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Reuters/ Robert Galbraith – A CalTrans worker displays a new section of roadway on the San Francisco Bay Bridge.

Rebuilding America:
The Role of Foreign Capital and Global Public Investors

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EXECUTIVE SUMMARY

Sovereign wealth funds, foreign state managed social security plans, foreign currency reserve funds, foreign government employee pension funds, state-controlled operating companies and other foreign investing vehicles today collectively control trillions of dollars in assets and are projected to maintain significant growth over the next decade. These disparate foreign government entities—characterized in this report as Global Public Investors ("GPIs")—are becoming increasingly influential players in the world economy. In the volatile contemporary global financial environment, the investment strategies of these foreign entities will impact capital flows and affect markets around the world.

Despite their growing salience in the international economy, policy-makers and political leaders in the United States have only a partial understanding of the investing practices, management and governance of these sources of foreign capital. There is finite knowledge regarding their strategic, political and regulatory implications and limited appreciation of their enhanced role in the deployment of global capital.

In this report, participants in the Brookings Institution Project on Foreign Capital and Global Public Investors have drawn on a variety of resources regarding how this class of international financial actors defines its core objectives, assesses and manages risk, and deploys capital.[1] We attempt to analyze what foreign capital and GPIs mean for the United States and what regulatory, political, and governance issues flow from their expanding size and pace of investment activity. In preparing this report, project participants interviewed senior investment professionals from sovereign wealth funds and other GPIs; consulted investment bankers who originate and execute investment opportunities for GPIs on a global basis; engaged some of the world's leading public policy researchers tracking the activities of sovereign wealth funds; held off-the-record conversations with former senior U.S. government officials; and also analyzed government data, surveyed think-tank literature and reviewed recent media and academic articles.[2] Based on these disparate sources, we seek to discern broad patterns of response by GPIs to the recent financial crisis and to assess the impact on long-term American interests.

Our goal is to fill the gaps in understanding within the policy and political communities. We aim to look beyond current paradigms of foreign direct investment in the United States to explore new models of how international entities, including sovereign wealth funds and other GPIs, might invest capital that would earn competitive risk-adjusted returns and also fund vital public priorities during a protracted period of budget deficits and dramatically enlarged national debt.

[1] The authors would like to gratefully acknowledge the substantive contributions to this study made by Derek Kirkland, Alicia Ng, Ken Miller, and Jenny Lu, and the valuable assistance provided by Mark Murtagh on global and American infrastructure investment. Views of the authors are their own and do not reflect the views of the institutions with which they are affiliated.

[2] Where a publicly available source can be cited, this report attempts to do so. But some of the analysis contained here flows from discussions with experts who required that their views and opinions be conveyed privately and not be publicly attributed to them.

With America's 2009-10 federal budget deficit projected to total $1.5 trillion and its public debt expected to rise to about $13.5 trillion this year, the need for foreign investment—properly focused and thoughtfully structured—is high. This report therefore identifies potential approaches to address long-term financial needs in partnership with foreign capital.

Participants in this study understand the anxiety triggered by certain kinds of foreign capital investment in the United States. Many worry about the influence of non-U.S. money and question the investment strategies and goals of foreign entities. It was not long ago, for example, that an attempted investment in America's shipping infrastructure by DP World, a state-owned company in the United Arab Emirates, sparked a nationwide backlash as critics emphasized the potential national security risks of a foreign entity managing maritime trade hubs. This report acknowledges that there are certain sectors that may be perceived as particularly sensitive, such as the military and defense industries, as well as selective natural resources and technology sectors and some U.S. infrastructure assets.

Yet there is an economic logic for expanding global capital investment in the U.S. According to the Congressional Research Service, foreign investment declined sharply after 2000, when $300 billion was invested in U.S. businesses and real estate. In 2008 foreign investment in the United States had surged to $351 billion but fell in 2009 to $269 billion, far below its peak.[3] In the aftermath of the financial crisis and a severe recession, the United States has pervasive capital needs for infrastructure development to enhance U.S. economic competitiveness, business investment to spur job creation, and technological innovation to fuel growth. There are multiple examples of other nations, such as Canada, the United Kingdom and Australia, that leverage foreign investment in infrastructure and other projects to finance and advance critical national priorities. While state governments generally preclude direct control or full ownership of those assets by foreign entities, minority investment agreements have proven both durable and mutually advantageous.

Our research dispels a number of myths and misperceptions about foreign capital practices and investment priorities. Based on the multitude of data-points we examined, this analysis concludes that the preponderance of sovereign wealth funds and other Global Public Investors are inherently cautious, focused on capital preservation, asset diversification, predictable returns, and the mitigation of political risk. As noted, most limit their equity ownership stake in public companies, financial institutions and private businesses to minority status and eschew direct management responsibility.

Based on our review of the practices and policies of Global Public Investors, we make a number of recommendations intended to improve the climate for foreign direct investment in the United States and strengthen the broader relationship between American policy-makers and political actors and foreign authorities with responsibility for the allocation of state sources of capital. Among our central conclusions are the following:

[3] "Foreign Direct Investment in the United States: An Economic Analysis," Congressional Research Service, February 1, 2011.

Acknowledging the Value of Foreign Capital to the United States: America's massive public debt and chronic budget deficits, compounded by projected periods of limited GDP growth of 2 to 3 percent annually, underscore the need for foreign capital—properly structured and deployed—to meet vital needs and promote long-term economic development. Xenophobic or paranoid reactions to foreign capital are not warranted given the generally conservative investment and management practices of leading Global Public Investors.

Driving Policies and Programs that Facilitate GPI Capital Deployment: The United States requires enhanced policies and innovative new programs that encourage GPI capital deployment to meet both public and private sector needs. America has a long tradition of foreign investment from European nations throughout our history, Japan in recent decades, and a variety of countries during the contemporary period. Today a surplus of capital from Global Public Investors is deployed around the world, its allocation determined not simply by the prospect of favorable risk-adjusted returns but also by calculations about the political and regulatory environment of host countries. America must compete aggressively in the contest for capital from the new class of Global Public Investors that are deploying greater resources in a diverse range of asset classes and public-private partnerships. In an integrated global economy public capital, like private capital, will inexorably find its highest and best use, based on the competitive dynamics of the global investment marketplace. The benchmarks for global capital investment, however, include but are not necessarily limited to the highest risk-adjusted return. Other inducements, protections and considerations that government can structure can influence investment decisions. The United States therefore requires a dynamic twenty-first century policy architecture to realize the potential represented by the increasingly broad reach of GPI capital deployment.

Promoting Investment in U.S. Infrastructure: It is widely acknowledged that the United States is in the midst of a crisis afflicting its outdated and crumbling national infrastructure, the rehabilitation of which is vital to American economic competitiveness. It is similarly acknowledged that federal and state sources of funding, today exacerbated by a growing pattern of acute municipal deficits, are wholly inadequate to address the scope of the challenge. Foreign capital, including sovereign wealth funds and other Global Public Investors, can aid infrastructure development through direct investment, public-private partnerships and other financial vehicles that facilitate GPI investment in local, state, and federal infrastructure projects. While the need for policies to support infrastructure development is acute, there may be a corresponding opportunity to attract Global Public Investor capital. As an asset class, infrastructure has attributes historically attractive to Global Public Investors, including relative transparency and predictability of returns on invested capital due to generally stable cash flows. Innovative public policies and government sponsored programs that support and encourage such investments could further attract Global Public Investors to U.S. infrastructure development.

Supporting Green Technology Development: Foreign capital from Global Public Investors can play a constructive role in helping to finance a Green Bank for the development of low-carbon and energy efficiency technologies, including the provision of financing for companies not currently well served by the conventional project finance market. In addition to emerging as a vibrant new industry with promising long-term growth prospects, clean technology or "cleantech" investment has become a focal point of environmental policy ambitions for both industrialized and emerging market economies. A Green Bank financing vehicle backed by the government with loan guarantees buttressing private capital investments could be potentially attractive to Global Public Investors.

