



Business Roundtable

Expanding Economic Growth Through Trade and Investment

A Blueprint for U.S. Leadership
in the 21st Century



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Business Roundtable

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Executive Summary

The United States faces a daunting set of international economic challenges that demand a reorienting of policies that have guided U.S. trade and investment policy over the past six decades.

We face the rise of powerful trading nations, some of which were minor competitors a decade ago. We face a rapidly evolving business climate driven by technological innovation, a surge in world energy prices and other factors. We face an economic landscape that requires U.S. businesses to compete and win around the world. Meanwhile, world trade talks have not kept pace with these developments and are now stalled after progressing slowly for much of this decade. The bipartisan consensus in the United States to pursue further trade liberalization is weak. And the compact between the Congress and the president for executive branch negotiation of trade agreements is set to expire in 2007.

These challenges require fresh thinking and a practical re-examination of U.S. trade and investment policy so that the U.S. economy continues to lead the world and U.S. workers and businesses continue to enjoy expanded opportunities for success — as well as to shore up U.S. geopolitical leadership.

To meet these challenges, Business Roundtable proposes the following policy blueprint.

First, we must maximize the effectiveness of the World Trade Organization (WTO) as a negotiating forum. We must successfully conclude the Doha Round — to allow the Round to languish would waste an important opportunity. But following Doha, we need to consider alternatives to the single-undertaking approach, which allows relatively minor but intractable trade issues to hold back progress in major areas of the global economy. We should explore using rolling negotiations and moving ahead in smaller groups. We should consider nonbinding approaches to facilitate liberalization in new regulatory areas. And while doing everything we can to ensure the WTO's effectiveness as a negotiating forum, we should preserve competitive options to the WTO.

Second, U.S. trade agreements must work better for the United States. Despite recent successes in concluding new free trade agreements (FTAs) with other nations, we could enhance the effectiveness of these agreements. We should work to harmonize and integrate our FTAs into more formidable trade and investment networks — to eliminate divergent rules and shore up U.S. strategic leadership in key regions of the world. And we should consider creative ways to achieve free trade with our largest trading partners. Other nations are actively negotiating agreements and taking the offensive to establish larger trade groupings; we cannot sit on the sidelines.

Third, the United States must actively address regulatory barriers. Our lack of a proactive policy on foreign regulatory issues means the United States plays defense in addressing new foreign regulatory barriers. The European Union has been more aggressive and effective in spreading its regulatory approaches to nations where we must compete. We need more high-level

engagement by senior U.S. officials to address regulatory issues in key markets such as Brazil, China and India, and we need to negotiate more mutual recognition agreements to ensure that U.S. product standards are accepted around the world.

Fourth, the United States must close the gaps in investment protection and tax treatment. Bilateral investment treaties (BITs) can facilitate and protect U.S. direct investment from discrimination, expropriation and other unfair foreign government actions and provide neutral dispute resolution. For example, in a day when countries still threaten to nationalize foreign businesses, U.S. businesses should not lack legal protections for just compensation because of the absence of a BIT. We also must conclude new tax treaties with key nations such as Brazil, Malaysia and Vietnam or risk exposing U.S. businesses overseas to discriminatory or double taxation.

Fifth, the United States must help bring the benefits of liberalized trade and investment to the world's poor. We need to give least-developed countries (LDCs) the tools they need to negotiate and successfully implement trade agreements that benefit their citizens. Development assistance must prioritize trade and investment liberalization and the infrastructure necessary for economic growth. Trade preference programs should be re-examined to ensure they are providing real benefits to LDCs, particularly in Africa. This is a moral imperative and also a practical policy path to reduce violence and political disorder through economic openness and prosperity.

Sixth and finally, we must lay a strong domestic groundwork for American global competitiveness. This includes pursuing an ambitious competitiveness agenda by providing tools for workers to adjust to structural changes; maintaining America's leadership in research and development; improving education for scientific and technical jobs; overhauling U.S. international tax rules; and implementing thoughtful, comprehensive approaches to address all aspects of the energy equation. We must narrow the current account deficit by addressing our low national savings rate, improving consumer demand overseas and ensuring equilibrium in global currencies. We must ensure that our own government policies are not discouraging foreign trade and investment. Finally, we must revitalize the congressional-executive relationship on trade and renew Trade Promotion Authority to sustain the momentum under way for new negotiations and solidify U.S. geopolitical leadership.

These tasks are ambitious, but the stakes are high. They will require a unified effort by Congress and the White House and support from the private sector. We must face reality squarely — the sooner, the better — to establish the conditions necessary for continued U.S. economic success on the world stage.

I. What's at Stake

In his landmark report on the United States in the 1830s, *Democracy in America*, Alexis de Tocqueville observed, "I cannot express my thoughts better than by saying that the Americans put something heroic into their way of trading." He was describing the emerging competitive threat to the established nations of Europe at the dawn of the Industrial Revolution. By the early 20th century, America had become the unrivaled global economic leader.

International commerce has been a key source of U.S. economic prosperity and global leadership for more than a century. The importance of the international economy to the United States is greater than ever today, with more than 26 percent of U.S. gross domestic product (GDP) represented by trade and nearly one in five U.S. jobs attributable to trade alone.

To ensure that international trade and investment continue to be a source of strength for the U.S. economy, national security and foreign policy, we must face up to the evolving global competitive realities and align U.S. government policies accordingly. These realities mean fiercer competition for U.S. companies and workers from an increasing number of nations around the world. They require an aggressive international economic policy and a sound domestic foundation to establish conditions for success in the global economy.

"I cannot express my thoughts better than by saying that the Americans put something heroic into their way of trading."

— Alexis de Tocqueville, *Democracy in America*

Issue

We face new and serious challenges to international economic success in the 21st century that need to be addressed squarely: the rise of new trading nations, slow-moving negotiating vehicles, developing economic blocs that exclude the United States, an unprecedented range of international regulatory challenges, worker insecurity from structural economic changes and unmet expectations of least-developed countries (LDCs).

Recommendation

The United States must rethink how to advance the objective of liberalized, rules-based trade and investment in light of new realities, while being guided by the past successes of our international economic policy.

Challenges of the New Century

Liberalized, rules-based trade and investment have benefited the United States and should continue to be the defining objective of U.S. international economic policy. However, *how* we further that objective needs rethinking and restructuring to account for the new realities and challenges confronting the United States in the 21st century. The new realities and challenges include the following:

- ▶ **Major new trading nations.** With the success of global economic liberalization, economic power has become more diffuse and competitive challenges more fierce. The U.S. share of world trade is still large, but it has steadily declined.¹ For many decades, the United States was the largest market for Korea and Japan. Now China is.
- ▶ **Cumbersome negotiating vehicles.** The success of trade liberalization also has led to a rapidly expanding and engaged membership in the world trading system, which, ironically, makes further global liberalization difficult to achieve. The World Trade Organization (WTO) now comprises 149 governments representing 4.5 billion people. A group this size will almost inevitably move slowly, at the very time the global economy is changing rapidly.

■ REALITIES AND CHALLENGES

- ▶ Major new trading nations
- ▶ Cumbersome negotiation vehicles
- ▶ Bilateral and regional agreements to which the United States is not party
- ▶ Divergent rules among FTAs
- ▶ Lack of agreements with many large U.S. trading partners
- ▶ Lack of competitive tools in some key markets
- ▶ Spread of EU regulatory models
- ▶ Worker frustration with extent of job retraining and assistance
- ▶ LDCs disappointed with results of liberalization
- ▶ Advanced economies resistant to opening markets

- ▶ **Economic integration without the United States.** With the diffusion of economic power — and the increased difficulty of making progress in the expanded global system — other countries have aggressively pursued trade and investment arrangements. East Asian nations, for instance, have taken steps toward regional economic integration that could leave the United States on the sidelines, subject to discrimination and without a leadership mantle in the region.
- ▶ **Free trade agreements (FTAs) that are not integrated.** As one reaction to this spurt of activity, the United States has negotiated a series of FTAs, which were called for by a 2001 Business Roundtable policy paper. Each FTA has a rationale, but U.S. FTAs are not being forged into a coherent system. This lack of integration has led to unnecessary transaction costs that deny commercial benefits as well as broader strategic benefits to the United States.
- ▶ **Lack of competitive tools in key markets.** In some key emerging markets, such as Brazil, China and India, U.S. businesses lack competitive tools that European and other competitors enjoy, such as bilateral investment treaties (BITs) and tax treaties. At the same time, we lack FTAs or similar agreements with some of our very largest trading partners.

- ▶ **New regulatory challenges.** U.S. firms face no greater set of challenges internationally than in the regulatory arena — yet regulatory issues are not treated as a key component of U.S. international economic policy. Meanwhile, the European Union (EU) is increasingly the regulatory model of choice for third countries, at times disadvantaging U.S. businesses.
- ▶ **Worker anxiety.** U.S. workers harmed by job losses due to technological innovation and changes in the global economy are frustrated by inadequate job retraining and assistance to take advantage of new jobs and opportunities created by these changes.
- ▶ **LDCs' unmet expectations.** Least-developed countries (LDCs) that have raised expectations for receiving the benefits of the world trading system are disappointed with the limited results they have seen because they continue to experience extreme poverty and political instability.
- ▶ **Advanced economies taking without giving.** Advanced developing countries are not fully reciprocating in opening their markets, despite having benefited from global trade and investment liberalization.

These developments present a fundamental challenge to U.S. economic competitiveness, growth and foreign policy in the 21st century and to continued global economic growth. They demand a new vision and plan of action for the coming years — and the realization that the need for these is urgent.

“Openness to international trade accelerates development; this is one of the most widely held beliefs in the economics profession, one of the few things on which Nobel prize winners on both the left and the right agree.”

—D. Dollar and A. Kraay, World Bank, 2001

A Foundation of Success

The future course of U.S. trade and investment policy must be guided by our past successes. Fundamental to these successes has been a bipartisan commitment to a rules-based international economic system, dismantling of trade and investment barriers around the world, and open investment policies — a commitment led and passed on by every U.S. president since Franklin D. Roosevelt.

Rules-based international system

Reciprocal dismantling of barriers → U.S. trade policy since FDR

Open investment policies

In the mid-1930s, the United States embarked on a new approach to trade, responding to the economic devastation and political strife that high tariffs and mercantilism contributed to in the first part of the century. With congressional endorsement, President Roosevelt and his energetic secretary of state pursued reciprocal, lower barriers to trade around the world. And in the waning days of World War II and early postwar years, visionary U.S. and Allied leaders created a compact for postwar economic growth, peace and stability, based on liberalized trade and anchored by multilateral institutions.

Under that compact, an expanding circle of nations agreed to reform their economies, open to the outside world and lower barriers to trade. This created a virtuous cycle: As liberalization among the initial group of 23 signatories to the General Agreement on Tariffs and Trade (GATT) produced positive results, more wanted to join, making the initial agreed-upon terms of liberalized trade all that more valuable. And as governments saw the benefits that liberalized trade produced, they sought to deepen liberalization by committing to additional rules.

The results have been extraordinary.

