# U.S. Senate
# Committee on Commerce, Science, and Transportation

# Hearing:
# "Are Trade Agreements Really Investment Agreements?"

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**The National Foreign Trade Council**
**and**
**The Organization for International Investment**

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### *Introduction*

Mr. Chairman, thank you for the opportunity to present the views of the National Foreign Trade Council (NFTC) and the Organization for International Investment (OFII) on how trade and investment flows are intertwined and how international trade and investment agreements affect corporate decisions about their global supply and production chains.

The member companies of both the organizations that I represent today, while different in the locations of their headquarters, are united in their support of the rules-based trading system. Most of the NFTC's members are U.S. based firms that trade and invest around the world. OFII's members are the U.S. subsidiaries of companies based abroad that are likewise active participants in the global trading system. While many of our members compete in a particular industry or sector, they broadly share a common view of the rules under which they compete: non-discrimination for foreign investors (national treatment), non-discrimination between goods imported and goods made domestically, multilateral agreement to limit the use of government subsidies, and protection of intellectual property. They support these rules in their home markets and seek them when trading abroad.

The growing importance of international investment is a natural consequence of the globalization that has been the hallmark of the past two decades. Whether searching for opportunities or looking out for competitors, business no longer has the luxury of limiting its view to its own backyard. Today's business environment, with its technological advances, multiple market possibilities, industry alliances, and greater consumer sophistication, demands that all companies compete through investment-led strategies.

Some critics charge that the investment flows encouraged by the rules-based system amount to nothing more than the exportation of American jobs. Others claim that under a liberalized trade regime investment always flows downhill to the lowest wage-earning countries with minimal environmental protections, the so-called "race to the bottom." In truth, the expansion of direct investment by both U.S. and non-U.S. companies has contributed substantially to the economic health of the United States, while helping to lift many other developed and developing countries to new heights of prosperity. We believe that international investment and trade, conducted under the rules-based trading system is a force for economic growth, democracy, stability and is of direct economic benefit for millions of individuals around the world.

It is by now an article of faith in the anti-globalization movement that investment flows are inexorably drawn to low-wage countries with lower protections for labor, the environment, or human rights. However, if that were true, one would expect the least developed countries to have been the recipients of massive investments in the last decade, but the facts do not support the critics' rhetoric.

**The United States: Largest Recipient of Foreign Investment**

The United States has been almost certainly the greatest beneficiary of the explosion in international investment during the past decade. U.S. affiliates of multinational companies, which number more than 9,700 companies, infused nearly $900 billion into the U.S. economy in the 1990s, more than the amount invested over the previous four decades combined. Today, the United States receives more than 30% of worldwide investment. According to the Commerce Department's Bureau of Economic Analysis, foreign investment in the United States was almost $317 billion last year. Once in the United States, U.S. subsidiaries continually reinvest a significant portion of their U.S. earnings back into their American operations. In 1999, they reinvested 53% of their earnings, totaling a record $18.8 billion. They also make significant investments in research and development and in new plants and equipment, all of which provide business to other companies in the United States. In 1998, U.S. subsidiaries spent a new high of $25.2 billion on U.S. research and development activities conducted by American scientists and engineers and supported by U.S. suppliers and sub-contractors.

In perhaps the best evidence of their impact, U.S. subsidiaries of foreign companies employ 5.6 million Americans and pay average annual salaries of over $46,000, well above the average salary for U.S. workers as a whole. They account for 13.5% of all U.S. manufacturing jobs. For the past 5 years, U.S. subsidiaries have paid record levels of federal taxes. According to the most recent IRS statistics (1997), foreign companies paid a record $19.7 billion in federal taxes, a 28% increase over the previous year.

In addition, U.S. subsidiaries exported a record $150.8 billion of merchandise in 1998, representing 22% of all goods exported by the United States. In fact, U.S. subsidiaries have accounted for at least 20 percent of U.S. exported goods for all but one year since 1980. America's low trade barriers and open investment policies are significant reasons why these companies choose the United States as a location not just to service our market but as an export platform to other markets.

