Testimony of David Marchick

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Committee on Foreign Relations

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Chairman Biden, Ranking Member Lugar, Members of the Committee:

Thank you for the opportunity to testify, and for holding this hearing. I worked on foreign investment issues during my time in government and for the past six years before I joined The Carlyle Group, a global private equity firm. I am speaking as much from my previous experience as from my current perspective at Carlyle.

Historical Context for This Debate

Mr. Chairman, twenty-one years ago next month, seven Members of the House of Representatives held a press conference outside the Capitol where they smashed Japanese products with sledgehammers. At that time, there was great anxiety over the rise of Japan – over whether Japan was going to buy up our key assets, and whether Japan would eclipse the United States as the leading economy. None of those fears materialized. Japan subsequently went

[1] Mr. Marchick served in the State Department and other agencies during the Clinton Administration and is the co-author of "US National Security and Foreign Direct Investment," (Peterson Institute, May 2006). Some of this testimony was drawn from the forthcoming article "Global FDI Policy: Correcting A Protectionist Drift," (Council on Foreign Relations), co-authored with Matthew Slaughter of the Tuck School of Business at Dartmouth.

through a protracted economic slump where the United States was actually *encouraging* Japan to increase economic growth, and the United States entered one of the most dynamic periods in its economic history. Although Japanese investment stirred controversy in the 1980s, today, Japanese firms are part of the fabric of American society. In 2005, 613,000 Americans were working for U.S. affiliates of Japanese companies.

Today, similar fears are being raised about another growing source of investment – from Sovereign Wealth Funds (SWFs).

Just as with respect to Japan in the 1980s, a significant amount of today's anxiety exists because foreign investment is coming from new countries. For example, in 2006, the UK, Switzerland, the Netherlands and Japan accounted for almost 60% of the cumulative stock (e.g. the cumulative amount of investment) of Foreign Direct Investment (FDI) in the United States but only accounted for 31% of the inward flow (e.g. the amount invested in that year). Other countries, including developing countries, are becoming much larger outward investors. This represents a dramatic shift in the paradigm that we have seen for many years – China, Brazil, India and Russia have traditionally been large recipients of FDI; today, they are starting to be significant sources of investment. From 2000-2006, outward FDI from China grew 6.9 times, from Russia 5.9 times, and from some Middle Eastern states more than 35 times.

Also evident is the fact that investments from developing countries are more likely to be affiliated with government ownership than are cross-border investments from developed countries. Of the top one hundred multinational companies in the world, only five are government owned. By contrast, of the top one hundred developing-country multinational companies, twenty-five are government-owned.

Sovereign wealth funds are also becoming larger sources of cross-border investments. Sovereign wealth funds have been around since 1953, when Kuwait, then controlled by the United Kingdom, established the Kuwait Investment Authority. SWFs invested either directly or through asset management firms in relative obscurity until the last couple of years, when the growing size and number of SWFs attracted the attention of the press and officials primarily in the United States and Europe.

There have been two predominant factors driving this growth: higher commodity prices, primarily in oil; and growing current account surpluses, particularly in Asia. Much of the growth has occurred in the developing world, including China, Russia, and the Middle East, and there have been more high-profile investments from government-affiliated entities. The growth in SWFs has come at a time of overall growth in outward investment from developing nations.

While the number and size of SWFs has grown in the past few years, SWF investments represent a small slice of the global investment market: in 2007, the value of SWF mergers and acquisitions (M&A) activity represented only 1.6 percent of total global M&A volume. The percentage may be larger in 2008, but overall will still represent a small component of global investment.

Sovereign wealth funds have a lot of money - $3.2 trillion according to some estimates – but are tiny compared to the $52 trillion in global pension and mutual funds and even smaller when considered in the context of the more than $160 trillion in global financial assets. Further, while there have been a number of high profile investments, the vast majority of SWF investments are for passive, minority stakes. SWFs have, in fact, served as an important source of stability at a time of great uncertainty in financial markets.

SWFs and Foreign Policy

The regular flow of investment from SWFs does not, in my view, give rise to foreign policy concerns for the United States. The U.S. benefits from foreign direct investment – it creates jobs and fosters growth. SWFs have been investing in the United States for decades without any problems. To my knowledge, no sovereign wealth fund investment has compromised the United States' or any other country's national security.

