UNDER SECRETARY OF STATE ROBERT D. HORMATS
REMARKS AT
U.S. COUNCIL FOR INTERNATIONAL BUSINESS
"CROSS-BORDER INVESTMENT IN A POST-RECESSION WORLD"
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## I. Introduction

Thank you, Jim, for your kind words of introduction. I'd like to also thank Bob Kimmitt, Chairman of Deloitte's Center for Cross Border Investments and the other principals of your firm. Let me also express my gratitude to our host, the United States Council for International Business [USCIB], as well as its sponsors and supporters. This meeting provides a timely opportunity for a much-needed dialogue among business, labor, NGOs and policy makers.

All of us understand the benefits of a robust investment environment and sound investment policies for job growth, wage increases, and technological progress. So we must work together to chart a path to bring these results about.

After nearly a decade of uninterrupted economic growth, economies and financial markets have taken a substantial hit in the last few years. And the U.N. Conference on Trade and Development [UNCTAD] reported a 14% drop in foreign direct investment [FDI] during 2008. By 2009, the Economist had reported flows falling almost 40%, only two years after reaching a record high of $1,979 billion in 2007. No matter how you look at it, the trends have been indisputable.

But there is hope. While the outlook for global FDI may seem poor to some, there is reason to believe U.S. and global investment will improve in the medium-term. And if the

American and world economies can regain their strength, a positive and supportive investment environment must play a vital role in that process.

President Obama understands this. In his 2010 State of the Union address he remind us that, "…the true engine of job creation in this country will always be America's businesses but government can create the conditions necessary for businesses to expand and hire more workers…and we can put Americans to work today building the infrastructure of tomorrow." And he has followed up his remarks with an ambitious goal of doubling U.S. exports within the next five years.

So how will we meet our target?

We will do so in part by sustaining a positive environment for international investment. The U.S.—along with other governments—needs to resist protectionism and economic nationalism. We need to recognize that FDI contributes enormously to our economic success. And we need to pursue policies that enhance confidence among investors.

This is a key to expanding our economic recovery and global economic growth. It's how we create jobs, promote exports, sustain manufacturing and service capabilities, and develop critical infrastructure in the U.S.

We know the right way forward will have two components: (1) encouraging inward investment and (2) protecting the rights of American investors abroad. By pursuing both avenues, we at the State Department are supporting a robust investment policy bilaterally and through multilateral partnerships.

## II. Importance of Inward Investment to U.S. Economy

An open investment environment is vital to a dynamic, and competitive American economy that can create high quality jobs. That is why we place great emphasis on sustaining it. Inward foreign direct investment supports the U.S. economy in myriad positive ways. We are the world's largest recipient of foreign direct investment -- and we need to keep it that way. In 2008 alone, the United States received $316 billion in FDI. There are a number of reasons why foreign investors are attracted to the United States, but let me list the main four:

- our open and welcoming investment climate;
- our adaptable economy;
- our skilled work force; and
- our spirit of innovation.

With all this in our favor, it's no surprise that we've enjoyed the fastest acceleration of productivity growth among the major industrialized countries. Even with the sharp drop [57%] in inward FDI in 2009, America remained the world's top investment destination.

Historically, European Union member states have been the leading investors in the United States. They hold 62% of the stock of FDI in the U.S., with Switzerland, Germany, the United Kingdom, France, and Spain as the top European investors. The next largest group of investors are Japan, Canada, and Australia.

But the fastest growing investors between 2004 and 2008 come from a newer group. This rapid-growth group is led by the UAE which has shown a 230% average annual increase over 4 years. Next we have India (with 64%), Spain (with 60%), Chile ( with 50%), Switzerland (with 38%), South Korea (with 31%), China (with 30%), and Indonesia (with 27%). I doubt that most Americans are aware of how much new investment is coming from this group of countries.

