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The Importance of Investment in the Global Economy

Over the last quarter century, foreign investment has accelerated at a breathtaking pace and shifts in the flow of this investment are now reshaping the global economic landscape. We have seen inward foreign direct investment stock roughly triple worldwide over the past decade -- and that holds true for developing countries as well as developed economies.

Today more than 80,000 multinational corporations (MNCs) are operating worldwide with more than 800,000 foreign affiliates – compared to 37,000 multinational corporations and 170,000 foreign affiliates active in 1993. Foreign investors not only bring fresh capital, technology, competitive spirit and ideas to new markets; they also bring jobs. They employ nearly 80 million people worldwide, a figure that is roughly twice the size of Germany's labor pool -- and one that has quadrupled over the past three decades. These foreign affiliates also point to a deeper level of economic integration among nations. They show a purpose and commitment beyond one-time sales or market entry into well-established trade patterns. Investment not only drives jobs and innovation, but it also increasingly drives trade.

The global sales of the foreign affiliates of MNCs now equal roughly two times the dollar amount of world exports according to UNCTAD's World Investment Report 2010. This makes foreign direct investment increasingly important in terms of the delivery of goods and services to international markets. Roughly one-third of world commerce takes place as intra-firm trade. And the bulk of technology that is transferred flows within the framework of the integrated international production system. FDI and the activities of MNCs have become central to the world economy at large, and particularly important to developing countries.

FDI flows also are the vital currents that can help restore global economic growth. We have already seen trade flows come back after the recent global recession. And the WTO estimates that trade will be up by nearly 10 percent in 2010 over the prior year. FDI, however, may not rebound at the same pace: UNCTAD is predicting only a modest and uneven recovery in global FDI this year of $1.2 trillion, after registering a little over $1.0 trillion in 2009, from $1.7 trillion in 2008. Global FDI flows fell very sharply in large part because of a substantial drop in cross-border merger and acquisition activity, due largely to more difficult financing conditions arising from the financial crisis. However, FDI flows have historically been less volatile than portfolio investment. As a relatively stable form of international capital flows that spurs growth and diversifies risk around the world, FDI can help foster global economic recovery.

Investment also drives development. In March 2002, more than 50 heads of state and 200 finance ministers took part in the International Conference on Financing for Development in Monterrey, Mexico. The Monterrey Consensus identified sound policies to attract international investment flows and adequate levels of productive investment as key factors in sustainable development. Since then, nations have broadly recognized that foreign investment is critical to economic growth in developing nations. While valuable and important, official development assistance cannot match the power, velocity and impact of private investment, which is an essential factor for countries to compete in the knowledge economy.

As Secretary Clinton put it, “Aid chases need; investment chases opportunity.” It is promising that last year alone, two-thirds of sub-Saharan African nations implemented reforms to improve their business climates, a factor that will be critical to the region’s ability to continue attracting and retaining international investment. Rwanda was the top reformer globally in 2008-09 in the World Bank’s Doing Business Report. As Rwanda substantially improved its investment climate in recent years, its investment stock has climbed from $55 million in 2000 to $412 million in 2009.

We are well into an age when many of our most daunting challenges are global, and greater levels of foreign investment will be necessary to overcome many of them: achieving global food security; mitigating climate change;

defeating violent extremism; and, improving conditions for the one-third of the world's population that lives in circumstances that offer little opportunity to create a better tomorrow for themselves or future generations.

Notwithstanding this consensus, in recent years, concerns have increasingly arisen about the potential for investment protectionism. Even before the financial crisis struck in 2008, researchers David Marchick and Matthew Slaughter had pointed out that a number of governments, representing countries who account for a significant share of total global investment flows, had already considered, or were considering, measures that would restrict certain types of FDI or expand government oversight of cross-border investment. Most of these measures were justified on the grounds of protecting national security interests and sectors deemed to be strategically important.

