

DO SOVEREIGN WEALTH FUNDS MAKE THE U.S. ECONOMY STRONGER OR POSE NATIONAL SECURITY RISKS?

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED TENTH CONGRESS

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WEDNESDAY, FEBRUARY 13, 2008

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met at 2:05 p.m. in room SD-106 of the Dirksen Senate Office Building, the Honorable Charles E. Schumer (Chairman of the Committee) presiding.

Senators present: Klobuchar, Maloney, Schumer, and Webb.

Representatives present: Maloney.

Staff present: Christina Baumgardner, Ted Boll, Heather Boushey, Stacy Ettinger, Anna Fodor, Chris Frenze, Nan Gibson, Rachel Greszler, Colleen Healy, Aaron Kabaker, Tim Kane, Israel Klein, Michael Laskawy, Robert O'Quinn, Jeff Schlagenhauf, Robert Weingart, and Jeff Wrase.

OPENING STATEMENT OF HON. CHARLES E. SCHUMER, CHAIRMAN, A U.S. SENATOR FROM NEW YORK

Chairman Schumer. Good afternoon, everyone. Our hearing of the Joint Economic Committee on Sovereign Wealth Funds, will come to order.

I'll make a brief opening statement, as will my Ranking Member, Vice Chair Maloney, and then we'll get right to our witnesses.

Anyway, I want to thank everybody 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 we'll answer that question to anyone's satisfaction today, but at the very least this Committee and the Federal Government need to spend a great deal of time thinking about it.

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

The initial focus of Congress is, correctly, on the transparency of these funds and whether that is best achieved voluntarily, perhaps

working through international bodies such as the IMF, or, if that approach doesn't work, through Federal legislation.

My preference would be for the former, but we may have to consider the latter.

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

It's no secret that our economy is not in good shape now. There's increasing evidence that a recession will be deeper than this Administration is willing to admit.

We've 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, lower than it has been since January of 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 this Administration's bad fiscal policy, putting tax cuts before everything else even during wartime.

Our current account deficit is at historic highs, approaching a 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 as the economy has slowed, we haven't had the resources to keep it moving.

Creating a perfect sovereign wealth storm, foreign countries have benefitted 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 by reducing our dependence on foreign oil, 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 be two options, neither of which is very attractive: We can allow a dramatic contraction of our economy, 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 the 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.

Until recently, much of the criticism has occurred when money is sent out of the United States, taking American jobs and moving the abroad. It is contradictory to complain about similar investments, when they're now being made by foreign entities, in the United States.

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, we should have concerns about their motivations.

We have seen plenty of private foreign investors put money into U.S. companies, without much evidence they're 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 the market on raw materials.

The closer foreign governments come to exercising control and influence, the greater our 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 asset like a utility, we are right to be concerned. For instance, 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 about the motivation of the Russian fund in natural gas. Russia has used natural gas as a political weapon in the past towards Western Europe.

In this regard, sovereign wealth funds are sometimes their own worst enemies. Most are not transparent or publicly accountable, and we know little about their government structures or fiduciary controls.

So, the bottom line is 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 United States declined for them.

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

I don't think the American people are yet persuaded. The funds 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 frankly, if you look through it, it tells you nothing about those questions.

It is clear that 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 that I believe they should answer: Do sovereign wealth funds report to an independent board of directors or directly to the government?

Do they disclose their investment goals? If the goals change, is that made public?

Are directors and the investment management teams 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 disclose publicly, quarterly financial and annual audited financial statements?

Do they publicly disclose all their portfolio holdings?

I also think we ought to review whether the reforms to the CFIUS process made by the Foreign Investment National Securities 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'll be taking a hard look at the new FINSA regulations, due to be published in the spring, in this regard.

Finally, it's 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. China and financial services come immediately to mind.

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 should not get a *carte blanche*.

[The prepared statement of Chairman Schumer appears in the Submissions for the Record on page 29.]

Chairman Schumer. Vice Chair Maloney.

OPENING STATEMENT OF HON. CAROLYN B. MALONEY, VICE CHAIR, A U.S. REPRESENTATIVE FROM NEW YORK

Vice Chair Maloney. Good afternoon. I want to thank Chairman Schumer for holding this hearing to examine the benefits and risks of sovereign wealth funds investing in the United States, and

I want to welcome all of our witnesses and thank them for being here today.

The term "sovereign wealth fund" has only recently entered our lexicon, but these government-controlled investment vehicles have been around and operating without incident for decades.

At the moment, these funds are providing much needed capital to U.S. banks, trying to regain their footing in the wake of the mortgage crisis. However, the growing market clout of these funds and the steep rise of their investments in the United States require that they receive greater scrutiny by Congress.

Bush administration policies have fostered a large amount of Federal borrowing from overseas, a greater reliance on foreign oil, and a weak dollar, all of which have created an environment that is ripe for foreign wealth funds with extraordinary oil profits or excess foreign exchange reserves to gobble up American assets at bargain prices.

Governments can have very different motivations than financial investors, so we would be remiss not to carefully examine the potential risks from these State-owned investment funds.

Reform of the Committee on Foreign Investment in the United States, CFIUS, was triggered by the revelation that the committee gave the green light to a deal that sold operation of many U.S. ports to a company owned by the Government of Dubai without any senior-level or national security review.

With proper implementation by the Administration, the new reforms will strengthen the system by which foreign investment in businesses in the United States is vetted for security concerns, and provides certainty and predictability to the CFIUS process in order to expand economic activity, create jobs, and encourage safe foreign direct investment.

I will continue to maintain a watchful eye over the ongoing implementation process, but I am confident that the Treasury Department intends to follow the law as I wrote it and have received assurances that the Department is already adhering to the new reforms.

I would also like to mention that our antitrust laws and the review by DOJ's Antitrust Division, protect against monopolies or a takeover of any sector, whether by a foreign or domestic entity.

In addition, I welcome the Administration's efforts to work with the International Monetary Fund to create an international code of conduct that would include greater disclosure of sovereign wealth fund activities and their governments.

An important lesson of this summer's mortgage crisis is that when capital markets become too opaque and risk exposure is not well understood, the consequences can be devastating for institutions and individuals.

Greater transparency of foreign wealth funds would be a welcome development, but it is not enough. Our challenge is to balance the potential risks to our economic and national security interests with our desire to maintain an open investment environment.

Again, I'd like to thank our Chairman for holding this hearing, and I look forward to gaining insights from our witnesses about the appropriate oversight of sovereign wealth funds. I yield back.

[The prepared statement of Vice Chair Maloney appears in the Submissions for the Record on page 31.]

Chairman Schumer. Thank you, Vice Chair Maloney.
Senator Klobuchar.

**STATEMENT OF HON. AMY KLOBUCHAR, A U.S. SENATOR
FROM MINNESOTA**

Senator Klobuchar. Thank you, Senator Schumer, and thank you for holding this hearing today. I'm looking forward to hearing our witnesses.

I was thinking as Congresswoman Maloney talked about the relevance of the subprime mortgage crisis. We've seen it in our State in a big way in the urban areas, but also now a doubling of foreclosures in the rural areas, and I would agree with her that a lot of the way this was handled, and the way these were marketed, was hidden from a lot of people and it contributed to that crisis.

As far as the subject for today, I would say that foreign investments in the United States can, of course, have a healthy impact on our economy; however, the dramatic increase that we've seen in the investment from these sovereign wealth funds raises significant and legitimate concerns that cannot be ignored, including those related to our national security.

I believe that foreign governments could manage their investments in pursuit of political or economic power objectives. The lack of transparency, as was earlier discussed, combined with the increasing share of investment capital, could threaten the stability of our financial markets. Sovereign wealth funds could also perpetuate undesirable underlying macro economic and financial policies such as China's manipulation of its exchange rate.

I also think that you can't talk about this without realizing the failed economic policies of this Administration and how they have exacerbated the steep rise of these sovereign wealth funds. The more we're dependent on foreign oil—and we're spending, what, \$200,000, \$300,000, \$400,000 a minute on foreign oil—it's contributed to our growing trade imbalance and to the weakening dollar, and this has created an environment that is ripe for the investment by these sovereign wealth funds.

As we look at solutions, I think we have to pay attention to concerns about the transparency and accountability of sovereign wealth funds; we have take steps to ensure that there is a level playing field for investment.

As Senator Schumer noted, in the countries that have the sovereign wealth funds, they shouldn't be allowed to close off their markets to American investors.

Finally, we should give careful consideration to the question of the appropriate level of regulation or reporting requirements extended to the sovereign wealth funds.

I look forward to hearing the answers from our panelists along the lines of those suggestions. Thank you.

Chairman Schumer. Well, thank you, Senator Klobuchar.

Now, I want to introduce our first witness. Our first witness is David H. McCormick, the Under Secretary for International Affairs at the Treasury Department.

In this capacity, he's principal advisor to the Secretary of Treasury on international economic issues, and also coordinates financial market policy with the Group of Seven Industrialized Countries, so he's very well versed in the issues we have before us.

Before joining Treasury, Mr. McCormick was the Deputy National Security Advisor to the President for International Economic Affairs, and he also served as the Under Secretary of Commerce for the Export Administration.

Prior to joining the Administration, Mr. McCormick was president and CEO of Free Markets and president of AREBA, both software and service companies. In addition, he's a graduate of West Point, holds a Ph.D. from the Woodrow Wilson School at Princeton, is a former Army officer and veteran of the first Gulf War.

Thank you for being here, Mr. McCormick. Thank you for your service, and you may proceed.

STATEMENT OF DAVID McCORMICK, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Under Secretary McCormick. Thank you, Chairman Schumer, Vice Chair Maloney, and other Members of the Committee. Good afternoon.

I very much appreciate the opportunity to appear before you today to discuss sovereign wealth funds.

At Treasury, we have been increasingly focused on sovereign wealth funds for more than a year now, and I'm pleased to have the opportunity to share with this Committee some of our views.

As many of you have just acknowledged, sovereign wealth funds are not new. The oldest funds date back to the 1950s in Kuwait and Kiribati.

Over the next four decades, their numbers slowly grew. By the year 2000, there were about 20 sovereign wealth funds worldwide managing total assets of several hundred billion dollars.

Now today, what is new is the rapid increase in both the number and the size of sovereign wealth funds. Fueled by high commodity prices and the rapid accumulation of official reserves, 20 new funds have been created since 2000, more than half of these since 2005.

Today there are nearly 40 funds managing total assets in a range of \$1.9 to \$2.9 trillion. At the Department of Treasury, we define a sovereign wealth fund as a Government investment vehicle funded by foreign exchange assets managed separately from foreign official reserves.

Sovereign wealth funds generally fall into two categories based on the source of the foreign assets: Commodity funds, which are funded through commodity exports or it is owned or taxed by the Government. Commodity funds serve several different purposes, including stabilization of fiscal revenues, intergenerational saving, and the balance of payment sterilization.

Non-commodity funds are the second type, and these are established through the transfer of assets from official foreign exchange reserves. Large balance-of-payment surpluses have enabled non-commodity exporting countries to transfer excess foreign exchange reserves to stand-alone funds.

Now, within the group of countries with non-commodity funds, foreign exchange reserves are now sufficient by all standards of reserve adequacy, and it is our view that greater exchange rate flexibility is needed, and we are actively engaged on many fronts, calling for increased flexibility in these countries.

In contrast, traditional reserves, which are typically invested for liquidity and safety, sovereign wealth funds seek a higher rate of return and are invested in a wider range of assets.

They emphasize expected returns over liquidity, and their investments can take the form of stakes in U.S. companies, as we have witnessed in recent months.

Sovereign wealth funds' assets are currently fairly concentrated. By some market estimates, only a handful of funds account for the majority of total sovereign wealth fund assets.

