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# SOVEREIGN WEALTH FUNDS: NEW CHALLENGES FROM A CHANGING LANDSCAPE

## HEARING

BEFORE THE

SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE, AND TECHNOLOGY

OF THE

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# SOVEREIGN WEALTH FUNDS: NEW CHALLENGES FROM A CHANGING LANDSCAPE

**Wednesday, September 10, 2008**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC AND
INTERNATIONAL MONETARY POLICY,
TRADE, AND TECHNOLOGY
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Maloney, Moore of Wisconsin, Meeks, Moore of Kansas, Watt, Sherman, Ellison; Paul and Manzullo.

Ex officio: Representative Bachus.

Chairman GUTIERREZ. This hearing of the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology will come to order. The subject of today's hearing is, "Sovereign Wealth Funds: New Challenges from a Changing Landscape."

Good afternoon, and thank you to the witnesses for agreeing to appear before the subcommittee. I look forward to hearing from you.

This hearing is a follow-up to the joint hearing we held with the Capital Markets Subcommittee in March of this year, when we focused on some of the sovereign wealth funds that we considered to be good actors. I view them as such because they seem more transparent and/or they tend to follow good governance practices.

But the sovereign wealth fund landscape is constantly changing. New players continue to enter the field, and new and different types of investments are being made. And international organizations such as the International Monetary Fund (IMF) and the Organisation for Economic Co-Operation and Development (OECD) are more involved in seeking a universal regulatory or best practices framework.

Just last week, the International Working Group of Sovereign Wealth Funds (IWG) announced preliminary agreement on a set of voluntary principles and practices that is intended to guide appropriate governance and accountability arrangements, as well as conduct of investment practices by sovereign wealth funds. The IWG, which is comprised of 26 funds, will present the guidelines for the IMF's policy-setting committee next month.

Sovereign wealth funds are not a new source of funding. They have existed for over 25 years. What is remarkable is the recent growth in their number and size. In the last 2 years, Saudi Arabia, Russia, and China created large funds. According to the 2007 estimates from Morgan Stanley, the largest sovereign wealth fund, the Abu Dhabi Investment Authority, controls around $875 billion in assets.

Although size estimates of sovereign wealth funds are hindered by the fact that they are often not transparent, the IMF estimates that sovereign wealth assets worldwide are somewhere between $1.9 trillion and $3 trillion. And private financial institutions have estimated that sovereign wealth fund assets will reach $10 trillion to $15 trillion by 2015.

Whether these are considered large or small figures depends on the metric used. The $3 trillion estimate surpasses the $1.5 trillion managed by hedge funds worldwide, but it's dwarfed by the $53 trillion managed by institution investors like pension funds and endowments. Regardless of how they are measured, sovereign wealth funds are already large enough to be systemically significant. I expect them to grow larger over time in both absolute and relative terms, especially with the increasing worldwide demand for commodities.

In my opinion, a discussion that the impact of this growth may have on the U.S. and global financial system is required. Obviously, sovereign funds represent a growing percentage of foreign investment in the United States, especially in the financial services industry.

Over the past year, sovereign funds have invested more than $40 billion in Wall Street's biggest players, including: the Abu Dhabi Investment Authority's $7.5 trillion in Citicorp in November; Merrill Lynch's $4.4 billion investment; the China Investment Corporation's $5 billion investment in Morgan Stanley in December of 2007; its investment in Visa's IPO in March of 2008; and lately, the Abu Dhabi Authority's $800 million purchase of a 75 percent stake in ownership of the Chrysler Building in New York City.

The purpose of today's hearing will be to discuss recent changes, both approved and proposed, in the regulation of sovereign wealth fund investment and practices—in particular, changes Congress made to the CFIUS process in 2007 and the IWG agreement I mentioned.

After the issues raised at the joint subcommittee hearing in March, and during the congressional delegation I led to the United Arab Emirates in May to meet with leadership of several funds, we now need to focus on transparency and good governance with respect to specific funds. I have particular concerns about the lack of transparency because of the sheer size of these investment vehicles.

By definition, these funds are extensions of the state, and should always be viewed as maximizing their nation's strategic interests, in addition to maximizing profits. Without a clear understanding of the intention of these funds, some of them hold the potential to create chaos in the marketplace. These concerns are particularly relevant when discussing countries like Russia and China, whose security and economic interests are not always consistent with our own.

For this reason, I welcome our witnesses' take on the potential financial impact some of the largest funds can have on the United States based on the investment decisions and sheer size of the fund.

I also want to focus on sovereign wealth funds that take more active approaches to investment, seeking not just to be a passive investor, but to control U.S. companies. I look forward to hearing from our witnesses, and I yield 5 minutes to the ranking member, Dr. Paul.

Dr. PAUL. Thank you, Mr. Chairman. Thank you for holding this hearing.

Once again, we confront the issue of sovereign wealth funds, an issue which has become quite important due to the large amount of dollars and dollar-denominated bonds held by foreign governments, and the fears of these governments, given the dollar's precipitous decline over the past few years.

The past few days have been quite interesting, with speculation that one of the reasons for the government takeover of Fannie Mae and Freddie Mac was the more than $1 trillion in Fannie and Freddie debt held by foreign governments. The threat of default on this debt would have undoubtedly had massive repercussions on the value of the dollar, and might have unleashed the so-called nuclear threat of a massive international sell-off of U.S. Government and agency debt.

The United States Government now finds itself between a rock and a hard place. The massive amounts of debt that we have allowed to accumulate are hanging over us like Damocles's sword. Foreign governments such as Russia and China hold large amounts of government and agency bonds, and there are fears that, as our creditors, they will exert leverage on us.

At the same time as the dollar weakens, the desire to sell bonds and purchase better performing assets increases, leading to fears from others that foreign governments will attempt to purchase American national champion companies, or invest in strategic industries to gain sensitive technologies.

In either case, most politicians overlook the fact that we are in this situation because of our loose monetary and fiscal policy. Actions that would stifle the operations of foreign sovereign wealth funds would likely result in corresponding retaliatory action by foreign countries against American pension funds, and could have the same detrimental effect on the economy, as the trade wars begun after passage of the Smoot-Hawley Tariff Act.

Rather than limiting or prohibiting investment by sovereign wealth funds, we should be concerned with striking at the root of the problem, and addressing inflationary monetary and fiscal policy. Debtors cannot continue building debt forever, and we now face strong indications that our creditors are eager to begin collecting what is owed them.

It is not too late to correct our mistakes, but we must act now, and cannot dally. We must drastically reduce government spending and wasteful and disastrous interventions into financial markets, and reign in the Federal Reserve's inflationary monetary policy. Failing to do so will ensure a descent into financial catastrophe. I yield back.

Chairman GUTIERREZ. Thank you. Congressman Sherman, you are recognized for an opening statement.

Mr. SHERMAN. Thank you. First, I should observe that the United States has sovereign wealth funds, not at the Federal level, but at the State level, where CalPERS and CalSTRS are among the biggest players in securities markets, investors in private equity, and, with the support of this Congressman, are taking into account not just narrow investment criteria, but also the political effect and international effect, and effect on the Nation of what they do.

Not only should we be concerned about sovereign wealth funds, but we should not assume that non-sovereign foreign investors are completely unmoved by political or governmental considerations. With a sovereign wealth fund, it is obvious that the government of the entity may control the investment.

But we in the United States operate under our legal system to the point where we believe—since so many of us are lawyers—that other people operate under the same legal system. Under our legal system, everything is published. Every governmental effect on investors is ascertainable by looking at regulations and laws.

In most societies, a telephone call from a government official can influence investors and private business in a way that is so strange to those of us who went to law school, that our economists and free trade advocates must insist that it could never happen, because it doesn't fit any of their models. And where the model differs from the reality, obviously, the reality is wrong.

As Mr. Paul points out, we have a growing debt to foreigners. This is best seen in our trade deficit. This trade deficit is a direct result of our failed trade policies, and our failed trade policies are a direct result of the obtuseness caused by a belief that if we change our laws and regulations to allow foreign products in, and they change their laws and regulations, that they, therefore, have let our products in, that if we change our laws and regulations, that means government is no longer influencing private sector actors. And therefore, if they change their laws and regulations, they have also eliminated governmental influence on their private sector actors, which is absolutely absurd.

And therefore, it should not surprise us that there is big money in imports. There is big power where there is big money. And with that big power, the lie can constantly be repeated that if we get other countries to change their laws and regulations, that we have accomplished as much as the other—as it would be if we changed our published laws and regulations.

So, I look forward to these hearings and many others. I think, ultimately, we are going to see a much further decline in the U.S. dollar, because a country with a government this bad is not going to retain a currency that is regarded as good. I yield back.

Chairman GUTIERREZ. The gentleman yields back. I have the ranking member of the full Committee on Financial Services, Mr. Bachus, who honored me with co-leading the delegation when we went out to look at the sovereign wealth funds. Mr. Bachus?

Mr. BACHUS. Thank you, Chairman Gutierrez. As the chairman mentioned, we visited Abu Dhabi and Dubai. And I am convinced, as a result of that visit and my study of that region of the world, that the enlightened leadership and the people of Abu Dhabi and

Dubai are a really stabilizing and positive influence on the Middle East, a very necessary thing.

And they are also committed to, I believe, some of the same freedoms we enjoy. There is a tremendous amount of freedom of the press there. We were in a meeting where a young student brought up a pollution problem there, in front of one of the leading sheiks. And I thought, "Well, that was pretty daring of her." And then, in the paper the next day it mentioned that problem, and that she had mentioned it. I was very encouraged at their commitment to having a free press.

As for the U.S. economy, we have entered our second year of a significant credit crunch. As we all know, growth has slowed from its peak, and there remain risks to the economy and financial markets. Many individuals and families are suffering through difficult times. And last weekend, action to place Fannie and Freddie under government control underscores the systemic risks that have been created by the unwinding of the housing bubble and the subprime lending debacle.

During this challenging time, sovereign wealth funds have played a constructive role in the U.S. economy by injecting billions of dollars of needed capital into some of the country's largest financial institutions. This has allowed those institutions to shore up their reserves, helping to soften the blow from the massive write-downs of mortgage-related securities that have destabilized the banking sector, and continue to do so.

Banks with strong capital are in a much better position to make loans to American consumers and businesses, and to help get our economy going again. In addition to benefitting the U.S. economy, these capital infusions have given sovereign wealth funds and the countries that administer them a vested interest in the continued health of the U.S. financial services industry, and the U.S. economy as a whole.

Like any other investor, sovereign wealth funds expect their investments to succeed. It is in their economic self-interest, therefore, that the United States businesses in which they invest billions continue to prosper.

Nonetheless, I am aware there are important questions we should ask about the growth of these investments, especially since some of the most recently established sovereign wealth funds are controlled by countries with whom the United States has struggled to forge positive economic and strategic relations. As I said, Abu Dhabi and Dubai certainly don't fall in that group.

We must, of course, remain vigilant to the national security implications whenever countries that do not have our best interests at heart seek to invest in our companies. But we must also not lose sight of the great benefits that foreign direct investment produces for our citizens. What we need is a process that is uniform and fair for all investors seeking a stake in the U.S. economy, the same way that investments by U.S. citizens domestically must be treated uniformly and fairly, and the way we expect U.S. investments overseas to be treated.

What would create a more effective investment framework is greater transparency on the part of sovereign wealth funds. To that end, the preliminary agreement reached last week by the IMF and

the International Working Group of Sovereign Wealth Funds is an encouraging development. While the final details are still being worked out, these generally accepted principles and practices for sovereign wealth funds should bring about a greater degree of transparency and foster a better understanding of governance and operations of these entities.

In conclusion, Mr. Chairman, capital is more mobile than it has ever been in the history of the world. And that capital can and will travel anywhere. While remaining vigilant to potential threats to our national security and our economy and our economic interest, our country must act responsibly to maintain an environment that is free and open to international investment so that all Americans continue to benefit from in-flows of foreign capital that creates jobs for American workers and fuels economic growth here in the United States.

With that, Mr. Chairman, I again thank you for holding this hearing.

Chairman GUTIERREZ. Would the gentleman care to be recognized? No? Thank you. Well then, I am going to introduce the witnesses. First, we have—I'm sorry, the gentleman from New York?

Mr. MEEKS. I have a quick statement.

Chairman GUTIERREZ. The gentleman from New York is recognized.

Mr. MEEKS. Thank you, Mr. Chairman, and good afternoon. I want to thank the chairman, my colleague, Mr. Gutierrez, and the ranking member, Dr. Paul, for holding today's critically important hearing on sovereign wealth funds, the new challenges for a changing landscape.

The rise of sovereign wealth funds as the new power brokers in the world economy should not be looked at as a singular phenomenon, but rather as part of what can be defined as a new economic world landscape. And, as such, it requires careful analysis in order to appropriately address any issues that arise from the growing prominence of sovereign wealth funds.

On March 5, 2008, two subcommittees of the U.S. House Financial Services Committee held a joint hearing on the subject of foreign government investment and the U.S. economy and financial sector. The hearing was attended by representatives of the U.S. Treasury Department, the Securities and Exchange Commission, the Federal Reserve Board, Norway's ministry of finance, and the Canadian Pension Plan Investment Fund.

On May 21, 2008, the House Committee on Foreign Affairs had a full committee hearing on sovereign wealth funds, the rise of sovereign wealth funds, and impacts on U.S. foreign policy and economic interests.

Assets under management of sovereign wealth funds increased 18 percent in 2007 to reach $3.3 trillion. And most of this growth stemmed from an increase in official foreign exchange reserves in some Asian countries, and rising revenue from oil exports.

Now, we—as we look at what is taking place here, it is clear that Congress has to look at sovereign wealth funds, see how it has and can be a help to—I know it has—to some municipalities, and see how we can continue to move forward in the global economy which we now live in. And I think that we have demonstrated a commit-

ment to the issues raised by the sovereign wealth funds, and that this committee in particular, under the leadership, of course, of Chairman Frank, along with the efforts of my colleagues on both sides of the aisle, and I expect we will continue to engage in constructive efforts to shape our Nation with policies with respect to sovereign wealth funds.

I look forward to visiting nations where we see a lot of—we went to Norway, and we will be going to others, so that we can make sure that sovereign wealth funds is a mechanism to help us in the global economy, and not hurt us. I would love to hear the testimony of the witnesses this afternoon. Thank you.

Chairman GUTIERREZ. I thank my colleague for his comments. I will introduce the witnesses now.

First, we have Dr. Ted Truman, a senior fellow at the Peterson Institute for International Economics. Dr. Truman previously served as the Assistant Secretary of Treasury for International Affairs from 1998 to 2001. Prior to that, he was Staff Director for the Division of International Finance at the Federal Reserve Board, and before that, an economist on the Federal open market committee.

Dr. Truman has written extensively in the area of sovereign wealth funds, including a blueprint for sovereign wealth fund best practices, published this year as a Peterson Institute Policy brief in international economics. He has also written, "The Management of China's International Reserves: China and a Sovereign Wealth Fund Scoreboard," also in 2008. And, "Sovereign Wealth Funds, the Need for Greater Transparency and Accountability," a 2007 Peterson Institute Policy brief. He received his B.A. from Amherst College, and his M.A. and Ph.D. in economics from Yale University.

Dr. Truman, please?

**STATEMENT OF DR. EDWIN M. TRUMAN, SENIOR FELLOW, THE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS; VISITING LECTURER, AMHERST COLLEGE; AND VISITING PROFESSOR, WILLIAMS COLLEGE**

Mr. TRUMAN. Thank you very much, Chairman Gutierrez, Ranking Member Paul, and other members of the subcommittee. It is a pleasure to testify before you today on the challenges posed by sovereign wealth funds.

By way of further introduction, the accountability of such funds has been the focus of my research and analysis for the past 18 months, as you indicated in your introduction. I use "sovereign wealth fund" as a descriptive term for a separate pool of government-owned or government-controlled assets that includes some international assets. I include all government pension funds, as well as non-pension funds, to the extent that they manage marketable assets.

Sovereign wealth funds may be funded from foreign exchange reserves, earnings from commodity exports, receipts from privatizations, other fiscal revenues, or pension contributions. Table 1, attached to my full testimony, lists 56 funds of 38 countries.

No two funds are the same. They have a wide range of structures, mandates, and economic, financial, and political (primarily

domestic, but in some cases international) objectives—normally, a mixture. Consequently, it is perilous to generalize about sovereign wealth funds and any associated threats to the U.S. economic and financial interests.

With that important qualification, my six summary conclusions are:

First, sovereign wealth funds are here to stay, and likely to grow in their relative importance, in particular as financial globalization continues.

Second, the U.S. economy is thoroughly intertwined with the global financial system through both the private and public sectors here and abroad. The United States, as Congressman Sherman indicated, is the number two player in the sovereign wealth fund game, in terms of international assets of our sovereign wealth funds. It follows that advocates of formally regulating sovereign wealth funds should be careful what they wish for. Any regulations or other restrictions that are applied to foreign sovereign wealth funds properly should be applied to our own funds, and would be applied to them by other countries.

Third, the most promising approach to dealing with the sovereign wealth fund phenomena is via what I call "reciprocal responsibility." Countries with such funds should embrace a voluntary set of best practices, along the lines of my sovereign wealth fund scoreboard. I hope it has been largely incorporated into the Santiago "generally accepted principles and practices" of sovereign wealth funds that is in the process of being adopted. That was referred to earlier. It is associated with the IMF. We don't know yet.

On the other hand, countries receiving sovereign wealth fund investments should strengthen the openness of their financial systems. At present, more progress is being made by countries making sovereign wealth fund investments than by recipient countries. My fear is that the financial hurricane that would result from an outbreak of financial protectionism over sovereign wealth funds would make the recent events look like a mere squall.

Fourth, it is fundamentally impossible to distinguish sovereign wealth funds by the degree of political motivation in their investment decisions. They are governmental entities, as has been pointed out, and governments are political.

Fifth, sovereign wealth funds do not pose a significant new threat to U.S. economic and financial interests. As long as we put in place and maintain sound economic and financial policies, we control our own destiny. In my view, we have adequate mechanisms to address any potential national security concerns posed by such funds, or, of much more relevance, other forms of foreign government investment in this country.

Sixth, I am a bit uneasy about the possibility that such funds may exercise what I call "undue influence" in connection with the investments in our financial institutions. It is my hope that our existing processes can deal with the more heavily regulated portions of our financial system, and improvements in the accountability of large hedge funds and private equity firms, which I also favor, could help elsewhere.

Finally, a few words about the sovereign wealth fund scoreboard that I have constructed for 46 funds. It is summarized in table 2,

attached to my full testimony. All sovereign wealth funds are not the same. Nor is there one cluster of "good" funds and another cluster of "bad" funds. The overall scores in my scoreboard range from 95 to 9 out of a possible 100. The simple average score is 56; the weighted average score is 51, weighing the funds by their estimated foreign assets.

The funds are in three broad groups: 22 funds with scores above 60; 14 with scores below 30; and 10 funds in the middle. The top group includes funds of a number of developing countries, the middle group includes funds of non-industrial countries as diverse as Russia, Mexico, Kuwait, and Singapore.

The bottom group includes two funds from Abu Dhabi which, nevertheless, reportedly have excellent reputations in the financial markets, as well as having made a favorable impression on Mr. Bachus. Eleven non-pension sovereign wealth funds have estimated assets of more than $60 billion. We scored nine of these funds. Two are in the top group and two are in the bottom group.

Thank you. I will be pleased to answer your questions.

[The prepared statement of Dr. Truman can be found on page 62 of the appendix.]

Chairman GUTIERREZ. Thank you, Mr. Truman, so much. Next, we have Dr. Brad Setser. Dr. Setser is currently a fellow for geoeconomics at the Council on Foreign Relations. He is an economist with expertise in finance, global capital flows, and emerging economies, and works in CFR's Maurice R. Greenberg Center for Geoeconomic Studies, focusing on foreign policy consequences of capital surpluses in East Asia and oil exporting states.

Dr. Setser most recently was a senior economist for RGE Monitor, an online financial and economic informational company. In 2003, he was an international affairs fellow for CFR, where he coauthored, "Bailouts or Bail-ins? Responding to Financial Crises in Emerging Economies," a book examining international monetary policy toward crisis in emerging market economies.

Dr. Setser served in the U.S. Treasury from 1997 to 2001, where he worked extensively on the reform of the international financial architecture, sovereign debt restructuring, and U.S. policy toward the IMF. He ended his time at the Treasury as the acting Director of the Office of International Monetary and Financial Policy.

Dr. Setser earned his B.A. from Harvard University, his DEA from Institut d'Etudes Politiques de Paris—last word in Spanish, not French—and his master's and doctorate's degrees from Oxford University.

Please, Doctor, proceed.

## STATEMENT OF DR. BRAD W. SETSER, FELLOW FOR GEOECONOMICS, COUNCIL ON FOREIGN RELATIONS

Mr. SETSER. I want to thank Chairman Gutierrez, Ranking Member Paul, and the members of the subcommittee for inviting me to testify today. It is a particular honor to be on the same panel as Ted Truman—my biography, which you read, sort of left out that during that entire period when I had those long titles, I was basically working for Ted. And it is an equal honor to be on the same panel as Dr. Drezner, who was a colleague at roughly my level at

the Treasury at that time. So you have somehow managed to acquire an all-Treasury panel.

I think over the last few years, capital has flowed in a rather unusual way. It has flowed, broadly speaking, from poor countries to rich countries, from fast-growing countries to slow-growing countries, from countries with appreciating currencies that often offered high returns on their financial assets to a country with a depreciating currency that provided a low return, and often from countries that would be more autocratic to countries like the United States, which are highly democratic.

This pattern of global capital flows does not stem, in my judgement, from private investment decisions. Private demand for the assets of emerging economies has actually been quite strong over most of this period. Rather, it reflects an unprecedented growth in the foreign assets of many emerging economies' governments.

Now, the U.S. slowdown and the rise in oil prices initially intensified this pattern, leading to basically a doubling of the pace, in my judgement, of official asset growth from maybe $800 billion a year to maybe $1.5 to $1.6 trillion a year. That pace has clearly slowed over the last month, as oil prices have fallen, and as some of the private capital flows, which I mentioned earlier, have reversed. Yet so long as oil exporters and countries like China continue to run very large current account surpluses, it is reasonable to think this basic pattern will continue.

A sharp fall in central bank purchases of U.S. debt, absent an increase in private demand for U.S. debt, leaves U.S. interest rates to rise, possibly significantly. Consequently, it would not be in the United States's interest.

On the other hand, the goal of U.S. policy, in my judgement, should not be to sustain large deficits through the ongoing growth of the funds of central banks and sovereign wealth funds. A world where China's government continues to add roughly $700 billion a year to its foreign assets, at a time when the oil exporting economies are adding a roughly equivalent sum, is unlikely to be a world that evolves in ways favorable to U.S. interests.

The debate over sovereign wealth funds should not be limited to a debate over where the CFIUS process strikes the right balance between protecting U.S. security interests and encouraging capital inflows. That leaves out questions about whether the same policies—exchange rate intervention, stockpiling oil surpluses in government hands—that have fueled the growth in sovereign funds also hinder necessary adjustments in the global economy. It also ignores the potential shifts in geopolitical influence associated with a world that relies heavily on other governments for financing.

And here I would note that the national security implications of relying so heavily on central bank demand for Treasury and agency bonds to fund the agencies in the U.S. deficit warrant at least as much consideration as the national security implications of sovereign wealth funds.

I want to emphasize three specific points. First, the majority of the growth in official assets continues to come from the growth in central bank reserves, not the growth in sovereign funds. And, best that I can tell, the increase, the general pattern of global capital flows that flows into the U.S. market has not been one which has

been going towards risky U.S. assets, but rather, one that has been concentrated in the least risky of U.S. assets, and that is probably where the greatest distortions lie in the U.S. market.

The $35 billion that sovereign wealth funds invested in U.S. banks is less than the average monthly increase in central bank holdings of treasuries and agencies at the Federal Reserve Bank of New York's custodial accounts.

Second, it's getting harder, not easier, to evaluate how central banks and sovereign funds are influencing U.S. markets. More of the growth in central bank reserves is coming from countries that do not disclose data about the currency composition of their reserves to the IMF. More countries are channeling some of their reserve growth through state banks, and not reporting that transparently. And many sovereign funds report significantly less data—many, not all, there are some important exceptions—than central banks.

And finally, both the set of countries with sovereign funds and the investment styles of those sovereign funds are evolving rapidly. In the future, the large sovereign funds, if current patterns of growth continue, will likely come from Russia, China, and Saudi Arabia, not from Abu Dhabi, Dubai, and Singapore. I think that's a significant change that warrants consideration, as well as the evolution in the individual investing styles of some of these countries, and I would be happy to take your questions.

[The prepared statement of Dr. Setser can be found on page 44 of the appendix.]

Chairman GUTIERREZ. Thank you so much. The last panelist is Dr. Daniel W. Drezner. Dr. Drezner is a professor of international politics at Fletcher School of Law and Diplomacy at Tufts University, and a senior editor at the National Interest.

