

THE WORLD BANK TREASURY

+ + + + +

SPEECH BY

THE HONORABLE LAWRENCE SUMMERS

AT THE

SOVEREIGN INVESTORS' FORUM

+ + + + +

TUESDAY

SEPTEMBER 11, 2007

+ + + + +

This transcript produced from a DVD provided by the World Bank.

P R O C E E D I N G S

MR. LAY: Okay, everybody. We'll get underway. Larry's here. I am going to be brief on the introduction. I wanted to make a couple of observations, very quickly. I think of course his background, we're all very familiar with, as Secretary of Treasury, president of Harvard, and he's currently holding a chair there. But I think more to the point, from our perspective, is that about 18 months ago, he shifted the burden of proof in a lot of the discussions that all of us have, and before Larry spoke in Mumbai about managing sovereign wealth, the burden of proof was on people who thought that you should be taking more risk, and to prove why that should happen. After he spoke, the burden of proof has shifted, and now the question is, for those of us who are responsible for the effective performance of public money, is how can we not be thinking about the diversification and investment in long-term public funds? And that has been a singular service. It's caused, as I think you know, a tremendous amount of discussion, which has--and which I think, in large part, has led to the meeting here today.

And so it's with great pleasure that I introduce Larry to all of you once again.

LAWRENCE SUMMERS: Thank you very much for your patience with me and with America's air traffic control system. I'm glad to be here to address an important, perhaps I would even say a central set of issues associated with the global financial system, and associated, I suspect, with all of your responsibilities.

I'm going to make a prefatory comment about the stakes involved in this, and then I hope relatively quickly, I'm going to make six observations on what seem to me to be crucial points, and try to leave room for you to debate with me or challenge with me on any of the points that I make.

The first thing I would say is that the rise of sovereign wealth funds, and of sovereign wealth, is, in many ways, the central financial challenge, public financial challenge of the beginning of the 21st Century.

When the Bretton Woods architecture was conceived in the aftermath of the Second World War, it was conceived with a clear objective--the promotion of a stable flow of capital that would be conducive to growth between richer, more industrialized, more central countries, and poorer, less-industrialized, less central function countries. The International Bank For Reconstruction and Development was, in that era, when much was attached to the private sector, to be a major conduit for the lending of those funds, initially to Western Europe, and thereafter, to the broader, developing world.

A crucial part of the IMF's mandate was the support for the flow of capital from the center to the rest of the world economy, and with the passage of time, and the collapsed, fixed exchange rate system, assuring stability and order in that flow of capital through its surveillance and through its provision of emergency lending, became the central mission of the fund.

It is however the defining characteristic of our time, that the dominant net international flows of capital are in the

opposite direction. They are from what were once called emerging markets, or developing countries, to the traditional industrial world.

The flows are dominantly not private sector flows but are flows associated with the activities of governance, either through wealth funds, pension funds, or the accumulation of central bank reserves.

The Marshall Plan was, and is, traditionally regarded as a benchmark of massive international capital flow from one nation to other nations. Over its four years, the total flow, under the Marshall Plan, represented about 5 percent of U.S. GDP. The 10- to \$15 trillion in sovereign wealth funds that are projected to exist some time within the next decade, represent a figure, more than 50 percent of GDP. Or to put the point in a different way, \$10 trillion in sovereign wealth funds invested with a singular lack of imagination, will pay annual income of \$500 billion.

\$500 billion exceeds the entire lending capacity of the international financial institutions--the World Bank, plus the IMF, plus the regional development banks. That is not the stock from the sovereign wealth funds as projected. That is a single year's income for the sovereign wealth funds projected. Or to put it in yet a different way, the annual increase in the value of sovereign wealth funds this year will substantially exceed the total potential lending power of the international financial institutions.

And so for all of those concerned with the global financial system, and, in particular, the official sector aspect of the global financial systems, I would suggest that the set of issues surrounding sovereign wealth funds will, over the next decade, dwarf almost any other issue.

With regard to sovereign wealth funds, I want to make six observations for your consideration.