Encouraging Best Practices: As Global Public Investors become increasingly central players in the international economy, expanded implementation of principles of transparency and disclosure will help to alleviate the political tensions surrounding their investing agenda and practices. Today there is great variability in adherence to the so-called "Santiago Principles" adopted on a voluntary basis in 2008 by the countries represented in the International Working Group of Sovereign Wealth Funds sponsored by the International Monetary Fund. Recently, some of the world's most prominent GPIs issued their first public disclosures. In 2010, the China Investment Corporation filed its first voluntary report with the U.S. Securities and Exchange Commission outlining its American holdings and the Singapore Government Investment Corporation and Abu Dhabi Investment Authority published their first annual reports. Looking ahead, it is possible to imagine that increased transparency by GPIs could be incentivized by new marketplace mechanisms that reward relatively greater levels of disclosure.

Stimulating Dialogue and Building Partnerships: To foster a climate that encourages investment and partnership between Global Public Investors and the United States, transparency and disclosure are principles that must be embraced by all relevant stakeholders. Amidst a period of legislative and policy activism on financial regulation in Washington, one of the most common concerns we observed was a lack of clarity among GPIs about the long-term regulatory and political environment in the United States.[4] Administration and congressional actors in Washington have ad hoc and extremely narrow channels of communication with Global Public Investors, which in turn exacerbates uncertainties about the rules and regulatory structures that will govern foreign direct investment in the United States. The absence of meaningful dialogue further limits the evolution of potential investment partnerships and new innovations in foreign financing mechanisms to deploy capital from GPIs in the United States. To remedy this problem, one of the most important yet easily implemented recommendations of this study is to create the Global Public Investors Roundtable, an informal group of administration policy-makers from the White House, Treasury, State and Commerce Departments and a range of congressional actors

[4] This frustration was expressed repeatedly but privately in multiple confidential discussions with senior managers of Global Public Investors, including sovereign wealth funds and state foreign reserve funds.

and their staff from both sides of the aisle in Washington who would meet with the world's leading Global Public Investors, Sovereign Wealth Funds and representatives of other international financial institutions on a periodic basis to share information and stimulate dialogue on economic, regulatory, tax, national security and political issues central to foreign investment in the United States. Such meetings could engender dual benefits: foreign investors could gain greater clarity into rules, regulations and policy directives that would contribute to predictability and stability while government actors could develop more robust strategies to encourage sources of foreign direct investment that have a near-term impact on job creation and competitiveness.

The following analysis describes the sources of foreign capital and the functional and geographic diversity of Global Public Investors, including modes of regulation, mechanisms for capital deployment, and contrasting investment strategies. We look at the impact of the financial crash on investment horizons and risk assessment, and note the caution many GPIs observed in the aftermath of the financial crisis. In examining the behavior and investment philosophies of Global Public Investors, we investigate common concerns ranging from the perceived political interests of state investors, the scope and degree of control associated with equity stakes, and relative levels of fund transparency. In general, we find limited evidence of political interference in investment decisions, a tendency to avoid controlling stakes in foreign companies and some improvement in fund transparency and disclosure. In the remainder of the paper, we explore the role that Global Public Investors can potentially play in vital spheres of the U.S. economy, such as investments in infrastructure development and low-carbon and energy efficiency technologies. Our analysis concludes with a proposal to stimulate a substantive and continuing dialogue between Global Public Investors and the American political and policy communities to explore issues of common interest related to foreign capital investment in the United States.

Sources of Foreign Capital

Our review surveyed several types of Global Public Investors, including state-owned enterprises, foreign government employee pension and retirement funds, state foreign exchange funds and the proliferating global order of Sovereign Wealth Funds increasingly concentrated in East Asia and the Persian Gulf and Middle East regions. Each type of investing entity embodies different objectives and management practices, and elicits varying degrees of scrutiny and controversy, depending on their goals and practices.

State-controlled and state-owned enterprises (SOEs) are commercial businesses operated by foreign governments. Russia's Gazprom, Brazil's Petrobras, Norway's Statoil, and Italy's ENI represent large enterprises in the energy sector largely operated by national governments.[5] There are over 300,000 SOEs in China alone employing over 75

[5] Aldo Musacchio and Francisco Flores-Macias, "The Return of State-Owned Enterprises," *Harvard International Review*, 2009.

million people. For example, Sinopec (the China Petroleum & Chemical Corporation) has a workforce of over one million, while the China National Petroleum Corporation has a labor force of over one and a half million people. SOEs, heavily represented in the industries focused on resource extraction, have in recent years emerged as major players in the global competition for energy and mineral resources.

Some governments have public employee or national pension funds that invest capital in American corporations, buy U.S. government securities, or take positions in a wide range of investment vehicles. Due to their conservative investment philosophy, sensitivity to "headline risk" that can stimulate government action and long-term investment horizon, they are predisposed to conventional portfolio management strategies and typically decline to purchase controlling interests in individual companies or financial institutions and do not seek to exercise management control. One example is South Korea's National Pension Service (NPS), the fourth largest pension fund in the world. In late 2010 an NPS official confirmed that in the following year it would purchase about $10 billion in the domestic foreign exchange market and that it would continue to diversify into foreign stocks and alternative assets, reducing its roughly 77 percent concentration in the global bond market. NPS manages approximately $272 billion in assets.[6] According to a survey by the Organization for Economic Cooperation and Development (OECD), the degree of regulation of state pension fund investments varies considerably around the world.[7]

The world's most closely watched investor of foreign exchange reserves is SAFE, China's State Administration of Foreign Exchange. Established in 1997, SAFE today manages an estimated $347 billion through the SAFE Investment Company, based in Hong Kong.[8] In addition to allocating state currency reserves—a significant portion of which have historically been allocated into high-grade American debt, specifically U.S. treasuries—SAFE is also mandated to draft standards and policies for the foreign exchange administration system, implementing risk management procedures and monitoring of balance of payments. According to a 2009 report, SAFE lost tens of billions of dollars in an ill-timed effort to hedge its concentration in American debt securities with a diversification push into global equities just before values plummeted. By June 2008, China's total holdings of U.S. equities exceeded $100 billion, more than triple the total of one year earlier, according to an annual survey published by the U.S. Treasury. "SAFE built up one of the largest U.S. equity portfolios of any foreign government entity investing abroad, including the major sovereign wealth funds," said Brad Setser, a former Senior Fellow at the Council on Foreign Relations, who estimated China lost $80 billion before global equity markets stabilized.[9]

The most prevalent mechanism for the deployment of state capital by Global Public Investors are Sovereign Wealth Funds ("SWFs"), which have existed for decades but have

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[6] "NPS May Buy $10 billion in South Korea Forex Market in 2011—Official," Reuters, November 30, 2010.

[7] Organization for Economic Cooperation and Development, "Survey of Investment Regulation of Pension Funds," February, 2010.

[8] Preqin Investor Intelligence Profile, 2010.

[9] "China Lost Billions Buying Stock Just Before Crash," by Jamil Anderlini, *Financial Times*, March 15, 2009.

grown dramatically in recent years. Sovereign Wealth Funds were initially conceived as vehicles to invest the proceeds generated by resource-rich states. The first SWF, the Kuwait Investment Authority, was created in 1953 to invest the country's oil revenues. But some of the world's largest SWFs are not dependent on commodity exports. Since 2005 at least 17 new SWFs have been created, including the China Investment Corporation ("CIC"), which was launched in 2007 with a mandate to manage a portion of China's foreign exchange reserves. CIC has rapidly emerged as one of the world's largest sovereign wealth funds, with an estimated $332 billion of assets under management.[10] Along with Temasek Holdings of Singapore and the Government of Singapore Investment Corporation, CIC represents an alternative paradigm of Sovereign Wealth Funds—global investing entities built on the foundation of significant mercantile power and huge export-led growth rather than vast reserves of petroleum. This distinction—between commodity and non-commodity investing entities—delineates essentially all of the world's Sovereign Wealth Funds.

