Rising Economic Powers and U.S. Trade Policy

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Summary

A handful of developing countries are becoming major players in the global economy due, in part, to their large populations, rising trade flows, and rapidly growing economies. These evolving economies are likely to be of increasing interest to the 113th Congress. Led by China, these rising economic powers (*REPs*) include Brazil, India, Indonesia, Mexico, Russia, and Turkey. Based on purchasing power parity estimates, China, India, Brazil, and Russia are now among the 10 largest economies in the world and Mexico (#11), Indonesia (#15), and Turkey (#16) are not far behind. With large economies and rising shares of world trade flows, the *REPs* have greater involvement in World Trade Organization (WTO) negotiations and dispute settlement cases, have protested with greater frequency U.S. economic and trade policies, and are more able and willing to deflect or reject U.S. trade and market access demands.

Although they have made great economic strides, any of these *REPs* could stumble if they do not take steps to improve their business climates by undertaking a range of trade, regulatory, and structural reforms. At the same time, other large developing countries that have enormous economic potential, such as Egypt, Iran, Nigeria, and Vietnam, could rise if they successfully address underlying political and economic challenges.

U.S. exports to the *REPs* and other developing countries have become an increasingly important source of growth for the U.S. economy. If the United States is to maximize its export potential and boost its living standards, U.S. exporters and investors may need to have better access to the *REP* markets. Trade and investment barriers remain considerably higher in most of the *REPs* than in the United States and other advanced countries. Efforts have stalled in these countries to reduce their barriers further, and several *REPs* have reactivated industrial policies or found ways to take advantage of gaps in the world trade rules to promote home companies at the expense of foreign companies.

The United States' ability to persuade these emerging economic powers to embrace the principles of free and fair trade is constrained by growing differences over the role of the state in economic activity. The more interventionist practices and philosophies of *REP* governments coincide with a desire to maintain "policy space" to promote development of their economies via policies that often appear to violate the letter or spirit of WTO rules and obligations. Persuading the *REPs* that a strengthened multilateral trading system is squarely in their national economic interests and a way to move their domestic economic reforms forward remains a challenge.

As global power and prosperity is reconfigured, U.S. trade policymakers face a number of overlapping and complex issues relating to the role of future trade liberalizing negotiations, U.S. leverage in influencing *REP* economic reforms, and the management of the global trading system. Given the checkered history of the Doha Round, future progress on trade liberalization within the WTO may require new approaches. Principles that have guided multilateral trade negotiations in the past, such as unconditional most-favored-nation (MFN) and special and differential treatment (S&D), may need to be reexamined. Similarly, if the United States wishes to negotiate free trade agreements (FTAs) with large and more significant trading partners, it may need to consider deviations from its standard FTA template. At the same time, ongoing Trans-Pacific Partnership (TPP) negotiations and a potential comprehensive U.S. FTA with the European Union (EU) could serve as incentives for the *REPs* to view multilateral or bilateral negotiations more favorably.

In an era in which global trade leadership is shifting and uncertain, the WTO's dispute settlement understanding (DSU) has become a key forum for managing trade relations. The DSU, despite weaknesses, is a way to engage the *REPs* directly about their responsibilities for upholding a system of multilateral trade rules.

The 113th Congress may review U.S. trade relations with the *REPs,* particularly if President Obama should ask for a renewal of Trade Promotion Authority (TPA) in 2013. Some observers maintain that U.S. trade leadership is bolstered when the President has TPA and a mandate from Congress to negotiate new trade agreements. In trying to tie the *REPs* with their very different state-led economic models into the more market-oriented WTO system, U.S. trade negotiators may need considerable resources, incentives, flexibility, and leverage.

Contents

Figures

Tables

Appendixes

Contacts

Introduction

For much of the post-World War II era, developing countries were relatively minor players in the world economy. Accounting for 80% of the world's population but less than 20% of the world's output two decades ago, developing countries throughout Africa, Asia, Latin America, and the Middle East were often dismissively referred to as the Third World. At the time, these countries generally exported raw materials, and few ever expected them to be able to export sophisticated manufactured goods to the industrialized world or to become significant world importers.[1]

Developing country economic prospects began to change in the 1980s with the spectacular success of four Asian countries—Hong Kong, South Korea, Taiwan, and Singapore. Dubbed the "Asian tigers," these countries adopted export-led growth strategies that helped boost annual per capita incomes by between 5% and 6% over the entire decade. This success, which also involved the use of industrial policies to develop their manufacturing sectors, helped shift the focus of other developing countries from production for domestic and regional markets to production for world markets.

This reorientation in thinking accelerated dramatically in the early 1990s with the advance of globalization. Bolstered by the fall of communism, the beginnings of the information technology (IT) revolution, sharply declining transportation costs, the freer movement of capital and technology from developed to developing countries, and economic reforms, economic growth in developing countries began to take off, reaching practically every region of the world and encompassing dozens of developing countries.[2]

China led the way with average annual real gross domestic product (GDP) growth increases of nearly 10% from 1979 to 2011. Its share in global GDP increased from 1.5% in 1990 to 9.5% in 2010. Growth in a handful of developing countries with very large populations, such as India, Brazil, Indonesia, Turkey, and Mexico, was also stronger than it had been in previous periods for various reasons. These other developing countries increased their share of global GDP from 15% to 22% over the same period, enabling developing countries as a group with now 83% of the world's population (5.1 billion people) to expand their share of global output to almost 33% today.[3] During this same period, the size of the global economy more than doubled, increasing from $28 trillion in 1990 to $68 trillion in 2010.[4]

Projections abound that a handful of developing countries will continue to gain shares of global output vis-à-vis the advanced countries, and in the process change the face of the global economy. A World Bank study projects that by 2030, developing countries will contribute about 50% of

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[1] Ian M.D. Little, *Economic Development: Theory, Policy, and International Relations,* 1982.

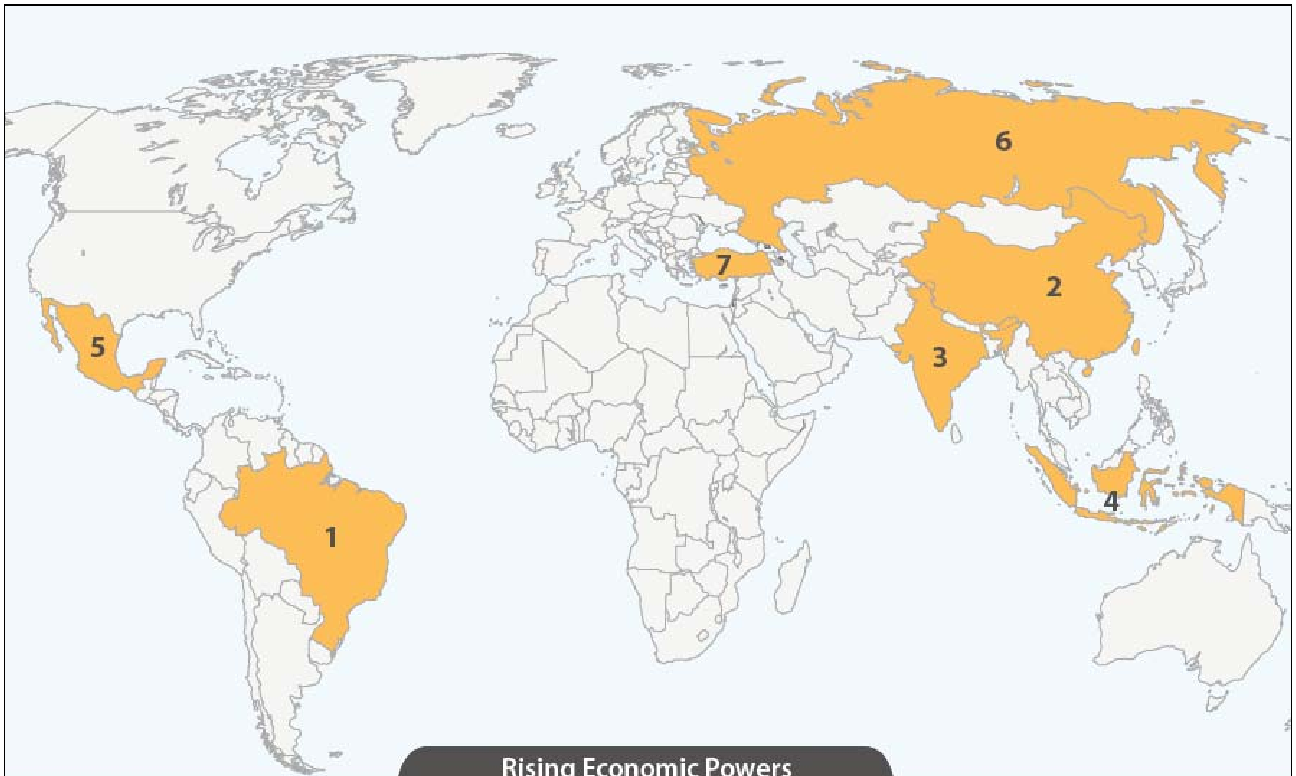
[2] CRS Report RL34091, *Globalization, Worker Insecurity, and Policy Approaches*, by (name redacted).

[3] World Bank and Development Centre of the State Council, P.R.C., *China 2030: Building a Modern, Harmonious, and Creative High-Income* Society, World Bank, Washington, D.C., 2012, p. 399 [hereafter cited as World Bank: *China* 2030].

[4] A previous CRS report (CRS Report R41969, *Rising Economic Powers and the Global Economy: Trends and Issues for Congress*, by (name redacted)) describes how a small group of fast-growing and highly populated developing countries are gaining larger shares of global GDP, trade and investment, and posing varied challenges for U.S. economic interests.

global output (with China contributing 20%) and two-thirds of global economic growth (with China contributing 25%).[5]

Figure 1. Rising Economic Powers



Rising Economic Powers

	Population *millions*	GDP *$trillions*	GDP per capita, *$'s*	Total Trade with US *$billions*	Average GDP Growth (%) *2003-2008 and 2009-2011*
1 Brazil	196.6	2.5	12,953		2003-2008 2009-2011
2 China	1,334	7.3	5,429		
3 India	1,242	1.8	1,488		
4 Indonesia	242	0.9	3,494		
5 Mexico	115	1.2	10,064		
6 Russia	142	1.9	13,089		
7 Turkey	74	0.8	10,498		
$U.S. 2011 dollars				$0 $300 $600	0 2 4 6 8 10 12

Source: Analysis by CRS. Data from World Bank Development Indicators and U.S. International Trade Commission.

[5] World Bank: *China 2030,* p. 6.

Long-term projections, however, can be far off the mark. Some of these countries may falter as aging populations, rising labor costs, corruption, environmental challenges, failure to innovate or reform more deeply, or infrastructure deficiencies limit them from growing as rapidly as predicted, while other developing countries currently not on anyone's radar screen could turn their economic and political fortunes around.

Nevertheless, there is widespread consensus that in addition to China, many of these other larger populous developing countries will continue to experience faster economic growth than the advanced economies, as they have over the past decade, thus continuing the shift of relative economic wealth to a handful of developing countries. Reasons for this assessment include both a continuing large potential for "catch-up" gains in output and productivity that these developing countries possess, combined with continuing slow growth in advanced economies due to deleveraging and the impact of high debt burdens.[6]

Despite likely gains in economic power, the living standards (as measured by per capita income levels) of the rising powers are likely to remain well below the levels in advanced countries due to their huge populations and still high poverty rates. But still "developing" countries are becoming significant forces in the world economy for the first time in hundreds of years, creating uncertainties regarding their role in the global economy.

These rising countries present the United States with both opportunities and challenges. On the opportunity side, rising imports from these economies offer U.S. consumers an expanding choice of products at lower prices, raising real incomes and contributing towards higher standards of living. Many of the imports are also intermediate goods used in the production of U.S.-produced goods, lowering costs and, thereby, helping to maintain the competitiveness of U.S. firms in the global economy. As their economies grow, the *REPs* are also providing U.S. exporters and investors with robust new markets—their successful growth strategies are expected to create billions of new "middle-class" consumers and unleash billions of dollars in infrastructure spending over the next few decades for which U.S. exporters of goods and services can compete.

At the same time, many U.S.-based firms and workers are competing now with an expanded pool of lower-wage labor, much of it located in the *REPs.* Such competition can nudge U.S.-based firms to reduce costs by adopting labor-saving technology, to move production overseas, or to shut operations that may no longer be competitive. Even firms and workers in high-end service sectors are feeling the pressure of competition from these countries.[7]

U.S. relations with the *REPs,* thus, are affecting U.S. economic welfare in fundamental ways. From the perspective of U.S. trade policy, efforts to reduce the trade and investment barriers of the *REPs* that are impeding U.S. producers and workers from maximizing the benefits of participation in the global economy are likely to be a high priority. But the views and practices of the *REPs* regarding the role of the state in economic activity, which may differ sharply from U.S. perspectives and actions, make the elimination of trade barriers and the negotiation of new world

[6] Assuming that workers in developed countries are already highly productive, for reasons ranging from more advanced technology to better infrastructure and health care, workers in developing countries have a lot more scope for "catching up" to them if they can fulfill their potential.