Beyond the clear benefits of both the direct and indirect jobs provided by U.S. subsidiaries, there is a new set of stakeholders in the U.S. who also derive personal benefit from the operations of these companies here and abroad: shareholders. A recent study, commissioned by OFII and Citibank, tracked the 100 publicly traded foreign-based companies whose subsidiaries generated the most U.S. sales. The study found U.S. investors own 20% of the total shares of these 100 companies. Among them, 62 have U.S. investors holding 10% of shares and U.S. ownership is as high as 30% or more for 22 of the companies. Nokia is a perfect example of one such foreign-based company with a major presence in the United States. It provides one of America's best selling cell phone brands, with over 5,500 U.S. employees in its Texas manufacturing operations. But the United States has another significant stake in the company: today, U.S. investors own 55% of Nokia's stock.

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**South Carolina: A foreign investment success story**

The benefits that accrue to Americans from the domestic investments of foreign companies can be seen not simply in quantitative data and upwardly sloping economic statistics, but in the stories about real changes in the quality of people's lives.

Mr. Chairman, we need not look further than your home state to witness how international investment has contributed to our economy. The story of foreign investment in South Carolina dates back to your tenure as Governor when you began to build the solid foundation of the excellent business climate the state enjoys today. As a result in part of your creation of a statewide network of technical colleges that emphasizes job training and your commitment to fiscal responsibility, South Carolina enjoys one of the lowest unemployment rates in the country.

The flood of blue chip international companies that have chosen South Carolina as a manufacturing location is remarkable if viewed historically. In the past, among the state's largest sources of employment were textile production and garment manufacturing. Fast-forward to today and you see a remarkably different economic landscape. Textile manufacturers still provide significant employment but are driven by the engine of their investment in hi-tech automation. Down the street from the new textile mills, sit the manufacturing operations of companies from around the world. According to Department of Commerce figures, the state now has 116,900 jobs supported by U.S. subsidiaries, 66,800 of which are in manufacturing, a 77% increase over 10 years.

One of the best examples of South Carolina's efforts to attract international companies is BMW Manufacturing's arrival in 1992. The luxury German carmaker, with a devotion to quality, was not looking for cheap labor or to get around a tariff wall. They were looking for a place to build a new type of car: the Z3. They wanted a location that would be a global center of excellence. The vehicles produced were not to be mere kits made in Germany to be slapped together in

South Carolina, but top-of-the-line automobiles manufactured basically from the tires up in the state.

BMW could have put this plant anywhere. It would have been easier to simply build it in Germany or elsewhere in Europe. If they were looking for cheap labor in the Americas or to surmount trade barriers, post-NAFTA Mexico would have been an obvious choice. But they did not. They chose South Carolina because of its educated workforce, the low cost of land and welcoming business environment. As part of their decision matrix, transportation was also central: getting components from around the country and the world in a timely fashion, while also exporting the finished cars to markets around the world, BMW needed good transportation options. The history of bringing BMW to South Carolina is now legend, but in this area, one of your efforts stand out: securing more than $45 million to facilitate BMW's needs at the Greenville-Spartanburg International Airport, thus helping attract the company to the state.

At the end of the day, BMW's decision to locate in South Carolina delivered significant economic benefits. According to the company, BMW Manufacturing Corp. has made a total investment of $1.675 billion in the state, paid total compensation of $699.2 million and paid taxes and duties of over $190 million. Most significantly are the nearly 8,000 people that are directly employed there where the average worker can earn salaries that top more than $56,000 a year. Additional jobs – approximately 4,700 – are attributed by BMW to the suppliers who have come to the state with a "multiplier" economic impact of $1 billion.

