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TRADE PROMOTION COORDINATING COMMITTEE

TPCC

DATE JUNE 10, 1994

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PLEASE SEE THE ATTACHED ADDITIONAL INFORMATION FOR THE TPCC PRINCIPALS MEETING TO BE HELD ON JUNE 14.

TRADE PROMOTION COORDINATING COMMITTEE

TPCC

June 10, 1994

MEMORANDUM FOR TPCC PRINCIPALS - See Distribution List

FROM: TPCC Secretariat

SUBJECT: June 14, 1994 Meeting TPCC Principals Meeting

Attached please find an additional background paper prepared by the Overseas Private Investment Corporation (OPIC), which will be discussed under the agenda item "Other Issues" at our meeting on June 14 at 2:00 p.m.

If you have any questions, please do not hesitate to contact us at (202) 482-5455.

TPCC PRINCIPALS DISTRIBUTION LIST

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OVERSEAS INVESTMENT
CREATING U.S. JOBS AND ECONOMIC GROWTH

Exports Follow Investment

American overseas investment plays a critical role in creating U.S. exports, jobs and economic growth.

Recent studies have shown a striking correlation between investment and exports (New York Times 7/7/93). According to one trade expert, "overwhelmingly, U.S. exports of manufactured goods go to countries where there is substantial U.S. direct investment presence." Investment here is defined as direct spending on business operations (e.g., acquisitions, plant construction, investment in operations) as opposed to portfolio investment (e.g., buying of securities or similar financial transactions).

Most international trade takes place not just between countries but between multinational companies and their overseas subsidiaries. For example, one-third of U.S. exports go to subsidiaries of American-owned operations overseas. This is because U.S. subsidiaries usually look to their parent companies and U.S. suppliers first when purchasing capital goods and production inputs.

American industries and firms with the greatest foreign investment maintain the highest rate of exports and also generate a large U.S. balance of payments surplus. During the 1980s, American multinational companies generated two-thirds of U.S. manufactured exports, primarily to their overseas affiliates, and contributed a yearly average U.S. balance of payments surplus of $83 billion. In 1990 alone, these exports generated 2.4 million in direct U.S. jobs and twice that figure when measured in direct and indirect American jobs.

U.S. export performance is strongest in product categories and geographic markets where multinational companies have significant investment positions. For many U.S. industries, the only way to maintain competitiveness in overseas markets is to invest and establish a presence.

The critical point is that these investments, not just low tariffs and open markets, are the engine for sales in foreign markets.

By Furthering Private Sector Investment, OPIC Creates U.S. Jobs and Exports

OPIC provides financing and political risk insurance to U.S. companies investing in emerging market economies and developing nations. Since 1971, the agency has supported investment in projects worth nearly $60 billion, generated $26 billion in U.S. exports, and created more than 100,000 American jobs. In the last fiscal year alone, OPIC-assisted projects supported $3.7 billion of investment in 37 countries, generated some $1.6 billion in American exports and created several thousand U.S. jobs.

Over the long-term, OPIC's efforts will make American businesses more competitive, create tens of thousands of jobs at home and abroad, generate billions of dollars in American exports, and further America's foreign policy and economic interests. Some examples include:

- In the Russian Federation, U.S. West is designing, constructing, and operating a cellular telecommunications network in St. Petersburg that will generate $26 million in American exports. OPIC issued $10 million in political risk insurance. OPIC is also offering financing and risk insurance to a second U.S. West investment project designed to upgrade telephone services elsewhere in the Russian Federation.

- In Uzbekistan, Newmont Mining Company is extracting gold with the support of $60 million of OPIC insurance. The Newmont investment will generate over $214 million in U.S. exports.

- In Colombia, OPIC supported the first Latin American power project financed on a non-recourse basis. With $35 million in OPIC finance and $100 million in insurance, K & M Engineering's natural gas-fired generating facility will produce $53 million in U.S. exports.

OPIC turns down ventures involving run-away plants. It refuses backing for projects that adversely affect the U.S. economy or local environment, or that fail to protect workers rights. OPIC maximizes the benefits to the U.S. economy from overseas investment by targeting assistance to projects that will generate the most U.S. exports and jobs, and to sectors and countries that are most critical for U.S. economic expansion.

In addition, OPIC now enjoys strong support from organized labor. George Kourpias, President of the International Association of Machinists, is a member of the OPIC Board. And the pension funds of U.S. labor unions comprise half the investors of the OPIC-supported Poland Partners Fund, designed to generate investment in that nation.

Citing trade and investment as the surest guarantee of long-term economic prosperity and nationa security, the President, Vice President, Secretary of State, and other senior U.S. Government officials ha repeatedly called on OPIC to expand its programs to meet current and future challenges facing the Unite States. For example, in FY93, the Trade Policy Coordinating Committee recommended that OPIC quadruple its per project lending limit and double its insurance limit -- to $200 million for each -- in order better serve U.S. interests in the developing and emerging markets. In fiscal year 1994, OPIC has been asked by the Administration to play a lead role in Russia and the New Independent States, South Africa, Gaza-West Bank, and Eastern Europe.

Certainly, there is no lack of market demand for OPIC services. Indeed, a large gap exists betwee supply and demand for project finance in markets not adequately serviced by private financial institutions. For example, while OPIC will offer $1.5 billion in financing in FY94, TPCC estimates that the worldwide potential for private sector investment is 300 times larger.

OPIC's effectiveness is measured by the amount of investment and benefits to the American econo it produces. For every $25 million in OPIC subsidy, the agency will offer $1 billion in financing that will generate $4.7 billion in total investment, $2.2 billion in U.S. exports, and 38,000 person years in U.S. employment.

Should Jeremy attend this?

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

MAY 26 1994

Alan is planning to attend

LDT
ASB
MN
File
JR

The Honorable Laura D'Andrea Tyson
Chair, Council of Economic Advisors
Old Executive Office Building
Washington, DC 20500

Dear Laura:

I personally want to invite you to attend the Principals meeting of the Trade Promotion Coordinating Committee (TPCC) on June 14, 1994. The meeting will last from 2:00-3:30 p.m. in Conference Room 5430 of the Department of Commerce.

Since the President announced our National Export Strategy at the White House in September, each of our Departments has committed significant time and energy to the implementation of this strategy. We have made steady progress in creating a more effective, aggressive, and streamlined export promotion and export finance program, which has been a key element in the President's economic growth message.

In advance of submission of our second Annual Report to Congress in September 1994, however, key decisions remain and much work still must be completed. It is important for us to address together a few key outstanding implementation issues such as resource allocation, as well as the TPCC's strategic direction over the coming year.

You will receive the formal agenda and discussion papers of the outstanding issues in early June. Please have your staff call Mary Juarez at (202)482-5455 to confirm your attendance.

I look forward to seeing you on June 14 to finalize the Administration's next steps in the TPCC process.

Sincerely,

Ron

Ronald H. Brown

I'll not be in town — Can Ross W go in my place please

L

cc: ASB
RW

TRADE PROMOTION COORDINATING COMMITTEE

TPCC

DATE June 9, 1994

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Please see the attached information for the TPCC

Principals meeting to be held on June 14.

TRADE PROMOTION COORDINATING COMMITTEE

TPCC

June 9, 1994

MEMORANDUM FOR TPCC PRINCIPALS - See Distribution List

FROM: TPCC Secretariat

SUBJECT: June 14, 1994 Meeting

Attached please find a copy of the agenda and background papers for the TPCC Principals meeting on Tuesday, June 14 from 2:00 - 3:30 p.m. in room 5430 of the Commerce Department. Please note that we have also included a copy of a draft memorandum from Director Panetta and Secretary Brown previously forwarded to the TPCC Deputies for comment. This document will form the basis of the resource allocation discussion.

If you have any questions, please contact the Secretariat at (202) 482-5455. Thank you.

Attachments:
- Agenda (1 page)
- Big Emerging Markets (7 pages)
- U.S. Export Assistance Center Network (2 pages)
- Export Controls (1 page)
- Trade Finance (2 pages)
- Resource Allocation Memorandum (4 pages)
- Outline Proposal for 1994 Report to Congress

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AGENDA

TPCC PRINCIPALS MEETING

JUNE 14, 1994

I.	INTRODUCTION
II.	BIG EMERGING MARKETS
III.	RESOURCE ALLOCATION
IV.	U.S. EXPORT ASSISTANCE CENTERS
V.	TRADE FINANCE
VI.	EXPORT CONTROLS
VII.	ADVOCACY
VIII.	1994 REPORT TO CONGRESS
IX.	OTHER ISSUES

BIG EMERGING MARKETS

The U.S. Government has traditionally focused its international economic and commercial policy on Europe and Japan. While the industrial nations will continue to be the largest U.S. markets for decades to come, another category of country holds far more promise for large incremental gains in U.S. exports. Of all the world trade growth in the next two decades, almost three-quarters is expected to come from the developing countries. But a small core of those nations, the ten largest economies, is likely to account for more than half of that growth. These are the "Big Emerging Markets" (BEMs).

A plan is needed that will take the United States through the beginning of the new century. We believe that the TPCC agencies, building upon the efforts detailed in the National Export Strategy, should examine ways to focus U.S. Government export promotion and finance resources on these Big Emerging Markets. An integrated commercial plan for each selected country can substantially boost the market share of U.S. exporters competing in these lucrative markets.

These ten BEMs share a number of important attributes. They are all physically large, have significant populations and represent considerable markets for a wide range of products. Virtually all have strong rates of growth, or clearly hold out the promise of economic expansion in the future. Virtually all have undertaken some significant program of economic reforms and seem likely to expand on those programs in the future. Virtually all are of major political importance within their regions; moreover, they are "regional economic drivers"--their growth will engender further expansion in neighboring markets.

While these criteria are not precisely scientific, and while each country may not measure up in every case, the Commerce Department identified the following candidates:

- in Asia--China, Indonesia, India, and South Korea;
- in Latin America--Mexico, Argentina, and Brazil;
- in Africa--South Africa;
- in Central Europe--Poland; and
- in Southern Europe--Turkey.

The list can be debated, of course, and the truth is that it continues to be refined and reevaluated.

U.S. exports to the BEMs totaled $106 billion in 1992, approximately a quarter of our exports. But while the ratio of Big Emerging Market gross domestic product to that of the industrialized world's is 1 to 4 today, it will be 1 to 2 in less than 20 years. BEMs are expected to more than double their share of world imports, as well, rising to nearly 27 percent by 2010. No other category of market shows such dramatic growth potential. During the past decade, the U.S. share of exports going to industrial countries has remained flat. During the same period, our share of exports going to developing countries other than those in this special category has actually gone down. By the year 2010, annual Big Emerging Market merchandise import levels will be roughly one trillion dollars higher than they were in 1990. That is only merchandise imports. Add services and it grows further still.

