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Joint Economic Committee Hearing: "Do Sovereign Wealth Funds Make the U.S. Economy Stronger or Pose National Security Risks?"

Opening Statement of Chairman Charles E. Schumer

Good afternoon and thank you all for coming. Today the Joint Economic Committee is having the first hearing of 2008 on the rise of foreign government-controlled funds investing large sums of money in our economy.

The question of the day is whether these huge pools of investment dollars, known as sovereign wealth funds, make the U.S. economy stronger or pose serious national security risks. I'm not sure that we will answer that question to anyone's satisfaction today, but at the very least, this Committee and the federal government needs to spend a great deal of time thinking about it.

To help us do some of that thinking today, we're honored to have an outstanding panel including: the current Treasury Undersecretary, David McCormick, a former Treasury Deputy Secretary under President Clinton and former Ambassador to the European Union, Stuart Eizenstat, and prominent foreign investment expert, Douglas Rediker.

The initial focus of Congress is correctly on the transparency of these funds and whether that is best achieved voluntarily working through the IMF, or if that doesn't work, through legislation. My preference would be for the former, but we may have to consider the latter.

I would like to take a few minutes to discuss the broader economy and why I believe we are faced with such an increase in investment by sovereign wealth funds in U.S. companies.

It is no secret that our economy is in bad shape now. There is increasing evidence that a recession will be deeper than this administration is willing to admit:

- We have spent too much and saved too little as a country and as consumers (our national savings rate is just above zero).
- Commercial and consumer credit markets have seized.
- Home foreclosures are rising in both subprime and prime markets.

- The value of the dollar has fallen in relation to other world currencies.
- Job growth is at historic lows since January 2001.
- And trade deficits are ballooning to historic highs.

But we also have long-term structural problems in the economy. The U.S. debt-to-GDP ratio is steeply rising, which is a reflection of bad fiscal policy putting tax cuts before everything else, even during wartime.

Our current account deficit is at historic highs, approaching one trillion dollars, and this highlights massive borrowing by the federal government to pay for rising defense and domestic spending.

So it shouldn't surprise us that, as Larry Summers said last year, "the world's greatest power has become the world's greatest borrower."

Even when the economy was going well, there wasn't enough of our own capital because we spend more than we save, we import more than we export, and we consume more than we produce. So when the economy slowed, we didn't have the resources to keep it moving.

Creating a perfect sovereign wealth storm, foreign countries have benefited from our unwitting largess. Thanks to the Bush Administration's failure to control the trade deficit, address currency market manipulation, and bring down oil prices – foreign governments have a lot of extra money, and we do not.

These governments are using their sovereign wealth funds to go on a buying spree in the United States.

The bottom line is that we're overextended and there may only two options – neither of which is very attractive.

1. We can allow a dramatic contraction of our economy;
2. Or we can allow foreign investment, in a measured way, to stave off further job loss and keep the economy humming.

It shouldn't surprise us that international bargain hunters have descended on the U.S. economy.

The acquisition of multibillion dollar stakes in Wall Street firms like Merrill Lynch, Citigroup and Morgan Stanley by Asian and Middle Eastern sovereign wealth funds, quite naturally, has sparked increasing interest and concern about their impact on the U.S. economy. With domestic credit markets locked up, U.S. businesses seem to have little choice but to turn to sovereign wealth funds as a source of much-needed capital.

Much of the criticism until recently has been when money is sent out of the United States, taking American jobs and moving them abroad. It is contradictory to complain about similar investments when they are now being made in the U.S.

In general, foreign investment has a healthy impact on the U.S. economy, and I've supported it. It augments domestic sources of capital and provides much-needed capital and liquidity. It can also create jobs and improve productivity.

However, where the foreign investor is a government or a government-controlled fund, I have concerns about their motivations. We have seen plenty of <u>private</u> foreign investors put money into U.S. companies without much evidence that they are investing for non-economic purposes. But it would be perfectly rational to expect a foreign government-controlled fund to have non-economic motivations.

For instance, foreign governments *might* have an interest in controlling strategic assets, securing access to sensitive information or technology, promoting a political agenda, or cornering a market on raw materials. The closer foreign governments come to exercising control and influence, the greater my concerns.

When Dubai Ports World attempted to purchase major U.S seaports in 2006, alarm bells went off. When it comes to a vital security asset like a port or even a basic infrastructure like a utility, we are right to be very concerned. If a Russian sovereign wealth fund bought a natural gas utility here, alarm bells would be going off again because serious questions and concerns would be raised.

In this regard, sovereign wealth funds are their own worst enemies. Most are not transparent or publicly accountable, and we know little about their governance structures or fiduciary controls. So the bottom line is that we don't know if their decisions are made exclusively on an economic basis.

We invited some of the largest sovereign wealth funds to testify before us today, but they directly declined or their government embassies in the U.S. declined for them.

While managing directors of these funds won't appear in front of Congress, a number of them have been quoted recently in the press attempting to assure lawmakers and the public that their motivations are purely financial and that they do not take direction from their government.

I am not yet persuaded. They need to do much more to make their case.

I met recently with the head of China's sovereign wealth fund. I asked him about the fund's investment policies and its interaction with government officials, but got no real answers. I did get this nice glossy brochure, but it does not really tell me anything.

It is clear we need to find out more about sovereign wealth funds – how they are run, what drives their investment decisions. Sovereign wealth funds should voluntarily provide information and agree to guidelines that promote good governance, accountability, and transparency. Here are some questions they should answer:

- Do sovereign wealth fund officials report to an independent board of directors or directly to the government?

- Do they disclose their investment goals? If those goals change, is that made public?
- Are directors and the investment management team selected on the basis of business qualifications and not political affiliation? Are their professional qualifications and experience made public?
- Is there a stringent code of conduct that compels members of the board of directors and management to report any attempts by the government to influence investment decisions?
- Do they publicly disclose quarterly and annual audited financial statements?
- Do they publicly disclose all their portfolio holdings?

I also want to review whether the reforms to the CFIUS process made by the Foreign Investment and National Security Act of 2007 (FINSA) are sufficient to address the unique risks associated with investments by sovereign wealth funds – and if not, propose additional legislation to close any loopholes. I will also take a hard look at the new FINSA regulations due to be published in the spring.

Finally, it is important to point out that many of the countries with the largest sovereign wealth funds still maintain high levels of protection against investment in their domestic industries. I hope that Treasury and the U.S. Trade Representative do better to ensure reciprocal market access for U.S. investors.

Ultimately, we need to maintain a careful balance between welcoming foreign investment and protecting national and financial security, as well as market stability. Sovereign wealth funds need to assuage concerns that they will manage their investments in terms of political or economic power objectives. The alternative I fear – already proposed by a number of lawmakers and other critics – is restrictions on sovereign wealth fund investments in the United States.

My hope is that sovereign wealth funds can assure us that they will behave like other economic actors, and if they do so that's all to the good. But until they do so, they shouldn't get carte blanche.