Roughly two-thirds of sovereign wealth fund assets are commodity funds, assets between \$1.3 and \$1.9 trillion, while the remaining one-third are non-commodity funds transferred from official reserves in the neighborhood of \$0.6 to \$1 trillion.

Sovereign wealth funds' assets may be small, relative to the \$190 trillion stock of global financial assets, with a roughly \$62 billion managed by institutional investors, but they are larger than the total assets under management by either hedge funds or private equity funds, and they are set to grow at a much faster pace.

The rise of sovereign wealth funds clearly has implications for the international financial system. They bring benefits, but they also raise potential concerns.

On the benefit side, as the President reaffirmed in his May 10 statement, the United States is committed to open investment and advancing open markets at home and abroad.

The depth, liquidity, and efficiency of our capital markets make the United States the most attractive country in the world in which to invest.

And the U.S. economy benefits from that open investment including investment from sovereign wealth funds.

These benefits come in the form of jobs, R&D spending, and higher wages. Over 5 million Americans, 4.6 percent of the U.S. private sector, are employed by foreign-owned firms with U.S. operations. These 5 million jobs pay 25 percent higher compensation on average than other jobs in other U.S. firms.

Additionally, foreign-owned firms contributed almost 6 percent of U.S. output and 14 percent of U.S. R&D in 2006. Foreign-owned firms reinvested over half of their U.S. income, about \$71 billion, back into the U.S. economy in 2006.

As many observers have pointed out, sovereign wealth funds have the potential to promote financial stability.

They are, in principle, long-term, stable investors that provide significant capital to the system. They are not highly leveraged, and they cannot be forced by capital requirements or investor withdrawals to liquidate positions quickly.

Yet, sovereign wealth funds also raise potential concerns. Investments in U.S. companies or other firms by sovereign wealth funds, as with other types of foreign investment, may create legitimate national security concerns.

Also, sovereign wealth funds could provoke a new wave of investment protectionism which raises risk for the United States as well as the global economy.

Sovereign wealth funds raise non-national security issues related to the larger role of foreign governments in markets. For example, through the inefficient allocation of capital, perceived unfair competition with private firms for their pursuit of strategic over return-oriented investments, sovereign wealth funds could potentially distort markets.

Finally, sovereign wealth funds may raise financial stability issues as actual or perceived shifts in their asset allocations could cause market volatility.

At the Treasury Department, we have been working on a number of steps to ensure the United States continues to benefit from investment, while addressing these concerns. First, we are aggressively implementing the reforms that strengthen the CFIUS process required by FINSA, and Executive Order 11858, signed by the President on January 23rd.

I want to be clear that CFIUS reviews the investment transactions of sovereign wealth funds based on considerations of genuine national security concerns just as it would for any other foreign-government-controlled investment.

FINSA protects our national security while keeping investment barriers low and reaffirming investor confidence and the long-standing U.S. open investment policy.

Second, we have proposed, in concert with other members of the G-7, the creation of a multilateral framework for best practices. The International Monetary Fund should develop best practices for sovereign wealth funds, building on existing best practices for foreign exchange reserve management.

These would provide guidance to new funds on how to structure themselves; it would reduce any potential systemic risks and would help demonstrate to critics that sovereign wealth funds can be responsible, constructive participants in the international financial system.

Third, we have proposed that the Organization of Economic Cooperation and Development, the OECD, identify best practices for countries that receive foreign government-controlled investment. These practices should focus on avoiding protectionism and should be guided by the well-established principles established by the OECD and its members on the treatment of foreign investment.

Meaningful and timely progress has been made. In May of last year Treasury hosted a G-20 meeting of finance ministry and central bank officials that included the first multilateral discussion of sovereign wealth funds.

On October 19th of last year Secretary Paulson hosted a meeting with the G-7 finance ministers and the heads of sovereign wealth funds from eight countries—China, Korea, Kuwait, Norway, Russia, Saudi Arabia, and Singapore, as well as the United Arab Emirates—to build support for this idea of best practices.

The next day, the IMFC, a ministerial-level advisory committee to the IMF, called on the IMF to begin a dialogue to identify best practices for sovereign wealth funds.

In November, in response to this statement, a first discussion on policy and operational issues relating to sovereign wealth funds took place among official-sector delegates at a roundtable that was hosted by the IMF, and a separate dialogue is well underway in the OECD on investment policy with regard to sovereign wealth funds.

At Treasury, we have also taken a number of steps internally and within the U.S. Government to enhance our understanding of sovereign wealth funds. Treasury has created a working group on sovereign wealth funds that draws on the expertise of both our International Affairs Division, where I work, and our Domestic Finance Division.

Treasury's new market room is ensuring vigilant ongoing monitoring of sovereign wealth fund trends as well as transactions.

Through the President's Working Group on Financial Markets, chaired by Secretary Paulson, we continue to discuss and review sovereign wealth funds on a regular basis.

We have also initiated outreach to ensure an ongoing and candid dialogue with countries that have sovereign wealth funds.

We are also coordinating actively with Congress, through staff briefings and committee hearings. As you may know, I testified before some of you on these issues, for the Senate Banking Committee, in November.

And in June and December of last year, we provided Congress with updates on our sovereign wealth fund-related work in an appendix to our Report on International Exchange Rate Policies, and we'll continue to provide those updates on a semiannual basis.

The Treasury Department will continue its work on sovereign wealth funds—analytically, bilaterally, and multilaterally—so the United States can shape an international response to ensure that these legitimate areas of concern are addressed, while also ensuring that the United States remains open to and welcoming of investment. Thank you.

[The prepared statement of David McCormick appears in the Submissions for the Record on page 32.]

Chairman Schumer. Thank you, Secretary McCormick, for your testimony. Now we'll go to questions. We'll try to limit them to 5 minutes each, to each of the witnesses.

First, mine is on CFIUS. As you know, we have a CFIUS process to review certain types of foreign investment transactions that might raise national security concerns.

And, as you also know, in the wake of the Dubai Ports deal, I was very much involved in helping Congress beef up the CFIUS review process.

CFIUS has the responsibility to review certain types of foreign investment deals that might raise national security concerns.

Now, we didn't know much about CFIUS before all of this, but today we don't know much more about it and the review process than we did 2 years ago.

The fact is that this is still a very opaque government panel chaired by Treasury. It doesn't have open deliberations or clear guidelines which deal with the views—which show us which deals it reviews and which deals it does not.

Obviously, sovereign wealth funds present different types of concerns than those raised by other types of foreign investment, par-

ticularly in regards to crossing the line between economic and non-economic motivations that I mentioned.

So, here are my questions: First, do you believe that CFIUS and its review process can or should be made more open to the public?

Second, do you believe that there is too much or too little political pressure based on which deals are or are not reviewed by CFIUS?

And, third, do you believe that CFIUS is adequately equipped to address the unique issues presented by sovereign wealth funds?

Under Secretary McCormick. Thank you, Senator. We, as you noted in your prepared remarks, are in the process of implementing the FINSA legislation through a new set of regulations that are already very consistent in our operation with the law.

We believe that that legislation was a great step forward in bringing improvements to our process that allows us to maintain the open investment posture, but also, first and foremost, to address national security issues that arise with any investment.

We think the process that's been established to date and required by the legislation in terms of the disclosure and the additional reporting after the fact on these cases to Congress is appropriate, and we think that the ongoing dialogue that we've had with Congress and many of your staffs on our implementation of CFIUS is also a very important step forward and a very important dialogue.

In terms of political pressure our view is that we are able to implement our decisions on CFIUS cases, as we have been mandated to do, with our focus exclusively on national security, and I believe that I can say to you today that I think we have operated in that spirit, both before and after the passage of the legislation.

We think that the legislation does allow us to appropriately deal with cases that involve sovereign wealth funds in the event that there is an issue of national security, and we also believe that the added rigor required by the statute in terms of the higher level of sign-off is appropriate, and we are executing as has been mandated by—

Chairman Schumer. How about on openness? I mean, we still—it's still an opaque process. Are your regulations going to require it to be more open, allow us to know more about which firms and which deals are reviewed, which are not, and why?

Under Secretary McCormick. Well, Senator, we have new reporting requirements, after the fact, to Congress, as you know.

I think it's a very sensitive issue to offer more transparency in the midst of a case, to explicitly get to the second question you raised, because I think the more that those deliberations are open, the more there's a risk of the potential decisions being politicized which, I know, is not the intent of the legislation and certainly not our intent within the Treasury Department.

We come at our implementation of the legislation and each specific case with a very clear sense of our mandate from you which is to start, first and foremost, with the issue of national security and make a determination of whether there is in fact a national security issue, and that is the way we've implemented it.

Chairman Schumer. Now, the other question with sovereign wealth funds of course is: Are decisions being made on an economic

basis or an non-economic basis—which you really didn't address that much in your testimony.

So, let me ask you this: Why should we be confident that these funds won't pursue other goals, now if not in the future, because they are owned by governments—and run by governments which are not solely economic entities, and they are not even primarily economic entities; isn't greater transparency exactly the sort of thing that could give both the Congress and the American people more confidence in the motivation of sovereign wealth funds?

Under Secretary McCormick. Yes, Senator, I think your point is a very fair one. So, I think our starting point in all of this is that we do have a history of sovereign wealth fund investment, and that sovereign wealth fund investment has been long-term, stable, and commercially driven up to this point.

But I don't think we should just accept with blind faith that the investment would be that way in the future, and that's why there is a legitimate policy issue here.

We think that a set of best practices that includes greater transparency on the things you mentioned, on objectives of the fund, how decisions are made ultimately, how risk is managed, how we ensure a degree of separation between the government and the investment committees of these funds is critical.

We think the IMF, through a multilateral effort, is the best way to achieve that and also to achieve the buy-in of the sovereign wealth funds who would actually implement these best practices.

Chairman Schumer. You think legislation might be necessary, if the IMF process doesn't work?

Under Secretary McCormick. Well, Senator, I'm hopeful that the process we're undertaking will work.

Chairman Schumer. But if it doesn't?

Under Secretary McCormick. Well, I hope that's not the case, Senator. The reason I say that is I think we have an alignment of interests here between the sovereign wealth funds, between the countries that are the recipients of that investment, and that alignment is to keep our markets open because that's in their interest as well as ours, and to give confidence to investment recipients that those investments truly are commercially driven.

Chairman Schumer. Thank you.

Vice Chair Maloney.

Vice Chair Maloney. Thank you. I would like to ask you about the legislation that gave the Treasury Department the power to define "foreign control," and how are you planning to define "control" in the new regulations for implementation?

Under Secretary McCormick. Congresswoman, we have defined "control" as the power to determine important matters affecting the U.S. company in which the foreign company is invested.

That definition is a functional one rather than a bright line. And by that, I mean that we look at a number of factors in terms of determining whether control does, in fact, exist.

The current regulations assume a presumption that a share-holding of 10 percent or less—or of less than 10 percent—is not control.

But we actually look at a whole series of factors and, in a number of cases, have determined that control does, in fact, exist with investment lower than 10 percent.

Those other factors include: Board participation; they include committees; they include minority rights, so we look at that whole set of factors in determining whether the investment is indeed passive or whether control exists.

We have not published the new regulations, as you mentioned. They will come out later this spring. I would expect that our general approach to control would remain very consistent with that.

Vice Chair Maloney. And when will you publish them?

Under Secretary McCormick. Ma'am, they're due later this spring.

Vice Chair Maloney. Later this spring. Now, the Administration has come out and said that they support voluntary guidelines and a voluntary code of conduct. How soon will such guidelines be available, and even assuming that they're successful negotiations of these guidelines, how in the world are we going to enforce them? Your comments on that, and why should we put our faith in an as-yet-to-be-written voluntary code of conduct that has no enforcement?

