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Foreign Direct Investment by Sovereign Wealth Funds: Using the Market and the Committee on Foreign Investment in the United States Together To Make the United States More Secure

Sovereign Wealth Funds (SWFs) recently have captured America's attention. Much of that attention has been critical, with a particular focus on whether the U.S. economy is becoming vulnerable to the policy whims of foreign states.¹ Yet SWFs face significant domestic commercial and political pressures to emphasize financial performance over policy goals. These pressures from home can protect against politically motivated U.S. investments. To the extent these motivations are insufficient, additional protections—such as the Committee on Foreign Investment in the United States (CFIUS), as well as our antitrust, banking, securities and other regulations—help assure that SWFs are likely to act pursuant to commercial interests.

THE RISE AND FEAR OF SOVEREIGN WEALTH FUNDS

SWFs and state-owned enterprises often arise in nations that historically have weak private sectors and a legacy of state ownership. SWFs typically are created when such governments have budgetary surpluses and little international debt. This excess liquidity is not always feasible to hold as cash or to consume immediately, especially when a nation depends on raw material exports like oil, copper, or diamonds. A state may create a SWF to reduce the

1. See, e.g., Teresa Tritch, *As One Bubble Collapses, Is Another Taking Shape?*, N.Y. TIMES, Sept. 9, 2007, § 4, at 13.

volatility of government revenues, counter the boom-bust cycle's adverse effect on government spending and the national economy, or build up savings for future generations.

Apart from offering economic benefits, such funds can play a role in alleviating global tensions. If governments in China, Russia, and the Middle East have large investments in the United States and the European Union (EU), then they also have a direct stake in the continuing prosperity of the West. Rather than politics interfering with business, engagement with SWFs can promote better political relations through stronger economic ties.

Notwithstanding these economic and political benefits, SWFs engender uneasiness. Some assert that government ownership in the U.S. economy is un-American,² while others view public owners as insufficiently responsive to economic stimuli, distorting market efficiencies.³ And there are some who suggest that the United States will fall victim to the policy interests of states that invest for geostrategic goals rather than commercial gains.⁴ These concerns are not unreasonable; America conceivably could have been reluctant to confront Russia over, say, its recent invasion of Georgia if the Kremlin controlled large portions of Wall Street. Indeed, one need look no further than our own backyard at how government pension funds, such as the California Public Employees' Retirement System (CalPERS) make politically inspired investment decisions.⁵ Large-scale investments plainly create at least a theoretical political weapon—even if that weapon potentially can damage the investor as much as (or more than) the target.

ADVISING SWFS AND STATE-OWNED ENTITIES ON U.S. INVESTMENT

I represent both domestic companies and foreign investors—including sovereign wealth funds—on national security and political matters associated

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2. See Christopher Cox, Chairman, U.S. Sec. & Exch. Comm'n, *The Rise of Sovereign Business*, Gauer Distinguished Lecture in Law and Policy at the American Enterprise Institute Legal Center for the Public Interest (Dec. 5, 2007), available at <http://www.sec.gov/news/speech/2007/spch120507cc.htm>.
 3. See Lawrence Summers, *Sovereign Funds Shake the Logic of Capitalism*, FIN. TIMES, July 30, 2007, at 11.
 4. See, e.g., Tritch, *supra* note 1, at 13.
 5. Examples include the previous campaigns to compel foreign investors to withdraw from South Africa and the current campaigns to force divestment from Sudan with regard to Darfur. See, e.g., Press Release, Cal. Pub. Employees' Ret. Sys., CalPERS Bans Investment in Nine Companies Tied to Sudan—Pension Fund Adopts Sudan Position Statement (May 17, 2006), <http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2006/may/sudan.xml>.

with foreign investment in the United States. I advise senior management on the risk landscape for these investments. They ask me to calibrate whether a deal may founder on national security grounds or on treacherous political shoals, and to handle the matter with the federal government and with Congress.

