money and raise funds in the international capital market. It was only during the 1970s that issuing bonds lost terrain to regular commercial bank loans.[6] The sharp increase in oil prices in 1973 led to large accumulations of capital in Western banks, providing developing countries easy access to bank loans. The heavy pushing of loans based on petro-dollars into developing economies led to a huge build-up of external debt in poor countries. Non-oil-exporting developing countries' external debt more than doubled, from $78.5 billion at the end of 1973 to $180 billion in 1976. At the end of 1981 developing countries' outstanding debts reached a total of $600 billion.[7] With the large increase in international interest rates and a strengthening of the dollar, debts which were already at unsustainable levels increased further. Developing countries were given new loans to pay interest on their existing debts. Mexico was the first country to declare its inability to service its external debt in 1982. More countries followed in what is referred to as the debt crisis of the 1980s.

"I remember how the bankers tried to corner me at conferences to offer me loans. They would not leave me alone. If you're trying to balance your budget it's very tempting to borrow money instead of raising taxes to put off the agony."
—Latin American Minister of Finance in the 1970s.[8]

[6] Fernandez-Ansola, J.J and Laursen, 1995: *Historical Experience with Bond Financing to Developing Countries*, Working Paper of the International Monetary Fund.
[7] UN, 2005: *The World Economic and Social Survey 2005*. (p. 142). http://www.un.org/esa/policy/wess/wess2005files/chap5.pdf
[8] Hertz, Noreena, 2004: *I.O.U.* (p. 65) Harper Perennial.

1980s and 1990s: Restructurings

The debt crisis was reinforced as banks refused to accept losses even though these were largely caused by irresponsible pushing of loans. In fact, the "debt crisis" was often referred to as a crisis for the banks that did not get their money back, and not as a crisis for the people of the countries which could no longer afford to pay for basic social services. During the 1980s restructurings and rescheduling of loans were carried out. Old debts were swapped for new debts on new terms; loans were exchanged into shares in state-owned companies, and other arrangements were made in order to restructure the loans.[9] This system of restructuring loans changed the format of the loans, with the result that in the mid-1980s a secondary market for developing countries' debt arose.[10] It is estimated that the secondary debt market grew by 800 percent in only two years; from an estimated $500 million in 1983 to $4 billion in 1985.[11] Lenders did not recognize the fact that the external debts were unpayable, and that the restructuring approach did not reduce the debt burdens.

At the end of the 1980s, debt burdens were still rising and lenders were forced to look into new ways of dealing with debt distress. In 1989 the Brady plan was introduced, named after Nicholas Brady, the US Secretary of the Treasury.[12] The plan offered developing countries to change their commercial debt into tradable bonds at a reduced price, on condition that they followed structural adjustment programmes provided by the International Monetary Fund (IMF). [13] 17 countries, most of them Latin-American, participated in the restructurings. Under these schemes, bank loans were transformed into bond debt. The total value of such transformed loans amounted to a total of $155 billion.[14] The tradability of the debts increased, helping developing countries restore their access to international capital markets. As a result, the secondary market for developing country debt continued to rise. In 1997 the secondary market trading reached $6 trillion, including $2.5 trillion Brady bonds.[15]

What about legitimacy?

Restructuring of debt makes it hard, or even impossible, to examine the origins of the loans. When bank loans were exchanged for Brady bonds, no attention was paid to the legitimacy of the loans or to banks' responsibility regarding reckless lending. The restructuring can therefore be understood as a way of legitimizing both banks' reckless lending as well as the borrowing by illegitimate regimes. Several military regimes had taken on large amounts of commercial loans. In Argentina, for instance, the debt contracted by the military regime rose from $7.9

[9] The Baker Plan, named after the Secretary of the US Treasury James Baker, was introduced in 1985.

[10] The debt market is a secondary market for trade in bonds. Previously issued bonds are sold and bought to the prevailing market price which depends on supply and demand and the risk and expected return associated with the specific bond and bond issuer. For a critical analysis, see Hertz, 2004: *I.O.U.*

[11] Hertz, Noreena, 2004: *I.O.U.* (p. 76) Harper Perennial.

[12] UN, 2005: *The World Economic and Social Survey 2005* (p. 143).

[13] Lenders could choose between exchanging their loans for bonds which preserved the original value of the bond but carried a lower interest rate, or bonds where the value was reduced with 30-50 percent but provided a floating interest rate. (World Bank: *Global Development Finance 2004*.) The Brady Plan was effective in resolving the crisis faced by Western Banks. Despite the fact that the banks accepted a certain write off, the Brady plan contributed more to restore liquidity in the markets than to write down debts and contribute to solvency. Hence, the debt crisis for poor countries was not resolved.

[14] Ibid.

[15] Hertz, Noreena, 2004: *I.O.U.* (p. 78) Harper Perennial.

billion to $45.1 billion in the period 1976 - 1983.[16] A similar trend could be seen in various other Latin-American, African and Asian countries.

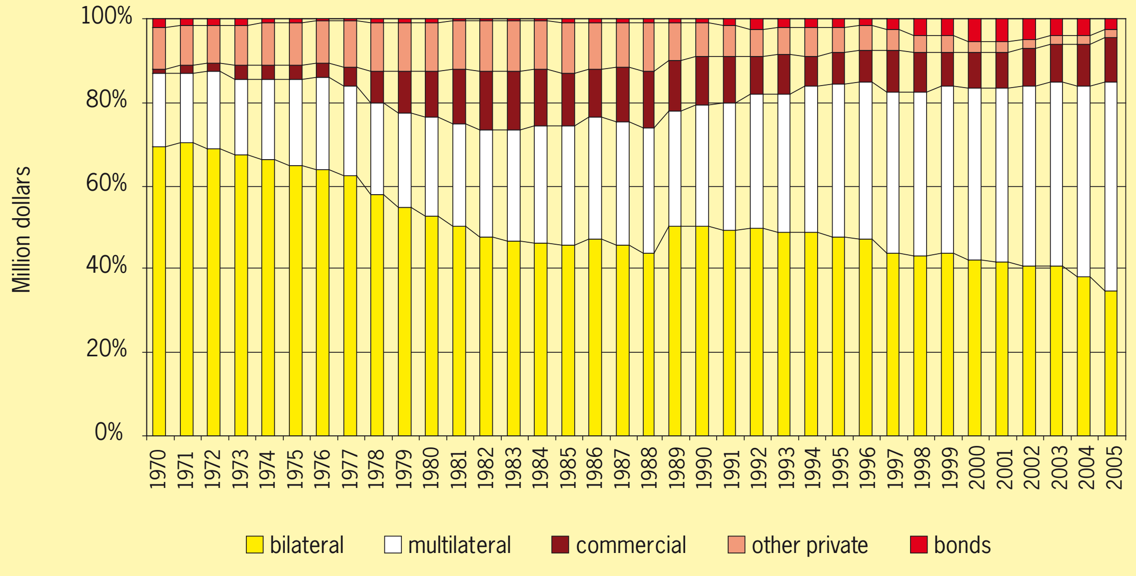
Joseph Hanlon links such restructuring to "loan laundering", saying that *the formal loans taken out by Suharto of Indonesia or Mobutu of Zaire have been paid off and no longer exist, but the debts are still there in the form of bonds or loans taken to pay off the original loans.[…] "[L]oan laundering" [is] an effort by lenders to try to wash away the taint of illegitimacy.*[17]

Turn of the Century: Increased Popularity

In the 1990s, developing countries regained access to international capital markets. Following investors' increased confidence, several middle-income countries were added to the list of countries issuing sovereign bonds. The issuance of bonds as part of total financing of emerging markets rose from 2 percent in 1996 to 35 percent in 2002.[18]

The figures illustrate how developing countries' external debt is spread on different loans. The figures show the sudden increase in bond lending from the late 1980s, especially in middle income countries. Low income countries have not benefited from the same access to international capital markets.

LOW-INCOME DEBT EVOLUTION.