[7] CRS Report R41145, *The Future of U.S. Trade Policy: An Analysis of Issues and Options for the 112th Congress,* by (name redacted).

trade rules more difficult. For their part, the *REPs* are also protesting U.S. policies on trade remedies, high tariffs on apparel and other import-sensitive items, pricing of medicines, agricultural subsidies and quotas, the temporary entry of foreign workers, and monetary expansion (so-called quantitative easing). In addition, they are making their concerns heard in international institutions, particularly the WTO.

How the *REPs* evolve may also affect the nature and integrity of the world trading system. U.S. trade policy officials have generally assumed that as the *REPs* gain weight in the international trading system, they will become more responsible stakeholders by sharing not only the benefits but the costs of system maintenance and by embracing the principles of free and fair trade with limited government intervention. As China and other developing economies with heavy state involvement in guiding economic activity evolve, it is not certain that they are going to accept this place in the liberal international economic order that the United States and Britain jointly constructed in the aftermath of World War II.

The rise of China and other developing countries has also coincided with a weakening of the WTO-centered multilateral trade order. Bilateral and regional preferential trade agreements have proliferated and WTO-sponsored multilateral trade liberalization negotiations have stalled. In this environment, questions arise over how the world trade order will be kept and how new rules will be established.[8]

These profound changes in the global economy raise a number of questions that the 113th Congress may wish to consider in its oversight of U.S. trade policy. First, what kinds of trade negotiations can best be utilized to open up *REP* markets in a way that provides for more balanced and mutually beneficial relationships? Second, in what ways can the United States best influence the *REPs* to adopt more market-oriented trade and economic policies or reduce barriers to U.S. exports and investment? Third, how can the United States best influence China and the other *REPs* to become responsible stakeholders in the world trading system?

This report is organized into four parts. Part one summarizes the key observations of the report. Part two discusses the key characteristics of the *REPs* and their reform challenges. Part three analyzes the relationship between U.S. trade interests and the *REPs*. Part four considers a range of U.S. trade policy responses to challenges raised by the *REPs*, including the role of Congress.

Key Observations

The key observations of the report are summarized below. More detailed analysis and information is provided in the main body of the report.

The Rising Economic Powers

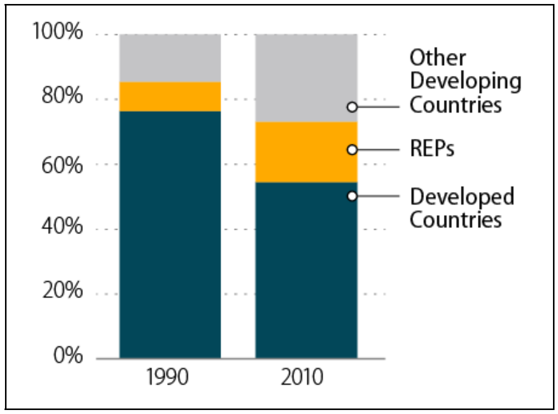
- **Countries:** A handful of developing countries with large populations and growing economies are becoming major players in the global economy. These rising economic powers (*REPs)* are led by China, but also include Brazil, India,

[8] Robert Skidelsky, "The Future of Globalization in the Light of the Economic Collapse of 2008," IISS Geo-Economic and Strategy Seminar, March 25, 2012, p.3.

Indonesia, Mexico, Russia, and Turkey. There are also a number of populous developing countries such as Egypt, Iran, Nigeria, and Vietnam that have enormous economic potential, but must overcome fundamental political and economic obstacles if they are to achieve their economic potential.

- **Characteristics:** Comprising 48% of the world's population, these seven countries have accounted for the bulk of a shift in global GDP to developing countries, going from 16% in 1990 to 33% in 2010 (see **Figure 2**). Based on purchasing power parity estimates, China, India, Russia, and Brazil are now among the 10 largest economies in the world and Mexico (#11), Indonesia (#15), and Turkey (#16) are not far behind. With large economies and rising shares of world trade flows, the *REPs* (particularly China, Brazil, and India) have greater involvement in WTO negotiations and dispute settlement cases, have protested with greater frequency U.S. economic and trade policies, and are more able and willing to deflect or reject U.S. trade and market access demands.

Figure 2. Shift in Shares of Global GDP



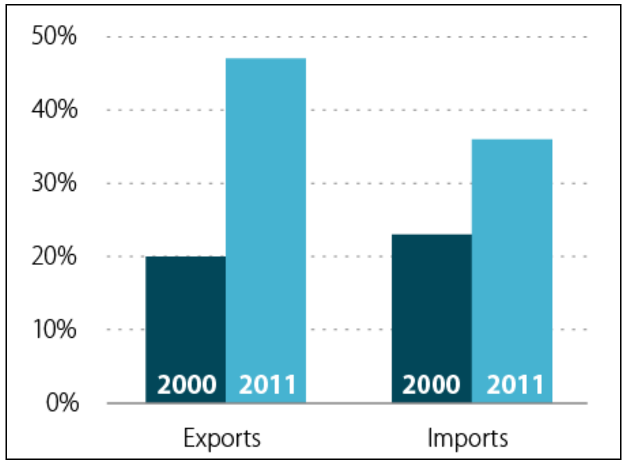
Source: Analysis by CRS. Data from World Bank World Development Indicators.

- **Reform Challenges:** Continued high growth requires ongoing reforms to address economic challenges, which constantly change as countries hit different income levels. Any of the *REPs* could stumble if they do not take steps to improve their business climates by undertaking a range of trade, regulatory, and structural reforms. Government corruption, poor infrastructure, weak governance, inadequate intellectual property protection, and inability to innovate are some of the reform challenges these countries share. All these reforms tend to be politically sensitive because they are opposed by vested interests.

U.S. Trade Interests and the *REPs*

- **U.S. Exports and Imports:** The *REPs* are becoming much more important U.S. trading partners (see **Figure 3**). They accounted for 47% of U.S. exports in 2011, up from 20% in 2000. Their share of U.S. imports has risen from 23% in 2000 to 36% in 2011. If the *REPs* continue to grow rapidly and open their economies further to trade, these trends could accelerate in the future.

Figure 3. REP's Shares of U.S.Trade



Source: Analysis by CRS. Data from U.S. International Trade Commission.

- ***REP* Trade Barriers:** If the United States is to maximize its export potential and boost its living standards, exporters and investors will need to have better access to *REP* markets. *REP* trade and regulatory barriers on multiple fronts—tariffs and non-tariff barriers, and restrictions on services and investment—remain considerably higher than in the United States and most other advanced countries. Many of these barriers are denying U.S. producers and workers the extension of comparative advantage, particularly in the areas of services, foreign investment, intellectual property, and government procurement, not only in *REP* markets, but also in third country markets. A number of these barriers are inadequately covered or difficult to enforce under current WTO rules.
- ***REP* Interventionist Policies:** The ability of the United States to persuade the *REPs* to embrace the principles of free and fair trade is constrained by growing differences over the role that the state should play in economic activity. While the rules-based GATT/WTO trading system favors commercial outcomes to be determined by market forces, most *REP* governments play a much larger role in their economies than does the U.S. government. As the 2008 global financial crisis may have weakened the case for free market approaches, some of these countries may now feel more willing to entertain market-distorting practices and take advantage of gaps in the rules.
- ***REPs* as "Responsible Stakeholders":**[9] As the *REPs* have benefitted greatly from participation in the global economy, many observers hoped that over time they would assume greater responsibility for the maintenance of the trading system. But decisions by Brazil, China, and India not to make concessions that could have facilitated the conclusion of the Doha Round of multilateral trade negotiations reflected policy calculations driven primarily by national interests and challenges. How to persuade these countries that a strengthened multilateral

[9] Robert Zoellick introduced the notion of China as a "responsible stakeholder" in the international community in a September 1, 2005 speech delivered before the National Committee on U.S.-China Relations. Zoellick at the time was serving as Under Secretary of State.

trading system is squarely in their national economic interests and a way to move domestic economic reforms forward remains a challenge. China, the largest exporter of manufactured goods and the second-largest economy in the world, is the *REP* looked to the most for providing leadership of the global trading system, but India and Brazil are not far behind.

U.S. Trade Policy Response

- **Changing Context for U.S. Trade Policy:** With the *REPs* accounting for a rising share of global GDP and trade, U.S. trade policymakers face very different conditions than those that prevailed in the second half of the last century. Support for multilateralism is weaker, bilateral and regional preferential agreements have proliferated, and priorities for trade liberalization and economic reforms are evolving as complex, new policy issues come to the fore. In this environment, questions arise over how the world trade order will be kept, how new rules will be established, and how the United States can best respond to the opportunities and challenges posed by the rise of the *REPs*.
- **Trade Policy Goals and the *REPs*:** Trade expansion promotes higher U.S. living standards, but all companies and workers do not gain equally. Today's more open global economy, which has intensified competition for low-skilled workers and pressures for automation, may be responsible for a number of contemporary economic concerns, such as job insecurity and income stagnation. These trends feed into growing public pressures for greater reciprocity in U.S. trade relations with the *REPs*, and raise questions concerning the role of trade negotiations and export promotion in achieving U.S. trade policy goals.
- **Trade Policy Strategy towards the *REPs***. The *REPs* still depend on access to advanced country markets and they may not easily ignore requests for reciprocal negotiations. Nor are the *REPs* likely to ignore the potential discriminatory effects of preferential trade agreements negotiated by the United States with other large and significant trading partners. In negotiating with the *REPs,* U.S. trade policymakers may wish to consider putting U.S. trade barriers on the table.
- **Multilateral Negotiations:** Given that the *REPs* did not use their growing influence to insure a successful conclusion of the Doha Round, further progress on trade liberalization within the WTO may require alternatives to existing multilateral processes and practices. Principles that have guided multilateral trade negotiations in the past, such as unconditional most-favored-nation (MFN) and special and differential (S&D) treatment, may need to be reexamined. Currently, 47 advanced and advanced developing countries are exploring a potential plurilateral agreement on services under the WTO umbrella (where some but not all WTO members are members), and other plurilaterals on foreign investment and state-owned enterprises have been proposed. Such agreements could help end simplistic distinctions between developed and developing countries which many of the *REPs* have tried to perpetuate.
- **Strengthening WTO Dispute Settlement:** In an era in which both global economic power and trade leadership are in transition, the WTO's dispute settlement understanding (DSU) has become a linchpin for maintaining global economic order. For the United States and other advanced countries, the DSU is a way to engage the *REPs* directly about their responsibilities for upholding a

system of multilateral trade rules. For the *REPs*, the DSU provides a way to challenge advanced countries' market access barriers and measures that some deem to be protectionist, such as extensive use of trade remedy laws. The DSU, however, does have weaknesses (e.g., cases can take three years to complete and remedies are not retrospective) which U.S. trade policymakers could try to address.

- **Bilateral and Regional FTA Negotiations and Other Bilateral Initiatives:** Increasingly, U.S. trade policy (as well as the trade policies of the other major trading countries) is becoming dominated by bilateral and regional negotiations to establish free trade agreements (FTAs). These agreements offer opportunities between pairs or groups of countries to reduce trade barriers and construct new rules in an effort to forge more integrated economies. U.S. FTAs since NAFTA went into effect in 1994 have been concluded with relatively small trading partners (South Korea excluded). These have been comprehensive in scope and have comprised high standards. For a number of reasons, the United States has not concluded FTAs with large and more significant trade partners, such as China, India, or Brazil, that could offer greater economic advantages. If the United States wishes to move in this direction, deviations from its standard FTA template may need to be considered. At the same time, ongoing Trans-Pacific Partnership (TPP) negotiations and a potential comprehensive U.S. FTA with the European Union (EU) could serve as incentives for the *REPs* to view higher standard multilateral or bilateral negotiations more favorably. In addition, other bilateral initiatives, such as cabinet-level working groups and trade and investment framework agreements, are or could be additional approaches used to elevate U.S. government attention and resources devoted to these key countries.
- **Unilateral Initiatives to Encourage *REP* Reforms:** U.S. unilateral initiatives traditionally took the form of threats to restrict a trading partner's access to the large U.S. market in order to influence trade barrier reductions. In today's more interdependent and rules-based world economy, unilateral initiatives take the form more of "carrots" or incentives than "sticks" or sanctions. Possible unilateral initiatives include measures that strengthen the U.S. economy so that it sets an example for the rest of the world, as well as U.S. proposals that resonate with the *REPs*' evaluation of their own economic self-interest.
- **Congressional Role:** Congress plays a large role in the development and administration of U.S. trade policy. The 113th Congress may consider a number of questions relating to the future direction of U.S. trade relations with the *REPs*, particularly if President Obama should ask for a renewal of Trade Promotion Authority (TPA) in 2013. Some observers maintain that U.S. trade leadership is bolstered when the President has TPA and a mandate from Congress to negotiate new agreements. In trying to induce the *REPs* with their very different state-led economic models into strengthening the market-oriented WTO system, U.S. trade negotiators may need considerable resources, flexibility, and leverage to engage them more successfully.

Who Are the Rising Economic Powers?

Predictions abound that a small group of the over 140 countries now classified by the World Bank as "developing" will be the growth engine of the global economy and will continue to gain global output vis-à-vis the advanced countries. Outside of the largest developing countries, such as China, India, and Brazil, there has been less consensus on which countries to flag for special consideration.

