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SOVEREIGN WEALTH FUND ACQUISITIONS AND OTHER FOREIGN GOVERNMENT INVESTMENTS IN THE U.S.: ASSESSING THE ECONOMIC AND NATIONAL SECURITY IMPLICATIONS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

ASSESSING THE ECONOMIC AND NATIONAL SECURITY IMPLICATIONS OF SOVEREIGN WEALTH FUNDS AND FOREIGN ACQUISITION

WEDNESDAY, NOVEMBER 14, 2007

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.access.gpo.gov/congress/senate/senate05sh.html

U.S. GOVERNMENT PRINTING OFFICE

50–364 WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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WEDNESDAY, NOVEMBER 14, 2007

WITNESSES

Additional Material Supplied for the Record

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WEDNESDAY, NOVEMBER 14, 2007

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 2:02 p.m., in room SD–538, Dirksen Senate Office Building, Hon. Evan Bayh presiding.

OPENING STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. I would like to call the meeting of the Committee to order. I would like to thank you all for being with us today. And I would like to begin by thanking Chairman Dodd for making this hearing possible and for elevating this important issue to such a priority position. Without the Chairman's support this could never have happened, and so I want to express my gratitude to him.

Chairman Shelby, I want to thank you for most especially your friendship, but also the good working relationship we have had on so many issues over the years, and it is good to be with you today.

And Senator Webb, welcome. Senator Webb is one of the driving forces behind this hearing, and so I am looking forward to hearing from you today, Jim, and thank you for continuing to focus on this very important, very important issue.

Senator WEBB. Thank you, Mr. Chairman. Good to be with you.

Senator BAYH. I am going to make a brief opening statement and then hear from my colleagues, and then we will get right to the witnesses.

The issue of sovereign wealth funds is a significant one. The number of these funds is growing. Of the 20 largest, 13 were started since 1990. With foreign currency reserves up 140 percent over just the last 5 years, this trend is likely to continue.

The size of these funds is also growing. There are now seven over $100 billion in assets, including Abu Dhabi at $625 billion, Singapore at $215 billion, Norway at $322 billion, Kuwait at $231 billion, China at $200 billion, Singapore at $108 billion, and Russia now at $127 billion.

These now dwarf in size the multilateral organizations designed to be the governing architecture of the global financial system. For perspective, the International Monetary Fund now holds assets with a market value of just $76.9 billion. The World Bank has just $40 billion on its balance sheet.

The number and size of these funds is likely to continue to grow. This is being driven by the increasing price of commodities, principally oil, trade imbalances and currency practices by countries that have the effect of increasing their foreign currency reserves. These situations show no signs of abating.

This situation presents the United States with both opportunities and challenges. It is better for the United States to have capital invested here to create jobs, improve our productivity growth, keep interest rates low, and our standard of living high. But sovereign wealth funds are inherently different than private investors.

As the Chairman of the SEC, Christopher Cox, recently observed—and I quote—government ownership of companies and investment funds poses a fundamental challenge to the market premise upon which the SEC operates. The lack of transparency that characterizes many sovereign wealth funds undermines the theory of efficient markets at the heart of our economic system. In addition, unlike private investors and their representatives—pension funds and mutual funds, for example—government-owned entities may have interests other than and that occasionally will take precedence over profit maximization.

Just as the United States has interests in addition to financial ones, so do other countries. Just as we value some things more than money, so do they. Why should we assume that other nations are driven purely by financial interests when we are not? Or are we?

The issue before us, and the subject of this hearing, is how to strike the right balance of interests. How do we attract capital from abroad and pursue our financial goals while reconciling this with other vital national concerns?

To help explore this, we have an extraordinary panel of witnesses today. But first, we will hear from other members of the Committee and Senators. Senator Shelby, I would like to begin with you.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Chairman Bayh.

This afternoon, as the Chairman has pointed out, we are meeting to examine the dynamic growth of sovereign wealth funds. A lot of this he has outlined in detail.

I hope this hearing, Mr. Chairman, is the first of several so that we have an opportunity here at the Banking Committee to examine fully the range of issues that these funds present to our economy and to our national security.

As you well know, we are entering to a different economic world where a lot of wealth has shifted from the United States and from Western Europe to developing countries like China and the Gulf States.

There are two unique features of sovereign wealth funds, as I understand it. First is their size. I have been told that they hold in excess of $2 trillion, Mr. Secretary, now and could go to $13 trillion to $15 trillion. This is serious, serious business. Recent trends indicate that these funds will continue to grow no matter what we do.

Second, sovereign wealth funds are not private investment vehicles, as what we have traditionally been involved in. They are government-controlled entities, as the Chairman pointed out. Government control introduces the possibility that they may be used for purposes other than their economic return.

For this reason alone, I think it is important to try to get a basic understanding of the various funds and their activities and perhaps their objectives. We need more information on how they are managed, how they are structured, and the types of investments they make.

We also need to know more about the objectives that I mentioned behind their investment activities. What is their motives here? Are they seeking higher returns, as the Chairman indicated? Are they also being used as a foreign policy tool, oftentimes maybe in the long run, against our interests.

Is there a role for global financial institutions such as IMF, OECD, and the World Bank in dealing with these funds? Finally, what effects can these funds have on exchange rates, Treasury securities, and the economic health of this country? We had better know, and this hearing today will get us going in the right direction.

But we have to remember, because sovereign wealth funds are only going to increase in asset size and continue to expand their global reach, this Committee, Mr. Chairman, has a continuing responsibility to monitor and understand these unique and growing investment vehicles. If we let this continue to grow, we will not be in control of our own economic destiny, as we have in the past.

Thank you.

Senator BAYH. Thank you, Senator Shelby, for those perceptive remarks.

Senator Dole, I think we go to you next, as a member of the Committee. And then, Senator Webb, to you.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you, Mr. Chairman, Ranking Member Shelby. I appreciate so much your holding this hearing on sovereign wealth fund acquisitions and foreign government investments in the United States.

I appreciate this Committee's recent work on currency manipulation by foreign governments, namely China, as this issue has great importance for my home State and its manufacturing jobs. I agree that today's hearing topic, too, is of particular relevance to this Committee.

Sovereign wealth funds have existed since the 1950's and the total number of these institutions has grown dramatically over the past 10 to 15 years. According to the IMF, there are currently more than 20 countries—including China, Russia, Venezuela, and United Arab Emirates—that have these state-sponsored investment vehicles, and half a dozen or more nations have expressed interest in establishing one.

Research conducted by Standard Chartered Bank in the United Kingdom indicates that the total investment by these funds is estimated at $2 trillion to $3 trillion. Based on current projections, this is more than hedge funds manage, with $1 trillion to $1.5 trillion, and more than private equity firms manage with $700 billion to $1.1 trillion.

The IMF estimates or projects that sovereign wealth funds will continue to accumulate international assets at the rate of $800 billion to $900 billion per year, which could bring the aggregate total up to $12 trillion by $2012.

One of the issues that has emerged with these funds is their transparency and whether they are willing to disclose and disseminate information. Some of these sovereign wealth funds already provide information regarding specific investments. For example, Norway's Government Pension Fund disclosed that it owns significant stakes in American financial institutions such as Bank of America, Citigroup, and AIG, as of December 31st, 2006. Unfortunately, other countries such as China and Venezuela do not make such data readily available.

I am pleased that this issue has captured the attention of Treasury Secretary Paulson, and I encourage the SEC and the IMF to continue monitoring sovereign wealth funds and to keep this Committee fully apprised. I hope that increased disclosure and transparency will instill a greater sense of confidence and understanding with regard to these investment vehicles, which no doubt have significant impacts on the continued integrity of the United States in international capital markets.

Again, I thank the Chairman, the Ranking Member, for holding this important hearing and I look forward to hearing from our witnesses regarding this emerging issue.

Thank you.

Senator BAYH. Thank you very much, Senator Dole.

Senator Webb.

STATEMENT OF SENATOR JIM WEBB

Senator WEBB. Thank you, Mr. Chairman, and I appreciate you allowing me to sit on this hearing today, to be something of an interloper in your business.

This is a very important hearing. It is a follow-on to a letter in September that I sent to Treasury Secretary Paulson, along with you, Senator Bayh, Ranking Member Shelby, and also the Chairman of this Committee, addressing the importance of the Committee for Foreign Investment in the United States to take into consideration passive foreign ownership interests and assets in the country, including the sovereign investment funds. The letter urged Treasury to promulgate regulations broad enough to ensure that potential national security implications of such investments are appropriately addressed in the context of ongoing foreign investment in our economy.

Although foreign governments have been investing for years in the United States through different investment vehicles, sovereign wealth funds have risen to recent prominence on a wave of high levels of foreign exchange reserve associated with increased commodity prices and export led growth. The growth of these funds demand that we focus on their strategic implications.

The practice of state capitalism which is a phrase, I believe, was coined by Dr. Lyons, who will be testifying before us today, allows sovereign wealth funds to potentially improve their strategic advantage or to secure access to sensitive technology from other countries.

Relative to our own security, the Committee on Foreign Investment in the United States is the primary source of protection from investment that threatens our national interest. The increased number, size, and growth potential of sovereign wealth funds raises the prospect that they may be structured so as to escape scrutiny in ways not yet contemplated by current law.

So the question before us really is how we balance the need for investment with safeguarding our national security assets in the context of these funds. Our witnesses today are going to provide us with an opportunity to ensure that we have adequate regulations and that we seek policy recommendations regarding the risks of these funds as they may affect not only our market stability, but also our national security.

I thank you again for inviting me to participate in this hearing.

Senator BAYH. Senator Webb, thank you, and I am particularly grateful for your interest in national security related issues, of which this is one. And you are always welcome to contribute to the work of the Committee.

We begin today with the Honorable David H. McCormick. As a matter of fact, you constitute a panel of one, David, so we are looking forward to hearing from you.

David McCormick is Undersecretary for International Affairs at the Department of the Treasury, where he oversees policies in the areas of international finance, trade and financial services, investment, economic development, and international debt policy. Until August, he was the President's Deputy National Security Advisor for International Economics and previously served as Undersecretary of Commerce for Export Administration.

In the private sector, Mr. McCormick ran a software company and was a consultant for McKinsey & Company. He is a graduate of West Point and holds a Ph.D. from the Woodrow Wilson School at Princeton University. He is a former Army officer and a veteran of the First Gulf War.

Mr. McCormick, we thank you for your service to our country and for you presence here today. We welcome your statement.

STATEMENT OF DAVID H. McCORMICK, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. MCCORMICK. Thank you, Mr. Chairman, Ranking Member Shelby, Senator Dole, Senator Webb. Thank you for the opportunity to be with you here today. I very much appreciate the chance to come and discuss sovereign wealth funds. At Treasury, we have been increasingly focused on sovereign wealth funds for more than a year now, and I am pleased to be able to share with this Committee our views.

As was said by many of your statements, sovereign wealth funds are not new. The oldest funds date back to the 1950's in Kuwait and Kiribati. Over the next four decades, these numbers have slowly grown. By the year 2000, there were 20 sovereign wealth funds worldwide, managing a total asset base of several hundred billion dollars.

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 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 trillion to $2.9 trillion.

At the Department of the Treasury, we define a sovereign wealth fund as a government investment vehicle funded by foreign exchange assets and managed separately from official reserves. These sovereign wealth funds generally fall into two categories. There are commodity funds, which are funded through commodity exports, owned or taxed by the government. Commodity funds serve different purposes, including the stabilization of fiscal revenues, intergenerational savings, and the balance of payments sterilization.

There are also non-commodity funds, which are established through the transfers 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 these stand-alone funds.

Now it should be noted that within this group of countries, 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 that increased flexibility in a number of countries.

In contrast to traditional reserves, sovereign wealth funds seek a higher rate of return and are invested in a wider range of asset classes. Their managers emphasize expected returns over liquidity and many investments are in the form of stakes in U.S. companies, as has been witnessed in recent months.

Sovereign wealth fund assets are large in their importance, but very concentrated. While a fraction of global financial assets, sovereign wealth funds are currently larger—as was already said—than the total assets under management by either hedge funds or private equity. However, 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 fund assets, while the remaining one-third are non-commodity funds transferred from official reserves.

The rise of sovereign wealth funds clearly has implications for the international financial system. They bring benefits to the economy and they also pose concerns.

As reiterated by the President in his May 10th statement, the U.S. is committed to open investment and advancing open markets at home and abroad. The United States economy benefits from open investment, including investment from sovereign wealth funds. 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. has derived many benefits in the form of jobs, R&D spending, and higher wages.

Sovereign wealth funds also have 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 rapidly.

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. Sovereign wealth funds could provoke a new wave of investment protectionism, which raises the stakes for the health of the global economy.

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

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

At the Treasury Department, we are working on a number of steps to ensure the United States continues to benefit from open investment while addressing these concerns. First, the new Foreign Investment and National Security Act, authored by the Chairman and Ranking Member of this Committee and signed into law by the President last summer, implemented through the Committee on Foreign Investment in the United States, ensures robust review of investment transactions that pose national security concern. It requires heightened scrutiny of foreign controlled investments. CFIUS is able to review investments from sovereign wealth funds, just as it is other foreign government-controlled investments, and it has and will continue to exercise this authority to ensure our national security.

Additionally, the new CFIUS legislation reaffirms investor confidence and longstanding U.S. open investment policy. We believe the U.S. investment security framework provides a good model for other countries where protectionist sentiment has been on the rise and we are actively engaged with these countries to head off undue protectionist responses abroad.

Second, we have proposed the creation of a multilateral framework for best practices. The International Monetary Fund should develop best practices for sovereign wealth funds, building on the existing best practices for foreign exchange reserve management. These would provide guidance to funds in areas such as fund objectives, structure, transparency, and risk management, while demonstrating to critics that sovereign wealth funds can be responsible, constructive participants in the international financial system.

Third, we have proposed the Organization for Economic Cooperation and Development, OECD, should identify best practices for countries that receive foreign controlled investment. I should say that many of the countries that are the holders of these sovereign wealth funds are also significant recipients of foreign investment. These practices should 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.

Meaningful and timely progress has been made. In May of this year, the Treasury hosted a G–20 meeting of Finance Ministry and Central Bank officials that focused the first multilateral discussion on sovereign wealth funds. Just last month, 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, Singapore, and the United Arab Emirates, to build support for best practices. The next day, the IMFC—which is a ministerial level advisory committee to the IMF—called on the IMF to begin a dialog to identify best practices for sovereign wealth funds.

Also, at Treasury we have 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 our international affairs team as well as domestic finance.

We informed Congress in June of some of our thinking on sovereign wealth funds 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.

We also created a new market room for ensuring vigilant ongoing monitoring of sovereign wealth funds trends and transactions. And through the President's Working Group on Financial Markets, which is chaired by Secretary Paulson, we continue to discuss and review sovereign wealth funds.

We have also initiated outreach to ensure an ongoing and very candid dialog with countries that have these sovereign wealth funds. The Treasury Department will continue its work on sovereign wealth funds through analysis, through bilateral and multilateral outreach, so that the United States can shape any international response to this issue in a way that addresses legitimate areas of concern while ensuring that the United States remains open to and welcoming of foreign investment.

Thank you.

Senator BAYH. Thank you, Mr. McCormick.

Senator Crapo, it is good of you to join us. I would give you an opportunity to make a statement at this time, or you can waive that, if you would prefer.

Senator CRAPO. I will waive that, and let's go ahead with the witness. Thank you.

Senator BAYH. Thank you.

I think these are 5 minutes rounds. Five minute rounds. Very good. I will try and keep my first round of questions to 5 minutes. I would ask my colleagues to try and do the same, and if need be we will be happy to have another round of questions.

Mr. McCormick, I am far from being the longest serving member of this body, but I have been around long enough now to have a little institutional memory. So I would like to take you on just a brief trip down memory lane.

I think it was 2001 when the financial projections for our country were that we would run surpluses that were of such magnitude that, in fact, we would pay off our national debt in fairly short order. There was a big debate at that time that if that, in fact, happened what would we do with the extra money? One of the things we heard pretty consistently from this administration was that well, we should not invest it in the private economy. I will read you a quote to that effect. I think it was from the then Chairman of the Federal Reserve, Alan Greenspan.

This is a quote from his testimony to the Budget Committee. "The Federal Government should eschew—" that is Greenspan-speak "—should eschew private asset accumulation because it would be exceptionally difficult to insulate the Government's investment decisions from political pressures."

That same year, before that same Committee, then-Secretary of the Treasury, Paul O'Neill, said "Government is big enough and has no business owning private companies."

My question to you is if it was wrong for the U.S. Government to invest in our private economy, why is it right for other nations? And what do we do to protect against the political influences that Chairman Greenspan warned about?

Mr. MCCORMICK. Thank you, Mr. Chairman. I think it is a very legitimate question. Through our policy focus, both with the non-commodity funds, as well as the commodity funds, we have very active dialogs about how to reduce the accumulation of foreign reserve, which I noted in my testimony far surpasses any reasonable level.

Senator BAYH. We wish you good luck with that.

Mr. MCCORMICK. Yes, sir. It is not an easy task.

So my discussion of sovereign wealth funds is by no means meant to encourage or validate or accept that that is good policy on the part of the countries that are accumulating these reserves.

With that said, the fact remains that a very significant amount of assets have already been accumulated. Under even the most conservative projections they will continue to accumulate. And so we are faced with the very real issue that there's a significant amount of capital out there which is going to be invested abroad.

Senator BAYH. And as I said in my testimony, we would like the capital. But I guess, to get back to my question, if we were concerned about political influences on decisions by our own Government, why should we not be equally concerned about political influences on the parts of other governments? And what can we do to protect ourselves from that?

Mr. MCCORMICK. Mr. Chairman, I think it is an area that we should monitor very carefully. And by that I mean if you look at the track record of the sovereign wealth in the United States to date, it is a track record that has generally been very responsible investing, long-term investing, and overall a very stable investment track record. That is not to suggest that the concern you raise is not a very legitimate one. And so I think that puts an added responsibility on us, through the CFIUS process, but also through our ongoing monitoring of this market and of these developments, to ensure that that is not happening.

Senator BAYH. You make a good point, that the track record to date has been a positive one without pernicious influence. But as all of us have noted, the size of these funds, the numbers of these funds, are growing very rapidly. And now they are growing in some countries that view themselves, at least in part, as competitors of ours, both economically and in other spheres, which raises a host of different questions.

So I will not continue to ask you about that, but I think you understand what I am saying. If it is a legitimate concern on the part of our own Government—for example, I just—one last point here.

We have a big debate about what to do to solve the Social Security imbalances in our country. We currently invest, at least as an accounting matter, in Treasury bonds with the excess fund that are paid in to the Treasury in terms of Social Security payments. If our Government decided that we could gain a higher rate of return by, instead of investing in Treasury bonds, let's say invest in Blackstone or something like that, a hedge fund, would our Government encourage such a policy?

Mr. MCCORMICK. Mr. Chairman, you know, it is an interesting question, in part because within the United States we already have what many would characterize as a sovereign wealth fund in the Permanent Fund in Alaska, which is a significant accumulation that is invested both at home and abroad.

I think one of the things that is interesting about the discussion on sovereign wealth funds is really there is a whole continuum of official reserves, which are increasingly being invested for higher returns in the equity markets; sovereign wealth funds, as we have just discussed; state-owned enterprises; and pension funds. And all of these are becoming much more significant global actors. Some of the same issues that we are discussing apply to some of those other investment categories, as well.

Senator BAYH. Well, and as a former Governor with a State that has a pension fund that does invest in the private marketplace, I have seen that as a positive development. But there are policies in place that try and insulate those investment decisions from political concerns, and I think legitimately so. And at the national level, when this whole subject was raised, there have been examples where States only occasionally—not frequently—have pursued social investing, shall we call it. And that raised enough alarm bells that it gave rise to Chairman Greenspan's testimony and several others.

So I raise it as an important issue.

I see my time has expired. I did have a couple of extra questions, but I will save that for the next round, Mr. McCormick.

Senator Shelby.

Senator SHELBY. Thank you.

Mr. Secretary, I have been looking at a sheet, and I have marked it up a little bit. I do not know if you have seen it. It shows the compilation of the estimated size of sovereign wealth funds in billions of U.S. dollars, and it adds up today to over $2 trillion. Some people think it will go up $12, $13 billion, could go more. And this is not exactly accurate, but it is close. About 80 percent of this money is connected to oil and gas one way or the other. Does that bother you that we have no energy policy, that we have become more and more dependent on foreign sources of energy and we are exporting our wealth and then they want to come back and invest in our company? And that is good to a point, but to what point? Does that concern you at times?

Mr. MCCORMICK. Yes, Senator Shelby, it does. I think this is really what lies behind the President's focus on energy security and the emphasis that he has placed on that particular area.

Senator SHELBY. Now, you do not have any illusions about energy security by any of the bills that we have been pushing and the President has been pushing, do you? You know, whether it is ethanol or whether it is solar power, all that is good. But it is not going to make much of a dent in our energy needs, is it, unless we really conserve energy, all of us, cut down on our energy consumption 25 percent, or build nuclear power plants and start walking more? You do not have any illusion about that, do you?

Mr. MCCORMICK. No, Senator, I do not.

Senator SHELBY. OK. So we can look for these sovereign wealth funds to grow rather than contract, could we not?

Mr. MCCORMICK. Yes, sir.

Senator SHELBY. And as they grow, they want to invest somewhere, and that somewhere is generally the United States or Western Europe, is it not?

Mr. MCCORMICK. Yes, sir, I think that is true, although I do think they are also beginning to see the emerging markets as a very attractive investment area as well.

Senator SHELBY. Does it concern you at all that companies' sovereign wealth funds would like to buy up some of our most strategic materials? What about iron or coal or oil, everything, oil companies? Does that concern you?

Mr. MCCORMICK. Yes, Senator, it does. I think the recent legislation that you and others here in Congress—specific legislation that you and others have recently passed and the President has signed is a great step forward in guarding against that possibility.

Senator SHELBY. Could you just highlight some of the differences here briefly this afternoon with respect to the management, internal controls, disclosure, and investment strategies of the different countries? Just pick out several that have sovereign wealth funds and how they are used.

Mr. MCCORMICK. Well, Senator, what is interesting as you look at this group of 40 or so is that they fall generally into two camps: in addition to the commodity/non-commodity distinction that I made, there are those that have been around a long time, and those that are relatively new. My experience, having talked to many of them on both sides of that divide, is that the ones that have been around for quite some time have really put in place an investment process, an investment decisionmaking, a governance structure that is very much like what we would see in a big private equity fund or a big hedge fund. The focus, of course, has been in creating intergenerational wealth, largely, and maximizing returns.

The funds that are relatively new I think are very much in the process of trying to define how they are going to do business, and I think therein lies our challenge, frankly, and our opportunity in terms of developing a coherent set of best practices that the newer funds might adapt to.

That is not meant to suggest that the transparency and the clarity within sovereign wealth funds is the same as you would find in a pension fund or in other areas where there is a great deal more transparency, and I think that also is our opportunity, is to get a higher level of governance and transparency across the entire sovereign wealth fund sector.

Senator SHELBY. How do you separate the objectives of a nation to survive, to expand for their own people, and the objectives of a sovereign wealth fund which is controlled by the nation?

Mr. McCORMICK. Well, Senator, I mean, I think at its core, we have to acknowledge that they are different. However, the path that we have been going down——

Senator SHELBY. And how are they different?

Mr. McCORMICK. Well, they are different in the sense that a private investment vehicle, a private company is designed, exists for the purpose of maximizing profit. The sovereign wealth funds can exist solely for the purpose of maximizing returns, but there is a possibility that they——

Senator SHELBY. But it is for the benefit ultimately of the state, is it not?

Mr. McCORMICK. It is indeed.

Senator SHELBY. OK, as opposed to the shareholders that you——

Mr. McCORMICK. Right. Yes, sir.

Senator SHELBY. So basically what we are doing in a sense is exporting our wealth to the world, especially in the energy areas, and others, and then they are using our wealth to buy back our companies. Is that correct? You know, money is looking for its best investment, and the money is going to be invested somewhere, is it not?

Mr. McCORMICK. Senator, it is. I would look at that inbound investment. I would describe that inbound investment I think a little bit differently.

Senator SHELBY. How would you describe it?

Mr. McCORMICK. I would describe that as in many ways the lifeblood of what has allowed companies in the United States to grow, to capitalize, to invest in R&D, to create higher-paying jobs. So investment as a general rule, as I know you know, Senator, has been a very critical part of our prosperity, and this sovereign wealth fund investment can also be a critical part of our future prosperity, but if and only if it operates within our markets in a way that is consistent with market fundamentals and market-driven investment decisions.

Senator SHELBY. I know you have a portfolio over at Treasury, and we set up CFIUS for Treasury to head that up, but you are not alone. But I hope that you will be very careful as you look at sovereign wealth funds' investments in this country as to who they are, what they are investing in, and the long-term repercussions for this country, our workers, and our companies.

Thank you, Mr. Chairman.

Senator BAYH. Thank you, Senator Shelby.

Senator Webb.

Senator WEBB. Thank you, Mr. Chairman.

Mr. McCormick, I want to understand your views and the administration's views in terms of any level of concern that you have about this concept. I did not quite get that from your testimony. Do you have concerns, national security concerns?

Mr. McCORMICK. Senator, the national security concerns that I think can exist from a sovereign wealth fund investment, a state-owned enterprise, or other investments, we believe can be addressed through the legislation that this Congress has passed.

Senator WEBB. So you believe under current policy there is no cause for national security concerns about the nature of these investments?

Mr. MCCORMICK. Well, Senator, I would say it a little bit differently, which is I believe that any given transaction from a sovereign wealth fund could pose very severe national security consequences. I believe the legislation that you have passed allows us the authority to deal with that appropriately.

Senator WEBB. How would you characterize the relationship between the United States and China? Adversary? Competitor? Ally?

Mr. MCCORMICK. I guess, Senator, I would characterize that as one of constructive engagement across a number of areas, and also a relationship that is tense and where we have lots of disagreement in other areas.

Senator WEBB. You would agree that in areas where two countries of the size and global interests on the United States and China, if there are disagreements that one country would want to be able to use leverage against the other?

Mr. MCCORMICK. As a general rule, yes, Senator, I think that——

Senator WEBB. I assume you would agree that there is—or maybe not. But I would assume you would agree that there is a difference when you look at an investment that actually is made by a foreign government and particularly into direct areas of the economy as opposed to, say, something like a T-bill?

Mr. MCCORMICK. Yes, Senator, I agree there is a difference. I would describe this as a continuum, so on the one end would be investment in T-bills and official reserves. Then you could see passive investment in the equity markets, and all the way up to a controlling investment in an individual company.

Senator WEBB. So in a situation that would likely—or can generally occur with this type of investment, I would think that, on the one hand, we could get ourselves into a situation nationally where we are dependent on certain levels of investment—there are sort of three areas of concern. One is that we would be dependent on a certain level of investment which would give another nation a form of quiet leverage. You have another situation with respect to the potential of access to sensitive information depending on what the investment is. And then, third, just due to the liquidity of our markets, which you commented on, there could conceivably be overt leverage in a situation where we would be having a confrontation with a country like China.

Would you care to comment on that?

Mr. MCCORMICK. Yes, Senator. I think just as you were on your second point in particular, access to sensitive information, sensitive technology, that was—I want to reinforce the point I made earlier, which is that I believe the CFIUS legislation that the Congress passed allows us to address that very direct national security concern. And I think those other areas of potential risk that you identify are legitimate ones and ones we need to monitor very carefully to ensure that that is not the case.

Senator WEBB. How would we resolve a situation if that were to occur? Given the construct of the law and of our governmental policies right now, what would we do?

Mr. McCORMICK. Regarding market instability, Senator?

Senator WEBB. Both forms of leverage, if we were to find ourselves in a situation of some tension, not necessarily even military tension but tension between ourselves and China in a situation where these types of investments were growing.

Mr. McCORMICK. Well, Senator, I think a characteristic, for better or for worse, of a global economy and one that is as integrated as ours is, is that we are dependent—and other countries are dependent—on this inflow of foreign capital. And this becomes the basis for growth and continued investment within the private sector of those respective countries.

I think if you looked at the distribution of the investment in the United States today, one of the things that would be most telling is the diversity of that investment and the degree to which we truly are the investment destination for the world.

Senator WEBB. But we do not do this, right?

Mr. McCORMICK. Excuse me, sir?

Senator WEBB. The U.S. Government, do we have these types of sovereign wealth funds? You mentioned one example in Alaska.

Mr. McCORMICK. We have that one——

Senator WEBB. As a National Government, we do not have this policy.

Mr. McCORMICK. We do not.

Senator WEBB. OK.

Thank you, Mr. Chairman.

Senator BAYH. Thank you, Senator Webb.

Mr. McCormick, as my opening comments indicated, I think it is good for our country to attract capital investment into our society. We need to do that in a way that does not compromise our other interests, and the reason for my quoting Chairman Greenspan is that I could not help but think that some people who now are desirous of this kind of investment would pitch a fit if our own Government was doing the same, and, therefore, we do not. But we do have State investment funds, as you pointed out, in Alaska, Indiana, and elsewhere, but we have built-in protections that insulate that from political decisionmaking and so forth. And so it seems to me that is what we need to do in this instance as well, and so we can get the benefit without the downside, and that is what I would like to ask you a couple of extra questions about.

You mentioned the work of the G–7 in terms of promoting transparency and best practices for sovereign wealth funds. Is it your opinion that those should be purely voluntary? Is that enough to protect the national interest? And whether voluntary or involuntary, if they are violated, what should the consequence for that be in terms of allowing sovereign wealth funds that do not follow best practices to continue to invest in our country?

Mr. McCORMICK. Senator, to begin with, I think that——

Senator BAYH. Is your microphone on, Mr. McCormick? The little red button. OK. You might pull it a little closer.

Mr. McCORMICK. Senator, as we review the current state of sovereign wealth funds, I think the starting point is that we believe there is a common objective here for most of the players involved, which is the free flow of investment. The sovereign wealth funds desire markets where they can maximize their return, and the investment destinations want to remain open to that foreign investment.

Senator BAYH. Life is easy if everybody plays by the rules, but what do we have if they do not?

Mr. MCCORMICK. At the G–7, I think there was agreement that some of the areas we outlined previously in the testimony and in our discussion are areas of concern. As I described earlier, on the national security front, we feel like we have the appropriate authorities to deal with that issue from a sovereign wealth fund or another investor in the United States.

Senator BAYH. So you are satisfied with having voluntary best practices?

Mr. MCCORMICK. Well, Senator, for the national security dimension of this, whether it is voluntary or not, if there is a sovereign wealth fund investment or any investment in the United States that raises a national security concern, we believe we have the authorities to deal with that appropriately.

The issues that could be raised that would be dealt with by best practices that we do not have a legal authority necessary to deal with are non-commercial intent, so investment for non-commercial reasons.

As I said before, the track record on this to date has been very positive, but we need to monitor it very carefully. And if we begin to see evidence that sovereign wealth fund investors are not investing in a market-determined way, then I think that would raise additional concerns.

Senator BAYH. Well, let me give you an example. One of the largest of these funds is now Russia's, and their behavior toward some other countries using energy as a leverage I think can best be described as thuggish. They are making substantial investments in some of the Balkan nations, perhaps as part of their intent to influence policies in those countries. When you have a country that has behaved like that, are voluntary guidelines enough?

Mr. MCCORMICK. Well, Senator, it remains to be seen. We have initiated a conversation on this. We have asked the IMF to take a leadership role. The IMF is now beginning to do that, and I think it will be a very telling process to determine what those best practices might be and how the sovereign wealth funds begin to work together, along with the investment destinations, to try to develop those.

There are other areas where these types of best practices have really had a positive effect, and we are optimistic they could be very helpful here as well.

Senator BAYH. As Chairman Cox mentioned in his statement, for American investors in America and American-operated companies, they are not entirely voluntary. I mean, we have mandatory standards of transparency and those sorts of things. I would encourage you to think carefully about what the consequences should be for non-American investors investing in our economy who choose to not play by the best practices. My guess is that if there are no consequences, we should not be too surprised if some decide that the rules are just simply inconvenient and they do not abide by them, and in this area I think that is probably not satisfactory.

Let me ask you one other question. My time on this round is up, and I will return to Senator Webb. I did have just a couple more.

You mentioned the IMF, and I think, you know, continuing to push on the currency manipulation front is a good one. I encourage you in that effort. I know the report due October is a little bit overdue. We are going to be interested to see if we actually made any tangible progress or whether we are just continuing to jawbone them.

But here is my question: The IMF is a good organization, but as a part of their charter, maintaining stable currencies, you know, market-based currencies, is a part of what they do. They have not had much impact on these countries that are maintaining artificial exchange rates. Why should we expect them to be any more effective in this area when they have been ineffective in the area of exchange rate policy?

Mr. MCCORMICK. Well, Senator, I think it would be fair to say and I think the new leadership at the IMF recognizes that it is a very dynamic time for the IMF when they really do need to reinvent themselves and define their mission for the next coming decades. And a critical part of that in the view of the United States is taking a very aggressive posture on currency surveillance and implementing the recently designed surveillance program that is being put in place—I know the Managing Director is committed to that—and taking on issues like sovereign wealth funds, which is an issue that is ideally suited in my view for the IMF to play a leadership role.

Senator BAYH. I am going to turn to Senator Webb. I would only observe that redefining their mission and, quote, taking on an issue, that is all well and good. But if they are not able to do anything about it, if people simply do not abide by the rules, well, that is not enough. And that is what we need to think carefully about, whether that organization, as well intentioned as they might be, is capable of being effective.

Senator Webb.

Senator WEBB. Thank you, Mr. Chairman.

Mr. McCormick, I have one other question, and I would like to presage it a little bit with looking back on a different kind of institutional memory. We went through a period in the 1980's where particularly with the competition against Japan, we saw as a result of their ability through MITI to develop an economic strategy for their companies, that policies were put in place, underpricing, dumping, designed to sort of unfairly diminish the abilities of American companies, whether it was pianos or guitars or motorcycles or cars, whatever. That kind of pales in comparison to what possibly could be the result of these practices if they go out of control because, on the one hand, Japan is an ally, and on the other, China particularly is a competitor, you know, at a minimum.

But we are having a—we are seeing a new phenomenon here in many ways, and that is that you have Government wealth entering a direct competition with private corporations in a way that, when I go back in my mind and look at what the Japanese were doing at that time, when you can concentrate your wealth, you can drive out competitors in the same business. You know, just totally serendipitously this morning in the *Financial Times*, there was an article—I do not know if you saw it or not—which discussed the—David Rubenstein of the Carlyle Group was talking about the potential of these types of investments taking down the predominance of American corporations that are in the same business, saying that these types of funds over the next decade could challenge the predominance of U.S. buyout firms because of the explosion of wealth and the ability to concentrate it, so you can compete in a way with very, very deep pockets that corporations cannot.

Would you have any thoughts on that? Actually, I would be interested in hearing from our witnesses on that point, too.