First. It is malpractice, financial malpractice, to maintain large volumes of reserves in substantial excess of plausible near-term needs for cash, in short-term safe financial securities. At the most obvious level, one shouldn't buy things that one doesn't need, and as any analyst who has studied the pricing of Treasury bills in the United States, or their counterparts in Europe and other parts of the industrialized world realize, such short-term financial instruments contain a very substantial payment premium for liquidity.

In many settings, it is appropriate to pay that premium for liquidity, but not in settings where one has no need or desire for liquidity, because one is investing only for the long term.

No respectable endowment, oriented to the future, maintained by any university or philanthropic institution, no responsibly-managed, defined benefit pension plan, investing with a horizon of several decades, few public pension plans choose to confine their investment strategy to safe, short-term financial securities.

The potential gains in long-term return, relative to long-term risk, from expansion in the menu of assets in which one invests, are enormous. The Harvard endowment, which has been an endowment that is thought to have performed particularly well in

very good times, has outperformed U.S. Treasuries by approximately 10 percentage points over the last five years, for the last 10 years, for the last 20 years.

The average managed endowment has outperformed, not by 10 percent points, but by 5 to 6 percentage points. Over much longer time periods, that include both good and bad intervals, even the crudest form of diversification, diversification into a broader range of long-term financial instruments, and into equities, has produced gains of 4 to 5 percent points relative to investments only in short-term financial securities.

Nor is it to be supposed that over long periods of time, there is anything particularly safe for a developing country about investing only in Treasury bills. In a world where inflation is uncertain, in a world where the behavior of real exchange rates is anything but certain, it is not even clear that the objective of risk minimization is best served through investment only in short-term government securities.

Nor, as recent events make dramatically clear, is it to be supposed that the safest course is necessarily the course of most incremental investment beyond government securities. As we have come to realize that a range of instruments regarded as the near-equivalent of government, associated with triple A ratings, have proven in the recent period to involve both substantial fundamental risk and also very substantial liquidity problems.

So I would make the judgment, that any honest financial professional would conclude that any nation, that for any reason, finds itself with a large abundance of liquid reserves to be invested abroad, in excess of what might plausibly be necessary in the short term, is committing financial malpractice if it does not move to invest those in more diversified and more aggressive ways than has been traditional.

Second observation. History speaks with absolute clarity to the objective that investment performance is maximized when investments are made by organizations who are accountable for investment performance, measured on the basis of investment performance, and not saddled with multiple agendas.

I learned this, very powerfully, in my first three months as president of Harvard. I had a set of ideas, and my set of ideas, to this day, I think were basically right, about how it would be enormously advantageous for Harvard, as a university, to acquire a set of land very close to Harvard Square, which would also be a very good investment, I thought.

And I went to the person who managed our endowment, and I said, look, this is really a tremendous thing, I think it's a pretty good investment, but it's really important for the university, for you to buy it. And the guy basically--and he's the guy who has really guided this tremendous performance--he basically threw me out of his office, saying, Larry, if it's important for the university to buy this investment, then the university, with the university's funds, can buy this investment, and if it's really the case that it's appropriate for the university to pay a premium because this is strategic and will be the laboratories of the future, that's fine, and if you would like technical advice on the structuring of mortgages for these

properties, and so forth, we would be delighted to provide it to you.

But our objective is to take this money and earn the highest return, with the least risk that we can, for the university.

And if our objective and our mandate becomes anything else, you will have no way to judge our performance because all of that will become an excuse, and you will set us on the road to far worse investment performance.

And I'm not maybe sensing a "shrinking violet," but, you know, I'm sorry, okay, I won't bother you again, I promise, and walk out of his office.

But it is an absolutely crucial point. And I would much rather see, to make an operational judgment, if I were advising the head of state of any country, and there was some large pool of money, I would much rather see a slightly smaller part of it "hived out" for an investment operation, and then the purity of that investment operation maintained, than a larger part "hived out" for an investment operation, but by the way, we're also going to support the national champion industries and we're going to reduce our dependence on a range of foreign products, and we're going to do things that will be supportive of the development of the local financial infrastructure, and that we will do seven other things.