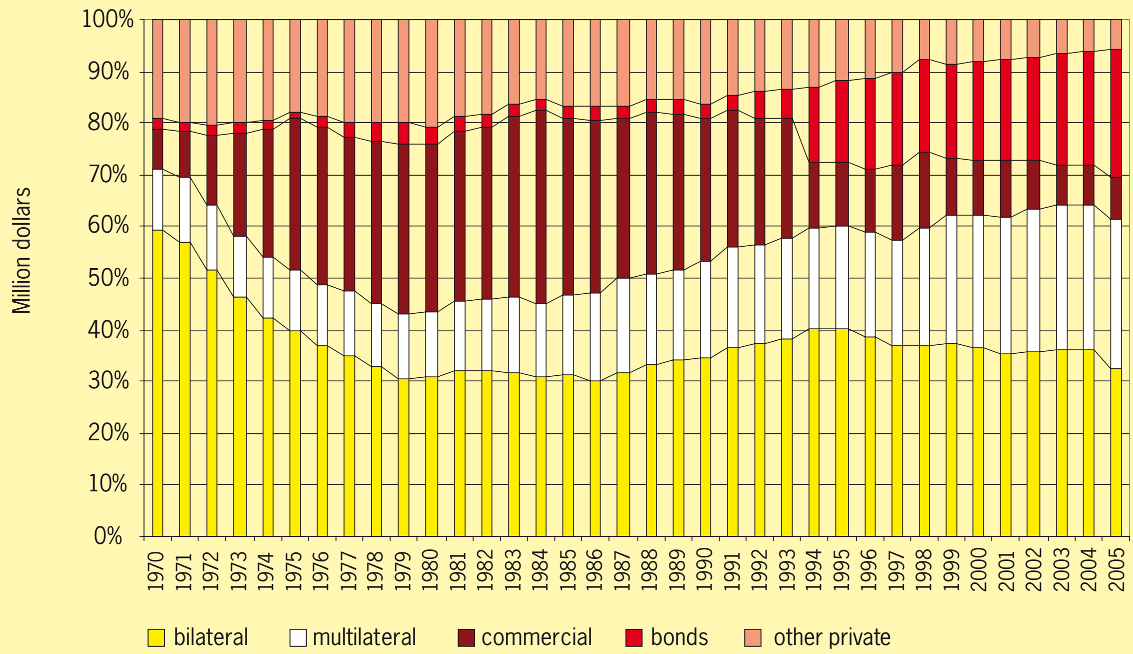


16 Ibid, p. 67.

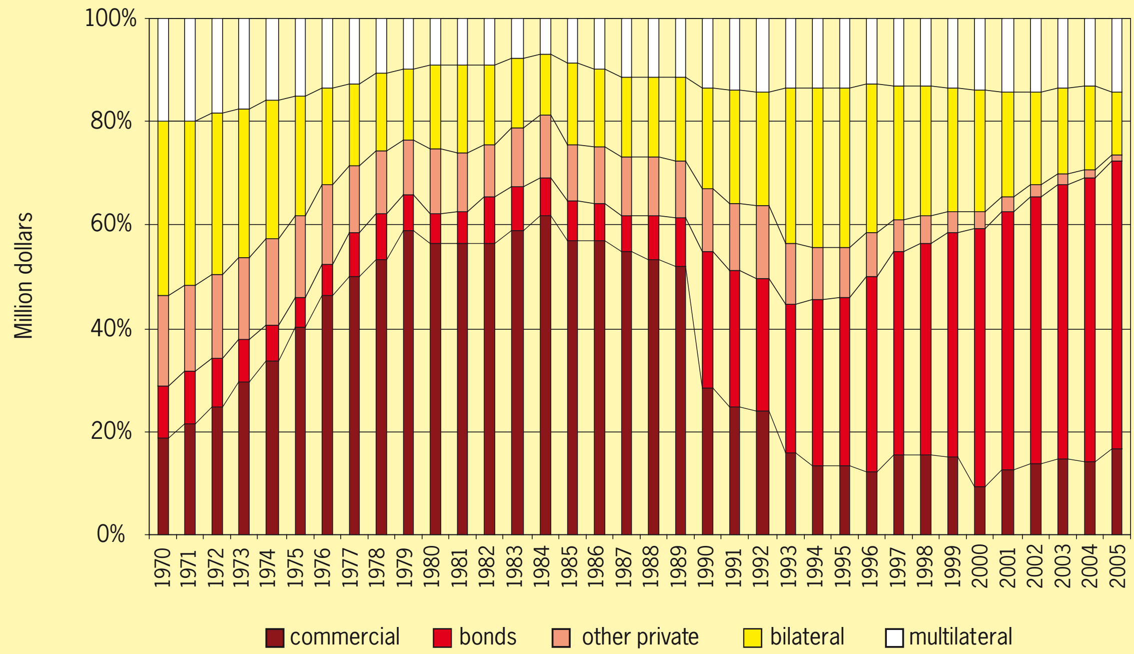
17 Hanlon, Joseph, 2008: *Lenders, not Borrowers, are Responsible for "Illegitimate" Loans. Article published in Not Just Numbers* (p.58) The Lutheran World Federation.

18 McGuire, P. and Schrijvers, M.A, 2003: *Common factors in emerging market spreads* (p.67).

EVOLUTION OF LOWER-MIDDLE-INCOME DEBT 1970–2005.



EVOLUTION OF UPPER-MIDDLE-INCOME DEBT 1970–2005.



Source: The new economics foundation.[19]

[19] *Debt relief as if justice mattered, A framework for a comprehensive approach to debt relief that works* (p. 35-39). The New Economics Foundation. http://www.jubileeresearch.org/news/debt%20relief%20as%20if%20justice%20mattered.pdf

As emerging market bonds gained the confidence of the international capital market, the investor base broadened. Emerging market bonds were more frequently found in pension funds' investment portfolios. At the turn of the century an increasing number of emerging market countries were able to issue longer-maturity bonds. This was beneficial to pension funds and other investors looking for long term investment opportunities, such as the GPFG.[20]

1.2. Government Bonds: Whose Risks and Responsibilities?

Responsibilities

The issuer is responsible for paying interest and for repaying the nominal value of the bond when the time is due. If the issuer government does not make payments on designated dates it defaults on the bond and hence violates the contract with the bond holders. There are no internationally agreed principles on how to deal with defaulted bonds, or any general guidelines on how the loss should be shared between different bond holders and under what circumstances. This has been a concern for both lenders and borrowers. Suggestions for dispute mechanisms tend to be biased in favour of bond holders. The investor is responsible for making wise investments, which implies an assessment of the risks associated with any specific bond and currency.[21]

Argentina; the largest default in history
In 2001 Argentines lined up outside local banks to withdraw savings from their accounts. They would rather save their money in their mattresses than in a bank on the verge of collapse. Until then Argentina had been "top of the class" at implementing IMF recommendations, and was generally regarded as a good example of how free market reform led to economic growth. The Argentine economy, however, was in deep crisis by 2001. The middle class took to the streets and organised large protests, using pots, pans and other utensils to make heard their criticism of the government's policies.

Investors and rating agencies had not been paying attention to signs of downturn or unrest and the people's call for default.

"'97, '98, '99 … we were just lending stupidly to Argentina. No one thought it could default, and there was always someone who would buy your bonds from you."
—Senior bond trader[22]

However, soon afterwards the Argentine peso devaluated and foreign capital fled the coun try. The banking system collapsed and accounts were frozen. The 2002 first-quarter GDP fell by 16.3 percent. Unemployment rates peaked and more than half the population found itself

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[20] While in 1998 roughly one third of emerging market debt traders were hedge funds, in 2002 the share of hedge funds had decreased to 10 percent. During the same time span the share of real money investors in the same market rose from 9 to 31 percent.
Ibid, p.68.

[21] When choosing to invest in high risk bonds, investors must take into account the possibility of not being repaid and thus, some would argue, share some of the loss in case of default.

[22] Hertz, Noreena, 2004: *I.O.U.* (p. 92) Harper Perennial.

below the poverty line.[23]

In August 2003 Nestor Kirchner was inaugurated as President of Argentina. He said he would not *'return to paying debt at the cost of hunger and exclusion of Argentines'* and offered bond holders about 25 cent on the dollar. By February 2005 most bond holders accepted the final offer of exchanging the defaulted bonds for new bonds worth about 35 per cent of the original value.[24]

In the report "Enough is enough: The debt repudiation option" Christian Aid explains what happened next:

"Argentina had broken the rules in a spectacular way: a huge sovereign debt default, combined with what was widely denounced in the business press as a refusal to bargain with creditors, and a dangerous confrontation with the IMF and its backers. The consensus amongst the experts was that Argentina would suffer severe long-term consequences, such as a long drawn-out depression and isolation from international markets.

But the result has been quite the opposite. The spectacular post-default growth of the economy has surpassed even the rosiest predictions. Within a few months of the default, economic recovery was underway in Argentina and there was positive growth in the last three quarters of 2002. The economy grew by 8.8 per cent in 2003 and 9 per cent in 2004 and is still going strong with fundaments having improved significantly since the successful debt restructuring. Unemployment dropped from 14.5 per cent in 2003 to 12.1 per cent in 2004.44 Investors have started to return, especially after a bond rescheduling in April 2005."[25]

Risks

Governments may issue bonds in local or foreign currency. Government bonds issued in local currency are normally perceived as low risk, even almost risk-free investments. In theory a government will always have the option to provide income to service their debt by e.g. raising taxes, cutting government spending or simply printing more money. Nevertheless, there have been examples of bond defaults.[26] Political and economic stability, currency risks and expected inflation levels are important elements when considering the risk associated with a specific country. In the case of high inflation or currency depreciation, the real value of bonds will decrease which means bond holders will gain less than expected. In the case of the GPFG, the associated risk is essential when determining which currencies to include in the investment portfolio.

Bonds issued in foreign currency are often referred to as sovereign bonds. Countries with unstable exchange rates or in which there is a threat of high inflation

[23] Christian Aid, 2007: *Enough is enough: The debt repudiation option* http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Debt%20Repudiation%20Christian%20Aid.pdf

[24] Ibid.

[25] Ibid, p. 25.

[26] There are various political and economic reasons why a country sometimes can not or does not service its debt. Some debts are illegitimate; the origins of the debt are of such a nature that it would be irresponsible to spend public money on serving it. Examples are loans contracted by dictators, apartheid debt or loans taken on in order to finance projects against the interests of the people are examples of illegitimate debts which should not be repaid. Other debt repayments are not serviced simply because high levels of debts prevent the government from providing basic social services to its citizens.

might find it difficult to issue local currency bonds and hence turn to other, more stable currencies. Other governments issue bonds in USD or Euro, for instance, to strengthen their currency reserves.[27] Compared to local currency bonds these are considered fairly high risk investments due to the fact that servicing these debts requires access to foreign capital. The need for sufficient foreign currency reserves and the risk of devaluation of the local currency, which will make the hard currency loan more expensive to service and hence increase the risk of default, are two of the main risks associated with foreign bonds.

Credit Rating Agencies

"I used to think if there was a reincarnation, I wanted to come back as the President or the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everyone."
James Carville, campaign manager of President Clinton[28]

The GPFG makes its bond investments based on assessments of risk and expected return, drawing largely on ratings made by Barclays. This is a so-called Credit Rating Agency; a private agency which provides ratings of bond markets and risks associated with government bonds. Agencies make judgements of the creditworthiness of issuers, based on investment environment, macroeconomic policies and economic and political stability. CRAs do not issue any guarantees. Most institutional investors make their own risk assessments in which the rating agencies' indexes are used as input.

Credit rating agencies' assessments, their choice of indicators and the conclusions they draw have a strong say in where public and private resources flow and don't flow. The agencies' centrality in guiding huge capital flows has been strongly criticized.

"As an Executive Director I got invited to make some comments at a "Risk Management Workshop for Regulators: Assessing, Managing and Supervising Financial Risk" arranged by the World Bank in Washington during the week 27 April – 2 May 2003. This is what I told them about the credit rating agencies.

'I simply cannot understand how a world that preaches the value of the invisible hand of millions of market agents can then go out and delegate so much regulatory power to a limited number of human and very fallible credit-rating agencies. This sure must be setting us up for the mother of all systemic errors.'

I never got invited to speak to them again."
—Per Kurowski, former World Bank Executive Director. [29]

[27] In the 1990s and beginning of this century roughly 77 percent of emerging market government bonds was denominated in US dollars, 17 percent in euro and 6 percent yen.
McGuire, P. and Schrijvers, M.A, 2003: *Common factors in emerging market spreads* (p.68).
[28] Hertz, Noreena, 2004: *I.O.U.* (p. 86) Harper Perennial.
[29] Kurowski, Per, August 29 2007: *Subprime banking regulations*. From Kurowski's blog "A view from the radical middle." http://perkurowski.blogspot.com

The UN has raised concerns regarding credit rating agencies' strong influence in the international private financial flows and pledged to *"strengthen modalities [...] to enhance and improve the level and objectivity of information regarding a country's economic situation and outlook."*[30] In the statement from the Follow-up Conference on Financing for Development heads of state said the following:

"Credit rating agencies also play a significant role in the provision of information, including assessment of corporate and sovereign risks. The information provided by credit rating agencies should be based on broadly accepted, clearly defined, objective and transparent parameters. The ongoing financial crisis has revealed weaknesses and raised concerns about accounting standards and the way credit rating agencies currently operate."[31]

1.3. Why Do Countries Issue Bonds?

Most countries issue government securities to smooth their consumption or to finance investments, pay existing debts, build up their foreign currency reserves or to finance government activities. After the financial crisis hit hard in September 2008 there has been a substantial use of government bonds in an effort by governments to stabilize the financial markets.