Liberalized international trade has vastly

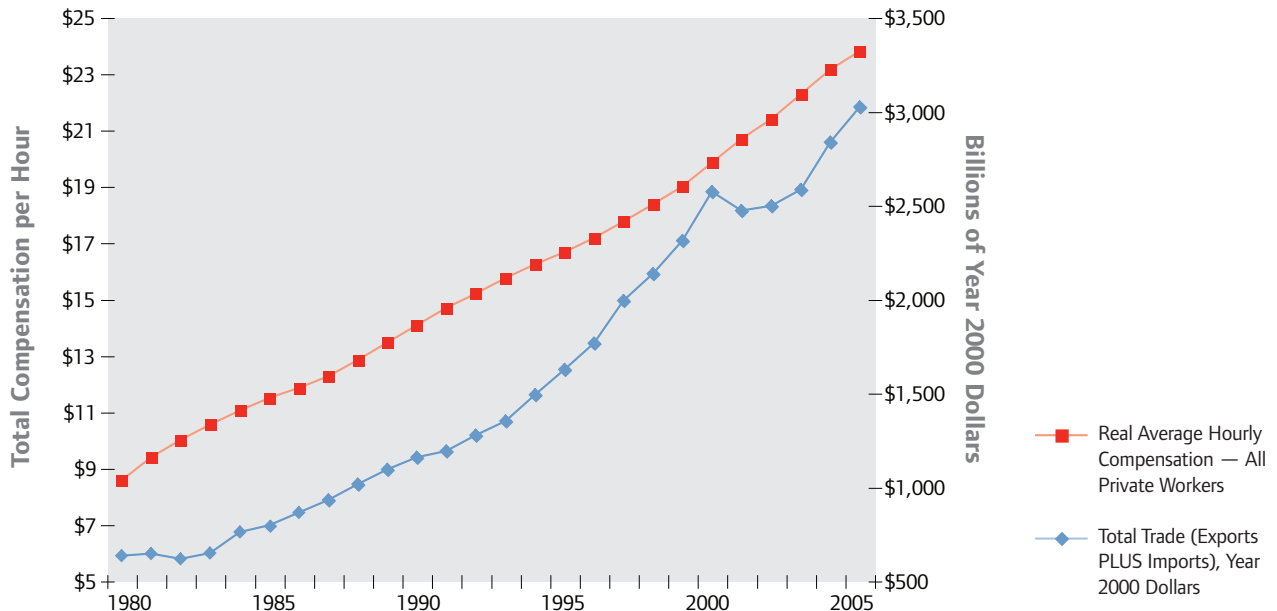
improved Americans' prosperity, promoted political freedom and openness, lifted hundreds of millions of people worldwide out of poverty, and improved working conditions dramatically. Here are some of these results:

Fueling economic growth and improving Americans' livelihoods. Since 1948, multiple rounds of trade negotiations under the GATT, the negotiation of FTAs and autonomous liberalization by the United States have improved the livelihood of Americans, spurred U.S. economic growth and expanded competition in the marketplace.

- ▶ Today, nearly one in five jobs in the United States — more than 31 million jobs — are attributable to international trade.

Liberalized international trade has vastly improved Americans' prosperity, promoted political freedom and openness, lifted hundreds of millions of people worldwide out of poverty, and improved working conditions dramatically.

Trade and U.S. Worker Compensation



Sources: U.S. Bureau of Labor Statistics and U.S. Bureau of the Census.

- ▶ Since 1948, as industrial countries lowered their average tariff rates from 40 percent to 4 percent, trade has soared. World exports have increased from \$58 billion to \$9 trillion a year, and U.S. goods and services exports have increased from \$12.7 billion to \$904.3 billion a year.
- ▶ Trade liberalization from the GATT negotiating rounds, the North American Free Trade Agreement (NAFTA) and other FTAs has increased the average American's income by an estimated \$5,000 per year.²
 - For example, the Uruguay Round, which resulted in the creation of the WTO, added at least \$70 billion annually to global welfare. More than one-quarter of this gain — \$19.8 billion — accrued to the United States.³

Promoting political openness. U.S. leadership in world trade and investment also has advanced the cause of political freedom around the world and enhanced U.S. geopolitical leadership.

- ▶ The principles of liberalized and open trade, economic interdependence, and market mechanisms — and the ensuing economic benefits — stood as a beacon to countries behind the Iron Curtain and hastened the end of the Cold War.

Trade liberalization →

Fuels economic growth and improves our standard of living
 Promotes political openness around the globe
 Reduces poverty in the developing world
 Improves conditions for workers

- ▶ During the Cold War, the American policy of promoting market-opening trade agreements strengthened our alliances with Europe and helped to keep developing countries out of Soviet influence by opening our market to their goods.
- ▶ The most economically open countries today are three times more likely to enjoy full political and civil freedoms than those that are economically closed. Those that are closed are nine times more likely to completely suppress civil and political freedoms than those that are open.⁴
- ▶ Open trade and investment has helped fuel growth, promote openness and expand opportunity in previously closed societies. Likewise, countries that have not participated significantly in the global economy, like many in the Middle East, have suffered anemic growth and an absence of opportunity for their citizens, contributing significantly to the region's instability.

Reducing poverty. U.S.-led policies of economic openness and trade liberalization have helped lift hundreds of millions of people around the world out of poverty. Economists agree that lowering barriers to imports is one of the most important steps a country can take to improve economic growth and reduce poverty.

- ▶ Developing nations that have liberalized their economies achieved an average 5 percent growth rate over a 20-year period, compared to less than 1 percent for developing countries that did not liberalize, according to a World Bank study.
- ▶ In China alone, economic opening and reintegration into the global trading system has brought 400 million people out of poverty.⁵
- ▶ The opening of trade in services, which has a multiplier effect by also enabling trade in manufactured and agriculture goods, is of particular benefit to developing countries.
 - Economic growth in countries that removed barriers to financial services has been a full percentage point higher than growth in countries with closed markets.⁶

While significant gains from trade arise from developing countries' opening their own markets, developing countries also have benefited from increased access to markets in the United States and other industrialized nations.

- ▶ Under the Caribbean Basin Initiative (CBI), beneficiary countries have increased exports to the United States more than threefold since the program began in 1983 and diversified beyond commodities. More than 60 percent of U.S. CBI imports are now in manufactured goods.
- ▶ Since the enactment in 2000 of the African Growth and Opportunity Act (AGOA), eligible countries have increased their exports to the United States by more than \$36 billion.

Improving labor conditions. U.S. economic engagement with the world has helped improve conditions and safeguard core worker rights.

- ▶ Increased trade creates new choices and economic opportunities for workers, which include the freedom to choose employers offering better pay and better working conditions. Liberalized trade also contributes to rising standards of living, which economic studies suggest is essential to raising labor standards.
- ▶ An Organisation for Economic Co-operation and Development (OECD) study found a positive correlation between trade liberalization and improvements in core labor rights standards.
 - ▶ That study reviewed 44 developing countries that engaged in significant trade liberalization. Freedom-of-association rights improved in 32 countries — 23 of which saw improvements after trade liberalization and nine of which adopted labor reforms prior to trade liberalization. In no nation that adopted trade reforms did labor rights become worse.
 - ▶ The 12 countries with relatively open trade regimes also displayed the best labor rights records. In contrast, the 11 countries that had restrictive trade regimes had the worst records.
- ▶ Global companies pay higher wages and expose local workers and companies to good corporate governance and respect for worker rights.
 - ▶ According to an International Monetary Fund (IMF) study, “trade liberalization has a positive overall effect on the employment and income of the poor.”⁷
 - ▶ U.S.-based companies in China pay an average hourly wage that is about three times higher than the hourly wage at comparable non-U.S. factories.⁸
- ▶ The United States has led the world in using trade agreements to promote labor rights.
 - ▶ Recently negotiated U.S. FTAs contain provisions designed to safeguard core worker rights, require our trading partners to effectively enforce labor laws, and provide for open and impartial tribunals to hear labor disputes. They also provide for labor cooperation and capacity building.
- ▶ Our trading partners have undertaken significant reforms of their labor laws in preparation for entering into FTAs with the United States.
 - ▶ El Salvador streamlined procedures for registration of new labor unions and created a program of free legal assistance to workers seeking to file a union registration form or a complaint.
 - ▶ Peru revised its labor laws to make establishing and joining a union easier, removed prohibitions on union political activity, and strengthened labor inspections.
 - ▶ Bahrain enacted significant labor law reforms that allowed independent labor unions for the first time since the 1970s.

II. Requirements for U.S. International Economic Success

To grow domestically and compete successfully in the global economy, U.S. businesses must be able to:

- ▶ **Export and import goods and services without high trade or other barriers** in the United States and abroad.
- ▶ Operate under **trade and investment rules consistent with business realities** and changing technology.
- ▶ Rely on and protect their **intellectual property and know-how**, and be free from requirements to transfer technology.
- ▶ Operate in **fair and transparent regulatory environments** that apply uniformly to foreign and domestic firms alike.
- ▶ Export around the world without having to adjust the **product design or testing** for each market because of unique local standards.
- ▶ Rely on **developed legal systems or fair arbitration systems** to resolve disputes.
- ▶ **Invest in markets freely and without discrimination**, and enjoy **basic protections for those investments**.

Issue

U.S. businesses require a comprehensive set of conditions to compete successfully around the world — the absence of any one can undermine our international competitiveness.

Recommendation

U.S. policymakers must look comprehensively at the tools available to ensure that they are creating the conditions for U.S. international economic success.

- ▶ Conduct business without the **risk of double taxation** by the country of transaction and country of residence.
- ▶ Rely on a **sound U.S. research and development base** and **an educated workforce**.
- ▶ **Compete without disincentives to export or investment**, such as unilateral sanctions and export controls that do not effectively advance national security interests.
- ▶ **Compete without burdens to international competitiveness**, such as mounting employee health care costs.

■ **WE HAVE THE TOOLS FOR COMPETITIVENESS**

- ▶ Multilateral trade negotiations
- ▶ Regional and bilateral trade agreements
- ▶ Regulatory mechanisms
- ▶ Bilateral investment treaties
- ▶ Tax treaties
- ▶ Developing country and LDC preference programs
- ▶ Domestic policy

The lack of even one of these conditions can undermine the international competitiveness of U.S. businesses and the U.S. international economic position. This requires U.S. policymakers both to construct a comprehensive policy that includes these conditions and to ensure their implementation.

The U.S. government has various tools available to establish these conditions for international competitiveness and should use them in a more effective and coordinated manner. The tools include:

- ▶ multilateral trade negotiations;
- ▶ regional or bilateral trade agreements of varying scope;
- ▶ regulatory agreements, dialogues or other mechanisms;
- ▶ BITs;
- ▶ tax treaties;
- ▶ preference programs for developing countries and LDCs; and
- ▶ domestic economic, regulatory and social policies, including policies in tax, education, science and technology, and health care.

Later in this paper, Business Roundtable proposes some new ways to use these tools to best address the new challenges and realities facing the U.S. economy in the 21st century. Following that are domestic policy prescriptions needed for U.S. businesses and workers to compete and win around the world.

III. Paths To Liberalize Global Trade and Investment: Maximizing the WTO's Effectiveness

The GATT and its successor, the WTO, have been effective in helping U.S. businesses compete successfully around the world and in facilitating U.S. and global economic growth. More broadly, the GATT and WTO have been the foundations of an international economic system that has served U.S. economic, security and foreign policy interests well over the past seven decades. A testament to the past success of the system is the growing number of WTO members — now 149 governments, representing 95 percent of world trade — and their increased level of engagement in the system.

But the system's large size also presents a challenge to moving ahead and to our success in negotiating improved trade and investment policies needed by American businesses. Since the GATT was expanded into the WTO in 1994, it has had only limited success in negotiating further global trade liberalization. It has been more successful in its other key role — administering the current system of WTO rules, including providing an agreed-upon enforcement avenue for existing agreements and providing for the entry of emerging economies into the system.

The current Doha Round of trade negotiations has highlighted the difficulty of using the WTO as a negotiating forum. Indeed, the imperative for re-examining the system's structure has been recognized by the WTO itself. In 2003, the outgoing WTO director-general appointed a Consultative Board to advise on the future of the WTO and recommend improvements.

Issue

The World Trade Organization (WTO) has been successful in anchoring a rules-based system for international trade that has served U.S. interests well. But, in facilitating further liberalization, it is not keeping pace with the rapidly evolving global business environment.

Recommendation

Governments should do everything possible to maximize the effectiveness of the WTO as a negotiating forum, including concluding the Doha Round, considering new approaches to future negotiations and preserving competitive options to the WTO.

The difficulty of moving forward is of particular concern given the rapidly changing nature of the global economy. As the nature of global trade changes and new sectors develop, we need tools and actions that can help U.S. companies and their workers keep pace.

Political leaders, policymakers and the business community should do everything possible to ensure the continued importance and centrality of the WTO in the international economic system. To preserve this role for the WTO, the United States and other members need to look creatively at ways of improving the WTO negotiating system — in particular, to ensure that the WTO remains an effective mechanism for negotiating market liberalization in a timely fashion.