Under Secretary McCormick. Well, I think, Congresswoman, it starts with the premise that I made earlier which is we believe it's in the best interests of the investors and the investment recipients to create more clarity around best investment practices and transparency around the process.

We think getting the sovereign wealth funds to be active participants in that is a very important part of striking the right balance in this whole thing.

Vice Chair Maloney. But the news reports that I've been reading there they're pushing back; they think they're unnecessary; they're saying they're not going to adhere to them, and they're just brushing them off.

But I'd like to ask you about a comment from former Secretary Larry Summers. He's suggested that one way to avoid these sovereign wealth funds from exerting control or influencing management would be to have them invest through an intermediary. Do you think that's workable? What's your comment on that idea?

Under Secretary McCormick. Well, I think, as Larry Summers has spoken out about this a number of times and, as I understand his remarks, is supportive of the voluntary best practices idea, whether the funds invest through an intermediary or whether they invest directly, the investments could be passive or have control.

So, through the CFIUS implementation we can look through the structure of the investment to ensure that if control is in place that we do an active national security review to ensure that no national security interests are at stake.

Vice Chair Maloney. Do you think it's possible to prohibit sovereign wealth funds from participating in or influencing management decisions once they own a stake in a company? And do you think you should continue with the 10-percent passive ownership? Are you going to put that into regulation? Or how do you stand on that?

But many people are concerned. My constituents raise—once they are stakeholders and they have a voice at the table, they can influence management; they can influence direction.

Under Secretary McCormick. Congresswoman, the definition, again, that we use is the ability to determine key decisions around the direction of the company. The 10-percent rule, as you referred to it, is a general guideline, and if there are other factors that give the acquiring company or the investing company greater ability to determine decisions, then that may in fact constitute control, and we've acted in that way in previous cases.

Vice Chair Maloney. Are you concerned that these emerging sovereign wealth funds could deliberately or inadvertently cause market disruptions?

Under Secretary McCormick. Congresswoman, as I said in my prepared remarks, I think that's a legitimate issue for us to ask. I think that conversation and many of the points you raise need to begin with the fact that we've looked at this very carefully and that has not been the case up until this point.

And so our challenge as policymakers is to ensure that we guard against that possibility in the future, but understanding that we do not have evidence that sovereign wealth funds have invested for anything other than commercial purposes.

Chairman Schumer. Thank you, Vice Chair Maloney.

Senator Klobuchar.

Senator Klobuchar. Thank you. Mr. McCormick, earlier you talked about national security as a guide. Ambassador Eizenstat, who is here with us, has stated that our definition of national security as far as it is used when discussing the impact of sovereign wealth funds remains largely undefined.

To what extent could we develop a more clear definition of what investments impact national security so that we wouldn't have murky transactions like the one in 2006 when Dubai was looking at the U.S. port investments?

Under Secretary McCormick. Senator, we think that the definition we use in the CFIUS process is the appropriate starting point for how we think about a particular transaction.

And I think there is a case to be made that we need to take care not to broaden that definition to the point where we expand it and ultimately risk sending a message that we're not open to investment.

Right now, the definition we have is questioning whether indeed the transaction can jeopardize national security.

It's not specific in terms of the types of sectors or the types of categories because the CFIUS Committee needs to have the liberty to look at each transaction on a case-by-case basis and ask themselves the fundamental question on whether in fact national security is at risk.

As I mentioned in my remarks, sovereign wealth funds do raise issues that go outside that definition of national security in terms of non-commercial investment behavior which we need to guard against, but in our view, CFIUS is not the best way to do that.

Senator Klobuchar. It just seems to me—as we have seen such a change in our national security and the kinds of threats to our national security, do you think that CFIUS has changed with the times?

Under Secretary McCormick. Congresswoman, given a lot of interest and input from Congress and a lot of good work that I

think has happened over the last couple of years, I do think CFIUS has evolved dramatically, and I think that if you talk about national security or national interest in the broader sense of the words I think we need to take care not to forget that, ultimately, remaining open to investment and ensuring that investment comes into the United States is a critical component of our national prosperity.

Senator Klobuchar. And I think it can do very good things, but my concern is—I was just thinking of our recent stimulus package where, you know, we pumped \$150 billion into the economy in order to ward off a recession and sovereign wealth funds now account for almost \$3 trillion of investment in the United States and we're looking at that number growing to, I think it's \$10 to \$15 trillion in the next 5 years.

Abu Dhabi's fund alone is almost five times the size of our recent stimulus package. Do you think that there is ever a point at which we would not only oversee and investigate these investments, but we would also look at capping the overall amount of sovereign wealth funds in our economy?

Under Secretary McCormick. Congresswoman, I start with, I think, a recognition as I know you do that the global economy has changed dramatically and that a continued flow of investment from country to country is an important driver of our economic prosperity. That capital that comes from sovereign wealth funds within the overall scheme of the global economy—as I said, there's \$190 trillion of financial assets—is still a relatively small mark, and even if the projections that we see, which one might question, because they are very significant growth rates over the next 4 or 5 years, even if those are true, sovereign wealth funds would still be a very small percentage of financial assets.

Now, those assets will flow to places that are open and attractive for investment, so one of the challenges is that we have those sovereign wealth funds invested in the United States and have some of the issues I have raised as concerns.

Another issue is that they don't invest in the United States, and we don't have a climate that continues to attract investment from that asset class as well as lots of others. So that's the balancing act that we collectively need to strike.

Senator Klobuchar. Well, you know, we have some sovereign wealth funds that have been around forever—Kuwait, Norway—and they have decades of investment experience. But then you have all these startup funds. I think there's one in Saudi Arabia and also a startup of a fund with at least \$6 billion in assets.

As these funds gain popularity as a higher-risk investment vehicle, do you think there should be anything done to oversee the startup of these new funds?

Under Secretary McCormick. Well, you've touched on what I think is one of the real challenges. There are some 40 sovereign wealth funds, and you have some that have been around for 30 years, are very sophisticated in terms of their investment practices, very sophisticated in terms of how they think about the market, a long track record of commercial investment, and then you have some that are brand new with enormous chunks of money.

And so as we collectively think about how we address that, what we're really trying to do is move some of those new funds up the continuum in terms of how they think about best practices, and help solidify and clarify some of the best practices that are already existing in some of the more mature funds, also impose new best practices where there's just things that aren't where they need to be.

So, you've hit on something that's very clear which is that we need to help some of those new funds in terms of how they think about their investment practices.

Senator Klobuchar. Thank you.

Chairman Schumer. Senator Webb.

Senator Webb. Thank you, Mr. Chairman.

Mr. McCormick, I assume you would agree with the notion that irrespective of the size of the investment, investment from different countries with different political systems potentially make us more vulnerable as a nation?

Under Secretary McCormick. Senator, I think the answer to that would be yes, and even to be more precise, some of the connections between the investor and the government in some of those countries raise legitimate questions.

Senator Webb. With respect to governments, for instance, you mentioned in your testimony Kiribati and Kuwait. I've been to Kiribati and I've been to Kuwait, and it's not exactly China in terms of the vulnerability of this country to the strong investment patterns of their governments.

That would seem to me to be inarguable.

Under Secretary McCormick. I think different countries do raise different investment questions.

Senator Webb. Right. And so one of the concerns that I and a number of other people have, which Senator Bayh, I think, addressed very well in a piece recently in the Wall Street Journal, is that this isn't simply a snapshot process in the way that we are dealing with one investment or another, but it is potentially a cumulative process that could affect the freedom of the U.S. Government to act in certain situations down the road. Wouldn't you agree that that's a potential danger here?

Under Secretary McCormick. Our CFIUS mandate is to look at each case in a very clear way and ask the question, as you just zeroed in on, on whether there is indeed a national security issue associated with that transaction.

But I do think it's a legitimate question or need to periodically step back and look at the broader investment patterns which we do on a periodic report to Congress that addresses some of the more fundamental questions of how all this fits together.

Senator Webb. Particularly with respect to countries that may have different viewpoints on issues that relate to the national strategy of the United States.

Could you describe the conditions under which the U.S. Government directly invests in American corporations?

Under Secretary McCormick. Senator, to my knowledge the Federal Government, with, I think, some rare exceptions in history, does not typically—

Senator Webb. Because it would be a conflict of interest, it would be assumed to be a conflict of interest. How about the U.S. Government directly investing in foreign corporations?

Under Secretary McCormick. Not typically the case.

Senator Webb. So you would agree, I would think, that this is something of an anomaly when we're inviting foreign governments to do something that our Government itself does not do?

Under Secretary McCormick. Senator, I think we went back and forth in the last hearing, and I did call out that there are some exceptions at the State level.

Senator Webb. But that's not what we're talking about here.

Under Secretary McCormick. The Alaska Permanent Fund, for example, is characterized by most analysts as a sovereign wealth fund, but as a general rule of thumb, I think your assessment is correct.

Senator Webb. OK, thank you, Mr. Chairman.

Chairman Schumer. OK, thank you, Mr. McCormick, for your testimony. We're going to continue to pursue this issue.

Vice Chair Maloney. May I ask him about one thing?

Chairman Schumer. Please go ahead, Ms. Vice Chair.

Vice Chair Maloney. May I ask just one question about a company? There's been several press reports on the Hu-Wai Technologies buying 3M Corp, 3C Corp, and I know that it was under CFIUS review.

Has that been completed, or is it still under CFIUS review?

Under Secretary McCormick. Congresswoman, if you'll forgive me, I really am not able to comment on a specific case.

Vice Chair Maloney. But is it still under review? That's my question?

Under Secretary McCormick. What I can confirm there is that both parties have acknowledged publicly that the case is in review.

Vice Chair Maloney. OK, thank you.

Under Secretary McCormick. Thank you.

Chairman Schumer. Thank you, Mr. McCormick.

Now let's call our next two witnesses, Stuart Eizenstat, as well as Douglas Rediker.

Chairman Schumer. Our first witness is Stuart Eizenstat. He is a partner at the law firm of Covington & Burling. He has had a lengthy and distinguished career in public service as Deputy Secretary of the Treasury under the Clinton administration; Ambassador to the European Union; Under Secretary of Commerce for International Trade; and as Chief White House Domestic Policy Advisor to Jimmy Carter. In his role as Special Representative of the President and Secretary of State on Holocaust-Era Issues he successfully negotiated major agreements with many of the European countries covering restitution payments.

He regularly writes on issues regarding international trade and international law and economics, and is a graduate of the University of North Carolina and Harvard Law School.

Douglas Rediker is currently co-director at the Global Strategic Finance Initiative at the New America Foundation, an initiative that addresses the fast-changing relationship between global capital flows, financial markets, foreign policy, and national security.

Before joining the foundation, Mr. Rediker spent over 16 years in Europe where he served as senior investment banker and private equity investor for some of the world's leading financial institutions including Salomon Brothers, Merrill Lynch, and Lehman Brothers.

More recently he was a London-based partner in a private equity firm where he was jointly responsible for establishing and managing the group's European operations. In addition, he has served on the board of directors of several companies, and written regularly on issues regarding international trade and economics.

We are going to ask each of you to limit your statements to 5 minutes because we have a vote coming up at 4:30—I believe it is at 3:30—and then we will ask questions. So Ambassador Eizenstat, your entire statement will be included in the record.

STATEMENT OF AMBASSADOR STUART EIZENSTAT, PARTNER, COVINGTON & BURLING; FORMER DEPUTY SECRETARY OF THE TREASURY, AND AMBASSADOR TO THE EUROPEAN UNION, WASHINGTON, DC

Ambassador Eizenstat. Thank you, Mr. Chairman, and colleagues for holding this important hearing.

Permit me to say at the outset that the challenges provided by the some \$3 trillion in sovereign wealth funds from China and Russia to the Gulf States and Saudi Arabia are as much a reflection of our own economic problems as they are about sovereign wealth funds themselves.