Mr. MCCORMICK. Well, Senator, I think it is a legitimate concern whether the degree to which these funds are so well capitalized allows them to invest in non-market ways based on non-market principles—in other words, investing more than the market would determine, and in doing so gain some advantage. It would not be an advantage in terms of its returns because it would have paid above market for the asset, but in terms of some political advantage.

So I think that is something we have to monitor very, very carefully, and I do not mean to suggest that the past is a flawless predictor of the future, but what we have seen here are very, very focused investors trying to maximize returns that have been largely managed by investment professionals, often not from the country themselves, invest in a passive way.

And the question, I think, that certainly we are contemplating, what steps should we take, working with others in the international community, to ensure that that is largely the kind of investment that we see going forward. And that I think is going to require a collection of actions, some multilateral, some bilateral, which I tried to describe earlier.

Senator WEBB. Thank you.

Thank you, Mr. Chairman.

Senator BAYH. Thank you, Senator Webb.

Mr. McCormick, I just have one last area of inquiry, and it has to do with the letter that was sent by Chairman Dodd and Senator Shelby and myself and Senator Webb about this sort of in-between area, where someone takes a minority interest stake in a company; it is not yet 51 percent, so they do not have absolute control; and yet it is possible that they exercise some considerable influence over the affairs in the company.

So my question to you is: First of all, what does the Department plan to do in response to the issue we raised? Are you contemplating anything in this area? That is No. 1.

No. 2, isn't it possible that the significant minority owners can exercise that kind of influence? And if the answer to that is yes, well, what do we do when it is short of 50.1-percent ownership stake?

Mr. MCCORMICK. Thank you, Senator. As you know, Exon-Florio allows the president to take action in situations where there is a demonstration of control. But the line, the red line in terms of what defines control—let me say it differently. There is no hard and fast red line in terms of what defines control. Control will be identified based on an evaluation across several different factors. Those factors would include ownership, voting rights, board seats, and so forth, which, when viewed in their totality would be demonstrative of a party's ability to significantly influence major decisions for the company.

There has been a presumption——

Senator BAYH. The ability to influence major decisions. And so you take all those factors together and the question is: Can they influence major decisions of the company?

Mr. MCCORMICK. Yes, Senator. There has been a presumption up until this point that a passive investment was one that was roughly at the 10-percent level or below. But there may even be instances when there is a 10-percent investment that the—because of other factors, that there is actually the ability for control.

So our challenge here is to really review each case on a case-by-case basis and do that in a way that identifies whether there is a controlling interest, but to also do that in a way that does not create so much uncertainty around transactions that you have ultimately created an incremental burden or chilling effect on investment.

Senator BAYH. Well, let me give you a recent for instance. I do not know how much you followed the recent change in the CEO position at Citigroup, which their largest shareholder is a Saudi prince who has apparently a 4-percent ownership stake, significantly below the 10-percent threshold that I gathered that we normally would assume would be passive. And according to published reports, he played a very active role in bringing about a change in the leadership of that company.

Now, I am not being critical of him. It may have been exactly the right thing to do. But, you know, there is an example of someone with a 4-percent stake who, I think by your definition, he apparently exerted influence over a significant development at that company.

Does he have a controlling interest in the company? Most people would ordinarily say at 4 percent, no, but it is hard to say he did not exert some significant influence over a major decision. So what do you do in a case like that?

Mr. MCCORMICK. Well, Senator, obviously all this is within the context of national security, so——

Senator BAYH. That is the largest private financial institution in our country.

Mr. MCCORMICK. Senator, as I said, all this is viewed within the context of national security, so if the ability to significantly influence decisions that could come at the expense of the national security of the United States, then control in that case would go into CFIUS and go through the appropriate review to ensure that that security interest can be mitigated or the transaction is not approved.

Senator BAYH. Well, one of the—and, again, you have been very patient here today, Mr. McCormick, and I know you are just here by yourself taking all these questions. But one of the things I think Chairman Shelby alluded to and, in fact, the CFIUS law spoke to was that in today's world—and you look at the Russian behavior as an example, and there are some others—the definition of "national security interest" is broader than it used to be. You will see the Chinese going around the world acquiring what they view as strategic energy interests, and it is not impossible that financial positions might be used in a similar vein.

And so we just need to see the world that is evolving and be ever mindful that in some non-traditional areas in today's world and tomorrow's world, they may, in fact, implicate national security interests where 20, 30 years ago, perhaps it was not the case.

Senator Webb, is there anything else you would like to touch upon before we let this good man go?

Senator WEBB. No. Thank you very much, Mr. Chairman.

Senator BAYH. Mr. McCormick, thank you very much.

Mr. MCCORMICK. Thank you, Senator.

Senator BAYH. As I said, I appreciate your service to our country.

Mr. MCCORMICK. Thank you.

Senator BAYH. We have a very distinguished second panel. If it is all right with you, gentlemen, I would like to introduce all of you together, and then, Mr. Larson, I think we will start with you, then Mr. Truman, and just move in that direction down the table.

Ambassador Alan Larson is senior international policy advisor at Covington & Burling where he counsels clients on issues of international business and public policy. He joined the Foreign Service in 1973 and retired in 2005 as Under Secretary of State for Economic, Business, and Agricultural Affairs. During his tenure, he served as Ambassador to the OECD in Paris and in numerous posts as an economic officer in Washington and at missions in Jamaica, Zaire, and Sierra Leone. He earned the rank of Career Ambassador in 2004 and was honored with the Secretary of State's Distinguished Service Award in 2005. Ambassador Larson is currently Chairman of Transparency International USA. He holds a Ph.D. in economics from the University of Iowa. There seems to be a great interest in all things Iowa these days, Dr. Larson, so we are glad that you are here representing that fine State—at least in part.

Dr. Edwin "Ted" Truman is also with us today. Ted Truman is a senior fellow at the Peterson Institute for International Economics in Washington, D.C. He served as Assistant Secretary for International Affairs at the Treasury Department from 1998 to 2001. Previously, he led the International Finance Division of the Federal Reserve Board and staffed the Federal Open Market Committee. Dr. Truman has been a member of a number of multilateral working groups on economic and financial issues and has published widely on international and sovereign investments. He holds a B.A. from Amherst and a Ph.D. from Yale. Dr. Truman, thank you for joining us.

Next is Patrick Mulloy. Mr. Mulloy, you are no stranger to this Committee. It is a pleasure to welcome you back once again to share your perspective. Pat Mulloy served on the bipartisan U.S.-China Economic and Security Review Commission from 2001 to 2006, including a period as Acting Chairman. The Commission reports to Congress on the national security implications of our economic relations with China. Mr. Mulloy also served as Assistant Secretary for Market Access and Compliance in the Department of Commerce's International Trade Administration. He spent 15 years on the staff of the Senate Banking Committee, including as chief international counsel and general counsel. Mr. Mulloy is currently the Washington representative for the Alfred P. Sloan Foundation, which funds studies and programs regarding the competitiveness of American industry and citizens. He is also an adjunct professor of international trade law at both Catholic University and George Mason University. A native of Pennsylvania, he holds a J.D. from George Washington University Law School and an M.A. from Notre Dame. Mr. Mulloy, welcome back. We are sorry about the Fighting Irish's football team this year, but there is always next year.

Dr. Gerard Lyons, welcome. Dr. Lyons is chief economist and head of Global Research at Standard Chartered Bank in London. Although based in the U.K., he travels extensively, visiting the bank's operations and clients in Asia, Africa, and the Middle East. He has held senior positions at a number of major financial institutions. Dr. Lyons is an expert on the world economy, the international financial system, macroeconomic policy, and global markets, and is invited to speak frequently on these topics. Originally from London, he obtained an M.A. from the University of Warwick and a Ph.D. from the University of London. Dr. Lyons, we are grateful for your presence here today.

Mr. Larson, why don't we begin with you. Technically, we are supposed to limit our comments to 5 minutes. If you need to run over a little bit, that is OK, but you could also submit—if it is a much longer statement, feel free to submit that for the record.

STATEMENT OF ALAN P. LARSON, SENIOR INTERNATIONAL POLICY ADVISOR, COVINGTON & BURLING, LLP

Mr. LARSON. Thank you very much, Senator Bayh, Senator Webb. It is a pleasure to be here. I would like to submit a longer statement for the record, and to summarize it, I would just begin by confirmation my name is Alan Larson, and when I was a Career Ambassador and an Under Secretary of State for Economic Affairs, I often used to deal with policy with respect to investment and inward acquisitions. Today, in my current private sector position, I sometimes get involved as an advisor on inward investment acquisitions, including some transactions that involve entities with foreign government ownership. So I have seen it from both the public and private sector side.

My testimony summarizes how foreign investments and acquisitions can benefit the United States by putting to work here capital that supports investment, growth, job creation, innovation, and competitiveness in our own economy. And I think all speakers have touched on that point.

In addition, foreign investments can mitigate the disruptive effects of global imbalances. They can transform foreign entities into stakeholders in the U.S. economy, stakeholders who prosper when our economy prospers.

There are a number of reasons why foreign entities may want to invest in the United States. My testimony goes into those. I am just going to touch on three here.

One is that some foreign government pension funds want to invest in assets that are diversified across sectors, across countries, and across different types, and in that they are like lots of other investors everywhere.

Second, as we have already discussed, some countries are very dependent on a single resource, such as oil, and they have economic reasons for wanting to diversify across investments in other countries in other sectors.

And, third—not conclusively—many foreign governments, including some of our closest allies, own operating businesses. We have discussed that that is not the American philosophy, and I agree with the American philosophy, but the fact is that some countries do have foreign-owned entities or foreign-owned enterprises, and we sometimes go abroad in trying to leverage the expertise that they have developed in their home market.

As has been discussed, these trends look very likely to continue to grow. As we know, high oil prices and current account surpluses provide some of the financial fuel for the rapid growth of these types of investments and acquisitions. Studies suggest that these surpluses are likely to continue and that a strong energy policy, even if we were to adopt a stronger one, and great progress in rectifying international imbalances, even if we were able to achieve that, are not going to dramatically change this picture.

Many of the speakers today rightly have emphasized the importance and the issue of transparency of Government investment entities. I think it is important that the G–7 has been prodded by the U.S. Government into leading an international exercise. It is designed to identify best practices on transparency, and that these best practices would be strongly recommended to Government investment entities. It is also important that the G–7 has asked the OECD to lead a similar exercise with respect to transparency on the part of investment-receiving countries so that their investment policies are transparent and that they avoid a lurch into protectionist policies.

Here in the United States, we have followed a clear policy of welcoming foreign investment while maintaining effective tools to allow us to scrutinize any transactions that might raise national security concerns. I think that the recently enacted Foreign Investment and National Security Act of 2007 is a robust tool for addressing any national security issues involving foreign acquisitions, including those by Government-owned entities or sovereign wealth funds.

FINSA mandates that the executive branch will focus on those acquisitions that raise national security concerns. I think it rightly does not look at economic factors or industrial policy considerations that could distract FINSA and lead away from—and dissipate resources on issues that are not crucial for national security.

I think that FINSA also requires—or, excuse me, I have lost my place here.

The acquisitions that do not result in control correctly lie outside the jurisdiction of FINSA, and this gets very much at the important point that Senator Webb and you, Senator Bayh, were raising. When there is not control, there is not, in my opinion, a risk that foreign persons might direct, determine, or decide core business policies in ways that raise national security concerns. I think this language is important. Is it influence? Is it the ability to direct, determine, or decide what the business strategy is going to be?

Again, I think that it would be important, if we want to protect national security, to keep our eye on those transactions that could result in foreign influence—in foreign ability to direct, determine, and decide these decisions.

Whenever an entity that is controlled by a foreign government makes an acquisition in the United States that falls within FINSA—and, therefore, within the scrutiny of CFIUS—this law already mandates that there is a presumption that the transaction will go into a second-stage review or an investigation. I think that is also an important safeguard. These transactions that involve Government-controlled entities are going to be looked at very, very carefully, and I think that is what Under Secretary McCormick was underscoring as well.

It is my understanding that the executive branch is mandated to promulgate regulations by next April in terms of the implementation of FINSA and that these regulations may address, update, and clarify the factors that the Government is going to consider when determining whether an acquisition would result in control by a foreign entity and the factors that the Government will consider in determining whether a foreign entity is, in fact, controlled by a foreign government. Therefore, I think this is a very important process that will take place between now and April and that in writing these regulations, it is going to be important for the executive branch to look carefully at other control tests that have been used and look carefully at some of the considerations that have been raised thus far in this hearing.

I think it is important, as well, that FINSA gives those agencies with security responsibilities an appropriately strong voice; it also gives the executive branch flexibility in defining when national security concerns are present, and this gives the administration the flexibility to recognize that national security may be touched by different considerations this year than it appeared that national security was touched by 10 years ago. This is an important aspect of the law, in my judgment.

I think that Congress and the administration should alertly monitor the new developments we are discussing today. But I think it is also important to recognize that Congress and the administration have worked together to put in place an effective law and an effective policy to address national security issues that may arise and that these equip us to address a future where foreign investments and acquisitions may well play a larger role in the American economic landscape.

Thank you.

Senator BAYH. Thank you very much, Mr. Larson.

Dr. Truman.

STATEMENT OF EDWIN M. TRUMAN, SENIOR FELLOW, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. TRUMAN. Thank you, Chairman Bayh, Senator Webb. It is a pleasure to appear before you here this afternoon.

In my longer written testimony, which I have submitted for the record, I make five main points.

First, sovereign wealth funds and related vehicles for external or cross-border investments by governments have been around for a long time, are growing in relative importance, and are here to stay.

Second, the existence and growing importance of these types of vehicles raise profound questions about the structure and functioning of the international financial system, as was reflected in the introductory comments by various Senators.

Third, the continuation of these trends does not currently pose a threat to U.S. national or economic security, in my view, that cannot be dealt with under existing laws, procedures, and regulations.

Fourth, it would be desirable to consider possible improvements in the U.S. statistical information base on foreign-government-related investments in our country.

Fifth, the U.S. Government should continue actively to encourage foreign governments with large cross-border investments to develop and follow a set of best practices with respect to managing those investments in their interests, in our interests, and in the interests of the stability and openness of the international financial system.

The scoreboard on existing sovereign wealth funds, which I have developed with my colleague Doug Dowson, provides a starting point for the development of such a set of best practices for sovereign wealth funds.

In the remainder of my oral testimony, I will touch on my fourth point and elaborate a bit on my fifth point.

In my view, consideration should be given to improving our statistical information in this area. I summarize in my written testimony my understanding of the nature and limitations of our current data. It would be useful to know about, one, the data that are currently available or not available on U.S. assets and liabilities of governments and government-owned and -controlled entities, broken down by the nature of those entities; two, the costs and complexities for the United States of expanding the collection of such information; and, three, the prospects for encouraging similar efforts in other countries.

Now, turning to my fifth point, what should be done to make the world safer for sovereign wealth funds? In my view, large sovereign wealth funds—at least it got a laugh out of Mr. Larson. Large sovereign wealth funds should increase significantly their accountability to——

Senator BAYH. People laugh at my testimony all the time, Dr. Truman. Don't take it personally.

Mr. TRUMAN. No, I was intending—I thought I might get a laugh. It is rare that my laugh lines get laughs.

Senator BAYH. Well, good.

Mr. TRUMAN. In my view, large sovereign wealth funds should increase significantly their accountability—and I would like to stop and emphasize the issue is not just the question of transparency. It really is a question of accountability. Transparency is a means to accountability. Accountability is what we are after. Accountability first to the citizens of the countries involved; second, to our citizens and Government as well as to those of other countries; and, last, not least to participants in international financial markets.

The most promising way to increase the accountability of these activities is through the establishment of a standard or a set of best practices for international investments in general and for sovereign wealth funds in particular. For sovereign wealth funds, best practices, in my view, should cover four broad categories: structure, governance, transparency and accountability, and behavior.

As I said earlier, to aid in the development of a set of best practices for sovereign wealth funds, my colleague Doug Dowson and I have developed a scoreboard for 32 sovereign wealth funds in 28 countries, which are listed in Table 1 in the testimony before you.

The scoreboard includes 25 elements grouped into four categories, and I want to emphasize that at least one sovereign wealth fund receives a positive score on each element, so I am not asking—maybe I should be, but I am not asking any—the collectivity to do anything that somebody else does not do, at least one other person does not do.

Table 3 attached to the testimony summarizes our results. Out of a possible 25 points, the highest score of 24 is recorded by New Zealand's Superannuation Fund, followed closely by Norway's Government Pension Fund at 23 points. The Abu Dhabi Investment Authority—ADIA—and its Investment Corporation—ADIC—in the United Arab Emirates record 0.5 points. The average is 10.27 points. Six of the ten largest sovereign wealth funds score at or below the average, including two of the three largest funds at the bottom of the table. One of the two is the Government of Singapore's Investment Corporation, called GIC. At the same time, Singapore's Temasek Holdings scores considerably above the average. I can answer more questions about this if you would like.

I endorse the Treasury's effort to encourage countries with sovereign wealth funds collectively and cooperatively to establish a set of best practices for those investment vehicles. The G–7, as you have heard, has embraced this approach to reinforce the global framework governing cross-border investment. The willingness of the Fund and the World Bank and the OECD to promote dialog on identifying best practices is also encouraging.

In the end, however, it will be the governments of countries that the sovereign wealth funds and their related activities that must decide that it is in their individual and collective self-interest to participate in those efforts. It is in our self-interest to facilitate that process.

Thank you very much.

Senator BAYH. Thank you, Dr. Truman.

Mr. Mulloy.

STATEMENT OF PATRICK A. MULLOY, WASHINGTON REPRESENTATIVE, ALFRED P. SLOAN FOUNDATION

Mr. MULLOY. Chairman Bayh, let me begin by thanking you, Chairman Dodd, Ranking Member Shelby, and Senator Webb for providing me the opportunity to testify today. I want to note that the views I will present are my own and not necessarily those of any of my employers. I also want to assure the Committee that I have no client, except the public interest, on these matters and have never been paid by any company or government or any other entity to advise it on foreign investment matters. I commend the

Committee for holding this important hearing, and as an alumnus of the Committee staff, I am really honored to be here.

Senator BAYH. It is good to know that there is life after the Banking Committee.

[Laughter.]

Mr. MULLOY. It was terrific while I was here, let me assure you.

Senator, in May of this year, you had me up before the Committee to talk about China's exchange rate practices, and in my testimony then, we talked about the provisions of the 1988 trade bill and the responsibilities given to Treasury in that bill—20 years ago almost—to identify countries that are underpricing their currencies to gain trade advantage. I told you in that hearing that Treasury had completely failed to carry out those responsibilities. I think one of the reasons we are here today to talk about sovereign wealth funds flows directly from the failure of Treasury to carry out those responsibilities given it by the Congress.

In June of this year, the Acting Under Secretary of the Treasury Clay Lowery made a speech in San Francisco to talk about sovereign wealth funds, and he said that these are Government investment vehicles which are funded by foreign exchange assets. So where do you get the foreign exchange assets to fund these? Trade surpluses are a big help.

So there are two aspects of these things:

One are the commodity funds, put together by the oil producers, and so they run trade surpluses because we are dependent upon imports of oil from them because we really do not have a good energy policy.

But the second part of this which Mr. Lowery identified were non-commodity funds. He said these are established through transfers of assets from official foreign exchange funds. In October of this year, the McKinsey group did a study on foreign sovereign funds. McKinsey told us that the Asian central banks will have $3.1 trillion in foreign reserve assets. It did so at the end of 2006. The study then went on to say, to put that amount in perspective, "it is twice as many assets as global hedge funds manage and twice the size of global private equity."

Now, these are huge amounts, and they are growing rapidly.

China's central bank right now has over $1.3 trillion in foreign currency reserves. Japan has $875 billion. The central banks of Hong Kong, India, Malaysia, Singapore, South Korea, and Taiwan together have another $1 trillion.

Now, the McKinsey study says—now, how are they able to accumulate these vast amounts of foreign exchange reserves? And the report put out by McKinsey says "exchange rate management." McKinsey tells us that these governments have had these large current account surpluses, and they like it. So in order to maintain the money coming in, they intervene in currency markets to keep their currencies underpriced against the dollar. That way, they get the surpluses. We get the cheap goods. They get the money to put in sovereign wealth funds.

Now, it is very interesting. The McKinsey study said on page 78, "For Asia"—and it is not just China; it is Asia—"the system has ensured the success of its export-led growth model and continuous and growing current account surpluses." Then the McKinsey study says, well, OK, what is the downside for the United States? They said the good side is we get a lot of good, cheap goods, and we get them invested in our Treasury to help us keep our interest rates down. What is the downside? They say we have a dollar, a higher dollar, which is propped up by the Asian central banks, which hinders our ability to export, particularly to Asia. We are getting some relief now on the euro because the euro is falling in value—I mean, is raising in value against the dollar. But we cannot—with Asia, they prop up the dollar. It harms our ability to export, and it knocks out our domestic industries that are competing against imports. It is a very—and then they say there are hazards for our country to be overreliant on foreign capital. I think these sovereign wealth funds are part and parcel showing that it is dangerous to be so overreliant on foreign capital.

Now, what are some of the problems? Senator Webb talked about strategic—that they can invest for strategic purposes. Mr. Lyons, who is here today, wrote a paper on that called "State Capitalism: The Rise of Sovereign Wealth Funds," and talked about strategic investments in telecommunications, energy, the financial sector, or even to get intellectual property rights that they do not develop but that they can buy—that we develop or others develop.

Two, what is another problem? And, Senator Bayh, you talked about this. Chairman Cox of the SEC made a major speech up at Harvard at the Kennedy School a couple of weeks ago, and he made the point you made. We have not wanted to have our own Government owning large chunks of our economy, and the road that we are on now, we are going to have foreign governments owning large chunks of our economy.

Now, Mr. Cox said at least if our own Government owned portions of our economy we could presumably try to influence our own Government to carry out our wishes. Here is what he said about the foreign governments. If the owner, on the other hand, is a foreign government, "the national interests a foreign government will advance will presumably be its own." OK. That is so clear.

Now, Warren Buffett, who I like very much—I follow him and I pay attention to what he tells me. He wrote an article in *Fortune* magazine in October of 2003 entitled, "Why I'm Not Buying the Dollar: America's Growing Trade Deficit is Selling the Nation Out From Under Us." Selling the Nation out from under us. He says we are behaving like a rich family that has a farm and we are no longer earning our way in the world and we sell off portions of the farm to foreigners every year to maintain a lifestyle we are no longer earning. That, he said, is the trade deficit. He said it was imperative that we take "action to halt the outflow of our national wealth."

In 2005, he writes a letter to his shareholders, and he refers to the United States as moving toward "sharecropper society." In other words, we are going to be working for other people because they are going to own us.

The Washington Post then put out an editorial in August of 2005 at about the same tine CNOOC was trying to buy Unocal, and the Post said Buffett's vision of where we are headed was "distressingly plausible." And the editorial then went on to say "the country is living beyond its means, spending more than it earns, and relying on foreigners to supply the difference.”

Senator BAYH. Mr. Mulloy, I am loath to interrupt, because I like you and I like Warren Buffett, we are a little bit over, and I would like to explore this with you in response to questions.

Mr. MULLOY. OK. I will make three key points.

One, we need an energy policy to reduce the outflow there.

Two, we have to understand these other Asian countries in particular are following mercantilist trade practices, and we need to address those. The bill reported by this Committee on exchange rates was very important. And in the provision that you have talked about, making these underpriced currencies and illegal export subsidy that should be countervailed, that is very important to get in that bill that you reported out of this Committee.

The third thing is, Senator Webb, keep an eye on that CFIUS process at the Treasury. There is going to be rulemaking, notice and comment rulemaking. The interests of the foreign governments and foreign investors are going to be all over that process, and I think a countervailing effort has to be made by this Committee to stay on top of that process, because Treasury in the past did not operate CFIUS the way you intended, and you had to amend it.

So those are my key points, and I thank you very much again, Senator, for the opportunity.

Senator BAYH. Mr. Mulloy, thank you very much.

Again, Mr. Mulloy, I apologize for intervening but I have some—part of having the gavel means trying to keep things more or less on schedule.

Mr. MULLOY. I understand.

Senator BAYH. Although, as you know, it is the Senate and we do tend to fall beyond. So thank you very much.

Yes, Dr. Lyons.

STATEMENT OF DR. GERARD LYONS, CHIEF ECONOMIST AND GROUP HEAD OF GLOBAL RESEARCH, STANDARD CHARTERED BANK

Mr. LYONS. Good afternoon, Senator Bayh, Senator Webb, members of the Committee. It is my pleasure and honor to appear before you today and offer views on sovereign wealth funds. Thank you for inviting me here to Washington to participate. I commend the Committee for devoting time to this examination of this issue.

I am going to offer brief oral testimony but I have, respectfully would request my written statement that covers the biggest 22 sovereign wealth funds be entered into the record.

I would like to talk about three areas. But before I do that, I should stress that sovereign wealth funds are both stakeholders and shareholders of Standard Chartered. Indeed, I met and sat with some last week when I was in the Middle East, so hopefully I'll give you some fresh thoughts.

But there are three areas I would like to talk about. First, the composition. Second, their possible impact on financial markets. And third, the strategic aspects of sovereign wealth funds that I think stresses the need for common ground rules.

First, in terms of composition, really I just want to reinforce the points already made. They are in the written paper. It is not just the size of these funds, which are $2.2 trillion and possibly more, in our view. It is difficult to contemplate fully how much or how big these funds will plump. In qualitative terms, they clearly are going to grow and therefore become far more important.

It is not just the size, as I say. Chairman Bayh listed what I call the super seven funds in his opening statement. But there is also the openness and transparency of these funds. One can differentiate between the funds. Some of them appear to be very transparent. They include Norway, Singapore's Temasek, Alaska, Malaysia and Canada's Alberta. Those funds provide detailed information on their size, returns achieved, and their portfolio composition. And many companies have seen these as investors without any apparent issues to date. One has to ask if these funds find it possible to provide such information and continue to perform as sovereign wealth funds, why cannot others?

In contrast, there are other, secretive, funds. They include the UAE funds, China, Qatar, Brunei, Venezuela, Taiwan, Oman, and Kuwait. And while secrecy in itself does not mean the funds will be a bad investor, in the global investor environment where transparency and accountability are seen as important positives, such opaqueness should be discouraged and openness clearly encouraged.

Second is their possible impact on the financial markets. I would stress that the source of these funds comes from four different areas. One has already been stressed, namely the movement in commodity prices. Second is the growth in foreign exchange reserves. And just to put that in perspective, a decade ago Asia held one-third of global currency reserves. Now it holds two-thirds. The bulk are still in dollars, although I would stress that, in my view, passive diversification from the dollar is already underway.

In addition to commodities and FX reserves, the third is clearly the investment performance. And fourth is what I would call the discretionary factor, how much a government wants to put into these funds. That is particularly important when one considers the new Chinese fund where, whilst in my view foreign exchange reserves in China will grow significantly—probably to $2 trillion by early 2009—it is not yet clear how much of that increase in reserves will be allocated to new funds.

Senator BAYH. What was your third factor, Dr. Lyons?

Mr. LYONS. Sorry, the investment performance of the funds. Basically how much money they are making.

They also will grow relative to other types of investors, as has already been stressed. I think it is important to appreciate that in other parts of the world sovereign wealth funds are viewed as a force for good, particularly in emerging markets. And that is partly because of where I believe sovereign wealth funds are expected to invest their money. I would stress four particular areas, two of which come into the category of state capitalism, as Senator Webb mentioned in his opening statements.

In terms of where I expect the funds to invest their money: one, I do expect them to take bigger stakes in equity and bond markets across the emerging world. That makes sense in economic and financial terms. Second, I do expect them to feed more money into alternative investments such as hedge funds and private equity.

And the third and fourth area which I would include under state capitalism, I believe that they will boost strategic links with countries that have not fully shared in globalization's success or, indeed, regions that have been shunned by the West. Africa comes immediately to mind. Although I would stress if a country wants to take a stake in such regions or areas, they do not have to just do it through sovereign wealth funds. And finally, I think they will take strategic stakes in sensitive areas within developed countries if, clearly, they are allowed to.

That leads on to the third and final aspect, which is the strategic aspect of these funds. I think this is very much in the case of trying to head off future problems rather than addressing the issue that is really big at the moment. In the paper I submitted, I said that my big concern is that these funds will see an opportunity to acquire strategic stakes in key industries around the globe, whether it be telecommunications, energy, the media, the financial sector, or indeed to secure intellectual property rights in other fields.

Whilst that can be viewed in a sinister way, I would also stress that it makes a lot of economic sense. If one is a low value-added country like China, then it makes sense to try and leap a few years by acquiring strategic assets that give access to intellectual property rights. Basically, countries will want to move up the value curve quickly. Of course, there may be other non-economic factors at play there. Also, buying into overseas firms will make sense for countries which are not thinking possibly of setting up sovereign wealth funds.

Reverse nationalism is an area that I think is already big, and that is basically the need to acquire strategic commodities and resources around the world. Not just energy but maybe hard metals and, indeed, soft commodities.

Despite that, I would argue a protectionist backlash against sovereign wealth funds would be damaging for global trade. I would reinforce some of the points already made about the need for sovereign wealth funds to be encouraged to adopt the best practice of open funds like Norway. I would also stress countries in the West to press for what I call the level playing field approach, to encourage the opening up of markets from which sovereign wealth funds emanate.

I think this is a particularly important point when we look at sovereign wealth funds. One of the reasons why I think they have become such a big issue is because of the imbalance to the global economy. For the global economy to become more balanced, it is not just a case of currency adjustment that is needed. One needs to see high savings regions like Asia and like the Middle East move away from export-led to domestic-led growth. Indeed, that is in their best interest as well, given their demographic profiles.

As they move toward domestic driven growth, part and parcel that process will be the opening up and deepening and broadening of their financial sectors. I think that is something that needs to be stressed. And that is a multi-year process which I think will address many of the issues here.

And of course, I would say and reinforce the point made that we need to try and improve the governance and transparency of sovereign wealth funds and to promote an investment framework that is fair and commercial driven.

So finally, I would say the sovereign wealth funds debate is a further sign of the shift in the global economy, the shift in economic and financial terms. In recent years, there has been much talk about the need for global policy form to change. Whether they will change remains to be seen, but even if they do change, whether they will be effective again remains to be seen. But in this particular area, it is an opportunity for countries in the West to work with emerging economies, particularly those from where the big funds come, to basically get some ground rules and a common code of practice.

I would stress that the more sovereign wealth funds invest strategically, that would be a concern. Yet, as long as the investments by these funds are for commercial reasons and not for political purposes, then these funds should be accepted. But as clearly stated, there is lots of issues within that.

Senator BAYH. Thank you very much, Dr. Lyons.

Perhaps I should pick up where you left off. As I said at the beginning, and Mr. Mulloy was going on—I think appropriately so—and you mentioned as well, some of the forces that are leading to the reserves that enabled these funds to be created. It seems as if the macroeconomic factors are not going to be changing any time soon. So this phenomena is likely to continue.

So we want to see these dollars recycled into our economy. That is beneficial to us. But we want to insulate ourselves from any political agenda on the part of countries that have the sovereign wealth funds. So I would like to focus with all of you on that, perhaps, Mr. Larson, starting with you, and then Dr. Truman, and then Dr. Lyons. I am not leaving you out, Mr. Mulloy. I had another question for you, but my first two questions to you three gentlemen—maybe we can just go in order.

No. 1, should the best practices that we envision for these funds be entirely voluntary? And if they are, I think, Dr. Truman, you emphasized—and I think appropriately so—the notion of accountability. So if the best practices are voluntary, what should the accountability be if the best practices are not followed?

Mr. LARSON. Thank you very much.

I do think that the international effort to develop best practices and get them adopted is an important one. My government career over 32 years was negotiation and I know that some of these can take a while. And I think that I would not want to offer undue hope that this will be quick and easy.

Having said that, I want to come back to the "what if" because I think that insofar as these entities are making acquisitions in the United States that have security implications, national security implications, that the law that Congress has put in place and the process that the CFIUS agencies run allows them to demand information with respect to a specific transaction, about the reasons why the investment is being made, whether it is political, whether it is——

Senator BAYH. Will the CFIUS process serves as a backstop to the voluntary nature of the best practices?

Mr. LARSON. I think it is a safety net, sir, yes.

Senator BAYH. Is there any inconsistency in your mind about why we would not insist upon adherence to best practices from global investors when, for publicly held companies in our country, we would probably not countenance such a thing, voluntary standards?

Mr. LARSON. Well, I think there is a difference.

Senator BAYH. In other words, if the SEC just said you know, the reporting requirements and that kind of thing, that is just best practices and you can follow it if you want to. And if you do not, the marketplace will do with you what it will?

Mr. LARSON. I am glad you asked that question, because let me zero in on some of the things that Chairman Cox said. I agree with the requirements that the SEC levies, and I do think that they protect investors and give confidence to investors. I agree with his comments that we have had, as Americans, a strong and correct desire to make sure that government is not conflicted as between its role as an owner of a company and its role as a regulator of an industry. And that was one of the things, I think, that was at the core of some of the remarks that the Chairman made in his speech at Harvard.

It is, in my judgment, a different set of issues that we face when we have foreign companies or entities and possibly government-owned entities making investments in the United States. And that is why the structure of the Foreign Investment National Security Act, I believe, took the form that it did. And it gave the executive branch tremendous authority to scrutinize, review, and if necessary prevent those acquisitions that would jeopardize national security.

Senator BAYH. I have only got 56 seconds left before I turn to Senator Webb, so I apologize. But I think you put your finger on an important point I wanted to make, which is I hope that the—and I was very grateful for the Under Secretary's comments and presence today. A lot of this will depend upon the zeal with which they enforce the new law.

In the past, it has been the perception of some that it has been largely a laissez faire interpretation of the regime that was in place. And perhaps they will have a bit more rigor going forward which, I think, would give a lot of people confidence in the fact that the appropriate framework may already be in place. But it is going to be dependant upon how they choose to enforce it. I guess that is what I—and some of us are going to be looking to see do they mean business here or is it going to be just kind of an anything goes attitude yet again.

And I apologize, Dr. Truman—thank you. I hated to interject, but I want to get to Senator Webb.

Dr. Truman, should it be voluntary? If not, how is accountability provided?

Mr. TRUMAN. Well, I would—let me turn on the microphone, excuse me.

I would go the same place where Al Larson started from. In some sense, in terms of the national security dimension, we have a mechanism that—I would come at it the other way.

From the national security dimension, you have things that prevent—whether or not you have best practices. Right? Some foreign government comes in, buys something, does not tell us, we can throw them out of the country after the transaction is made, right, and have mitigation agreements and so forth and so on.

So the best practices, in some sense, has to do with the other things we are concerned about, right? The citizenship elements. Do we know what they are doing? Do we—what kind of things they are buying, whether they are passive investments, whether they—and so I think that is a—I would it the other way around.

You have the first line of defense, in some sense, is for government's own investments, is the CFIUS, whatever abbreviation you now call it.

And the second would be a set of best practices. I think to be successful the principle should be—as it is often called—comply or explain. If you have a significant number of countries who are following essentially the best practices, then the system—right—public opinion has a lot of leverage, a lot of leverage over countries and entities that are not following those best practices.