Serving as counsel in this field means that I often see distortions in the deal economics that can deeply affect the bottom line. Several years ago, for example, a U.S. client received a multi-billion-dollar offer from a foreign investor for certain of its assets. The buyer had state-ownership from a “sensitive” country. We believed (but were not certain) that CFIUS would approve the transaction; we also were concerned that the transaction could encounter opposition in Congress. To complicate things, the U.S. company also had received a much lower offer—by hundreds of millions of dollars—from an American buyer for the same assets. Unlike the foreign buyer, the American buyer would not be subject to a CFIUS review or political opposition. Our client had to weigh taking the higher bid against the risk that CFIUS would reject the transaction, or that a political backlash might kill the deal. I was asked whether the company should accept the foreign bid, together with the CFIUS and political risks, or take the much lower and relatively riskless American bid.

They don’t teach you this stuff in law school. With my heart in my throat, I assured the general counsel and his CEO that CFIUS likely would approve the transaction and that with an appropriate strategy we could minimize the political risk as well. They accepted the foreign bid. CFIUS did not object, we managed the political dynamic, and the seller maximized the sale price of its assets. While I am called upon regularly to deliver these assessments, they are never easy or certain given the unpredictability of the national security and political environments, which continue to distort the marketplace every day.

My foreign clients are not sinister government officials with a map of the world and a hotline to the head of state. Instead, they typically are seasoned investment professionals—often Western-educated Wall Street alums—whose compensation depends on financial performance. Yet when we advise on an investment in the United States, they and we have special considerations that have little to do with profitability. Together we assess whether to file with CFIUS for a national security review. That review, in turn, determines whether the company must implement potentially costly measures to mitigate national security concerns, whether certain sensitive assets must be isolated from the client’s influence, or whether some assets are so sensitive that they simply must be sold off. We also consider whether the transaction will become a political football and fall victim to the pundit’s sound bite.

CFIUS IS CAPABLE OF REVIEWING SWF INVESTMENTS FOR NATIONAL SECURITY CONCERNS

Foreign SWFs and the United States speak different languages when it comes to state-backed investments, a miscommunication that adds to the difficulties of any review. Foreign entities need to understand that the U.S. economy has no tradition of government ownership and that such ownership has long been suspect. At the same time, Americans must remember that government ownership in the economy is often prevalent elsewhere and that in some places there are still relatively few alternatives to such ownership.

Often overlooked is the fact that the performance of SWFs in the United States is watched closely back at home. This internal pressure comes from the rising profile of SWFs and the increasing importance that many states attach to them.⁶ Although governments have not been particularly successful private market participants in the past—due to misaligned incentive structures and less sensitivity to market stimuli—internal pressures for economic success can work to change this trend. These pressures are critical components of SWF investment behavior and key protectors against nefarious conduct.

To reinforce these pressures, Congress wrought an elegant mechanism in CFIUS. I have seen the Committee repeatedly scrutinize transactions, and at times uncover legitimate national security concerns. I also have seen it negotiate tough national security agreements to mitigate those concerns, and even reject transactions where it felt the national security concerns could not be adequately mitigated. While I have not always agreed with the Committee's judgment, I have never felt that the Committee weighed inappropriate considerations in reaching that judgment. At the same time, I have felt that the legitimacy of this careful and impartial review has at times been jeopardized by calls from Congress for CFIUS to act in a particular manner.⁷ In the case of investments by SWFs, Congress should have the courage of its convictions and allow the CFIUS process to work.

Why is all of this important? As recent times have shown, our economy needs the long-term patient capital offered by SWFs. Moreover, their investment in America is one of the best methods we have to expose foreign states to the functioning of a modern market economy. When foreign investors own U.S. businesses, their economies become intertwined with ours, causing

6. See, e.g., Robert M. Kimmitt, *Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy*, FOREIGN AFF., Jan./Feb. 2008, at 119.

7. See, e.g., Letter from Senator Jon Kyl, et al., U.S. Senate, to Robert Kimmitt, Deputy Sec'y of the Treasury (Oct. 19, 2007) (on file with author).

them to experience both the rush of American economic success and the pain of American economic failure.

CONCLUSION

There are important commercial and political pressures on SWFs to maximize their financial performance. These imperatives are complemented by a decades-long track record in which SWFs have shown themselves to be quiet, long-term investors. We also have CFIUS, together with a whole host of antitrust, banking, securities, and other regulations, to provide a secure safety net to assure that this past performance continues. With these safeguards, the economic and political upsides to maintaining our open door policy for foreign investment by SWFs are substantial and—if one truly believes in the capitalist model—have the potential to make us safer in the long term.

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