Successfully Conclude the Doha Round

■ IMPROVING THE WTO SYSTEM

- ▶ Doha Round
- ▶ Rolling negotiations
- ▶ Plurilateral agreements
- ▶ Nonbinding commitments
- ▶ Capacity building and technical assistance
- ▶ High-level political engagement
- ▶ Increased transparency

In the short term, policymakers and negotiators must remain focused on the critical importance of successfully concluding the Doha Round. Doha presents a rare opportunity to foster global economic growth by ambitiously and comprehensively lowering trade barriers around the world. Governments have set forth ambitious goals to reduce agriculture tariffs and domestic support, to increase market access for industrial and other nonagricultural goods, to reduce the costs and time in cross-border clearance of goods, and to liberalize services.

However, the lack of political commitment by our trading partners to fulfill the promise of a comprehensive and ambitious outcome has been disappointing. Having missed every major deadline since January 2005, the negotiations have been suspended, and many have given up on the effort. The negotiations need to be revitalized so that the work done so far and the potential benefits from a successful Doha Round are not wasted.

Rolling Negotiations at the WTO

For new WTO negotiations in the future, the United States and other governments should seriously consider alternatives to the single-undertaking approach. It should instead consider “rolling negotiations” that allow progress to build by solving one problem at a time. When there is a sufficient level of interest and possibility of movement in a particular sector or area, WTO members could move ahead.

Recent WTO negotiations, organized as “single undertakings,” have required negotiating in concert issues as far ranging as tariffs on manufactured goods, agricultural subsidies, services market access and dumping rules. Members thus must accept a grand package as an all-or-nothing matter. This can yield meaningful results and create positive negotiating

With our global trade totaling \$3.3 trillion, the United States has critical interests at stake in multiple areas, but they may not all enjoy the same dynamics for success.

dynamics, but it also creates great difficulties in moving forward effectively when the negotiating dynamics in one area differ significantly from those in other areas.

When structuring future negotiations following the Doha Round, policymakers must ask whether single undertakings and the broad consensus they require are so important that discord over a single negotiation should prevent reaping benefits of agreement elsewhere. With our global trade totaling \$3.3 trillion, the United States has critical interests at stake in multiple areas, but they may not all enjoy the same dynamics for success.

All U.S. trade sectors deserve the central attention of U.S. trade negotiators. However, where there is possibility of reducing barriers to U.S. exports in certain critical areas, we should be cautious about holding those reductions up for sectors in which progress will be on a significantly slower timetable.

Moving Ahead in Smaller Like-Minded Groups

WTO governments should seriously consider launching plurilateral negotiations open to all members when structuring new WTO negotiations.

In the 1970s, the United States and other GATT signatories addressed the reluctance of primarily developing countries to move forward on a broad front by launching negotiations on a plurilateral basis in the form of the Tokyo Round Codes. These negotiations were open to all governments that participated in the GATT, but it was each country's option whether to sign on to the final deal for each topic area. This structure allowed the willing to move ahead, while the reluctant could observe with the option of joining later.

The Tokyo Round resulted in agreements among like-minded countries in important functional and sectoral areas of commercial interest to the United States. For instance, the United States obtained access to important foreign government procurement markets, safeguards against discriminatory product standards and protections against arbitrary customs valuation methods. The initial benefits of those agreements to the

“[T]he plurilateral approach would enable sets of WTO Members wishing to negotiate more ambitious commitments to do so.”

— WTO Consultative Board, 2004

United States were multiplied as other governments chose to commit as well. In fact, by 1994, with the exception of government procurement, all of the Tokyo Round Codes functional agreements were accepted by the entire membership.

Today, the world trading system faces a similar challenge. There is a large membership with differing levels of interest in moving forward in different areas. And the challenge to the multilateral system from these differing levels of interest is more critical today than it was in the 1970s, as major traders have been exploring other mechanisms to pursue trade liberalization in the absence of results from the WTO.

In some areas of interest, plurilateral negotiations might reach commitments on a most-favored-nation (MFN) basis. However, even in those circumstances, governments that are unwilling to make commitments themselves should not be able to enforce the commitments of others. In other areas, it might be more prudent, and politically necessary, to move forward on a non-MFN basis among like-minded countries so that deeper tariff cuts or other steps would apply only to goods or services that originate in WTO members that have themselves agreed to the stepped-up commitments.

Other Means To Facilitate Global Trade and Investment Liberalization

In addition to rolling negotiations and plurilateral agreements, the United States and other WTO members should consider other means to improve the effectiveness of the WTO as a negotiating forum. Here are some of them:

Alternative paths to liberalization: Nonbinding commitments. While legally binding and enforceable rules are the ideal path to liberalization, other paths can be effective in achieving the goal. Such steps also may serve as building blocks for binding and legally enforceable rules in the future.

For example, regulatory issues are complicated, and on some issues, regulators rightly will want to preserve flexibility. However, they may be willing to experiment with new models, provided they are not committing to an enforceable obligation. In those circumstances, the United States should consider pursuing endorsement of best practices or model regulatory principles.

Capacity building and technical assistance. Members should consider incorporating provisions for trade adjustment assistance and capacity building for LDCs within agreements, particularly in areas where those countries lack adequate regulatory regimes. This would help ensure that developing countries could both implement new commitments and enhance their willingness to undertake new commitments.

Increased high-level political engagement in negotiations. Ministers from WTO members convene only once every two years in “ministerial conferences.” The infrequency of these meetings produces tremendous pressure and inflates the expectations of what can be accomplished, magnifying the disappointment when the results fall short. The infrequency of these meetings also diminishes the high-level political engagement in the ongoing negotiating work at the WTO. Members should provide for a more regular convening of ministers.

Increased transparency. The United States has taken the lead in pushing for increased openness and transparency at the WTO. Indeed, compared to the GATT system, the WTO process is much more transparent. But WTO members need to take further steps — such as mandating that dispute settlement proceedings are open to the public (with appropriate protections for business confidentiality) — to enhance the legitimacy of the system.

Preserving Competitive Options to the WTO

One way to push the WTO system forward is to continue to negotiate bilateral and regional FTAs, which both supports the multilateral system — by providing experience with liberalized trade and investment — and prods the system — by offering additional paths toward global trade and investment liberalization. The United States should continue to negotiate FTAs and integrate existing FTAs into more formidable regional arrangements, as discussed later in this paper.

Another way to push the WTO system forward is to explore other options to achieve multi-lateral trade and investment liberalization, in case the WTO ceases to be a viable negotiating forum. For instance, a grouping of industrialized and rapidly industrializing countries — including Brazil, Canada, China, the EU, Japan and the United States — might be willing to commit to zero tariffs on nonagriculture trade. If the WTO cannot accommodate such an arrangement, interested nations could work on an ad hoc basis or through an existing organization like the OECD.

The WTO will always have a key role as administrator of the existing WTO agreements. But if the WTO’s effectiveness as a negotiating forum wanes despite our best efforts to strengthen it, the United States should explore other options.

IV. Making Trade Agreements Work Better for the United States

Over the last decade, the United States largely sat on the sidelines as our key trading partners aggressively negotiated preferential trade arrangements around the world. Business Roundtable called attention to this development in a February 2001 policy paper. Since then, with congressionally granted Trade Promotion Authority in hand, the U.S. Trade Representative (USTR) has pursued trade and investment agreements with some energy around the world to level the playing field. This negotiating push has put the United States back on the offensive, helping open and reform new markets, level the playing field for U.S. businesses, and test-drive new areas for attention in the multilateral system.

The bilateral (and two subregional) FTAs that the United States has negotiated provide undeniable benefits, but their potential benefits for the U.S. economy have yet to be fully tapped. The challenge for the United States now is to build on the series of FTAs negotiated to ensure that current and future agreements are most effectively serving the strategic needs of the United States and the economic needs of U.S. businesses, workers and consumers.

In particular, the United States should be working to harmonize the disparate trading rules under the agreements and to link the agreements — so that what are now a string of smaller bilateral and subregional arrangements would become more formidable trading networks.

This would help us better take advantage of market openings under the agreements and better reflect the realities of the global economy. Today, as a result of complex and integrated supply chains, a final good or service often involves business activity in multiple countries, each contributing components or services they are uniquely suited for.

Issue

The United States has negotiated a series of free trade agreements (FTAs) over the past five years, providing real benefits to the United States. However, the FTAs are not being forged into a coherent system, resulting in conflicting rules for business and missed geopolitical opportunities. In addition, we lack FTAs with many of our largest markets.

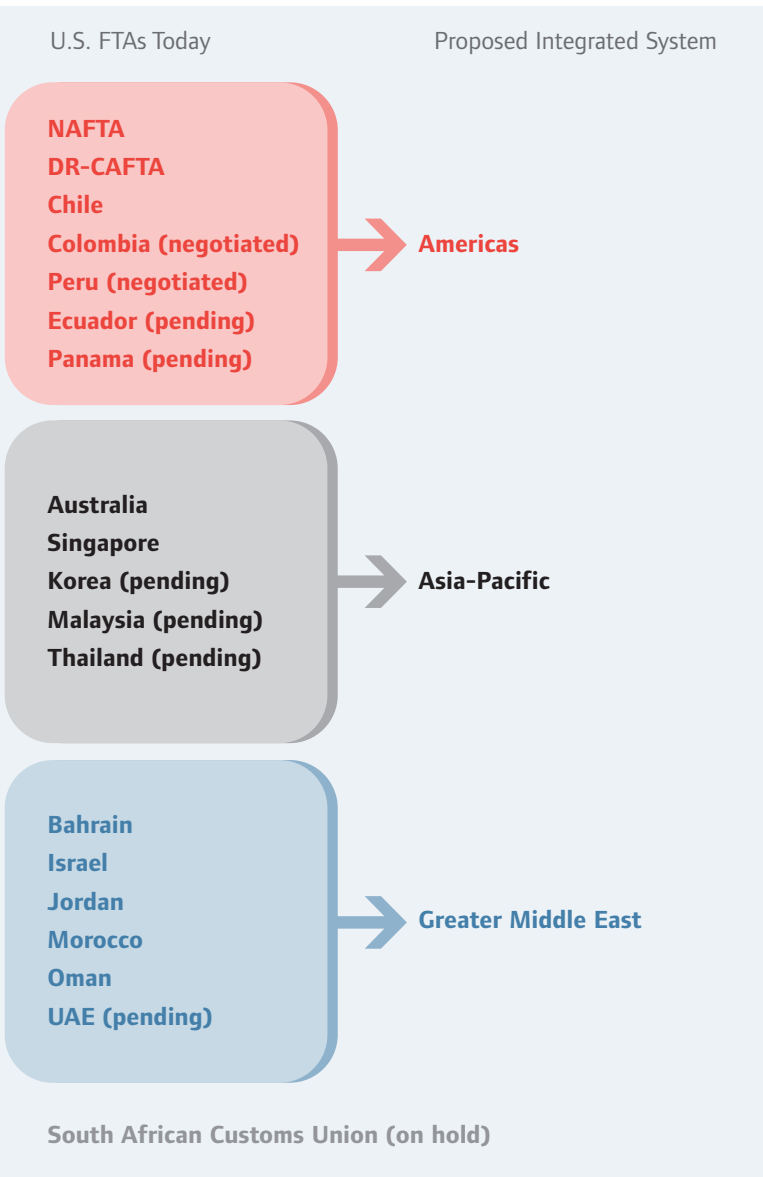
Recommendation

Harmonize rules among trade agreements and link our agreements. Explore ways to achieve more open trade with our largest markets.

Building on FTAs also would promote openness and development by encouraging intra-regional trade and investment — and shore up U.S. leadership in key regions of the world.

In addition to consolidating and harvesting results from current agreements, the United States should consider ways to further open trade and investment with — and promote reform in — our very largest markets. In the past, conventional wisdom has ruled out FTAs with some of our largest markets, such as the EU and Japan, because of governments’ unwillingness to agree to comprehensive free trade in agriculture. Given the high stakes in these trading relationships, policymakers should test the conventional wisdom and explore pragmatic and effective ways to move forward.