Dr. Drezner has served as International Economist at the Treasury Department's Office of International Banking and Securities Markets. He also held a research position at the Rand Corporation.

Dr. Drezner has published articles in numerous scholarly journals, as well as The New York Times, The Wall Street Journal, and The Washington Post on foreign policy and foreign affairs. He has provided expert commentary on U.S. foreign policy and global political economy for C–SPAN, CNNfn, CNN International, and ABC World News Tonight, and is currently a regular commentator for Newsweek International and NPR's Marketplace.

He received his B.A. in political economy from Williams College, and an M.A. in economics and a Ph.D. in political science from Stanford University. We welcome him and his testimony. Thank you.

## STATEMENT OF DR. DANIEL W. DREZNER, PROFESSOR OF INTERNATIONAL POLITICS, THE FLETCHER SCHOOL, TUFTS UNIVERSITY

Mr. DREZNER. Chairman Gutierrez, Ranking Member Paul, thank you very much for the invitation to testify. It's also a privilege to be on the same panel with Dr. Setser and Dr. Truman. I would add that Brad, I think, is being generous in saying we were on an equal level when I was at Treasury. As memory serves, he

was a few pay grades above me. So it's good to know that I can potentially catch up.

I have submitted my complete written testimony, so I will just try to quickly make five points.

The first is—and again, I agree with Dr. Setser on this—sovereign wealth funds, in particular, are a symptom, rather than a cause of the current macro-imbalances we are experiencing. The underlying drivers of what's going on are the combination of a low U.S. savings rate; an inelastic demand for energy, and imported energy in particular; in some cases undervalued currencies, which are leading to persistent trade deficits. And, therefore, the primary focus should be on those underlying problems, rather than this symptom of sovereign wealth funds.

The second point I would make is that, as symptoms go, sovereign wealth funds are relatively benign in their effects. In my opinion, most of the concerns about their ability to act geostrategically in the United States have been overstated. I am not saying these concerns are completely unfounded. I just think, as current commentary exists, they have mostly been exaggerated, and I would be happy to talk about that further in Q&A.

Furthermore, the increase in sovereign wealth fund investment in the United States is leading to more interdependence, not so much asymmetric dependence, on the United States from the sovereign wealth funds investors. So, while there is some constraint in terms of U.S. foreign policy, which I will go to in a second, the extent of sovereign wealth fund investment in the United States also gives these other countries a direct incentive in the stake in our economy.

And finally, it should be pointed out on this that not all sovereign wealth funds see eye to eye. As Dr. Truman said, there is a heterogenous group of sovereign wealth funds. The largest ones currently are relatively close allies of the United States, or at least housing countries that are allies of the United States.

And I think, if anything, we saw from the recent IMF meeting in Santiago that there might be a bit of a schism between the more mature sovereign wealth funds, such as the Kuwait Investment Authority, and, for lack of a better way of putting it, the "arriviste" sovereign wealth funds coming from Russia and China. The older, more mature market funds who have operated in Western markets largely uninterrupted and largely undisturbed for several decades, are probably upset at, suddenly, all the renewed focus of attention.

Third, I would say the current structures to deal with official sovereign investment in the United States are largely adequate to the task. The CFIUS and FINSA guards against national security concerns were put in place, in some ways, anticipating this problem as a result of the Dubai Ports World incident. And we, right now, see other OECD countries looking to adopt CFIUS-style procedures. So, in that sense, we are the template, rather than having to push further on.

It is too soon to tell whether or not the IMF/IWG process for developing the Santiago principles will actually lead to improved behavior by sovereign wealth funds. I will say, however, that if you are going to articulate a set of transparency standards, it is relatively easy for private actors to determine whether those trans-

parency standards are actually being adhered to. It is always good to have more information about these sovereign wealth funds, and so I certainly encourage active monitoring and intelligence about them. But that is different from more regulation.

Fourth, Russia and China, in particular, do not have an advantage, in terms of their sovereign wealth funds, because they are so-called authoritarian capital powers. There is a claim sometimes that authoritarian capitalist states can use "patient capital." They can invest with the idea of thinking about the long term, rather than worrying about short-term losses.

I think looking at the behavior of both Chinese and Russian investors in the past year flatly contradicts that. There has been a significant amount of blowback in China because of the CIC's investment purchase of Blackstone last year. You now have conspiracy theories among mid-ranking Chinese banking officials that the United States has somehow tricked China into buying large amounts of debt, with an idea that they are, therefore, trapped into holding them. There has been significant blowback in Russia over the fact that Russian official investors have large amounts of Fannie Mae and Freddie Mac debt, as well.

Authoritarian countries have short-term political problems, just like democratic countries. And so the notion that authoritarian countries have an advantage, I think, is incorrect.

Finally, there are undoubtedly some negative effects that come from growing sovereign wealth fund investment, and I talk about this in my written testimony. First, there is no question that U.S. democracy promotion efforts will be hindered. And, second, financial globalization looks more and more like a game of mutually assured destruction, in that, as Larry Summers put it most famously, "There is now a financial balance of terror between capital importing countries and capital exporting countries."

Now, fortunately, mutually assured destruction can lead to a more peaceful coexistence, but it's a relatively nervous coexistence, and I would certainly acknowledge that. Thank you very much.

[The prepared statement of Dr. Drezner can be found on page 32 of the appendix.]

Chairman GUTIERREZ. Thank you. The new Cold War. Thank you very much. We will now go to questions.

Dr. Drezner, let me just follow up, since you finished on your last point. You wanted to get them all, so you were trying to be very disciplined about the clock. I appreciate that.

Please elaborate just a little bit on the financial industries and mutual destruction, and the banking industry and their mutual terrors.

Mr. DREZNER. The financial balance of terror, as it were, is that, you know, there is that old line that if you owe the bank $1,000, that's your problem. If you owe the bank $1 billion, that's the bank's problem. Something that plays is similar here, which is we are the ones that are borrowing from sovereign wealth funds, but we have now borrowed so much that the countries that are holding our debt also do have a stake in our country succeeding.

We can debate about this. There is no question that these countries could pursue what's called the nuclear option, which is to sell all of their debt, and to sell all of, you know, their equity in U.S.

markets. There is no question they can do that. But in the same way, during the Cold War, the Soviet Union could have launched all of their ICBMs in a first strike against the United States. The reason they didn't do that is because it would have destroyed them, just as much as it would have destroyed us.

So, in that sense, there are high degrees of interdependence between the United States and capital exporting companies to the United States. This degree of interdependence, as I said, will constrain U.S. foreign policy in some ways. There are ways in which we do need to please our foreign creditors.

At the same time, there are limits on what foreign creditors can do to influence us, precisely because they can't see all of their assets wiped away with the blink of an eye. They would be equally devastated.

Chairman GUTIERREZ. Thank you. Thank you very much. Dr. Setser, in your testimony you indicated that many foreign governments clearly expected the U.S. Government to protect their central banks from taking losses on their holdings of Fannie Mae and Freddie Mac bonds. What makes you so sure that foreign government investors expected to be protected, and do you think we got ourselves in such a bad situation, in terms of GSEs and foreign investment, where we are so leveraged to these foreign central banks that we had to make certain promises to them?

Mr. SETSER. Well, I read the press statements coming from China quite closely, and I know some of the names that were associated with those statements. And when a former member of the monetary policy of the Central People's Bank of China indicates that this would be devastating to the global financial system, I think that indicates a level of concern.

And having spoken with some Chinese bankers, and discussed with them various options, and seen the deeply concerned reaction at any suggestion that some type of restructuring might be extended to the bonds, not just a change in the equity structure of the companies, I think it was quite clear there was a very high level of concern.

And then, finally, I watch, as I'm sure others do, the custodial holdings of the New York Fed quite closely. Foreign central banks' total holdings of agencies peaked in late July. And after average purchases of, say, $20 billion a month of U.S. agency bonds over the course of this year, in the month of August their holdings fell by about $12 billion, which I think is indicative of more than just expressions of concern, but a desire to see much greater clarity before they were willing to add to their existing holdings.

Chairman GUTIERREZ. Are they going to lose a lot of money in China, given the GSE's debacle?

Mr. SETSER. They will not lose money because of GSE's debacle, because the U.S. Government, I think, has made it clear that the debt of the bonds that the GSEs have issued will be honored in full. China will take losses, but those losses will come from having very large exposure to the U.S. dollar, and having, as a by-product of its currency policy, in some sense, overpaid for U.S. dollars on a consistent basis. And that will produce very significant losses.

And I think that's what worries me a little bit about the interdependence, is this interdependence where one party is going to

take financial losses. And, as a byproduct of that, they have clearly gained an advantage for their exports, or for its encouraged production of U.S. companies as well, in China. But it's not clear to me that the Chinese public is on board fully with the losses that will likely be incurred.

And there is a complicated set of issues about how the economic meaning of losses at a central bank, that I am sure Ted Truman will be more than happy to comment on and explain. But I do think that the political reaction inside China is important.

Chairman GUTIERREZ. I want to go to Dr. Truman. So, following up on your colleagues now, right—your former almost students, using their words—so, could you just elaborate a little bit on the currency issue? How do you feel about the Chinese government and their transparency, lack of manipulation of their own currency, and the inter-relationship between the dollar and what's going on there in our government?

Mr. TRUMAN. They weren't students; they were colleagues. I learned as much from them as they learned from me.

It is a complicated question. And, in fact, you will find—I think—the three of us probably agree on some things, and then we disagree on some others. But those others are probably deeply into the economist weeds, so I apologize for this, because I do disagree a little bit.

You do have this problem, that—to simply answer your question—the Chinese buy dollars. The Chinese currency goes up. So value of the dollars in Chinese currency, the renminbi or the yuan, goes down. Their dollars are worth fewer yuan. And if you were a citizen of China, you would turn around and say, "Why did we waste our money buying this currency that is going down?" I think that is the political problem.

Now, of course, the dollar is still worth a dollar, if you want to put it that way. So, in terms of the value of purchasing power in the United States, it is the same amount today as it was worth—approximately, even aside from inflation, but presumably interest covers inflation, mostly.

So there is a sense in which they could have been doing better if they had bought something else, or they kept the money at home. On the other hand, the currency reserves, the dollars they accumulated, because they didn't want their currency to appreciate versus our currency were going down in yuan. If you want to be crude about it, that's the price they paid for resisting the currency appreciation.

So, I don't feel too sorry for them, though I agree with Dan and Brad that in some sense it is a political issue in China and in several other countries who have set up sovereign wealth funds. They have woken up one morning with lots of foreign exchange reserves and said, "No, how come we have this pile, and now we have to justify to our citizens what we are doing."

So, rather than just parking it in Treasury securities, and so forth and so on, the way they did before, they have gone out and said, "Well, we are going to buy equities," or, "We are going to to invest in hedge funds or private equity firms, in order to generate at least more return than just holding Treasuries." But it's a re-

sponse to, in some sense the by-product, of the foreign exchange policy.

Chairman GUTIERREZ. I will try to see if we have time to follow up. Dr. Paul, 5 minutes.

Dr. PAUL. I want to direct a question to Dr. Drezner. You said in your opening statement that we are looking at more of a symptom than a cause, and I wanted to follow up on that, because I agree with you on that. Just the fact that these funds exist is not a problem, and may be just symbolic of a different problem.

First off, how do other countries react to this problem? What do other countries and other governments think about it? Are they having this same discussion, or is the only discussion a concern with us here? Do you have a feel for that?

Mr. DREZNER. To be technical to that question, I would say other countries are freaking out even more than this one.

Dr. PAUL. Other countries are concerned about this?

Mr. DREZNER. Yes.

Dr. PAUL. And what are they worrying about?

Mr. DREZNER. They are worried—in some ways, again, because the United States has the CFIUS procedure in place already, and because FINSA was passed last year in response to what happened in 2006, in some ways the United States was out in front, because it already had, in many ways, a regulatory infrastructure in place. The European Union does not have similar infrastructure. Other countries are only now just beginning to get this stuff online.

And it also should be pointed out that many of the countries that house sovereign wealth funds are also even more protectionist when it comes to foreign direct investment. So, as a result, Germany just recently passed a law, I believe, to guard against sovereign wealth fund investment that will probably be declared illegal by the European court, because it's so restrictive. Australia also passed a law in the beginning of this year. You are also seeing moves by other countries, as well.

Again, I think the United States was actually ahead of the curve, in terms of already having pre-existing structures. And, as a result, it's probably not done as much, as a result.

Dr. PAUL. Would you say, then, they are treating a symptom, or are they looking at the basic cause of the problem?

Mr. DREZNER. No, I think they are still treating the symptom.

Dr. PAUL. Still—okay. Let's talk about the real cause. Is there an imbalance in the distribution of our currencies and values because the United States issues the reserve currency of the world? Is that related to this problem?

Mr. DREZNER. I would say it's partially related, but I would actually probably defer to Dr. Truman on this, who has slightly more expertise on the dollars of the reserve currency than I would.

There is no question that, if anything, the dollar, having the reserve currency, actually allows the United States to run a balanced payments deficit that no other country in the world would be allowed to do. So that's certainly true.

On the other hand, the magnitude of the deficit we are talking about now dwarfs the sort of comfort level I think most economists would have, in terms of running a deficit just because the—our currency is the reserve currency.

Dr. PAUL. Okay. I will, then, ask Dr. Truman. What I am thinking about along this line is, if we can issue the reserve currency of the world, and there is no substance to it because we have license to issue it, we are likely to issue a lot of it. And as long as there is a trust, whether it's a worthy trust or not, other countries are going to take our dollars, which encourages us to print more dollars, and we get to export our inflation, so to speak, causing some of these problems.

Do you agree that there is something to this, that because we have a reserve currency we contribute this significantly to the imbalance because we get away with something maybe that we shouldn't be getting away with?

Mr. TRUMAN. I agree with you 35 percent, if I may put it that way, that because we—as Dan said—issue a reserve currency, it means that we can more easily finance our deficit. And that leads us to both internal and external deficits and, perhaps, to be less concerned about them than we should be.

On the other hand, as you said in your very statement, in some sense it also gives the opportunity to the rest of the world to vote with their feet, or vote with their pocketbooks, or vote with their balance sheets. So it's another manifestation of this sort of mutually assured destruction, if you want to use that term.

So, if we go too far, they can walk away from the dollar. There will be some consequences for them financially, but there are other things that they can walk away into: commodities, on the one hand, if you're really worried about inflation, or into other currencies.

And so, the financial leaders of the United States, if I can put it that way, and you guys in Congress too, for that matter, every time something happens—and you see it today in the newspapers, talking about Fannie and Freddie, "We are going to put this on the budget, and it's going to count as part of the debt," and that is going to drive up interest rates.

So that, in some sense, is the market, including the international market, voting at least a level of concern about how we are running our affairs. And they can do that more easily for the United States than they can do it for Zimbabwe.

Dr. PAUL. Well, it seems like there will be a limit to how long we can maintain this balance. And, eventually, we can't come up with bailing out Fannie Mae and Freddie Mac, which would have really disturbed this balance, because the dollar would have continued down, and it gave a tremendous boost to the dollar. But that's hardly seen as curing the problem. It is, once again, treating the symptoms.

But I appreciate your testimony, and I yield back.

Chairman GUTIERREZ. Thank you. Congresswoman Gwen Moore from Wisconsin, you are recognized for 5 minutes.

Ms. MOORE OF WISCONSIN. Thank you, Mr. Chairman. This has been very helpful testimony this afternoon, and I don't know exactly who to direct my questions to.

But I—one of the things that I am very curious about is that since I have joined this committee there has been a tremendous urging on the part of Europeans and even Americans for China to

not manipulate its currency, so to speak. And, really, listening to your testimony today, I am curious.

If they were, in fact, to allow their currency to rise based on market forces, wouldn't that be less of an incentive to hold on to our American exchange reserves? And you know, what if they were to say, "Okay, everybody—the Europeans, the Americans—wants our currency to rise. Let is rise." What do you think could be those consequences?

Mr. SETSER. I think it depends on whether China lets its currency rise to the market clearing rate, or makes a much more incremental adjustment. If China makes an incremental adjustment, I think the basic dynamics that we see now would continue. That is to say China will continue to run a meaningful trade surplus, because it will take time for the trade surplus to—China's trade surplus—to come down, even with something of an appreciation.

And Chinese residents and foreign investors will believe that there is still more adjustment to come, and that will lead to ongoing growth in China's reserves. We sort of have seen this. This is sort of more or less what happened after China allowed its currency to adjust by a small amount in 2005, and is also, broadly speaking, the pattern that we have seen in the past year when, until the past 3 months, China allowed a faster-paced appreciation.

Here I would also note that it is important to differentiate between movements against the dollar, which have been present, and movements, in China's case, against a broad basket of its currencies. If China is going up against the dollar, and the dollar is going down even faster, China's currency isn't really going up. And that, more or less, has been the case. So I think that's sort of a big gap that has to be made up.

In the unlikely event that China moved all the way to a market clearing rate, and private outflows had to balance its trade surplus, there would be a very significant adjustment in the pattern of capital flows out of China, which might have significant market implications. But I think the probability of that is fairly low.

Ms. MOORE OF WISCONSIN. Okay.

Mr. TRUMAN. But—

Ms. MOORE OF WISCONSIN. Okay, go on.

Mr. TRUMAN. I am going to add just one point, which is that, meanwhile, China has accumulated $2 trillion. So even if they stopped buying dollars tomorrow, or 5 years from tomorrow, they still would have to worry about investing those dollars in the United States, or somewhere else.

So, in that sense, the problem is still with us. The legacy of the problems of the past would still be with us. That was the only thing I would add.

Ms. MOORE OF WISCONSIN. Okay. Let me ask this. I am really relieved to hear from this panel that there is—it's really doubtful that there could be any really politically motivated funds management of these sovereign wealth funds, that they are really looking for the best rate of return.

What would happen, in your estimation—a couple of things. What if, for example, the Chinese people were to decide that they—they were to prevail on, say, that the great level of poverty in the country is intolerable, and that they needed greater liquidity, and

they needed to cash in some of these foreign exchange reserves? And of course, you know, they have this basket of currencies, and perhaps if the U.S. dollar continues to plummet, that's a political motivation that's not nefarious, but it's something that could really happen.

If they needed a great influx of liquidity, and decided that they needed to cash it in to take care of domestic issues, is that a scenario that we can hedge against?

Mr. SETSER. If I can, I don't think it's a scenario we need to hedge against, because I think the way that scenario would play out is that China would, in some sense, borrow money domestically, which it is currently doing. The China Investment Corporation is issuing bonds domestically inside China to buy foreign assets.

It could change from issuing bonds domestically to buy foreign assets to using that money to make domestic investments inside China. I personally think that would probably be a good trade. It would be in China's interests to do more of that.

In a macroeconomic sense, that would mean that China would run a larger fiscal deficit, and that would tend to reduce the size of China's current account surplus. So, rather than thinking—

Ms. MOORE OF WISCONSIN. That would help us? That would—

Mr. SETSER. There would be more—

Ms. MOORE OF WISCONSIN. Would that bring us more into—

Mr. SETSER. We are in a—it depends on who the "us" is. It would help anyone in the—

Ms. MOORE OF WISCONSIN. "Us," the United States.

Mr. SETSER. Well, it would help exporters, who would—there would be more demand inside China, so there would be more sales of goods to China. It might mean somewhat smaller Chinese purchases of U.S. financial assets, but that would be just sort of a rebalancing away from the situation we have had over the past several years, where exporters have not sold as much as they otherwise would have, and financial players have had access to funds at a lower rate than they otherwise would have.

I think if you want to have the global economy adjust, you need to have China invest more in China, and China invest a little bit less in U.S. treasuries.

Mr. TRUMAN. We stop exporting paper to them, and we start exporting goods to them.

Ms. MOORE OF WISCONSIN. Okay.

Mr. DREZNER. Could I just add one thing?

Ms. MOORE OF WISCONSIN. Yes, with the indulgence of the Chair. May he answer?

Chairman GUTIERREZ. Yes.

Ms. MOORE OF WISCONSIN. Thank you.

Mr. DREZNER. Just one other thing, which is this is one of the problems with sovereign wealth funds, in terms of relationship to U.S. democracy promotion, which is the scenario you just outlined is not an inconceivable one.

Furthermore, if you were to have some kind of democratization, let's say, in the Gulf countries as well, this could also lead to unpredictable effects. There is a paradox, in terms of sovereign wealth funds particularly emerging in countries that have relatively low

per capita income, because the political perception is, "Why are we holding trillions of dollars, or hundreds of billions of dollars in U.S. dollars, and not investing it domestically?"

Furthermore, if you marry that in some cases in countries with relatively rampant anti-Americanism, if you have a democratic regime, they could actually then decide to act politically. And it should be noted that it's actually sovereign wealth funds based in democratic countries that are most likely to attach political conditions to their investment. And I am thinking here of CalPERS in the United States and Norway's fund, as well.

Mr. MEEKS. [presiding] Mr. Manzullo?

Mr. MANZULLO. Pass.

Mr. MEEKS. Take a pass? I will recognize myself then, before I go to Mr. Watt.

Let me follow up with Dr. Setser really quick. I know that you just said that investment from China, Russia, and Saudi Arabia should be the ones that concern us. Can you elaborate on that a little bit further?

Mr. SETSER. Sure. Right now, China is adding roughly $700 billion to its foreign assets. So, you know, that's why I was not concerned if China had a bigger fiscal deficit. I think it would just mean that they would add $600 billion or $500 billion or $400 billion to their foreign assets. But that is, by far, the biggest source of foreign assets around, and that has generally been invested in fairly safe treasuries, some in agencies.

If that were to change, that would have a much bigger impact, in my judgement, than the shift of a smaller country. And China, obviously, has a somewhat different political relationship with the United States than does a country like Norway or a country like Singapore.

The second biggest source of foreign asset growth in the global economy right now is probably Saudi Arabia. They are certainly going to add over $100 billion to their foreign assets. And, again, that has been invested very conservatively, as best we can tell. There is extremely little reliable information.

And then, until the events in Georgia led to a significant outflow of money from Russia, Russia was the third largest source of foreign asset growth in the global economy. Combine those pools of money and you're looking at an increase. The annual increase in their foreign assets was approaching about $1 trillion. The annual influx of new money into the Gulf funds, into the Norway fund, was about $150 billion.

So, when I look at the magnitudes, and look at how those flows could change, and who would—what the impact would be, it strikes me that the biggest changes potentially would come from these sets of countries.

And then, as Dan alluded to quite accurately, these countries are much poorer than the existing countries. And even in the existing countries with big funds, I think there is pressure. You know, if you look at some of the stuff that Abu Dhabi is doing, it's designed to spur their own economic development to buy—you know, "Let's put some money in Ferrari, and then Ferrari should put a theme park in Abu Dhabi, because we want to compete with Dubai." Is

that commercial? Is that political? Is it prestige? It's all kind of rolled together.

And I think you could possibly see some of those same complicated political pressures emerging amongst these other countries, and I think that might change the way sovereign funds invest.

Mr. MEEKS. Thank you. Let me ask you this question. And I think everyone agrees, when we are talking about that, that it's the symptom and not the cause of some of the economic problems. But here we have had several hearings, as I indicated in my opening statement, on the questions of transparency, etc.

I know in Chile, for example, that recently the International Monetary Fund just broke a preliminary agreement with the world's largest sovereign wealth funds about a code of conduct that covers issues of transparency, governance, and accountability of sovereign wealth funds.

I heard Dr. Truman say we have to be careful in how we regulate, because it could boomerang back to us, because as quiet as it's kept, a lot of our pension funds, etc., that is sovereign wealth dollars that we use overseas.

The question that I have is should we—you know, in trying to settle some of this issue of transparency, should we, the United States, be one of the leaders in trying to set this code of conduct, and call for—in pursuing a policy of transparency and rules that can be enforced by all the countries across the board?

Mr. TRUMAN. Let me answer, with your permission. Actually, we have been involved. I think it is useful to you to understand; it was not the Fund who did this; it was actually the countries with the sovereign wealth funds.

Because the United States has sovereign wealth funds in addition to the State pension funds—as was mentioned, Alaska has a fund, and Wyoming has a fund, and so forth and so on. So we were in the room with Abu Dhabi and with Singapore. And also, Australia was in the room, and also Canada was in the room, because they are the same—and Norway was in the room.

So, this is an agreement that involves all the countries who were in the room, the 23 or 26—23, actually, the number is; there were 3 observers, so they—23 countries who were in the room, and that whatever the agreement is, they all agreed to apply it, all the large funds, with the exception of Hong Kong and Saudi Arabia—if you think it has a sovereign wealth fund, but Saudi Arabia said they don't have one—also was participating in this.

So on the assumption that they all have agreed, which is the assumption I am making, and on the assumption that it's a strong agreement, in terms of increased accountability and transparency, then you actually have had a useful document to get people to come together. It's not an imposed regulation. It's an agreement about how they are going to try to conduct their own business, going forward.

And that, I think, is actually encouraging, because it is an international agreement about how to approach this matter, which is, I think—I don't want to offend anybody here in Congress—is probably preferable to doing it unilaterally by our own action.

