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Hearing on the Implications of Sovereign Wealth Fund Investments for National Security
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Good afternoon, Co-Chairman Wortzel, Co-Chairman Mulloy, and Members of the Commission. On behalf of the 1,500 member companies of the U.S. Business and Industry Council and the supporters of its Educational Foundation, thank you for the opportunity to share our views on the national security implications of sovereign wealth fund investments United States.

The small and medium-sized family held companies – mainly manufacturers – that comprise most of the Council's membership reject the view that the idea of free markets so central to our prosperity and our political liberties is a synonym for "anything goes." Our member companies and other supporters are all strong believers that business and economic activity should be dominated by private actors operating within a legal and regulatory framework that emphasizes objectives such as vigorous and sustainable competition, equality of opportunity, and transparency and the freest possible flow of information.

Our members and supporters are just as insistent on the need for the federal government to take a realistic view of national security, one that fully recognizes its vital economic, financial, and technological dimensions. Finally, they believe that preserving the greatest degree of freedom of action for our country in world affairs – its sovereignty – is another central element of national security, and as a such deserves the highest priority.

We believe that the ballooning role played by SWFs in the U.S. and world economies poses major potential threats to all these critical objectives, and that therefore Washington should adopt a highly restrictive posture toward them. Moreover, we believe that the same posture is needed for other foreign government actors seeking to acquire U.S. assets – e.g., state-owned or affiliated entities not mentioned often enough in the embryonic SWF policy debate. In fact, American policymakers must understand an added and critical complication to the challenge of formulating policy responses to official foreign investments – the immense buildup of capital and foreign exchange reserves by entire national economies where the line between public and private sector is difficult at best to draw.

SWFs have attracted the spotlight recently not because they themselves are an entirely new phenomenon. Many have existed and invested in the United States for decades. Rather, the new focus reflects a combination of:

>their rapidly growing dimensions, which carry the potential to disrupt markets. In this instance, however, the exact size of the funds and their growth rates are not the only issues that must be considered. Because SWFs and other state-controlled or related entities can typically mobilize

very large amounts of capital very quickly, without resorting to elaborate decision-making processes, they are likely to continue to punch considerably above even their currently formidable weight – as has been seen recently by their sudden huge investments in major American and other foreign banks and brokerages;

>Their shift from the government bonds they have traditionally purchased to the entire range of financial assets, which raises the prospect of gaining control over these assets;

>The secretiveness surrounding the make-up and operations of most SWFs, which can also be detrimental to the functioning of genuinely free markets;

>The related issue of their origins in governments that have challenged U.S. national security interests, and that epitomize anti-market values such as cronyism and contempt for law.

In preparing for these hearings, the Commission has posed thoughtful questions about SWFs.. They are exactly the kinds of questions that U.S. authorities need to be asking themselves – and answering – before allowing SWFs and other foreign government entities to acquire even more of the American economy. At this point, however, definitive answers are very difficult to come by, and situation will remain murky for years to come because we stand at the very beginning of the Age of SWFs. It is simply too soon to describe clear patterns of behavior, much less draw bright-line distinctions among funds from different parts of the world or representing different types of governments, beyond a handful of observations already widely reported in the media – e.g., all SWFs so far seem determined to keep equity purchases below threshholds that would trigger regulatory oversight even though such oversight is quite threadbare at present.

For the same reason, it is simply too soon to know what kinds of challenges to and complications for national security policy SWF activities might present – or whether any significant threat will materialize at all. Yet complacency is not an acceptable attitude for government to take in the face of such existential uncertainties. SWF enthusiasts who eagerly note that the funds so far have provided no concrete cause for concern are tantamount to teenagers who have begun to start driving under the influence, and brag that they’re still alive. Government must provide the adult supervision, and specifically take a longer view informed by, among other factors, history, logic, and our knowledge (or lack thereof) of the countries and political systems that have creating these funds. In this view, the potential causes for concern are more than adequate to justify extreme caution in policymaking.

In particular, it is all too easy to envision circumstances in which SWF and other official foreign investments in U.S. assets could threaten national security. As widely discussed already, such investors could seek to transfer militarily-sensitive knowhow to home governments that often oppose U.S. diplomatic objectives, or to third-countries or non-state movements with similarly adversarial profiles.

But the simple possession of assets could create serious problems as well. 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? Moreover, a single instance of SWFs throwing their weight around or employing their leverage more subtly could produce genuinely disastrous results. Official investments in key U.S. assets, moreover, pose an entirely different set of economic and financial risks that deserve a separate discussion of their own. Such investments would need to create extraordinary and durable benefits indeed to justify living with the risks that we can know about and anticipate, as well as with the nasty surprises that events regularly serve up.

