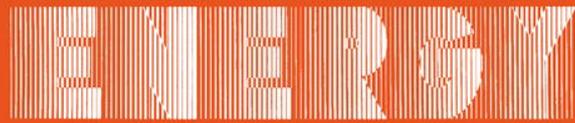


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Sovereign wealth funds as a new instrument of climate protection policy? A case study of Norway as a pioneer of ethical guidelines for investment policy

Danyel Reiche ^{a,b,*}

^a American University of Beirut (AUB), Faculty of Arts & Sciences, Department of Political Studies and Public Administration (PSPA), Jesup Hall, Room 205, P.O.Box 11-0236, Riad El Solh, Beirut 1107 2020, Lebanon

^b Wuppertal Institute, Germany

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ABSTRACT

In 1990 a sovereign wealth fund was founded in Norway in which the country invests surpluses from oil and gas industry sales. The fund is designed to secure the state's ability to act in a post-petroleum era. At the end of the 1990's the voice of Norwegian civil society insisted that the sovereign wealth fund should not only ensure intergenerational justice, but should also contribute to the implementation of values and norms of the present country. At the end of 2004 the parliament finally agreed upon ethical regulations for the investment of the sovereign wealth fund. Now the second largest sovereign wealth fund in the world only invests in businesses that adhere to those ethical regulations. In the present paper, I seek to illustrate the emergence and outcomes of this new development in the Norwegian sovereign wealth fund.

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1. Problem definition

The debate on sovereign wealth funds (SWF) is a relatively new discussion in academia. The term *sovereign wealth fund* was first used in 2005 in an article by A. Rozanov entitled "Who holds the wealth of nations?"¹ Most SWFs are found in states generously equipped with deposits of fossil fuels and other natural resources. They serve as the depository of excess income from the sales of natural gas, petroleum, and other resources. There are different functions of SWFs. The IMF has suggested distinguishing between stabilization, savings, reserve investment corporation funds, development and pension reserve funds.²

Most of the existing academic literature on SWFs describes the rise of SWFs, clusters the different funds, analyses the current and future impact of SWFs on global financial markets and studies the compliance of SWFs with the Santiago Principles, which were

developed by a group of SWFs in 2008 and mainly focus on transparency and accountability of the funds.³ There is also an increasing number of documents by international organizations and governments that aim to coordinate and exchange knowledge between the different SWFs and agree on common principles.⁴

This article focuses on the Norwegian SWF. There are two reasons for which I chose this case and think this article can make an additional contribution to existing literature on SWFs:

1. There is a lack of academic studies on the Norwegian sovereign wealth fund. Most case studies on sovereign wealth funds are on SWFs in Arab states.⁵ It is paradoxical that the majority of studies done are conducted on the least transparent funds; however, this is attributed to the fact that not only are most of the largest SWFs found in this part of the world (see below Table 1) but also because of the fear of the West that, due to SWFs and their substantial financial weight, a power balance shift is taking place in world politics.⁶ The Norwegian SWF is

* American University of Beirut (AUB), Faculty of Arts & Sciences, Department of Political Studies and Public Administration (PSPA), Jesup Hall, Room 205, P.O.Box 11-0236, Riad El Solh, Beirut 1107 2020, Lebanon. Tel.: +961 1 350 000x4346; fax: +961 1 744 461.

E-mail address: dr09@aub.edu.lb

¹ Ref. [1].

² Ref. [2].

³ Refs. [3–22].

⁴ Refs. [23–28].

⁵ Refs. [29–39].

⁶ Ref. [40].

among the largest sovereign wealth funds and is the only one that is located in a country with high democratic standards.⁷ This democratic environment helped to facilitate the writing of this article, as the fund is much more transparent than the other major funds and key actors that are involved in the governance of the Norwegian funds were easily accessible and willing to meet for interviews.

2. A case study on the Norwegian SWF is not only relevant because of the size of the funds (being the second largest SWF by the end of 2007). The focus of this article is on the implementation of a new instrument for the fund's investment policy, the so-called ethical guidelines. These ethical guidelines make Norway a unique case among all the SWFs. Since the financial weight of SWFs is growing in global financial politics there is a need to debate standards about where and how these funds are to be invested. The Santiago Principles only focus on transparency and accountability. The Norwegian SWF is a pioneer case for the formulation of investment standards on moral grounds.

While no articles on SWFs specifically have been published in this journal, *Energy* has published a number of articles dealing with energy efficiency and renewable energy in Norway (some of the articles were on neighboring countries but did also mention Norway).⁸ The present article can thus contribute to and further expand on this existing body of literature.

2. Objectives of the paper

In Norway a sovereign wealth fund was established in 1990 for the investment of surplus revenues from oil and gas industry sales. The Norwegian Governmental Pension Fund, with ca. 8000 shareholdings and fixed assets of more than 438 billion USD (282.13 billion €),⁹ is among the world's largest sovereign wealth funds. The fund is designed to secure the state's ability to continue in the post-fossil-fuels era, driven by a vision of intergenerational justice.

At the end of the 1990s, Norwegian public opinion insisted that the sovereign wealth fund should not only be used for intergenerational justice, but should also contribute to the implementation of universally accepted values and norms. At the end of 2004 the parliament (*Storting*) finally agreed on ethical guidelines for investments made by the sovereign wealth fund on the basis of the Graver Report.¹⁰ The present report will trace the emergence and outcome of this development by addressing the following

⁷ Norway is ranked number 2 in the 2008 democracy index by The Economist. See <http://a330.g.akamai.net/7/330/25828/20081021185552/graphics.eiu.com/PDF/Democracy%20Index%202008.pdf>, last access on April 9, 2010.

⁸ Refs. [41–47].

⁹ Status as of late 2007, Deutsche Bank Research, http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000219224.pdf, last accessed 29 May 2008. All amounts in this report are from 20 June 2008 and measured using the currency converter at <http://www.oanda.com/convert/classic>. In this case 1 NOK, 0.12453 €, converts to 0.19335 USD [48].