Key Investment Principles

As foreign investment is contributing more substantially to our economic prosperity, policies designed to foster, protect and fully benefit from it require greater focus. These include improvements to the investment climate that will attract greater flows, stronger intellectual property rights protection, and better investor aftercare and dispute prevention. A rapidly changing global investment landscape brings many new opportunities as well as challenges.

Some of these changes require further examination and may prompt new policy approaches. At the same time many basic principles remain valid. Those that have proven so successful in the effective functioning of open markets will continue to be vital to success in fostering greater economic growth and development. Both UNCTAD and OECD, the two key international organizations focused on investment policy, strongly advocate the benefits of opening economic sectors to foreign investment, fair and equitable treatment for foreign investors, reforms that result in predictable regulatory and legal environments for investors, and the value of Investor-State arbitration to resolve disputes between governments and foreign investors. It is easier to attract foreign investment when foreign and domestic firms can compete on an equal basis and when there are full intellectual property rights protections.

A recent World Bank study of patenting as it relates to economic growth in 92 countries over the period of 1960-2000 found that a 20 percent increase in the annual number of patents granted, wherever the technologies originated, was associated with an increase of 3.8 percent in output. This is an unusually powerful finding: the issuance of patents, which in turn is likely fostered by stronger IPR regimes, stimulates economic output. Another study, conducted in 2004 by researchers at the University of Nottingham, found that strong IPR protections stimulated growth in countries with high per capita incomes, and yielded even greater gains in countries with low per capita incomes, by encouraging imports and FDI from advanced countries.

Policies that discriminate against foreign investors, or mandate technology transfer, or impose other performance requirements, on the other hand, make capital skittish and hamper development. Theodore Moran's research showed that affiliates of foreign multinational firms tend to be more technology- and capital-intensive as well as faster growing in terms of output and employment when host countries do not constrain affiliate operations through requirements such as local-input sourcing and mandatory technology transfer. Likewise, countries that seek to evade their international obligations by ignoring arbitral investment tribunals or by backing away from commitments to international investment arbitration not only undermine their own investment climates but harm the prospects for foreign investment into developing nations more broadly. All countries – whether capital exporters, recipient nations, or both – have a strong interest in preventing such serious backsliding, which research has shown to be detrimental over time.

To return to sustainable global economic growth, we must keep our countries open for business and sustain a commitment to principles of fair competition in our own markets and global markets. We in the U.S. are strong believers in the importance of foreign investment to our own country. Since the early stages of our Republic, under the leadership of Alexander Hamilton, we have believed in the importance of foreign investment into our own economy and in the importance of a legal and regulatory environment that provides confidence to foreign investors. We continue to believe in that.

Through its network in nearly 80 countries worldwide, the U.S. Government's *Invest in America* program promotes and supports inbound FDI to the U.S. This program facilitates investment inquiries, acts as ombudsman for the international investor community, advises on policy related to U.S. competitiveness in the attraction of FDI and provides foreign investor education. Individual U.S. states, cities, towns, and regions also actively promote themselves to foreign businesses as a destination for FDI. Our governors and mayors are especially eager to attract foreign investment to their localities – and many of them travel widely to describe the virtues and attractions of their states and cities.

We in the State Department, as well as our colleagues at the Department of Commerce, fully support them and welcome the opportunity to facilitate contacts and cooperation to attract investment to our shores. The knowledgeable and talented American work force, our laws that provide for a stable and predictable business environment and the highly competitive nature of our economic culture are all positive factors for investors.

We note that many other countries also are eager to attract foreign investment. Amid the financial crisis, the G-20 took on a leadership role for the world community by calling for a commitment by the world's largest markets not to erect new barriers to investment and trade. All countries need to resist protectionism and economic nationalism. We need to pursue policies that enhance confidence among investors. The path to recovery is not yet assured, and we need to remain vigilant against protectionist temptations. But nations have largely met the G-20 call. That the global economy is growing again this year is in large part due to the G-20's leadership – and the partnerships to strengthen the system that include large emerging and industrialized nations.