Complications and Competition

The BEMs will also be the competitive battleground of the future. Japan, Europe, and several developing countries can be expected to be fierce rivals in these markets. Pursuing our interests in these countries will require deft balancing of commercial and foreign policy considerations. It is in the Big Emerging Markets that commercial opportunities co-exist so closely with complications of human rights, worker rights, nuclear non-proliferation, and violations of intellectual property right laws.

The stakes are high but now is the moment to gain the advantage. Many of the big infrastructure projects which constitute the foundations on which these Big Emerging Markets will build their futures are being bid out now. Getting in early will offer returns for many years to come. That is yet another reason why it is essential that we begin implementing a strategy soon.

Strategy for Big Emerging Markets

Economic reform is central to the future of all of the Big Emerging Markets and the United States should focus on how to help. Reliable economic and financial information is at a premium in each, more so than in the developed world, and we should work with the BEMs to develop their capabilities in this regard. Infrastructure projects are particularly important, and any technical advice the United States can provide can be of great assistance. Technical assistance might also be useful to develop more sophisticated financial systems in these markets. The BEMs need access to U.S. markets in order to grow, and keeping our market open to fairly priced goods may be the single most important thing we can do for them.

Moreover, in the context of our National Export Strategy, the

TPCC should intensify its efforts to coordinate USG export promotion programs, Ex-Im Bank financing, insurance from the Overseas Private Investment Corporation, and feasibility studies from the Trade Development Agency. A TPCC Advocacy Coordinating Network, supported by the Advocacy Center at Commerce, focuses the Administration's efforts to help American firms win contracts abroad. Not surprisingly, many, if not most, of the targets are in the BEMs.

Of course, U.S. success in the Big Emerging Markets will not depend on any element of the program so much as the skill and perseverance of the Government, the willingness and commitment of the American business community to follow through, and the ability of the U.S. Government and corporate America to work in tandem.

The Sectoral Dimension

Part of the Congressional mandate for the National Export Strategy requires a sectoral, as well as a geographic, focus for our efforts. In addition, as we began explorations of the key opportunities within the individual Big Emerging Markets, one consistent target of opportunity became clear: infrastructure. Upon further examination, however, it also became clear that we were not talking about one particular sector, but rather a variety of sectors and groups of sectors, ranging from transportation to environmental technologies to financial services.

As a result, we have begun an effort aimed at identifying groups or clusters of industries for particular focus in our export promotion efforts within the BEMs. Like the BEMs themselves, the list of sectors is not static, but is instead an evolving one. Among the characteristics of such sectors are the potential for future growth and creation of a significant number of high-paying U.S. jobs, the extent to which U.S. industry is competitive internationally, the existence of Clinton Administration domestic policy initiatives that can be used to leverage an increase in exports, and the extent to which Governmental action in concert with the private sector can improve our international competitiveness.

Based on these and other criteria, we have identified, as a start, six clusters of economic activity for special consideration in our export promotion efforts. These are: environmental technologies, information technologies, health technologies, transportation technologies, energy technologies, and financial services. While we will continue to provide support in our export promotion efforts to the full range of U.S. industries in all our export markets, we will consider particular efforts in support of these clusters of industries--ranging from improved government analysis and information to tailored export promotion services like trade fairs and trade shows--in the Big Emerging Markets.

Specific Country Policy. The above measures constitute only part of a strategy. Because for all the attributes these countries share, their size and the consequent complexity of their systems, their divergent locations around the world, and the practical realities that often confound government programs all compel an approach to the BEMs the right way, the hard way--one at a time.

As a consequence, not one but ten strategies need to be formulated, each carefully tuned to the specific market in question. The process has begun of launching intensive, in-depth studies of each, identifying their strengths, potential problems, the approaches that competitors are likely to take. These studies will guide customized individual strategies. Already, a TPCC task force on Indonesia has developed a trade promotion strategy for this key BEM.

China. One of the most striking developments in East Asia in recent years is the emergence of a growing triangular economic relationship within the Chinese Economic Area (CEA), composed of China, Taiwan and Hong Kong. Since the mid-1980s, the growth of gross domestic product in the CEA has been among the fastest in the world. The CEA has the largest number and highest total dollar value (approximately $560 billion) of infrastructure projects on the drawing boards over the next seven years, and holds the world's largest foreign exchange reserves with which to pay for these projects.

Indonesia. A population of 188 million and a GDP projected to grow at 7 percent annually through the end of the decade, combined with a central position in the Association of Southeast Asian Nations (ASEAN), make Indonesia a regional economic driver, whose growth engenders further economic expansion into neighboring markets. Infrastructure projects again top the list of opportunities for U.S. businesses, with the Indonesian Government planning ambitious projects in power generation, telecommunications, air traffic and pollution control. Demand for consumer goods, particularly in Jakarta, is expected to grow fast. Private consumption, currently in the range of $75 billion a year, should exceed $100 billion by the year 2000.

India. Historically one of the world's most closed and difficult business environments, India has begun a measured but steady movement toward a more open, market-oriented system. As India's largest foreign trade and investment partner, this bodes particularly well for the United States. Indian imports from the United States rose by 44 percent last year to a record $2.8 billion. In 1993, the Indian Government approved approximately

$1.2 billion of U.S. investment or roughly equal to the cumulative investment for the last four decades prior to 1991. India's huge population of almost 900 million, with a "consumer" class of 100-250 million, and its diverse and relatively developed industrial base (the world's 12th largest) make it a market with potentially unprecedented commercial opportunities.

South Korea. Although Korea is our eighth-largest trading partner, with $14.6 billion in U.S. exports in 1992, it is also one of the most difficult markets in Asia for exporting goods and services, and for foreign investment. President Kim's five-year economic plan promises a "new Korea" of liberalized domestic economic and international trade policies to restore growth to 7 percent and double per capita incomes by 1998. This potential rise in income levels, combined with Korea's 44 million people, could make for an appealing and dynamic consumer market. Major project opportunities over the next several years include $20 billion in superhighway expansion, $12.5 billion for port expansion and construction, $15 billion for a new Seoul international airport, $2 billion in telecommunications projects, $50 billion in power projects and $12 billion in environmental projects.

Mexico. NAFTA's passage last November opens the door to the Mexican market for many U.S. firms. Mexico's 87 million consumers make it the 11th-largest market in the world. Mexico's economy is growing rapidly, pulling in durable goods and industrial materials to modernize infrastructure and plant facilities. Almost all of Mexico's imports of these materials come from the United States, which explains the 136 percent increase in capital goods exports to Mexico between 1987 and 1993. The biggest potential export sectors for U.S. products and services to Mexico are: environmental technology and capital equipment; telecommunications equipment; medical equipment; and infrastructure-related services and capital equipment.

Argentina. The Argentine market--33 million people with the highest per capita income in Latin America and an advantageous agriculture and natural resource base--was the world's third fastest growing for the past three years, representing significant opportunities for U.S. firms. In addition, the integration of the economies of Argentina, Brazil, Paraguay, and Uruguay into the "Southern Common Market" (Mercosur) by 1995-96 will create a broader potential market of 200 million people. Major export opportunities will arise in the following sectors: mining, gas and petroleum exploration and development, processed foods and beverages, health and medical services, environmental products and services, communications equipment, and tourism-related equipment.

Brazil. In 1990, the Government of Brazil began significant market liberalization efforts, lowering import duties from over 100 percent to a current average of 14 percent and reducing trade and investment barriers. Liberalization policies continue under the current Franco administration, albeit at a slower pace. Brazil's GDP grew by 4.5 percent in 1993, dampened by inflation and economic uncertainties. U.S. exports to Brazil amounted to $6 billion in 1993, placing Brazil among our top 20 export markets in the world. The United States continues to be the top supplier to Brazil, accounting for almost one-third of total Brazilian imports. Brazil's telecommunications and informatics markets offer tremendous potential for U.S. equipment manufacturers and service providers. Brazil's energy sector also offers significant potential for U.S. technology and equipment. In addition, state and municipal governments in Brazil have undertaken major environmental and infrastructure projects.

South Africa. With the elections on April 27, a government of national unity is expected to emerge that will rule South Africa for five years. All the major political parties in South Africa have expressed a clear unwavering commitment to encouraging U.S. firms to return to the South African market, and ANC president Mandela has made several appeals to the American business community to explore commercial opportunities in South Africa. South Africa's $20 billion import market should expand as its economy emerges from four years of recession and as business confidence solidifies. The United States 14 percent market share should increase as remaining state and local sanctions are repealed. South Africa is the economic powerhouse of the African continent, boasting a GDP of $114 billion and a global trade surplus of nearly $1 billion. With the lifting of sanctions by other African countries, foreign and domestic companies view South Africa as a springboard to regional markets.

Poland. Starting in 1990, Poland adopted a "shock therapy" approach to economic reform, abolishing controls and instituting tight monetary and wage policies. The reforms have led to an explosion of private entrepreneurial activity. By dint of its 38 million people, 1993 GDP of $85 billion and strategic location, Poland is easily the most important single market in Eastern Europe. Poland remains the United States principal trading partner in the region, buying $1 billion of U.S. exports in 1993, and U.S. investment in Poland amounts to another $1 billion. Poland's GDP growth is expected to reach 4.5 percent in 1994. Promising sectors for U.S. investment include food and beverage production and distribution, electronics and telecommunications, energy, construction, and consumer products. U.S. exporters can expect the most fertile ground for their wares in the aircraft, computer hardware and software, telecommunications equipment, consumer goods and medical equipment sectors.

Turkey. Turkey has become an important market for U.S. firms.

Real GNP growth has averaged 5 percent annually since 1981, and, despite the worldwide economic slump, GNP grew by 7.5 percent in 1993. Turkey's foreign trade sector has surged even faster than the economy as a whole. U.S. exports to Turkey jumped from $540 million in 1980 to $43.4 billion in 1993. The Turkish Government strongly encourages foreign investment and has made major strides in the last decade to enhance the investment climate. Major infrastructure projects include the $30 billion Southeastern Anatolia Project, an extensive complex of dams, hydropower plants, and irrigation infrastructure development such as airports and highways. The market for telecommunications is expected to expand to $1.5 billion by 1995. The market for pollution control equipment is estimated at $325 million and growing rapidly.