From a functional perspective, SWFs typically fall into four categories. Revenue Stabilization Funds are created to cushion the impact of volatility in commodity revenues and stabilize a state government's fiscal balance and broader economy. Future Generation Savings Funds are designed to build and preserve state wealth over a long-term time horizon or to cover state pension liabilities. Holding Funds manage a state government's direct investments in companies, including state-owned enterprises, and are structured to support the government's overall development strategy. Finally, as a JP Morgan research report noted, a fourth category of Sovereign Wealth Funds "often cover(s) one or several of the previous three purposes, but their size tends to be so large that the main objective becomes optimizing the overall risk-return profile of existing wealth."[11]

Estimates of the aggregate total of Assets Under Management ("AUM") of all Sovereign Wealth Funds are projected to be approximately $4.1 trillion as of the close of 2010.[12] The estimate is inherently uncertain because some of the world's largest funds, such as the Abu Dhabi Investment Authority ("ADIA"), China Investment Corporation, and Saudi Arabia's SAMA Foreign Holdings do not publicly disclose all of their holdings. Despite the imprecision of current estimates, Sovereign Wealth Funds have grown significantly since 1990, when their aggregate AUM was a fraction of that size.[13]

As the amount and scope of capital controlled by Sovereign Wealth Funds has grown, so too has the concentration of leading SWF players. The top 10 funds ranked by AUM today control roughly 85 percent of total SWF assets, with oil exporters managing roughly two-thirds of the capital deployed by the largest funds.[14] Seven countries from three geographic regions control the world's largest Sovereign Wealth Funds: Saudi Arabia, the

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[10] Preqin Investor Intelligence Profile, August 12, 2010.

[11] "Sovereign Wealth Funds: A Bottom-Up Primer," JP Morgan Research, May 22, 2008.

[12] Estimates based on marketplace data aggregated by the Sovereign Wealth Fund Institute at swfinstitute.org.

[13] Simon Johnson, "The Rise of Sovereign Wealth Funds," *International Monetary Fund Finance and Development*, September 2007.

[14] Edwin Truman, "A Blueprint for Sovereign Wealth Fund Best Practices," Peterson Institute for International Economics Policy Brief, April, 2008.

United Arab Emirates and Kuwait in the Middle East and Gulf region; Norway and Russia in Europe; and China and Singapore in East Asia.[15]

The Persian Gulf

Sovereign Wealth Funds in the Middle East and Persian Gulf constitute the largest share of total SWF assets under management of any region, with 44 percent of total holdings, or $1.42 trillion, according to the Sovereign Wealth Fund Institute.[16] The largest regional investing powers are the Abu Dhabi Investment Authority ($627 billion), and the Saudi Arabian Monetary Agency ($431 billion). Kuwait is also a large player in the Gulf with a projected $202 billion in AUM.[17] As noted previously, the funds' origin derives from their immense oil surplus, constituting both an attempt at greater income diversification and an instrument to mitigate the sometimes volatile oscillation of global oil prices.

In recent years, ADIA has disclosed partial information on its holdings and offered a number of media interviews with senior officials, including its late Managing Director, Sheikh Ahmed Bin Zayed Al Nehayan.[18] In 2009, ADIA published its first annual report outlining its investment strategy, portfolio overview, and recent investment activities. ADIA disclosed that 60 percent of the fund's assets were in "index-replicating strategies." About 80 percent of its portfolio is invested with external asset managers. Between one-third and one-half of the fund was invested in North America, with the rest scattered among Europe, developed markets in Asia, and emerging markets.[19] Before his death in a plane accident in 2010, the Sheikh told the German business daily *Handelsblatt* that the fund would continue to take a "long-term view" on its investing strategy and would employ controls that "act as a brake on excessive risk taking during bull markets." The Sheikh indicated that historically ADIA allocated between 40 to 60 percent of its capital in global equities, 15 to 30 percent in fixed income, and the remainder in real estate, private equity, infrastructure, and alternative investments.[20]

The Saudi Arabian Monetary Agency, while controlling assets for investment, is actually the Saudi central bank and tends to be more conservative in its allocation strategy than SWFs. Brad Setser, formerly of the Council on Foreign Relations, is one of the world's leading experts on Sovereign Wealth Fund investment and allocation strategies. He uses estimates of oil prices and national sales to measure the size of SWF holdings. Using this technique, Setser estimates SAMA has $400 billion in bonds and deposits, representing the preponderance of the fund's assets. According to market research provider Preqin, SAMA does not make private equity investments.[21]

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[15] Richard Cookson, "For A Few Sovereigns More: Sovereign Wealth Funds and the Changing Balance of Power in Financial Markets and the World Economy," HSBC Global Research, February, 2008.

[16] The Sovereign Wealth Fund Institute material is online at www.swfinstitute.org.

[17] Private institutional investment estimates.

[18] "Inside the Abu Dhabi Investment Authority," by Emily Thornton and Stanley Reed, *Business Week*, June 6, 2008.

[19] Abu Dhabi Investment Authority, *ADIA Review 2009*.

[20] Handelsblatt, "Interview with ADIA Managing Director," January 11, 2010.

[21] Preqin Investor Intelligence Profile, April 21, 2009.

Europe

The largest SWF in Europe is the Government Pension Fund of Norway. Like Sovereign Wealth Funds in the Gulf and Middle East, it derives most of its capital from oil revenues and has benefitted from record price levels in recent years. Norway has arguably the most transparent SWF in the world, releasing returns, asset allocations, quarterly returns, and projections. They also explicitly make investment decisions based on the recommendations of an ethics council, guidance which has resulted in divestment from a number of companies. About 60 percent of the fund's assets are invested in global equities.

East Asia

The dominant Sovereign Wealth Funds of East Asia, most notably those launched by China and Singapore, were created to manage the accumulated foreign currency reserves in excess of balances necessary to maintain exchange rate controls. Although both China and Singapore now use a managed float exchange rate regime, both countries' funds have survived and grown considerably. Chinese (including Hong Kong) and Singaporean funds now control over $1 trillion in AUM.

Singapore has two Sovereign Wealth Funds, Government of Singapore Investment Corporation ("GIC") and Temasek Holdings. Each fund publishes an annual report disclosing selective investment information.[22] GIC, which is wholly owned by the Singaporean government, was established in 1981 and is widely regarded as among the world's most sophisticated global Sovereign Wealth Funds, with offices worldwide in Singapore, Beijing, Shanghai, Seoul, Tokyo, Mumbai, London, New York and San Francisco. Similar to most other SWFs, media reports indicated that GIC experienced a decline in the value of equity investments in 2008 and 2009.[23] In 2010 the fund's AUM resumed strong growth and is today projected to be $315 billion[24]

Temasek has enjoyed strong growth since its inception in 1974 as an entity whose sole shareholder is the Singapore Ministry of Finance. In the year 2007, before the financial crash, the value of Temasek's portfolio reportedly grew 35 percent and included a range of global investments such as Standard Chartered Bank, ABC Learning Centers (Australia), Intercell AG (Austria), Country Garden and Yingli Green Energy (China), INX Media (India), Mitsui Life (Japan), and PIK Group and VTB Bank (Russia).[25] Temasek is run by Ho Ching, the wife of Singapore's Prime Minister and daughter-in-law of Singapore founder Lee Kuan Yew.[26] Temasek's AUM is estimated to be $186 billion.[27]

In China, national investment entities are funded and controlled by the government. As previously noted, the State Administration of Foreign Exchange (SAFE Investment

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[22] "Report on the Management of the Government's Portfolio for the Year 2007/08."

[23] "Singapore's GIC Assets Drop 25% from Peak, Straits Times Says," Andrea Tan, *Bloomberg*, March 4, 2009.

[24] Preqin Investor Intelligence Profile, 2010.

[25] "State Capitalism: The Rise of Sovereign Wealth Funds," *Oxford Analytica*, 2007.

[26] "Singapore's Temasek Says Goodyear Not Taking CEO Role," *Reuters*, July 21, 2009.

[27] Preqin Investor Intelligence Profile, 2010.