¹⁰ On the basis of a parliamentary resolution from June 2002, a commission was formed under the chairmanship of Oslo law professor Hans Petter Graver that would operate from October 2002 until June 2003 to write a report that would provide the foundation from which the Parliament would decide the ethical regulations in late 2004. For its part, the Graver Report conducted ample lobbying on the part of nongovernmental organizations (NGOs), especially Future in our Hands and the umbrella organization Forum, for the integration of ethical criteria in the investment policies of the sovereign welfare fund. Integration of these criteria was supported from the beginning, in particular by the Socialist Party. Interestingly, the rightist Progressive Party (FrP) also agreed to the proposals, with a strong disposition to profile the petroleum revenues for social domestic purposes, in a transsituational alliance in the appointment of the Graver Commission (Interview Graver) [49,59].

Table 1

The largest sovereign wealth funds (status as of late 2007).

Country	Investment volume in billions USD (€)
United Arab Emirates	\$875 (563.62 €)
Norway	438 (282.13)
Saudi Arabia	300 (193.24)
Kuwait	200 (128.83)
China	144 (92.76)
Russia	140 (90.18)

Source: Deutsche Bank Research, http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000219224.pdf, last accessed 29 May 2008.

questions: Why were the ethical guidelines called for? Which instruments were introduced for their implementation? Which actors have been created for their implementation? To what extent can sovereign wealth funds be a new instrument in climate protection policies?¹¹ What are the possibilities, but also limitations, in stimulating the global discussion of climate protection? Are there initial diffusion effects from the Norwegian case to other sovereign wealth funds or financial actors?

In addition to analyzing documents and policy papers, I conducted interviews¹² with relevant actors, among them representatives of the institutions involved in the governance of the ethical guidelines: the Norwegian State Bank, which interacts with businesses in the fund's portfolio to sensitize them to the values and norms of the ethical guidelines (so-called active ownership); the Ethics Council, which has the task of submitting proposals for the exclusion of businesses from the fund's portfolio; and the Ministry of Finance, which has the right of final decision regarding exclusions.

3. Natural resources as a basis for sovereign wealth funds

Norway is ranked among the countries with the highest standard of living in the world. In corresponding rankings such as the Human Development Index (HDI), which measures the state of human developments¹³ and is published annually by the United Nations Development Program (UNDP), the north European countries are continually placed in the top group. In the HDI rankings of 2007–2008, Norway took second place behind Iceland and ahead of Australia.¹⁴

Norway owes its prosperity largely to its oil and gas deposits. However, it has attempted to minimize the use of these fossil resources domestically in order to primarily export them to further the nation's prosperity. For example, 98.2 percent of all domestically produced electricity (figures for 2007) is produced in comparatively environmentally friendly and affordable hydroelectric power plants.¹⁵ Interestingly, the largest hydroelectric stations

¹¹ Other aspects of the ethical regulations such as human rights are not further explored because they fall outside the scope of this report.

¹² I have conducted interviews with the following persons: Dr. Alm, Kristian: Professor at the Norwegian School of Management [60]; Dr. Føllesda, Andreas: Professor at the University of Oslo, member of Ethics Council [61]; Graver, Hans Petter: Professor at the University of Oslo, leader of the Graver Commission; Kvam, Anne: Head of Corporate Governance, Norwegian Bank Investment Management [69]; Valborg, Lie: Asset Management Department (Government Pension Fund), Ministry of Finance [62]; and Lund, Eli: Executive Head of Secretariat, Council on Ethics, Norwegian Governmental Pension Fund–Global [63].

¹³ Parameters are based on the Gross National Product per inhabitant of a country, life expectancy and education level, encompassing the literacy rate and the rate of enrolment of its citizens.

¹⁴ United Nations Development Programme, <http://hdr.undp.org/en/statistics/>, last accessed 29 May 2008 [50].

¹⁵ 0.7 percent of the electricity was produced by wind power, 1.1 percent in thermal power plants. The total amount of electricity produced in Norway in 2007 was 136.1 TWh. See http://www.nve.no/modules/module_109/publisher_view_product.asp?EntityId=11476, last accessed 10 June 2008 [51].

were put into service between 1970 and 1985—after the oil and gas long-range goals were already established. Norway is the sixth largest hydroelectric power producer in the world, although no other country produces as much hydroelectricity per inhabitant.¹⁶

Most sovereign wealth funds are found in states generously equipped with deposits of fossil fuels and other natural resources. They therefore serve as the depository of excess income from the sales of natural gas, petroleum, and other resources in order to secure against price declines. If the price of raw materials falls, the sovereign wealth fund's reserved assets, produced during a period when prices were higher, may be utilized. Some countries recognize that sovereign wealth funds are a precaution for the day when resources are depleted and cease to generate income. At that time the funds would pay, for example, for pension payments or other state programs. In addition, investment in sovereign wealth funds is designed to stop the overheating of national economies. For instance, Norway's revenues from oil and gas sales are so high that their full use domestically could result in extreme inflation.¹⁷

The Norwegian Governmental Pension Fund, which will be examined below, was the second largest sovereign wealth fund in the world in late 2007. Only the investment volume of oil revenues by the United Arab Emirates was larger (see Table 1).

4. From the first Norwegian oil fields to sovereign wealth fund

Since 1959, when the Groningen natural gas field was developed in the Netherlands, the search for oil and gas deposits in the North Sea has increased. A decade later the first oil field was developed in Norwegian territory. In June 1971 production in the Ekofisk oil field began. Norway is the fifth largest oil and third largest natural gas exporter, as well as the tenth largest oil and fifth largest natural gas producer, in the world. The European Union has a significant strategic interest in Norway,¹⁸ which is the largest supplier of natural gas to the EU after Russia and reliably accounts for about one-third of natural gas imports in Western Europe. Germany is Norway's main buyer of natural gas, and the German company E.ON Ruhrgas is Norway's largest single customer of natural gas. The Norwegian government predicts that production from fossil fuel sources within its national borders will increase in the coming years. Indeed, oil production will fall as reserves of oil are depleted, but this loss will be compensated for by further growth in natural gas production.¹⁹

In 1990 revenues from oil and natural gas sales began to be set aside in so-called petroleum funds.²⁰ In 2004, when ethical regulations had been established (see below) for the funds' investment policy, a name change took place; it has since been called the Norwegian Governmental Pension Fund, which consists of two funds: the Norwegian Governmental Pension Fund—Global and the Norwegian Governmental Pension Fund—Norway. In late 2007 around 95 percent of the funding assets were invested in the Norwegian Governmental Pension Fund—Global. To prevent the

domestic economy from overheating, the Norwegian Governmental Pension Fund—Global invests its assets completely overseas. Stock shares hold 60 percent of funding assets, and the other 40 percent are fixed in bonds. The Norwegian Governmental Pension Fund—Norway invests in businesses in Norway and neighbouring Scandinavian countries.

