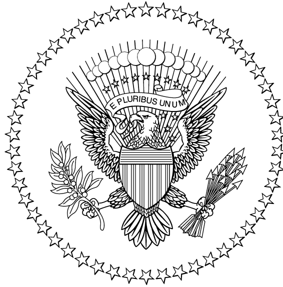
Economic Report of the President



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COUNCIL OF ECONOMIC ADVISERS

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CHAPTER 8

Modern International Trade

Open markets and free trade raise living standards both at home and abroad. The President's policy of opening markets around the world is based on this solid foundation. Yet, as international trade has grown in both volume and scope, so too have concerns that old ideas about trade policies no longer apply to today's trade environment.

The key points in this chapter are:

- Free trade allows countries to mutually benefit from specializing in producing products at which they are adept and then exchanging those products. This rationale remains the same, even with advances in technology and new types of trade.
- Foreign direct investment is playing an increasingly important role in world trade, as companies invest across borders to gain skills, technology, resources, and market access.
- The Administration has advanced multilateral, regional, and bilateral trade agreements in order to open global markets. Lower trade barriers benefit consumers worldwide and expand markets for America's manufactured goods, farm products, and services.

Free Trade: Beyond the Basics

The Administration's pursuit of trade liberalization is based upon a long history of intellectual support for free trade. Modern trade theory begins with the nineteenth century's David Ricardo. Ricardo's central insight—his elegant model of comparative advantage—is the starting point from which to explain the gains from trade.

Ricardo's model of comparative advantage addressed the question of how a home country could compete with a foreign trading partner that is better at producing everything. Ricardo showed that even if a foreign country could produce each of two goods for less than the home country could (that is, the foreign country has an *absolute advantage* in the production of the goods), there could still be mutual gains from trading the two goods. The key to the argument is that it is relative costs of production (*comparative advantage*) that matter, not absolute advantage.

As an example of Ricardo's theory of trade, consider a situation in which one country requires two hours to produce a unit of each of two goods, while in a second country it takes five hours to make Good One and ten hours to make

Good Two. In Ricardo's simple model, the price of each good in the first country before trade is one unit of the other good, because the two goods take the same resources to produce. In the second country, Good Two would be expected to cost twice as much as Good One, because it takes twice as much labor to produce it. The first country has an absolute advantage in both goods, but comparative advantage still provides a basis for trade. In this case, the second country would gain from importing Good Two, which costs only half as much in the other country (only one unit of Good One). The second country would pay for these imports of Good Two by exporting Good One. Similarly, the first country would import Good One, which in its trading partner costs only one-half a unit of Good Two. It would pay for its imports by exporting Good Two. In the end, world production rises as a result of trade, and each country can consume more of both goods. This stylized example illustrates that comparative advantage allows countries to gain when they specialize in producing items in which they are relatively the most productive.

Critics do not usually argue that Ricardo's theory of comparative advantage is incorrect, but instead that it omits key aspects of trade that may undermine the theory's results and alter the consequent policy prescriptions. In basic trade theory, for example, capital and labor do not move across borders seeking the highest return. At least for capital, such movements are now routine. Economic models that take into account both capital and labor (Ricardo's theory discussed only labor) show that countries as a whole still gain from free trade. There are, however, differing impacts of trade on different parts of the economy and the labor force. Policies aimed at supporting individuals affected by trade are thus vital to ensuring that its gains are widely shared. These policies are discussed later in the chapter.

Globalization and the Terms of Trade

Theoretical arguments showing the gains from trade compare a situation in which a country is open to trade with one in which it is closed. The differences in production technology between a trading partner and the home country mean that different prices prevail in the two countries before they open their borders to trade. It is this difference in prices that allows both countries to benefit from trade. With the advent of trade, a new price for exchanging products will be reached, somewhere between the countries' original prices. This new price is known as the *terms of trade*. Each country gains from opening when the terms of trade differs from the pre-trade price.

Over time, events in either country could change the terms of trade. Other things equal, each country would prefer the price it receives for its export good to increase, just as any merchant would wish to receive more for the product he sells.

After trade is opened, it is possible that changes in the world economy could move the terms of trade in directions that benefit one country but not the other. In this case, both countries would still be better off than they were prior to trade, but one country would see its gains diminished. Such subsequent price changes could come from changes to the countries' technologies or from the discovery of natural resources, such as oil, that lead to changes in production and trade patterns.