Company), established in 1997, manages an estimated $347 billion. SAFE is specifically mandated with China's foreign exchange holdings, while CIC was originally funded by a bond issuance, the proceeds of which were then used to purchase $200 billion in foreign reserves. CIC is estimated to have a total AUM of $332 billion.[28]

Both CIC and SAFE have a mandate to invest globally to boost Chinese Foreign Direct Investment ("FDI"), which has historically lagged behind the United States. During 2009, Chinese companies invested $48 billion overseas, contributing to total accumulated FDI of $211 billion, equal to about 4.3 percent of Chinese GDP. In 2009 American companies invested $340 billion internationally, for a total accumulated FDI estimated at $3.245 trillion, about 23 percent of U.S. GDP.[29]

CIC has three different investment departments. The Central Huijin Investment Corporation manages domestic financial investments. The China Jianyin Investment Company manages domestic assets and the disposal of non-performing loans. A third department manages foreign investments. Based in Beijing, CIC is expected to employ more than 1,000 employees when it is fully operational, including 100-200 investment specialists.[30] In the summer of 2010, CIC initiated a round of global recruiting to support its business development plans, seeking 64 investment professionals in a range of areas from asset allocation and asset management to private equity.[31]

Diversity of Fund Size and Investment Strategies

As noted previously, Global Public Investors vary enormously in their size, funding source, and investment strategies. In recent years, market research suggests the largest SWFs have invested 50 to 55 percent of their portfolio in developed world stocks, with smaller proportions in fixed income, real estate and other alternative assets, including private equity and hedge funds.[32] In contrast, analysts Brad Setser and Rachel Ziemba believe the preponderance of assets held by the Saudi Arabia Monetary Agency to be invested in conservative, dollar-denominated bonds rather than riskier assets subject to market fluctuations. Financial services were heavily favored in 2008, with large infusions by SWFs in Singapore, China, and the United Arab Emirates in American banks after the beginning of the subprime crisis, as well as substantial investments by ADIA in leading financial institutions. Other Global Public Investors, such as China's SAFE, have favored different asset classes, investing excess foreign exchange reserves most aggressively in sovereign debt instruments, especially those issued by the United States.

Sovereign Wealth Funds financed by petroleum profits have a different predilection for their investment strategies. The commodity-based funds of Norway, Russia, and the Gulf operate, in a sense, as national endowments, storing wealth for a time when their

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[28] Preqin Investor Intelligence Profile, 2010.

[29] Ken Miller, "Coping With China's Financial Power: Beijing's Financial Foreign Policy," *Foreign Affairs*, Vol. 89, No. 4 (July/August 2010).

[30] Preqin Investor Intelligence Profile, August 12, 2010.

[31] Bloomberg News, July 27, 2010.

[32] JPMorgan Research, "Sovereign Wealth Funds: A Bottom-Up Primer," May 22, 2008.

mineral resources may be less plentiful. This strategy works to smooth consumption over periods of low prices. For small yet oil-rich states, this type of forward looking strategy encourages revenue diversification among a broad array of asset classes to reinforce an easier transition to a post-oil economy.

Long-Term Investment Horizons and Impact of the Financial Crash

Private discussions with a range of senior professionals associated with Global Public Investors produced a common theme. Both investment professionals from within state-sponsored entities and the investment bankers and analysts who cover such institutions characterized the orientation of GPIs as one focused on the long-term investment horizon. Some GPIs in fact model their asset allocation and investment strategies on inherently conservative assumptions consistent with the mandate of a well managed pension fund that eschews short-term profit-taking, seeks to mitigate market risk, prioritizes capital preservation and acquires assets with extended investment durations.[33] The Abu Dhabi Investment Authority, for example, has publicly stated its view that the country's short-term horizon is at least three to five years forward, a view which allows asset managers to look past immediate market fluctuations.[34] For GPIs and Sovereign Wealth Funds that have historically invested hundreds of billions of dollars in the private equity industry, it is an established expectation that so-called General Partners (GPs) who invest the capital of Limited Partners (LPs) may take years to acquire a company and as much as five to seven years beyond that to engineer an exit that will realize capital gains which in turn will be returned to investors. The long-term horizon favored by most Global Public Investors, however, does not insulate them from the shock of short-term losses, which are politically charged domestically because of the perception—and indeed the reality—that national wealth has been diminished.

The financial crisis imposed significant pain on state investment entities as it did to public investors around the world. Norway reported a 23.3 percent decline in 2008, while GIC of Singapore was reported to have lost 24 percent of its value.[35] Temasek Holdings reportedly suffered a 31 percent loss between March and November of 2008.[36] Analysts Setser and Ziemba projected that major losses were sustained by ADIA, the aggregate value of which they claim declined from $453 billion in December 2007 to $328 billion in December 2008, although they acknowledged that these estimates were based on the assumption that around 60 percent of ADIA's portfolio was held in equities. Since then, ADIA has indicated that its equity holdings during this period were actually closer to the

[33] This conclusion is also consistent with the work of Brad Setser, "Sovereign Wealth and Sovereign Power: The Strategic Consequences of American Indebtedness," Council on Foreign Relations Report, September, 2008.

[34] "Inside the Abu Dhabi Investment Authority," by Emily Thornton and Stanley Reed, *Business Week*, June 6, 2008.

[35] "Singapore Left with 2nd Largest Citi Stake," John Burton and Jamil Anderlini, www.sott.net, February 27, 2009.

[36] "Temasek Mulls 'Opportunistic' Mining Investments," Netty Ismail and Jesse Riseborough, Bloomberg, March 24, 2009.

lower end of its 40 to 60 percent range. The valuations cited are considerably lower than the current estimate of $627 billion for ADIA's AUM cited by other research sources tracking Sovereign Wealth Funds.

Setser and Ziemba found that for Persian Gulf Sovereign Wealth Funds, portfolio decisions depend largely on oil prices. Their report postulates an elasticity of demand for foreign assets with respect to the price of oil. According to their analysis, oil must average $75 dollars a barrel for the total amount of foreign asset purchases to remain positive beyond domestic expenditures. They find that after the crash of 2008, SAMA of Saudi Arabia became the largest regional buyer by share of foreign assets, probably due to their more conservative portfolio allocation and huge oil reserves.[37]

In another study of how Sovereign Wealth Funds responded to the financial crash, the Monitor Institute reports that some funds pulled back to invest at home.[38] The Executive Director of the Qatar Investment Authority (QIA), Hussain al Abdulla, announced that after losses suffered in 2008, QIA would exercise caution in its new international investments.[39]

For state investment entities dependent on natural resources revenues, government capital infusions remain linked to commodity prices. In particular, the Gulf States, Norway, and Russia have all seen their revenue streams fluctuate, depending on the price of oil, which has both climbed and declined over the past several years.

SAFE investments in international oil companies have been purely financial, with no controlling stake in actual concessions or the development of new oil resources. In fact, SAFE's investments in Western oil companies do not exceed 1 percent of any business's publicly available shares. Similarly, in 2008 CIC made portfolio investments in Total which did not give them control over management or production decisions.

Cautious Investors after the Crash

A number of Sovereign Wealth Funds, responding to a decreased risk appetite after the crash, switched to big Treasury purchases as asset managers reallocated out of equities.[40] Some foreign government central banks lost confidence in big Western financial institutions.[41] The net effect was a major withdrawal of foreign capital funding from global banks.[42] China's CIC reacted to the financial collapse by shifting investments toward

[37] "GCC Sovereign Funds: A Reversal of Fortune," by Brad Setser and Rachel Ziemba, Council on Foreign Relations, January 2009.

[38] Monitor Institute, "Weathering the Storm: Sovereign Wealth Funds in the Global Economic Crisis of 2008," SWF Annual Report, April, 2009.

[39] Vernon Silver and Henry Meyer, "Sheikh Who backed Barclays Gets Another Shot With Qatar's Money," Bloomberg News, May 11, 2009.

[40] Landon Thomas, Jr., "Sovereign Funds Now Prefer Hoarding Cash to Rescuing U.S. Financial Firms," *New York Times*, October 14, 2008.

[41] Heather Timmons and Keith Bradsher, "To Avoid Risk and Diversify, Sovereign Funds Move on From Banks," *New York Times*, September 19, 2008.