Changing Investment Patterns

Yet there are many other challenges resulting from the changing investment landscape. There is little doubt, for instance, that the growing importance of emerging economies in the global economy has a major impact on the contours of international investment. Since World War II, the largest flows have occurred between developed economies, with the single largest bilateral investment relationship existing between the U.S. and Europe. Investment relationships between developed and developing economies had largely been characterized by outflows from developed economies to developing countries.

This pattern has changed and will continue to change. A number of the large emerging economies – particularly Brazil, Russia, India, China and South Africa but others as well – are now increasingly important overseas investors. In 2009, FDI flows from emerging and developing economies into other markets approached one-quarter of a trillion dollars. These countries held overseas investment stock of nearly $2.7 trillion – more than three times their total a decade earlier. This means that these countries now have a greater stake in the global system of rules and practices that govern investment. It also means that there is likely to be a growing convergence around similar sets of principles and practices.

It is fitting that we come to Xiamen to discuss these changes given the important and growing role that China and other advanced emerging economies are playing in the global investment picture.

Since I traveled with Henry Kissinger to China as a young White House economic adviser in the early 1970s, the investment relationship between China and the United States has burgeoned. U.S. investment stock in China has grown from $49 million in 1982 to more than $49 billion in 2009. OECD studies show China's outward investment increasing significantly; in the United States alone, Chinese investment stock roughly doubled from $385 million in 2002 to nearly $800 million in 2009. The Peterson Institute of International Economics recently noted that "China's OFDI has reached commercially and geo-economically significant levels and begun to challenge international investment norms and affect international relations."

China is not alone in bringing new dynamism to investment patterns. As many of the large emerging economies, notably Brazil, Russia, India, China and South Africa, become more significant outward investors, they share strong interests in protecting their own foreign investment. Many are reconsidering some of their own long-standing restrictions on investment and changing policies that have left important sectors closed to foreign investment.

Developing countries, emerging economies and countries in transition have come increasingly to see FDI as a source of economic development and modernization, income growth and employment. They recognize that FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development. All of these contribute to higher economic growth -- which is a potent tool for alleviating poverty and fostering political stability in developing countries. As world leaders gather to discuss progress on the Millennium Development Goals (MDGs) in New York later this month, let us not forget the important contributions that FDI can make to helping the world achieve the MDGs and other important development goals.

Moreover, FDI may help improve environmental and social conditions in the host country by transferring "cleaner/greener" technologies and leading to more socially responsible corporate policies. Here in China, for example, the question arises about whether China's environment is being sacrificed as a result of the country's boom in inward investment. Researchers Judith Dean and Mary Lovely analyzed the latest data on air and water pollution from China's State

Environmental Protection Agency and found that the pollution intensity of Chinese exports actually fell dramatically between 1995 and 2004, both because foreign investors introduced cleaner production techniques and because these investors have induced a shift to cleaner products. So deeper global engagement is reducing the environmental cost of Chinese income growth. Rather than facilitating the migration of dirty industries to the developing world, FDI flows to China are making the production of Chinese exports cleaner over time.

There is a growing understanding that corporate social responsibility is increasingly insisted on by consumers in industrialized and developing countries alike. They demand transparency, accountability and quality products to meet their health, safety and environmental expectations. Consumers, using the Internet, are increasingly focused not just on the actual products they buy, but also on the conditions under which these products are made. In order to compete, and win the allegiance of consumers, companies have to adhere to global standards of corporate social responsibility, such as the OECD Guidelines on Multinational Enterprises.