The possibility that a country could lose from global price changes is at the heart of some recent critiques of globalization. One critique noted, for example, that as China develops and becomes more similar to the United States, the United States could be made worse off. There are two problems with this critique. The typical view of globalization is that it is a phenomenon marked by increased international economic integration. The critique above, however, is of a situation in which development in China leads to less trade, not more. If China and the United States have differences that allow for gains from trade (for example, differences in technologies and productive capabilities), removing those differences may reduce the amount of trade and thus reduce the gains from that trade. The worst-case scenario in this situation would be a complete elimination of trade. This is the opposite of the typical concern that globalization involves an overly rapid pace of international economic integration.

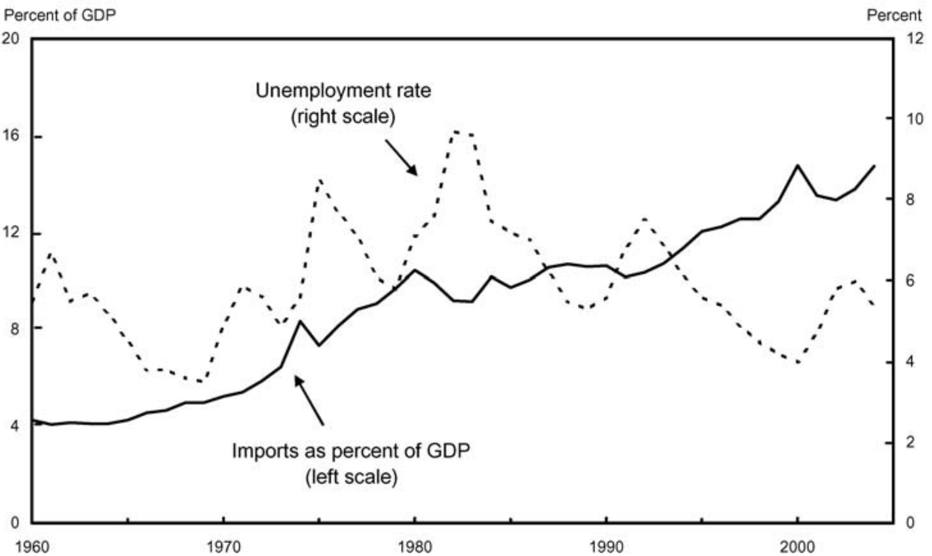
The second problem with the critique is that it ignores the ways in which modern trade differs from Ricardo's simple model. The advanced nations of the world have substantially similar technology and factors of production, and seemingly similar products such as automobiles and electronics are produced in many countries, with substantial trade back and forth. This is at odds with the simplest prediction of the Ricardian model, under which trade should disappear once each country is able to make similar products at comparable prices. Instead, the world has observed substantially increased trade since the end of World War II. This reflects the fact that there are gains to *intra-industry* trade, in which broadly similar products are traded in both directions between nations (the United States both imports and exports computer components, for example). Intra-industry trade reflects the advantages garnered by consumers and firms from the increased number of varieties of similar products made available by trade, as well as the increased competition and higher productivity spurred by trade. Given the historical experience that trade flows have continued to increase between advanced economies even as production technologies have become more similar, one would expect the potential for mutually advantageous trade to remain even if China were to develop so rapidly as to have similar technologies and prices as the United States.

The Impact of Trade on Labor Markets

According to standard economic theory, the degree to which an economy is open to trade affects the mix of jobs within an economy and can cause dislocation in certain areas or industries, but has little impact on the *overall* level of employment. The main influences on total employment are factors such as the available workforce and the levels of interest rates, taxes, and regulations that govern the labor market. Trade tends to lead a country to specialize in producing goods and services at which it excels. Trade affects the mix of jobs because workers and capital would be expected to shift away from sectors in which they are less productive relative to foreign producers and toward existing and new sectors. This would be expected to lead to higher productivity and thus higher wages for workers.

The conclusion that free trade has little effect on the *overall* number of jobs is borne out in data on the U.S. economy. If trade were a major determinant of the Nation's ability to maintain full employment, measures of the amount of trade and the unemployment rate would move in tandem, but in fact, they usually do not. The increase in imports as a percentage of gross domestic product (GDP) over the past several decades has not led to any significant trend in the overall unemployment rate (Chart 8-1). Indeed, over the past decade, the U.S. economy has experienced historically low unemployment, while exports and imports have grown considerably.