[42] Stanley Reed, "Sovereign Wealth Funds Take a Big Hit," *Business Week*, December 31, 2008.

hedge funds and re-insurance companies.[43] After the crash, it directed renewed consideration of investments in industries with long-term strategic value to China's economy, such as the mining and minerals sector.[44]

Not all of the market reverberations from the financial crisis were negative. Sovereign Wealth Funds that held their ground and did not liquidate their equity positions in the financial industry during the crash and subsequent recovery ultimately made money. In 2009, Kuwait announced that it had made $1.1 billion on its $3 billion Citibank stock purchase of January 2008, representing a net gain of 37 percent on an annualized basis. Singapore and Qatar also reaped sizeable gains. Singapore's GIC, for example, made a $1.6 billion profit in 2009 after it sold half of its Citibank stock.[45] And Qatar reaped a gain of over $1 billion on its investment in Barclays.[46] In the end, their capacity to sustain dramatic swings in market volatility and an adherence to a long-term investment horizon served many Sovereign Wealth Funds well.

Politics and SWF Investment

The common characteristic of foreign government ownership or management of Sovereign Wealth Funds and other state entities that deploy capital on a global basis has prompted some observers to question whether geopolitical interests influence investment decisions. For example, China's enormous surge in global investments in mining, minerals and energy assets is seen by some as a new, defining feature of its foreign policy. Others have similarly questioned whether American interests are threatened by foreign investment in key American institutions or essential infrastructure. The strong and immediate reaction of the American public, and subsequently that of Congress, in the spring of 2006 to the proposed takeover of six American ports by DP World—and the battle the year before between Chevron and the China National Offshore Oil Corporation (CNOOC) for energy company Unocal—illustrates the continued sensitivity to foreign investment in what are perceived to be strategic American assets.

The geopolitical and strategic rationale for foreign direct investment by Sovereign Wealth Funds and other state actors is an entirely legitimate subject of analysis. While some state investing entities in China are particularly focused on the energy and natural resources sector, it is difficult to discern an overt political agenda in the investing activities of the world's most prominent Sovereign Wealth Funds and Global Public Investors, which are increasingly managed by western-trained investment professionals or are partnering with North American and European institutions.

The United Arab Emirates, for example, conducts business with all of the major investment banks around the world, and is regarded as an apolitical investor with professional and largely conventional investing objectives. ADIA's new Chief Investment

[43] Tina Wang, "China's Sovereign Wealth Fund Turns Inward," *Forbes.com*, September 19, 2008.
[44] Dexter Roberts and Fredrik Balfour, "China's Shopping Spree," *Business Week*, July 27, 2009.
[45] Eric Dash, "Big Paydays for Rescuers in the Crisis," *New York Times*, December 7, 2009.
[46] Julia Werdigier, "Qatar Takes Profit on a Stake in Barclays," *New York Times*, October 20, 2009.

Officer for private equity is a Wall Street veteran, James Kester, who was educated at Cornell University and earned his MBA from the Wharton School at the University of Pennsylvania.[47] Other recent hires for ADIA include Ted Chu, chief economist at General Motors as chief economist, and Bill Martin, former Chief Risk Officer at Commonfund and currently Chairman of the Global Association of Risk Professionals, as chief risk officer. The Korean Investment Corporation, established in 2005 and modeled on Singapore's GIC, manages $37 billion and has an American, Scott Kalb, as its Chief Investment Officer. Kalb is a former hedge fund manager at Tudor Investments who has emphasized his intention to diversify KIC's portfolio beyond its 90 percent concentration in public market investments by expanding into new asset classes such as private equity, real estate, credit and distressed debt.[48]

The Qatar Investment Authority, which holds an estimated $85 billion in AUM, made a commitment in 2008 to the Qatar-UK Clean Technology Investment Fund, which was established as a partnership between Qatar Investment Authority and Carbon Trust Investments.[49] The Canada Post Pension Plan, a state retirement fund with $14.5 billion of AUM, late last year was reported to be partnering with the Ontario Municipal Employees Retirement System and Singapore's GIC to invest in the Bluewater shopping mall, one of the largest commercial real estate assets in Britain.[50]

Pattern of Avoiding Controlling Equity Stakes

Sovereign Wealth Funds and state investing authorities typically do not take controlling stakes in Western companies. Their equity interests in private companies are generally managed by general partners who invest their capital, such as the Carlyle Group, the $97 billion private equity firm, or other large global players such as KKR, TPG and Apollo. The largest direct investments in Western financial institutions made by GIC, Temasek, CIC and others were non-controlling, minority stakes. Recently, SWFs taking large stakes in public companies have reportedly forfeited board representation and voting rights in an effort to show they were not interested in interfering with day-to-day management of companies. An anonymous survey conducted by *Investors' Daily* in February 2009 cited fund executives who voiced similar positions, saying "We have no interests in controlling assets."[51] The Monitor Institute report in fact noted the disadvantages to such a posture, observing that the principles behind shareholder capitalism require that public owners hold directors accountable.[52]

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[47]Paul Clarke, "Who Is James Kester, ADIA's New CIO For Private Equity?", efinancialcareers-gulf.com

[48] Tomoko Yamazaki and Komaki Ito, "KIC Plans More Joint Ventures With Sovereign Funds Next Year," Bloomberg, November 29, 2010.

[49] Private Equity industry reports, as shared by a participant in the Brookings Project on Global Public Investors.

[50] Graham Ruddick, "Bluewater Attracts Overseas Bids," *The Telegraph*, November 6, 2010.

[51] Charles Watson, "Cashed up Sovereign Wealth Funds Wait for Bottom", *Investor Daily*, February 26, 2009.

[52] Monitor Institute, "Weathering the Storm: Sovereign Wealth Funds in the Global Economic Crisis of 2008," SWF Annual Report, April, 2009.

Varying Levels of Fund Transparency and Disclosure

Despite an increased integration of western senior investment professionals and advisers among Sovereign Wealth Funds, one of the issues that continues to exacerbate political sensitivity in some countries is the varied level of transparency and disclosure across funds.[53] Some funds disclose detailed information about their investment philosophy and allocation strategies, while others do not. As Gerard Lyons of Standard Chartered Bank Global Research observes, the asymmetry of information creates uncertainty for policymakers.[54]

Edwin Truman of the Peterson Institute for International Economics has written extensively on Sovereign Wealth Funds and has created an index to measure relative degrees of SWF transparency.[55] His original index (compiled before several of the funds released further information) scores 33 questions in the areas of structure, governance, accountability, and behavior. Of national funds, Norway scores the highest on transparency with 94 percent of possible points awarded.

In an effort to provide greater transparency, the China Investment Corporation filed a voluntary report with the U.S. Securities and Exchange Commission regarding its American holdings. CIC indicated that one-quarter of its $9.63 billion invested in the United States as of December 31, 2009 was in exchange-traded funds, mainly in the commodity and various sector funds. Since the last Peterson Institute rankings, ADIA, GIC, and Temasek have published annual reports detailing investment priorities and allocations. Based on these filings, Truman has raised his transparency scoring for some of these countries, including ADIA.

The focus on transparency among Sovereign Wealth Funds was stimulated in part by U.S. policy following the DP World controversy. According to a former Treasury Department official, the administration of George W. Bush developed a three-part strategy. First, the administration sought to demonstrate to Congress that it was being responsive to the concerns posed by Sovereign Wealth Funds. Second, the administration made direct efforts to engage SWFs to better understand their perspective on global investing. Third, the Bush administration wanted to be the catalyst for a multilateral process to develop best practices on transparency and disclosure.[56]

By 2008 the Bush administration had realized the core objectives of its strategy, most significantly by aligning with the International Monetary Fund in its sponsorship of the first multilateral dialogue on voluntary disclosure practices for Global Public Investors. The IMF working group produced what came to be known as the "Santiago Principles"

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[53] Edwin Truman, *Sovereign Wealth Funds: Threat or Salvation?*, Washington, D.C.: Peterson Institute for International Economics, 2010.

[54] Gerard Lyons, "State Capitalism: The Rise of Sovereign Wealth Funds," Standard Chartered Bank Global Research, October 15, 2007.

[55] Edwin Truman, "A Scoreboard for Sovereign Wealth Funds," Peterson Institute of International Economics, October 19, 2007; Edwin Truman, "A Blueprint for Sovereign Wealth Fund Best Practices," Peterson Institute for International Economics, April, 2008; and Edwin Truman, "Sovereign Wealth Funds: Threat or Salvation?" Peterson Institute for International Economics, September, 2010.