The cash flow from oil and natural gas activity is invested in the Norwegian Governmental Pension Fund, which includes the difference between revenue (such as taxes and dividends from energy-producing companies, some of which the state receives) and the expenses of the state's oil and natural gas transactions. In 2007 this income provided surpluses of 316 billion NOK (39.40 billion €; see Table 2). Norway's structural national deficit without its oil and natural gas income is made up of the earnings from the state fund.²¹ The parliament (*Storting*) has decided that to avoid inflation and overheating of the domestic economy, a maximum of 4 percent of fund returns should be incorporated into the national budget. Fund returns over 4 percent are placed as additional earnings in the Governmental Pension Fund. Therefore, the recent high earnings due to high oil prices contribute to a further growth of the funds in addition to the current income. In 2007 alone the Government Pension Fund has grown to 392 billion NOK (48.81 billion €; see Table 3).

5. From intergenerational justice to contemporary ethics

The launching of the Norwegian sovereign wealth fund can be characterized, in the words of Hans Jonas, as an "ethic of distant responsibility."²² The objective is that abundance of national resources should not only allow for one or two generations to prosper in the present, but should also provide for future generations. When oil and gas are no longer available, the fund should have enough reserves that future generations be able to maintain the current high standard of living (see above). This claim of intergenerational justice enjoys wide acceptance in Norwegian society. However, in the late 1990s Norwegian civil society introduced the notion that the "sovereign wealth fund and ethics" theme had yet another facet: what will concretely be produced with the reserved money? Does it contribute to the spread of values in the Scandinavian state, or does it work against them?

The notion that money is not neutral and apolitical but can significantly influence social development is not new. In the nineteenth century church groups across the world, particularly in the United States, began defining exclusion criteria for the investment of their assets: businesses selling products such as alcohol, tobacco, and pornography would be considered taboo for monetary investments. Inspired by social developments such as the environmental and feminist movements or, for example, the establishment of gay rights organizations, a development in the area of the private investments came out of the United States in the 1970s that also strongly takes ethical principles into consideration. In doing so, fund exclusion criteria were formed (e.g., no money should be invested in nuclear power, genetic technology, or firms refusing to hire homosexuals) while other investment criteria rest on positive criteria. Accordingly, money is either placed in certain model industries such as renewable energies or organic farming, or it is invested according to the so-called best-in-class objective, in which an "ethics champion" is selected for investment in each of various fields, such as telecommunications and auto manufacturing.

¹⁶ Ministry of Petroleum and Energy, <http://www.regjeringen.no/en/dep/oed/Subject/Energy-in-Norway.html?id=86981>, last accessed 30 May 2008 [52].

¹⁷ Norwegian Ministry of Finance 2006. For general information on the subject of sovereign welfare funds, see also [http://wissen.spiegel.de/wissen/dokument/75/10/dokument.html?titel=Staats](http://wissen.spiegel.de/wissen/dokument/75/10/dokument.html?titel=Staatsfonds&id=55700157&top=Start&suchbegriff=staatsfonds&quellen=&v1=0)

[fonds&id=55700157&top=Start&suchbegriff=staatsfonds&quellen=&v1=0](http://de.wikipedia.org/wiki/Staatsfonds) as well as <http://de.wikipedia.org/wiki/Staatsfonds>, last accessed 30 May 2008 [53,55].

¹⁸ To foster this relationship, the EU-Norway Energy Dialog has been ongoing since September 2006. The parties have agreed to strengthen in particular exchange and cooperation in the area of CO₂ deposits and storage. See the press release of the EU Energy Commissioner Andris Piebalgs dated 25 July 2007 [54].

¹⁹ Ministry of Petroleum and Energy, <http://www.regjeringen.no/en/dep/oed/Subject/Energy-in-Norway.html?id=86981>, last accessed 30 May 2008 [52].

²⁰ Until this time the revenue was applied to the general budget.

²¹ The deficit in 2007 amounted to 1.3 billion NOK (161.89 million €), the budget forecast for 2008 saw a deficit of 13 billion NOK (1.62 billion €), and in 2006 it was actually 44 billion NOK (5.48 billion €).

²² Ref. [56].

Table 2
The Norwegian oil and gas sector (in billions NOK).

	2007	2008	2009	2012	Oil price sensitivity 2008 ^a
Assumptions:					
Crude oil (NOK per barrel)	423	500	408	400	
Production (millions m ³ oil equivalent)	238	240	249	251	
Crude oil and natural gas	148	141	140	136	
Export value ^b (billions NOK)	509	600	528	502	7.3
Accrued taxes and royalties ^c (billions NOK)	197	233	187	153	6.0
Paid taxes and royalties ^c (billions NOK)	191	216	210	156	3.0
Net cash flow ^d (billions NOK)	316	356	332	268	5.5

^a Effects of an oil price increase of NOK 10 per barrel.

^b Crude oil, natural gas, NGL, and pipeline transport.

^c Income and property taxes, surtax, production tax, area tax, and CO₂ tax. NO_x-tax in 2007 and 2008.

^d Taxes and excise duties, net revenues from State Direct Financial Interest, and dividends from State oil. Source: Statistics Norway; Ministry of Finance, <http://www.regjeringen.no/en/dep/fin/Press-Center/Press-releases/2008/reviced-national-budget-2008-sound-fisca.html?id=511405>, last accessed 30 May 2008.

