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INVESTING IN SUSTAINABILITY: ETHICS GUIDELINES AND THE NORWEGIAN SOVEREIGN WEALTH FUND

DR. ANITA M. HALVORSSEN* AND CODY D. ELDREDGE**

I. INTRODUCTION

Companies that bring sustainability to the core of their business strategy, often referred to as “socially responsible,” are increasingly outperforming their competitors over the long term.1 The investment world is also gaining cognizance of this and has begun focusing on environmental, social, and corporate governance (“ESG”) issues, referred to as responsible investment. Responsible investors are moving companies toward sustainable development by aligning investors’ financial decisions with the companies’ impacts on the environment and societies.2

This integration process can also be referred to as internalizing the negative externalities of production, in the broadest sense, both at home and abroad, thereby eliminating those externalities altogether, or at a minimum incorporating environmental and social costs into the cost of production. Unfortunately, investors often overlook the link between environmental and financial returns, especially if the focus is on short-term returns rather than long-term sustainability. As a category of investors growing in prominence, sovereign wealth funds stand at the intersection of sustainable investment and the desire to maximize financial returns. Due to the sheer size of sovereign wealth funds as investors, it will be to no small extent their responsibility to push companies to work toward mitigating

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2. In this article, sustainable development, sustainability, and ethics and are used interchangeably. Sustainable development, as defined by the Brundtland Commission (the U.N. World Commission on Environment and Development (WCED)), calls for economic “development that meets the needs of the present without compromising the needs of future generations.” WORLD COMM’N ON ENV’T AND DEV., OUR COMMON FUTURE, ch. 2 ¶ 1 (1987), available at http://www.un-documents.net/our-common-future.pdf [hereinafter OUR COMMON FUTURE]. Sustainable development is also described as an integrative principle, integrating economic with environmental and social concerns. See Nico Schrijver & Friedl Weiss, Introduction to INTERNATIONAL LAW AND SUSTAINABLE DEVELOPMENT xii-xiii (Nico Schrijver & Friedl Weiss eds., 2004).
these externalities, and in particular climate change, because their investment decisions can have such a large influence on companies.\textsuperscript{3}

This article will demonstrate that one particular investor, the Norwegian Sovereign Wealth Fund, Government Pension Fund—Global ("GPFG"), has not ignored the importance of integrating ESG issues into its investment decision-making. The GPFG is the largest sovereign wealth fund ("SWF") in the world and thus arguably one of the most influential investment funds.\textsuperscript{4} Since the introduction of the Ethics Guidelines in 2004, the GPFG has prioritized sustainability within its investment decision-making, and has in many ways been successful in that endeavor.\textsuperscript{5} Given its successes in achieving high rates of return while facilitating sustainable/ethical business practices among its investment recipients, the GPFG should be regarded as a model for best practice for other institutional investors.

The work of the main entity mandated to implement the Ethics Guidelines, the Council on Ethics, has been described as evolving into a "coherent jurisprudence of ethics for corporate investment" using public power to influence private governance among companies.\textsuperscript{6} Its recommendations have been followed closely by other pension funds which have, in turn, also excluded the same companies from their investment portfolio.\textsuperscript{7}

The GPFG engages in responsible investing through two mechanisms: (1) exercising the ownership rights granted to it through the securities it controls in corporations (active ownership) to place firms on a path to sustainability, and (2) observation and exclusion of companies from its investment portfolio when those firms engage in unethical/unsustainable practices. The empirical analysis set out in this paper focuses on the latter mechanism, highlighting the ways in which it is routinely successful in motivating states to adopt sustainable business practices.

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4. See Sovereign Wealth Fund Rankings, supra note 3.


To date, there has been little empirical analysis examining the effectiveness of the GPFG in enforcing its Ethics Guidelines. We present evidence showing that the Council on Ethics, under certain circumstances, is more successful at influencing corporate behavior. Specifically, we show that the Council on Ethics is more effective as the relative size of the investment in a given corporation increases. This serves as a model for other institutional investors who may wish to implement Ethics Guidelines targeting the behavior of corporations in their investment portfolios.

Although the GPFG has succeeded in facilitating sustainable behavior while contributing to the development of best practices for responsible investors, we also suggest several reform proposals for improving the overall effectiveness of the GPFG in implementing its Ethics Guidelines. The Norwegian Ministry of Finance established the Strategy Council for the GPFG in the spring of 2013 in order to review the work of the GPFG on responsible investment. Elements of its report, "Responsible Investment and the Norwegian Government Pension Fund Global," published last November, will be examined and other suggestions for change will also be introduced. The reform proposals include: expanding the grounds for exclusion to include, among others, companies that produce energy from fossil fuels, or at the very least energy production from coal and oil sands; granting the Council on Ethics more autonomy; increasing the level of transparency in the active ownership of the investment arm of the GPFG, including when entering into dialogue with companies; and lastly, amending the mandate for the investment arm, requiring it to fully consider the Organisation for Economic Co-operation and Development ("OECD") Guidelines for Multinational Enterprises when managing the companies currently within its investment portfolio, prioritizing companies for assessment when they present a significant risk of actual or potential adverse environmental or social impacts.

Part II introduces the GPFG, its legal framework, and the Council on Ethics and its efforts at influencing the corporations in which it invests. Part III addresses the interrelated questions about company compliance with the Ethics Guidelines


9. DIMSON ET AL., supra note 8, at 3.

10. Id. at 3-4.

and what drives firm compliance with such guidelines. Part IV sets out the sustainable pathway using the GPFG as a model for other institutional investors. Part V introduces some reform proposals focusing on how to strengthen the GPFG's responsible investment strategy. Part VI concludes with the observation that the GPFG remains a solid model for other institutional investors, even more so if it incorporates some of the reform proposals.

II. NORWAY’S SWF - GPFG

12. A. Origins

Norway began exploiting its oil and gas reserves in 1971. In 1990, the Norwegian government established a sovereign wealth fund, first called the Petroleum Fund, and later renamed the Government Pension Fund–Global. The goal of the GPFG is to use revenues from Norway’s oil reserves without affecting general income flow to the government, thereby buffering the impact of volatile oil revenues on government spending. The fund also serves as an instrument for long-term financial savings, ensuring that Norway’s oil wealth benefits not just the current generation, but also future generations, thereby fulfilling an important ethical obligation in line with the principle of intergenerational equity. The GPFG is also mandated to function as a responsible investor in fulfilling this ethical obligation, exercising good corporate governance and promoting sustainable development in economic, social, and environmental terms.

12. See Anita Halvorssen, Addressing Climate Change Through the Norwegian Sovereign Wealth Fund (SWF): Using Responsible Investments to Encourage Corporations to Take ESG Issues into Account in Their Decision-Making, 8 INT’L & COMP. CORP. L.J. 1, 4-15 (2011) for background on sustainable development and SWFs.


17. EDITH BROWN WEISS, IN FAIRNESS TO FUTURE GENERATIONS: INTERNATIONAL LAW, COMMON PATRIMONY AND INTERGENERATIONAL EQUITY 17-18 (1989) (defining intergenerational equity is defined as justice between generations).