To issue bonds is often seen as a milestone for developing countries, representing a recognition of their creditworthiness and sound economic policy. According to the IMF *"some of the key drivers behind increases in sovereign bond issuances on international capital markets include current levels of economic growth, inflation, current account, fiscal stance, sustainable levels of debt, track records of servicing existing debt, policy transparency and data dissemination, investor interest, sufficient risk appetite and the demand for diversification"*.[32] Between 2004 and 2008, 10 developing countries entered the international capital market as new bond issuers.[33]

The motivations behind a country's decision to issue specific bonds, which are then subsequently purchased by the GPFG, might impact the ethical assessment of the investments. In the following we will use the categorization made by the Commonwealth Ministerial Debt Sustainability Forum, April 2008. They considered that *"bond issuances had three primary purposes: a) balance sheet operations (the retirement of high cost or short maturity debt, payment of arrears or reduction of domestic debt); b) the financing of specific projects; c) general government purposes"*.[34]

General Government Purposes

Governments issue bonds because they are in need of liquidity to smooth financial

[30] UN, 2008: *Doha Declaration on Financing for Development: outcome document of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus* (para 61). http://www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf
[31] Ibid. (para 75).
[32] Eurodad, 2008: *North-South Financial flows: trends and status* (p.50) Eurodad report for ActionAid.
[33] *These are: Pakistan, Indonesia, Vietnam, Ecuador, Fiji, Seychelles, Ghana, Sri Lanka, Gabon and Georgia. Eurodad, 2008: Finance ministers debate Eurodad charter.* Eurodad webpage. http://www.eurodad.org/aid/article.aspx?id=118&item=2222
[34] Ibid.

transactions, or to finance general government spending. In Norway, for instance, total assets are higher than the total debt. According to the Norwegian Central Bank, Norway still takes on loans by issuing bonds *"to ensure certain liquidity in order to be able to cover daily payments which, because of high daily fluctuations, might be hard to calculate in advance"*.[35]

There are examples of both developed and emerging economies that finance general spending through bond borrowing. In the US, for example, the issuance of massive amounts of bonds over the last years has financed tax cuts and military spending. The GPFG's investments in US Treasury bonds increased from 13 billion NOK in 2006 to more than 150 billion in 2007.[36] GPFG's investments in US Treasury bonds have been criticised for being contradictory to international law and Norwegian foreign policy.

Loan financing of general government spending can be a threat to debt sustainability if activities financed are not productive. In addition, bond lending raises questions related to the legitimacy of the borrowing regime and as to whether the country's activities are in compliance with international law and the bond holder's moral conviction. The purpose of the issuance of bonds is not specified in the contract. Hence, a bond loan can finance any government spending. The GPFG's investments in bonds issued by Israel, Sri Lanka, China, the USA and other countries have been criticised for contributing to war, international law violations and massive violations of human rights, in contradiction to Norwegian foreign policy as well as the ethical basis of the fund.

"No. There is no label on the money lended, saying what it should be spent on. You could just as well say they're spent on decreasing the budget deficit of Israel, or to finance the Israeli school system."[37]

Roger Schjerva, the Norwegian Deputy Minister of Finance, when asked whether Norway, after a massive increase in the GPFG's investments in Israeli government bonds, had contributed to financing Israel's war on Gaza.

Schjerva's statement underlines an essential ethical challenge regarding government bond investments. The money could finance any government activity.

Project Financing

Some countries issue bonds to finance specific projects. These are often long-term investments in for example infrastructure. Bond-financed projects are often expected to contribute to economic growth, and hence validate themselves in the long-run. Ghana, the first Sub-Saharan country to issue bonds on the international market, issued sovereign bonds to finance infrastructure gaps and projects within the coun-

[35] Norges Bank, 2003: *Why government debt?* Norges Bank webpage. http://www.norges-bank.no/templates/article____12330.aspx
[36] Bilden, Kaare M. 14 March 2008: *Øker omstridte investeringer*. NyTid. http://www.nytid.no/arkiv/artikler/20080314/oker_omstridte_investeringer
[37] Bilden, Kaare M. 11 March, 2009: . NyTid. http://www.nytid.no/nyheter/artikler/20090311/oljefondet-oker-i-israel/

try's energy sector.[38] It was underlined by Deputy Governor of the Bank of Ghana, Dr Mohamadu Bawumia, that *"[p]rojects selected for market finance should be high yielding with a high economic rate of return to allow the project to pay for itself and should be growth catalytic by removing critical bottlenecks in the economy"*.[39]

Ethical challenges regarding project financing relate to the quality and purpose of the project, its consequences for affected people and communities, and environmental impacts. Governments often make a public statement to explain the purpose behind issuing specific bonds, but the bond issuer is not accountable towards the bond holders in regards to how the money is spent. Income from a bond auction goes into the Treasury, and a bond contract does not stipulate the purpose of the bond. It is nevertheless relevant to discuss bond-financed projects. This because fungibility[40] of money must be taken into consideration when investing in government bonds issued for specific purposes.

Payments of Debt to Other Lenders

"[A]nyone who buys bonds from Indonesia or Argentina ought to check to see if they were used to pay off previous illegitimate debts"
—Joseph Hanlon[41]

During recent years there has been a shift in many low- and middle-income countries' debt profiles. Several middle-income countries have made prepayments on their debts to international financial institutions and the Paris Club. Latin American countries in particular have made efforts to pay their way out of the international financial institutions (IFIs).[42] In 2005, 80 percent of the IMF's loan portfolio was to Latin America. In contrast, by early 2008, Latin America represented only 1 percent of the IMF portfolio.[43] Some countries have issued bonds on domestic or international capital markets to raise the funds needed to prepay the debts.[44] Gabon, for instance, issued bonds in the international market for the first time in 2007. The funds were used to prepay debts to Paris Club creditors.[45]

[38] Ghana's 2008 Budget Highlights state that "[A]n amount of US$200 million from the US$750 million sovereign bond will be used for the Road sector including the dualisation of the Accra-Kumasi highway. Ninety million US dollars from the sovereign bond has been allocated to build the western corridor of the railway network. […] An amount of US$460 million out of the sovereign bond proceeds will be spent in the energy sector with focus on the transmission and distribution network."
Government of Ghana, Nov 15 2007: *2008 Budget Highlights* (p. 8)

[39] Baah-Wiredu, 2007: *Sovereign Bond Will Close Infrastructure Development Gap*. Ghana Government webpage. www.ghana.gov.gh

[40] Fungibility is something that is interchangeable. For example some would argue that lending money to an illegitimate regime is legitimate as long as the loan is for building schools. However, the loan releases funds that can be used for oppressive actions.

[41] Hanlon, Joseph, 2008: *Lenders, not Borrowers, are Responsible for "Illegitimate" Loans*. Article published in Not Just Numbers (p.58) The Lutheran World Federation.

[42] The financial crisis has however decreased the flow of private capital (and development assistance). Need for finance is urgent, and several low- and middle income countries have turned to the IFIs for assistance. Hence there might be a shift back to increased multilateral lending for some countries.

[43] Bank Information Center, 2009: *Global crisis is good news for IFIs in Latin America*. http://www.bicusa.org/en/Article.11015.aspx

[44] Eurodad, 2008: *North-South Financial flows: trends and status* (p.50) Eurodad report for ActionAid.

[45] World Bank: *Global Development Finance 2008* (p. 46) http://siteresources.worldbank.org/INTGDF2008/Resources/gdf_ch02_033-080_web.pdf

In addition to financial considerations, prepayments are often based on a desire to avoid policy conditions attached to loans from the traditional lenders such as the IMF. Bond holders like the GPFG have no political influence on the debtor country, and the economic terms are to a high degree set by the issuing government. Thus, in contrast to conditional loans which make governments accountable to IFIs and other lenders, bond debt makes the borrower government more accountable to the citizens of the country and increases the country's policy space. Prepayments of IMF debt and other loans carrying policy conditions have thus been welcomed by CSOs around the world, particularly in Latin America.

On the other hand, there is a concern about the legitimacy of such prepaid debts as there are often a series of unanswered questions: What were the origins of the loans; who took them on under which conditions and what were the impacts for the people of the borrowing country? Peru's prepayments to Paris Club creditors in 2007 were expected to be financed by bonds issued in the domestic market. The prepayments were questioned by Jubilee Peru which stated, with reference to illegitimate debts: *"when prepaying bilateral debt, we are denying the possibility of future cancellations"*.[46] In 2005 both Brazil and Argentina announced they would repay all their debts to IMF ahead of schedule. Civil Society Organisations protested and argued that the IMF loans were illegitimate and should not be repaid.[47]

Prepayments of debt cancel out the past and make it less probable that these questions will ever be raised and answered and, hence, that an assessment of the legitimacy of the original loans will ever be conducted. Prepayments also hinder cancellation of these debts at a later stage, even though they might be proven to have been illegitimate. By paying the debts the borrower country implicitly accepts the legitimacy of the previous claims and waives the possibility to repudiate or try dubious debts in a debt workout mechanism.

"We reject the fact that our countries used their important capacity to coordinate policy and actions in order to repay debts that are illegitimate, immoral, and odious, and which furthermore have already been repaid. [...] [T]his decision rewards the IMF, setting it free of guilt and responsibility, while at the same time it deepens the non-compliance by our governments of their obligations towards the millions of fellow citizens who suffer the everyday violation of their economic and social rights through impoverishment and indigence."

—"Life before debt!" Declaration by organizations and campaigns of Jubilee South in Argentina and Brazil, 2005.[48]

[46] Jubilee South, Jubilee USA, Eurodad and CDTM, 2007: *International Illegitimate Debt Campaign Bulletin*, Issue 3, August 2007.
[47] Ambrose, Soren, 2007: *The Decline (& Fall?) of the IMF*. Global Policy Forum. http://www.globalpolicy.org/socecon/bwi-wto/imf/2007/03imfdecline.htm
Moreover the prepayments of the debts were financed by using reserves, and CSOs argued that the countries' reserves should rather be spent on the people than on the IMF.
[48] Reed the whole declaration here: http://www.choike.org/nuevo_eng/ifis/informes/227.html

2

2. THE NORWEGIAN GOVERNMENT PENSION FUND – GLOBAL

The Norwegian Government Pension Fund - Global (GPFG) is a Sovereign Wealth Fund, previously known as the Petroleum Fund. At the end of 2008 the Fund's holdings amounted to 2 275 billion Norwegian kroner, about $340 billion,[49] which makes it the world's second largest sovereign wealth fund.[50] About one fourth of its total holdings were invested in government bonds.[51]

2.1. History and Management

From Fossil Fuels to Future Pensions

The Fund's holdings stem from oil and gas extracted from the North Sea. Petroleum was discovered in the North Sea in 1969 and production started in 1971. Almost twenty years later, in 1990, the Government Petroleum Fund law was passed in the Storting, the Norwegian Parliament, and in 1996 the first net transfer to the Fund was made. The accumulation of capital in GPFG is said to represent a reallocation of oil and gas resources into financial wealth which also belongs to future generations. This has consequences for the Fund's objectives and management. Objectives are long-term; the capital accumulated is meant to provide general welfare, including pensions, for future generations.