Norway is the only state to have formulated so-called ethical regulations for its sovereign wealth fund.²³ A central feature of this philosophy is the concept of “active ownership” to inform companies of the general expectations inherent in the ethical guidelines and to ensure that they have established internal procedures to verify that these expectations are being met. Otherwise, in cases of noncompliance, shares in the companies are sold and excluded from the fund’s portfolio. The Ethics Council that has been established submits to the Ministry of Finance proposals for businesses to be excluded for noncompliance. The Ministry of Finance has the right of final decision; however, it has reportedly to date always followed the suggestions of the Ethics Council. Guidelines for the three relevant actors (Bank, Ethics Council, and Ministry of Finance) are the ethical regulations passed by the Norwegian parliament in late 2004, based upon the Graver Report.

Businesses that produce weapons (or conduct transactions with businesses that do) or negatively impact fundamental human rights in their normal application are to be excluded from the fund’s investments. Firms that contribute to serious or systematic human rights violations, including malicious deaths, torture, denial of freedom, forced labour, the worst forms of child labour, and other exploitation of children are to be banned from the portfolio. These ethical guidelines also include ancillary adverse effects on individual rights in situations of war and conflict, such as corruption and other serious violations of fundamental ethical norms. Furthermore, the ethical regulations affirm that businesses should be excluded if they contribute to serious harm to the environment. The next section will elaborate on this point.

6. Application of the ethical regulations in the domain of environmental and climate protection

One can easily imagine what falls under the category of weapons deemed unethical and can promptly understand their association with landmines, cluster bombs, and the like as well as

²³ The sovereign wealth funds in Islamic countries adhere to the regulations of Islamic banking. Following these, they apply social and ethical exclusion criteria, such as banning investments in alcohol producers and distributors and companies that deal in prostitution, pornography, gambling or the processing and trade of pork. See http://de.wikipedia.org/wiki/Islamic_Banking, last accessed 2 June 2008 [57].

Table 3
National budget und Government Pension Fund in overview (in billions NOK).

	2006	2007	2008
1. Fiscal Budget			
Total revenues	994.9	1030.1	1119.5
Revenues from petroleum activities	376.6	337.4	381.4
Revenues excluding petroleum activities	618.3	692.7	738.1
Total expenditures	683.5	715.1	776.9
Expenditures on petroleum activities	21.2	21.1	25.7
Expenditures excluding petroleum activities	662.3	694.0	751.1
Fiscal budget surplus before transfers to the Pension Fund: Global	311.4	315.0	342.6
–Net revenues from petroleum activities	355.4	316.4	355.7
–Non-oil budget surplus	–44.0	–1.3	–13.0
+Transfers from the Pension Fund: Global	57.4	2.8	13.0
–Fiscal budget surplus	13.4	1.5	0.0
2. Government Pension Fund			
Net transfer to the Pension Fund: Global	298.0	313.6	342.6
+Dividends on the Pension Fund	64.1	78.4	81.6
–Surplus in the Pension Fund	362.1	392.0	424.2
3. Fiscal Budget and Government Pension Fund consolidated surplus			
	375.5	393.5	424.2

Source: Ministry of Finance, <http://www.regjeringen.no/en/dep/fin/Press-Center/Press-releases/2008/reviced-national-budget-2008-sound-fisca.html?id=511405>, last accessed 30 May 2008.

the worst forms of child labour. These are comparatively comprehensible criteria and pose a question as to what three straightforward words in environmental protection—“severe environmental degradation”—mean in practice. When do businesses contribute to serious harm to the environment? What are the goals of active ownership in the case of environmental protection? What is the position of the state/sovereign fund in discussions with businesses on what should be accomplished? How does a business disqualify itself so as to lead to its exclusion from the portfolio?

In this section the concept of active ownership will be explained as an important instrument for the implementation of ethical regulations before the second instrument—the exclusion of businesses—is elaborated.

The Norwegian State Bank interacts with businesses from its portfolio in order to sensitize them to the values and norms of the Norwegian sovereign wealth fund. Along with ethical regulations, the bank, in its work for “sustainable business,” refers to international agreements in its goal of conducting responsible business, according to the managers of the Corporate Governance Unit, which is specifically mentioned by the UN Global Compact, the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance, and the OECD Guidelines for Multinational Enterprises. Contained therein are guidelines for concerns that may be raised to ensure that, for example, executive boards’ salaries are proportional, appropriately reflecting current business performance; that stockholders are transparently informed about all relevant aspects of the firm’s operations and offer ample voting possibilities to business groups; and that corruption is not tolerated.

Activity reports for the fund give impressive figures on how many business groups participate and how many proposals for investments were put forward. Nevertheless, the 10-person Corporate Governance Unit of the bank knows its limitations; this group deals with an asset selection pool of ca. 8000 businesses with further shareholdings between approximately 800,000 and 1 million businesses. Therefore, the bank’s approach is to set internal preferences for the so-called active ownership, focusing on certain regions and sectors that will be structurally pursued. In the area of environmental protection, and in light of the American presidential and congressional elections in November 2008, the decision has been made to concentrate active ownership on the area of climate protection in the United States. The director of the Labour Unit has

justified this in light of the United States' disproportional contribution to global warming. In the bank's view, it makes sense to concentrate on this major country in which there is still a backlog in climate protection policies.

The bank has therefore targeted major enterprises in the fields of energy and transport whose policies are decisive for the operations of political actors on the U.S. federal level. The theory goes that were changes in the U.S. Congress to be made, the worldwide debate on climate change and environmental protection could be positively influenced. Therefore, the bank meets with firms from its portfolio that organize lobbying activities against planned climate protection laws in the Senate and House of Representatives. The goal is to convince these businesses of the various advantages of a proactive climate protection policy and of the corresponding expectations of the Norwegian sovereign wealth fund. A focal point is specifically trading of emissions credits—how the businesses' operations conform to the EU's emissions credits system (which Norway has joined²⁴ as the first non-EU-country to take part),²⁵ as well as the impetus that the companies would contribute to efforts in the United States for the implementation of an emissions credits trading system.