U.S. EXPORT ASSISTANCE CENTERS

The Export Enhancement Act of 1992, the GAO and the Trade Promotion Coordinating Committee (TPCC) called for the creation of "one-stop shops," now known as U.S. Export Assistance Centers (USEACs). USEACs combine the export marketing counseling of the US&FCS with the trade finance assistance provided by EXIM and SBA. Through co-location and cooperation with local public and private export service partners, the USEACs increase the depth and range of export services available to clients and promote a more rational and integrated delivery network. The participating Agencies opened four pilots in Baltimore, Chicago, Long Beach and Miami for business on January 31, 1994.

Current Operations

- USEAC staff have begun providing value-added joint counseling sessions which have generated additional business for the participating agencies. In Baltimore, the Exim City-State partner submitted $16.8 million in applications to EXIM for foreign credit insurance and other loans in March alone. EXIM reports that the co-location with the DOC has nearly doubled the pool of qualified applicants for its finance programs.

- On April 6, Vice President Gore recognized the success of the project when he presented the USEACs with a Hammer Award for Excellence in Reinventing Government.

Future Plans for the USEAC Network

- The participating agencies have developed a two-tiered methodology for the selection of future sites based on both quantitative and qualitative criteria. Quantitative criteria, which include volume of exports, number of manufacturing establishments and number of service establishments, have been incorporated into a resource allocation model to first identify the states and second, the cities which hold the greatest export potential. While the quantitative methodology provides us with an objective ranking of sites based on export potential, qualitative factors such as the existence of trade infrastructure (e.g. ports), the opportunity to leverage resources with state, local and private partners and the presence of DOC, SBA and EXIM offices in the region will adjust the ranking to reflect cost and service efficiencies.

- The TPCC Report recommends that the agencies identify ten additional sites to be opened in CY '95. To make the best use of our limited resources, we have designed a national network of regional and district USEACs. We are in the process of selecting additional regional sites as the second step toward the creation of this network. We have also identified locations for the district USEACs to complete our "hub and spoke" design.

- In addition to creating USEACs, we plan to modernize the entire domestic network to provide advanced telecommunications and computer technology and to develop greater cooperation with state and local partners in order to extend export marketing and trade finance services across the country. This comprehensive approach will better serve the administration's goal of job creation through exports.

EXPORT CONTROLS

Over the last year, the Clinton Administration has made major progress in eliminating unnecessary and ineffective controls and streamlining the export control process, while improving the implementation and enforcement of those export controls which are still required by U.S. security and policy interests. This action has ameliorated a significant obstacle to exporting.

- <u>Computers</u>: In September 1993, the United States controlled the export of computers operating at over 12.5 MTOPS (million theoretical operations per second--a measure of the processing speed of the computer). This control level required licensing authorization for almost any computer above the level of a desktop personal computer (PC) and even caught some PCs. The TPCC announced that steps would be taken to raise the control level for computer exports to most destinations to 500 MTOPS. When fully implemented, this action would free about $30 billion of computer exports per year from the requirements for licensing.

  The Administration has met its goal and in some respects has exceeded it. Today, computer exports only need specific authorization if the performance is above 1000 MTOPS, if the shipment is destined to a relatively few countries of nuclear proliferation concern, or if it is bound for military end-users in certain countries. The 1000 MTOPS level for individual validated export licenses is applicable to Russia and China--two rapidly emerging markets with great potential for the future. This 1000 MTOPS level was made possible by the implementation of a new general license--"GLX"--which recognized the changed security threat which was symbolized by the termination of CoCom.

- <u>Supercomputers</u>: A year ago, the definition of a "supercomputer" for export control purposes had been overtaken by technology and was hopelessly out of date. The TPCC proposed to increase the definition of a supercomputer from 195 to 2000 MTOPS. As required by our international commitments, the Administration discussed this matter with the Japanese. On December 10, the Japanese agreed, as an interim measure, to move the supercomputer threshold to 1500 MTOPS. We are pursuing further negotiations with the Japanese to attain the 2000 MTOPS threshold.

- <u>Telecommunications</u>: We have eliminated the need for prior authorization of most telecommunications equipment to most destinations and end users. American telecommunications manufacturers can now compete on an even footing in such large potential markets as China and Russia. This fulfills the promise of the TPCC report and even goes beyond it.

- <u>Procedural reform</u>: The Administration has taken significant steps to implement the TPCC's procedural reforms of the export control system. The gridlock of the past has been addressed. The Administration has also recommended further reforms in its proposal to Congress for a new Export Administration Act (EAA).

TPCC 1994: SUMMARY OF TRADE FINANCE INITIATIVES
TRADE FINANCE WORKING GROUP

1. PROJECT FINANCE

The TFWG has attempted to gauge the size and nature of the project finance market to determine the likely level of demand for this highly specialized and complex financing to be encountered by the USG and other public and private sector sources. Within this framework, existing and potential gaps in USG support that either do or could inhibit US exporters ability to compete are identified along with possible solutions to fill these gaps.

2. MULTILATERAL DEVELOPMENT BANKS

As a follow-on to the 1993 TPCC MDB recommendations regarding the large export potential currently untapped by US exporters, the TFWG focused on developing specific actions to enhance the immediate and ongoing quality and timeliness of the dissemenination of information to US companies regarding MDB opportunities.

3. SMALL BUSINESS

With the recent development of the Exporter Database (Bureau of the Census/Commerce), the USG has a major tool with which it can better understand the current and potential impact small business exports has and could play in the total US export picture, and the nature and scope of financing needs encountered particularly by small buisness -- ultimately enabling the USG to be in a position to provide programs that will actually benefit small business exporters. Accordingly, the TFWG is contemplating a set of comprehensive recommendations aimed at developing and maintaining a definitive and current "book of knowledge" regarding small business financing needs to be used to offer specific and beneficial programs that are also competitive with other ECA programs for small business.

4. UNTIED AID

While the use of tied aid has decreased in recent years due primarily to agreements reached within the OECD, our foreign competitors' use of untied aid in developing countries has grown considerably, quite possibly to gain commercial market share. A proposal was recently presented at the OECD that calls for greater global untying of aid dollars and transparency. In the meantime, however, untied aid continues and generally to the disadvantage of US suppliers who might otherwise benefit from these opportunities. While the TFWG believes that the development of negotiating positions would be best handled at senior USG level, there are a number of actions which the USG could take that would support the USG positions. Accordingly, the TFWG is developing a set of specific recommendations aimed at: (1) elevating the issue of untied aid within both the USG and the OECD, and (2) developing the means for the USG to routinely gather and disseminate more timely and accurate information and intelligence regarding untied aid transactions and trends, and documentation of specific cases.

5. MARAD: PR 17

PR 17 directs Eximbank to ensure that goods financed under its long-term programs are shipped on US flag vessels subject to availabilty, capacity and reasonable cost. In the event that a US exporter cannot engage the services of a US flag vessel, the Maritime Administration will consider granting waivers if a finding is made that one or all of these factors prohibit the use of US vessels. There are two types of waivers that are available: one is referred to as a general waiver whereby 50% of the cargo generated by a loan/guarantee may be shipped in vessles of the recipient country. The other waiver, known as a statutory waiver permits a specific shipment to be made on a foreign flag vessel if a US flag vessel is not available at a "reasonable rate"* or if the vessel cannot accommodate the cargo.

The issue that has been presented to Eximbank is that for large/major projects that involve large pieces of equipment, there is a very limited/no supply of US flag vessels physically designed to accommodate these size requirements. Moreover, major projects have long lead times yet bid packages need to include all costs so the US exporter can present a comprehensive package to the foreign purchaser for consideration up front. The problem that these US companies face is that the pricing differential between US vs. foreign flag shipping can be quite substantial with the foreign flags costing anywhere from 5 - 20% less than US. Thus, a US exporter can either factor in US vessel shipping costs and run the risk of its bid price being uncompetitive, or it can include a foreign flag price and run the risk of cost overruns or loss of profit. Hence, a preliminary proposal has been developed that would allow MARAD to consider a project waiver rather than require a shipment by shipment waiver.

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* reasonable rate is defined by the Maritime Administration as a "US reasonable rate" irrespective of rates charged by foreign flags.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

June 8, 1994

Memorandum for TPCC Deputies

From: Harry G. Meyers HGM
Chief, Commerce and Justice Branch
Office of Management and Budget

Subject: Draft Guidance for FY 1996 TPCC Budget Cross-Cut Process

Christopher F. Edley, Jr., Associate Director for General Government at OMB, has asked me to solicit the views of your agency on the attached draft letter that would provide a mechanism to implement Section 201 of the Export Enhancement Act of 1992, directing the Trade Promotion Coordinating Committee to produce a unified export promotion budget for the United States.

We would appreciate a response from you by 4:00 p.m. Friday, June 10 so we can consider placing this memo on the agenda of the TPCC principals meeting on June 14th. The substance of this draft memo <u>will</u> be discussed at the principals meeting, so please share this memo with your principal.

Please provide specific edits and word changes where applicable. Direct your responses to the attention of Ann Burget, FAX 395-1150. For further information you can contact either Ms. Burget at 395-3025, or me at 395-3918.

Thank you very much.

MEMORANDUM FOR TRADE PROMOTION COORDINATING COMMITTEE MEMBERS

From: Leon E. Panetta
Director, Office of Management and Budget

Ronald H. Brown
Secretary of Commerce and
Chairman of the Trade Promotion Coordinating Committee

Subject: Guidance for FY 1996 TPCC Budget Cross-Cut Process

As you know, the Trade Promotion Coordinating Committee (TPCC) is intended to channel your expertise and influence as key policy officials from agencies involved in Federal programs related to export promotion, to coordinate and focus our National Export Strategy. Further, the TPCC is mandated by the Export Enhancement Act of 1992 to undertake certain endeavors, namely to "establish a set of priorities for the Federal activities in support of United States exports and explain the rationale for the priorities," and to "propose to the President an annual unified Federal export promotion budget that supports the plan for priority activites" (15 USC 4727 Sec 2312(c)(4)). The TPCC's September 30, 1993, report "Toward a National Export Strategy" committed the Administration to produce such a unified budget.

Given the reality of tight budgets, it is essential that we support the programs that have the most potential for advancing the Administration's agenda in this area. We believe that the TPCC can help guide the Administration in identifying key initiatives and providing useful input to the FY 1996 budget decision-making process.