Mr. MEEKS. Thank you. Let me ask one other question, then I'm going to yield to Mr. Watt and Mr. Manzullo is—or to the chairman.

Different area. Trying to figure out how to, you know, maybe you can do some good for poor countries. And Bob Zoellick of the World Bank had said not too long ago, and urged some of the sovereign wealth funds to invest 1 percent of their assets in equity in Africa. And you know, I sit on the Foreign Affairs Committee also, and look at the condition of Africa and the infrastructure and things.

I was just wondering. What would your opinion be that we would—to set—in Chile, all the countries got together and said, "We are going to put together 1 percent, we are going to set aside 1 percent for investment and infrastructure and other things in the continent of Africa," what would you—what's your opinion of something of that nature, as Mr. Zoellick had put it?

Mr. TRUMAN. You have heard from me on this subject, so I will let someone else answer.

Mr. DREZNER. I will give a quick answer. I would say, first of all, as I said before, there is a political tension in some of these countries that host sovereign wealth funds about the fact that they are holding trillions of dollars of assets, but within their own country are relatively poor.

So there might be—that tension might still exist. If China was suddenly to say, "We are going to dedicate 1 percent of our sovereign wealth fund to helping Africa," I could see citizens in Chengdu asking, "Well, what about us?" So that could be one problem.

The second thing that should be pointed out is that the foreign policy effects of this we are already seeing in Africa in the form of official Chinese investment, in terms of aid flow, which is—on the one hand, this would undoubtedly help, in terms of African economic growth. On the other hand, it would also cause these countries to be far less willing to make policy reforms advocated by the United States and by the bank and fund, because they would be less dependent upon the bank and fund for development capital.

Mr. MEEKS. Mr. Manzullo? Thank you.

Mr. MANZULLO. Well, thank you. I am sorry I'm late, but in this great world of automation, I was trying to make a car payment on the Internet, and then on the telephone. And so I finally had to call the government office of the car manufacturer to say, "Why don't you have somebody answer the telephone?"

So, I guess maybe my question to each of you would be, "When someone calls your office, do you have a live person who answers the telephone," but I don't want to do that.

I am just throwing that out. In fact, when I was with Secretary Gutierrez several months ago, and people wanted to know how to grow business and succeed, he said, "The first thing that you never do is have an 800 number or an automated answering machine."

I don't know why I brought that up, but the level of frustration is high, and it's the same time that somebody cut the telephone line in front of our house back home, and my wife was on the cell phone waiting for the telephone people to pick up her phone.

The—when CFIUS was amended last year, I offered the amendment that called for the elevated level of review, in the event that

there was a sovereign wealth fund involved. It probably came out of the Dubai transaction.

And when I look at these sovereign wealth funds—I mean, for example, in the United States, a State teacher's pension union—I'm sorry, a State—yes, a State teacher's union pension fund, that would be called a sovereign wealth fund, is that correct? Because—

Mr. TRUMAN. I would, but not everybody would.

Mr. DREZNER. There is some debate on this issue.

Mr. MANZULLO. Well, that's like the telephone company. I mean, you know, tell me—because I see in—go ahead.

Mr. TRUMAN. Well, if it is a foreign government pension fund, it would be subject under CFIUS to the same kind of government restrictions. I am sure that I don't speak for the United States Treasury, but it would fall under the government category of CFIUS regulations today.

Mr. MANZULLO. Right.

Mr. TRUMAN. If it is a foreign government pension fund.

Mr. MANZULLO. Right.

Mr. TRUMAN. So, if it was Canada, or it was Canada's pension fund, it would fall under the government regulations.

Now, whether it was, strictly speaking, a sovereign wealth fund is another matter. The Canadians—as they probably told you in that hearing—said, "No." They think they are not. I think they are—it quacks like a duck. The Canadian pension fund, as far as its being a sovereign wealth fund, in my view, because it quacks like a duck, therefore it is a duck, and I would consider it that. But the Canadian pension fund does not consider itself a sovereign wealth fund.

Mr. MANZULLO. All right. The reason I ask that is that I know there was a lot of angst—and, in some cases, rightly so—but according to the stats that I look at here from Dr. Truman, it says that governments in the United States own or control more than $3 trillion, or 20 percent of the global government total of sovereign wealth funds.

And so, you have made the statement. I guess I was just asking you to—

Mr. TRUMAN. Okay. Sorry. We have U.S. State and local government pension funds that are approximately $3 trillion in value.

Mr. MANZULLO. Okay.

Mr. TRUMAN. And approximately a quarter of those funds are invested abroad. That's an estimate, since I haven't counted all of them. But that's how much CalPERS, which is one of the biggest ones—

Mr. MANZULLO. Okay. Let me stop you right there, then.

Mr. TRUMAN. Okay.

Mr. MANZULLO. State and local pension funds would be considered to other countries SWFs.

Mr. TRUMAN. Well, think about it this way. Certainly, Alaska's fund is. And, in the case of Abu Dhabi and Dubai, those are states within the United Arab Emirates.

Mr. MANZULLO. Okay.

Mr. TRUMAN. So you're dealing with subnational units in the case of Abu Dhabi and Dubai.

Mr. MANZULLO. Okay.

Mr. TRUMAN. And so you only have a question of whether you want to think of a pension fund as a sovereign wealth fund. And, in terms of political issues, as Dan pointed out when he cited the example of CalPERS, many people would argue that CalPERS has a political agenda in its investment strategy. I don't think it has been political in the past.

Mr. MANZULLO. You mean that California wants to secede from the union?

Mr. TRUMAN. Yes, or the rest of us want to throw them out.

Mr. MANZULLO. Okay.

Chairman GUTIERREZ. The time of the gentleman is—

[Laughter]

Mr. MANZULLO. Chairman, thank you. I know that—I was just—the point of my inquiry was to try to define and lower the expectations of many that there is something innately wrong with SWFs. And you answered the question. Thank you.

Chairman GUTIERREZ. Congressman Watt.

Mr. WATT. Thank you, Mr. Chairman. Let me just say first I was privileged to accompany the chair of this subcommittee to Abu Dhabi and various places to look and understand more about sovereign wealth funds, and came away with less of a concern, probably, than—coming back, than I had when I left the United States going there, partially because those sovereign wealth funds that we looked at were controlled by people who were friendly to us, as has been indicated.

The larger problem, as I saw it, was that you can't set up a set of rules in what is theoretically a free world market for one set of people who are your friends that is different than the set of rules that you set up for those who are not your friends.

And I think either Mr. Setser or Mr. Drezner—I didn't hear Mr. Truman's testimony, so I know it wasn't him—but one of you talked about this tension between the old funds and the new funds. The problem is that you can't have a different set of rules. Or can you have a different set of rules for those people who are your friends? In the economic free market, can you have a set of rules that is different for your friends than for your enemies?

Can you have two sets of rules, first of all? I guess that's the—and I would welcome a yes or no answer to that, because I—

Mr. DREZNER. I am an academic, sir, so I would have to say, "It depends." I can't give you just yes or no.

I mean, my understanding of the CFIUS procedures is that the—

Mr. WATT. Don't talk to me about CFIUS. I am talking about rules in general, transparency, because I am going on to CFIUS.

Do you accept the general proposition that you, in a free economic world market, have to have a set of rules that are consistent, across the board?

Mr. DREZNER. I would say yes.

Mr. WATT. Okay. All three of you—

Mr. TRUMAN. And I would say, you can do it—have the same rules—but I—

Mr. WATT. Yes, you can. But—

Mr. TRUMAN. You end up—

Mr. WATT. But the general proposition is that you have to have—

Mr. TRUMAN. It's unwise, yes.

Mr. WATT. All right. If that is the case, then I guess my next question, then, becomes is CFIUS adequate to—actually, it could set up a different set of rules, as far as CFIUS is concerned, because it's about national interests. And I understand that we could set up a different set of rules related to national interest, based on who our friends are and who our enemies are.

I haven't been all that enamored, historically, with the choices that we have made across the board about who our friends and who our enemies are, in terms of dictators, you know. They serve our interest, even though they don't promote, necessarily, our values. But that's a different question.

I accept that notion. Okay. The 20 or so countries got together and they made up these transparency rules. What happens if our enemies say, "We don't abide by those transparency rules?" They really have no enforceable effect at this point. That's where governments step in, I guess. The private market can set up some rules, but it can't enforce the rules, I take it.

Are the rules sufficiently enforceable, and equally applicable to both our friends and enemies, other than CFIUS, that you're satisfied where we are at this point, I guess is the bottom line question that I am asking.

Mr. TRUMAN. Let me try this.

Mr. WATT. Okay.

Mr. TRUMAN. The first part of the answer is that we don't know yet, because we don't know what the rules are. But let's assume that the rules are ones that you and I would agree on were sensible rules.

I am now going to give you a hypothetical answer. That group got together and wrote rules. There were various countries, including Russia and China, to use those two examples, who participated in the process. They now have a lot of peer pressure—

Chairman GUTIERREZ. Dr. Truman, I ask you to—we have a vote on the House Floor.

Mr. TRUMAN. They will have a lot of peer pressure to obey those rules. And there is no assurance of that, but I think there will be a lot of pressure on them, as sovereign wealth funds, to abide by the common rules that were agreed.

Chairman GUTIERREZ. Thank you very much. Congressman Keith Ellison, from Minnesota.

Mr. ELLISON. Professor Drezner, in your submitted testimony for today's hearing, you mentioned a comment made by former Treasury Secretary Larry Summers about the geopolitical concerns caused by "the financial balance of terror."

Could you extrapolate on that thought a little bit, and share what you had in mind when you made those comments?

Mr. DREZNER. Certainly, Congressman. Traditionally, if you study international relations, you tend to observe that there is a lot more cooperation out there on economic issues than there are on security issues.

And one of the reasons this has been hypothesized to be the case is that if countries defect from the rules of the game on trade, or if they defect the rules of the game on finance, the implications aren't immediate. Whereas, if a country defects on the rules of the

game in security, you have a war, and it's suddenly a very instantaneous shift in the distribution of power.

One of the things that is happening as a result of the deepening financial interdependence we are seeing now is that the game in economics is beginning to shift from one where if there is a defection there are costs, but the costs play out over a long period of time, to the point where if the People's Bank of China were to decide not to buy agencies, or sovereign wealth funds were to decide not to buy dollars, the effects could be potentially much more drastic and much more immediate.

Now, does this mean, therefore, that will happen? No. Just as in the case of where you had countries with large numbers of nuclear weapons, mutually assured destruction means you don't have an incentive to strike first.

So, as a result, my tendency is to think that there is a financial balance of terror. And, really, the question is how comfortable are you with that? Mutually assured destruction led to 40 years of peace during the Cold War, but it also led to a fair amount of anxiety, as well. And I am just trying to be balanced in saying there is some good and there is some bad, as a result of this.

Mr. ELLISON. Thank you. This is one for all of the panelists. What do you believe is the key to preventing the politicization of sovereign wealth funds? Is the solution for the recipient country to control which funds are allowed to invest in that country, or is it more effective to establish transparency guidelines for all sovereign wealth funds to be held within their countries of origin?

Mr. SETSER. If I can begin, I mean, I think all sovereign funds are created as a result of a political decision of one kind or another.

The decision to take oil export revenues and to channel that to a sovereign fund, rather than to use it to finance domestic investment is a political decision. The decision to intervene in the foreign currency market, to keep your currency from going up, is a political decision. The act of accumulating foreign assets, if you're a government, is a political decision.

The question then becomes—and you know, we in the United States have a limited capacity to directly stop that, and we pay a good dollar for imported oil. Once we paid the dollar, it's someone else's decision about how they want to use that dollar. They can use it to buy more goods, or they can use it to buy more financial assets.

Once, though, they have made a decision to not spend the dollar, to invest the dollar, then they have a series of choices about how to invest. And many countries have a national interest in making money. They save the dollar, and they would like to make more money.

Other countries may have another kind of national interest. They may say, "Well, we, as a country, are under-represented in the global ownership of oil or minerals, so we would like to invest in ways that would increase the share of global mineral supply that is owned by our nationals. And, as a government, we have the foreign exchange, we can help channel some of that foreign exchange to state companies that are expanding abroad."

That is a decision, it's a political decision. It may not fall under the rubric of an investment by a sovereign wealth fund, and I think

that's one of the points of agreement amongst our testimony, that focusing solely on sovereign wealth funds is too narrow. There is a much broader rubric of sort of state capitalism, state enterprise, all of which can draw indirectly on some of the foreign exchange.

You can also make an investment that is designed to enhance—support your own economic development. Now, that's kind of an awkward thing to do because, remember, the beginning point is a decision that you didn't want to spend the money at home, and you were shipping the money abroad. So there is sort of a tension there.

But you could buy assets which you think will have positive spillovers for your own plans for economic development. Maybe you will invest in a company and then they will make an investment back in you, which kind of undoes some of the initial decision to invest abroad.

Or, you think that you can buy some intellectual property which has some value to you, and that is why there is a process of review. And I think that is sort of a sensible way of trying to balance the reality of money that is under control of governments can be invested for a range of purposes, probably primarily to make money, but not necessarily exclusively. And you have to evaluate it on a case-by-case basis.

Mr. TRUMAN. I think that was a good answer. A clear answer to a complicated question.

Mr. ELLISON. Yes, right. Are we done?

Chairman GUTIERREZ. Thank you. Yes, the time of the gentleman has expired. We have about 7 minutes before we have a vote on the House Floor.

First, I want to thank you all. I wish we didn't have to go vote, so we could, I am sure, have members continue to engage in this conversation, this dialogue that we are having. We are going to have more hearings on sovereign wealth funds. I think it's important that this panel understand it, and that the Financial Services Committee take issue with it.

But it seems to me that what I come away with, more and more—whatever panel—is that: China undervalues their currency, which leads me to believe that the only way you can do that is to manipulate your currency; that they are a growing economic force; they are changing the world, not just because of the Beijing Olympics and how many gold medals they won, though that's an indication of what they are investing in; and their prestige, internationally.

It's not something I am particularly afraid of, I just want to make sure we are strong, and that we have—and that there is some balance and fairness, and that we are not—you know, they are not getting some—and I think that when you bring—we look at—and I am going to continue to look, and I thank you for all stressing sovereign wealth funds is a symptom.

But when you have Russia controlling all of the gas, attempting to control all of these new gas pipelines, and all of these new—how would I say it—energy pools, when you see the way they are acting in Georgia, when we know we have not transparent governments with not transparent billions of dollars, I think I am not quite as

unworried as all of you are, or appear to be, as you testified today before this committee.

Things have a way of changing. I have seen China. We have seen how China acts in Africa when it wants raw materials, and the kind of governments that it will support, in spite of our best efforts. That is a scary situation, what they are going to be doing with their sovereign—and I understand it.

I really—and, Dr. Truman, I thank you for putting these sovereign wealth funds in the categories, because I like the fact that you actually give them points. And, I mean, for transparency, and the way—and I think that is a huge difference in something that my colleague Mr. Watt, and others—you know, what is the—they are not all the same. They are not all the same.

And I just want to end with this. I went to Abu Dhabi. I went to Dubai. I came back, much like Mr. Watt, less worried about them. I mean, they surround themselves with these—they are either Brits or Australians or Americans. It's hard to tell that they were actually a sovereign wealth fund.

But what's curious is when you ask them who controls the money, they try to act as though they were equity traded on the, you know, S&P 500 or the U.S. Stock Exchange. They won't give you the name of the sheik, they won't give you the name of the crown prince who actually controls the money. And in that, there is a distinct difference. And with Russia, there are other kinds of differences.

So, I thank you all for coming. I want to thank the witnesses and the members for their participation.

The Chair notes that some members may have additional questions for the witnesses which they may wish to submit in writing. Therefore, without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses and to place those responses in the record, and also to submit written statements for the record.

This subcommittee hearing is now adjourned. Thank you.

[Whereupon, at 3:35 p.m., the hearing was adjourned.]

# A P P E N D I X

September 10, 2008

**COMMITTEE ON FINANCIAL SERVICES**
**SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE AND TECHNOLOGY**
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

**September 10, 2008**

**Sovereign Wealth Funds:**
**New Challenges from a Changing Landscape**

**Statement for the Record Submitted By**
Congressman Donald A. Manzullo
Congressman Kenny Marchant

Mr. Chairman: Thank you for holding this hearing today.

This Committee has thoughtfully examined the emergence of Sovereign Wealth Funds (SWFs) over the past year. We have heard testimony from SWFs which represent the "gold standard" of their genus, and learned a great deal about their activities and best practices.

However, policy-makers on both sides of the aisle have rightly raised important questions and concerns about SWFs, which need to be addressed. It is a fine line between introducing valuable foreign investment and providing the means to undermine our economic and financial stability.

As they grow into entities investing trillions of dollars internationally, SWFs carry the potential to disrupt or manipulate markets, particularly in cases where SWFs and their host nations use economic assets for political, strategic or other non-commercial purposes. Because SWFs and other state-owned enterprises can typically mobilize very large amounts of capital very quickly, often without transparency and shareholder accountability, they are likely to continue to pose a greater risk to otherwise efficient functioning markets.

We would like to remind our colleagues of the benefit and economic growth derived from direct foreign investment, even in the instance of foreign sovereign investment. In most instances, this is a welcome and positive phenomena. However, some SWFs and their governments have challenged U.S. national security interests and engaged in anti-free market practices such as fraud and contempt for the rule of law, which have harmed U.S. investors and may again cause them devastating financial losses. In particular, the Russian Government's inappropriate use of corporate and capital resources to pursue its international strategic and political objectives, often with no regard for growth and return on investment, should be very alarming.

In October of last year, this Committee held a hearing on the Yukos affair, and we examined the Russian government conduct leading to U.S. investors losing approximately $7 billion. Yukos was a publicly-traded energy company which was leading the Russian marketplace with the introduction of transparent financial reporting, accounting practices, and corporate governance.

Yukos was, at one point, preparing to voluntarily adopt Sarbanes-Oxley-like measures of financial control.

Unfortunately, we heard testimony which recounted how Yukos was re-nationalized by Russian authorities, and U.S. investors lost all $7 billion of their equity investment. To this very day, Russian officials have not dealt with the inequity and disregard for the rule-of-law in dealing with affected U.S. investors.

In order for this Committee and other policymakers to have confidence in the economic intentions of a Russian SWF, Russian authorities are wise to respect the rule-of-law and the principle of fair-functioning markets. We are of the opinion this process should begin by asking the Russian authorities to respond in good-faith to the unjustly harmed U.S. investors in the Yukos affair. Otherwise, we need to examine what regulations can be adopted to minimize the risk of market manipulation and create accountability if it occurs.

We look forward to examining the issue in today's hearing and in the coming months of this Committee's work. Thank you.

# Sovereign Wealth Funds and the (in)Security of Global Finance[1]

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September 2008

## Introduction

Sovereign wealth funds (SWFs) sit at the intersection of high finance and high politics. Their net worth is currently estimated to exceed $3 trillion – more than the value of all private equity or hedge funds.[2] Their explosive growth of these funds raises regulatory and geopolitical concerns. The Deputy Treasury of the Secretary wrote in *Foreign Affairs* earlier this year that, "SWFs are already large enough to be systematically significant.... they are likely to grow larger over time, in both absolute and relative terms."[3] Many policy analysts argue that SWFs are symptomatic of shifts in the global distribution of power away from the advanced industrialized states and towards authoritarian capitalist governments in the developing world.

Are these fears of sovereign wealth funds justified? In most respects, the growth of sovereign wealth funds has marginal effects on American national security and foreign policy. SWFs are a symptom of other national ailments – persistent macroeconomic imbalances and a failure to diversify America's energy supply. As symptoms go, however, sovereign wealth funds are relatively benign in their foreign policy effects. If anything, these investments demonstrate the complex interdependence of the Pacific Rim and Middle East with the American economy. Some negative policy externalities come with these funds, however; their growth will significantly impair democracy promotion efforts in the developing world.

## Concerns about sovereign wealth funds

I will define sovereign wealth funds as *government investment vehicles that acquire international financial assets to earn a higher-than-risk-free rate of return.* They are not

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[1] A lengthier version of this testimony will appear in the fall issue of the *Journal of International Affairs*. The Center for International Governance and Innovation and the Glasshouse Forum provided invaluable support during the research of this testimony. Jen Weedon provided invaluable research assistance.
[2] These categories are far from mutually exclusive; sovereign wealth funds account for 10% of private equity investments globally.
[3] Robert Kimmitt, "Public Footprints in Private Markets," *Foreign Affairs* 87 (January/February), p. 121

a recent invention – Kuwait created the first modern fund in 1953. What is new about SWFs is their recent investment trends and countries of origin.

To seek higher rates of return, sovereign wealth funds have shifted from bond and index funds to assets that carry greater risk. SWF cross-border mergers and acquisitions more than doubled between 2006 and 2007.[4] They have also been attracted to "alternatives" such as hedge funds, derivatives, leveraged buyout firms, and real estate. There are reports that sovereign wealth funds are increasingly big speculators in commodity futures markets.[5] Sovereign funds based in Bahrain and Dubai have begun to leverage themselves in order to make bigger overseas acquisitions.[6]

Although the concept of a sovereign wealth fund is not new, close to half of the top forty SWFs have been created since 2000. In the past two years, Saudi Arabia, Russia and China created large sovereign wealth funds. Press reports indicate that Brazil, India and Nigeria will create new funds in the near future. Two kinds of governments are pumping money into sovereign wealth funds: commodity exporters and countries running fiscal and trade surpluses. Commodity-exporting countries hold approximately two-thirds of total SWF assets. For the oil exporters, the incentive to create a sovereign wealth fund is three-fold. First, these economies want to create assets that ensure a long-term stream of revenue to cushion themselves against the roller coaster of commodity booms and busts. As many economists have observed, these countries are simply converting assets extracted from the earth into a more liquid form. Second, many of these governments are trying to build up reserve funds for the day when all of the oil is extracted from below ground. Third, by focusing on foreign investments, these governments are attempting to forestall the Dutch disease of rapidly appreciating currencies. Overseas investment via sovereign wealth funds can accomplish all of these tasks.

Export engines are also using sovereign wealth funds to keep their currencies fixed at a low par value. As of 2007, China had accumulated more than $1.8 trillion in foreign assets in order to prevent the renminbi from appreciating too rapidly. This keeps Chinese exports competitive in the United States. More than 80% of these assets exist in the form of foreign exchange reserves – i.e., safe investments with very low rates of return. As these reserves have accumulated, so have the opportunity costs of amassing dollars in such low-yield investments. According to some estimates, the cost is close to $100 billion a year.[7] This explains the 2007 creation of the China Investment Corporation. Sovereign wealth funds more of an effect than a cause of the macroeconomic imbalances that have led to the massive, decade-long increase in all government controlled assets.

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[4] Marko Maslakovic, "Sovereign Wealth Funds 2008." International Financial Services, London, April 2008.
[5] David Cho, "Sovereign Funds Become Big Speculators," *Washington Post*, August 12, 2008.
[6] Duncan Kerr, "Arab Sovereign-Wealth Funds Dip a Toe in the Debt Pool," http://blogs.wsj.com/deals/2008/08/13/arab-sovereign-wealth-funds-dip-a-toe-in-the-debt-pool/, accessed August 15, 2008.
[7] Dani Rodrik, "The Social Cost of Foreign Exchange Reserves," *International Economic Journal* 20 (Summer 2006): 253-266.

The growth of sovereign wealth funds have provoked a variety of policy concerns, ranging from their effects on corporate governance to fears of a protectionist backlash. Underlying these myriad issues are the twin problems of transparency and sovereignty. Compared to mutual funds or pension funds, the transparency of most sovereign wealth funds ranges from bad to worse.[8] The largest sovereign wealth fund, for example, is the Abu Dhabi Investment Authority (ADIA). An institution that has in existence for more than thirty years has yet to reveal its fund size, portfolio structure, performance, or investment objectives. Until earlier this year, ADIA's official website was confined to a single page containing no financial information; it now consists of several web pages containing no financial information.

The lack of transparency is problematic when combined with the size and sovereignty of these investment vehicles. SWFs are, by definition, extensions of the state. They are therefore viewed as maximizing their country's long-term strategic interests rather than as profit-maximizing actors. Even defenders of sovereign wealth funds as responsible financial actors acknowledge that some SWFs might have strategic objectives in their pattern of acquisitions. The funds themselves have repeatedly insisted that they merely seek to maximize their rate of return. Nevertheless, the perception among financial actors diverges from the self-perception of SWFs. A recent survey of global financial institutions revealed that private actors viewed sovereign funds as more likely to seek strategic interests than maximizing their financial returns – even though SWF respondents stressed the latter over the former.[9]

Without a clear read on the intentions of sovereign wealth funds, their actions have the potential to roil financial markets. As Alan Greenspan pointed out, the strongest check against financial misbehavior is "counterparty surveillance" – the incentive of investors to make sure that their investment funds are acting prudently and profitably.[10] The trouble with sovereign wealth funds is that, in most cases, there is no counterparty surveillance. In the best-case scenario, like Norway, democratically-elected parliaments must approve changes in investment strategies. This kind of oversight is consistent with the spirit of counterparty surveillance. In places like the Russia and China, however, the lack of transparency, oversight and accountability is much more problematic.