Past attempts to identify the rising economic powers from the developing world have adopted many different monikers—emerging markets, *Big Emerging Markets*, *BRICs*, *Near-BRICs*, *Next-11*, and *Pivotal Powers*—often driven by different objectives, such as generating interest in new investment opportunities. (See **Appendix A** for a summary of these past efforts.) This report focuses on countries that are not only up and coming, located throughout the world, and providing expanding markets, but are also playing an increasingly large role in determining the shape of the global trading system.

Most predictions mapping out the rise of specific developing countries use a simple methodology that incorporates data on labor force and capital stock growth combined with more subjective evaluations on how individual governments will cope with a range of political and economic challenges. To the extent that the underlying political and institutional dimensions are given more weight, projections regarding the rise of any one country are probably going to be less firm than the fact that the greatest potential for high rates of economic growth (and a continuing shift of economic power) rests with a small group of developing countries (see **Appendix B** for more detail on the methodology behind the economic projections).

There are large differences among the universe of rising developing countries, giving scope for varied groupings and categories. The likely uneven rise of developing countries is an important consideration for prioritizing U.S. trade interests and concerns. While this report focuses primarily on seven large, populous rising economic powers—China, Brazil, India, Indonesia, Mexico, Russia, and Turkey—some of these countries' economic prospects could easily decline if fundamental challenges are not addressed. Simultaneously, a number of large developing countries, such as Egypt, Iran, Nigeria, and Vietnam, could emerge as global economic forces over time if their geopolitical conditions are dramatically altered and economic deficiencies addressed. These long-shot or turnaround economies have the size to exert influence if they break out of their economic doldrums and political constraints. In addition, nearly a dozen or so fast-growing developing countries, such as Colombia, Poland, and Malaysia, are providing rapidly growing commercial opportunities for U.S. traders, consumers, and investors, although these countries may not have the size to become forces in the global economy. (See **Appendix C** for a discussion of these two alternative country groupings.)

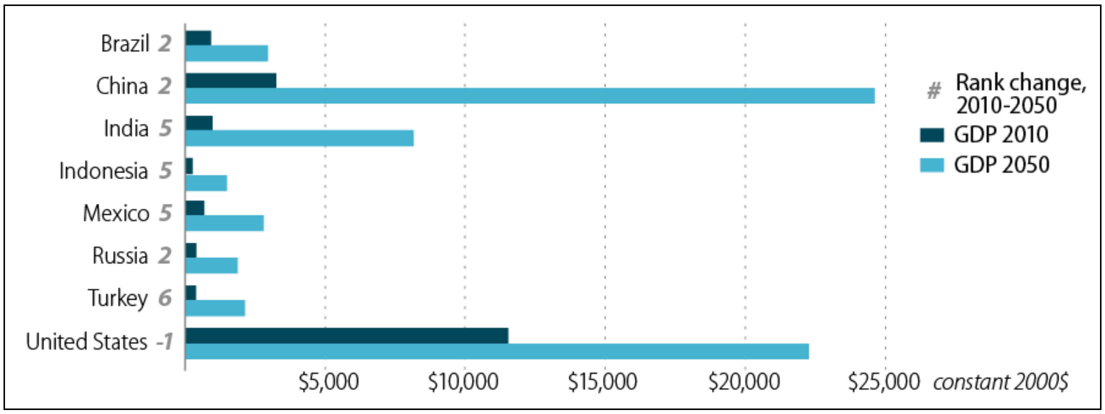
Defining Characteristics

There are significant differences among the seven countries dubbed as rising economic powers (*REPs)* in this report. These include political systems, per capita income levels, approaches to economic development, and trade patterns. Perhaps most importantly, China and Russia tend to be authoritarian states, while Brazil, India, Indonesia, Mexico, and Turkey are committed to democratic institutions. Furthermore, of these latter five states, Mexico is a bit different given its strong economic links with the United States through NAFTA and its close proximity to the United States. But the one characteristic they all share is a large economy in absolute terms.

As shown in **Table 1**, all seven are currently ranked among the top 21 largest economies in the world in 2010 based on GDP calculations in nominal dollars—with China #3, India #8, Brazil #9, Mexico #13, Russia #17, Turkey #18, and Indonesia #21. Projecting out 40 years to 2050 (see **Figure 4**), one recent study predicts that all the *REPs* will rise in the rankings with China overtaking the United States as the largest economy in the world. Turkey is projected to gain the most in rankings (6 spots), followed closely by India, Mexico, and Indonesia (5 spots each).

Figure 4. REP and U.S. GDP in 2010 and 2050

(in constant 2000 U.S. dollars)



Source: HSBC Global Research, "The World in 2050: Quantifying the Shift in the Global Economy," January 2011.

Table 1. Projections of the Largest Economies in the World, 2050

2010 Rankings	2050 Projections	Rank Change 2010-2050
1. United States	1. China	+2
2. Japan	2. United States	-1
3. China	3. India	+5
4. Germany	4. Japan	-2
5. United Kingdom	5. Germany	-1
6. France	6. United Kingdom	-1
7. Italy	7. Brazil	+2
8. India	8. Mexico	+5
9. Brazil	9. France	-3
10. Canada	10. Canada	0
11. South Korea	11. Italy	-4
12. Spain	12. Turkey	+6
13. Mexico	13. South Korea	-2
14. Australia	14. Spain	-2
15. Netherlands	15. Russia	+2
16. Argentina	16. Indonesia	+5

2010 Rankings	2050 Projections	Rank Change 2010-2050
17. Russia	17. Australia	-3
18. Turkey	18. Argentina	-2
19. Sweden	19. Egypt	+10
20. Switzerland	20. Malaysia	+10
21. Indonesia	21. Saudi Arabia	+2

Source: HSBC Global Research, "The World in 2050: Quantifying the Shift in the Global Economy," January 2011.

Notes: GDP **c**alculations based on constant 2000 U.S. dollars. Unlike nominal GDP, real GDP can account for changes in the price level. Also note that Egypt and Malaysia were not ranked in top 30 in 2010.

Comparisons of national wealth are also frequently made on the basis of purchasing power parity (PPP).[10] Measuring national wealth in PPP terms tends to increase the GDP of developing countries by taking into account that many non-tradable goods such as haircuts, meals, medical care, and housing tend to cost less in developing countries. One PPP GDP ranking (see **Table 2**), estimates that China, India, Russia, and Brazil were among the 10 largest economies in the world in 2011 and projects that by 2020, China will have the largest economy in the world and India the second largest, with the Russian (#6), Brazilian, (#7), and Mexican economies (#8) also among the top 10.[11]

Table 2. Purchasing Power Parity GDP Estimates, 2011 and 2020

($billions)

Rank-2011	Country	PPP GDP (2011)	Rank-2020	Country	PPP GDP (2020)
1.	United States	15.10	1.	China	25.21
2.	China	11.45	2.	United States	22.22
3.	India	4.51	3.	India	9.87
4.	Japan	4.49	4.	Japan	5.74
5.	Germany	3.23	5.	Germany	4.32
6.	Russia	2.38	6.	Russia	3.97
7.	U.K.	2.32	7.	Brazil	3.83
8.	Brazil	2.30	8.	Mexico	3.15
9.	France	2.28	9.	U.K.	3.04
10.	Italy	1.96	10.	France	3.04
11.	Mexico	1.95	11.	South Korea	2.44
12	South Korea	1.50	12.	Italy	2.41

[10] PPP estimates take into account the amount of adjustment needed in an exchange rate between countries in order for the exchange rate to be equal to each country's purchasing power. In other words, the exchange rate adjusts so that identical goods in two countries have the same price when expressed in the same currency.

[11] The December 2012 U.S. National Intelligence Council (NIC) *Global Trends: 2030* report projects that China's GDP will surpass the U.S. GDP by 2030.

Rank-2011	Country	PPP GDP (2011)	Rank-2020	Country	PPP GDP (2020)
13.	Spain	1.49	13.	Indonesia	2.28
14.	Canada	1.43	14.	Canada	2.10
15.	Indonesia	1.12	15.	Spain	1.89
16.	Turkey	1.07	16.	Turkey	1.87
17.	Iran	0.98	17.	Taiwan	1.51
18.	Taiwan	0.94	18.	Australia	1.48
19.	Australia	0.93	19.	Iran	1.32

Source: Economist Intelligence Unit estimates.

Aggregate GDP—the size of a country's economy (whether measured in constant dollars or calculated based on PPP)—captures the potential impact of a country on the international trading system and its ability to resist unilateral pressure from another country. A country with a large economy tends to have important trading relationships with more countries (i.e., global trading relationships) and is increasingly part of global supply chains involving multinational companies. As shown in **Table 3**, the seven *REPs* that are the primary focus of this report have gained dramatic shares of world exports, rising from 7% in 1990 to 20.6% in 2011. By 2016, the *REPs* are projected to account for nearly 25% of global exports.

Table 3. *REP* Share of Global Exports

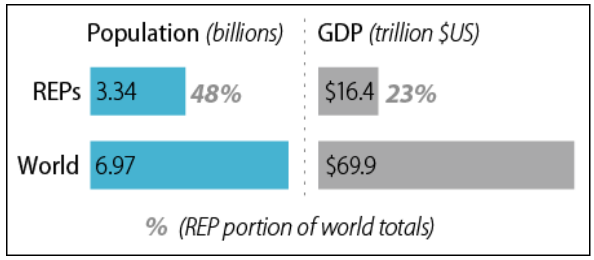
(in percent)

Country	1990	1995	2000	2006	2011	2016 (est.)
Brazil	0.92	0.91	0.86	1.15	1.40	1.40
China	1.82	2.90	3.89	8.08	10.70	13.10
India	0.53	0.62	0.70	1.06	1.70	2.10
Indonesia	0.75	0.89	0.97	0.84	1.10	1.30
Mexico	1.20	1.50	2.60	2.09	2.00	2.20
Russia	1.43	1.62	1.61	2.52	2.90	2.60
Turkey	0.38	0.42	0.44	0.72	0.80	0.80
Total REP 7	7.04	8.91	11.06	16.46	20.60	23.50

Source: Economist Intelligence Unit trade data base.

With large economies and trade flows, these countries have greater involvement in WTO negotiations and dispute settlement processes, as well as greater autonomy in applying the rules and obligations of the WTO system domestically. The *REPs* have also protested with greater frequency U.S. policies and practices that they deem are detrimental to their own national economic interests. In the aftermath of the 2008 financial crisis, *REP* leaders have criticized U.S. economic policies and reliance on free market orthodoxy more vociferously. While their protests and criticisms have not been followed by changes in U.S. trade or economic policies, the *REPs* arguably have become more able to deflect U.S. trade and market access demands.[12]

Figure 5. Total REP-7 Population and GDP, 2011



Source: Analysis by CRS. Data from the World Bank World Development Indicators.

Large populations and growing economies are the driving force in positioning the *REPs* higher in the global GDP rankings. As shown in **Figure 5**, the seven *REPs* in 2011 accounted for 48% of the world's population (3.34 billion out of 6.97 billion people) and 23% of the world's GDP ($16.4 trillion out of $69.9 trillion). The fact that China has the world's largest population, India the second largest, and Brazil the fifth largest has helped make these three the second-, third-, and eighth-largest economies in the world (according to PPP calculations), respectively. At the same time, per capita incomes of the *REPs* in 2011 (see **Table 4**) were approximately one-fifth the per capita income levels in the high income countries of the Organization for Economic Cooperation and Development (OECD) ($8,144 versus $38,667), indicating that reaching the much higher OECD living standards with their large populations may be a stretch in the near term.[13]

Table 4. Economic Indicators of the *REPs*

Country	Population 2011 (millions)	Average Real Annual GDP Growth (2003-2008)	Average Real Annual GDP Growth (2009-2011)	GDP per capita (current US $ in 2011)
Brazil	196.6	3.7	3.3	12,953
China	1,334.1	11.3	9.6	5,429
India	1,241.5	8.0	8.2	1,488
Indonesia	242.3	5.6	5.8	3,494
Mexico	114,.8	3.0	1.1	10,064
Russian Federation	141.9	7.1	0.2	13,089
Turkey	73.6	5.9	4.3	10,498
REP total	3,345.1	6.4	4.6	8,144
World/High Income OECD	6,973.7	2.1	0.2	38,667

[12] Gregory Shaffer and Charles Sutton, "The Rise of Middle-Income Countries in the International Trading System," Legal Studies Research Paper Series No. 12-51, University of Minnesota Law School, pp. 5, 9.

[13] The OECD is an international organization based in Paris designed to promote policies that will improve the economic and social well-being of people around the world. Its 34 members include the world's most advanced countries, but also two *REPs*, Mexico and Turkey.

Country	Population 2011 (millions)	Average Real Annual GDP Growth (2003-2008)	Average Real Annual GDP Growth (2009-2011)	GDP per capita (current US $ in 2011)
United States	310.5	2.3	0.3	48,447

Source: World Bank data found at http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2.

Notes: In the World/High Income OECD category, population and GDP data are for the World and average growth rates and GDP per capita data are for High Income OECD countries.

