BONNIE GLICK

SENIOR VICE PRESIDENT, MERIDIAN INTERNATIONAL CENTER

HOUSE COMMITTEE ON FOREIGN AFFAIRS

Tuesday, February 3, 2015

"The Strategic Importance of the Western Hemisphere: Defining U.S. Interests in the Region"

Mr. Chairman, Ranking Member, and Members of the Committee: Thank you for the invitation to testify today. I am grateful for the Committee's interest in hearing about the Strategic Importance of the Western Hemisphere and Defining U.S. Interests in the Region. I am here in my capacity as the Senior Vice President of Meridian International Center, a Washington, DC-based non-profit that focuses on promotion of global leadership through international engagement. We connect public and private leaders at all levels to promote collaboration in solving global problems. I also come in my capacity as a former executive of the IBM Corporation, another global entity also focused on solving some of the world's toughest problems through the application of "Smarter" solutions. I spent the past twelve years with IBM before joining to Meridian in May, and much of my time was spent in Latin America. Prior to that, I had the distinct honor of working in Latin America as a Foreign Service Officer in the Department of State.

By crossing sectors – from public to private to non-profit – I have seen the impact that U.S. engagement in the Western Hemisphere can have. I'd like to focus today specifically on the economic importance of remaining engaged with our neighbors to the south. My comments today will draw largely from my experience in Mexico and South America as an IBMer working to promote scientific and computational collaboration with companies in the natural resources and finance sectors.

Very often, U.S. engagement with our neighbors to the south is predicated on some sort of crisis – avian flu, immigration, drug trafficking, etc. and its impact on us. All too often, we have overlooked the tremendous growth in Latin America and Brazil over the past decade. Simply paying lip service to the BRIC and the follow-on countries has done a disservice to the hard work that has been done collaboratively, the best practices that have been adopted from U.S. industry, and the international exchanges that have occurred. I like to say that the importance of Latin America is better summed up in a Spanish word than in an English word. In Spanish, the word "intercambio" sums up the benefits that accrue to all business parties in the relationships we develop in the Western Hemisphere. An "intercambio" is an interchange – kind of a clumsy word in English, but quite elegant in what it implies. We no longer "teach" or "train" our neighbors. We no longer "provide guidance" or improve their lots simply by providing our goods, services, or intellectual capital. The intercambios that exists today are multi-directional streets. Really, they are the super-highways of information and knowledge exchange. All parties involved benefit, and this leads to economic growth.

Economic Perspective on the Region: Defining U.S. Economic Interests in the Western Hemisphere

For decades, the U.S. corporate and trade focus on Latin American economies has been on lower value products: commodities, raw materials, etc. Any economist will say that these building blocks are critical to more developed markets in search of inputs for higher-valued manufactured and industrial products. And, of course, the outcome of this economic relationship always favors the market producing higher valued goods and services. Emerging market country strategies have, for years, focused on going "up the value chain" in terms of the values of their inputs. Some countries have hit the mark. South Korea is probably the most successful example of an "Asian Tiger" over the past two decades – moving from low margin inputs for technology and manufacturing industries and living in the shadow of Japan to being a world leader in technology and R&D, along with high end manufacturing. Several Latin American countries' economies have seen successes that mirror the Asian Tigers, although none has been as successful as South Korea.

Still in all, when U.S. companies are looking for countries in which to invest, countries where there are good prospects for growth, countries where the return on their investments, long-term, will be reasonable, countries where strong partnerships can be formed, it makes sense to look toward Latin America.

Why is the Western Hemisphere Important for U.S. Economic and Business Interests?

The global economy calls for diversification of investments – we know this as it relates to personal investments, and it is no less true for corporate investments. Successful countries where we used to have bilateral government-to-government relationships based on foreign assistance and dependency have morphed into countries where businesses can have relationships based on mutual interests and growth.

Colombia is an example of U.S. foreign assistance that worked. Plan Colombia provided Colombia's leaders in the late 90s and early 2000's with needed assistance to combat narcoterrorists. Under the leadership of President Uribe and his advisers in Bogota, some of whom were educated in the United States, Colombia successfully routed the majority of the narcoterrorists. President Santos has the relative luxury of being able to negotiate with the remaining FARC rebels from a position of strength in an attempt to end their continued violence and terror strikes on the nation and its infrastructure. Today, Colombia is a thriving democracy and an economic and financial powerhouse in the region. Additionally, many of the well-educated Colombians who fled their country (often finding safe haven in the United States) are now returning from diaspora. They are taking leading roles in Colombian industry and opening new enterprises in Colombia while also opening their doors to U.S. investors and partners. Medellin, once the drug capital of the world under the infamous Pablo Escobar, is now one of the leading financial and industrial centers in Latin America. Colombia's largest bank, Bancolombia (NYSE: CIB), is headquartered in Medellin and has revenues of nearly $6B with branches throughout Latin America and in the Untied States. This once profoundly dangerous city is now listed by Forbes Magazine as one of the 10 best cities in the world for international retirees.