Chart 8-1 **Imports and the Unemployment Rate, 1960-2004**
Over the long run, there is no connection between increased imports of goods and services and the strength of the labor market.



Note: GDP and imports for 2004 are annualized using data for the first three quarters.
Sources: Department of Commerce (Bureau of Economic Analysis) and Deparment of Labor (Bureau of Labor Statistics).

Similar conclusions arise from examination of data on the trade or "current account" balance (the broadest measure of the difference between exports and imports of goods, services, and income flows). From 1960 to the third quarter of 2004, the current account balance moved from a surplus of 0.5 percent of GDP to a deficit of roughly 5.6 percent of GDP. Yet the average unemployment rate in 2004 was 5.5 percent, the same as the average unemployment rate in 1960. Over this period, the U.S. economy gained more than 75 million jobs—an increase of roughly 140 percent. Increased trade has neither inhibited overall job creation nor contributed to an increase in the overall rate of unemployment.

That factors other than trade are the most important influences on the labor market is of no consolation to a worker who loses a job because of competition stemming from international trade. To assist people facing such dislocation, the Administration has built upon and developed programs to help workers acquire the skills needed to prosper in new jobs.

The Administration has proposed a reform of the overall workforce training system to help Americans obtain marketable skills needed to compete for jobs in emerging and innovative fields. The Administration recognizes that effective workforce training requires the cooperation of the private sector and community colleges and has worked to nurture these partnerships through the High Growth Job Training Initiative at the Department of Labor and through the recently-enacted Community-based Job Training Grants.

In addition, the Administration has proposed the establishment of Personal Reemployment Accounts, an innovative approach to worker retraining. With these accounts, qualifying individuals who lose their jobs would receive an account with funds that can be used for training and other services that best fit their needs. Individuals who find new employment relatively quickly would be eligible to keep the balance of their accounts as a cash reemployment bonus. The accounts would thus provide both support to unemployed workers and an incentive to find new employment.

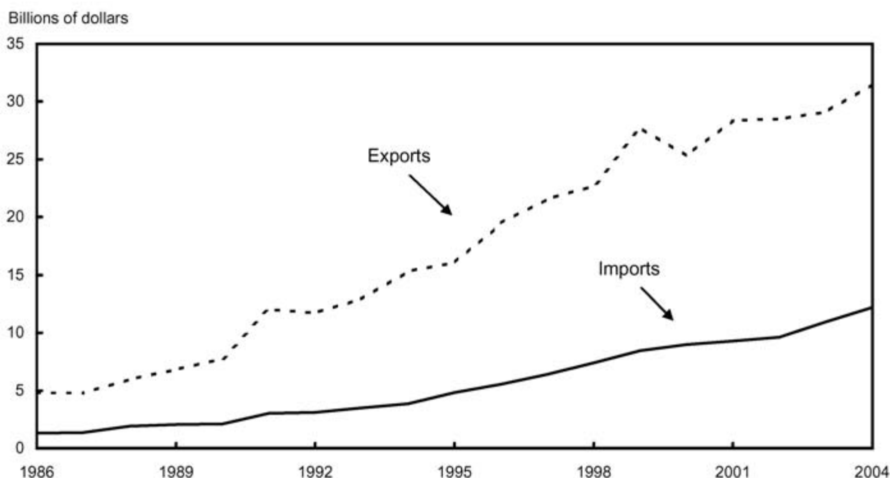
The Administration has also worked to enhance the long-standing Trade Adjustment Assistance program, which provides training and income support to workers directly hurt by import competition. As part of the Trade Act of 2002, eligibility was extended to workers indirectly affected by trade, such as workers employed by firms that supply goods and services to industries directly affected by trade competition. Benefits were enhanced to include a health insurance tax credit and a wage supplement for older workers who found new jobs that did not pay as well as their previous jobs. This assistance, which will total $12 billion over 10 years, will ease the adjustment for displaced workers and help them move into jobs for which their skills are most in demand.

