Seeking SWF

In this time of global financial crisis, America needs a sovereign wealth fund of its own.

There are many reasons to feel uncomfortable about Barack Obama's proposed near-trillion-dollar stimulus package (and the $700 billion bailout that preceded it last year). There are serious questions—about whether the cost is ultimately bearable; whether the timing is too late to be truly counter-cyclical (and thus have its intended effect); whether it will crowd out private investment or create perverse incentives to eligible firms; whether this or that sector or taxpayer should receive aid; whether the right safeguards and oversight are put into place; and, of course, whether the government should play such a role in the private sector in the first place.

This last, most fundamental question partly stems from the fact that the U.S. Treasury is the wrong public institution for such a job, and the federal

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government's fiscal budget is the wrong account from which to draw such funds. For one, the annual budget process is not an appropriate mechanism for deciding long-term capital investments; it is like paying for college out of your weekly paycheck. And two, there is a distinctly undemocratic, non-transparent, and potentially corrupt aspect to the control that the executive branch can exert in directing such investments.

But what if the United States had—as a number of other rich countries already do—a sovereign wealth fund (SWF)? Then neither Treasury Secretary Timothy Geithner nor Federal Reserve Chairman Ben Bernanke would have to cross this invisible—yet important—line to bail out private firms or otherwise jump-start the economy beyond bread-and-butter monetary policy efforts. We wouldn't have to worry about drawing down short-term funds for long-term projects. The U.S. sovereign wealth fund could do it all.

By sovereign wealth fund, I mean a national mutual fund of stocks, bonds, and real estate holdings, including investments in private firms, established in the hopes of realizing profits as well as public goods that may or may not produce a direct revenue stream but which are important to the long-term productivity of the U.S. economy. In other words, the fund would bring in profits for "shareholders"—i.e., American citizens—but also provide a source of investment funds for business. Not only would it make sense from an accounting perspective to make long-term economic investments via such a fund, but the establishment of such an institution would have other salutary effects on American society, including the reconceptualization of the distinction between public and private capital, democratizing long-term decision making, spreading investment knowledge, and raising our dismal private savings rate. In short, the creation of a sovereign wealth fund is a key step in turning the United States into an "Investor Society."

Rethinking Fiscal Policy

If we are going to spend an unprecedented sum of public funds to stimulate the economy—while also boosting future productivity through targeted education, environmental, health, and infrastructure investments—we should also take this historic opportunity to rethink the very dichotomy between the public and private sectors. Indeed, one way to think about the distinction between the role of a central bank or Treasury Department and that of a national investment fund is the way we think about personal checking versus saving accounts: We don't solve problems with the latter by dipping into the former. The current stimulus plan is like using your overdraft line of credit to prop up your retirement savings account. America has been running its books as if there were just one big checking account to deal with both capital investments and trips to the candy store.

This approach to fiscal policy is largely a legacy of John Maynard Keynes and the quest for full employment. In the standard, industrial model of Keynesian economics, job growth is what drives the economy, and consumption, in turn, is what drives job growth. As a result, most politicians are obsessed with jobs as the main avenue to economic security, the idea being that we need to create more and more jobs that pay higher and higher wages, and, in turn, find the right people to fill those jobs. This was, many assume, the underlying justification for long-gone efforts like the Works Progress Administration, but also enduring programs like Social Security.

But in fact, the social insurance programs that are the most lasting legacies of the New Deal were really intended to be stopgaps on the way to the full employment that was going to be achieved through careful counter-cyclical monetary and fiscal policy in the Keynesian tradition. Little did policymakers of the 1930s know that unemployment insurance, welfare, farm subsidies, and, of course, Social Security would be the programs that took root and grew, or that the full employment of all able-bodied workers would remain a pipe dream even in the best of times.

We should de-link economic security from the vagaries of the labor market by helping average Americans become part of an investor class.

This jobs-jobs-jobs bias has led politicians to tilt at expensive fiscal windmills, particularly during recessions. Mainstream progressive politicians are right about the fact that productivity gains are not equally distributed to workers. (And, in fact, profits have been rising as a percentage of national income while wages have been declining.) But these progressive leaders are misleading themselves and taxpayers when they say they can fix the problem by scuttling trade deals or cutting tax rebate checks, all in an effort to boost jobs. In a globalized economy where wages are always lower somewhere else, keeping manufacturing jobs here is a losing battle.