Their remarkable growth and their decision to invest more broadly in a portfolio beyond the investments by their central banks and treasury bills is a reflection of our own growing dependence on expensive foreign oil and our massive Current Account deficit.

All of us need to be spending as much time and energy, if not more, on dealing with these structural economic problems as on the consequences of the problem. In effect, we should look at sovereign wealth funds as recycling the U.S. petro dollars and our appetite for products from China and emerging markets.

I am a strong believer in the importance of the free flow of capital around the world and the value of foreign direct investment in creating jobs and adding to creativity and innovation in our economy.

For sure there is a difference between private foreign investment and that of sovereign wealth funds and their close cousins State-owned enterprises. But even there the distinction is not always as clear as it may seem.

For example, many European companies have some government ownership through Golden Shares, and many European governments now are trying to create so-called national champions to better compete in the global marketplace.

We need to be careful that in dealing with sovereign wealth funds we don't deter the free flow of international capital. I believe that sovereign wealth funds do bolster the U.S. economy and that on balance they are a significant net plus for our economy.

If we take the "welcome" sign off, they will invest their growing wealth elsewhere in the world. At the same time, there are legiti-

mate concerns that need to be addressed heavily revolving around the need for transparency and good governance.

This in my opinion does not mean that they must divulge all their holdings and investments, but rather that they need to be transparent in their governance, their relationship to their governments, their processes, their goals, and determining whether they obtain subsidized government financing on individual deals which would create an unfair advantage over U.S. or other private foreign corporations who have to rely on private credit markets for competing for the same acquisitions.

We have a legitimate interest in assuring that sovereign wealth funds have a purely commercial, not political or national security, interest in their investments in our country.

Beyond transparency and good governance, there are certainly a limited number of matters in which national security is implicated by sovereign wealth funds or State-owned enterprise acquisitions. But in a globalized world economy in which we no longer have a monopoly on hardly any product, it is important that national security not be defined so broadly that it is used as a pretext to deter foreign investment.

Mr. Chairman and Members of the Committee, I would urge Congress at this point not to legislate or to pressure regulators to heavily impose regulations on sovereign wealth funds. The reason is that Congress has reasonably and recently provided the executive branch with the means to deal with genuine national security threats from sovereign wealth funds or state-owned enterprises in the form of last year's bipartisan Foreign Investment and National Security Act, FINSA, which Chairman Schumer was clearly a leader in developing.

We should give the CFIUS process under this new legislation time to work through these sovereign wealth investments before we come to any further conclusions.

Moreover, it is critically important that Congress not take unilateral action. It is vital that we try to develop multilateral principles.

For example, Europe has similar concerns as we do with sovereign wealth funds and State-owned enterprises. As just one example is Russia's Gazprom expressing interest in acquiring energy assets in the UK and elsewhere in Europe, eliciting a strong response from government leaders and from EU officials.

The Bush administration has wisely agreed to a multilateral approach. The IMF, as we've said, is directly working now with major sovereign wealth funds on developing a set of Best Practices which they hope to have completed by April.

The OECD is doing the same with host countries and their report will be ready at roughly the same time. In addition, the Government Accounting Office is examining sovereign wealth funds and, as we've noted, Treasury will have its regulations out in the spring on the new FINSA law.

We should let these activities play out, and in particular see how sovereign wealth funds react to the IMF effort to develop a set of principles focused on transparency before we consider anything beyond voluntary principles.

In short, as I've stated in more detail in my testimony, I firmly believe we can both protect our national security and remain open

to the vast majority of sovereign wealth funds investments in the United States, most of which do not implicate national security.

One example: The purchase, for example, by Dubai of Barney's hardly touches on national security. For sure there are going to be some highlight cases which do, but by and large most of these investments really do not touch national security interests, and we have to be very careful that we distinguish those that do not from those that might.

[The prepared statement of Mr. Eizenstat appears in the Submissions for the Record on page 36.]

Chairman Schumer. Thank you, Ambassador.

Mr. Rediker.

STATEMENT OF DOUGLAS REDIKER, CO-DIRECTOR, GLOBAL STRATEGIC FINANCIAL INITIATIVE, THE NEW AMERICA FOUNDATION, WASHINGTON, D.C.

Mr. Rediker. Thank you, Mr. Chairman, Madam Vice Chair, and Members of this Committee for the honor of addressing you.

I am particularly pleased to be invited to speak before you because I was born and raised in New York City which I believe puts me in very good company here today.

Chairman Schumer. What high school did you go to, Mr. Rediker?

Mr. Rediker. Fieldston.

Chairman Schumer. Fieldston? Hmm, very nice.

Mr. Rediker. Thank you.

[Laughter.]

Mr. Rediker. As a general matter, I believe that both U.S. and global economies are strengthened by the free flow of investment capital and increased liquidity that open markets provide.

As significant providers of capital to these markets, sovereign wealth funds have thus far been a positive influence in U.S. and global markets.

Recently, significant capital injections by sovereign wealth funds in several major financial institutions have been a stabilizing force at a time of market uncertainty and volatility.

Capital flows from sovereign wealth funds benefit U.S. investors, companies, and workers not only in the financial services sector but more broadly, as increased liquidity results in higher stock and asset prices and lower risk premiums.

It is indisputable that funds from foreign governments, whether in the form of central bank reserves or through sovereign wealth funds, have contributed to more benign financing conditions in this country than would have otherwise been the case.

While I believe that continued investment by sovereign wealth funds is positive and should be encouraged, I also believe that the nature and scale of these investment funds warrants continued vigilance and oversight by Congress.

Especially when compared with other industrialized nations, I believe that this country's national interests are relatively well protected and well regulated.

National security and market integrity are already protected, not only by CFIUS and FINSA legislation, but also through existing laws which prohibit, restrict, or require disclosure from foreign in-

vestors in areas as diverse as securities trading, export controls, ownership of media and communications assets, and the broad protections afforded by our antitrust laws.

There are of course some areas that warrant particular attention. I believe the U.S. Government should continue to support calls for increased sovereign wealth fund disclosure. Transparency would benefit the markets by calming suspicions aroused by lack of information and would increase the likelihood that markets would be alert to concentration issues and potential contagion risks.

Transparency should be part of a broader code of Best Practices adopted in a collaborative effort by sovereign wealth funds. I do not support calls to impose mandatory disclosure obligations as a prerequisite for investing in U.S. markets as I believe these would be ineffective and potentially counterproductive.

These funds should recognize the benefits of smooth, functioning markets and financial stability and may also embrace the opportunity to judge their own returns against relevant indices, and even their peer group, as well as to demonstrate that they are investing in a manner consistent with the best interests of the people of the countries that they govern.

Within the United States, I believe that the investment environment for sovereign wealth funds should be as clear and predictable as possible. In particular I suggest that specific guidance be provided regarding the interpretation of control which would require a formal CFIUS review.

One of the most compelling lessons I learned during my career in finance was that investors abhor uncertainty which discourages investment by injecting unquantifiable risk into an investment decision.

If a sovereign wealth fund complies with all relevant laws and regulations and is later subject to unforeseen scrutiny and delay, it is likely that that investment decision will be negatively impacted.

Over the past decade, international capital markets have transitioned away from U.S. domination to being truly global in scope and leadership. Sovereign wealth funds are but one manifestation of the past decade's shift towards a truly multi-polar global financial marketplace, a marketplace where the sources, intermediation, and destinations of capital outside of the United States have grown at a tremendous pace.

Those who seek alternatives to invest in and trade through U.S. financial markets now have multiple options to choose from.

When addressing sovereign wealth funds it is imperative that this Committee take into account the crucial issues of this country's national and economic security, financial market integrity, and the continued competitiveness of our capital markets.

As part of that effort, I believe that professionally managed sovereign wealth funds with some \$3 trillion of capital to invest, who agree to abide by the rules that we set for investing in this country, should be encouraged to do so.

Thank you.

[The prepared statement of Mr. Rediker appears in the Submissions for the Record on page 40.]

Chairman Schumer. Well, thank you both for your excellent testimony.

I guess my first question is to both of you. You heard my opening remarks where I stressed both the benefit that these investments have in the United States, particularly given our economic situation where we don't have a wealth of capital and we have a need for it, but also the call for transparency in a variety of ways.

The reason for transparency is just to make sure we are not crossing the economic line and getting into political involvement, which a government-owned fund might naturally have the inclination to do.

First, I laid out a number of things that were measures of transparency. Do you generally agree with those? Disagree? Tell me what you think.

And do you think the funds now are transparent enough is, I guess the second question I would ask in relation to that: Ambassador?

Ambassador Eizenstat. I generally agree. I think transparency is absolutely crucial because transparency also gets to the issue of governance. We want to know the relationship that these funds have to their governments, to ministries. We want to know whether the boards of directors and the management of sovereign wealth funds are in fact as they are; for example, with Gazprom, which is really a State-owned enterprise, are really government ministers or are they private individuals? All the issues of governance can get—we can get to through the issue of transparency.

I really hope that sovereign wealth funds understand that transparency is also in their interest as well. That is because it will cool tempers here. It will increase their own levels of governance. And this is also important.

Now one other thing on transparency, Mr. Chairman. When you come to an individual transaction the question is—and transparency is a way to find it out—is the government subsidizing the particular acquisition in question?

Is it providing below-market financing? Which if it does is unfair competition with private foreign corporations or with U.S. companies trying to acquire the same asset. That is a very important issue.

Now in terms of models, Temasek is a sovereign wealth fund that publishes annual reports. They have since 2004. And you know, they have a good track record. Others do not. So I think that this exercise with the IMF is terribly important, and it should be as much in their interest as it is in ours.

Chairman Schumer. Mr. Rediker.

Mr. Rediker. Thank you, Mr. Chairman.

First of all in terms of the question: Are they transparent enough now? Well, obviously many are not. In the case of the Norway they are. Temasek does a very good job. But I think that if there is a malicious motivation on the part of a sovereign wealth fund or State-owned enterprise, there is no level of transparency either we on a bilateral basis or the IMF could impose on them that would actually cause them to disclose something that they were not willing to disclose if they really have a motivation to hide it.

So even a fund like that of Norway, which does an excellent job, almost too much information, does not disclose its derivative positions. If a country, like Russia for example, that we did not believe was looking out for our best interests wanted to comply with a code of best practices, but still wanted to hide something, they could do it.

So I think we should not get—I certainly agree that we should be pushing them for increased transparency and disclosure, but let's not make believe that that is going to solve all of our ills.

Chairman Schumer. It would certainly be a lot better to have it than not.

Mr. Rediker. One hundred percent. And I would encourage it.

Chairman Schumer. I could understand if there were a nefarious purpose, but if there's a nefarious purpose I suppose the foreign government could disguise its investment with an individual and not do it through a sovereign wealth fund.

Mr. Rediker. Absolutely. But I encourage increased disclosure and transparency. But I would echo my colleague's comment here which is that it is far more effective if they believe it is in their interests as well. And I think that that is entirely consistent with the undertakings of the IMF—

Chairman Schumer. I think you may find that I generally believe most of the countries have purely economic purposes. You take a small gulf oil state which has tons of money and no place to invest it on its own, obviously they want to have a good rate of return.

There are other countries—I mean Russia would be the most obvious—where the government relishes using economic threat and has. China is a little further over. And you know, you get—I can have the luxury, which say Mr. McCormick does not, of sort of speculating about these countries, but obviously it goes into the decision.

My final question to each of you is:

Since the IMF guidelines will be voluntary, what do we do if there are nations that do not wish to abide by them? I think most will, because as I agree with both of you it is in their interests, particularly if their motivations are good, but what do you do if a country says no?

Ambassador?