In terms of benefiting future generations, it is important to focus on sustainable development and place it in the context of SWFs. Balancing maximum financial returns with sustainable development is difficult for any profit-making entity, but SWFs, having a longer investment timeframe, are in a better position to promote sustainable development. In an effort to address this challenge, the Norwegian Parliament adopted Ethics Guidelines for the GPFG in 2004, specifically prohibiting investments that would put the fund at an unacceptable risk of contributing to serious or systematic human rights violations, severe environmental damage, and gross corruption,\textsuperscript{19} essentially spelling out the requirements of sustainable development. After an evaluation process in 2008, these guidelines were amended in 2010.\textsuperscript{20}

B. Legal and Institutional Framework

While the GPFG was established in 1990,\textsuperscript{21} it did not receive any funds until there was a budget surplus in 1996.\textsuperscript{22} The government’s net cash flow from petroleum operations is transferred in its entirety to the GPFG through the state budget, whereas the fiscal guidelines stipulate that only the expected real return on the fund—four percent of the fund should be returned to the budget for general spending purposes—hence the real value of the fund itself will be protected.\textsuperscript{23}

The Norwegian State is the official owner of the GPFG, and the Ministry of Finance manages it on behalf of the Norwegian people. However, in order to have political backing, major changes to the GPFG’s investment strategy are presented to Parliament before being implemented.\textsuperscript{24} The Ministry of Finance determines the overall investment strategy for the GPFG, and follows up on its operational management.\textsuperscript{25} The operational management of the GPFG has been delegated to the Norwegian Central Bank, \textit{Norges Bank}.\textsuperscript{26} This role, however, is not a Central Bank function, and is therefore strictly separated from the Central Bank’s other activities and referred to as the Norges Bank Investment Management ("NBIM").\textsuperscript{27} The GPFG is not established as a separate legal entity, but as a deposit account at the \textit{Norges Bank}. \textit{Norges Bank} has a management agreement with the Ministry of

\textsuperscript{19} See \textit{Guidelines for Observation and Exclusion}, supra note 5, § 2 (3); \textit{NBIM Management Mandate}, supra note 5 (replacing 2004 ethical guidelines); \textit{infra} note 55 and accompanying text.
\textsuperscript{20} See \textit{Guidelines for Observation and Exclusion}, supra note 5.
\textsuperscript{21} The Government Petroleum Fund, 22 June 1990, Act No. 36.
\textsuperscript{23} \textit{Eriksen}, supra note 13, at 6.
\textsuperscript{25} Backet, supra note 24, at 454.
\textsuperscript{26} Id. at 455.
\textsuperscript{27} GPF REPORT NO. 20, supra note 18, at 37.
Finance specifically delegating the operational authority over the GPFG to the bank and this agreement is publicly disclosed.\textsuperscript{28}

The GPFG’s assets are invested strictly in foreign financial instruments (thirty-five to forty percent in bonds, sixty percent in equities, and five percent in real estate), in over seventy developed and emerging markets.\textsuperscript{29} Unlike traditional pension funds, the GPFG is not earmarked for specific liabilities, but is an instrument for general savings on the part of the State.\textsuperscript{30} Because it has a very long investment horizon and is not subject to short-term liquidity requirements, the GPFG has a higher risk-bearing capacity than many comparable funds.\textsuperscript{31} As of 2013, the market value of the GPFG is NOK 5,038 billion (approx. U.S. $840 billion).\textsuperscript{32} Currently, the GPFG is invested in over eight thousand companies and owns approximately 1.3 percent of global listed shares.\textsuperscript{33}

The goal for the investment strategy of the fund is to achieve maximum financial return with moderate risk to help ensure that future generations will be able to draw the maximum possible benefit from the oil wealth.\textsuperscript{34} In order to achieve a maximum financial return, and as a long-term investor, the government sees its role as being a responsible investor, promoting good corporate governance and safeguarding environmental and social concerns.\textsuperscript{35} This applies particularly to the broadly diversified, economy-wide investor—often referred to as “universal investor,” such as the Norwegian GPFG.\textsuperscript{36}

There is broad political support for the ethical framework for the responsible management of the GPFG.\textsuperscript{37} Being a responsible investor is defined as ensuring

\begin{itemize}
\item \textsuperscript{29} \textit{Investments, Norges Bank Inv. Mgmt.}, \textit{http://www.nbim.no/en/Investments} (last visited July 20, 2013).
\item \textsuperscript{30} \textit{GPF Report No. 20}, supra note 18, at 12.
\item \textsuperscript{31} Id.
\item \textsuperscript{34} \textit{GPF Report No. 20}, supra note 18, at 11-12.
\item \textsuperscript{35} Id. at 11.
\item \textsuperscript{36} Interview with Anne Kvam, former Head of Corporate Governance, Norges Bank Investment Management, (July 23, 2008); see \textit{Norwegian Ministry of Fin.}, \textit{On the Management of the Government Pension Fund in 2009: Report No. 10} (2009-2010) to the Storting 133-36 (2010), \textit{available at} http://www.regjeringen.no/pages/2500165/PDFS/STM200920100100010000EN_PDFS.pdf [hereinafter \textit{GPF Report No. 10}]. “A universal owner (UO) is defined as an owner with investments spread across a large number of companies in many industries and countries.” Id. at 133; see also \textit{James P. Hawley & Andrew T. Williams, The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic} 3 (2000).
\item \textsuperscript{37} \textit{GPF Report No. 20}, supra note 18, at 12.
\end{itemize}
that the GPFG is managed in a way that "promotes better functioning, legitimate and efficient markets and sustainable development in the broadest sense." Promoting sustainable development in economic, environmental, and social terms is regarded as a precondition for good financial returns over time. This goal is in keeping with the U.N. Principles for Responsible Investment ("U.N. PRI") that the Ministry of Finance, as formal owner of the GPFG, has signed. These principles emphasize that ESG issues can affect the performance of investment portfolios.

C. Ethics Guidelines

In 2004, based on the work of the Graver Committee, the Norwegian Parliament debated and then accepted unanimously the Ethics Guidelines for the GPFG—to better fulfill its ethics obligations for future generations. The Graver Committee focused on two main ethical obligations: (1) the obligation to ensure financial returns so that future generations will benefit from the oil wealth contingent on sustainable development, and (2) the obligation to respect fundamental rights of those who are affected by the companies in which the Fund invests. These obligations became the premise for the Ethics Guidelines.

After an in-depth review process in 2008-2009, the Ethical Guidelines of 2004 were replaced on March 1, 2010, adding several new measures to fulfill the ethical obligations. These were mostly procedural with few changes to the substantive provisions of the guidelines. After consultations, two new sets of guidelines were adopted by the Ministry of Finance. The first set of guidelines, the Guidelines for Norges Bank’s work on responsible management and active ownership was integrated into the new regulations on the management of the GPFG. The second set of guidelines was the Guidelines for observation and exclusion from the GPFGs investment universe, the main focus of this paper. These two sets of guidelines constitute the new Ethics Guidelines.