Create Networks of Open Trade and Investment: Making FTAs Work Better for the United States



The United States has negotiated 12 FTAs with 19 countries — nine within the past five years. This is an impressive record of activity with real benefits for the United States, but integrating these agreements would magnify and enhance their benefits. The picture of our current arrangements looks like the first column in the chart at left; the picture ought to look more like the second column.

As the chart demonstrates, a critical mass of U.S. agreements exists in three key regions of the world — the Americas, Asia-Pacific and the Greater Middle East. The critical mass offers economic and strategic benefits that are not being fully utilized.

Our FTA partners have agreed to common principles of open trade and investment and to liberalize their markets with the United States. Despite this commonality of principles, we have no mechanism to integrate the separate bilateral relationships into more cohesive regional arrangements and no concrete plan for doing so. There are several reasons why we should.

- ▶ Integration can help strengthen U.S. leadership in various regions of the world and counter the creation of closed regional blocs that exclude the United States.
 - For instance, Asian nations have been moving toward a closed regional integration that excludes the United States — with important economic and security implications. This includes establishment of a free trade zone by the Association of Southeast Asian Nations (ASEAN); China’s ambitious FTA diplomacy, including negotiation of an ASEAN-China FTA; and preparations for an East Asia Free Trade Area, comprising Southeast Asian nations, China, Japan and Korea.

- ▶ Integration of individual bilateral FTAs into larger regional groupings can help the United States develop common regulatory approaches and pursue their adoption internationally, in a way that would be much more difficult working from a bilateral basis.

“A comprehensive East Asia Free Trade Area that excludes the United States would immediately cost the United States about \$25 billion annually in lost exports.”

— Institute for International Economics, May 2004

- ▶ Integration can facilitate the development of coalitions on issues in the WTO and other international negotiations.
- ▶ Integration can help promote economic growth and U.S. values in troubled regions of the world.
 - For instance, in the Middle East and North Africa, integration of our FTAs offers the possibility of facilitating intraregional trade and thereby promoting development and economic bonds across the region.

SOLVING THE HODGEPODGE PROBLEM

On a more operational level, integration of the agreements will better serve U.S. trade and commercial interests, as well as those of our free trade partners. The proliferation of inconsistent bilateral arrangements creates a problem of transaction costs because each FTA has its own rules to determine whether goods qualify for duty-free treatment under the agreement. Known as “rules of origin,” they are not uniform across agreements, creating serious practical problems for U.S. businesses — at times making it difficult to take advantage of the agreed-upon market liberalization.

Diverse and conflicting rules of origin also create compliance costs and transactional burdens that can outweigh the benefits of the tariff reductions themselves. The burden of complying with rules of origin increases with the complexity of the rules and the number of different sets of rules that companies must navigate.

When the EU harmonized rules of origin among its various FTAs and allowed for cumulation, its trade with its FTA partners increased by 22 percent.

For example, to comply with value-content thresholds, a company may need to install origin-tracking systems that can be prohibitively expensive. Likewise, a producer facing varying rules of origin under FTAs may have to use different production inputs for the same product to gain preferential access in each FTA partner. Faced with these burdens,

companies at times choose to forgo the benefits of some FTAs altogether, rather than hack their way through the growing thicket of rules of origin.⁹

A solution to this problem is to integrate the U.S. FTAs by harmonizing the rules of origin in the various agreements into a uniform set of rules and combining them into a single system. In particular, all U.S. FTAs would have uniform rules of origin, and an exporter could satisfy those rules through economic activity in any of our FTA partners.

The EU has taken this path, with positive results. In 1997, it established the Pan-European Cumulation System (PECS), providing for cumulation among the EU and its FTA partners, a group that constitutes two-fifths of world trade.¹⁰ Cumulation can be structured in various ways, but it essentially allows for goods to enjoy FTA benefits when the required level of processing or value added occurs in the territory of any combination of the various FTA partners, not only in the territories of the two parties to the bilateral FTA.

The EU and its partners amended their FTAs to substitute a common set of rules of origin in place of their original individual rules.¹¹ The PECS system increased trade between the EU and its trading partners on the order of 22 percent by mitigating the trade-depressing effects of divergent rules of origin and allowing for cumulation.¹² Moreover, the impact of the PECS system continues to grow, as participating countries use the system for most of their other trade agreements.¹³

Cumulation is especially important because it better reflects 21st-century commercial reality, in which goods are often made with inputs from multiple countries. Supply chains that go into final products have become much more complex and integrated, so it is no longer unusual for products to have components from 20 countries or more.

Cumulation also helps convert bilateral arrangements into more economically significant regional arrangements. And it encourages intraregional trade and investment, which can support economic development and even political rapprochement in traditionally closed parts of the world, like the Middle East.

Indeed, the United States has used rules of origin toward such positive ends with the creation of the Qualified Industrial Zones to promote economic interaction between Jordan and Israel, both U.S. free trade partners. U.S. FTAs with Morocco and Bahrain already refer to the possibility of negotiating future regional cumulation arrangements, but this has not yet been acted upon.

ACHIEVING INTEGRATION — A STAGED APPROACH

Completely achieving integration among U.S. FTAs is a long-term project and will need to proceed in stages. Administration officials should begin now to map out a path toward integration and agree on plans of action with our FTA partners. Also, in ongoing and future bilateral and subregional negotiations, where regional FTAs are not feasible, integration should be discussed up front with agreed-upon, concrete plans of action.

A staged approach could proceed this way:

- ▶ First, establish institutional mechanisms for pursuing integration in each region. For each region, the parties might establish a working group to agree on a blueprint for integration and to oversee subsequent negotiations. It may make sense to begin the process in each region as a corollary to an ongoing or a new bilateral FTA negotiation in that region.
- ▶ Second, harmonize rules of origin and allow for cumulation among FTA partners on a regional or global basis. Rules ideally would be harmonized into one global set of rules, but if that is not feasible, rules should at least be harmonized regionally.
- ▶ Third, integrate agreements in other respects, such as services market access or institutional arrangements, on a regional basis.

The challenge for the United States now is to build on the series of FTAs negotiated to ensure that current and future agreements are most effectively serving ... the economic needs of U.S. businesses.

COMPLETING THE REGIONS

While working to integrate existing agreements, the United States should define a strategic framework and vision for commercial relations in each region and on that basis complete negotiations in the regions. Where feasible, the United States should negotiate with the remaining economies on a group basis. Where not, the United States should target the significant trading partners in each region, such as Indonesia in Southeast Asia, and engage in bilateral negotiations. At the same time, in the context of implementing integration plans discussed above, the administration should devise docking mechanisms to permit others to accede in the future.

Free Trade with Our Major Markets?

Recent U.S. FTA activity has opened important new markets and acquired good building blocks for further liberalization, including integration of agreements as discussed above. But since the conclusion of the NAFTA in 1994, the U.S. government has not seriously considered FTAs or similar agreements with our very largest markets (with the recent exception of FTA negotiations with Korea, our seventh largest market).

One important reason for not moving forward with our largest markets — including our second largest market (the EU) and our third biggest single-country market (Japan) — has been the difficult issue of agriculture. The U.S. government has taken the view that FTAs must be truly comprehensive — with tariffs going to zero on all products including agricultural products.

With respect to our very largest markets, the time has come to reconsider our approach to comprehensiveness to ensure that our policy is best serving U.S. interests and promoting international economic growth.

Our trade and investment relationships with the EU and Japan are gigantic. U.S.-EU trade totals far more than half a trillion dollars annually. One-third of all U.S. exports go to Europe, and one-quarter of all European exports go to the United States. Although tariffs are relatively low, businesses face many nuisance tariffs — for which processing costs to companies can exceed the revenues collected — on both sides of the Atlantic, while U.S. service suppliers and manufacturers face a wide array of regulatory challenges in Europe.

U.S. policymakers and negotiators face the following choice: Maintain a rigid approach to comprehensiveness and do not move ahead [with our very largest markets], or proceed more pragmatically.

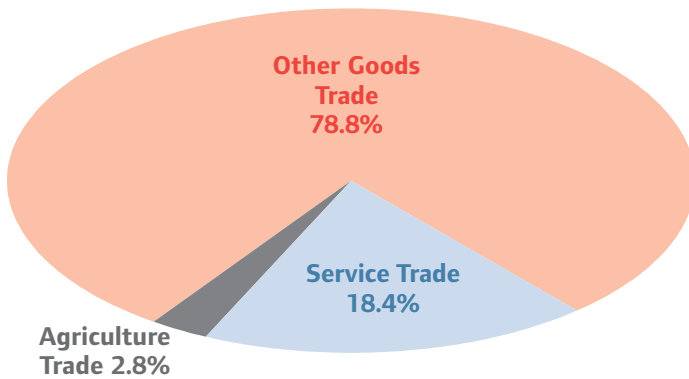
All cannot be solved by an FTA. But where regulatory issues are undermining U.S. market access or U.S. trade and investment interests, an FTA may be an effective tool to address the issues. Studies suggest that dismantling the remaining tariff and nontariff barriers between the United

States and the EU would add about 0.5 percent to U.S. GDP.¹⁴ Likewise, total U.S.-Japan trade is \$258 billion annually. As with Europe, nuisance tariffs affect many sectors, and U.S. businesses across a wide spectrum of goods and services sectors face significant regulatory challenges.

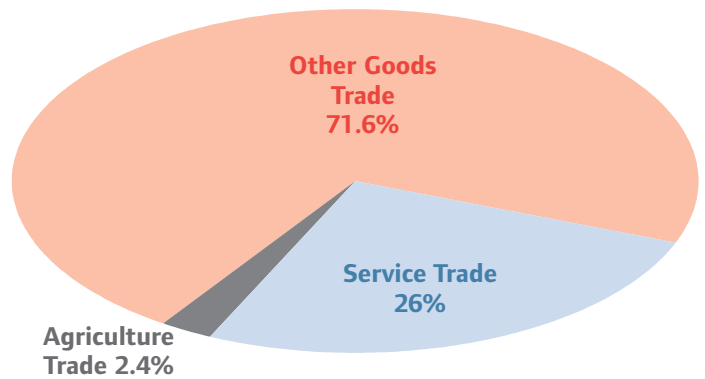
Among these extensive and complex relationships, agriculture occupies a small proportion of trade. In the case of U.S.-EU trade, agriculture's share is 2.8 percent; in the case of U.S.-Japan trade, it is 2.4 percent.

Business Roundtable strongly supports the goal of opening the European and Japanese agriculture markets, and the U.S. government should be using every tool it can to open

U.S. Trade with the European Union



U.S. Trade with Japan



Sources: U.S. Bureau of Economic Analysis and U.S. Bureau of the Census.

those markets. But there appears to be little prospect for establishing free trade in those agriculture markets in the foreseeable future, so U.S. policymakers and negotiators face the following choice: Maintain a rigid approach to comprehensiveness and do not move ahead, or proceed more pragmatically.

As a matter of WTO practice, most governments have taken a more flexible approach to the issue of comprehensiveness than the United States — including the EU with respect to agriculture. And the WTO agreement itself does not mandate that “all trade” be covered.¹⁵

One option the United States should consider is an agreement for full liberalization in all areas but agriculture, assuming that a truly comprehensive FTA covering agriculture is not achievable with the EU and Japan.

Another option that the United States should consider is an agreement for free trade in services with key markets, where progress on goods trade is too difficult or on a different track. Indeed, the WTO contemplates such agreements, although few if any WTO members have explored this path.¹⁶ Services trade is a core area of U.S. comparative advantage. As the U.S. International Trade Commission put it, “U.S. ... firms are preeminent in global services trade,”¹⁷ and services comprise approximately 30 percent of total U.S. exports.

A services FTA provides an alternative way to move forward with economies such as Japan or the EU, where the United States has large services trade — \$66 billion and \$248 billion, respectively — but faces a variety of regulatory and market access barriers. A services FTA also may present opportunities to tackle barriers in key emerging markets like India or even China. In those cases, the prospect of an FTA with the United States could help overcome entrenched interests that have held back services liberalization in those countries.