[56] Private briefing to Brookings Project by former Bush administration Treasury Department official.

for Sovereign Wealth Fund transparency and disclosure.[57] The principles were formally adopted in October 2008 by 24 nations and most of the world's leading SWFs. Among the key principles were commitments to ensure better transparency, best practices on risk management, and guidelines for decision-making processes that preserved appropriate levels of independence from sponsoring governments.

A recent study by Sven Behrendt of the Carnegie Endowment for International Peace examined the record of compliance with the Santiago Principles. He found that "eighteen months after the publication of the Santiago Principles, their implementation is highly uneven." According to Behrendt's study, a number of countries have made a strong commitment to implementing the principles, while others have only partially fulfilled them.[58]

Some funds have been slow to implement the Santiago Principles because they view transparency as inimical to their commercial interests and seek to preclude competitors from gaining access to proprietary information. These state investors see little upside in broad public disclosures but rather perceive real competitive risks in enhanced transparency. Other state investors discount the competitive risks of greater disclosure and consider transparency to be an ascendant and stabilizing norm in the international economy.[59] Positive feedback loops through transparency ratings from trusted brands would encourage GPIs to be more open about their actions.

The American Infrastructure Crisis and Foreign Capital

It is an undeniable fact in America's fiscal and political debate that the nation's public sector faces a drastic shortage of capital. The current federal budget deficit alone is projected to run about $1.5 trillion. Aggregate public debt grew 50 percent between 2000 and 2007 and at the close of 2010 has climbed to about $13.5 trillion, equal to 94 percent of GDP, up from 51 percent in 1988. Interest on the national debt reached $414 billion in Fiscal Year 2010, one of the largest expenses in the federal budget following national defense and international security spending, Social Security and Medicare. The growing U.S. fiscal crisis has myriad implications, the most obvious of which is the absence of resources to fund vital public needs, including infrastructure renewal.

The roots of the infrastructure crisis run deep. The transportation, energy and social infrastructure of the United States is suffering from decades of underinvestment. From the 1950s to the 1970s, approximately 3 percent of America's GDP was allocated to infrastructure. Since the 1980s, it has been less than 2 percent. By contrast, Japan spends 6 percent of its GDP on infrastructure, South Korea devotes 5 percent, and Australia aims

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[57] International Working Group of Sovereign Wealth Funds, "Sovereign Wealth Funds: Generally Accepted Principles and Practices," October, 2008.

[58] Sven Behrendt, "Sovereign Wealth Funds and the Santiago Principles," Carnegie Endowment for International Peace, Number. 22, May, 2010.

[59] Private not-for-attribution briefings provided to the Brookings Institution Project on Global Public Investors.

for 4 percent.[60]

The consequences of underinvestment in infrastructure are pronounced and wide-ranging. Today, more than one-quarter of America's bridges have been judged structurally deficient or functionally obsolete.[61] In the state of Pennsylvania alone, there are over 6,000 structurally deficient bridges.[62] According to a July 2008 report from the American Association of State Highway and Transportation Officials, bridges are typically designed for a 50-year life, but the average age of U.S. bridges in now 43 years.[63] According to the United States Department of Transportation, between 1982 and 2005 hours of traffic delays per traveler tripled, with 2.9 billion gallons of fuel wasted annually as a result of vehicle congestion.[64] Power outages and power quality disturbances on our nation's aging and bottlenecked power grid are estimated to cost the U.S. economy between $25 billion and $180 billion annually.[65]

While the federal government supports planning—and in some cases mandates—many infrastructure programs, the responsibility for implementation and financing falls largely to state and local government, which typically have funded such spending with municipal debt. Similar to most of the private sector, in recent years state and local governments have relied heavily on ever-higher levels of debt. Total municipal debt outstanding in the U.S. has increased at a compounded annual growth rate of 8.1 percent since 2000 to nearly $2.5 trillion. The recent dislocation inflicted by the economic downturn and the recession has decimated state revenues, slashed budgets and placed severe pressures on borrowing in many states. As a result of these mutually reinforcing dynamics—mammoth development costs correlating with unprecedented public debt—the need for alternative sources of capital for U.S. infrastructure investment has become self-evident.

Through much of the 20th century, state and local finance meant access to the municipal bond market. In recent months, however, investors have been withdrawing money from municipal bond investment funds, a trend that is likely to accelerate over growing concerns about the solvency of many states struggling with acute budget deficits. That trend would be exacerbated by the adoption of a measure proposed by the federal deficit commission, which has called for the elimination of the tax exemption of interest on municipal bonds, which in turn would end the subsidy that Washington now provides to taxpayers who invest in state and local debt securities. Finally, voters today are unlikely to approve many new bond acts and elected officials who use borrowing methods that skirt

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[60] Greg Coombs and Chris Roberts, "Trends in Infrastructure," Australian Treasury Department, 2007.

[61] *2009 Report Card for America's Infrastructure*, American Society of Civil Engineers, March 2009.

[62] Pennsylvania Department of Transportation website: http://www.dot.state.pa.us/internet/web.nsf/secondary?openframeset&frame=main&src=infobridge?openform.

[63] *Bridging the Gap: Restoring and Rebuilding the Nation's Bridges*, American Association of State Highway and Transportation Officials, July 2008.

[64] *The Path Forward Funding and Financing Our Surface Transportation System - Interim Report of the National Surface Transportation Infrastructure Financing Commission*, U.S. Department of Transportation, February 2008.

[65] *2009 Report Card for America's Infrastructure*, American Society of Civil Engineers, March 2009.

voter approval do so at their peril. As a result the historical foundations of state and local capital formation are fading away.

In the last few years, a paradigm shift has emerged in which many agencies and departments of state and municipal government around the country have begun to explore partnerships that seek to align the investment objectives of the private sector with the policy objectives of the public sector in the long-term, successful delivery and operation of infrastructure facilities and services. This financial model, known generally as a public-private partnership, has long been the preferred framework for infrastructure procurement in the developing world, often used to spur foreign direct investment, and has become a major program in many developed nations, in particular the United Kingdom, Australia and Canada. Indeed, most policy pronouncements about the need for additional investment in infrastructure in the United States are coupled with a call for the leveraging of private investment, as President Obama did in his 2011 State of the Union address.

There are many precedents for foreign investment in U.S. infrastructure assets. Foreign governments have been indirect investors in U.S. infrastructure via federal government bonds, which have been used to fund many infrastructure projects. More directly, foreign investors have been awarded long-term highway leases. Canadian and Australian public pension funds and European infrastructure developers have invested their own capital as well as the capital of infrastructure funds composed of limited partners including, typically, major institutional investors, both domestic and foreign.

Significant Sovereign Wealth Funds and other Global Public Investors have publicly expressed support for a major program of American infrastructure renewal and have indicated a potential interest in deploying capital in appropriately structured minority investment vehicles. Zhou Yuan, head of asset allocation for the China Investment Corporation, told the BBC news service in November 2010 that the Obama administration should spend $1 trillion on infrastructure over the next five years. At a New York meeting of the Chinese Financial Association, Yuan said that the CIC was urging the U.S. government to form a public-private partnership to create super high-voltage transmission lines and high-speed links between American cities, potentially creating 500,000 high-paying manufacturing jobs. Yuan suggested that CIC could be a potential investor in such a U.S. infrastructure initiative. "If the conditions are right, and if, on a risk return basis, we believe this is a good investment, then yes," Yuan said, adding: "But of course we want to emphasize the fact that we are going to be a passive investor. We're not here to run anything or to own anything."[66] The possibility of foreign investment in U.S. infrastructure development was reportedly discussed in a January 2011 meeting between President Obama and Chinese business leaders, including Lou Jiwei, Chairman of CIC. According to news accounts, the White House encouraged the exploration of potential

[66] "China SWF Pushes Obama to Invest in Infrastructure; Lou Jiwei Warns of Slowing Economic Growth," assetinternational.com, November 3, 2010.

