THE BROOKINGS INSTITUTION

SOVEREIGN WEALTH FUND BRIEFING

Washington, D.C.

Thursday, December 6, 2007

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P R O C E E D I N G S

MS. BRAINARD: Alright, let us begin the program. Please take your seats. We are having a very wintry morning today in Washington; so, we will just have to begin, and the remaining participants can join when they arrive.

We have a great line up of speakers for this briefing, and a lot of people around the table who work in and around these topics; so, I think we can have a terrific conversation whenever the rest of the attendees arrive.

This is obviously a topic that has captured the imagination to say the least, both of Wall Street, and, of course, here on Capital Hill for better or worse. And we're delighted that both Diana and Gerard could come from such long distances to be with us here to talk about them.

Both of their institutions have recently released reports that have gotten a lot of attention for trying to look at these players and set them in context, do some numerical estimates about how big they are now, but more importantly how big they are likely to grow.

And we're also fortunate to have Ted Truman here with us and Martin Bailey, who have both worked on these issues as well, and there are some people around the table who have done some reports that we'll try to get into the discussion.

Now, you know, why is everybody so mesmerized? Well, I think maybe it was Ted's paper -- I can't remember from one of these studies I've learned that Kiribati had one back in 1956, so they're not new. Nobody probably spent a lot of time or attention on Kiribati's sovereign wealth fund in 1956, but, you know, what is new is that in the last few years, a lot of these funds have become more active, have grown very fast. They have spread to a set of new players, and all the underlying drivers suggest no reason to believe that they're not going to continue to grow very rapidly under a range of scenarios and both Diana and Gerard will talk about that.

The second factor is probably some of these are moving their assets into higher risk investment strategies, so there’s some interest in what does this imply for the financial markets, and I think, you know, here in Washington, these funds are just the most visible manifestation of a much broader shift in power away from the industrialized economies to both commodity producers and also to new manufacturing export powerhouses.

So in some ways, they're capturing a broader set of anxieties.

What I think you’ll see from Diana’s comments and Gerard’s comments, depending on where you sit, these entities are interesting from different perspectives. When you sit in Washington, you care greatly about government ownership and what makes them different as a result of that. When you sit in the financial markets, you care greatly about how will they affect financial markets and will they act like existing players? Are they like hedge funds? Are they like private equity funds? Or are they fundamentally different?

So the McKinsey study is really looking at broader set of players and placing them in context. The Standard Chartered study is kind of going deep and then Ted looks at them from the perspective of the government ownership and puts them together with other types of concentrations of government foreign assets.

And so we get very different answers depending on whether you’re looking at them from a policy perspective or financial markets perspective. And then, you know, some of the questions that come up is, you know, are they playing by different motives. They clearly are concentrations of wealth that, unlike hedge funds, unlike private equity funds, have grown not because they're being rewarded by the market for having been successful.

So they really are very different on a number of fronts. And then this raises questions of transparency of governance and accountability and both Gerard and Ted will speak to that as well as Martin.

So let’s get started with an exploration of how to think about them how big, how fast they're growing, and then we’ll start with Diana and move to Gerard and then to Martin and then start to segue also to some of the policy questions and bring Ted in and then bring some of the other people around the table.

Quickly on just bios, you have them in front of you. But Diana, for those of you who don’t know her, is the Director of the McKinsey Global Institute, which is the kind of think tank of McKinsey, which has done a lot of very interesting work looking at things like off shoring, looking at climate and conservation, looking here at financial markets issues.

Gerard Lyons is a chief economist and group head of Global Research at Standard Chartered and has been in and around a variety of European and international banks for many years; and has done a lot apparently quite successful forecasting. So I’d like to hear the secret of that.

Martin Bailey is -- has returned home to Brookings very recently, where he’s heading up a new initiative on business and the economy. Everybody knows him well from his time as Chair of the Council of Economic Advisors. He has been an advisor to McKinsey and has worked on this set of issues with them and is one of the leading experts on productivity and competitiveness, and a whole variety of other topics. And Ted, who’s not on the formal agenda, but should be, is over across the street at our sister institution, the Peterson Institute, and was both at the Fed and at Treasury in very senior positions and has written and thought a lot about these issues recently.

So let’s start with them.

MS. FARRELL: Good morning, and thanks for venturing the snow to get here.

What I hope to do in the next few minute is just to provide the context in which these developments are occurring and it really stems from the work that we at McKinsey Global Institute do on capital market developments, globally.

We have over the span of five years been mapping what are the major changes in the global financial stock -- cross border flows, different positions of countries around the world. And we bring to it, in addition to what the IMF and some of the other organizations that do this from a macro and self-reporting level, the experience that we have on the ground in many of these markets to really try to begin to understand what is this process of global capital market integration all about.

What we learned in the last round of that work is that for the first time, the sort of global financial stock, globally, it’s about $167 trillion by the last count, and before very recently, these players, which, as Lael says, are not at all new, emerged as newly powerful. And so we describe them as power brokers, new power brokers, not because they're new, but because they're newly powerful.

But it’s helpful we find to think of these four -- petrodollars, Asian Central surpluses, hedge funds, and private equity -- as a group partly because they reinforce each other in very important ways.

There are very strong linkages across them and because the combined impact on the four of them is where we see some of the more interesting developments in the capital markets more broadly.

Let me introduce the players as we see them and then talk a little bit about why we think they're actually structurally part of the capital markets today, what we see is some of the more benign developments they bring, and perhaps some of the concerns that we see raised, our perspective on those concerns.

So the four power brokers, as I said, are first petrodollars. They're the largest. It’s about $3.4 to $3.8 trillion dollars of surplus into the global capital market. This is, of course, a large number of different players. It’s the GCC. It’s the Middle East economies. But it’s also Norway and Russia and others.

The second is the Asian Central surpluses -- again, a combination of countries, primarily China now first, second, Japan, a couple of others -- Taiwan and others. And the surplus that they bring into the market is not only a consequence of their trade position, but also their foreign exchange rate policies and, of course, the foreign direct investment picture that is there.

Now these two are part of the picture, and we characterize them as sources of new liquidity into the market.

The next two are really vehicles for managing that liquidity into the market, and they are hedge funds and private equity. Hedge funds today are probably about $1.5 trillion dollars, unleveraged. Fully leveraged they are north of $6 trillion.

And we really do see that these are a set of players that were sort of mavericks until very recently and are now absolutely mainstream in the roles that they're playing in the capital market.

Private equity, interestingly, that for a long time the one that got the most hype is actually the smallest at around $700 billion, and this is really a development of just achieving a lot more scale and a lot more action not only in the private markets where they have traditionally played, but increasingly bringing public companies back into the private sphere, and we do think that they are contributing more to a different corporate governance model, a hybridization of the existing governance models.

Now together, these four players come up to about eight and half trillion dollars once you take out all the overlaps, and that’s about 40 percent of global pension fund assets. So that’s a way of sort of calibrating just how sizeable they’ve gotten.

Their growth is really a five-year phenomenon. So this is a new center stage.

They're growing about two or three times as fast as the underlying pension fund assets, insurance assets, so otherwise, private equity at around 14 percent, and the liquidity sources are more like 19 and 20 percent. It’s very, very fast growth in this context.

Now I say that it’s important to look at them jointly, and I think that’s right because we do find that they are mutually reinforcing in many important ways, and so we have petrodollars fueling the hedge fund houses.

By our estimates, some 25 to 50 percent of hedge fund activity is actually petrodollar funds. And that’s a relatively little known dynamic, but an important one.

We also see, of course, that hedge funds are creating their own private equity firms, as are some of the Asian surpluses are generating not new private equity activities, but in some cases more active and more extensive ones. We find, of course, the private equity is leveraging through hedge funds and we find that all these connections across the four players actually matter a lot in the ways in which they -- the roles that they're playing in the markets.