V. A Proactive Approach to Foreign Regulatory Barriers

For U.S. trade to succeed and grow, trade agreements are critical, but they alone are not enough. Our trade and investment growth and the resulting economic benefits depend on the United States having a comprehensive set of agreements and mechanisms in place. Mechanisms to address regulatory issues are discussed in this section, and those to address investment protection are discussed in Section VI.

Regulatory barriers are the issue of the future for U.S. international economic policy, as tariffs and other border measures are cut even more deeply in key developed and emerging markets and service sectors are opened to foreign competition. For instance, the American Chambers of Commerce in China, the EU and Japan all have rated regulatory issues as the number one or number two challenge in their markets. Trade agreements and traditional trade policy can be used to address some regulatory issues, but not all of them, and not always with the greatest effectiveness.

U.S. businesses face a wide range of regulatory barriers overseas — government policies that purport to further a legitimate regulatory aim but have the purpose or effect of inhibiting U.S. trade and investment. They include:

- ▶ Regulatory models in areas such as health and safety or competition policy that are not based on science or evidence or differ fundamentally from international approaches.
- ▶ Mandatory product standards that differ from U.S. or international standards and duplicative local testing requirements.

The American Chambers of Commerce in China, the EU and Japan all have rated regulatory issues as the number one or number two challenge in their markets.

Issue

U.S. businesses face no greater set of challenges internationally than in the regulatory arena.

Recommendation

Actively promote U.S. or international regulatory approaches, negotiate more mutual recognition agreements (MRAs) to ensure U.S. product standards are accepted around the world, and integrate regulatory issues into the core of U.S. international economic policy.

“Standards and related technical regulations affect approximately 80 percent of world trade.”

—Department of Commerce, 2004

- ▶ Lack of transparency in the regulatory process.
- ▶ Inconsistent enforcement of regulations.
- ▶ Regulatory bodies that are not independent and have close ties to (and in some cases may formally delegate authority to) local industries.
- ▶ Overly burdensome approval procedures.
- ▶ Regulatory regimes that impose different requirements for foreign businesses or equity caps on foreign businesses in key sectors.
- ▶ Regulatory approaches and decisions that are not based on science or objective evidence.

These barriers are central to U.S. economic success globally, but regulatory issues too often are treated as a corollary to — rather than as a key component of — U.S. international economic policy. When a particular regulatory development occurs that seriously affects U.S. businesses, this and past administrations have certainly been responsive and reacted aggressively in some cases. But the U.S. government needs to adopt a forward-looking strategy and plan of action that are integrated with U.S. international economic policy.

To facilitate U.S. exports and trade leadership, the United States needs a more aggressive, activist approach to international regulatory issues. Business Roundtable suggests the following three ways to do that.

Actively Promote U.S. or International Regulatory Approaches

The U.S. government, with substantial private-sector input, should devise and execute a comprehensive strategy to promote sound regulation abroad, including the adoption of U.S. or international product standards and harmonization of standards. This is necessary to counter the spread of an inconsistent patchwork of local or EU-inspired regulatory approaches that will increasingly disadvantage U.S. exports.

For instance, the EU recently approved a massive overhaul of its chemicals regulation that, when fully implemented, will impose stringent new standards and require changes in product composition, design and testing that will add potentially billions in costs to businesses. Also, the EU has taken a nonscientific approach to regulation of biotechnology products, keeping out U.S. products. And the EU has sought to regulate cosmetics in an aggressive manner that exceeds approaches of any other major economy, banning the marketing or sale of any product tested on animals, regardless of where that testing occurred.

These different regulatory approaches impose unreasonable and serious requirements on U.S. businesses exporting to or investing in Europe. Even more ominous, the EU has an aggressive and well-funded plan to spread its regulatory approaches throughout the world, particularly in developing countries. It spent at least \$44 million in 2004 on technical assistance programs outside the EU just on standards-related issues, with total spending of more than \$313 million since 1989.

When the EU succeeds in spreading its regulatory approaches to foreign markets and those approaches diverge from ours (as they often do), U.S. exporters are disadvantaged in parts of the world far from Europe. The EU plan thus poses a serious threat to U.S. economic interests.

The U.S. government lacks a comparable strategy. The secretary of commerce did launch a Standards Initiative in 2003 to ensure that the federal government works to eliminate standards-related market barriers to U.S. commerce. But U.S. engagement on technical assistance and other cooperative programs on either standards or broader regulatory issues is limited, and funding is paltry.

If both the EU and United States continue on these two paths, we will see increasing numbers of countries opting for EU or hybrid regulatory approaches to the detriment of U.S. businesses and workers. For instance, China

recently adopted unreasonably burdensome environmental regulations on electrical appliances and information products modeled largely on the EU's Directive on Waste Electrical and Electronic Equipment and Directive on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment.

More broadly, the United States should work actively to harmonize the development of new standards internationally.

“Standardization is not only a technical tool; it is becoming a political instrument of the EU economic and industrial policy.”

— EU director of regulatory policy, October 2005

Aggressively Negotiate Mutual Recognition Agreements

Another way to ensure that the United States can compete successfully around the world without unfair regulatory barriers is by negotiating Mutual Recognition Agreements (MRAs). The United States should aggressively negotiate agreements that obligate our trading partners to recognize our product standards and conformity assessment procedures.

Under these agreements, trading partners would commit to accept U.S. product or services standards, as well as the procedures to ensure that products conform with those standards. Where an MRA has been negotiated, U.S. firms can sell to that market without having to

adjust product design, production process or labeling for the local market or prove that a product adheres to the foreign standards.

MRAs provide significant benefits to U.S. companies trying to export their goods abroad, yet we have very few such agreements. The United States has concluded MRAs with only three trading partners, as well as a narrower agreement with Japan on agriculture products.

The absence of MRAs hurts U.S. businesses, particularly if a competitor from the EU or elsewhere can rely on its own standards and conformity assessment procedures to enter the market.

“Increasingly our trading partners utilize [technical assistance] programs to influence the selection of standards by [emerging] economies and create favorable trade alliances.”

— American National Standards Institute, December 2005

Integrate Regulatory Issues into Core of U.S. International Economic Policy

The U.S. government should integrate regulatory issues more effectively into international economic policymaking and implementation. For instance, although U.S. regulatory agencies have a voice in the trade policy and implementation process, most lack a senior official solely responsible for international regulatory issues and do not address divergent regulatory approaches abroad as a central part of their missions.

One exception has been the U.S.-Japan Regulatory Reform and Competition Policy Initiative (successor to the U.S.-Japan Dereg Dialogue), an effort led on both sides at the presidential level. This has resulted in improvements to the regulatory environment in Japan in areas ranging from telecommunications to competition policy, facilitating Japanese growth and U.S. trade and investment.

But the United States lacks a comparable structure and process for other critical trading partners. For instance, China’s regulatory environment is notoriously opaque and unpredictable — to the disadvantage of U.S. exporters and investors. At the same time, China is working to build a new regulatory infrastructure to manage its rapidly developing economy. The United States needs focused, high-level attention to help accelerate Chinese regulatory reform and ensure that China adopts regimes in line with U.S. or international approaches.

VI. Closing the Gaps on Investment Protections

Closing the BIT Gap: The United States Has Fallen Behind

To succeed in a global economy, U.S. companies must be able to conduct business around the world in an open and equitable environment. This means conducting business without unfair foreign regulatory barriers or state intervention, as discussed in Section V.

It also means being free from unfair government action, which bilateral investment treaties (BITs) provide protection against. For example, BITs can prohibit discrimination and expropriation without just compensation, guarantee the transferability of funds, and provide a neutral international arbitration mechanism for resolving investment disputes. Thus, a BIT can facilitate, protect and increase foreign direct investment and trade.

Yet in many of the most important developing markets, the United States does not have in place this critical tool for protecting and promoting U.S. investment and, in turn, U.S. exports to those markets. A local commercial presence makes it far easier for a U.S. company to understand and develop the market, establish sales outlets and provide after-sales services.

Underscoring the critical role of BITs are the following statistics.

- ▶ Exports of goods by U.S. companies to their foreign affiliates totaled \$157 billion in 2003, accounting for nearly one-quarter of all U.S. goods exports.¹⁸

Issue

U.S. businesses lack protections against unfair government action and double taxation in some key foreign markets, protections enjoyed by our European and other competitors.

Recommendation

More aggressively negotiate bilateral investment treaties (BITs) and tax treaties, which will better enable U.S. businesses to compete internationally.

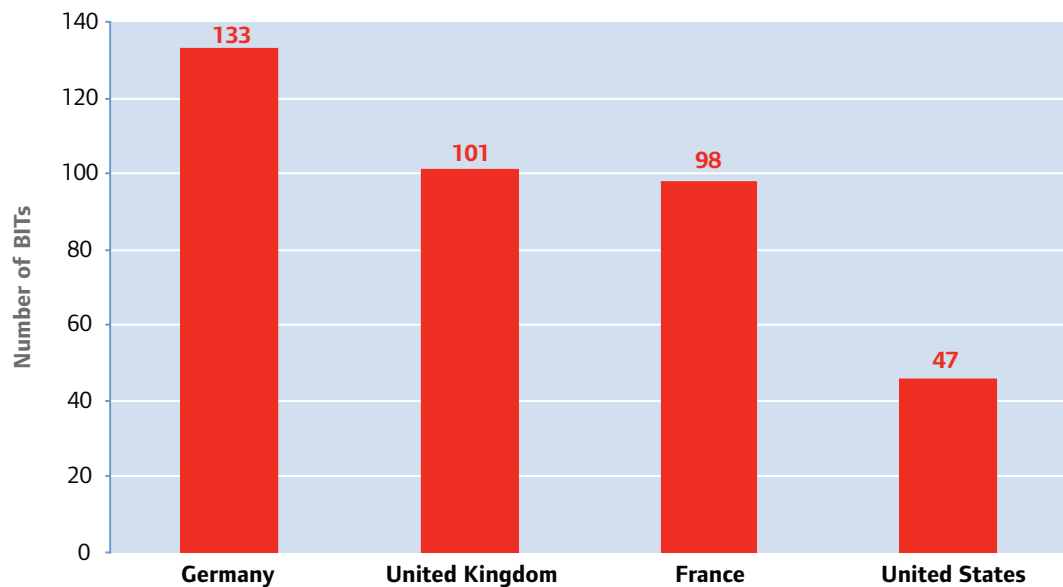
- ▶ Approximately two-thirds of U.S. exports are made by U.S. companies with investments overseas.¹⁹
- ▶ Every dollar of outward foreign direct investment is associated with \$2 in U.S. exports.²⁰

U.S. companies' overseas operations also generate income remitted back to the United States, which then is reinvested in U.S. operations and supports U.S. job creation.

- ▶ U.S. companies' foreign affiliates remitted more than \$250 billion in income to the United States in 2005 alone. Total sales of U.S. affiliates abroad exceed \$2.2 trillion annually.²¹
- ▶ For every one job that that U.S. companies created in their foreign affiliates, they created nearly two U.S. jobs.²²
- ▶ Conversely, foreign businesses invest in the United States, employing more than 5 million Americans from new investments of \$80 billion in 2004.²³

Despite the obviously major stakes involved, U.S. businesses often lack the protections that their European or other counterparts enjoy around the world. The United States has negotiated only 47 BITs. Germany alone has negotiated nearly three times that number.

The United States Lags Behind Its Peer Economies in BIT Coverage



Source: United Nations Conference on Trade and Development.

The U.S. shortfall includes some key emerging markets.

- ▶ In China, the world's fourth largest and fastest growing economy, U.S. investors do not have the protection of a BIT — unlike investors from 114 other countries, including nearly all European countries, which do.
- ▶ In India, with a population of more than 1 billion and GDP growth of more than \$2 trillion since 2000, U.S. investors do not have the protection of a BIT. Investors from 57 other countries, including nearly all European countries, do.
- ▶ In Indonesia, Southeast Asia's largest country, U.S. investors do not have the protection of a BIT. Investors from 59 other countries, including nearly all European countries, do.²⁴

[I]n many of the most important developing markets, the United States does not have in place [BITs, a] critical tool for protecting and promoting U.S. investment and ... exports.

