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"The Challenges of Sovereign Investment"

United States Council for International Business
Hosted by: The Bank of New York Mellon

New York City - February 26, 2008
***** AS PREPARED FOR DELIVERY *****

The United States is the world's largest recipient of inbound foreign domestic investment. We benefit greatly from this investment.

Foreign-owned firms employ 4.5 percent of the U.S. work force, and account for 13 percent of research-and-development and 10 percent of plant and equipment spending.

The United States is also the world's largest source of outbound foreign domestic investment. In 2006, nearly $700 billion was returned to U.S. investors as a result of these overseas investments.

Over the past twenty years, total global cross-border investments have expanded faster than international trade in goods and services.

This is no small accomplishment given that global trade has expanded in this period at almost twice the rate of global economic growth.

As President Bush affirmed last year in his Statement on Open Economies, "a free and open international investment regime is vital for a stable and growing economy, both here at home and throughout the world."

Our long-standing commitment to global open investment policies is reflected in the 40 or so existing bilateral investment treaties (BITs), and our pursuit of new BITs with a number of major emerging economies, including Brazil, Russia, India and China.

Our commitment is also reflected in the limited U.S. regulatory approach towards inbound investment.

However, the tremendous recent rise in one class of investors – namely, sovereign wealth funds and other "sovereign investors" -- has prompted calls in the U.S. and elsewhere for greater scrutiny of certain inbound investments.

Given the growing economic significance of sovereign wealth funds and other sovereign investors, a closer look at the objectives and consequences of their investments is warranted.

But such examination should be undertaken mindful of the critical role cross-border investments have had on job-creation, economic growth and productivity.

Likewise, owners and managers of sovereign wealth funds should operate in a manner that is mindful of the unique questions and concerns that governments have about sovereign investors.

First, a little background on the growth of sovereign wealth funds and the U.S. regulatory framework applicable to foreign investment.

Sovereign Wealth Funds

Sovereign wealth funds have existed for decades. Kuwait, Norway, and other countries created these funds to manage earnings from commodity sales.

The funds serve legitimate goals of managing near-term financial risk and transferring wealth across generations.

As commodity prices have soared in recent years, the number and size of sovereign wealth funds have grown dramatically. There are now nearly 40 funds accounting for about $3 trillion in assets.

While this figure may seem small in relation to the $190 trillion stock of global financial assets, sovereign wealth funds today are about twice the size of hedge funds and three times the size of private equity funds.

Moreover, the total assets of sovereign wealth funds could climb to $15 trillion over the next 7 years, according to some estimates. Half of the existing sovereign wealth funds have been created since 2000. A week rarely passes now without a massive new investment by a sovereign wealth fund.

As the presence of sovereign wealth funds has risen, public scrutiny has also risen. Concerns have focused on the national security impact of certain investments, the potential unfair advantage that sovereign funds could have in competing with private funds, and the risks to financial security as these funds grow.

I will focus my remarks on concerns affecting national security and how governments can most appropriately respond to those concerns.

Regulatory Framework

Fortunately, a framework already exists in the United States to assess the national security risks, if any, of foreign direct investments, including by sovereign wealth funds, if they result in control of a U.S. company.

That framework is provided by the Foreign Investment and National Security Act (FINSA) which was enacted last year, as an amendment to the Exon-Florio legislation of 1988.

The law expresses the President's authority to block or mitigate certain transactions that could impair national security.

The law provides statutory authority for the Committee on Foreign Investment in the United States (CFIUS) to review certain inbound investments to assess national security implications, if any, and to make recommendations to the President.

No President should ever hesitate to block a transaction that truly threatens national security. But such decisions must be based on rigorous analysis, not protectionist or xenophobic sentiments.

The record reflects that CFIUS – of which USTR is a member – takes this responsibility seriously and that the U.S. remains extremely open to foreign direct investment. In 2006, there were 1,730 cross-border transactions. Only 113 of these came before CFIUS for review. None were blocked.

In a very small number of cases, the parties to the transaction chose not to close the deal in the face of national security concerns raised in the CFIUS process. The notion that the U.S. investment climate has turned protectionist is not supported by the facts.

It is important to note that, in drafting FINSA, Congress rejected calls to allow the President to block transactions on the basis that they could impair "economic security."

Doing so would have unhinged CFIUS from its core function of assessing national security and would have left a wide and ambiguous definition of what constitutes "economic security."