The Principle of Non-Interference

The Norwegian Government has the stated aim that the Government Pension Fund (GPF) should be the best governed fund in the world.[52] An important principle behind this governance plan is that the Fund should not be used as a political instrument and, therefore, should not interfere with Norwegian foreign policy. This principle, which is supported by a broad political consensus, implies that investments should be guided by purely financial interests, although carried out within an ethical framework. The National Budget 2008 states that *"It is part of our responsibility as managers to ensure that the fund is managed with the aim of achieving as high a return as possible within a moderate risk. This allows also future generations to benefit from our accumulated wealth."*[53]

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49 NBIM, 2009: *Government Pension Fund - Global. Annual Report 2008*. http://www.norges-bank.no/templates/report____73483.aspx

50 According to SWF Institute as of the valuation in October 2008. The largest Sovereign Wealth Fund being Abu Dhabi Investment Authority of the United Arab Emirates, SWF Institute says about the Abu Dhabi Investment Authority that [i]t is rumoured to be the largest of the Sovereign Wealth Funds. The uncertainty is due to the Fund's lack of transparency. SWF Institute: http://www.swfinstitute.org

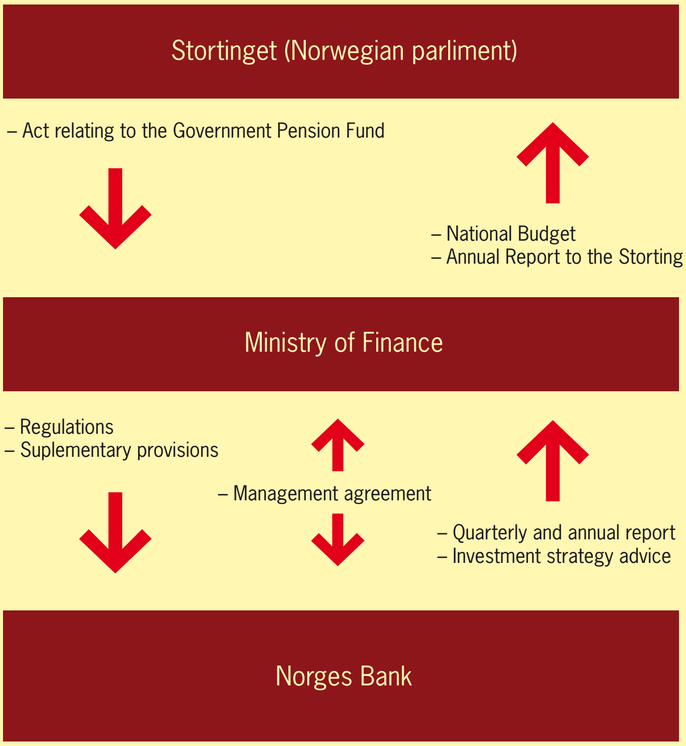
51 NBIM, 2009: *Government Pension Fund – Global Fixed income securities at 31 December 2008*. http://www.norges-bank.no/upload/73982/fi_holdings_spu_sorted.pdf

52 The Government Pension Fund consists of two separate funds: The Government Pension Fund -Norway, which assets are invested in Norway and the other Nordic countries, and The Government Pension Fund -Global which is exclusively invested in non Norwegian assets and the part assessed in this report. More information can be found at the webpage of the Ministry of Finance:
http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund.html?id=1441

53 Author's translation.
Ministry of Finance, 2007: Nasjonalbudsjettet 2008 (ch. 5.1.) http://www.regjeringen.no/nb/dep/fin/dok/regpubl/stmeld/2007-2008/Stmeld-nr-1-2007-2008-/5.html?id=482995

The principle of non-interference is reflected in the GPFG governance model which sets out a clear division between political and operational responsibilities. While the Storting (the Norwegian Parliament) has charged the Ministry of Finance with the overall responsibility, the operational management of the Fund is assigned to the Norges Bank Investment Management (NBIM).[54] NBIM consequently makes investments within the framework decided by the Ministry of Finance and the Storting. Ethical Guidelines and significant changes to the framework are discussed by the Storting.

GOVERNANCE MODEL



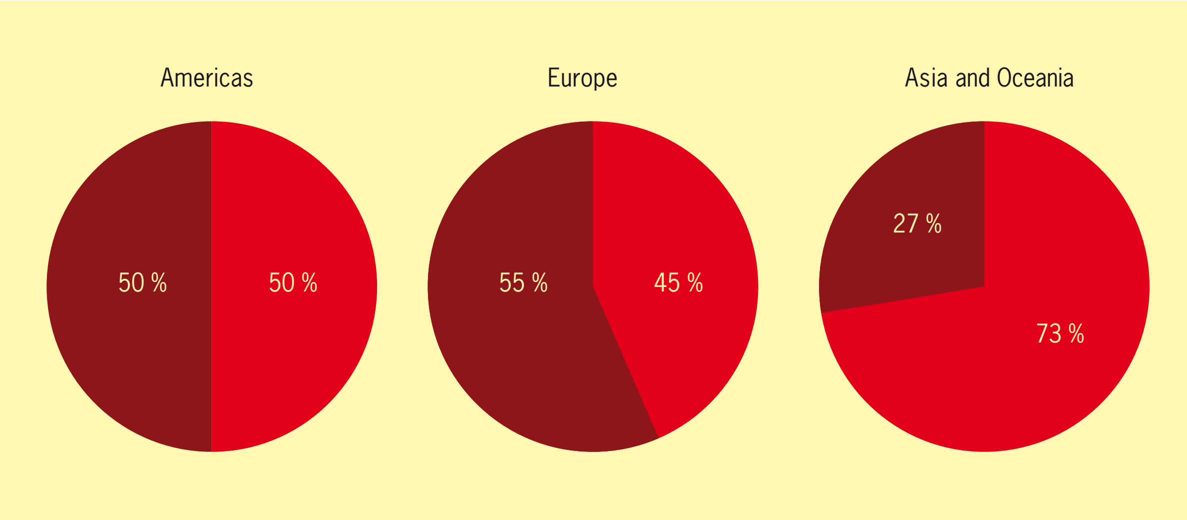
Source: NBIM[55]

Government Bonds in the Investment Strategy

The long-term investment strategy is to achieve a high long-term return with a moderate level of risk. The strategy is set out in the Act relating to the Government Pension Fund, which specifies how investments shall be distributed between different assets and geographical areas. How to diversify investments in order to achieve the best portfolio is often subject to public debate. Considerations are made regarding profits, risks and the benefits to the current and future generations. To a certain extent discussions regarding the strategic framework also cover environmental and development issues.

[54] Norges Bank is the Norwegian Central Bank
[55] NBIM, 2009: *Government Pension Fund -Global. Annual Report 2008* (p. 7)

The guidelines and composition of the investment portfolio has changed over the years. During the first years the Fund was to be invested almost exclusively in government bonds issued in developed markets. Equities were included in the portfolio in 1998. In 2006 the Storting decided to increase the share of equities from 40 to 60 percent, and hence reduce the holdings in fixed income securities (bonds) to 40 percent. As it takes Norges Bank some time to change the portfolio, in 2008 the holding of bonds represented about 50 percent of the Fund.[56] The holdings of government bonds at the end of 2008 amounted to about 555 billion Norwegian kroner invested in 45 countries, out of which 19 are developing countries.[57]



The figures illustrate the GPFG's investments in shares and fixed income distributed between regions in 2008.[58]

Source: NBIM.

The strategy is concretised in a benchmark portfolio for specific shares and bonds. The benchmark portfolio is decided by the Ministry of Finance and serves as a point of reference for the management of the Fund. Norges Bank's task as manager of the GPFG is hence to achieve as high a return as possible relative to that of the benchmark portfolio.

The strategic benchmark portfolio for fixed income securities has the following composition:

- 60 per cent of the portfolio shall consist of bonds in Europe issued in the following currencies: Euro, British pound, Swiss franc, Swedish krona and Danish krone. No investments shall be made in Norwegian krone.
- 35 per cent of the portfolio shall consist of bonds issued in the United States and Canada, issued in the following currencies: Canadian dollar and US dollar.
- 5 per cent of the portfolio shall consist of domestic government bonds from de-

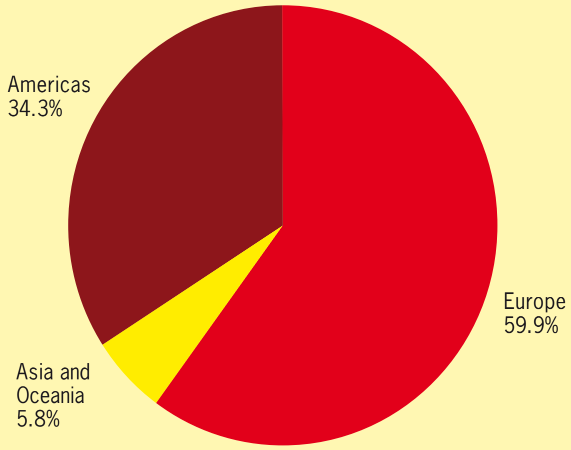
[56] Ibid.
[57] Ibid, Holdings Fixed Income.
Developing countries defined according to the World Bank, as on the World Bank website: Country Classification
[58] Ibid. (p. 12-13.)

veloped markets in Asia/Oceania (Australia, Japan, New Zealand and Singapore). This section of the benchmark portfolio consists of the following currencies: Australian dollar, Japanese yen, New Zealand dollar and Singapore dollar.

All bonds in the benchmark portfolio are rated on indexes provided by Barclay Capital.[59]

NBIM's investment universe is, however, not limited to the regions and currencies mentioned above. The NBIM is allowed to make investments in countries and currencies which are not covered by the benchmark portfolio. The benchmark portfolio serves only as a target with regard to the financial return. The return of the actual portfolio, i.e. the investment choices made by the managers in NBIM, shall not differ from that of the benchmark portfolio with more than 1.5 percentage points.

REGIONAL BREAKDOWN OF THE FIXED INCOME PORTFOLIO ON 31 DECEMBER 2008. PER CENT.



The figure illustrates how bond investments were distributed regionally in 2008. These investments include both corporate and government bonds.

Source: NBIM.[60]

Sovereign Wealth Funds: Modern Imperialists?
Over recent years the world has seen a dramatic increase in the number and size of Sovereign Wealth Funds (SWFs) – investment funds owned by governments.[61] Like the Norwegian Government Pension Fund, many of these funds raise their capital from natural resources.

[59] Based on Guidelines for management of the Government Pension Fund – Global, section 1.2. Please see the Guidelines for omitted details. Do also note that in the English version of the reference portfolio (as of April 3rd. 2009) it is referred to bonds included in indexes provided by Lehman Brothers. In the Norwegian versions this has been changed to Barclays after the bankruptcy of Lehman Brothers in September 2008. http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund/the-guidelines-for-the-management-of-the.html?id=434605

[60] NBIM, 2009: *Government Pension Fund - Global. Annual Report 2008* (p. 14)

[61] For a detailed definition of a SWF, see http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf p 27 (appendix 1)

Their strong presence in the international capital market has given rise to a debate and an international concern about SWFs' potential political influence as investors, often with a lack of transparency regarding strategies and actual investments. With their large wealth the SWFs represent an enormous investor base, and there is a fear of SWFs becoming modern, financial imperialists. In October 2008 the International Working Group of Sovereign Wealth Funds, facilitated by the IMF, established the "Generally Accepted Principles and Practices", a set of voluntary principles for SWFs, mainly focussing on their management and transparency.[62] The debate is mostly focused on the SWFs' holdings of shares.