There are several means through which sovereign wealth funds could, theoretically, influence the policies and capabilities of recipient countries. The most direct means could take place through direct ownership and control of strategic sectors or critical infrastructure.[11] SWFs could sabotage the firms they purchase, crippling the recipient country's capabilities. Leverage could also be exercised through the threat of investment withdrawal. Indeed, the president of the Chinese Investment Corporation warned the *Financial Times* this year that, "there are more than 200 countries in the world. And,

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[8] Edwin Truman, "A Blueprint for Sovereign Wealth Fund Best Practices," Peterson Institute for International Economics Policy Brief PB08-3, April 2008.
[9] "Sovereign Wealth Funds and the Global Private Equity Landscape," Norton Rose, June 2008. Accessed at http://www.nortonrose.com/knowledge/publications/2008/pub15287.aspx?page=all&lang=en-gb.
[10] Alan Greenspan, *The Age of Turbulence* (New York: Penguin, 2007).
[11] Gal Luft, "Selling Out: Sovereign Wealth Funds and Economic Security." *The American Interest* 3 (July/August): 53-56.

fortunately, there are many countries who are happy with us."[12] Alan Tonelson articulated a similar concern earlier this year: "If, for example, the Chinese government held significant stakes in a large number of big American financial institutions, especially market-makers, and if our nation's current period of financial weakness persists, how willing would Washington be to stand up to Beijing in a Taiwan Straits crisis?"[13]

Leverage can also be exercised more subtly, through the cooptation of domestic interests within recipient countries. As previously observed, SWFs have acquired ownership stakes in many Western financial institutions. Private equity and hedge funds rely on SWF investments for a significant fraction of their capital. Even if these sovereign wealth funds adopt a passive investment posture, it is hard not to believe that some implicit degree of cooptation would not take place. For example, after receiving a $3 billion investment from China's sovereign wealth fund, the CEO of Blackstone wrote an op-ed in the *Financial Times* warning against any measures to block SWF investment, comparing such steps to the Smoot-Hawley tariff.[14]

Even without direct ownership, financial institutions can profit from harmonious relations with SWFs, through consulting and asset management contracts.[15] For example, State Street Global Advisors – who coined the term "sovereign wealth fund" – has an Official Institutions Group that manages approximately $270 billion in assets from more than 70 government clients. With sovereign wealth funds sitting on so much capital, the financial sector will tend to lobby politicians in their home countries on behalf of these entities. Since these firms represent a powerful interest group within the OECD economies, they could act as a conduit to blunt policy responses to SWFs.

From an American perspective, the authoritarian cast of the fastest-growing sovereign wealth funds is an additional source of concern. Sovereign wealth funds based in authoritarian countries theoretically possess two advantages over SWFs based in democratic countries. First, consistent with their regime type, authoritarian SWFs would be expected to be less transparent, allowing them to act with greater agility. Second, because authoritarian societies are better able to suppress dissent, they should be able to make investments that might be unpopular in the short-term but yield much greater long-term rewards. Some analysts are concerned that the "patient capital" of capitalist authoritarian states could cause their SWFs to act in a more strategic and a more profitable manner.

This leads to the final, more existential policy concern. As a long-term development model, sovereign wealth funds are viewed as one component of a possible rival to liberal

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[12] Quoted in Jamil Anderlini, "China fund shuns guns and gambling," *Financial Times*, June 13, 2008.
[13] Alan Tonelson, testimony before the U.S. China Economic and Security Review Commission hearing on the Implications of Sovereign Wealth Fund Investments for National Security, February 9, 2008. Accessed at http://www.uscc.gov/hearings/2008hearings/written_testimonies/08_02_07_tonelson_statement.php, February 2008.
[14] Stephen Schwarzman, "Reject sovereign wealth funds at your peril." *Financial Times*, June 19, 2008.
[15] Andy Mukherjee, "Sovereign Wealth Funds a Boon for Asset Managers," Bloomberg News, October 23, 2007; Chris Larson, "Managers Eye Asian SWF Billions," *Financial Times*, August 3, 2008; Miracky et al, "Assessing the Risks," p. 28-29.

free-market democracy. State-led development societies – in which governments use SWFs to buy off dissent and promote development and technology transfer – could emerge as a viable challenger to the accepted political economy of the advanced industrialized states. This would have corrosive effects on the West's soft power. It would be an open question whether the rest of the world would look at the Western development model as one to emulate. Crudely put, far fewer countries would want what the United States and European Union wants.

**Evaluating the policy concerns**

Looking at the empirical record, many of the concerns articulated in the previous section appear to be either overblown or cross-cutting. For example, the argument that sovereign wealth funds co-opt domestic interests in recipient countries also cuts in the opposite direction; private actors benefit from their association with a sovereign wealth fund when acting in the SWF's home market. It is possible, for example, that Blackstone has had preferred access to the Chinese market following CIC's investment in that private equity firm. In the time since CIC's investment, Blackstone announced its purchased of a 20% stake in a state-owned Chinese chemical manufacturer, as well as a high-end commercial building in downtown Shanghai. They have announced plans to set up a Beijing office to facilitate even more transactions, relying on CIC for assistance within China. Blackstone's successes have occurred while other private equity firms encountered fierce resistance to similar kinds of investment.[16]

The argument that SWFs exacerbate market uncertainty also appears to lack empirical foundation. It contradicts the supposed comparative advantage of sovereign wealth funds – which is that they can hold large positions for long stretches of time, weathering short-term panics and downturns. Sovereign wealth funds would therefore be expected to function in a countercyclical, stabilizing manner – as their investments in the financial sector earlier this year suggest. Furthermore, in contrast to their private sector counterparts, SWFs traditionally have not been highly leveraged. Their equity investments to date have been focused in regions and sectors where they have local knowledge. The general consensus among financial analysts is that sovereign wealth funds have taken a long-term, passive approach to their overseas investments.[17] The bulk of recent SWF equity investments in OECD countries has been for either non-voting shares or stakes too small to warrant corporate control.

While sovereign wealth funds have been increasing their risk profiles, it is not clear that they are acting in a riskier fashion than peer financial institutions. Given the current state of financial markets, large private institutions are also interested in investing in higher-yield assets, particularly in the developing world. After analyzing recent acquisition patterns of several large SWFs, Rachel Ziemba concluded, "Increasingly a vast array of

[16] Tony Munroe and George Chen, "Blackstone Group opening Beijing rep office," Reuters, August 4, 2008.

[17] For a dissent, see Brad Setser, "Just How Stabilizing?" July 30th, 2008. Accessed at http://blogs.cfr.org/setser/2008/07/30/just-how-stabilizing/.

pension funds, endowment funds, sovereign funds all seem to be coalescing to a similar asset allocation – high equity, more exposure to alternatives, real assets like commodities and less exposure to bonds. And everyone wants more emerging market exposure."[18]

The strategic concerns about sovereign wealth funds also rest on uncertain grounds. Financial analysts identify the primary "strategic" goal of SWFs as acquiring expertise or technology that can facilitate economic development in the home country. Many of these investments complement the home country's preexisting comparative advantage. Arab SWFs, for example, are more likely to acquire equity stakes in the energy sector; Singapore's Temasek has been more likely to acquire port facilities. A recent Monitor Group study examined 785 SWF equity purchases from 2000 to the present.[19] They found that investments in strategic sectors – transportation, defense, aerospace, and high technology – comprised less than one percent of the value of all purchases. Even expanding the definition to include energy and utilities, less than five percent of all sovereign wealth fund acquisitions were for controlling interests in strategic sectors in OECD markets.[20]

Nevertheless, some sovereign wealth funds have made investments decisions based on criteria other than profit maximization. In the United States, CalPERS decided to divest its holding in firms doing business in Sudan. The recent Divest Terror campaign has been designed to use U.S. state pension funds to pressure European firms into divestiture from Iran. Norway's GPFG has articulated a set of ethical guidelines to regulate its equity investments – but one country's ethics is another country's politics. In early 2008, Muhammar Khaddafi threatened to withdraw Libyan SWF investment from African nations resistant to his idea of strengthening the African Union.[21] There is no evidence, however, that any of these attempts to exercise leverage had any policy effects. A recent European Central Bank paper examined stock prices after Norway's SWF strengthened its ethical guidelines for investment and divested from firms like Wal-Mart and United Technologies. They found no significant effect on firm performance or rate of return.[22]

These results are consistent with the general consensus in international relations – threats of economic exit only work under a limited set of circumstances.[23] The literature on economic coercion and economic interdependence also suggests that sovereign wealth funds lack the capability to coerce the OECD economies. Even relative optimists about

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[18] Rachel Ziemba, "Growing Sovereign Wealth," August 27, 2008. Accessed at http://blogs.cfr.org/setser/2008/08/27/growing-sovereign-wealth/, August 2008.

[19] William Miracky, Davis Dyer, Drosten Fisher, Tony Goldner, Loic Lagarde, and Vicente Piedrahita, "Assessing the Risks: The Behaviors of Sovereign Wealth Funds in the Global Economy," Monitor Group, June 2008.

[20] Furthermore, this five percent is all the result of Singapore's Temasek purchased four energy and utility firms in OECD countries – one in Australia, one in the United Kingdom, and two in South Korea.

[21] Reuters, "Libya's Gaddafi says may pull Africa investments," January 30, 2008.

[22] Roland Beck and Michael Fidora, "The Impact of Sovereign Wealth Funds on Global Financial Markets," European Central Bank Occasional Paper Series no. 91, July 2008.

[23] See, for example, Jonathan Kirshner, *Currencies and Coercion* (Princeton: Princeton University Press, 1995); Daniel W. Drezner, *The Sanctions Paradox* (Cambridge: Cambridge University Press, 1999); Mark Crescenzi, "Economic Exit, Interdependence, and Conflict." *Journal of Politics* 65 (August 2003): 809-832; Benn Steil and Robert Litan, *Financial Statecraft* (New Haven: Yale University Press, 2006).

the utility of financial statecraft place strict preconditions on the ability of states to use it. The sender must be significantly more powerful than the target. The sender must be able to assemble an institutionalized multilateral coalition to enforce the sanctions. The expectations of future conflict between the target and the sender coalition must be low. In the absence of these conditions, financial statecraft will almost always fail.

The home countries of sovereign wealth funds possess none of these advantages in trying to leverage their investments into political gain. Small countries closely allied with the United States – Norway, Singapore, the United Arab Emirates, Qatar, Kuwait – own and operate the largest SWFs. These economies have the potential to inflict economic harm on the advanced industrialized states – but they would damage their own economies even more in the process. Even when expectations of future conflict are very high, no country has even tried to deploy economic coercion when their own costs exceed those of the target costs. In theory, there is the possibility that states with sovereign wealth funds could create a balancing coalition against the United States and/or the European Union. On many issues – particularly energy prices – the Pacific Rim economies and oil-exporting states have divergent foreign policy interests. The likelihood of coordinated coercion against the established markets is quite low.

Over time, as SWFs acquire even more assets in recipient countries, their bargaining leverage could increase. The complex interdependence created by sovereign wealth funds cuts both ways, however. To be sure, the United States needs SWF investment to finance its large current account deficit. However, most other asset markets are neither big enough nor open enough to cater to large-scale sovereign wealth investments. Large market jurisdictions – the United States and European Union – should be able to dictate most of the rules and regulations regarding these funds.[24] While some OECD economies might need SWF investment, it is equally true that capital exporters need America and Europe to keep their jurisdictions open to inflows. These markets remain the only ones deep and liquid enough to absorb inflows in the trillions of dollars. Indeed, the very countries that are bulking up their sovereign wealth funds at the moment are the most protectionist when it comes to inward investment.[25]

The IMF process to create a code of conduct for sovereign wealth funds bears this point out. In 2007 the G-7 Finance Ministers requested the IMF to develop a code of conduct for sovereign wealth funds. This initial reaction of sovereign wealth funds to this step ranged from tepid to very hostile. For example, Gao Xiqing, the president of the Chinese Investment Corporation, told *60 Minutes* that an IMF code would "only hurt feelings"

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[24] Daniel W. Drezner, *All Politics Is Global: Explaining International Regulatory Regimes* (Princeton: Princeton University Press, 2007).

[25] Takeshi Koyama and Stephen Golub, "OECD's FDI Restrictiveness Index: Revision and Extension to More Economies," OECD Working Paper on International Investment 2006/4, December 2006 ; Rachel Ziemba "Responses to Sovereign Wealth Funds: Are 'Draconian' Measures on the Way? RGE Monitor, November 2007; U.S. Government Accountability Office, *Laws and Policies Regulating Foreign Investment in 10 Countries*, GAO-08-320, February 2008.

and characterized the idea as "politically stupid."[26] Nevertheless, the U.S. Treasury Department persuaded ADIA and GIC to jointly issue a set of policy principles regarding SWFs and recipient countries. These included commitments to governance and transparency standards, as well as a pledge to use commercial and not political criteria in determining investments.[27] As of this writing, an IMF appears on track to approve a set of Generally Accepted Principles and Practices (GAPP) at its fall meeting. Implicit pressure from recipient countries – as well as the larger and older SWFs – should cause the "Santiago Principles" to have an appreciable effect on SWF transparency.

Are SWFs based in authoritarian countries different from those based in democratic countries? Yes and no. On the one hand, there is indeed a strong relationship between SWF transparency and the political characteristics of the home country. The transparency of government investment vehicles is closely and positively correlated with the home country's rule of law and democratic accountability. Multivariate tests also find a strong and positive correlation between a country's political and civil liberties and the quality and transparency of its sovereign wealth funds.[28] Not surprisingly, sovereign wealth funds headquartered in the OECD economies are much more transparent than those headquartered in the developing world.

There is less evidence, however, that authoritarian regimes have exploited their opacity to outperform the market, or invest their capital more patiently. The recent experiences of Russia and China are revealing in this regard. The China Investment Corporation (CIC) has received considerable domestic flak for its investment in Blackstone, after that firm's stock value has plummeted by 40%. The way CIC is financed – through domestic bond sales rather than an explicit transfer of foreign exchange from SAFE – actually forces the fund to try to maximize its short-term rate of return in an unforgiving exchange rate environment. CIC's performance has exacerbated tensions between China's finance ministry and its central bank over the management of foreign reserves. A few months after the Blackstone investment Lou Jiwei, the head of CIC, did worse than expected in Central Committee elections. In response to CIC missteps, the central bank's State Administration of Foreign Exchange (SAFE) began to act like a sovereign wealth fund, adding more confusion to their foreign investment strategy. Similarly, Russia's central bank received withering domestic criticism when it was revealed that it held over $100 billion in Fannie Mae and Freddie Mac securities. In response, the bank cut its exposure by forty percent – but to do this it was forced to sell low.[29]

Authoritarian countries might not have elections, but they still must cope with bureaucratic rivalries, domestic discontent, and audience costs. Furthermore, while there

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[26] *60 Minutes* transcript accessed at http://www.cbsnews.com/stories/2008/04/04/60minutes/printable3993933.shtml, August 2008; Jamil Anderlini, "China fund shuns guns and gambling," *Financial Times*, June 13, 2008.

[27] Bob Davis, "U.S. Pushes Sovereign Funds to Open to Outside Scrutiny," *Wall Street Journal*, March 3, 2008. Policy principles accessed at http://treas.gov/press/releases/hp881.htm, August 2008.

[28] Beck and Fidora, "The Impact of Sovereign Wealth Funds on Global Financial Markets."; Olivia Mitchell, John Piggott, and Cagri Kumru. 2008. "Managing Public Investment Funds: Best Practices and New Challenges." NBER Working Paper 14078, June 2008.

[29] Reuters, "Media mudslinging scares Russian oil wealth managers," August 1, 2008.

are sound policy reasons for these countries to set up SWFs, they must still cope with the political incongruity of investing billions of government dollars in the developed world while tolerating significant pockets of domestic poverty. In China, Russia and Singapore, governments have had to respond to domestic criticism of SWF investments; in the United Arab Emirates, they have had to address questions of corruption. In many ways, therefore, authoritarian politics can be just as limiting as democratic politics in hampering long-term strategic planning.

This is why the existential threat of sovereign funds as an alternative development strategy is likely overblown. As Kenneth Rogoff pointed out in testimony last year: "Governments have a long tradition of losing massive amounts of money in financial markets. This tradition is not likely to end anytime soon."[30] Indeed, sovereign wealth funds based in Nigeria and Ecuador have gone bust in the past. One recent econometric study examined 53 SWF equity purchases from 1989 to 2008 and found that, on average, two year abnormal returns amounted to -41%.[31] The McKinsey Global Institute estimates that as of July 2008, SWFs had collectively lost $14 billion from recent investments in the financial sector.[32]

**Some warning notes**

Sovereign wealth funds are unlikely to disrupt the functioning of the American economy or compromise national security through their investment strategies. They are symptom of other problems, however. The rise of sovereign wealth funds highlights American macroeconomic weaknesses. In the future, they will impair American efforts at democracy promotion. They also threaten to reduce the degree of cooperation in global financial governance.

Sovereign wealth funds are simply the latest manifestation of the explosive growth in official assets ranging from currency reserves to state-owned enterprises. U.S. consumption is keeping energy prices high. A low U.S. savings rate, combined with the foreign manipulation of exchange rates, has allowed some Pacific Rim economies to inflate their current account surpluses. Those are the macroeconomic forces that are causing foreign governments to expand their sovereign wealth funds. Addressing those problems sooner, rather than later, will go a long way towards eliminating sovereign wealth funds as a political hot potato. Improving the savings rate of Americans, for example, would help to reduce the large current account deficit that is fueling the growth of sovereign wealth funds in the Pacific Rim. Reducing energy demand would also reduce the growth of sovereign wealth funds among energy exporters – though such a

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[30] Kenneth Rogoff, "Foreign Holdings of U.S. Debt: Is Our Economy Vulnerable?" Testimony prepared for U.S. House of Representatives Committee on the Budget, June 26, 2007. See also Anders Åslund, "The Truth about Sovereign Wealth Funds," Foreignpolicy.com, December 2007. Accessed at http://www.foreignpolicy.com/story/cms.php?story_id=4056, February 2008.

[31] Veljko Fotak, Bernardo Bortolotti, and William Megginson, "The Financial Impact of Sovereign Wealth Fund Investments in Listed Companies," Working paper, University of Oklahoma, June 2008, accessed at SSRN: http://ssrn.com/abstract=1108585.

[32] Diana Farrell, Susan Lind and Koby Sadan, "The New Power Brokers: Gaining Clout in Turbulent Markets." McKinsey Global Institute, July 2008, p. 9.

reduction would be partially offset by rising demand around the globe. Recent trends suggest that market forces are moving in the preferred direction. In recent years the Chinese renminbi has appreciated by 20% against the dollar. High fuel prices will likely contribute to greater conservation efforts and reduced energy demand.

The rise of sovereign wealth funds will also have some negative second order effects for American foreign policy. SWFs will impair democracy promotion efforts. These investment vehicles aid and abet in the persistence of "rentier states" – governments that do not need their citizens to raise revenue. Democratization is a much more difficult policy for the United States to pursue when the target government is sitting on trillions of dollars in assets to buy off discontented domestic groups. Authoritarian governments in the Middle East and East Asia will be more capable of riding out downturns that would otherwise have threatened their regimes. These funds are a means through which authoritarian regimes can guard against the vicissitudes of the free market. As the Asian financial crisis demonstrated a decade ago, market shocks can fell authoritarian governments. Sovereign funds, combined with ever increasing foreign reserves, can forestall economic crises before they topple authoritarian power structures.

More perversely, the growth of sovereign wealth funds, combined with rising nationalism and anti-Americanism in capital exporting countries, would give the United States even less reason to *want* democratic transitions in these parts of the globe. Consider the effect of a populist or fundamentalist revolution taking over in Saudi Arabia or the Gulf emirates. Rampant anti-Americanism among the Arab populace could encourage a new government to purposefully sell off SWF investments in the United States in order to induce a financial panic. While such moves would be economically disastrous to these countries, such actions are not inconceivable in the early stages of a revolutionary government. Even if China or the Persian Gulf emirates were to democratize more gradually, one could easily envisage nationalist parliaments using their SWFs to constrain U.S. actions. Sovereign funds in democratic societies have been willing to inject political conditionality into their capital markets. As previously noted, interest groups have been eager to use America's financial muscle to alter the behavior of foreign actors in Sudan, Iran and Russia. There would be no reason to expect other democratic, capital-rich countries to behave differently.

There is final, more sobering consideration. The emergence of sovereign wealth funds needs to be considered in the context of other changes in the global political economy. In the past, a key explanatory factor for high levels of cooperation in the global economy was the absence of tight coupling. Historically, the effect of a powerful actor defecting from the rules of the game did not usually have dramatic and immediate effects in international economics. The globalization of finance, combined with the re-emergence of powerful state actors in capital markets, changes this equation. As Larry Summers and others have pointed out, there are geopolitical concerns that come with the "financial balance of terror" created by current macroeconomic imbalances.

The shifting of government assets from central banks to sovereign wealth funds and state-owned enterprises exacerbates these concerns. Transparency measures cannot

completely erase concerns about the capabilities and intentions of powerful sovereign actors. These concerns, combined with the tight coupling of today's financial markets, will cause the incentive structures in global finance to more closely resemble those of nuclear deterrence – specifically, the logic of mutually assured destruction. This does not mean that the financial equivalent of World War III will take place. It does mean, however, that policymakers must be increasingly cognizant of that contingency.

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Beyond the academy, Drezner has served as an international economist at the Treasury Department's Office of International Banking and Securities Markets. He has also held a research position at the RAND Corporation. He has consulted for various for-profit, non-profit and public sector agencies, including the National Intelligence Council. He was a non-resident fellow with the German Marshall Fund of the United States, a Council on Foreign Relations International Affairs Fellow, and a post-doctoral fellow at Harvard University's Olin Institute for Strategic Studies. He received his B.A. in political economy from Williams College and an M.A. in economics and Ph.D. in political science from Stanford University.

Drezner is the author, most recently, of *All Politics is Global: Explaining International Regulatory Regimes* (Princeton University Press, 2007), which explores how and when regulatory standards are coordinated across borders in an era of globalization. His previous books include *U.S. Trade Strategy* (Council on Foreign Relations, 2006), *Locating the Proper Authorities* (University of Michigan Press, 2003), and *The Sanctions Paradox* (Cambridge University Press, 1999). His next book, *An Unclean Slate*, will examine the future of global governance.

He has published articles in numerous scholarly journals as well as in the *New York Times, Wall Street Journal, Washington Post, Foreign Policy*, and *Foreign Affairs*. He has provided expert commentary on U.S. foreign policy and the global political economy for C-SPAN, CNNfn, CNN International, and ABC's *World News Tonight*. He is currently a regular commentator for *Newsweek* International and NPR's *Marketplace*. He keeps a daily weblog at www.danieldrezner.com. He is a member of the American Political Science Association, International Studies Association, and the Council on Foreign Relations.

**September 10, 2008**

# Testimony of

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**Fellow, Geoeconomics**
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**Before the**
**Subcommittee on Domestic and International Monetary Policy, Trade and Technology of the Financial Services Committee**
**U.S. House of Representatives**

## Sovereign Wealth Funds: New Challenges from a Changing Landscape

[1] The Council on Foreign Relations takes no institutional position on policy issues. All statements of fact and expressions of opinion contained in this testimony are the sole responsibility of the author. The author would like to thank Arpana Pandey for help with the preparation of the charts in this testimony.

Over the last few years, capital has flowed – in broad terms -- from poor countries to rich countries, from fast growing countries to slow growing countries, from countries that offered a high return on financial assets to countries that provided a low return and, increasingly, from autocracies to democracies. This unusual – even unnatural – pattern of global capital flows has not been the product of private investment decisions. Private demand for emerging market assets, until very recently, has been strong – and in many ways stronger than private demand for US financial assets. The current flow of capital flows from emerging economies to the US is a reflection of unprecedented growth in the foreign assets of emerging market governments.

The US slowdown, together with the rise in oil prices, initially intensified this pattern. The growth in the foreign asset growth of the major emerging markets rose from around $800 billion a year in 2006 to an annual pace of around $1.5 trillion. In the past month, a welcome fall in oil prices combined with a reduction private inflows to the emerging world to slow the pace of official asset accumulation. Yet so long as the oil-exporters and China continue to run large external surpluses, key emerging market governments can be expected to continue to accumulate foreign assets and to provide large amounts of financing to the US.

A sharp reduction in central bank purchases of US debt – absent an offsetting increase in private demand for US financial assets -- would lead US interest rates to rise, possibly significantly. Central banks and sovereign funds, in my judgment, have been willing to accept a lower interest rate on their dollar holdings than private investors would require to provide an equivalent amount of financing. A sharp, sudden fall in official demand for US assets is consequently is not in the United States' interest. At the same time, the goal of US policy should not be to sustain a large deficit through ongoing financing from central bank and sovereign funds. A world where China's government continues to add roughly $700 billion to its foreign assets a year at a time of record growth in the foreign assets of the world's large oil-exporting economies is unlikely to be a world that evolves in ways favorable to US interests.