Chinese investment in infrastructure assets.[67]

Infrastructure is an attractive asset class to many institutional investors. By its very nature, infrastructure is a lower yielding but typically stable, long-term investment with predictable revenue streams, high switching costs for users and meaningful barriers to entry for competitors. Institutional investors such as public pension funds with long-term liabilities have historically been attracted to the infrastructure investments for a portion of their portfolio's asset allocation. It could be argued that the significant capital accumulated in public pension funds, both domestic and international, as well as Global Public Investors, aligns powerfully with the steady and predictable risk-adjusted returns and potential government support associated with capital-intensive, large-scale infrastructure investment. That argument carries even greater resonance in light of the reality confronting U.S. policymakers and state and local governments—the sheer scope of capital demanded for comprehensive infrastructure investment far exceeds the capacity of domestic institutional investors or sources of public funding. If the United States is truly committed to the imperative of infrastructure renewal, it should remain open to possible sources of foreign capital investment.

There are different mechanisms to facilitate the flow of foreign capital into the United States to support the enterprise of infrastructure renewal that are consistent with legitimate concerns about national security and the perceived political risk of foreign investment in assets considered critical and essential to the American economy. If properly designed and with necessary controls, foreign capital represents a viable pathway for the United States to obtain the resources necessary for a program of infrastructure enhancement that will pay significant long-term dividends for U.S. competitiveness.

U.S. policymakers can look to other developed economies, such as Canada and the United Kingdom, which rely extensively on outside investor capital for infrastructure development, for model best practices to guide a comparable American program. The specific legal and financial structures through which such capital is invested vary depending on the sponsoring government and the nature of the asset. However, nearly all such arrangements involve three factors: (i) an upfront investment of outside investor capital, (ii) the expectation of a financial return to the investors over time, and (iii) the transfer of at least some of the risks and rewards of ownership from the government to the investors.

In the most common form, these arrangements involve a national or local government granting to an investor group a long-term concession for an infrastructure asset, such as a highway, in exchange for a financial investment. The infrastructure assets involved can be either existing facilities or so-called "green field" projects to be constructed as part of the concession agreement. The investor group is typically responsible for maintaining and operating the asset in accordance with standards stipulated in the concession agreement, including the absorption of operating costs that may be greater than originally projected.

[67] "Chinese Firms Set Sights on U.S. Investments—Computer Maker Lenovo Underlines Broader Interest; White House Encourages Sovereign Wealth Fund to Take Stakes," by Rebecca Blumenstein and Laura Meckler, January 27, 2011, *Wall Street Journal Asia* and WSJ.com.

At the end of the concession period, the investor group's rights and responsibilities revert back to the government sponsor of the concession.

In recent years, Canada has been particularly active in leveraging outside investor capital to fund infrastructure projects, including highways, bridges, hospitals, courthouses, wastewater facilities and concert halls. By opting for private-public partnerships over traditional procurement methods, Canada and its provinces have advanced the country's infrastructure development goals without tapping tax revenues or increasing municipal debt burdens. According to a recent study by the Conference Board of Canada, over 100 transactions have been concluded with private sector consortia in Canada since the early 1990s.[68]

Other viable models of infrastructure investment have been established. Several private infrastructure funds already exist that pool capital from multiple investors, both foreign and domestic, including pension funds, sovereign wealth funds, endowments and high net worth individuals. While fund governance mechanisms are rarely publicly disclosed, they typically limit the role that a single investor can play to an advisory capacity and minority status with no rights for operational control of infrastructure assets. An entity such as the proposed Infrastructure Bank, advocated by President Obama in September 2010, represents yet another model to channel private capital investment.[69]

Current models suggest the possibility of a national infrastructure investment vehicle for the United States that could be structured as a peer institutional investor to domestic public pension funds. Sovereign Wealth Funds and other Global Public Investors could be limited partners, with no single fund or group of investment entities of a single country permitted to hold a controlling share. No foreign investor would exercise decision-making authority about the operation or management of infrastructure assets. Beyond the decision to invest—and the customary right to serve on an investment committee—all foreign entities would be passive minority shareholders. Through such a deliberate and transparent structure, an investment pool of limited partners with both defined rights and restrictions could decisively mitigate the risks of foreign investment in U.S. infrastructure assets.

A vehicle for foreign investment in infrastructure development could deploy capital in several non-exclusive and mutually reinforcing ways. Such an entity could invest in private infrastructure funds which meet its investment objective. It could invest side-by-side with private infrastructure funds. It could make direct investments or it could partner with operating companies. In several recent larger transactions, multiple sources of equity have partnered, and a foreign investment vehicle in infrastructure assets could participate in the formation of these larger pools of equity required for what are often very large projects.

Along with other institutional investors and private funds, an infrastructure investment vehicle could coordinate with current and future federal programs that

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[68] "Dispelling the Myths: A Pan-Canadian Assessment of Public-Private Partnerships for Infrastructure Investments," The Conference Board of Canada, January, 2010.

[69] William Galston, "Infrastructure Bank Proposal Would Spur Economic Growth," Brookings Institution, September 7, 2010 and Bruce Katz, "Innovation and Infrastructure," Brookings Institution, January 20, 2010.

provide low-cost leverage for these equity investments. These programs could include extensions or future versions of the Department of Transportation's TIFIA loan program for surface transportation, various forms of Private Activity Bonds and a National Infrastructure Bank. A range of mechanisms could be fashioned that balances the needs of foreign investors with requirements for the operational control and necessary ownership structure of U.S. infrastructure investments. The obstacles to such foreign investment are not related to the flexibility and innovation inherent in modern forms of private-public partnership for infrastructure development, which have produced effective models appropriated around the world. The obstacles are political, requiring the will and imagination of policymakers and government officials.

Co-Investment in Low-Carbon and Energy Efficiency Technologies

Another investment vehicle for foreign capital is a proposed Green Bank known as the Clean Energy Deployment Administration (CEDA). Under its original design announced in 2009, CEDA would be funded with up to $10 billion from the Department of the Treasury that in turn would be used to guarantee $100 billion in revolving federally backed loans, which advocates argued could be used to attract another $100 billion in private capital to accelerate deployment of smart grid technologies, renewable generation, carbon abatement programs and nuclear power.[70] The Brookings Institution Growth Through Innovation Project has recommended that Congress and the Administration seriously consider the creation of a Green Bank. By supporting the establishment of a "standing entity which would considerably reduce the cost of financing for low-carbon energy infrastructure," a Green Bank would stimulate job creation and advance the development of low-carbon technologies.[71]

It remains to be seen if the CEDA model would attract interest from Global Public Investors. But the proposal underscores the possibility of U.S. government co-investment program comparable to SBIC financing sponsored by the U.S. Small Business Administration and Investment Division. Such an initiative would align investments from foreign state entities and the U.S. government in companies with viable technologies that have not reached scale and are not currently served by the conventional project finance market. By absorbing mezzanine finance risk, a structural gap that disadvantages green technology companies from moving beyond the venture phase to broader commercialization could be filled by both the U.S. government and GPIs.

Many nations recognize the need to innovate through new technology and to reduce greenhouse gases.[72] Industries around the globe perceive long-term incentives in developing and deploying pollution abatement technologies with the potential to generate new jobs and unleash billions in private sector investment. Some Global Public Investors have already staked out ambitious initiatives in the cleantech space. For example, the

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[70] Peter Behr, "Green Bank Proposals Probe the Hostile Frontier of Politics and Finance," *Climate Wire*, New York Times and NYT.com. October 2, 2009.

[71] Strobe Talbott, "Forum on Growth Through Innovation," Brookings Institution, November 23-24, 2009.

[72] Juliet Eilperin, "EPA, Senate Take Aim at Greenhouse Gases," *Washington Post*, October 1, 2009.

Mubadala Development Company of Abu Dhabi, a Sovereign Wealth Fund, is invested in the "cleantech" sector through its Masdar renewable energy and sustainable technology initiative.

