IMPACT ANALYSIS

Opportunities and Risks Impacting International Business

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Dear Friends:

Although U.S. labor and some sugar interests continue to oppose the deal, the United States Congress soon may vote on the DR-CAFTA trade accord. On pages 1-2, Ana Isabel Eiras, a senior policy analyst at The Heritage Foundation, analyzes the agreement's benefits—which exceed trade and investment opportunities.

On page 3, John Manzella discusses the importance of trade and reveals some of its misconceptions.

On page 4, read how trade disputes continue to hamper international business—and how there's plenty of blame to go around.

I hope you find this issue informative, and as always, we welcome your comments.

Sincerely,

Barbara Travis
Executive Director
Mississippi World Trade Center

The Democratic Benefits of a Free Trade Agreement with Central America

By Ana Isabel Eiras, The Heritage Foundation, Washington, D.C.

Increasing economic opportunity and strengthening homeland security are the two major goals of the U.S. government. Advancing free trade is essential to reaching both of these goals. Hence, the Bush Administration and Congress should be praised for significantly advancing free trade with Australia, Morocco, Chile and Singapore.

The U.S. now has an even more important opportunity to expand trade with countries right on its doorstep through DR–CAFTA, a free trade agreement with the Dominican Republic, Costa Rica, Guatemala, Honduras, El Salvador, and Nicaragua. The Administration should push Congress to approve this free trade agreement promptly.

The DR–CAFTA countries have made enormous progress toward democracy and economic liberalization since the 1970s, when almost all of them were ruled by dictators who opposed free markets. In recent years, each of these countries has implemented positive institutional reforms.

Approving DR–CAFTA would "lock in" these reforms and encourage them to continuing reforming. America would benefit greatly from a more open, institutionally stronger Central America, not just by opening a myriad of investment and trade opportunities to U.S. business and individuals, but also because these reforms will foster long-term peace and prosperity in the DR–CAFTA countries.

From War to Democracy

Throughout the 1970s and into the 1980s, every DR–CAFTA country except Costa Rica was ruled by a dictator or in a state of civil conflict, or both. The countries suffered from great political instability. The economies focused inward, and protectionist policies perpetrated widespread poverty.

Eventually peace accords were signed, democratic government returned, and all of these countries began to promote more open-market policies. According to the annual *Index of*

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Economic Freedom, published by The Heritage Foundation and *The Wall Street Journal*, all the DR–CAFTA countries have advanced economic freedom since 1995 at different paces.

Advancement occurred primarily in trade policy and monetary policy. Since 1995, tariffs, non-tariff barriers, and inflation rates have declined in each country. Government intervention—which essentially assesses the degree of privatization in the economy—also has improved in all the countries except Honduras. In most DR–CAFTA countries, many businesses formerly owned and run by the state have been privatized. Except in the Dominican Republic, the banking and financial sectors have been improved in terms of regulation and privatization. Wages and prices in El Salvador, Costa Rica and Guatemala are set freely by the market, but Honduras and Nicaragua still control prices to some degree.

From dictators, civil chaos, and conflict, the DR-CAFTA countries have come a long way. Yet more reform is needed and should be encouraged. For example, none of the DR–CAFTA countries has a strong rule of law, and the maze of business regulations (e.g., labor, zoning and licensing) makes operating a business excessively complex and encourages corruption. With the exception of Costa Rica and El Salvador, all of the countries have extensive barriers to foreign investment and capital flows. Because these barriers make participation in the economy difficult, many of these economies still have large informal economies.

Benefits for DR-CAFTA Countries

DR–CAFTA is a comprehensive agreement. It would not just reduce tariffs and eliminate quotas, but also deregulate the services sector, for example, by removing local residency requirements. The agreement expands access to foreign direct investment and fosters transparency rules, essential for doing business in the DR–CAFTA countries. According to the International Trade Administration, the agreement "requires regulatory authorities to use open and transparent administrative procedures, consult with interested parties before issuing regulations, provide advance notice and comment periods for proposed rules, and publish all regulations."

Clearly, deregulating the services sector would benefit U.S. companies that are competitive in this area. In addition it would be equally—if not more—important to the DR–CAFTA countries' own businesses, enabling them to increase productivity, and increasing the skills of millions of workers in their countries as new foreign businesses and new technologies enter their economies. With higher skills, workers will be more valuable and earn more money, improving their living standards.