Do SWFs from resource/energy exporting countries or SWFs from Asian goods exports pose the greatest potential threats? Answering this question requires deciding which poses the greatest challenge to U.S. security – the emergence of a genuine Chinese military, economic, and technological superpower? The activities of Al Qaeda or other Islamic terrorist organizations? The reappearance of a powerful, adversarial Russia? In my view, no purpose is served by choosing. All such possibilities must be actively monitored and responded to, though of course the salience of each danger will vary with time.

Clearly, however, acquisitions by government-related investors from China or Russia – meaning any investors from those two countries, given the state's commanding role over the entire economy – raise a real danger of diverting sensitive products and technologies to potential adversaries, not to mention the implications of such lawless dictatorial governments gaining influence and even outright control over institutions vital to America's continued strength and prosperity.

Nor should anyone believe that the CFIUS process or any of the other statutory limits on foreign acquisitions of U.S. assets provides anywhere near the protection needed against such threats. The CFIUS process, for example, remains a rubberstamp even after last year's post-Dubai reforms. In particular, it lacks any provisions to monitor or enforce the modifications and conditions that it all-too-rarely imposes on prospective takeovers.

Foreign government investments from Persian Gulf oil kingdoms in particular – a second category of resource and energy exporter after Russia – raise the somewhat different yet equally worrisome possibility of transfers to third parties such as terrorist organizations or to rogue states like Iran and North Korea. For example, at the end of 2006, the Financial Times reported that "Washington is alarmed at the diversion of sensitive military technology to Iran and Syria via Dubai" and that U.S. officials had threatened reprisals unless the trafficking were halted.

In the case of these kingdoms' investments in financial institutions, U.S. officials need to consider the possibility of transferring funds to terrorist organizations through money-laundering schemes. Last December, the Financial Times reported the emergence of just such concerns in the United Kingdom "thanks to the much-publicised arrival of significant capital from opaque sources such a the former Soviet Union, sovereign wealth funds, and Middle Eastern oil states."

Washington clearly lacks the capabilities at present to monitor and enforce the manifold forms of communications and interactions between the management of these finance firms and their foreign government shareholders, whatever the formal U.S. legal status of these shareholders.

(These same limitations obviously apply to cases involving Chinese investors in U.S. technology companies.) And banks and brokerages in financial distress will obviously experience great difficulties saying No to requests to handle controversial deposits, fund transfers, and clients.

In addition, those who call the Gulf kingdoms allies clearly have already forgotten one of the central lessons of 9-11 – that the Middle East is a region where distinguishing friend from foe can be excruciatingly difficult. Further, the composition and workings of these governments are extremely opaque to outsiders; in fact, so far as can be reliably known, the monarchies in question are essentially extended families characterized by the most byzantine forms of inter-personal relationships and rivalries. Finally, as suggested by the reference to Dubai above, the kingdoms long have played the economic role of entrepots, prospering by facilitating traffic all manner of licit and illicit goods, and continually seeking to appease larger, more powerful neighbors.

None of the most popular policy responses suggested in Washington or elsewhere to the emergence of SWFs has much potential to prevent these and other prospective dangers. Codes of conduct proposals that typically focus on securing greater transparency sound appealing. But given the financial weakness of the United States nowadays, and given the leverage consequently enjoyed by capital-rich SWF governments, it's difficult for the time being envisioning Washington – or any combination of recipient-country governments – standing their ground on these questions, much less successfully insisting on the kinds of monitoring and enforcement that would give the Codes some semblance of teeth.

Far better for the United States to recognize explicitly that the benefits promised by foreign government investments fall far short of the dangers they pose, and understand that the best protection against their accumulation of power and influence is to prevent such accumulations in the first place. Washington should limit sharply the share of any one U.S. entity's assets that can be bought by SWFs and similar investors in toto, and by government investors from any one country. A ten percent ceiling for total foreign government ownership seems a reasonable starting point, along with a one percent ceiling for the government-related investments from any one country (to guard against multiple official investors from the same country building up outsized stakes). Such a policy would permit SWFs and their various official relatives to inject plenty of capital into the U.S. economy. But it would require them to spread out their investments in ways that could not possibly create undue influence. Nor would such a policy cause significant hardships for official foreign investors. In a $13 trillion economy, they should be able to find plenty of attractive opportunities for profitably deploying their cash.