We request that all TPCC members submit to the TPCC Secretariat no later than July 1, 1994, what you believe to be the key policy and programmatic initiatives that support the Administration's goals in advancing our National Export Strategy. Submission should include a discussion of your agency's current programs, incorporating those proposed for FY 1995, interagency programs, and new initiatives contemplated for FY 1996. The suggested format for these submissions is attached. The initial submission should not include budget figures, but rather should focus on programmatic content.

During the summer, the TPCC members will review these submissions and convene a series of working groups to develop a position on the policies and programs essential to fulfilling the Administration's goals for export promotion in FY 1996. This document should also include recommendations of TPCC performance measures to assist in evaluating the effectiveness of different initiatives. The report will be reviewed by the TPCC principals.

We request that by September 16, TPCC members submit to the TPCC Secretariat an update of their July submission that reflects the agency's FY 1996 budget request to OMB and any new program priorities (it should reflect the agency budget submission to OMB and should include the requested funding levels.) The TPCC will then evaluate and prioritize these new initiatives from a cross-cutting perspective based on its previously developed consensus priorities. In addition, the TPCC will identify any essential programs and initiatives absent from Departmental submissions.

The outcome of this process will be guidance from the TPCC principals for consideration by OMB in its development of the President's FY 1996 budget. This final product should encompass the entire National Export Strategy and will include at least two "packages" of funding options, one at the total FY 1995 enacted levels, and another at the FY 1996 agency request levels. In addition to these two funding packages, the TPCC may suggest a number of other funding alternatives that vary from the level of funding compared with the FY 1995 enacted and the FY 1996 agency request levels. This guidance from the TPCC principals will be provided to OMB no later than October 24, 1994.

We believe that the Administration has an excellent opportunity to use the expertise and experience embodied in the TPCC to fulfill the Administration's National Export Strategy. Clearly, this is an evolutionary process, building on the frameworks developed this past year. Thank you for your assistance.

Attachments

U.S. DEPARTMENT OF GOVERNMENT
FY 1996 EXPORT PROMOTION PROGRAMS

Base Programs

- Include name of program, a description of up to one paragraph, and a contact person.

Interagency Initiatives

- Include name of program, a description of up to one paragraph, and a contact person.

New Initiatives

- Include name of program, a description of up to one paragraph, and a contact person.

Overall Priority Ranking of Programs

- (Include Base, Interagency, and New Programs)

Note: July submission will not include numbers. September revision should be updated to reflect Agency budget submissions and include funding levels. The format of the final October product will follow at a later date.

OUTLINE PROPOSAL -- 1994 TPCC REPORT TO THE CONGRESS

I. The Export Imperative: Include a quantification of what key U.S. agencies have done to increase exports and the support TPCC has received from the President, Congress, and the exporting community.

II. Building a National Export Strategy

A. Framework for Action: implementing the 65 recommendations in the 1993 Report

1. Strengthening partnerships to promote trade:

    a. advocacy

    b. leveraging private sector resources (e.g., privatization of trade events and dissemination of commercial information through private sector sources)

2. Helping small- and medium-sized business: (e.g., USEACs, working capital program reform)

3. Removing obstacles to exporting: export controls and product standards

4. Improving access to trade financing

5. Enhancing USG trade promotion overseas: commercial strategic plans

6. Creating U.S. jobs and promoting a better environment: the TPCC Environmental Exports Strategy

7. Allocating resources strategically

B. Focusing on Targets of Opportunities -- new initiatives over the last year

(In the introduction, describe USG trade promotion activities in traditional markets (e.g., Germany and Japan) and set THE stage for discussion of new directions (i.e., the BEMs).)

(Include a comparison of what foreign competition is doing.)

1. Defining the Big Emerging Markets (BEMs)

   a. Regional Strategies
      1. Asia
      2. Latin America

   b. Country Strategies

   c. Sectoral Strategies with the BEMs

2. Alliances with Economies in Transition

   a. The Middle East

   b. Russia and the NIS

   c. South Africa

3. Trade in Services (includ. tourism)

4. Trade and Investment

III. An Agenda for the Future: A Commercial Policy

EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

WASHINGTON, D.C. 20500

MEMBER

November 18, 1993

MEMORANDUM FOR LARRY SUMMERS (Treasury)
STROBE TALBOTT (State)
NICK BURNS (NSC)
DAVID LIPTON (Treasury)
TOM SIMONS (State)
GRAHAM ALLISON (Defense)
JOAN SPERO (State)
BO CUTTER (NEC)
JEFF GARTEN (Commerce)
GORDAN ADAMS (OMB)
LEON FURTH (OVP)
RUFUS YERXA (USTR)
DAN SPECKHARD (State)

FROM: JOE STIGLITZ

SUBJECT: US trade policy toward Russia

Please find attached a brief memo on trade issues raised by Russian policy-makers during my recent trip to Moscow.

US Trade Policy and the Reform Effort in Russia

Russian policy-makers' views on trade

During my recent trip to Moscow, I met with several high-ranking Russian Government economic policy-makers, including Yegor Gaidar (First Deputy Prime Minister for Economics), Andrei Illarionov (Chief Economic Adviser to the Prime Minister), Sergei Vasiliev (Director of the Center for Economic Reform), and Sergei Alexsashenko (Deputy Finance Minister). All of them stressed that improved market access to the developed economies was crucial to Russia's reform effort.

Gaidar was particularly concerned by US policy. He expressed his frustration with the United States for simultaneously imploring Russia to undertake rapid reforms but then imposing-- or at least threatening to impose-- anti-dumping duties or other trade restrictions whenever Russia was successful in exporting goods to the US. The US, he noted, strongly supported liberal market access and free trade policies in principle, especially as a guiding principle for Russian reform. But at the same time, the US seemed all too willing to commit apostasy in the face of any domestic political pressure for protection.

Gaidar stressed that the US national interest was best served by low prices of imported inputs (such as the raw materials which constitute the vast majority of Russia's exports) and suggested that few US jobs were at stake in US-Russian trade disputes. Most of the cases, he added, did not satisfy the typical economic definition of dumping (i.e., selling the same product abroad for less than it is sold domestically). In fact, for many goods, Russian domestic prices were <u>lower</u> than the world price because of export restrictions. Imposing anti-dumping duties on Russian goods was thus contrary to both the US national interest and to the usual definition of dumping.

Gaidar expressed even stronger reservations about quantitative trade restrictions, which were particularly harmful to the reform process. It is a difficult political task, Gaidar emphasized, to move the Russian economy away from a quantitative allocation system, as the G-7 and international financial institutions have urged. When G-7 countries impose quantitative trade restrictions on those few industries which have successfully found markets in the West, the political difficulties are compounded substantially.

If any trade restrictions were necessary, Gaidar noted, he would strongly prefer price-based mechanisms (such as taxes or even anti-dumping duties) rather than quantitative restrictions. But he added, once again, that these were a vastly inferior second-best policy-- for both the US and Russia-- compared to free trade.

CEA Analysis and Policy Suggestions

The Council of Economic Advisers strongly concurs with Gaidar's analysis. Free trade is in the US national interest, both in terms of domestic economic welfare and also foreign policy considerations. When political considerations force us to resort to trade restrictions, we should adopt interventions which are the least damaging to the US and to reform in Russia (both economically and politically).

A. Economic welfare. The United States is a net importer of most of the raw materials and other semi-processed goods which Russia exports. When increased Russian exports put downward pressure on the prices of these goods, US firms which sell the same goods suffer. But US firms which use the goods as inputs in the production process gain. Since the US is a net importer of these goods, domestic consumption is, tautologically, higher than domestic production. The "savings" from a lower price (for domestic consumers) are therefore larger than the "costs" of a lower price (for the domestic import-competing sector). In effect, domestic consumers benefit from transfers from both domestic and foreign producers. The US as a whole benefits (effectively, our terms-of-trade improve).

Many industries which appeal for protection claim that Russian exports result in a loss of US jobs. But the beneficial impact of Russian exports for other US exports should reveal the fallacy in this jobs argument. The primary effect of increased Russian exports is a shift in US jobs (away from the import-competing sector and toward the industries which use the good as an input), not a loss in jobs. In the current aluminum dispute, for example, the continuation of large export flows from Russia may result in the closure of several US smelters. But other US industries-- from auto manufacturers to soft-drink bottlers-- gain from the lower prices engendered by Russian exports. The net impact of the exports on the total number of jobs in the US is unlikely to be significant, and may well be slightly positive.

B. Foreign policy. On the eve of visits to Russia by both Vice President Gore and President Clinton, we must be extremely sensitive to the foreign policy implications of our trade policies. Market access issues have been raised in the past by both President Yeltsin and Prime Minister Chernomyrdin, and it is likely that they will be discussed during the imminent trips of the Vice President and President.

Our fundamental foreign policy objective in Russia is to speed the process of reform and democratization. In support of this objective, we have pledged (and provided) substantial amounts of aid and technical assistance. It is at best incongruous, and at worst completely counter-productive, for us to provide aid while effectively precluding Russia from exporting to us. As a source of hard-currency, marketing skills, and diversified production, exports are crucial to the reform process-- much more so than aid. Exports have been the key to success in virtually every economic success story. Furthermore, we lose a lot of credibility by ostensibly advocating free trade (and insisting that the Russian Government resist domestic political pressure for protectionism) but then imposing trade restrictions whenever our domestic import-competing industries complain. A policy of "aid not trade" undermines both our foreign policy objectives and our credibility.

If negotiated trade restrictions are absolutely necessary for political reasons in the US, we can still design them in a manner which mitigates the negative impact on Russia and therefore on our foreign policy objectives. Price-based mechanisms are preferable to quantitative measures; taxes are at least more market-friendly than output or export restraints, since they allow supply behavior to respond to changing economic conditions. And Russian reformers have clearly indicated that in their domestic political struggles, imposing a tax is vastly preferable to imposing a quantitative restriction.
Thus, a quantitative restriction is extremely deleterious to reform for both economic and political reasons: economically, because it fails to allow supply and export behavior to respond to changes in market conditions, and, politically, because it engenders corruption and bolsters domestic proponents of central-planning. Quantitative restrictions stultify both the reforms and the reformers.

<u>Policy conclusions.</u>

1. For both economic and political reasons, the general presumption of our trade policies should be to avoid restricting exports from Russia. If negotiated trade restrictions are absolutely necessary, we should focus on designing taxes (such as export, energy, or environmental taxes) rather than quantitative measures.