With the exception of Mexico from 2003 to 2008 and Russia from 2008 to 2011, the *REPs* have been growing faster than the advanced high income OECD countries by a considerable margin. In the aggregate, they grew three times faster than the high income OECD countries from 2003 to 2008 (6.4% compared to 2.1%) and 23 times faster from 2009 to 2011 (4.6% compared to 0.2%). If these growth rates persist, the *REPs* will continue to gain in the GDP rankings in the years ahead.

Reform Challenges

Robust capital inflows and ballooning exports to the United States boosted *REP* growth rates during the 2003-2008 period. Ruchir Sharma, author of *Breakout Nations,* argues that this was a golden period that is unlikely to be repeated, while some other analysts are much more optimistic that some developing countries, particularly China, India, and Brazil, can continue to grow at the historically rapid rates of the last decade and remain growth engines of the global economy.[14]

The case for slower growth is based on two major factors. The first is that advanced countries, hamstrung by high consumer and government debt, likely will be growing at much lower rates in the foreseeable future. The International Monetary Fund (IMF), for example, projects that in 2013 advanced countries will grow at only one-third the rate of emerging markets and developing countries (2% versus 6%).[15] If growth slows in advanced countries, they could buy less from the developing world, much of which is highly dependent on exports for its growth.

A second factor is that the richer a country becomes, the harder it is to grow rapidly. In the case of middle-income countries, World Bank research determined that only 13 of the 101 countries deemed middle income (currently defined as any country with a gross national income per capita between $1,006 and $12,275) in 1960 had advanced to high income by 2011. To make this transition up the value-chain, governments can no longer simply borrow technology or add more capital and labor, but must find ways to foster private sector development and innovation.[16]

Economic history, thus, suggests that there is nothing inevitable in the continued rise of any of the *REPs* or any other developing country. Every individual developing country may have great economic potential, but there is no easy path for continued high growth. Continued high growth

[14] World Bank, *China* 2030, pp. 16-17; and Jim O'Neil, *The Growth Map: Economic Opportunity in the BRICs and Beyond*, Portfolio/Penguin, 2011.

[15] IMF World Economic Outlook, April 2012.

[16] World Bank, *China 2030,* p.13.

requires ongoing efforts and reforms to address economic challenges, which constantly change as countries hit different income levels.[17]

The magnitude of the reform challenges for the *REPs* is captured by World Bank estimates of a country's openness or receptivity to business operations. As shown in **Table 5**, the *REPs'* rates are quite low, with the business climates of Russia, Brazil, Indonesia, and India comparable to countries such as Bangladesh (#122), Uganda (#123), and Swaziland (#124). The United States' business environment was rated the fourth-best in the world.

Table 5. *REP* Business Climates

Economy	World Ranking
Mexico	53
Turkey	71
China	91
Russia	120
Brazil	126
Indonesia	129
India	132
United States	4

Source: World Bank, Ease of Doing Business Index, 2011. This index ranks economies from 1 to 185. A high ranking (a low numerical rank) means that the regulatory environment is conducive to the operation of a business.

To improve their business climates and reinvigorate their economies, the *REPs* could undertake a range of trade, regulatory, and structural reforms. By reducing tariffs, quotas, and foreign investment restrictions, the *REPs* could open their economies at the border to more international competition. Trade-related reforms encompassing services regulation, regulation of food-safety and technical standards, intellectual property protection, public procurement, customs administration, and competition rules could also increase competition. Structural reforms to address corruption, labor and product market restrictions, and other regulatory barriers could also help free the economies of the *REPs* from government intervention. Overall, the resulting intensified competition could help improve worker productivity, economic growth, and living standards.

All these reforms tend to be politically sensitive because they affect government-business relations, as well as entrenched political and vested business interests. A political determination to overcome special interests that stand to be disadvantaged by the reforms, thus, may be important for most of these reforms to be initiated and implemented. A country's economic future in this sense depends substantially on its politics. In situations where there is growing political will to initiate domestic reforms, the scope for international negotiations and solutions could increase substantially.[18]

While the reforms are primarily a matter of unilateral action, some trade specialists believe that action in one country can create a situation where *REP* governments would want to emulate reforms of the others to stay competitive.[19] Key reforms that each country may need to consider vary and are highlighted below.

[17] Japan's rapid growth in the 1980s and continuing struggles since the 1990s illustrates that advanced countries are not immune from reform challenges either. For the United States, getting a handle on federal debt and budget deficits is considered by many economists a priority for bolstering long-term growth potential.

[18] Razeen Salley, "Trade Policy in the BRICS," p.16.

[19] Razeen Sally, "The Crisis and the Global Economy: A Shifting World Order? ECIPE No. 3/2011, p.29.

China

Averaging a phenomenal 9% growth rate over the past three decades, China has been one of the world's fastest-growing economies. But today it faces formidable challenges in continuing on this path. Its main reform challenge may be to make the economy more consumption and less investment driven.[20] To rebalance the economy, China will need to undertake various competition-enhancing reforms, ranging from public sector and financial sector reforms to secure private property rights, deregulation of internal trade, market pricing for internal inputs, and better provision of health, education, pensions, and social security. A number of other measures could be taken to bolster the private sector at the expense of China's still large state-owned or state-controlled companies. These could include limits on industrial policy activism, better enforcement of intellectual property rights, and accelerated services liberalization.[21] Rebalancing will likely encounter resistance from powerful vested interests as they may challenge the heart of the Communist party's grip on power. Not only party members, but vested interests in the state-owned companies, military, banks, and family clans would likely resist the reforms in order to preserve their positions of power and wealth.[22] Other key risks to achieving stable long-term economic growth include pervasive corruption, environmental degradation, and an aging population.

India

A number of economists have projected that India will approach China's rapid growth rates over a sustained period of time and become the third-largest economy in the world in a few decades. But these growth projections could easily be derailed by endemic obstacles associated with bloated government, corruption, overregulation, grinding poverty, and poor infrastructure. By most accounts, corruption and overregulation are rampant, stifling the environment for most businesses. The Heritage Foundation's 2011 Index of Economic Freedom ranks India 124th out of 179 countries based on its restrictive trade policies, heavy government involvement in the banking and finance sectors, rigorous investment caps, demanding regulatory structures, and a high level of corruption.[23] A massive blackout that affected more than 650 million people in late July 2012, the largest in world history, was a stark reminder that India's inefficient and poorly managed power sector could easily undermine its long-term economic ambitions.[24] With the economy slowing, to an estimated 5%-6% rate of growth in 2012, down from over 8% in 2011, concerns are rising that a regime of heavy government regulation is responsible for economic slowdown (a return to the "license Raj " days between 1947 and 1990).[25] It is still uncertain whether Prime Minister Manmohan Singh, who championed the economic reforms of the 1990s, will be able to overcome the opposition in his own party and among his coalition partners to a strong reform agenda.[26]

[20] Guy de Jonquieres, "China's Challenge," ECIPE Policy Brief, 01/2012, p.3.

[21] Razeen Salley, "Trade Policy in the BRICS," p. 7.

[22] George Magnus, "Will Asia Shape or Shake the World Economy? ECIPE Policy Brief, No. 05/2012, p. 5.

[23] CRS Report RL33529, *India: Domestic Issues, Strategic Dynamics, and U.S. Relations* , coordinated by (name re dacted).

[24] Simon Denyer and Rama Lakshmi, "Power Fails in Half of India," *Washington Post,* August 1, 2012.

[25] Tyler Cowen, "Never Mind Europe, Worry about India," *New York Times*, May 6, 2012.

[26] Pratap Bhanu Mehta, "How India Stumbled," *Foreign Affairs*, July/August, 2012.

Brazil

Brazil's solid performance during the 2008-2009 financial crisis and its early recovery, including strong 7.5% growth in 2010, and a large cushion of foreign exchange reserves (approximately $350 billion), has contributed to its growing global influence and role. But its economic growth fell in 2011 to 2.7%, and growth in 2012 is projected to be 1.5%-2%. If Brazil is to become a world economic power, the country may need to pursue reforms in areas including infrastructure and taxes. Brazil's housing, transportation, telecommunications, and power grids all need major investments and improvement. The World Economic Forum ranks Brazil's quality of infrastructure 104th out of 142 countries surveyed, behind China (69th), India (86th), and Russia (100th).[27] Brazil's tax burden has escalated from 22% in 1998 to 36% of GDP today.[28] The heavy burden increases the cost of doing business in a variety of ways, including very high electricity prices for industrial users—which are almost doubled by some 28 different taxes.[29] Burdensome regulations in opening and closing businesses, archaic labor laws, corruption, and bureaucratic red tape also contribute to Brazil's business environment. Brazil's President Dilma Rouseff has acted to reduce taxes and bring private firms into upgrading roads and ports, but other reforms may also be needed to help reignite growth.[30]

Mexico

Mexico's per capita income is about $10,000, the third highest among the *REPs,* but its economy grew on average by only 2% per year from 2000 to 2010. Once the richest country in Latin America, in recent years Mexico has been surpassed by its largest regional rivals—Brazil and Chile—due to persistently sluggish growth. More robust growth rates over the past few years (4.5% in 2010, 3.9% in 2011, and a projected 4.0% in 2012) have reignited foreign investor interest in Mexico. Nevertheless, a number of factors still could constrain Mexico from growing at a faster pace in the years ahead. These include a continuing large state presence in some economic sectors, an inadequate education system, a rigid labor market, high income inequality, and mismanagement of its dwindling oil wealth. Competition is also weak in many sectors in Mexico, hurting efficiency, productivity, and consumer well-being.[31] The country's top 10 business families control the majority of the concentrated sectors. With low growth and high inequality, Mexico's new President Enrique Pena Nieto could consider a number of structural reforms to strengthen the economy's growth potential and move the country out of its middle-income status. These include investing in infrastructure and education, breaking up monopolies, re-writing labor laws to make it easier to hire and fire, and opening more sectors to foreign investment—changes the Mexican Institute for Competitiveness has said could add 2.5 percentage points to Mexico's growth rate.[32]

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[27] *The Economist,* "Investing in Brazil's Infrastructure," August 11, 2012.

[28] *The Economist,* "The Brazil Backlash."

[29] *The Economist,* "Economic Policy in Brazil," September 15, 2012.

[30] *Financial Times,* "We Want a Middle-Class Brazil," October 3, 2012.

[31] According to a joint OECD-Mexican government study, the average Mexican household spends an estimated one-third of its budget on products that are produced in monopolistic or oligopolistic markets.

[32] *The Economist,* "The Man to Beat: Mexico's Presidential Election," March 31, 2012.

Turkey

Turkey's economy averaged 6% growth from 2003 to 2008—one of the highest sustained rates of growth in the world. Growth dropped to 1.1% in 2008 and declined by 4.7% in 2009, but rebounded to over 9% in 2010 and to over 8% in 2011. While GDP growth is projected to be only around 2.9% for 2012, it will still be one of the strongest rates of growth throughout Europe.[33] Steady economic growth requires the government to finance a large current account deficit. While in the past Turkey's trade deficit has been financed mostly by long-term loans and foreign direct investment, short-term inflows have funded a rising proportion of the funding gap since 2010. An important priority for Turkey, thus, is to attract more equity and foreign direct investment inflows, which generally are accompanied by skill and technology transfers, and fewer short-term loans and portfolio inflows, which are more prone to sudden reversal.[34] To attract more investment, Turkey may need to consider liberalizing its foreign investment regime. Stringent labor regulations, a somewhat unpredictable regulatory environment, and intellectual property violations may be additional concerns for foreign investors. The World Bank has urged sweeping reforms to address high severance packages, limitations of temporary work, and high social security costs.[35]

Russia

Before the 2009 financial crisis, Russia's economy was growing at around 7% from 2003 to 2008. The growth, which was fueled by rising demand for its oil, gas, and commodities, helped raise the Russian standard of living substantially. With oil prices dropping by 75% from mid-2008 to early 2009, the economy grew by a meager two-tenths of one percent from 2009 to 2010.[36] While the economy has recovered and is projected to grow between 3.5% and 4% over the next few years, it is unlikely to reach a potential estimated annual growth rate of 5.5%-6% in the years ahead.[37] In addition to its significant dependence on the production and export of oil and other natural resources, Russia has other persistent flaws in the economy that are limiting its recovery and long-term growth prospects. These include (1) a population, particularly working-age population, that is declining (some project that it could drop to 80 million-90 million by 2050);[38] (2) it has few companies that make internationally competitive goods; (3) its economy is not very diversified; (4) its business environment remains difficult and controlled by insider deals; and (5) its economy has an increasing public welfare burden on its public finance.[39] The economy has also been plagued by low domestic and foreign investment, high rates of crime and corruption, lack of independent judicial protection of property rights, and capital flight.[40] While Russian President Vladimir Putin began his third term in 2012 pledging to modernize the Russian

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[33] *IHS Global Insight*, "Turkey," July 12, 2012.

[34] OECD Economic Surveys: Turkey, July 2012.

[35] *IHS Global Insight,* "Turkey," July 11, 2012.

[36] *Russian Banks and Brokers Report,* "Is Russia's Economy Heading down a Cul-de-Sac," November 30, 2011.

[37] *IHS Global Insight,* "Russia," August 30, 2012, and Sergey Aleksashenko, "Russia's Economic Agenda to 2020," *International Affairs* 88: 2012, p. 33.

[38] Over the next 20 years Russia may lose 15- 20% of its labor force, resulting in serious labor shortages and considerable lost output [cited in Sergey Alekashenko, "Russia's Economic Agenda to 2020, p. 39].