38. Id.
39. Id. at 13.
40. Id.; see also Signatories to the Principles for Responsible Investment, PRINCIPLES FOR RESPONSIBLE INV., http://www.unpri.org/signatories/signatories (last visited July 20, 2014).
41. See U.N. PRI, supra note 1.
42. Graver Committee Report, supra note 15, § 6 Annex 1 (describing the committee as a government appointed committee with a mandate to propose a set of ethics guidelines).
45. Id.
46. The Council on Ethics for the GPFG, supra note 8; see also GPF REPORT NO. 10, supra note 36, at 93.
47. Id.
48. See id.
49. Id. at 92-93 (The Storting (the Norwegian Parliament) gave its approval to the Government’s plan. See § 3.2 of Recommendation no. 277 (2008-2009) to the Storting).
The mechanisms used by the GPFG to fulfill these ethical obligations are active ownership and observation or exclusion of companies. In order to safeguard the GPFG’s financial interests, Norges Bank, through NBIM, is mandated to exercise active ownership rights for the fund’s investments. The Council on Ethics makes recommendations on the observation and exclusion of companies to the Ministry of Finance, which then makes the final decision. This process could give the appearance of such decisions being subject to political considerations, yet the Ministry emphasizes that it is acting in its capacity as an investor with the goal of maximizing the long-term real return and that other political objectives must be pursued by other means, for instance through foreign affairs or environmental policies. The Ministry of Finance has stated “we risk losing our credibility as a financial investor if we use the Fund [GPFG] as an instrument in our foreign policy.”

The exercise of the ownership rights by NBIM is based on the U.N.’s Global Compact, the OECD Guidelines for Corporate Governance, and the OECD Guidelines for Multinational Enterprises. NBIM’s exercise of its ownership rights in the GPFG are considered active in the sense that the NBIM is an active shareholder observing standards of corporate governance in the form of shareholder rights and informal means to influence the corporations’ adherence to the Ethical Guidelines. As part of its ownership activities, the NBIM uses several approaches to influence corporations in its investment portfolio, including shareholder proposals and voting at annual general meetings, dialogue with companies, legal action, meeting with regulatory authorities, and collaboration with other investors. In recent years, the NBIM has also published documents outlining their social and environmental expectations of companies in which the GPFG invests in order to strengthen its active ownership effort, the first being on children’s rights, entitled the NBIM’s Investor Expectations on Children’s

51. NBIM Management Mandate, supra note 5, §§ 2.2-2.3.
52. The Council on Ethics for the GPFG, supra note 8.
55. Graver Committee Report, supra note 15, §§ 3.1, 5.1; see also GPF REPORT NO. 10, supra note 36, at 125.
56. GPF REPORT NO. 10, supra note 36, at 125.
Rights. The NBIM’s Investor Expectations on Climate Change Management and Water Management were soon to follow.

The Council on Ethics, in charge of recommending observation and exclusion, was established by royal decree in 2004. It has five members and a secretariat of seven people. The Council on Ethics works with a number of consultants. Furthermore, it uses software programs to monitor newswires and other sources for reports or information related to or involving companies in the GPFG’s portfolio in order to flag the worst offenders of the Ethics Guidelines.

If a company is involved in the production of weapons that through normal use violates fundamental humanitarian principles, it is identified through a negative screening process and excluded from the investment universe (product-based exclusion). Furthermore, companies producing tobacco have been added to the criteria for exclusion. Companies will be excluded from the investment universe (conduct-based) if there is an unacceptable risk of the GPFG contributing to or being responsible for:

a) Serious or systematic human rights violations such as murder, torture, deprivation of liberty, forced labor, the worst forms of child labor, and other child exploitation;

b) Serious violations of the rights of individuals in situations of war or conflict;

c) Severe environmental damage;

d) Gross corruption;

e) Other particularly serious violations of fundamental ethical norms.


59. The Council on Ethics for the GPFG, supra note 8; see also Guidelines for Observation and Exclusion, supra note 5, §§ 2-5.

60. GPF REPORT NO. 20, supra note 18, at 89.


62. Id. no. 16.

63. Guidelines for Observation and Exclusion, supra note 5, § 2(1)(a).

64. Id. § 2(1)(b). This was one outcome of the evaluation process in 2008-2009. Id. The criterion is limited to production of tobacco products, and does not include associated products, such as, filters and flavor additives, or the sale of tobacco products. Id.

65. Guidelines for Observation and Exclusion, supra note 5, § 2(3).
The premises for the Ethics Guidelines clearly state that the GPFG's investment should generate a sound return, contingent on sustainable development, and not represent an unacceptable risk of complicity in grossly unethical acts, including the areas of human rights and the environment. Only states can violate their human rights obligations directly under international law (outside the realm of international criminal law), yet companies can contribute to human rights violations committed by states and the GPFG, in turn, may contribute to the companies' complicity through its ownership. No evidence of contribution needs to be provided for the GPFG to take action; the presence of an unacceptable risk is sufficient to trigger a response. This also applies to acts or omissions in regard to the environment. Only the most serious violations of the ethical standards should provide a basis for exclusion. The fact that a risk is deemed unacceptable is linked to the seriousness of the ongoing act, whether a company is accused of several counts of unethical conduct, and the degree of probability of the act taking place in the future. Past acts alone are not enough for exclusion from the GPFP, yet past patterns of conduct can be relevant when they indicate future conduct. The Council on Ethics also makes sure that there is factual evidence to support the accusations leveled at the company.

To date, the Ministry of Finance, based upon recommendations from the Council on Ethics, has screened out investments in eighteen companies on the basis of their production of certain kinds of weapons, such as central parts of nuclear weapons, and involvement in the production of cluster munitions and landmines. In addition, one company has been excluded for selling military material to Burma. Twenty-one companies have been excluded for tobacco production. In order to avoid the unacceptable risk of the GPFG contributing to serious or systematic human rights violations or severe environmental damage, eighteen companies have been excluded from GPFG. Two companies were excluded on grounds of other particularly gross violations of fundamental ethical

67. Id.
68. GPF REPORT NO. 10, supra note 36, at 77; see also Guidelines for Observation and Exclusion, supra note 5, § 2(4).
70. GPF REPORT NO. 10, supra note 36, at 77.
72. Id. (referring to Dongfeng Motor Group Co Ltd. (28 Feb. 2009)).
73. Id.
74. Id.
norms and three for serious violations of the rights of individuals in situations of war or conflict.

No companies have yet been withdrawn from the investment universe of the GPFG due to their lack of action to mitigate climate change, under the "severe environmental damage" criterion under the Guidelines for Observation and Exclusion. Currently, this criterion does not cover climate change. The NBIM, on the other hand, has entered into dialogue with companies lobbying against regulations requiring action to mitigate climate change and has used its voting rights as a shareholder on climate change resolutions introduced by shareholders at the general meetings of targeted companies. The NBIM has also communicated its expectations to companies in regard to addressing climate change, as mentioned above.

In addition, in 2012, NBIM expanded its climate change focus area to include deforestation of tropical rainforests as a means of emitting carbon, in addition to its existing focus on emissions of greenhouse gases through the burning of fossil fuels as stipulated in its expectation documents. Based on that decision, it divested stocks from twenty-three palm oil companies from GPFG's investment portfolio determining that they were producing palm oil in an unsustainable manner, contributing to tropical rainforest deforestation.