Colombia is no longer a country looking for handouts or seeking international assistance with its problems. Colombia is now a "Latin Tigre." Another example of its success is in the oil industry. Colombia's oil giant, Ecopetrol (NYSE: EC), is a parastatal company that is half owned by the government and half publicly traded. Ecopetrol is regarded as a well-managed giant with revenues of nearly $38B. The current downturn in oil prices has certainly impacted Ecopetrol, but its asset base and reserves will allow it to weather the economic storm. Ecopetrol invests heavily not just in exploration and production – in Colombia and around the world (including the Gulf of Mexico). But it also invests heavily in R&D. It's scientific staff is based on a university-like campus in Bucaramanga and engages in deep scientific research using sophisticated super computers and advanced methodologies to develop in-house intellectual property. Many of their scientists received PhDs in the United States, and they have been returning to Bucaramanga both for quality of life improvements and in order to develop the Colombian petroleum industry as leading experts. I have worked personally with many of them, and I can attest to the quality of their work. It is published and presented, in Engish and in Spanish – it is world-class.

Colombia lets the world know that it is "open for business." Indeed, in 2014, it rose from spot #53 to spot #34 on the World Bank's "Ease of Doing Business" index.

Brazil represents a country that is far enough away from the United States that it has not been as impacted by the United States as some of its neighbors – for good or for ill. It has largely grown and flourished on its own – the biggest player in its backyard.

Brazil's period of prosperity, when the BRIC was the preeminent force of nature in emerging markets (around the turn of the 21st century), began in the late 1990s with decisions made by the government of Fernando Cardoso to denationalize some of Brazil's government-owned enterprises (steel milling, telecommunications, and mining). Moving massive and poorly performing industries into private industry allowed for sustained growth of around 5%/year.

The privatization push in Brazil continued, and industries have thrived. Brazil's natural resources (oil/gas, minerals/mining, agriculture), manufacturing (aircraft, automobiles, steel), financial, IT, and healthcare/life sciences sectors have all thrived and grown over the years. However, the Brazilian government, beginning under Luiz Ignacio "Lula" da Silva and continuing under President Dilma Roussef, has often looked at the economic miracle of Brazil as a means to provide expanded and (sometimes) unaffordable services to the country's large population.

The result of expanded social services is a strained education system with sometimes mismatched resources (e.g., there are not enough petroleum engineers being trained and perhaps too many social scientists). Other strains are seen in a heavy tax burden, one of the highest in the world on personal income, sales tax, and corporate revenues/profits. Brazil, once the darling of the BRIC, has become a burdensome place and is near the bottom of the list of the World Bank's "Ease of Doing Business" index, in the unenviable 120th place.

Brazil, under President Dilma Roussef, has been wracked by charges of corruption around the country's parastatal oil/gas behemoth, Petrobras (NYSE: PBR). Indeed, corruption allegations marred her reelection campaign and, after her election victory, she promised to investigate corruption allegations. She has taken steps as well to shore up her economic team with advisers from the "University of Chicago School of Thought," including her newly-appointed Finance Minister Joachim Levy. Dilma certainly hopes these moves will help to move Brazil out of recession, where it has been floundering for the past several quarters, and where it is forecast to be for the next few, at least. Decreased economic growth is not what Dilma wants as her legacy, nor would this be of benefit to us in the United States.

The oil/gas industry, and Petrobras in particular, is the largest industry in Brazil. The U.S. and international companies have large-scale presences in Brazil, and they work in collaboration with Petrobras. It is in Brazil's interest to root out corruption in Petrobras in order to reassure global investors that their investments will be secure there. Allegations are that the corruption stems from the top.

International investors, including Americans, will not flee from Brazil. Brazil has the largest offshore oil discovery on earth. The offshore exploration and production off the coast of Rio de Janeiro will continue and expand for decades to come. The oil discoveries in Brazil will create jobs for Americans as well as Brazilians. Trained petroleum engineers, welders, mechanics, rig operators, drillers, safety officers, etc. will all be required for long term projects. Many of these people could be Americans with years of experience gained both in U.S. and foreign oilfields. Additionally, U.S. investments in operations in Brazil should reap rewards in the form of financial returns on their investments, should production continue over the years.