Instead, we should focus on de-linking—to the maximum extent possible—economic security from the vagaries of the labor market by helping average Americans become part of an investor class. That is, we Americans should be thinking about ourselves as an "Investor Society," as global capital managers. Yes, this may take a feat of imagination to envision during a period of recession and a bearish stock market, but, in fact, the downturn is an opportunity to take stock of our fundamental policy strategies.

With the current consumption-based approach to social and economic policy, there will always be a disconnect between the macroeconomic health of the

U.S. economy and the economic fortunes of the typical American family. That's because technology-induced productivity growth often results in a windfall for the few at the top and little or no increased income rewards for those at the bottom. By contrast, if everyone were an investor, national productivity gains could instead be distributed in the form of dividends. When productivity went up, we could actually work less and take more time off when our kids were born or our parents were ailing, for instance. Such a work-deemphasizing approach would represent nothing short of a whole new economic policy—one better fit to a post-industrial knowledge economy and a fragile global ecosystem threatened by our consumerist culture.

A pipe dream? Hardly. Many other countries already enjoy such benefits. Qataris, Norwegians, and Emiratis all enjoy standards of living similar to ours without having to work much (or fret over the existence of jobs). In fact, most of the Persian Gulf countries import foreign labor to perform necessary jobs without the controversy over immigration that Americans perennially endure here. Granted, all these countries owe many thanks for their wealth to worldwide demand for oil and natural gas. But America has plenty of wealth, too—after all, we are the largest, most productive economy in the world. (Singapore, meanwhile, has built a significant sovereign wealth fund with practically no natural, extractable resources.) The difference is, we are squandering that wealth while foreign investors—such as the Chinese—buy up our capital stock with weak dollars that we use to finance our ongoing trade and budget deficits.

The Rise of Sovereign Wealth Funds

The ongoing controversy over the Federal Reserve and Treasury Department's unprecedented bailouts for private firms has missed a larger trend in global finance: The rise of sovereign wealth funds. Today trillions of dollars of global equity are controlled by these financial behemoths, which have been around since the 1950s, even if the name "sovereign wealth fund" was only coined in 2005. Asset values are obviously volatile, but best estimates put the total assets controlled by such funds at around $2.4 trillion (between one and two percent of total global equity), with another $6 trillion controlled by national pension accounts and other similar entities. The Abu Dhabi Investment Authority is generally considered the largest SWF, with equity totaling around $750 billion. Abu Dhabi is joined by Norway, Singapore (which has two such funds), Russia, China, Taiwan, and Kuwait—which holds the oldest sovereign wealth fund in the world—to round out the "big seven," though countries as diverse as Azerbaijan, Ecuador, Nigeria, and Brazil have also created such entities.

These funds invest both at home and abroad and, like a family savings account,

provide a buffer against economic shocks. In fact, a little known wrinkle of the last year and a half of bad economic news has been the role these funds have been playing in propping up U.S. companies. Long before Citigroup received monies from the Treasury, the corporation was kept afloat by funds from the Abu Dhabi Investment Authority; later, the China Investment Corporation came close to purchasing a 10 percent stake in the firm. Most of the other notable U.S. financial companies that have received bailout money have also gotten infusions of foreign cash via these government investment funds, including Morgan Stanley and Merrill Lynch. In other words, the American taxpayer—via the Troubled Assets Relief Program (TARP)—is now indirectly protecting Chinese investors.

As a result, most of the public debate in the United States regarding sovereign wealth funds has been between the private sector and government free traders who want to attract foreign investment, and isolationist or protectionist politicians who fear a loss of national economic sovereignty. Private foreign direct investment is one thing, the latter half argues, but ownership stakes held by secretively administered equity funds and controlled by non-democratic foreign governments are quite a different animal. Indeed, if political scientist David Stasavage is right that democracy's roots lie in the need for the government to borrow funds from the governed, trading the franchise in return for credit, so to speak, then the reliance on foreign government funds to sustain the economy can plausibly be thought of as dilution of the power of American voters.

Foreign ownership of U.S. assets is nothing new. Since before America's founding, entities from the United Kingdom collectively have had the single biggest foreign ownership of U.S. based equity. (One-fifth of all overseas dividends from U.S. companies go to Great Britain.) But today's sovereign wealth funds are scarier to some Americans than "Mother England" ever was, since they do not represent countries with which we share a "special" relationship, a common language, culture, and a dominant racial majority.

These somewhat jingoistic concerns have led several Western countries to hold hearings and even pass legislation in an attempt to limit foreign control over domestic firms. French President Nicolas Sarkozy has railed against foreign investors, while the German parliament even passed a law requiring the Foreign Ministry to review any major acquisition of a German firm by a non-European government. And after the United States held hearings on the reach of SWFs, the "big seven" even held a summit to adopt voluntary limits and regulations to stave off statutory barriers.