GPFG is considered one of the best managed funds with respect to transparency and the very clear statement that purely financial interests will guide the Fund's investments. Some have argued that ethical guidelines per se constitute a threat to the non-interference policy because they could be perceived as making the Fund a political instrument or a moral imperialist. In international ratings on SWFs however, GPFG receives high scores, both when it comes to the non-interference policy and the ethical framework.[63]

2.2. Ethical Guidelines for Corporate Investments

The ethical guidelines for the GPFG were adopted in 2004. They serve as an ethical framework for the Fund's corporate investments. Investments in sovereign bonds are not included in the guidelines, nor are investments in bonds issued by international organisations. The guidelines are widely recognized and have proved that it is possible to construct a comprehensive yet operational ethical framework within finance. Not only is there a broad political consensus regarding the fund's ethical guidelines, they are also based on the concept of 'overlapping consensus'. This means that the basic norms and values should reflect a normative consensus shared by the broad scope of Norwegian contemporary society, as well as by future generations who will also be affected by the investment choices that are made today.

The following two premises form the basis of the Ethical Guidelines:

— *The Government Pension Fund – Global is an instrument for ensuring that a reasonable portion of the country's petroleum wealth benefits future generations. The financial wealth must be managed so as to generate a sound return in the long term, which is contingent on sustainable development in the economic, environmental and social sense. The financial interests of the Fund shall be strengthened by using the Fund's ownership interests to promote such sustainable development.*

— *The Government Pension Fund – Global should not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages..*[64]

The guidelines are carried out by three mechanisms:

— *Exercise of ownership rights in order to promote long-term financial returns,*

[62] For more information about the Working Group and the Principles, see http://www.iwg-swf.org/index.htm

[63] Ministry of Finance, 2008: *Nasjonalbudsjettet 2008* (ch.5) http://www.regjeringen.no/nb/dep/fin/dok/regpubl/stmeld/2008-2009/stmeld-nr-1-2008-2009-.html?id=529276

[64] Ministry of Finance, 2005: *The Ethical Guidelines*. http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund/Ethical-Guidelines-for-the-Government-Pension-Fund---Global-/the-ethical-guidelines.html?id=434894

based on the UN Global Compact and the OECD Guidelines for Corporate Governance and for Multinational Enterprises.

- *Negative screening of companies from the investment universe that either themselves, or through entities they control, produce weapons that through normal use may violate fundamental humanitarian principles.*
- *Exclusion of companies from the investment universe where there is considered to be an unacceptable risk of contributing to:*
  - *Serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other child exploitation*
  - *Serious violations of individuals' rights in situations of war or conflict*
  - *Severe environmental damages*
  - *Gross corruption*
  - *Other particularly serious violations of fundamental ethical norms.*[65]

A Council of Ethics has been established whose role is *"to provide evaluation on whether or not investment in specified companies is inconsistent with the established ethical guidelines"*.[66] In line with the ethical guidelines, the Council of Ethics' mandate is limited to evaluation of corporate investments. The Council and its members do not make evaluations or statements regarding government bond investments.

In 2008 the Ministry of Finance carried out an evaluation of the ethical guidelines. As a result of the evaluation additional mechanisms to promote the Fund's ethical basis will be developed.[67]

2.3. Ethics and Government Bonds

Since 2006 there has existed a mechanism whereby the Ministry of Finance can prevent NBIM from investing in fixed securities issued by certain countries.[68] The decision to exclude a country from the investment universe must build on broad international consensus. This mechanism has been used once, in 2007, when Burma was excluded from the GPFG investment universe. Thus, the only current restriction on NBIM regarding investments in government bonds is the following paragraph in the Guidelines for management of the GPFG: *"The Fund may not be invested in fixed income securities issued by the following sovereigns: Burma (Myanmar)."*[69]

[65] Ibid.

[66] Council on Ethics' webpage: http://www.regjeringen.no/en/sub/Styrer-rad-utvalg/ethics_council.html?id=434879

[67] The results of the evaluation were presented in the Ministry of Finance annual White Paper on the Management of the Government Pension Fund on April 3rd 2009. The report available in Norwegian. (St.meld. 20 2008-2009. Om forvaltningen av Statens pensjonsfond i 2008) http://www.regjeringen.no/upload/FIN/Statens%20pensjonsfond/stmeld20_2008-2009/stm20.pdf

[68] The mechanism was introduced because of the change in the Regulations on Management of the GPFG. Until 2006 the investment universe, the sample from where the managers in the NBIM choose assets, countries and currencies, was given in the form of a detailed list of accepted currencies in which NBIM was allowed to make investments. Since 2006 the investment universe has been broadened and there exists no such list. Hence the need for a mechanism which opens for the possibility for negative screening of states.

[69] Ministry of Finance, 2005: *Provisions on the management of the Government Pension Fund* Chapter 3.2; Restrictions on investments in certain fixed income securities issued by sovereigns. http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund/the-guidelines-for-the-management-of-the.html?id=434605

The Ministry of Finance points to the principle of non-interference to defend what must be said to be a weak ethical guidance for NBIM's investments in government bonds, and argues that a more comprehensive framework would imply interference with Norwegian foreign policy. The broad international consensus that is required in support of any decision to exclude a country from the investment universe is normally understood as consensus on UN sanctions. The Ministry of Finance is also allowed to exclude countries on the basis of other wide-ranging international sanctions in cases where the Security Council does not reach an agreement.

In the Consultation paper – Evaluation of the Ethical Guidelines for the GPFG, the Ministry of Finance states the following:

"Government bonds and bonds issued by international organisations give rise to special considerations. It is pointed out in the Graver Report, on p. 68,[70] *that Norway maintains diplomatic relations with a country despite being in disagreement with its policies in relation to, for example, human rights, with the exception of states that are subjected to international sanction regimes. Regular foreign policy channels will offer much more important opportunities for exercising influence in this respect, and commercial and other contact will in many cases afford better opportunities for exercising influence than does isolation.*
[...]
The Ministry is of the view that the threshold for excluding a country's government bonds from the GPFG shall be very high. The Ministry agrees with the Graver Committee that regular foreign policy channels constitute much more important policy measures for purposes of influencing the governments of other countries in the desired direction. Such decisions must therefore reflect broad-based political agreement in line with the principle of "overlapping consensus", to prevent any uncertainty to arise as to the purpose of the investments of the Fund. Consequently, decisions to bar investment in the government bonds of certain countries should primarily apply to countries that are subject to UN sanctions, or countries that are subject to other broad-based international measures that Norway has supported."[71]

In the public consultations which were carried out as part of the evaluation, a number of Norwegian CSOs did not agree with the Ministry's analysis as reflected above, and called for a more comprehensive ethical framework for government bond investments. Concerns were raised regarding human rights, climate issues and Norway's role as a conflict mediator. The debt movement was concerned about how to ensure that the GPFG does not contribute to illegitimate debt and argued that a more comprehensive framework for government bond investments is needed in order for the GPFG to rightfully claim status as a responsible investor.[72] Nonetheless, as illustrated in the Ministry's Considerations, the Ministry finds widening this framework to be a non-starter.

[70] Author's note: When the ethical guidelines were established, they build on a report carried out by a committee chaired by Professor Hans Petter Graver.

[71] Ministry of Finance, 2008: *Consultation paper – Evaluation of the Ethical Guidelines for the Government Pension Fund – Global* (p. 13) http://www.regjeringen.no/upload/FIN/Vedlegg/aff/evaluation_ethical_Guidelines.pdf

[72] Ministry of Finance, 2009: *Om forvaltningen av Statens pensjonsfond i 2008*, (p.139) St.meld. nr. 20 (2008-2009) http://www.regjeringen.no/nb/dep/fin/dok/regpubl/stmeld/2008-2009/stmeld-nr-20-2008-2009-.html?id=553201

The Ministry's Considerations

"In cases where the UN Security Council implements sanctions against a state by e.g. restricting commerce, the sanctions might also prohibit investments in the affected country. If the country in question has issued fixed securities, these will consequently be excluded from the investment universe. There is a possibility of lack of unity within the UN regarding sanctions. The Ministry has, however, left an opening for the possibility not to invest in fixed securities in cases where a country is subject to other extensive international measures which Norway has supported. It is the Ministry's view that the threshold for excluding a country's government bonds from the Norwegian Government Pension Fund should be very high. In agreement with the Graver-committee, the Ministry finds ordinary channels for foreign policy a much more important tool in influencing foreign governments to move in a desired direction. To avoid confusion concerning the goals of the Fund's investments, such decisions should reflect broad political consensus. Decisions not to invest in certain countries' fixed securities should therefore first and foremost apply to countries on which the UN Security Council has placed sanctions, or countries that are subject to other international measures to which Norway consents. Based on this it has been decided that the Norwegian Government's Pension Fund – Global (GPFG) cannot be invested in fixed securities issued by the state of Burma.

The government bases its policy on the fact that to exclude a country's government bonds from the investment universe would be a dramatic boycott of the country concerned. The government will only implement such action if adhering to international sanctions. It has not been a Norwegian policy to apply unilateral measures on countries that are at war, civil war etc. This could also be perceived as a strong politicisa tion of the Fund and give an impression of the Fund as a tool for implementing foreign policies. Another aspect is that investments in government bonds probably cannot in general be seen as directly financing war/conflict, as it could just as well to be utilized for legitimate purposes such as providing schools and medical care. It is not an option, disconnected from such an international consensus, to use the threat of withdrawing investments as a general tool for Norwegian foreign policy

Norway engages in active dialogue on human rights with specific countries. Currently, there is a comprehensive dialogue on human rights with China, Indonesia and Vietnam. The political network is an important element in these dialogues, as is the construction of a structure where policy makers, judiciaries, academics and CSOs can build networks. This contact creates an arena where the different actors can exchange information and voice worries and criticism in a trusting environment. In such a setting, the government assesses it ill-judged and not suitable to use investment funds from the GPFG as a tool to force changes. Dialogues on human rights must be based on equality and a confidence in the power of dialogue.

Some of the entities which participated in the public hearing have proposed an extended use of investment bans or to change the criteria. In light of what has been presented above, the department thinks that the ethical guidelines for the Fund's investment in government bonds should be continued as they are today."[73]

"The Ministry continues to see a renunciation from investing in a country's fixed securities as a dramatic boycott of that country, excluding it from the investment universe on the basis of the country's actions. Burma represents a special case in several ways, but in this context the most important factor is the scope of the international sanctions toward Burma. At present there are no other measures or sanctions with consensus in the Storting that have the same scope as the ones aimed at Burma. It is not an option, without a similar international consensus, to use investment bans as a general tool in Norwegian foreign policy."[74]

Source: Ministry of Finance

[73] Ibid. (p. 140) Author's translation.
[74] Ibid. (p. 90) Author's translation.

3

3. THE NORWEGIAN GOVERNMENT PENSION FUND – GLOBAL: A RESPONSIBLE LENDER? CONCERNS AND PROPOSALS

The Norwegian Government Pension Fund - Global (GPFG) lends money to states around the world through its investments in government bonds. In 2008 GPFG's holdings of government bonds amounted to 555 billion Norwegian kroner, about $85.5 billion. These investments are not subject to ethical guidelines, despite Norway's stated aspirations to be at the forefront of responsible lending and its ambitions to be the best fund manager in the world. Few seem to have reflected upon the moral implications of these inconsistencies.