Of course the drop in oil prices worldwide has had an impact on the Brazilian economy, much as it has ours. But just as our oil and gas operations have not ground to a halt, neither have those in Brazil. While quarterly reports will, for the short term, remain flat or even lower (in Brazil's case, Petrobras's share price was down 30% just in the month of December), no one predicts the drop in oil prices, or demand for oil, to decline long term. Petrobras's financial outlook and debts may require it to restructure some of its finances in the short term, but long term prospects remain good.

What does Brazil's oil market have to do with jobs in the United States? As I just noted, on the one hand, Americans are being employed in significant numbers as expatriate subject matter experts in Brazil. On the other hand, expanded reserves in Brazil, with opportunities for U.S. investment by large U.S. oil companies means that U.S. oil companies have a geographic diversification of their holdings and can weather financial storms with less risk. This mitigated risk allows those same American companies to expand operations and employment very directly in the U.S. and in other operations abroad. U.S. equipment manufacturers can generate significant sales, in turn boosting our own economy and stimulating job creation at home. It means the continued growth of a critical American industry.

Brazil is not just oil-rich. Brazil is rich in all natural resources: Oil/gas, minerals, precious metals, farmland, water, livestock. Conceivably, Brazil could cut itself off from the rest of the world and survive on its own. Survive, but not necessarily thrive or grow. Brazil's natural resource wealth and its ability to move "up the value chain" from being a commodity supplier to being an integrator and manufacturer of finished goods has allowed Brail to cover a full range of export options. Brazil exports everything from soy to finished airplanes.

Who is buying Brazil's goods? Brazil's largest trading partner used to be the United States, but it is now commodities-hungry China. Behind the two largest trading partners is Brazil's third largest export market, Argentina.

I'd like to explore briefly the situation in **Argentina**. Like its neighbor Brazil, Argentina is rich in natural resources. It has everything from oil/gas to minerals to agriculture to vineyards and on and on. However, unlike Brazil, we all know that Argentina has squandered both international good will and patience. Argentina's government is so corrupt that its financial accounting is no longer accepted internationally. There is such limited transparency into things like its foreign reserve holdings and government spending and price-fixing that its inflation rate – spiraling upwards on a daily basis – is no longer even reported. The leadership of Kristina Fernandez de Kirchner is so corrupt that it now appears that, in cahoots with Iran, Kirchner may be behind the assassination of a Special Prosectuor, Alberto Nisman, the day he was to testify about his findings around the Amia Center bombing in 1994 in which 85 members of the Jewish community were murdered.

Argentina is corrupt. The national oil company, YPF, nationalized Spanish oil company Repsol's holdings in Argentina – valued at over $10B. YPF "negotiated" a settlement in which Repsol is to be reimbursed an adjusted $5B for the seizure. Foreign reserves are at such a low level that companies are forbidden from taking dollars, euros, etc. out of Argentina. Indeed, foreign companies with a presence in Argentina have to reinvest all profits in their Argentine entity – they cannot repatriate profits to corporate headquarters outside the country.

Why would companies, American or otherwise, choose to remain in Argentina? The intellectual capital in the country is world-class. Argentine universities are first-rate, many graduates study abroad, including thousands in the United States, and they choose to return home because of a profound sense of nationalism and good quality of life. Companies know that there is an excellent and loyal workforce available to them – clamoring for good jobs at competitive wages. Companies are also well aware of cycles – business cycles and political cycles. The reign of Kristina Kirchner and the party of Juan Peron will eventually pass, and there will be a rethinking of Argentina's role in the international business world. If companies can sustain operations without running at a loss in Argentina, then it is wise to stay the course and wait out the storm. The potential benefits are quite large. That said, short term business and investment in Argentina is not for the fainthearted. The country occupies spot #124 on the World Bank's "Ease of Doing Business" index.

For many years, **Chile** held a role as the darling of Latin American business that is slowly being supplanted by Colombia. Chile remains a financial and mining industry giant in the region, but the newly-returned presidency of Michele Batchelet has many in industry seeing the return of more socialist tendencies that are less business-friendly. The new tax regime will be the first test of the global business community's patience with Chile.