But rather than spite ourselves with a twenty-first-century version of the Smoot-Hawley Tariff Act, why not step onto this global financial playing field ourselves? If the United States had such a fund, perhaps our concerns over

foreign ownership would be mitigated by the knowledge that we are buying up foreign firms just as other countries are purchasing stock in ours.

What Would It Look Like?

Americans may be justifiably skittish about a quasi-public, quasi-private financial entity in the wake of the collapse and nationalization of the mortgage giants Fannie Mae and Freddie Mac, which occupied a similarly ambiguous niche. However, an American SWF would represent a somewhat converse arrangement. Fannie Mae and Freddie Mac privatized profit to their common stock holders while socializing risk, thanks to the loan guarantees by the federal government. A sovereign wealth fund, on the other hand—to the extent that it is managed without corruption—would socialize both risk and reward. Of course, this assumes that proper oversight and safeguards can be instituted in order to prevent cronyism in the deployment of capital reserves. For instance, the Freedman's Savings Bank, created in the wake of the emancipation of African American slaves after the Civil War, failed during the Panic of 1873 largely because the (white) board of directors put the ex-slaves' savings into their friends' companies (mostly railroads).

Initially, such a fund would necessarily be created with debt, so it would, in practice, represent no more than an accounting sleight of hand, much like Social Security when it was first created. But this isn't new debt—it is already a fait accompli in the current fiscal environment; the creation of the fund could be accomplished by an act of Congress that redirects TARP and other stimulus funds from the Treasury to this new public authority. (Of course, a corresponding law would be needed to draw a sharp line between the activities of the Federal Reserve and the SWF to prevent the Fed from playing the same role of investing in private companies and gaining equity as it did, for example, in the case of AIG.) However, over time this fund would diverge from the rest of the federal budget in terms of its revenue stream, outlays, and management model. It would be run like any other mutual fund: by a board of directors elected by shareholders—who, in this case, are the American people.

Much of the equity in a U.S. SWF could be directed to a new investment agenda at home. For example, it could be through this fund that we bring capital to underserved communities. Or it could be the basis of an investment agenda in green technologies, as some environmentalists have championed. And, yes, it might even invest in foreign firms.

EXISTING MODELS OF GOVERNANCE

Some lucky Americans already have experience with such an investment vehicle. Alaskans enjoy the returns from the Alaska Permanent Fund that was seeded by

oil and mineral rights revenues. However, even the Alaskan Permanent Fund Corporation is not managed with complete transparency. While the Board of Directors is constrained by statute to invest certain percentages of the fund into specific asset classes, board membership itself is a product of political patronage rather than direct democracy. A similar model is provided by Norway's sovereign wealth fund. Seeded by the Scandinavian country's oil windfall, the fund deploys a "socially responsible" investment strategy—for example, it recently divested itself of shares of Walmart stock due to concerns about that company's labor practices. But like Alaska's, the Norwegian fund is managed by political appointees who are not directly accountable to the "shareholders," but rather the state.

In a democratic society such as ours, the fund should be controlled by the American people and should be directed to socially responsible investments. But it's not just political idealism that dictates a more direct-control model. While European parliamentary democracies have a long history of crony industrial policy (whereby the major centralized players—e.g., trade unions, the state, capital—get together and plan the economy), the United States is a fractured cacophony of competing interests and sometimes contradictory goals across the branches and levels of a federalist government. That is not to say the state has not played a huge role in our economic choices, just that we like to tell ourselves there is no coordinated central planning.

In this cultural context, the notion of a secretary of the Treasury or a Federal Reserve Board chair deciding where to invest our collective wealth rightly raises our collective bristles. Even a board of directors appointed to terms that do not align perfectly with presidential terms—like the Fed or the National Labor Relations Board—would probably leave shareholders uncomfortably in the hands of "experts" who can themselves be highly politicized.

But there already exists a viable model for fund governance: Fidelity, Vanguard, TIAA-CREF or any number of large investment funds. In a U.S. SWF, each adult citizen would own one inalienable share (i.e. non-transferrable and non-heritable) and therefore cast one vote at the annual (online) shareholders' meeting, where they would elect a board of directors. There's one important distinction: Since each citizen has one inalienable share, there should be no worries about power becoming concentrated in the hands of a few robber barons.