As living standards rise and people enjoy better lives, their interest in preserving those lives also will increase. And because they have more to lose from a crisis, they will strive to preserve peace and stability. As a result, the likelihood of civil conflict decreases. At the same time, the improved domestic situation reduces the incentives to leave home in search of a better life elsewhere. Therefore, these people are less likely to emigrate illegally to other, more prosperous countries like the U.S.

Benefits for America

From an economics standpoint, DR–CAFTA would open a myriad of business opportunities for many American businesses, from exporting to the region, to new markets for investment opportunities. In addition, it would decrease the flow of illegal immigration to the U.S. However, the ultimate benefit would come from the economic and political stability the agreement would bring to the region. As the living standards of the DR–CAFTA countries' citizens rise, so will their economic stability, and therefore, their ability to preserve a less volatile political environment. Congress should pass this agreement not just for the sake of the U.S. economy, which would benefit from expanded markets and lower costs for millions of imported products, but also for security reasons. A more stable Central America is key to the long-term fight against terrorism and anti-American sentiment.

Congress should promptly approve DR–CAFTA not just to open a myriad of investment and trade opportunities to millions of U.S. businesses, but also because DR–CAFTA would foster long-term peace and prosperity in these Central American countries.

DR–CAFTA Should Be Approved

DR–CAFTA is an extremely important agreement for the United States, for both economic and security reasons. Advancing free trade is one the best foreign policy tools to help the U.S. economy and improve homeland security. The DR–CAFTA countries have made enormous progress toward democracy and economic liberalization since the 1970s, and the free trade agreement would consolidate their democracies and institutional reforms.

Congress should promptly approve DR–CAFTA not just to open a myriad of investment and trade opportunities to millions of U.S. businesses, but also because DR–CAFTA would foster long-term peace and prosperity in these Central American countries. ■

—Ana Isabel Eiras is Senior Policy Analyst for International Economics in the Center for International Trade and Economics at The Heritage Foundation.

Trade Is Key to Our Prosperity: Protectionist Policies Would Be Disastrous

By John Manzella

International trade is a primary generator of business growth in the U.S. And millions of higher-paying, higher-skilled jobs are dependent on it. Importantly, companies that export grow faster and fail less often than companies that don't. What's more, their workers and communities are better off.

Unfortunately, many Members of Congress have made trade the scapegoat of virtually all America's economic problems. Although their intentions are good, their trade policy recommendations, if implemented, would be disastrous.

If anti-trade policymakers had their way, they would raise import barriers in an attempt to isolate producers from foreign competition. In response, foreign countries would retaliate by keeping U.S. products out. This would have an enormously negative impact on U.S. industry. In addition, America would lose more jobs than it would gain.

If we did the exact opposite—and eliminated all barriers to trade—we would generate a net increase in jobs! According to the U.S. International Trade Commission, if all U.S. trade barriers had been eliminated in 1999, more jobs would have been gained than lost—a number representing only one one-hundreth of 1 percent of the labor force. Plus, total output would have increased by $60 billion.

Furthermore, if U.S. tariffs were raised, imported consumer products would become much more expensive, hurting U.S. families. In turn, less disposable income would be available for education, health care, rent or mortgages. And factories that incorporate foreign components in their products would have to raise prices or absorb the difference.

New technologies and innovation, which have significantly boosted productivity, are primarily responsible for the loss of manufacturing jobs—not trade. As a result, fewer workers can produce much more than ever before. Surprising to many, U.S. manufacturing production has rapidly increased, not decreased, over the last 50 years, according to the Federal Reserve.

> Would we want to go back and save buggy maker jobs at the expense of auto workers, dump ATMs because they eliminated bank teller positions or destroy voice mail because it replaced receptionists?

Consider this: would we have wanted to stop rising productivity in the U.S. agricultural industry that caused the number of farm jobs to fall from 9.5 million in 1940 to 2.2 million today? Currently, U.S. agricultural output can virtually feed the world. America did not "lose" 7.3 million farm jobs: they shifted to emerging industries. As a result, we became more efficient and prosperous.

Would we want to go back and save buggy maker jobs at the expense of auto workers, dump ATMs because they eliminated bank teller positions or destroy voice mail because it replaced receptionists?

Since 1970, the U.S. economy generated 60 million net new jobs. What's more, the Department of Labor projects a net increase of another 21.3 million from 2002 through 2012, with 96 percent in the service sector.