Now importantly, we think that this structural. And the reason we say that as opposed to a temporary response to high oil prices or otherwise is that in each case we’ve gone into detail to say look at a scenario of low oil prices. Would that significantly alter? Look at a scenario of a contraction in demand in Asia. Would you see a very different surplus scenario there? Look at the investor appetites for the kinds of investments that are out there. Do you see a decline in appetite for alpha, which is what hedge fund do when they're successful providing or extraordinary returns based on better operational performance, which is again when they're successful what private equity firms are doing, and we say all of these, even under very conservative situations will continue growing. All the more so, because they have now accumulated a level of assets that imply the income on the assets will generate growth going forward.

And so we see them playing an important role already and one that will remain. Just to put a number to it. The most conservative assumptions you could think of that are reasonable, absent some catastrophic event, would have the assets of these four players double by 2012.

And under more sort of base case type of scenarios, we could see them getting as high as $20 trillion, $21 trillion. That would be three quarters of global pension fund assets by 2012. So meaningful.

Now how do we think about this? Individually, some of these have major clout. You think about China's Central Bank now $1.3 trillion of assets externally. That's arguably the single largest investor out there in the global capital marketplace. Saudi ARAMCO, if it were publicly listed would be twice the market cap of GE. That's a way of sort of sizing how big these are individually.

Well, we think that it's important to understand their impact in a balanced way and would argue that the debate right now has weighted too heavily on some of the concerns and insufficiently and potentially some of the benefits they bring.

So let me start with the benefits and say that the first one we see is that it is adding significant liquidity in many markets that's making the cost of capital lower and access to capital better. You could argue that we've had a bit too much of good thing. That's possible, because we've seen some of the froth in the credit markets. But as a general rule, if you look at the U.S., which has been absorbing most of this capital, we estimate that the Asian surpluses have contributed to something like a 55 lower basis point interest rate, long-term interest rates in the U.S. Throw in the petrodollar money, another 20 basis points.

So something like 75 basis points lower interest rates in the U.S as a result of this liquidity. Again, it may have been a little too much of a good thing, but in general, that's a benign development.

And it's not just a U.S. phenomenon. The liquidity we see has spread beyond the U.S. because, for example, petrodollar money, 25 percent of it, of their assets, or so are making their way into Asia and North Africa, which are systems that have been very shallow from a financial point of view traditionally and they are now beginning to become better intermediated as a result of some of this liquidity.

So that's one benefit I would put on the table that I don't know gets enough attention.

The second one is when you look at the investment preferences of some of these players, they are pushing the frontier in terms of horizons -- longer term interests. They have a high risk appetite as a general rule. They're taking more concentrated positions in individual stakes and the result of that is, in fact, the reshaping or expanding the risk return frontier, which as a general rule is a good thing. It provides a broader menu for different investor appetites which allows risk and return to be better matched.

And we see instances of that actually translating into more activism. When it works well, it is better performance overall of these assets. I'll talk about when it doesn't work so well sometimes and we do see evidence of that.

The third dynamic that we're having that we would put more in the benign camp, although each of these is a double-edged sword, as I've been pointing out, is the -- that the ways in which these players are reshaping the public-private definitions of corporate governance and capital markets and you take, for example, the view that some people held that the activities of private equity firms were the demise of the publicly traded market because they were taking these large publicly traded companies, bringing them private, and this is the next wave.

We take a slightly different view, which is to say it’s not the end of the public markets. It’s the beginning of a hybridization of several types of corporate governance models, private and public, government and private sector, and so we see this notion of state-owned companies coming out of China, coming out of oil companies in the Middle East and otherwise in Asia investing in traditionally publicly traded companies. We see the private equity bringing publicly traded markets in, but raising capital in public markets, as Blackstone has done. We see these hybrid models, we think will have the effect of changing the performance dialogue, getting over some of the agency issues, some of the incentive issues that public companies had, which can be good in some ways, but also making regulatory intervention harder either because they're under the protection of a sovereign entity or because they're not -- they're obscured to the public regulators.

So this is a good transition to what are some of the risks associated with them. I think that the first risk that people would put on the table is the non-economic motives that some of these players bring, particularly associated with states that are seen as unfriendly to the U.S. or to Western Europe or otherwise, and, of course, this is the sovereign wealth fund discussion in particular with -- which Gerard and Ted can talk more about, but we would make just a couple of points here.

One is that it’s very important to realize that there are a range of players here, and so when we talk about motives of players to try to put a face on it as a single sort of government either sovereign wealth fund or entity misses the fact that there are at least six different things going on there.

We have sovereign wealth funds qua sovereign wealth funds. We have government investment corporations, which are actually a little bit different. We have central bank asset activity, again a little bit different -- all sovereign. And we have state-owned companies which are again government but a different thing. And when we think about the motives of each of these, they're different and they’ll play out differently and so in calling for intervention of some sort that difference of state-owned actors is important.

Now that’s only 60 percent of the picture. There’s actually an additional two players that are not even government entities, but are playing in this added liquidity, and those are private companies that, of course, are gaining liquidity either through trade surpluses or oil money and high net worth individuals of which there are a lot, particularly in the Middle East and now Russia and others.

And so we have a more complex picture that suggests to us that this non-economic motive issue is a legitimate concern, first and foremost, but that so far has not really played out. Most of these sovereign wealth funds have, for the most part, acted responsibly. They're engaging in the dialogue of what disclosure. I will say that while they are sitting at the table, it’s our perspective that the traditional Anglo-Saxon notions of disclosure and transparency will be challenged in a new dialogue that will come out in a slightly different place than where we’ve been for the last while and I think that’s just a realistic view of the situation.

Second concern is the potential for inflationary pressure, particularly in the form of asset bubbles. And one might argue, as I said earlier, that all this liquidity may have been a little too much of a good thing. Have we seen evidence of asset bubbles, and I think we just make a big differentiation between the public markets, where it’s quite hard to make a case for asset bubbles. You look at the U.S. where most of this liquidity has come in, and price earning ratios have actually been in decline. In Europe, you’ve actually had stable price earning ratios. Japan’s been doing kind of crazy stuff on price earnings, but it certainly hasn’t gone up by any stretch of the imagination.

And so I don’t think there’s a lot of evidence in the publicly traded markets. In the private markets or the illiquid markets perhaps something is going on there, because we see the real estate froth and we don’t know where that will come out, but clearly has been fueled by some of this liquidity and some more liquid assets beyond real estate like art and otherwise we do see potential froth in those markets.

The third set of risks are really around have these new players introduced more credit or systemic contagion risk into the marketplace overall. And I think that’s a good question given that in the case of private equity and credit, we do see more leverage in the whole system and we saw, for example, in the subprime crisis recently contagion effects coming out of the mortgage markets even into equities and otherwise. Is this more risk than we've had before?

And we would say the following. First, there is risk. The risk never went away, despite the fact that people thought they were making the risk go away. Having said that, it's not at all clear that there is more risk in the market relative to the just broader size, and we say that because we look at what the potential impact of significant fallout in the credit markets would be today if you had some of these private equity firms go under. In the U.S. private equity is about five percent of the total market cap. Europe it's about three percent. Clearly, it would be meaningful. It's not likely to be devastating absent some other sort of perfect storm kind of situations.

As far as the systemic risk and contagion, our view would be that again the risk is still there, and we do see that as these players get bigger and do more different things across fixed income equities, et cetera, you have the conditions for that. Having said that, the robustness of their systems is improving dramatically. And maybe more importantly, we've seen a real shift away from directional strategies which is what hedge funds used to do by the large part, which is now more in the vain of market neutral strategies, which we think tends to at least suggest that the risks have not increased, but obviously they're still there.