You can do it, if I may put it that way. You and your colleagues can do it. The newspapers can do it. And public opinion, since this is also in the interest of the people in the countries themselves, can do it.

Senator BAYH. If I could just interject, please go ahead and then I want to get to Dr. Lyons. But I am going to need to get to Senator Webb. Two of the reasons that we are here today——

Senator WEBB. Mr. Chairman, it is not a problem. I am interested in hearing this, as well.

Senator BAYH. Thank you, Senator.

Two of the reasons we are here today, Doctor. No. 1, the line between what constitutes a national security interest and what constitutes an economic or financial interest may not be quite as clear and bright as we would all like it to be. Part of that is a process of interpretation.

Dr. Lyons alluded to other countries perhaps having a strategic interest in acquiring our intellectual property, which if our national economic comparative advantage is going to be by being a more highly innovative economy and our intellectual property is bought for a few cents on the dollar, that has some potentially pretty significant ramifications for our country.

So that is just one example.

Mr. TRUMAN. I accept fully that these lines are not easy to draw.

Senator BAYH. The second thing was what some of us would call the relaxed attitude of the administration on enforcing the previous regime.

Mr. TRUMAN. We can discuss it. I favor a narrow approach personally. My judgment, and it is a matter of judgment and I understand it is a matter of judgment for a narrow definition of national security. But I recognize that there are other issues involved. There are issues involved whether you are a government-owned corporation or entity or not, about proprietary information and so forth and so on. Those are issues which extend, it seems to me, in the continuum extend from government to non-government and it is a very complicated issue.

I think it is appropriate that we have laws and rules and regulations in this area. I would note that, just to come back on the publicly held corporations, I mean it is true that outside of CFIUS itself, there are rules and regulations in terms of publicly owned entities that require certain disclosures when large—or even relatively small stakes—are accumulating, including your friend the Prince, the Saudi Arabian Prince. That had to be disclosed.

So it is not as if we do not—but on the other hand, I think it is in the interest of the countries involved, right, as well as our own, right, that there be more disclosure and accountability, including to the countries involved.

I say in my testimony that, in some sense, if this money is wasted, right, the biggest—which is one risk, right? You pursue non-economic objectives, right? And even if they are overall national security objectives and it is wasted, in some sense you get nothing on either dimension, right? Then the people who really pay are the citizens of the country involved.

And there are a lot of examples where that has happened already, whether it is Nigeria or Ecuador or appearing to be happening in Venezuela. So in that sense, accountability, in some sense, the biggest risk, in some sense, is to the countries' wasting their money. You can have issues about where the money came from in terms of the foreign exchange reserves. But at least as far as the commodity funds, it was dug out of the ground, right? And then the wealth became below ground, became above ground, and if it ended completely wasted, in some sense, the country in a longer term sense is much worse off.

And that also can have national economic and security implications for the United States if Venezuela, for example, implodes as a consequence of this process.

Thank you.

Senator BAYH. Dr. Truman, thank you. Dr. Lyons, I would love to hear from you, but I have run substantially over. Senator Webb has been very courteous, but I would like to turn to him and then maybe in a second round get back to you.

And I have not forgotten you, Mr. Mulloy. Do not worry.

Senator Webb.

Senator WEBB. Senator Bayh, I would actually like to hear from Dr. Lyons on your question, if you do not mind. I did not anticipate we were going to get that long of an answer from Dr. Truman when I yielded a few minutes, but I would like to hear a little more if Dr. Lyons would care——

Senator BAYH. You were almost Senatorial in your response, Dr. Truman.

Mr. LYONS. Rather than repeat the comments that have already been made, and which I agree with, maybe just three different perspectives or three perspectives that reinforce.

One is, obviously this Committee is looking at things from a U.S. perspective. I would very much certainly encourage the Committee to try and view this in the multilateral basis and try and export best practice. If it is seen that the U.S. is putting up some blockages, justified or whatever, then the money from sovereign wealth funds will simply go elsewhere. I think it is therefore important to work with these funds to basically have best practice.

And best practice is only going to be adopted if the funds see it as being in their best interest, as well.

Senator BAYH. Well, we want the money and we would encourage them to follow best practices. The question is what do we do when they do not?

Mr. LYONS. Which leads on to China. It is interesting, I agree with the points about China's currency. When I go to China, it is very clear that financialism is how they approach all aspects of policy, including the currency. China, although it is one country, is a multitude of different economies, some of which are booming, some of which—Western Central China, Northeast part of China—have clearly been held back.

And Hu Jintao, the President, when he gave his policy speech earlier this year, was saying that even though China was growing strongly—indeed rapidly—it is not generating enough jobs at the moment for urban workers. It needs 25 million a year and it is currently generating 9 million to 11 million a year.

So when one looks at it from a Chinese perspective, they are almost very fearful of allowing their currency to appreciate more aggressively. And therefore, they approach financialism.

But what I find interesting is, in my view, the way the U.S. approach changed in recent years, rather than just focusing on the currency debate with China, but trying to package it as part of the need for China to open up and deepen its financial markets. I think that met with more reception in China, and I think that is the right way to proceed.

But I think it is inevitable that China will not allows its currency to appreciate too aggressively, but certainly one should encourage them to try and appreciate it further. But the point is that they will continue to accumulate reserves. We can all debate the speed at which they do so.

And the final point I would make about security, I think there is widespread global agreement about protecting areas of defense security. As you pointed out, it is very difficult beyond that. And indeed, in the U.K., in the Enterprise Act, the U.K. Chancellor, the Finance Minister, talked about areas of sensitivity, again far more vague.

But I think the important point is that for any investors, they need to know where the line in the sand is. And if one is to protect areas outside the defense, then that is in any country's—clearly in any countries' interest if they wish to do that—or agreement rather to do that. But I think it is important to actually know where those lines in the sand are.

But ultimately, I think we should be working closely to try and get best practice. But I think it will take time, actually, because many of these funds have only really come under scrutiny and under public domain in the last year. The more they are in the public domain, under public scrutiny, then hopefully the more progress there will be.

Senator WEBB. Thank you, Mr. Chairman.

I would like to request the Chair reset the clock, since that was not in response to my question. I would like to have a few minutes here.

Senator BAYH. The clock has been reset.

Senator WEBB. Again, I would like to thank you for holding the hearing and to all the witnesses, I was very interested in all your testimony. I found it to be very illuminating. I took a lot of notes, a lot of things to think about.

From my perspective, I would just like to make it clear that the concern that I have, and I think a lot of people who see this the way that I do, is not foreign investment. It is foreign government investment. And that is something that is quite different.

And when we are talking about the individual transactions or the individual direct business activities that are going to be examined, there is another piece of that. And that is whether, in the aggregate, we might reach a tipping point with respect to one nation or another. It is a different kind of thing. In some cases, the economic and the non-economic factors tend to merge, just as the commercial and the political can tend to merge.

As I was listening to the testimony, one thought was going through my mind. And that is I do not think we have really yet come to grips philosophically with what is going on here. Dr. Lyons, you created a couple of terms here that I think are applicable. Mr. Mulloy, you talked about a sharecropper society in which that is basically the definition of colonialism, quite frankly, that somebody else owns the assets and somebody—another group of people does the work. One group gets the labor and the other group gets the profit.

But somewhere in here with this notion of state capitalism, we are emerging, in some cases, to a new form of national power. Very clearly, with the countries that are our competitors. It is a very unique situation to be in. It is almost—we went through colonialism and then we had socialism and then we had fascism with the government sort of accommodating large scale industry. And now we have state capitalism, and I think that is a very good term.

When it comes to nations that are in competition with us on a number of other fronts that affect a clear definition national strategy, we have to look at that. And we have to look at that not only in terms of individual transactions but the vulnerabilities that they are bringing to our ability to articulate our policy around the world. We can understand how this began. We can understand the inception of this, with the nations—particularly in Asia—having accumulated so much capital—or excuse me, so much money—that they want to invest and that is healthy when it is properly designed, that they do so in our country.

But I am just sort of curious. I would like to hear Dr. Lyons and Mr. Mulloy particularly, in the time that I have address this philosophical environment that we are moving into.

Mr. LYONS. I completely agree with the comments of Senator Webb. I think it is not just foreign investment. It is a differentiation between private foreign investment and state investment.

One phrase used in the U.K. is the Wimbledon effect, which relates to the first point about private investment. Basically, the feeling in England or Britain is that we have the best tennis tournament in the world. But Britain rarely ever wins it. But that is not the point. The important point is that the tournament takes place in London with all of the associated benefits.

The phrase is used, the Wimbledon effect, not so much for tennis but more because of the city of London. The city of London is seen as one of the world's major financial centers. But the ownership, a very small part of it, is in British hands. Lots of it is international hands. And the important point is that that is the right thing. As long as you have the right legal framework, you have the right environment, then it does not really matter who owns the companies, who owns the business, as long as it takes place in London.

And I think that is the right approach. But as you say in your comment, it refers to the private sector part of the foreign investment.

When it comes to government involvement, it is a very difficult ball game for all the reasons we mentioned before. Governments approach things not just in terms of maximum short-term, maximum long-term return, it is maybe not to maximize returns for investors. It is very much a different set of criteria.

The interesting aspect is that this does not really just mean sovereign wealth funds. If one looks—let's take China as an example. China is investing heavily in Africa, not through China's sovereign wealth fund but through CMOOC or Petrol China. Indeed, one can argue China's Development Bank, Chen Yuan, the president there, have taken stakes overseas in Barclay's, et cetera.

Now all of this is justifiable in economic terms but all these different parts of China's ink, you could say, link back to the government. So when one starts to look at it in a government perspective, whether at different incentives structures, than it does actually have a profoundly different aspect. And therefore, it becomes very difficult to get the common ground rules to apply in that flavor.

The important point, I would argue, is maybe to try and step back and encourage China to open up its financial sector even further, one of the points I was making, and try and work with them so they see it as in their best interests to adopt the principles that we in the West see as in our best interest, as well.

Mr. MULLOY. Senator, thank you for the question.

Being on that China Commission for 6 years and reading the press clips that the staff would prepare for us every weekend—magazine articles, newspapers, everything—you begin to form some impressions of what you think is happening here. China was a great society, a great economy. They had a bad 200 years. They want it back. They tried communism and a collectivist economic approach. It did not work. Deng Xiaoping came in, in 1978, and he said, "We need to have the Westerners, the foreign investors help us build our economy." And they provided all kinds of incentives and strategies to make that happen. And we have gone along, and many other foreign corporations have done so as well.

So there has been tremendous technology transfer, tremendous knowledge transfer. We have not fully grasped what is happening here, and we have no counter strategy. I am not out to demonize the Chinese. I mean, what the heck? If you were them, you would be doing the same thing. But they have a strategy, and we do not have any counter strategy.

This is an article by Peter Navarro that appeared March 13th. He is a business professor at the University of California, and he has written some books on China. He said, "China may invest its equity funds strategically to established controlling interests in U.S. companies and thereby gain influence over decisions ranging from the offshoring of production and technology transfers to lobbying against U.S. legislation to promote fair trade with China."

Now, let me just give you another one. This is from Inside U.S.-China Trade, September 12, 2007. There is an article here called "Multinational Firms Begin Campaign to Derail China Trade Legislation." That is your bill, Senator. He said all the major exporters, importers, and firms with investments in China are all meeting to figure out—and they are being put together by the U.S.-China Business Council, the Retail Leaders Association, ECAT, Chamber of Commerce, Business Roundtable. It is a lobby. It is a lobby——

Senator BAYH. It is always nice to be taken seriously.

Mr. MULLOY. I mean, really, it is an amazing situation.

So this is what I think we need to understand. There is a strategy. The U.S. Government, we need to really think and do some serious effort to have the committees of the Congress look into some of these things and begin to put together, just like we put together the 1988 competitiveness and trade bill, a new globalization bill to prepare us for this different kind of international economic competition that we are now in. And I think that is very important for the country to be doing, Senator, and thank you for the question.

Senator WEBB. Well, thank you both for your responses. I am not one who is attempting to demonize China, either. I think that what we have seen over the past 36 years with China, being able to aggressively pursue relations with them, it has been very healthy. It is something that we probably should be thinking about with Iran. We have been able to bring them into the international community. At the same time, we have to recognize their size and the potential and the fact that they are a competitor, and we need to address those situations in a way that prevents us from further vulnerability, and that was my motivation—one of my motivations in asking for the hearing, and, Mr. Chairman, I thank you very much for having held it.

Senator BAYH. Thank you very much, Senator.

Mr. Mulloy, I think you addressed it. I was going to ask you about—oh, as long as we have the energy situation that we do and the trade situation that we have, and as I think Dr. Lyons pointed out, even the conscious currency policies that some countries have designed to promote domestic stability, we are going to continue to face the phenomenon that we are dealing with here today, and the question is: How do we responsibly deal with that? As I said at the outset, how do we get the advantages of the investment, but insulate ourselves from political pressure or an agenda on the part of other countries that may have interests other than our own.

And so with regard to the piece of legislation you mentioned, I would much prefer to have global currency markets establishing the value of respective currencies. But as long as some countries choose to pursue industrial policies, we have to think carefully about what the consequences of those are, and then act in accordance with our own interests.

Dr. Truman, you look like you are volunteering an answer.

Mr. TRUMAN. If you will permit, Mr. Chairman, I just wanted to say on the record I agree 100 percent about this issue of the Government role, and I have said in my own writings—and I think the issue, if I may turn Gerard Lyons' phrase on its end, is state capitalism, the question is how much of it is state and how much of it is capitalism. That is essentially the issue that we have to try to sort out.

I would like to make one point on the question of the linkage of this to the imbalances. I agree with are living beyond our means, and that is a big problem. But let's say we magically went back to a current account deficit or a small—balance or small surplus or deficit. There actually still would be a case for a lot of cross-border investment because it is diversification. And it may not be so important for the United States, which actually has a lot more in terms of Government-owned, Government-managed—I mean, CalPERS and so forth and so on, and various Government-owned pension funds. We actually do have a lot of that, though it is structured in a way which is transparent and accountable and so forth and so on.

And that makes sense, even for the United States, which has a lot—we can diversify a lot within the country. It makes a lot more sense for Singapore to have a lot of diversification outside.

So even if we were in current account balance, in some sense, given the different governmental structures of the world we have, even if we had current account balance and then built up an extra $10 trillion worth of—or net of $3 to $5 trillion worth—$2.5 trillion worth of debt over the last 24 years. The existing say $14 trillion on both sides would still be there, and in some sense raise all the same questions, right? Because we have different—because we would have our $14 trillion abroad, most of which was managed by private investors, right? And they would have their $14 trillion in the United States, a lot of which—of which a much more significant fraction was managed by governments. And that is the issue that you are raising, and I think it is a profound issue, and we cannot go remaking their governments. We can try to persuade them that our system works better, and my guess is that is what is going to happen over the next 25 years in some sense, just as with central planning. But the diversification motivation is still there, and we in some sense still have the same problem even in the absence—I agree with you entirely—of this overhang of living beyond our means that we have been living with for the last whatever number of years you want to pick.

Senator BAYH. Well, a lot of good issues have been raised here today, and, gentlemen—yes, Mr. Mulloy, you raised your hand.

Mr. MULLOY. I agree that we are in a bind now, that we need to get these best practices, and I agree probably the best way is to have a good CFIUS process that is quite aggressive and what we think the best practices are. And I do not think that will happen, Senator, without strong oversight from this Committee on the rulemaking and other things that go on in Treasury.

Senator BAYH. This Committee with the assistance of Senator Webb.

Mr. MULLOY. Yes.

Senator BAYH. Well, I think that is a good point, and, again, I want to thank all of you. I think there were some excellent points raised here today, and the first one being that there is a difference between foreign investment on the part of individuals or private entities and government-sponsored entities. That is No. 1.

No. 2, a good CFIUS process can backstop voluntary best practices. One of the hard parts about that is when is it a national security interest and when is it a financial or an economic interest and how do you differentiate one from the other and so forth.

I suspect that these imbalances will last for a while. You are right, it would make sense from a portfolio theory standpoint to diversify investments in any event, but I suspect what is happening today—and Mr. Mulloy would probably agree—is that we are at least temporarily maintaining a higher standard of living for us at the expense of our children and grandchildren, is what is happening here. And I do not think a great nation does that for long.

But that is a topic for another day and another panel, and until then I want to thank all of you for your time. Dr. Lyons, you have come a long way. We are grateful to you. And, again, thank you for your service to our country through your presence here today.

We stand adjourned.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 2pm EST, November 14, 2007
CONTACT Ann Marie Hauser, (202) 622-2960

UNDER SECRETARY FOR INTERNATIONAL AFFAIRS DAVID H. MCCORMICK TESTIMONY BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Chairman Dodd, Ranking Member Shelby, 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. It should be noted, that 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

[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.

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 enabled 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 reserve. 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 $53 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, President Bush publicly reaffirmed in his open economies statement 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

[2] "Sovereign Wealth Funds," Appendix 3 of the Semi-Annual Report to Congress on International Economic and Exchange Rate Policies, June 2007.

markets should continue to make the United States the most attractive country in the world in which to invest.

Foreign investment in the United States, including from sovereign wealth funds, strengthens our economy, improves productivity, creates good jobs, and spurs healthy competition. In 2006, there was a net increase of $1.9 trillion in foreign-owned assets in the United States. Foreign direct investment (FDI) is particularly beneficial to our economy. FDI supports nearly 10 million U.S. jobs directly or indirectly, 13% of R&D spending in the U.S., 19% of U.S. exports, and pays 30% higher compensation than the U.S. average.

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 global economy. Protectionist sentiment could be partially based on a lack of information and understanding of sovereign wealth funds, in part due to a general lack of 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 is needed.

Second, transactions involving investment by sovereign wealth funds, as with other types of foreign investment, may raise legitimate national security concerns. The new Foreign Investment and National Security Act (FINSA) authored by the Chairman and Ranking members of this committee and signed into law by President Bush last summer, implemented through the Committee on Foreign Investment in the United States (CFIUS), ensures robust reviews of investment transactions, based on the consideration of genuine national security concerns, and requires heightened scrutiny of foreign government-controlled investments. 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 could 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 FINSA through the CFIUS process. 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. We believe the U.S. investment security framework provides a good model for other countries where protectionist sentiment has been on the rise due to concerns about sovereign wealth funds, and we are actively engaged with these countries to help them avoid undue protectionist responses.

Second, we have proposed that the international community collaborate on a multilateral framework for best practices. The International Monetary 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 Organization for Economic Cooperation 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 proportionality, predictability and accountability, and should be guided by the well-established principles embraced by OECD and its members for the treatment of foreign investment. It is important to address the growing importance of sovereign wealth funds, on both sides of the investment equation.

We have already seen meaningful progress along these lines. On May 12-13 of this 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 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. The next day, the International Monetary and Financial Committee – a ministerial level advisory committee to the IMF – issued a statement calling on the IMF to begin a dialogue to identify best practices for sovereign wealth funds.

Fourth, Treasury has taken a number of steps internally and within the U.S. Government to enhance our understanding of SWFs. 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 dialogue with countries with significant sovereign wealth funds and their management.

Treasury is actively coordinating with Congress through staff briefings and committee hearings. As you know, we informed Congress in June of some of our initial thinking on sovereign wealth funds 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 ensure the United States shapes an appropriate international response to this issue, addresses legitimate areas of concern, and ensures that the United States remains open to and welcoming of foreign investment.

-30-

Investments and Acquisitions in the United States by Government Entities

Testimony by Alan Larson
Senior International Policy Advisor
Covington & Burling LLP

before the Senate Committee on Banking, Housing and Urban Affairs

November 14, 2007

Mr. Chairman, Senator Shelby and other distinguished Senators:

My name is Alan Larson. I am a Career Ambassador and former Under Secretary of State for Economic Affairs. In those capacities, I frequently dealt with inward investment and acquisitions issues. In my current position, I sometimes advise clients, including government corporations and government investment funds, on how to ensure that proposed acquisitions comply with the policies of the United States.

I am honored to participate in this important hearing. I hope that my public and private sector experiences will be helpful to the deliberations of the Committee.

The Benefits for Foreign Investment in the United States

This Committee is well aware of the benefits of foreign investment. Let me briefly summarize a few of them.

Financial investments from abroad add to the pool of capital available to support investment, economic growth and job creation in the United States. Investments in U.S. government and corporate bonds, for example, help keep interest rates low. Investments in the stocks of private companies help those companies finance their investment opportunities.

Direct investments, such as greenfield investments or acquisitions of existing assets or companies, contribute to the production base in the United States. They stimulate competition and support job creation. Often these investments bring technology and management techniques that sharpen American competitiveness.

In addition, foreign investments in the United States contribute to the efficient operations of the global economy, including through the recycling of surpluses generated abroad. At this time, the global economy is experiencing significant imbalances. Oil exporting nations and some Asian countries are generating large current account surpluses, while the United States and oil importing nations tend to have current account deficits. Foreign investments in the United States are one means to facilitate international adjustment to these imbalances.

There are broader political advantages to foreign investments and acquisitions. Countries who put money at work in the United States become stakeholders in the U.S. economy. Their economic interests are advanced if the economy of the United States thrives.

This Administration, and previous ones, have wisely pursued a policy that is based on openness to inward investment, while at the same time ensuring that the U.S. Government has the tools to deal effectively with the small number of inward acquisitions that might pose national security issues. I believe that the Foreign Investment and National Security Act of 2007, a law that benefited from strong leadership by this Committee, provides an effective framework for implementing this balanced policy.

Government Investment Entities: Not a New Phenomenon, a Variety of Shapes

The foreign government entities that invest abroad take many different forms. Some of them have familiar names and have been part of the economic landscape for a long time. Others are newer and less familiar.

Governments and government entities have several reasons for considering foreign investments and making acquisitions of foreign assets. Managers of government pension funds, for example, are responsible for ensuring that government revenues generate an adequate return to pay for the pensions of government workers or others who participate in government pension plans. In the United States, the Federal government and State governments have put in place such pension plans. The motivation is to accumulate resources sufficient to pay for the expenditure obligations of the future.

In some cases governments want to ensure that revenues associated with the production of depleting natural resources such as oil produce lasting benefits for their citizens over several generations. They may establish organizations that invest these revenues in a manner that generates returns for future generations, when the resources may have run out. In the United States, the state governments of Alaska and Wyoming operate such plans. Internationally, a number of oil producing countries operate such investment funds In many instances, these funds are directed by professional managers in accordance with broad investment strategies.

State-owned enterprises (SOEs) are a part of the economic fabric of most countries. In the United States, they include transportation companies such as Amtrak and electric utilities such as the Tennessee Valley Authority. In many other countries, government-owned companies operate internationally and are engaged in transborder trade and investment.

In some recent cases, countries' Central Banks have generated large foreign exchange reserves. These foreign exchange reserves traditionally have been held as cash or invested in foreign government bonds. In recent years, there have been vigorous discussions about the extent to which these foreign exchange reserves will be held in dollar-denominated assets (as a majority of them have been in the past) or Euro-denominated assets. The weakness of the dollar provides fuel for the debate. At the same time, some countries with large foreign exchange reserves have developed programs for converting a portion of these reserves into a wider range of financial assets that could earn a higher rate of return.

As this brief discussion makes clear, there is a wide range of reasons why foreign governments seek to invest foreign assets. In discussions of sovereign wealth funds and other government-owned entities, it is important to be specific about the type of government-owned entity, its investment aims and its operating methods.

<u>Reasons for Foreign Government Entities to Invest in the United States</u>

Foreign government entities have good reasons for considering investments in the United States as part of their portfolio.

Pension funds and commodity funds typically seek diversification and a reasonable balance of risk and return. Financial counselors advise American families to hold a mix of assets across different asset types, different economic sectors and different regions of the world. For the same reasons, foreign funds often want to have exposure to the dynamic U.S. economy as part of their investment portfolio. This appears to reflect the approach that many of the large sovereign wealth funds have followed during the last thirty years.

Many oil exporting countries have small populations. Even if they formulate large domestic investment programs, they cannot sensibly invest all of their oil revenues at home. In contrast, excessive domestic investment would tend to create asset bubbles, destabilizing local inflation or exchange rate appreciation that would cripple domestic exporters. The so-called "Dutch disease" is an example of the economic problems that well-managed commodity funds can mitigate. In addition, a well-managed fund allows a country dependent largely on one product to diversify away from a commodity that may be susceptible to boom and bust cycles.

Even if they compile big shopping lists that include large amounts of imports, some resource rich exporters cannot spend all their current revenues in a prudent manner. Making investments abroad is a sensible strategy for putting these earnings to work rather than dissipating them in unproductive expenditure. The Government of Australia, for example, has established a "Future Fund" for investing budget surpluses related, in part, to revenues generated by commodity production.

In other cases, a foreign investment fund may have financial objectives that go beyond mere diversification or saving for the future. In some cases, a foreign fund with substantial financial resources may calculate that certain U.S. assets have been undervalued by markets. The fund managers may believe that they are more patient than the market and see the potential for financial gain in making a longer-term investment in an undervalued asset.

In some cases, a fund or an SOE may have still broader economic objectives. Some funds pursue domestic and regional investment policies designed to establish a position as a financial and transportation hub. In some cases, those domestic and regional investments generate expertise that creates a business interest in investing in similar sectors in the United States.

In other cases, an SOE may seek to grow by making investments at home and abroad in its core business or related businesses. For example, when the Saudi firm SABIC acquired earlier this year the plastics business of General Electric, that investment was motivated by SABIC's interest in using its expertise in the production of petroleum based plastics to broaden its international footprint.

The Demand for Investments and Acquisitions in the United States Is Likely to Grow

It is likely that government-owned entities will be interested in making a growing number of investments and acquisitions in the United States during the next decade, so long as our market is open.

The McKinsey Global Institute has estimated, for example, that oil exporting nations already hold $1.5-1.8 trillion dollars in assets. McKinsey calculates that at current oil prices, petro-dollar resources are likely to double by 2012. In light of the limited absorptive capacity of many oil producing countries, large increases in the financial surpluses available to be invested abroad are likely.

It is possible that oil prices will slump, but in my view this is highly unlikely. Demand growth remains strong, including growing demand from fast growing economies such as China and India. As the oil intensity of our economy has been slashed, consumers and businesses seem to have become less sensitive to high prices and our economy has become less susceptible to recessions induced by high oil prices. At the same time, supply uncertainties in a number of oil producing countries raise continuing worries about disruptions, and there are limited prospects for supply growth during the next five years. On balance, I believe it is more likely that prices and petro-dollar investments will rise rather than fall during the next five years.

I am not an expert on government pension funds and I do not have studies of the subject to cite. Nevertheless, I offer the hypothesis that, seeing the growing budgetary demands created by retiring workers and ageing societies, many governments are likely to try to put more government revenues into pension funds and that they will try to make this money work harder. If so, that is likely to mean that these funds will be larger players in international investments and acquisitions. Certainly at my firm, we are seeing evidence of this phenomenon from individual pension funds.

As countries like China and Russia achieve higher levels of economic development, more of their companies will be interested in "going global." For companies that have this aspiration, there is, in my view, no substitute for having a presence in the United States, the most dynamic large developed economy in the world. For a number of historical reasons, China and Russia are home to a number of SOEs. I believe that many of these SOEs have good economic reasons to aspire to be significant investors in the United States.

Policy Issues: Global Imbalances and Transparency

If there is growing interest for investments and acquisitions in the United States by foreign government-owned entities, what would this mean for public policy in the United States?

The fundamental policy issue is whether these trends create new national security risks that require new policy approaches. Are these entities controlled by foreign governments? Are they pursuing economic objectives or political objectives? Are the tools now available to the government sufficient?

Most of these entities, and all of the ones with which I have worked, are responsible organizations pursuing business and economic objectives and doing so in a responsible manner consistent with U.S. law and policy. So a fundamental implication is that the policy response of the United States should be generally to welcome this interest, while having the tools to scrutinize acquisitions that pose national security issues. As discussed at the beginning of this testimony, investments and acquisitions by these entities can support investment, economic growth, innovation and job creation in the United States. They can support our competitiveness and make these firms and their governments stakeholders in the U.S. economy.

At the same time, policymakers should be attentive to the questions and concerns that increased investments and acquisitions may raise. Some part of this concern is related to the international imbalances that contribute to the growth foreign of government assets. Some part of the concern is related to the unfamiliarity of certain of the entities.

It is important, for a number of reasons, that the United States and other countries do what they can to address the underlying imbalances in the global economy. We should be honest in accepting that the large oil imports and the large current account deficit of the United States are a mainspring that is contributing to the accumulation of large surpluses of investment capital abroad. Tackling the root causes of these imbalances, including through more effective energy policies, is a crucial national priority in its own right. Nevertheless, my assessment is that there is no sensible energy policy that is going to decrease dramatically the accumulation of petro-dollars over the next decade.

In the case of China, it is perhaps understandable that investments and acquisitions will spur attention to the issues of exchange rate inflexibility and lack of market access that are seen as contributing to the accumulation of foreign exchange surpluses in China. It is important that China and the United States make progress on these issues, including in the Strategic Economic Dialogue. It would not serve U.S. interests, however, to establish policies of linkage or reciprocity that would make U.S. investment policy contingent on progress in these other policy areas. And I believe that Chinese entities, including government entities, will have growing interest and growing capacity to make acquisitions in the United States, even if exchange rate and market access issues are fully resolved.

It also is important that the United States deal with transparency concerns that have been raised recently by sovereign wealth funds and the increased flow of investment and acquisitions by government controlled entities.

In this regard, it is useful that the Treasury Department has launched an international process of deliberation on good practices for sovereign wealth funds. Some of these funds do not publish financial figures nor provide an overview of broad investment strategies. Greater disclosure would be a service to their shareholders, the citizens of their own country. At the same time, greater communication on these issues would dispel many concerns in countries that benefit from investments and acquisitions from these entities.

It also can be useful for government entities to elucidate their governance structure, so it is clear whether investment and acquisition decisions are being driven by economic objectives and professional managers, or by political objectives and political figures. A fund or enterprise that invests government money on the basis of a transparent and clearly elucidated investment strategy, whose objectives are purely financial and economic rather than political, which is operated by professional managers and which has a governance system that restricts or removes the scope for governments influence raises far fewer concerns than government entities that are pursuing political goals. Foreign government ownership or partial ownership does not necessarily result in foreign government control.

At the same time, the Treasury Department has called for dialogue within the OECD to promote policies in investment receiving policies that are transparent and non-protectionist. There are serious pressures in Europe and Canada for revision and strengthening of investment screening laws. In my judgment, some of these laws already tilt too far in the direction of investment screening. They place limitations on inward investment and acquisitions based not on national security reasons, but rather on fuzzy rationales such as economic security or maintaining the dominant position of national champions. There is a real risk that new laws and regulations will go too far in restricting investment.

Policy Issues: The Foreign Investment and National Security Act of 2007 (FINSA)

In the United States, Congress has enacted legislation (FINSA) that updates and improves a framework that has served the United States well. I would like to congratulate this Committee for its leadership in shepherding sensible legislation to the finish line. Let me highlight a few features of FINSA that are of critical importance in ensuring that the U.S. economy remains open to foreign investments and acquisitions, while ensuring that the government has the tools it needs to deal with any national security issues.

FINSA retains a focus on those acquisitions that raise threats to national security, and where other laws and regulations are not sufficient to deal with the issue. It is important that FINSA remain focused on this relatively narrow class of acquisitions and does not dissipate its efforts in attempting to screen acquisitions on the basis of vague criteria.

Second, FINSA sensibly retains a focus on acquisitions that establish control. Acquisitions in which foreign persons gain control--essentially the ability to direct, determine and decide major business issues--could, in certain circumstances, raise national security issues. It is important that agencies focus on such acquisitions, and do not dissipate scarce resources in examining acquisitions that create minority, non-controlling positions.

Third, FINSA focuses government scrutiny on those acquisitions where a foreign entity is controlled by a foreign government, where that entity makes an acquisition that would create control over a U.S. company, and where that acquisition raises national security concerns. In such cases there is a presumption that the transaction will be subject to a second stage review, otherwise known as an investigation. This presumption of an investigation can only be overturned if the Deputy Secretary of the Treasury and the Deputy Secretary of the relevant security agency agree that an investigation is unnecessary. This provision provides confidence that acquisitions by foreign government controlled entities will receive thorough review.

Fourth, FINSA retains the longstanding provision that one CFIUS agency, on its own, is sufficient to ensure that there is an investigation of a proposed transaction. This provision ensures that security agencies have a strong voice. In addition, one CFIUS agency, on its own, is sufficient to require that a transaction go to the President for review even if other CFIUS agencies are prepared to approve it. This ensures that any transaction where security concerns have not been resolved reaches the President, the executive branch official with the ultimate responsibility for protecting national security.

Fifth, FINSA provides the Administration with flexibility in determining when national security concerns are raised by a proposed transaction. The working practice of CFIUS has made clear that national security concerns may be raised, inter alia, when acquisitions involve assets in the defense industry sector, in critical infrastructure and in telecommunications. But CFIUS does not define national security nor does CFIUS limit it to specific sectors. In my view, it is correct policy, however, not to try to define or limit national security.

For these and a host of other reasons, FINSA provides a robust tool for the Government in dealing with any potential national security issues. Congress should encourage the Administration to take a thoughtful and deliberative approach toward writing and implementing regulations.

Congress should continue to monitor the operation of FINSA and the progress of transparency work in the IMF and the OECD. Congress should continue to observe developments as government entities make additional investments in the United States. The United States should continue to be open to foreign investment, including investment and acquisitions by government-controlled entities.

Conclusion

FINSA provides an effective tool that has benefited from a recent and thoughtful tune up. FINSA offers an effective safety net for dealing with any issues that may arise, including issues related to acquisitions by foreign government-owned entities. Now the most important thing for Congress and the executive branch to do is to stay cool and use the tool that you have crafted. Thank you.

Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications

Testimony before the Committee on Banking, Housing, and Urban Affairs
United States Senate
November 14, 2007

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Chairman Bayh, ranking member Shelby, and members of the Committee on Banking, Housing, and Urban Affairs, it is a pleasure to appear before you this afternoon to discuss sovereign wealth fund acquisitions and other foreign government investments in the United States and their implications for U.S. economic and national security.

In my testimony, I discuss the increasing relative importance of cross-border investments by governments, including by their so-called sovereign wealth funds (SWF), and the forces behind these phenomena. I outline some of the economic, financial, political, and national security issues that they raise. I present the results of a scoreboard on SWF that I have developed with Doug Dowson. Finally, I draw some implications for U.S. economic and financial policy.

In brief, I make five points. First, sovereign wealth funds and related vehicles for external or cross-border investments by governments have been around for a long time, are growing in relative importance, and are here to stay. Second, the existence and growing importance of these types of cross-border investment vehicles raise profound questions about the structure and functioning of the international financial system. Third, the continuation of these trends does not currently pose a threat to U.S. national or economic security that cannot be dealt with under existing laws, procedures, and regulations. Fourth, it would be desirable to consider possible improvements in the U.S. statistical information base on foreign-government-related investments. Fifth, the U.S. government should continue actively to encourage foreign governments with large cross-border investments to develop and follow a set of best practices with respect to managing those investments in their interests, in our interests, and in the interests of the stability and openness of the international financial system. Our scoreboard provides a starting point for the development of such a set of best practices for sovereign wealth funds.