**U.S. Investment Abroad Supports Jobs at Home and Development Abroad**

As much as companies abroad have invested at record levels in the United States, U.S. firms have kept apace in their overseas investments, investing $802 billion during the 1990s, more than they had in the prior four decades combined. But for all the talk of the "Asian tigers," new eastern European markets, China's liberalizing economy, or India's economic reform, the geographic destination of U.S. foreign investment has not changed. Europe continued to account for nearly 55% of the total U.S. foreign direct investment during the last ten years. Within North America, Canada received 8% of U.S. outbound investments, drawing $2 of U.S. investment for every $1 invested in Mexico since 1994. Within the Asia-Pacific region, U.S. firms did not favor China, the second largest market in the region, but rather Australia, which is a smaller market than many U.S. states. Australia attracted 20% of the total U.S. investment in the Asia-Pacific region because of its educated workforce, legal protections, and technological capabilities. U.S. multinationals' investment strategies are much more motivated by access to affluent markets, skilled labor, and technological advantages than the possibility of reducing wages.

Today, more than 75% of all foreign direct investment is in the developed world. As noted, the United States itself is host to more than 30% of all such investment. The United Kingdom runs a distant second with a little more than one-fourth the total of the United States or $82 billion as of 1999. China, by contrast, received only $40 billion in 1999, less than 5% of global flows.

Thus, investment has, in fact, raced to the top, flowing in overwhelming proportion to stable democracies that are characterized by high living standards, well-developed regulatory regimes, and transparent legal systems.

Statistics on wages similarly belie the anti-globalization rhetoric. In 1998, the average compensation paid to workers at majority-owned U.S. affiliates throughout the world was $33,100. In Canada and Europe, the average compensation at these subsidiaries topped $41,200. Investment simply has not "raced" to the lowest wage levels.

Nor is it true, as critics often claim, that U.S. firms' foreign workforce is concentrated in developing countries with low wages and poor conditions. In fact, the vast majority of people employed by U.S. affiliates live in other wealthy, developed countries. In Europe, U.S. affiliates employed roughly 3.5 million workers in 1998 – more than the combined U.S. workforce in Latin America and developing Asia. Almost a million Canadians are employed by U.S. subsidiaries – more than four times the number working in China.

## U.S. Foreign Investment Promotes Exports

U.S. outbound investment also promotes U.S. export industries. As of 1998, the assets of non-bank foreign affiliates of U.S. companies exceeded $4 trillion. In the same year, non-bank foreign affiliates of U.S. companies had over $2.4 trillion in sales in their domestic markets, nearly two and one-half times the amount of U.S. exports of goods and services. And these increased levels of foreign investment and foreign sales pull U.S. exports. According to the Survey of Current Business, exports by U.S. multinationals were $438 billion in 1998, an amount equal to some two-thirds of all U.S. exports. More than 40% of exports were to the majority-owned affiliates of those U.S. companies. Thus, rules-based trade agreements contributing to international investment flows do not export jobs, but rather lead to increased exports of goods and services and make a substantial contribution to the economic well-being of our country as a whole.

## The Economic Returns from U.S. Foreign Investment

U.S. investment overseas reaps significant economic returns for Americans through higher employment levels in the United States, more sources of revenue, and improved productivity. There are countless examples of high-paying, quality American jobs that are directly tied to the expansion of U.S. trade and investment. Consider the example of GE Power Systems, a $15.2 billion global business with operations around the world and throughout the United States. GE Power Systems is headquartered in Atlanta, GA but has major operations in Greenville, SC; Belfort, France; Houston, TX; Florence, Italy and Schenectady, NY to name just a few.

GE recently announced that construction is well underway at the Baglan Bay Power Station in South Wales, site of the world's first GE H System. The 480-megawatt Baglan Bay Power Station will supply electricity and steam to industrial and commercial facilities within the new

Baglan Energy Park, with excess power bid into the U.K. grid. The Energy Park is one of the largest single areas of industrial development in the U.K.

The cornerstone of the GE H System is the 50-hertz MS9001H gas turbine, which was shipped from GE's Greenville, SC gas turbine manufacturing facility in December of 2000. The *H System* will produce 480 MW of electricity, enough to power 168,000 homes. It will be fueled by natural gas. Gas powered turbines used for power generation are similar to jet aircraft engines, but on a larger scale.