Ambassador Eizenstat. This is a very difficult question. First, I hope that most will. But if hypothetically some do not, it seems to me then you get into two types of investments.

One is that I would be less concerned even for a sovereign wealth fund that does not abide by voluntary guidelines if they are investing in real estate, and a hotel, and a retailer, where there is really no national security interests.

However, if they decide to invest in anything that implicates the CFIUS process, then CFIUS could have a presumption against acceptance and make it clear, because I think as Mr. Rediker said, and Dave McCormick, certainty is very important. They should have the knowledge that if they do not abide by these rules, if they are not good international citizens—and we talk about a globalized economy. A globalized economy also means accountability and re-

sponsibility by emerging markets and developing markets to play by international rules. That is what WTO rules are all about.

So I think that in those circumstances they should know that there is at least a presumption when they're in the CFIUS process and touch on national security interests that would be a presumption against such investments.

Mr. Rediker. I would certainly agree with everything that Ambassador Eizenstat said. I would point out, though, that in general if an investor sovereign wealth fund is investing solely in a passive capacity, then it does not trip into many of these whether it's CFIUS or the other disclosure or approval processes.

ADIA, for example, out of Abu Dhabi has been a model investor for many decades and has not been the most forthcoming in the area of transparency, but has not raised its investment in any area that has caused us any national security or market concerns.

So I think that the existing process, as Ambassador Eizenstat said, should take into account whether they are being forthcoming, and whether they are being transparent if it falls into a CFIUS review process, but otherwise I think the market has functioned reasonably well in nonvoting passive stakes and we should not be terribly concerned about it.

Ambassador Eizenstat. Let's remember, if I may say, Mr. Chairman, there really are two things that trigger CFIUS, and I was involved on the government side and sometimes now on the private side. There are two things.

One is the issue of control which, as David McCormick said, is not mechanical. There is a presumption on 10 percent, but the real issue is you could have 1 percent and if you control the board, if you control management, if you have a say-so over the budget, if you have say-so over acquisitions or divestments, then you move from passive to control. So control is one.

And then the national security link is the second. If you don't touch either of those, which is the case in most of these investments, then the issue of opaqueness becomes less of a problem.

It would be desirable, but I would not say it should create a necessary presumption against the investment.

Chairman Schumer. Thank you both for what you're proposing. Aside from the national security, which is separate and apart, there is sort of a scale of push and pull between control and transparency, or "influence" is a better way to put it, based on what the Ambassador said, influence and transparency.

The more influence you have, the more transparency you need; the less, the less. It is interesting.

Vice Chair Maloney.

Vice Chair Maloney. Thank you, Mr. Chairman.

The CFIUS process is voluntary, as you know, and its main thrust—as you both said—is national security, homeland security. But Ambassador Eizenstat, you raised another issue that is incredibly important. And that is, competitiveness, market and financial security for our own firms to be able to compete against government-subsidized entities.

I know since I've read many CFIUS cases it is very hard to determine what percentage is influenced by a government. Oftentimes they incorporate in different countries, all over the place.

One right on top of the other. And you really have to have a subpoena to figure out who really owns it.

But even in the cases where foreign governments were buying stakes in our own American firms, I was wondering were American investors given the same opportunity to buy in at the same terms? I never saw that discussed in detail.

But I think that something that you raised is: If a foreign government is subsidizing a shell company to compete and buy properties that are not related to national security, they have a tremendous advantage that can undercut the competitiveness of American businesses. And my question is:

Aside from the national security—CFIUS is taking care of that—this competitive advantage that they have, and what kind of safeguards should we put there? I believe this is a separate question from CFIUS which is primarily national security and security concerns.

But buying Barney's for example, that is obviously not a national security concern, but if the government is subsidizing it then an American cannot in any way compete in buying it. What protections do you think we should have for American commerce just in the competitive atmosphere of government subsidy, government-sponsored enterprises buying up real estate and companies in America? Or stakes, important stakes, passive stakes in companies in America?

Ambassador Eizenstat. This is a very difficult and appropriate question. Again, within the CFIUS domain, CFIUS can and does have a great capacity to bore into the governance of companies, to look at shell companies and so forth.

Vice Chair Maloney. I am very aware of that. I have followed that, and they can get to the shell companies. But those that are not part of national security, that is the concern in my question.

Ambassador Eizenstat. I understand, and it is an appropriate question. I think that there really is not a vehicle for dealing with that other than perhaps putting some oversight or public pressure when such a transaction occurs.

To the extent that there is competition between a State-owned enterprise that is subsidizing that transaction, or a European national champion that is making that acquisition on a private company, then the private company would probably have to go to the Congress and urge that Congress look at that and insist on some kind of a level playing field.

But there is currently no structure to deal with that. In terms of whether legislation should be necessary, I would prefer to see if there are not some other ways to deal with that. But it certainly is a very vital question and one that we should look at more closely.

Vice Chair Maloney. But it is not something that a business person or company can go to Congress with, because it usually happens very quickly. You pick up the paper and find out that a foreign entity, a sovereign entity has bought a major company or a major stake, and it is not clear whether Americans were given an opportunity to compete for it, and certainly they cannot compete if it is government subsidized.

Ambassador Eizenstat. But there the market is taking care of it in a sense if—and again hypothetically let's say Barney's—decides that they do not want to auction themselves and get a better price, and turn down a foreign acquirer, even one that is subsidized, that is their market decision.

If they were wise, perhaps, and again I am using this only hypothetically, they would say, well, let's see what better deal I can get in the market from another company. And then you would have a more transparent process.

So if a company is willing to sell itself even to a foreign entity that is subsidized, that is its decision and the marketplace will basically bear that out that no national security implications. They might be wise again to have a more transparent process where they give other bidders the opportunity, but I would be prepared by and large to let the market take care of that.

Vice Chair Maloney. But obviously American companies cannot compete if it is government-sponsored and government-subsidized.

Mr. Rediker, would you like to respond?

Mr. Rediker. Yes, please, Madam Vice Chair. I think I am not sure I understand the concept of "subsidy" here. Because my focus on this general issue would be when we have a Barney's transaction, for example, a competing bidder from the United States would likely look to its bankers and to the capital markets to provide leverage in the credit markets to enhance its return on its equity.

The real issue here is that sovereign wealth funds with several trillions of dollars under management do not need to access those credit markets. So I am not sure that it is the subsidy that would be my concern; rather, it would be the fact that sovereign wealth funds have a lot of liquid capital to invest in equity right now without regard to the market turmoil which would affect those in the private sector that are usually more subject to the volatility of those capital markets to finance the returns on those investments.

Vice Chair Maloney. Well, I think that you have raised an important point, Ambassador Eizenstat, and I do not think that there is anything out there to really level the playing field for American firms.

I note that under the CFIUS process, which only kicks in when it is a national security concern, they can spend a year looking at the shell company and finally figure out that the shell company is owned by the government and then turn it down.

You do not have anything like that in the regular commerce that is not part of national security. So what do you think we should do about it, if anything? If you leave it to market forces, then our businesses that are not subsidized would just be beaten out of the market.

Ambassador Eizenstat. Well, I mean at this point, with the exception of very few cases, I have not really heard of U.S. companies who are complaining that they are being beaten by these kinds of subsidies, outside of a CFIUS context.

If it became more of an issue, it is something Congress could look at, but I think at this point I am prepared to let the market take care of itself and let the company to be acquired make the decision about whether it is getting a better deal.

Also, there are many other factors beyond the question of sovereign wealth funds. For example, a U.S. company may wish to be acquired by another U.S. company in terms of technology, management teams, expertise. Most of these sovereign wealth funds are not in a position to be able to control any kind of a sophisticated U.S. company, at least without being passive investors and allowing U.S. management to participate.

So I think the market by and large will sort that out.

Vice Chair Maloney. Well, my time has expired.

Chairman Schumer. Well, I want to thank both witnesses. This hearing has explored the issue, I think, in a careful and thoughtful way. We have a ways to go, obviously. This is a new area. There are dangers, but there are dangers to doing nothing; there are also dangers to doing too much, as you both pointed out; and we are going to have to thread that needle. And so far I think we are off to a pretty good start.

So I thank both of you, as well as Secretary McCormick and my colleague, Congresswoman Maloney, as well as Senators Webb and Klobuchar. The hearing is adjourned.

[Whereupon, at 3:28 p.m., Wednesday, February 13, 2008, the hearing was adjourned.]

Submissions for the Record



JOINT ECONOMIC COMMITTEE
SENATOR CHARLES E. SCHUMER
CHAIRMAN



PREPARED STATEMENT OF SENATOR CHARLES E. SCHUMER, CHAIRMAN

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 private 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 noneconomic 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*.



JOINT ECONOMIC COMMITTEE
 SENATOR CHARLES E. SCHUMER, CHAIRMAN
 REPRESENTATIVE CAROLYN B. MALONEY, VICE CHAIR



PREPARED STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY, VICE CHAIR

Good afternoon. I would like to thank Chairman Schumer for holding this hearing to examine the benefits and risks of sovereign wealth funds investing in the United States. I want to welcome our witnesses and thank them for testifying here today.

The term sovereign wealth fund has only recently entered our lexicon, but these government-controlled investment vehicles have been around and operating without incident for decades. At the moment, these funds are providing much needed capital to U.S. banks trying to regain their footing in the wake of the mortgage crisis. However, the growing market clout of these funds and the steep rise of their investments in the United States require that they receive greater scrutiny by Congress.

Bush Administration policies have fostered a large amount of federal borrowing from overseas, a greater reliance on foreign oil and a weak dollar—all of which have created an environment that is ripe for sovereign wealth funds with extraordinary oil profits or excess foreign exchange reserves to gobble up American assets at bargain prices.

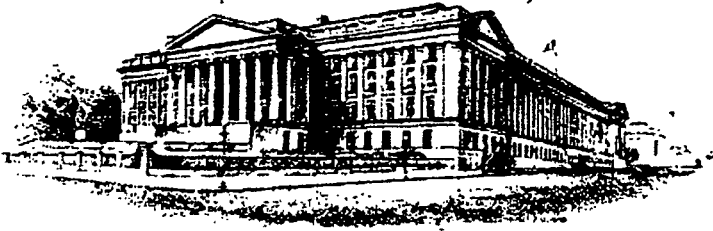
Governments can have very different motivations than financial investors, so we would be remiss not to carefully examine the potential risks from these state-owned investment funds. Reform of the Committee on Foreign Investment in the United States (CFIUS) was triggered by the revelation that the committee gave the green light to a deal that sold operation of major U.S. ports to a company owned by the government of Dubai without any senior level review.

With proper implementation by the Administration, the new reforms will strengthen the system by which foreign investment in businesses in the United States is vetted for security concerns, and provide certainty and predictability to the CFIUS process in order to expand economic activity, create jobs, and encourage safe foreign direct investment. I will continue to maintain a watchful eye over the ongoing implementation process, but I am confident that the Treasury Department intends to follow the law as I wrote it, and have received assurances that the department is already adhering to the new reforms.

I welcome the Administration's efforts to work through the International Monetary Fund to create an international code of conduct that would include greater disclosure of sovereign wealth fund activities and governance. An important lesson of this summer's mortgage crisis is that when capital markets become too opaque and risk exposure is not well understood, the consequences can be devastating for institutions and individuals. Greater transparency of sovereign wealth funds would be a welcome development, but it may not be enough.

Our challenge is to balance the potential risks to our economic and national security interests with our desire to maintain an open investment environment.

Mr. Chairman, thank you for holding this hearing and I look forward to gaining some insights from our witnesses about the appropriate oversight of sovereign wealth funds.