The U.S. Advantage in Services Trade

This section considers the burgeoning trade in services. The performance of U.S. service workers and firms has been particularly strong. The United States exports more services than it imports, and this surplus has been growing in recent years. Moreover, U.S. services exports tend to involve relatively highly-skilled and highly-paid occupations, such as engineering, financial services, or architectural services. While services trade may not have been envisioned in the time of Ricardo, the principle of comparative advantage holds. Any move toward economic isolationism would thus threaten the competitive gains made by U.S. exporters while harming U.S. consumers and firms that benefit from imports.

One prominent type of services trade is measured in the "business, professional, and technical services" category. This statistical category encompasses advertising, telecommunications, computer and data processing services, and accounting and legal services. The United States exports services when a U.S. firm provides engineering or architectural services to partners in other countries. Annual U.S. exports in this category have grown by almost $25 billion since 1989, compared to a $10 billion increase in imports over this period (Chart 8-2). The growing trade surplus in this category is particularly striking in light of the widening of the overall current account deficit. The existence of a trade surplus suggests that the United States has a comparative advantage in the international provision of tradable services.

Chart 8-2 **Trade in Business, Professional, and Technical Services**
Over the last two decades, the trade surplus (the difference between exports and imports) has been growing in the category that includes services such as advertising, telecommunications, computer and data processing services, and accounting and legal services.



Note: Exports and imports for 2004 are annualized using data for the first three quarters.
Source: Department of Commerce (Bureau of Economic Analysis).

Ricardo's theory that countries mutually gain from trade if they each specialize in producing those items they could make relatively efficiently was inspired by trade in goods. Given the difficulties of communication and transportation in the nineteenth century, there would have been little point in theorizing about trade in services.

In the modern global economy, however, services trade plays an important role in international commerce and an especially positive one for the United States. Advances in communication have made possible the increased trade in services. These developments pose a challenge to industries that did not previously face foreign competition, though.

As noted above, the United States is good at the provision of services. Expanded access to the broader international marketplace would be expected only to further strengthen the U.S. advantage. The U.S. advantages in services have fueled job gains both directly in firms that export services and indirectly in firms that hire more workers in the United States as a result of the efficiencies they gain through trade. One study of the effect of services trade in the information technology sector found that it created over 90,000 net new jobs in the United States in 2003 and is expected to create 317,000 net new jobs by 2008. These new hires tend to be in positions requiring relatively high levels of skills or creativity, such as software development.

Foreign Direct Investment: An Increasingly Important Part of Trade

While the intellectual foundations behind free trade are unchanged, the means by which goods are exchanged between countries have changed greatly since the time of Ricardo. Goods are no longer simply produced in one place using only that country's resources and then sent off on ships to be unloaded at a foreign port. Instead, many of the goods Americans enjoy today—whether produced in the United States or abroad—are made with components from a variety of sources.

Production of goods in this fashion is facilitated by *foreign direct investment* (FDI). FDI occurs when an individual or firm buys a foreign company or takes control of a sufficiently large portion of a foreign company (typically 10 percent or more of the target firm's stock) that it can influence management decisions. *Greenfield FDI* occurs when a company builds a plant abroad from scratch (i.e., turns a "green field" into a factory), though this type of investment is less common. FDI in turn gives rise to increased trade.

U.S. firms investing or setting up enterprises abroad can increase opportunities for exporting their goods. Moreover, there is a good deal of evidence suggesting that increased employment at the foreign subsidiaries of

U.S. firms is associated with a corresponding increase in employment in the U.S. parent company. Similarly, recent research shows that one dollar of spending on capital investments abroad by U.S. firms is associated with an additional 3.5 dollars of spending on capital investment at home. The available evidence thus suggests that, on the whole, overseas investment by U.S. firms goes hand in hand with expansion at home.

Subsidiaries of foreign firms operating in the United States make important positive contributions to the U.S. economy as well. These firms bring over technology, techniques, and skills that in turn lead U.S. industries to be more efficient. U.S. subsidiaries of foreign companies employed 5.4 million U.S. workers in 2002, nearly 5 percent of total private-sector employment. This is up from 3.9 million workers in 1992 (4.3 percent of total private employment at that time).

The Global Supply Chain and FDI

The production of goods today can involve many firms in different countries performing a variety of distinct functions to bring products to market. A car made by an American company could include parts made by firms in the United States, Japan, Canada, and other countries, and it might be assembled in Canada or in Mexico. Producing this car could involve one firm extracting and molding the steel for the chassis, another firm designing and assembling interior components such as the seats and steering wheel, and a third firm transporting cars to the showroom. Within these steps, the production process could further involve a mix of domestic and imported components. Likewise, a car produced by a foreign company could be made in the United States and include a large share of components made here as well.