Although the details of these BITs certainly vary and most are far less detailed than the 2004 U.S. Model BIT, some of these agreements provide the core ingredients of a high-quality investment agreement: national treatment; MFN treatment; fair and equitable treatment; prohibition on direct and indirect expropriation without just compensation; and an investor-state arbitration mechanism using the International Center for Settlement of Investment Disputes (ICSID), the ICSID Additional Facility, United Nations Commission on International Trade Law (UNCITRAL) and/or ad hoc arbitration.

For example, consider that in Venezuela, where a new government threatens nationalization in the oil and gas and other sectors, U.S. companies lack protections and assurances of just compensation because the United States has no BIT with Venezuela. In contrast, when Argentina imposed capital export restrictions, levied significant export duties and revalued the peso in response to the economic crisis of 2002, U.S. investors were able to protect their legal interests by recourse to the dispute settlement provisions of the U.S.-Argentina BIT.²⁵ A number of those cases are now pending before ICSID.²⁶

Similarly, when a foreign government entered into a commercial contract with a U.S. company and failed to make dividend payments, that company was able to use the investor-state dispute settlement mechanism under a BIT to resolve the matter — where host country courts might not have provided an expeditious, neutral and fair process.²⁷

Thus, without a BIT, U.S. investors are subject to the whims of host country governments, often in the developing world, without any check. The United States should be working aggressively to close the gap in BIT protection where possible, catching up with the advantage

that our European and other competitors enjoy today. At the same time, an agreement should provide meaningful and effective protection, and Business Roundtable does not endorse entering into a hollow BIT for the sake of an agreement.

The United States also should pursue other policies — such as those recommended in Section V (regulatory barriers) — to improve the investment climate in foreign markets and ensure that our companies can compete on a level and equitable playing field.

Negotiating Tax Treaties with Key Economies

With substantial private-sector input, the U.S. government should continue to identify the key markets where U.S. businesses lack tax treaty protection and agree on a plan to negotiate those protections. U.S. companies competing in the global economy need the protection and certainty of tax treaties.

The United States has an extensive array of tax treaties, but some key markets are missing, and the United States should continue to press for tax treaties with those markets.²⁸ For instance, the United States lacks tax treaties with Brazil, Malaysia and Vietnam, despite their large economies and extent of actual and potential U.S. trade and investment.

Tax treaties provide clear ground rules that govern tax matters relating to trade and investment. They protect traders and investors from double taxation of the same income. And they ensure that U.S. investors do not suffer discrimination in the application of foreign tax laws.²⁹ As the U.S. Treasury has said, “An income tax treaty removes impediments to international trade and investment by reducing the threat of double taxation that can occur when both countries impose tax on the same income.”³⁰

The absence of a tax treaty thus can increase costs and create uncertainty for U.S. businesses, leading to lost business opportunities and diminished potential returns on international transactions.

“As the United States considers how to create jobs and maintain export growth, it is important that we try to eliminate impediments that prevent our companies from fully accessing international markets. ... In the case of taxes, we should work to ensure that companies pay their fair share, while not being unfairly taxed twice on the same revenue.”

— Sen. Richard Lugar, Feb. 2, 2006

VII. Bringing the Benefits of Trade and Investment to the World's Poor

Many citizens of the world's LDCs have realized no tangible economic benefits from being part of the global economy, despite worldwide economic growth. Hundreds of millions of people in those countries still live in abject poverty and are not reaping the benefits of the global economic system. It is a collective moral imperative to successfully integrate LDCs into the global economy.

Open trade policies of the 20th century have helped countries as diverse as Brazil, China, India, Mexico and South Korea grow their economies, increase trade and improve standards of living for their citizens. Expanding international trade and investment also helps improve labor standards, environmental protection, rule of law and democratic principles in those countries that join the global economic system.

As noted earlier in this paper, liberalized trade and investment go hand-in-hand with improved labor rights, as countries improve enforcement and international firms bring higher wages, better working conditions and more job choices to developing countries' workers. Similar benefits include better environmental protection, the spread of the rule of law and expanded political openness.

Issue

Too many people in the least-developed countries (LDCs) have not received the benefits from trade and investment liberalization and the global economy.

Recommendation

Close resource gaps that inhibit LDCs from effectively negotiating, implementing and taking advantage of trade and investment liberalization; integrate trade objectives into development assistance more effectively; and re-examine preference programs to ensure they are providing real benefits to the world's poor.

- ▶ As two Business Roundtable reports described in detail, multinational companies that invest in developing countries already strive to ensure that those operations are seamlessly integrated into worldwide operations. In doing so, these companies expose workers, suppliers, customers and governments to ethical and responsible business behavior.³¹ For example:
 - ▶ U.S. companies strive to uphold strict corporate codes of business conduct and ethics in developing countries where they do business.
 - ▶ Companies bring improved environmental technologies, energy efficiency, and health and safety standards to their facilities in developing countries. Many U.S. companies apply global standards for environment and health and safety at all of their worldwide facilities, meaning that facilities often exceed local environmental standards and set important examples for domestic firms.

- ▶ U.S. businesses' investments abroad provide workers with higher wages, improved training opportunities and working conditions that exceed those in locally owned factories.

- ▶ Open trade and investment helps improve civil society by introducing and disseminating ideas and information technology and giving citizens more opportunities to communicate with other citizens both inside and outside their countries.

This is a moral good, which alone is enough reason to proceed. But it is important for at least two other reasons, as well.

First, poverty and absence from the global economy go hand-in-hand with violence and instability, particularly in Africa and the Middle East. Bringing LDCs into the world trading system thus is critical to U.S. interests of supporting peace, stability and democracy in those parts of the world. This would reassert U.S. geopolitical leadership.

Second, the inability to address LDCs' economic challenges also impairs efforts to further liberalize global trade and investment. Countries that have not participated in global economic growth are likely to resist further liberalization from fear of being left further behind. Providing effective leadership for a global trading system that lifts LDCs out of poverty, therefore, must be a key part of U.S. trade and investment policy.

Following are some strategies that can help accomplish that goal.

Addressing Resource Gaps Through Capacity Building and Technical Assistance

The United States should continue to strengthen its trade capacity-building and technical assistance programs for LDCs and address the real problems those economies face in participating in the global trading system.

LDCs often cannot integrate with and reap the benefits of participating in the global economy because they lack the resources and capacity to develop coherent national trade policies, negotiate agreements that benefit their citizens, implement those agreements and help their businesses take advantage of new opportunities. This prevents LDCs from negotiating beneficial bilateral or multilateral trade liberalization agreements or from taking advantage of such agreements once they are negotiated. These resource gaps come in many forms.

- ▶ **Inadequate regulatory and enforcement structures.** Developing countries often lack the regulatory structures necessary to implement liberalization commitments made in trade negotiations.
 - ▶ Developing countries may not be willing to make commitments if they do not have the necessary resources to implement those commitments. For example, developing countries may be unwilling to undertake commitments to enforce intellectual property rights due to concerns about their ability to implement such commitments.
 - ▶ In other cases, developing countries may enter agreements only to realize few benefits because of inadequate regulatory structures. Weak regulatory regimes for telecommunications or financial services may limit flows of foreign investment. Developing countries with insufficient sanitary and phytosanitary (food safety) regulatory capacity may have difficulty implementing agriculture trade commitments or taking advantage of export opportunities.

- ▶ **Inadequate infrastructure.** Inadequate physical and service infrastructure can undermine the benefits of trade liberalization.
 - ▶ Poor port facilities, which may cause costly delays or inability to transport perishable goods, can hinder a country's ability to increase imports and exports in response to trade liberalization.
 - ▶ Lack of adequate telecommunications or financial services infrastructure may hinder domestic producers' ability to access newly opened foreign markets and may limit foreign investment that was anticipated from a trade agreement.

- ▶ **Lack of trade policy coordinating and negotiation capacity.** Trade negotiations are complicated and expensive undertakings that require significant government resources. Even unilateral trade policy decisions require significant government coordination, data gathering and forecasting tools that may not be fully developed in poorer countries.

- ▶ **Lack of business capacity.** Businesses in LDCs may lack the technology and experience necessary for success in a global economy. Businesses with attractive products may forfeit global market share if they do not have access to information technology for tasks such as inventory management, shipment tracking and marketing. Inexperience with electronic commerce or technology can lock producers out of the 21st-century marketplace.

Important efforts already are under way to help LDCs integrate trade and development policy. Under the auspices of the WTO, major donor countries and multilateral agencies have created the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries. This provides LDCs with funding and technical assistance to help integrate trade and development policies and implement those strategies. It also helps many LDCs, including many in Africa, develop diagnostic studies to better integrate trade and development policy.³²

The United States also is helping in other ways. The U.S. government is working to integrate trade into development assistance programs and to aid LDCs in integrating into the global trading system. In 2005, the United States dedicated \$1.3 billion to “Aid for Trade” assistance, and it plans to double that amount to \$2.7 billion by 2010.³³

Business Roundtable suggests the following measures to improve capacity-building and technical assistance programs.

Identify capacity-building and technical assistance needs early. Trade capacity-building programs should focus on helping developing countries identify and remedy capacity-building and technical assistance needs early in a trade negotiation or before the negotiation begins. This can increase countries’ abilities to both make and keep trade commitments.

Integrate technical assistance provisions into trade agreements. Negotiators should consider incorporating technical assistance and capacity-building provisions into the text of trade agreements with LDCs. Explicit provisions for capacity building will help ensure that developing countries can make and keep commitments and will help direct programs to those areas that are most critical.

Facilitate public-private technical assistance and capacity-building coordination. Governments and private businesses should explore ways to coordinate technical assistance and capacity building. Government and private-sector efforts often are duplicative and sometimes conflicting. It is important that the limited resources be well managed and used.

Address gaps in infrastructure. Trade capacity-building and technical assistance programs to LDCs should identify and help remedy gaps in physical, services and regulatory infrastructure. These gaps create significant barriers to participation in the world economy, the development of healthy markets and economic growth.

Better Integrating Trade Objectives into Development Assistance

The United States should ensure that the overarching goal of improving LDCs' ability to participate in the global economy and grow through trade and economic openness is an integral part of all of our aid programs.

The United States and other industrialized countries give significant aid to developing countries through bilateral and multilateral programs. In addition to support for multilateral development banks and assistance agencies, the United States provides billions of dollars in development assistance through various programs at the U.S. Agency for International Development, the Millennium Challenge Corporation and the Overseas Private Investment Corporation.

Expand the role of development banks. The United States and other donor countries should ensure that trade capacity building and technical assistance are better integrated into the programs carried out by the World Bank and the regional development banks. Expansion of trade is a vital component of economic development and poverty alleviation and must be considered when programs are developed and implemented. The World Bank and other development banks have long made liberalized trade and investment a priority.

The IMF, International Trade Centre, United Nations Conference on Trade and Development, United Nations Development Program, World Bank, and the WTO have combined efforts in an Integrated Framework (IF) to respond to the trade development needs of LDCs. However, recent assessments of the IF point to significant shortcomings, including slow processes, a serious gap between diagnosis and implementation, and lack of ownership by LDCs of trade and development integration strategies.³⁴

The IF Steering Committee recently adopted reform recommendations to help address these problems, but leadership from the United States and other major donor nations will be critical to ensure that programs for trade capacity building are expanded and better integrated into all development bank assistance programs.³⁵

The United States should ensure that the overarching goal of improving LDCs' ability to participate in the global economy and grow through trade and economic openness is an integral part of all of our aid programs.

Use the HELP Commission to ensure that development assistance programs complement and enhance efforts to open trade. Congress recently created the Commission on Helping to Enhance the Livelihood of People Around the Globe (HELP Commission) to examine the successes and failures of U.S. development assistance and make recommendations. One task of the Commission is to “compare the effectiveness of increased and open trade with development assistance, and analyze the advantages and disadvantages of such trade and whether such trade could be a more effective alternative to United States development assistance.” Business Roundtable urges that the Commission give full consideration to ensuring that development assistance programs complement and enhance efforts to open trade.