Our challenge now is to embrace this new dynamic. Not only must we maintain and grow the historic trans-Atlantic investment relationship, but we also must reach other potential investment partners to draw more FDI to the U.S. The BRIC economies (Brazil, Russia, India and China) are becoming important investors globally. Some of their long-standing restrictions on outward investment are changing as they recognize the importance of such investment for their own economic success.

The State Department is taking this opportunity to build on common ground. We're taking critical steps to forge multilateral investment policy in the OECD and UNCTAD, and in our dialogues with the EU and BRICs. Our aim is to strengthen and expand sound investment policies and practices in more and more countries, with the objective of seeing the emergence of a coherent rules-based international system.

Let's review more specifically the positive impact of inward FDI on the U.S economy:

**1.** *Creates New Jobs:* According to our most recent numbers, U.S. affiliates of foreign companies (majority-owned) employed approximately 5.5 million U.S. workers, or nearly 5% of private industry employment. Between 2003 and 2009, over 4,500 new projects were announced or opened in the U.S. by foreign companies. And that's created over $314 billion in investment and about 632,500 new American jobs.

**2.** *Boosts Wages:* U.S. affiliates of foreign-based companies tend to pay higher wages than other U.S. companies. Internationally owned companies support an annual U.S. payroll of $433 billion, with average annual compensation per employee of $72,000. On average, U.S. subsidiaries of foreign firms pay 30 % higher wages and salaries than do all U.S. establishments taken collectively.

3. *FDI Reinvests Profits Back into the U.S. Economy:* Based on our latest available annual figures, foreign affiliates reinvested $64 billion of their profits back into the U.S. economy.

4. *Increases U.S. Exports:* Foreign-owned companies operating in the U.S. use their distribution networks and knowledge about tastes and markets abroad to export goods made in this country. Approximately 20% of all U.S. exports have come from U.S. subsidiaries of foreign companies in recent years.

5. *Strengthens U.S. Manufacturing and Services:* Thirty percent of the jobs supported by U.S. affiliates of foreign companies are in the manufacturing sector. These account for 12 % of all manufacturing jobs in the United States. Approximately 60 % of all foreign investment in the United States is in the service sector, improving the global competitiveness of this critical segment of the U.S. economy.

6. *Brings in New Research, Technology, and Skills:* Affiliates of foreign companies (majority-owned) spend tens of billions of dollars on research and development in the U.S. and hundreds of billions on plants and equipment.

7. *Contributes to Rising U.S. Productivity:* Inward investment leads to higher productivity growth through an increased availability of capital and strong technological capabilities. Productivity from foreign and domestic investment is a key factor that increases U.S. competitiveness abroad and raises living standards at home.

These positive outcomes are not lost on our nation's governors. For years, they have sought to bring inward FDI to their respective states. Here are a few observations on the subject from several prominent governors:

- "California leads the entire nation in foreign direct investment and we are grateful for the technology, for the opportunities and for the jobs this provides for our state. In fact, it is estimated that more than half a million workers are getting jobs here in California by foreign-owned companies and this is one example right here. And when you combine that with the billions of dollars worth of properties through foreign investment in factories and equipment, which is altogether $120 billion of investment, it all adds up to a giant recipe for California's success." --Governor Arnold Schwarzenegger

- "We're working hard each and every day to attract more foreign direct investment to the commonwealth. If Pennsylvania is to successfully capture its fair share of investment, the state must act aggressively to ensure that international companies are adequately informed and familiar with Pennsylvania's strengths ¬ our leading research institutions, emerging industries, competitive business environment and skilled workforce. Attracting a solid international business like Osstem to Pennsylvania illustrates what we can accomplish through hard work." --Governor Edward G. Rendell

- "In addition to pursuing opportunities to promote Nebraska products, we are also interested in efforts to increase foreign investment in our state. Today there are more than 30 Japanese-owned businesses in Nebraska. We want to continue to recruit new businesses here to our state."
  --Governor Dave Heineman

- "At last count, there is $92 million worth of direct foreign investment in Texas by Indian companies. And there are 317 Texas workers employed by companies based in India. The benefits of investment are more than just financial gains in our state. Foreign direct investment creates new jobs and unleashes an infusion of innovative technologies, progressive management strategies, and effective workforce practices." --Gov. Rick Perry

To illustrate concretely why these governors are so energized on this issue, let me cite an example of a recent, and significant, inward investment. Its source might surprise you. It doesn't come from the UK, France, Germany, or Japan—it comes from Russia.