There should be no misunderstanding here. No one is rushing for the doors in Chile – the business climate there remains robust and growing. The fact that Chile's economy, on some levels, remains highly dependent on the world's appetite (especially China's) for natural resources has been a source of some concern for companies. But the fact that Chile is the world's number one producer of copper ensures that it will not be forsaken as market needs change. Yes, there may be some economic softening, but the bottom line is that Chile's economy is strong and is viewed as a strong, long-term continued economic player. Indeed, Chile's place on the World Bank's "Ease of Doing Business" index, slot #41, indicates its significance in the international marketplace.

Chile is also one of the most educated countries, per capita, in Latin America. Large numbers of Chilean students study in American colleges and universities each year and make use of their educations in their home country. This melding of American experiences with national capabilities further builds the international network that leads so many corporations to Chile. Adding to that network are the facts that Chile's banking and finance regulations are considered open and transparent, its unemployment rate is low (approx. 6% in 2013), and its labor force is diversified (across agriculture, industry, and services). The economic climate in Chile is excellent.

What does this mean for U.S. companies, exports, and jobs? High per capita income means that Chileans import more – their reasonable (for now) tax code indicates that this will continue. There are markets within Chile's middle class for American products. The diversified nature of the economy, with approximately 13% of the labor force engaged in agriculture, ensures that Chile's agriculture exports reach U.S. markets during "off-season." It used to be the case, at least when I was growing up, that you could only get certain fruits in the grocery store when they were “in season,” and we all looked forward to the summer growing season. The winter in the U.S. is summer growing season in Chile, and we all, literally, reap the fruits of the Chilean harvests and exports during that time of the year.

It also means that there is a ready and open market for our exports. The seasons never end in this relationship.

A highly educated workforce in Chile also means that U.S. companies can work with Chileans – in the U.S. and/or in Chile. U.S. and Chilean mining companies operate extensively in Chile, cooperating and collaborating to extract minerals using best practices derived from each country’s global experiences. American mining companies certainly learned lessons in 2010 when Chilean mining officials rescued 33 miners trapped in a collapsed mine in the remote Atacama region of the country. Indeed, the entire world learned lessons.

Chile’s services industry is the largest part of its economy (64%). This is indicative of the advances in Chile’s economy – from raw materials/commodity provider to world markets to services provider. The services are widely considered to be world-class, whether in outsourcing of back office operations or financial services or education and training. American companies maintain offices in Chile in order to ensure that they have a strong foothold in South America that is focused on delivery and growth.

An example of this is a Fortune 500 company, Air Products and Chemicals (NYSE: APD) based in Allentown, PA. Air Products acquired a 2/3 stake in Chilean company, Indura, in 2012 at a value of nearly $1B. The strategy behind the acquisition was to increase Air Products’ sales of industrial gases and welding equipment in Latin America and to make Air Products the second biggest provider of industrial gases in Latin America, with $1.5B in annual sales. It was, at the time, Air Products’ largest acquisition to date. When explaining the acquisition, then CEO John McGlade said that Indura would expand Air Products’ geographic presence and add additional growth opportunities – it would balance Air Products’ global portfolio. For Air Products, Latin America is the next-highest growth region in the world after Asia.

Why not start this discussion about the importance of the Western Hemisphere to U.S. business and trade with a discussion of **Mexico**? I believe that we all already know a lot about Mexico, and I wanted to introduce thinking about some of the critically important countries in South America that are driving growth in our half of the world. I also wanted to use Mexico and its role as leader among Spanish-speaking countries to drive growth worldwide. Mexico is the second largest economy in Latin America (behind Brazil), and it wields a tremendous amount of influence due in no small part to its proximity to the world’s economic golden goose – us.

We can discuss the importance of Mexico’s significance to the U.S. economy and job creation for days or months or years. But the realization of Mexico’s criticality was made evident through NAFTA 20 years ago and has only grown. Mexico currently sits at spot #39 on the World Bank’s “Ease of Doing Business” index.

After the U.S. and Canada, Mexico is the third-largest oil producer in the Western Hemisphere and the 10th largest in the world, but its hydrocarbons industry has been in decline. The 75-year old state monopoly known Pemex has crippled Mexican competitiveness in the sector. Pemex was struggling to reverse a decline in production – from 3.4M barrels/day in 2004 to 2.5M barrels/day in 2014. However, in August of 2014, in a key win for President Enrique Pena Nieto's reform drive, the Mexican Senate voted 78-26 for the package of bills to overhaul the sector and breathe new life into Latin America's second largest economy. This victory took many by surprise given that Pena Nieto's PRI party has been historically opposed to touching the issue, both because of the votes generated by unionized oil workers who owe their jobs to the state and because of the anachronistic "patrimony" grounds preventing U.S. and other foreign energy firms from entering the market.

