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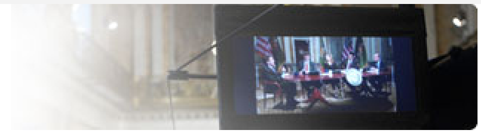
Henry M. Paulson Jr.

U.S. DEPARTMENT OF THE TREASURY

Press Center



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Abu Dhabi, UAE – Thank you, it is a pleasure to be with you here in Abu Dhabi. The UAE has a long history of economic engagement with other lands, dating back to the great pearl trade and the legendary 15th Century explorer and trader known as the "Lion of the Sea."

It is appropriate, then, that I am here today to discuss the benefits of open investment and trade policies and to reaffirm the United States' commitment to an open economy.

Oil Markets

However, I will start with a most pressing issue -- the reality and implications of record-high oil prices in this region and around the world.

Surging oil revenues have led to a massive accumulation of capital in the Gulf in a very short time. To put this in context, GCC countries will provide about 18 percent of global capital exports in 2008 -- more than double their share just five years ago.

The upside of this oil wealth is that the Gulf countries have an historic opportunity to shore up their economic fundamentals, diversify their economies and make needed investments in human capital -- steps that should help avoid the boom and bust cycles of the past and support broad based growth. Many of the region's leaders are embracing this opportunity by paying down debt, setting aside wealth for future generations, increasing health and education spending, and improving the environment for foreign and domestic private investment.

Nowhere is this more evident than here in the UAE, where a vibrant, diversified economy is reflected in an innovative and extraordinary construction and services boom. Examples of remarkable projects abound -- designs for a carbon neutral city, a new, dynamic financial center and a new university. These projects are evidence of the benefits of adopting outward-oriented policies, and I hope they encourage other countries to follow suit.

The downside of increased oil revenues is that the Gulf is experiencing new challenges – such as inflation -- that are, in some instances, being addressed with measures like price controls and wage hikes that are likely to exacerbate the problem. And beyond this region, record high oil prices are putting a large burden on the world economy and creating hardships for families, households and industries everywhere. This threatens to exacerbate economic volatility in the Gulf and abroad.

There are no simple or quick remedies for this, and let me be clear in stating that the Gulf region alone cannot alleviate the pressures in global oil markets. High oil prices are the result of supply and demand factors that are likely to persist for some time. Supplies have been affected by low capacity expansion and declining yields, while demand has surged largely due to growth in emerging markets. Speculation and the depreciation of the dollar are likely only small factors behind oil price increases.

Successfully alleviating the pressures in oil markets will require matching supply to demand. On the demand side, we need to allow market forces to work, to avoid subsidies and other potentially distorting policies. We also need to invest in renewable fuels and alternative technologies, and to reduce oil dependency through improved energy efficiency. As I saw this morning when I visited the massive alternative energy program at the Masdar project, the UAE is already leading the way in this critically important field.

On the supply side, we are urging all oil producing countries to open oil markets to foreign investment, which would support faster and more efficient growth. The UAE is a case in point. As an important first step, Abu Dhabi is financing massive investments in upstream production and domestic refining capacity through partnerships with foreign companies. More liberalization along these lines would benefit all oil producing countries. In the case of the UAE, the United States is benefitting too; U.S. suppliers of oil and gas field equipment and services are 45 percent of the UAE's total imports.

Open Investment

Investment flows to the region are growing rapidly: there has been a three-fold increase in foreign direct investment over the past decade, and U.S. foreign direct investment grew by 120 percent between 2001 and 2006, in part due to liberalization of investment policies in the Gulf. However, the potential is much greater and, in many Gulf countries, investment barriers persist in key sectors, such as energy and real estate.

Further investment in the Gulf will bring innovation, technology, create new jobs, improve services and contribute to a widening economic base. I understand that as economies change, uncertainty can create resistance to openness. It is critical to understand, however, that in the long run, openness to trade and investment will not only bring prosperity, but will also improve stability by better enabling economies to manage external shocks and smooth out business cycles. Remaining closed to investment will have the opposite effect, by inhibiting growth and magnifying domestic economic vulnerabilities. The Gulf's past is a reminder of this lesson -- when oil prices were low the region endured years of lackluster growth and declining living standards.

Open economies also introduce greater competition, and many U.S. companies have become industry leaders in part because of this competition. If our companies weren't investing in markets overseas, they would lose that global presence and their leadership position. If multinational companies can't grow in markets around the world, they will shrivel up at home too. And U.S. companies that invest abroad create at least one job at home for every job they create overseas.

Countering Protectionism

I have met with many leaders from the Middle East who ask if the United States really continues to welcome foreign investment. Some here worry about growing protectionist sentiment in the United States, and they also worry specifically that U.S. sentiment toward Middle East investment has been permanently affected by the Dubai Ports World case. My response is the same as that expressed by President Bush during his Middle East visit two weeks ago -- as we seek to open new markets abroad, America will keep our markets open at home to investment from private firms and from sovereign wealth funds. We reject measures that would isolate us from the world economy.

Since coming to Treasury, and in the aftermath of Dubai Ports World, I have actively worked to ensure that the United States continues to benefit from open investment. In fact, in the two years following DP World, the number of U.S. acquisitions by Gulf country investors rose by more than 100 percent and the combined value of those deals rose by more than 400 percent. Despite what the headlines may say, our investment review process has looked at just over 10 percent of the publicly announced acquisitions by Gulf investors, and all of those transactions were allowed to proceed.