So let me just stop there, and just leave these couple of thoughts. We think it’s helpful to think about this whole discussion, the sovereign wealth fund and others, in the context of the broader developments of added liquidity and new vehicles for managing liquidity. We think these players are newly powerful and will change the name of the game, and it’s a structural change that will continue at least for the near term five, 10 years or so.

We think that they bring both benign and concerning elements together, but we need to bring those in balance with one another. Let me leave that there, and turn to Gerry.

MR. LYONS: All right. Thank you very much. It’s a pleasure to be here and my comments follow very much on from Diana by focusing solely or more particularly on sovereign wealth funds. There’s three parts to my short talk this morning. First, I’d like to put some context around the context issue, sorry, of sovereign wealth funds; second, focus on what they do; and then, third, look at what we should do in response. So basically, context, what they do, and basically how we should respond.

Sovereign funds. Lael mentioned at the beginning that they're not new. Some of them have been around since the ‘50s, so the question one has to ask is why all the fuss, particularly over the last six to 12 months?

And I would say it’s a whole combination of factors coming together at the same time. The number of countries with sovereign wealth funds is increasing. Indeed, 12 of the biggest 22 have started since the millennium.

The amounts at their disposal are huge, and the possible investments are more controversial.

The controversial element has very much been highlighted by the origin of some of these funds, with particular focus and concern about funds coming from Russia and from China. Although it’s quite ironic in the case of Russia, as I’ll mention later, they're quite an open and transparent fund. But I think it links into wider issues, such as energy security.

So basically, a whole combination of factors have come together. There have been a number of recent reports about sovereign wealth funds. One thing that's common about all the reports is that no one agrees as to the size of these funds, and that's partly because the funds themselves are not very transparent, and we've just heard about private equity and hedge funds. Our estimates of the size of the sovereign wealth funds is $2.2 trillion in terms of our report.

Although since that report was written, I've actually been told by a very senior person at one of the funds that we were well off the mark. And so we are reassessing some of our figures.

But overall, these are only 1.3 percent of global financial assets at the moment, and it's very difficult to quantify exactly how big they will become, because it depends on the whole number of circumstances, including the macroeconomic outlook.

But at the very least, one can say in qualitative terms, they will become much bigger, and I agree with Diana that this is a structural shift.

The source of the money for sovereign wealth funds in our view comes from four different areas.

One it's commodities. Second, it's foreign exchange reserves, which is particularly important in terms of China.

Currently, China's FX reserves are $1.3 trillion. On current trends, assuming no overall change in policy, and that's allowing for a 7.5 percent appreciation of the CMY per annum, China's reserves will reach one point -- sorry -- $2.16 trillion by the end of next year.

It's not clear where those additional reserves will go. In fact, behind the scenes in China, there's a big battle shall we say as to whether Lu Ji raise funds to get the additional reserves or indeed whether the money should be used more practically elsewhere.

But nonetheless, FX reserves are one of the sources of some of these funds.

Third, which has been particularly important in recent years, is investment income -- the fact that these funds have done very well, although one could say in these markets everyone has done well.

And fourth is the discretionary element. Different countries are announcing sovereign wealth funds as the thing they should have, and Malaysia, they might use bond issues, et cetera, but basically there’s discretionary elements.

So bringing the four together -- commodities, FX reserves, the investment income, and discretionary items.

Many people, for simplicity’s sake, tend to differentiate between commodities and non-commodity funds. It does raise wider questions:

Are the growth of sovereign wealth funds reflecting a lack of flexible exchange rates?

Are they just reflecting a cyclical boom in oil and energy prices?

Or, as came out at the OECD last Friday, where I was speaking on this topic, someone from one fund said that one needs to look at them as being reflecting different countries at being at different stages of development, and governments basically wanting to move up the value curve, as I’ll come to later.

One aspect that’s quite clear about these funds is that they are heavily concentrated. We called it a Super Seven -- Abu Dhabi, GIC of Singapore, Norway, Kuwait, China, Russia, and Temasek. Of course, definitions vary. One could include for some people Saudi Arabia in here, but we don’t.

Transparency is another big issue, which, I think, should rightly concern us. Some funds are very transparent -- Norway, Alaska, Temasek, and Malaysia.

In contrast, some funds are very secretive; in fact, most of the Middle Eastern funds -- China, Brunei, Venezuela, Taiwan, Oman.

And in terms of investment strategy, all of the funds, or the bulk of them, claim that they are commercially driven, but what’s uncertain is the strategic aspect of some of these funds.

So that hopefully gives you some context that it’s a whole host of issues -- the origin of the funds, the concentration of the money, the source of where they get their funds, their transparency, and their investment strategy.

The second part to my talk is what do they do, or indeed what do we know or what do we fear they could do?

And here the market and strategic aspects very much come together. I think we need to be quite clear about the issue. It’s a -- the issues are between commercial versus strategic and between private versus government.

A few weeks ago, I testified before the

Senate Banking Committee, as did Mr. Truman, and at the beginning of that committee, I thought it was -- Senator Bayh, who was very impressive, began by reminding us that in 2001 in Washington, a big debate at the time -- it's hard to believe this actually now -- was that America was going to have a perpetual budget surplus and might be able to repay its national debt. It shows how times can change.

But he then quoted from both [then Federal Reserve Chairman] Greenspan and then Treasury Secretary Snow, who both basically said the same thing in terms of these quotes. And we should not allow the U.S. government to buy U.S. private sector companies.

And Senator Bayh started that session by saying if that was the situation here in Washington six years ago that we shouldn't allow the U.S. government to buy U.S. private sector assets, why should it be any different now about foreign governments being able to buy U.S. assets?

And I think that's a very valid point. Now there are, however, as in many things in life, pluses and minuses. Sovereign wealth funds, as has already been mentioned, do have some positive benefits. They are seen as long-term, stable investors. Many of these funds are commercially driven. And indeed as Citi found out last week in the present market turmoil they're a source of much needed liquidity and capital.

Indeed, I should say at Standard Chartered, sovereign wealth funds are shareholders in Standard Chartered. In fact, our biggest shareholder is Temasek.

We, however, make sure that they do not run our strategy, and we treat them like any other big investor. But it is a challenging issue for many firms in the future.

Interestingly enough, if you go across the emerging markets -- in Standard Chartered 95 percent of our business is in Asia, Africa, and the Middle East -- what's interesting is that there's a very different perception of emerging -- of sovereign wealth funds in other countries around the world. People see them as a force for good, largely, in my view, because the feeling is that any income -- investment income coming in is good and indeed, if used correctly, much of this money coming in can be used to deepen financial markets in some of these countries around the world.

In my view, I see sovereign wealth funds not only doing what they’ve already been doing, but I think they're going to have a bigger impact in some other areas in coming years, and I’ve highlighted four.

One, in emerging markets themselves. And I think this reflects the changing balance of the world economy. In fact, the Asian Development Bank early this year at Kyoto, when they had the annual meeting, one of the big issues was how Asia, again on current trends, is going to grab a bigger proportion of global trade. By 2020, Asia will account for over one-third of global trade; the U.S. will only dominate one seventh. That’s basically a two and one-half times difference.

And basically new trade corridors are being seen and sovereign wealth funds in my view will start to invest more in the nascent equity markets around the emerging world.

Second, I would expect to see them -- and some of them already are planning to do this -- put more money in alternative investments, whether it’s hedge funds or private equity.

Both naturally reinforce the commercial aspect of sovereign wealth funds. But there are two other aspects of sovereign wealth funds which I term states' capitalism.

I expect to see more money reinforcing those countries with strategic aspirations going in -- more of the money going into certain countries. In particular, I'm talking about China into Africa, although it should be said that the money doesn't have to go via a sovereign wealth fund.