In accordance with these goals, discussions with company representatives sought to target the Lieberman-Warner Climate Security Act. In October 2007 the U.S. Senate proposed a bill from Senators Joseph Lieberman (I-CT) and John Warner (R-VA) that envisions the implementation of a national emissions credits trading system, in which, by 2050, the greenhouse gas emissions in the United States would be reduced by 63 percent from levels in 2005 (with concrete interim goals for 2012 and 2020).²⁶

According to statements from the director of the Corporate Governance Unit, the bank was meeting with high-ranking representatives of large firms from the energy and transport sectors to press this issue. Bank directors were given the impression that the bank's concerns would be taken seriously. Meanwhile, many businesses in the United States have argued for the implementation of an emissions credits trading system on the federal level in general, in particular the Lieberman-Warner bill. Even partially affiliated networks (such as the automobile and truck manufacturer Ford) have lobbied for a cap-and-trade system, such as the United States Climate Action Partnership (USCAP).²⁷ It is difficult to measure how much the Norwegian bank has influenced rising acceptance for the introduction of new policy instruments such as an emissions credits trading system, but the bank hopes to have made a contribution.

The outcomes of the work of the five members of the Ethics Council,²⁸ who direct a Secretariat with six full-time co-workers, are measurable, or are at least more transparent than the active ownership. Since the implementation of the ethics principles, the Ministry of Finance has, on the recommendation of the Ethics

Council, banned 28 businesses from the portfolio of the sovereign wealth fund. Twenty firms were excluded because of their production of weapons deemed particularly inhumane (or were affiliated with businesses that did).²⁹ Seven businesses were banned because of violations of other ethical criteria.³⁰ Two were excluded because of human rights violations, and six were accused of having made serious environmental violations: Freeport McMoRan Copper & Gold Inc., DRD Gold Ltd., Vedanta Resources Ltd. (including their shareholdings), Sterlite Industries Ltd., Madras Aluminium Company Ltd., and Rio Tinto Group.

Freeport was the first business banned by the Ethics Council from the portfolio for environmental reasons. It is a mining business based in the United States and operates one of the world's largest copper mines on the island of New Guinea in Indonesia. Rio Tinto Group is a multinational mining company that is also active in Indonesia. DRD Gold is a South African business that runs the Tolukuma gold mine in Papua New Guinea. In all cases the natural river systems were used as dumping sites. The Ethics Council found that Papua New Guinea and Indonesia are the only nations that still permit dumping in rivers. The Ethics Council is aware that not all environmental standards from industrial and developing countries can be implemented; however, in this case, all of the international key actors agreed that the dumping of mining waste into rivers is unacceptable because it leads to damage to the environment that is enormous, irreversible, and long lasting. Upon inquiry, both businesses showed no intention of changing their dumping practices and were thus removed from the fund.³¹

The British metal and mining company Vedanta Resources Ltd. and its subsidiary firms, Sterlite Industries Ltd. and Madras Aluminium Company Ltd. are banned in India because of their environmental and human rights violations in the main areas of their business activities. In their production of primarily copper, aluminium, and zinc, the companies have been involved in the dislocation of native tribes. In addition to their serious human rights violations, their threats to the environment are considerable, most notably the large amounts of high-risk poisonous refuse from their mining operations: through reckless, unsafe dumping, soil and ground water are contaminated with hard metals, which would continue to contaminate the soil and groundwater even despite an immediate halt of production and would lead to long-term damage to the environment. The Ethics Council also refers explicitly to the comments from a committee of the highest Indian court that criticize the companies' actions. In India, Vedanta's centers of production are predominantly located in densely populated areas, where, in addition to the numerous directly employed workers who may be harmed, many other people are affected by the company and its practices. Furthermore, because of newly planned projects that do not set higher environmental standards,

²⁴ Norway has been a part of the EU emissions credits trading system since the start of the second phase on 1 January 2008. Forty percent of the Norwegian CO₂ emissions are integrated in the trading system with the EU. In the trial phase in Norway, which ran similar to the first phase of the EU system from 2005 to 2007, only 10 percent of the CO₂ emissions from the system were covered.

²⁵ Norway is, along with the EU, a member of the European Economic Area and is closely connected with other member countries in addressing economic concerns. EEA is an agreement between the member states of the EU such as Iceland, Liechtenstein, and Norway to expand the single market of these states. For reference see www.bundesregierung.de/Content/DE/Lexikon/EUGlossa/E/2005-11-22-europaischer-wirtschaftsraum-ewr.html.

²⁶ Compare <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:S.2191> [65,66].

²⁷ See <http://www.wri.org/climate/us-climate-action-partnership>. For more details on the change of opinion in the United States, refer to Danyel Reiche, *Vom Schmutzdelinquent zum Öko-Pionier? Zur Neuausrichtung der US-Energiepolitik*, in: *Blätter für Deutsche und Internationale Politik*, March 2007, pp. 341–347 [67,68].

²⁸ The members of the Ethics Council are available only part time and hold professions such as appointments as university professors. Expense allowances are paid for monthly sessions [58].

²⁹ Eight companies were excluded because of the production of cluster bombs, 11 businesses (among them Boeing) because of the production of atomic weapons, and one firm because of the production of anti-personnel landmines. Compare Council on Ethics for the Government Pension Fund—Global: *Annual Report 2007*, p. 10.

³⁰ In two cases it has negotiated with the world's largest single retailer WalMart, once with the parent company in the United States and once with a subsidiary in Mexico. The Ethics Council systematically criticized the WalMart companies for human rights and workers' rights violations, forced overtime without compensation, and systematic discrimination of women. WalMart has not responded to communications from the Ethics Council. The United States ambassador in Norway protested against the exclusion of WalMart (Interview Lund).

³¹ Ministry of Finance, <http://www.regjeringen.no/en/dep/fin/Press-Center/Press-releases/2006/Two-companies-Wal-Mart-and-Freeport-.html?id=104396&epslanguage=EN-GB> as well as <http://www.regjeringen.no/en/dep/fin/Press-Center/Press-releases/2007/Mining-company-excluded-from-the-investm.html?id=462551&epslanguage=EN-GB>, last accessed 4 June 2008.

the Ethics Council saw no other choice but to expel these companies from the fund.

