GULF ROUNDTABLE SUMMARY

Recentering the Global Economy:
Gulf capital and the future of wealth

PARTICIPATING SCHOLAR

Daniel Gross is one of the most widely read economics and business writers working today. Since last summer, he has been a senior editor at *Newsweek*, where he writes the "Contrary Indicator" column. He also writes the "Moneybox" column for *Slate*, and previously wrote the "Economic View" column for the *New York Times*. Over the years, he has contributed hundreds of articles to more than 60 publications. He has written four books, most recently *Pop! Why Bubbles Are Great for the Economy* (HarperCollins, 2007). His 1996 book, *Forbes Greatest Business Stories of All Time* was a *New York Times* business best seller and has been translated into nine languages. Mr. Gross holds degrees from Cornell University and Harvard University. ■

"U.S. companies have no choice but to depend on sovereign wealth funds for assets," stated Daniel Gross, Newsweek's chief economic columnist. A growing supply of dollar-based capital piling up on the balance sheets of foreign governments has intersected with a sudden demand for capital in the United States. These conditions have created opportunities for U.S. businesses, but it has also created concerns about foreign influence in the United States. Gross examined the role of sovereign wealth funds (SWF) and the challenges and opportunities posed by sovereign wealth fund investment in the United States at a CSIS Gulf Roundtable on March 26, 2008.

The rise of sovereign wealth funds reflects flush foreign governments' search for alternative investment vehicles. At a macroeconomic level, the global economy has seen steady growth for several years, but that growth has not been entirely even. Large amounts of capital have accumulated in China, to which the world has outsourced much of its former manufacturing capacity, and among governments whose countries produce large amounts of oil. In the past, foreign governments have invested much of their surplus capital in safe, low-yielding U.S. Treasury bonds. For decades, these bond investments helped keep U.S. borrowing costs low and increased the value of the U.S. dollar. In recent years, however, low U.S. interest rates have combined with a falling dollar to make the old ways of doing business very unattractive. Foreign governments have increasingly turned to making equity investments as they seek to maximize their return on capital.

None of this is entirely new. Kuwait started the first sovereign wealth fund, the Kuwait Investment Authority, in the 1950s. The Norway Petroleum Fund has also been a pioneer in saving its oil wealth for its citizens. The pace has picked up, however. China set up its fund last year worth $200 billion, and the Abu Dhabi Investment Authority (ADIA) is now worth approximately $875 billion.

As a proportion of global wealth, the funds remain small actors. Their total value is unlikely to exceed $2.9 trillion, representing only two percent of global equity holdings. It is the speed of their growth rather than their absolute size that has raised the alarm, Gross said.

As Chinese and Gulf investors have become more aggressive looking for investment opportunities, demand for capital in the United States has been rising. In particular, the

THE GULF ROUNDTABLE SERIES

The CSIS Middle East Program launched the Gulf Roundtable in April 2007 to examine the strategic importance of a broad range of social, political, and economic trends in the Gulf region and to identify opportunities for constructive U.S. engagement. The roundtable defines the Gulf as the United Arab Emirates, Saudi Arabia, Oman, Qatar, Bahrain, Kuwait, Iraq, and Iran. The roundtable convenes monthly, assembling a diverse group of regional experts, policymakers, academics, and business leaders seeking to build a greater understanding of the complexities of the region. Topics for discussion include the role of Islamist movements in politics, the war on terror, democratization and the limits of civil society, the strategic importance of Gulf energy, media trends, trade liberalization, and prospects for greater regional integration. ■

subprime mortgage crisis has left U.S. banks and financial institutions with billions of dollars in losses and set them on a global quest for capital. Gross said that the obvious places to look for such capital are in the places that have enormous surpluses, namely Asia and the Gulf.

A number of high profile deals have highlighted this convergence of supply and demand, and the recent $7.5 billion ADIA–Citigroup deal was among the most prominent. According to Gross, ADIA did not merely buy shares in Citigroup, but essentially loaned money to the company at dramatically higher costs than the company had been able to obtain in the past. Other significant deals included China's $3 billion stake in Blackstone, which amounted to 10 percent of the private equity firm, and Dubai-based Istithmar's $942 million acquisition of Barneys New York.

Since there is no one in the United States now capable of fulfilling these needs for capital, U.S. companies must look abroad to Asia and the Gulf.

Though these funds have met a crucial demand in the U.S. economy, they have also generated a significant backlash on various levels. Many Americans profess discomfort and suspicion that foreign governments will attempt to invest in strategic sectors of the U.S. economy or use their investment against U.S. interests. In addition, Americans typically prefer that large companies act transparently, fully disclose their holdings and activities, and allow for a significant shareholder role. Sovereign wealth funds generally do few of those things, prompting concern over their motives. Some fear that funds backed by foreign governments will pursue the foreign governments' interests rather than those of the shareholders; conversely, others fear that such funds will become overly passive investors, leading to CEO entrenchment.

These concerns play into growing anxiety about the place of the United States in the world. Sharply increasing economic growth in the developing world, combined with slowing growth in the developed world means that U.S. primacy is declining. Although the traditional view is that most economies around the world depend on a healthy U.S. economy to prosper, many economists and businessmen see a possibility that the U.S. and world economy may no longer be so inextricably linked. On a more popular level, concerns that unscrupulous Chinese businessmen are trying to poison Americans while Arabs are trying to use their American dollars to undermine U.S. interests in the Middle East resonate strongly in some quarters.

One of the most interesting divergences is this: U.S. bankers are motivated by the need to secure deals and make profits, and have few quarrels accepting foreign capital. U.S. politicians, on the other hand, have been swift to raise the red flag when a deal involves strategic sectors. Two examples were Congress' actions to block the Dubai Ports deal and Chinese efforts to purchase a stake in Unocal.

Sovereign wealth funds have been increasingly cautious about confrontation with Congress, avoiding investment in strategic sectors that would raise scrutiny by the Committee on Foreign Investment in the United States (CFIUS). In many cases they are taking minority positions and not exercising voting rights. Some, such as the Abu Dhabi Investment Authority and the government of Singapore, have agreed with the United States Treasury on a set of principles to guide their investment in U.S. markets.

The public and some politicians suspect that governments will not always act to maximize profit in their investments, but will rather use them for political purposes.

Gross was skeptical of the role for voluntary codes of conduct in managing sovereign wealth funds. He argued that such codes are mainly for public consumption, and will do little to regulate transactions and capital flows. He noted that when a bank needs money it is concerned with who has cash, not whether the potential funder adheres to a specific code of conduct. What might be more successful is for managers of sovereign wealth funds to explain their strategies directly to American investors through media interviews and local meetings. Gross concluded that he expects current trends to continue. Gulf and Asian wealth must be invested somewhere, the United States remains the world's biggest economy, and U.S. businesses will continue to need capital for the foreseeable future. ■