ONE PERSON/ONE VOTE

With over half of U.S. households now involved in the securities markets either directly or indirectly (through defined-contribution pension plans that they can manage themselves), double the rate of 30 years ago, the American population clearly has the knowledge and sophistication to manage its own national

investments. While many folks may delegate their voting proxy to chosen representatives—just as they do for most funds they own—others may attend an annual, electronic town hall shareholders' meeting to make their preferences heard and their votes count with respect to the management of the fund. With a modified online social networking application—a sort of "Facebook for finance"—that allowed individuals to aggregate their shares into vote bundles to back certain candidates for the board or particular investment strategies, such a fund could represent the greatest experiment in direct democracy—on the largest stage—in world history.

A similar one-person/one-share ownership structure has been proposed by Peter Barnes to manage airborne emissions through a "Sky Trust." In order to properly price the right to emit greenhouse gasses or other matter into the atmosphere, the Sky Trust—owned by the American people, one share each—would sell the rights at a price determined by auction, within overall limits set by international treaties such as Kyoto. Barnes, however, would have the federal government administering the program directly, making it essentially a version of a cap-and-trade system, with distributed revenue rather than an investment portfolio.

The world's largest economy should be walking softly in the world, carrying a big money sack.

This simple auction strategy may be appropriate for a single-issue fund—so to speak—but an SWF must manage trade-offs across multiple domains: Invest in green technology or biotech? Educational software or high-speed rail? Who would determine the possible investments? Would a truly democratic SWF invest in socially responsible projects? There is, of course, no guarantee that the "wisdom of crowds" would lead us to the best investments for future generations. And of course, every seemingly bright idea has unintended consequences. (Just think of the environmental impact of any number of technologies, from coal-fired rail in the nineteenth century to the oil-driven interstate highway system of the twentieth.) But ideally, these decisions and tradeoffs—made by the shareholders rather than a Congress beholden to lobbyists and donors—would balance typical private-sector concerns about profitability and return on investment against the desire to develop commonly pooled resources such as our stock of human capital, our transportation and energy infrastructure, and the environment; the putative Sky Trust could, in fact, represent one tranche of the overall portfolio. And the logic of statutory floors or ceilings on, for example, the amount that can be realized as dividends or invested in a particular sector, or be sold off, can be

built into the founding constitutional charter, as was the case for the Alaska Permanent Fund.

For example, the Abu Dhabi Investment Authority owns shares of private, overseas companies, but at the same time devotes significant resources to luring and building cultural and educational institutions to the Emirate—notably the Louvre and my employer, New York University. A sovereign wealth fund thus structured is neither communist—though the people would be the owners via the state—nor does it constitute traditional industrial policy—since the decision-making power is not controlled by the people who run the rest of government but rather the American people themselves, through shareholder votes. It would represent, arguably, the most democratic form of budgeting in history.

The Benefits of an American SWF

BOOSTING PRIVATE SAVINGS

The benefits of such a fund are manifold, the most obvious being to reverse the declining private savings rate. As recently as 1984, the rate stood at 10.8 percent of national income. By 2006 it had slid into the red, at negative 1.0 percent. We have the lowest savings rate of the G-20 countries and the lowest rate since the Great Depression. How did the country achieve such an abysmal number amidst an unprecedented growth spurt? Answering this question is key to understanding the recent disconnect between the macroeconomic health of the economy as traditionally measured and the poll numbers that show most Americans are less sanguine and, in fact, anxious about their economic prospects.

Indeed, some may argue that it was strong capital growth, particularly in housing, during this period prior to the subprime lending crisis that has allowed our savings rates to fall, since they are made up—at least in part—by capital gains. Others argue that it is increased income volatility that has necessitated a lower net savings rate, since we spend down and use credit in order to smooth consumption in a volatile labor and marital climate. Still others will assert that we have simply gone on a consumption binge, thanks to policies—such as the home mortgage interest deduction—that have had the perverse consequence of promoting borrowing rather than savings.

But underlying these disparate possibilities is the institutional context of savings in America. Like our health care system, our savings system is broken to a large extent due to its historic linkage to employers. Today, in an era of flex time and more frequent job change, only about half of workers are covered by an employer retirement plan. And less than 30 percent of low-income workers (the bottom fifth) have the opportunity to take advantage of such plans. Just as it does not make sense from a competitiveness or efficiency standpoint for

the United States to lean on employers to provide health care, the same can be said for savings policy. Individuals should be able to enjoy all the tax and match benefits of savings regardless of employer.

