

Remarks of Franklin L. Lavin
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(as prepared)

Thank you Carla (Hills) for that gracious introduction. I'm delighted to be here at the CSIS Advisory Board meeting with many old friends. It is the terrific cross section of serious policy people and serious business people that makes CSIS so useful. I'm particularly honored because I previously served as a Fellow at CSIS and had the chance to participate directly in these discussions. It's a pleasure to be back.

In keeping with the spirit of CSIS as the best place in town to do serious policy business, I was here back in March to discuss Iraq's economy.

I believe we are at an interesting moment in international relations, with the mechanisms of the Cold War largely dissolved or re-oriented, but without the emergence of replacement architecture that helps provide stability to the international system. It is an era that seeks definition, but this evolution can sometimes only be fully grasped in retrospect.

What I would like to talk to you about today is to first offer some thoughts on the economic dimension of this moment, and then discuss some specific challenges we have in front of us today.

International Trade Trends

In my view there are three large-scale, systemic trends unfolding that will shape the international economic environment, and have implications for political and security issues.

The first trend is the addition of three billion new customers to the international trading community. Some might note this could also imply three billion new competitors. With the integration of China, India, and much of Eastern Europe into the international economic system over the past 25 years, we have effectively doubled the economic population of the world. The potential benefits, as well as the potential economic dislocation brought about by this phenomenon, is exacerbated by the range of development levels encompassed in this new population grouping.

The second trend is the “death of distance,” actually the title of a book by Frances Cairncross. The point is that distance and location are decreasing in their importance to business decision-making. The advent of e-mail, global integrated logistics, web-based marketing, and the expansion of a trans-national managerial class mean businesses have unprecedented flexibility as to what activities they undertake and how they disaggregate these activities around the world.

The third trend is the revolution in trade liberalization. When the GATT was established in 1947, the average weighted tariff of the U.S. was about 40 percent, and now it is less than four. When we add to this GATT/WTO process the some 300 FTAs that the U.S. and others have signed -- a development we should welcome, by the way -- we are enjoying the most open trading moment in modern times.

These three trends help explain the extraordinary growth in international trade and investment in recent years

Global FDI flows have more than doubled in the past three years, from \$558 billion in 2003 to \$1.23 trillion last year. U.S. exports have doubled in the last dozen years, from \$720 billion in 1994 to \$1.4 trillion last year. Indeed, if you look at exports share of the overall U.S. economy, they comprised 11.1 percent of U.S. GDP last year, the highest ever in dollar terms. It was 9.6 percent five years ago, and 5.2 percent 50 years ago.

The world is spinning faster. It has never been easier for U.S. businesses to enter other markets. At the same time it has never been easier for others to enter our market. This helps explain why at a moment of a global economic boom, we also see a consistent strain of economic anxiety.

And before we view this trajectory as a pure economic boon, let me reference two other phenomena that are a by-product of these three factors.

The first is the magnification effect, a simple way of describing the socio-economic impact of moving from a smaller, closed economic platform to a larger integrated system. This move magnifies existing strengths and weaknesses. Those institutions that are capable of competing on a world stage now have the ability to do so. Hollywood, Wall Street, Silicon Valley are examples. Those institutions, and individuals who are not so capable derived benefit from operating in a smaller economic space, and now potentially risk economic deterioration, at least in relative terms, but this economic evolution I have been describing.

A second phenomenon is that we see a shift in power, from the “collaborators” to the “disruptors.” Large-scale institutions can take full advantage of the efficiencies of an integrated system. But people and institutions on the margins have more trouble benefiting from this emerging global system, or simply find disruption appealing for political or social reasons. If they seek to maximize their power within the system, they do so by disrupting the process. We have seen this starkly in the WTO process, which now includes a sizeable population of states that have little if any trade interests. Thus they derive almost no benefit from a successful WTO round, yet they have the ability to stymie the entire process for a parochial issue. Sometimes this phenomenon is violent, as with terrorism, sometimes it is akin to a social pathology, as it is with computer hackers, sometimes it is organic, as it is with pandemics. I am not equating these various disruptions; I am just noting that in a game-theory view of decision-making, the pay-off matrix now offers a higher reward to some if they were to engage in disruption rather than collaboration

The more integrated you are, the more efficient you are, and the more vulnerable you potentially are as well.

The Administration’s Economic Policies

To my mind the benefits of the three trends I describe far outweigh the potential risks I have just mentioned, but we should at least be mindful of these risks.

Let me wrap up by touching on the trade agenda this year. First, FTAs: the Administration will be submitting four FTA’s to Congress: Peru, Columbia,

Panama and Korea. These represent an important step ahead for the U.S. economy as well as an important political step. Whether we are looking to undercut narco-traffickers, or to show support for an ally in Asia, our FTAs carry important policy messages with them in addition to their economic benefits.

Beyond the FTA's, there is the Doha Round at the WTO. IIE estimates that a successful Doha Round would raise U.S. household income by an additional \$100 billion a year. Yet consensus in Geneva, or even on Capitol Hill, to further trade liberalization remains elusive. This Administration remains firmly committed to a successful conclusion of the Round. To my mind we have at least a few more months to reach the finish line.

Finally, China. The three trends I started with can be seen most acutely in China: millions of new customers and competitors, the death of distance, and the decline of trade barriers as China joined the WTO.

This presents a sharp challenge and an opportunity for the U.S. Since we began our engagement with China some 35 years ago, Administrations of both parties have deemed it to be in the strategic interest of the U.S. for China to be integrated into the world trading system, meaning an economy that was internationalized and rules-based.

We have a range of approaches to engage China, with the preferred mechanism being negotiation and dialogue. We see this primarily through the SED and the JCCT process.

But we also have other mechanisms as well.

In March, the Commerce Department decided to apply U.S. anti-subsidy law to Chinese imports.

Earlier this month, USTR initiated a dispute settlement process at the WTO regarding two cases of intellectual property rights.

We view both of these as prudent steps, primarily to bolster the negotiating track. Lest anyone think that this represents a stark policy shift, or that a trade war is looming, I can offer some comments on the Commerce side of these actions.

All of these approaches add up to a comprehensive strategy that will help China become a mature, full partner in the international trading system.

Conclusion

In conclusion, I believe we are in the midst of a global revolution in international business practice with broad political and social ramifications.

At the same time, a protectionist backlash to these policies may happen. Leaders in business and government around the world are going to have to make hard choices as we guide our countries and companies ahead.

Your commitment to developing America's international policy means that you understand what is at stake. I share your objective of creating a more

prosperous and secure world. And I want thank you for your leadership in the past and your continued engagement to build a better world.