How well do service jobs pay? Over the last decade, the U.S. service industry has become highly sophisticated. In turn, average hourly earnings for service production workers have already caught up to those in manufacturing, according to the Bureau of Labor Statistics.

In an attempt to remedy several U.S. economic problems, many Members of Congress apply old-era solutions to today's challenges. This is part of the problem.

Today, technological advances, the fall of Communism and globalization are shaping a new world. In response, we can elect representatives who recognize this and take actions to improve the country's competitiveness or chose policymakers who hope the world of yesterday returns.

Trade is not the cause of American economic ills. It's one of our bright spots on our economic horizon. ■

—John Manzella, president of Manzella Trade Communications, is a leading author and strategic communications consultant on issues involving international business.

Global Trade Disputes Continue: The Impact on U.S. Exporters

By John Manzella, in association with Stephanie Frank

The United States always has been a leading proponent of free trade. However, many now believe this leadership position is at stake—especially since U.S. willingness to accept World Trade organization (WTO) rulings is questioned.

For example, both WTO and NAFTA committees have ruled that Canadian lumber subsidization evidence is insufficient. Nevertheless, the U.S. continues to impose tariffs on Canadian softwood lumber exports to the U.S. This dispute has been unresolved since 1982.

Everybody's Doing It

The U.S. is not alone in terms of non-compliance with international trade rulings. And, if the number of global trade disputes is any indication of unfair play, the U.S., European Union (EU) and several other countries share company.

Since 1995, the year the WTO was established, the international body has accepted about 30 trade dispute cases annually. As of April 6, 2005, the U.S. alone has been charged with 86 trade disputes; the EU or member states have been charged with 54, according to the Washington, D.C.-based Progressive Policy Institute.

Convoluted Tax Codes and Subsidies

In today's competitive world, national tax laws and subsidies have become extremely complex, resulting in numerous unintended consequences—including multiple trade disputes. For example, for decades, EU industries, such as aerospace and telecommunications, have been subsidized. This has boosted their international strength or shielded them from global competition. In addition, the EU has exempted its exporters from paying a value added tax, which, in effect, has reduced their tax burden.

Although Europe's tax loopholes and subsidies distort trade by artificially increasing the attractiveness of its exports, its indirect tax system is technically WTO-compliant.

To counter this, the U.S. crafted the Foreign Sales Corporation (FSC) tax code in 1984. This was designed to help U.S. exporters compete more fairly with EU companies, as well as others around the world. Many U.S. companies claimed it was a success. In fact, a National Foreign Trade Council report stated that 3.5 million U.S. export-related jobs benefited from FSC tax incentives in 1999.

However, the EU challenged the FSC rule through the WTO, and won in 2000. To appease the EU and global trade body, the U.S. repealed the law. In its place, the U.S. Congress created the Extraterritorial Income Exclusion (ETI) Act of 2000. But this law still didn't satisfy the EU. Consequently, the EU challenged it through the WTO, and won.

A Creative Solution

To remedy the situation, on October 22, 2004, President Bush signed legislation repealing ETI. The bill also reduced corporate tax rates for domestic manufacturers and simplified tax rules on overseas profits.

Without this, it was argued that approximately 6,000 U.S. exporters, who relied on ETI to compete, would have been hurt. Boeing estimated that repealing ETI without a suitable replacement would result in the loss of nearly 10,000 of its high-tech jobs,

as well as 23,000 more jobs with its suppliers.

Why? In 2002, Boeing's heavily subsidized European rival, Airbus, was estimated to have received more than $30 billion in EU financial support. Boeing claimed this gave the EU conglomerate an unfair advantage. Furthermore, analysts believed this affected the entire U.S. aerospace industry that employed nearly 800,000 highly-skilled workers in 2002.

Nevertheless, the Boeing-Airbus fight continues to rage for over a decade without a solution in sight.

Impact on U.S. Exporters

Should the number of trade disputes continue to climb resulting in retaliation, American exporters stand to suffer losses. Retaliatory actions, which typically come in the form of increased tariffs, raise the cost of American products in foreign markets. Often leading to decreased sales for U.S. companies, this can translate in fewer jobs for American workers. As a result, it is in the interests of the U.S., the EU, and others to swiftly remedy disputes and focus on more profitable long-term trade relations. ■

—Stephanie Frank is a trade analyst.

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