Also, I would expect to see more money going into sensitive sectors, and I'll come onto that in a second.

But in commercial terms, I think they'll reinforce a trend away from fixed-income into equities and they'll reinforce a trend away from the dollar in global FX portfolios.

This leads to some market issues that I think we should consider, and Diana touched on one or two of them.

Regulators around the world I speak to are worried about the potential distortion from the larger role of these sovereign wealth funds. I think this is a particular issue in countries that don't actually talk about this as an issue at the moment, particularly smaller equity markets in the emerging world.

It makes a lot of economic and maybe strategic sense that if you think a particularly company listed in Vietnam or wherever is going to become important, that it makes sense to buy a stake in it now. It's quite cheap.

There's also likely to be a concern about resulting in an inefficient allocation of capital. And that's linked them very much to the issue that there might be perceived unfair competition with private firms.

When one talks to people in the private equity world, they already see sovereign wealth funds very much on the commercial side, but there is an issue as to whether because sovereign wealth funds are not playing by the same rules, they can have a pursuit maybe of a strategic investment aspiration that can override economic return that the private equity firms are looking at.

And also concerns have been expressed to me by some regulators about financial stability, given the non-transparent position in certain markets and asset classes, although, of course, these issues could apply to lots of other investors.

There is a strategic aspect, which, at the moment, is more a fear than the reality. But I think it’s something that certainly in the U.K., where I come from, is being sort of talked about, although, in my view, is not being addressed.

It makes a lot of economic sense for countries from where these sovereign funds come to actually try and move up the value curve.

If you take China, which is growing phenomenally, based largely on low income -- oh, I’m sorry -- low wages, I mean it makes sense for them to use anything they can to basically move up the value curve. But it’s true for other countries as well. But so it’s true for other countries as well.

That would in my opinion imply buying assets in energy, assets in the financial sector, assets in the media, assets in telecoms, or basically anything that gives you greater access to intellectual property rights. It makes economic sense, and I would argue it makes strategic sense.

Also, I think it’s linked into the whole issue of resource nationalism. And, of course, in this area I don’t think it’s just about sovereign wealth funds.

I would say that China into Africa is a classic example of how this is a broader issue linked into the concern about the origin of these funds.

Take how China has actually -- the pendulum between China and Africa has actually swung violently in recent years. It was very much in China's favor. Then African countries reacted. China then engaged African leaders. This time last year 50 African leaders were invited to Beijing. This May the eight African Development Bank meeting took place in Shanghai. At the end of that meeting, $20 billion was announced as being made available for Africa, which coincidentally just exceeded what all the G-7 countries in totality had offered to Africa over the next four years.

And China has since then added further money.

So it's not just linked into sovereign funds. It's linked into a broad issue.

But what do the funds themselves say or what would they argue in their defense?

If someone from the Russian funds was here, they would actually argue that their fund is pretty transparent. It tells you exactly that they're going to invest in triple-A rated assets in 14 countries. They're looking for maturities of three years to three months. Forty-five percent will be dollars; 45 percent will be euros; 10 percent will be pounds. That’s pretty transparent, although not completely transparent compared to some other funds.

But, as I say, it’s a wider issue.

China -- since the whole debate about sovereign wealth funds has taken place, it’s interesting to note that Lu Ji Wei, who runs China’s fund, is now on the global charm offensive, as I would call it. He turns up in London next Monday having as far as I’m aware of being in Singapore just recently.

And as a big Middle East fund said to me, and they’ve said this on the record, so I don’t mind mentioning it in this context, their feeling is that local society dominates in the Middle East. Therefore, they don’t feel they have to share all their information.

They do have weekly coffee annual reporting. They have internal and external audits, and they also have an investment strategy committee. But they don’t make any of this public, but their feeling is they don’t have to.

And when one talks to sovereign wealth funds generally, they argue that why should they be transparent when hedge funds aren’t. I argue that two wrongs don’t make a right. Both should be transparent. And also many of them talk about CalPERS. They fear that CalPERS and others like them have strategies that are equally questionable.

But I think again it’s not a case of saying because someone over there does something that you don’t like means that you should defend your position. It does give us a feeling as to where people are coming from, which leads onto the third part of my talk, which is what should we do about this?

In some respects, as has already been mentioned by my colleagues up here, we have to step back and recognize that this is a sign of how the world economy is changing. I don’t think it means that suddenly America is no longer important. But the balance of power is changing and within that not everyone plays by the same rules.

I think it’s linked in to the debate in recent years about how global policy fora need to change. But for global policy fora to change I think all parts of the world need to actually engage in that process, and it’s not clear to me everyone is.

And in terms of sovereign wealth funds, it throws up an immediate problem as to how to actually proceed here -- ideally, multilaterally, but in reality probably we’re going to proceed regionally and nationally.

In the U.K., we talk about the Wimbledon effect. Basically, England has the best tennis tournament in the world, but never wins it. But the important thing is the tournament takes place in London.

Similarly, we have the same approach in the City of London -- the Wimbledon effect. It doesn’t matter that the city is basically owned by foreigners as long as they actually play in London.

But I think there are now wider concerns, because as I would say, I believe that the U.K. economy is up for sale, and I think the whole question of ownership will be really tested in the next couple of years.

We’ve only really had a problem in mid ‘70s when Kuwait was speculated to be buying BP. So we do protect sensitive and secure areas, but I think the debates will very much be tested out in my opinion in the U.K.

Whether it’s the private or the government, I think it’s clear that rules are needed, and our response needs to be based on sound analysis and clear understanding. It was good at the IMF G-7 that they had a meeting with eight of the big funds -- China, Korea, Kuwait, Saudi, UAE, Singapore, Norway, Russia.

So at least there’s some engagement, and I think that needs to continue. The OECD is trying to sort of promote open investment regimes and it may be they’ll run with this whole issue.

I think the aim for all of us in the room and ideally these organizations like the OECD is to promote an investment framework that’s fair and commercially driven, and to address concerns without any unnecessary constraints on capital flows.

But I think there are some things that we should aim for. We should aim for best practice. I think sovereign wealth funds should be made to be more open and transparent. While secrecy in itself does not guarantee that you’re a good investor, in the financial environment where transparency and accountability are big pluses, I think it’s an important issue that should be pushed. And the fact that some sovereign wealth funds are open and transparent and can do what they want to do means in my mind that all of them should be open and transparent.

I think we should look at how we can curtail any strategic influence of these funds if they take investments in the West. Some people have argued that this should be to encourage investment by third parties. Others have said that it should mean non-voting shares to restrict the overall managerial involvement.

I’m not sure, but at least these are issues on the table. And when it comes to strategic investment, in my view, I think it’s every country’s right to defend strategic areas.

The problem is one country’s definition of a strategic area may not be the same as another, and, therefore, we have to be aware of the possibilities of law of unintended consequences or the backlash.

If you try and stop funds coming into certain areas, all they might do is just put all of their money into emerging market equities and you’ll see these funds starting to dominate in countries which are likely to become much more important in the future.

I think we need to have clear lines as to what's on and what's off in terms of strategic investments, and also I think we need to address some of the factors behind the growth of these funds, particularly in the non-commodity funds -- basically, China's currency policy. And finally, I think we need to push for level playing fields. Not everyone has the same idea as to what a level playing field is, but, like most things, I think we need to push for it, be patient maybe, and to understand people's initial starting positions.

So in summary, I think there are three areas. First to understand the context behind these funds; second, to appreciate what they do. Some of them are very commercially driven, but there is in my view a strategic aspect that I think could become more important. Third, and finally, what we should do. In some respects, it's a reflection of how the world is changing. And if the world's changing, then it's all the more important for us to actually have an open debate about this and other issues to try and have clear global ground rules. Thank you.

