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"Sovereign Wealth Funds: Foreign Policy Consequences in an Era of New Money"
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Over the past several months, few issues in international finance have generated as much discussion and comment as have Sovereign Wealth Funds ("SWF"s). This Committee deserves enormous credit for recognizing the potentially significant foreign policy consequences of the rapid accumulation by foreign governments of enormous, growing pools of capital. These large concentrations of government-controlled wealth raise complex issues that transcend traditional boundaries between foreign policy, financial markets, international economics and national security.

It is my belief, however, that too much focus on SWFs may, in fact, divert attention from the more fundamental foreign policy issue that these funds have come to represent – that of the rise of "state capitalism" and the broader use of finance as a tool of foreign policy. These, I believe, are increasingly important 21st century phenomena.

SWFs are simply a particular type of global financial market investor.[1] They should not automatically trigger foreign policy concerns. Too much focus on SWFs as potential tools of political influence fails to take into account that the world's more than fifty SWFs are very different in terms of the origin of funds, size, structure, investment philosophy and motivation. Other than the commonality of government ownership, they are really not a definable class of either political or financial actors. But it is specifically foreign government ownership and the possibility that these increasingly wealthy foreign governments may use finance as a tool to advance their national interests abroad that makes them of interest as a matter of foreign policy.

In many cases, SWFs are neither the major repositories of government controlled wealth, nor the financial tool through which a country might seek to exert financial influence for political gain. While

[1] There are also definitional questions as to what constitutes a SWF. For example, some analysts include in SWF calculations part or all of the $327 billion held by the Saudi Arabia Monetary Authority ("SAMA"), while others exclude these funds, classifying them as central bank reserves instead. Similarly, the China Investment Corporation ("CIC") is that country's acknowledged SWF. But, China's State Administration for Foreign Exchange ("SAFE"), which manages China's central bank reserves and is not generally considered a SWF, has recently made significant investments in international equities.

SWFs are believed to control approximately $3 trillion of assets, foreign government-owned central bank assets are estimated to exceed $7 trillion. State-owned-enterprises ("SOE"s) represent an additional distinct investment vehicle. There is greater likelihood that, if a country sought to use financial tools to advance foreign policy goals, it would do so either through the use (or threat of use) of central bank reserves to impact currency markets or via an SOE. For example, it is generally taken for granted that central bank interventions in currency markets have at least some element of political rather than pure financial motives. Likewise, foreign policy considerations are very much involved in potential investments by SOEs. For example, past rumors of interest in acquisitions by Russia's Gazprom have caused great consternation in many European countries for fear of the political motivation and impact of such an investment. Such issues are less likely to be raised by means of an investment by a SWF.

We should be cautious about finding common denominators among the motives and actions among widely differing governments based on the particular financial structure through which they hold and invest their wealth. This is why the U.S. and international community have struggled to put in place criteria by which to judge SWFs, as well as appropriate rules and responses to govern their actions. There is little in common between the risks posed by SWFs of strong democratic allies like Canada and Norway and those whose political systems and motivations are more worrying, like those of China and Russia.

I believe the criteria by which many suggest we judge the risks posed by SWFs has resulted in an over-emphasis on transparency and disclosure, while ignoring the more subjective, but more valuable, assessment of the political risk that a particular government owner poses. This is dangerous. While increased transparency and disclosure should be encouraged, such an over-emphasis on transparency of SWFs alone may, in fact, lead to unnecessary conflict with allies, which, for a multitude of reasons may fail to meet the requisite level of transparency. Likewise, we may take false comfort from those SWFs that comply with transparency rules, but whose government owners use of a broad array of other financial tools to advance foreign policy interests and which should warrant closer attention.[2]

[2] For example, the Abu Dhabi Investment Authority ("ADIA"), the largest SWF with assets estimated to approach $875 billion, has been a responsible investor in the U.S. and global markets for over three decades. In financial circles, ADIA is considered a high quality investor and has never been accused of acting in a manner inconsistent with international political or financial norms. Yet, ADIA consistently receives failing grades as an SWF because it does not publicly disclose information about its holdings, investments or governance structures. In fact, ADIA, which, along with Singapore, recently agreed to improve its disclosure practices, if judged against its financial peer group of large international hedge funds and private equity funds, rather than against its political ones, is in line with the industry norm. By contrast, Russia's National Wealth Fund, established in February of this year, has announced that it intends to disclose its financial holdings in a transparent manner, leading to high marks on the various SWF transparency indices. However, Russia, through various non-SWF entities, has demonstrated a willingness to use its recently acquired financial heft to advance its national interests abroad.

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It is important to note that a comprehensive review of relevant legislation and regulation already in place in this country should provide this Committee with comfort that we are already well protected from market-based threats that SWFs may pose to our national or economic security. Last year's revised CFIUS/FINSA legislation, as well as existing protections afforded by the SEC, Federal Reserve, Antitrust authorities and other relevant legislation and regulation, provide a high degree of protection from improper takeover approaches or unwanted material investments from SWFs.

But we must acknowledge that over the past several years, many of the world's emerging nations have accumulated capital at an unprecedented pace[3]. At the same time, we have witnessed the rise of competing centers of global finance not only in Europe but also in Asia and the Middle East. While the U.S. remains the world's sole military superpower, we can no longer claim the same level of financial dominance. While the U.S. is, of course, still a financial powerhouse, we are no longer the only game in town. This shift has significant foreign policy and political consequences. We should expect that certain other countries may seek to further their national interests by using the financial tools that they increasingly have at their disposal. In their minds, finance and foreign policy are increasingly intertwined.[4]

Independent of their commitment to SWF best practices, countries like China, Russia and Venezuela can be expected to selectively use finance as an instrument of power and influence. They have already begun to do so. For example, last year U.S. financial markets reacted to veiled threats that China might resort to the "nuclear option" of dumping US dollars. At the same time, Russia called for a new "balance of power" by seeking the support of emerging market countries for their proposals to a new global financial architecture and Venezuela tried to win some "hearts and minds" by refinancing other nations' IMF debt through its participation in capital market transactions. None of these initiatives involved SWFs, and yet they are clear examples of the attempted use of increasing financial might to exert strategic influence over foreign affairs.

From Britain's use of financial tools to expand its empire in the 18th and 19th centuries to the U.S. threat in 1956 to wreck havoc on Britain's currency if it did not end its occupation of the Suez, history is replete with examples of the use of finance and financial markets as tools of foreign policy. It is, I believe, important to recognize and address as a top priority the foreign policy consequences raised by the increasing wealth of other nations. But I do not believe that we achieve any meaningful economic, foreign policy or national security benefits by targeting SWFs with additional burdens. As significant

[3] Over the first half of 2007, central banks in the world's emerging economies accumulated over $600 billion of new reserves – an amount that is double the total reserve position of the IMF – whose mission used to include preventing the collapse of many of these same governments.

[4] In fact, traditional foreign policy phrases like "nuclear option," "balance of power", "mutually assured destruction" and other similar terms are now embraced by many financial, as well as military, strategists.

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providers of capital to our markets, SWFs have thus far been a positive influence on the U.S. and global economies.