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

PREPARED STATEMENT OF DAVID H. MCCORMICK, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Chairman Schumer, Vice-Chair Maloney, Ranking Member Saxton, Senator Brownback and Members of the Committee, good afternoon. I very much appreciate the opportunity to appear before you today to discuss sovereign wealth funds. This is a timely hearing on a very important topic. At Treasury, we have been increasingly focused on sovereign wealth funds for more than a year now. I am pleased to be able to share with the Committee some of our views.

HISTORY AND CONTEXT

First, some history: sovereign wealth funds are not new. The oldest of these funds date back to the 1950s in Kuwait and Kiribati. Over the next four decades, their numbers slowly grew. Three of the largest and most respected funds—the Abu Dhabi Investment Authority, Singapore’s Government Investment Corporation, and Norway’s Government Pension Fund-Global—were founded in 1976, 1981, and 1990, respectively. By the year 2000, there were about 20 sovereign wealth funds worldwide managing total assets of several hundred billion dollars.

Today, what is new is the rapid increase in both the number and size of sovereign wealth funds. Twenty new funds have been created since 2000, more than half of these since 2005, which brings the total number to nearly 40 funds that now manage total assets in a range of \$1.9–2.9 trillion. Private sector analysts have projected that sovereign wealth fund assets could grow to \$10–15 trillion by 2015. Two trends have contributed to this ongoing growth. The first is sustained high commodity prices. The second is the accumulation of official reserves and the transfers from official reserves to investment funds in non-commodity exporters. Within this group of countries, foreign exchange reserves are now sufficient by all standard metrics of reserve adequacy. For these non-commodity exporters, more flexible exchange rates are often necessary, and Treasury actively pushes for increased flexibility.¹

So what are sovereign wealth funds? At the Department of the Treasury, we have defined them as government investment vehicles funded by foreign exchange assets, which manage those assets separately from official reserves.² Sovereign wealth funds generally fall into two categories based on the source of the foreign exchange assets:

- Commodity funds are established through commodity exports, either owned or taxed by the government. They serve different purposes, including stabilization of fiscal revenues, intergenerational saving, and balance of payments sterilization. Given the recent extended sharp rise in commodity prices, many funds initially established for fiscal stabilization purposes have evolved into savings funds. In the case of commodity funds, foreign currency typically accrues to the government and does not increase the money supply and create unwanted inflationary pressure.

- Non-commodity funds are typically established through transfers of assets from official foreign exchange reserves. Large balance of payments surpluses have en-

¹ Russell Green and Tom Torgerson, “Are High Foreign Exchange Reserves in Emerging Markets a Blessing or a Burden?” Office of International Affairs Occasional Paper No. 6, U.S. Department of the Treasury, March 2007.

² U.S. Department of the Treasury, “Sovereign Wealth Funds,” Appendix 3 of the Semi-Annual Report to Congress on International Economic and Exchange Rate Policies, June 2007.

abled non-commodity exporting countries to transfer “excess” foreign exchange reserves to stand-alone funds. In the case of non-commodity funds, foreign exchange assets often derive from exchange rate intervention, which then increases a country’s money supply. Monetary authorities take additional steps to lower the money supply and stave off inflation by issuing new debt, but there may be a cost associated with this if the cost of the new debt is more than the returns that the government earns on its foreign exchange assets.

In contrast to traditional reserves, which are typically invested for liquidity and safety, sovereign wealth funds seek a higher rate of return and may be invested in a wider range of asset classes. Sovereign wealth fund managers have a higher risk tolerance than their counterparts managing official reserves. They emphasize expected returns over liquidity, and their investments can take the form of stakes in U.S. companies, as has been witnessed in recent months with increased regularity.

However, sovereign wealth fund assets are currently fairly concentrated. By some market estimates, a handful of funds account for the majority of total sovereign wealth fund assets. Roughly two-thirds of sovereign wealth fund assets are commodity fund assets (\$1.3–1.9 trillion), while the remaining one-third are non-commodity funds transferred from official reserves (\$0.6–1.0 trillion).

To get a better perspective of the relative importance of sovereign wealth funds, it is useful to consider how they measure up against private pools of global capital. Total sovereign wealth fund assets of \$1.9–2.9 trillion may be small relative to a \$190 trillion stock of global financial assets, or the roughly \$62 trillion managed by private institutional investors. But sovereign wealth fund assets are currently larger than the total assets under management by either hedge funds or private equity funds and are set to grow at a much faster pace.

In sum, sovereign wealth funds represent a large and rapidly growing stock of government-controlled assets, invested more aggressively than traditional reserves. Attention to sovereign wealth funds is inevitable given that their rise clearly has implications for the international financial system. Sovereign wealth funds bring benefits to the system but also raise potential concerns.

BENEFITS

A useful starting point when discussing the benefits of sovereign wealth funds is to stress that the United States remains committed to open investment. On May 10, 2007, President Bush publicly reaffirmed, in his Statement on Open Economies, the U.S. commitment to advancing open economies at home and abroad, including through open investment and trade. Lower trade and investment barriers benefit not only the United States, but also the global economy as a whole. The depth, liquidity and efficiency of our capital markets should continue to make the United States the most attractive country in the world in which to invest.

In 2006, there was a net increase of \$2.5 trillion in foreign-owned assets in the United States, while U.S. net international investment abroad increased by \$2.2 trillion. International investment in the United States fuels U.S. economic prosperity by creating well-paid jobs, importing new technology and business methods, helping to finance U.S. priorities, and providing healthy competition that fosters innovation, productivity gains, lower prices, and greater variety for consumers. Over five million Americans—4.6 percent of the U.S. private sector—are employed by foreign-owned firms’ U.S. operations. Over 39 percent of these five million jobs at foreign-owned firms are in manufacturing, a sector that accounts for 13 percent of U.S. private sector jobs. These five million jobs pay 25 percent higher compensation on average than jobs at other U.S. firms. Additionally, foreign-owned firms contributed almost 6 percent of U.S. output and 14 percent of U.S. R&D spending in 2006. Foreign-owned firms re-invested over half of their U.S. income—\$71 billion—back into the U.S. economy in 2006. A disproportionate 13 percent of U.S. tax payments and 19 percent of U.S. exports are made by foreign-owned firms. Without international investment, Americans would be faced with painful choices regarding taxes, spending on government programs, and their level of savings and consumption. Foreign investors’ economic interests become more dependent on the health of the U.S. economy—giving the investor an incentive to support U.S. economic interests.

As many observers have pointed out, sovereign wealth funds have the potential to promote financial stability. They are, in principle, long term, stable investors that provide significant capital to the system. They are typically not highly leveraged and cannot be forced by capital requirements or investor withdrawals to liquidate positions rapidly. Sovereign wealth funds, as public sector entities, should have an interest in and a responsibility for financial market stability.

POTENTIAL CONCERNS

Yet, sovereign wealth funds also raise potential concerns. Primary among them is a risk that sovereign wealth funds could provoke a new wave of investment protectionism, which would be very harmful to the U.S. and global economies. Protectionist sentiment could be partially based on a lack of information and understanding of sovereign wealth funds, in part due to limited transparency and clear communication on the part of the funds themselves. Concerns about the cross-border activities of state-owned enterprises may also at times be misdirected at sovereign wealth funds as a group. Better information and understanding on both sides of the investment relationship are needed.

Were protectionist pressures to lead to greater restrictions on international investment, this would weaken the United States. The United States could lose out to other countries in the competition for international investment and the benefits it brings. U.S. businesses' worldwide operations could suffer. The United States is the world's leading foreign investor. If the United States imposed new restrictions, other countries could impose restrictions on U.S. investors, jeopardizing the benefits generated in the United States by U.S. businesses that operate globally. Protectionism could raise questions about whether we have faith in the dynamism and productivity of the U.S. economy. Foreigners invest in the United States because they have faith in our future and believe our economy will provide them a good return. The United States has long welcomed international investment—and has used this capital to create new U.S.-owned businesses, expand existing businesses, and grow our economy. Protectionism could also damage the U.S. relationship with major allies such as Western Europe, Canada and Japan, which account for 90 percent of international investment in the U.S.

Second, transactions involving investment by sovereign wealth funds, as with other types of foreign investment, may raise legitimate national security concerns. The Committee on Foreign Investment in the United States (CFIUS), which is chaired by Treasury, conducts robust reviews of certain investments that could result in foreign control of a U.S. business to identify and resolve any genuine national security concerns. The Foreign Investment and National Security Act (FINSA) became effective on October 24, 2007, and strengthened the CFIUS process. CFIUS is able to review investments from sovereign wealth funds, just as it would other foreign government-controlled investments, and it has and will continue to exercise this authority to ensure national security.

As we take our work forward on sovereign wealth funds, Treasury is also considering non-national security issues related to potential distortions from a larger role of foreign governments in markets. For example, through inefficient allocation of capital, perceived unfair competition with private firms, or the pursuit of broader strategic rather than strictly economic return-oriented investments, sovereign wealth funds could potentially distort markets. Clearly, both sovereign wealth funds and the countries in which they invest will be best served if investment decisions are made solely on commercial grounds.

Finally, sovereign wealth funds may raise concerns related to financial stability. Sovereign wealth funds can represent large, concentrated, and often non-transparent positions in certain markets and asset classes. Actual shifts in their asset allocations can cause market volatility. In fact, even perceived shifts or rumors can cause volatility as the market reacts to what it perceives sovereign wealth funds to be doing.

POLICY RESPONSE

Treasury has taken a number of steps to help ensure that the United States can continue to benefit from open investment while addressing these potential concerns.

First, we are aggressively implementing reforms that strengthen the CFIUS process, reflected in FINSA and Executive Order 11858, issued by the President on January 23. We are proceeding steadily through a vigorous drafting process for new regulations which will become effective later this Spring following public notice and comment. One of the reforms codified by FINSA, which we have already implemented, is an elevated level of accountability within CFIUS for review of foreign government-controlled transactions. I want to be clear that CFIUS reviews the investment transactions of sovereign wealth funds, based on the consideration of genuine national security concerns, just as it would for any other foreign government-controlled investment. FINSA protects our national security while keeping investment barriers low and reaffirming investor confidence and the longstanding U.S. open investment policy.

Second, we have proposed that the international community collaborate on the development of a multilateral framework for best practices. The International Mone-

tary Fund, with support from the World Bank, should develop best practices for sovereign wealth funds, building on existing best practices for foreign exchange reserve management. These would provide guidance to new funds on how to structure themselves, reduce any potential systemic risk, and help demonstrate to critics that sovereign wealth funds can be responsible, constructive participants in the international financial system.

Third, we have proposed that the Organisation for Economic Co-operation and Development (OECD) should identify best practices for countries that receive foreign government-controlled investment, based on its extensive work on promoting open investment regimes. These should have a focus on avoiding protectionism and should be guided by the well-established principles embraced by OECD and its members for the treatment of foreign investment.

We have already seen meaningful progress along these lines. On May 12–13 of last year, Treasury hosted a G–20 meeting of Finance Ministry and Central Bank officials on commodity cycles and financial stability, which included perhaps the first multilateral discussion of sovereign wealth funds among countries with these funds and countries in which they invest. Following a period of extensive direct bilateral outreach with sovereign wealth funds, Secretary Paulson hosted a G–7 outreach meeting on October 19, 2007 with Finance Ministers and heads of sovereign wealth funds from eight countries (China, Korea, Kuwait, Norway, Russia, Saudi Arabia, Singapore, and the United Arab Emirates) to build support for best practices.

On October 20, 2007, the International Monetary and Financial Committee—a ministerial level advisory committee to the IMF—issued a statement calling on the IMF to begin a dialog to identify best practices for sovereign wealth funds. On November 15–16, 2007, the IMF hosted a roundtable meeting for sovereign asset and reserve managers. In response to the IMFC statement, the IMF added a special session on policy and operational issues relating to SWFs for official sector delegates. This marks the beginning of an important process in the IMF. IMF Managing Director Dominique Strauss-Kahn opened the roundtable meeting and underlined that some form of agreement on best practices for the operations of SWFs could help maintain an open global financial system.³ A separate dialog is well underway in the OECD on investment policy issues with regard to SWFs, building on the discussions on Freedom of Investment, National Security, and “Strategic” Industries.