Sovereign wealth funds is the descriptive term applied to separate pools of international assets owned and managed by governments to achieve a variety of economic and financial objectives. They sometimes include domestic assets as well. Those assets may be managed directly by a government entity or may be subcontracted to a private entity inside or outside the country. Their objectives may include the accumulation and management of a tranche of reserve assets, the stabilization of the macroeconomic effects of sudden increases in export earnings, the management of pension assets, or the transfer of national wealth across generations. In practice, they usually involve multiple objectives. Moreover, SWF are only one form of governmental cross-border investment; other forms include foreign exchange reserves, other loosely organized collections of government assets, and government-owned or government-controlled financial or nonfinancial institutions.

Sovereign wealth funds are new only as a descriptive term. Previously they may have been described as stabilization funds, nonrenewable resource funds, trust funds, or similar terms. The first such fund was established by the Pacific island nation of Kiribati in 1956 to manage revenues from phosphate deposits. A number were established before

1980 in the context of the build-up of oil export revenues during the 1970s; at least a dozen have been established since 2000. Although most of them derive the major portion of their funding from revenues from natural resources, some countries have used fiscal surpluses, revenues from privatizations, and foreign exchange reserves to fund their SWF. Table 1 attached to this testimony provides a list of 32 SWF of 28 countries along with the dates on which they were established, the principal source of their funding, and estimates of their size. My total is $2.1 trillion. Differences in definitions and timing can lead to different totals. My figures do not include the $142 billion recently added to China's new SWF, the China Investment Corporation, or Libya's new $40 billion Investment Authority. They do include, in some cases sizeable, holdings of domestic assets.

The growth of SWF and similar governmental activities reflect multiple, interrelated trends in the world economy and financial system: increased global integration, substantial elimination of restrictions on international capital flows, technological innovation, sustained spectacular growth rates in many emerging-market countries, ageing populations and the expansion of pension funds and related pools of assets, recognition that diversification contributes to increased investment returns, loosening of "home bias" in investment decisions, rapid growth in foreign exchange reserves, and enormous wealth transfers from most traditional industrial countries to a number of emerging-market and developing countries as a consequence of the sustained rise in commodity prices in recent years. Most of these trends will not be reversed in the near future. SWF and similar governmental activities are here to stay.

What is distinct about these trends is that they involve a dramatic increase in the role of governments in the ownership and management of international assets. This characteristic is unnerving and disquieting. It calls into question our most basic assumptions about the structure and functioning of our economies and the international financial system. In the United States, we favor a limited role for government in our economic and financial systems; we have a market-based economy and financial system; we view central planning as a failed economic framework of the past; and we presume that most cross-border trade and financial transactions involve the private sector on both ends of the transaction. Unfortunately, our orientation is not congruent with certain facts, and we are being called upon to recalibrate our understanding of the world.

Table 2 attached to this testimony displays the holdings of foreign exchange reserves (as of June 2007) and the estimated size of the sovereign wealth funds (where relevant) for the 10 countries with the largest reserve holdings, for the 5 other countries with the otherwise-largest sovereign wealth funds, and for Saudi Arabia. Saudi Arabia has small official reserves and no formal SWF, but the Saudi Arabian Monetary Agency reports substantial holdings of international securities on and off its balance sheet (shown in the SWF column). The countries are ranked by the combined size of these holdings shown in the first column, adjusting as best we can for double counting. The combined total for the 16 countries is \$6 trillion.

More generally, total holdings of foreign exchange reserves and sovereign wealth funds are about \$9 trillion: about \$6 trillion in foreign exchange reserves, \$2 trillion in SWF, and \$1 trillion in miscellaneous financial holdings by countries like Saudi Arabia. The \$9 trillion represents at least 12 percent of all cross-border assets—a share that has probably doubled over the past five years and can be expected to continue to rise. The 12 percent figure does not include other cross-border investments by government-owned or government-controlled financial and nonfinancial institutions other than SWF. The absolute and relative size of all such government-owned and government-managed cross-border assets is likely to continue to increase driven by the combination of economic and financial forces outlined above. These forces are shifting wealth toward countries with different conceptions of the role of government in their economic and financial systems.

These developments, in turn, give rise to a number of risks.

First is the risk that governments will mismanage their international investments to their own economic and financial detriment and with negative consequences for the global economic and financial systems.

Second is the risk that governments will manage those investments in pursuit of political or economic power objectives—for example, promoting state-owned or state-controlled national champions to global champions.

Third is the risk of an outbreak of financial protectionism in host countries, in *anticipation* of the pursuit of political or economic objectives by the owners of the investments or in *response* to the actual actions of those governments.

Fourth is the risk that in their management of their international assets, governments will contribute to market turmoil and uncertainty.

Fifth is the risk of conflicts of interest for government owners of the international assets and the domestic or foreign institutional or individual managers of those assets with an associated potential for corruption.

At this point, these risks, with one exception, are largely in the realm of the hypothetical, in particular, with respect to sovereign wealth funds. For example, on the fourth risk, most experienced observers with whom I have spoken do not see SWF posing a threat to financial-market stability on the basis of the past behavior of the owners and managers of these funds.

In my view, the most serious risk is to the economic and financial stability of the countries accumulating these huge stocks of international assets. This accumulation poses enormous political and policy challenges for the authorities. The understandable temptation is to try to use international assets to promote domestic economic development objectives. Doing so is essentially impossible without undermining or reversing the fiscal, monetary, and exchange rate policies that gave rise to the initial accumulations of the external assets. With the possible exception of exchange rate policies, such reversals are likely to boost inflation, create wasteful distortions in domestic economies, and contribute to slower, not faster, growth and development.

It is important to remember that a number of countries have established SWF only to squander and liquidate the resources that have been set aside under short-term political pressures. Two examples are Ecuador's Stabilization Fund and Nigeria's Petroleum (Special) Trust Fund. Venezuela appears to be following a similar trend with its two SWF. Also recall that, in general, governments are not skilled investors. They are not good at picking winners. Government-owned banks tend not to be the most profitable. I was told recently that preliminary research suggests that recent mergers and acquisitions by Chinese corporations, many of which are government-owned or government-controlled, underperform other cross-border mergers and acquisitions.

Notwithstanding my view that the greatest risks are to the countries whose governments have accumulated the large stocks of international assets, authorities in the countries where those assets are invested also have legitimate concerns about how they will be managed. Those concerns focus primarily on acquisition of large or controlling stakes by foreign governments or government-controlled entities in institutions in the host countries, i.e., the United States. In this connection, with respect to sovereign wealth funds, it is important to appreciate that only a few such funds currently follow acquisition strategies. We have reasonably complete information on the investment strategies of 24 of the 28 countries with SWF listed in table 1.[1] At present, the SWF of only 8 of the 24 countries follow investment strategies involving the acquisition of significant or controlling stakes in companies: Brunei, Canada, China, Kuwait, Malaysia, Qatar, Singapore, and the United Arab Emirates. Moreover, in the cases of Canada and Malaysia, the companies involved are domestic.

Of course, this pattern could change, and foreign government-owned or government-controlled financial and nonfinancial institutions do acquire stakes in companies in other countries, including controlling stakes. The enactment of the Foreign Investment and National Security Act of 2007 revised the framework and procedures of the Committee on Foreign Investment in the United States. With these changes and the existing powers of the Securities and Exchange Commission as well as other U.S. financial regulators, we are well positioned, in my view, to evaluate and, if necessary, to block any U.S. acquisitions by a SWF or other foreign government entity to protect our national security.

[1] We lack sufficient information about Algeria, Iran, Oman, and Sudan.

With respect to economic security concerns, my view is that the greatest risk to the U.S. economy is that we will erect unnecessary barriers to the free flow of capital into our economy and, in the process, contribute to the erection of similar barriers in other countries to the detriment of the health and continued prosperity of the U.S. and global economies. We may not in all cases be comfortable with the consequences of the free flow of finance and investment either internally or across borders, but on balance it promotes competition and efficiency.

However, I would identify one area in which those responsible for our financial system should monitor future developments: investments of SWF in private equity firms, hedge funds, and regulated financial institutions. Some observers of private equity and hedge funds have concerns about the implications of their activities for the stability of our economy and financial systems. I do not share most of those concerns though I have long favored increased transparency for large private equity and hedge funds.

For those who have deeper concerns about such pools of capital, I note that foreign governments via investments by their SWF or through other channels provide capital to them that subsequently is leveraged. This trend deserves watching. With respect to the acquisition by a SWF, or by a government-owned or government-controlled entity, of a stake in a U.S. financial institution already subject to supervision and regulation, the responsible U.S. authorities should continue to review and monitor such investments to limit the potential for distortions in the allocation of capital and conflicts of interest that are resolved in unhealthy directions.

Consideration should also be given to improving our statistical information in this area. The U.S. government collects extensive data on foreign investments in the United

States and U.S. investments abroad. I applaud the painstaking efforts by several agencies of the executive branch over the past decade to improve the comprehensiveness and quality of these data.

With respect to information on the stocks and flows of investments in the United States by foreign governments, my understanding is that the published data cover foreign official institutions defined as central banks, finance ministries, and other government institutions, including sovereign wealth funds. However, our data collection system does not presently permit the identification of holdings and activities in the United States by sovereign wealth funds separately from holdings and activities of other foreign official institutions. My understanding, as well, is that our data also do not separately distinguish financial and direct investments in the United States by government-owned (or government-controlled) banks and corporations.

Published data on U.S. official assets abroad include holdings by the U.S. Treasury, Federal Reserve, and other federal lending agencies, but my understanding is that foreign assets of U.S. government owned or sponsored entities are included among private assets. Finally, my understanding is that we also do not identify separately holdings by government owned or sponsored entities at the state and local level, for example, by the Alaska Permanent Fund or state pension funds such as the California Public Employees' Retirement System (CalPERS).

I do not want to minimize the cost or complexity that would be involved in the collection and publication of more detailed data on U.S. international assets and liabilities on the basis of whether the assets are owned (or, more complex, are controlled) by U.S. or foreign governments at all levels. In addition, the usefulness of such data would depend on whether a large group of other countries were willing to participate in parallel data collection efforts. (Although U.S. data include investments in the United States by SWF such as the Norwegian Government Pension Fund-Global as holdings by foreign official institutions, data published by Norway in its international accounts do not report those assets as official holdings or as subcategories of other types of investments.) The fifth edition of the IMF's Balance of Payments Manual provides for the reporting of countries' official holdings of foreign debt and equity securities other than as reserve assets in subcategories of holdings of such assets (and liabilities), but few if any countries report their data this way. Moreover, my understanding is that the draft sixth edition of the IMF's Balance of Payments and International Investment Position Manual contemplates a more complete categorization of international financial data in terms of the general government and other governmental subentities. However, the new manual has not yet been completed and published, nor are all its new features likely to be implemented widely once the manual has been adopted.

Nevertheless, it would be instructive for U.S. statistical agencies to prepare information for the Congress on what statistical information is currently available on U.S. assets and liabilities of governments and government owned or controlled entities broken down by the nature of those entities, on the costs and complexities for the United States of expanding the collection of such information, and on prospects for encouraging similar efforts in other countries.

What should be done to make the world safer for sovereign wealth funds? They should increase significantly their accountability to the citizens of their countries, to the U.S. citizens and our government as well as to the citizens and governments of other countries, and to participants in international financial markets. The increased size and scope of these funds and related cross-border governmental financial activities coupled with the prospect that their disproportionate expansion will continue has put them on the international radar screen, as their owners and managers know, and it is in their interests to respond appropriately.

The most effective way to increase the accountability of these activities is through the establishment of a standard or a set of best practices for international investments, in general, and for sovereign wealth funds, in particular. For sovereign wealth funds, best practices should cover four categories: (1) structure, (2) governance, (3) transparency and accountability, and (4) behavior. To aid in the development of a set of best practices for SWF my colleague Doug Dowson and I have developed a scoreboard for the 32 sovereign wealth funds of 28 countries listed in table 1. It is based on systematic, publicly available information about the 32 SWF. The scoreboard includes 25 elements grouped in the four categories.[2] At least one SWF receives a positive score on each element. The construction of the scoreboard is described in more detail in the appendix to my testimony.

Table 3 attached to this testimony summarizes our results. (Table 4, also attached, provides the scores for the 32 SWF on each element as well as subtotals for each category.) Out of a possible total of 25 points, the highest score is 24 recorded for New Zealand's Superannuation Fund, followed closely by Norway's Government

[2] As a point of reference, we also scored the California Public Employees' Retirement System. CalPERS assets were $244 billion as of August 2007; its 2006 annual report states that 25 percent were foreign. CalPERS scores slightly lower than Norway's SWF at 21.75, the same as Timor-Leste's Petroleum Fund.

Pension Fund-Global at 23 points.[3] The Abu Dhabi Investment Authority (ADIA) and its Investment Corporation (ADIC) in the United Arab Emirates record 0.5 points. The average is 10.27 points. Six of the largest SWF score at or below the average, including two of the three largest funds at the bottom of the table. One of the two is the Government of Singapore's Investment Corporation (GIC). At the same time, Singapore's Temasek Holdings scores considerably above the average.

As is displayed in table 3, the 32 funds fall into five groups of 5 to 8 funds each; the first and third groups could be further subdivided as indicated. In the first three categories—structure, governance, and transparency and accountability—scores are correlated, but not perfectly, with overall scores. On balance, the scores are higher (relative to the potential maximum) in the structure category, which covers the clarity of the objectives of the fund, the source of its funding, the use of its principal and earnings, and its integration with the country's fiscal framework. The scores in the governance category are lower relative to the theoretical maximum. This category covers the respective roles of the government and managers and the existence of corporate governance and ethical guidelines. The relative average score is about the same for the larger transparency and accountability category, which is based on the nature of regular public reporting on the investments and performance of each fund. However, in this category the variance of the scores is the largest.

The development of a set of best practices for sovereign wealth funds, and similar understandings covering other cross-border government investments, offers the most promising way to increase the accountability of these activities, which are likely to

[3] Norway's SWF has not strictly followed its rules on the use of earnings from its SWF, does not provide the currency breakdown of its investments, and is not subject to a fully independent audit. New Zealand's SWF has no formal guideline governing the speed of adjustment in its portfolio.

increase in relative importance over the next decade. The associated increase in transparency, which is a means to the end of greater accountability, would help to reduce the mysteries and misunderstandings surrounding these governmental activities. At the same time, the environment for them would become more stable and predictable.

I endorse the efforts of the U.S. Treasury to encourage countries with sovereign wealth funds to act collectively and cooperatively in establishing a set of best practices for those investment vehicles. The G-7 has embraced this approach to reinforcing the global framework governing cross-border investment. The willingness of the IMF, World Bank, and OECD to promote a dialogue on identifying best practices is also positive. In the end, it will be the governments of countries with the sovereign wealth funds and related activities that must decide that it is in their individual and collective self interest to participate in these efforts. It is in our self interest to facilitate this process.

Table 1: Sovereign Wealth Funds

Country	Name	Date Established	Source of Funds	Current Size[a] (billions of US dollars)
United Arab Emirates				522 – 897[e]
	Abu Dhabi Investment Authority and Corporation	1976	Natural resources	(500 – 875[e])
	Istithmar (Dubai)	2003	Natural resources	(12[e])
	Mubadala Development Company (Abu Dhabi)	2002	Natural resources	(10[e])
Singapore				208 – 438[er]
	Government of Singapore Investment Corporation	1981	Foreign exchange reserves	(100 – 330[er])
	Temasek Holdings[b]	1974	Fiscal surpluses	(108)
Norway	Government Pension Fund – Global	1990	Natural resources	329
Kuwait	Kuwait Investment Authority	1960	Natural resources	213
Russia	Stabilization Fund of the Russian Federation	2004	Natural resources	148[r]
China	Central Huijin Investment Company[b]	2007	Foreign exchange reserves	68[e]
Qatar	Qatar Investment Authority	2005	Natural resources	50[e]
Australia	Future Fund[b]	2006	Fiscal surpluses	49
Algeria	Revenue Regulation Fund	2000	Natural resources	43
United States	Alaska Permanent Fund[b]	1976	Natural resources	40
Brunei	Brunei Investment Agency	1983	Natural resources	35[e]
Korea	Korea Investment Corporation	2005	Foreign exchange reserves	20[r]
Kazakhstan	National Oil Fund	2000	Natural resources	19
Malaysia	Khazanah Nasional[b]	1993	Fiscal surpluses	18
Canada	Alberta Heritage Savings Trust Fund[b]	1976	Natural resources	15
Venezuela				16
	National Development Fund[c]	2005	Natural resources	(15)
	Macroeconomic Stabilization Fund	1998	Natural resources	(1)
Chile	Economic and Social Stabilization Fund	2006	Natural resources	10
New Zealand	Superannuation Fund[b]	2001	Fiscal surpluses	10
Oman	State General Reserve Fund	1980	Natural resources	10[e]
Iran	Oil Stabilization Fund	2000	Natural resources	9[e]
Botswana	Pula Fund	1997	Natural resources	6
Mexico	Oil Income Stabilization Fund	2000	Natural resources	3
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	2000	Natural resources	2
Trinidad and Tobago	Heritage and Stabilization Fund	2007	Natural resources	1
Timor-Leste	Petroleum Fund	2005	Natural resources	1
Kiribati	Revenue Equalization Reserve Fund	1956	Natural resources	<1[e]
São Tomé and Príncipe	National Oil Account	2004	Natural resources	<1
Sudan	Oil Revenue Stabilization Account	2002	Natural resources	<1
Total[d]				2,148

e = estimate, r = some or all assets are included in reserves

a. Data are from the end of 2006 or the most recent date available.
b. A portion of the holdings is in domestic assets.
c. A portion of these holdings is intended for domestic investment.
d. Total uses the midpoint of the range of estimates.

Table 2: Foreign Exchange Reserves and Sovereign Wealth Fund (SWF) Assets
Billions of U.S. dollars

Country	Total	Foreign Exchange Reserves June 2007	SWF
China	1,401	1,333	68
Japan	893	893	–
United Arab Emirates[e]	743	43	700
Russia[r]	397	397	148
Norway	385	56	329
Singapore[der]	350	144	323
Saudi Arabia[s]	281	22	259
Taiwan	266	266	–
Korea[r]	250	250	20
Kuwait	233	20	213
India	206	206	–
Brazil	147	147	–
Hong Kong	136	136	–
Algeria	134	91	43
Malaysia[d]	116	98	18
Qatar[e]	56	6	50
Total	5,993	4,107	2,170

d = a portion of SWF holdings is in domestic assets.
e = size of SWF is estimated.
r = reserves include SWF in whole or in part.
s = the "SWF" is non-reserve holdings of international securities reported by the Saudi Arabian Monetary Agency.

Table 3: Summary Scoreboard for Sovereign Wealth Funds

		Structure	Governance	Transparency & Accountability	Behavior	Total
New Zealand	Superannuation Fund	8.00	4.00	12.00	0.00	24.00
Norway	Government Pension Fund – Global	7.50	4.00	10.50	1.00	23.00
Timor-Leste	Petroleum Fund	8.00	2.00	11.75	0.00	21.75
Canada	Alberta Heritage Savings Trust Fund	7.50	3.00	9.00	0.00	19.50
United States	Alaska Permanent Fund	7.50	2.00	8.50	0.00	18.00
Australia	Future Fund	8.00	2.00	7.00	0.00	17.00
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	5.00	2.00	9.50	0.00	16.50
Chile	Economic and Social Stabilization Fund	7.00	2.00	6.50	0.00	15.50
Botswana	Pula Fund	5.50	2.00	7.00	0.00	14.50
Kazakhstan	National Oil Fund	6.00	2.00	6.50	0.00	14.50
Singapore	Temasek Holdings	4.00	1.50	8.00	0.00	13.50
São Tomé and Príncipe	National Oil Account	8.00	2.00	2.25	0.00	12.25
Trinidad and Tobago	Heritage and Stabilization Fund	6.50	2.00	3.75	0.00	12.25
Kuwait	Kuwait Investment Authority	6.00	3.00	3.00	0.00	12.00
Malaysia	Khazanah Nasional	4.00	1.50	4.00	0.00	9.50
Russia	Stabilization Fund of the Russian Federation	4.00	2.00	3.50	0.00	9.50
Korea	Korea Investment Corporation	6.00	2.00	1.00	0.00	9.00
Kiribati	Revenue Equalization Reserve Fund	5.00	2.00	0.50	0.00	7.50
Mexico	Oil Income Stabilization Fund	5.00	0.00	2.00	0.00	7.00
China	Central Huijin Investment Company	5.50	0.00	0.50	0.00	6.00
Venezuela	National Development Fund	1.50	0.50	4.00	0.00	6.00
Iran	Oil Stabilization Fund	4.00	1.00	0.50	0.00	5.50
Venezuela	Macroeconomic Stabilization Fund	3.00	0.50	2.00	0.00	5.50
Oman	State General Reserve Fund	3.00	0.00	2.00	0.00	5.00
Sudan	Oil Revenue Stabilization Account	4.00	0.00	1.00	0.00	5.00
Algeria	Revenue Regulation Fund	3.00	1.00	0.50	0.00	4.50
United Arab Emirates	Istithmar	3.00	0.50	0.25	0.00	3.75
United Arab Emirates	Mubadala Development Company	3.00	0.50	0.00	0.00	3.50
Brunei	Brunei Investment Agency	1.00	0.50	1.00	0.00	2.50
Singapore	Government of Singapore Investment Corporation	1.50	0.00	0.75	0.00	2.25
Qatar	Qatar Investment Authority	2.00	0.00	0.00	0.00	2.00
United Arab Emirates	Abu Dhabi Investment Authority and Corporation	0.50	0.00	0.00	0.00	0.50
Total Possible Points		8.00	4.00	12.00	1.00	25.00
Average Number of Points		4.80	1.42	4.02	0.03	10.27
United States	California Public Employees' Retirement System	8.00	3.00	10.25	0.50	21.75

Table 4: Scoreboard for Sovereign Wealth Funds

		Structure								
			Fiscal Treatment							
		Objective	Source of Funding	Use of Fund	Integrated with Budget	Guidelines Followed	Investment Strategy	Changing the Structure	Separate from International Reserves	Subtotal
Algeria	Revenue Regulation Fund	1	1	0	0	0	0	0	1	3
Australia	Future Fund	1	1	1	1	1	1	1	1	8
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	1	1	0.5	0.5	1	0	0	1	5
Botswana	Pula Fund	1	0.5	1	1	0	1	1	0	5.5
Brunei	Brunei Investment Agency	1	0	0	0	0	0	0	0	1
Canada	Alberta Heritage Savings Trust Fund	1	1	1	1	0.5	1	1	1	7.5
Chile	Economic and Social Stabilization Fund	1	1	1	0.5	1	0.5	1	1	7
China	Central Huijin Investment Company	0.5	1	1	1	1	0	0	1	5.5
Iran	Oil Stabilization Fund	1	1	1	0	0	0	0	1	4
Kazakhstan	National Oil Fund	1	1	1	0.5	0	1	0.5	1	6
Kiribati	Revenue Equalization Reserve Fund	1	1	1	1	0	0	1	0	5
Korea	Korea Investment Corporation	1	1	0	1	1	1	1	0	6
Kuwait	Kuwait Investment Authority	1	1	0	1	0	1	1	1	6
Malaysia	Khazanah Nasional	0.5	1	0	0	1	0.5	0	1	4
Mexico	Oil Income Stabilization Fund	1	1	0.5	1	0	0.5	0	1	5
New Zealand	Superannuation Fund	1	1	1	1	1	1	1	1	8
Norway	Government Pension Fund – Global	1	1	1	1	0.5	1	1	1	7.5
Oman	State General Reserve Fund	0.5	0.5	0.5	0.5	0	0	0	1	3
Qatar	Qatar Investment Authority	0.5	0.5	0	0	0	0	0	1	2
Russia	Stabilization Fund of the Russian Federation	1	1	0	1	1	0	0	0	4
São Tomé and Príncipe	National Oil Account	1	1	1	1	1	1	1	1	8
Singapore	Government of Singapore Investment Corporation	1	0.5	0	0	0	0	0	0	1.5
Singapore	Temasek Holdings	1	1	0	0	0	1	0	1	4
Sudan	Oil Revenue Stabilization Account	0.5	1	0.5	1	0	0	0	1	4
Timor-Leste	Petroleum Fund	1	1	1	1	1	1	1	1	8
Trinidad and Tobago	Heritage and Stabilization Fund	1	1	1	0.5	1	1	0	1	6.5
United Arab Emirates	Abu Dhabi Investment Authority and Corporation	0	0	0	0	0	0.5	0	0	0.5
United Arab Emirates	Istithmar	1	0.5	0	0	0	0.5	0	1	3
United Arab Emirates	Mubadala Development Company	1	0	0	0	0	1	0	1	3
United States	Alaska Permanent Fund	1	1	1	1	1	1	0.5	1	7.5
Venezuela	Macroeconomic Stabilization Fund	1	1	0	0	0	0	0	1	3
Venezuela	National Development Fund	0.5	0	0	0	0	0	0	1	1.5
Total[a]		28	25.5	16	17.5	13	16.5	12	25	4.8
United States	California Public Employees' Retirement System	1	1	1	1	1	1	1	1	8

a. For each category the value under subtotal represents the average for all funds.

Table 4: Scoreboard for Sovereign Wealth Funds (continued)

		Governance					Transparency & Accountability				
							Reports		Investments		
		Role of Government	Role of Manager	Guidelines for Corporate Responsibility	Ethical Guidelines	Subtotal	Annual Report	Quarterly Report	Size of Fund	Returns	Types
Algeria	Revenue Regulation Fund	0	1	0	0	**1**	0	0	0.5	0	0
Australia	Future Fund	1	1	0	0	**2**	1	0	1	1	1
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	1	1	0	0	**2**	1	1	1	1	1
Botswana	Pula Fund	1	1	0	0	**2**	1	1	1	1	1
Brunei	Brunei Investment Agency	0	0.5	0	0	**0.5**	0	0	0	0	0
Canada	Alberta Heritage Savings Trust Fund	1	1	1	0	**3**	1	1	1	1	1
Chile	Economic and Social Stabilization Fund	1	1	0	0	**2**	1	1	1	0	1
China	Central Huijin Investment Company	0	0	0	0	**0**	0	0	0	0	0.5
Iran	Oil Stabilization Fund	0	1	0	0	**1**	0	0	0.5	0	0
Kazakhstan	National Oil Fund	1	1	0	0	**2**	0.5	0.5	1	1	0.5
Kiribati	Revenue Equalization Reserve Fund	1	1	0	0	**2**	0	0	0.5	0	0
Korea	Korea Investment Corporation	1	1	0	0	**2**	0	0	1	0	0
Kuwait	Kuwait Investment Authority	1	1	0	1	**3**	0.5	0	0.5	0	0
Malaysia	Khazanah Nasional	0.5	1	0	0	**1.5**	0.5	0	1	0	0.5
Mexico	Oil Income Stabilization Fund	0	0	0	0	**0**	0	0	1	0	0
New Zealand	Superannuation Fund	1	1	1	1	**4**	1	1	1	1	1
Norway	Government Pension Fund – Global	1	1	1	1	**4**	1	1	1	1	1
Oman	State General Reserve Fund	0	0	0	0	**0**	0	0	0	0	0
Qatar	Qatar Investment Authority	0	0	0	0	**0**	0	0	0	0	0
Russia	Stabilization Fund of the Russian Federation	1	1	0	0	**2**	0	0	1	0	1
São Tomé and Príncipe	National Oil Account	1	1	0	0	**2**	0	0	0	0	0.25
Singapore	Government of Singapore Investment Corporation	0	0	0	0	**0**	0	0	0.25	0	0.5
Singapore	Temasek Holdings	0	1	0.5	0	**1.5**	1	0	1	1	0.5
Sudan	Oil Revenue Stabilization Account	0	0	0	0	**0**	0	0	1	0	0
Timor-Leste	Petroleum Fund	1	1	0	0	**2**	1	1	1	1	1
Trinidad and Tobago	Heritage and Stabilization Fund	1	1	0	0	**2**	0.5	0	1	0	0
United Arab Emirates	Abu Dhabi Investment Authority and Corporation	0	0	0	0	**0**	0	0	0	0	0
United Arab Emirates	Istithmar	0	0.5	0	0	**0.5**	0	0	0.25	0	0
United Arab Emirates	Mubadala Development Company	0	0.5	0	0	**0.5**	0	0	0	0	0
United States	Alaska Permanent Fund	1	1	0	0	**2**	1	1	1	1	1
Venezuela	Macroeconomic Stabilization Fund	0	0.5	0	0	**0.5**	0.25	0.25	1	0	0.5
Venezuela	National Development Fund	0	0.5	0	0	**0.5**	1	0.5	1	0	0
Total[a]		16.5	22.5	3.5	3	**1.4**	13.25	9.25	21.5	10	13.25
United States	California Public Employees' Retirement System	1	1	1	0	**3**	1	1	1	1	1

a. For each category the value under subtotal represents the average for all funds.

Table 4: Scoreboard for Sovereign Wealth Funds (continued)

		Transparency & Accountability: Investments: Location	Transparency & Accountability: Investments: Specific	Transparency & Accountability: Investments: Currency Composition	Transparency & Accountability: Mandates	Transparency & Accountability: Audit: Regular	Transparency & Accountability: Audit: Published	Transparency & Accountability: Audit: Independent	Transparency & Accountability: Subtotal	Behavior: Speed of Adjustment	Grand Total
Algeria	Revenue Regulation Fund	0	0	0	0	0	0	0	0.5	0	4.5
Australia	Future Fund	0	0	0	0	1	1	1	7	0	17
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	0.5	0	1	0	1	1	1	9.5	0	16.5
Botswana	Pula Fund	0	0	0	0	1	0	1	7	0	14.5
Brunei	Brunei Investment Agency	0	0	0	0	1	0	0	1	0	2.5
Canada	Alberta Heritage Savings Trust Fund	1	0	0	0	1	1	1	9	0	19.5
Chile	Economic and Social Stabilization Fund	0.5	0	1	1	0	0	0	6.5	0	15.5
China	Central Huijin Investment Company	0	0	0	0	0	0	0	0.5	0	6
Iran	Oil Stabilization Fund	0	0	0	0	0	0	0	0.5	0	5.5
Kazakhstan	National Oil Fund	0	0	0.5	0.5	1	0	1	6.5	0	14.5
Kiribati	Revenue Equalization Reserve Fund	0	0	0	0	0	0	0	0.5	0	7.5
Korea	Korea Investment Corporation	0	0	0	0	0	0	0	1	0	9
Kuwait	Kuwait Investment Authority	0	0	0	0	1	0	1	3	0	12
Malaysia	Khazanah Nasional	1	0	0	0	1	0	0	4	0	9.5
Mexico	Oil Income Stabilization Fund	0	0	1	0	0	0	0	2	0	7
New Zealand	Superannuation Fund	1	1	1	1	1	1	1	12	0	24
Norway	Government Pension Fund – Global	1	1	0	1	1	1	0.5	10.5	1	23
Oman	State General Reserve Fund	0	0	0	0	1	0	1	2	0	5
Qatar	Qatar Investment Authority	0	0	0	0	0	0	0	0	0	2
Russia	Stabilization Fund of the Russian Federation	0.5	0	1	0	0	0	0	3.5	0	9.5
São Tomé and Príncipe	National Oil Account	0	0	0	0	1	0	1	2.25	0	12.25
Singapore	Government of Singapore Investment Corporation	0	0	0	0	0	0	0	0.75	0	2.25
Singapore	Temasek Holdings	1	0.5	0	0	1	1	1	8	0	13.5
Sudan	Oil Revenue Stabilization Account	0	0	0	0	0	0	0	1	0	5
Timor-Leste	Petroleum Fund	1	1	1	0.75	1	1	1	11.75	0	21.75
Trinidad and Tobago	Heritage and Stabilization Fund	0	0	0	0.25	1	0	1	3.75	0	12.25
United Arab Emirates	Abu Dhabi Investment Authority and Corporation	0	0	0	0	0	0	0	0	0	0.5
United Arab Emirates	Istithmar	0	0	0	0	0	0	0	0.25	0	3.75
United Arab Emirates	Mubadala Development Company	0	0	0	0	0	0	0	0	0	3.5
United States	Alaska Permanent Fund	0.5	0	1	0	1	0	1	8.5	0	18
Venezuela	Macroeconomic Stabilization Fund	0	0	0	0	0	0	0	2	0	5.5
Venezuela	National Development Fund	0	0	0	0	1	0	0.5	4	0	6
Total[a]		8	3.5	7.5	4.5	17	7	14	4.0	1	10.27
United States	California Public Employees' Retirement System	0.25	0	1	1	1	1	1	10.25	0.5	21.75

a. For each category the value under subtotal represents the average for all funds.

APPENDIX

Scoreboard for Sovereign Wealth Funds

This appendix presents the scoreboard that I have constructed with the assistance of Doug Dowson. It covers four basic categories: (1) structure, (2) governance, (3) transparency and accountability, and (4) behavior. Within each category, we pose a set of yes/no questions. The total number of questions is 25. For two of the categories, we group questions in subcategories.

For each of our 25 questions, the answer is yes for at least one SWF. If the answer is an unqualified yes, we score it as "1". If the answer is no, we score it as "0". However, for many elements, we allow for partial scores of 0.25, 0.50, and 0.75, indicated by (p) in the descriptions below.

We evaluate 32 SWF in 28 countries (table 1), as well as the California Public Employees' Retirement System (CalPERS) as a reference point.[4]

In collecting the answers to our questions we looked for sources of systematic, continuously available, public information. For some of our facts we relied on independent, published reports, for example by the IMF or World Bank. However, in general, we required that the SWF produce an ongoing flow of detailed information. Consequently, for some SWF more is known about them than is reflected in our scoring,

[4] In our evaluation of SWF, we include the funds of two subnational units, the Alberta (Canada) Heritage Savings Trust Fund and Alaska (United States) Permanent Fund. (We might have included Wyoming's similar fund.) We also include two national pension funds, New Zealand's Superannuation Fund and Australia's Future Fund. We do not classify Norway's Government Pension Fund – Global as a "pension fund" despite the inclusion of that word in its title because at present earnings from the fund are used to finance Norway's general budget. For pension funds, such as CalPERS (whose portfolio is about 25 percent in foreign assets) that are established by law and generally subject to restrictions under such laws, it is somewhat easier to record a high score. For a revised scoreboard, we plan to include pension funds in (non-Quebec) Canada, France, Ireland, the Netherlands, Quebec, and Thailand, Hong Kong's Investment Portfolio (which is part of its reserves), Dubai Holding, Nigeria's "Excess Crude Account," and the Harvard Management Company as an additional reference point.

but that information is anecdotal and occasional rather than systematic and regular. It is not sufficient that an individual SWF provides information in ad hoc interviews with the press as has been done, for example, by the Government of Singapore Investment Corporation and the Abu Dhabi Investment Authority. Although we have tried to be rigorous and systematic in our evaluation of each SWF, some degree of subjectivity necessarily is present in our procedure.