The debate over sovereign funds should not be limited to a debate over whether the CFIUS process strikes the right balance between protecting US security interests and maintaining capital inflows. That leaves out the question of whether the same policies – exchange rate intervention, stockpiling the oil windfall in government hands – that have fueled the growth in sovereign funds also hinder global adjustment. It also ignores the potential shifts in geopolitical influence associated with a world where the US relies heavily on other governments for financing. The national security implications of relying so heavily on central bank demand to finance the United States' fiscal deficit and the "Agencies" (Freddie Mac, Fannie Mae, Ginnie Mae, the Federal Home Loan Banks) purchases of private mortgages warrant at least as much attention as the national security implications of sovereign wealth fund investments in US banks. The US should aim to bring its external deficit down to a size than can more easily be financed by private demand for US financial assets.

My testimony will emphasize three key points:

- The majority of the growth in "official assets" continues to come from the growth in central bank reserves, not the growth in sovereign funds. This is true both for China and the oil-exporting economies – the two main centers of official asset growth. While the purchase of large stakes in US and European banks late last year and earlier last year attracted enormous attention, the magnitude of these investments remains small relative to central banks' ongoing purchases of US Treasury and Agency bonds. A narrow focus on the national security concerns that arise from direct investment is a mistake; there is a risk that the US now needs central bank financing more than some countries need more central bank reserves.
- It is getting harder, not easier, to assess how central banks and sovereign funds influence global and US markets. A rising share of the total growth in central bank reserves comes from countries that do not disclose data on the currency composition of their reserves to the IMF. A few large sovereign funds do not disclose their size, let alone information about the currency composition of their assets. As a result, we know less about how sovereign investors are impacting markets than we used to. Without a significant increase in the transparency of sovereign funds – along the lines proposed by Ted Truman – any further shift in official asset growth toward sovereign funds will reduce the transparency of the international financial system. It is not clear whether the new Generally Accepted Practices and Principles (GAPP) for sovereign wealth funds will result in this kind of shift.
- Both the set of countries with sovereign funds and the investment styles of sovereign wealth funds are evolving rapidly. Until recently, the set of countries with large sovereign wealth funds – as opposed to state pension funds -- was generally quite rich, very small and strategically dependant on the US for protection from larger regional neighbors. Looking forward, though, the largest sovereign funds are likely to come from countries that are much poorer, much larger and much less aligned with the US that the countries with the largest existing funds. At the same time, the increased size of sovereign funds and emergence of new players has led to a proliferation of investment styles – with some funds using leverage, taking large stakes in individual companies and making external investments intended in part to support economic development. There is little the US can do to change this, but it does suggest the need for ongoing scrutiny of sovereign investment.

Let me turn to each point in turn.

***Central banks and risk-averse flows still dominate***

In the four quarters that end in June 2008, central banks, sovereign wealth funds and state banks likely added $1.5 trillion to their total assets – a sum roughly twice the size of the US current account deficit. There is more uncertainty about the increase in the dollar assets of central banks and sovereign funds over the last four quarters, but the total increase could have exceeded $1 trillion. Not all of that made its way into US assets, but

much did. It is possible that the buildup of dollar assets by sovereign funds and central banks – counting funds that they have handed over to private fund managers – provided all the funds needed to support the United States current account deficit and ongoing purchases of foreign assets by US residents over the last four quarters (see Chart 1 and 2). The monthly US capital flows data systematically understates official inflows as a result of flows through London and the use of private fund managers.

The exceptional pace of current official asset growth is a by-product of a second feature of the current environment: Asia, which imports oil, is adding more to its foreign assets than the oil exporters (See Chart 3). During previous oil shocks, Asia's current account balance deteriorated and the increase in the growth of the official assets of the oil exporter was matched by a fall in the growth in the official assets of Asian oil-importers. The combination of large surpluses in the oil-exporting regions of the globe and oil-importing Asia necessarily implies large deficits in other oil-importing regions.

The scale of the increase in China's foreign assets over the past 12 months is truly mind boggling. The foreign assets of the People's Bank of China – counting a line item called "other foreign assets" –increased by $680 billion between June 2007 and June 2008. That total includes some valuation gains on China's existing holdings, but it excludes funds shifted to China's sovereign wealth fund, the China Investment Corporation and some funds shifted to the state banks. It is reasonable, in my judgment, to think that China alone added close to $750 billion to its foreign assets – a total that likely implies a roughly $450 billion increase in China's dollar assets (Chart 4). If China's likely purchases through London and Hong Kong are factored into the US data, it is not unreasonable to think that China added between $325 and $350 billion to its Treasury and Agency holdings over this period (Charts 5 and 6). China's total foreign asset growth almost certainly exceeded the combined increase – excluding valuation gains (and losses) in the central bank reserves and sovereign funds of the oil-exporting economies.

While the rise in oil prices – and, to a lesser degree, the creation of the China Investment Corporation (CIC) – have increased the funds available to sovereign wealth funds, central banks still hold far more assets and account for more of the growth in official assets than sovereign funds. The average monthly increase in central bank's custodial holdings at the New York Federal Reserve in 2008 easily exceeds total sovereign wealth funds investment in US banks and broker-dealers.[2] As a result, the pattern of central bank purchases continues to have a bigger impact on financial markets than the actions of sovereign funds. The central bank "buyer's strike" on Agency bonds in the month of August is an obvious example. While public attention has focused on the willingness of sovereign wealth funds to take risk, recent moves in financial markets reflect – at least in part – a sharp increase in central bank demand for Treasuries and other safe assets. Most sovereign equity holdings currently seem to be managed by private fund managers and

[2] Sovereign wealth funds have injected about $35 billion of equity capital into Merrill Lynch, Citigroup and Morgan Stanley. That total would rise if the funds sovereign have provided to UBS and Barclays are counted. The average monthly increase in central banks' custodial holdings of Treasury and Agency bonds at the Federal Reserve Bank of New York is above $40 billion.

thus do not appear in the US capital flows data as official flows. But the fall in total foreign purchases of US equities – counting the capital injected into US banks and broker-dealers by sovereign funds – is indicative of a broad reduction in sovereigns' appetite for risk over the last 12 months. This flight from risk intensified recently; net purchases of US equities over the last few months have been close to zero, while purchases of Treasury and until very recently Agency bonds increased (Chart 7).[3]

The global pace of official asset growth clearly slowed last month, as the price of oil fell and private capital began to move out of some emerging economies. However, the underlying surplus of China and the oil exporters remains large. That implies continued growth in the foreign portfolios of central banks and sovereign funds and ongoing official demand for US assets, even if those flows are somewhat more subdued than a few months ago.

**Less transparency**

The increased scale of official asset accumulation suggests that official investors have a greater capacity to influence markets than before. Official purchases of "safe" US assets - -notably Treasury bonds – have likely reached record levels over the past 12 months, as there is good reason to think that central banks account for the majority of Treasury and Agency bonds purchased by London. If that is the case, total central bank purchases of Agency and Treasury bonds reached $500 billion over the 12 months through June. This is higher than back in 2003 and 2004, at the peak of Japanese intervention in the foreign exchange market. Some studies suggest that central bank demand reduced the interest rate on the ten-year Treasury note by over 100 basis points in 2003 and 2004. Data limitations make it difficult to make a comparable assessment now, but it isn't unreasonable to think that central bank purchases of Treasuries and Agencies currently have a similar impact on the market.[4]

The difficulties estimating central bank purchases of Treasuries and Agencies highlight a more general problem: the quality of the data on the activities of central banks and

[3] The latest Treasury data on the composition of capital inflows comes from the month of June; central banks started to lose confidence in the Agencies in mid July. The capital flows data for August likely will show strong evidence of a shift from Agencies toward Treasuries. Such a shift already apparent in foreign central banks' custodial holdings at the New York Federal Reserves Bank.

[4] Japanese purchases of Treasuries didn't to register in the TIC data as official purchases and Japan purchased few Agencies. Chinese purchases more Agencies and its purchases do not tend to register in the monthly TIC data as official purchases; rather they tend to show up only in the Treasury's annual survey. As a result, there is a growing gap between measured official flows in the monthly TIC data and the increase in official holdings in the annual survey data – as well as a consistent gap between the TIC data and the Federal Reserve's custodial data. The balance of payments data is revised after the survey data, but the monthly TIC data is not. On the assumption that Chinese US bond purchases are now close to $350b – the amount required to keep the dollar share of China's reserves roughly constant – China alone would be having an impact on the US market comparable to the impact all Asian central banks together had back in early 2004. Francis Warnock has estimated that such demand lowered US long-term rates by more than 100 basis points. It consequently is not unreasonable to think Chinese demand is reducing US interest rates by 50 to 100 bp. Such an assessment though requires combining two controversial estimates, as there is debate over both the scale of Chinese purchases and the market impact of central bank purchases.

sovereign funds has deteriorated markedly since 2003 (Chart 8). Global reserve growth has shifted from countries that generally meet the IMF's Special Data Dissemination Standard (SDDS) for reserve disclose and report data on the currency composition of their reserves to the IMF to countries that do not. Over the last four quarters, countries that do not disclose data on the currency composition of their reserves to the IMF accounted for slightly more of the increase in global reserves than countries that report the currency composition of their reserves to the IMF. The IMF data templates were also designed for a time when it was assumed that reserves would be held in fairly safe assets – and thus are not able to help evaluate whether central banks have been, for example, increasing or reducing their (aggregate) holdings of equities. Central banks do not need to keep their aggregate equity holdings a secret: both Norway and the Swiss National Bank disclose the bond/ equity split as well as the currency composition of their reserves portfolio. If more countries disclosed this data, whether publicly or privately to the IMF, it could be aggregated and reported.

Moreover, some countries seem to have asked their state banks to build up significant "reserve-like" foreign assets that are not counted in the official reserves data. The $200 billion increase in "other foreign assets" reported by the People's Bank of China is the obvious example.[5] This is the second most rapidly growing pool of official assets in the world over the last 12months – as it is topped only by the increase in China's formal reserves.

The shift in reserve growth toward central banks that fall short of current best practice for reserve disclosure has been augmented by a second trend: many sovereign funds disclose less data, and less timely data, than most central banks. Ted Truman's work has illustrated that standards for disclosure for sovereign funds are far from uniform: Norway's fund discloses far more than a typical central bank; others disclose far less. But a few large sovereign funds have never disclosed their total size, let alone their portfolio composition. If the standard of disclosure by sovereign funds does not change, and if more of the growth in governments' foreign assets is channeled through sovereign funds, the transparency of the international financial system will fall.

The absence of data about the currency and portfolio composition of a growing share of central bank reserves and a majority of the assets of sovereign funds calls into question the often made statement that sovereign funds have had a stabilizing effect on the market. That may be the case, but it difficult to demonstrate in the absence of solid data on how central banks and sovereign funds have adjusted their aggregate portfolios during the crisis. Indeed, it is quite likely that a retreat from risk assets by many central banks and some sovereign funds (particularly after initial losses on their investments in the banks) has offset some of the positive effect of the capital sovereign funds provided to US and European financial institutions.

[5] The growth in "other foreign assets" of the People's Bank of China seems to correspond with the increase in China's reserve ratio; it likely reflects the dollars the state banks now hold with the PBoC to meet this requirement.

The content of the new Generally Accepted Practices and Principles (GAPP) for sovereign wealth funds have not been made public. This makes it difficult to determine whether these principles will address these concerns. Some recent improvements in sovereign fund transparency have been modest: the agreement between the Treasury and ADIA did not include any commitment to disclose the size of ADIA – and little information has been disclosed about the broad contours of ADIA's portfolio. Other changes have gone in the wrong decision: over the past year, China has taken a series of policy decisions that have had the effect of making the growth in its foreign assets far less transparent. Assessing how sovereign funds are influencing the overall market doesn't require that sovereign funds disclose their holdings of individual companies. It does require consistently disclosing – with an appropriate lag – their size and basic information about the allocation of a country's external portfolio across different asset classes.

***New countries, new strategies***

Today's large sovereign funds are generally found in the countries that are:

- Rich
- Small
- Strategically allied with the US
- With the exception of Norway, not democracies

Arpana Pandey of the Council of Foreign Relations and I plotted sovereign wealth fund transparency – using Ted Truman's ranking – against the Economist's index of democracy and an index of a country's strategic ties to the US.[6] There is a clear correlation between "democracy" and "sovereign fund transparency" – but no correlation between a country's strategic ties with the United States and its transparency (Charts 9 and 10).

However, the enormous increase in the size of sovereign wealth funds many investment banks now project is not possible if the expansion of sovereign funds is limited to the Gulf's small monarchies, Singapore and Norway. These projections implicitly assume that a growing share of the increase in the foreign assets of the governments of China, Russia and Saudi Arabia will be challenged through sovereign funds rather than central banks.

The set of countries that recently have created sovereign funds are, generally speaking, also much larger, much poorer and less closely aligned with the US than the set of countries that currently have large funds. Russia has a far larger population relative to its oil production than a country like Norway – let alone Abu Dhabi. It also is far poorer. Saudi Arabia is also poorer than the small Gulf monarchies. And China is poorer still: The average per capita income of the countries that currently host the five

[6] This is based on a country's willingness to host US bases as well as formal treaty commitments.

largest funds is over $50,000 (PPP); China's per capita income is still only around $5,000 in PPP terms, and less at market exchange rates.

As the composition of the countries with sovereign funds changes, the way sovereign funds typically invest could also change. Indeed, some countries with large existing funds already seem to be changing the way they invest -- several countries in the gulf now place a premium on investments that can be argued to support their countries' efforts to develop and diversify their own economies. Here it is important to note that the most obvious way to support domestic economic development is to invest more at home, and to build up a smaller foreign portfolio. The decision to build up foreign assets, whether to prevent exchange rate appreciation as a part of China's strategy of supporting its export sector or to try to limit the risk that an oil windfall will lead to a large real appreciation and "Dutch disease,' implies investing abroad rather than at home. But this doesn't preclude making investments abroad that can be argued to further a country's development plans, to enhance its regional profile or to help secure mineral or other strategic resources.

Two cases, one at each end of a ranking of sovereign investors by per capita income, are instructive: Abu Dhabi and China.

Abu Dhabi's sovereign fund – ADIA – is generally believed to be the largest fund in the world. Both Abu Dhabi's emir and the IMF have indicated that the widely reported estimate that it has $800 billion in foreign assets are too high; especially after some of its assets were spun off to a new, smaller fund, a more realistic estimate, in my view, would puts its total foreign assets in vicinity of $500 billion. ADIA isn't renowned for its commitment to openness, but it is generally thought that its portfolio has been modeled on the portfolio of a large US or European pension fund -- or perhaps the portfolio of a US university endowment. It traditionally has relied heavily on external fund managers, avoided taking large positions in individual companies and shied away from flashy domestic investments. It also is thought to have significant investments in private equity funds and hedge funds.[7]

Abu Dhabi though seems to have made a conscious decision to broaden the way it invests not by changing ADIA's investment style but rather by creating a host of new funds and ambitious state firms. Several of these funds have a much stronger focus on supporting Abu Dhabi's efforts to diversify its economy away from oil (and capture some of the attention that its less wealthy neighbour Dubai has gathered). A new fund, the Abu Dhabi Investment Council (the "Council") was set up to manage ADIA's regional investments, but it already has made forays into the US and Europe. Another fund, Mubadala, has made a series of investments designed to support Abu Dhabi's domestic tourist industry (notably by an investment in Ferrari linked to Ferrari's willingness to build a theme park in Abu Dhabi) and aircraft parts industry. Taqa – a state-owned firm that some suggest should be viewed as another sovereign fund -- has been buying oil and gas facilities globally – a strategy doesn't obvious help to reduce Abu Dhabi's exposure

[7] Both the 2008 Business week and 2006 Euromoney profiles of ADIA provide more information about ADIA's portfolio than its website.

to swings in commodity prices. Several of these new institutions, it should be noted, explicitly use leverage.

Like Abu Dhabi, China has begun to experiment both with new investment strategies and new institutions for managing its rapidly growing foreign assets. And, as with Abu Dhabi, trying to fit these activities into a single coherent strategy is difficult.

In 2006, China shifted – through the use of foreign exchange swaps with the domestic banking system – the management of up to $100 billion of its foreign exchange reserves to the state banks. The state banks previously had received $75 billion of China's reserves as part of their recapitalization. These funds appear to have been invested in bonds that yield a bit more than US Treasuries. After taking losses on some of these investments during the subprime crisis, though, China's data indicates that the state banks have been shrinking their foreign securities portfolio. China also has created a sovereign fund – the CIC – that at least initially was willing to take significant risks with its external portfolio.[8] However, after seeing the current market value of its investments in Blackstone and Morgan Stanley slide, it too seems to have become more cautious: Stephen Green of Standard Charted recently reported that the CIC has discovered that it could "lend out some its huge dollar reserves domestically for huge premiums on top of LIBOR, … at substantially less risk than investing abroad."[9] China's central bank – through the State Administration of Foreign Exchange – has supposedly been given the authority to invest up to 5% of its foreign assets in equities. That implies it could have an equity portfolio of up to $100 billion – a sum that places it among the world's largest sovereign equity managers.

Finally, Chinese state firms have been increasing their investment abroad – often with the support of China's state banks. Chinalco's (a state owned aluminum company) purchase of a large stake in the Anglo-Australian mining firm Rio Tinto was financed in part by a large loan from the China Development Bank. And the China Development Bank had just received a large infusion of foreign exchange from the China Investment Corporation as part of its recapitalization. At this stage, it isn't clear fully whether the China Investment Corporation will primarily be a passive external portfolio manager, a vehicle for managing the state's stake in China's domestic state banks or a vehicle for indirectly channeling funds to Chinese firms looking to expand abroad. China itself probably doesn't know. And even if China opts to limit the CIC's support for state firms, it could easily create another vehicle for channeling funds to state firms looking to expand abroad. China's government is not cash-constrained.

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[8] Roughly $70 billion of the $210 billion China's Ministry of Finance raised for the CIC was used to purchase the PBoC's existing stakes in the state banks. Another $20 billion was injected into the China Development Bank, and additional $20 to $30 billion has been set aside to recapitalize the Agricultural Bank of China. The CIC is reportedly still in the process of selecting portfolio managers to manage its remaining funds; its impact on global markets to date has been limited.

[9] The CIC can only help the PBoC sterilize China's reserve growth if it manages a true foreign portfolio – or if its domestic loans to China's banks and state firms finance a buildup of their foreign assets. Green's report raises questions about how effectively the CIC and the PBoC are coordinating their activities.

In his past testimony before the Senate Banking Committee, Ted Truman noted that the "dramatic increase in the role of governments in the ownership and management of international assets" was "disquieting" to the US, as "it calls into question our most basic assumptions about the structure and functioning of economies and the international financial system .... We presume that most cross-border trade and financial transactions will 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 out understanding of the world." The complex inter-relationship between China's sovereign fund, China's state banks and its state firms is a prime example.

Generalizing about the investment strategies of sovereign funds ("don't use leverage," "passive long-term investors," "interested only in returns") is becoming harder as new countries create new funds – and countries with large existing funds experiment with new investment strategies. Focusing solely on sovereign funds is mistake. China's central bank now has one the biggest sovereign external equity portfolios in the world. Investments by state banks, state firms and new sovereign investment vehicles that are interested in taking large stakes in individual companies likely pose more security risks than passive investments by traditional sovereign funds.

At this stage, further revisions to the CFIUS review process do not appear to be necessary. Nor is the CFIUS process the only way of regulating sovereign investment. The China Investment Corporation, because if its ownership of the Chinese state banks, had to apply for an exemption from certain provisions of the US bank holding company act when ICBC and CCB, two of China's largest state banks, sought to establish US branches. The Federal Reserve granted this exemption, but it also indicated that it would monitor the ICBC lending for transactions with related parties. The Federal Reserves' letter – at least in my reading, and I most certainly am not a lawyer -- seems to restrict the CIC's ability to take a large stake in a U.S. bank so long as it also owns China's state banks.[10] That seems reasonable: China's recent propensity to use the state banks as a vehicle for holding some of the reserves accumulated to support its exchange rate policy suggests that its state banks continue to be managed on less-than-commercial principles.

One final point is worth making. Many governments clearly expected the US government to protect their central banks from taking losses on their holdings of the bonds issued by Freddie Mac and Fannie Mae. It is, unfortunately, not inconceivable that the US government might need to take over a US bank or broker-dealer owned in part by a sovereign wealth fund (or state bank) at some point in the future. The US should make clear that it will not protect sovereign investors in the banking system in such an event even if this complicates the banks' current efforts to raise capital.

***Conclusions***

[10] Letter from Robert deV. Frierson, Deputy Secretary of the Board of Governors of the Federal Reserve System to H Rodgin Cohen, Esq. The letter notes: "CIC and Huijin and any company, including any foreign bank, that is controlled by CIC or Huijin (either separately or in combination) are required to obtain prior Board approval to make a direct or indirect investment in 5 percent or more of the voting shares of a bank holding company or a U.S. bank ... "

Governments now account for a large share of gross capital inflows to the United States. Chinese purchases have been especially large. Most of this inflow, particularly in the last six months, has gone into the Treasury and Agency bond market. This has reduced concerns associated with large scale investment by government funds in US firms. But it remains likely that, over time, foreign governments will increase their equity holdings, particularly if official asset growth remains at its current elevated levels.[11] China alone could, if it so desired, easily purchase more than $200 billion of US equities a year – more than all foreign investors combined in 2007, let alone in 2008. Such a shift, if it materializes, will pose challenges to US policy. But so too have large purchases of U.S. bonds by central banks and sovereign funds; the recent difficulties of Freddie Mac and Fannie Mae are an obvious example. The best way to address these concerns is the obvious: policy shifts here in the US and abroad that would reduce surpluses abroad and deficits here, and bring the US external deficit back to a level that could be more easily be financed by private demand for US assets.

CHARTS

CHART 1 – Emerging market reserves growth and current account balances as a share of World GDP

[11] China's holdings of equity remain very small relative to its holdings of bonds – and relative to foreign holdings of Chinese equity. Total Chinese direct investment abroad at the end of 2006 totaled $82.4b, while foreign direct investment in China totaled $544.2b The roughly $30b in outward direct investment by Chinese firms in 2007 is still significantly smaller that the over $80b in inward direct investment by foreign firms in China. Foreign portfolio equity investment in China was $106.5b at the end of 2006 while Chinese portfolio equity investment abroad was $1.5b It is likely that China will want to move toward a more balanced portfolio over time. This shift though will be difficult so long as China's government accounts for all of China's foreign investment.