A sovereign wealth fund would also have a role to play here. Evidence shows that saving and investing are habit-forming. Once individuals are drawn into the financial system, they are more likely to avail themselves of more sophisticated financial tools. Assets beget saving, which, in turn, begets investment. Financial firms know this, which is why they lure clients into the door with enticing loans, rates of return, and other financial services and then "sell" them an entire portfolio of services. By this logic, once more Americans have experience with owning an asset, they may be more likely to save and invest privately. That is, we might expect increased investing savvy and financial literacy beyond what is directly produced by the ownership of one share of the fund. Indeed, the rise in private investing over the last three decades has largely been driven by individuals initially brought into the market through their employer-based 401(k). In this vein, a U.S. SWF may reach the majority of Americans who still do not invest in securities markets and draw them into the "investor class."

CIVIC PARTICIPATION

Positive externalities need not be limited to private savings and financial literacy; they extend to civic life more generally. While there has been much recent debate over whether America's tradition of civic association is in decline, surely with real money at stake in such a transparent, direct way, many Americans would log in to participate in the Fund's collective governance. As such, one might optimistically expect positive spillover effects on civic life in the form of not only higher voting rates during election season, but also greater concern with our collective future.

Ample research shows that once individuals become owners, they have a different attitude toward the future that, in turn, generates positive externalities in terms of human capital investment, and respect for the rule of law. One study took advantage of a natural experiment in Argentina: By chance some squatters obtained title to their land, while others arbitrarily did not. Interviews later showed those who owned formal assets had more psychic investment in capitalism and an ideology of individual self-reliance. We know it wasn't just innate differences in those motivated to obtain assets, since it was random who got formal titles. For their part, commercial banks have known this for years. In urban settings, many banks will not offer home loans to apartment purchasers in buildings where a significant share of the units are not owner-occupied, since owners have a real stake in the upkeep of the community's real estate values in

a way that renters do not. The same could be said for our collective future in a universal stakeholder society.

A FOREIGN POLICY TOOL

So far, most of the debate about America's relationship to sovereign wealth funds has revolved around the desire to recruit capital from the Abu Dhabis of the world to America's shores to stimulate job growth, or, alternately, about fears of a loss of control over its own policies thanks to undue foreign influence. These discussions are hardly fitting for the world's largest economy, which should instead be walking softly in the world, carrying a big money sack.

America used to get away with not having a significant collective presence on the global financial stage, since the dollar was the default currency in world markets; it could flex its financial muscle merely by tweaking the money supply. But with a weaker dollar relative to historical benchmarks and stronger alternative currencies like the euro, those days are over. Yes, U.S. companies continue to be major players on the world stage. But private sector equity cannot (and should not) be expected to carry the weight of national interest. U.S. corporations answer to their shareholders (who are increasingly foreigners) and not to the American public. But a U.S. SWF would also answer to the American people, and thus give the country a powerful collective voice in international finance. Indeed, the more America has a collective, national financial stake in other countries (and vice versa), the more it will have a mechanism to ensure peace, prosperity, and democracy abroad without the necessity of pointing guns or spending directly on aid. Put simply, when there are more ties of mutual interest, the propensity to conflict is mitigated. After all, who wants to bomb a country in which they hold major investments? In this vein, Americans should cheer China's ownership of U.S. firms. Now not only is it in the interest of the Chinese (or Russians) to have access to American consumer markets (which could be thought of as a new form of dependency), it is also important to these would-be rivals that Americans enjoy productivity growth and profitability, since they are getting royalties on that growth, so to speak.

A Time for Action

But achieving an investor society will require Americans to rethink their fundamental economic approach. Put simply, they have been obsessed with job growth as the only means to foster economic security. But that is fighting against the tides of capital, which inevitably flows to cheaper labor markets. Americans must keep in mind that the growth in jobs is just a means to the desired end of economic security for all Americans. But what if Americans—who now work

more hours than almost any other world population—needed to work less thanks to great wealth?

Yes, a recession may not seem like the ideal time to start saving for the future—but it is precisely when households are feeling the pinch that they understand the notion of saving for a rainy day. After all, our recent dip into negative savings happened when the housing market was booming. Now families are squirreling away money. As a nation of scrappy immigrants, Americans have lots of experience in saving and squirreling away money despite limited resources and other obligations—at least since the time of Benjamin Franklin. It's time they rediscovered those roots of thrift and investment by starting the U.S. SWF. Otherwise the country's financial future will increasingly be in the hands of the Chinese, Saudis, and other states that may make us shudder. In a globally connected political economy, America cannot stand on the sidelines. D