That the pursuit of synergy, along with the achievement of high investment performance, is the "road to ruin."

I would suggest that when countries condition investments on the invested entity, building out financial infrastructure in their country, it is a mistake.

When they seek to support particular industries, it is a mistake. The best investment performance will come when investment performance is the sole focus.

Third observation. The first three of these observations go to the country level. The second three will go to the international system.

Broad diversification through indirect investment strategies offers the best prospect for high risk-adjusted returns. There are two crucial phrases in that sentence. The first is broad diversification. The second is indirect investments. Let me say a word about each of them.

One way I sometimes make this point is to pose the question to people. Suppose you currently are sitting with a portfolio that is 50 percent invested 50 percent in Treasury bills and 50 percent in stocks, and I offer you your choice between three other investments that you can add to the portfolio.

The first investment is very strongly positively correlated with the stock market and moves with the stock market.

In fact, it moves two to one with the stock market, and so it has an expected return, over Treasury bills, of 5 percent--of 10 percent rather than the stock market's 10 percent. So investment one is two-for-one with the stock market.

Investment two--each of these you can only get a limited quantity of. Investment two will for sure, for sure, pay the Treasury bill rate plus one percent.

Investment three will pay the same as the stock market, 5 percent above Treasuries, is uncorrelated with the stock market, and has twice the volatility of the stock market. Which investment would you choose to add to your portfolio?

The answer is, it turns out if you do the relevant calculation and you do it right, is you would overwhelmingly choose to add the third investment to your portfolio.

The first isn't really doing anything for you, it's just leveraging the stock market, and everything you could accomplish by making the first investment, you could make by reducing your holdings of Treasury bills and purchasing more stocks.

The second provides some advantage but only a marginal advantage.

The third, because the investment is uncorrelated with the stock market, yields a very substantial benefit to--a very minor increase in the total riskiness of the portfolio, while having the same return as the stock market, will provide a significant contribution to increasing the total return.

The point--and there are a variety of examples of this kind that can be constructed--is that in evaluating investments, most investors look first at return, then at variance, and then at correlation. Many new sovereigns, thinking about broadening their investment menu, actually do it slightly differently.

They look first at standard deviation, or risk, then at return, and then at correlation.

But, in fact, in evaluating any new investment, the central question is its correlation. And so when people proceed in what seems to them to be the safe way, we have moved into U.S. Treasuries, and we've moved from three months to two years, and yes, we're now going to go into U.S. agency securities, they, in fact, may be adding less risk reduction to their portfolio per bit of return than if they move into some asset class that seems to them much more exotic. Equities which otherwise aren't correlated, or some form of alternative investment vehicle.

And so the third thing I would urge is a focus on correlation in assessing new investment categories, and I think that will incline much more towards a broader menu, equities as well as fixed-income instruments, alternative investments as well as equity investments, and will suggest that many of the "we're more comfortable with gradual broadening of the menu strategies," have less risk reduction associated with them, and less prudence associated with them than meets the eye.

The other part of my clause was an emphasis on indirect investment. There is, it seems to me, almost nothing in history or in logic, to suggest that in the vast, vast majority of cases, public officials, working in investment authorities, are likely to be very good at exercising control rights over the performance of particular businesses.

They are neither trained to exercise those control rights with skill and acumen. The constraints associated with being in the public sector preclude a variety of aspects of compensation than in other settings, incent those control rights to be exercised well, and--I'll get into this more in a few moments--the political constraints on which, under which

governments operate, make it quite problematic for them to have control rights over enterprises, to be involved in judging whether a company's labor policy is or is not appropriate, whether a given CEO should or should not be compensated in a certain way, whether a--what the appropriate strategy for an enterprise is.

So at the level of the investment manager, I would highlight three--I would sum up, highlight three issues. Broaden the menu, separate and focus the investment authority, diversify broadly, and make the investments indirectly.

What about the response of the international community to all of these considerations. Here, I would highlight three observations as well.