MR. BAILY: Thank you. I appreciate that. I learn something new every day. I couldn't understand why BP seemed to be calling itself Beyond Petroleum as opposed to British Petroleum, but maybe it's reflecting that the diversity of its shareholder base, for I can't think why Kuwait would want to go to Beyond Petroleum as the name.

Anyway, I had the opportunity to participate in the McKinsey capital markets work and learned a lot from that. In my comments here, I'm going to not certainly reflect the views of McKinsey nor particularly of Brookings, but my own thoughts about some of the issues around sovereign wealth funds.

As has been remarked earlier, and as Ted Truman made clear in his testimony recently, these things have been around for a long time. But I want to make a slightly different point around that, which is if you go back to the 1950s or even to some extent still today, the U.S. has traditionally been a huge or U.S. companies have traditionally been huge investors overseas. And while we view that as being somewhat different -- those are private sector companies as opposed to the U.S. government -- I think to the rest of the world it often looked like the same thing that

GM was in some sense a reflection of America and so the U.S. has had the opportunity I think to benefit greatly from this overseas investment, and so before we sort of get too much on our high horse about not wanting foreign governments to control our own economy, we should remember that there's a certain amount of tit for tat here; that globalization goes two ways, and if the U.S. has advantages from investing overseas, we need to be receptive to that kind of investment in the U.S.

Now concern obviously in the '80s and early '90s. We talked about Japan, Incorporated, so that was a little bit sort of coming back the other way. We were concerned that Japan was buying up the U.S. I think one of the lessons from this is that those concerns are generally exaggerated; that we don't get bought up by the other countries, certainly not an economy as large as the U.S. doesn't get bought up. Maybe smaller economies, Canada and the U.K. have to be more concerned about that.

But the U.S. is such a large economy; it's unlikely in any reasonable time horizon to suffer from that problem.

Let me talk a little bit now about what might some of the concerns be around sovereign wealth funds and some of these have been touched on.

The first one is around acquiring technology, and that's been a big concern in Europe. Angela Merkel and I think she's trying to gather support within the rest of Europe. She was concerned about the beginnings of the Russia Fund wanting to invest in Deutsche Telecom and EADS. So the concern was that they were going to buy the company, buy the technology, and then use it to ship back to Russia.

Now is that a legitimate concern or not? I can see why it is a concern. I mean, traditionally -- the traditional model in a sense that's still a model many people have is that you develop technology in your own country and then your workers, your economy gets the full benefit.

But to a great extent, that model is no longer applicable. Certainly, American companies that develop a technology apply it in their operations around the world. They don't just apply it in the U.S.

So is it -- are we still in that situation where we're trying to preserve our crown jewels of technology or do we simply now operate in a more global environment in which we shouldn't be so concerned.

There I do think it's a difference whether it's a private company or a public company, but some of the effects may be the same.

Now one issue, of course, is that do they overpay or underpay for technology. I mean, a lot of times I think foreign investors actually overpay for technology, so you may actually get a good deal selling out your technology. I've always thought that, you know, we had a lot of conflict between the U.S. and Japan in the '90s over -- between Kodak and Fuji. I've always kind of though that if Kodak had just sold out its film business that would have been a great deal. And, you know, why worry about that technology, it only had a limited life left on it.

So maybe we worry too much about some of these things.

The second concern about sovereign wealth funds is are they going to distort markets? We believe that capital markets allocate capital correctly and that means that they have to have the correct pricing of different assets so that resources are allocated correctly.

If foreign wealth funds come in and make decisions that are not purely economic, not purely in terms of the shareholder value, then maybe they will distort our markets.

For example, Norway makes the decision not to buy certain companies, most notably Wal-Mart but also some defense companies.

Now at what point do you get a distortion of the markets? You don't necessarily get a distortion just because a fund like Norway's decides to select one set of companies and not another. One outcome of discrimination, for this is what this is in a sense, is market segmentation. In the area of discrimination against people, for example, if only a few companies discriminate against women let's say or minorities, then that should not change the relative wages of those groups. If most companies discriminate in that way, then it will change the outcome. As long as it's only a few companies, you just get this market segmentation. So Norway can hold a portfolio without Wal-Mart, but Wal-Mart's price in the market would not be affected.

Now Wal-Mart obviously doesn’t believe that because they are negotiating with the fund, but that may be because they're concerned about spill over effects, reputational effects other than that.

But certainly if you have very large investors coming into the stock market, making choices that are not economic choices, then you would end up with some distortion of prices and some inefficiency in the capital market.

By the way, the rubric of all these concerns is the one that you mentioned that Senator Bayh was concerned about. We don’t want the U.S. government holding assets holding assets. Why would we want foreign governments?

Another concern is over the threat to withdraw money. If a foreign -- a sovereign wealth fund owns a very large proportion of key U.S. companies, and they say well, we don’t like your foreign policy and you’d better change it otherwise we’re going to withdraw our investment. That’s a threat that cuts two ways. Obviously, it could potentially have a negative effect on a company if a large shareholder pulls out, but it’s also going to be a very costly event for the wealth fund itself, because if you pull out of an investment very quickly, typically you lose a good bit of money on doing that.

So I think that’s a limited threat. Again, it depends a good bit on how large the investment is owned by any single fund.

So let’s address directly the point of if we don’t want the U.S. holding equities, why would we permit foreign governments to do that.

Well, how badly do we dislike the thought of the U.S. government holding equities? In that debate around the budget surpluses, those budget surpluses, by the way, came at a time when Lael and I were both in the government, so those were the good old days.

I didn’t have that much concern about it. It seemed to me that you certainly don’t want the U.S. government directly holding equities. The question more is whether there’s any arms length arrangement that you could set up that would make the holding of those assets acceptable?

For example, I would have thought that it would not be impossible to have the Social Security Trust Fund hold equities. I don't know whether that’s a good idea or not, but I don’t see any sort of huge barrier why that would be. If it were administered by an independent board of trustees that had the mandate not to respond to political pressures, but purely maximize the wealth of the recipients from Social Security, I don’t see a big problem with that.

If the government, U.S. government runs big surpluses, should it hold equities? Well, we’ll cross that bridge when we come to it. I think there would have to be very strict restrictions.

So what does that imply about what we should do about the sovereign wealth funds, and again I’m borrowing a little from some of Ted’s testimony here, but this is my own thoughts also.

As with investing in the Social Security Trust Fund, I think we should be tolerant of sovereign wealth funds that have independent boards that make sure that the investment is made on purely economic or financial grounds and not on strategic or nationalist grounds; that we should demand that if sovereign wealth funds are going to invest in our economy, they should play by those rules and be concerned about profits, shareholder value, and other issues of concern to companies, but not with the strategic value to the national economy.

Now how you would enforce that is a bit difficult. And so again, I think it would depend a little bit on how large the investment was. As long as the investment was below some limit, I don't think I would be overly concerned because there's just not that much influence they can have. If it got above a certain limit, if we're thinking about coming in and buying all of the company, then I think you would have to have that degree of independence to make sure we get the separation between the public sector and the private sector, which is an integral part of our economy.

Let me stop there.

MS. BRAINARD: Great. This is a good, actually a very good transition to Ted. And, Ted, you've got some specific proposals on the table. Can you talk a little bit about the transparency and accountability proposals, a little bit about -- you've done some evaluations of these funds on the various criteria that you would use to try to improve governance and so give us a little sense on that.

The one thing I haven't see in your writings, but I'd be interested to hear you talk about also is, you know, these are things we're asking these sovereign wealth funds to do and in some cases foreign exchange reserve managers more generally. And I think you make a good argument -- I'm not sure they would buy it, but you make a good argument why it's in their own self interest to do it, but is there -- should there be more of a bargain here, where some of the recipient, countries, the host country governments, are also putting some self restraint on the table and what would that look like?