[39] One estimate holds that over half of all Russians now depend on the state for a living, 40% as recipients of social benefits and 12% as government employees. Cited in Ruchir Sharma, *Breakout Nations,* p. 88.

[40] CRS Report RL33407, *Russian Political, Economic, and Security Issues and U.S. Interests*, coordinated by (nam e redacted).

economy, proposed reforms to limit bureaucratic interference in the economy and a new wave of privatizations were scaled back or deferred.[41] However, Russia's entry into the WTO in 2012 and projections of the disappearance of its oil-fueled trade surpluses could pressure the government to pursue fundamental reforms in order to attract foreign investment.[42]

Indonesia

Since Indonesia was transformed from a tightly controlled authoritarian state in the late 1990s to an open, moderate, and multi-religious democracy, it has grown at an average of more than 5% per year. This year it is expected to grow by over 6%, a full 1% faster than the rest of South East Asia. With a current GDP at $900 billion, Indonesia's economy could easily top $1 billion by 2013.[43] If Indonesia is able to meet its target of 7%-8% GDP growth by 2014, it must address numerous reform challenges.[44] By most accounts Indonesia's ports are overstretched, its electrical grid is suboptimal, and its road networks are very poor. The World Economic Forum in 2011 ranked Indonesia 82 out of 142 economies in the quality of its infrastructure—just ahead of India (86). These inadequacies add to manufacturing costs and widen regional disparities in prices for basic commodities. Endemic and pervasive corruption also adds to Indonesia's high cost economy. High-quality education is lacking for training a young labor force in the skills it needs for the country to move up the value chain. Even with skilled labor in short supply, Indonesia still maintains rigid labor regulations that make starting a business, enforcing contracts, and hiring labor quite difficult.[45] Legislation has been introduced to address some of these shortcomings in Indonesia's business environment, but these measures face an uncertain future due to conflicting views on reform within the governing coalition.[46]

U.S. Trade Interests and the *REPs*

The evolution of the economies of the *REPs* impacts U.S. exports, jobs, and economic growth in important ways. If the United States is to maximize its export potential and boost its living standards, exporters and investors will need to have fair and balanced access to the *REP* markets. *REP* trade barriers, however, are extensive compared to market access and "ease of doing business" obstacles found in most advanced countries. The ability of the United States to persuade these countries to reduce their barriers arguably is constrained by growing differences over the role that the state should play in economic activity—differences that were exacerbated by the 2008 financial crisis. The more interventionist practices of the REP governments coincide with a desire to maintain "policy space" to promote economic development via policies that often appear to violate the letter or spirit of WTO rules and obligations.

[41] *IBS Global Insight*, "Russia," August 30, 2012.

[42] *The Economist*, "Russia's Economy and the World Trade Organization," July 14, 2012; Charles Clover, "Russia Faces End of Petrodollar Surplus," and CRS Report R42085, *Russia's Accession to the WTO and Its Implications for the United States*, by (name redacted).

[43] Karen Brooks, "Is Indonesia Bound for the BRICs?" *Foreign Affairs*, November-December 2011, v.90, issue 6, pp. 109-118.

[44] U.S. Department of State, Background Note: Turkey, 2012.

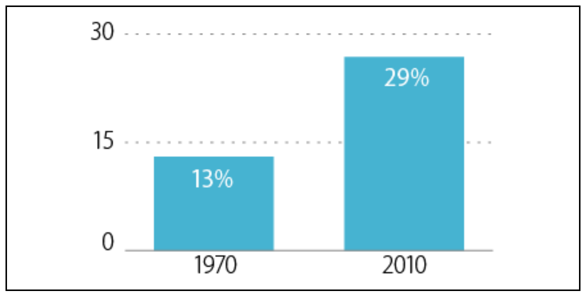
[45] Vikram Nehru, "Indonesian Manufacturing Needs a Shot in the Arm," Carnegie Endowment, June 26, 2012.

[46] The Economic Intelligence Unit, Country Report: Indonesia, August 2012.

With the imperative for the United States to export more, it may be a critical time to persuade these rising countries to adhere more closely to the free market norms and obligations of the WTO system, as well as to consider negotiations that could address many of the barriers not currently covered by WTO disciplines. A major concern is that if this is not done soon, these countries may use their growing economic power to maintain one-sided advantages over time. Reaching robust agreements on the rules of the game between different centers of power which do not share the same values, however, remains a formidable undertaking.

REP Markets and U.S. Prosperity

Figure 6. Trade as a Percentage of U.S. GDP



Source: Analysis by CRS. Data from Bureau of Economic Analysis.

The United States is the world's largest trading and investing country and depends increasingly on the world economy to spur economic growth and generate high-wage jobs. Over the past four decades (see **Figure 6**), U.S. trade in goods and services has accounted for an increasing share of the value of GDP, rising from 13% in 1970 to 29% in 2010. Trade over the past 40 years has also grown more rapidly than the U.S. economy, rising at an average rate of 5.9% per year in real terms compared to an average GDP real growth rate of 2.8%. Over a more recent period (3rd quarter of 2009 to the 3rd quarter of 2011), exports alone contributed 1.2 percentage points to the 2.4% annual increase in U.S. real GDP growth.[47]

Many economists argue that exports will be increasingly important to U.S. economic growth in the years ahead. One important reason is that 95% of the world's population and 80% of the world's purchasing power is outside U.S. borders. Another important reason is the high levels of U.S. public and private debt which will constrain government and consumer spending as the two historically primary engines of U.S. economic growth.[48] With ongoing pressures to reduce government spending and consumer debt, exports could become an increasingly important source of growth for the U.S. economy.[49]

Traditionally, manufactured goods and agricultural products have accounted for the bulk of U.S. exports. Recent research indicates that there is much underutilized potential in the export of business services.[50] The fact that over the past two decades nearly all job growth in the U.S.

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[47] Office of the United States Trade Representative, *2012 Trade Policy Agenda and 2011 Annual Report*, Annex 1 [hereafter cited as USTR, *2012 Trade Policy Agenda*].

[48] As GDP is a function of government spending (G), consumption (C), investment (I), and net export (exports-imports), constraints on rising levels of G and C will require increases in either I or net exports for GDP increases to occur.

[49] Tyler Cowen, "What Export-Oriented America Means," *The American Interest,* May/June 2012. At the same time, U.S. household debt, as measured by debt payments to disposable income, has declined from 14.05 in the 3rd quarter of 2007 to 10.69 in the 2nd quarter 2012. A continuing reduction of this ratio could position U.S. consumers for more spending in the future.

[50] J. Bradford Jensen, *Global Trade in Services,* Peterson Institute for International Economics, Washington, D.C., 2011.

economy has been in non-tradable sectors, particularly in health care and public sector employment, is a compelling reason why U.S. employment growth will require much stronger performance in the tradable sectors, particularly services.[51]

For most of the post-World War II period, the bulk of U.S. trade ties have been with the advanced countries of Western Europe (Germany, the United Kingdom, and France), Canada, and Japan. Over the most recent decade, those ties, shifting increasingly to developing countries, grew twice to three times faster than the United States and other advanced countries.[52] Since 2000, U.S. goods exports to developing countries grew almost three times as fast as U.S. goods exports to industrial countries, 135% compared to 54%. Due to this long-term higher growth difference, the share of U.S. goods exports to developing countries grew from 45% in 2000 to 55% in 2011.[53] The seven *REPs* alone accounted for 47% of U.S. exports in 2011, up from 20% in 2000.[54]

Developing countries, led by the *REPs*, have also become a much more important supplier of U.S. imports. Since 2000, the share of U.S. goods imports from developing countries has grown almost four times faster (130% compared to 36%) than imports from advanced countries. As a result, the U.S. share of imports from developing countries increased from 49% in 2000 to 61% in 2011.[55] The *REPs* accounted for 36% of U.S. imports in 2011, up from 23% in 2000. Some portion of this increase, however, is accounted for by U.S. multinationals, such as Apple and Dell, which design their products in the United States and assemble them abroad.[56]

U.S. foreign investment ties with the *REPs* have not experienced the same shift. The stock of U.S. foreign direct investments in Brazil, China, India, Indonesia, Mexico, and Turkey (Russia is not included for lack of data) is low and declining slightly. These six *REPs* in 1995 accounted for almost 8% of U.S. direct investment stocks abroad, but less than 6% in 2010. By contrast, Europe's share of total U.S. direct investment stocks abroad has increased from 49% in 1995 to 55% in 2010.[57] Further liberalization of *REP* FDI restrictions, combined with weakening growth prospects for Europe, could commence a gradual reversal of this trend.

The share of U.S. trade accounted for by the *REPs,* however, is likely to grow in the future if their economies continue on their current trajectories. Their successful growth strategies are expected to create billions of new "middle-class" consumers and unleash billions of dollars in infrastructure spending that will be contested by exporters and investors across the world.

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[51] Michael Spence and Sandile Hlatshwayo, "The Evolving Structure of the American Economy and the Employment Challenge, Council on Foreign Relations, 2011.

[52] CRS calculations based on Bureau of Economic Analysis data on U.S. Direct Investment Position Abroad on a Historical-Cost Basis.

[53] USTR, *Trade Policy Agenda,* Annex 1.

[54] CRS calculations based on World Trade Atlas data.

[55] UTSTR, *2012 Trade Policy Agenda,* Annex 1.

[56] The proliferation of global supply chains has made it increasingly difficult to interpret the implications of U.S. trade data. Such data may show where products are being imported from, but they often fail to reflect how the value-added is distributed across countries. Chinese data indicate, for example, that over 50% of its exports are generated by foreign-invested firms in China. Thus, in many instances, U.S. imports from China are really imports from many countries. For elaboration, see CRS Report RL33536, *China-U.S. Trade Issues*, by (name redacted).

[57] CRS calculations based on Bureau of Economic Analysis data on *U.S. Direct Investment Position Abroad on a Historical Cost Basis.*

Estimates of the Growing "Middle-Class" in the *REPs*

Many different estimates have been made on the number of people in developing countries whose incomes are rising above a certain threshold, putting them in a position to demand and purchase non-essential goods or services such as cars, computers, meals at restaurants, or education. The estimates typically have been based on a range of income-based measures, per capita income thresholds, and household surveys. Based on a definition of the middle class as falling between $10 a day to $100 a day per capita, a Brookings Institution study estimated the "middle-class" in emerging markets will expand from less than 1.8 billion people today to about 5 billion in 2030. But based on the number of cars in circulation as a proxy to estimate the number of people in developing countries who belong to the "middle class," a Carnegie Endowment study estimated that 530 million people now living in the REP countries can be considered "middle-class."

The Obama Administration's National Export Initiative (NEI) is a response to many of these trends. Launched in 2010, the NEI is an effort to double U.S. exports by 2014 and to create 2 million jobs. If the United States is to meet this objective, U.S. exporters, service providers, and investors will need to have greater non-discriminatory market access to the big developing country economies now and in the years ahead.[58]

REP Trade Barriers

Many of the *REPs* implemented significant trade and foreign direct investment liberalization in the 1980s and 1990s. China, India, and Brazil, in particular, reduced their barriers to trade and investment markedly. Applied tariffs and other "at the border" barriers were simplified and reduced. Many non-tariff barriers affecting quotas, licensing, and foreign direct investment were also liberalized. These fundamental reforms for the most part were undertaken unilaterally or independently by national governments, but they were also reinforced and locked in by commitments made in the multilateral trade negotiations of the 1980s (the Tokyo Round) and the 1990s (the Uruguay Round), as well as by the proliferation of free trade agreements such as NAFTA. By helping to integrate the *REPs* into the global economy, the reforms were powerful factors for producing growing shares of world trade and investment, which in turn promoted more rapid growth and poverty reduction during the last decade of the 20th century.

Despite the reforms of the 1980s and 1990s, levels of protection on multiple fronts—tariffs, non-tariff barriers, and restrictions on services and investment — remain considerably higher in the *REPs* than in the United States and other advanced countries. The economic impact of *REP* barriers on the U.S. economy is difficult to quantify, but it is clear that they limit U.S. opportunities in many markets.

U.S. companies and workers face an array of obstacles in trying to do business in *REP* markets. The list of barriers and selected country examples covers tariffs, services, government procurement, foreign investment, intellectual property rights, operation of state-owned or state-controlled companies, and export restrictions on raw materials. Technical regulations and standards also affect market access by requiring the adjustment of products and production facilities to comply with different requirements. Many of these barriers may deny U.S. producers and workers the extension of comparative advantage, particularly in the areas of services, foreign investment, intellectual property, and government procurement. Many of the measures are also inadequately covered or difficult to enforce under current WTO rules. Moreover, some of the

[58] CRS Report R41929, *Boosting U.S. Exports: Selected Issues for Congress*, by Shayerah Ilias et al.

barriers and practices interact to create formidable shields of *REP* home markets together with supports for strengthening home or national companies.