In fact, most SWF investment is completely passive and/or managed by third party investment managers. For these investments, it is hard to even create a hypothetical foreign policy or national security concern that could arise. Even where SWFs take controlling stakes in companies, most transactions do not raise any national security or foreign policy concerns. For example, there should not be any national security concerns associated with investment in most sectors of the economy, including the retail, real estate, or hospitality sectors, each of which have been the focus of SWFs. For those investments in more sensitive sectors, the United States has a robust, layered set of laws and regulations that protect important governmental interests associated with any investment, sovereign or otherwise. Last year, Congress passed the Foreign Investment and National Security Act, which strengthened the foreign investment review process in the United States. FINSA protects against threats to national security, and CFIUS has demonstrated its willingness to block or mitigate problematic investments. Other laws and regulations are in place to address other government interests, including antitrust, consumer welfare and safety and security. Even if there were cause for concern associated with sovereign wealth funds, our existing legal and regulatory structure should capture and fix – or block – any problematic investments. Bottom line: when foreign entities invest in the United States, the US is sovereign, not them.

By contrast, official or even informal actions to restrict SWF investment in the United States could cause foreign policy problems, or at a minimum, create unnecessary tensions with our allies and non-allied sources of investment. Legislative or regulatory steps to restrict SWF investments will not only cause harm to the U.S. economy, but also alienate countries which are critical allies on a variety of issues that are core to U.S. interests. Actions to curb SWF investment would not only impact China and Russia, it would also negatively impact Australia, one of our closet allies; Singapore, with whom we have a strategic defense alliance; and the UAE, which has troops in Afghanistan and is a critical ally against extremism in the Middle East. Even unofficial actions – including politicization of investments – can have a negative impact on the U.S. economy and U.S. national interests. Several significant sovereign wealth funds have recently stated that they will look to invest outside the United States or Europe because of the political environment. This unfortunate development harms our economy and potentially causes unnecessary tensions with other countries. Finally, if we start blocking investments in the United States, we can be certain that other countries will retaliate against U.S. investment abroad. Since the U.S. is the largest source of FDI in the world, we have more at stake than any other country in the world.

Mr. Chairman, SWFs are growing fast because of high energy prices and our large current account deficit. American dollars are going overseas, and SWFs are one important way that foreign countries can recycle these dollars. I would much rather have SWFs invest in the United States than abroad – their investments creates jobs, economic activity and opportunities for American firms and workers. Their investments further integrate these countries into the global economy, and align their interests with those of the United States. These investments also

could help create economic security and a stronger middle class in the source countries, and as we know well, a vibrant middle class is an important source of stability.

In my view, a more important foreign policy and national security concern is the United States' growing dependence on foreign countries to finance our current account deficit. At $738.6 billion in 2007, our current account deficit now accounts for about 70 percent of the world's total across all deficit countries. Beyond traditional surplus countries like Japan, fast-growth countries such as China, Russia, and Saudi Arabia have assumed a larger financing role. There is nothing unhealthy about foreign financing of deficits. However, the unprecedented size, trajectory and sustained nature of our deficit, combined with growing structural imbalances, does raise concerns.

We have little control over some of the factors leading to these structural imbalances. For example, some countries are clearly intervening at significant levels in order to lower the value of their currency. And the U.S. is uniquely positioned to continue to attract large amounts of investment to finance our deficit. But we can and should take steps to reduce the growth of our fiscal deficit, to encourage greater private savings rates in the United States, and to reduce demand for oil.

Carlyle's Experience with Government Investment Organizations

I'd like to take a moment to explain The Carlyle Group's positive experience with two investments from government-affiliated entities. First, the California Public Employees Retirement System (CalPERS), the largest public pension fund in the world, acquired a 5.5 percent interest in Carlyle in 2000. Second, the Mubadala Development Company, a firm that invests funds on behalf of the government of Abu Dhabi, purchased a 7.5 percent stake of Carlyle in 2007. The terms of these investments are pretty simple: CalPERS and Mubadala

acquired passive stakes in Carlyle. They exercise no control or influence over our investment decisions. Their investments have allowed us to create strong U.S. companies, grow jobs and spur innovation. CalPERS and Mubadala each receive a quarterly or annual financial report, and we will work hard to produce an attractive rate of return for both entities. Both CalPERS and Mubadala are sophisticated investors, and we are grateful for the confidence they have shown in us.

Summary

In summary, SWFs are having a positive impact on the United States and international economies. They have proven to be a source of capital for the US at a time of volatility in our financial markets. Indeed, if some of our largest financial institutions did not receive large infusions of capital from SWFs late last year and early this year, it could have led to economic disorder, which itself conveys a sense of weakness and vulnerability.

To date, SWF investments have been typically passive, minority stakes. For active, controlling investments, the United States has a proven set of laws and regulations that protect our national interests associated with any foreign investment. Barring a particular problem with a particular transaction, our doors should be wide open to foreign investment. Formal or informal steps to close our economy or restrict investments would not only harm U.S. interests but also unnecessarily cause tensions with our allies and other countries with which we have important strategic objectives.

Thank you once again for the opportunity to appear before you today.