Severstal Russia is one of the world's leading privately-held steel and mining companies. Severstal North America is the fourth largest steel maker in the United States. Its assets include both integrated plants and mini-mills, with a significant downstream distribution business and a wide geographical presence. It owns plants in Dearborn, Michigan; Sparrows Point, Maryland; Warren, Ohio; Wheeling, West Virginia and Columbus, Mississippi.

In a speech to the U.S. - Russian Business Council in October 2008, the CEO of Severstal, Alexsei Mordashov, announced the opening of the greenfield plant in Mississippi; this amounted to an investment of over $1 billion. It has already created over 500 jobs in that state.

He said the factors leading to the company investing in America was the business-friendly aspects of the U.S. economy and how Severstal was able to benefit from this environment. He noted several "fundamentals" of the U.S. economy that enabled Severstal's growth. These included a high degree of self-sufficiency in raw materials, competitively priced inputs, a highly developed infrastructure with opportunities for development, a young and growing workforce, and flexible legislation allowing a "real free market."

Strong public support has also been a key to Severstal's success. It has come in the form of large cash and land grants from state governments and acquired companies. But it also comes in the form of favorable public statements made by governors and other state and local leaders, as well as support from unions.

The Severstal example also illustrates my next point: that inward FDI does not necessarily favor right-to-work states over those with strong union states. Note that of Severstal's five acquisitions in the U.S., four were in union states. Foreign firms have significant direct investments in every state of the union. Employment in these firms ranges from well over half a million in California, to several thousand in North Dakota. Following California, the states with the highest number of residents or workers employed by foreign firms are New York (a strong union state), Texas (a right-to-work state), Pennsylvania (another strong union state), Illinois (another union state), and Florida (a right-to-work state). 40% of the foreign firms' employment is in the manufacturing sector. You'll be interested to know that's <u>more than twice the share</u> of manufacturing employment in the U.S. economy as a whole.

<u>National Security Concerns – The Committee on Foreign Investment in the United States (CFIUS)</u>

As I've said previously, foreign investments in the U.S. are critical to economic growth and job creation here at home. At the same time, we have a statutory obligation to protect national security, a responsibility that we take very seriously. The Committee on Foreign Investment in the United States (CFIUS) is the inter-agency panel which reviews the national security implications of certain cross-border mergers and acquisitions (M&As). The State Department works with other CFIUS agencies in seeking to ensure protection of U.S. national security interests while making certain that American citizens continue to reap the benefits associated with inward investment.

CFIUS conducted both a review and an investigation with respect to 23 of the 155 notices received in 2008 (23 of the notices were withdrawn). The President did not take action to block or prohibit any transactions in 2008. The total value of all publicly announced acquisitions of U.S. companies by all foreign investors during that period exceeded $400 billion.

## III. Outward Investment

Let me now turn briefly to outward investment. We know that some overseas investments by American companies can lead to job losses here, but for many companies, expansion abroad supports employment and dynamic operations at home.

In the past decade, the stock of U.S. direct investment abroad has more than tripled, increasing from $1 trillion in 1998 to $3.2 trillion in 2008. U.S. companies earned $350 billion from overseas direct investments and remitted about a third of those earnings to U.S. parent firms in the form of dividends.

For many, foreign-affiliate activity complements, rather than is a substitute for, key parent activities in the United States, boosting U.S. wages, employment, and capital investment. Research conducted by Professor Matthew Slaughter of Dartmouth comes to several interesting conclusions about these parent companies in recent years.