Tariffs

Tariffs are taxes imposed on goods at the border and the easiest kinds of barriers to measure. The average tariffs imposed by the *REPs* on goods entering the country are two to four times higher than the U.S. average tariff of 3.5%. As shown in **Table 6**, Indonesia has the lowest simple average applied tariff (6.8%) among the *REPs*, and Brazil the highest (13.7%). But the differences are more stark in terms of bound tariffs, where the *REPs'* rates range from approximately three times higher (China at 10%) to 14 times higher (India at 48.7%). The discrepancy between the applied and bound tariff rates of the *REPs* has been a long-standing concern, particularly because at any time the *REPs* may raise their tariffs higher without violating WTO obligations.[59] Brazil, for example, recently did just that, increasing import duties to 25% on some 100 products.[60]

Table 6. Tariff Profiles of the U.S. and the *REPs*

Country	Simple Average Final Bound (Total)	Simple Average Final Bound (Ag)	Simple Average Final Bound (Non-ag)	Simple Average MFN Applied (Total)	Simple Average MFN Applied (Ag)	Simple Average MFN Applied (Non-ag)
United States	3.5	4.8	3.3	3.5	4.9	3.3
Brazil	31.4	35.4	30.7	13.7	10.3	14.2
China	10.0	15.7	9.2	9.6	15.6	8.7
India	48.7	113.1	34.6	13.0	31.8	10.1
Indonesia	37.1	47.1	35.5	6.8	8.4	6.6
Mexico	36.1	44.2	34.9	9.0	21.5	7.1
Russian Federation	n/a	n/a	n/a	9.5	13.5	8.9
Turkey	28.5	60.7	17.0	9.9	43.4	4.8

Source: WTO Tariff Profiles databank.

Notes: Due to NAFTA, the United States faces zero tariffs in exporting to Mexico. Simple average MFN applied rates are for 2010 and trade weighted averages calculated for 2009.

[59] Binding is a form of concession under WTO rules in which a party agrees to bind its maximum tariff levels for a product by placing that tariff level on record. These "bound" rates become part of a WTO member's schedule of concessions. In practice, many WTO members do not apply their bound rates, but apply much lower rates. These are called "applied" tariffs. In theory, a WTO member that is not applying its bound tariff rates can cut bound rates without providing any new real market access. Conversely, a WTO member can also at any time raise applied tariff rates to the bound level without having to pay any compensation to its trading partners.

[60] Jennifer Hillman, "Global Swing States and the Trade Order," *German Marshall Fund*, Global Swing States Working Paper 2012, p.5.

Services Barriers

Some economists believe that reducing barriers to U.S. exports of services is critical to the U.S. economy and should receive priority attention.[61] The United States has a comparative advantage in exporting business services (information, banking, insurance, legal, scientific, managerial, express delivery, and e-commerce). Comprising 14% of U.S. employment, jobs in business services tend to be high-wage and high-skilled. But the international sales activities of business services lag manufactured exports by an estimated margin of 4:1. This export underperformance is due substantially to barriers to services trade which tend to be quite high in *REP* markets.[62]

Table 7. Tariff Equivalents of Service Barriers

Country	Current Tariff Equivalent
Brazil	55.54
China	67.93
India	68.06
Indonesia	67.93
Mexico	44.32
Russia	51.26
Turkey	43.89
United States	6.03

Source: Gary Clyde Hufbauer and J. Bradford Jensen, *Framework for the International Services Agreement,* Policy Brief 12-10, April 2012, p. 17.

REP services barriers include market-entry barriers (outright bans and quotas) that prevent entry into the market, national treatment barriers that discriminate between domestic and foreign service providers (discriminatory government procurement policies), and regulatory barriers that apply to all providers but create additional hurdles for U.S. suppliers. According to Peterson Institute estimates, as shown in **Table 7**, the *REP* service barriers range from 7 (in the case of Mexico) to 11 times (in the case of India) more onerous than U.S. service barriers. And as shown in **Figure 7**, services tariff equivalents of the *REPs* tend to be much larger than their agricultural and non-agricultural tariffs.

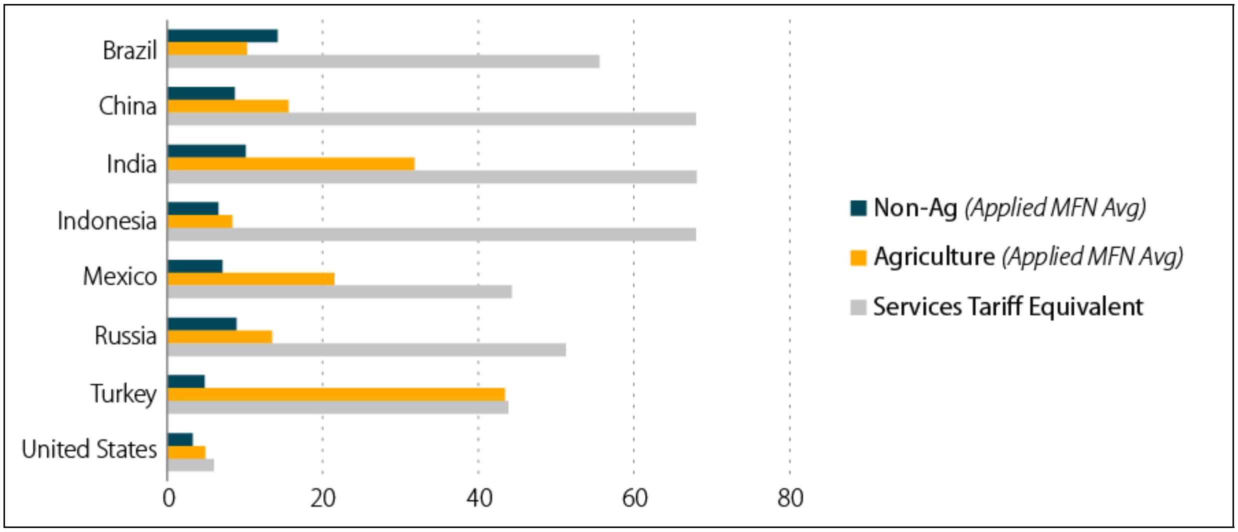
The market access commitments of the WTO General Agreement on Trade in Services (GATS), concluded in 1994, are modest, and the United States has attempted to expand on them in the FTAs it has negotiated. In addition, the United States is pushing broader services provisions in the ongoing Trans-Pacific Partnership negotiations, and trying to build support for a plurilateral international services agreement among willing WTO partners.[63]

61 Michael Spence and Sandile Hlatshwayo, "The Evolving Structure of the American Economy and the Employment Challenge," Council on Foreign Relations, 2011.

62 J. Bradford Jensen, *Global Trade in Services,* pp. 137-153.

63 CRS Report R42344, *Trans-Pacific Partnership (TPP) Countries: Comparative Trade and Economic Analysis*, by (name redacted).

Figure 7. Goods Tariffs and Services Tariff Equivalents



Source: WTO Tariff Profiles databank. Gary Clyde Hufbauer and J. Bradford Jensen, *Framework for the International Services Agreement,* Policy Brief 12-10, April 2012, p. 17.

Government Procurement

Increases in *REP* spending on infrastructure projects over the next two decades are expected to be worth trillions of dollars. This spending could lead to a substantial increase in demand for U.S. capital goods, construction, engineering, and financial services if *REP* barriers, particularly discriminatory government procurement policies, are modified. This is because much of the spending on infrastructure is likely to be financed, controlled, and regulated by governments and those governments are likely to face strong domestic pressures to favor domestic firms in granting contracts.

Securing equal treatment in government procurement, thus, should be a major priority for the United States. The Government Procurement Agreement (GPA) has provided the main legal framework at the WTO level since 1996 for opening up government procurement markets of key trading partners to international competition. The GPA does this by guaranteeing that some public spending decisions are made on a non-discriminatory, transparent, and competitive basis for the WTO members that have signed the agreement. But it is an agreement which comprises only a handful of mostly advanced countries and offers limited coverage of services. None of the *REPs* are signatories to the GPA, although China has been negotiating to join the GPA for many years. Countries that want to join the GPA have to submit offers which must be agreed by all GPA members.

REP procurement markets remain significantly closed, incomplete, and non-transparent. As illustrated in **Table 8**, the bulk of purchases often is not determined by cost or technical factors, but by domestic policy goals such as promoting domestic manufacturing, or the development of home technologies (to say nothing of promoting non-economic interests.)

Table 8. Selective *REP* Procurement Policies

County	State Law/Policy	Details of Law/Policy	Rationale
China	2002 Government Procurement Law	As re-drafted, regulations require over 50% local value added for bidding purposes.	The Government Procurement Law is seen as a tool to help promote local industry.
Brazil	Procurement Decree 12.349/2010	The Decree establishes a 25% margin of preference for manufactured goods and national services in compliance with Brazilian technical standards.	The procurement law is part of an overall new policy to promote Brazilian industry.
India	Government Procurement Guidelines	Guidelines issued in February 2012 require a percentage of all electronic products be reserved for domestic manufacturing.	The guidelines are designed to preserve the security of India's information technology sector and promote Indian manufacturing.
Indonesia	Presidential Decree 54/2010	Article 98 provides preferences to goods and services with a minimum of 25% local content (even where bid is 15% higher in price).	The policy appears to boost Indonesian manufacturing by imposing local content requirements that discriminate against foreign companies.
Mexico	Government Procurement Rules	Public tenders covering a range of goods and services are restricted by a minimum national content of 65% for 2012.	Aim is to boost domestic manufacturing through procurement policies.

Source: Data from Information Technology and Industry Council.

Intellectual Property Protection

U.S. high tech companies and workers are among the most innovative in the world. According to a U.S. Chamber of Commerce study, an estimated 19 million Americans are employed in intellectual property-intensive industries such as information technologies, business software, entertainment, pharmaceuticals, and video games. Intellectual property rights (IPR) protection and enforcement of patents, copyrights, and trademarks are considered an essential facilitator of innovation and creativity, which are vital to strengthen the U.S. economy through creation of economic opportunities and high-paying jobs for Americans. Although difficult to quantify, it is estimated that IPR infringement results in billions of dollars of losses to U.S. stakeholders.[64]

One example of these losses is provided by an annual survey of piracy rates of computer software undertaken by the Business Software Alliance. According to this survey, the *REPs* have some of the highest piracy rates of computer software in the world, while the United States and Europe have some of the lowest rates. For 2011, the survey pegged Indonesia's piracy rate at 86%, China's at 77%, Russia's at 63%, India's at 63%, Turkey's at 62%, Mexico's at 57%, and Brazil's

[64] USTR, *2012 Trade Policy Agenda,* p.9.

at 53%. By contrast, the European Union's piracy rate was estimated to be 33% and the U.S. rate at 19%. A piracy rate of 86% means that for every $100 dollars of legitimate software sold, an additional $86 worth of unlicensed software also made its way into the market.[65] Significant piracy also exists in the film, music, publishing, and Internet spheres.

The United States has sought increased IPR protection in its FTAs that go beyond the level of protection provided in the WTO Trade Related Aspects of Intellectual Property (TRIPS) Agreement. Some of these efforts to enhance intellectual property protection have made considerable progress among U.S. free trade agreement (FTA) partners, but serious problems remain among the *REPs*. A study done by the U.S. International Trade Commission estimates those losses to U.S. industry from intellectual property infringements in China alone totaled roughly $48 billion in 2009. To crack down on piracy and counterfeiting, the U.S. government has brought two IPR-related cases against China in the WTO, and placed China, as well as India, Indonesia, and Russia, on a USTR *Priority Watch List* in an effort to secure greater and fairer access of intellectual property-intensive products exported to *REP* markets. Many of these countries have made significant strides to improve their IPR laws, but enforcement remains a significant concern.[66]

Foreign Investment Restrictions

Foreign direct investment (FDI), both inward and outward, is of substantial importance to the U.S. economy.[67] It is a force for spurring U.S. productivity, increasing investments in technology, and raising living standards. Strong investment protections and other policies help support U.S. foreign investment abroad and foreign investment in the United States.[68]

Overall, restrictions on FDI are low in most advanced economies, but high among developing countries. According to an OECD study (see **Figure 8)**, among the *REPs*, China, Russia, Indonesia, Mexico, and India are among the most inhospitable countries in the world toward FDI.[69] Turkey and Brazil are much more open, with Brazil's restrictions being comparable to the level of U.S. restrictions and Turkey being much more open than either Brazil or the United States. The OECD index is based on four measures: foreign equity restrictions, screening and prior approval requirements, rules for key personnel, and other restrictions on the operations of foreign enterprises.[70]

[65] Business Software Alliance, *2011 Piracy Study,* found at http://www.BSA.org.

[66] CRS Report RL34292, *Intellectual Property Rights and International Trade*, by Shayerah Ilias and (name redacted).