III. GPFG’S – EMPIRICAL EVIDENCE OF EFFECTIVENESS

The observation and exclusion mechanisms employed by the GPFG to monitor compliance with the Ethics Guidelines leave open the possibility that firms found to be in breach of these guidelines can alter their unethical behaviors and shift their internal practices toward sustainability. Given that unsustainable practices can lead to divestment and exclusion from the GPFG, corporations face some incentives to adhere to its Ethics Guidelines; this is especially the case where corporations may wish to avoid the costs, both material and reputational, of being


76. Companies Excluded from the Investment Universe, supra note 71 (Shikun & Binui Ltd. (31 May 2012), Africa Israel Investments (30 Jan. 2014), and Danya Cebus (30 Jan. 2014)).


divested and publicly identified as having unethical and unsustainable practices. Thus, in addition to monitoring compliance with the GPFG’s Ethics Guidelines, through observation and exclusion, the Council on Ethics has the additional effect of redirecting unsustainable corporate behavior and frequently placing corporations on more sustainable pathways.

This section provides an empirical analysis of this process; it assesses the effectiveness of the GPFG in altering corporate behavior once violations of Ethics Guidelines have been detected. It begins with two case studies of corporations, Germany-based Siemens AG and U.S.-based FMC Corporation, both of which have been publicly identified for engaging in unsustainable practices by the Council on Ethics, and have subsequently addressed these unsustainable behaviors. Then the section provides a large-N empirical analysis of all firms that have similarly been identified by the Council on Ethics since 2005.

A. The cases of Siemens and FMC Corporation

In 2007, the GPFG publicly identified the Germany-based multinational conglomerate Siemens AG as the subject of a Council on Ethics investigation for gross corruption. In its investigation, the Council on Ethics highlighted instances where the corporation had actively engaged in corrupt behaviors spanning more than a decade, including bribing public officials in over twenty-five countries to win various tenders and to obtain government contracts. At the time of the investigation, the GPFG held investments worth approximately U.S. $500 million in Siemens stocks and bonds.

Siemens undertook immediate efforts to respond to the concerns raised by the GPFG, providing to the Council on Ethics information about its guidelines relating to corruption and arguing that compliance with such guidelines had become “a top priority.” In its letter to the Council on Ethics, Siemens further emphasized that it was “committed to clearing up all misconduct no matter who was responsible, and will endorse the necessary consequences.” Indeed, Siemens’ high level of responsiveness to the Council on Ethics drew acknowledgement in the Council’s annual report.

In 2009, the Norwegian Ministry of Finance placed Siemens on an “observation list” for a period of four years, during which the Council on Ethics and NBIM were both tasked with monitoring and reporting on Siemens’ efforts to redress its corrupt practices. During that period, the Council on Ethics continued

80. Id. at 45.
81. Id. at 55.
82. Id. (emphasis omitted).
to observe Siemens and engaged in direct dialogue with the company to monitor its efforts at implementing more sustainable business practices.\(^8\)

In 2012, Siemens was removed from observation following a report by the Council on Ethics that emphasized a shift within the corporation toward addressing and eliminating corrupt practices. The Council on Ethics noted that “it [was] unlikely that there was a higher risk of corruption in Siemens than in other comparable companies” and thus recommended that its observation period come to an end.\(^8\)

This process reveals that efforts undertaken by the GPFG helped facilitate a change in Siemens’ corporate behavior in a more sustainable direction. While Siemens’ corruption was widely publicized and became the subject of a number of lawsuits, market-based pressure from investors such as the GPFG no doubt influenced Siemens’ decision to implement more sustainable practices over time. This is corroborated by Siemens’ high level of responsiveness to inquiries from the Council on Ethics.

An additional case further illustrates the ways in which the Council on Ethics can be successful in motivating companies to engage in more sustainable behaviors. In 2010, the Council on Ethics recommended to the Ministry of Finance that it exclude the U.S.-based FMC Corporation for “particularly serious violations of ethical norms” tied to its practice of purchasing phosphate minerals mined from the non-self-governing territory of Western Sahara.\(^8\) The Ministry of Finance concurred with the Council’s recommendation and divested securities worth some U.S. $50 million the following year.\(^8\)

During the course of the investigation into alleged unethical practices, FMC Corporation revealed to the Council on Ethics that it was party to long-term contracts with Moroccan companies to purchase phosphates from Western Sahara, and that it intended to continue this practice into the future.\(^8\) Indeed, FMC Corporation notified the Council on Ethics that its operations were in many ways dependent on access to such phosphates.\(^8\) In its Annual Report, the Council notes that, “FMC Corporation makes it clear that FMC Foret [its Spanish subsidiary] will continue to buy phosphate from Bou Craa [northern Western Sahara], and that the company’s plant in Huelva, Spain, to a great extent is dependent on access to

83. ANNUAL REPORT 2009, supra note 75, at 5.
84. ANNUAL REPORT 2012, supra note 78, at 6-7.
85. ANNUAL REPORT 2011, supra note 75, at 6-7. FMC Foret’s phosphate trade with the state-owned Moroccan mining company was contrary to the interests of the local population and not for their benefit. Id. This breach of the Ethics Guidelines fell under the category “other particularly serious violations of fundamental ethical norms.” Guidelines for Observation and Exclusion, supra note 5, § 2(3)(e).
86. ANNUAL REPORT 2011, supra note 75, at 6; Norway Blacklists US/Canadian Fertilizer Firms over Sahara Imports, WESTERN SAHARA RESOURCE WATCH (June 12, 2011), http://www.wsrw.org/a105x2177.
87. ANNUAL REPORT 2011, supra note 75, at 57-58.
88. Id. at 58.
phosphate of the quality found at Bou Craa.” The Council on Ethics regarded this information as an assurance that FMC Corporation intended to continue engaging in what it considered to be grossly unethical behavior; this information formed the basis of the Council’s decision to recommend exclusion. Following FMC Corporation’s exclusion from the GPFG, the Council on Ethics continued to contact the corporation to determine whether it continued to purchase phosphates mined from Western Sahara. This practice is established in Paragraph 5 of the GPFG’s Ethics Guidelines, which directs the Council on Ethics to “routinely assess whether the basis for exclusion still exists and may, in light of new information, recommend that the Ministry of Finance reverse an exclusion ruling.” In August 2012, FMC Corporation notified the Council on Ethics that it had ceased purchasing phosphates from Western Sahara. Notably, the company also stated that it had no “plans or agreements that include future purchases of phosphates from Western Sahara.” This marked a significant shift in behavior for FMC Corporation, which had purchased phosphates extracted from Western Sahara for some forty years. In light of this information, the Council on Ethics recommended to the Ministry of Finance that FMC Corporation’s exclusion be reversed. The Ministry of Finance accepted the recommendation, and FMC Corporation subsequently reappeared in NBIM’s investment portfolio.

The above cases illustrate the ways in which the Council on Ethics’ screening and exclusion mechanisms can have the effect of redirecting unethical behaviors. Both Siemens AG and FMC Corporation were highly responsive to the Council on Ethics and eventually redressed their unethical practices in ways that placed each firm on a more sustainable pathway. These shifts in corporate behavior are attributable to investor-side concerns over long-term sustainability. The remainder of this section turns to a larger quantitative test of these mechanisms to evaluate their ability to motivate firms to change unethical behavior.