Fourth, Treasury has taken a number of steps internally and within the U.S. Government to enhance our understanding of sovereign wealth funds. Treasury has created a working group on sovereign wealth funds that draws on the expertise of Treasury’s offices of International Affairs and Domestic Finance. Treasury’s new market room is ensuring vigilant, ongoing monitoring of sovereign wealth fund trends and transactions. Through the President’s Working Group on Financial Markets, chaired by Secretary Paulson, we continue to discuss and review sovereign wealth funds. We also have initiated bilateral outreach to ensure an ongoing and candid dialog with countries with significant sovereign wealth funds and their management.

Treasury is actively coordinating with Congress through staff briefings and committee hearings. As you may know, I testified on these issues before the Senate Banking Committee in November. Also, in June and December of last year we provided Congress with updates on our sovereign wealth fund-related work in an appendix to the Report on International Economic and Exchange Rate Policies, and we will continue to provide updates on a semi-annual basis.

The Treasury Department will continue its work on sovereign wealth funds through sound analysis and focused bilateral and multilateral efforts to help ensure the United States shapes an appropriate international response to this issue, addresses legitimate areas of concern, and together with other countries, remains open to foreign investment.

PREPARED STATEMENT OF STUART E. EIZENSTAT, PARTNER AND CHAIR OF THE
INTERNATIONAL PRACTICE GROUP, COVINGTON & BURLING LLP

Chairman Schumer, Vice-Chair Maloney, Ranking Member Saxton and Members of the Committee, good afternoon. Thank you very much for holding this important and timely hearing.

During the Clinton Administration I was fortunate to hold several positions that brought me into frequent contact with issues of inward investment into the United States: I was the US Ambassador to the European Union, Under Secretary of Com-

³ IMF Convenes First Annual Roundtable of Sovereign Asset and Reserve Managers, IMF Press Release, November 16, 2007. <http://www.imf.org/external/np/sec/pr/2007/pr07267.htm>

merce for International Trade, Under Secretary of State for Economic, Business and Agricultural Affairs, and then Deputy Secretary of the Treasury. Since my government service I have been the chair of the International Practice Group at Covington and Burling, LLP where I have engaged in this issue from the private sector.

I am honored to participate in the Committee's discussions and hope that my experience and contributions will be helpful to the Committee's deliberations.

The question posed in the title the Committee has given this hearing, whether Sovereign Wealth Funds (SWFs) strengthen or imperil the US economy, is the critical question in the SWF debate. Permit me to say at the outset that the challenges provided by the some \$3 trillion in SWFs, from China and Russia to the Gulf States and Saudi Arabia, are as much a reflection of our own economic problems as they are about SWFs themselves. Their remarkable growth and decisions to broaden their portfolio beyond the investments of their central banks in Treasury bills, is a reflection of our growing dependence on expensive foreign oil and our massive current account deficit. This Committee and the Congress, and all of us, should be spending as much time and energy on dealing with these structural economic problems as on the consequences of those problems. In effect, SWFs are recycling U.S. petro-dollars and our appetite for products from China and Emerging Markets.

In addition, I am a strong believer in the importance of the free flow of capital around the world, and of the value of foreign direct investment (FDI) in creating jobs in the United States, and adding creativity and innovation to our economy. There is a difference, for sure, between private foreign investment and that of SWFs and their close cousins, State Owned Enterprises (SOEs). But even there, the distinction is not always as clear as it may seem. Many European companies, for example, have some government ownership through "golden shares". Moreover, many European governments are trying to create "national champions" to better compete in the global marketplace. We need to be very careful that in dealing with SWFs, we do nothing to deter the free flow of international capital.

I strongly believe that SWFs do bolster the US economy, and that on balance they are a significant net plus for the U.S. economy. If we take off the "welcome sign", they will invest their growing wealth elsewhere in the world. At the same time, there are legitimate concerns about SWFs that need to be addressed. These heavily revolve around the need for "transparency" and good governance. This, in my opinion, does not mean that they must divulge their holdings and investments, but rather that they should be transparent in their governance, in their relationships to their governments, in their processes, in their goals, and in determining whether they obtain subsidized government financing on individual deals—which would create an unfair advantage over U.S. or foreign corporations who must rely on the private credit markets for competing for the same acquisitions. We have a legitimate interest in assuring that SWFs have a purely commercial, not a political or national security, interest in their investments in the U.S.

Beyond transparency, there certainly are a limited number of matters in which national security risks are implicated by SWFs and SOEs acquisition. But in a globalized world economy, in which the U.S. does not have a monopoly on products, it is important that national security not be defined so broadly that it is used as a broad basis to deter foreign investment.

I urge Congress not to seek legislation or to pressure regulators to impose heavy regulations on SWFs at this stage. The reason for this is that Congress has wisely provided the executive branch—in the form of last year's bipartisan Foreign Investment and National Security Act (FINSIA)—the means to deal with genuine national security threats from SWFs and SOEs. In my opinion we already have the legislative tools necessary to effectively address any national security concerns raised by SWF investments, and we should give the CFIUS process the time to work through SWF/SOE investments on a case by case basis.

Moreover, it is critically important that Congress not take unilateral action. It is vital that we try to develop multilateral principles. Europe, for example, has similar concerns with SWFs/SOEs; for instance, Russia's Gazprom has expressed interest in acquiring energy assets in Europe. The Bush Administration has wisely agreed to support this multilateral approach. The IMF is now working directly with all the major SWFs on developing a set of "best practices", which they hope to have completed by April. The OECD is doing the same exercise with host countries, and their report will be ready in roughly the same timeframe. Moreover, the Government Accounting Office is examining SWFs and their report will be an important touchstone. We should allow these activities to play out, and, for example, see how the SWFs react to the IMF effort to develop a set of principles focused on transparency.

THE BENEFITS AND CONCERNS OF THE "NEW" SOVEREIGN WEALTH FUNDS

The benefits of foreign investment into the US are well known. Such investments support economic growth and job creation; they help keep domestic industry competitive; they grease the wheels of the international economy by helping to right financial imbalances; and, as we have seen since last summer as SWFs began investing heavily in the US financial industry, foreign investments can be ready sources of assistance to distressed sectors, in this case bolstering the US economy while providing a needed vote of confidence in the US financial system at a difficult time.

Moreover, we know that SWFs are not recent innovations. The first versions beginning in the 1950s and 60s with states as diverse as Kuwait, Kiribati and Norway establishing national investment vehicles, many of which have long invested in the US. SWFs have a strong record of making long-term investments, with a generally passive involvement in the management of the companies in which they invest.

Most SWF and SOE investments raise no national security risks.

For instance, the acquisition of Barney's, the U.S. retailer, by Dubai, hardly impacts on national security. CFIUS approved the sale of IBM's PC division to Lenovo (which our firm handled), which is partly owned by the Chinese government. Further, SWFs' recent investments in U.S. and European financial institutions have been for small stakes, well under 10%, with no board seats or management voice. It is important to recognize that the control test—which can trigger CFIUS review—is not a mechanical test of 10% voting shares. There are a variety of factors to consider, such as whether the SWF/SOE has the right to appoint members of the board of directors; the right to appoint or veto members of management; the right to approve the corporate budget; the right to approve of new investments and divestitures. Generally, SWFs/SOEs have not insisted on this level of control.

Even if a SWF or SOE transaction presents some risk to national security, CFIUS has proven well-equipped to analyze the risk and negotiate appropriate measures to mitigate that risk. If, for some reason, CFIUS determines that the risk cannot be satisfactorily mitigated, the President has the power to block the transaction.

There are some different factors at work in the recent emergence of SWFs. The amount of money under SWF management is greater than it has ever been. Fueled in some cases by high commodity prices (as is the case for the Persian Gulf, Russian and Norwegian funds) and in others by trade surpluses "unequaled as a percentage of the global economy since the beginning of the 20th century" (as for East Asian SWFs) SWFs are thought to control as much as \$3 trillion in assets—greater than the global stock of assets invested in either hedge funds or private equity. Even so, SWFs account for no more than 1.3 percent of the world's financial assets.

And, the number of SWFs are increasing, with some new entries representing perhaps the biggest challenges for US regulatory review. There are now more than 40 major SWFs, with as many as a dozen established since 2005. Given the size and number of the new players in the SWF world, some measure of anxiety was expected and prudent.

The timing of the emergence of SWFs also sharpened fears. The 2008 Presidential campaign has begun, memories of two highly politicized bids by foreign government owned companies for key US assets were still raw (CNOOC's bid for Unocal was in 2005, the Dubai Ports World controversy erupted in 2006), and news of SWFs came just as Congress was completing its legislative overhaul of the US investment screening mechanism—the Committee on Foreign Investment in the United States (CFIUS) codified in FINSIA—a task that was precipitated by the CNOOC/Dubai Ports World events but took on new urgency once SWFs appeared.

GOVERNANCE AND TRANSPARENCY—THE CRITICAL SWF REFORMS

If there has been an underlying theme for most of the concerns verbalized about SWFs it the assertion that these funds, as a whole, are nontransparent, and consequently policymakers cannot be sure what drives the funds' investments, divestments, and other behaviors. It is asserted that that SWFs may be political or intelligence-gathering tools out to harm the United States, rather than profit maximizers. And, it is disquiet emanating from this alleged feature of SWFs that has led many of those otherwise positively disposed toward free capital movements—including Treasury Department officials, capital markets regulators, and some in the think tank community—to question whether some regulation is needed. Senior government officials from Robert Kimmitt and Clay Lowery at Treasury to Chris Cox, the Chairman of the SEC, to experts like Ted Truman at the Peterson Institute, have raised a number of legitimate concerns:

- whether the governments subsidize individual transactions;
- the potential for imprudent investments to increase risks for market stability;

- whether they have a political agenda, such as Gazprom has exhibited in Ukraine, Georgia and elsewhere;
- whether there is a risk of insider trading;
- whether there is a risk for corruption, if government officials are directly involved from countries with a record of corrupt activities;
- whether there is a risk of leakage of sensitive technology to countries which are not allies of the U.S.

Tellingly, SWFs have followed these debates and concerns and appear to have made recent investments with political sensitivities in mind. As I mentioned, the recent SWF investments in the financial sector have explicitly and invariably been non-controlling minority investments, have not included any board seats for the SWFs or powers to control management, budgets, or new acquisitions or divestitures, and have generally been below 10% voting shares.

Further, some SWFs have already responded to calls for greater openness.

I hope that SWFs will take steps to be more transparent. Even in the short run, increasing transparency produces benefits not just for the host states, but for the SWFs themselves. Real transparency promises to ease the acceptance of SWF investments as host states come to understand SWFs' investment strategies and management structures, and can be assured that commercial rather than political interests control investments, and that SWFs do not receive unfair subsidies that may make competitive bidding with private entities difficult. Finally, SWFs will very likely come to understand that adopting some measures of transparency and other robust regulation for themselves is the best way to avoid more heavy-handed regulation from both the US and other investment recipients.

Across the Atlantic, Joaquin Almunia, the EU Commissioner for Economic and Monetary Affairs, has explicitly suggested such a *quid pro quo*, stating that there were "good reasons" to ask funds about their investment strategies and holdings, and if they do not provide such information "we can find good reasons to 'react' in some cases, where these funds try to invest . . . in strategic sector[s] or . . . specific industries."

UNILATERAL RULES MAY HARM THE U.S.