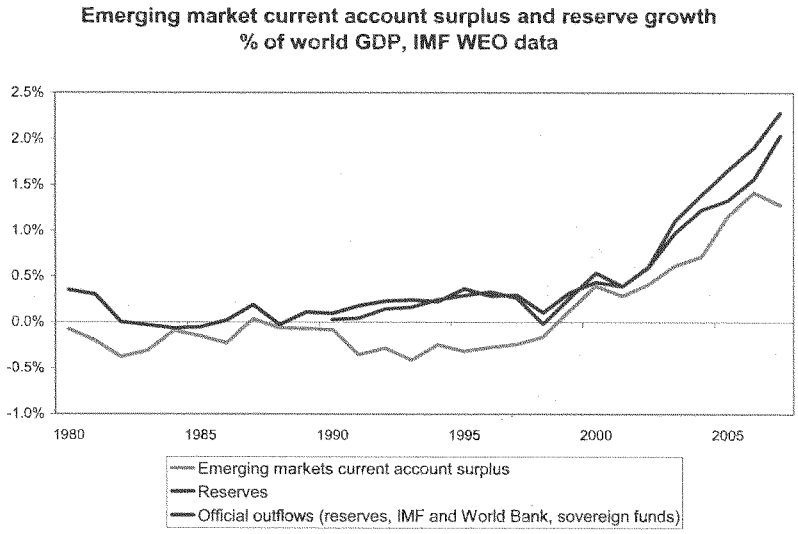



CHART 2 – Estimated increase in central bank and sovereign fund assets

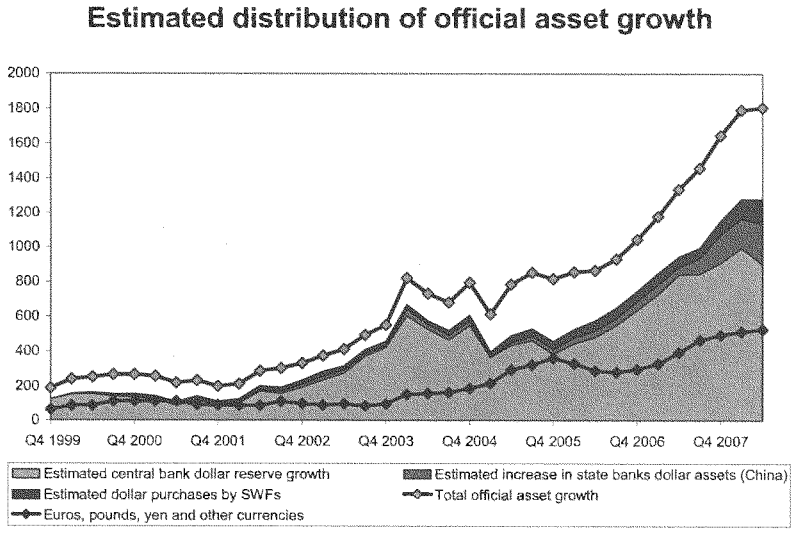


CHART 3 – Growth in the foreign assets of central banks and sovereign funds in Asia relative to central banks and sovereign funds in the oil exporting economies. Rolling 4q sums

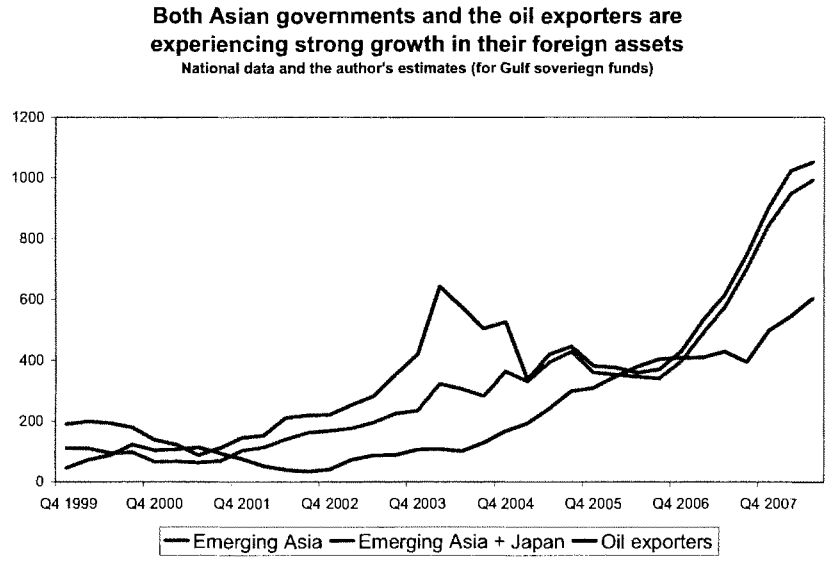



CHART 4 – Estimated dollar reserve growth v US financing need (Current account deficit and long-term capital outflows). Data is presented as a rolling four quarter sum in $ billion. Estimate for official asset growth come from the author.

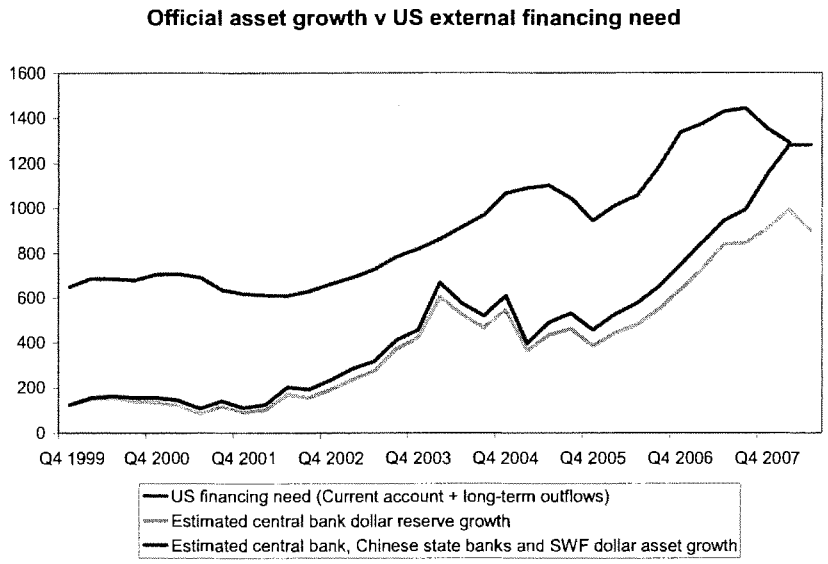



CHART 5 – China's current holdings of US Treasury and Agency bonds, including likely purchases through the UK

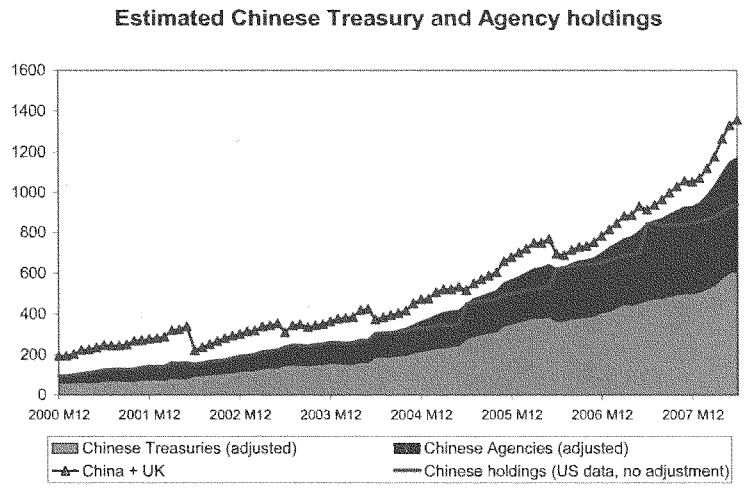



CHART 6. Estimated Chinese purchases of Treasury and Agency bonds, including likely purchases trough the UK

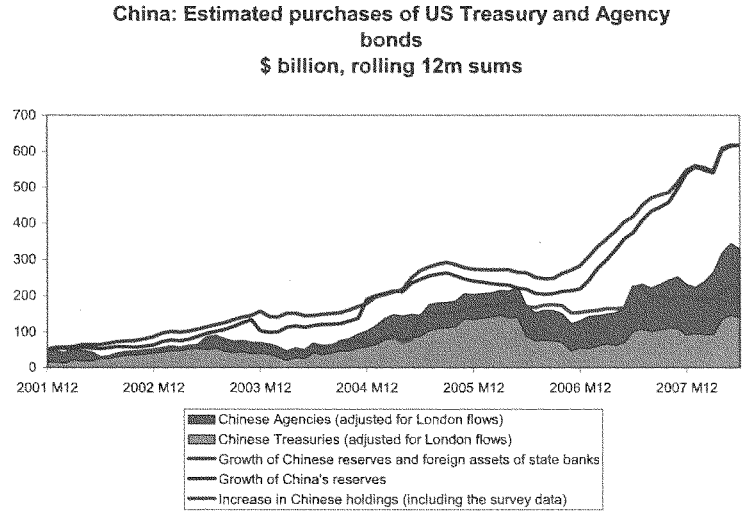


CHART 7. – High-frequency capital flows data. US Treasury capital flows data.

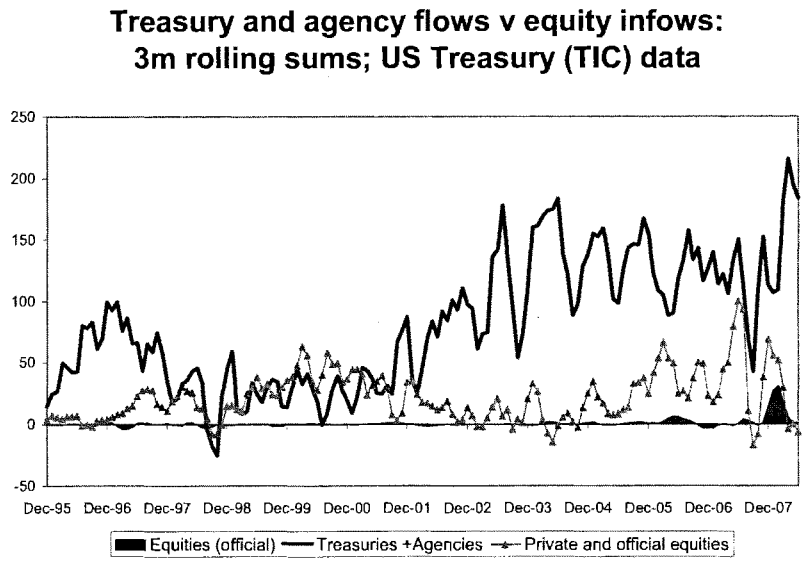



CHART 8 –Deteriorating quality of aggregate data on central banks and sovereign funds. Data from the IMF (COFER) and the author. Central banks that disclose more information than central banks disclose to the IMF are considered transparent.

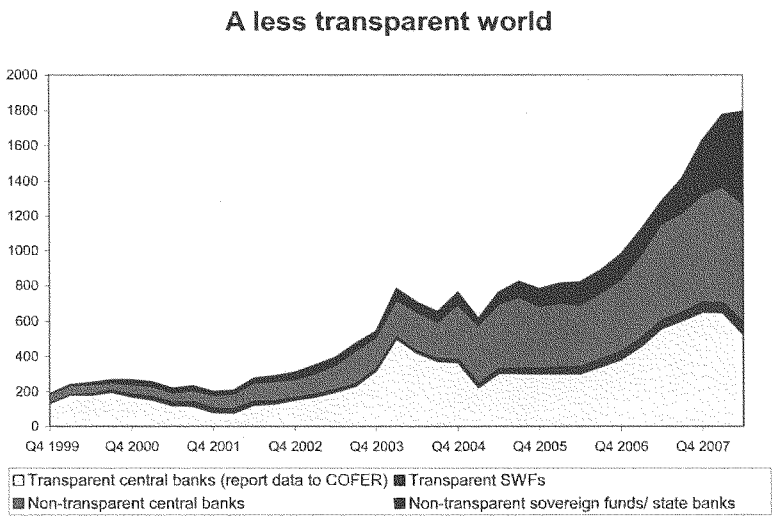



CHART 9 –Sovereign fund transparency v. the form of government of their home country

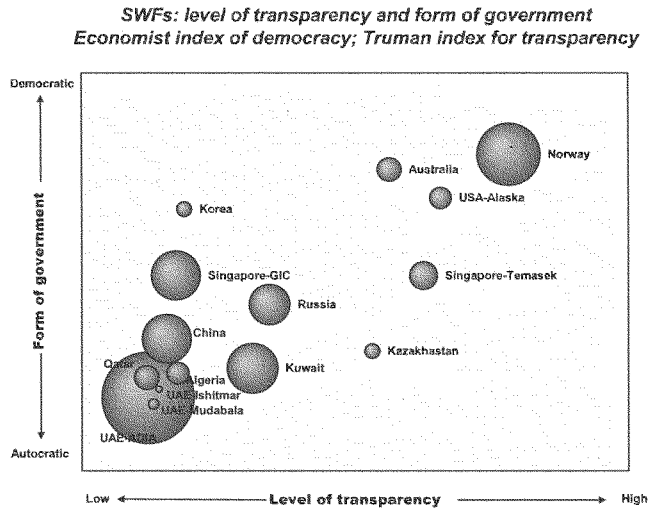
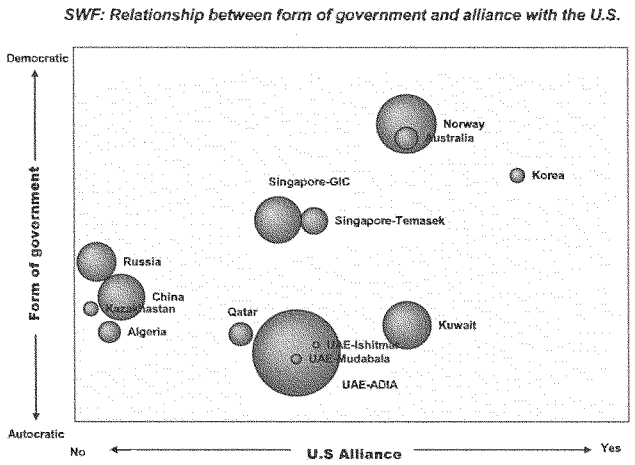


CHART 10 – Sovereign fund transparency v. their home country's strategic ties to the US



# Sovereign Wealth Funds: New Challenges from a Changing Landscape

Testimony before the Subcommittee on
Domestic and International Monetary Policy, Trade and Technology
Financial Services Committee
U.S. House of Representatives

September 10, 2008

Edwin M. Truman
Senior Fellow
Peterson Institute for International Economics

Chairman Gutierrez and members of the Subcommittee on Domestic and International Monetary Policy, it is a pleasure to testify before you today on the challenges posed by sovereign wealth funds.

The broadest definition of a sovereign wealth fund (SWF) is a collection of government-owned or government-controlled assets. Narrower definitions may exclude such assets as government financial or non-financial corporations, purely domestic assets, foreign exchange reserves, assets owned or controlled by sub-national governmental units, or some or all government pension funds. However, it is useful to keep these broader concepts in mind when discussing SWFs. The reason is that many of the anxieties that are conventionally associated with SWFs, narrowly defined, more appropriately are concerns about the management of government assets other than those of sovereign wealth funds.

The accountability of SWFs has been the focus of my research and analysis. I use "sovereign wealth fund" as a relatively broad descriptive term for a separate pool of government-owned or government-controlled assets that includes some international assets. I include all government pension, as well as nonpension, funds to the extent that they manage marketable assets. The basic objectives of both types of SWFs are essentially the same. They raise virtually identical issues of best practice with respect to government control and accountability regardless of their specific objectives, mandates, or sources of funding.

Sovereign wealth funds, on my terms, may be funded from foreign exchange reserves, earnings from commodity exports, receipts from privatizations, other fiscal revenues, or pension contributions. (Table 1 lists 56 sovereign wealth funds of 38 countries.) These funds have been around for more than half a century with a range of structures, mandates, and economic, financial, and political (primarily domestic, but in some cases maybe international) objectives – normally a mixture.[1] Consequently, it is perilous to generalize about sovereign wealth funds and any associated threats to U.S. economic and financial interests.

With that important qualification, my six summary conclusions are:

First, sovereign wealth funds are here to stay and likely to grow in their relative importance in the international financial system as financial globalization continues.

[1] Table 1 also lists the dates when the funds were established, the sources of their funding, and estimates of their size. The table includes 44 SWFs that I have identified that are not hard-wired to government pension funds and 12 representative pension SWFs. Note that the data in table 1, in the other tables attached to this testimony, and described in the text include the government pension SWFs of Chile and Thailand that were not part of the analysis presented in my *Blueprint for Sovereign Wealth Fund Best Practices* released as Policy Brief 08-3 by the Peterson Institute for International Economics, April 1, 2008.

Second, the U.S. economy is thoroughly intertwined with the global financial system on both the asset and liability side of our balance sheet through both the private and public sectors. We are a major player in the SWF game. It follows that advocates of formally regulating sovereign wealth funds should be careful what they wish for. Any regulations or other restrictions that are applied to foreign SWFs properly should be applied to our SWFs and would be applied to them by other countries.

Third, the most promising approach to dealing with the SWF phenomenon is via "reciprocal responsibility." Countries with SWFs should embrace a voluntary international standard of best practice along the lines of my scoreboard outlined below. Countries receiving SWF investments should strengthen the openness of their financial systems. At present more progress is being made by countries making SWF investments than by recipient countries. The financial turmoil that would result from an outbreak of financial protectionism would make recent events feel like a mere squall.

Fourth, it is fundamentally impossible to distinguish sovereign wealth funds by their degree of political motivation in their investment decisions. They are governmental entities, and governments are political.

Fifth, SWFs do not pose a significant new threat to U.S. economic and financial interests. As long as we put in place and maintain sound economic and financial policies, we control our own destiny. We have adequate mechanisms to address any potential national security posed by SWFs, or other forms of foreign government investment in this country. At this point they appear to be minimal.

Six, I am a bit uneasy about the possibility that some funds may exercise "undue influence" in connection with foreign governmental investments in our financial

institutions. I hope our existing processes can deal with the more heavily regulated portion of our financial system. Improvements in the accountability of large hedge funds, and private equity firms, which I favor, could help elsewhere.

* * * * *

It is useful to place the activities of sovereign wealth funds in a broader perspective. The size of global capital markets is at least $200 trillion.[2] A conservative estimate of financial assets owned or controlled by governments is $15 trillion, or about 8 percent of global financial assets.[3] Governments in the United States own or control more than $3 trillion (20 percent) of the global governmental total.[4] The United States is in the business of sovereign wealth management.

International assets owned or controlled by governments are at least $10 trillion: $6 trillion in foreign exchange reserves, $2.7 trillion in assets of nonpension SWFs, and at least $1.3 trillion in government pension funds.[5] Excluding our modest holdings of foreign exchange reserves, the international assets of U.S. SWFs are about $800 billion mostly in the form of the pension funds of state and local governments. The aggregate amount of international assets held by U.S. sovereign wealth funds is second only to the estimated SWF holdings of the United Arab Emirates.

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[2] International Monetary Fund, *Global Financial Stability Report*, April 2008, table 3 provides a figure of $190 trillion as of the end of 2006. The total includes stock market capitalization, public and private debt securities, and commercial bank assets.

[3] This estimate includes $6 trillion in foreign exchange reserves, $6 trillion in government pension funds (excluding the U.S. social security fund and government pension funds that invest exclusively in government assets or are not involved in the management of marketable assets), and $3 trillion in assets of nonpension sovereign wealth funds.

[4] U.S. governmental financial assets include $3 trillion in state and local government pension funds, $50 billion in other sub-national SWF assets, and $40 billion in foreign exchange reserves.

[5] Based on various estimates, government pension funds around the world hold about $6 trillion in assets and roughly 25 percent of those are foreign.

As an additional point of reference, at the end of 2007, U.S. total holdings of foreign assets were $15.4 trillion. About 93 percent was managed by the private sector. Foreign holdings of U.S. assets were $17.9 trillion. About 80 percent was managed by the private sector.[6] U.S. holdings of international financial assets are about 20 percent of the global total.

Over the past five years, the size of the global capital market has doubled, but asset holdings of SWFs have quadrupled. I expect them to continue to expand rapidly. The explosive growth of SWFs reflects the sustained rise in commodity prices as well as aspects of global imbalances. However, the increased international diversification of financial portfolios – the weakening investors' so-called home bias – is as least as significant as macroeconomic factors in explaining the growth of SWFs.

In my judgment, it is a mistake to conflate the important issues raised by the growth of sovereign wealth funds with the probably more serious issues raised by global imbalances, in general, and our large and continuing current account deficits, in particular. As evidence, consider the fact that in Germany there is great concern about sovereign wealth fund investments, but Germany is in perpetual current account surplus and has a positive net international investment position. SWFs are part of the ongoing globalization of the international financial system.

The increasing relative importance of SWFs has exposed two tensions.

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[6] U.S. and foreign data on the international stocks and flows of financial assets generally do not distinguish government from non-government investors. The above estimate of assets controlled by U.S. governmental units includes federal government assets as reported by the Commerce Department (The U.S. Net International Investment Position at Yearend 2006, Bureau of Economic Analysis, BEA 08-32, June 27, 2008) plus estimated holdings of $750 billion by state and local government pension funds that are included in our statistics among private sector assets. In the same Commerce Department release, foreign official assets in the United States include foreign exchange reserves and some holdings of sovereign wealth funds, but the data as collected do not distinguish between the two categories. The figures cited exclude, on the asset and liability side, the "gross positive fair value" of derivatives.

The first is the dramatic redistribution of international (or cross-border) wealth from the traditional industrial countries, like the United States, to countries that historically have not been major players in international finance. The newcomers have had little or no role in shaping the practices, norms, and conventions governing the system. Consequently, the leaders and citizens of many of those countries feel they have little stake in the health and stability of the international financial system.

The second is the fact that governments own or control a substantial share of the new international wealth. This redistribution from private to public hands implies a decision-making orientation that is at variance with the traditional private-sector, market-oriented framework with which most of us are comfortable even though our own system does not fully conform to that ideal; witness the current tribulations of our so-called government sponsored agencies.

These twin tensions, in turn, are manifested in five more specific concerns.

First, home governments may mismanage the international investments of their SWFs damaging their own economic and financial health and stability, including via large-scale corruption in handling the huge amounts involved. It is a well-known, though often ignored, regularity that governments are not good at picking economic winners; for example, government-owned banks tend to be less profitable than private banks. These concerns about financial mismanagement are the principal reason why it is in the interests the citizens of every country with a SWF to favor the establishment of internationally agreed SWF best practices.

Second, governments may manage their SWF investments in pursuit of political objectives – raising national security concerns – or economic power objectives—for

example, promoting state-owned or state-controlled national champions as global champions. Such behavior contributes not only to political conflicts between countries but also to economic distortions.

Third, financial protectionism may be encouraged in host countries in anticipation of the pursuit of political or economic objectives by the funds or in response to their actual actions. Development of and compliance with SWF best practices would help to diffuse this source of backlash against globalization. At the same time, countries receiving SWF investments should be as open as possible to such investments subject to the constraints of national security considerations narrowly defined.

Fourth in the management of their international assets, SWFs *may* contribute to market turmoil and uncertainty. They also *may* contribute to financial stability, but their *net* contribution is difficult to establish a priori, in particular if their operations are opaque but also because judgments can only be reached on a case by case basis.

Fifth, foreign government owners of the international assets may come into conflict with the governments of the countries in which they are investing. For example, government ownership adds a further dimension in balancing open markets and appropriate conventional microprudential, as well as the newly rediscovered macroprudential, supervision and regulation of the financial system.

At this point, these concerns, with the important exception of the first – potential adverse economic and financial implications for the countries with the SWFs – are largely in the realm of the hypothetical. The others are much more salient in the context of cross-border investments by government-owned or government-controlled financial or non-financial corporations. Nevertheless, a loud, often acrimonious, public discourse

about SWFs is underway in many countries, not only in the countries receiving SWF investments, but also in the countries making the investments.

The challenge is to make the world safe for sovereign wealth funds.

Starting in May 2007, I have advocated the establishment of an internationally agreed voluntary set of best practices for SWFs. My view was that the natural place to start was with the current practices of individual funds today. To this end, I created a scoreboard for 46 of the 56 funds listed in table 1, including the 12 pension SWFs.[7] The scoreboard rates funds on their current practices and includes 33 elements grouped in four categories: (1) structure, (2) governance, (3) accountability and transparency, and (3) behavior. We have the funds based on systematic, regularly available, public information. At least one fund receives a positive score on each element. In fact, at a minimum, several do.

Table 2 attached provides a summary of the scoreboard results for all elements and for each of the four categories.[8] Let me offer a few summary observations:

First, all sovereign wealth funds are not the same. Nor is there one cluster of "good" funds and another cluster of "bad' funds. The overall scores range from 95 to 9 out a possible 100. The rating of each fund can be improved.

Second, the funds are in three broad groups: 22 funds with scores above 60, 14 funds with scores below 30, and 10 funds in a middle group. The top group includes funds of a number of developing countries, including Thailand (84), Timor-Leste (80), Azerbaijan (77), China's pension fund (77), Chile (71), and Kazakhstan (71). The middle

[7] We scored the two new Russian SWFs as the single fund it was before its recent transformation. The remaining nine funds, indicated by "c" in table 1, are either too new to score or we could not find sufficient information to do so.

[8] Table 3 provides the results for each fund on each element. The appendix provides a list of the 33 elements.

group includes funds of non-industrial countries as diverse as Russia (51), Mexico (49), Kuwait (48), and Singapore, whose two funds are in this group (45 and 41). Singapore's two funds have close-to-identical overall scores, but their scores differ on several individual elements. The bottom group includes two funds from Abu Dhabi (15 and 9) each of which, nevertheless, reportedly has an excellent reputation in financial markets.

Third, as you can see from table 2, there is a strong correlation (0.967) between the total scores for the 46 SWFs and the category of accountability and transparency. Many commentators like to stress the *transparency* of SWFs, but in my view the central issue is their *accountability* to their own citizens (as direct or indirect owners of the assets), to citizens (including government officials) in the countries in which they invest, and to participants in financial markets. Transparency is only a means to this end.

Fourth, 11 nonpension SWFs have estimated assets more than $60 billion. We scored nine of these funds.[9] Two are in the top group (those of Norway (92) and Hong Kong (67)) and two are in the bottom group (one in Abu Dhabi (9) and one in Qatar(9)).

Fifth, again focusing on the nine largest nonpension funds that we scored, four funds say that their investment decisions are made exclusively by investment managers (Norway (92), Kuwait (48), and the two Singapore funds (45 and 41)). We could find no such statements for the other five funds (Hong Kong (67), Russia (51), China's investment corporation (29), Abu Dhabi (9), and Qatar (9)).[10]

Taking this information at face value, would it be right to infer that in the first four cases there is no political influence on investment decisions and in second five cases

[9] The two funds that we did not score are in Saudi Arabia, whose reported non-reserve assets are regarded by some as a de facto SWF, and in Dubai, in which case we could not find enough information about its Investment Corporation.

[10] One should not necessarily conclude from this evidence that there is higher-level interference in investment decisions in these funds; their governance policies are unclear on this point.

investment decisions are guided by political considerations? Quite frankly, I doubt it. In the latter cases, it is reasonable to conclude that the political authorities may influence, guide, or approve major investment decisions. We know that is the case for China Investment Corporation.