Three points of qualification: First, the objective of this scoreboard is to provide a benchmark, such as might be provided by a set of best practices. Second, the scoreboard is based upon public information that we were able to access principally using the Internet, as is appropriate today. To be useful in establishing accountability and transparency, information should be public, but we may not have accessed all the information available, and we necessarily applied judgment in some of our interpretations. Third, any benchmark provides a basis for countries to assess their own practices and performance. Countries in different circumstances may conclude that particular elements are not relevant to their situations. However, the benchmark provides a reference point to assess and justify their decisions.

The four categories in our scoreboard are listed below with subcategories where relevant. The 25 questions are stated with comments on some of them. Table 3 summarizes the results of this exercise. Table 4 provides the scores of the 32 funds on each element as well as subtotals for each category.

Structure (8)[5]

1. Is the SWF's **objective** clearly communicated? (p - 28)[6]

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[5] The number in parentheses indicates the number of elements included in the category as well as the maximum number of points that can be recorded for each SWF in the category.

Fiscal Treatment (4).[7]

Fiscal Treatment is central to a SWF's role in the macro-economic stability of the country. This involves several components including how a SWF receives its funding, how its principal and earnings may be employed by the government, and whether the government follows those procedures. As detailed, for example, in IMF (2007), basic principles of good public finance aim at limiting pro-cyclical influences on fiscal policy. It follows that the SWF should not be used as a second budget, should be integrated with the overall budget of the government, and the government should not explicitly or implicitly borrow against resources building up in the SWF. In addition, clear rules and principles help to limit the potential scope for corruption in the use of the SWF for foreign or domestic purposes.

2. Is the **source of** the SWF's **funding** clearly specified? (p – 25.5)
3. Is nature of the subsequent **use** of the principal and earnings in the fund clearly stated? (p – 16)
4. Are these elements of fiscal treatment **integrated with** the **budget**? (p – 17.5) In some cases, the integration is looser than in others. For this element, as well as element #5, some SWF that have been recently established do not have an established record of compliance. In those cases, we gave the SWF full credit.

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[6] The number in the parentheses, for some elements preceded by a "p", indicates the total number of points out of 32 (the number of funds) recorded in this category. In other words, the number summarizes the score of the SWF as a group on each element. The figure is also at the bottom of each column in table 3.
[7] The word or words in bold are keyed to the columns in table 4. The number in parentheses indicates the number of elements included in the subcategory as well as the maximum number of points that can be recorded for each SWF in the subcategory.

5. Are the **guidelines** for fiscal treatment generally **followed** without frequent adjustment? (p – 13)

Other Structural Elements (3)

6. Is the overall **investment strategy** clearly communicated? (p – 16.5)
7. Is the procedure for **changing the structure** clear? (p – 12) Where a SWF has been established by law, the procedure for changing many elements of the structure is clearer than when that is not the case.
8. Is the SWF **separate from** the country's **international reserves**? (25) A lack of separation between the SWF and international reserves creates ambiguity about the investment objectives of the SWF as well as about the management of the government's international reserves.

Governance (4)

9. Is the **role of the government** in setting the investment strategy of the SWF clearly established? (p – 16.5)
10. Is the **role of the manager** in executing the investment strategy clearly established? (p – 22.5)
11. Does the SWF have in place and publicly available **guidelines for corporate responsibility** that it follows? (p – 3.5)
12. Does the SWF have **ethical guidelines** that it follows? (3) It could reasonably be argued that the objectives of a SWF should be merely to implement its investment strategy and maximize financial returns subject to whatever risk management constraints that have been established. In this case, its "ethical guidelines" would involve ignoring ethical considerations, and we would score such a SWF with "1"

even though we have not identified such an entity. However, in some cases, the SWF may implicitly limit its investments in certain instruments, entities, activities, or countries without a clearly articulated set of guidelines. In the absence of any information on this point, a SWF receives a "0" in our scoring.

Transparency and Accountability (12)

Accountability is the principal objective of the scoreboard exercise and any set of best practices. Transparency is at the core of establishing accountability.

Reports (2).

Any SWF that does not provide some sort of regular public report on its activities does not score many points in this subcategory or for the category as a whole.

13. Does the SWF provide at least an **annual report** on its activities and results? (p – 13.25) In cases where there is an annual report, but it contains little or no information on the activities of the SWF, we give it a score of more than zero but less than 1. We also give partial credit (0.25), for example, for a report to parliament that is not published.
14. Does the SWF provide **quarterly reports** on its activities? (p – 9.25) As with element #13, we allow for a partial score. We acknowledge that views differ on the desirability of quarterly financial reporting. Some argue that it promotes too much focus on short-term returns. In our view, the principal argument for quarterly reporting rests on transparency. The entity should be able to withstand the influence of excessive short-term emphasis given that it is not generally subject to the disciplines of the market.

Investments (7).

15. Do regular reports on the investments by the SWF include the **size of** the **fund**? (p – 21.5)? Where a SWF states that it is "at least" of a certain size, we give partial credit (0.25).
16. Do regular reports on the investments by the SWF include information on the **returns** it earns? (10) In a number of cases, reports indicate the overall increase in the size of the fund without any distinction between the addition of new resources and earnings on resources previously incorporated in the fund. This practice receives no credit. Some reports on returns may provide an overall figure, perhaps translated into domestic currency, as well as additional detail, which one might think deserves extra credit, but we do not give extra credit.
17. Do regular reports on investments by the SWF include information on the **types** of investments? (p – 13.25) For example, in what sectors and in what instruments? A general description receives only partial credit.
18. Do regular reports on the investments by the SWF include information on the geographic **location** of investments? (p – 8) A listing of broad regions of the world receives only partial credit.
19. Do regular reports on the investments by the SWF include information on the **specific** investments? (p – 3.5) For example, which instruments, countries, and companies? In some cases, only "significant" investments are identified, receiving partial credit.

20. Do regular reports on the investments by the SWF include information on the **currency composition** of investments? (p – 7.5) Partial credit is given where a SWF provides information on broad groups of currencies.
21. Are the holders of investment **mandates** identified? (p – 4.5) The rationale is that by disclosing the holders of individual investment mandates the public both in the country and outside the country can check on the records, quality, and reliability of those intermediaries. Disclosure also limits the scope for sweetheart arrangements. To receive full credit, a SWF must publish the names of each holder of a mandate. If it merely states that it grants mandates, we give it no credit.

Audits (3).

Regular audits, preferably independent as well as published, are a central element of accountability. For this reason, we have assigned a maximum of three points to this subcategory.

22. Is the SWF subjected to a **regular audit**? (p - 17)
23. Is the audit **published**? (7)
24. Is the audit **independent**? (p – 14) In some cases, SWF are subjected to regular audits that are published, but the auditor is internal to the SWF in whole or in part, which detracts from objectivity and receives a partial deduction.

Behavior (1).

We include only one element in this category. One could imagine several other elements that might be included, for example, whether the SWF engages in short sales or the use of derivatives, which many SWF with moderately active investment strategies do in part and also disclose that fact. In addition, it might be desirable if the SWF consulted with the country of location for any large investment or disinvestment or with the country of issue of the currency involved. In an initial version of this scoreboard, we included such an element, but because we were unable to find a SWF that followed such a practice, we dropped it from our scoring exercise.

25. Does the SWF indicate the nature and **speed of adjustment** in its portfolio? (p - 1) This is done only by the Norwegian Government Pension Fund-Global, as far as we could determine. The declared policy of that fund is to use new inflows to make adjustments in its portfolio in light of market changes that move its existing portfolio away from its benchmarks, in other words, a policy of portfolio rebalancing. CalPERs states that it seeks to invest efficiently, bearing in mind the impact of management and transaction costs on the return on its assets, and we gave it partial credit.

Reference

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TESTIMONY OF PATRICK A. MULLOY
BEFORE THE SENATE COMMITTEE
ON BANKING, HOUSING & URBAN AFFAIRS
HEARING ON
"SOVEREIGN WEALTH FUND ACQUISITIONS AND OTHER FOREIGN GOVERNMENT INVESTMENTS IN THE U.S.: ASSESSING THE ECONOMIC AND NATIONAL SECURITY IMPLICATIONS"

NOVEMBER 14, 2007

Introduction

Chairman Bayh, let me begin by thanking you, Chairman Dodd, Ranking Member Shelby and Senator Webb for providing me the opportunity to speak before you today on the economic and national security implications of sovereign wealth funds and other foreign government investments in our nation.

My name is Patrick Mulloy and I served as a member of the twelve person, bipartisan, bicameral United States-China Economic and Security Review Commission from its creation in early 2001 through the end of 2006. I presently serve as the Washington representative of the Alfred P. Sloan Foundation and also teach International Trade Law and Public International Law as an Adjunct Professor at the law schools of Catholic University and George Mason University.

I should note that the views I will present today are my own and not necessarily those of any of my present employers nor the U.S.-China Economic and Security Review Commission. I do want to assure the Committee that I have no client except the public interest on these matters and have never been paid by any company or any other entity to advise it on foreign investment matters.

I commend the Committee for holding this important hearing and I am honored by the invitation to testify. It is a source of enormous personal satisfaction for me to have served on the staff of the Committee from 1983 to early 1998 when I left to take a position as Assistant

Secretary in the Commerce Department's International Trade Administration. During the period of 1987-1988 when the provisions of the Omnibus Trade Act of 1988 dealing with "exchange rates" and "foreign investment reviews" were being formulated by the Committee, I served as the Committee's General Counsel and was directly involved in the discussions that led to their formulation and enactment into law. The sovereign wealth fund and other foreign investment issues we are discussing today are directly related to those two sections of the 1988 trade bill.

Prior Oversight Hearings

In October 2005 Chairman Shelby and Ranking Member Sarbanes invited me to testify before the Committee on the background of the foreign investment provisions enacted in 1988 and amended in 1992 and how they were being implemented by the Treasury Department chaired Committee on Foreign Investment in the United States or CFIUS. I am delighted that some of the concerns I expressed at that hearing were taken into account by the Committee in the CFIUS reform legislation entitled the "Foreign Investment and National Security Act of 2007" which you formulated on a bipartisan basis and got enacted into law just a few months ago.

In May of this year, International Finance Subcommittee Chairman Bayh and Ranking Member Martinez invited me to testify on the "exchange rate" provisions of the 1988 Omnibus Trade Bill and the performance of the Treasury Department in carrying out the statutory obligations given it by that law to identify and report to Congress the names of countries that were manipulating their currencies to gain trade advantages with the United States. In my May testimony I told the Subcommittee that the Treasury Department had failed to carry out the responsibilities given to it by Congress in that 1988 law. That failure is at least one reason we are here today to discuss the issue of sovereign wealth funds and increased foreign ownership of the United States economy. I will explain in my testimony why I make that direct link.

I am pleased, however, that the Committee subsequent to the May hearing did formulate and report out for consideration by the full Senate legislation to address some of the measures that were advocated by me and others to address exchange rate manipulation by other nations including China.

Sovereign Wealth Funds

As I begin my discussion of sovereign wealth funds, and knowing that many officials in the Executive Branch along with some business leaders will not be sympathetic to the concerns I will raise, let me remind the Committee that under Article I, Section 8 of the Constitution it is the Congress, not the Executive Branch, which is charged with the regulation of foreign trade, foreign investment and the value of our nation's currency. Our Founding Fathers knew such matters directly impacted people's lives and wanted them under the control of the branch of Government closest to the people. The rise of "sovereign wealth funds" and the increased foreign ownership of our economy are directly related to our mismanaged trade policies which have failed to take into account the government-directed mercantilist trade policies of many of our trading partners.

In June of this year, then Acting Under Secretary of the Treasury Mr. Clay Lowery made a speech in San Francisco on "sovereign wealth funds". He said he would use the term to mean:

> "a government investment vehicle which is funded by foreign exchange assets and which manages those assets separately from official reserves"

He said such sovereign wealth funds typically fall into two categories based on the foreign government's source of foreign exchange assets. These are:

1. Commodity funds – which are established through commodity exports such as oil and gas. The tripling of oil prices since 2002 has created a windfall for oil-exporting nations such as Abu Dhabi, Kuwait, and Norway. McKinsey and Company in an October 2007 report entitled The New Power Brokers, which examines sovereign wealth funds, has estimated that investors from oil-exporting nations collectively owned between $3.4 trillion and $3.8 trillion in foreign financial assets at the end of 2006. That report also said many oil exporting nations have now set up state-owned investment funds, often called sovereign wealth funds, to invest **some** of the assets they have acquired through their oil exports. The October 2007 study done by McKinsey and Company tells us that "sovereign wealth funds", unlike "central bank reserves" (also known as "foreign exchange reserves"), have diversified portfolios that range across equity, fixed income, real estate, bank deposits, and alternative investments such as hedge funds and private equity. According to the McKinsey October 2007 study; the largest sovereign wealth fund among oil exporters is the Abu Dhabi Investment Authority which reportedly has total assets of up to $875 billion.
2. Non-Commodity Funds – which are typically established through transfers of assets from official foreign exchange reserves. Large balance of payment surpluses, according to the McKinsey Study, have enabled non-commodity exporters to transfer "excess" foreign exchange reserves to stand alone investment funds to be managed for higher returns. Most of the non-commodity holdings of foreign exchange reserves are held by the Asian central banks. **The October 2007 McKinsey study estimates that at the end of 2006**

Asian central banks had $3.1 trillion in foreign reserve assets. The study then stated:

> **"to put this in perspective, it is twice as many assets as global hedge funds manage and twice the size of global private equity".**

China's central bank had $1.1 trillion in reserves at the end of 2006 and the Bank of Japan had $875 billion. The central banks of Hong Kong, India, Malaysia, Singapore, South Korea, and Taiwan together have another $1 trillion.

Now how are these Asian central banks able to accumulate these vast and fast-growing amounts of "foreign exchange reserves"? The McKinsey study tells us on page 77 that:

> "…**exchange rate management has been key**. Since the Asian financial crisis, the region's economies have benefited from rapidly growing exports, and apart from Japan, have switched from running current account deficits to large current account surpluses. **The logical long-run corollary of these surpluses, combined with foreign capital inflows would be the appreciation of the currencies of the surplus countries. However to preserve the competitiveness of the region's exports, Asian central banks have intervened in the foreign exchange markets to prevent rapid appreciation, buying foreign currencies (mainly the dollar) while selling domestic currency.**

The McKinsey study on page 78 then explores the pros and cons of having the Asian central banks manage the value of the dollar in a system some economists called Bretton Woods II. The study states:

> **"For Asia the system has ensured the success of its export-led growth model and continuous and growing current account surpluses.** For the United States the benefit has been twofold. American consumers have the advantage of being able to bring in a huge range of cheap goods manufactured in Asia. But of even more importance is the fact that the United States has been able to maintain a large and growing current account deficit while at the same time maintaining significantly lower interest rates than would normally prevail with a large deficit position – because Asia has provided low cost funds to finance the shortfall".

The McKinsey Report then goes on to note that the Bretton Woods II system has two distinct disadvantages for the United States. A higher dollar (propped up by the Asian central banks) hinders our nation's ability to export (and harms import sensitive domestic industries) and there are hazards from an over-reliance on foreign capital.

Recently Asia's governments have begun to shift some of their foreign exchange assets into "sovereign wealth funds". The Government of Singapore Investment Corporation has around $150 billion under management. China has taken at least $200 billion of its foreign reserve assets and put them into its sovereign wealth fund the China Investment Corporation. It can always transfer more from its foreign exchange reserves into its sovereign wealth fund as it is accumulating foreign exchange at a rate of well over $300 billion annually. Its trade surplus with just the United States this year will be over $250 billion.

Problems for the U.S. with Sovereign Wealth Funds

1. Purchases of Strategic Assets and Technologies

   Mr. Gerald Lyons, the Chief Economist of the Standard Chartered Bank, issued a paper on October 15, 2007 entitled "State Capitalism: The Rise of Sovereign Wealth Funds". In that paper he noted that sovereign wealth funds are presently valued at $2.2 trillion, but could reach $13.4 trillion in a decade. One concern he identified on page 9 of his paper is that these funds may make purchases (investments) for strategic, rather than economic purposes. He noted that through these funds foreign governments could acquire:

> "strategic stakes in key industries around the world such as telecommunications, energy, the financial sector, or even to secure intellectual property rights in other fields."

In 1992 the Treasury Department as part of its CFIUS responsibilities was tasked by law to report to Congress within one year and every four years thereafter whether any foreign government had a coordinated strategy to acquire U.S. companies involved in the research and development or production of critical technologies. In its 1993 report the Treasury said it could not find credible evidence of such strategies but said that "should not be viewed as conclusive proof" such strategies did not exist. It did indicate some governments did identify "technologies that are critical to national economic development and thus prime targets for acquisition through M&A's." In its first update to that report submitted to the Congress in September of 2007, the Treasury again reported it "did not find strong enough evidence to conclude that any individual company had a coordinated strategy or was acting on a coordinated strategy on behalf of its respective government.' The Treasury report did note, however, that "there is significant evidence that foreign governments are involved in other efforts to acquire such technologies." That was in the Treasury's unclassified report. I understand that there is a classified version and I would urge you to have your staffs peruse that and brief you on it. It just seems reasonable to me to assume that if some foreign governments are using illicit means to acquire U.S. developed critical technologies, that they will probably buy companies producing them if they can utilize that means to access these critical technologies.

2. Increasing Foreign Government Ownership of Our Market Economy

Another concern was expressed by SEC Chairman Christopher Cox in an October 24th speech at the Kennedy School of Government at Harvard University. In that speech entitled "The Role of Government in Markets", Chairman Cox noted that sovereign wealth funds, which are already enormous in his view, could "grow as large as $12 trillion over the next eight years". He then went on to state:

> "The economic rationale for our legislative and regulatory deference to markets is called into question when the major marketplace participants are not profit-maximizing individuals but governments with national interests".

The SEC Chairman then went on to discuss why in the United States we have traditionally been against large government ownership of our economy, noting our emphasis on private ownership is directly tied to America's dedication to individual freedom. He stated:

> "...the fundamental question presented by state-owned public companies and sovereign wealth funds does not so much concern the advisability of foreign ownership, but rather of government ownership".

He then revisited the issue of foreign ownership later in his speech and noted that if ownership is held by our own government, we can at least influence it to use its ownership to "put our nation's interests first." If the owner on the other hand is a foreign government, he said,

> "the national interests a foreign government will advance will presumably be its own".

So there are, in Chairman Cox's view, legitimate concerns a nation must take into account when it considers whether to follow policies giving foreign owners and particularly foreign governments increasing amounts of control over its domestic economy.

Foreign Ownership and Trade Deficits

On October 26, 2003, Fortune Magazine carried an article by Warren Buffett entitled "Why I'm Not Buying the Dollar: America's Growing Trade Deficit is Selling the Nation Out From Under Us". In that article, Mr. Buffett noted that America's trade deficit exceeded 4 percent of GDP (it is closer to 5.5 percent now), and our nation owed the world $2.5 trillion from the cumulative effect of past trade deficits. He then wrote:

> "In effect our country has been behaving like an extraordinarily rich family that possesses an immense farm. In order to consume 4 percent more than we produce – that's the trade deficit – we have day after day been both selling pieces of the farm and increasing the mortgage on what we still owe".

He then said it was imperative that we take "action to halt the outflow of our national wealth" and advocated a plan to do so. I will discuss that plan later in my testimony.

In the winter of 2005 Mr. Buffett in his annual letter to the shareholders of his company Berkshire Hathaway, stated that our country's continuing and massive trade deficits are leading us in the direction of becoming a "sharecropper society", not an ownership society. In July of 2005 a debate raged in Washington about whether the Chinese National Offshore Oil Company (CNOOC), which was 70 percent owned by the Chinese government, should be prohibited from purchasing UNOCAL, a privately owned American company. During an interview on CNBC Mr. Buffett was asked to comment on the matter and stated:

> "If we are going to consume more than we produce, we have to expect to give away a little part of the country".

Associated with the same debate about the CNOOC/UNOCAL merger, the Washington Post published an editorial which appeared on August 7, 2005 entitled "A Sharecropper Society". In it the Post expressed concern that Mr. Buffett's vision of where the United States was headed was "distressingly plausible." The editorial noted that "the country is living beyond its means, spending more than it earns, and relying on foreigners to supply the difference." **On October 24th of this year the Washington Post published an editorial entitled "Countries Buying Companies" about sovereign wealth funds.** The editorial stated:

> **"Sovereign wealth funds, however, offer governments a way to take over businesses for political as well as economic purposes.** That's a benign prospect if the buyer is Norway, a member of NATO. It is more troubling if the government behind the money is that of China, Russia, or Venezuela ... the **accumulation of so many dollars in foreign hands is the result of years in which the United States has imported more than it exports."**

The fast-increasing surge of sovereign wealth funds are just another indicator that the country is living beyond its means, spending more than it is earning, and relying on foreigners to purchase our assets to supply the difference. Most of the so-called foreign investment in this country is not "green field" investment whereby new assets are being created, but rather the sale of existing assets to new foreign owners. This is what Warren Buffett means by the "sharecropper economy reference. In allowing this to happen on our watch we are not doing well for future generations of our citizens.

What is to Be Done: Immediate Steps

America's political leaders must realize that the United States is part of an increasingly competitive global economy in which many of our trading partners, such as China, Korea, Japan and Taiwan have national goals and strategies to move their economies forward. Under pricing their currencies to achieve trade surpluses and attract investment is just one part of their economic strategies. Our nation must begin to develop our own national goals and a strategy to accomplish them to ensure that the Asian countries do not achieve their economic goals at our expense. Some elements of our own "national strategy" or if you prefer "business plan" might be:

1. The development of an energy policy that promptly begins to reduce our reliance on imported oil and gas. Spending on the technologies to accomplish this, which means investing in America, would create new high tech jobs in our nation and in time reduce the speed by which oil and gas exporters are building their sovereign wealth funds with our own dollars.
2. The development of policies to aggressively address the mercantilist trade practices (being used by China and many of our other Asian trading partners) such as currency manipulation, barriers to imports, illegal export subsidies, forced technology transfers, subsidies to attract investment ,and the massive theft of intellectual property. This Committee has already developed and reported to the Senate legislation to begin to address currency manipulation. I hope that additional measures can be added to that legislation when it is taken upon the floor, such as a provision to make an under-priced currency an illegal export subsidy that can be addressed by our countervailing duty laws.

It would also be good public policy to include measures to stop the influx of contaminated toys, foods and other items that threaten the health and welfare of our citizens.

3. A third element of such a strategy is to have in place a CFIUS process for reviewing foreign acquisitions of U.S. companies that ensures our Government does not permit the selling off of assets that are critical to our national security. The CFIUS legislation enacted this summer goes a long way in doing that. It gives the intelligence agencies a key role in the review process and ensures closer scrutiny of purchases made by foreign government-owned corporations.

Under the new statute, however, the more searching CFIUS review process for a foreign government acquisition only takes place if the foreign government acquires "control" over the American assets and it leaves the word "control" to be defined by agency rulemaking. The Treasury Department, which will pursuant to the Administrative Procedures Act engage in "**notice and comment**" rulemaking, is likely to receive more comments to be lenient in defining control than strict. It was thus reassuring to see that Senators Dodd, Shelby, Bayh and Webb have written to Secretary Paulson on that matter. Their September 27th letter urged the Treasury in its rulemaking process to take account of the fact that:

> "...in some cases passive foreign ownership interests in assets in the United States, including through sovereign investment funds may have national security implications".

It will be very important for this Committee to continue its recent close oversight of the CFIUS process to ensure that the Treasury implements the new statute in the manner intended by its Congressional authors. You can be sure interests representing foreign investors, including foreign government investors; will be active participants in the rulemaking now underway at the Treasury Department.

What is to Be Done: Further Steps

1. Emergency Trade Summit

During the period of August 2006 through January 2007, I had the opportunity to participate as a senior staff member on the Horizon Project, which was established by the Democratic Policy Committee to develop proposals to address America's economic prosperity and security. At the conclusion of their work the leaders of the Project briefed both the Democratic and Republican Policy Committees about their recommendations.

The Horizon Project group of CEOs and policy experts, which included the President of the Sloan Foundation with whom I work, was very concerned about our nation's massive and ongoing trade deficits and recommended, among other things, that:

> "An Emergency National Summit on the Trade Deficit be convened to be attended by relevant Cabinet officers, the bipartisan leadership of both Houses of Congress and a small number of top corporate and labor leaders".

The Project report stressed that capping the size of the trade deficit had to be a top national priority. One method the report advocated was the so-called Buffett proposal which was put forth by Warren Buffett in the May 2003 edition of Fortune Magazine which I referred to earlier in my testimony. Under the Buffett plan our nation's trade account could be balanced through a system whereby the Federal Government would issue import certificates to exporters of goods in the amount equal to the dollar value of their exports. Such a system could be phased in over a period of time. The Alfred P.

Sloan Foundation has recently funded a proposal submitted by a group of trade economists and lawyers to examine how the Buffett proposal could actually be implemented. The Horizon Project noted that Senators Dorgan and Feingold encapsulated the Buffett proposal in S.3899, a bill they introduced in the last Congress, which would phase in balanced trade for regular commerce over five years and for petroleum trade over ten years.

Another way to reduce the trade deficit considered by the Horizon Project was to use unilateral emergency tariff increases as President Nixon did in August of 1971. Either the Buffett proposal or the tariff increases could be justified under Article XII of the GATT/WTO agreement which permits parties to take measures to deal with serious balance of payment difficulties. The fast declines of our currency against the currencies of nations which do not prop it up are evidence of our balance of payments problem. Serious discussion in the Congress of either proposal would give us much needed leverage to deal with China and the other Asian countries which under-price their currencies and utilize other mercantilist practices to achieve massive trade surpluses at our expense.

2. Align Corporate and National Interests

America's political leaders must understand that other countries such as China have instituted policies, including subsidies and an under-priced currency, to give incentives to U.S. and other multinational corporations to help them grow their own economies. Our corporations are operating in a system that compels them to focus on making profits for their shareholders. Top corporate officials get significant financial rewards for achieving these objectives. Public officials, who are accountable to

America's citizens, must develop policies to counter foreign practices designed to entice our corporations to serve their interests. We must find the means to align the interests of American based multinational corporations with the national interest which includes keeping and creating well-paying high tech jobs in this country and not transferring huge chunks of our productive capabilities out of the country.

3. Craft an Omnibus Globalization Bill

Over 20 years ago the joint House and Senate leadership, acting in a bipartisan manner, decided to craft an omnibus trade bill to address some of the competitive challenges then facing the nation. Each relevant Committee of the Congress was charged to conduct hearings and to elicit ideas and concepts that could be encapsulated into one Omnibus bill. This process began in 1986 and continued in 1987 and resulted in the Omnibus Trade and Competitiveness Act of 1988.

As one who participated in that process and found it exhilarating, I urge the Congress to again institute such a process and use the year 2008 to lay the groundwork through comprehensive hearings for an Omnibus Globalization bill. Such a Bill would be designed to shape our nation's participation in the globalization process in a manner that reduces our current account deficits and lifts the living standards for our citizens. Any new Administration that comes to power in January 2009, will, I am sure, welcome a cooperative relationship with the Congress in crafting such a bill.

Conclusion

The rapidly-rising status of sovereign wealth funds, which the Committee is examining today, are just one more sign that our nation is not doing well in the global economic competition that will only intensify as we move forward into the 21st century. While it is very useful to examine proposals to make such funds more transparent and to establish behavioral guidelines for them, the real lesson we should take from their rise is that we must take action now to forthrightly address our massive trade deficits which are feeding the growth of these funds.

Dr Gerard Lyons, Chief Economist and Global Head of Research, Standard Chartered Bank

Oral Testimony for US Senate Banking Committee

14th November 2007

Good afternoon Senator Bayh, Ranking Member Shelby, and Members of the Committee. It is my pleasure and honour to appear before you today to offer views on Sovereign Wealth Funds. I thank you for inviting me to participate, and I commend the Committee for devoting so much time to an examination of this issue.

I will offer brief oral testimony today, and respectfully request that my complete written statement be entered into the record.

There are three areas I would like to focus on:

First, the composition of these funds;

Second, their possible financial market impact;

Third, the strategic aspect of Sovereign Wealth Funds (SWFs) and the need for common ground rules.

First their composition

Sovereign Wealth Funds have existed since 1953 and are here to stay. Their size and influence is set to grow. Already valued around $2.2 trillion, on current trends they could even reach $13.4 trillion in a decade.

There are a number of reasons for the increased current focus on these funds now. The number of countries having their own fund has risen, the amounts at their disposal are huge and their possible investments have become more controversial. Although many SWFs are keen to ensure high investment returns, there is now added concern about where and what they could buy. The establishment of China's fund is just the latest example.

Of the twenty two largest SWFs, seven were in existence before 1990, six started in the 90s and nine since the millennium.

One can examine SWFs in terms of their size. Seven super funds stand out and include the Abu Dhabi Investment Authority ($625b), Norway ($322b), GIC of Singapore ($215b), Kuwait Investment Authority ($213b), China Investment Corporation ($200b), Russia Stabilisation Fund ($128b) and Temasek of Singapore ($108b).

One can also examine SWFs in terms of their openness and transparency. Some funds are very transparent and include, Norway, Singapore's Temasek, US (Alaska), Malaysia, Canada (Alberta). These funds provide detailed information on their size, returns achieved and their portfolio composition. And many companies have seen these as investors without any apparent issues to date.

In contrast there are some secret funds and these include the UAE funds, China, Qatar, Brunei, Venezuela, Taiwan, Oman and Kuwait. Whilst secrecy in itself does not mean that a fund will be a bad investor, in a global financial environment where transparency and accountability are seen as important positives, such opaqueness should not be encouraged.

Second, their possible financial market impact

There are four driving forces behind the growth in these funds:

(1) The movement in oil and other commodity prices. Sixteen of the largest twenty two funds have commodities as their main source of income.

(2) The growth in foreign exchange (FX) reserves. Total global FX reserves are $5.75 trillion, with Asia accounting for $3.66 trillion. Reserves are rising sharply. For instance, a decade ago, Asian central banks accounted for one-third of global currency reserves, now they account for two-thirds.

(3) The investment performance and returns achieved by the fund, which will clearly be influenced by many factors, including the macroeconomic and financial climate and the fund's own strategy.

(4) Discretionary factors. Among the six of the largest twenty-two that do not rely on commodity prices, the financing varies. Some, like China, may rely on transfers from FX reserves. A key factor will be how governments wish to finance these funds and the amount that they wish to funnel to them.

The size of SWFs may also grow relative to other types of investment. SWFs constitute 1.3% of total global financial assets but this is likely to rise. The current $2.2 trillion in SWFs compares with figures of $1-1.5 trillion for hedge funds and between $0.7 trillion to $1.1 trillion for private equity.

Expect these government controlled funds to: take bigger financial stakes in equity and bond markets across emerging economies; to feed more money into alternative investments such as hedge funds and private equity; to boost strategic links with countries that have not shared fully in globalisation or which have been shunned by the West; and to take more strategic stakes in sensitive areas within developed countries. It is these last two areas, which I call State Capitalism, that are the most problematic aspects of sovereign wealth funds.

Third the strategic aspect of these funds

Making investments for purely commercial reasons is one thing, but when they involve government owned funds and the stake is potentially strategic it is clearly raises other issues. The big worry is that these funds see an opportunity to acquire strategic stakes in key industries around the globe, whether it be:

- Telecommunications,
- Energy,
- The media
- The financial sector,
- Or even to secure intellectual property rights in other fields.

The difficulty is that many of the more strategic funds are not so transparent and thus it is hard to measure such stakes. Nonetheless, the economic rationale behind such strategic acquisitions is clear. Some countries may see this as a way to move up the value curve quickly, as they acquire intellectual property and access to research, design and development that it may take years to develop at home. For instance, the expertise of emerging economies, such as China, in low cost manufacturing could quickly be extended by the acquisition of high tech firms overseas.

Buying into overseas financial firms (whether through SWFs or other arms of a government) makes long-term strategic sense for many emerging economies, particularly if it allows them to transfer such financial skills back home to help develop and deepen domestic financial markets.

Resource nationalism is an attempt to buy access to strategic commodities and resources around the world. This is linked into the fundamental shift in the demand for commodities. China stands out here given its insatiable appetite for all types of commodities, and not just energy.

A protectionist backlash against strategic investments could be damaging for global trade. SWFs should adopt the best practice of open funds like Norway. In addition, there is a strong case to be made to encourage the opening up of markets from which SWFs emanate (the so-called level playing field). But this will take time and we are more likely to see Western governments seeking to protect strategic sectors, as is their right. The aim should be to improve governance and transparency of SWFs and promote an investment framework that is fair and commercially driven.

The rise of SWFs should be seen as a further sign of a shift in the world economy and Western countries should seize this as an opportunity to work with emerging economies such as China and Russia and others to find common ground rules and a code of practice. Although multilateral groups like the IMF and World Bank or even the World Trade Organisation may be best placed to decide a code of practice the danger is that they will be ineffective. In fact more SWFs may invest strategically in order to position their economies on the world stage. Yet, as long as investments by SWFs are made for commercial reasons, and not for political purposes, then these funds should be accepted.

State Capitalism: The rise of sovereign wealth funds

13th November 2007

By Gerard Lyons

(Gerard Lyons is Chief economist and group Head of Global Research at Standard Chartered and is also Economic Advisor to the Board).

Sovereign Wealth Funds (SWFs) have existed since 1953 and are here to stay. Their size and influence is set to grow. Already valued around \$2.2 trillion, on current trends they could even reach \$13.4 trillion in a decade. Here I provide a comprehensive and up to date analysis of SWFs, detailing the largest 22, what drives them and their likely future impact.

1. The Super Seven: There are already seven big SWFs that have over \$100 billion in assets. These are the funds that dominate and include Abu Dhabi, GIC of Singapore, Norway, Kuwait, China, Russia and Temasek.

2. The Secret Funds: Whilst one way of looking at these funds is their size, another is to analyse their investment approach and philosophy. A number of funds are not so transparent and include the UAE funds, China, Qatar, Brunei, Venezuela, Taiwan, Oman and Kuwait.

3. Three Crucial Implications:

(a) The influence of SWFs on financial markets is set to grow. Expect these government controlled funds to: take bigger financial stakes in equity and bond markets across emerging economies; to feed more money into alternative investments such as hedge funds and private equity; to boost strategic links with countries that have not shared fully in globalisation or which have been shunned by the West; and to take more strategic stakes in sensitive areas within developed countries. It is these last two areas, which I call State Capitalism, that is the most problematic aspect of sovereign wealth funds.