The explanatory factors for the lack of ethical guidelines are linked to political issues. The Norwegian Government fears that a stronger ethical framework for government bond investments would blur the line between political positions and investment decisions. This is a valid concern, taking into account the international debate related to sovereign wealth funds' increasing power, political as well as economical.

Still, we believe it is possible to establish an ethical framework which includes government bond investments. Such a framework should be based on the already existing ethical foundation of the Fund. This chapter assesses some of the ethical challenges related to GPFG's role as a lender and proposes recommendations for what should be included in a checklist for the Fund's investments in government bonds. To rightfully call itself a responsible investor and lender, the GPFG must ensure that its money does not contribute to gross human rights violations and violations of international law. Also, the GPFG should consider the quality of procedural arrangements related to the bond issuances, more specifically whether commonly accepted principles such as transparency and parliamentary participation are ensured.

Given the functioning of the debt market and standardized bond contracts, some challenges faced need to be treated at an international policy level. The first part of the chapter therefore looks into policy issues concerning bond lending and borrowing at a systemic level. The Norwegian government, being the owner of the world's second largest sovereign wealth fund, has a particular responsibility to help ensure fair and predictable rules of the game in the debt market. Issues of debt sustainability and debt work-out mechanisms are highly relevant to Norway's role as the owner of the GPFG and responsible for the Fund's operations in the international market for sovereign bonds.

3.1. Bonds and Responsible Financing; a Systemic Issue

The Norwegian government is at the forefront of international efforts on the issues of illegitimate debts and responsible financing. In 2007 Norway became the first government to cancel debts on the grounds of failed development policy in the past and, subsequently, to take co-responsibility as a lender.[75] The Minister for International Development Erik Solheim said, when presenting the groundbreaking decision, that the evident consequence and moral obligation following this decision was for Norway to take the lead on the international debate of creditor co-responsibility. Since then, the Government has made efforts to develop a more responsible financial framework, including measures to move towards common international acknowledgement and a clarification of the concept of illegitimate debt.[76] Nonetheless, despite some important initiatives, there exist no comprehensive guidelines or set of rules to ensure a national responsible lending policy. The lack of consistency becomes very clear when looking into the GPFG's government bond investments.

The international sovereign lending and borrowing architecture suffers from a lack of clear rules and regulations. Today's system is mainly regulated by national law and lenders' interests, and has contributed to the unsustainable debt burdens of several developing countries and, moreover, the build-up of illegitimate debt. Chapter one demonstrated how government bonds form part of unsustainable and illegitimate debts, as well as the degree to which government bonds have increased as part of several developing countries' debt portfolios over the last years.[77] In 2008, 19 of the 45 countries in which the GPFG held government bonds were classified as developing countries.[78]

In a report assessing North/South financial flows, Eurodad says: *"According to the IMF external borrowing via the issuing of sovereign bonds also introduces new risks. These include abrupt changes in market conditions, exchange rate exposure, terms of trade swings, external conditions and debt sustainability problems."*[79]

Debt Sustainability

To issue bonds has proven useful to developing countries in order to cover financial needs and, in the case of bonds issued in foreign currency, access external financing. Also, as explained in chapter one, bond financing could be advantageous as far as policy space and acknowledgement from the international society is concerned. On the other hand, debt accrued via the issuance of bonds is a costly way of financing

[75] The loans stemmed from the Shipping Export Campaign which objective was to help the Norwegian shipyard out of a crisis in the late 1970s. Through the campaign cheap credits were offered developing countries which bought Norwegian ships. However more consideration was given the crisis in Norwegian shipyards than the development effects of the projects. Credits were granted to high risk projects and standard rules and procedures for development aid were ignored. The decision to cancel the remaining claims was based on inadequate needs analyses and risk assessments when the credits were granted. For more information about the Ship Export Campaign and the cancellation of these debts, please see Abildsnes, Kjetil, 2007: *Why Norway took creditor responsibility*. http://slettgjelda.no/filestore/eng.pdf

[76] In 2007 the World Bank and UNCTAD, both funded by the Norwegian government, issued papers on the concept of odious debt. Norway has also contributed to raise the concept of "illegitimate debt" within other forums in the World Bank and UN.

[77] The financial crisis followed by reduced investment levels, lowers the demand for bonds, and numbers of both middle- and low income countries turn to the multilateral finance institutions for loans, hence shifting the loan portfolios back to multilateral loans.

[78] NBIM, 2009: *Government Pension Fund - Global Annual Report 2008, Holdings Fixed Income*. Developing countries defined according to the World Bank.
World Bank website: Country Classification http://go.worldbank.org/K2CKM78CC0

[79] Eurodad, 2008: *North-South Financial flows: trends and status* (Phase II), (p. 51). Eurodad report for ActionAid.

for most developing countries. Due to low credit ratings and often high levels of risk related to currency changes and inflation, investors demand high interest rates.

In the course of the financial crisis, private financing is becoming even more expensive. In the report "A New Debt Crisis?" Jubilee Debt Campaign UK assesses the impact of the financial crisis on developing countries:
At the same time the cost of borrowing is rising in the developing world, as investors withdraw, risk premiums and interest rates go up. JP Morgan's EMBI index measures the difference between returns on emerging market debt instruments and US Treasury bonds, and is a key measure of risk aversion. According to this index, there was a huge increase in risk aversion in the second half of 2008, with the difference in returns (the 'spread') growing from around 300 points to nearly 900 points in the last quarter of 2008. This means that it is much more expensive for developing countries to borrow money on the financial markets.[80]

The high levels of debt strongly constrain national budgets and limit the countries' possibilities to invest in public services such as education and health. Current initiatives on debt sustainability fail to take human development measures into account and, moreover, do not include all lenders. Bond holders, such as the GPFG, are not provided with incentives to take issues of debt sustainability into account when making investments.[81] Civil Society Organisations call for a more comprehensive framework which takes human development measures into account and is legally binding to all lenders and borrowers. A rule-based framework could ensure that private creditors consider, among other measures, issues of debt sustainability when investing in developing countries' debt.

Debt Disputes

Sometimes countries are prevented from servicing their debts due to large or unjust debt burdens or dramatic changes in external or internal circumstances. This was illustrated in chapter one. Today there is no internationally agreed procedure for how to deal with defaulted or unjust debt.[82] Questions of debt disputes and defaults are particularly challenging in the case of government bonds, because the borrower faces a highly diverse lender base. Negotiations on how to deal with repayment problems could involve hundreds or even thousands of bond holders.

Related to the issue of debt negotiations is the existence and operations of so-called vulture funds. These are private investors who specialize in making profit on poor countries' debt. The 'vultures' buy up developing countries' debt at a cheap price in the secondary market. Subsequently, they seek to recover the full amount, meaning the full face value of the debt plus interest and penalties, through negotiations

[80] Edwards, Sarah, 2009: *A New Debt Crisis? Assessing the impact of the financial crisis on developing countries* (p.10). Jubilee Debt Campaign. http://slettgjelda.no/filestore/Debt_crisis_report_web.pdf

[81] Of course with the exception provided by the functioning of the bond market. If debts sustainability in a country is threatened, bonds issued by that country will be assessed as high risk and hence investors which are avers of risk will not buy these bonds.

[82] Ad hoc mechanisms for debt negotiations exist, such as the Paris Club for official creditors and the London club for private banks. There are also debt relief initiatives in place for multilateral lenders. Bondholders, however, are not committed to participate in negotiations or in debt relief mechanisms.

or even litigations.[83] Governments and civil society alike worry about vulture funds' activities and their serious impacts on the economies of poor countries. Measures to avoid 'vulture' operations are crucial in order to ensure fair and effective debt negotiations which take into account the rights of both lenders and borrowers.

A promising development in debt negotiations is that since 2003 so-called Collective Action Clauses (CACs) have frequently been included in bond contracts. CAC is a mechanism which allows the majority of the bond holders to come together and negotiate with the issuer on behalf of all bond holders. The agreement reached between the borrower and the majority of bond holders, usually a super-majority of 60-75 percent, is binding to all bond holders.[84] CACs are therefore advantageous with respect to avoiding vulture fund operations. A principal shortcoming regarding CACs, however, is that they can only be included in future debt. There are also challenges related to juridical enforceability and hold-outs, i.e. bondholders who reject to participate in negotiations.[85]

The lack of an international insolvency mechanism and the activities carried out by vulture funds operating in the bond market emphasize the need for an internationally agreed procedure to deal fairly and efficiently with debt disputes. A fair and transparent debt work-out mechanism should entail a neutral decision-making entity which both lenders and borrowers could turn to with the objective of assessing the legitimacy and sustainability of debts. A framework will need to protect the rights of creditors and debtors, and protect debtors from civil law suits during the structuring process. Decisions made should be legally binding to borrowers and lenders, official as well as private. In March 2009 the commission which was established within the UN to assess the impacts of the financial crisis on developing countries and propose measures to be taken, underlined the need for an *"equitable and generally acceptable sovereign debt restructuring mechanism"*. [86]

Responsible Lending and Borrowing

Even in a market governed by the principle of 'the survival of the fittest', there is a growing recognition of the importance of the legitimacy of debts and contracts to avoid reckless lending and borrowing. Hence lenders' and borrowers' responsibilities in loan contraction processes have received increased attention over the last years.

Different stakeholders emphasise different aspects of the concept of responsible lending and borrowing and the debate to a certain degree suffers from a lack of common language. Among lender countries and institutions the term 'responsible' lending and borrowing is often used in parallel to the term 'sustainable' lending and borrowing. Civil society on the other hand under-

[83] For more information about vulture fund activity, policy responses and country examples, please see Hurley, Gail, 2008: *Taming the Vultures: Are New Measures Enough to Protect Debt Relief Gains*. Eurodad. http://www.eurodad.org/uploadedFiles/Whats_New/Reports/The%20Rise%20of%20the%20Vulture%20layout.pdf

[84] Odubekun, Francis, 2005: *Debt Restructuring and Rescheduling*. Power point presentation at National Workshop on Capacity-Building For External Debt Management in The Era of Rapid Globalization, 2005

[85] Ibid.

[86] UN, 2009: *Recommendations by the Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system* (para 71) Draft General Assembly Resolution on March 19 2009. http://www.un.org/ga/president/63/letters/recommendationExperts200309.pdf

lines that there is more to responsibility than sustainable debt levels. Responsibility includes qualitative matters such as contractual agreements, transparency, human rights issues and the need for predictability and clear dispute mechanisms. Moreover, where some focus on the need for responsible borrowing, others emphasise that lenders need to take their part of the responsibility. The term 'responsible finance' covers both aspects.

Despite the increased concern for both quantitative and to a certain degree qualitative debt matters among traditional lenders, initiatives have been weak, lender-biased and presenting no real incentives for lenders to actually implement them. 'Guidelines', 'framework' and 'principles' are all voluntarily and have no sanction mechanisms towards lenders who choose not to follow the guidance.