B. Influencing corporate behavior

We propose that the ability of the GPFG to influence corporate behavior toward more sustainable practices is tied to the degree of market leverage it possesses over a given corporation. We argue that the magnitude of this leverage, in turn, is a reflection of the relative size of the investment the GPFG maintains in a given corporation. Larger relative investments lead to more leverage because they magnify the consequences of observation and potential exclusion when the Council on Ethics identifies companies for unethical practices. We thus conduct

89. Id.
90. Id. at 58, 62.
91. ANNUAL REPORT 2012, supra note 78, at 50.
92. Guidelines for Observation and Exclusion, supra note 5, § 5(5).
93. ANNUAL REPORT 2012, supra note 78, at 50-51.
94. ANNUAL REPORT 2011, supra note 75, at 57.
95. ANNUAL REPORT 2012, supra note 78, at 51.
96. Id. at 6-7.
an empirical test that models the likelihood of a corporation altering its unethical behavior as a function of the relative size of investment the GPFG maintains in that firm. We hypothesize that larger relative investments are more likely to influence corporate behavior in a direction toward more sustainable practices than smaller relative investments.

1. Sample

The high level of transparency within the GPFG permits us to test our hypothesis on all corporations that have been publicly identified as subjects of investigation by the Council on Ethics, as well as all corporations that have been negatively screened for unethical practices. These are firms such as Siemens AG and FMC Corporation that have been investigated for engaging in unethical behavior by the Council on Ethics. In the process of being investigated, these companies have the option to alter their practices to bring them into alignment with Ethics Guidelines before they are excluded from the fund. There are seventy-nine such corporations that appear in our sample.97

2. Variables

Our Dependent Variable ("DV") is a dichotomous measure that captures whether a corporation changes its unethical practice following an investigation by the Council on Ethics. If the corporation alters its behavior, it is coded as a one. If a corporation is investigated for unethical practices and is subsequently divested and never alters its behavior, it is coded as a zero.

Our primary independent variable ("IV") is designed to capture the degree of market leverage the GPFG maintains over a target firm. It measures the percentage of outstanding shares of a firm that are owned by the GPFG. We calculate this variable by dividing the value of the GPFG's investment in the firm in Norwegian Kroner ("NOK") by the value of the corporation's total outstanding shares in NOK. All figures are calculated based on values taken from the year the corporation was publicly revealed as the subject of investigation. The minimum percent ownership in the sample is zero, while the maximum percent ownership is 2.07 percent of total outstanding shares. In cases where the percent ownership of a corporation is zero, the GPFG has typically engaged in negative screening, and has never owned shares in that corporation. These data are publicly available from NBIM's annual reports.98

We also include a number of control variables ("CV") in our analysis. Our first CV is the size of a corporation by market capitalization the year it was

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97. Information on each of these corporations was compiled from the Council on Ethics' annual reports for years 2005 to 2013. See Annual Reports, REGJERINGEN.NO, http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/annual-reports.html?id=458699 (last visited July 20, 2014).

identified as the subject of investigation by the GPFG. Market capitalization is presented for all corporations in NOK, even if that corporation's shares and bonds are traded in a currency other than NOK. We include this control under the assumption that the size of a corporation may influence its likelihood of altering an unsustainable behavior. For example, large firms may be less wary of the costs of divestment and thus less sensitive to any market leverage exerted by the GPFG. Conversely, large firms may be more sensitive to the reputation costs of being identified as the subject of investigation for unethical behaviors; in such cases, these firms may be more likely to alter an unethical behavior.

Our second CV measures the level of democracy of the country within which the firm is chartered, or the state within which the violation of the Ethics Guidelines occurred where that country is different. For example, Wal-Mart USA, which appears in the sample for violations of human rights, is coded based on the level of democracy in the United States, while Wal-Mart de Mexico is coded based on the level of democracy in Mexico. To measure the level of democracy, we use the 21-point "Polity Score" scale, where states with the lowest level of democracy are coded as -10 and states with the highest level are coded as 10.99 We include this control under the assumption that corporations in more democratic countries may be more receptive to efforts at incorporating sustainable practices than corporations from less democratic countries.

Our third CV is a dichotomous measure indicating whether a firm has been negatively screened or investigated for the production of munitions. This category of companies represents a uniquely difficult set of cases for the Council on Ethics. For most of these companies, weapons production is a core business function. It is therefore less likely that these firms will cease the production of munitions to align their behavior with the GPFG's Ethics Guidelines. This is especially the case when compared with other types of unethical behaviors, like corruption or environmental degradation, which companies may be more willing to address insofar as they do not constitute a central function of the business.

A similar logic motivates the inclusion of our final CV, which indicates whether a corporation produces tobacco. While tobacco-producing firms have the opportunity to alter their unethical behaviors, none to date have.100 This is unsurprising, as implementing sustainable practices for these corporations would imply abandoning tobacco production altogether. There are eighteen tobacco-producing firms that have been excluded from the GPFG. The dummy measuring tobacco production predicts a perfect rate of corporations failing to alter their unsustainable behaviors; it thus has the statistical effect of dropping these observations from the sample. Notably, this accounts for the drop in the number of observations used to estimate our model.

100. See Annual Reports, supra note 97.
3. Case Selection

Testing our hypothesis on this sample raises the potential for selection bias. If the Council on Ethics systematically investigates corporations that are more likely \textit{a priori} to alter their unethical practices, then only these corporations will select into our sample, while corporations that are less likely to alter unethical practices will be excluded. This selection problem threatens to undermine the generalizability of our results. The obvious econometric solution, a two-stage Heckman selection model, is infeasible due to the exclusion restriction requiring us to identify some instrument that predicts whether a corporation will select into an investigation for unsustainable practices.

While we cannot model any selection bias, we can determine whether there is anything systematically different about firms that select into Council on Ethics investigations from those that do not. To determine whether there is anything substantively different about companies that select into our sample from companies that do not, we take two random draws of seventy-nine corporations from the GPFG's investment universe. This is equivalent to the number of corporations in our sample. For each randomly drawn firm, we calculate the percent of total outstanding shares controlled by the GPFG. We then perform difference-in-mean tests (two-tailed) to determine whether there is a statistically significant difference across means for firms that select into our sample and the firms that do not. If there is no sample selection bias, there should be no statistically significant difference in means between the corporations in our sample and the corporations randomly drawn in terms of the percent of shares owned by the GPFG.

The results of the difference-in-means tests reveal no significant differences (at ninety percent confidence) between the mean percentages of outstanding shares controlled by the GPFG for corporations that select into our sample. There is thus nothing systematically different about firms that select into our sample versus those that do not in terms of the relative slice of shares controlled. This suggests that the Council on Ethics does not choose corporations that it believes will be \textit{a priori} more amenable to implementing more sustainable practices, while failing to investigate firms that will be less willing to address its concerns.

We test our hypothesis using logistic regression; our model is laid out in equation form below:

\begin{equation}
\text{Equation Below}
\end{equation}

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102. For the first random draw, \(t(79)=1.2406, p=0.1096\); for the second random draw, \(t(79)=1.2407, p=0.1096\).