(b) There is a serious likelihood of Western governments and SWFs clashing over what they can buy and where. A protectionist backlash against strategic investments would be damaging for global trade. There is a huge difference between what is needed and what is likely to happen. There is a strong case for SWFs to adopt the best practice of open funds like Norway. But many governments will argue that it is their money and why should they be so transparent when other areas of financial markets are not. In addition, there is a strong case to be made to encourage the opening up of markets from which SWFs emanate (the so-called level playing field). But this will take time and we are more likely to see Western governments seeking to protect national champions and strategic sectors, as is their right. The aim should be to improve governance and transparency and promote an investment framework that is fair and commercially driven.

(c) The rise of SWFs should be seen as a further sign of a shift in the world economy and Western countries should seize this as an opportunity to work with emerging economies such as China and Russia and others to find common ground rules and a code of practice. Although multilateral groups like the IMF and World Bank or even the World Trade Organisation may be best placed to decide a code of practice the danger is that they will be ineffective. In fact more SWFs may invest strategically in order to position their economies on the world stage! Yet, as long as investments by SWFs are made for commercial reasons, and not for political purposes, then these funds should be accepted.

Table of Contents:

Section 1: The impact and implications

Appendix

1. The impact and implications

1a. Introduction

This Report focuses on a major global issue - the rise of sovereign wealth funds (SWFs). We have been at the forefront of this debate, although we have talked about it in terms of State Capitalism - as it is this, rather than all aspects of SWFs, that is the crux of the issue. State Capitalism is the use of government controlled funds to acquire strategic stakes around the world.

The growth of SWFs and the location of the countries from which they originate provides another example of how the balance of economic and financial power is shifting.

SWFs are not new. In fact some of them have a long history, with the first being established as long ago as 1953. Of the twenty two largest SWFs that are examined in this report, seven were in existence before 1990, six started in the 90s and nine since the millennium. A number of smaller funds have started in recent years and, as existing funds prove successful, this may well encourage other countries to establish their own. Given how long SWFs have been in existence, it is remarkable how focus on them has only recently become a big issue, particularly in policy circles. Why is this?

The change seems to be occurring on both sides. On the SWF side, the difference is that now the number of countries pursuing such a strategy of having their own fund has soared and the amounts at their disposal are huge. Although many SWFs are keen to ensure high investment returns, there is now added concern about where and what they could buy. China's fund is just the latest example.

Meanwhile, in terms of countries into which this money is flowing, there now seems to be far more awareness of the existence of SWFs. In particular, three broad issues stand out as bringing this to wider attention. One, is the potential for these funds to make more strategic investments - hence the term State Capitalism. Second, is the surge in size of these funds and the likelihood that they will continue to grow. Third, is the increased concern about the lack of transparency of some of these funds. All this has focused attention on the fact that, as the consequences of State Capitalism are not clear, there are no ground rules regarding how SWFs should behave and thus no rules as to what they can buy. This, in turn, has added to concerns about future protectionism.

In many respects, SWFs are their own worst enemy. Their air of secrecy, including for some a lack of transparency has, in recent years, led to some concern. Although the funds may argue that there are others within the financial markets that are equally secretive, it is the suspicion about their intentions that makes this a more problematic area. This need not be the case. Some SWFs are very open - Norway is perhaps the best example of a fully transparent fund.

There are many challenges with SWFs: a major one being their opaqueness, an additional challenge being how one defines a SWF. Allowing for certain exceptions, their main characteristics are: ownership by a sovereign nation state rather than a regional or local state entity; not national pension funds and not central banks or authorities that perform roles typical of a central bank. This is a credible set of qualifying assumptions. It does, however, exclude the likes of Saudi Arabia's Monetary Authority (SAMA), which has reserves of $251 billion, and which also acts as a conduit for the investment of Saudi government funds totalling $116 billion.

The biggest is the Abu Dhabi Investment Authority (ADIA), but as it not a transparent fund, the estimate of $625 billion may not be spot on. The uncertainty about some funds is highlighted by some of the wide guesstimates that exist. Take Kuwait as an example. The figure of $213 billion cited in this Report is based on a reply to a Parliamentary question and seems to be more reliable than most other estimates, which vary widely. If any of these figures are not spot on it is a reflection of the secrecy of the SWFs themselves! Overall, it is calculated that the estimated size of the top 22 SWFs is $2.2 trillion. If you add in recent smaller funds, such as Azerbaijan, Trinidad & Tobago, Ecuador, Nigeria and others, $2.3 trillion is the likely scale.

1b. Scale - the Super Seven

This Report shows that within the major SWFs there is a Super Seven. These are the seven funds already with over $100 billion in assets. The Super Seven are:

- Abu Dhabi,
- Singapore - GIC,
- Norway,
- Kuwait,
- China,
- Singapore - Temasek,
- and Russia.

In fact, three of these are also among the five largest if one uses a different benchmark, such as the size of funds as a proportion of GDP. So, in relation to GDP, the five big funds are:

- Abu Dhabi,
- Brunei,
- Kuwait,
- Qatar,
- and Singapore - GIC.

1c. Rapid growth rates and future size

Given the scale of these funds now, an important issue is their likely future size. There are a number of driving forces behind these funds.

(i) The movement in oil and other commodity prices: petrodollars and revenues generated by the recent boom in commodity prices have been particularly important for the growth in

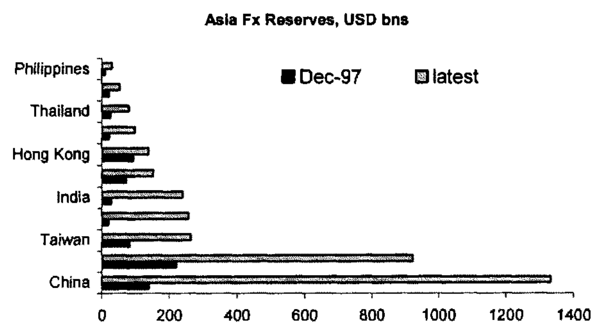
SWFs. Sixteen of the largest twenty two funds have commodities as their main source of income.

(ii) The growth in foreign exchange (FX) reserves. The importance of reserves as a key driver behind SWFs should not be overlooked. Total global FX reserves are $5.75 trillion, with Asia accounting for $3.66 trillion. Reserves are rising sharply. For instance, a decade ago, Asian central banks accounted for one-third of global currency reserves, now they account for two-thirds.

(iii) The investment performance and returns achieved by the fund, which will clearly be influenced by many factors, including the macroeconomic and financial climate and the fund's own strategy. There are, in essence, two parts to SWFs: one, is a fund management, asset allocation investment; the second is a strategic investment.

(iv) Discretionary factors. Among the six of the largest twenty two that do not rely on commodity prices, the financing varies. Some, like China, may rely on transfers from FX reserves. Others, like Malaysia's Khazanah Nasional (number twelve in size) may be partly financed by debt. A key factor will be how governments wish to finance these funds and the amount that they wish to funnel to them.

Chart 1



Source: Standard Chartered

Some of these funds have recently enjoyed rapid growth. Growth rates were estimated last year for twelve funds, ranging from zero to 100%. Given such a wide spread, it is clear that it is hard to say anything definite about potential growth rates. Taking out the extremes, and looking at this in relation to other data, a good guide to average annual performance is just under 20%.

If this growth rate was repeated over the next decade the funds would reach $13.4 trillion. But, of course, the last few years have been spectacular for the world economy and for financial markets. Whilst that may suggest caution about the future growth rate, many of the funds may continue to be fed by growing FX reserves. Even if we just assumed that there were no additions to these funds and that they experienced only a modest return over the next ten years, matching an average of the annualised returns seen on US and emerging equities over the last decade then the size of these funds would grow to $5.2 trillion, in itself a large number. Furthermore, the aims of SWFs vary and whilst some may seek to maximise returns, the strategic element sometimes works against that principle. This makes it hard to gauge their likely future size, although it will be fair to assume they will be large and their influence will grow.

There is every likelihood that the SWFs that countries in the West are most concerned about will continue to grow significantly. Take China, for instance. China's new SWF, the China Investment Corporation (CIC), will have an initial capital of around $200 billion and will absorb an earlier fund, established in 2003, the Huijin Investment Company. There is no ideal level of FX reserves, despite many academic studies attempting to determine some magical formula. Yet China's behaviour appears to suggest that they believe FX reserves have reached a significant level to allow China to cope with any external shock. That level would appear to be around $1.1 trillion. Reserves have continued to rise, to around $1.4 trillion, coinciding with the establishment of its $200 billion fund. The amount allocated to this fund looks set to grow. With China committed to a gradualist appreciation of the CNY, its currency reserves look set to keep rising, reaching $2 trillion in early 2009. As reserves grow, it would be no surprise if additional amounts were used in stages to swell the size of China's SWF to, say, $600 billion within two years! Recent developments within China have put a lot of emphasis on this new fund being performance dependent, particularly as behind the scenes not everyone appears happy with its remit. This, in turn, could encourage The State Administration of Foreign Exchange (SAFE) to become more aggressive in its managing of remaining FX reserves, to lessen the argument for more funds going into the new SWF. Furthermore, the new CIC fund, will also use some of its funds to help restructure the financial sector.

Over time, in general and not necessarily in every country, it seems likely that SWFs will grow at a faster pace than the rise in FX reserves. The funds will not only be fed by the growth in reserves but are likely to enjoy gains on their investment, swelling their size further. Of course, currency policy itself has a big bearing. The appreciating currencies are, by and large, likely to be those enjoying current account surpluses. The lesson of Asia over the last decade is testimony to how this could continue to play out over the next ten years. As intervention takes place to stem the pace of appreciation, this not only leads to currency reserves rising further, but keeps the currency competitive, underpinning its current account. But at some stage, possibly even in coming years and certainly over the next decade, Asia itself will move from being export driven to relying much more on domestic demand. In which case, current account surpluses will shrink and the growth in currency reserves may slow. Although this in itself may remove one of the drivers of the rise in SWFs it will be replaced by another driver - namely the growth in Asian domestic demand will go hand in hand with the deepening of Asian financial markets. And, if SWFs invest in these markets at an early stage (as they already appear to be) then they are likely to enjoy rapid investment returns, as the capitalisation of these asset markets grow.

The size of SWFs may also grow relative to other types of investment. According to figures quoted from McKinsey, the world has $167 trillion of financial assets. Thus SWFs constitute 1.3% of this total. But this is likely to rise, particularly as the four constituent parts (i) to (iv) outlined above look set to grow. The current $2.2 trillion in SWFs compares with figures of $1-1.5 trillion for hedge funds and between $0.7 trillion to $1.1 trillion for private equity. Yet the growth in SWFs itself is likely to feed both of these areas, as the investment allocation of SWFs may see more funds directed into alternative investments such as hedge funds and private equity. The growth of SWFs, alongside that of hedge funds, private equity, government pension funds and of currency reserves is a clear indication of the shift underway in parts of the financial markets.

The IMF's Global Financial Stability Report from this spring also highlighted the shift underway in markets, although in their analysis the IMF groups the rise in FX reserves and in SWFs together, *"Tentative estimates of foreign assets held by sovereigns include $5.6 trillion of international reserves and between $1.9 trillion and $2.9 trillion in types of sovereign wealth fund (SWF) arrangements. These amount to about 10 times less than the assets under management of mature market institutional investors ($53 trillion) and modestly higher than those managed by hedge funds ($1 trillion to $1.5 trillion) (Financial Stability Forum, 2007). Current IMF projections are that sovereigns (predominantly emerging markets) will continue to accumulate international assets at the rate of $800 billion to $900 billion per year, which could bring the aggregate foreign assets under sovereign management to about $12 trillion by 2012."* But, as we mention above, not only are SWFs likely to grow at a faster pace than the increase in FX reserves, but they could exceed such FX reserves in total size in a number of years.

Not only are FX reserves different to SWFs, but so too are sovereign pension funds. Again these funds are sizeable, whether they are in Chile, Ireland or Saudi Arabia. Collectively, one could argue that all of these (SWFs, FX reserves and sovereign pension funds) are a sign of the increasing might of emerging economies and they reflect another sign of the changing balance of power in the world economy.

1d. Secrecy and accountability

But it is not the age or the size of these funds that has recently prompted attention; it is the opaqueness or secrecy of the fund, and in particular concern about the strategic intention of some funds. Some funds are very transparent. These include:

- Norway,
- Singapore's Temasek,
- US (Alaska),
- Malaysia,
- Canada (Alberta),
- and Azerbaijan.

These funds provide detailed information on their size, returns achieved and their portfolio composition. And many companies have seen these as investors without any apparent issues to date.

In contrast, some funds have very low levels of transparency including

- UAE funds,
- Kuwait,
- China,
- Qatar,
- Brunei,
- Venezuela,
- Taiwan,

- and Oman.

A simple way to picture this is two axes: on the horizontal axis one measures a fund's transparency, from low (or opaque) on the left to high on the right. Meanwhile, on the vertical axis, funds can be measured on how their investment decisions are made, namely conventional (say, asset allocation) to strategic. On this basis, one could construct four boxes:

- Bottom left being low transparency but conventional investment strategy;
- Bottom right high transparency and conventional strategy;
- Top right being high transparency and strategic;
- Top left being low transparency and strategic.

Chart 2 would imply that the SWFs in the bottom right pose little concern, as they are not strategic and are transparent. The other three boxes all prompt questions, with the biggest area of concern relating to the top left segment. The four SWFs here being both strategic in their investment and also having relatively low transparency. Once again this graph demonstrates the difficulty of generalising about such funds, as a number have very different characteristics. The most secretive funds are on the extreme left of the chart. Whilst secrecy in itself does not mean that a fund will be a bad investor, in a global financial environment where transparency and accountability are seen as important positives, such opaqueness should not be encouraged.

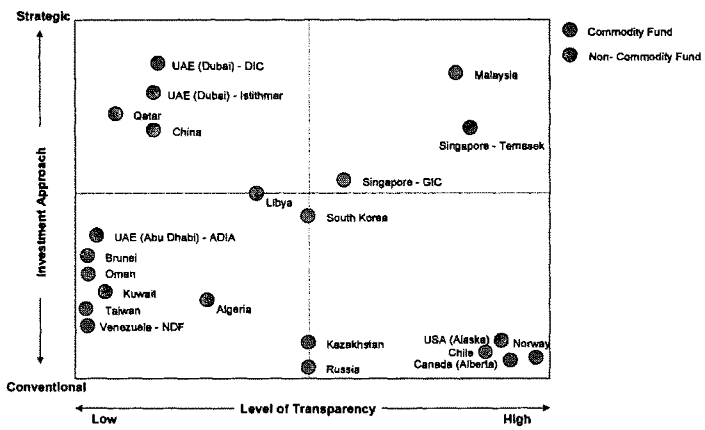
One of the surprising aspects of this chart is the position of Russia - seen as relatively transparent and also less strategic than other funds. Allthough both of these characteristics may change when, as of next year, the Russian fund begins to invest partially in more risky assets (so far it does not invest in global equities), this nonetheless might genuinely raise questions as to why there appears to be such apprehension about their intentions. That the situation is likely to change is perhaps the concern amongst some countries. But if there is change it can be two-way. For instance, in my view the increased US dialogue with China, particularly in areas such as the Strategic Economic Dialogue, plus China's desire to ensure high returns form their fund may account for their decision to allocate some of their new money to be managed by international investment managers. That, of course, leads on to what is best practice for SWFs? The bottom right of this chart highlights a number of funds that may be seen as adopting best practice.

1e. Implications - strategic behaviour

What then are the implications of SWFs? One can look at this in many different ways, in terms of their impact on economies and markets around the world, how the funds themselves might evolve, the likelihood that they will feed protectionist sentiment in the West, and indeed whether governments and funds can work together to ensure some common ground rules.

Chart 2: The Top 22 Sovereign Wealth Funds

Overview of Investment Approach and Transparency



Source: Standard Chartered and Oxford Analytica

The performance aspect of SWFs and the need to ensure high returns is likely to encourage them to take bigger financial stakes in equity and bond markets across emerging economies as well as to feed more money into alternative investments such as hedge funds and private equity. But consider some aspects of their strategic behaviour first.

Strategic stakes are bought: Making investments for purely commercial reasons are one thing, but when they involve government owned funds and the stake is potentially strategic it is clearly another thing. The big worry is that these funds see an opportunity to acquire strategic stakes in key industries around the globe, whether it be:

- Telecommunications,
- Energy,
- The media
- The financial sector,
- Or even to secure intellectual property rights in other fields.

The difficulty is that many of the more strategic funds are not so transparent and thus it is hard to measure such stakes. Nonetheless, the economic rationale behind such strategic acquisitions is clear. Some countries may seen this as a way to move up the value curve quickly, as they acquire intellectual property and access to research, design and development that it may take years to develop at home. For instance, the expertise of emerging economies, such as China, in low cost manufacturing could quickly be added to by the acquisition of high tech firms overseas. Of course that raises questions, such as should China be able to secure intellectual property rights overseas, at a time when it cannot guarantee to safeguard such rights for foreign firms in their market? Buying into overseas financial firms (whether through SWFs or other arms of a government) makes long-term strategic sense for many emerging economies, particularly if it allows them to transfer such financial skills back home to help develop and deepen domestic financial markets.

Resource nationalism: This means an attempt to buy access to strategic commodities and resources around the world. This is linked into the fundamental shift in the demand for commodities. China stands out here given its insatiable appetite for all types of commodities, and not just energy. For instance between 2004 and 2006, China moved from accounting for 21% to 26% of total global demand for six industrial commodities (by last year accounting for 30% of zinc demand, 32% tin, 19% nickel, 27% lead, 23% copper and 26% of global demand for aluminium).

In softer commodities it also accounts for a significant proportion of demand (16% wheat, 19% maize, 21% soybean and 31% rice). There is also the buying of overseas strategic assets linked to energy. And here attention is sometimes focused on what happens in the home country from which a SWF originates as much as on what happens abroad. For instance, Russia, and other oil producers, are also in a powerful position as national oil companies become bigger and in the process edge out western multinationals from their oil reserves. And a wider concern linked in here is how will the owners of these stakes behave in the future.

The role of SWFs in enhancing a country's strategic agenda should not be overlooked, although in reality there are many ways that a country can seek to provide funds to another country. China's strategic ambitions should not be doubted, as its relationship with Africa highlights. This relationship has changed over the years. After initial enthusiasm a few years ago about Chinese investment in Africa there was then a backlash, as concerns were raised in Africa about both China's intentions and about whether its investment was in the Continent's best interests. Given China's strong incentive to purchase access now to future supplies, the Chinese responded by courting African policy makers. Nearly 50 African leaders were hosted in Beijing last autumn, whilst the annual African Development Bank took place this May in Shanghai, during which the Chinese announced the availability of further funds to be invested in African projects. This could yet evolve further. How will the market and trading companies cope with direct government to government deals on commodity flows, or even with buying of the mining companies themselves?

1f. Implications - protectionist stance

Protectionist backlash: There is a need to take seriously the likelihood of Western governments and SWFs being on a future collision course over what they can buy, and where. A protectionist backlash against strategic investments is very real and threatens global trade. As we have seen from recent years, not all countries that are on the receiving end of these flows like this idea. The Thai authorities did not like Temasek of Singapore's purchase of a telecommunications stake in their country, whilst Dubai Ports World had to abandon their attempt to buy P&O's US ports after it prompted a national security debate in the US Congress. China's CNOOC bid for Unocal was also blocked in the US. Future political reactions could be far worse. It is not only governments that should be concerned; markets need to take note of the consequences.

The desire of some governments to protect their strategic assets from the clutches of SWFs is coinciding with a rising anti-globalisation sentiment in some countries. If governments attempted to protect strategic industries or important companies, this poses the question of how one defines a strategic industry? One linked to defence is understandable - hence in the UK the government has a golden share in British Aerospace that allows it to veto foreign control. But in other areas it is more difficult to say. Yet it is possible to conceive of a number of areas where there are legitimate reasons for a cautious or even protectionist stance on behalf of the recipient country. Such examples might be if the outcome would damage domestic competition; if the outcome was detrimental to national security - which is already a key issue in the US whether or not it is a SWF or any other investor that wishes to buy; and perhaps such a response is legitimate if a SWF is secretive and its intentions are strategic.

Before we get to this situation there is a need for ground rules to be established on SWFs. These could be imposed at the country or regional levels, but that is a second-best outcome. Far better for a credible global body to seek to establish some ground rules, providing the views of emerging countries were fully reflected. Of course, this risks an ineffective outcome.

Many factors have contributed to the recent economic boom, including the opening up of world trade and global financial flows. But the transition to a more global economy can be painful - whilst there are winners (especially in the emerging world), there are also losers (including low skilled workers in developed countries who may not receive large wage gains). It is in response to this that protectionist sentiment may gain a strong footing and the rest of the world is observing this situation in the US.

Yet the European stance is equally important - especially as European-Asian trade has now overtaken US-Asian trade.

In recent EU bilateral trade negotiations, they UK's desire to insert social or sustainability clauses in order to protect not just areas of national security but also areas of national sensitivity led to much confusion and highlighted how complex this area is and in my mind provided another example of the need for widely agreed ground rules in such trade negotiations.

In some respects it picks up the present mood in Western Europe, which appears to be leaning towards more protection. According to the Centre for European Reform, *"Several EU Governments have become alarmed about SWFs. Germany, for example, is thinking of preventing such funds from buying local companies in sensitive sectors. The European Commission is considering how it should respond: should it outlaw such defences or establish them at EU level?......the EU needs to ensure that any measures taken in response to SWFs do not threaten the openness of its single market."*

1g. Implications - market impact

Money goes elsewhere: For instance, if the US Congress becomes more protectionist, blocking state inflows from, say, China, would the money just go elsewhere? Indeed this already appears to be happening in terms of flows from the Middle East that in the past predominantly went to the US. Whilst the US is still the main recipient, a report earlier this year from the Institute of International Finance, using estimates from the United Nations, suggests that there has been a shift away from the US, and that between 2002-2006 20% of investment from Gulf States went to Europe, 11% to the Middle East/North African and 11% to Asia.

It is likely that SWFs could divert their attention from markets in the West to focus on nascent equity and bond markets in emerging economies. In fact such a strategy makes sense anyway, as whether one is cautious or optimistic about the global economy, emerging economies are likely to see stronger rates of growth than OECD countries, and offer better longer-term investment opportunities.

Financial markets: Government intervention through state funds could cause distortions particularly if the funds become active in regional markets across parts of Asia, Africa and Latin America that are smaller, less liquid and lacking maturity. There the impact of foreign state funds could be huge. In recent times there have sometimes been concerns in financial markets of what could happen to US Treasury yields if Asian central banks sold, but in this context for emerging markets the impact of SWFs is likely to be seen in a positive light - provided the markets are big enough and have the capacity to absorb such inflows.

Pro-cyclical market impact: The impact of larger SWFs on markets could be pro-cyclical, reinforcing trends that are coming into place. Indeed it is possible to see the impact of FX diversification away from the dollar and of SWF investment in smaller and faster growing emerging markets as resulting in a strong impact, adding to dollar weakness and emerging market equity strength. Furthermore, as the funds become bigger they could shift to more risk-seeking behaviour, feeding alternative investments such as hedge funds and private equity, as mentioned above, as well as enhancing the attraction of emerging markets. There is a risk that the presence of SWFs in riskier asset markets could lead to a moral hazard problem, especially if the SWFs have strategic and not just profit maximising objectives. The attraction of emerging markets could go hand in hand with a further shift in global FX reserves away from the dollar. Although the bulk of global reserves are in dollars, its share is declining, albeit slowly. It is not in Asian countries' interests to actively sell the dollar now, but we believe that passive diversification is already underway, as Asian central banks put less of new reserves into dollars. Of course, if they were to actively sell the dollar then the impact - both direct and more particularly indirect - would be significant. For instance, if Asian central banks were to switch reserves to match countries with whom they trade, they would need to offload $1.39 trillion, or a quarter of the world's total reserves.

Greater equity purchases in mature markets: Yet even in the mature established markets there could be consequences. The desire to increase returns could see greater equity purchases by state funds, raising the question of how they will behave if they are equity holders when hostile takeovers take place? Would one really want a fund run by the Russian authorities, say, deciding on the fate of a hostile banking takeover?

1h. Implications - need for ground rules

Level playing fields: This is often referred to in terms of reciprocity. Whilst the fear is a protectionist response the West should use the growth of state capitalism to force change for good. For instance, in the UK's financial sector, the aim will be to continue to embrace the Wimbledon effect - better to have the best financial market in London, even if most of the key players are foreign owned. But at Wimbledon the playing field is flat. Chinese banks may buy, own and exert full control over British banks, but could the reverse happen? If the West accepts that Chinese firms can buy freely overseas using state reserves then this should lead to pressure for China to open its domestic markets further. And the same pressure should be applied to other countries with large state funds that invest overseas.

Best practice: SWFs need to adopt the best practice of the open funds such as Norway. Appropriate regulation of all aspects of the financial sector is needed, and sovereign funds should not be immune, particularly as their importance grows. Whether it is possible to have a code of conduct for SWFs remains to be seen, the likelihood being that many countries will view it as their money, and they may not view it as relevant what Norway, or indeed other countries do. This is in all likelihood what would happen.

Avoiding collision: There are some crucial steps that need to be taken to prevent a collision between SWFs and host nations into which they invest. Yet the preconditions for such a collision seem to be already falling into place:

- SWFs are growing significantly and the need for resources, as well as a desire to acquire expertise is resulting in a significant strategic element in many SWFs.

- This growth mirrors structural shifts in the world economy, where emerging markets are outperforming and assets in these markets look set to exhibit steady and even rapid growth (albeit allowing for near-term cyclical challenges as the pace of global growth slows in the next two years).

- The challenges of globalisation, plus below trend growth in the US in 2008 and 2009, feed a protectionist stance in the US and in some Western European countries.

How this might play out is hard to say, but it is unlikely to be pleasant.

Non-voting stakes: In trying to establish workable ground rules for SWFs, one issue is that of non-voting shares. If SWFs behave as institutional investors that own minority stakes then there may be few grounds for objection, or cause for concern. But if the SWFs begin to acquire large stakes this may lead to valid questions being asked. In particular, one concern is that direct influence by government controlled stakes may lead to capital misallocation and inefficiency. Another is that fear of political interference in business decisions and strategies. One possible solution is to limit SWFs to non-voting shares, although the challenge here is the ability to discriminate between different types of investors.

As there is a strong case for more openness and best practice in terms of governance. The growth of newer SWFs has prompted much discussion about whether they will be able to attract the talent to manage such funds. But, in reality, this is no different to others in the rapidly growing financial sector across emerging markets. It may, of course, encourage such funds as they grow to allocate money to third party fund managers. Although that may ease concerns about their transparency it does not remove the need for more openness.

Code of conduct: Western countries may need to accept the rise of SWFs as a further sign of a shift in the world economy and should seize this as an opportunity to work with economies such as China, Russia, countries in the Middle East and others to find common ground rules and a code of practice. Although multilateral groups like the IMF and World Bank or even the World

Trade Organisation may be best placed to decide a code of practice the danger is that they will be ineffective.

State capitalism and resource nationalism are already a major economic phenomenon. Across Asia, Russia and the Middle East governments look set to use their country's currency reserves and savings to acquire overseas assets. Whether it is China, Korea, Qatar or Abu Dhabi or a host of others their funds appear intent on improving returns, building up long-term assets and acquiring strategic stakes around the globe. The shopping list is long!

Force for good: The mood towards SWFs in many emerging countries appears to be to view them as a potential force for good. I have either heard such views directly, or heard them relayed to me from colleagues. In some respects this is a reflection of the SWFs being seen as a further shift in the balance of economic and financial power, and also reflecting the increasing confidence seen in regions such as Asia and the Middle East. Furthermore, there is the expectation that such SWFs will be a source of liquidity and of investment flows into emerging markets.

Section 2: The largest sovereign wealth funds

2a. Selection Criteria

The following analysis has been carried out with the support of Oxford Analytica.

One of the many challenges with SWFs is how one defines them. In this analysis the SWFs that we have included fulfil the following criteria:

- Owned by a sovereign nation state, rather than a regional or local state entity. As exceptions to this rule, we have included five subnational-level funds that are financed by foreign exchange assets resulting from commodities exports, and that are large enough to rank within our top 22: ADIA (Abu Dhabi), Istithmar (Dubai), Dubai International Capital, Alberta Heritage Savings Trust Fund (Canada) and Alaska's Permanent Reserve Fund.

- Not national pension funds, unless these are financed directly by foreign exchange assets generated by commodity exports. This excludes, for example, Australia's Future Fund, Thailand's Government Pension Fund and Chile's Pension Guarantee Fund, while permitting the inclusion of Norway's Government Pension Fund - Global.

- Not central banks or authorities that perform roles typical of a central bank (eg supervision or currency issuance), even if these organisations also manage foreign exchange assets. This excludes organisations such as the Saudi Arabia Monetary Authority (SAMA), which has foreign reserves of 251 billion US dollars. In addition, SAMA acts as a conduit for the foreign investments of Saudi government funds, including the General Organization for Social Insurance and the Retirement Pensions Agency, which together have total assets of 116 billion US dollars. However, SAMA is the country's central bank, performing roles such as currency issuance, so we have not included it.

- Investment funds rather than producers of goods or services (although they may invest in productive companies). This excludes state-owned energy companies and state development banks.

2b. Methodology

The methodology for gathering data has centred on a search of publicly available data, particularly:

- SWF websites, if these exist.
- Media reports on the activities of SWFs.
- Research reports by other financial institutions on SWFs.

For several of the least transparent SWFs, information was also requested by e-mail.

The Appendix to this report provides data on some additional funds, which we analysed, but which did not make the top 22 by being excluded using the above criteria (funds i-iii in the appendix) or on grounds of size (funds iv-ix). Many other significant global funds do not meet the above criteria, so the appendix is not an exhaustive list. In addition, many other small funds are currently being launched or have existed for some time, for instance in Ecuador or Nigeria, but either their small size and/or a lack of clarity about their functions means that we did not gather sufficient data to warrant their inclusion in the appendix.

2c. Summary of Findings

The 22 SWFs identified by the study manage assets worth an estimated total of over two trillion dollars. The following analysis highlights the differences between the funds in seven main areas: age, source of funds, scale, aim, governance, investment activity, and growth rate.

Table 1: Estimated size of largest Sovereign Wealth Funds (Billion US Dollars)

Country	Fund Name	Launch year	US$ billion(1)	% of 2006 GDP
UAE (Abu Dhabi)	ADIA	1976	625.0	520.7%
Norway	Government Pension Fund - Global	1990	322.0	102.6%
Singapore	GIC	1981	215.0	169.0%
Kuwait	Kuwait Investment Authority	1953	213.0	268.7 %
China	China Investment Corporation	2007	200.0	8.0%
Russia	Stabilization Fund	2004	127.5	14.2%
Singapore	Temasek	1974	108.0	84.9%
Qatar	Qatar Investment Authority	2005	60.0	185.3%
Algeria	Revenue Regulation Fund	2000	44.4	49%
US (Alaska)	Permanent Reserve Fund	1976	40.2	0.3%
Libya	Libyan Investment Authority	2007	40	117%
Brunei	Brunei Investment Authority	1983	30.0	309.4%
Malaysia	Khazanah Nasional BHD	1993	26.1	12.3%
Korea	KIC (Korea Investment Corporation)	2005	20.0	2.2%
Venezuela	National Development Fund (Fonden)	2005	17.5	10.5%
Canada (Alberta)	Alberta Heritage Savings Trust Fund	1976	16.3	1.3%
Taiwan	National Stabilization Fund	2001	15.2	4.0%
Kazakhstan	National Fund	2000	14.9	15.6%
Chile	Economic and Social Stabilization Fund	2007	11.2	8.7%
UAE (Dubai)	Istithmar	2003	8.0	6.7%
UAE (Dubai)	DIC	2004	6.0	4.0%
Oman	State General RF	1980	6.0	16.0%
Total			2,158	

2d. Age

Sovereign wealth funds are far from being a new phenomenon. A number of oil exporters were among the earliest. This includes not only Gulf State funds such as the Kuwait Investment Authority (established in 1953) but also funds in the United States (Alaskan Permanent Reserve Fund, established 1976) and Canada (Alberta Heritage Savings Trust, 1976).

Table 2: Launch Year

Launch year	Top 22 SWFs
2000-2007	China, Russia, Qatar, South Korea, Kazakhstan, Chile, UAE (Dubai) - Istithmar, UAE (Dubai) - DIC, Taiwan, Libya, Algeria
1990-1999	Norway, Malaysia, Venezuela
Pre-1990	UAE (Abu Dhabi) - ADIA, Singapore (GIC and Temasek), Kuwait, United States (Alaska), Brunei, Canada, Oman

2e. Source of funds

The large majority of SWFs are financed by the export of commodities. Most non-commodity funds are recent, including China (2007), South Korea (2005) and Taiwan (2001). The two Singaporean funds (launched 1974 and 1981) are the only well-established, large non-commodity SWFs.

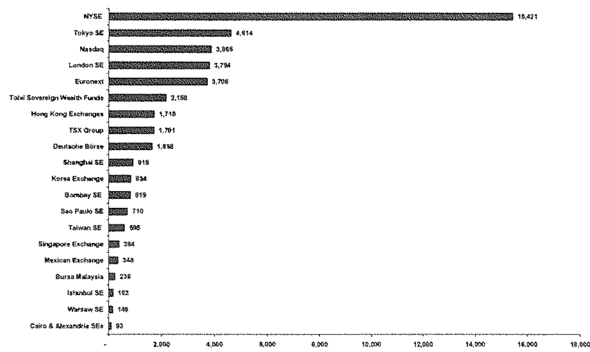
Table 3: Source of funds

Source of funds	**Top 22 SWFs**
Commodities	UAE (Abu Dhabi) - ADIA, Kuwait, US (Alaska), Brunei, Canada, Chile, Oman, Norway, Venezuela, Russia, Kazakhstan, UAE (Dubai) - Isithmar, UAE (Dubai) – DIC, Libya, Algeria
Non-commodities	Singapore (GIC and Temasek), China, Taiwan, South Korea, Malaysia

2f. Scale

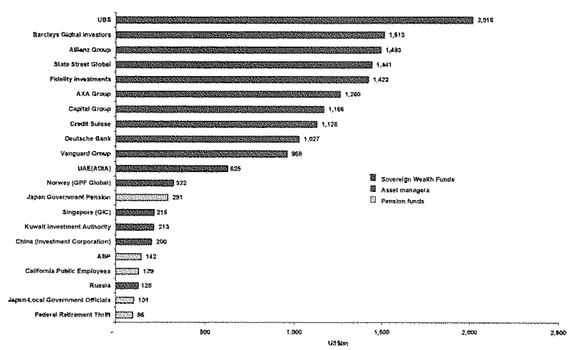
In section 1b I talked of the SWFs in terms of the Super Seven. Once can also try and gauge their scale in other ways. The two charts below illustrate the scale of SWFs, respectively, compared to the size of major stock exchanges, and compared to the sizes of leading asset managers and pension funds. These comparisons make it clear that SWFs have, and will continue to have, an extremely significant impact on global financial markets.