Proposal for a Comprehensive Framework

A promising initiative attempting to answer some of the above-mentioned challenges is Eurodad's Charter on Responsible Financing.[87] The charter presents a set of principles and practical arrangements that should be included in standard loan agreements in order to ensure predictability and fair conditions for lenders and borrowers, as well as protect the people and environment in developing countries. The overall aim is to ensure sustainable and responsible lending and borrowing through a set of legally binding standards that both lenders and borrowers commit to adhere to. Most principles are applicable to any kind of loan contracts – official and private.

A majority of the principles suggested by Eurodad can be applied to government bonds. Suggestions regarding public consent, transparency and repayment difficulties as well as contractual arrangements are of particular interest in this regard. These are important measures in order to avoid unsustainable debt burdens, to ensure predictability in case of a changing external financial environment and to ensure legal contracts and mandates and parliamentary control over debt levels and the purpose of issuances. The charter also suggests that restrictions on the sale of credits on secondary markets are established to help prevent vulture fund litigation. The proposal has been welcomed by Commonwealth Finance ministers.[88]

The Charter is meant to give some very concrete input to the ongoing debate on sustainable and responsible lending and borrowing. It has received fairly positive feedback from both lenders and borrowers. The Norwegian government's position has been that the Charter is a good starting point when discussing the details on what co-responsibility implies and how responsibilities should be shared between lenders and borrowers. In line with other lenders, the Norwegian government has raised concerns about whether such a comprehensive framework will constitute a new set of conditionality, now framed as responsibility. In the discussions on responsible financing it is important to differentiate between policy conditions imposed by one of the contracting parties (conditionality) and principles applying to both parties to ensure predictability, a fair share of risks and responsibilities, and accountability of both lenders and borrowers to the citizens of their countries.

[87] Hurley, Gail, 2008: *Eurodad Charter on Responsible Financing*. Eurodad. http://www.eurodad.org/whatsnew/reports.aspx?id=2060

[88] Hayes, Lucy and Hurley, Gail: *Eurodad Report Back: Bank/Fund and UN FfD meetings, Spring 2008*. http://www.eurodad.org/uploadedFiles/Whats_New/News/Eurodad_springmeetings.pdf
Ministers were represented from Cameroon, Ghana, Guyana, Malawi, Mozambique, Sierra Leone, United Republic of Tanzania and Zambia.

Lenders, including the Norwegian government, have also underlined the importance for the framework to have the support of borrower countries in order to gain legitimacy for the proposals. In this context it is promising that the Finance Ministers of nine Commonwealth HIPC countries when they met in April 2008 *"urged the international community to carefully consider the proposals set out in Eurodad's Charter on Responsible Lending"*.[89]

Recommendations:

The Norwegian government should

— *strengthen efforts in working for a rule-based international lending and borrowing architecture. A set of rules should be established that applies to both lenders and borrowers, is enforceable and applies to private as well as public debt.*

— *continue and strengthen efforts in support of an international fair and transparent debt workout mechanism. Such a mechanism should assess the sustainability and legitimacy of the debts in question.*

— *advocate for collective action clauses to be included in sovereign bonds in order to avoid aggressive litigator hold-outs in case of repayment difficulties by the borrower state.*

3.2. Human Rights and International Law

Ethics and Politics – a Challenging Combination

The nature of government bonds requires these investments to be treated differently from corporate investments in terms of mechanisms used to enforce ethical principles. One such feature is that bond holders do not have democratic rights and thus cannot make use of active ownership to promote ethical points of view. Furthermore, as the Norwegian Ministry of Finance very clearly points out, mechanisms such as negative screening and withdrawal of financial assets are distinctly stronger when enforced on government bonds than on corporate investments. The Norwegian state has, and seeks to maintain, diplomatic relations to states with whom it might disagree on issues regarding for instance human rights. To exclude a country from investments or to withdraw investments based on a country's policies is indeed a very strong signal. If the withdrawal is based on a political statement it could even be perceived as a boycott of the country in question and thereby harm diplomatic relations. Political considerations constitute significant challenges to the introduction of ethical guidelines for government bond investments and should not be understated.

Nevertheless, keeping the political challenge of balancing policies and ethics, finance and diplomacy in mind, we believe the government should be willing to enter into discussions on how mechanisms could be constructed to ensure that the Fund's ethical objectives are indeed enforceable to the Fund as a whole.

[89] Ibid.

Purchasing and holding securities, especially in countries in war and conflict, can also be perceived as political and could be in contradiction to official foreign policy. It would also be contradictory to Norwegian foreign policy not to make sure that Norwegian state capital does not contribute to gross violations of international law and human rights. Moreover, indirect financing of such violations fully contradicts with the Fund's ethical objectives and the basis of these; the principle of overlapping consensus.

These concerns of being perceived as political and of interfering with Norwegian foreign policies interestingly echo the concerns raised a few years back regarding the establishment of ethical guidelines for corporate investments. To make an ethical framework well-defined enough to implement was also then seen as a major challenge. Yet the existing guidelines have proven to be both enforceable and perceived as what they are; ethical guidelines, not a means of implementing Norwegian foreign policies.

Controversial Investments

Sovereigns involved in armed conflict or accused of gross violations of human rights have been the focus of public debates regarding ethics in the GPFG's government bond investments. The holding of bonds issued by Israel and Sri Lanka in particular, has come under scrutiny. "*[Investments in Israeli government bonds] allow Israel to build settlements and to continue their policy of occupation; that is not acceptable,*" said the leader of the Norwegian Labour Youth, Martin Henriksen, in 2007 when commenting the fact that the GPFG doubled its investments in Israel in one year.[90] In January 2009, in a comment to the Norwegian magazine NyTid, the doctor and activist Mads Gilbert said "*[t]he fact that the occupying power Israel benefits from Norwegian investments via the GPFG is incomprehensible; and no less so after the extensive killings of civilians and destruction of civilian Palestinian society in Gaza. […] Norway should not contribute to financing Israeli warfare or activities related to the occupation of Palestine.*"[91]

"The way this is practiced also represents a double moral standard regarding the purchase of bonds. The government has chosen to exclude Burma, but has not excluded the purchase of fixed securities issued by Saudi-Arabia, Syria, Iran, Venezuela, Sudan, Zimbabwe, Cuba, Pakistan or China, to mention some – all of which are countries where human rights violations are an integral part of the country's principles."[92]
—Christian Tybring-Gjedde, the Progress Party.

[90] Randen, Astrid, 20 July 2007: *Dobler investeringer i Israel*. NRK. Author's translation. http://www.nrk.no/nyheter/okonomi/1.3001078

[91] Bilden, Kaare M, 11 March 2009: *Oljefondet øker i Israel*. NyTid. Author's translation http://www.nytid.no/nyheter/artikler/20090311/oljefondet-oker-i-israel/ Gilbert was among the few international witnesses to the Gaza war January 2009. He worked as a doctor at the Shifa hospital in Gaza.

[92] Author's translation of quote from Christian Tybring-Gjedde's statement in the Storting (the Norwegian Parliament) 28 February 2008. http://www.stortinget.no/no/Saker-og-publikasjoner/Sporsmal/Interpellasjoner/Interpellasjon/?qid=39070#a6

Double Standards

In January 2009, two weeks after Israel started the war on Gaza, Finance Minister Kristin Halvorsen requested the Council of Ethics to assess the GPFG investments in companies operating in Israeli or Palestinian territory. She said *"the situation is acute and there are gross attacks on civilians. We must ensure that Norwegian money is not invested in companies contributing to violations of human rights or international law."*[93] On the other hand, she strongly rejected those who called for withdrawal from investments in the Israeli government itself. "*A decision to sell the government bonds would be to go far into foreign policy. This would, in reality, imply a boycott and that is not acceptable to this government,*" she said.[94]

The GPFG is prevented from investing in corporations violating the human rights. It is also considered unethical to invest in a company which contributes to such violations committed by a state. What then about financing the state itself? Amnesty International Norway has repeatedly pointed to this incoherence, underlining the fact that the legal responsibility to respect and promote human rights lies with the state. To fund a regime which is responsible for serious violations of international law is not illegal. Nevertheless, funding international law violators clearly contradicts both the principle of overlapping consensus and the basis of the GPFG's ethical guidelines.[95]

"It should not be the case that the Government Pension Fund Global demands more from companies' behaviour than from states in respecting human rights."
—Beate Ekeløve-Slydal, Amnesty International Norway[96]

Human Rights and Illegitimate Debt

Today there is no generally agreed definition of illegitimate debt, but even a conservative definition would include loans to states where gross violations of human rights are likely to be committed. Loans taken on to finance unproductive purposes and project funding where projects seriously harm the affected population who in return will be the ones repaying the loan should also be included even in a fairly conservative definition of illegitimate debt.

It is challenging to draw the line between what are gross violations and what are not. The Eurodad Charter on Responsible Financing suggests that "*[a]ctivities financed must not violate human rights and must not contribute to the violation of human rights. These rights are set out in the internationally recognised human rights treaties and conventions to which either borrowers or lender is signatory. The Danish invest-*

93 NTB 12 January 2009: *Avviser salg av israelske statsobligasjoner.* Author's translation.
94 Ibid. Author's translation.
95 Foundation for the GPFG's ethical guidelines states: *The Fund should not make investments that entail an unacceptable risk that Fund is contributing to unethical acts or emissions, serious violations of fundamental humanitarian principles, gross violations of human rights, gross corruption or severe environmental degradation. Even though the mechanisms to avoid such risks are only valid for corporate investments, the basis for the guidelines regards the Fund as a whole.*
96 Bilden, Kaare M, 11 March 2009: *Oljefondet øker i Israel.* NyTid. Author's translation

ment company BankInvest's SRI-fund has a negative screening of sovereigns and excludes countries with severe violations of the international norms for human rights, labour rights, the environment and International Humanitarian Law."[97]

There is no evident answer to the question of how severe violations of treaties and conventions must be before the GPFG should avoid investing in government bonds from a certain country. For the Fund to operate according to its own objectives and the moral conviction of the society at large, and to avoid contributions to illegitimate debts, we do however find it clear that guidelines must be stronger than they are today. We believe that the government should go further into these questions given its aspirations to be a responsible lender and investor.

Recommendations:

The GPFG should not contribute to violations of international law or gross violations of human rights. The GPFG should be extremely careful when investing in countries in armed conflict, war or civil war.

The Ministry of Finance should further explore how respect for human rights and international law can be included in an ethical framework with an aim to avoid contributions to violations of these.

3.3. Transparency and Public Consent

The purpose of the borrowing is not the only factor affecting the legitimacy of loans. What is the process of issuing bonds and how is it handled? Who are involved in the decision-making process and what are the report mechanisms? These aspects need to be looked into in order to ensure that the parliament, representing the people who will repay the loans in the future, is properly informed about the size and purpose of the funds generated via the bond issuance, and is part of the decision-making process. Moreover, transparency and proper mechanisms are crucial to facilitate participation and consent from groups who will be directly affected by bond issuances. This concern is particularly important if bonds are issued to finance specific projects. In general, parliamentarian participation contributes to ensuring that loans taken on are in accordance with national strategies. Public consent and transparency are essential for people to be able to hold their elected leaders accountable.