In the former cases, it is difficult to conclude that political considerations are completely absent from investment decisions. For example, it would be a stretch to imagine that the investment managers in Singapore's Government Investment Corporation or Temasek did not consider the potential international (and domestic) political ramifications of their large investments in foreign financial institutions before they committed to making them. This observation merely reinforces my earlier point: when a government entity makes an investment decision (no matter how it is formally structured to insulate it from political pressures) its decisions will be interpreted at home and abroad through a political lens. Just ask the Norwegians about the brouhaha over their reported disinvestment in Icelandic government bonds!

Finally, although each of the 12 representative *pension* SWFs is in the top group, that group of 22 funds also includes 10 *nonpension* SWFs. Thus, it is not unreasonable, in my view, to hold nonpension SWFs to the standard of accountability of pension funds. Chile's pension and nonpension SWFs both score in the top group (71). On the other hand, China's National Social Security Fund is in the top group (77), but the China Investment Corporation is in the bottom group (29). It is reasonable to ask why the latter entity cannot be as accountable as is the former entity.

Turning to the issue of sovereign wealth funds and their potential to disrupt financial markets, any investor with a large portfolio has that potential whatever his or

her motivation. However, the very size of such portfolios helps to inhibit them from doing so, in other words, discourages them from shooting themselves in their feet.

At the same time, it is inappropriate in my opinion to view SWFs as cornucopias available to be tapped to rescue the U.S. or the global financial system. For every SWF investment in a U.S. financial institution, that fund has to disinvest, or not invest, in some other asset, normally in the United States or at least in U.S. dollars. If they invest in Citigroup, they don't invest in General Motors.

Some observers of private equity firms and hedge funds have concerns about their implications of such entities for the stability of our economy and financial system. I do not share most of those concerns though I have long favored increased accountability for large private equity firms and hedge funds. However, the facts do not support those who argue that SWFs are not like hedge funds and private equity firms in their speculative activities. Sovereign wealth funds invest in hedge funds, in private equity firms, and in other highly leveraged financial institutions whose activities, including the use of leverage, are indistinguishable from hedge funds and private equity firms. In effect, sovereign wealth funds are providing the capital that those firms subsequently leverage to generate high rates of return for the funds. They are no different from other investors except that their stakes may be measured in the billions rather than in the hundreds of millions of dollars.

Should we be concerned about SWF investments in U.S. financial institutions? In most countries, financial institutions are subject to special regulatory regimes, in part, because they are viewed as quasi-public utilities and, in part, because financial institutions have special privileges in the form of access to discount windows, deposit

insurance, and payments systems. The basic question is whether foreign government ownership, even if indirect or noncontrolling, is compatible with this special status.

Even in the case of a stake that is less than, say, 5 percent and not associated with board membership, will the government of the sovereign wealth fund that is a shareholder seek to exercise what I would call "undue influence" over the financial institution in its business and investment decisions? Or otherwise come into conflict with U.S. government regulators and supervisors? "Undue influence" is a vague term. Presumably all shareholders, exercising their shareholder rights, seek to influence the decisions of the entities in which they have stakes. Nevertheless, in my view, this is more of a problem in the case of investments in regulated financial institutions than in the case of investments in nonfinancial institutions, whose assets are less portable. Therefore, it is reasonable to ask the supervisors and regulators what procedures they have in place to reduce the probability that the government owners of sovereign wealth funds do not seek to exercise "undue influence" over the decisions of financial institutions in which they have significant stakes.[11]

At the same time, it is highly probable that foreign investors—governmental or nongovernmental—in U.S. financial or nonfinancial institutions will complicate the enforcement of U.S. securities laws. But this is a fact of life in the 21st century. It does not provide a sufficient basis for limiting or barring such investments. Financial markets are global. This reality presents enforcement challenges. Limiting portfolio investments to countries that are currently our friends does not eliminate potential problems. There is

[11] I also think it is reasonable to consider whether we need to improve the quality of our statistical information on US assets and liabilities of governments and government-owned or -controlled entities, including sovereign wealth funds. At present, we have very little, systematic information aside from liabilities that are lumped in with foreign exchange holdings.

often no consensus about who are our "friends," and today's friends may be regarded differently tomorrow. Moreover, as we learned in the case of Crédit Lyonnaise and Equitable Life, which involved the French government, blood is thicker than water.

What about those SWF investments in hedge funds and private equity firms? Are they a matter for concern? As I see it, in effect, the SWFs are hiring these entities to manage their investments and maybe to develop some additional expertise for the SWF as a byproduct. Whether one approves of such investments depends on one's view of the activities of hedge funds and private equity firms. Sentiment is not uniform on such matters. In my view, the principal concern is the nature of the contract between the SWF and the hedge fund or private equity firm. If it is an arms-length contract, then I would have no concern. If the SWF can direct and shape the investment policies of the entity, I would have more concern. As I said earlier, I favor greater accountability by large hedge funds and private equity firms in general, and not just to their counterparties but also to the general public and including about the nature of arrangements with their principal investors.

How should the U.S. Congress and the Administration address sovereign wealth fund investments in the United States? Notwithstanding my view that the greatest economic and financial risks associated with SWFs are to the citizens of the countries whose governments have accumulated the large stocks of international assets, authorities in the United States and other 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 in private institutions. At present, this is the exception not the rule for SWFs.

My interpretation of the recent exhaustive report by the Monitor Group on equity investments by sovereign wealth funds is that they are rather small in aggregate. The global total value of all "deals" from 2000 to the first quarter of this year was reported to be $250 billion, less than 10 percent of the assets of SWFs, and many of those deals did not involve controlling stakes.[12] However, one area of concern and potential conflict is the apparent use by a few countries, such as China and potentially Brazil, to use their SWFs to promote the expansion of their own economic enterprises.

Of course, the current, largely benign pattern could change, and foreign government-owned or government-controlled financial and nonfinancial corporations do acquire stakes in companies, including controlling stakes. The 2007 Foreign Investment and National Security Act (FINSA) revised the framework and procedures of the Committee on Foreign Investment in the United States (CFIUS). 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 to evaluate and, if necessary, to mitigate, to block, or to pursue any U.S. acquisitions or investment by a SWF or other foreign government entity to protect our national security or to enforce our laws and regulations governing financial markets and institutions.

With respect to economic security concerns, 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

[12] Miracky, Michael, Davis Dyer, Drosten Fisher, Tony Glodner, Loic Lagarde, and Vincent Piedrahita, "Assessing the Risks: The Behavior of Sovereign Wealth Funds in the Global Economy," Monitor Group, June 2008.

investment either internally or across borders, but on balance it promotes competition and efficiency.

The challenges posed by SWFs to the countries with the funds and to the international financial system require, in my view, a multilateral, two-pronged approach of what I would call "reciprocal responsibility" by the countries with the SWFs and by the countries receiving investments by them.

To this end, I have advocated the establishment of an internationally agreed voluntary set of best practices for SWFs. The news on this front is positive.

Last week it was announced that the IMF-sponsored International Working Group of Sovereign Wealth Funds had reached agreement in principle on Generally Accepted Principles and Practices (GAPP) for Sovereign Wealth Funds covering their institutional framework, governance, and investment operations – the so-called Santiago Principles. I do not think it is important whether the resulting document is called principles, practices, or both. I do not think it is important whether they are "generally accepted" or "best." What is important is the content, which we do not know yet. The reports I have read are encouraging. I am confident that the content will be less than perfect, but members of this committee understand that in politics compromise is necessary if you are going to get anything done. I will be surprised if the GAPP template does not "score" at least 70 on my scoreboard.

I believe that the IMF should be congratulated on facilitating an agreement in record time – less than a year since the first call by the IMFC (International Monetary and Financial Committee) and less than six months after the start of intensive work. It is significant that the agreement is expected to be embraced by 23 countries, including all

but one country with a nonpension SWF with more than $50 billion in foreign assets. (The exception is Hong Kong. Saudi Arabia was an observer, and as a formal matter does not have a SWF.) Over the next year, I expect that there will be a substantial improvement in the scores of most SWFs on my scoreboard.

I know that there are concerns about the voluntary nature of this agreement and about its enforcement. I would point out that very few international agreements have enforcement mechanisms, which does not mean that they are useless. Moreover, in the case of SWFs, we need to be sensitive to the risk of regulatory arbitrage. If too much emphasis is placed on sovereign wealth funds as defined in the Santiago Principles, countries will just disband their funds and conduct the same activities through more clandestine means.

The second prong of reciprocal responsibility regarding SWFs involves strengthening the investment frameworks of countries that receive SWF investments to ensure that appropriate investments are welcomed. This involves primarily the industrial or OECD countries. Again, doing so is in the interests of the recipient countries as well as the investing countries.

A less-well-publicized exercise to this end is underway in the OECD (Organization for Economic Cooperation and Development) headquartered in Paris. It seeks to build on existing Declarations and Codes of that organization. A June 4-5, 2008 OECD Ministerial Council Meeting in Paris adopted a Declaration on Sovereign Wealth Funds that weakly called for recipient countries not to erect protectionist barriers, not to discriminate among investors in like circumstances, and to restrict the use of safeguards

where are national security concerns are involved. The OECD process is not scheduled for completion until next year.

How are observers to judge results to date or in prospect and are they likely to be sufficient to provide comfort to countries that are not members of the OECD seeking to invest in those countries with their SWFs? I have three concerns.

First, OECD investment codes are binding only on investments from other members. Members commit to use their best efforts to extend them to nonmembers, but this is a potential loophole that should be closed.

Second, a country's decision to invoke the national security "exemption" from a policy of open investment is not subject to appeal or discussion even within the OECD as part of its so-called peer review process. The country alone makes the decision.

Third, more than half of OECD members have lists of sectors closed off from foreign investment. Links to national security for some of them are tenuous, for example maritime dredging and salvaging in the United States. It is noteworthy that Germany's proposed new foreign investment legislation will also have a test of "public order" as well as national security. Furthermore, Canada recently prevented Alliant Techsystems of the United States from buying the space technology division of MacDonald-Dettwiler, which specializes in satellites and space robotics. This seems like a questionable national security call for such close allies. As another example, Japan rejected the Children's Investment Fund's expanded investment in a Japanese power producer on the grounds of a potential disruption of "public order." Finally, New Zealand recently prevented the Canada Pension Plan from buying a substantial stake in the Auckland airport because the investment failed to meet the test of being a "benefit to New Zealand."

What are we to conclude from about the OECD efforts? My conclusion is that OECD members have more work to do.

In conclusion, the phenomenon of sovereign wealth funds is a permanent feature of our global economy and financial system. Their potential impacts on U.S. economic and financial interests may be disquieting, but they do not endanger our economy or financial system. U.S. authorities should exhaust all multilateral approaches to make the world safe for SWFs – in the form of SWF best practices and open financial environments – before turning to any additional, bilateral remedies for concerns that to date are largely imaginary.

**Table 1: Sovereign wealth funds**

| Country | Current Name | Date Established | Source of Funds | Current Size[a] (billions of US dollars) | |
|---|---|---|---|---|---|
| **NONPENSION FUNDS** | | | | | |
| Algeria | Revenue Regulation Fund | 2000 | Natural resources | 47 | |
| Azerbaijan | State Oil Fund of the Republic of Azerbaijan | 1999 | Natural resources | 2 | |
| Botswana | Pula Fund[d] | 1993 | Natural resources | 7 | |
| Brunei | Brunei Investment Agency | 1983 | Natural resources | 35 | (e) |
| Canada | Alberta Heritage Savings Trust Fund[d] | 1976 | Natural resources | 17 | |
| Chile | Economic and Social Stabilization Fund | 2006 | Natural resources | 15 | |
| China | China Investment Corporation[d] | 2007 | Foreign exchange reserves | 200 | |
| | Shanghai Financial Holdings[c,d] | 2007 | Fiscal surpluses | 1 | (e) |
| Gabon | Fund for Future Generations[c] | 1998 | Natural resources | 0.4 | (e) |
| Hong Kong | Exchange Fund Investment Portfolio[b,d] | 1993 | Foreign exchange reserves, fiscal surpluses | 139 | |
| Iran | Oil Stabilization Fund | 2000 | Natural resources | 10 | |
| Kazakhstan | National Fund for the Republic of Kazakhstan | 2000 | Natural resources | 23 | |
| Kiribati | Revenue Equalization Reserve Fund | 1956 | Natural resources | 1 | (e) |
| Korea | Korea Investment Corporation[b] | 2005 | Foreign exchange reserves | 30 | |
| Kuwait | Kuwait Investment Authority[d] | 1953 | Natural resources | 213 | |
| Libya | Libyan Investment Authority[c] | 2006 | Natural resources | 50 | |
| Malaysia | Khazanah Nasional[d] | 1993 | Fiscal surpluses | 18 | |
| Mexico | Oil Income Stabilization Fund | 2000 | Natural resources | 5 | |
| Nigeria | Excess Crude Account[b] | 2003 | Natural resources | 17 | (e) |
| Norway | Government Pension Fund – Global | 1990 | Natural resources | 375 | |
| Oman | State General Reserve Fund | 1980 | Natural resources | 13 | (e) |
| Qatar | Qatar Investment Authority | 2005 | Natural resources | 60 | (e) |
| Russia | National Wealth Fund[b] | 2008 | Natural resources | 32 | |
| | Reserve Fund[b] | 2008 | Natural resources | 128 | |
| São Tomé and Príncipe | National Oil Account | 2004 | Natural resources | 0.02 | (e) |
| Saudi Arabia | Saudi Arabian Monetary Agency[c] | 1952 | Natural resources | 270 | |
| Singapore | Government of Singapore Investment Corporation[b] | 1981 | Foreign exchange reserves, fiscal surpluses, employee contributions | 200 – 330 | (e) |
| | Temasek Holdings[d] | 1974 | Government enterprises | 110 | |
| Sudan | Oil Revenue Stabilization Account | 2002 | Natural resources | 0.1 | |
| Timor-Leste | Petroleum Fund | 2005 | Natural resources | 2 | |
| Trinidad and Tobago | Heritage and Stabilization Fund | 2007 | Natural resources | 2 | (e) |
| United Arab Emirates | Emirates Investment Authority[c] | 2007 | Natural resources | n.a. | |
| United Arab Emirates (Abu Dhabi) | Abu Dhabi Investment Authority and Council | 1976 | Natural resources | 500 – 875 | (e) |
| | International Petroleum Investment Company[c] | 1984 | Natural resources | 12 | |
| | Mubadala Development Company | 2002 | Natural resources | 10 | (e) |
| United Arab Emirates (Dubai) | DIFC Investments[c] | 2006 | Natural resources | n.a. | |
| | Dubai International Capital[c] | 2004 | Natural resources | 13 | |
| | Investment Corporation of Dubai[c] | 2006 | Natural resources | 82 | (e) |
| | Istithmar | 2003 | Natural resources | 12 | (e) |
| United States | Alaska Permanent Fund[d] | 1976 | Natural resources | 37 | |
| | Permanent Mineral Trust Fund (Wyoming)[d] | 1974 | Natural resources | 4 | |
| | Severance Tax Permanent Fund (New Mexico)[d] | 1973 | Natural resources | 5 | |
| Venezuela | Macroeconomic Stabilization Fund | 1998 | Natural resources | 1 | |
| | National Development Fund | 2005 | Natural resources | 21 | |
| ***Subtotal[e]*** | | | | **2,972** | |
| **PENSION FUNDS** | | | | | |
| Australia | Future Fund[d] | 2006 | Fiscal surpluses | 53 | |
| Canada | Canada Pension Plan[e] | 1966 | Employee contributions | 121 | |
| | Caisse de dépôt et placement du Québec[d] | 1965 | Employee contributions | 157 | |
| Chile | Pension Reserve Fund | 2006 | Fiscal surpluses | 2 | |
| China | National Social Security Fund[d] | 2000 | Fiscal surpluses | 71 | |
| France | Fonds de réserve pour les retraites[e] | 2001 | Fiscal surpluses | 50 | |
| Ireland | National Pensions Reserve Fund[d] | 2001 | Fiscal surpluses | 31 | |
| Japan | Government Pension Investment Fund[d] | 1961 | Employee contributions | 1,274 | |
| Netherlands | Stichting Pensioenfonds ABP[d] | 1922 | Employee contributions | 315 | |
| New Zealand | Superannuation Fund[d] | 2001 | Fiscal surpluses | 10 | |
| Thailand | Government Pension Fund[d] | 1996 | Employee contributions and fiscal surpluses | 13 | |
| United States | California Public Employees' Retirement System[d] | 1932 | Employee contributions | 237 | |
| ***Subtotal*** | | | | **2,337** | |
| **Total[e]** | | | | **5,308** | |

(e) = estimate; n.a. = not available

a. Data are from the end of 2007 or the most recent date available.
b. Some or all assets are included in reserves.
c. Excluded from scoreboard.
d. A portion of the holdings is in domestic assets.
e. Total uses the midpoint of the range of estimates.

*Sources:* National authorities, IMF, other public sources.

**Table 2: Summary sovereign wealth fund scoreboard (percent of maximum possible points)**

| Country | Fund | Structure | Governance | Accountability & Transparency | Behavior | Total |
|---|---|---|---|---|---|---|
| *Canada* | *Canada Pension Plan* | 100 | 100 | 96 | 83 | 95 |
| *New Zealand* | *Superannuation Fund* | 100 | 100 | 100 | 75 | 95 |
| United States (Alaska) | Alaska Permanent Fund | 100 | 80 | 100 | 83 | 94 |
| *Canada (Québec)* | *Caisse de dépôt et placement du Québec* | 100 | 100 | 89 | 83 | 92 |
| *France* | *Fonds de réserve pour les retraites* | 100 | 100 | 89 | 83 | 92 |
| Norway | Government Pension Fund – Global | 94 | 100 | 100 | 67 | 92 |
| *United States (California)* | *California Public Employees' Retirement System* | 100 | 100 | 96 | 67 | 92 |
| United States (Wyoming) | Permanent Mineral Trust Fund | 100 | 90 | 82 | 100 | 91 |
| *Japan* | *Government Pension Investment Fund* | 100 | 90 | 80 | 83 | 87 |
| *Ireland* | *National Pensions Reserve Fund* | 100 | 100 | 86 | 58 | 86 |
| United States (New Mexico) | Severance Tax Permanent Fund | 100 | 50 | 86 | 100 | 86 |
| *Netherlands* | *Stichting Pensioenfonds ABP* | 100 | 100 | 86 | 50 | 85 |
| *Thailand* | *Government Pension Fund* | 100 | 100 | 88 | 42 | 84 |
| *Australia* | *Future Fund* | 100 | 80 | 68 | 83 | 80 |
| Timor-Leste | Petroleum Fund for Timor-Leste | 100 | 40 | 96 | 50 | 80 |
| Azerbaijan | State Oil Fund of the Republic of Azerbaijan | 88 | 60 | 89 | 50 | 77 |
| *China* | *National Social Security Fund* | 100 | 40 | 82 | 67 | 77 |
| Canada (Alberta) | Alberta Heritage Savings Trust Fund | 94 | 60 | 79 | 50 | 74 |
| Chile | Economic and Social Stabilization Fund | 94 | 60 | 86 | 17 | 71 |
| *Chile* | *Pension Reserve Fund* | 94 | 60 | 86 | 17 | 71 |
| Hong Kong | Exchange Fund | 88 | 40 | 79 | 33 | 67 |
| Kazakhstan | National Fund for the Republic of Kazakhstan | 88 | 60 | 64 | 33 | 64 |
| Botswana | Pula Fund | 69 | 60 | 54 | 33 | 55 |
| Trinidad and Tobago | Heritage and Stabilization Fund | 100 | 60 | 46 | 0 | 53 |
| Korea | Korea Investment Corporation | 75 | 60 | 45 | 25 | 51 |
| Russia | Reserve Fund and National Wealth Fund | 72 | 40 | 50 | 33 | 51 |
| São Tomé and Principe | National Oil Account | 100 | 60 | 29 | 17 | 48 |
| Kuwait | Kuwait Investment Authority | 75 | 80 | 41 | 0 | 48 |
| Mexico | Oil Income Stabilization Fund | 69 | 20 | 43 | 50 | 47 |
| Singapore | Temasek Holdings | 50 | 50 | 61 | 0 | 45 |
| Singapore | Government of Singapore Investment Corporation | 63 | 40 | 39 | 17 | 41 |
| Malaysia | Khazanah Nasional | 44 | 50 | 46 | 0 | 38 |
| China | China Investment Corporation | 50 | 50 | 14 | 17 | 29 |
| Kiribati | Revenue Equalization Reserve Fund | 69 | 60 | 7 | 0 | 29 |
| Algeria | Revenue Regulation Fund | 56 | 40 | 11 | 17 | 27 |
| Nigeria | Excess Crude Account | 50 | 30 | 14 | 17 | 26 |
| Iran | Oil Stabilization Fund | 50 | 20 | 18 | 0 | 23 |
| Venezuela | Macroeconomic Stabilization Fund | 50 | 0 | 18 | 17 | 23 |
| Venezuela | National Development Fund | 38 | 0 | 27 | 0 | 20 |
| Oman | State General Reserve Fund | 50 | 0 | 18 | 0 | 20 |
| Sudan | Oil Revenue Stabilization Account | 56 | 0 | 14 | 0 | 20 |
| Brunei Darussalam | Brunei Investment Agency | 31 | 0 | 25 | 0 | 18 |
| United Arab Emirates (Abu Dhabi) | Mubadala Development Company | 44 | 10 | 7 | 0 | 15 |
| United Arab Emirates (Dubai) | Istithmar World | 38 | 10 | 7 | 0 | 14 |
| Qatar | Qatar Investment Authority | 34 | 0 | 2 | 0 | 9 |
| United Arab Emirates (Abu Dhabi) | Abu Dhabi Investment Authority and Council | 25 | 0 | 4 | 8 | 9 |
| ***Subtotal Nonpension*** | | 68 | 41 | 44 | 25 | 46 |
| ***Subtotal Pension*** | | 99 | 89 | 87 | 66 | 87 |
| **Total** | | 76 | 53 | 55 | 35 | 56 |

Note: Pension funds are in italics.