MR. TRUMAN: Let me try to answer those questions. I agree with most of what Diana and Gerard and Martin have said. They're all three sensible people, even though we may differ a little bit on nuances.

I certainly agree that the -- I tried to be mellower at the -- since I acquired my Medicare card, I try to be mellower.

Certainly, this is a -- the world is different, and I think that's the important point. It's an important point made by Diana and her -- their work and Gerard, and this makes us very disquieted.

The -- and one of the points I'd like to make which is not quite one is-and it was alluded to is the sovereign wealth fund defined as a separate entity is only one dimension of government involvement, right? And in many respects, a lot of the things that have attracted attention actually have not been by sovereign wealth funds. They’ve been by government-owned X. Indeed, in the Russian case, to date, the sovereign wealth fund is all in passive investments, right. They're basically what? Passive investments. It’s not clear will it be in the future, right?

So the concerns about Russia have to do with government-owned corporations or highly influenced corporations and not sovereign wealth funds per se, which is a bit of a problem; right? So if you narrow everything in terms of sovereign wealth funds, they just define themselves out of the way. As Gerard said, Saudi Arabia doesn’t have what most people would consider a sovereign wealth fund, because it’s not a separately boxed in or doesn’t appear to the outside to be a separately boxed in thing. I mean they obviously have some controls, so one would hope.

So it’s disquieting. I think there are two points that haven’t really been made in this area, and one is that governments qua governments are actually not particularly good at making investments. I mean it’s the whole debate about picking winners. There are people on all sides of that issue, but government-owned banks performed less well than private-owned banks and it goes down -- not that they can’t pick some winners, but in general they don’t pick winners well. And related to that is in some sense the biggest risk in some sense to sovereign wealth funds comes from -- I won’t take it personally -- you came back for the beginning of my (inaudible) -- is to the countries themselves.

So if the money is squandered, right, since this is wealth of the country, right, if the country gets hurt and it stabilizes the country and so forth and so on.

So there -- and indeed one of the tensions in many of these funds is how do you use this money to help us, right, since many of these countries are not what you’d describe as very wealthy. Some are, right?

So China is facing this. How do you or even Korea, right -- how do you use all this money or even Japan, right? They had the house talking something. How do you use this money to help us at home? Right?

Well, once you’ve got it abroad, it is very -- it is essentially impossible to use it at home.

Clever investment bankers will create a structure, but I think fundamentally it is impossible as a first approximation, impossible to do that. And that's a political problem.

My second point is we referred to protectionism, level playing fields and so forth and so on. One important problem, including even with Martin's little proposal is it is essentially I think impossible to put the genie back into the bottle. I mean I don't know all the cases in point, but many of these entities -- I mean the one I like to cite is Kuwait has owned a large piece of Daimler since the 1970s, a large piece. And I think it probably would in some sense be disqualified under Martin's rule.

Are you really expecting to write this to be, you know, changed today? Right. And that's -- so it's not even clear how you would do (inaudible)

So that's where you end up with sort of trying to improve the environment, with best practices. As Lael pointed out and others, I have done sort of a crude attempt to do this by creating a scoreboard for what I call it for 32 sovereign wealth funds of 28 countries. And I asked them 25 questions in effect and say in the public record how do you answer those questions. Can you determine the answer to those questions; yes or no, basically. And the scores are over a wide range, available at www.petersoninstitute.org in connection with my testimony referred to.

One of the important issues here is the market thinks this is nonsense, or I shouldn’t say that. Many people in the market think this is nonsense. They say we’ve been dealing with especially the Middle Eastern companies for decades. Right. They're no problem; right? It is ironic that -- I think that’s the right word -- that the entity that scores the lowest on my scoreboard, Abu Dhabi just invested seven and a half billion dollars in Citi, and we welcomed it. That being said, I think this whole issue about practices is we’re headed there. I mean, I -- just to be a little personal about this, I put this scoreboard out in the middle of October, and at least four and I would actually think five countries have reacted to it. From the top to the bottom, if I may put it that way. The Norwegians were worried that I scored New Zealand higher.

So I mean that’s -- and I think you -- I mean in some sense we’re going there. The -- I think there are issues of data. We actually don’t -- we the United States -- don’t have very good data on all this. And we probably have better data than the rest of the world.

That’s sort of the first step of monitoring. And I think there are real financials -- there are some financial system issues; right? The way I answer the hedge fund private equity fund issue, right, is, you know, since they're investing in these things so if you’re worried about private equity funds and hedge funds, then you should worry about sovereign wealth funds who invest in them; right? If you’re not, then no. But sort of that’s the way I would -- I tell that story.

And I think you need to worry about regulated financial institutions, right, regulated financial institutions because they're regulated are different; right? Or else we wouldn’t regulate them. And the supervisors need to have some way of assuring the political forces in some sense that undue influence is not being used or there isn’t insider trading or a number of financial system abuses that are associated regulatory (inaudible).

But it may well be that yesterday's problem is today's solution. And in some sense that's pretty what Diana's preaching in some sense and half of what Gerard is preaching.

So that's basically my reaction to all that. I think that answers basically your questions, but maybe not all of them.

Did I give you enough time?

MS. BRAINARD: You did not talk about the U.S. side, but maybe I'll get Bob --

MR. TRUMAN: The upside?

MS. BRAINARD: -- the U.S. side, but maybe I'll get Bob Kaproth to talk a little bit about that. Let me open it up to discussion because time is short, and just, you know, wave your card at me.

Well, I was thinking about some of the (inaudible) questions and the broader -- so let me open it up to discussion and if there aren't any comments, then I'll turn to some other people in the room and put them on the spot, but welcome any questions before -- or comments before doing that. Yes.

SPEAKER: I just have a question for someone on the panel. Where is the IMF and the G-7 going in their effort that was launched during the recent meeting? What are they really looking for in terms of-or is that publicly known from sovereign wealth funds? I'd be curious because I mean talk about transparency. There's not much there.

MR. TRUMAN: I could refer it to Robert, but maybe I'll do it for you.

I mean the IMF has started a dialogue on this question about how whether one can put together at the request of the G-7. The IMF has a dialogue on setting up a set of best practices; right? And there are big issues about what you mean by best practices. And Gerard referred to some of those -- some of those issues.

One thing he didn't mention, which is actually very interesting is many of these sovereign wealth funds say the reason why we're not transparent is because we're protecting ourselves from domestic political issues, all right, who want to spend the money. So we told them how much money that we have; right? Abu Dhabi, which doesn't even tell you how much money they control, right, if we -- that's not necessarily an example of why they do it, but maybe. But we told them how much money. They would want it.

Now. All right. I mean in some sense this is what happened to Alaska if you want to put it that way. All right. We told them how much money it is and they've got much more of it now than rather than later. We could argue about the politics of that. So I think that's what, you know, we're best practice, but on the transparency, I mean I think the (inaudible) big issue is accountability; accountability in terms of to their domestic residents, to the markets, and to the host country; right? And transparency is just a means to that end -- as a device to establish accountability all the way around.

But I think what you're having -- I mean you're doing a process. You have a two-way process. One is the fund is conducting this right to see where there can be agreement on best practice and the institutions themselves are examining their navels if you want to put it that way. Is that like old Ted? Examining their navels to see what -- how they -- because they realize that they no longer are under the radar and so you have a two-pronged effort and one would hope that it would come together with a -- to creating a more open process, because they're not going to go away. That’s clear.

MS. BRAINARD: Robert?

MR. KAPROTH: Well, let me just try to provide a bit more specificity on what we are doing at Treasury and in the U.S. government.

We have been very focused on being neither protectionist, because we do want to stay open to investment, nor complacent about the potential implications of what we would agree is a structural shift in the global economy towards higher accumulation of cross border official assets.