First, the ways in which reserves are accumulated. The policies, and the exchange rate sphere, and other spheres that lead to their accumulation, are an appropriate issue of international discussion, international surveillance, and international concern. It has always struck me, and there has been some important evolution on this issue in the last year, so what used to strike me strikes me less now, that under the international norms of financial discourse that prevailed during my time at the Treasury, if a country had a misadministered value-added tax, that led to inefficient and wasteful revenue collection within it, that was seen as an appropriate matter for serious and focused IMF surveillance, and for intense dialogue with the country, and for substantial discussion around the board table at the IMF, because that was part of the article four surveillance process.

If, on the other hand, in the name of maintaining a certain exchange rate, which, by its nature, was not just that country's exchange rate but was also other countries exchange rate, since exchange rates are inherently bilateral, in doing so through the accumulation of large volumes of investment in securities issued within other countries, what would seem to be a quintessentially cross-border financial issue, it was explained that, no, that exchange rate regime was not an appropriate matter for IMF scrutiny, because, after all, exchange rate regimes were within the purview of individual countries.

I think it is very difficult to defend that logic, and I think the recent changes in IMF surveillance procedures that have been announced, but I think it is fair to say, in a de facto sense, have not yet been importantly tested, recognize the anomaly of which I just spoke, but that it would and should be a matter of international dialogue, what the size of the buildups of reserves are, what the economic context for them is, what the reasons are.

That is not to say that the accumulation of substantial reserves constitutes a prima facie case that a country is doing anything wrong, or should create a presumption of suspicion. Only that the issues involved in the accumulation of reserves should be a crucial part of the surveillance process and of the international policy dialogue.

Second. There are major challenges associated with, and problematic aspects, associated with the politicization of the capital market through the activities of sovereign wealth funds. It would be an ultimate irony, and in my view, a terrible tragedy,

if the tremendous trend that has taken place, with enormous benefit in most parts of the world over the last two decades, towards privatization, towards greater reliance on private sector entities, were to be reversed through a wave of cross-border nationalizations achieved through the activities of sovereign wealth funds.

This is of course very much related to the question of indirect investments that I spoke of, investments made through intermediaries, rather than directly in companies, and investments when made in companies that did not involve taking a controlling interest.

One can only imagine some of the possibilities for mischief here. And not all of these are purely hypothetical. When central bankers gather to discuss the international policy environment, and international policy challenges, are working together to cooperate, to promote global economic growth? Or are some trawling for information about future policy actions in other countries on which they can speculate with their country's reserves? This is not a purely hypothetical concern, that the world has never seen, even to this date.

It is common, when heads of state meet, for there to be discussion of commercial issues, particularly vexing trade barriers or foreign direct investment policies.

Would we like to see the day when one head of state asks another about the possibility of more favorable tax legislation affecting a company that a national investment authority had purchased a controlling investment in. Would one like to see that kind of connection?

What would one think of a country that through its sovereign wealth fund sought to purchase a major competitor for one of its own companies and then to use its influence with that major competitor to direct its energies elsewhere so that its competition would be less ferocious, or perhaps to purchase a major supplier and cause it to profit maximize somewhat less aggressively in order that a national champion company might prove to be more profitable?

Or what if a government that seeks to promote its own view of how domestic policies should be arranged rather than the view that exists in another country by instructing its sovereign wealth fund to divest particular companies or use its influence within particular companies to promote what are seen as more appropriate labor practices or more appropriate environmental practices?

Alan Greenspan believed with great force that it would be catastrophic for the American Social Security fund, trust fund, to be invested in any way, shape or form in stocks because of the potential for abuse along the lines that I have just described. That seems to me to in some ways be too cynical a view, and it seems to me the case that we are discussing here where the whole issue or the overwhelming preponderance of the issue goes to cross-border investments is a very different one.

But if these investments were to start taking the form of direct and controlling interests, what I've called cross-border nationalizations, it seems to me they would become much more

problematic, and it seems to me quite appropriate for potential host countries and for the international financial institutions to face that issue in a square way.