103. The beta coefficients represent the parameters estimated by maximizing the likelihood function associated with the equation we present. These coefficients, in turn, allow us to use data simulations to calculate the probability of a company changing its unethical behavior following negative screening or exclusion.
Logit (Firm compliance) = \beta_0 + \beta_1 \times \text{Percent Firm Control} \\
+ \beta_2 \times \text{Firm Size} \\
+ \beta_3 \times \text{Democracy} \\
+ \beta_4 \times \text{Weapons} \\
+ \beta_5 \times \text{Tobacco}

4. Results

The results (presented in Table 1) provide support for our hypothesis that the likelihood of a corporation changing an unethical behavior increases as the relative size of the GPFG’s investment in that corporation increases. This suggests that corporations tend to be more receptive to investors’ efforts at implementing sustainable practices as the relative size of the investment increases. Notably, it only requires small relative increases in investment size for companies to change their practices. In other words, small relative increases in investment share yield disproportionate increases in the probability of a corporation changing its behavior. This also suggests that, under certain circumstances, corporations can be highly sensitive to the expectations of investors with regard to sustainable practices, even when those investors own only small relative slices of a corporation’s tradable securities.

For example, based on simulations (presented in Table 2), the model predicts a forty-one percent likelihood of a firm abandoning an unethical practice following negative screening or an investigation when the GPFG controls zero shares. This low likelihood is perhaps unsurprising given that the GPFG maintains almost no market leverage over such firms. However, when the GPFG controls a quarter of one percent of outstanding shares in a firm, the probability of that firm changing an unethical behavior rises to 0.52. Stated differently, there is about a fifty percent chance that a firm will change its behavior when investigated or negatively screened when the GPFG controls 0.25 of the total outstanding shares of that firm. The likelihood of observing a change increases substantially to 0.71 when the GPFG controls as much as 0.75 percent of outstanding shares in a corporation. When this increases to one percent, the likelihood of a firm changing some unethical behavior further increases to 0.78. The pattern is consistent throughout simulations as the percent of shares controlled rises; indeed, the model predicts a ninety percent chance that a corporation will discontinue an unethical behavior when the GPFG controls 1.75 percent of outstanding shares. This again suggests that only small relative increases in the amount of securities controlled by investors has the ability to magnify substantially market leverage in terms of convincing corporations to adopt more sustainable practices.

The size of a corporation by market capitalization has a weakly significant relationship (p<0.10) to the likelihood of that corporation altering its behavior following investigation or negative screening from the Council on Ethics. While the relationship is not significant at conventional thresholds, it is notable that the relationship is positive, suggesting that larger companies may be more likely to change their behavior than smaller companies. This could indicate that larger
companies may be more sensitive to investor interests related to sustainable practices.

As expected, the coefficient on the dummy variable indicating whether a company engages in weapons production is significant and signed negatively; this demonstrates that companies engaged in weapons production are indeed less likely to alter their unethical practices than are companies that are investigated or screened for violations in other areas. Indeed, the model predicts only a thirty-two percent likelihood of such a company changing its behavior following negative screening or an investigation when the GPFG controls one percent of total outstanding shares. When the relative slice of control doubles to two percent, the model predicts only a sixty-four percent likelihood of a firm changing its behavior. Substantively, this suggests that it is more difficult to wield market leverage over weapons manufacturers in an effort to implement more sustainable practices.

Last, the level of democracy of the country in which a given firm is located bears no significant relationship to the likelihood of that company changing some unethical behavior. In other words, companies in highly democratic countries are no more (or less) likely to change their behavior than are companies in undemocratic countries. This null result is perhaps heartening for investors who may wish to target companies in undemocratic countries, as they appear to be just as receptive to implementing sustainable practices as companies chartered in countries that are highly democratic. Substantively, this result suggests that the location of a company bears little relationship to its receptiveness to investor pressures over implementing more sustainable practices. Market leverage appears to have the same effect on firms, whether they’re chartered in democratic countries or otherwise.

<table>
<thead>
<tr>
<th>Table 1: Explaining Changes in Corporate Behavior</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent Shares Owned</td>
</tr>
<tr>
<td>Firm Size</td>
</tr>
<tr>
<td>Democracy</td>
</tr>
<tr>
<td>Weapons</td>
</tr>
<tr>
<td>Constant</td>
</tr>
</tbody>
</table>
Pseudo R2 0.243
Percent Predicted Correctly 67.92
N 53

* p<0.05, WS p<0.10; robust standard errors reported in parentheses, two-tailed tests.

**Table 2: Predicted Probability of a Firm Changing its Behavior at Levels of Percent Firm Ownership**

<table>
<thead>
<tr>
<th>Percent Ownership</th>
<th>Likelihood Change</th>
<th>Confidence Interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0.41</td>
<td>0.20-0.65</td>
</tr>
<tr>
<td>0.25</td>
<td>0.52</td>
<td>0.33-0.70</td>
</tr>
<tr>
<td>0.50</td>
<td>0.62</td>
<td>0.44-0.77</td>
</tr>
<tr>
<td>0.75</td>
<td>0.71</td>
<td>0.51-0.87</td>
</tr>
<tr>
<td>1.00</td>
<td>0.78</td>
<td>0.54-0.93</td>
</tr>
<tr>
<td>1.25</td>
<td>0.84</td>
<td>0.57-0.97</td>
</tr>
<tr>
<td>1.50</td>
<td>0.87</td>
<td>0.58-0.99</td>
</tr>
<tr>
<td>1.75</td>
<td>0.90</td>
<td>0.59-0.99</td>
</tr>
<tr>
<td>2.00</td>
<td>0.92</td>
<td>0.60-0.99</td>
</tr>
</tbody>
</table>
INVESTING IN SUSTAINABILITY

Estimating using CLARIFY\textsuperscript{104}; firm size and democracy are held at their mean values, while weapons production is held at its mode.

IV. THE SUSTAINABLE PATHWAY-GPFG AS A MODEL FOR OTHER INSTITUTIONAL INVESTORS

The GPFG has been referred to as the “gold standard of sovereign wealth funds” by the President of the European Commission.\textsuperscript{105} The GPFG is also listed among the most transparent of the SWFs, with a rating of ten, the highest score on the Lindaburg-Maduell Transparency Index.\textsuperscript{106} This rating is based on several factors, including: whether the fund discloses its “history including reasons for its creation, origins of wealth, and government ownership structure”; whether the fund provides “up-to-date independently audited annual reports,” and its ownership stakes in companies, and provides guidelines with regard to “ethical standards, investment policies, and enforcement of guidelines.”\textsuperscript{107}

Measured against the U.N. PRI, and considering its most recent revisions, the GPFG is a workable model for other institutional investors. Now that it has brought environment and climate change to the forefront, it is more likely to take ESG issues into account in a broader fashion. The exclusion mechanism is a long, time-consuming process which some may claim is not necessary if investors take ESG issues into account in a more holistic manner in their investment decision-making. However, as with all voluntary approaches, they will only be as effective as the reliability of the self-reporting mechanisms. Having an exclusion mechanism available can indeed be very effective, as we have shown, and should remain as a ‘stick’. The best approach is to address ESG issues at all levels, having both investors and companies integrating ESG issues into their decision-making process. States should be encouraged (or assisted) to adopt practical legislation addressing ESG issues.

Currently, there are few globally accepted best practice standards for SWFs regarding taking ESG issues into account.\textsuperscript{108} The Norwegian Ministry of Finance considers the U.N. PRI an important initiative because it “combines the need for a

\textsuperscript{104.} MICHAEL TOMZ, JASON WITTENBERG & GARY KING, CLARIFY: SOFTWARE FOR INTERPRETING AND PRESENTING STATISTICAL RESULTS (Version 2.0 2003), http://scholar.harvard.edu/gking/clarify.