Challenges to Global Investment Flows

The emergence of new players also highlights the prominent role of state-owned enterprises and sovereign wealth funds, their public financing, and its impact on the competitive landscape. The principle increasingly known as "competitive neutrality" suggests one way that governments can address these challenges. Governments can create frameworks to ensure competitive neutrality between large state-owned enterprises and private firms to preserve competition and avoid crowding out of, or discrimination against, private initiative. To ensure competitive neutrality, several techniques or policy measures can be employed: reshaping management incentives within state-owned enterprises; effectively applying competition law to avoid creating an uneven playing field; intensive evaluation of the taxation, financing and regulatory provisions that exist for state-owned enterprises; and implementing corporate governance reforms within these enterprises.

As nations attract foreign investment from a more diverse array of sources, investor credibility is growing in importance. Longstanding guidelines for model corporate conduct are being updated to reflect the current challenges. For example, the OECD Guidelines on Multinational Enterprises are being updated this year. Discussions are currently underway with respect to possible guidelines regarding conflict minerals. The OECD's Anti-Bribery Convention and the recently adopted Recommendation for Further Combating Bribery of Foreign Public Officials in International Business Transactions are particularly significant tools for promoting responsible investor conduct, propriety, integrity and transparency worldwide. We seek partnerships with many nations to implement them. Non-OECD member countries are free to accede to this Convention; several have done so and we encourage other major trading nations to join them.

The changing patterns of FDI flows also pose other challenges where the solutions may be less clear. With the importance of innovation to the success of firms competing in national and global markets, questions are arising about national policies to promote innovation by domestically based firms using discriminatory or exclusionary methods – and government procurement tests – that adversely impact foreign-owned firms.

For the United States, <u>protection of our intellectual property is a core national economic interest</u>. Methods to promote innovation around the world that are based on proven practices of tax credits and similar techniques can be and have been quite successful. But discrimination or exclusion against the products of foreign companies on the basis of where technology was developed or who holds the patent, or similar measures, are harmful to many foreign firms and in the final analysis makes them less inclined to engage in real collaboration on cutting edge innovation. Moreover, as emerging countries develop their own innovative technologies, they should be insistent on fair treatment of their companies that have produced those technologies and of the products they sell.

Another challenging issue relates to competition for natural resources. Firms owned by governments, or acting on the basis of government policies, are playing a greater role in global natural resources investment and trade. When they invest in new and alternative supplies, they often *expand* global resource supplies for all nations. Where they concentrate on securing *existing* sources of supplies, they are perceived to potentially limit access of other nations and therefore raise concerns. Theodore Moran's recent analysis of resource-oriented investments suggests a differentiated picture: that foreign investments in small, independent resource producers will likely lead to expansion of supplies and increasing competitiveness of industries while investments in major producers which put foreign governments in a position to control or constrain production are more concerning.

Then there are security-related issues. Technological innovation, new sources of capital and other factors affecting the nature of security threats are evolving rapidly. We all share the need to protect legitimate security interests. In the U.S. we have very clear laws and procedures to do that. These are fully consistent with our open investment policy for the vast majority of investment that does not adversely affect our security and our eagerness to attract such overseas investment.

The OECD's Guidelines for Recipient Country Investment Policies Relating to National Security, adopted in May 2009, provide excellent guidance for how governments can approach some of these national security concerns. The Committee on Foreign Investment in the United States (CFIUS), which reviews notified foreign investment transactions for national security concerns alone, demonstrates a very strong alignment with these guidelines. Thomson Financial estimates that there are an average of 2,000 merger and acquisitions involving foreign acquirers in the United States annually. According to the 2009 CFIUS Report to Congress, an average of 135 transactions came before CFIUS annually from 2006 to 2008. Substantially fewer (65) were reviewed in 2009.

Questions also are arising about the combined impact of thousands of bilateral investment treaties on countries' capacity to understand fully the scope of their commitments and to manage their risks. A number of countries are reviewing their approaches to investment agreements altogether based on factors such as: their desire to balance protecting investors and preserving the appropriate level of flexibility to regulate in the public interest; and, the inclusion of specific provisions to advance other policy interests, such as the protection of labor and environmental interests. For example, the U.S., Canada, and Mexico have reviewed and modified their practices based on experiences gained since the advent of NAFTA. And the EU is reconsidering its approach to investment rules based on the Lisbon Treaty. Japan also has changed its approach in recent years. South Africa, Brazil, and other major emerging economies are also reflecting on the changing investment landscape, their evolving interests, and how it might affect their approach to such agreements.