Major U.S. and international oil companies have kept a close eye on the legislation. The Mexican government hopes the reform will bring needed technologies to Mexico to enhance exploration efforts both for oil and gas from hydraulic fracturing in shale formations and for oil in the deep water Gulf of Mexico. However, the legislation as it stands in early 2015 is overly complicated and needs further revisions. These modifications would require further streamlining of regulatory oversight and an even more diminished role for Pemex. The U.S. Government can assist Mexico by facilitating trade, regulatory reform, and infrastructure development, all of which will benefit both countries. The U.S. should continue to encourage additional market-oriented reforms.

Part of the August overhaul will reduce Pemex's tax burden – a burden so great that, over the past ten years, Pemex only twice cleared a small profit after its state contributions. This has undermined Pemex's ability to invest in research, technology, and human capital. It has also been subject to budgetary oversight– the lack of autonomy has kept it from being competitive. One of the most controversial measures in the recently passed legislation calls for the government to absorb part of the Pemex workers union's unfunded pension liabilities, currently over $125B – equal to 10% of Mexico's GDP. Workers would then have to renegotiate their labor contract with Pemex.

Mexico must attract private companies for its energy sector to recover and grow. The reform legislation will allow private companies to sign profit-sharing contracts as soon as 2015 to drill for oil and natural gas. Industry giants will not invest in Mexico if the regulatory environment is unfavorable or uncertain, but also if it is uncompetitive.

Mexico is on the cusp of a significant boom in jobs related to the oil and gas industry, but it also faces a short-term human capital crunch. If private and foreign companies begin operations in Mexico, the 160 petroleum engineers graduating each year from Mexican universities will fall far short of demand. On the regulatory side, it is estimated that the National Hydrocarbon Commission alone will require 500-600 specialized staff to regulate the sector. It currently employs 51. The Mexican government should promote exchanges between national and international universities, companies, and think tanks to promote human capital development in Mexico.

Of course there are questions of security that present challenges to Mexico's long-term energy success. Many of the most promising shale prospects are in the northeast, which coincides with many hot spots of drug-related violence. This could stave off some foreign investment, but most international energy firms are used to operating in hostile environments. Their decisions about Mexican operations will be driven by projections of security costs vs. potential revenue.

Mexico is the lynchpin country in forming the **Pacific Alliance**, a free trade area comprised of Mexico, Colombia, Peru, and Chile. It was formed as a counterbalance to the Mercosur trade bloc (Brazil, Argentina, Venezuela, Uruguay, and Paraguay). The counterweight, though, packs quite a punch. In its first year, the Pacific Alliance's trade with external partners outpaced Mercosur's. The pattern appears likely to continue. State control in the largest Mercosur countries will be a continued limiting factor on U.S. investments in the region.

This newly-formed trade bloc of Latin American "Tigres" shows great promise in the global economy. The IMF notes that last year, Mercosur member countries had average growth of 0.6%, while Pacific Alliance countries had average growth of 4.2%. Indeed, Pacific Alliance countries are attracting foreign direct investment that would otherwise have been directed toward Brazil, Argentina, and Venezuela.

We should not relax, however, and think that U.S. companies can sit back and reap the rewards from relationships that are driven by geography. The name of the emerging trade bloc gives clues as to its orientation. A pivot to Asia.

Latin countries have seen how an American sneeze can cause a regional cold. They have learned the importance of diversification. This is true not just as it relates to their export capabilities, but regarding their export markets as well. Chile has vastly expanded exports in agriculture, fish/seafood, wines, minerals, financial products, and services. Colombia has moved beyond raw materials and into finished goods, services, minerals, oil and gas, and of course coffee and flowers. Peru is branching beyond its traditional exports. And Mexico can export almost anything we can export.

The Pacific Alliance Tigres are eyeing Asia. Not just China, but other Asian markets as well. This will make Alliance members more competitive globally, and it will mitigate some of the risk that might come from an American sneeze.

Indeed, the super highway I referenced earlier is every bit a present-day reality. American businesses must fasten their seatbelts for the ride along it. Businesses should remain engaged so as not to lose market share to China and the Asian Tigers. Engagement, investment, collaboration, partnership, and active participation all ensure that our businesses will grow, we will continue to hold a footprint in the most stable region outside North America, and we will create jobs and investment opportunities for Americans at home and abroad.