Firms invest in other countries for many reasons. One is that by investing abroad, firms may be able to take advantage of resources that are unique to the country in which the foreign business is located. Examples could be as straightforward as the development of a mining project, which by necessity must be undertaken where the natural resource is located, or the construction of an aluminum smelter in a country with abundant deposits of bauxite, the ore from which aluminum can be economically retrieved.

Firms might undertake foreign investment because it can be more cost-effective to own a supplier rather than be one of the suppliers' many customers. Once the goods are produced, the domestic firm can use its distribution networks, infrastructure, and knowledge about foreign tastes to export into new markets as well as increase sales in existing markets. Firms might also invest in retailing operations in other countries in order to exercise control over the sale of their products. Moreover, some firms invest abroad to avoid the trade barriers and transportation costs they might face if they produced in only one country for export to the whole world.

FDI spurs increased trade as firms move goods between parent companies and their foreign affiliates. Foreign affiliates use the goods from the parent company as both inputs to production and final goods to be sold through their distribution networks. In 2002, 35 percent of total U.S. trade in goods was accounted for by trade within components of firms with operations in two or more countries. This includes the flow in both directions, between U.S. companies and their majority-owed subsidiaries abroad, and between majority-owned U.S. subsidiaries and their foreign parent companies.

How Inward FDI Strengthens Domestic Firms

Foreign direct investment into the United States by foreign firms can increase the competitiveness of U.S. domestic firms. Studies suggest, for example, that American auto firms were driven to produce higher-quality and more fuel-efficient cars in the late 1970s and 1980s when foreign car manufacturers began producing and selling cars in the United States.

Evidence also shows that foreign direct investment into the United States is associated with the adoption of new technology, techniques, and skills by locally-owned companies. The transfer of expertise can include skills in areas such as operations, marketing, management, and organization; it can be especially important in sectors such as biotechnology in which research and development activities play a prominent role. Such technology can "spill over" to domestic customers and suppliers through a number of channels. Examples would include when workers at a foreign subsidiary leave and find employment with local firms, when domestic customers incorporate the products of these foreign firms into their supply chains, and when foreign firms provide their U.S. suppliers with access to information or technology in order to improve their own products' quality and reliability. For example, one foreign auto manufacturer in the United States recently shared with its U.S. steel suppliers its innovations for producing stronger, rust-resistant steel. One study estimates that such "spillovers" accounted for about 14 percent of the productivity growth in U.S. manufacturing firms between 1987 and 1996.

Encouraging FDI

Many factors lead foreign firms to consider the United States when deciding to invest abroad. These include a large pool of talented workers, access to deep capital markets, a culture that supports innovation and risk-taking, and a stable legal, political, and economic environment. Evidence shows that countries prone to corruption, political instability, and having private firms or industries taken over by the government are less likely to receive foreign direct investment than countries that protect investor and intellectual property rights. A recent study found that the United States was

ranked the second-best country out of 145 in terms of ease of doing business, just after New Zealand. In comparison, China was ranked the 42nd-best place and India the 120th.

At home, the United States maintains an open and nondiscriminatory policy toward investments made by foreign firms. With limited exceptions, such as for national security reasons, the United States permits foreign investment in all sectors. The United States does not screen investments on size or the companies' country of origin, does not restrict FDI to involve establishing only new facilities, and, with limited exceptions, does not have performance requirements such as local content requirements or export quotas.

Achievements in Trade Negotiations

The Administration has pushed aggressively to open global markets to trade. This has been done through multilateral talks under the auspices of the World Trade Organization (WTO) and through agreements to liberalize trade between the United States and various partners. The Administration has worked to ensure that the benefits promised under the agreements are realized for U.S. consumers, workers, manufacturers, farmers, and service providers. At the same time, lower trade barriers benefit people in U.S. trading partner countries. When U.S. trading partners do not fulfill their obligations, the Administration has sought their compliance through a practical, problem-solving approach. When that fails, however, the Administration has utilized formal dispute-settlement mechanisms.