**Table 3: Scoreboard for sovereign wealth funds**

| | | Structure | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Fiscal Treatment | | | | | | | |
| | | Objective Stated | Source of Funding | Use of Fund Earnings | Integrated with Budget | Guidelines Followed | Investment Strategy | Changes in the Structure | Separate from International Reserves | Subtotal |
| **NONPENSION FUNDS** | | | | | | | | | | |
| Algeria | Revenue Regulation Fund | 1 | 1 | 0.5 | 0 | 0 | 0 | 1 | 1 | 4.5 |
| Azerbaijan | State Oil Fund of the Republic of Azerbaijan | 1 | 1 | 0.5 | 1 | 1 | 0.5 | 1 | 1 | 7 |
| Botswana | Pula Fund | 1 | 0.5 | 1 | 1 | 1 | 1 | 0 | 0 | 5.5 |
| Brunei Darussalam | Brunei Investment Agency | 1 | 0.5 | 0 | 0 | 0 | 0 | 1 | 0 | 2.5 |
| Canada (Alberta) | 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 | 1 | 1 | 0.5 | 1 | 1 | 7.5 |
| China | China Investment Corporation | 1 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 4 |
| Hong Kong | Exchange Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 0 | 7 |
| Iran | Oil Stabilization Fund | 1 | 1 | 0.5 | 0 | 0 | 0 | 0.5 | 1 | 4 |
| Kazakhstan | National Fund for the Republic of Kazakhstan | 1 | 1 | 1 | 1 | 0.5 | 1 | 0.5 | 1 | 7 |
| Kiribati | Revenue Equalization Reserve Fund | 1 | 1 | 1 | 1 | 0 | 0.5 | 1 | 0 | 5.5 |
| 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 | 1 | 1 | 0 | 0 | 0 | 0.5 | 0 | 1 | 3.5 |
| Mexico | Oil Income Stabilization Fund | 1 | 1 | 0.5 | 1 | 0 | 0.5 | 0.5 | 1 | 5.5 |
| Nigeria | Excess Crude Account | 1 | 1 | 1 | 0 | 0 | 0 | 1 | 0 | 4 |
| Norway | Government Pension Fund – Global | 1 | 1 | 1 | 1 | 0.5 | 1 | 1 | 1 | 7.5 |
| Oman | State General Reserve Fund | 0.5 | 1 | 0.5 | 0.5 | 0 | 0 | 0.5 | 1 | 4 |
| Qatar | Qatar Investment Authority | 1 | 0 | 0 | 0 | 0 | 0.25 | 0.5 | 1 | 2.75 |
| Russia | Reserve Fund and National Wealth Fund | 1 | 1 | 0.5 | 1 | 1 | 0.25 | 1 | 0 | 5.75 |
| São Tomé and Principe | National Oil Account | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Singapore | Government of Singapore Investment Corporation | 1 | 0.5 | 1 | 1 | 1 | 0.5 | 0 | 0 | 5 |
| Singapore | Temasek Holdings | 1 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 4 |
| Sudan | Oil Revenue Stabilization Account | 0.5 | 1 | 0.5 | 1 | 0.5 | 0 | 0 | 1 | 4.5 |
| Timor-Leste | Petroleum Fund for Timor-Leste | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Trinidad and Tobago | Heritage and Stabilization Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| United Arab Emirates (Abu Dhabi) | Abu Dhabi Investment Authority and Council | 0.5 | 0 | 0 | 0 | 0 | 0.5 | 0 | 1 | 2 |
| United Arab Emirates (Abu Dhabi) | Mubadala Development Company | 1 | 0 | 0 | 0 | 0 | 0.5 | 1 | 1 | 3.5 |
| United Arab Emirates (Dubai) | Istithmar World | 1 | 0.5 | 0 | 0 | 0 | 0.5 | 0 | 1 | 3 |
| United States (Alaska) | Alaska Permanent Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| United States (New Mexico) | Severance Tax Permanent Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| United States (Wyoming) | Permanent Mineral Trust Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Venezuela | Macroeconomic Stabilization Fund | 1 | 1 | 0 | 0 | 0 | 0.5 | 0.5 | 1 | 4 |
| Venezuela | National Development Fund | 0.5 | 0.5 | 0 | 0 | 0 | 0 | 1 | 1 | 3 |
| ***Total[a]*** | | **32** | **28.5** | **18.5** | **20.5** | **15** | **20.5** | **23** | **26** | **5.4** |
| **PENSION FUNDS** | | | | | | | | | | |
| Australia | Future Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Canada | Canada Pension Plan | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Canada (Québec) | Caisse de dépôt et placement du Québec | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Chile | Pension Reserve Fund | 1 | 1 | 1 | 1 | 1 | 0.5 | 1 | 1 | 7.5 |
| China | National Social Security Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| France | Fonds de réserve pour les retraites | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Ireland | National Pensions Reserve Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Japan | Government Pension Investment Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Netherlands | Stichting Pensioenfonds ABP | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| New Zealand | Superannuation Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| Thailand | Government Pension Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| United States (California) | California Public Employees' Retirement System | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 |
| ***Total[a]*** | | **12** | **12** | **12** | **12** | **12** | **11.5** | **12** | **12** | **8.0** |
| **GRAND TOTAL[a]** | | **44** | **40.5** | **30.5** | **32.5** | **27** | **32** | **35** | **38** | **6.1** |

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

Table 3: Scoreboard for sovereign wealth funds (continued)

| | | Governance | | | | | | Accountability & Transparency | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | Investment Strategy Implementation | | | |
| | | Role of Government | Role of Managers | Decisions made by managers | Guidelines for Corporate Responsibility | Ethical Guidelines | Subtotal | Categories | Benchmarks | Credit Ratings | Mandates |
| **NONPENSION FUNDS** | | | | | | | | | | | |
| Algeria | Revenue Regulation Fund | 1 | 1 | 0 | 0 | 0 | **2** | 0 | 0 | 0 | 1 |
| Azerbaijan | State Oil Fund of the Republic of Azerbaijan | 1 | 1 | 1 | 0 | 0 | **3** | 1 | 1 | 1 | 1 |
| Botswana | Pula Fund | 1 | 1 | 1 | 0 | 0 | **3** | 1 | 1 | 1 | 0 |
| Brunei Darussalam | Brunei Investment Agency | 0 | 0 | 0 | 0 | 0 | **0** | 0 | 0 | 0 | 1 |
| Canada (Alberta) | Alberta Heritage Savings Trust Fund | 1 | 1 | 1 | 0 | 0 | **3** | 1 | 1 | 0.5 | 0 |
| Chile | Economic and Social Stabilization Fund | 1 | 1 | 1 | 0 | 0 | **3** | 1 | 1 | 1 | 1 |
| China | China Investment Corporation | 1 | 1 | 0 | 0.5 | 0 | **2.5** | 0.5 | 0.5 | 0 | 0 |
| Hong Kong | Exchange Fund | 1 | 1 | 0 | 0 | 0 | **2** | 1 | 1 | 1 | 0 |
| Iran | Oil Stabilization Fund | 0.5 | 0.5 | 0 | 0 | 0 | **1** | 0 | 0 | 0 | 1 |
| Kazakhstan | National Fund for the Republic of Kazakhstan | 1 | 1 | 1 | 0 | 0 | **3** | 0.5 | 1 | 1 | 0 |
| Kiribati | Revenue Equalization Reserve Fund | 1 | 1 | 1 | 0 | 0 | **3** | 0 | 0 | 0 | 0 |
| Korea | Korea Investment Corporation | 1 | 1 | 1 | 0 | 0 | **3** | 0.5 | 0.5 | 1 | 0 |
| Kuwait | Kuwait Investment Authority | 1 | 1 | 1 | 0 | 1 | **4** | 0 | 0.5 | 1 | 0 |
| Malaysia | Khazanah Nasional | 0.5 | 1 | 0.5 | 0.5 | 0 | **2.5** | 0.5 | 1 | 0 | 0 |
| Mexico | Oil Income Stabilization Fund | 0.5 | 0.5 | 0 | 0 | 0 | **1** | 0 | 0 | 0 | 0 |
| Nigeria | Excess Crude Account | 0.5 | 1 | 0 | 0 | 0 | **1.5** | 0 | 0 | 0 | 1 |
| Norway | Government Pension Fund – Global | 1 | 1 | 1 | 1 | 1 | **5** | 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 | Reserve Fund and National Wealth Fund | 1 | 1 | 0 | 0 | 0 | **2** | 1 | 0 | 1 | 1 |
| São Tomé and Principe | National Oil Account | 1 | 1 | 1 | 0 | 0 | **3** | 0.5 | 0 | 0 | 1 |
| Singapore | Government of Singapore Investment Corporation | 0.5 | 0.5 | 1 | 0 | 0 | **2** | 0.5 | 1 | 0.5 | 0 |
| Singapore | Temasek Holdings | 0 | 1 | 1 | 0.5 | 0 | **2.5** | 0.5 | 0.5 | 0 | 0 |
| Sudan | Oil Revenue Stabilization Account | 0 | 0 | 0 | 0 | 0 | **0** | 0 | 0 | 0 | 1 |
| Timor-Leste | Petroleum Fund for Timor-Leste | 1 | 1 | 0 | 0 | 0 | **2** | 1 | 0.5 | 1 | 1 |
| Trinidad and Tobago | Heritage and Stabilization Fund | 1 | 1 | 1 | 0 | 0 | **3** | 1 | 0.5 | 0 | 1 |
| United Arab Emirates (Abu Dhabi) | Abu Dhabi Investment Authority and Council | 0 | 0 | 0 | 0 | 0 | **0** | 0.25 | 0.25 | 0 | 0 |
| United Arab Emirates (Abu Dhabi) | Mubadala Development Company | 0 | 0.5 | 0 | 0 | 0 | **0.5** | 0 | 0.5 | 0 | 0 |
| United Arab Emirates (Dubai) | Istithmar World | 0 | 0.5 | 0 | 0 | 0 | **0.5** | 0.25 | 0 | 0 | 0 |
| United States (Alaska) | Alaska Permanent Fund | 1 | 1 | 1 | 1 | 0 | **4** | 1 | 1 | 1 | 1 |
| United States (New Maxico) | Severance Tax Permanent Fund | 1 | 1 | 0.5 | 0 | 0 | **2.5** | 1 | 1 | 1 | 1 |
| United States (Wyoming) | Permanent Mineral Trust Fund | 1 | 1 | 1 | 0.5 | 1 | **4.5** | 1 | 1 | 1 | 1 |
| Venezuela | Macroeconomic Stabilization Fund | 0 | 0 | 0 | 0 | 0 | **0** | 0.5 | 0 | 0 | 1 |
| Venezuela | National Development Fund | 0 | 0 | 0 | 0 | 0 | **0** | 0.25 | 0 | 0 | 0 |
| ***Total[a]*** | | **21.5** | **24.5** | **16** | **4** | **3** | **2.0** | **16.75** | **15.75** | **14** | **16** |
| **PENSION FUNDS** | | | | | | | | | | | |
| Australia | Future Fund | 1 | 1 | 1 | 1 | 0 | **4** | 1 | 1 | 0.5 | 1 |
| Canada | Canada Pension Plan | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 1 | 1 |
| Canada (Québec) | Caisse de dépôt et placement du Québec | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 0.5 | 1 |
| Chile | Pension Reserve Fund | 1 | 1 | 1 | 0 | 0 | **3** | 1 | 1 | 1 | 1 |
| China | National Social Security Fund | 1 | 1 | 0 | 0 | 0 | **2** | 1 | 1 | 1 | 1 |
| France | Fonds de réserve pour les retraites | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 1 | 1 |
| Ireland | National Pensions Reserve Fund | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 0 | 1 |
| Japan | Government Pension Investment Fund | 1 | 1 | 1 | 1 | 0.5 | **4.5** | 1 | 1 | 1 | 1 |
| Netherlands | Stichting Pensioenfonds ABP | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 1 | 0 |
| New Zealand | Superannuation Fund | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 1 | 1 |
| Thailand | Government Pension Fund | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 1 | 1 |
| United States (California) | California Public Employees' Retirement System | 1 | 1 | 1 | 1 | 1 | **5** | 1 | 1 | 1 | 1 |
| ***Total[a]*** | | **12** | **12** | **11** | **10** | **8.5** | **4.5** | **12** | **12** | **10** | **11** |
| **GRAND TOTAL[a]** | | **33.5** | **36.5** | **27** | **14** | **11.5** | **2.7** | **28.75** | **27.75** | **24** | **27** |

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

**Table 3: Scoreboard for sovereign wealth funds (continued)**

| | | Investment Activities | | | | | Reports | | Audit | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Size | Returns | Location | Specific Investments | Currency Composition | Annual | Quarterly | Audited | Published | Independent | Subtotal |
| **NONPENSION FUNDS** | | | | | | | | | | | | |
| Algeria | Revenue Regulation Fund | 0.5 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1.5 |
| Azerbaijan | State Oil Fund of the Republic of Azerbaijan | 1 | 1 | 0.5 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 12.5 |
| Botswana | Pula Fund | 1 | 0 | 0 | 0 | 0 | 1 | 0.5 | 1 | 0 | 1 | 7.5 |
| Brunei Darussalam | Brunei Investment Agency | 0 | 0 | 0 | 0 | 0 | 0.5 | 0 | 1 | 0 | 1 | 3.5 |
| Canada (Alberta) | Alberta Heritage Savings Trust Fund | 1 | 1 | 1 | 0 | 0.5 | 1 | 1 | 1 | 1 | 1 | 11 |
| Chile | Economic and Social Stabilization Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 0.5 | 0 | 0.5 | 12 |
| China | China Investment Corporation | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2 |
| Hong Kong | Exchange Fund | 1 | 1 | 0.5 | 0 | 0.5 | 1 | 1 | 1 | 1 | 1 | 11 |
| Iran | Oil Stabilization Fund | 0.5 | 0.5 | 0 | 0 | 0 | 0.5 | 0 | 0 | 0 | 0 | 2.5 |
| Kazakhstan | National Fund for the Republic of Kazakhstan | 1 | 1 | 0.25 | 0 | 0.25 | 0.5 | 0.5 | 1 | 1 | 1 | 9 |
| Kiribati | Revenue Equalization Reserve Fund | 0 | 0 | 0 | 0 | 0 | 0.5 | 0.5 | 0 | 0 | 0 | 1 |
| Korea | Korea Investment Corporation | 1 | 0.25 | 0 | 0 | 0 | 0.5 | 0 | 1 | 0.5 | 1 | 6.25 |
| Kuwait | Kuwait Investment Authority | 1 | 0.5 | 0.25 | 0 | 0 | 0.5 | 0 | 1 | 0 | 1 | 5.75 |
| Malaysia | Khazanah Nasional | 1 | 1 | 1 | 0.5 | 0 | 0.5 | 0 | 1 | 0 | 0 | 6.5 |
| Mexico | Oil Income Stabilization Fund | 1 | 1 | 0 | 0 | 1 | 0.5 | 0.5 | 0.5 | 0.5 | 1 | 6 |
| Nigeria | Excess Crude Account | 0.5 | 0 | 0 | 0 | 0.5 | 0 | 0 | 0 | 0 | 0 | 2 |
| Norway | Government Pension Fund – Global | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 14 |
| Oman | State General Reserve Fund | 0 | 0 | 0 | 0 | 0 | 0.5 | 0 | 1 | 0 | 1 | 2.5 |
| Qatar | Qatar Investment Authority | 0 | 0 | 0 | 0 | 0.25 | 0 | 0 | 0 | 0 | 0 | 0.25 |
| Russia | Reserve Fund and National Wealth Fund | 1 | 0.5 | 0.5 | 0 | 1 | 0.5 | 0.5 | 0 | 0 | 0 | 7 |
| São Tomé and Príncipe | National Oil Account | 0.5 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 1 | 4 |
| Singapore | Government of Singapore Investment Corporation | 0 | 0.25 | 0.25 | 0 | 0 | 0.5 | 0.5 | 1 | 0 | 1 | 5.5 |
| Singapore | Temasek Holdings | 1 | 1 | 1 | 0.5 | 0 | 1 | 0 | 1 | 1 | 1 | 8.5 |
| Sudan | Oil Revenue Stabilization Account | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2 |
| Timor-Leste | Petroleum Fund for Timor-Leste | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 13.5 |
| Trinidad and Tobago | Heritage and Stabilization Fund | 1 | 0 | 0 | 0 | 0 | 0.5 | 0.5 | 1 | 0 | 1 | 6.5 |
| United Arab Emirates (Abu Dhabi) | Abu Dhabi Investment Authority and Council | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.5 |
| United Arab Emirates (Abu Dhabi) | Mubadala Development Company | 0 | 0 | 0 | 0.5 | 0 | 0 | 0 | 0 | 0 | 0 | 1 |
| United Arab Emirates (Dubai) | Istithmar World | 0.5 | 0 | 0.25 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 |
| United States (Alaska) | Alaska Permanent Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 14 |
| United States (New Mexico) | Severance Tax Permanent Fund | 1 | 1 | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 12 |
| United States (Wyoming) | Permanent Mineral Trust Fund | 1 | 1 | 0 | 0 | 0.5 | 1 | 1 | 1 | 1 | 1 | 11.5 |
| Venezuela | Macroeconomic Stabilization Fund | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2.5 |
| Venezuela | National Development Fund | 1 | 0 | 0 | 0 | 0 | 1 | 0.5 | 1 | 0 | 0 | 3.75 |
| ***Total*** [a] | | **24.5** | **15** | **9.5** | **5.5** | **10.5** | **18** | **13** | **21** | **11** | **19.5** | **6.2** |
| **PENSION FUNDS** | | | | | | | | | | | | |
| Australia | Future Fund | 1 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 1 | 1 | 9.5 |
| Canada | Canada Pension Plan | 1 | 1 | 0.5 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 13.5 |
| Canada (Québec) | Caisse de dépôt et placement du Québec | 1 | 1 | 1 | 1 | 1 | 1 | 0 | 1 | 1 | 1 | 12.5 |
| Chile | Pension Reserve Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 0.5 | 0 | 0.5 | 12 |
| China | National Social Security Fund | 1 | 1 | 0.5 | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 11.5 |
| France | Fonds de réserve pour les retraites | 1 | 1 | 0.5 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 12.5 |
| Ireland | National Pensions Reserve Fund | 1 | 1 | 1 | 1 | 0 | 1 | 1 | 1 | 1 | 1 | 12 |
| Japan | Government Pension Investment Fund | 1 | 1 | 0.25 | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 11.25 |
| Netherlands | Stichting Pensioenfonds ABP | 1 | 1 | 0.5 | 1 | 1 | 1 | 0.5 | 1 | 1 | 1 | 12 |
| New Zealand | Superannuation Fund | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 14 |
| Thailand | Government Pension Fund | 1 | 1 | 0.25 | 1 | 0 | 1 | 1 | 1 | 1 | 1 | 12.25 |
| United States (California) | California Public Employees' Retirement System | 1 | 1 | 0.5 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 13.5 |
| ***Total*** [a] | | **12** | **12** | **7** | **8** | **7** | **12** | **9.5** | **11.5** | **11** | **11.5** | **12.2** |
| **GRAND TOTAL** [a] | | **36.5** | **27** | **16.5** | **13.5** | **17.5** | **30** | **22.5** | **32.5** | **22** | **31** | **7.8** |

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

Table 3: Scoreboard for sovereign wealth funds (continued)

| | | Behavior | | | | | | | Grand Total |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Derivatives | | | |
| | | Portfolio Adjustment | Limits on Stakes | No Controlling Stakes | Policy on Leverage | Policy on Derivatives | For Hedging Only | Subtotal | |
| **NONPENSION FUNDS** | | | | | | | | | |
| Algeria | Revenue Regulation Fund | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 9 |
| Azerbaijan | State Oil Fund of the Republic of Azerbaijan | 0 | 0 | 1 | 0 | 1 | 1 | 3 | 25.5 |
| Botswana | Pula Fund | 0 | 0 | 1 | 0 | 1 | 0 | 2 | 18 |
| Brunei Darussalam | Brunei Investment Agency | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6 |
| Canada (Alberta) | Alberta Heritage Savings Trust Fund | 0 | 0 | 0 | 1 | 1 | 1 | 3 | 24.5 |
| Chile | Economic and Social Stabilization Fund | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 23.5 |
| China | China Investment Corporation | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 9.5 |
| Hong Kong | Exchange Fund | 0 | 0 | 0 | 0 | 1 | 1 | 2 | 22 |
| Iran | Oil Stabilization Fund | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 7.5 |
| Kazakhstan | National Fund for the Republic of Kazakhstan | 0 | 0 | 0 | 0 | 1 | 1 | 2 | 21 |
| Kiribati | Revenue Equalization Reserve Fund | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 9.5 |
| Korea | Korea Investment Corporation | 0.5 | 0 | 0 | 0 | 1 | 0 | 1.5 | 16.75 |
| Kuwait | Kuwait Investment Authority | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 15.75 |
| Malaysia | Khazanah Nasional | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 12.5 |
| Mexico | Oil Income Stabilization Fund | 0 | 0 | 1 | 0 | 1 | 1 | 3 | 15.5 |
| Nigeria | Excess Crude Account | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 8.5 |
| Norway | Government Pension Fund – Global | 1 | 1 | 1 | 0.5 | 0.5 | 0 | 4 | 30.5 |
| Oman | State General Reserve Fund | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6.5 |
| Qatar | Qatar Investment Authority | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 3 |
| Russia | Reserve Fund and National Wealth Fund | 0 | 1 | 1 | 0 | 0 | 0 | 2 | 16.75 |
| São Tomé and Principe | National Oil Account | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 16 |
| Singapore | Government of Singapore Investment Corporation | 0 | 0 | 0.5 | 0 | 0.5 | 0 | 1 | 13.5 |
| Singapore | Temasek Holdings | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 15 |
| Sudan | Oil Revenue Stabilization Account | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6.5 |
| Timor-Leste | Petroleum Fund for Timor-Leste | 0 | 0 | 1 | 0 | 1 | 1 | 3 | 26.5 |
| Trinidad and Tobago | Heritage and Stabilization Fund | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 17.5 |
| United Arab Emirates (Abu Dhabi) | Abu Dhabi Investment Authority and Council | 0 | 0.25 | 0.25 | 0 | 0 | 0 | 0.5 | 3 |
| United Arab Emirates (Abu Dhabi) | Mubadala Development Company | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 5 |
| United Arab Emirates (Dubai) | Istithmar World | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 4.5 |
| United States (Alaska) | Alaska Permanent Fund | 0 | 1 | 1 | 1 | 1 | 1 | 5 | 31 |
| United States (New Mexico) | Severance Tax Permanent Fund | 1 | 1 | 1 | 1 | 1 | 1 | 6 | 28.5 |
| United States (Wyoming) | Permanent Mineral Trust Fund | 1 | 1 | 1 | 1 | 1 | 1 | 6 | 30 |
| Venezuela | Macroeconomic Stabilization Fund | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 7.5 |
| Venezuela | National Development Fund | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6.75 |
| ***Total*** [a] | | **3.5** | **5.25** | **15.75** | **4.5** | **12** | **9** | **1.5** | **15.1** |
| **PENSION FUNDS** | | | | | | | | | |
| Australia | Future Fund | 0 | 1 | 1 | 1 | 1 | 1 | 5 | 26.5 |
| Canada | Canada Pension Plan | 0 | 1 | 1 | 1 | 1 | 1 | 5 | 31.5 |
| Canada (Québec) | Caisse de dépôt et placement du Québec | 0 | 1 | 1 | 1 | 1 | 1 | 5 | 30.5 |
| Chile | Pension Reserve Fund | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 23.5 |
| China | National Social Security Fund | 0 | 1 | 1 | 0 | 1 | 1 | 4 | 25.5 |
| France | Fonds de réserve pour les retraites | 1 | 1 | 1 | 0 | 1 | 1 | 5 | 30.5 |
| Ireland | National Pensions Reserve Fund | 0.5 | 0 | 1 | 0 | 1 | 1 | 3.5 | 28.5 |
| Japan | Government Pension Investment Fund | 1 | 1 | 1 | 0 | 1 | 1 | 5 | 28.75 |
| Netherlands | Stichting Pensioenfonds ABP | 1 | 0 | 0 | 0 | 1 | 1 | 3 | 28 |
| New Zealand | Superannuation Fund | 0 | 0.5 | 1 | 1 | 1 | 1 | 4.5 | 31.5 |
| Thailand | Government Pension Fund | 0 | 1 | 1 | 0 | 0.5 | 0 | 2.5 | 27.75 |
| United States (California) | California Public Employees' Retirement System | 1 | 0 | 0 | 1 | 1 | 1 | 4 | 30.5 |
| ***Total*** [a] | | **4.5** | **7.5** | **10** | **5** | **10.5** | **10** | **4.0** | **28.6** |
| **GRAND TOTAL** [a] | | **8** | **12.75** | **25.75** | **9.5** | **22.5** | **19** | **2.1** | **18.6** |

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

**APPENDIX**
**Scoreboard for Sovereign Wealth Funds**

This appendix presents the elements of the scoreboard described in the testimony. For each of the 33 questions, if the answer is an unqualified yes, we score it as "1." If the answer is no, we score it as "0." However, partial scores of 0.25, 0.50, and 0.75 are recorded for many elements, indicated by (p) in the descriptions below.

The four categories in the scoreboard are listed below with subcategories where relevant. The words in bold are keyed to the results presented in table 3 for each SWF on each element.

**Structure**

1. Is the SWF's objective clearly communicated? (p)

***Fiscal Treatment***

2. Is the **source of** the SWF's **funding** clearly specified? (p)
3. Is nature of the subsequent **use** of the principal and earnings of the fund clearly stated? (p)
4. Are these elements of fiscal treatment **integrated with** the **budget**? (p)
5. Are the **guidelines** for fiscal treatment generally **followed** without frequent adjustment? (p)

***Other Structural Elements***

6. Is the overall **investment strategy** clearly communicated? (p)
7. Is the procedure for **changing the structure** of the SWF clear? (p)
8. Is the SWF **separate from** the country's **international reserves**?

**Governance**

9. Is the **role of the government** in setting the investment strategy of the SWF clearly established? (p)
10. Is the **role of the managers** in executing the investment strategy clearly established? (p)
11. Are **decisions** on specific investments made **by the managers**? (p)
12. Does the SWF have in place and publicly available **guidelines for corporate responsibility** that it follows? (p)
13. Does the SWF have **ethical guidelines** that it follows? (p)

**Transparency and Accountability**

***Investment Strategy Implementation***

14. Do regular reports on investments by the SWF include information on the **categories** of investments? (p)
15. Does the strategy use **benchmarks**? (p)
16. Does the strategy limit investments based on **credit ratings**? (p)
17. Are the holders of investment **mandates** identified?

***Investment Activities***

18. Do regular reports on the investments by the SWF include the **size of** the **fund**? (p)
19. Do regular reports on the investments by the SWF include information on its **returns**? (p)
20. Do regular reports on the investments by the SWF include information on the geographic **location** of investments? (p)
21. Do regular reports on the investments by the SWF include information on the **specific** investments? (p)
22. Do regular reports on the investments by the SWF include information on the **currency composition** of investments? (p)

***Reports***

23. Does the SWF provide at least an **annual report** on its activities and results? (p)
24. Does the SWF provide **quarterly reports**? (p)

***Audits***

25. Is the SWF subjected to a **regular** annual **audit**? (p)
26. Is the audit **published** promptly? (p)
27. Is the audit **independent**? (p)

**Behavior**

28. Does the SWF indicate the nature and **speed of adjustment** in its portfolio? (p)
29. Does the SWF have limits on the **size of** its **stakes**? (p)
30. Does the SWF not take **controlling stakes**? (p)
31. Does the SWF have a policy on the use of **leverage**? (p)
32. Does the SWF have a policy on the use of **derivatives**? (p)
33. Are derivatives used primarily for **hedging**?

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