7. Contribution of the ethical regulations to climate protection: restrictions and successful application

The use of the ethical regulations as an effective instrument in climate protection policies is restricted by the sovereign welfare fund's large portfolio. Limits are placed on how much the fund can invest in one firm, designed to limit the fund's possible influence. The Corporate Governance Unit of the Norwegian States Bank as well as the Ethics Council have reached a capacity limit with ca. 8000 businesses that hold investments in ca. 800,000 to 1 million additional businesses. To support its work, the Ethics Council uses two specialized firms assigned to analyzing newspaper articles about activities of the businesses in the sovereign wealth fund portfolio. In this way, blatant offences against the ethical regulations can be exposed. This strategy presumes, however, that news of serious damage to the environment (and other violations of the ethical regulations, such as against human rights) also reaches the public. The Ethics Council's strategy of using press reports for this purpose comes up against barriers when analyzing businesses in different parts of the world, in particular those in countries without a free press and a responsive public. One can assume that sooner or later the public will learn about the worst instances of environmental pollution (thanks in part to the work of nongovernmental organizations).

The 10 members of the Corporate Governance Board, however, can proceed to set targeted goals only by using the Ethics Council, which has only a partly secure working base and the motto "In restriction lays the master." In 2007 the bank led a meeting with about 15 businesses, representing not more than 0.19 percent of the businesses in the fund's portfolio. To add further complexity, the fund has usually acquired only a small share of various corporations. Theoretically, the fund can purchase assets so that the majority of its holdings are stocks from large-scale enterprises such as Daimler Chrysler, Volkswagen, Allianz, or Siemens and then try to influence the companies' business activity to meet Norwegian values and norms. For reasons of distribution of risk (and not to lose sight of the main goal of maintaining prosperity for future generations), a limit has been established for the percentage of shares in a company the fund can purchase. In the past, however, this limit has been repeatedly raised, the last time in June 2008, from 5 to 10 percent.³² This theoretically increases the influence of the bank on businesses, for example, to adopt a proactive stance on climate protection. On average, however, the fund nevertheless does not hold more than 0.8 percent of the shares in a given corporation.

A further restriction of the application of the ethical regulations lies in the fact that 40 percent of the holdings of the fund are fixed in bonds, a majority of which are state bonds. But in order for state bonds to be excluded from the portfolio, a country must be formally accused of unethical behaviour, something that occurs only on rare occasions. The first such exception was made in 2007 with the decision not to invest in state bonds from Burma (Myanmar).

In effect, the ethical regulations pertain primarily to the 60 percent of the fund assets that are invested in stocks. Despite the addressed limitations, the actual influence of the fund may nevertheless be larger than assumed. Due to Norway's reputable status worldwide (see the above mentioned Human Development Index as well as the Democracy Index), it is unlikely that a business would wish to be excluded from the Norwegian sovereign fund. Moreover, the fact that businesses are already being excluded shows that the

sovereign welfare fund not only uses words but, if necessary, also follows through with actions. The bank's active ownership policy strengthens the main instrument of the ethical regulations. It is taken much more seriously through dialogue with representatives of companies and large enterprises than the case would probably be without the threat of exclusion of the businesses lying in the background of conversations. Indeed, the successes of active ownership are hardly measurable; however, it is unmistakable that businesses in the United States are proactively held to the goal of climate protection as well as to increasing support for initiatives for the implementation of an emissions credits trading system, whereby a main goal of the bank is reached without the bank itself having contributed much in the specific situation. Because of the United States' large contributions to global greenhouse gas emissions and the country's important role in worldwide political developments, the latest setting of priorities of active ownership is, without question, open to much scrutiny. However, the question is how the ethical regulations can, in the future, be further developed in a direction that works more toward their goals.

8. Evaluation of the ethical regulations

Recently Norway has begun an evaluation of the ethical regulations put in place in the sovereign wealth fund. Two separate reports researched the work of the Ethics Council and the bank one in regard to their cooperation [70] and one on the possibility of using "positive selection" as a future investment strategy [71]. Both reports were introduced in June 2008 at a public hearing at the Ministry of Finance. A written consultation paper from the Ministry of Finance summarizes the essential statements and lays out the schedule for the evaluation process [72].

The consultation paper indicates a positive evaluation of the existing system. It nevertheless expects that, in the future, in addition to a modification of the regulations for active ownership and notably for the exclusion of businesses on ethical grounds (such as a newly introduced exclusion of tobacco companies³³ or—less likely—the exclusion of firms involved in pornography or gambling), a third instrument is to be instituted: so-called positive screening (also called positive selection). This means that fund assets will focus on certain areas in which to invest. Information from some of the interviews I conducted indicates that when priorities for positive screening are announced, businesses from the area of renewable energies will likely be candidates for investment. A member of the Ethics Council mentioned the renewable energies sector as the "closest candidate." For reasons of distributing risk, however, even in discussions with very active NGOs it was stressed that only a certain percentage of the fund assets (and not the entire capital) would be subjected to positive screening (in several discussions, the figure given was 10 percent of the fund assets). The Finance Minister from the socialist party responsible for the state fund is considered a supporter of positive screening.

The basic objectives of positive screening would be linked to something that at one time existed with the environmental investments. From the start of 2001 to late 2004, a small part of the fund assets was targeted for investments in businesses whose business practices, it was assumed, have only a comparatively small negative influence on the environment. This would fulfil the specific environmental requirements or could show definite certification. The British consulting firm Ethical Investment Research Service (EIRIS)

³² The limit was raised in 2000 from 1 to 3 percent; in 2006 from 3 to 5 percent (Interview Kvam) [69].