In the case of government bonds this implies that the parliament should be involved in the issuing process. In Norway, the Storting authorizes the Ministry of Finance to borrow based on an annual proposition to the Storting.[98] This is especially important in countries where democracy is weak and there is a threat of large debt build-up, possibly including illegitimate debts. Commonwealth ministers also highlighted parliamentarian involvement as crucial when they discussed new bond issuers at the Commonwealth Ministerial Debt Sustainability Forum in April 2008.[99] Also, information about bond issuances should be made public and there should be transparency

[97] Based on this clause, Russia and Venezuela are excluded from the portfolio.
[98] Ministry of Finance webpage. http://www.regjeringen.no/en/dep/fin/Selected-topics/Economic-Policy/the-central-governments-outstanding-debt.html?id=443404
[99] Eurodad, 2008: *Finance ministers debate Eurodad charter.* http://www.eurodad.org/aid/article.aspx?id=118&item=2222

regarding government bond auctions and the result of these. Information should be made available in main national languages.

Although the main responsibility for creating conditions that ensure public participation, transparency and accountability in the borrowing country lies with the borrowing government, lenders should be held accountable if lending when procedural conditions are not according to the mentioned principles.

Recommendations:

The GPFG's investments in government bonds should be in accordance with the following principles:[100]

— *Parliamentary and citizen participation: The bond issuance process must be transparent and participatory, i.e. parliaments and, in the case of project financing, citizens and affected communities in the borrower nation must be given adequate time and information to debate the taking-on of the loan, including purpose, terms and conditions of the loan in accordance with the national constitution.*

— *Public disclosure of information: The bond contract and information about bond auctions and the results of these must be available to the public in borrower and lender nations.*

— *Language: The contract must be available in the main national languages (including the language(s) of affected communities) of the debtor nation. Both original and translated versions should have equal validity in a court of law.*

3.4. Technical and Legal Terms and Conditions

Bond investments differ significantly from other kinds of lending regarding contractual agreements, their function and the relation between the contracting parts. The issuer, or borrower, unilaterally sets the terms and then sells the bond to the highest bidder.[101] Because bonds are traded at the debt market, contracts are standardised and do not differentiate between buyers. Some might therefore argue that there cannot be special clauses or guidelines attached to one fund's bond investments. Nevertheless, it is feasible for the GPFG to establish a checklist of certain technical and legal terms and conditions that must be fulfilled prior to any bond investment. It is of course crucial for a responsible investor to ensure that investments take place within legal terms and conditions.

History shows a number of shady contracts, loans which disappeared into corruption and loans taken on by leaders with no legal authorization or no democratic mandate. Issues of legality are closely linked to the need for transparency in the loan market. Chapter 3.3 called for transparency in the process of bond issuance, whereas chapter one illustrated how bond transactions have contributed to obscure the history of

[100] Recommendations are based on the Eurodad charter on Responsible Financing.
Hurley, Gail, 2008: *Eurodad Charter on Responsible Financing*. http://www.eurodad.org/whatsnew/reports.aspx?id=2060
[101] In theory sets conditions unilaterally. Nevertheless, issuers are dependent upon approval from the international financial markets. As illustrated in chapter one, credit rating agencies also have a strong say in the bond market.

loans and the circumstances under which they were given. Lenders, despite being aware of unlawful or unethical circumstances, have not been held responsible for participation in shady business.

Ecuador refuses to repay illegitimate bonds
In Ecuador in 1999 Brady bonds[102] were restructured into new bonds, called global bonds. Ecuador has conducted an official debt audit – a commission has examined loan contracts and studied impacts of the loans on Ecuador and its people in order to assess the legitimacy of the debt.[103] As a result, the president of Ecuador, Rafael Correa, in December 2008 decided to default on some of the mentioned global bonds on the grounds of illegitimacy.

The commission proves that the signatories of the contract did not have legal authorization to sign the agreements. Moreover, Ecuador's debt was overrated when restructured into Brady bonds in 1994. The commission states that the market value of the debt in 1994 was about $1700 million, while it was exchanged for Brady bonds worth almost $3400 million. This implies that bonds were issued for about the double amount of the real value of the debt.[104] Moreover, due to restructuring, there were charged interest rates on interest, which according to the report is a violation of Ecuadorian law.

After the debt audit Ecuador's President Rafael Correa has decided to default on the global bonds and has invited bondholders to negotiations on Ecuador's terms. *"We will restructure that debt in accordance to our interests,"* Correa said during a weekly media address. *"We will do it legally and with legitimacy because that debt was overvalued when it was renegotiated in 1999."*[105]

The Eurodad Charter on Responsible Financing provides suggestions for technical and legal terms and conditions that should be included in a standard loan agreement or taken account of prior to the loan contraction. The following proposals are the most relevant for bond contractions by the GPFG and should be included in an ethical framework:

Recommendations:

The GPFG's investments in fixed securities issued by states should be in accordance with the following principles:[106]

— *Legal authorisation to enter into the transaction: The loan document must be signed by authorised representatives of both borrower and lender. It must show that it has secured the necessary parliamentary and/or other administrative approvals in the borrower country.*

102 See chapter one for an introduction to Brady bonds.
103 For more information, see the commission's home page (in Spanish): http://www.auditoriadeuda.org.ec/
104 Comisión para la auditoria integral del crédito público, 2008: *Final Report of the Auditing of the Ecuadorian Debt* (p.33)
105 Reuters, March 2009, *Ecuador says to present bond plan on April 20*
106 Recommendations are quoted from the Eurodad Charter on Responsible Financing. Hurley, Gail, 2008: *Eurodad Charter on Responsible Financing*.

— *Penalties: There should be no usurious penalty premiums. These should be set at the same rate as the original interest rate, for example if the original loan carries an interest rate of 3%, the penalty premium should carry a maximum interest rate of 3%.*

— *Legal authorisation to negotiate: Proof of legal power of attorney and negotiation must be provided by both sides of the contract before commencement of any negotiations on the loan.*

CONCLUSION

Borrow my Pension refers to the Norwegian Government Pension Fund - Global's (GPFG) lending of money to other countries. The lending takes place in the form of investments in government bonds. Surprisingly, given Norway's commitments to responsible lending and investment, these investments are not subject to any ethical guidelines. The only exception is a mechanism preventing the Fund from investing in bonds issued by Burma.

The aim of this report has been to stimulate a debate about the non-existence of ethical guidelines for the GPFG's investments in government bonds. GPFG's investments in companies are subject to fairly comprehensive ethical guidelines which are frequently discussed in the public. Few, however, seem to be aware that about one fourth of the GPFG's investments are not included in the current ethical framework. The report recommends further work to be done with the aim to include government bonds in the ethical framework and establish suitable mechanisms for the implementation of this.

Responsible investments and responsible lending are highly prioritized by the Norwegian government. The Ministry of Finance, the formal owner of the Fund, seeks to be the best fund manager in the world and to strengthen its role as a responsible investor. In addition, the Ministry of Foreign Affairs is strongly committed to working for responsible lending and borrowing and has taken progressive positions on issues of illegitimate debt. The weak ethical guidance for the Fund's investments in government bonds is highly contradictory to these commitments.

Borrow my Pension illustrates how bonds have played a role in the build-up of unsustainable and illegitimate debts. Ethical challenges regarding government bond investments include issues related to the fungibility of money and to restructurings of loans. Financial resources raised by the issuance of government bonds normally go directly into the Treasury without any earmarking of funds. The money invested by the GPFG and other bond holders can therefore be used to finance any government activity. This raises serious concerns when it comes to investments in countries involved in war or armed conflict and countries in which the government is responsible for gross violations of human rights. Another main concern regarding the ethical responsibilities of a government bond investor is related to the restructurings of loans. Frequent restructurings and lack of transparency makes it hard to obtain information about the origins of the restructured debts. The issuance of bonds can efficiently be used to pay down or restructure illegitimate debts and, hence, draw a line over the past without opening for an assessment of the legitimacy of the loans. Yet no mechanism is in place to ensure responsible behaviour in the bond market or how to deal with debt disputes or defaults.

Norway should meet these challenges on two levels: Firstly, the Norwegian government, being the owner of the world's second largest sovereign wealth fund, should commit to working for fair and predictable rules of the debt market. Challenges such as unsustainable levels of debt, speculations in trade with poor countries' debts and the lack of an international procedure for debt solvency issues are directly related to government bond issuances and investments. Norway should work at the international policy level, to create a rule-based system in which lenders and borrowers commit to following international standards concerning e.g. transparency and public consent, human right issues, contractual agreements and procedures in case of disputes or payment difficulties. The government should also strengthen its efforts in support of an international fair and transparent mechanism to deal with debt disputes and repayment difficulties. Such a mechanism should assess the sustainability and legitimacy of the debts in question.

Secondly, the Ministry of Finance should expand the ethical framework of the GPFG in order to make it applicable to the whole fund, including investments in government bonds. A framework should be established that prevents pensions of current and future generations of Norwegians to be earned on activities which strongly contradict the moral conviction of the public, e.g. through the financing of gross human right violations or payments of illegitimate debts.

Due to the nature of government bonds, mechanisms to enforce the Fund's ethical objectives must be different for such investments than for investments in companies. Mechanisms such as negative screening and withdrawal of financial assets are distinctly stronger when enforced on government bonds than on corporate investments. The main reason behind the Ministry of Finance' reluctance to even consider an establishment of ethical guidelines for the GPFG's government bond investments is linked to this matter. The Norwegian state has, and seeks to maintain, diplomatic relations with states with whom it might disagree on issues regarding for instance human rights. To exclude a country from the investment universe or to withdraw investments based on a country's policies is indeed a very strong signal. If the withdrawal is based on a political statement it could even be perceived as a boycott of the country in question and thereby harm diplomatic relations. Political considerations constitute significant challenges to the introduction of ethical guidelines for government bond investments and should not be underestimated.

Nevertheless, keeping the challenge of balancing policies and ethics, finance and diplomacy in mind, we believe the government should enter into discussions on how mechanisms could be constructed to ensure that the Fund's ethical objectives are indeed enforceable to the Fund as a whole. This report proposes that a "checklist" is established to avoid unethical investments in government bonds. Such a list should include provisions regarding human rights and international law. The GPFG should not contribute to violations of international law or gross violations of human rights and should, moreover, be extremely careful when investing in countries involved in armed conflict. An ethical framework should also provide provisions regarding transparency and public consent, such as parliamentarian participation in the loan contraction process and public disclosure of information. Technical and legal terms and conditions should also be addressed. Most recommendations in this report are based on the Eurodad Charter on Responsible Financing. These are not proposals for a complete set of ethical guidelines, but can hopefully serve as a starting point for discussions on how to secure responsible lending from the GPFG.

The commitment to behave according to certain ethical standards cannot stop where politics start. To rightfully call itself a responsible investor and lender, the government will need to establish mechanisms which ensure that all investments made by the GPFG are actually covered by the ethical framework of the Fund. We hope this report will be a constructive contribution in the process of developing a responsible ethical framework for lending and investment of future pensions.

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