2. Negotiated trade restrictions are often undertaken in order to avert the imposition of anti-dumping duties. For so-called non-market economies like Russia, the process used to determine whether dumping has occurred, and the size of the dumping duty if it has, is extremely biased. The European Union has recently reformed its anti-dumping laws to address the

special needs and problems of the "economies in transition." In light of this, it seems necessary for us to reconsider the broader range of our trade policies toward the economies in transition.

9420192

United States Department of State

The Deputy Secretary of State

Washington, D.C. 20520

September 7, 1994

MEMORANDUM FOR: BRIAN ATWOOD
ADMINISTRATOR
AGENCY FOR INTERNATIONAL DEVELOPMENT

AMBASSADOR TOM SIMONS
COORDINATOR
U.S. ASSISTANCE TO THE NIS

SUBJECT: TRADE AND INVESTMENT INITIATIVE

As I mentioned at the Policy Steering Group meeting, we have had an excellent record of resolving NIS assistance issues by consensus. This is a testament to you and all those who work on the assistance program. It is rare that I am in the position of having to choose between sides in a dispute.

That said, after hearing the debate on Thursday, I understand why it has been so difficult to reach agreement on the issue of how best to fund this initiative. Everyone appears to accept the central role for private capital in supporting economic restructuring and the need to move as quickly as possible in promoting and attracting greater investment in Russia and the NIS. At the same time, there is recognition that both creating the institutional foundations for a market economy and directly supporting U.S. businesses are important elements to this strategy. The problem is how to do so within extremely tight budget constraints.

After carefully reviewing the matter, I believe OPIC and TDA should be allocated the additional funds recommended by the Coordinator. In making the decision, I was not particularly swayed by the relative merits of paying for the initiative out of FY'94 versus FY'95 funds. Rather, I was concerned that sufficient resources should be provided to OPIC and TDA to continue to respond to the growing demand from U.S. businesses. While I understand the "pushing on a string" analogy made by Brian at Thursday's meeting, I believe the joint ventures created through the OPIC and TDA programs can play an important role in creating business success stories that will build public support for reform in Russia and serve as harbinger of an economic renewal.

Creating new constituencies in Russia will also be key to encouraging the Duma, Federation Council, and regional and local governments to adopt the market reforms and advice being supported by our technical assistance program. Finally, while we can work with our European partners on sharing the burden of the technical assistance program, only the U.S. can provide direct support to U.S. businesses to encourage them to invest during this transitional period.

This decision should not be interpreted as a rejection of AID's urging that we must build market infrastructure. I agree wholeheartedly with Brian's assessment of the importance that creating the institutions and enabling environment will play in the economic future of Russia and its ability to attract private capital. For this reason, I am concerned over the effect of scaling back some of AID's private sector programs.

To see what can be done to address this problem, I would ask the Coordinator's Office and AID to prod the Europeans to take a greater role in supporting some of these vulnerable activities, particularly in the areas of post-privatization, capital market development, and housing reform which were highlighted in the paper. I would also like the two organizations to review the budget one more time to determine whether any additional resources can be found in other programs to accommodate an increase in AID's private sector activity. However, this should not be done at the expense of Gore-Chernomyrdin commitments or our important people-to-people exchange programs.

Since the Summit presents an important opportunity to highlight the new emphasis we are placing on expanding trade and investment in our bilateral relationship with Russia, I would also like the Coordinator's Office to work with AID and the other agencies to put together an FY 1996 Budget that highlights this commitment by September 21.

Strobe Talbott

Promoting Trade and Investment in Russia

Issue: How can we most effectively signal a new emphasis on trade and investment at the September Summit with President Yeltsin?

Areas of Agreement:

- Trade and investment are critical to generating the capital which Russia needs to restructure its economy.

- Significant barriers to trade and investment persist. While Russia secured about $1 billion in direct foreign investment in 1993, much smaller East European countries attracted two or three times this amount.

- We need a two-pronged strategy to realize trade and investment potential with Russia: (1) create a business environment that attracts foreign capital; and (2) directly support trade and investment ventures that produce tangible benefits for Russia and the U.S. Programs associated with these objectives are mutually reinforcing.

- The September Summit provides an opportunity to announce a significant NIS-wide initiative to boost U.S. trade and investment through funding for TDA, OPIC and Commerce programs. About 70 percent would be allocated to Russia.

Key Disagreement: How to finance a $100 million NIS initiative on trade and investment?

Options:

- **Option 1** (proposed by the Coordinator): Allocate $100 million solely from FY 1995 funds, $86 million from the FREEDOM Support Act (FSA) and $14 million from funds directly appropriated to TDA and OPIC.

- **Option 2** (proposed by USAID): Utilize FY 1995 appropriations ($65 million from the FSA, $14 million from TDA and OPIC) and $21 million in year-end FY 1994 funds that will soon be transferred to TDA and OPIC, but have never been announced or pledged.

Facts on the Options:

- The attached table outlines the impact of the two options on the FY 1995 Russia budget.

- Option 1 allocates $374 million in FSA funds to Russia, including $54 million for TDA and OPIC, and cuts about $29 million from direct support for private sector development and housing and municipal reform.

- Option 2 allocates $394 million in FSA funds to Russia, including $45 million for TDA and OPIC, and maintains a higher core budget for private sector development and municipal reform.

- Both options would allow the U.S. to meet commitments under the Gore-Chernomyrdin Commission.

- The $20 million difference in the total budget for Russia between Options 1 and 2 would fund TDA and OPIC in the other NIS at $24 millon rather than $12 million in order to reach the $100 million NIS total; transportation of humanitarian goods at $25 million rather than $20 million; and $3 million in other small program differences.

Rationale for Option 1:

- Allocation of $100 million from FY 1995 funds sends a clear, unambiguous signal that we intend to put new emphasis on direct support for trade and investment, reinforcing the Summit message of economic partnership with Russia. Commingling of FY 1994 and FY 1995 funds could be interpreted as double counting a portion of our overall FY 1994 budget that we already announced. This could vitiate the political message we wish to send. Any reference to the announcement of initiatives funded from two fiscal years at Vancouver does not apply since we needed to act quickly without new appropriations.

- Adequate funding exists for private sector development, even with increased OPIC and TDA funding levels. The $20 million in dispute is <u>not</u> critical to success in building Russia's new economic environment but <u>is</u> critical to the political objective we seek at the summit.

- Funds available to support private sector initiatives in Russia through FY 94 total $270 million. Option 1 proposes to add another $123.8 million in FY 1995, $110 million for private sector development and housing reform and $13.8 million for tax police reforms and bankers training. AID still has the flexibility to adjust program priorities within this FY 1995 budget figure to ensure that the most critical tasks for building a market environment, including in the housing area, are completed.

- The amount yet to be spent between now and 1996/97 on building the new market environment in Russia total $400 million. In light of what has already been accomplished with the limited expenditures to date (as of June 30, expenditures totalled $94 million), we believe that the Option 1 budget proposal provides ample funding for achieving our most critical objectives for a market environment in Russia. Should additional funds be necessary to advance key goals, closer coordination with other donors and international financial institutions should enable us to bridge any remaining gap in funding.

- Opportunity Costs:

  - Reducing **OPIC** funding from $60 to $45 million would eliminate about $245 in OPIC loan guarantees that would generally be matched by another $245 million in non-OPIC investment finance. OPIC has a pipeline of 25 investment projects that will be ready for financing in FY 1995 and loan requests of about $1 billion. Not all will come to fruition, but the actual investment to be foregone would be in the hundreds of millions.

  - Reducing **TDA** funding from $18 to $12 million would eliminate support for about 20 feasibility studies valued at approximately $12 million when company financial contributions are included. TDA's policy is to support projects that have the potential of generating a minimum of $10-15 million in U.S. exports. The trend line for the NIS, however, is not clear yet.

  - Reduced OPIC and TDA funding may also reduce pressures for reform from below by market-oriented Russian firms benefitting from the two programs.

Rationale for Option 2:

- The $20 million in dispute provides no additional political benefit for the summit, but it jeopardizes key strategic objectives in creating a market economy in Russia. The important issues for the Russians are (1) to get a clear and unambiguous signal that we will commit $100 million to trade and investment programs; and (2) that we will produce on our commitments. The issue of whether funds are drawn from the FY 1994 or FY 1995 budget makes no material difference as long as the funds have never been pledged or announced. Funds from various fiscal years were successfully commingled at the Vancouver Summit.

- $37 million has already been cut from technical assistance programs to finance the $57 million for TDA and OPIC proposed in option 2. Every assistance program has been scrubbed in conjunction with State staff and cut to the core.

- The FY 1995 funding level of $130 million proposed in option 1 for the private sector program in Russia is substantial. But the process of creating the structures for a private sector economy is far more complex than the phase I privatization of assets. Phase II is building the policy, legal, regulatory, and institutional framework for a competitive market system - a challenge that takes decades in most societies.

- Funds available to support private sector and economic reform programs in Russia need to be disaggregated to be understood. Of the $270 million available, about $75 million supports completion of the voucher privatization program; funds which will be fully expended in October. About $115 million is committed to post-privatization programs: creating capital markets, drafting commercial codes, creating Russian centers to support enterprise restructuring; launching the land privatization initiative; these funds will be spent by January 1995. About $50 million supports a regionally based small business/job creation program. The remaining $30 million supports tax policy reform, bankers training and technical assistance for accession to the GATT. For virtually all these programs, funds requested for FY 1995 will fund activities as FY 1994 funds are fully expended. No FY 1995 funding can be cut without materially reducing the scope of the economic reform program.

- Opportunity Costs:

  - **Capital Market Development.** Funding would be cut from $20 million to $10 million, restricting U.S.assistance to two out of Russia's five emerging regional capital markets. This would cut direct support for capital markets covering over three-fifths of the country, severely hindering ability to trade shares and raise investment capital for privatized firms in these areas.

  - **Post-Privatization Assistance.** Funding would be cut from $20 million to $10 million for 10 local privatization centers. The centers are currently the only vehicle to provide independent financial and management advice to restructuring enterprises. The U.S. invested $16.5 million to establish the centers. A $10 million cut would require closing 5 centers.

  - **Housing and Municipal Reform.** Funding would be completely eliminated. This program led to legislation that legalized housing privatization and privatization of 8 million housing units. Stopping the program would eliminate technical advice to mayors in three cities seeking to privatize housing and municipal services, as well as stop new pilots in construction finance. Government expenditure in this area accounts for about 40 percent of municipal budgets and must be rationalized to allow for new social safety net programs.

Other related programs:

- The U.S. has already committed over $450 million for three enterprise funds in Russia that will directly support private investment.