Re-examining the Preference Programs

The United States should review its preference programs to ensure that they are providing real benefits to LDCs in terms of trade and development, and Business Roundtable welcomes USTR Schwab’s announcement in August 2006 to do just that.

The United States maintains a number of trade preference programs that provide favorable access to our markets for goods from qualified developing countries. The Generalized System of Preferences (GSP) provides duty-free access for thousands of goods from developing countries that meet certain criteria. In addition, the United States maintains specialized regional preference programs that offer even greater duty-free access to eligible countries, including the AGOA, the CBI and the Andean Trade Promotion Drug Eradication Act.

Each of these programs has facilitated increased imports and exports by beneficiary countries. For example, since it began in 2000, AGOA has helped increase U.S. two-way trade with sub-Saharan Africa by 115 percent.³⁶ The programs have helped the beneficiary countries grow and modernize their economies and move from reliance on primary product exports to increased exports of value-added manufactured goods. They also have paved the way for deeper liberalization in the form of FTAs. For example, the CBI beneficiary countries agreed to deeper, reciprocal openings in the Dominican Republic — Central America Free Trade Agreement (DR-CAFTA).

Ensuring that preferences deliver real economic benefit. The United States should review all of its preference programs to ensure that they provide the benefits that will help LDCs successfully access the American market. Accessing the U.S. market will help LDC industries gain the experience necessary to export regionally and, eventually, to the global marketplace. The basket of goods covered by the various programs should be examined to ensure that the LDCs have preferences that are consistent with their exports. If necessary, preference programs should be expanded to include a greater range of products that are important LDC exports.

Targeting the LDCs. To ensure that preference programs like GSP deliver real benefits to our neediest trading partners, preference programs should distinguish between developing countries that have robust, growing economies and those, such as most sub-Saharan African nations, that do not. LDCs and rapidly growing developing countries are not similarly situated and should not be treated the same.

Removing barriers to south-south trade. The United States should use GSP to help LDCs access the growing regional markets with more advanced developing countries nearby. A significant portion of the barriers to exports from developing countries comes from other developing countries. Forty percent of world trade occurs between developing countries, and according to World Bank estimates, 70 percent of the tariff burden faced by developing countries is imposed by other developing nations.

In determining GSP eligibility, the president is permitted to consider a number of relevant factors, including the country's protection of intellectual property rights, its trade-distorting investment practices and its efforts to liberalize services trade. To leverage greater market access for LDCs, the United States should consider additional criteria for advanced developing countries that review the country's own openness to imports from LDCs.

Garnering meaningful multilateral commitments from advanced developing countries. Advanced developing countries now need to be full players in the multilateral trading system.

In determining GSP eligibility for advanced developing countries, the president should consider the role the country has played in negotiations of multilateral trade liberalization. The advanced developing countries have benefited greatly from the open world trading system. Liberalized trade and investment regimes have opened significant markets to their exports and helped them grow their industries and lift their citizens from poverty.

Opening these countries' markets more completely to services, manufactured goods and agricultural trade will help bring the benefits of liberalized trade to their own farmers, manufacturers and consumers (many of whom remain poor), while bolstering and expanding global trade liberalization.

Opening [advanced developing] countries' markets more completely to services, manufactured goods and agricultural trade will help bring the benefits of liberalized trade to their farmers, manufacturers and consumers.

VIII. Laying the Domestic Groundwork for American Competitiveness

Business Roundtable supports aggressive new domestic policies to strengthen our economy at home to ensure our competitive edge in the world marketplace. Strengthening American competitiveness must be a priority for U.S. economic policy in the 21st century. Following are major policies we recommend.

Actively Promote an Ambitious Competitiveness Agenda

Make a Serious Commitment to Worker Training, Adjustment Assistance and Job Creation

Global competitiveness requires scientific and technological capabilities that keep U.S. companies at the forefront of innovation and make U.S. workers the first choice for companies seeking a skilled and productive workforce. Appropriate government programs should ensure that all American workers have the skills they need to compete and prosper in a rapidly evolving economic environment.

The growing pace of innovation and level of globalization has increased the problem of worker displacement and the normal phenomenon of job turnover. We know that this process creates far more jobs than it eliminates. For instance, in the third quarter of 2005, the economy created 8.1 million new jobs while eliminating 7.4 million old jobs.³⁷ But this is little consolation to workers who lose their jobs and undergo serious disruptions.

Issue

No matter how well crafted and executed, U.S. international economic policy will succeed only if we have strong domestic groundwork.

Recommendation

Pursue an ambitious competitiveness agenda, including making a serious commitment to worker training and adjustment programs, strengthening American leadership in research and development, improving science and technical education, overhauling U.S. international tax rules, and pursuing a comprehensive energy policy. Narrow the current account deficit. Ensure that our own government policies are not discouraging trade and investment. Revitalize the congressional-executive relationship on trade and renew Trade Promotion Authority.

Competition and job turnover periodically create strident calls to withdraw the United States from the global economy. But successful U.S. economic policy has always been about job creation and growth, not about freezing the U.S. economy at any one stage. Open economic policy means a natural process of jobs lost but replaced by new ones. We must prepare Americans for these new jobs.

Easing the structural transition. Structural changes in employment caused by changing technology, innovation and a more integrated global economy must not become an excuse for protectionism. Government policy should aim to facilitate these structural transitions, while easing the short-term pain accompanying transition.

- ▶ Whether job losses are related to technological change or trade, the administration and Congress should provide robust assistance to affected workers to help them adjust, retool their skills and re-enter the workforce with high-paying jobs.
- ▶ When market disruption occurs due to unexpected surges of imports, the government should be responsive to injured U.S. businesses and workers. In some cases, this may mean short-term, WTO-consistent import limits that permit U.S. firms to adjust to the new competition. In any case, this should mean assistance to those firms and workers to help them retool and retrain.

Providing adjustment assistance for the 21st-century economy. We must reform government adjustment assistance programs to provide workers with 21st-century skills — and to reform federal and state employment and training programs crafted for an economy that no longer exists. Many such programs were designed to help manufacturing workers adjust to cyclical downturns in the economy, but the changes today are structural. Moreover, the patchwork system of programs currently in place for educating and training American workers is not functioning effectively.

In March 2004, Business Roundtable issued *Securing Growth and Jobs*, which called for improving adjustment assistance programs for dislocated workers. Those recommendations are still valid today.³⁸ For example:

- ▶ Allow workers to begin retraining or education programs immediately upon losing their jobs or before, if possible. Current state programs often discourage or prohibit the unemployed from participating in training until unemployment benefits are exhausted.

“The challenge for policy makers is to ensure that the benefits of global economic integration are sufficiently widely shared — for example, by helping displaced workers get the necessary training to take advantage of new opportunities — that a consensus for welfare-enhancing change can be obtained.”

— Ben Bernanke, Federal Reserve Chairman, Aug. 26, 2006

- ▶ Streamline systems and eliminate the multiple bureaucracies in current programs. Unemployed and at-risk workers must be able to learn skills more easily and use available training and education programs.
- ▶ Fine-tune worker training and education programs for the 21st-century economy, providing training in skills and fields that are critical to American competitiveness and giving workers the flexibility to participate in innovation and change in the economy.
- ▶ Create incentives for business to support employee education in science and technology fields. In today's competitive environment, businesses and their workers need to constantly update skills and technology. Federal and state governments should develop incentives, such as tax credits or matching funds, to help employers further their employees' education through additional education and training.

STRENGTHEN AMERICAN LEADERSHIP IN RESEARCH AND DEVELOPMENT

The United States must commit to maintaining our international leadership in research and development — one of the cornerstones of U.S. economic leadership. Throughout the 20th century, the United States led the world in innovation in a broad range of industries, including consumer products, information technology, telecommunications and pharmaceuticals, among others.

Strong research and development has been the engine that drives our economic growth. In fact, economists estimate that up to half of U.S. economic growth in the latter half of the 20th century was due to advances in technology.³⁹ However, America has been falling behind in the innovation race.

- ▶ Nearly half of technology patent applications are filed by foreign competitors.⁴⁰
- ▶ About one-third of all jobs in the United States require science or technology competency, but currently only 17 percent of Americans graduate with science or technology majors.⁴¹
- ▶ As a percentage of our GDP, U.S. federal research and development spending peaked *40 years ago*, in 1965, at just under 2 percent of GDP. Today it is about 0.8 percent of GDP.⁴²

Economists estimate that up to half of U.S. economic growth in the latter half of the 20th century was due to advances in technology.

Business Roundtable's 2004 report also called for policies to spur U.S. growth, including facilitating research and development, encouraging new investment in manufacturing technology, improving worker adjustment and education programs, and raising U.S. student achievement. A July 2005 report, *Tapping America's Potential: The Education for Innovation Initiative*, issued by Business Roundtable and 14 other national business groups, called for investments in basic research and education to bolster U.S. innovation capacity. Since then various legislative proposals have come forward, and in February 2006, the president proposed the American Competitiveness Initiative.

These are welcome steps, but they will require sustained, high-level attention by the administration and Congress to come to accomplish these important tasks:

- ▶ **Boost federal research and development investment, particularly in basic research.** Federal investment in basic research has been the foundation for many commercial advances. However, since 1970, the federal share of research and development spending has declined from 57 percent to about 30 percent.⁴³ The declining share of federal expenditures on research and development presents an ominous trend for long-term innovation. Basic research can have very large economic benefits to the economy as a whole and is unlikely to be sufficiently funded by private sources because the knowledge gained cannot be appropriated solely by those performing the research. To ensure future U.S. leadership, federal expenditures for basic research and development must increase.

- ▶ **Encourage business research and development expenditure.** The Research and Experimentation Tax Credit provides significant incentives for corporate research and development by providing a tax credit of 20 percent of qualifying research and development expenditures. Business Roundtable believes the benefits from the research credit should be expanded and enhanced.
 - ▶ First, the types of research and development that qualify should be expanded, and the qualifying percent eligible for the credit should be increased.
 - ▶ Second, the tax credit should be made permanent, as the president's American Competitiveness Initiative proposes. Its temporary status means that Congress must periodically vote to extend the credit — creating unnecessary uncertainty for investors considering long-term research and development projects.

IMPROVE EDUCATION TO BUILD A COMPETITIVE WORKFORCE

America's leadership in the world economy depends on well-educated workers and outstanding universities, but even here we are falling behind other nations. The warning signs are ominous. For example:

- ▶ The number of engineering doctoral degrees awarded in the United States has been declining since 1995. Doctorates in all science fields also have been falling.⁴⁴

- ▶ The United States now ranks only 17th in the world in the number of college students pursuing science and engineering.⁴⁵
- ▶ In international tests of math and science skills, American high school seniors score well below those of our economic competitors.

This is happening at the very time we must rely increasingly on workers with greater science and technology expertise — yet the domestic supply of qualified workers is not keeping up with demand. According to one economist, “[T]railing other [developed] countries on education measures may reduce U.S. economic growth by as much as a half a percentage point a year.”⁴⁶ To address the problem, Business Roundtable and other national business groups set a goal to double the number of bachelor’s degrees awarded annually to U.S. students in science, technology, engineering and mathematics by 2015.⁴⁷

Again, the president’s American Competitiveness Initiative provides a strong blueprint for improving educational preparedness. It recognizes that excellence in science and technology requires expanding the pool of workers with high-level science and engineering skills and must start long before the university level. The initiative includes such proposals as:

- ▶ Improving math and science education, especially for low-income students, by providing funding for improving math and science curriculum, increasing the number of highly qualified teachers, and expanding Advanced Placement coursework.
- ▶ Creating more scholarships and loan-forgiveness programs for students entering the science, technology, engineering and math fields.
- ▶ Providing incentives and training to strengthen science and math teaching in American schools, including enabling math and science professionals to become adjunct high school teachers.

We also should invest more in graduate research fellowships and trainee programs that have a proven track record of increasing the number of highly trained scientific and technical workers that are in high demand. The administration and Congress, in close collaboration with state officials, must provide the necessary leadership and commitment to ensure that we meet these goals.