The GE Power Systems Greenville plant is the largest and most advanced heavy-duty gas turbine production facility in the world. At the facility, GE has the capacity to produce large gas turbines ranging in size from 40 to 480 MW used for generating electric power around the globe. The facility employs approximately 2,900 people and is the largest exporter of manufactured goods in South Carolina.

But the story doesn't end with the highest technology component, the gas turbine from South Carolina. Other components are key to making the Baglan site work, for instance the plant will use a GE LM2500 gas generator supplied by GE Nuovo Pignone in Florence, Italy.

Interdependence is a business norm in the global marketplace. It is no longer rare to find the jobs or economic welfare of a company in a small Midwest town tied to the successful operation of its foreign affiliate in Europe or Asia. But the good news has been and remains that these transnational economic relations are winning propositions for the people on both ends.

***Conclusion***

This hearing asks whether trade agreements are really investment agreements. The real question is whether trade agreements cause U.S. companies to invest abroad. The data I have presented suggests the answer is: "no." However, if the Committee is concerned about artificial influences on U.S. companies' decisions to invest abroad, then we might suggest two other questions for future Committee hearings:

**"Do trade *barriers* force firms to invest abroad?"** Some companies have been forced to invest and manufacture abroad in order to overcome government trade barriers on the raw materials they use or as a market entry strategy to surmount protectionist barriers to their finished products. This certainly applies to some foreign direct investments in places like China, Brazil and India. How many U.S. companies, that desire to compete in every major market, could have supplied these markets from their U.S. operations? How many other international investors in the U.S. like BMW would be able to use their U.S. operations as an export platform to South America if we had successfully completed the Free Trade Agreement for the Americas (FTAA) in the last Administration where the negotiations started? How many more jobs would be supported if we could lower the tariffs and non-tariff barriers that some nations have erected?

**"Are the trade agreements that *other countries* are concluding driving U.S. companies to invest abroad?"** The United States has been falling behind in negotiating trade agreements that lower barriers for U.S. goods and services. Today, the European Union has 27 free trade or special customs agreements around the world, 20 of which it negotiated in the 1990s; it is negotiating another 15 right now. Countries throughout East Asia are quickening the pace of special trade negotiations. Japan is negotiating a free trade agreement with Singapore, and is exploring free trade agreements with Canada, Mexico, Korea, and Chile. In our own hemisphere, there are 30 free trade agreements, and the United States is party to only one.

We believe production location decisions for multinational companies take into account the trade treatment of the goods and services from each of their global locations along with production costs and transportation expenses.

U.S. Trade Representative Robert Zoellick illustrated this very well at a lunch hosted by the NFTC last week. He told the story of Caterpillar and the motor graders they make in Illinois. Caterpillar's Illinois-made motor graders face nearly $15,000 in tariffs when exported to Chile. When Caterpillar manufactures them in Brazil for export to Chile, the tariff is just $3,700. And when Caterpillar's competitors make them in Canada, it can be exported to Chile free of tariffs because of the Canada-Chile free trade agreement.

If we continue to miss out on the effort to lower trade barriers, we may find that U.S. based companies have little choice but to service some countries and whole regions from manufacturing sites outside the United States.

Mr. Chairman, contrary to the premise of today's hearing, trade agreements lower artificial government barriers to trade and thus allow companies to make manufacturing location and production decisions under clearer economic conditions. Multinational companies' decisions in regard to their global supply chain are a complex calculation involving workforce quality, transportation access and cost, proximity to key suppliers or customers and the overall business climate in a location. Trade barriers skew the calculation, often to the detriment of the United States. Trade agreements that lower these barriers will allow U.S. manufacturers like BMW's South Carolina plant and Caterpillar's motor grader plant in Illinois to compete on a level playing field both against other related manufacturing locations abroad and those of their competitors.

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