- In FY 1994, $300 million was transferred from FREEDOM Support Act funds to Eximbank for two years of program support in the NIS. Eximbank has used $225 million of that funding for offsets to loans in Russia and the NIS.

- In the coming year, the $90 million Commodity Import Program will be expended, providing a major impetus to U.S exports in Russia's oil and gas sector.

31-Aug-94

FY 95 Budget: Russia Options

PROJECTS	Opt 1	Opt 2
110-0001 Special Initiatives	$500	$500
110-0002 Energy	$28,000	$28,000
110-0003 Environment	$17,000	$17,000
110-0004 Health Care	$5,000	$5,000
110-0005 Private Sector	**$110,000**	**$130,000**
110-0006 Food Systems	$8,000	$8,000
110-0007 Democratic Reform	$26,000	$26,000
110-0008 Housing		**$8,700**
110-0009 Economic Restructuring	$13,800	$13,800
110-0010 Eurasia Foundation	$5,000	$5,000
110-0011 Enterprise Funds	$55,000	$55,000
110-0012 Exchanges and Training	$37,000	$37,000
SUBTOTAL	$305,300	$334,000
OPIC/TDA	**$54,000**	**$45,000**
Crime	$15,000	$15,000
TOTAL	**$374,300**	**$394,000**

19

Ch Com't Preliminary

These principles can be used to address the question, "Does ownership matter for trade policy?" There is an increasing concensus that there are significant gains to be had by establishing a liberal world trade order. We have emphasized that, in such a world, more than national treatment will be required; some measure of reciprocity is essential. Under such a regime, governments would, presumably, not treat products produced by firms owned by foreigners (regardless of where production occurred) any differently from products produced by those owned by nationals. Indeed, one can envisage a world in which, in the long run , asymmetries in ownership, trade patterns, and other linkages across firms firms based in different countries become insiginficant. In such a world, distinctions concerning the original nationality of the enterprise will also become of little or no importance.

We are, however, not yet in such a situation. This paper has been concerned with setting priorities, for, for example, export promotion. Other things being equal, how should....abroad? In the current situation, where there is a need to set priorities, we believe that they should be set in such a way as to maximize the impact on U.S. national income. This implies the following prioritization:

....

(6) Point about export creation versus export diverting not clear

Final par.

(Delete from While...to end)

Earlier, we set forth our goal of seeking reciprocity--establishing a roughly uniform set of regulations or standards applying to all firms in all countries. Such reciprocity should eventually be extended not only to regulatory actions, but also to trade promotion actions. If other countries treat American firms symmetrically with their own firms, there are strong arguments for the U.S. to reciprocate. The gains from establishing a *fair* international trading order outweigh the more immediate gains that might derive from promoting American owned firms.

p. 15

Add sentence:

The linkage between trade barriers and investment flows implies that careful attention must be paid to the sequencing of liberalization of goods and investment markets.

DRAFT

Council of Economic Advisers
Economic Policy Paper

July 1993

Principles to Guide U.S. Trade Policy: Market Access and Export Promotion Policies

TABLE OF CONTENTS

* Joe — please read these parts. I have inserted your material, but I am not yet satisfied with the National treatment vs. reciprocity part.

This must go out tomorrow.

Laura

SUMMARY

This paper sets out general principles and priorities that should guide U.S. trade policy regarding export promotion and the opening up of foreign markets. In the post-war period, U.S. trade policy has been guided by three broad principles, which remain valid today: (1) the promotion of U.S. economic interests; (2) the achievement of an open, multilateral trading system operating according to a clear set of rules and international code of conduct; and (3) the promotion of economic development in less developed countries.

During the last forty years, multilateral efforts to lower trade barriers have resulted in an unprecedented expansion of world trade and significant benefits to countries that have actively promoted trade. Efforts to open markets further, however, are facing increasing resistance because remaining impediments are often associated with policies that countries pursue for non-trade-related objectives. In many countries, such domestic policy interests have combined with groups which directly benefit from current protection to create a powerful obstacle to further trade liberalization. Given limited negotiating resources, the U.S needs to set priorities in its export-promotion and market-opening efforts.

From the perspective of economic policy, the principle criterion for setting priorities in export-promotion and market-opening should be: *What is the long-run effect on the U.S. economy, taking into account the benefits to workers, producers, and consumers?* This paper considers various trade-offs in the current economic environment and sets out some priorities for market-opening policies.

BACKGROUND AND PROBLEM STATEMENT

In the post-war period, U.S. trade policy has been guided by three broad principles:

(1) the promotion of direct U.S. economic interests;

(2) the achievement of an open, multilateral trading system operating according to a clear set of rules and international code of conduct; and

(3) the promotion of economic development in less developed countries.

On various occasions, trade policy has been used as an instrument of foreign policy, pursuing non-economic objectives. Examples include the U.S. grain embargo against the Soviet Union and the international embargo of trade with South Africa. Such uses of trade policy to further non-economic interests must be judged on a case-by-case basis, evaluating the trade-off between the economic costs to the U.S. of such policies against their potential effectiveness in achieving foreign-policy goals. This paper focuses on U.S. economic interests, and will not consider the use of trade policy for non-economic goals.

With some exceptions and compromises, policies based on these principles have proved to be broadly complementary for much of the post-war period. Following these principles, the U.S. supported: the establishment of the GATT, the IMF, and the World Bank; the lowering of trade barriers through successive rounds of multilateral negotiations under the auspices of GATT; the recovery of the economies of Europe and Japan (through the Marshall Plan and other policies); the establishment and continued evolution of the European Common Market; and the growth of developing countries through preferential trade agreements and economic assistance through bilateral and multilateral agencies.

The experience of the last half-century indicates that these policies have been extremely successful. World trade has increased enormously, and this trade has generated enormous benefits. Trade has been a major "engine of growth" for the world economy, in marked contrast to the pre-war period where protectionism exacerbated and helped spread the great depression. U.S. industries —both their workers and owners— have benefited from increased exports and access to imported intermediate inputs. U.S. consumers have been able to purchase a much wider variety of products at much lower prices than would have been possible without the expansion of trade.

On average, the performance of developed and developing countries that have pursued growth strategies based on increased international trade has ranged from very good to spectacular. Both theory and practice have shown that the expansion of trade is a "win-win" proposition, with all countries participating in the world trading system gaining significantly.

In the last 10-15 years, a number of trends have led to the need to re-evaluate the role of trade in the world economy and the nature of U.S. trade policy. These trends include:

(1) Europe and Japan have completed their recovery from the destruction of World War II and have grown rapidly. They are now mature economies, largely on a par with the U.S.

(2) A number of semi-industrial developing countries have grown dramatically during this period and have come to play a significant role in world trade in manufactures. These countries either have graduated, or are on the verge of graduating, to the status of developed countries.

(3) After a period of relatively stable growth, the world economy since the mid-1970s has been buffeted by a variety of shocks, including wide swings in the price of oil, recessions, and major movements in exchange rates.

(4) The trend of liberalization of trade polices and the lowering of trade barriers, which continued through the Tokyo Round of GATT negotiations, has reversed. While formal tariff barriers are low, a number of protectionist policies have emerged that restrict trade in a number of important commodities such as textiles, automobiles, and steel. With the lowering of tariffs, non-tariff barriers have become relatively more important. These barriers have proved to be particularly difficult to deal with in the context of GATT.

(5) Trade has become steadily more important to the U.S. and virtually all other countries over the post-war period, and it is no longer possible for a country to insulate itself from the world economy.

Increasing integration of the world economy, while generating many benefits, has also led to increasing strains in trade policy, both for the U.S. and for our major trading partners. In many countries, there is now perceived to be less complementarity between the goals of pursuing direct national economic interests and the achievement of an open, rule-based, world trading system. As trade has become more pervasive, interactions between trade policy and domestic policies have become more important. For example, policies regarding sectors such as agriculture and services, which used to be regarded as purely domestic concerns, have come to have serious trade implications and are a major focus in the Uruguay Round of GATT negotiations.

In formulating trade policy, countries have increasingly come to take into account important features of their economies and those of their trading partners. These include characteristics such as the existence of significant non-tariff barriers to trade in important sectors; imperfectly competitive markets supported by non-tariff barriers to foreign competition; technological "externalities" and "spillover" effects; and dynamic gains from increasing returns, learning, and early access to markets.

In particular, the U.S. has come to recognize that our major trading partners (the EC, Japan, and some of the graduating semi-industrial countries) have economic systems characterized by more direct government involvement in their industrial sectors than is the case for our economy. These countries have sought to support their domestic industries through a coordinated strategy of "industrial policy," using a variety of instruments including sectoral subsidies and non-tariff barriers to foreign competition.

We have also increasingly come to realize that there are certain markets (*e.g.*, financial markets) in which some government intervention is strongly justified. Virtually all governments justifiably intervene in financial markets, for example, albeit in different ways. Certainly, market failures due to imperfect information, absent markets, or the existence of markets which are inherently imperfect, are common. Government intervention in such markets, which is justifiable on the grounds of domestic economic policy, may well impinge on trade policy. There is, of course, the danger that governments will use domestic concerns as a convenient excuse for pursuing policies whose real intent is to protect domestic industries from foreign competition. It is important, though in practice often difficult, to differentiate between cases where there are legitimate domestic policy concerns and instances of hidden protectionism.

In this economic environment, it has proved difficult to negotiate further trade liberalization and market access in a multilateral setting under the auspices of GATT. The Uruguay round has proven difficult to complete, and the U.S. —along with other countries— has sought alternative approaches, even while actively seeking to complete the round. Examples include separate bilateral and regional free trade arrangements (such as the completed Canadian-U.S. free trade agreement and the current NAFTA negotiation) and other bilateral negotiations (such as the current "framework" discussions with Japan).

These efforts reflect new approaches for the U.S. in opening up protected markets outside of the GATT framework. This policy paper discusses principles that should guide the formulation of trade policies seeking to promote U.S. exports and open foreign markets in our major trading partners, given the changes in the world economic environment described above.

This paper does *not* address several key issues, which will be taken up in later policy papers, including the appropriate use of trade-policy instruments and the relationships between trade policy, industrial policy, and technology policy.

SETTING TRADE POLICY PRIORITIES

The three broad principles that have guided U.S. trade policy since World War II remain valid. First, the primary goal of U.S. trade policy should be to advance U.S. economic interests. Second, in the medium to long run, U.S. economic interests are best furthered by policies that serve to maintain and extend an open and stable world trading system. Third, the U.S. gains, both economically and politically, when less developed countries are successful in achieving rapid, sustainable growth.