This section addresses the progress made in fostering global trade, which provides mutual advantages to the United States and to all nations. The section also discusses efforts to make sure that all nations live up to the agreements they have signed. Because China has grown in importance as a U.S. trading partner, this section begins with a discussion of U.S. trade with this emerging economy. It then describes efforts to ensure the protection of intellectual property rights. It concludes with a description of progress in the negotiation of bilateral and multilateral trade agreements.

Trade with China

Prior to China's accession to the WTO, exports from the People's Republic of China were granted access to the U.S. market on substantially similar terms as exports from members of the WTO. This access, however, depended on an annual Congressional vote to grant China "Normal Trading Relations" status (also known as "Most Favored Nation" status). There were some exceptions to China's equal access, most notably in textiles and apparel. Because China was not a member of the WTO, it was not subject to the sort of reciprocal

obligations to lower trade barriers that WTO members undertook in decades of trade negotiations.

The Administration's efforts to bring China into the WTO culminated in China's December 2001 accession. WTO membership offered China the stability of Permanent Normal Trade Relations and access to the WTO's rules-based dispute-settlement mechanisms, but demanded of China extensive, far-reaching, and often complex commitments to change its trade regime, at all levels of government, and open its market to greater competition. China committed to lower trade barriers in virtually every sector of the economy, provide national treatment (treat imports on an equal basis with domestically-produced goods), improve market access to goods and services imported from the United States and other WTO members, and protect intellectual property rights (IPR). In light of the state's large role in the Chinese economy, China also agreed to special rules regarding subsidies and the operation of state-owned enterprises. In accepting China as a fellow WTO member, the United States also secured a number of significant commitments from China that protect U.S. interests during the period in which China implements its WTO obligations. The United States in turn agreed to accord China the same treatment it accords the other 146 members of the WTO.

That treatment includes a gradual liberalization of the market for textiles and clothing. This is a sector that has been gradually transformed by advances in technology and transportation, as well as by the opening of this sector through trade agreements. Much of the world textile and apparel market had been governed for decades by a global agreement that set bilateral quotas. Those countries that were founding members of the WTO in the mid-1990s agreed to liberalize textiles and apparel trade over the ensuing 10 years, a process that culminated with the elimination of quotas on January 1, 2005.

Since China's WTO accession, the Administration has worked to secure access to China's market for U.S. companies and their workers, farmers, and service providers, as promised by China's WTO membership, and to protect U.S. rights within Chinese markets. Where possible, the Administration has tried to resolve differences through negotiation. This approach has shown concrete results; in April 2004, for example, meetings of the Joint Commission on Commerce and Trade resolved seven potential WTO disputes involving high-technology products, agriculture, and intellectual property protection. When successful, this negotiated approach can deliver more-immediate results than those available through the sometimes-protracted legal procedures of a formal WTO dispute. When this pragmatic approach has not produced prompt and effective results, however, the Administration has also pursued dispute resolution under WTO procedures. It filed the first-ever WTO case against China to address discriminatory tax treatment of U.S. semiconductors in China. Within four months of the filing,

the Chinese government agreed to eliminate the problematic tax program to address U.S. concerns, resolving the dispute without lengthy litigation.

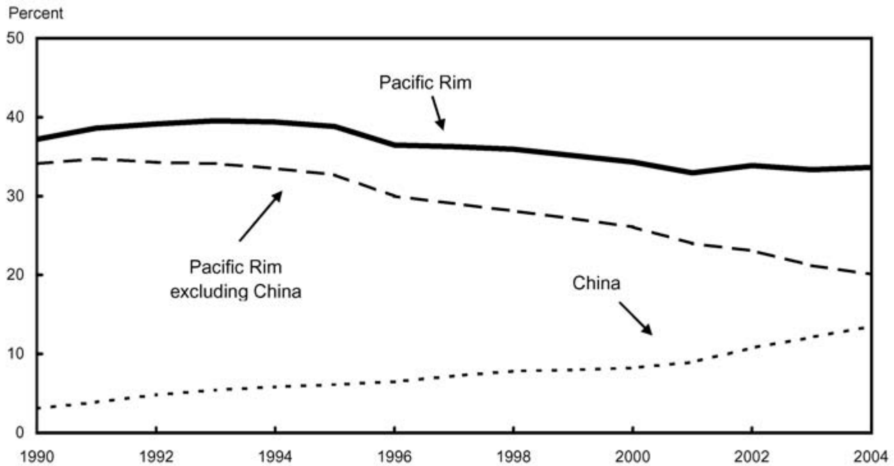
A central point of discussion with the Chinese has been about the benefits of moving to a flexible, market-based exchange rate. The U.S. government and organizations such as the International Monetary Fund (IMF) have argued that the exchange rate should have greater flexibility. Greater flexibility in China's exchange rate would allow for smooth adjustments in international accounts and would help protect China from the "boom-bust" economic cycles of the past. Such a change poses a number of economic challenges. The Department of the Treasury has been actively engaged with the Chinese in working toward such a transition and has established a technical cooperation program to address areas the Chinese view as impediments to greater flexibility, leading to three missions in 2004 that covered currency risk management, banking system best practices, and developing an exchange rate futures market in China.