Workforce + R&D + Education → Competitiveness

MAKING U.S. INTERNATIONAL TAX RULES MORE COMPETITIVE FOR U.S. BUSINESSES

Many of the U.S. international tax rules were crafted in the 1960s and no longer work for the current global marketplace. They are critically in need of an overhaul.

U.S. tax rules depart from international norms in a number of areas and increase tax burdens for U.S. companies compared to their foreign counterparts. With the growing importance of international commerce for all countries, the shortcomings of U.S. international tax policy will be magnified.

The United States uses a worldwide tax system that taxes American companies on the income they earn in foreign countries as well as the income they earn at home. Companies then can offset the taxes paid on their overseas income with “foreign tax credits” — but there are various restrictions on the ability to claim these credits. In contrast, as noted by the president’s Advisory Panel on Federal Tax Reform, two-thirds of OECD countries typically use forms of territorial tax systems that generally impose no tax on the active income earned abroad by their global companies. Further, the United States imposes restrictions on deferral of current taxation on active income earned overseas. These limitations increase tax liability on active foreign earnings relative to most competing nations, thereby resulting in significant compliance costs.

The need for U.S. companies to compete on a global scale means that we no longer can ignore the competitive disadvantages imposed by our tax rules. We must undertake reforms to our tax code to make it more competitive with the tax systems of our major trading partners.

FOCUSING OUR NATION ON THE ENERGY CHALLENGE — A CALL TO ACTION

Today, energy policy is an issue of critical importance to our entire nation. Strong economic growth, led by many Asian countries, is driving worldwide demand for energy and putting upward pressure on prices. Because of supply constraints and the resulting price volatility in global energy markets, America can no longer be assured of the low-cost energy we historically have enjoyed.

Failure to meet these challenges will adversely affect economic growth, as rising energy costs divert capital away from business investment, reduce consumer purchasing power and make the United States less competitive in the global economy.

The administration and Congress must pursue thoughtful, comprehensive approaches that address all aspects of the energy equation — by increasing conservation and energy efficiency, enhancing domestic energy supplies and availability, and investing in new fuels and energy-efficient technologies.

Despite its appeal, energy independence is an unrealistic goal for the United States for the foreseeable future. But we can and must do more to safeguard our energy security. Policies that reduce the energy intensity of the U.S. economy, encourage new technologies, increase conservation and promote domestic fuel sources will over time cushion the United States from upheavals in global energy markets.

The government must encourage research and investment in all promising innovations that increase supply and promote efficiency, and it must stimulate development and deployment of new technologies and fuels so they reach the marketplace as soon as possible.

Given the reality of continued reliance on foreign energy sources and the growing energy demands of China, India and other countries, our foreign policy must strategically integrate energy and environmental policies with national security goals. This means recognizing the interdependence of the world's major energy-producing and energy-consuming nations and building on the historical U.S. commitment to open investment and free trade.

Business Roundtable recently released an "Integrated Energy Policy Framework" with the following recommendations:

- ▶ Improve energy security by increasing conservation and energy efficiency.
- ▶ Enhance energy supply and availability while addressing global climate concerns.
 - ▶ Meet future energy and raw material needs for power generation and manufacturing by encouraging a diverse mix of clean, cost-effective fuels, feedstock and technologies.
 - ▶ Increase environmentally responsible exploration and development of North American oil and gas reserves.
 - ▶ Invest in development and cost-effective deployment of petroleum-replacing biofuels (e.g., ethanol from crops or cellulose, biodiesel) for the electricity and transportation sectors.
 - ▶ Increase construction and modernization of critical infrastructure for reliable and efficient movement of fuels, feedstock and electricity.
- ▶ Promote new energy technologies through incentives and public-private research and development partnerships.
- ▶ Align energy security goals with other national policy objectives.

Narrow the Current Account Deficit

Various new policies are needed to bring down our rapidly growing, and unsustainable, current account trade deficit, now more than 6 percent of U.S. GDP. By essentially borrowing from abroad to finance current consumption, America is piling up huge debts for future generations to repay — with the potential to hinder growth, productivity and American competitiveness.

Most economists agree that a current account deficit is neither a sign of economic weakness nor a harbinger of immediate economic problems for the U.S. economy. Perhaps more important, the trade deficit is not an indicator that the U.S. policy of trade liberalization is flawed. Business Roundtable proposes the following necessary policies to address this problem.

ADDRESS LOW SAVINGS AND INVESTMENT IN THE UNITED STATES, INCLUDING FEDERAL BUDGET DISCIPLINE

The current account deficit is a result of a domestic savings shortfall in the United States, while demand for investment capital continues to rise. This is partly a result of the very low personal savings rate of American families — below 1 percent of income since mid-2000.

Policies to encourage private savings by American citizens can help finance new domestic investments and reduce the risk of personal financial distress. Such policies should include:

America is piling up huge debts for future generations to repay — with the potential to hinder growth, productivity and American competitiveness.

- ▶ **Encourage individual savings.** Tax-free savings accounts, such as IRAs and college tuition programs, should be expanded, streamlined and made more widely available to all Americans. Americans should be encouraged to save for education and retirement.
- ▶ **Facilitate workplace retirement plans.** The employment-based retirement system is a proven and effective means of increasing savings. Of the \$10 trillion in the U.S. retirement system in 2003, more than \$4.5 trillion has been put aside through the use of private employer-sponsored retirement plans, including defined benefit and defined contribution plans. Policies that encourage the growth of retirement plans are essential; the recent enactment of the Pension Protection Act of 2006 is a historic step in the right direction.
- ▶ **Enhance financial literacy.** One of the most basic elements of savings is understanding the need to save. Yet financial literacy is deficient across all generations and socioeconomic levels. Savings would be materially enhanced if Americans across all socioeconomic classes were more financially literate.

In no small part, the U.S. trade deficit is a result of lack of consumption abroad [T]he United States cannot be the sole engine of growth in the global economy.

Equally important is continued progress in reducing the federal budget deficit and addressing the longer-term growth in entitlement spending, which would otherwise result in significant future budget imbalance.

- ▶ While in the near term federal budget deficits appear manageable, over the longer term the growth in entitlement spending, primarily Social Security, Medicare and Medicaid, threatens to overwhelm the budget and the economy. Significant reform is needed to control the growth of spending in entitlement programs.
- ▶ Timely, responsible action on entitlements and spending is necessary to maintain the foundation for the long-term growth of the economy.

PROMOTE GROWTH AND CONSUMER DEMAND ABROAD

To help eliminate the trade deficit, we must encourage economic growth and increased consumer demand abroad. In no small part, the U.S. trade deficit is a result of lack of consumption abroad because of long periods of stagnant economic growth in Japan and some of our primary European trading partners, such as Germany. These same countries also have far more savings than could possibly be used by the low investment rates in their slow-growing economies.

These excess savings have had the beneficial result of providing investment capital for the safe and growing U.S. economy, but they also underscore that the United States cannot be the sole engine of growth in the global economy.

The U.S. government must continue to develop and implement policies to promote international economic cooperation, including policies that convince other countries to adopt trade, fiscal, monetary and regulatory policies that will stimulate their own economic growth. These include:

- ▶ **Encourage economic growth abroad.** The United States should encourage its trading partners to adopt economic policies that increase their economic growth and consumption. There are some signs that foreign economies are emerging from their economic slump. Japan is finally rising from its persistent recession and has increased its own central bank interest rate from zero. Leading European economies also have begun posting stronger economic growth.
- ▶ **Open markets for U.S. goods and services.** Improving markets for overseas U.S. sales of goods and services will help shrink the deficit by growing U.S. exports. This requires convincing our trading partners to reduce trade barriers and open their markets. The United States should continue on the path of negotiating bilateral and multilateral agreements that achieve meaningful market opening for U.S. exports.

ENERGIZE EFFORTS TO FORCE GLOBAL REVALUATION OF CURRENCIES

The U.S. current account deficit is exacerbated by policies of numerous trading partners that keep the value of their currencies artificially low in relation to the U.S. dollar. Currency market intervention by China, Japan and Korea helps keep their currencies undervalued in relation to the U.S. dollar. Such policies make U.S. goods artificially expensive in those foreign countries and make goods from those countries artificially cheap for American consumers. For instance, in the auto sector, an artificially weak yen results in thousands of dollars of price advantage for Japanese exports.

As part of a package of policies that include increasing U.S. savings and strengthening the international trading system, the United States should continue to work with Asian economies and the IMF to ensure that they stop intervening in currency markets to manipulate trade flows.

A recent positive development is the April 2006 decision of the IMF board of governors empowering the IMF to address global current account imbalances in a comprehensive manner. These multilateral consultations will need strong, high-level support in Washington and other major capitals to be successful.

Another important step would be to have China become part of the G-8. As the world's second largest economy, China should be included in the international economic architecture. China also should have greater responsibilities, and thus a larger role, in the IMF. These steps would facilitate closer coordination of economic policy between China and the world's other major economies. If properly managed, G-8 membership and an expanded role at the IMF could help transform what are now U.S. bilateral demands that China revalue its currency to shared responsibilities.

Identify and Eliminate Disincentives to Trade and Investment

The administration should ensure that other policies are not inadvertently creating disincentives to trade and investment and that appropriate incentives are being provided. In the Trade Agreements Act of 1979, Congress recognized that a wide range of government regulations and programs can serve to either discourage or promote exports, and it required the president to review all such regulations and programs.⁴⁸ This prompted the most comprehensive review of its kind undertaken and served as a basis for action.⁴⁹

Congress should work with the administration in organizing a similar study today to catalogue current disincentives and incentives to U.S. exports as a basis for executive and legislative action. The study also should look at disincentives to inward trade that undercut the competitiveness of U.S. consuming industries, as well as disincentives to inward investment, such as inappropriate regulatory burdens that may lead foreign companies to invest elsewhere.

Revitalize the Congressional-Executive Relationship on Trade Negotiations

Congress should renew TPA as a vital tool for continued American international economic leadership; it is due to expire in July 2007. The president and Congress should work together to craft an enduring solution to TPA renewal that gives both branches, on a bipartisan basis, the tools necessary to provide global leadership in developing international trade and investment policies and guiding negotiating objectives.

If TPA is not renewed, America's ability to negotiate important bilateral, regional and multi-lateral agreements will be severely compromised. Our ability to open global markets to our industrial goods, agricultural products and services will be diminished, and we will risk losing market share to our global competitors. We also will lose an important tool to anchor U.S. strategic influence around the world.

Between 1994 and 2002, when the president did not have this authority, the United States fell dangerously behind in negotiating FTAs and investment agreements, causing U.S. businesses and farmers to lose market share in Latin America, Africa and Asia and leadership mantles in these key regions. Since TPA was renewed in 2002, the United States has kept pace with foreign competitors and helped level the playing field for U.S. companies and their workers.

Today, with the Doha Round in serious question; unfinished negotiations with key countries in Asia, Africa and Latin America; and the pressing need for new initiatives highlighted in this policy paper, the need for TPA has never been greater.

If TPA is not renewed, America's ability to negotiate important bilateral, regional and multilateral agreements will be severely compromised. Our ability to open global markets ... will be diminished ... and [w]e will ... lose an important tool to anchor U.S. strategic influence around the world.

IX. Conclusion: There Is No Time To Lose

If there is one word that summarizes our call to action on trade and investment policy reforms, it is this: urgency.

Both Congress and the administration must recognize the accelerating pace of global economic changes and raise competitiveness to a higher priority. Our competitors on every continent are surging ahead without us — concluding agreements among themselves, building new trade relationships that exclude us, and jeopardizing our economic and geopolitical leadership.

The United States and its companies and workers have faced foreign competition admirably in recent years — showing unequalled agility and strength in world markets and an ability to adapt to rapid changes that remains the envy of the world. We hope to see that same ability emerge from U.S. trade and investment policy decisions in the crucial months ahead, and American business leaders stand ready to help.

The time to act is now; there is no time to lose.

Endnotes

1. U.S. share of global GDP: more than 17 percent in 1948; 12.5 percent today.
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