Promoting Effective Transparency and Accountability

The International Monetary Fund's 2008 Santiago Principles call for improvements in the disclosure of asset allocations, portfolio strategies, and investment priorities for the world's diverse array of sovereign state investors. These voluntary guidelines promoted by the IMF offer one way for an increasingly influential set of actors in the global economy to alleviate some degree of the misunderstanding that surrounds their investment activities. Greater adherence to the Santiago Principles will not only help build confidence among investors, but also provide greater stability in global financial markets, as a 2008 Congressional Research Report concluded.[73] Greater transparency with meaningful incentives will strengthen the climate for sovereign investment in the United States and enhance understanding among American political elites.

Engaging the Political and Policy Communities and Building Partnerships with Global Public Investors

Given America's need for global capital investment during a protracted period of necessary debt reduction, it is crucial to develop a national policy framework—both through the private and public sectors—that helps attract foreign capital. Because global capital is the ultimate fungible resource of the twenty-first century, a failure to ensure a favorable and fully competitive environment for foreign sovereign investment will simply mean that other countries and regions will benefit at the expense of the United States. A predicate to building a national policy framework and investment partnerships with Global Public Investors is an enhanced understanding of their unique role in the global economy and the potential they represent to the United States.

There is a recent history of worrisome developments in the United States that complicates Washington's relationship with Global Public Investors and Sovereign Wealth Funds. One is U.S. protectionist sentiment in the aftermath of the financial crisis, displayed by some political leaders in the form of "buy American" provisions in the 2009 economic stimulus package and requirements that financial institutions receiving TARP money limit the number of foreign employees they bring to America on H-1B visas.[74] Legislative provisions that demand preferential treatment for U.S. companies and workers encourage foreign countries to adopt the same restrictions. As the late Sheikh Ahmed Bin Zayed Al Nehayan of the Abu Dhabi Investment Authority observed, restrictions in cross-

[73] Martin Weiss, "Sovereign Wealth Funds: Background and Policy Issues for Congress," Congressional Research Service, March 26, 2008.

[74] Darrell M. West, *Brain Gain: Rethinking U.S. Immigration Policy*, Washington, D.C.: Brookings Institution Press, 2010.

border investments compromise the world's economic recovery and raise barriers to future investment and growth.[75]

Another complication for foreign state investors, particularly Sovereign Wealth Funds, is that in earlier periods, their strongest political advocates were large Wall Street banks, a class of economic actors that has suffered enormous reputational damage in the aftermath of the crash. Global financial institutions made the argument that SWFs were valuable sources of new capital investment and crucial to international trade and commerce. But in an era of financial regulatory reform, as America's largest financial institutions have been on the defensive and weathering populist attack, Wall Street advocacy for foreign capital providers is a low priority that would be viewed negatively by legislators and the broader public.

Not-for-attribution discussions with Global Public Investors reveal a discernible and deep anxiety about the volatility of the American political system and significant concerns about the lack of predictability in the regulatory and legislative domains. Uncertainty about the future tax regime applied to foreign capital has been corrosive, particularly with respect to the tax treatment of foreign real estate and certain other forms of investment. Some foreign investors have been anticipating potential "clawbacks" resulting from altered tax provisions. The recent upheaval of the 2010 midterm elections and the rise of the Tea party has only exacerbated a pervasive sense of uncertainty and perceived political and regulatory risk.

Compounding current tensions is the simple fact that many American political and policy elites today have little interest in or knowledge of, Global Public Investors, particularly Sovereign Wealth Funds and State-Owned Enterprises.[76] That lack of understanding is reciprocated by sovereign investors conducting business in the United States, who lament the turbulence subsuming both the rules and rule-makers that will govern potentially billions of dollars of deployed capital.

One possible means of alleviating the mutual lack of substantive understanding that exists between American political and policy elites and Global Public Investors would be to initiate a dialogue between these two very disparate constituencies. As noted in the introduction to this report, one of the most important yet easily implemented recommendations of this study is to create the Global Public Investors Roundtable, an informal group of administration policy-makers from the White House, Treasury, State and Commerce Departments and a range of congressional actors and their staff from both sides of the aisle in Washington who would meet with the world's leading Global Public Investors, Sovereign Wealth Funds and representatives of other international financial institutions on a periodic basis to share information and stimulate dialogue on economic, regulatory, national security and political issues central to foreign investment in the United States.

One of the themes the Roundtable dialogue might address would be current issues

[75] Handelsblatt, "Interview with ADIA Managing Director," January 11, 2010.

[76] Government Accountability Office, "Sovereign Wealth Funds: Laws Limiting Foreign Investment Affect Certain U.S. Assets and Agencies Have Various Enforcement Processes," May, 2009.

relating to the policy review process—and sometimes bitter politics—associated with foreign direct investment. The federal government Committee on Foreign Investment in the United States ("CFIUS") has jurisdiction over non-U.S. investment. It was created as an inter-federal agency body in 1975 and was updated through the Foreign Investment and National Security Act of 2007.[77] It is composed of representatives from 14 federal agencies, including the Departments of Treasury, Justice, Homeland Security, Commerce, Defense, State, and Energy; the offices of the U.S. Trade Representative and Science and Technology; as well as the Office of Management and Budget, Council of Economic Advisors, and Assistants to the President for National Security Affairs and Economic Policy. According to the group's enabling order, the committee has "primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment."[78] Typically, there is scrutiny of foreign investment that aims to acquire 10 percent or more of the shares of an incorporated American business. Based on a 1988 amendment to the Omnibus Trade and Competitiveness Act, the president may block any foreign investment deemed a threat to U.S. interests.[79] Following notification of a purchase, CFIUS members have 30 days to review the proposed deal and 45 days to investigate its national security implications. The president then has 15 days to make a formal decision approving or prohibiting the transaction.[80]

A greater understanding of the CFIUS process—by Global Public Investors, Congress and the broader public—could alleviate concerns about sovereign investment in the United States. In the aftermath of the DP World and CNOOC cases various reforms were proposed, a number of which would have been damaging to the U.S. economy without enhancing U.S. national security.[81] The GPI Roundtable could constitute one means of convening a substantive dialogue with the potential to avoid conflict in the future.

Conclusion

Global Public Investors are increasingly central to aspects of the U.S. economic recovery, a fact the Obama administration appears to be embracing. As noted previously, in late 2010 and again in January 2011, U.S. and Chinese officials discussed a potentially significant investment through CIC in U.S. infrastructure development. More recently, Washington reached out to Sovereign Wealth Funds such as GIC to probe interest in the acquisition of up to $20 billion in shares of the insurer AIG, which was bailed out by the government at

[77] Joel Moser, "Inbound U.S. Infrastructure Investment," Fulbright & Jaworski Briefing, April 22, 2010.

[78] Executive Order 11858, May 7, 1975.

[79] The so-called Exon-Florio Amendment is still the source of public policy debate. See Graham and Marchick, *US National Security and Foreign Direct Investmen*t, pp. 33-58.

[80] Congressional Research Service, "The Committee on Foreign Investment in the United States", 7-5700, February 4, 2010.

[81] Edward M. Graham and David M. Marchick, *US National Security and Foreign Direct Investment* (Institute For International Economics, Washington, D.C. 2006).

the acme of the financial crisis.[82] Looking ahead, as the realities of America's debilitating deficits at both the state and federal levels become embedded into the political debate and its policymaking discourse, there will be an even greater impetus to explore the potential role of Global Public Investors in foreign direct investment in the United States. While there are self-evidently legitimate concerns about the form and structure of such investment in sensitive asset classes of a strategic nature, there are also established government mechanisms to evaluate such investment proposals and multiple models of public-private partnerships around the world that demonstrate the ability to mitigate defined risks and ameliorate political sensitivities. Given their international mandate, increasingly sophisticated management practices and surplus of capital, there is a potential role for Global Public Investors to play in rebuilding America, including in infrastructure development to the cleantech sector. It is the thesis of this report that such opportunities should be explored—methodically, thoughtfully, thoroughly and in partnership with leading political actors and policymakers in Washington and global state investment entities who share economic interests that may be structured to align with the United States. In an increasingly competitive environment for capital globally, a thoughtful policy architecture to realize the potential of this capital would serve the country well.

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[82] "U.S. Woos Sovereign Funds in AIG Sale," by Francesco Guerrera and Tom Braithwaite, *Financial Times*, February 14, 2011.

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