Multilateral Response to Challenges and Opportunities

The growing importance of investment and these new opportunities and challenges suggest the need for greater analysis of the changing landscape, continuing reflection on our changing interests, greater engagement in our bilateral relations, and a revaluation of how to improve our multilateral engagement. The work of UNCTAD and OECD has played a unique and important role in combining a forum for intergovernmental dialogue on policy best practices, with analysis of emerging issues, and advice to governments seeking to undertake policy reforms to improve their ability to attract and reap the economic benefit from international investment, and we strongly support their work. We should constantly look for better ways of utilizing these institutions and strengthening cooperation between them and with other international groups.

OECD and UNCTAD bring great strengths and complementary perspectives. The OECD, whose members account for 90 percent of global investment flows, has, since its creation, had an active agenda on international rules and best practices for investment, which is pursued through its Investment Committee. UNCTAD is a universal body and its Investment & Enterprise Division is sensitive to the development dimensions of international investment. Its Investment Commission and expert groups seek to build broad intergovernmental consensus on core challenges related to investment and development facing the international community.

Together UNCTAD and OECD do the research and analysis that provides the backbone necessary for sound policymaking on investment. UNCTAD recently issued its "World Investment Report 2010," the latest in a highly regarded series of annual reports that track global trends in investment flows and stocks as well as international investment agreements, and studies the impact of foreign investment on developing nations. Like UNCTAD, the OECD produces high quality reports, such as the International Direct Investment Statistics Yearbook. They conduct analytical work on bilateral investment treaties which will be critical to evaluating the impact of a diverse array of over 2,500 agreements.

One of the most valuable contributions these two organizations make is their policy advice on investment to national governments. The OECD's investment policy reviews and advice has helped those countries aspiring to membership, or to adherence to relevant OECD instruments, as well as other emerging economies and developing countries. It also has played an important role in assisting their efforts to improve their investment climates. The OECD's Policy Framework for Investment continues to provide a valuable diagnostic tool for governments in this regard. The Freedom of Investment Roundtables provide an important forum for member and non-member countries to discuss developments relevant to their pledges to avoid protectionism and expand international investment flows as we seek to recover from the economic crisis. It also discusses emerging issues with respect to international investment and the policies necessary to address them.

UNCTAD also provides complementary advisory and technical assistance to support developing countries' policy reforms, negotiation of international investment agreements, and investment promotion capabilities. UNCTAD has assisted developing countries in tackling the practical challenges related to investment. It also has helped to spearhead a promising effort among Latin American countries to establish an advisory center that could help them to avoid investment disputes and better manage them when they do occur, potentially benefiting both the recipient countries as well as the investors. The United States has high regard for and actively participates in UNCTAD's Investment Policy Reviews of developing countries, which focus attention at the highest levels of developing nations' governments on the steps needed to succeed in competing for investment.

2009 saw a new level of collaboration emerge between UNCTAD and OECD as the G20 called for them to jointly monitor and produce quarterly reports on measures relevant to their pledge to avoid protectionism. Identifying and evaluating investment-related measures is critical to governments' efforts to hold one another accountable. Those countries that have been most successful in attracting investment have a special role to play in supporting and guiding these institutions' efforts and in sharing their own national experiences with those nations who aspire to match their success.

UNCTAD should be congratulated on its excellent work at this Forum to focus high-level attention on how much of our shared prosperity depends on foreign investment, by attracting senior officials from governments and a broad set of stakeholders. The United States hopes that the serious issues identified by our discussion today will encourage both UNCTAD and OECD to deepen their collaboration, and also to organize a single international meeting of this caliber to continue our high-level discussions next year.