- They provided more than 19 % of U.S. private sector jobs;
- they accounted for nearly a quarter of America's GDP;
- they exported nearly half a trillion dollars worth of goods to the rest of the world;
- they undertook roughly 30 % of all U.S. capital investment; and

- they performed over 75 % of Research &Development in the U.S.

As U.S.-based MNCs have expanded employment abroad, so too have they expanded employment in America. Foreign direct investment abroad remains crucial to many U.S. companies because it is essential to their ability to sustain and expand sales in foreign markets. For many, access to foreign markets depends on their presence in those markets.

## IV. What we're doing and what do we need to do?

Currently there are some 2,500 bilateral investment treaties [BITS] and other agreements worldwide. The qualitatively different degrees of investor protections, investment promotion policies , and, in some cases, market access commitments may raise important issues of coherence. These may be particularly challenging for developing countries, but they also are a concern to the rest of us. The United States supports the work underway at the OECD and UNCTAD to better understand these complex issues.

I want to stress that these questions and challenges should not become the basis for undermining the important role these agreements play in supporting international investment flows. And recent actions by some governments to terminate or withdraw from existing agreements will not improve their prospects for attracting the kind of international investment critical to their economic development. In fact their actions raise questions about their willingness to abide by their international obligations with respect to dispute settlement procedures under these agreements.

Increasing capital flows across international borders will require that investors feel secure about the host country's willingness to abide by their contractual obligations, including dispute settlement mechanisms.

The U.S. government has traditionally upheld the rights and interests of American investors abroad and we intend to continue to do so. Broadening acceptance of open international investment policies is the foundation of economic growth, job creation, and technological advances in the U.S. and worldwide. It will remain a major component of U.S. diplomatic engagement as we move forward.

The State Department actively encourages nondiscriminatory, open, and market-oriented environments for U.S. investment abroad. We do this through a wide range of bilateral and multilateral initiatives, including the Organization for Economic Cooperation and Development (OECD) Freedom of Investment project, the UN Conference on Trade and Development (UNCTAD), and the Asia-Pacific Economic Cooperation forum (APEC), as well as with outreach to most advanced and key emerging economies.

The Department also works with USTR to lead joint efforts to conclude bilateral investment treaties that support two-way investment. Our aim is a rules-based system on national treatment, dispute resolution, and market access for new investment. The United States presently is a party to BITs with forty countries.

My colleague, Assistant Secretary Jose Fernandez, is co-chairing, with his USTR counterpart, Miriam Sapiro, the inter-agency process to update our model BIT. But the overall process is very much an inter-agency effort – with virtually every agency playing a vital role. Once this phase is completed, and we have concluded extensive consultations with all concerned, especially Congress, we expect to resume progress in BIT negotiations with China, India, Georgia, Mauritius, and Vietnam, and identify other potential new BIT partners, including several in Africa.

We have engaged in a long series of consultations with labor, business, environmental groups and others on a new model BIT. The process is not without controversy. We want to protect the interests of American investors—which is the key purpose of the BIT— and we want to ensure, as a matter of high priority, labor and environmental protection in our treaties. BITs are not perfect vehicles for achieving all of our objectives, but we aim to do our best.

## VI. Conclusion

As President Truman so eloquently made the case over 60 years ago, "We must develop a larger flow of international trade and international investment, on a sound basis. This will result in larger markets for ourselves, and larger markets for other free countries."

The United States has a significant stake in continuing to work with our economic partners both multilaterally and bilaterally to implement policies that facilitate global investment flows based on sound principles and practices.

In closing, let me leave you with one thought. As we've seen, inward investment is important to domestic job creation and much outward investment supports exports from the home country. Investment policy requires the same level of attention that we have given to trade, finance, and development. We know it relates closely to all three, and good policies in these areas reinforce one another. Sound policy that ensures a welcoming environment for investment in the U.S. must now be, as it has been traditionally, a high priority because our current and future prosperity will be significantly advanced by it. Thank you.

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