Chart 3. Size of Sovereign Wealth Funds compared to the market capitalisation of selected stock exchanges



Sources: Oxford Analytica, World Federation of Exchanges

Chart 4. AUM (US$BN) of selected Sovereign Wealth Funds, Asset Managers and Pension Funds



Sources: Oxford Analytica, Watson Wyatt. Figures for asset managers refer to end 2005

2g. Aim

Although the strategic investment component of the SWFs is now a concern, the tables below on the funds show that they were typically established with a primary focus on one or more of the following aims:

(i) *Macroeconomic stabilisation.* Countries that are highly dependent on commodity exports are exposed to swings in global prices. The primary aim of the fund in these cases can be to smooth short- and medium-term fluctuations.

(ii) *Higher returns.* Countries that have surplus funds are increasingly seeking to maximise returns. This is motivated by the opportunity cost associated with funds being invested in risk free assets.

(iii) *Future generations.* Several funds were created with the objective to create a reserve of wealth for the future, when natural resources will have been depleted.

(iv) *Domestic industries.* Some of the funds have also been used to restructure and encourage domestic industries.

2h. Governance

Management responsibility for SWFs varies widely, from Ministries of Finance and central banks through to separate entities that often have executive boards to make decisions. External money managers are typically contracted to manage funds on the basis of policies set by the board.

A limited number of funds, including the Norwegian fund, provide detailed information on their operations and performance. Among newer funds, there is a divergence between those that have sought to adopt best practice, and those where arrangements seem to have emerged on an almost ad hoc basis and where little is known of formal codes. Most obviously in the latter category is the new Chinese fund, and this is partly why China's SWF investments are raising most concern in recipient markets.

2i. Investment activity

The flurry of SWF activity in established stock markets this year has been striking. Investment policies vary, but tend to do so according to the SWF's primary aim and governance.

- 'Future generations' funds with high levels of transparency, such as the SWFs in Norway, Alberta and Alaska, have a high level of diversification and hold only small stakes. Norway's fund owns shares in about 3,500 companies, and it holds stakes that are typically below 1%.
- Stabilisation funds such as Russia's, for example, are tasked with delivering stable and low-risk returns, and so are limited to investment in AAA-rated sovereign bonds, with a given currency composition to manage currency risk.

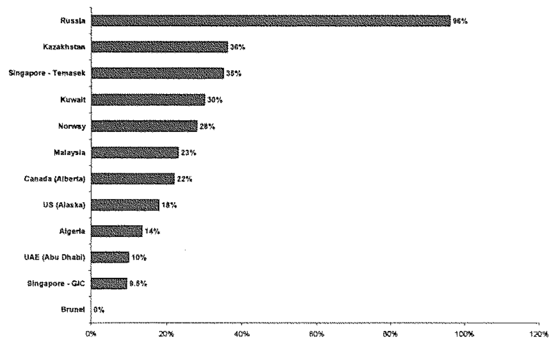
- Low-transparency funds such as the Abu Dhabi Investment Authority (ADIA) usually prefer investing in small stakes to avoid disclosure requirements.

- A number of funds have acquired significant stakes in foreign companies. These include the China Investment Corporation, GIC, Temasek, the Kuwait Investment Authority, the Qatar Investment Authority, and Dubai's Istithmar and DIC.

2j. Growth rates

Growth rates could be estimated for only twelve funds (see chart 5). For several funds direct information on growth rates in 2006 is not available, and the estimates are based on secondary sources or proxies for growth, such as returns over longer periods of time or estimates of returns or transfers to the fund.

Chart 5. Estimated growth rates of a selection of SWFs



Source: Oxford Analytica

Top 22 Sovereign Wealth Funds

1. Abu Dhabi Investment Authority (UAE)

Launch Year	1976
Fund Value (US dollars)	Estimates vary significantly -- from 250 billion to 1 trillion.[1] Our analysis says 625 billion.
Fund Value as % of GDP	521%
Growth Rate	10% p.a.[2]
Financing	Oil
Objective	Diversify investment of foreign currency reserves from oil exports.
Ownership	100% owned by Government of Abu Dhabi.
Management	Sheikh Khalifa, president of the UAE, is the Chairman.
Investment Policy and Asset Allocation	No investments in commodities and Middle East stock markets. Stakes in financial institutions in the region include Banque de Tunisie et des Emirats (30%), Arab Banking Corporation in Bahrain (27%), Arab International Bank in Egypt (25%), and the Joint Arab Investment Corporation (23%). Until 2006, investments only in foreign assets. ADIA's asset allocation: 50-60% in equities, 20-25% in fixed income, 5-8% in real estate, 5-10% in private equity and 5-10% in alternatives. Usually investments are limited to less than 4.5% to avoid disclosure. In 2006, a new institution was set up, the Abu Dhabi Investment Council, with the goal of investing both within and outside Abu Dhabi.
Outlook/Trends	The United Arab Emirates are expected to run annual current account surpluses of 35-40 billion US dollars over the medium term if oil prices remain at about the current level. ADIA could potentially be allocated a large part of these funds.
Transparency	Transparency is very low. In the 30 years since it was established, it has never publicly declared the value of assets it has under management. There is a lack of clarity about how much cooperation and competition there is between ADIA and ADIC.[3]
Recent investments	In May 2007 ADIA acquired 8% of EFG-Hermes, an Egyptian investment bank. In July 2007 purchased a small stake in Apollo Management, a US private equity company. In September 2007 ADIA announced a takeover of PrimeWest Energy Trust (Canada) for 5 billion dollars, according to press reports.

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1 250 billion (2005, State Street); 250-500 billion (2007, Financial Times); 600-1,000 billion (2007, Financial News); 875 billion (2007, Morgan Stanley).

2 Euromoney.

3 Abu Dhabi has another state-owned diversified investment company, Mubadala Development Company, which recently purchased 7.5% of Carlyle Group. Its links to ADIA and ADIC are unclear. Although its international investments are listed on its website, transparency about the size of this fund is extremely low. Oxford Analytica's estimate, based on comparing Mubadala's number of staff (250) with the staff-fund value ratios at ADIA and the Qatar Investment Authority, is that Mubadala's fund value could be 120 billion US dollars.

2. Government Pension Fund - Global (Norway)

Launch Year	1990
Fund Value (US dollars)	322 billion (March 2007).[4]
Fund Value as % of GDP	93%
Growth Rate	28% (2006)[5]
Financing	Receipts from oil licenses, oil taxes. About 80% of the government's oil-related revenues are transferred into the GPF.
Objective	The assets are to be used to meet the country's growing pensions bill after 2015.
Ownership	Norwegian Government (Ministry of Finance).
Management	Operational activities are delegated to Norges Bank Investment Management (NBIM), which is part of the Norwegian Central Bank. Most of the GPF is managed internally by the Norwegian central bank, but there are 50 external bond and equity managers running about 28% of the total.
Investment Policy and Asset Allocation	- Bonds represent 60% (over half of them AAA-rated) of the portfolio and equities 40%. - Asset allocation broadly reflects the structure of Norway's imports but with over-emphasis given to the liquid US markets. - The benchmark is for over 50% to be placed in European currencies and 35% in North American. - Asia accounts for less than 10% of asset allocation. The GPF's investments in emerging markets is growing. - It has an ethical screening process to exclude companies with "unacceptable violations of fundamental ethical norms".
Outlook/Trends	NBIM forecasts the fund will reach 500 billion US dollars by 2009.
Transparency	High. Annual and quarterly reports publicly available.
Recent Investments	The fund owns shares in about 3,500 companies, and it holds small stakes, typically below 1%.

[4] Norges Bank http://www.norges-bank.no/Pages/Article____42084.aspx

[5] Oxford Analytica calculations from Norges Bank data. http://www.norges-bank.no/Pages/Article____41397.aspx

3. Government of Singapore Investment Corporation

Launch Year	1981. A restructuring in 1999 led to the creation of three operating units: the Public Markets Group, investing in equities, fixed income, and money market instruments; Government of Singapore Investment Corporation (GIC) Real Estate, investing in real estate-related assets; and GIC Special Investments, investing in venture capital and private equity funds, as well as direct investments in private companies.
Fund Value (US dollars)	100-330 billion (2007).[6] Our analysis says 215 billion.
Fund Value as % of GDP	169%
Growth Rate	GIC's annual return has averaged 9.5% in US dollar terms over the 25 years to March 2006, since its launch in 1981. In real terms, the annual rate of return averaged 5.3%.
Financing	Financed by reserves from high savings rate.
Objective	To preserve and enhance the international purchasing power of Singapore's reserves, by achieving a real rate of return above the G3 inflation rate by a specified amount over a specified long-term horizon. For medium-term performance monitoring, to outperform an appropriate composite of recognised market indices, through optimal allocation among and within asset classes.
Ownership	Private company wholly owned by the Government of Singapore.
Management	Lee Kuan Yew, Chairman; Dr Tony Tan, Deputy Chairman & Executive Director. Lim Siong Guan Group Managing Director (as of September 22, 2007).
Investment Policy and Asset Allocation	Invests in 40 markets, with a long-term focus through systematic diversification across equities, fixed income, foreign exchange, commodities, money markets, alternative investments, real estate and private equity.
Outlook/Trends	Increased holdings in emerging markets are likely.
Transparency	Medium. Information about structure and investments, but no detailed financial reports on website.
Recent Investments	July 2007: Part of consortium in 895 million US dollar acquisition of Myer Melbourne site for redevelopment. July 2007: Acquisition of a 50% in WestQuay Shopping Centre, UK, for 600 million US dollars. June 2007: Purchase of Chapterhouse Holdings Ltd., whose primary asset is the Merrill Lynch Financial Centre, for 960 million US dollars. May 2007: Formation of joint venture with Sumitomo Corporation to invest 1.3 billion US dollars over two years in Japanese retail properties. April 2007: Acquisition of 50% of for Westfield Parramatta (Australian real estate company) for 584 million US dollars.

6 'Well over 100 billion' (GIC website: http://www.gic.com.sg/aboutus.htm, 2007) to 330 billion (Morgan Stanley, 2007).

4. Kuwait Investment Authority

Launch Year	1953
Fund Value (US dollars)	213 billion (March 2007), of which 174 billion invested in the Future Generations Fund and 39 billion in the Public Reserve Fund.[7]
Fund Value as % of GDP	265%
Growth Rate	30% (2006)[8]
Financing	Oil. Each year, 10% of state revenues are transferred to the Kuwait Investment Authority's (KIA's) Future Generations Fund (FGF). Assets cannot be withdrawn from the FGF. The KIA also manages the Public Reserve Fund, the main treasurer for the government.
Objective	To achieve a long term return in order to provide an alternative to oil reserves for Kuwait's future generations.
Ownership	Ministry of Finance
Management	Its board includes the oil minister, a representative of the central bank and of the finance ministry. Management of the FGF is outsourced to third-party managers.
Investment Policy and Asset Allocation	The FGF invests outside Kuwait. Its portfolio includes investments in private equity, hedge funds and real estate.
Outlook/Trends	The FGF is shifting from a very conservative strategy, aimed at preserving capital, towards a more risk-taking approach, focused on growth.
Transparency	Low. Disclosure to the public of any information related to KIA's work is prohibited by law.
Recent Investments	The KIA holds significant stakes in Daimler Benz and in the engineering group GEA.

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[7] Arab Times (based on a statement by the Minister of Finance) http://www.mafhoum.com/press10/304E20.htm.

[8] Arab Times http://www.mafhoum.com/press10/304E20.htm.

5. China Investment Corporation

Launch Year	2007. Official launch in September, although investment activities started earlier.
Fund Value (US dollars)	200 billion of foreign exchange reserves is currently being transferred to China Investment Corporation (CIC). An additional 200 billion may be added if Central Huijin Company, a People's Bank of China-dominated investment entity that controls three of China's 'big four' state banks, is folded into CIC as expected. At current market value, Huijin's shareholdings of the Bank of China, China Construction Bank and Commercial Bank of China are worth over 200 billion US dollars.[9]
Fund Value as % of GDP	8%
Growth Rate	The fund's initial capital is still being transferred.
Financing	Transfers from foreign exchange reserves.
Objective	To increase the return on assets. Chinese officials have suggested that the objective will include social and political returns.
Ownership	Chinese government.
Management	Deputy Secretary-General of the State Council Lou Jiwei, is likely to be appointed as the president of the new company. This will make it a ministerial-level organisation answering directly to the State Council. The names of the core management team have yet to be announced. The general manager will possibly come from the central bank or State Administration of Foreign Exchange. CIC is likely to delegate a substantial portion of management to foreign portfolio managers; however, there is likely to be a long selection process.
Investment Policy and Asset Allocation	Intended to manage a wide array of assets, not just shares from a few major financial institutions (as had been the case with Central Huijin Company).
Outlook/Trends	The fund may be required to aim for annual returns above 10%, in order to cover management costs and probable renminbi appreciation.
Transparency	Low.
Recent Investments	CIC in May this year invested three billion US dollars to acquire almost 10% of the initial public stock offering of US investment fund Blackstone Group LP. The People's Bank of China bought a 0.46% stake in BG Group plc in June and July this year for 250 million US dollars. This purchase is rumoured to have been on behalf of the CIC.

[9] Oxford Analytica Daily Brief.

6. Stabilization Fund (Russia)

Launch Year	2004
Fund Value (US dollars)	127.5 billion US dollars (March 2007).[10]
Fund Value as % GDP	14%
Growth Rate	96% (September 2006 to August 2007).
Financing	Export duty on oil and petroleum products and taxes on mineral resources. The base price of oil is set at 20 US dollars per barrel, above which revenues start accumulating in the fund. The government has the right to withdraw money if oil prices fall below the base level.
Objective	Absorb volatility of commodity prices. The fund is currently used to finance the pension fund and to repay foreign debt. The government can tap amounts above the base threshold of 500 billion roubles (18 billion US dollars) for expenditures outside the official budget.
Ownership	Ministry of Finance.
Management	The fund is managed by the Ministry of Finance. Some asset management functions are delegated to the central bank.
Investment Policy and Asset Allocation	Securities must be issued by governments of US and selected EU countries. Further restrictions on minimum amount and structure of the issue (eg AAA rated, no options, fixed coupon).Current currency composition: US dollars - 45 %, euros - 45 %, pounds sterling - 10 %.
Outlook/Trends	In 2008, the fund will be divided into a reserve fund, which will continue to be invested conservatively and used when oil and gas incomes fall; a more aggressive fund, which will invest in higher risk assets; and federal budgetary spending. The more aggressive fund may be allocated only 19 billion dollars initially.[11]
Transparency	The Ministry of Finance publishes a monthly public report on the fund's accumulation, spending and balance. Details on investments are reported quarterly to the Russian Parliament.
Recent Investments	The fund has not yet started to invest in global equities.

[10] Stabilization Fund of the Russian Federation, http://www1.minfin.ru/stabfond_eng/sobj_eng.htm

[11] Financial Times, September 18, 2007: http://www.ft.com/cms/s/0/187ba59a-657f-11dc-bf89-0000779fd2ac.html

7. Temasek Holdings (Singapore)

Launch Year	1974
Fund Value (US dollars)	108 billion (March 2007).[12]
Fund Value as % of GDP	85%
Growth Rate	The value of Temasek's portfolio grew 35% over the year ending on March 31, 2007. Total shareholder return for the year was 27%.[13]
Financing	Reserves from high savings rate and reinvested profits.
Objective	Active shareholder and investor. Aims to create and maximise sustainable value for owner.
Ownership	An 'exempt private company' with Minister of Finance as shareholder.
Management	S Dhanabalan, Chairman. Ho Ching, CEO. Operates as an autonomous and professional investment house, guided by an independent board.
Investment Policy and Asset Allocation	Operates under commercial principles to maximise long-term returns. Temasek's geographical asset mix in March 2007 was: Singapore (38%); rest of Asia (excluding Japan) 40%; OECD economies (excluding South Korea): 20%, others 2%.
Outlook/Trends	Since 2002, Temasek has raised its focus on Asia (except Singapore and Japan). Over the 12 months to March 2007, exposure to Singapore declined from 44% to 38% and exposure to the rest of Asia (excluding Japan) rose from 34% to 40%. 61% of the portfolio is in the financial services, telecoms and media sectors.
Transparency	High. Audited annual financial reports, as well as periodic updates, are provided to the Ministry of Finance. While not required to release financials publicly, group financial highlights have been published since 2004 in the annual Temasek Review.
Recent Investments	Temasek confirmed on July 23 this year that it is investing almost 2 billion US dollars in Barclays plc. Temasek will invest a further 3 billion US dollars in Barclays conditional upon completion of the merger with ABN AMRO. Temasek also holds 17.22% in Standard Chartered Bank[14]. Other overseas investments during the year to March 2007 included new holdings in ABC Learning Centres (Australia, Temasek holds 12%), Intercell AG (Austria, 8.1%), Country Garden and Yingli Green energy (both China), INX Media (India, less than 25%), Mitsui Life (Japan, 4.6%), PIK Group and VTB Bank (both Russia). Temasek in May 2007 increased its stake in STATS ChipPAC to 83%. In late September 2007 press reports noted that Temasek and Singapore Airlines together acquired 24% of China Eastern Airlines Corporation.

[12] Temasek Holdings website: http://www.temasekholdings.com.sg/

[13] Temasek Holdings website: http://www.temasekholdings.com.sg/

8. Qatar Investment Authority

Launch Year	June 2005
Fund Value (US dollars)	Estimated value 50 billion to 70 billion (March 2007).[15] Our analysis says 60 billion.
Fund Value as % of GDP	185%
Growth Rate	--
Financing	Gas.
Objective	Involved in the investment of Qatar's surplus financial resources in local and international markets; establishment of companies and projects; economic and energy affairs.
Ownership	Qatar government.
Management	Sheikh Tamim Bin Hamad Al Thani, son of the Emir of Qatar, is the Chairman of the authority.
Investment Policy and Asset Allocation	--
Outlook/Trends	Fund size expected to double by 2010. Qatar Investment Authority (QIA) plans to expand its investments in Asia up to 40% of its portfolio (with the rest in the Americas and Europe), particularly financial institutions and consumer-oriented export industries.
Transparency	Low. No reports provided.
Recent investments	UK care homes provider Four Seasons Healthcare (100%). Other holdings include 20% (now 24% according to some press reports in late September) of London Stock Exchange Group, 9.98% in Nordic Exchange OMX (Sweden), 5.1% in Lagardere (France), 97.3% of BLC Bank (Lebanon), 20% in the Housing Bank for Trade and Finance (Jordan) and 5% in Raffles Medical Group (Singapore). QIA was a co-investor in Dubai International Capital's July 2007 purchase of a 3.12% stake in European Aeronautic, Defence & Space Co (EADS). QIA is currently bidding to buy UK retailer Sainsbury, through its Delta Two Fund, which already holds 25% of Sainsbury.

[14] London Stock Exchange, September 13, 2007.

[15] Financial News.

9. Revenue Regulation Fund (Algeria)

Launch Year	2000
Fund Value (US dollars)	44.4 billion (June 2007)[16]
Fund Value as % of GDP	49%
Growth Rate	9% rise in Algerian dinar terms between October 2006 and June 2007.[17]
Financing	Oil revenue recorded in excess of budget law projections. The Fund resources may be supplemented by advances from the Banque d'Algérie.[18]
Objective	1) Offset the shortfalls resulting from oil tax revenue below budget law projections. 2) Reduce the external public debt.
Ownership	Algerian government
Management	Bank of Algeria
Investment Policy and Asset Allocation	n.a.
Outlook/Trends	n.a.
Transparency	Low. No reports available, no information on investment policy.
Recent Investments	n.a.

16 El Watan (based on draft budget law for 2008) .
http://www.elwatan.com/spip.php?page=article&id_article=77485

17 http://www.algerie-dz.com/article6788.html

18 IMF (2005), 'Algeria: Report on the Observance of Standards and Codes—Fiscal Transparency Module' http://www.imf.org/external/pubs/ft/scr/2005/cr0568.pdf

10. Permanent Reserve Fund (Alaska)

Launch Year	1976
Fund Value (US dollars)	40.2 billion[19] (2006).
Fund Value as % of GDP	0.3%
Growth Rate	17% July 2006 to June 2007; 18% July 2005 to June 2006.
Financing	Oil. Each year, the fund's realised earnings are split between inflation-proofing, operating expenses, and the annual Permanent Fund Dividend.
Objective	Benefit future generations of Alaskans once oil reserves are depleted. Only investment income can be spent by the State legislature. Principal cannot be spent without a vote. Target return: 5% over 10-year period.
Ownership	State of Alaska.
Management	Managed by the Alaska Permanent Fund Corporation (APFC). Part of the portfolio is allocated to several dozen external managers.
Investment Policy and Asset Allocation	Target asset allocation: 34% domestic equities, 19% international equities; 25% domestic fixed income; 4% international fixed income; 10% real estate; 4% private equity; 4% absolute return. Historical return over 10 years is 8.4%.
Outlook/Trends	Expected to reach 46 billion US dollars by 2012.
Transparency	High - public reports.
Recent Investments	The fund invests in several dozen sectors and countries. Top five stockholdings are GE, Exxon, Microsoft, Google and Procter & Gamble.

[19] Alaska Permanent Fund Corporation (2006), annual report. http://www.apfc.org/

11. Libyan Investment Authority

Launch Year	2007
Fund Value (US dollars)	40 billion (target)[20]
Fund Value as % of GDP	117%
Growth Rate	--
Financing	Initial funds transferred from central bank. The Libyan Investment Authority will receive an annual portion of the oil revenue surplus.
Objective	Diversify oil revenues into financial assets
Ownership	Libyan government
Management	Libyan Investment Authority. Chairman is Mohamed Layas.
Investment Policy and Asset Allocation	Portfolio Investments managed through Western banks and institutions.
Outlook/Trends	The fund plans to purchase real estate worldwide and, when it is more established, also engage in private equity transactions.
Transparency	Low/medium. Data on size and investments made available through the media.
Recent Investments	Set-up an investment fund (total 2 billion US dollar) with the Qatar Investment Authority to invest in Libya, Qatar and Western markets. Other assets: Lafico (real estate, 3 billion US dollars), Libyan African investment portfolio (5 billion US dollars), portfolio investments in capital markets (8 billion US dollars).

[20] Financial Times, http://www.ft.com/cms/s/0/c4bd32be-7cd2-11dc-aee2-0000779fd2ac.html?nclick_check=1

12. Brunei Investment Agency

Launch Year	1983
Fund Value (US dollars)	30 billion US dollars (March 2007).[21]
Fund Value as % of GDP	309%
Growth Rate	At its peak during the 1990s, it is estimated that the value of the Brunei Investment Agency (BIA) was at least 100 billion US dollars. The value of the fund then declined and seems to have stabilised at about 30 billion US dollars over the last several years.
Financing	BIA manages the country's foreign exchange reserves.
Objective	To increase the real value of Brunei's foreign exchange reserves.
Ownership	Part of the Ministry of Finance.
Management	Chairman is Pehin Dato Seri Setia Awg Hj Yahya bin Begawan Mudim Dato Paduka Hj Baker. Awang Haji Ali bin Haji Apong was appointed Acting Managing Director in May 2003.
Investment Guidelines	Holdings in the United States, Japan, ASEAN countries and Western Europe.
Outlook/Trends	An ongoing dispute over billions of US dollars, which it is claimed were channelled from the BIA to private bank accounts during the 1990s, now appears close to being resolved. Former Chairman of BIA Prince Jefri Bolkiah has been accused by the Sultan of Brunei (his brother) of misdirecting BIA funds. A ruling is expected before the end of this year. The conclusion of that case will help the BIA to continue to rebuild.
Transparency	Very low.
Recent Investments	BIA last year purchased a stake in Jordan Phosphate Mines Company Ltd.

[21] Morgan Stanley estimate.

13. Khazanah Nasional (Malaysia)

Launch Year	1993
Fund Value (US dollars)	26.1 billion (May 31, 2007).[22]
Fund Value as % of GDP	12%
Growth Rate	23% (annual average May 2004-May 2007)[23]
Financing	Non-commodity fund partly financed by debt.
Objective	Part of Khazanah Nasional's (KN's) mandate is to make strategic investments abroad, under the overarching objective of 'nation building' for Malaysia. Other key themes of the strategic investment mandate include: Creating sustainable value; raising national competitiveness; and cultivating a culture of high performance. Through its investments in Malaysian legacy companies, KN seeks to achieve these aims by promoting restructuring and reorganisation.
Ownership	Ministry of Finance. KN is the investment-holding arm of the government of Malaysia.
Management	The Prime Minister of Malaysia is the Chairman of the Board. The Management team is headed by Managing Director Dato' Azman b. Hj Mokhtar.
Investment Policy and Asset Allocation	KN has investments in over 50 companies, in Malaysia and abroad, within over a dozen different sectors. The major sectors are utilities (23.5% of portfolio in May 2007), media and communications (22.3%), and infrastructure and construction (18.2%).
Outlook/Trends	KN is a leader in innovative Islamic finance. It issued the world's first exchangeable Sukuk (Sharia-compliant bond) in October 2006, for 750 million US dollars. The proportion of KN's total portfolio held in foreign investments has risen from 0.2% in May 2004 to 9.2% in May 2007. Over the next three years, KN aims to increase synergies across its investments and to continue to broaden the base of its investments.
Transparency	High. Annual report provides good data.
Recent Investments	KN has investments in 12 Asian countries, Saudi Arabia, the UAE, New Zealand and the UK (Proton, the Malaysian national carmaker). The main destinations of KN's investment abroad are Indonesia (4.3% of total portfolio), India (1.8%), China (1.6%) and Singapore (1.4%).

[22] Khazanah Nasional annual review of June 1, 2007 (using exchange rate of May 31, 2007. Net worth, using the same exchange rate, is 18.3 billion US dollars): http://www.khazanah.com.my/docs/2007%20Annual%20Review%20June%20007.pdf

[23] Growth between May 2004 to May 2007 was 87%. Khazanah Nasional annual report: http://www.khazanah.com.my/docs/2007%20Annual%20Review%20June%202007.pdf

14. Korea Investment Corporation

Launch Year	2005
Fund Value	Initial capital of 20 billion dollars (2007).[24]
Fund Value as % of GDP	2.2%
Growth Rate	Initial capital is still being invested.
Financing	Of the Korea Investment Corporation's (KIC's) initial capital, 17 billion US dollars was transferred from the Bank of Korea's foreign exchange reserves, and 3 billion dollars from the Ministry of Economy and Finance's Foreign Exchange Stabilization Fund.[25]
Objective	To achieve a stable and continuous return exceeding the benchmark within an appropriate level of risk, and to foster development of local financial industry and of local talent pool.[26]
Ownership	Government of Korea.
Management	The KIC is designed to be run commercially and independently. It has engaged external fund managers but has not provided further details. The Korean government expects KIC's external fund managers to transfer global best practices to local Korean managers over time. Serck-Joo Hong was appointed president and CEO in September 2006.
Investment Policy and Asset Allocation	KIC's asset classes may include securities (including stocks and bonds defined under the KIC Act), foreign currencies and derivatives.
Outlook/Trends	It is the government's intention to invest the full initial 20 billion US dollars by the beginning of next year, and to begin covering its costs by 2010. A further 90 billion US dollars of existing official reserves could soon be transferred to the KIC.
Transparency	Medium. KIC plans to disclose its financial statements and accounting standards, audit report for financial statements, mid- and long-term investment policies, total value of assets under management and rate of return, composition ratio and rate of return for each asset class. The Steering Committee exercises supervision over KIC's business, and may, as prescribed under the KIC Act, entrust a private accounting firm to inspect the business.
Recent Investments	KIC's first investment was made in November 2006. KIC has not provided further details.

[24] http://www.kic.go.kr/en/?mid=in01

[25] Dow Jones.

[26] http://www.kic.go.kr/en/?mid=in01

15. National Development Fund (Venezuela)

Launch Year	2005
Fund Value (US dollars)	17.5 billion (end 2006).[27]
Fund Value as % of GDP	11%
Growth Rate	The value of the fund increased from zero to 17.5 billion US dollars in just over two years.
Financing	Transfers from the international reserves of the Central Bank of Venezuela and from the national oil company Petroleos de Venezuela SA (PDVSA).
Objective	The National Development Fund's (Fonden's) official role is to manage and disburse funds for purchasing foreign debt, goods and services in foreign currency, and to maintain a reserve in case of disasters.
Ownership	Government of Venezuela
Management	--
Investment Policy and Asset Allocation	Fonden's portfolio is unclear.
Outlook	The Fonden appears to have become a major vehicle for funding domestic investments in infrastructure and social projects. This is likely to continue and so will limit the proportion of the fund that is available for investment abroad. In the event of a decline in the oil price, there is a risk that the size of the fund may decline rapidly as it is used to fund current domestic public expenditure.
Transparency	Very low. There is no auditing, accountability or parliamentary oversight of the funds, a significant proportion of which are believed to be held outside Venezuela.
Recent Investments	--

[27] Unofficial quote by senior member of Central Bank of Venezuela.

16. Alberta Heritage Savings Trust Fund (Canada)

Launch Year	1976
Fund Value (US dollars)	16.4 billion [28]
Fund Value as % of GDP	1.1%
Growth Rate	22% (January to December 2006).
Financing	Oil
Objective	To manage savings from Alberta's non-renewable resources. The investment income earned by the Heritage Fund is transferred to the province's budget.
Ownership	Ministry of Finance.
Management	Investment Management Division, within the Ministry of Finance.
Investment Policy and Asset Allocation	Target investment allocation: 29% fixed income; 15% US equity; 15% non- North American equities; 15% Canadian equities; 10% real estate; 4% private equity; 12% other.
Outlook/Trends	Forecasted to reach 16.5 billion US dollars in 2009/10.
Transparency	High. Quarterly and annual reports and business plans are publicly available.

[28] Alberta Heritage Savings Trust Fund: http://www.finance.gov.ab.ca/business/ahstf/index.html

17. National Stabilization Fund (Taiwan)

Launch Year	2001
Fund Value (US dollars)	15.2 billion (August 2007).[29]
Fund Value as % of GDP	4%
Growth Rate	The value of the National Stabilization Fund (NSF) appears to have declined slightly from 16.1 billion US dollars at its launch.[30]
Financing	The sources of the NSF are a 6.3 billion US dollar collateral-backed loan from local financial institutions and 9.45 billion US dollars in cash from postal savings, postal insurance savings, and pension funds for public sector workers.
Objective	'Crisis management' for Taiwan's capital markets, which tend to be dominated by individual investors. The fund's draft regulations stipulate that it can be used on three conditions: 1) When share prices on the stock market fall significantly over an extended period of time. 2) When massive movements of international capital occur or when foreign speculators attempt to manipulate fluctuations in local financial markets. 3) When major domestic or overseas events threaten market order or national security. However, the draft regulations state that the fund will not be used to intervene in the foreign exchange market.
Ownership	Ministry of Finance
Management	A committee chaired by the finance minister is responsible for the fund's management. It consists of seven to nine members, including the governor of the central bank; the minister of transportation and communications; the director-general of the budget, accounting and statistics; the chairman of the Council of Labour Affairs; the director-general of the Central Personnel Administration; and up to three scholars invited by the Ministry of Finance.
Investment Policy and Asset Allocation	--
Outlook/Trends	The NSF has come under considerable media pressure to intervene in order to support Taiwan's stock market during periods of turbulence this year. It is unclear whether/how much the NSF may have intervened so far.
Transparency	Very low. Managers and others associated with the NSF are subject to imprisonment and fines if found guilty of leaking information about the committee's investment plans.[31]
Recent Investments	--

[29] Taipei Times archive: http://www.taipeitimes.com/News/biz/archives/2007/08/18/2003374790

[30] Taiwan Journal: http://taiwanjournal.nat.gov.tw/ct.asp?xItem=17763&CtNode=122

[31] Taiwan Journal: http://taiwanjournal.nat.gov.tw/ct.asp?xItem=17763&CtNode=122

18. National Fund (Kazakhstan)

Launch Year	2000
Fund Value (US dollars)	14.9 billion US dollars (August 2007).[32]
Fund Value as % of GDP	16%
Growth Rate	The value of the National fund (NF) increased by 36% between August 2006 and August 2007.[33]
Financing	The NF was integrated into the budgetary system in July 2006: receipts from all extractive companies are now channelled to the NF.
Objective	Dual function of saving for future generations and stabilising government budget. The NF is also drawn upon to fund public investment.
Ownership	Government of Kazakhstan
Management	ABN AMRO Mellon Global Securities Services provides custody and income collection; portfolio accounting, including daily valuation; monthly reconciliation; performance measurement; compliance monitoring; and securities lending. Investment management is allocated via a bidding process. External managers for global fixed income are ABN AMRO Asset Management; BNP Paribas Asset Management/FFTW; Deutsche Asset Management; State Street Global Advisors; and Union Bank Privée. External Managers for global indexed equities are Credit Suisse Asset Management and HSBC Asset Management.
Investment Policy and Asset Allocation	The NF has two portfolios: a stabilisation portfolio (minimum 20% of the NF) – to ensure lower volatility of returns, and a savings portfolio – to ensure higher long-term returns. Benchmarks: Stabilisation portfolio: Merrill Lynch 6-month US Treasury Bill Index. Savings portfolio: 75% Salomon World Government Bonds Index 80% US dollar hedged (SWGB Index 80% hedged); 25% Morgan Stanley Capital International (MSCI) World excluding Energy sector. Investment categories: Government Bonds included in SWGB; corporate bonds with A- credit rating or higher; mortgage backed securities and asset backed securities with credit rating above AA-; stocks included in MSCI World Index; derivatives for tactical asset allocation and hedging.
Outlook/Trends	--
Transparency	Medium. The NF website provides up-to-date data on revenues and expenditure. However, specific explanations of how the NF's resources are being used are lacking.
Recent Investments	The NF is fully invested in foreign markets.

[32] National Fund website: http://www.nationalfund.kz

[33] Asian Development Bank/National Bank of Kazakhstan: http://www.adb.org/Documents/Books/ADO/2007/KAZ.asp

19. Economic and Social Stabilization Fund (Chile)

Launch Year	March 2007. The Economic and Social Stabilization Fund (ESSF) absorbed the Copper Stabilization Fund, which was launched in 1985.
Fund Value (US dollars)	11.2 billion, including funds of Copper Stabilization Fund (September 30, 2007).[34]
Fund Value as % of GDP	8.7%
Growth Rate	Annualised internal rate of return of 2.6%.[35]
Financing	Copper-related revenues. Revenues in excess of the 1% structural surplus will be paid into the ESSF, which is designed to finance any fiscal deficits that may occur in periods of economic downturn.
Objective	To smooth government expenditure in social areas (eg education, housing and health).
Ownership	Government of Chile
Management	Managed by the Central Bank. Custodial services provided by JP Morgan Worldwide Securities Services.
Investment Policy and Asset Allocation	The fund can invest domestically and abroad. As of September 2007, the portfolio allocation was as follows: 67.5% sovereign, 2.2% agency, 30.3% bank. Quarterly and monthly reports provide further detail on the currency breakdown (between US dollars, euros and yen) and the terms of the investments.
Outlook/Trends	Currently formulating investment strategy to include new asset classes.
Transparency	High. Monthly and quarterly reports are available on the Ministry of Finance website.
Recent Investments	See above for current portfolio allocation.