Amidst these changes in policy, trade between the United States and China has been growing rapidly. For goods trade through November 2004, China ranked as the third-largest trading partner of the United States. For most of the period since China's WTO accession, U.S. exports to China have been growing at a rate faster than its imports from China (from 2002 to 2003, for example, U.S. goods exports to China grew by 28 percent while imports from China grew by 22 percent), but this export growth is occurring from a much smaller base and so the bilateral trade deficit has grown. The growing bilateral deficit has led to concerns in some circles about China's rising prominence in world trade. In fact, the data suggest that the increased imports from China are largely coming at the expense of imports from other countries in the Pacific Rim (Chart 8-3). This change is due in large part to China's role as a final assembly platform for exports for Asian manufacturing firms. The total share of imports from the Pacific Rim has fallen from its recent high in the mid-1990s. This helps to demonstrate why bilateral trade deficits have little economic significance and why they are not a useful measure of the benefits of a trading relationship; these bilateral measures can be driven by a reallocation of trade among partners of the sort that is common in a world of hundreds of trading nations.

Intellectual Property Rights

In 2004, the Administration launched a major initiative to protect intellectual property rights. This initiative is called STOP! (for Strategy Targeting Organized Piracy) and is the most comprehensive initiative ever advanced to combat trade in pirated and counterfeit goods. The initiative is a government-wide effort to empower American businesses to secure and enforce their intellectual property

Chart 8-3 **U.S. Imports of Goods**
While the share of U.S. imports of goods from China has been increasing, the share of imports from the rest of the Pacific Rim has been falling.



Note: Pacific Rim countries include: Australia, Brunei, China, Hong Kong, Indonesia, Japan, Korea, Macao, Malaysia, New Zealand, Papua New Guinea, Philippines, Singapore, and Taiwan. Imports for 2004 are annualized using monthly data through November.
Source: Department of Commerce (Bureau of the Census).

rights in overseas markets, stop fakes at our borders, expose international pirates and counterfeiters, keep global supply chains free of infringing goods, dismantle criminal enterprises that steal America's intellectual property, and reach out to like-minded trading partners and build an international coalition to stop piracy and counterfeiting worldwide. This initiative builds on the Administration's strong existing record of global enforcement and negotiation.

Such efforts are particularly important to the United States, which is a major producer of innovative goods. Recordings, films, books, and software are among the most successful U.S. exports. Property rights in general are vital to the functioning of a market economy (see Chapter 5, *Expanding Individual Choice and Control*). The enforcement of intellectual property rights ensures that creators of innovative products capture the returns to their efforts. This enforcement is vital as well to provide incentives to encourage future innovation (see Chapter 7, *The Global HIV/AIDS Epidemic*). Empirical studies have shown that improvements in a nation's intellectual property protection can lead to increased trade. These studies found the effect to be particularly strong in goods that were easy to imitate, providing evidence that theft of intellectual property displaces legitimate imports. One study found that strengthened patent protection in large developing countries could increase their imports by almost 10 percent.

Trade Liberalization

Tariffs and other barriers to trade in developing countries are still much higher than those in the United States, so there remains considerable scope for lowering barriers both to benefit our trading partners and expand market access for U.S. firms. Imposing barriers to trade means higher prices for consumers and firms and a lower standard of living.