My contention that SWF-specific legislation is not needed at this juncture comes not just from my hope that over time many SWFs will become more transparent of their own accord. Rather the imposition of unilateral rules on US investment for SWFs may harm the competitive position of our economy. After all the United States is only one of many markets in which SWFs can choose to invest. As former Secretary of State Colin Powell noted, "capital is a coward," and unilateral rules in the US that are not matched by similar regulations in other potential host states may adversely impact our ability to attract FDI and consequently may diminish our competitiveness. It is worth remembering that the majority of SWF money that has been invested into the US is actually recycled US dollars resulting from our oil dependence (for the Middle Eastern funds) and mass current account deficit (for the East Asian funds). It seems far better to have this money recycled here, than to be moved elsewhere.

THE WAY AHEAD—MULTILATERAL DISCUSSIONS AND THE "NEW" CFIUS

The necessity for a global solution that evens the playing field between potential recipients of investments provides one of the guideposts to the most effective future direction for US policy on the SWF issue. Fortunately such a multilateral approach is underway. Last fall, the Treasury Department, along with finance ministries from the rest of G8 and those of several states owning leading SWFs asked the International Monetary Fund and the Organization for Economic Cooperation and Development to begin working on best practices.

The IMF process, which is focused on best practices for the SWFs themselves, is due to issue its recommendations in April. Though the IMF will likely touch on several aspects of reform, it seems evident that a central focus of the guidelines will be on enhancing SWF transparency in order to increase the number of SWFs that publish annual accounts and provide outsiders some insight into governance and investment strategies. In a hopeful sign, some SWFs including Singapore's Temasek, are closely assisting the IMF efforts.

Working alongside the IMF, the OECD's Investment Committee has begun working on best practices for host countries, and in particular the processes of host country review of SWF investments. The OECD report is due in March. The OECD's primary concern is that some recipient states may overreact to SWFs and erect needless procedural barriers to SWF investments which may chill wider FDI flows.

Though still being drafted, the OECD rules will likely borrow from best practices in some of its members, including the US CFIUS process.

The CFIUS process, newly vested with enhanced transparency and predictability, provides the other guidepost for effective domestic response to SWFs. Though as this Committee knows the CFIUS regulations are due to be released in April, even before the rules are finalized it is clear that FINSA's improvements on CFIUS are significant and important. Its enhancements include a greater clarity for foreign investors, a result of new transparency regarding the factors CFIUS considers in moving a transaction from a 30-day review to a 45-day investigations, alongside the requirements that CFIUS issue public guidance on the types of transactions that have been reviewed and that have raised national security concerns. Moreover, the law's provision for a "lead agency or agencies" for the government entity with greatest equities in a transaction promises to instill discipline in CFIUS and lead to more routinized review processes. Finally, the law requires the involvement of senior-level officials in major CFIUS actions including with respect to certifications provided to Congress and decisions not to investigate transactions involving foreign government ownership.

We should rely on the wisdom of FINSA and take solace from the CFIUS process and its recent ability to quickly clear transactions—such as the sale of IBM's personal computer business to Lenovo. That the review processes were transparent and efficient, simultaneously promoting both open investment and national security, suggests that the current tools—set to be improved further after the release of the CFIUS regulations—can effectively address SWF investments.

I counsel Congress to withhold judgment on the necessity for further legislation until both the CFIUS regulations are published and can be assessed in practice, and the IMF and OECD have delivered their reports.

HISTORY, TRANSPARENCY AND NUANCE—THE KEY TO EFFECTIVE REGULATION OF SWFS

If the past is prologue, history does not suggest that most SWFs will engage in politically motivated investments. SWFs have been long-term, stable and passive investors. Though they may be less risk averse than central banks solely investing in T-Bills, most SWFs are run with profit in mind. Quickly unwinding positions, or investing for political as opposed to financial gain, could be as damaging to SWFs (if not more so) as to host countries. Most SWFs have been mandated to secure healthy returns and many have received political and public rebuke at home for unsuccessful investments. Further, SWFs are aware of the growing political sensitivities regarding their investments and most would be loathe to upset host governments for fear of wearing out their welcome.

Even if history and the structure of SWFs suggest that we have little to fear, the current approach adopted by the Bush Administration should be lauded. Unilateral, protectionist regulations have not been contemplated, neither has the Administration raised the potential for imposing reciprocity as a test for SWF investments. In some quarters this has been a commonly suggested response to the SWF influx and asks the reasonable question why the United States should allow unfettered access to its assets to state-backed SWFs when those states do not allow commensurate access to their assets. A successor of mine as Deputy Treasury Secretary, Robert Kimmitt, made the Administration's rejection of reciprocity clear in his recent Foreign Affairs piece: raising reciprocity as a barrier to SWFs "is not on the list" of policy proposals. He argues correctly that the benefits the United States receives from foreign investment are irrespective of whether or not other countries provide US investors similar rights.

Indeed, instead of unilateral restrictions, constructive deliberation on a multilateral basis is critical so as to ease bona fide concerns regarding investors' intentions and fund transparency, while ensuring that host states remain open to receiving the benefits SWF investments can bring—benefits that include both domestic financial stability in distressed sectors and wider global stability as the world's major economies become ever more interdependent.

To that end, transparency coupled with nuance are key. Clearly there should be some limits to SWF acquisitions. However, these prohibitions should be clear, narrowly focused and few and far between. Broad prohibitions are not needed, and with nuanced review that takes into account the transparency of a particular investor and the magnitude of specific investments (differentiating between controlling and passive stakes), there is little reason that our aim of protecting national security cannot be consistent with opening up the vast majority of the American economy to SWF funds. Relying on the CFIUS process makes per se rules even less needed, given that appropriate protections can be negotiated on a case-by-case basis, ranging from insisting that investors establish an arm's length proxy relationship to handle

sensitive investments, to striking nuanced mitigation agreements of the kind the Government has forged with scores of foreign investors.

It is my view that a chorus of support for moderated, thoughtful reaction to SWFs must be developed now, before SWFs become a political third-rail and the United States loses out in attracting both needed funds and in retaining the mantle of the world's most dynamic economy.

Thank you. I will gladly respond to any questions.



NEW AMERICA FOUNDATION

PREPARED STATEMENT OF DOUGLAS REDIKER, CO-DIRECTOR, GLOBAL STRATEGIC FINANCE INITIATIVE, THE NEW AMERICA FOUNDATION

Thank you Mr. Chairman, Madam Vice Chair and members of this committee for the honor of addressing you today.

By way of introduction, I spent most of the last seventeen years working as an investment banker and private equity investor based primarily in London, England. This experience, I believe, gives me a somewhat different perspective on Sovereign Wealth Funds and the role that they play in today's international capital markets. Currently, I co-direct the Global Strategic Finance Initiative at the New America Foundation. The New America Foundation is a non-profit, post-partisan public policy institute in Washington D.C.

Over the past several months, few issues in international finance have generated as much discussion and comment as have Sovereign Wealth Funds. I commend you and your colleagues for the informed and balanced views that you have expressed and the questions that you have posed on this important subject.

As a general matter, I believe that both the U.S. and global economies are strengthened through open markets. Overall, economic health is bolstered and fortified by the free flow of investment capital and increased liquidity that open markets provide. As significant providers of capital to these markets, Sovereign Wealth Funds have thus far been a positive influence in U.S. and global markets. Most recently, significant capital injections by Sovereign Wealth Funds in several major financial institutions have been a stabilizing force, potentially averting a significant market downturn at a time of high market uncertainty and volatility.

Capital flow from Sovereign Wealth Funds benefits U.S. investors, companies and workers not only in those specific cases involving investments in our financial services sector, but more broadly, as increased liquidity results in higher stock and asset prices and lower risk premiums, especially of riskier, less liquid assets. A recent estimate quantified the potential gross capital inflows from Sovereign Wealth Funds over the next 5 years to global equities at \$1 trillion and \$1.5 trillion to global debt markets, increasing to \$3.1 trillion and \$4.6 trillion respectively over the next decade.¹

While I believe that continued investment by Sovereign Wealth Funds should be encouraged, I also believe that the nature of this investment on this scale warrants continued oversight by Congress. Your vigilance should ensure the continued competitiveness and smooth functioning of our financial markets, while also protecting both our national security and the integrity of these markets.

It is to this Committee's credit and to others in the U.S. Congress and the Administration that when compared with other industrialized nations, the United States' national security interests and financial market integrity are relatively well regulated. Last year's revised CFIUS/FINSA legislation, as well as existing provisions under U.S. Securities and Exchange, Antitrust, Export Control, and other similar legislation and regulation, protect and regulate both our national security interests and potential acquisition targets from improper takeover approaches or material investments from foreign state investors.

¹ Steffen Kern, Deutsche Bank, September 10, 2007.

There are, however, areas that could benefit from some improvement. In particular, I believe that the U.S. Government should continue to support calls for increased disclosure and transparency of asset mix, investment guidelines, currency composition and geographic diversification by Sovereign Wealth Funds. Such increased disclosure would benefit the markets in many ways and could calm suspicions borne of lack of information. Increased transparency would be more likely to alert the market to concentration issues and potential contagion risks.

While increased disclosure and transparency is in everyone's interest, I would not recommend making disclosure a mandatory pre-requisite for investment in our markets. To do so, would likely be counterproductive and ineffective. I believe that any insistence on transparency should be part of a broader code of best practice, adopted in a collaborative effort by Sovereign Wealth Funds and the IMF, motivated by a collective desire for financial stability and smooth functioning of the markets. Sovereign Wealth Funds may further welcome the opportunity to judge their own returns against relevant indices and their peer group, as well as by the opportunity to demonstrate that they are investing in a manner consistent with the best interests of the people of the countries they govern.

Within the U.S., I believe that the investment environment for Sovereign Wealth Funds should be clear and predictable. Regulations regarding when a CFIUS review is warranted should be as express and explicit as possible. For example, I suggest that regulatory guidance be provided regarding the interpretation of control as opposed to that of the more amorphous concept of influence.

In my years in investment banking and capital markets, one of the most compelling lessons I learned was that investors abhor uncertainty. Uncertainty discourages investment by injecting unquantifiable risk into an investment decision. I believe that it is imperative that Sovereign Wealth Funds and other foreign investors understand that their investment is welcome in the United States. Furthermore, investors should know precisely on what terms they are welcome.

If a Sovereign Wealth Fund complies with all relevant laws and regulations and then is subject to unforeseen scrutiny or delay, their investment decision will be negatively affected. To ensure that the U.S. maintains its role as the most open, transparent and welcoming capital market in the world, the U.S. should not discourage any investment made in compliance with the law.

Over the past several years, international capital markets have transitioned away from US domination to being truly global in scope and leadership. Sovereign Wealth Funds are but one manifestation of the past decade's shift toward a truly multi-polar global financial marketplace—a marketplace where the sources, intermediation and destination of capital and financial expertise outside the U.S. have grown at a tremendous pace.

Competing centers of global finance and capital now exist not only in Europe, but also in Asia and the Middle East. Those who seek alternatives to invest in, and trade through, US financial markets now have multiple options to choose from.

When addressing the issue of Sovereign Wealth Funds, it is imperative that this Committee take into account crucial issues of national and economic security, financial market integrity as well as the continued competitiveness of our capital markets.

In that context, I believe that professionally managed Sovereign Wealth Funds, like other foreign investors, should be encouraged to invest in the U.S. in virtually all asset classes. The U.S. Treasury has made it a priority to ensure that the United States continues to be the most attractive place in the world to invest and should be applauded for this effort. As a complement to this effort, we should ensure that we spell out unambiguous "rules of the game" for all investors—domestic and international. Assuming they abide by those rules, Sovereign Wealth Funds, which today represent perhaps \$3 trillion of investment capital, should be welcomed as a major part of that effort.

Thank you.