[34] Ministry of Finance of Chile: http://www.hacienda.cl

[35] Ministry of Finance of Chile: http://www.hacienda.cl

20. Istithmar (Dubai/UAE)

Launch Year	2003
Fund Value (US dollars)	No reported value. Estimated value 8 billion.[36]
Fund Value as % of GDP	7%
Growth Rate	--
Financing	Oil
Objective	Focus on financial returns, but also support Dubai's status as an international commercial hub.
Ownership	Part of holding company Dubai World, founded by Sheikh Mohammed, Prime Minister of the UAE and Ruler of Dubai.
Management	Sultan Ahmed Bin Sulayem, Chairman of Dubai World, is also Istithmar's Chairman. CEO is David Jackson, former investment banker at Lehman Brothers.
Investment Policy and Asset Allocation	Focus on consumer, financial, real estate and industrial sectors. Detailed asset allocation not available. Appears to invest mainly in equities and real estate.
Outlook/Trends	Expected to invest 3-4 billion US dollars annually.
Transparency	Low -- no reports provided. List of investments available.
Recent investments	1.2 billion US dollars in Standard Chartered Bank. 3% stake in hedge fund GLG. Agreement to buy fashion chain Barneys in August 2007 for 942 million US dollars. In September 2007 Istithmar joined MGM Mirage's joint venture with Kerzner International to build a multi-billion dollar resort in Las Vegas, according to press reports.

[36] Euromoney, Financial News.

21. Dubai International Capital (UAE)

Launch Year	2004
Fund Value (US dollars)	No reported value. Estimated value 6 billion.[37]
Fund Value as % of GDP	4%
Growth Rate	--
Financing	Oil
Objective	The purpose of DIC is to create a return for its shareholder, Dubai Holding and its ultimate shareholders, the Ruling Family of the Emirate of Dubai.
Ownership	Part of Dubai Holding, which also includes a number of large-scale infrastructure and investment projects in Dubai. It is not, as commonly thought, an investment arm of the Government of Dubai.
Management	Sameer Al Ansari, Executive Chairman and CEO, former Group Chief Financial Officer for The Executive Office of Sheikh Mohammed.
Investment Policy and Asset Allocation	Focus on private equity investments. Operates through three divisions: global buyouts, Middle East/North Africa investments, and public equities (leveraged stakes in large public companies).
Outlook/Trends	Expected to invest 3-4 billion dollars annually.
Transparency	Low. No public reports available, but list of selected investments.
Recent investments	800 million pound sterling acquisition of Tussauds Group. 700 million pound sterling acquisition of Doncasters. 675 million pound sterling secondary buyout of Travelodge. One billion US dollar investment in DaimlerChrysler. DIC purchased 'substantial stakes' in HSBC Holdings (May 2007) and in Indian bank ICICI Bank Ltd. (July 2007). It has also invested in EADS (July 2007).

[37] Euromoney, Financial News.

22. State General Reserve Fund (Oman)

Launch Year	1980
Fund Value	Not disclosed. Estimates range form 2-10 billion US dollars.[38] Our analysis says 6 billion.
Fund Value as % of GDP	16%
Growth Rate	--
Financing	Oil and gas.
Objective	Fund budget shortfalls.
Ownership	--
Management	--
Investment Policy and Asset Allocation	--
Outlook/Trends	--
Transparency	Very low
Recent investments	Wave Seafront Resort in Oman. Reported to be involved in the development of Heron Tower in London.

[38] Euromoney, Morgan Stanley.

Appendix

i. The Future Fund (Australia)

Launch Year	2006
Fund Value (US dollars)	42 billion (May 2007).[39]
Fund Value as % of GDP	6%
Growth Rate	The fund has a target return of 4.5-5.5% above Consumer Price Index inflation (CPI) over the long term. The Board has interpreted this as an objective to provide a return of at least 5% above CPI over rolling 10-year periods.
Financing	Government surpluses. The fund's value also includes the value of approximately 2.1 billion shares in Telstra Corporation, most of which are held under escrow until mid-2008.
Objective	Established to fully fund the future superannuation payments of public servants, which currently come from the federal budget. The fund aims to fully underwrite the unfunded superannuation liability by 2020.
Ownership	Government of Australia.
Management	In May 2007 a competitive tender to manage the Future Fund was won by US fund management company Northern Trust Corporation. The fund is overseen by an independent Board of Guardians, selected on the basis of expertise in investment management and corporate governance. The Chairman of the Board of Guardians and CEO of the Future Fund Management Agency is David Murray. Paul Costello is the General Manager of the Future Fund Management Agency.
Investment Policy and Asset Allocation	Invest in a broad, diversified range of assets. The Future Fund does not intend to publish details of its investment programme.
Outlook/Trends	The size of the Future Fund in 2020 may be about 103 billion US dollars[40].
Transparency	Medium. The first annual report is due to be published in September.
Recent Investments	The initial cash contributions to the Fund -- about 33 billion US dollars, have been invested with the Reserve Bank of Australia before being transitioned into a broad range of asset classes. This strategic asset allocation process has started and is likely to take several years to complete. Most of the Telstra shares cannot be traded until November 2008.

[39] http://www.futurefund.gov.au/

[40] Parliament of Australia, Research Note no. 43 2004-05

ii. Government Pension Fund (Thailand)

Launch Year	1997
Fund Value (US dollars)	10.9 billion.[41]
Fund Value as % of GDP	
Growth Rate	The net rate of return to members was 3.44% in 2006 and 6.83% in 2005.[42]
Financing	No less than 20% of annual budget, plus monthly member and employer (government) contributions.
Objective	Management of retirement savings.
Ownership	Government of Thailand
Management	The GPF is supervised and managed by the Government Pension Fund Board. It uses seven fund managers to manage about one-fifth of its portfolio.
Investment Policy and Asset Allocation	Emphasises the safety of the principal fund, coupled with good returns that outperform long-term inflation. As of June 2007, the GPF's asset allocation was: Thai fixed income 67.77%, Thai equity 11.57%, global equity 12.64%, Alternative investment 4.02%, Property 4.00%.
Outlook/Trends	The GPF has stated this month that it is positioning itself as a global fund manager.[43] Next year it plans to explore investing in global bonds rather than just local bonds.
Transparency	Medium-high. Quarterly financial statements available on website, but little detail about specific investments.
Recent Investments	--

[41] GPF website: http://www.gpf.or.th/GeneralServlet

[42] GPF website: http://www.gpf.or.th/GeneralServlet

[43] http://www.thailandoutlook.com/thailandoutlook1/top%20menu/investor%20news/Daily%20News%20Summary?DATEDAILY=Friday,%20August%2010,%202007

iii. Pension Guarantee Fund (Chile)

Launch Year	December 2006
Fund Value (US dollars)	1.42 billion (September 30, 2007).[44]
Fund Value as % of GDP	1.1%
Growth Rate	Annualised internal rate of return of 2.47%.[45]
Financing	Funded through part of the annual structural surplus.
Objective	Designed to guard against the fiscal impact of an ageing population. Cannot be drawn upon until 2016.
Ownership	Government of Chile.
Management	Managed by the Central Bank. Custodial services provided by JP Morgan Worldwide Securities Services.
Investment Policy and Asset Allocation	The fund can invest domestically and abroad. As of September 2007, the portfolio allocation was as follows: 66.2% sovereign, 2.5% agency, 31.3% bank. Quarterly and monthly reports provide further detail on the currency breakdown (between US dollars, euros and yen) and the terms of the investments.
Outlook/Trends	Currently formulating investment strategy to include new asset classes.
Transparency	High. Monthly and quarterly reports are available on the Ministry of Finance website.
Recent Investments	See above for current portfolio allocation.

[44] Ministry of Finance of Chile: http://www.hacienda.cl

[45] Ministry of Finance of Chile: http://www.hacienda.cl

iv. Botswana Pula Fund

Launch Year	1966
Fund Value (US dollars)	4.7 billion (March 2007)[46]
Fund Value as % of GDP	38%
Growth Rate	--
Financing	Diamonds
Objective	--
Ownership	--
Management	--
Investment Policy and Asset Allocation	--
Outlook/Trends	--
Transparency	--

46 Morgan Stanley

v. State Oil Fund (Azerbaijan)

Launch Year	1999
Fund Value (US dollars)	1.5 billion[47]
Fund Value as % of GDP	8%
Growth Rate	5% (December 2005 to February 2007)
Financing	Oil
Objective	Assets are used to finance the state budget, new infrastructure projects and social projects.
Ownership	Government of Azerbaijan.
Management	The executive director (Shahmar Movsumov) is appointed directly by the president of Kazakhstan. The Supervisory Board includes several members of the Cabinet. About 8% of the fund's assets are administered by external managers.
Investment Policy and Asset Allocation	About 60% of the fund is invested in cash, the remainder mostly in bonds. Only a marginal portion (0.3%) is invested in equities.
Outlook	--
Transparency	High. Annual reports publicly available.
Recent Investments	--

[47] State Oil Fund http://www.oilfund.az/

vi. Heritage and Stabilization Fund (Trinidad & Tobago)

Launch Year	2006
Fund Value (US dollars)	1.4 billion (2006).[48]
Fund Value as % of GDP	9%
Growth Rate	500 million US dollars were transferred to the HSF in 2006.[49]
Financing	60% of excess revenues will be allocated to the Heritage and Stabilization Fund (HSF).[50]
Objective	To insulate fiscal policy and the economy from swings in international oil and gas prices and to accumulate savings from the country's oil and gas assets for future generations. The main aim is to be able to maintain public expenditure over the long term when oil and gas revenues decline.
Ownership	Government of Trinidad & Tobago
Management	The Central Bank is responsible for the day-to-day management of the HSF, in order to meet investment objectives set by the Board. However, most of this management is being outsourced to external fund managers. The Board is appointed by the President of Trinidad & Tobago, following advice from the Ministry of Finance.
Investment Policy and Asset Allocation	The HSF invests in foreign assets. It has a long-term focus on maximising expected returns within a set of risk constraints. The Board determines the level of risk tolerance (within a range of medium to high) of the HSF and the target portfolio return.
Outlook/Trends	Transfers out of the fund for the purpose of economic stabilisation will be resisted if the value of the HSF declines to one billion US dollars.
Transparency	Legislation stipulates quarterly reports by the Central Bank to the Board, and annual reports by the Minister of Finance to parliament. Some or all of these will be made public.
Recent Investments	--

48 Ministry of Finance: http://www.finance.gov.tt/documentlibrary/downloads/10/Enill%20Media%20Briefing%20on%20the%20Economy%20current%201.pdf

49 Ministry of Finance: http://www.finance.gov.tt/documentlibrary/downloads/10/Enill%20Media%20Briefing%20on%20the%20Economy%20current%201.pdf

50 Bank for International Settlements: http://www.bis.org/review/r070522d.pdf

vii. Fund for Macroeconomic Stabilisation (Venezuela)

Launch Year	2003 (previously the FIEM – Investment Fund for Macroeconomic Stabilisation). Legislation governing the Fund for Macroeconomic Stabilisation (FEM) was revised in 2005.
Fund Value (US dollars)	793 million (March 2007).[51]
Fund Value as % of GDP	0.5 %
Growth Rate	13% growth over the last four years. 3.3% annual growth to August 2007.[52]
Financing	Transfers of state funds resulting from fiscal surpluses, privatisations and other ad hoc transfers.
Objective	To provide for stability of public expenditure at national, state and municipal levels.
Ownership	Ministry of Finance.
Management	The Treasury Bank (a state institution). The president of the FEM and its four board members are nominated by the president of Venezuela.
Investment Policy and Asset Allocation	--
Outlook/Trends	The relative importance of the FEM has decreased sharply over the last two to three years as the government has established alternative off-budget funds such as Fonden (see above), which have far larger resources. There is no sign of this trend changing.
Transparency	Basic data on the fund is available on the website of the Central Bank of Venezuela. However, there is no transparency about where the fund is being invested.

[51] Central Bank of Venezuela

[52] Central Bank of Venezuela

viii. Revenue Equalization Fund (Kiribati)

Launch Year	1956
Fund Value	400 million dollars[53]
Fund Value as % of GDP	526%
Growth Rate	--
Financing	Phosphates
Objective	Possible financing for domestic enterprises.
Ownership	--
Management	Possible financing for domestic enterprises.
Investment Policy and Asset Allocation	Prudent management. Was entirely invested in offshore funds in 2001. Designed to maintain real per capita value over time.
Outlook/Trends	Financing of budget shortfalls means slower fund growth.
Transparency	--
Recent Investments	--

[53] Morgan Stanley.

ix) Foreign Exchange Reserve Fund (Iran)

Launch Year	1999
Fund Value (Us dollars)	Press reports from earlier this year suggest that as of January 2007, the Foreign Exchange Reserve Fund (FERF) was empty or even overdrawn.[54]
Fund Value as % of GDP	Zero
Growth Rate	The Iranian Central Bank suggested in January 2006 that the value of the FERF would rise to 14-15 billion US dollars by March 2006.[55] Since then, the resources of the FERF appear to have been used up by the government.
Financing	Revenues related to hydrocarbons exports.
Objective	Provide support to domestic industry and cover fiscal deficits.
Ownership	Government of Iran.
Management	Government of Iran.
Investment Guidelines	--
Outlook	The FERF appears no longer to be relevant. However, there is a chance that it may be replenished from future privatisation revenues or further hydrocarbons windfalls.
Transparency	Very low.
Recent Investments	In 2004 the FERF committed to disbursing over 8.5 billion US dollars for domestic industrial projects.[56]

[54] http://www.rferl.org/featuresarticle/2007/02/12a0ffc6-05c1-4265-a73f-a512fb376c12.html

[55] http://www.payvand.com/news/06/jan/1027.html

[56] http://www.payvand.com/news/04/nov/1062.html

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM ALAN P. LARSON

Q.1. Please discuss the potential, if any, for systemic risk when Sovereign Wealth Funds invest in private equity, hedge funds, or regulated financial institutions.

A.1. Sovereign Wealth Funds ("SWFs") invest capital that has accumulated in countries with financial surpluses. Their investments in financial institutions in the United States put that capital to work in our country. As a general matter, such investments reduce the systemic risk that would otherwise arise if capital surplus countries hoarded their surpluses.

Periodically, the international financial system comes under stress as a result of an excess of ill-considered investments in particular sectors, countries or instruments. The latest example of this phenomenon is the international financial disruption resulting from ill-considered investments in poorly understood sub-prime mortgage securities.

The sub-prime crisis resulted from, by and large, decisions by financial institutions in the United States. The sub-prime crisis elevated international systemic financial risk. Fortunately, the stability of the international financial system has been bolstered, and systemic risk has been reduced, by investments of "patient capital" from SWFs. The investments made by SWFs in financial institutions whose capital base had been badly eroded by investments in sub-prime investment vehicles have been stabilizing.

Q.2. Beyond choosing to invest through Sovereign Wealth Funds, what other means could countries with large current account surpluses employ? Are such other means more or less desirable than using Sovereign Wealth Funds?

A.2. Countries that accumulate current account surpluses could dispose of those surpluses in a variety of ways. The citizens of these countries are, of course, the persons in a position to decide which approach best serves their goals and objectives.

Most countries with large surpluses choose to devote part of those surpluses to the modernization of public infrastructure, including roads, ports and airports as well as social infrastructure such as health and education. Such investments make sense so long as they are well-targeted and subjected to rigorous cost-benefit analyses.

Countries with surpluses could choose to distribute a portion of those surpluses to their citizens in the form of grants or reduced taxes. Putting a larger share of the surpluses into the hands of the private sector is appealing.

At the same time, the citizens of some countries take the view that at least a portion of government surpluses should be invested in a way that creates returns for future generations. They believe that, after a certain level, the benefits of public sector investments or direct grants to citizens can be diminishing. These countries have chosen to invest part of their surpluses in funds or investment companies.

Q.3. Federal Reserve Chairman Bernanke has stated that he believes inflows of foreign capital into our markets, particularly to purchase Treasury bills and other dollar-denominated assets, have helped to keep interest rates low. In other words, the globalization of capital flows has benefited our economy by suppressing interest rates and maintaining the value of the dollar. Do you believe that Sovereign Wealth Funds can affect the value of the dollar or our domestic interest rates?

A.3. Chairman Bernanke is correct in asserting that foreign investment in the United States tends to lower interest rates and to support the value of the dollar in relation to other currencies. SWF investments in the United States have had this positive effect on our economy. Recent SWF investments in U.S. financial institutions have supported the capital base of these institutions, indirectly bolstering credit, growth and job creation.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM ALAN P. LARSON

Q.1. Do you have any evidence or reason to believe that sovereign wealth funds have invested based on, or shared, inside government information?

A.1. When sovereign wealth funds invest in the U.S. economy, the most important information relates to the firm or industry sector that is the target of the investment. In the transactions with which I am familiar, the foreign investors relied on investment banks and industry experts to assist the due diligence that guided their investment decisions. In my experience, SWFs and the governments whose money they invest do *not* have inside government information on U.S. firms or on the industries in which those firms operate.

Q.2. Do you have any evidence or reason to believe that countries have manipulated markets for gain in their sovereign wealth funds? For example, using the regulatory powers of the state to move market prices.

A.2. In the transactions I know about, sovereign wealth fund investors have not benefited from market manipulation. The SWF investors I know seek to comply with U.S. laws and regulations. Their home governments have not manipulated—nor do those governments have the power to manipulate—the international or U.S. markets in which the SWF invests.

Q.3. Do you have any evidence or reason to believe that sovereign wealth funds have used or had access to national intelligence or other state assets for their investment decisions?

A.3. I have not encountered instances when SWFs have used national intelligence to guide their investment decisions.

Under the new Foreign Investment and National Security Act of 2007, the CFIUS process will benefit from analyses by the Director of National Intelligence. I would encourage DNI to include in its analyses an assessment of whether a foreign investor has had access to national intelligence in making their investment decisions.

Q.4. Do you have any evidence or reason to believe that sovereign wealth funds have been used as a policy tool similar to how some state-run companies have been, most prominently in Russia?

A.4. SWFs differ significantly one from another. The ones with which I am most familiar operate commercially and are independent from government policy and government direction of their investment decisions. The SWF investments in the United States with which I am familiar have been used to advance commercial objectives, not the home government's policy objectives. The Foreign Investment and National Security Act of 2007 provides the U.S. Government with tools, which it should use, to investigate any proposed SWF acquisition when there is reason to believe that a foreign government might try to use that acquisition, to the detriment of the national security of the United States, to advance a national policy objective.

Q.5. Have there been any destabilizing effects of sovereign wealth funds, such as shifts of large amounts of capital?

A.5. Investments by SWFs have, on balance, promoted financial stability. They have recycled capital to the United States. In 2007, SWF investments bolstered the capital stock of fragile U.S. financial institutions.

Most SWFs have a track record of being long-term commercial investors. Most SWFs have made diversified, minority investments. I am not aware of any instances where SWFs have shifted large amounts of capital in a manner that is destabilizing.

Q.6. We have CFIUS to look at foreign control for national security reasons. What do we have to look at political and economic security concerns of sovereign wealth (or other foreign) investments?

A.6. Congress was correct, in my judgment, in writing the Foreign Investment and National Security Act of 2007 in a way that keeps the focus of CFIUS investigations on possible threats to national security. Consistent with the President's broad responsibilities to protect national security, CFIUS has the flexibility to investigate potential national security threats that might arise from economic or political factors.

Some countries have engaged in screening of foreign investment based explicitly on economic criteria such as a "net economic benefits." Congress was wise, in my view, to shun this approach. Markets rather than government policymakers are best placed to determine whether investments have a sound economic basis. The United States correctly has refrained from "picking winners and losers" and from designating "national champions." The same American philosophy lies behind our decision not to have the Government decide, on economic or political grounds, which foreign investments to permit to take place.

Q.7. What tools do we have to monitor these investments?

A.7. I believe that the government's intelligence capabilities and its oversight of mitigation agreements provide the executive branch with tools it needs to monitor these investments. Congress has increased funding for agencies to monitor compliance with the mitigation agreements. The Executive Branch is obligated to report to the Congress on its oversight of mitigation agreements and should promptly inform the Congress if additional tools or resources are needed.

Q.8. China has been very active in traditional and economic espionage in this country. Are you worried they are using that information either to make investments or to pass information to companies they invest in?

A.8. The U.S. Government should actively use its counter-intelligence capabilities to defend against traditional or economic espionage. If there is reason to believe that a proposed acquisition by a foreign investor could be used to engage in espionage, that concern would be grounds for a rigorous CFIUS investigation. If the investigation confirms that a serious threat exists, CFIUS should take appropriate action to address the threat.

Q.9. The IMF is looking into voluntary best practices for sovereign funds. What other options do we have to learn more about what the funds are doing?

A.9. The IMF's work to develop a code of best practices is likely to expand information about the governance of SWFs, increase the transparency of their operations, provide a better understanding of the differences among SWFs, and offer greater clarity as to their investment strategies and methodologies.

When an SWF makes an acquisition that falls under the jurisdiction of the laws of the United States, our laws and regulations give the United States adequate tools to learn what we need to know about what the fund is doing. I recommend that we place primary reliance on U.S. law to address the policy needs of the U.S. government.

Q.10. How can we leverage these investments in U.S. markets to get other countries to open their markets to U.S. private investment?

A.10. The Government of the United States should, and does, actively work to open foreign markets to U.S. private investment. The government uses a number of tools, including the negotiation of Bilateral Investment Treaties, to accomplish this. In addition, the World Bank has been an effective advocate in persuading foreign countries to reduce barriers to foreign investment. Country after country has come to see that private foreign investment brings a great boost for economic development and that barriers to such investment should be reduced or eliminated.

Using specific investment transactions as leverage to promote reciprocity in the provision of investment opportunities to foreign countries is neither necessary to encourage liberalization abroad, nor is it in the interest of the United States. We have adopted an open investment policy in the United States because it is in our own economic self-interest.

Q.11. Do countries with sovereign funds investing in the U.S. allow similar investments from U.S. private or government investment?

A.11. Each country that has established an SWF maintains a somewhat different policy towards foreign investment. In many cases, countries whose SWFs seek to invest in the United States have been quite open to foreign investments. Singapore, for example, has negotiated a Free Trade Agreement with the United States that has an investment chapter providing significant investment opportunities for U.S. firms. There also are substantial U.S. investments in Norway, Canada and those Middle Eastern countries which have government-owned investment companies.

In other cases, of course, U.S. companies still face significant investment restrictions in countries that are the home of sovereign wealth funds. The U.S. Government should make strong efforts to persuade these countries to open their investment markets.

Q.12. Are there any sovereign wealth funds being used to enhance the lives of the wealthy elites, while the general population suffers?

A.12. The SWFs with which I am familiar are directed to make investments that will provide broadly shared benefits for the citizens of their countries. Some government-owned investment funds are investing in order to finance pension benefits of their citizens. In other cases, SWFs have been accumulating assets for future generations, but the governments have not yet distributed the earnings of SWFs.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM PATRICK A. MULLOY

Q.1. Do you have any evidence or reason to believe that sovereign wealth funds have invested based on, or shared, inside or government information?

A.1. No. However, Chairman Cox of the FCC raised concerns about such issues in his Oct. 24th speech at the Kennedy School of Government at Harvard University.

Q.2. Do you have any evidence or reason to believe that countries have manipulated markets for gain in their sovereign wealth funds? For example, using the regulatory powers of the state to move market prices.

A.2. No.

Q.3. Do you have any evidence or reason to believe that sovereign wealth funds have used or had access to national intelligence or other state assets for their investment decisions?

A.3. No. I have no evidence, although it would not surprise me if they did.

Q.4. Do you have any evidence or reason to believe that sovereign wealth funds have been used as a policy tool similar to how some state-run companies have been, most prominently in Russia?

A.4. No. I have no evidence of that.

Q.5. Have there been any destabilizing effects of sovereign wealth funds, such as shifts or large amounts of capital?

A.5. Not that I am aware of.

Q.6. We have CFIUS to look at foreign control for national security reasons. What do we have to look at political and economic security concerns of sovereign wealth (or other foreign) investments?

A.6. You are correct. The CFIUS process currently examines the national security concerns of foreign acquisitions of controlling influence of U.S. companies. I think the Executive Branch interprets "national security" in the law governing the CFIUS process too narrowly. I believe that political and economic security concerns could be addressed in the CFIUS process if the Executive Branch carried out its CFIUS responsibilities in the manner intended by the Congress.

Q.7. What tools do we have to monitor these investments?

A.7. I am not aware that the U.S. government monitors foreign sovereign wealth fund investments or other foreign government investments in the United States. I believe the sole exception would be if such monitoring was agreed to as part of a CFIUS review of a foreign acquisition. Congress should enact legislation making the activities of foreign government controlled investment in the United States more transparent.

Q.8. China has been very active in traditional and economic espionage in this country. Are you worried they are using that information either to make investments or to pass information to companies they invest in?

A.8. The recently released Defense Department Annual Report to Congress entitled "Military Power of the People's Republic of China 2008" states on page 8 that, "Officials from the FBI have identified China as running an aggressive and wide-ranging effort aimed at acquiring advanced technology from the United States." Thus, it would not surprise me if China targeted gaining access to key technologies as part of their government investment decisions in the United States.

Q.9. The IMF is looking into voluntary best practices for sovereign funds. What other options do we have to learn more about what the funds are doing?

A.9. The IMF codes, if developed and agreed upon, would not be binding on IMF member nations. Member nations of the OECD are also using that organization to examine and discuss the national security concerns raised by sovereign wealth fund investments. While I believe these multilateral efforts can be helpful in highlighting key issues and recommending best practices for such funds, I believe that the United States Government, perhaps after evaluating the IMF and OECD work products, should pass legislation imposing what it considers "best practices" on sovereign wealth funds. That way we would know what we think are the best practices could be enforced.

Q.10. How can we leverage these investments in U.S. markets to get other countries to open their markets to U.S. private investment?

A.10. China is desirous of making investments in the U.S., but as the February 2008 report by GAO entitled "Foreign Investment: Laws and Policies Regulating Foreign Investment in Ten Countries" makes clear, China prohibits foreign acquisitions in key industries and sectors of its economy. For example, CNOOC, which wished to purchase Unocal in the summer of 2005, could not itself be purchased by an American investor. We might with China enter into some kind of reciprocal investment agreement to gain leverage to open China's market to U.S. investment. We should not, however, waive our own national security concerns just in the interest of ensuring more open investment opportunities for U.S. firms abroad.

Q.11. Do countries with sovereign funds investing in the U.S. allow similar investments from U.S. private or government investment?

A.11. I refer you to the GAO report, "Foreign Investment: Laws and Policies Regulating Foreign Investment in Ten Countries", dated February 2008. GAO did this report at the request of Senator Richard Shelby, the ranking member on the U.S. Senate Banking Committee. It is a very good review of the foreign investment policies followed by a number of key nations.

Q.12. Are there any sovereign wealth funds being used to enhance the lives of the wealthy and elites, while the general population suffers?

A.12. While I have heard allegations along these lines, I have not studied the matter thoroughly. I do think that many of the trade policies being followed in the WTO and other bodies tend to focus on benefits for small groups within many societies and not for the populace of the countries as a whole. That is why within the U.S. and many other nations there is a growing resistance to "globalization" as it is now proceeding.

Q.13. Mr. Mulloy, I understand there is a relationship between China's accumulation of dollar-denominated assets—its $1.4 trillion war chest—and its efforts to keep the Yuan undervalued against the dollar. According to a recent survey of 18 exchange-rate studies by the Peterson Institute, the Yuan remains 40% undervalued, in spite of the dollar's recent fall against other currencies whose exchange rates are more market determined. China's accumulation of reserves and its deliberate, trade distorting policy to keep the Yuan undervalued are two sides of the same coin. I applaud Chairman Dodd and Senator Shelby for moving legislation out of this Committee to address the problem, and I hope they are able to persuade our Majority Leader to give it the priority it deserves. My question to you, Mr. Mulloy, is what effect would this legislation have on sovereign wealth funds, and what is the danger of Congress failing to use the tools it has available to address currency?

A.13. On pages 4 and 5 of the prepared testimony I submitted to the Committee when I testified on November the 14th. I quoted from a McKinsey and Company report entitled, "The New Power Brokers", which examines sovereign wealth funds. That McKinsey Report tells us, on pages 77 and 78, that China and other Asian countries have accumulated huge dollar reserves through trade surpluses with the United States. It further tells us that exchange rate management, i.e. keeping the dollar overvalued by intervention in foreign exchange markets, has been part of their trade strategy, and has permitted them to acquire the dollars they have put in their sovereign wealth funds. As I noted on page 11 of my prepared testimony, the United States must craft trade policies to address the mercantilist trade practices being used by China and/or other Asian partners. I mentioned the Banking Committee bill to address currency manipulation in my testimony and strongly supported its passage. I also made other recommendations on pages 13 through 15 of my prepared testimony that we consider other legislation to combat China's IMF illegal currency practices. Their underpriced currency, as Chairman Bernanke noted in a December 2006 speech in Beijing, acts as an export subsidy. We should have a law to permit our industries to be able to bring countervailing duty cases against such a subsidy as you, Senator Bunning, along with many other of your colleagues have proposed.

Table 1.7. Size and Structure of Major Sovereign Wealth Funds

Country	Fund Name	Assets	Source of Funds	Ownership and Investment Management	Investment Strategy and Strategic Asset Allocation (SAA)
United Arab Emirates	Abu Dhabi Investment Authority (ADIA)/ Abu Dhabi Investment Council (ADIC)	$250 billion to $875 billion[1]	Oil	Owned by the emirate of Abu Dhabi, ADIA has been the primary conduit for investing oil surpluses in overseas assets since 1976. Recently a separate legal entity, the ADIC, was established to encourage competition with the ADIA. Abu Dhabi's surpluses will now be allocated to both the ADIA and ADIC.	Major global investor. Investment strategy and asset allocation is unknown.
Norway	Government Pension Fund—Global	$308 billion (as of March 31, 2007)	Oil	Owned by the government and managed by Norges Bank Investment Management.	Global asset allocation with 40 percent in equities and 60 percent in global fixed income.
Saudi Arabia	No designated name	$250+ billion[2]	Oil	Saudi Arabia Monetary Agency manages the foreign assets; $225 billion is held on its own balance sheet, a portion of which is designated as reserves, and $51 billion is managed on behalf of various government agencies.	Major global investor. Although the size of assets is known, the investment strategy and SAA is not known beyond broad indications.
Kuwait	Kuwait Investment Authority (KIA) General Reserve Fund (GRF) and Future Generations Fund (FGF)	$160 billion to $250 billion[1]	Oil	The KIA is an autonomous government body responsible for the management of the GRF and FGF, as well as any other funds entrusted to it on behalf of the government of Kuwait.	The GRF is invested in the local, Arab, and international financial markets. The FGF has a global asset allocation based on investment guidelines approved by the FGF board.
Singapore	Government Investment Corporation (GIC)	$100+ billion	Other	Separate investment corporation established in 1981, fully owned by the government.	Global asset allocation (not made public). Invests in all major asset classes.
	Temasek Holdings	$100+ billion	Other	Temasek Holdings is a private company, set up in 1974 to hold and manage investment previously held by the principal shareholder, the Ministry of Finance.	SAA weights unknown. Geographical distribution as of March 2006 was 38 percent Singapore assets, 40 percent in rest of Asia, 20 percent in the Organization for Economic Cooperation and Development, and 2 percent in "other" countries.
China	State Foreign Exchange Investment Corporation[3]	$200 billion	Other	To be determined.	To be determined.
Russia	Oil Stabilization Fund[4]	$127 billion (as of August 1, 2007)	Oil	Owned by the government and managed by the Russian Central Bank.	Invests largely in fixed-income assets, with 44 percent in U.S. dollars, 46 percent in euros, and 10 percent in pound sterling.

Table 1.7 ***(concluded)***

Australia	Australian Future Fund	$42 billion (as of May 1, 2007)	Other	Established in 2006. Owned by the government and managed by the Future Fund Management Agency. The aim is to underwrite the government's future superannuation liabilities.	Australia
United States (Alaska)	Alaska Permanent Reserve Fund	$35 billion (as of June 30, 2007)	Oil and minerals	Owned by the state of Alaska, established in 1976, and managed by the state-owned Alaska Permanent Fund Corporation.	SAA consists of 53 percent equities, 29 percent fixed income, 10 percent real estate, and 8 percent alternative assets.
Brunei	Brunei Investment Authority General Reserve Fund[1]	$30 billion	Oil	Owned by the government and managed by the Brunei Investment Agency.	Invests in a large global portfolio of financial and real assets. SAA not made public.
Korea	Korea Investment Corporation	$20 billion	Other	Launched in 2005 to manage $20 billion of entrusted foreign exchange reserves, of which $17 billion is from Bank of Korea and $3 billion from the government.	Plans to invest in a global asset allocation. SAA not yet available.
Canada	Alberta Heritage Savings Trust Fund	$15 billion (as of March 31, 2007)	Oil	Owned by the government of the Province of Alberta, managed by Alberta Finance.	Invests in a global SAA with 30 percent fixed income, 45 percent equities, 10 percent real estate, and 15 percent alternative assets.
Chile	Economic and Social Stabilization Fund	$9.83 billion (as of July 31, 2007)	Copper	Established in 2006. Owned by the government and managed by the Central Bank of Chile as a fiscal agent.	SAA consists of 72 percent government bonds and 28 percent money market instruments in U.S. dollars, euros, and yen.
	Pension Reserve Fund	$1.37 billion (as of July 31, 2007)	Copper	Established in 2006. Owned by the government and managed by the Central Bank of Chile as a fiscal agent.	SAA consists of 79 percent government bonds and 21 percent money market instruments in U.S. dollars, euros, and yen.
Botswana	Pula Fund[2]	$5+ billion	Diamonds	Owned jointly by the government and the Bank of Botswana. The government's share of the Pula Fund is accounted for on the balance sheet of the Bank of Botswana.	The fund invests in public equity and fixed-income instruments in industrialized economies. The fund does not invest in emerging markets, as they may be highly dependent on commodities.

Sources: Public information from websites; IMF; and Morgan Stanley Research.

Note: Other countries with known sovereign wealth funds include Azerbaijan, Kingdom of Bahrain, Chad, Ecuador, Equatorial Guinea, Gabon, Islamic Republic of Iran, Ireland, Kazakhstan, Kiribati, Libya, Malaysia, Mauritania, Mexico, Oman, Qatar, Sudan, Taiwan Province of China, Timor-Leste, Trinidad and Tobago, Uganda, and Venezuela.

[1] Estimates by Morgan Stanley Research and PIMCO.

[2] In some countries, such as Saudi Arabia and Botswana, there is no formal sovereign wealth fund but the monetary agency manages foreign assets on behalf of various government agencies.

[3] Announced on March 9, 2007, the fund may be established at the end of 2007.

[4] Starting in February 2008, the Oil Stabilization Fund will be divided into two separate funds with distinct policy objectives (Stabilization Fund versus National Welfare Fund).