Assessing U.S. Economic Interests

The goal of advancing direct U.S. economic interests implies that U.S. policy should focus on cases with the biggest direct payoff for the U.S. economy. The best measure of the benefits to workers, producers, and consumers is their income.

The first criterion for evaluating trade policy should be an assessment of its total effect on U.S. national income.

One of the reasons for placing a high priority on establishing a world trade order based on open access is that it allows the U.S. (and other countries) to take full advantage of comparative advantage, specializing in those products and stages of the production process in which they have particular strength. It is precisely by permitting such specialization that international trade yields a win-win situation for all participants. Given that the U.S.'s long run strength lies in high-value activities such as research and development and skill-intensive, high-tech production processes, establishing a world trade order based on free trade is of particular value to the U.S.

In setting trade priorities, attention needs to be focused on value added and linkages through purchases of intermediate inputs. What is relevant is not whether the final assembly occurs in the United States, but the fraction of the value of the good which is produced in the United States. Thus, a car made in the United States (by either an American or foreign-owned firm) may contain components made abroad. The percentage of U.S. value added might be less than that for a computer assembled in Korea or Mexico but containing components such as a hard drive and chips made in the U.S.

In particular, the following criteria should be used to set priorities and determine the importance of pursuing a particular market-opening policy:

(1) Does the foreign protectionist practice have a significant impact on U.S. workers and high-wage U.S. employment, either directly or through linked markets for intermediate inputs?

(2) Does the foreign practice significantly affect the sales and profits of U.S. firms, either directly or indirectly?

(3) Does the foreign practice restrict access by U.S. consumers to the cheapest sources of goods and services?

In the long run, in a growing world economy, our prosperity is linked to the prosperity of others —increased trade has proven to benefit all participants. Increased imports are as important as exports in promoting our welfare. It is a serious mistake to view trade from a narrow Mercantilist perspective that sees benefits arising only from exports. In the short to medium run, however, especially if there is a problem with unemployment, a focus on exports is valid.

When there is significant unemployment, exports contribute to an increase in national income both through an increase in employment and (when the firm is domestically owned) through an increase in profits. Production for exports directly affects both the structure and volume of employment. Foreign restrictions on our access to exports markets are always damaging to the U.S.

Targeting Exports

Increases in exports in some sectors may have especially beneficial effects. In particular, in sectors characterized by spillovers and dynamic efficiency gains, the losses from trade restrictions are especially serious. These effects may be particularly marked in high-value-added and/or high-wage sectors. By the same token, increases in exports from sectors or regions with high unemployment rates, or which more generally increase the demand for unemployed workers or workers with low wages, may be particularly beneficial. These policies not only increase national income, but also have desirable distributional consequences.

Increases in trade based on long-run comparative advantage or which enable the U.S. to establish a niche in a particular market are likely to be of greater value, since the benefits are likely to be more permanent. The benefits of opening up markets to products in fairly competitive areas in which the U.S. does not have a long-run comparative advantage are likely to accrue mostly to others who are better placed to compete in those markets.

A particularly strong case for government intervention to open markets for U.S. firms occurs when the firms being excluded are small or medium sized. Foreign protection often represents a fixed cost that must be overcome by firms desiring to enter the foreign market. Small and medium-sized firms are the most adversely affected by such policies. If a given sector is characterized by many small and medium-sized firms, then government assistance in opening foreign markets is especially needed.

Thus, in determining priorities for opening up markets, U.S. policy needs to look at factors such as:

(1) *Permanence of the market advantage.* If the U.S. manages to gain market access, how long will U.S. firms actually maintain an advantage in that market?

(2) *Existence of dynamic gains, learning, or increasing returns.*

(3) *Existence of externalities or spillovers to other sectors.* Does the sector have significant linkages to other sectors through markets for intermediate inputs? Does the sector generate significant technological spillovers?

(3) *Technological advantage.* Is the sector one in which the U.S. has a technological advantage, especially involving the use of high-wage U.S. labor?

(4) *Size of firms in the affected industry.*

(5) *Distributional considerations.* Does expansion of the sector yield favorable distributional effects?

Abuses

Some trade restrictions seem particularly objectionable, in that they represent a significant abuse. In determining trade priorities, the first focus of analysis should be on the direct effect on the U.S. economy. If two policies have equal effects on national income, however, the U.S. should direct its policy effort against the one which represents the most significant abuse.

How can one determine the magnitude of abuse contained in a protectionist practice? A number of criteria are relevant:

(1) How large is the gap between the outcome under the practice and the outcome that would have occurred with an open market? For example, if a government gives preference to its own companies in procurement when the cost differential from foreign competitors is 3%, then the gap between the distorted and free-market outcomes is small. If the cost differential is 40%, then the gap is large and the abuse is significant.

(2) How unusual is the practice? Is the practice a major deviation from acceptable practices under GATT rules or under a bilateral or regional agreement? For example, all governments give some preference to their domestic airlines (*e.g.*, requiring government employees to fly on national carriers), which has little effect on the market outcome and has become an accepted practice in a bilateral setting.

(3) Is the practice part of a pervasive and persistent pattern of policies aimed at protecting the domestic market for particular commodities? It may be important to view individual protectionist practices in a wider policy context. A particular policy may be significant because it is part of a system of mutually supporting protectionist policies.

In some cases, it may be desirable to focus attention on trade abuses which, while not common, are not unique. A successful effort at eliminating the abuse in one country may have a positive spillover, in making other countries more receptive to the elimination of the abuse.

National Treatment versus Reciprocity

As noted earlier, trade policy today needs to be attentive to differences in national economic policies which, though perhaps not motivated by trade considerations, have important consequences for trade. Countries vary widely in the degree to which they intervene in various markets or regulate firms in various sectors. Gaining access to highly regulated markets in foreign countries under the principle of national treatment may engender far less benefits to U.S. firms than to foreign firms gaining access to less regulated U.S. markets.

In formulating policies to open foreign markets which are highly regulated, a number of considerations are relevant:

(1) Some argue that opening U.S. markets to exports from countries that maintain closed domestic markets is equivalent to "unilateral disarmament" —we put our markets at risk without gaining anything in return. This argument reflects the long-standing Mercantilist fallacy and ignores the benefits to consumers from lower prices. The fact that other countries protect domestic producers and so hurt their consumers certainly does not suffice to justify retaliation which hurts U.S. consumers. More analysis is required concerning the nature of the protected markets to evaluate the potential gains and losses from retaliation.

(2) While trade —evn when one partner fails to trade "fairly"— is usually mutually beneficial, there are important issues concerning how the gains from trade are shared. Restrictive practices by foreign countries may result in those countries appropriating for themselves more of the gains from trade.

(3) National treatment may, *in effect*, be discriminatory. Consider a situations where there has been discrimination in the past and the government imposes barriers to entry or expansion. Even if those restrictions are applied according to the principle of national treatment, and hence are applied uniformly to foreign and domestic firms, the result will be to lock in the consequences of past discrimination, since foreign firms will be effectively prevented from increasing their market share.

(4) Through regulatory and other policies, countries can often discriminate against foreign producers *in effect*. Such discrimination is often subtle and hard to detect. In cases where there is a history of discriminatory actions, affirmative policies to rectify the consequences of past market discrimination may be justified.

(5) In many cases, the best way to deal with discriminatory domestic policies which are effectively protectionist is through a multilateral process of harmonization of regulations, at least among the the more developed countries.

In sum, the existence of major differences in domestic policies and practices complicates the analysis of potential gains from increasing market access. In this environment, pursuing the goal of national treatment ~~is certainly valid~~, but there may still be significant imbalances in the benefits from increased market access. In such cases, aggressive policies aimed at redressing the imbalance may be needed.

In setting priorities for redressing imbalances in the potential gains from increasing market access, the U.S. should emphasize those practices which most affect our economic interests and which, simultaneously, can be least well justified in terms of the legitimate economic and political objectives of the foreign countries.

APPLICATIONS OF THE PRINCIPLES

Conflicts with Domestic Policies

While today most countries recognize the importance of a liberal world trading order, there is also widespread, selective government intervention in domestic markets —interventions which can be justified as economically beneficial. While U.S. policy should clearly oppose policies which seek to impede trade, it is not so clear what our judgement should be regarding policies pursuing other goals, but which distort trade as a side effect. Examples include domestic subsidies to sectors such as agriculture and policies aimed at protecting the environment.

One obvious answer is that all of these issues need to be addressed through multilateral negotiations. The Uruguay round of GATT negotiations is breaking new ground in seeking to devise rules regarding allowable domestic subsidy policies in sectors such as agriculture and services, and for activities such as R&D. The intent is to extend the GATT rule-based trading system to include these difficult areas.

If successful, such international agreements should limit the trade-distorting effect of domestic subsidy policies. They should also give foreign producers equal standing with domestic producers in local markets which are subject to government regulation (*e.g.* financial markets or sectors in which there are environmental concerns). It is important to recognize, however, that even agreements to lower or eliminate domestic subsidies to particular sectors will not necessarily establish a "level playing field" in which foreign firms will rapidly acquire significant market share. While access will be easier, there are still advantages for countries which are more technologically advanced, which have more developed capital markets, or which have a prior market presence in markets where there are potential barriers to entry (not related to trade policy). Changing domestic subsidy policy and regulatory practices will not necessarily lead to foreign entry.

There does not seem to be a simple principle upon which we can rely in such situations. Rather, we will need to follow a case-by-case approach, respecting the legitimate domestic concerns of our trading partners, but recognizing that such concerns are sometimes used to justify policies that serve only to restrict foreign competition.

In this case-by-case approach, certain aspects of subsidy policies and industrial structure need to be taken into account:

(1) American consumers may benefit from the subsidies provided by foreign governments, and these benefits need to be taken into account in determining how we respond.

(2) When foreign government subsidies form part of a predatory policy designed to drive out American producers so that prices can eventually be raised, then the U.S. government needs to be particularly concerned. Similarly, if such practices deprive American producers of the opportunities to benefit from technological spillovers or to gain from early entry into high-tech markets, there is a strong case for U.S. concern. Note, however, that in competitive markets, such subsidies are unlikely to be predatory. Even if that is the intent, predatory policies are unlikely to be successful in competitive markets.

(3) In some cases, domestic pressures from producers advancing arguments concerning technological spillovers result in parallel subsidies in several countries. While consumers may benefit from such a pattern of subsidies, the technological benefits may not justify their cost to the government. In such a case, there are gains to be had for all sides in a multilateral agreement to restrict subsidies, or to pool investments in new technologies.