To dismantle these barriers and make the benefits of free trade available to U.S. exporters, producers, and consumers, the Administration has pursued trade agreements on several fronts. After intense diplomacy at meetings in Geneva in July of last year, the United States achieved international agreement on a framework for moving forward on the Doha Development Agenda of WTO trade negotiations. These talks, which were launched in 2001 in Doha, Qatar, have focused on measures that will especially benefit developing nations, including the elimination of agricultural export subsidies. The Administration has also pursued free trade agreements (FTAs) that set modern rules for commerce, meet high standards of market access for goods, and break new ground in areas such as services, e-commerce, intellectual property protection, transparency and the effective enforcement of environmental and labor laws. Agreements were concluded in 2004 with Australia, Morocco, Bahrain, and with the participants in the Central American Free Trade Agreement (CAFTA), including Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic. At the same time, the United States continued negotiations with the five nations of the Southern African Customs Union (Botswana, Lesotho, Namibia, South Africa, and Swaziland) while launching new negotiations with Thailand, Panama, and the Andean nations Colombia, Ecuador, and Peru. The President has also announced to Congress his intention to begin FTA negotiations with the United Arab Emirates and Oman.

Tariff reduction commitments negotiated in our bilateral FTAs in 2004 will save foreign consumers and businesses from paying higher prices for imports and would be expected to spur increased productivity and thus higher incomes in liberalizing countries. When combined with agreements already negotiated by the Administration, partner countries accounting for almost $50 billion in 2003 trade have committed to eventually eliminate tariffs on almost all U.S. exports. Tariffs that averaged as high as 19.6 percent for U.S. exports will be reduced to zero as a result of these agreements.

Opening markets expands opportunities for U.S. farmers, businesses, and workers. An example of the benefits of open markets can be seen in the impact of the recent trade agreement with Chile. Caterpillar Corporation manufactures mining trucks in Decatur, Illinois, that it sells around the world. The Escondida copper mine in Northern Chile—the largest copper mine in the

world—uses mining vehicles to move more than 350 million tons of material per year. Before the free trade agreement with Chile went into effect in January, Caterpillar's mining trucks were subject to tariffs of $60,000 or more. These mining trucks now enter Chile duty-free, and have become Illinois' biggest export. In 2004, Caterpillar tripled its sales to Chile and added nearly 2,700 people to its U.S. payrolls.

The increase in market access for U.S. exports gained through trade diplomacy is especially noteworthy because the United States enters these negotiations with trade barriers that are very low. Central American nations, for example, already had extensive access to the U.S. market through the Caribbean Basin Initiative. Under the terms of the CAFTA, those countries are now making reciprocal commitments to allow in U.S. goods and services.

Bilateral FTAs can also strengthen opportunities for progress in regional and WTO negotiations. In his first term, the President made multilateral trade negotiations a priority. In the second term, concluding multilateral trade negotiations held under the auspices of the WTO will be a top priority for the Administration. Under the President's leadership, the United States successfully led the effort to ensure that 2004 was not a "lost year" for the Doha Development Agenda negotiations. Early in 2004, the United States mounted an intensive effort to get the Doha negotiations on a practical track toward success. U.S. negotiators pressed trading partners to narrow differences, establish key frameworks for detailed negotiations, and push forward to reach an agreement that would foster increased economic growth, development, and opportunity. The diplomatic effort focused on the key market access areas of agriculture, industrial goods, and services; the effort in 2004 developed frameworks that will be built upon in moving forward with the wider WTO agenda. At the end of July 2004, negotiations were successfully put back on track. WTO ministers are scheduled to meet in Hong Kong, China, at the end of 2005, to chart the final course for the negotiations.

To ensure continued U.S. global leadership on trade, two legislative steps are necessary. First, Congress needs to reaffirm the United States' commitment to the WTO in its regular review. Second, Trade Promotion Authority (TPA) must be renewed. TPA leaves the power to regulate international commerce in the hands of the Congress. Under TPA, Congress agrees to accept or reject an accord negotiated by the President without modification. If TPA is not renewed, it will likely be difficult—if not impossible—to achieve the kind of comprehensive benefits the Administration has already negotiated in its free trade agreements to date. At stake are the substantial gains that would come from a successful conclusion to the Doha talks. These gains would accrue both to the United States and to all participants in the global trading system.

Conclusion

The United States is the world's leader in many ways and remains the leading advocate for pro-growth policies around the world. Connecting the world's economies through trade provides economic benefits at home while offering opportunities to other nations that are embracing economic reforms. Peace and prosperity go hand in hand, each reinforcing the other. The President's policies are designed to foster rising living standards at home, while encouraging other nations to follow our lead.