And so we have thought that it is really only responsible public policy to think through what some of those implications might be. The two sets of issues that we have been focused on are first, the implications for financial market dynamics and financial stability. And here we would agree with much of what has been said about how there is good reason to be reassured, because sovereign wealth funds are in principle long-term investors that won’t deviate from their strategic asset allocation in the face of short-term volatility. They're not highly leveraged. They can’t be forced by investor withdrawals or capital requirements to liquidate their positions quickly. So there are a lot of reasons to be reassured.

That doesn’t mean that there is nothing at all to think about, though, because sovereign wealth funds can represent large, concentrated, and often not terribly transparent positions in financial markets. And there is at least the potential for actual shifts or in the absence of transparency even perceived shifts to cause movement in the markets.

The second set of issues that we have been focused on is the implications of the rise in sovereign wealth funds for investment policy. And again, here we are very focused on staying open to investment, and continuing to receive its benefits in terms of productivity, growth, employment, and so forth.

To the extent sovereign wealth funds raise national security issues, we do have a CFIUS that has existed for 20 years. Congress just passed a new bill, which we think is very good. So we do feel like we have the tool that we need there.

We do recognize, though, that there are non-national security issues to think about. Many of these have already been mentioned in terms of the efficiency of capital allocation broadly and the perception, the potential perception of unfair competition with private firms, and many of these issues speak to the importance that sovereign wealth funds be managed and make investment decisions on purely commercial grounds.

So in terms of what -- and what we have been doing and what the international community has been doing, at Treasury we've been really trying to approach this issue in a reasoned and in a measured way.

First within the U.S. government, the President's Working Group on Financial Markets has launched a review of sovereign wealth funds and that is ongoing. Second, we have supported the development of two sets of best practices, actually, and this gets to what Lael said. The first is for the IMF to develop a set of best practices for sovereign wealth funds, and in October -- October 19th, Secretary Paulson hosted a dinner with G-7 finance ministers and finance ministers and heads of sovereign wealth funds from the eight countries that Gerard mentioned. The following day the International Monetary and Financial

Committee, which is a finance minister-level committee that represents all 185 member countries of the IMF through a constituency arrangement, asked the IMF to start a dialogue on sovereign wealth funds, including best practices, and the IMF held an initial meeting roughly three weeks ago and they've posted that -- they've posted a press release on their Web site.

In terms of the specifics of what will be the outcome of this process, I mean it will have to be multilateral discussion, and so it's too early to say with a lot of specificity what that will be.

What I would say is that we do have a model because back in 2001, the IMF developed guidelines for foreign exchange reserve management, and to a large extent, sovereign wealth fund assets can be viewed as an extension of official reserves.

There are statistical issues with respect to what you can count as a reserves in terms of is it liquid, is it readily available to the balance of payments, is it readily available to the monetary authorities to meet a balance of payment need.

But essentially, these are foreign assets that are controlled by the government and which are more or less liquid, so you can take a look at the reserves, best practices in the main categories that includes what are the institutional framework, the broad objectives and scope of the fund, transparency and accountability, and risk management. You know, and it’s reasonable to think that those broad categories will form the framework of what the IMF will be discussing going forward.

The second set of best practices that we have supported applies to recipients of official investment, including from sovereign wealth funds. And the OECD has a long history of promoting open investment regimes and so what we have said is that it would be very helpful if the OECD developed a set of best practices for inward government controlled investment, including from sovereign wealth funds so that sovereign wealth funds also can face an open, transparent and predictable inward investment regime.

MR. KALLMER: I am John Kallmer. I manage investment policy at the Office of the U.S. Trade Representative, and I would just like to agree with everything Robert said. This is a set of issues we're focused on heavily as well and I thought it was important that certain of our speakers mentioned today that really the challenge from a public policy point of view is not just funds as funds, but sovereign investors as a whole, and really when it comes to the back-end question of how governments respond, I think the principles that Robert pointed out are right on and I would be really interested just to hear from people around the table, both from the private sector and from other countries, recognizing that the OECD does have a work program on the topic but also that this phenomenon is moving quickly and there will be calls for action or inaction immediately. What are some of the things that people here think governments can do or cannot do that would be most productive and constructive in addressing these concerns?

MS. BRAINARD: Cliff has just spent some time participating in the Russian debate in terms of how their sovereign and sovereign-related investments are governed, and so I thought it would be good to go into the Russian case a little bit. And then as we approach the end of time, I think I'll come back to the panelists and give everybody a generous 60 seconds to respond to any questions and final thoughts.

MR. GADDY: There have been several references to Russia and these things are extremely interesting. It is very, very relevant for Russia and of course Russia is very relevant for this discussion. I wanted to focus on something that perhaps has not been mentioned and I think could be really important for looking at the role that Russia plays.

I'll just give a little background. Briefly, you have a new Russia under Putin that regards everything that happened in the 1990s in terms of international architecture both financial and especially political, of course, and security-wise, as illegitimate because Russia was not a sovereign nation in their view, and in many ways that is true. Now primarily because of the financial sovereignty being reestablished as a top priority by Putin, they have been acting in a political way that is very different as we know especially since 2004 and 2005.

On the political side, Russia simply rejects the conventional arms agreement, expansion of NATO, the war in the Balkans, you name it, everything that we are having problems with them now they just seem to be not willing to participate constructively because they do not see any reason for them to help out in something that they had no stake in. But on the economic and financial fronts, it is a very different thing and there is an extremely important discussion going on. The Russians definitely want to be on the inside of a new international financial architecture, a global architecture, and they really believe that that is what happening now, at least a number of them do, and I will get to that in a second.

There are a number of people in Russia who really want the country to play a constructive role. Many of them are what we call the reformers and they are not entirely on good terms with the Kremlin. They are trying, however, to play a constructive role in terms of technocratic solutions and find ways that they can make proposals that will not be counter to what they perceive what the Kremlin wants and one of those is this role that Russia can play internationally.

The problem is it is a very thin group. There are just a handful of truly professional economists and others inside the government, there are also a number of people outside in financial circles and in the businesses and corporations, and they are trying to do this, sometimes on their own initiative, sometimes in collaboration with the Kremlin.

We had Yegor Gaidar here at Brookings on Monday and he happens to be one of the individuals involved. I think this is one of the most interesting under-the-radar debates or discussions that is going on in Russia right now because I think as Ed mentioned, there is plenty of sentiment in Russia to not even engage in the outside world, we have all the money we need, let's just plow it back into our own domestic economy, we do not need them, they do not need us. Those are very strong sentiments and so it is not by any means ironically clear that the Russians are out to try to invest and take over the world as some Europeans seem to fear. It might be a bigger danger that they decide they do not want to use this money outside. It would be I think bad for them and for us as well.

MS. BRAINARD: Final thoughts before we come back to the panel? Yes?

SPEAKER: I just have one. From a particularly U.S. perspective, I think one of the big issues here is whether the administration's approach through the multilateral system will be enough and soon enough to satisfy the Congress which has been more obviously politically motivated. If you look at what has been happening to the CFIUS paradigm and what happened, the deals from sovereign wealth funds are going to continue no matter what. We have seen that. And the question for all of us is there is a great tension here between national regulation versus multilateral maybe soft regulation. I do not think it is clear who is going to prevail and I think a lot has to do with the pace of the IMF/OECD process and the tolerance of the political forces in this country to sort of hold off and let that process move forward or to preempt it.

MS. BRAINARD: This is quite remarkable at this time of year; nobody has said the word U.S. election once which is remarkable.

SPEAKER: I thought I heard it.

MS. BRAINARD: Did you hear it? I think it was in there. I think there are some questions on the table back from some of the public sector folks. Mohsin Khan, I think we lost him to the snow and I do not know whether any of his colleagues are here to speak for the IMF, but in any case, let's go back through the panel and let's just go from Martin over and get some final thoughts.