\textsuperscript{107.} Id.

\textsuperscript{108.} Id.
common platform and understanding of the issues and the need for a certain amount of flexibility in execution on the part of the individual investor."

The work of the GPFG may itself form the basis of a new global best practice standard. Actions taken by the GPFG may have a wider multiplier effect, prompting responsible investment not just by other SWFs, but also private sector institutional investors.\(^1\) There seems to be a growing preference toward engaging with companies rather than excluding them. However, there is a dilemma in "the paradox of the opportunity to positively influence a company by being an active shareholder, while inherently supporting their irresponsible practices by being an investor."\(^2\) The NBIM Investor Expectations on Climate Change Management is a promising tool, since it is followed up with an annual compliance report, assessing whether the companies the GPFG is invested in are meeting the NBIM’s expectations. Thereby, the Norwegian GPFG could be viewed as a leader in the industry and with some tweaking be a model of best practice.

Regarding the GPFG, the Ethics Guidelines can be an effective tool to influence corporate behavior, especially the observation and exclusion mechanisms. In addition, the NBIM’s environment-related active equity mandates should help promote sustainable companies ahead of others in the investment universe. Furthermore, the NBIM’s Investor Expectations on Children’s Rights, Water Management, and Climate Change Management and their respective annual assessment reports will lead to more dialogue between the NBIM and reluctant companies that are part of the investment portfolio of the GPFG, encouraging them to get on a more sustainable path.

V. REFORM PROPOSALS

The Strategy Council for the Government Pension Fund Global, established in the spring of 2013, with a mandate to strengthen the work of the GPFG on responsible investment,\(^3\) delivered its report, the Responsible Investment and the Norwegian Government Pension Fund Global, to the Ministry of Finance on November 11, 2013.\(^4\)

The report of the Strategy Council recommends that an outline for a responsible investment framework should be set out for the GPFG. It would include its motivation, mandate, principles, strategies, and evaluation.\(^5\) Furthermore, it recommends consistency among the GPFG’s objectives, priorities, requirements, and priorities.

112. See The Council on Ethics for the GPFG, supra note 8 that requires the Council of Ethics to ensure the GPFG’s investments comply with the ethical guidelines.
113. DIMSON ET AL., supra note 8, at 4, 31.
114. Id. at 17.
and activities in the responsible investment framework. In addition, it emphasizes more transparency and accountability. Based on these recommendations, the Strategy Council sees a need to integrate all the responsible investment activities of the fund into NBIM, giving the Board of Norges Bank the final say on divestment decisions, rather than the Ministry of Finance as it is today.\textsuperscript{115}

The objective of the GPFG’s responsible investment strategy, originally set out by the Graver Committee, has broad political support.\textsuperscript{116} More transparency and accountability has already been called for by several NGOs.\textsuperscript{117} The main issue being debated about the report is its recommendation calling for the integration of the resources and competence of the Council on Ethics into NBIM. The authors strongly disagree with this recommendation, as will be explained below in the context of the effectiveness of the implementation of the Ethics Guidelines.

The exclusion mechanism the Council on Ethics uses when it makes its recommendations to the Ministry of Finance at the outset of the investment process, eliminating producers of unethical products from the investment portfolio, has been very effective.\textsuperscript{118} Indeed, some manufacturers have been eager to inform the GPFG if they have stopped producing some products to again be able to be included in the GPFG’s portfolio.\textsuperscript{119}

In addition, the mechanism to place companies under observation or exclude them from the investment portfolio if there is an unacceptable risk that the company contributes to unethical behavior, seems, as the authors’ empirical analysis has demonstrated, to work well as a tool to encourage companies to move toward sustainable development.\textsuperscript{120} Yet, several suggestions have been made for improvements, among them, giving the Council on Ethics more autonomy.\textsuperscript{121} This, however, is contrary to the Strategy Council’s recommendation to integrate the Council on Ethics into NBIM. Keeping the Council on Ethics separate from NBIM is very important because it allows the Council to focus purely on ethical

\textsuperscript{115} Id. at 30.

\textsuperscript{116} See supra text accompanying note 37.


\textsuperscript{118} Originally called the negative screening process. See DIMSON ET AL., supra note 8, at 5.

\textsuperscript{119} ETIKKRAĐET, RECOMMENDATION TO REVOKE THE EXCLUSION OF THE COMPANIES BAE SYSTEMS PLC. AND FINMECCANICA S.P.A. FROM THE INVESTMENT UNIVERSE OF THE GOVERNMENT PENSION FUND GLOBAL 1 (2012) (unofficial translation), available at http://www.regjeringen.no/upload/Fin/etikk/2013/bae_finmec_eng.pdf (BAE Systems plc wrote to the Ethics Council 10 days before they received the routine enquiry from the Council asking if MBDA—a company which BAE Systems plc through a joint venture, had a controlling interest in—was still involved in the production of nuclear weapons. BAE Systems plc stated that MBDA’s production of ASMP-A had now been completed, thus the basis for the exclusion of MBDA’s owners no longer applied.).

\textsuperscript{120} For example Siemens and FMC Corporation made changes. See discussion supra Part III.a.

\textsuperscript{121} SHAMMAS, supra note 7, at 4.
issues without being distracted by the financial implications of its recommendations. As long as sustainable development is not given priority over financial issues, the controlling function of the Council on Ethics should be upheld in an independent entity accountable only to the Ministry of Finance, since it represents the owners, the people of Norway. The Council is, in fact, evolving into a quasi-judicial entity in making its recommendations to the Ministry. As Backer explains, the work of the Council on Ethics has "the beginnings of a coherent jurisprudence of ethics for corporate investment, utilizing public power to influence private governance among enterprises." This value should not be underestimated as it has, as stated above, been followed closely by other pension funds that have, in turn, also excluded the same companies from their investment portfolio.

More autonomy for the Council on Ethics would make sense in some circumstances. Giving the Council on Ethics greater say in exclusion cases, rather than just making recommendations to the Ministry of Finance, would keep the decision further away from politics whose influence has been criticized by some commentators. Then the Council on Ethics would have to acquire authority over NBIM regarding ethics issues. This is not compatible with the GPFG's current structure, which means NBIM's mandate from the Ministry of Finance would need to be amended. The Council on Ethics could have a final say in the straightforward exclusion cases and in problematic cases, a recommendation to the Ministry of Finance could be either accepted or turned down within a deadline of six months by the Ministry, without second-guessing the Council on Ethics' thorough analysis. In recent cases, the Ministry has used more than a year to decide whether to accept some of the Council on Ethics' recommendations, often leading to the information used in the Council's investigation being outdated as was also stated in the Strategy Council's report.