Just where the line should be drawn, just what the definition should be, just what the rules of the road should be are, I think, very difficult questions. But as one who has, I think, established a general reputation as being very supportive of open capital markets, being very supportive of a more integrated global economy, being very resistant to capital controls of any kind, I do not think that the general logic of open markets should lead to an entirely laissez faire attitude towards what are, in fact, de facto cross-border nationalizations.

I guess my final observation would be that the international financial institutions have in my view a very important role here. They have a very important role here in supporting countries as they move to more appropriate investment practices, as I know our World Bank hosts have been engaged in for some years. In no circumstance -- let me repeat this because in the way I expressed this thought on an earlier occasion there was some confusion -- in no circumstance do they have a role in managing countries' reserves or in making investment decisions for countries.

In the same way that the international institutions have a role, except perhaps on a transitional basis, in the same way that the international institutions have over many years provided very important assistance to countries in procuring very sophisticated services and products of many kinds, they do have a potentially important role in helping countries purchase and obtain sophisticated assistance in the management of reserves.

They also, I would suggest, have the two roles that I have implicitly sketched in my last two observations of providing and supporting an international surveillance process that recognizes the important consequences of global reserve accumulation and of national reserve accumulation policies and an important role, as well, in establishing rules of the road that both promote all of the benefits of international investment and diversification, but avoid the, I think, very real risks of an excessive repoliticization of the investment process through the activities of sovereign wealth funds.

Let me conclude where I began. This is an issue that I believe is of great importance for the international financial system, but also of great importance, importance measures in the hundreds of billions of dollars a year, over time for the welfare of the citizens of countries around the world.

Yes, there are problems. Yes, there will be contentious issues, but of capital it can surely be said that it is better to have too much than too little, and that we are able to address a world in which so many countries now have so much capital that they can invest is something from which we can all derive very considerable satisfaction.

Thank you very much.

(Applause.)

LAWRENCE SUMMERS: I have sought to provoke a little bit by not pulling my punches as I stated those observations, and so

I'm happy to respond to anything.

Ken.

PARTICIPANT: Yeah, Larry. We haven't been talking very much about this let's call it the strategic cross-border investment issues that have been so much a topic of recent discussion in this area. I'm curious though if you could elaborate a little bit on where your concerns lie.

There are examples in the United States of large public funds, the California Employee Retirement System, for example, is one of them, which routinely exercise -- are activists in corporate governance, and if you talk to them they'll tell you that they believe they're doing it because it is their role to achieve -- in their efforts to achieve superior returns for the beneficiaries of the fund.

Canute Kyer was here earlier today, wasn't able to join us this afternoon, but, of course, the Norway Fund, as you can read in their reports, cast 3,500 corporate proxies last year and have a team of people who are very actively engaged in trying to exercise what they view to be their rights as a corporate owner, albeit a minority owner, in these situations, and Kanute will be the first person to tell you that he's not interested in taking control in cross-border interests.

How do you parse that up? Because you were very clear on the point of sovereign strategic interests, but I'm curious about your reactions on these sort of complex borderlines.

LAWRENCE SUMMERS: I think it is not an easy set of issues at all. I think if you accept the principle that you're not taking on control rights on acting enterprises in other countries, you have reduced -- you have removed a major level of problem.

If you then are at the question of how one should behave as a shareholder, potentially a large and influential shareholder, there is the question of whether we want -- there are then a couple of questions.

One is is that responsibility to be used only to pursue profit maximization. The company is non-managed. The CEO is not doing a good job. There's an entrenched board. We vote to throw him out.

Or should it be used as it sometimes is in the CalPERS case to pursue our values? We don't like the sale of tobacco products. We are concerned about countries that do business in countries that we think violate people's human rights.

And I think that is quite a slippery slope. I think it is quite a slippery slope for state pension funds, and I think it is potentially an even more vexing slope for the larger cross-border funds and for funds that are intervening in other countries.