³³ Based on reports from Norwatch, the investments of the Governmental Pension Fund in tobacco companies in 2006 were increased by 44 percent for a total of 1.29 billion €. Compare Pia Gaarder, Petroleum Fund: Developing Countries Up in Smoke, www.norwatch.no, last accessed 11 June 2008 [82].

was responsible for testing the fulfilment of requirements. The environmental funds would not be outsourced but were still part of and would also be administered by the Norwegian State Bank. In 2001 initially 1 billion NOK (124.53 million €) was held ready for the environmental funds and, in each following year, was increased by the same amount (in total 2 billion NOK/249.05 million €).

With the introduction of the ethical regulations in late 2004, the environment fund was terminated. Nevertheless, the environmental fund can be seen as a pioneer for the later implementation of ethical criteria, because it marked the first time other criteria were used for risk distribution and profit maximizing. Should the so-called positive screening now be deployed on a large scale, the experience of the earlier environmental funds can still be drawn upon. Exciting questions for the future include: Should the positive screening approach serve to invest only in certain subsidiaries? Or should the so-called best-in-class approach be used to purchase shares, with the respective “ethical champions” from the different subsidiaries being possible candidates? Should there be definite certification prerequisites for share purchases? Or should admission be based on a specific index?

When one considers the level of investment property (status as of late 2007, 438 billion USD/282.13 billion €; see Table 2) and then takes into account the discussed use of 10 percent of the state fund for investments toward positive screening of working businesses in the area of environmental protection, one can assess the huge amounts of capital that would be freed for an ecological transformation of the energy economy.

A correspondingly interesting idea that the consultation paper pursued is that up to 5 percent of the state fund's assets should take a new form of investment for the acquisition of property, namely closed real estate funds that also consider “green” criteria, such as efficient energy and water consumption (Ministry of Finance 2008, p. 35f.).

9. Diffusion of the ethical regulations

In regard to the possibilities and limitations of the spread of ethical regulations to other countries, one may consider that in Norway a superior situation prevails: the national economy is booming, natural gas will still be available for many decades as an important income source for the state, there is approximately full employment, and the standard of living ranks among the highest in the world (see above). In this context, themes such as ethical economics and climate protection are attributed greater priority in the political agenda as large parts of society may be weary to lose their high standard of living. Another factor to consider is that many other countries with sovereign welfare funds are not open democracies and do not enjoy a civil society that discusses such matters in public political discourse.³⁴

However, using the sale of foreign currency and gold reserves, other states such as Germany could consider creating their own sovereign welfare fund with concentration on issues such as economic activities for climate protection, thus adopting Norway's approach. In doing this, the critical majority of such sovereign welfare funds with an ethical concentration would proliferate and increase their potential global pressure. Indeed, Germany's funds are rather small in comparison with its counterparts in the United Arab Emirates and Norway (see Table 1). Still, in addition to its gold reserves, the German Central Bank handles foreign currency reserves worth just over 30 billion €, most of which are invested in American debt bonds. These investments always yield lower profits because of the American low-interest-rate policy. C. Reiermann, in his plea for a German state fund, writes, “The innovative

investment strategy would not only function as a security against misbehaving foreign state funds, it would also pay off. The shareholdings return more than US-American state bonds. With the surplus earnings, additional investments would be possible, for example, in education, or debts could be repaid, making room [for new projects] in the state's budget.”³⁵

However, sovereign welfare funds constitute only 2 percent of the financial market worldwide.³⁶ It will be interesting to follow the extent to which the Norwegian state fund can inspire other corporate financial actors with its ethical regulations. The first imitator of the Norwegian ethical regulations has already stepped forward. Some large Scandinavian investors followed Norway's example in 2006, among which are Oslo Pension Fund, the largest Norwegian security group, Kommunal Landspensjonkasse (KLP), and the second Swedish pension fund, Allmänna Pensionsfonden (AP 2). Quite some time after KLP had issued ethical regulations, all four Swedish pension funds founded a combined ethical council. It plans to screen the 3500 businesses in which the fund holds shares in accordance with environmental and social standards.³⁷

In an interview, the State Secretary in the Norwegian Ministry of Finance, Roger Schjerva, says that 20 international funds and investors follow the policies of the Norwegian Governmental Pension Fund and exclude the same businesses, among them the Italian investment company Generali, which manages funds comparable in size to the Norwegian pension fund. On its website Generali refers explicitly to the Norwegian ethical regulations.³⁸

It must be assumed that the number of imitators will increase. In interviews with the representatives of the Ministry of Finance, the Ethics Council, and the Norwegian State Bank, representatives report great interest in the Norwegian ethical regulations worldwide. This is reflected by the innumerable invitations to bank representatives to attend conferences³⁹ and visits from different companies' financial representatives to Oslo. International actors, such as the OECD and the World Bank, increasingly regard the Norwegian sovereign welfare fund as a model (not only because of the ethical regulations, but also primarily for its contributions to intergenerational justice), emphasized by its being referenced in consultations.

After the specifications from Eli Lund, the Ethics Council is currently working with the International Monetary Fund on a set of best practices guidelines for sovereign welfare funds based in large part on the Norwegian experience. The Norwegian State Bank uses the United Nations as a platform to transport its values and norms into the global arena, for instance, as part of the UN Principles for Responsible Investment (UN-PRI). Furthermore, the bank participates in networks such as the International Corporate Governance Network (ICGN).

With the “Oil for Development” program published in 2005 by the Norwegian Agency for Development (NORAD), Norway has been consulting with 24 resource-rich developing and newly industrializing countries on how the income from their oil and gas sales can be

³⁵ Compare Christian Reiermann, Why Germany Needs Its Own Sovereign Wealth Funds, in Spiegel online from 30 April 2008, www.spiegel.de/wirtschaft/0,1518,550512,00.html [74].

³⁶ Storn A. We Are Guests in Their House, Interview with Yngve Slyngstad, head of the Norwegian Sovereign Wealth Fund, in Die Zeit from 13 March 2008, downloaded at www.zeit.de/2008/12/Staatsfonds-Interview-Deutsch?page=1 [76].

³⁷ Susanne Bergius, Kein Komplize sein. Norwegens Pensionsfonds investiert nur in ethisch korrekte Firmen. Sünder fliegen in aller Öffentlichkeit aus dem Portfolio, zum Beispiel Wal-Mart. Das sorgt für Aufsehen, in: Die Zeit online from 25 May 2007, www.zeit.de/online/2007/22/gro-nystuen-konzept [77].