(4) Countries in earlier stages of development are more likely to have less developed capital markets and technological capacity. For developing countries, there is a strong case for government assistance to improve the operation of capital markets and develop (or borrow) new and appropriate technology, given the important role of these factors in development. The U.S. has recognized the special needs of developing countries in the past, and should continue to do so.

What are the implications for other policies of the framework used to evaluate market-access and export-promotion policies? The twin goals of advancing direct U.S. economic interests and establishing an open world trading system lead to a rejection of import protection policies on the domestic front, even for high-wage industries. Such policies are typically ineffective, economically inefficient, and violate the principle of an open trading system.

More problematic, however, are those domestic policies which serve a variety of economic and political objectives, but which, at the same time, may serve as a barrier to market access for foreign firms into the United States. It may be difficult for the United States to complain about particular practices of foreign governments which have the effect of impeding trade, while there are similar or other practices in the U.S. which have a corresponding effect.

A more nuanced approach, which recognizes the validity of domestic concerns for both the United States and foreign governments, must balance those advantages against the disadvantages of the resulting trade impediments. Such a balanced approach seeks to eliminate, in a symmetric way, both U.S. and foreign practices in which the disadvantages from the trade impediments dominate. Recognizing these nuances in international negotiations, both bilateral and multilateral, should lead to greater respect for U.S. policies and to a more rapid opening of international markets.

National Ownership and Location of Production

These principles can be used to address the question, "Does ownership matter for trade policy?" Other things being equal, how should the U.S. set priorities concerning export promotion policies which benefit, perhaps differently, U.S. companies producing goods in the U.S.; foreign companies producing goods in the U.S; and U.S. firms producing goods abroad?

(1) The top priority for market-opening policies should be to pry open closed foreign markets, expanding export sales of goods produced in the U.S. by U.S. firms. Such cases are likely to provide the largest economic benefit to U.S. citizens, especially when they lead to an expansion of high-wage employment in the United States, directly or indirectly, or involve sectors with potential technological spillovers.

(2) The second priority should be U.S. exports of foreign-owned firms (especially when they are not directly competing with U.S. companies). While the profits will accrue to foreign nationals, such exports generate direct and indirect employment in the U.S.

(3) The third priority should be the opening of markets for U.S. firms that are producing abroad. In this case, the profits accrue to U.S. firms, while the employment effects in the U.S. may be weak or nonexistent.

While this prioritization provides a general guideline for policy, individual situations will need to be reviewed on a case-by-case basis, and we expect there to be exceptions to the general priorities.

National ownership matters for a number of reasons:

(1) Companies usually have their headquarters in their own country. Headquarters provide top management jobs, high-wage administrative jobs, and often skilled jobs in R&D, design, etc. More generally, U.S. companies are more likely to hire U.S. workers in managerial and other top jobs.

(2) A larger share of profits from U.S. production goes to the U.S. government from U.S. firms, since shareholders pay U.S. taxes on dividends and capital gains.

(3) U.S. companies are more likely to reinvest in the U.S. and may use more intermediate inputs produced in the U.S. Indirect employment linkages are thus more likely to be significant for U.S. companies.

(4) Knowledge spillovers occur significantly within firms, and so benefits to U.S. firms will generate greater overall benefits to the U.S. economy.

(5) American companies are more likely to have large trade linkages with other American firms; they are, for instance, more likely to use American suppliers of intermediate goods.

(6) Much of U.S. foreign investment is export creating rather than export diverting, and gains in learning in foreign markets can have spillovers to high-wage U.S. employment.

(7) Only a very small fraction of equity in U.S. firms is owned by foreigners, so most of the returns go to U.S. shareholders who pay U.S. taxes.

(8) For U.S. firms to obtain the full return on their investment in research and development (R&D) and other innovative activities may require that they be able to produce in other countries. Licensing arrangements may be a poor substitute for direct production. And the larger the world output of U.S. firms, the greater is their incentive to engage in R&D. The contribution of U.S. firms to U.S. national income may not be well reflected simply in statistics describing the fraction of production which occurs in the U.S.

(9) Other countries generally promote their national companies, regardless of where they produce, and do not defend U.S. companies that employ their workers. Foreign companies that employ U.S. workers can thus rely on their home governments to defend their interests. U.S. companies, whether they produce at home or abroad, have no one else to defend them besides the U.S. government.

Although the direct U.S. benefits are likely to be largest from policies that increase U.S. exports rather than assisting U.S.-owned firms that largely produce abroad, the U.S. government should still make a practice of vigorously defending the interests of U.S. firms in other countries. Policies that assist U.S. firms, even when they are not directly producing a given product in the U.S., may stimulate high-wage U.S. employment to service their overseas operations. In addition, benefits to U.S. shareholders will lead to repatriated profits and may increase U.S. investment. Finally, a policy of promoting U.S. firms even when they produce abroad helps maintain an open trade and investment system and deters attempts by host governments to expropriate foreign assets and investments.

While in the current situation, there are arguments for giving some preference in establishing priorities for market opening to American-owned firms over foreign-owned firms, both producing within the U.S., two caveats should be noted:

(1) It was argued above that the principle of national treatment may not suffice to ensure comparable benefits from bilateral or multilateral agreements on increased market access. In such cases, there are arguments for seeking reciprocity —establishing a roughly uniform set of regulations or standards applying to all firms in all contries. Presumably, such reciporicity might eventually be extended not only to regulatory actions, but also to trade promotion actions. If other countries treat American firms symmetrically with their own firms, there are strong arguments for the U.S. to reciprocate.

(2) In the long run, asymmetries in ownership, trade patterns, and other linkages across firms "based" in different countries may become less significant. In this case, distinctions concerning the original nationality of the enteprise will also become of little or no importance.

U.S. Investment Abroad

An increasingly large fraction of trade occurs *within* multi-national firms. If U.S. firms are precluded from producing within a country, then U.S. producers of intermediate goods may be at a marked disadvantage in terms of market access. Thus, a policy of opening up opportunities for U.S. firms to invest abroad may be justified not only in terms of expanding the opportunities for increased profits, but also in terms of the enhanced possibilities for increased exports of U.S. goods.

The basic economic principles underlying international investment are identical to those that underlie international trade in goods and services: the principle of comparative advantage. Those who worry that U.S. capital moving abroad will deprive the U.S. of jobs fail to note that: (1) if U.S. capital does not seize opportunities abroad, other countries will; and (2) if other countries expand their foreign investment, the linkages between that investment and the home countries will give them advantages over the U.S.

At the same time, it should be noted that *some* international investment is not motivated by basic economic principles of comparative advantage, but by a desire to get around trade barriers. For example, some past investment in Mexico was undertaken to give

U.S. firms access to the protected Mexican domestic market. The removal of trade barriers would decrease rather than increase the flow of such investment to Mexico.

Financial Sectors

For a variety of reasons, virtually all governments intervene in financial markets. Particularly in less developed countries, such intervention is justified as a necessary part of implementing a development strategy. In many cases, government exercises its influence through moral suasion, sometimes backed up by the threat to withhold certain discretionary benefits (like the right of banks to open up additional branches). There is concern that the lending policies of foreign banks will not be as sensitive to government influence, and hence such banks will not support the country's overall development strategy.

Given the nature of the policy tools used to regulate financial institutions, there is a concern that foreign and domestic banks are not on a level playing field in most countries. Without addressing the validity of these claims, the U.S. should recognize that the perception of foreign countries that these claims are valid makes many countries particularly resistant to opening up their financial markets.

Following the principle that the U.S. should put the highest priority on those markets that have the greatest impact on U.S. national income, it makes little sense for the U.S. to place a high priority in opening up capital markets in foreign countries. Such opening mainly creates jobs abroad, with little effect on U.S. labor or national income. Particularly in cases where foreign governments are especially resistant to liberalizing financial markets, we will have to expend considerable political capital to attain any results, with only limited benefits to the U.S. economy.

Structural Impediments

There are a variety of practices, in both the private and public sectors, which may serve as impediments to trade. Countries may, for instance, require safety inspections, duplicating those of the foreign producers. There should be a concerted multinational effort to reduce these non-tariff barriers, focusing on practices that have the greatest effect (intended or unintended) on international trade flows. In particular, among the members of the OECD, there should be efforts to establish common regulatory standards. Where deviations from common standards are imposed, we should require both a clear scientific rationale for such deviations and the establishment of procedures to ensure that those deviations do not serve as an impediment to trade.

For example, performance standards for customs inspections should be developed that establish clear guidelines both for costs and delays and that are monitored by independent auditing agencies. Safety and health standards should be set in a clearly defined manner, and we should direct efforts to establish international auditing processes to ensure that the standards are enforced and implemented in a fair and equitable manner.

Measuring Success

Success in opening up markets may not be reflected in overall balance-of-trade statistics. Macroeconomic forces affecting aggregate rates of saving and investment and the real exchange rate largely determine the overall balance of trade in a country. The existence of a trade surplus for a particular trading partner is not necessarily an indicator of closed markets and focusing on bilateral trade surpluses is, in general, inappropriate. Focusing on sectoral trade imbalances is even more inappropriate. In addition, opening up foreign markets very likely will not affect the overall balance of trade significantly, although it should always improve the international terms of trade facing a country.

It is also important to note that changes in macroeconomic forces, including the real exchange rate, will have major effects on trade flows. In judging whether or not market-opening or export-promotion policies have been successful, it is necessary to control for the effects of changes in macro policies and changes in the real exchange rate. Such an evaluation can be difficult, requiring careful economic analysis of a counterfactual alternative: "What would have happened if the macro environment had remained unchanged?"

In general, it is more appropriate to evaluate issues of market closure and the success of market-opening policies at the micro level. The analysis of the impact of trade impediments in particular markets is analogous to the problem in antitrust law of identifying the existence of monopoly power and of determining the extent of damages due to the improper use of such market power. The most telling evidence is direct indicators of policies and practices that are used to close markets from competition, but unambiguous evidence of this sort is oftenhard to obtain. Measures such as market shares and deviations between domestic and world prices provide indicators of both the existence of practices which have the effect of closing markets of of the success of efforts to open those markets.

In setting policies regarding market opening, the focus should first be on the policies and instruments used by the country to protect particular markets from foreign competition. The appropriate measure of success is the cessation of the use of such policies and instruments. In unusual circumstances, when there is evidence of persistent and pervasive trade impediments aimed at protecting a domestic market, setting quantitative targets regarding foreign sales or market shares may be the only tool available to reduce the market abuses.