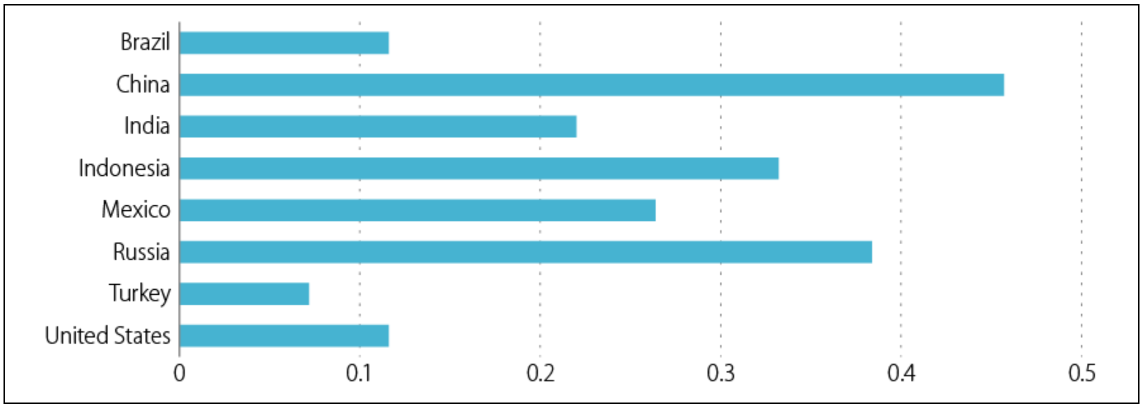
[67] Foreign direct investment is the acquisition of real assets such as real estate, a manufacturing plant, or a controlling interest in an ongoing enterprise by a foreign national. More than 50% of U.S. outward foreign direct investment is in advanced countries. Companies invest overseas for a variety of reasons, including new markets, higher returns and lower production costs.

[68] CRS Report RS21118, *U.S. Direct Investment Abroad: Trends and Current Issues*, by (name redacted).

[69] Perhaps paradoxically, China was the second largest recipient of global FDI (after the United States) in 2011.

[70] Blanka Kalinova, Angel Palerm and Stephen Thomson, "OECD's FDI Restrictiveness Index: 2010 Update," OECD Working Papers on International Investment, No. 2010/3, OECD Investment Division, http://www.oecd.org/daf/investment/workingpapers

Figure 8. FDI Restrictiveness Index by Country, 2010



Source: OECD Working Papers on International Investment, No. 2010/3, p.18.

There are no comprehensive multilateral investment rules and disciplines governing foreign investment, despite past attempts in the WTO and OECD. Consequently, cross-border investment rules can be freely negotiated in bilateral agreements between countries. The United States has utilized FTAs and Bilateral Investment Treaties (BITs) to provide core protections that help promote and protect U.S. investments.

The United States started BIT negotiations with China and India in 2008, and these negotiations are ongoing. There is also interest in negotiating BITs with some of the other *REPs*, particularly Russia, Brazil, and Indonesia. There may be more momentum for negotiating additional BITs in light of the Obama Administration's recently completed review of U.S. model BIT provisions.[71]

State-Owned or State-Controlled Enterprises (SOEs)

State-owned or state-controlled enterprises (SOEs) play an important role in most of the *REPs*. Some 117 state-owned and public companies from Brazil, Russia, India, and China appear on Forbes list of the world's largest companies. The list includes national champions such as Mexico's Pemex, a state-owned oil company, and Brazil's Vale, a huge mining company. In addition, more than half of India's 40 largest companies and most of China's largest banks are SOEs. Some 140 SOEs dominate key sectors of Indonesia's economy, including oil, telecommunications, and shipping.[72]

SOEs enjoy numerous competitive advantages over private companies, including direct subsidies such as low interest-rate loans, and discounted land, electricity, and fuel. Indirect subsidies can include bidding on state contracts which are often pre-disposed in their favor. As a result of these subsidies and being able to sustain financial losses, SOEs are in a position to win market share from private companies that operate largely in accordance with commercial and market principles.[73]

[71] CRS Report RL33978, *The U.S. Bilateral Investment Treaty Program: An Overview*, by (name redacted) and Shayerah Ilias.

[72] Oxford Analytica, "Reforms to Continue as SOE Divestment Slows," March 24, 2011.

[73] *The Economist,* "The Visible Hand," Special Report on State Capitalism, January 21, 2012.

There are few international agreements or rules that might be used to discipline SOEs. The GATT requires state enterprises to operate in a manner "solely in accordance with commercial considerations." Yet this provision has been interpreted loosely and SOEs continue to use any and all special privileges granted to them by their governments.[74]

In light of weak international or multilateral obligations, the United States has addressed the potential unfair competition element of SOEs, in part, through FTAs. U.S. FTAs with Australia, Chile, Colombia, Peru, and South Korea, for example, contain national treatment, non-discrimination, and transparency provisions, while upholding the prerogative of countries to establish and maintain SOEs. Stronger disciplines are being proposed in the TPP negotiations to ensure that the SOEs operate on a commercial basis. If stronger rules can be agreed to in these negotiations with countries such as Vietnam and Malaysia, it is hoped that they could eventually serve as a template for negotiations with the *REPs*, and perhaps more broadly for the WTO.[75]

Export Restrictions on Raw Materials

The growth in global demand and upward price pressure driven by the rapid industrialization of the *REPs* has sparked concerns with regard to the sound functioning of global markets for raw materials. For the production and export of many high-tech and "greener" products, many U.S industries are dependent on imports of specific raw materials. Of the *REPs*, China, Brazil, Russia, and India all impose restrictions on export of raw materials. The restrictions increase the prices for U.S. industries that use raw material inputs, thus potentially jeopardizing the competitiveness of selected U.S. industries, and ultimately consumers. At the same time, the restrictions hold down prices for firms in the countries that impose the restrictions.

Country examples include China's restrictions on rare earth metals, Brazil's restrictions on raw hides and skins, India's restrictions on cotton exports, Indonesia's restrictions on 14 key minerals—including nickel, copper, and gold—and Russia's high export duties on wood, ferrous, and non-ferrous scrap. Tackling these kinds of restrictions is challenging because they are not fully ruled out by WTO disciplines. While quantitative restrictions (notably export quotas and export licenses) are subject to General Agreement on Tariffs and Trade (GATT) rules, export taxes are generally not covered by multilateral disciplines (except when provisions were specifically negotiated in WTO accession protocols as is the case for China and Russia for a number of raw materials).[76]

REP Interventionist Practices

The United States played a large role in the creation of the open market, rules-based GATT/WTO trading system. The system provides a set of non-discriminatory rules, a framework for cooperation, and processes for negotiating trade agreements and resolving disputes. In addition,

[74] Stephen S. Kho and Sean Heather, "Checkers or Chess? Facing State Capitalism – Part II, *Law 360,* Portfolio Media, 2011.

[75] CRS Report R42344, *Trans-Pacific Partnership (TPP) Countries: Comparative Trade and Economic Analysis*, by (name redacted).

[76] For additional information on China's rare earth controversy, see CRS Report R42510, *China's Rare Earth Industry and Export Regime: Economic and Trade Implications for the United States*, by (name redacted) and Rachel Tang.

the system seeks to limit the role of governments in economic activity by allowing commercial outcomes to be determined by market forces and genuine competition.

While there are competing views within the United States today about the proper role that governments or the state should play in promoting and regulating economic activity, many analysts consider the United States to be one of the most open, market-oriented or capitalist economies in the world.[77] The *REPs* have considerably more state involvement in their economies, as well as very different ideas about how government, business, and labor should cooperate. Moreover, they pose clear-cut philosophical and practical challenges to the belief that the market and the private sector, not the state, must be the primary engine of economic expansion.[78]

These interventionist challenges may have gained traction as a result of the 2008 global financial crisis, as some spokesmen from rising economic powers argued that the financial crisis was caused by excesses in U.S. financial markets and inadequate regulation. In the process, some governments questioned in stark terms the notion that free markets are always efficient and that governments should get out of the way.[79] Others reactivated industrial policies, granted industry-specific subsidies that distort trade, conditioned foreign investment approvals on the use of domestically produced components, or otherwise imposed selective protectionist measures to promote home companies at the expense of foreign companies.[80]

Most of the *REPs* tend to invite just enough market forces into their economies to create some competition, while also retaining control over key industries. In seeking to promote investment, the key factor in generating growth, *REP* governments have utilized variable arrangements of state control and open markets. Characterized by Ian Bremmer as state capitalism, *REP* leaders also use government ownership, intervention, and influence over the economy as a way to protect and promote their own home companies at the expense of foreign firms.[81] The contours of their economic systems vary from country to country, but all share a proclivity for government interventions that impact commercial outcomes.

- **China** may be the most successful country practicing a version of state capitalism. In 2008, just as the Western financial crisis was beginning, Chinese Premier Wen Jiabao articulated his view of state capitalism: "The complete formulation of our economic policy is to give full play to the basic role of market forces in allocating resources under the macroeconomic guidance and regulation of government. We have one important piece of experience of the past thirty years, that is to ensure that both the visible hand and the invisible hand are given full play in regulating market forces." As a practical matter, this model defies easy description. On the one hand, China is still nominally communist, with five-year plans and a sometimes heavy-handed involvement or control of a dozen or

[77] According to the Heritage Foundation's Index of Economic Freedom, which tracks one broad measure of market openness, the United States ranked 10th in 2012.

[78] German Marshall Fund, "The Case for Renewing Transatlantic Capitalism," Edited by Pawlel Swieboda and Bruce Stokes, 2012, p. 7.

[79] David Rothkopf, *Power, Inc.: The Epic Rivalry Between Big Business and Big Government and the Reckoning that Lies Ahead,* Farrar, Strauss, and Girous, 2012, p. 345.

[80] USTR Trade Estimates Report, 2012.

[81] Ian Bremmer, *The End of the Free Market: Who Wins the War Between Corporations and Governments?* Wiley, 201, p.23.

so of the most important and strategic sectors. On the other hand, the state sector is shrinking and the conventional wisdom is that China will not keep growing at sustainable levels unless it becomes less state-directed.[82]

- **Russia** practices a highly interventionist form of state capitalism. The Kremlin relies on both direct government control and intervention in key sectors and control of politically connected businessmen to further both the interests of the state and those who run it. The country's vast oil and gas reserves are used as a key tool to promote financial and political independence and promote Russia as a great power abroad.[83] At the same time, the Russian model also allows many large segments of the domestic economy to remain relatively open for private (including foreign) investment. Consumer driven sectors like retail, construction, real estate, and wireless telecommunications are mostly free of direct political interference. In some sectors, political officials have found that consumer demand is best fueled by free markets.[84]
- **Brazil's** economy is market based, although significant state involvement continues to shape economic activity through industrial policies and ownership of major enterprises. The government is also the primary source of capital and long-term local currency financing and often attempts to influence some of the largest private companies, known as national champions, to invest domestically in strategic sectors such as natural resources and telecommunications. In Brazil it can be said that there is very little controversy over the government playing a large role as an investor, provider of social welfare, and driver of economic growth.[85]
- **India** combines a state-dominated economic model of an earlier era and one driven by private enterprise. India still uses five-year economic plans that are created, implemented, and monitored by a state planning commission. State involvement in politically sensitive sectors such as food, fuel, fertilizer, electricity, and water remains high. The Indian government continues to play an active role in the management of business activities.[86]

The governments of Mexico, Indonesia, and Turkey also play a much larger role in their economies than does the U.S. government, influencing market outcomes, promoting state objectives, and advancing national power. In the process, these countries arguably may be more willing to entertain market-distorting practices and take advantage of gaps in the rules.

WTO rules constrain many of the policy options pursued by the *REPs* to promote and favor the development of home-grown technologically advanced industries. In resisting compliance with the letter or spirit of their WTO obligations, many *REP* leaders argue that developing countries

[82] Pieter Bottelier, "China's Economy Is Slowly Becoming More Normal," Carnegie International Economic Bulletin, July 26, 2012.

[83] David Rothkopf, *Power, Inc.,* pp. 353-356.

[84] Ibid. p.109.

[85] Council on Foreign Relations, Independent Task Force No. 66, Global Brazil and U.S.-Brazil Relations, 2011, p. 9.

[86] David Rothkopf, *Power, Inc.,* p. 355.

should have the flexibility to use the same array of interventionist policy strategies that advanced countries once employed to facilitate their own economic growth.[87]

REPs as "Responsible Stakeholders"

The changing configuration of global economic power has coincided with a shift in the leadership of the global economy. Arguably, U.S. and European leadership, which was largely credited with creating the architecture of the post-war trading system—including the GATT and its successor organization, the WTO—has declined. Whether the decline is due to inclination or capability, the WTO has struggled to adapt to new voices and centers of influence. In the process, there is growing uncertainty about the future of the WTO and the direction of the world trading system. In particular, there is concern that a leadership vacuum could lead to economic and political conflict in the years ahead if the WTO system is not strengthened.[88]

Many observers assumed that because the *REPs* have benefitted enormously from participation in the existing global trading system, they would over time become responsible stakeholders (sharing not only the benefits of the global trading system but the responsibility of system maintenance) as they gain weight and power in the global economy. Some assumed that as responsible stakeholders the *REPs* would pursue a path of greater openness and actively promote and embrace the principles of free and fair trade with limited government intervention. As responsible stakeholders, it was also expected that they would work to break the stalemate in the Doha Round and not to stand aside and let it fail.