So I would prefer to say that unless there are fairly compelling reasons otherwise, it is better for investments to be made through intermediaries. So let Fidelity decide how to vote the stock. If the investments are to be made directly, that the mandate with which proxies are approached should, in line with my second observation, be crafted as narrowly as possible around maximizing returns.

The difficulty, I think, is that that's a very difficult thing for political entities to do. You mean we're not concerned that we're investing in countries, companies that are promoting such-and-such a sinful practice?

And inevitably there will not be absolutes here, but as these funds grow to be a larger and larger part of the total capital market, I think these issues will become that much more problematic, and I think one of the reasons to avoid -- one of the benefits of an extra level of intermediation is that if it's properly managed, the fees are really quite trivial and you avoid having to take public responsibility for questions that are actually rather difficult to take public responsibility for.

You know, do we want -- let's take another example. Suppose a sovereign had owned a four percent stake in Dow Jones. Wouldn't there have been something awkward about the government of Country X, say, given the history that has not been entirely unvexed, the government Singapore or the government of China, being in a position of voting on whether it was or was not appropriate for Rupert Murdoch, who would presumably have a long memory, to get to own Dow Jones?

I would think that that was a kind of question that governments might well prefer to arrange their affairs so they didn't face, and while those kinds of issues are obviously much more likely to arise in media companies or in aerospace defense companies than they are in some other areas, I think one does well to be aware of the full magnitude of the potential conflicts and also the kinds of pressures that will come over time.

Yes, sir.

PARTICIPANT: (Speaking from an unmiked location.)

It's a short question, Professor Summers. I liked your example of the Harvard Fund very much, but I couldn't help thinking that Harvard, after all, it's a business, and the objective is to maximize profits.

When we think of society, the society's objectives, or we were trained to think so, it's welfare maximization. And from the growth theory point of view, we hold that they choose the right mixture of capital and labor and technology that takes them to the steady state and hopefully they stay there.

From this point of view, I mean, I'm looking at the sovereign funds, and these are coming mostly from developing economies --

(End is Tape 1, Side 1.)

PARTICIPANT: -- is that you might ask as an economist, do you have any insights on this?

Thank you.

LAWRENCE SUMMERS: I think there are a couple of aspects of your question. First, Harvard is a nonprofit institution. Nobody gets the profits from Harvard, and Harvard thinks it exists to increase the public welfare through its intellectual work in teaching and research. So the notion of a kind of broad analogy between Harvard's somewhat diffuse purpose and a sovereign wealth fund I actually think is a pretty good one and is in many ways better than the example of a corporate pension fund that I might otherwise have considered.

I think your question goes to something that I think is a very difficult question, which is, look, the way the question is put in many countries is, "I don't get it," some citizen or some politician says. "How come we're investing in Treasury bills that earn two percent real when we could be investing in new infrastructure for our country that's got a social return of 12 percent?"

And that's a really powerful question, and the answer usually takes -- usually is of one of two kinds. Sometimes the answer is, well, we're doing a lot of that and we can only absorb so much infrastructure, and we're going to have a lot of money now, but before long the oil is going to be out of the ground and then we're not going to have a lot of money. So we're buying, we're investing to assure that we're going to have a continuing flow of money even after we run out of oil.

Depending upon the facts of a case, that may be an entirely legitimate answer.

The second answer and the more analytically interesting answer is, well, we could invest it at home, but if we invested it at home, then we'd be taking all of these dollars or these euros and we'd be buying things and buying up local currency with them, and if we did that, our local currency would rise in value, and if our local currency rose in value, that would have a whole set of consequences within our economy. The people who bought imported things would be happy because they'd be cheaper, and the people who are engaged in exports would be less happy because they'd be much less competitive, and our growth strategy, which has been importantly based on export led growth and the benefits that it brings, would be inconsistent with channeling the investment at home.

You know, is that right in any particular case? That's very much an empirical argument, and you can't judge across cases.

I think the point that's usually missed by the sort of simplistic domestic critics is that you can't bring the investment home without having consequences for the exchange rate policy and for the level of the real exchange rate, which doesn't mean that you might not be much better off with increased infrastructure and a stronger exchange rate, but you do have to think about it in those terms.