³⁸ See www.norwatch.no, news from 31 January 2008, last accessed 15 May 2008, as well as <http://www.generali.com/generalicom/sezione.do> [73,78].

³⁹ “I can travel 265 days of the year,” says the representative of the bank in this connection, in an interview (Interview Kvam) [69].

³⁴ Ref. [75].

invested toward long-term sustainability. Understandably, the distribution of the ethical regulations does not yet appear to be central here, as many countries first need to be convinced of the general concept of state funds.⁴⁰ To reach other states, NORAD aims at cooperation with the World Bank and UNDP.⁴¹

The revocation by India's highest court of Vedanta's operating license because of an exclusion from Norwegian state fund, among other reasons, shows what dynamics can develop from a company's exclusion from the Norwegian sovereign welfare fund (Interview with Føllesdal). This is further evidence as to how innovations by national states can have serious consequences on global political developments.⁴²

10. Outcomes and future prospects

In terms of global climate protection, the significance of the Norwegian sovereign welfare fund until now has been certainly limited but should not be underestimated. Businesses responsible for significant environmental damage would be banned from the portfolio, and companies in the United States are being convinced to take a proactive approach to proposed climate protection laws in Congress, such as the introduction of an emissions credits trading system.

Also, if fixed assets were to be introduced as a part of direct investments, for instance, in businesses in the area of renewable energies, the ethical regulations would be further optimized as an instrument of climate protection policies.

The right-populist Progressive Party in Norway (FP) has attempted to demand that less money be set aside in sovereign welfare funds and more used for domestic social purposes. In earlier polls (conducted in mid-2008) support for this party reached 30 percent.⁴³ The ethical regulations, however, are largely accepted in Norwegian politics and society. An indication of their general acceptance is also given in that the ethical regulations were introduced by a conservative government and, at the moment, continue to be developed by a middle-left government. Refinements are predominantly being made toward sharpening modifications. Critics of fund's ethical regulation practices, for instance, primarily target inconsistencies, such as when a business is excluded from the funds, but is still invested in nationally, (such as the case of Lockheed Martin, which is still used by the Norwegian Ministry of Defence to supply weapons). "We will never be able to act 100% consistent in all areas. But that should not lead us to the conclusion of doing nothing," says the Ministry of Finance.⁴⁴

However, Norway should contribute to climate protection not only through managing the funds in connection with its global activities (carried out in up to 95 percent in foreign investments) but also through its domestic policies. During the international negotiations for a climate protection agreement, the kingdom has been trying to distinguish itself as a proactive state; however, it finds itself in a dilemma being an oil and natural gas producer, which contributes significantly to greenhouse gases. The ambitious goal of a "carbon-

neutral Norway" by 2050 should also call for proactive policies in the areas of energy efficiency, energy savings, and the development of renewable energies and should include realistic short- and mid-term intermediate steps for a new working package of measures, instead of trusting in the uncertain future possibilities of carbon capture storage. The reality is that the energy usage in Norway since 1980 has been growing at an average rate of 1.4 percent per annum.⁴⁵ Electricity prices in particular are too low in comparison to those in Western European states to incentivize energy savings and efficiency approaches such as the CO₂ taxes launched in the beginning of the 1990s are necessary for its further development.

Indeed, the usage of hydropower in the electricity market hovers at around 98 percent. Due to resistance from the environmentally conscious community in Norway it is not politically realistic to undertake commercial development of the country's largest, still untouched rivers and to build more hydroelectric installations to guarantee a 100 percent supply from hydroelectricity in the energy market. To satisfy recent electricity demand, coal energy from Denmark and nuclear power from Sweden have had to be imported repeatedly, along with the first natural gas-powered plant, which went online in Norway in 2007. Despite the country's large wind power potential, only in 2008 has this surpassed the 1000 MW mark, which is below average even in comparison with other European countries. The state has still not developed convincing subsidy policies with adequate compensation and long-term investment security in which renewable energies other than hydroelectricity form the basis for increased usage.⁴⁶

Claims that the Norwegian institutional environment is adequately served by the Agency for Renewable Energies and Energy Efficiency (ENOVA)⁴⁷ are doubted by many experts. Also, it is questionable if the situating of the renewable energy and energy efficiency goals within the Ministry's oil and energy goals makes sense. Norway, with its Atlantic coast line and its thin population density, would have the chance to develop wind power so that not only the electricity market but also the transport sector (electric cars) could be served from the electricity produced.⁴⁸ With an environmentally friendly electricity and transport sector in connection with the already lenient energy use standards for heating requirements in the building sector, Norway could be seen as a global pioneer, not only through its foreign economic activities but also in its serving as an exemplar for furthering climate protection through its policies.

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⁴⁰ In other interviews NORAD says it wants not only a better world, but above all that the interests of the Norwegian oil and gas economy must be kept in mind.

⁴¹ Equipo Nizkor: *Norway Breaking the Oil Curse*, www.derechos.org/nizkor/econ/norway.html, last accessed 20 June 2008 [79].

⁴² For a more detailed report, see Danyel Reiche, *Zur zentralen Bedeutung des Nationalstaates im Mehrebenensystem. Ein Beitrag zur gegenwärtigen Governance-Diskussion*, FFU-report 04-2005, downloaded at http://web.fu-berlin.de/ffu/ffu_e/index.html [80].

⁴³ Compare Bernd Parusel, *Norway's Right Temptation*, in: *Blätter für deutsche und internationale Politik* Nr. 08/2006, pp. 912–915 [81].

⁴⁴ Ministry of Finance, <http://www.regjeringen.no/en/>, last accessed 30 May 2008 [83].

⁴⁵ BFAI: *Norway–Energy Economics 2006*, downloaded at www.bfai.de.

⁴⁶ A planned combined green certificate with Sweden failed. See [84].

⁴⁷ ENOVA has 40 members.

⁴⁸ Norway is already an electric-auto production state. See [85].

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