We have reaffirmed, at every opportunity, the longstanding U.S. commitment to open economies. One of my highest priorities remains challenging the mistaken notions that underlie protectionism -- with facts, figures and a firm belief in a future that holds more promise, not less.

We also worked with our Congress to ensure that our framework for reviewing investments is fully consistent with this posture. Congress passed a new law to codify improvements to the review process, which is done through our Committee on Foreign Investment in the United States, CFIUS, which reviews certain investments that raise legitimate national security concerns. This new law, and the resulting administrative changes, signal recognition by both Congress and the Administration that while we must safeguard national security, we can do so while continuing to welcome foreign investment. Most notably, the law ensured that the CFIUS process remains narrowly focused on investments that raise legitimate national security concerns, and treats all foreign investments equally, regardless of their source. These reforms provide investors with greater clarity and predictability. We are continuing to make improvements, as the process is still far from perfect. And when the inevitable challenges arise in the future, we will meet and overcome them without swaying from our commitment to safeguard national security while keeping America open to investment.

And, in order to continue to benefit from sovereign wealth fund investment, we proposed that the International Monetary Fund develop a set of credible, best practices for these funds. The IMF expects to produce these recommendations this fall. I will expand on this issue for a moment because our objectives are not always fully understood. Among some sovereign wealth fund managers, our initiative has raised concerns that we are trying to limit the scope of their activities or release privileged information. In fact, our purpose is just the opposite. We are trying to quell calls for restrictions by urging sovereign wealth funds to endorse best practices to create a dynamic rise to the top and help allay concerns about opacity and systemic risks. Thank you to the leaders at the Abu Dhabi Investment Authority for your constructive role on this important issue.

As the United States has reformed our investment review regime, we have been careful to not reach beyond national security to broader industrial or economic interests. Other nations are also reviewing their international investment policies, as safeguarding security interests is legitimate and necessary. Yet no economy or people are served well in the long run by hiding protectionism under the cloak of such safeguards.

The U.S. Economy

Maintaining open investment and free trade policies is especially crucial now, as the world economic landscape changes. As you know, the U.S. economy is going through a rough period – after six straight years of almost 3 percent average annual growth, our growth rate slowed significantly late last year. We are facing a trio of headwinds – a housing correction, capital markets turmoil and high and rising energy prices.

We have acted quickly to respond to the housing downturn through a series of public and private initiatives to help financially-able homeowners stay in their homes and to keep mortgage finance available. President Bush and the U.S. Congress also came together in February to enact a $150 billion fiscal stimulus package that is providing support to individuals and businesses this year, when it's needed.

This fiscal stimulus will provide support to the economy as we weather this period. Unemployment remains low and increased exports are partially offsetting other less positive factors. Overall, I believe that the United States is on the right path to resolving market disruptions and building a stronger financial system. Our long term prospects remain strong. One thing is very clear to me – whatever our current difficulties, I wouldn't bet against the U.S. worker or the U.S. economy.

Although we expect to be working through housing and capital markets issues for some time, we also expect to see a faster pace of economic growth before the end of the year. The capital and credit markets are calmer now than earlier in the year. The de-leveraging and re-pricing of risk continue, as does the capital-raising that is so essential for U.S. financial institutions to continue to support the broader economy. Although I believe we are on the right path, a number of our important credit markets are still not functioning as normal and we should expect some bumps in the road ahead.

As we work through this period, we have also developed the necessary policy responses. The private sector and financial regulators are working to implement a series of recommendations from the President's Working Group on Financial Markets, including in the areas of mortgage origination, securitization, risk management, credit ratings agencies, and over-the-counter derivatives.

Many of these issues are as global as our markets, and we have worked closely with the Financial Stability Forum (FSF), to bring an internationally coordinated response. The FSF has produced a series of recommendations that complement efforts underway in the United States. Although the FSF recommendations are in response to recent financial turmoil, they are instructive for all markets, even those less affected by recent events.

Currency Markets

The forces I have discussed -- the changing global economic landscape, our response to the current financial turmoil, the growing role of sovereign wealth funds, and international efforts to promote openness to trade and investment in the face of growing protectionist pressures -- are shaping today's and tomorrow's international financial system. I want to be clear -- the United States is committed to a strong and stable international financial system, and I fully recognize my country's special responsibility in this regard. I also recognize that well-functioning and orderly currency markets are an essential part of this responsibility.

A great deal of attention, and rightly so, has been paid to our current economic challenges in the United States, particularly the housing correction and the stresses in the financial markets. I don't want to make light of these challenges. They are very real. And, when we have a problem in our markets, we don't minimize it, but we shine a light on it and move quickly to clean it up. As I discussed earlier, we are responding aggressively and comprehensively to address our challenges and minimize the impact on the U.S. and global economies. But we also take confidence from the fact that the performance of the U.S. economy for the past five decades is unmatched and its long-term fundamentals compare favorably today to any advanced economy in the world.

I have repeatedly stated that a strong dollar is in our nation's interest. The U.S. dollar has been the world's reserve currency since World War II and there is a good reason for that. The United States has the largest, most open economy in the world, and our capital markets are the deepest and most liquid. The long-term health and strong underlying fundamentals of the U.S. economy will shine through and be reflected in currency values.

I am committed to promoting policies that enhance the underlying competitiveness of the U.S. economy and ensure that the dollar remains the world's reserve currency. And, as I have emphasized today, these include being a strong advocate for open investment and trade, and working to address the current challenges in our economy, including the housing correction and stress in our capital markets.

Thank you.

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