MR. BAILEY: Just to go back to the issue of in some sense of the ‘we do not want the U.S.’, why do we want other countries. One concern about the U.S. is that we do not want to kind of unify, we do not want to create a socialist government where the U.S. government controls the private sector. So in some sense we should be a little more tolerant of other countries because we are not unifying it, they are diverse and have different interests, but obviously the other reason is that we want to make sure that the decisions are made on a commercial basis.

Ted said "my proposal," and I do not think what I said rose to the level of proposal, that the genie was already out of the bottle, I do not think so. What I heard from Treasury and from USTR was that they are also concerned about making sure that these investments are made on a commercial basis and they should be. That is very hard to do, but the way to do that presumably is to make sure that the people making the investment decisions have the independence and the motivation to make them in the way that we think they should be made.

I think you could have a different set of rules. If you are a very small player, if you are just talking about a few billion here or a few billion there, you are not going to have that much influence on the U.S. economy so maybe it does not matter too much if you have an independent board. The reason we are concerned about this or the reason we are talking about this is because this thing is getting much bigger. If the size of these investments become much larger, then we become much more concerned to make sure that the decisions are made on a commercial basis, and that is what I was talking about.

MR. LYONS: Thanks. Just a few comments from comments made from around the room. Just to reinforce what Ted was saying that a few of the funds had come back to him since he has written his report, it is interesting, likewise has happened with us since we wrote our report. I think we should not overlook the fact that once you start to put something in the public spotlight, it does people who previously kept off the table to actually come out, if something is in the public spotlight, people tend to try and want to be seen to be good. And as I mentioned, Lu Ji Wei (ph) has sort of been on a global as I called it charm offensive I think would not have happened if this had not been in the public spotlight. But if things are in the public spotlight, then I would encourage people to have a balanced debate and it was good to hear the comments particularly from the U.S. Treasury on that front.

Which leads on to the next point which came I thought in terms of the comments from the guy at the end of the table, when I was in the Middle East recently, someone said to me, I won't say who said it, but they said they feared that because of the reaction from the U.S., that would put people in a different point, their point being that they in the past would have seen themselves surely as being in the U.S. boat, but they felt that they were now being forced to sit in the boats with Russia and China, and they said if you sit in the boat long enough with new people, you suddenly become friends with them. Their point was that that might be, how I would say, an unintended consequence, that if people feel picked upon, then they might suddenly react somewhat differently.

I think in terms of without reinforcing everything I've said or repeating everything I've said, several funds are here to stay, there are issues, commercial versus strategic, private versus government, but I think very much that the issue is to look at this in the global perspective, and the rules of the game are changing and how the West and how the U.S. takes the lead I think will be very important because there are many small countries around the world that are already becoming more important and the balance of economic power is changing and I think it is very important that we do have some ground rules here, and I ideally would like to see a multilateral approach, but as we saw with trade, the multilateral approach broke down and people started to do bilateral trade deals. In this issue, I think if the multilateral approach does not proceed, then people will become more regional, more national, and I do not think necessarily we will get the best outcome if that happens. Thank you.

MS. FARRELL: I guess I would make an observation and then pose a question that I think is on the table, I don't have an answer to it, but I think is the core question here. The observation is that I think at this point the most important thing we can do to your point of what can people do is to put the spotlight on this, to create precisely this kind of dialogue, to do the kind of scoping and sizing that we've tried to do as a contribution to this, the kind of scoreboarding that Ted has been trying to do, the work that Gerard is doing, simply because I think that people tend to fear what's new and different and this is new, and maybe not new, but newly playing out, it is different, and so the first and most important thing we need to do, and I think it's wonderful that you are all here to do it, is let's inform ourselves, let's put the spotlight on it, let's measure it eight different ways, let's have all these dialogues because with each one I think people get closer to an understanding of can we feel comfortable or not, and certainly that has been our intent in all of this, is to try and bring this to light in the context of broader capital market developments, et cetera, to provide that.

And I am comforted very much by the conversations we have had with Treasury, with even the congressional staff people who can be impatient and otherwise, with many of the folks in that, while some of the public debate gets loud and rhetorical and that's always the case particularly around election time, most people are actually being relatively reasonable about this. We don't hear when you actually get to where most of the decisions are being made too much kind of crazy stuff out there at all, and so that has been comforting. People are getting an understanding and certainly in the conversations we have had, that is the sense we are getting. So that is my observation, I think we are doing what's most important to do first, is get the facts right, get the perspective right, and make sure that all the key players are in the room talking about it.

The question I would put on the table, and I think it alludes to some of the comments that have been made, is really this question of what is the right leadership and oversight of this whole picture, not just sovereign wealth funds narrowly, but the broader picture of global liquidity, vehicles for managing liquidity, global capital markets which is where our head is in a lot of this, and I think we are not just in the context of financial markets, but trade and otherwise, it is a very uncomfortable situation in which all our institutions were established when it was a national game and on the margin there was some stuff going on on the border and we could allow the multilateral organizations and otherwise who have very little compliance power at the end of the day to worry about that stuff on the margin. I think a lot of the work we do certainly on capital markets but not just capital markets, energy markets, trade, et cetera, suggests that we do need a very different from of leadership around what is eventually not a national boundary question, and where that leadership is going to come is a real challenge because the U.S. has less credibility in forging that leadership in the world going forward despite the fact that it plays such a dominant role in financial markets and therefore it would be natural. There is suspicion, there is this dynamic you raised about we are putting people in a boat and all of a sudden we are creating actually less ability to create that leadership.

So I don't know where that leadership will come from and that is the question I put on the table that I think is a question we all need to struggle with because I think that kind of leadership will be required. I don't think the multilateral organizations as much as they're doing good stuff, I think the IMF stuff is good and the OECD stuff is extremely good and important, is going to be sufficient because we don't have the right compliance enforcement mechanisms around that.

MS. BRAINARD: Ted, final, final thought?

MR. TRUMAN: First, I should have said thank you for asking me to join this panel, Lael, I appreciate it. Second, I'm not going to touch Diana's question though I agree it's an important question and you're just not going to snap your fingers. I think it is important to understand these issues and I think and I hope that this country which is probably most threatened by this changing structure in some sense because it is part of the disintegrating hegemony if you want to put it that way or changing hegemony is a big issue.

Speaking of elections, I think on the election point that what you are seeing is that part of this above the radar, on the radar issue now is that sovereign wealth funds, government investors, are going to be very careful. It is not an accident I say as an outside observer that Citicorp investments was informed to the Senate and the House -- before he was announced and they got positive responses. That is Mark's way of doing business all the way around. Right? And I think it wasn't an accident the way it was structured either and that helps in the short-run and it to some extent adopts the Bailey principle or whatever we are going to call it.

There is I think a basic question here, just the last thought, and the way I'll put it is the following. When I was having a conversation with someone from the Middle East on this who I had known for a long time, said I don't understand what the problem is. We tell you everything you want to know. That was true that that country told the Federal Reserve and the Treasury everything they wanted to know, but that actually doesn't quite satisfy our friends on Capitol Hill or the general public and that is part of the tension here between our way of doing things and their way of doing things that may be forcing these people into the wrong boat or canoe or whatever the image is, but we have to live with it in our own political environment and our own political environment involves that whispering in Ben Bernanke's ear doesn't quite cut it anymore, and that's my last word on that one.

MS. BRAINARD: Thank you to everyone for braving the snow. I think the conversation was very illuminating. There was a lot of agreement among the panel but obviously not a political context, so it suggests there's a lot of underlying agreement both on the private sector and the public sector side as to the implications of these entities where the big questions are where do we get from here to there on the regulatory side, and to be continued. Thank you.

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