You also have to think about it, and I don't have time to go on at length about this, is what should one think of as the domestic counterpart of the accumulation of the sovereign wealth fund. Should one think about it as the domestic counterpart being an increased level of national savings, either directly or indirectly, or should one think about this as borrowed money that's been borrowed in effect in the process of carrying on unsterilized -- excuse me -- sterilized intervention? And that may affect the appropriate investment strategy as well.

PARTICIPANT: Okay. I think we have time for one more question, and then we'll wrap up so that we can continue with the program. Anyone else?

Cynthia.

PARTICIPANT: Do you think the United States should have its own sovereign wealth fund using its own mineral royalty income

as the source of that fund?

LAWRENCE SUMMERS: No. I think insofar as the United States has revenues that could usefully be capitalized, we should use them to reduce the budget -- we should use them to reduce the budget deficit and raise the level of national savings and have all the things that go with that. But the United States is, it seems to me, the antithesis of the kind of country that should have a sovereign wealth fund precisely because of our low savings rate and precisely because we are a country that, as the markets judge it, has substantial investment opportunity relative to domestic savings -- relative to domestic savings flow.

PARTICIPANT: I do see one more over here and then we are going to wrap up.

PARTICIPANT: (Speaking from an unmiked location.)

LAWRENCE SUMMERS: Well, because there are two. I wasn't quite sure where you were going with your question. There are, I think, two sets of issues. There are a set of issues around what in its harsh form would be called mercantilistic exchange rate manipulation leading to reserves. And I think we should be open to the hypothesis that there is such a thing.

I'm always -- this is a little -- this is going to seem to be like a bit of a cheap shot, but I'll say it anyway -- I'm always struck that when the subject is financial stability, central banks are deeply concerned with asymmetry. The idea that you'll bail people out when things go down, but you don't punish them when they go up and you create some kind of put by doing that is a matter of great anxiety to the world central banking community.

On the other hand, when the question is excessive current account deficits and excessive levels of borrowing, that's a matter of great concern to the central banking community, but whenever anybody suggests that you become concerned with excessive levels of saving and excessive levels of lending and excessive excesses of exports over imports, somehow that concern with symmetry doesn't arise.

And so I think more symmetry in the surveillance mechanism is the first part, but I think your question probably was more directed at the second part of it, and I would just say that apart from the traditional national security concerns with sensitive technologies and sensitive industries, which typically do not sharply distinguish -- you know, typically at least in the United States, the SIFIUS process is much more oriented to the nature of what's being purchased than it is to the nature of who's doing the buying, and I think what one actually should be thinking in terms of is a broader, two dimensional test in which what's being purchased matters and of what kind of strategic significance and scale it is, and also who's doing the buying.

And I recognize that coming out of many countries the distinction between a government authority's purchase and a private purchase is less sharp edged than I've spoken about it and is less sharp edged than it probably would be given American customs. So I can't define for you precisely what the right rules are, but the reason I chose to speak about it is that it seems to me the principle that is often enunciated which is sovereign

wealth fund, you know, the syllogism which is if George Soros wants to buy a company, that's the same as if a foreigner wants to buy a company, and if a foreigner wants to buy a company, that's the same as if a foreign government wants to buy a company, and we should let George Soros buy any company that wants to sell to him.

Therefore, we should let any foreign government buy any company that wants to, which is often enunciated in discussions of this subject, somehow seems to me to go too far to one extreme.

But this is an area where what the philosophers call the fallacy of the excluded middle is very present, you know. The fallacy of the excluded middle is to say, well, you know, there's A which is bad and there's C which is good, and that whole distinction is invalid because you can think of a bunch of Bs part way along where it's hard to decide whether they're good or bad. Therefore, the whole concept doesn't have any meaning.

And the fact that there's some very difficult line drawing, it seems to me, shouldn't be a basis for adopting free market fundamentalism in this area.

Thank you very, very much for the chance to be with you.

PARTICIPANT: Thank you, Larry.

(Applause.)

(End of recording.)