The Strategy Council has stated that with the current structure there are "risks of litigation from companies and other shareholders." However, this has not happened to date for the simple reason that "whether or not to invest in a company is a matter of free choice", as the Graver Committee expressed it in its report in

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123. Backer, supra note 6, at 24.
124. Id. at 50.
125. See SHAMMAS, supra note 7, at 9.
127. DIMSON ET AL., supra note 8, at 23.
128. Id.
There is no public hearing or appeals process regarding an exclusion decision because it is not a legal process. It is an investor making a decision to sell because it is not happy with its investment. That happens all the time in the market place for whatever reason—it is a matter of “free choice.”130 Yet, the Council on Ethics does give the companies a chance to respond to the allegation of potential unethical behavior.131 In addition, all exclusions are reviewed annually to determine if any of the excluded companies can return to the GPFG’s portfolio and there is a move towards engaging more with companies rather than excluding them. However, this system only works if there is a ‘stick’ in the background to keep everyone focused on the consequences for not cooperating. If the Ethics Guidelines were to become legal requirements, then the Council on Ethics, which is not a legal tribunal, would have to adopt a standard litigation process, including due process rules, to avoid undermining the legitimacy of the Fund in global markets.132

The exercising of ownership rights is growing in popularity among investors. Employing environmental-related investment mandates is also growing in use. Yet, sixty percent of companies still do not consider ESG issues important.133 The standard dilemma is weighing the financial returns against the ethical expectations, which the Strategy Council has deftly expounded upon in its report.134 Yet, the Norwegian people through their Parliament agreed to focus on ethics when they established the Ethics Guidelines. That was a political decision. The investment managers do not have the authority to make decisions on ethics, they have the expertise when it comes to analyzing the risks involved, but they cannot decide which risks are the right ones to take.135 NBIM’s department dealing with active ownership policy has the mandate to weigh the Ethics Guidelines up against the financial interests, while the Council on Ethics focuses only on the ethics. Obviously, this department, being quite small and definitely not the main focus of the NBIM is going to have a challenge in fulfilling its mandate. Support and guidance from the Council on Ethics could strengthen their position.

Many observers have suggested expanding the focus areas for NBIM in its active ownership and divestment policies to coincide more with the OECD Guidelines for Multinational Enterprises.136 Some argue that investor expectations

129. Graver Committee Report, supra note 15, § 2.2.
130. Id.
131. ANNUAL REPORT 2011, supra note 75, at 9.
133. Towner, supra note 3, at 40.
134. DIMSON ET AL., supra note 8, at 5.
136. See OECD GUIDELINES ON MULTINATIONALS, supra note 54, at 13-16.
should include human rights in general, not just children's rights.137 Other environment and social issues should also be given their own investor expectations. The current investor expectations, which include children's rights, climate change, and water management, are quite disparate issues, seemingly random. One could base the investor expectations on, for instance, gradually introducing the major areas addressed in the OECD Guidelines for Multinational Enterprises, prioritizing companies for assessment when they present a significant risk of actual or potential adverse environmental or social impacts.138 Increased transparency by stipulating which criteria are used to choose which issues are to be included in the investor expectations, as the Strategy Council has suggested, and making them available to the public would likely add to the legitimacy of NBIM and allow the owners of the GPFG, the Norwegian people, to better hold it to account.139

Suggestions have also been made for NBIM to publish information regarding its dialogues with companies following up on its active ownership.140 The list of top scorers on compliance reporting with regard to investor expectations on children's rights, climate change and water management is all very well, but does not encourage accountability by measuring how effective these mechanisms are.141 Compare this to the Council on Ethics that publishes all its recommendations on exclusions made to the Ministry of Finance, which our empirical analysis has shown to be effective.142

Rather than integrating the resources and competence of the Council on Ethics into the Norges Bank, the Council on Ethics should become more autonomous and NBIM itself should beef up its active ownership and be accountable to the Council on Ethics for its work in that area. As long as the Council on Ethics and NBIM cooperate, then there is less chance of overlap. What is needed is more funding in the ethics area. The cost of the work of the Council on Ethics and NBIM on active ownership is a very small fraction of what is used by the investment managers (internal and external managers). These managers should also become more sensitive to ESG issues in their investment practices. Currently, positive screening (environmental investments) amounts to a very small fraction of the value of the GPFG portfolio;143 it needs to be substantially increased

137. Interview with Hans Petter Graver, University of Oslo, Norway (Aug. 20, 2013).
138. See POSCO CASE, supra note 11, at 47.
139. DIMSON ET AL., supra note 8, at 27.
140. See HASLIE REPORT, supra note 117, at 22; SHAMMAS, supra note 7, at 11 for an explanation of how the Swedish national pension fund, AP, enters into dialogue with the companies it invests in.
141. HASLIE REPORT, supra note 117, at 19.
143. It was projected that only NOK 20 billion (less than 1% of the value of GPFG's portfolio) would be invested between 2010 and 2015. GPF REPORT NO. 20, supra note 18, at 27; see also BENJAMIN J. RICHARDSON, SOVEREIGN WEALTH FUNDS AND THE QUEST FOR SUSTAINABILITY: INSIGHTS FROM NORWAY AND NEW ZEALAND, NORDIC J. OF COM. L., no. 2, 2011, at 1, 24-25.
and over time will show much bigger returns as the market receives the signals that the green economy is our only choice for the future. If Norway is serious about promoting sustainable development, then it has to bear that short-term cost. However, as a universal investor, this short-term cost is not as great as the long-term cost of reneging on responsible investment since that is more likely to have a material effect on portfolio risk and performance.144

Finally, a much debated theme is divesting from fossil fuel investments entirely (or at least coal and oil sands). The GPFG, the entity that was supposed to leverage against shifts in oil prices to safeguard the stability of the mainland economy, is now giving up that function, since according to the HSBC report, oil stocks will go down in value due to action taken to address climate change.145 Furthermore, if the long-term perspective on sustainable development is taken, it is clear that the goal of staying below the two degree Celsius increase in temperature will not be reached if most of the fossil fuels are not left in the ground. This, of course, reflects the oxymoronic situation that the income of the GPFG is based on the exploitation of oil and gas. Just as other SWFs accumulate income from other natural resources, Norway should aim to gradually shift from oil and gas to renewable energy. A first step would be amend the Ethics Guidelines to add exploitation of coal and oil sands to the list of products excluded from the GPFG portfolio as has been suggested from several quarters.146

VI. CONCLUSION

The Albright Group and Simon Chesterman, who were hired by the Norwegian Ministry of Finance to evaluate the Ethics Guidelines of the GPFG in 2008, stated that "[t]he work done by NBIM and the Council [on Ethics] has established Norway as a leader on ethical issues in the global economy, in particular through NBIM’s work on child labour and the Council’s practice of publishing thorough opinions."147 Our analysis corroborates the opinion of the Albright Group; we show that the Council on Ethics is highly effective in certain cases at motivating changes in corporate behavior in ways that put the companies in the GPFG's investment portfolio on a path to sustainability. Though we agree with the Strategy Council's report of 2013 that coherence and transparency in the context of the GPFG are important, we strongly disagree with its recommendation of integrating the Council on Ethics' function into NBIM.

144. See definition of universal investor supra note 36.
147. CHESTERMAN, supra note 132, at 3.
Strengthening responsible investment by giving more autonomy to the Council on Ethics, and beefing up the transparency of NBIM and expanding its focus areas to correspond more closely with the OECD Guidelines for Multinational Enterprises, will place the Norwegian SWF in a position to be an even better model of a responsible investor. This, in turn, should encourage corporations to take ESG issues into account in their activities.