Congress deserves tremendous credit for recognizing that blocking an inward investment is an extraordinarily serious exercise of governmental power, and should be done in only the rarest of circumstances, namely when national security interests require it.

Unfortunately, other countries have not been so disciplined. Under the guise of "economic nationalism" and overly broad concepts of national security, a number of countries have expressed intentions to block an array of inbound investments for reasons appearing to have more to do with protectionism than national security.

As the world's largest outbound investor, the United States has a strong interest in discouraging countries from adopting protectionist investment policies.

Our legitimacy and success in pursuing this goal will be affected by how we are perceived in terms of our own scrutiny of inward foreign direct investment.

While FINSA requires a higher-level accountability within CFIUS in order to close out foreign government controlled transactions without an investigation, the substantive standard used by CFIUS does not distinguish between foreign investments by governments or private parties.

The President may block any transaction if it would "impair national security."

The substantive standard used by CFIUS does not distinguish between foreign investments by government or private parties. In either case, the President may block a transaction only if it would "impair national security."

Best Practices for Sovereign Wealth Funds

Having established that U.S. interests in maintaining open investment policies require that sovereign wealth funds and other sovereign investors be treated fairly and as transparently as national security considerations allow, what are the interests and responsibilities of sovereign investors?

Sovereign investors have legitimate interests in diversifying portfolios and seeking the best returns possible on their investments. As noted earlier, the United States can benefit greatly from inbound investments from sovereign and private entities alike.

But sovereign investors must appreciate the public concerns that have been raised on all continents with regard to the objectives and effects of these funds.

While investment policy should not become politicized, it is important that sovereign investors be mindful of the concerns that have grown as the size of their assets and investments have grown.

The central question surrounding sovereign wealth funds and other sovereign investors is whether they are motivated simply by commercial interests – that is, achieving sound returns on investment – or by other political or strategic interests.

This concern was expressed recently by a senior Senator with oversight over foreign investment in a *Wall Street Journal* opinion piece.

He wrote that "investments by foreign governments are inherently different than private investment. Sovereign nations have interests other than maximizing profits and can be expected to pursue them with every tool at their disposal."

While long-existing sovereign wealth funds, for example, have operated in the interests of commercial goals rather than non-commercial ones, the Senator is not alone in the United States or abroad in perceiving sovereign wealth funds as prone to operating on non-commercial terms. We must address these perceptions.

U.S. Secretary of the Treasury, Hank Paulson, is leading a review of sovereign wealth funds under the auspices of the President's Working Group on Financial Markets.

The Treasury Department last year called upon the International Monetary Fund, with the support of the World Bank, to develop best practices for sovereign wealth funds, building on existing best practices for foreign exchange reserve management.

Such 'best practices' would serve to demonstrate that sovereign wealth funds can continue to be responsible, constructive participants in cross-border investing.

The Treasury Department also called upon the Organization for Economic Cooperation and Development (OECD) to identify best practices for countries receiving foreign government-controlled investment.

Such 'best practices' would serve to avoid the adoption of protectionist measures by using well-established principles embraced by the OECD and its members for treating foreign investment generally.

It is essential that governments and sovereign investors take complementary steps to mitigate calls for measures that could have the effect of limiting the benefits of commercial investments by such investors.

In a recent *Foreign Affairs* article, Deputy Treasury Secretary Bob Kimmitt outlined what some of these complementary steps could be.

He urged countries receiving sovereign investment to avoid protectionism and to uphold fair and transparent investment review processes.

He urged sovereign wealth funds to invest commercially rather than politically, to be transparent, and to compete fairly with the private sector.

Adoption of these and other measures by sovereign wealth funds would go a long way toward mitigating the rising concerns about these funds.

Without greater transparency by sovereign investors generally, the risk of a backlash against these funds will increase, along with more urgent calls for regulatory mandates.

With the help of the IMF, the World Bank and the OECD, we can manage the rising importance of sovereign wealth funds and other sovereign investors in a manner that builds public trust and maintains the climate of open investment.

With each passing year, the liberal movement of goods, services and investments across borders is more and more important to America's economic growth.

Over the past year, about 40 percent of U.S. economic growth has been due to exports. Economic growth attributable to cross-border investment would push this number even higher.

We live in a globalized world. We are better off for it. Numerous studies by the World Bank and others have made clear that nations that are more open to trade and investment enjoy greater economic growth than those that are less open.

In addressing concerns raised by the emergence of sovereign wealth funds and other sovereign investors, we cannot lose sight of the benefits of our long tradition of embracing foreign investment in this country.

Thank you.