These expectations have not yet been realized. Some observers believe that the *REPs*, led by China, India, and Brazil, have preferred the status quo to co-leadership of the global trading system, protection of their domestic markets to market openings, and manipulation of current rules to designing new rules. Other *REPs*, such as Indonesia and Turkey, which could play a constructive supporting role have also been either obstructionist or defensive in the Doha Round.[89]

While many of the leaders of the *REPs* argue that they do show trade leadership by defending what they perceive as their national interests, others disagree and point to factors that may be inhibiting the *REPs* from exercising leadership. For example, while each of the *REPs* has a large GDP, they are all relatively poor in terms of GDP per capita. This perhaps creates a gap between the world's expectations about their ability to shoulder important roles and responsibilities in global governance and their perceptions of their own capabilities to do so.[90] The *REPs* also face formidable challenges at home, including weak national institutions and governance by elites prone to corruption, which may curb any appetite for global leadership and keep their leaders focused on domestic issues.[91]

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[87] Ha-Joon Chang, *Bad Samaritans: The Myth of Free Trade and the Secret History of Capitalism,* 2008*;* and Dani Rodrick, *The Globalization Paradox: Democracy and the Future of the Global Economy,* 2011.

[88] Robert Skidelsky, "The Future of Globalization in the Light of the Economic Collapse of 2008," p.13.

[89] Razeen Salley, The Crisis and the Global Economy," pp. 28-29.

[90] George Magnus, Will Asia Shape or Shake the World? ECIPE, 5/2012, p.2.

[91] Razeen Salley, "The Crisis in the Global Economy," p.28.

One hope for *REP* leadership rested in the rise of the G-20 as the primary forum for addressing global economic issues. Created in 2008 in response to the global crisis, the G-20 was credited with facilitating an effective response by the rising powers in keeping the world economy afloat. China and India, in particular, both adopted large spending programs to keep their own economies from declining, which, in turn, had some positive effects on the world economy. But the G-20 has become less effective since the crisis, and cooperation remains elusive. Collective pledges, such as on concluding the WTO Doha Round, have not been implemented. Soft cooperation may be the best that can be hoped for as deep-seated differences among G-20 members on underlying economic policies prevent hard coordination on rebalancing the global economy and implementing policies to prevent a future crisis.[92]

As the *REPs* focus on dealing with internal challenges to economic growth, greater enthusiasm and a stronger commitment to the principles of WTO membership could be helpful as they attempt to overcome vested interests and protectionist pressures at home. A multilateral trading system based on mutual obligations and concessions has historically helped governments deal with their domestic political challenges to economic reforms.

China's Key Role

With the largest population and the second-largest economy in the world, China is the *REP* looked to the most for shouldering global responsibilities and in delivering global public goods. Which direction China will take is uncertain, but it is sure to have a big impact on the other *REPs*.[93] A number of factors may push China either towards or away from accepting more leadership responsibilities.

On the one hand, China has a huge stake and self-interest in maintaining an open multilateral trading system. Its rise to prosperity has depended on an open world trading system to generate growth and demand. Assuming it becomes the largest trading country (both goods and services) and largest economy in the world in the decades ahead, its need for stable rules, open markets for its exports, and access to raw materials and intermediate inputs that are not produced domestically will only grow. China's large state-owned companies also want opportunities to invest abroad. These stakes in an open world trading system ought to provide an incentive for China to provide more active leadership in strengthening the rules of the trading system, especially if it is threatened by protectionism. Moreover, its regime's claim to legitimacy hinges on the country's continuing welfare and prosperity.[94]

China's movement toward responsible stakeholder status could also be bolstered by internal forces pushing Chinese authorities to reduce control over the economy. The World Bank, for instance, recently concluded that China will not keep growing at sustainable levels and will not

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[92] CRS Report R40977, *The G-20 and International Economic Cooperation: Background and Implications for Congress*, by (name redacted).

[93] It also can be argued that, with the possible exception of Russia, the approach the other *REPs* adopt on becoming "responsible stakeholders" may be more fluid and open than China's. If so, the other *REPs*, particularly Brazil, India, Indonesia, and Turkey, may be as influential as China in affecting the future of the world trading system. For elaboration of this view, see Daniel M. Kliman and Richard Fontaine: "Global Swing States: Brazil, India, Indonesia, Turkey and the Future of International Order, *German Marshall Fund of the United States* and *Center for New American Security*, November 2012, and Jennifer Hillman, "Global Swing States and the Trade Order," *German Marshall Fund of the United States*, Global Swing States Working Paper 2012.

[94] Guy de Jonquiere, "China's Challenges," ECIPE Policy Brief, No. 01/2012, p. 8.

avoid the trap that most middle-income economies fall into unless its economy becomes less state-directed. SOEs still account for a significant amount of Chinese industrial production and put a heavy strain on China's economy. Government support of unprofitable SOEs, half of which reportedly lose money, diverts resources from potentially more efficient and profitable enterprises. Accordingly, a less directed economy or an economy in which the private sector and markets gain the upper hand would be consistent with movement towards responsible stakeholder status—a China that is more integrated into the rules and norms of the global trading system.[95]

On the other hand, China's leaders may believe that they can achieve the country's international economic objectives, particularly access to natural resources, through diplomacy, foreign aid, and preferential trade agreements with other countries. Moreover, China's leaders have for three decades defied the predictions of critics that central planning cannot work efficiently. China's continued growth, despite a recent slowing, has led some in China to conclude that China's state dominance in key industrial and service sectors should and will continue. The challenge is that genuine integration into the global economic order would demand significant modifications to the Chinese political economy and how China is ruled. Such modifications could change the dynamics of how the country is run or even weaken the relevance of the Communist Party. While its leaders may recognize that they (via the state) misallocate capital on a massive scale, they may do so in large part to keep a hold on power. Under this view, it is hard to see China taking on a global trade leadership role given that most incentives will be in promoting the power interests of the Party elites.[96]

While it is uncertain which path China will take, any change is likely to be incremental and gradual. Reflecting Deng Xiaoping's much quoted injunction "to stand firmly, hide our capabilities, bide our time, never try to take the lead" in international affairs, China's use of power in the past has been cautious.

U.S. Trade Policy Response

Major shifts in the structure of the world economy have taken place. The *REPs* now account for significant shares of global GDP and trade. As a result, they also have increased their economic influence and bargaining leverage. This reconfigured global economy coincides with very different conditions than those that prevailed in the second half of the last century.[97] Most notably, the traditional structure of postwar multilateralism has weakened; bilateral and regional preferential trade agreements have proliferated; and priorities for trade liberalization and economic reforms are in flux during a period of heightened economic uncertainty. In this environment, questions arise over how the world trade order will be kept, how new rules can be established to discipline foreign trade-distorting practices, and how the United States can best respond to the challenges and opportunities posed by the *REPs*.[98]

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[95] World Bank, *China 2030,* pp.18, 61.

[96] John Lee, "China's Economy a Party Plan," *Australian Financial Review,* January 5, 2012.

[97] In 1948, when the General Agreement on Tariffs and Trade was created, U.S. GDP accounted for 65% of total GDP of the 23 GATT members. By 2011, U.S. GDP accounted for about 22% of the total GDP of the now 157 members of the WTO. CRS calculations based on IMF data in current dollars.

[98] Robert Skidelsky, "The Future of Globalisation in Light of the Economic Collapse of 2008," p.3.

Any response could begin by reconsidering overall U.S. trade policy goals, as well as specific objectives vis-a-vis the *REPs.* To promote those objectives, policymakers have a full range of multilateral, regional, bilateral, and unilateral trade initiatives to consider. How the Obama Administration and 113th Congress prioritize and shape these trade initiatives will fundamentally determine the course of U.S. trade leadership in the years ahead.

Trade Policy Goals and the *REPs*

The overriding goal of post-World War II trade policy under successive administrations has been to promote the highest possible standard of living for U.S. residents. To this end, there is a broad consensus among policymakers and economists that by removing a country's tariffs and non-tariff barriers to allow greater specialization in production and trade, the ensuing expansion of trade will have a favorable impact on overall economic well-being.[99]

Most economists, however, also agree that while a nation's general welfare may increase, freer trade does not necessarily distribute those production and consumption benefits equally. While firms and industries that are competitive may gain by increasing exports or by expanding their operations overseas, some segments of the economy that are unable to survive increased competition could lose through worker layoffs and plant closures. In addition, there are growing concerns that today's more open global economy, which allows millions of low-wage workers around the world to compete with American labor, and digital machines to replace many forms of human labor, is responsible for a number of contemporary economic concerns. These concerns include income stagnation for the majority of American workers and increased job insecurity, particularly among lower-skilled workers.[100]

Given this dilemma, few economists call for halting trade liberalization efforts or technological advances (i.e., globalization). But they do recognize that trade policy alone cannot address many of the challenges U.S. companies and workers face in an increasingly global economy. These experts generally argue that U.S. policy must address those displaced by trade by providing them with better education and training necessary to compete in a globalized economy. Such policies, they argue, are necessary not only to improve U.S. living standards, but also to limit, if not reverse, the decline in popular support for foreign trade.[101]

In addition to recognizing the domestic aspects of the labor market challenges, U.S. trade policymakers are also subject to growing public pressures for greater reciprocity in U.S. trade relations with the *REPs.* Polling data reflect an American public that is increasingly skeptical of the benefits of globalization in general and free trade agreements in particular. More concern about the U.S. ability to compete for trade and investment is directed at the *REPs* than with advanced trading partners such as Japan or the European Union.[102] These attitudes stem both from concerns of U.S. stakeholders about jobs, import competition, and wage stagnation and from the

[99] CRS Report R41145, *The Future of U.S. Trade Policy: An Analysis of Issues and Options for the 112th Congress*, by (name redacted).

[100] David Leonhard, "Standard of Living Is in the Shadows as Election Issue," *New York Times,* October 23, 2012.

[101] CRS Report R41145, *The Future of U.S. Trade Policy: An Analysis of Issues and Options for the 112th Congress*, by (name redacted).

[102] Edward Gresser, "Trade and the 2010 Elections," Remarks to the Washington International Trade Association, November 10, 2010.

tendency of the *REPs* to keep their markets relatively more closed than the U.S. economy to promote home companies and industries.[103]

How the United States can best persuade the *REPs* to make trade liberalization a higher priority or take more responsibility for supporting the world trading system remains uncertain. On the one hand, it may help U.S. policymakers to have better information on and understanding of the factors driving *REP* policies, particularly how their trade policies are influenced by domestic growth and development priorities. In many cases, *REP* trade policy concerns and obligations tend to be subordinated to powerful elites and domestic concerns. Yet, the *REPs* still depend on access to the U.S. and other advanced country markets, and, thus, cannot easily ignore requests for reciprocity or threats of market closure. Nor are the *REPs* likely to ignore the discriminatory effects of preferential agreements negotiated by the United States with large and significant trading partners.

On the other hand, in choosing to engage the *REPs*, U.S. policymakers may also need to reconsider long-standing positions on trade agreements. Some of these positions relate to multilateral trade agreements and others to the template or formula the United States has used in negotiating bilateral and regional agreements. To better match their rising economic importance, policymakers may also wish to consider the resources and level of attention the U.S. government devotes to these countries. In addition, U.S. policymakers may also consider negotiating reductions of U.S. trade barriers about which the *REPs* often complain. These alleged U.S. barriers include agricultural subsidies, trade remedy laws, Buy-American policies, foreign investment restrictions, and work visas, among others. Under these circumstances, reciprocal bargaining and negotiations may still be possible to maximize economic welfare and avoid trade conflict.[104]

Trade Negotiating Initiatives

There is little disagreement that the rapid growth of the *REPs* presents an opportunity for gains in exports of U.S. manufactured goods, services, and agriculture, as well as opportunities for the expansion of U.S. investments abroad. A range of trade negotiating approaches may be employed to open up *REP* markets in a way that provides for more reciprocal and mutually beneficial economic relationships. These approaches are multilateral and plurilateral negotiations under the WTO, including possible reforms of the WTO dispute settlement mechanism, bilateral and regional negotiations to establish free trade agreements (FTAs), and unilateral actions that may either threaten or entice the *REPs* to open their markets to U.S. exports, or to end otherwise objectionable commercial policies.

[103] CRS Report, CRS Report RL34091, *Globalization, Worker Insecurity, and Policy Approaches*, by (name redac ted).

[104] Both the GATT and the WTO were designed to help governments promote trade through an exchange of concessions. When Country A agreed to lower a trade barrier, Country B would follow. Economists often say that such reciprocal bargaining is bad economics because unilateral reductions in trade barriers enhance a country's welfare. But many observers maintain that such bargaining is good politics because it helps leaders in both countries deal with vested interests who favor protection over trade liberalization.

Multilateral Negotiations

Multilateral negotiations were the predominant trade liberalizing vehicle in the 1960s and 1970s, at a time when the economies of the United States, France, Germany, and the United Kingdom accounted for the predominant share of global GDP. This is not the case today, as demonstrated by the inability to conclude the WTO Doha Round of multilateral trade negotiations, which were launched in 2001.[105]

The Doha negotiations have been stymied by persistent differences between the United States and Europe, on the one hand, and the largest rising economic powers, on the other hand. The United States and Europe, for the most part, have shared similar interests in encouraging the big emerging economies, such as China, India, and Brazil, to open their import markets further for services and manufactured goods, while retaining some measure of protection for their own agricultural sectors. Developing countries sought the reduction of U.S. and European agricultural tariffs and subsidies, non-reciprocal market access for manufacturing sectors, and protection for their services sectors. In the past they might have taken any deal offered by the West because they were not obligated to make any significant concessions, today, countries like India and Brazil now hold out for the deal of their choice. This resolve may have been bolstered by a view by some that they made greater commitments in the 1990s Uruguay Round of multilateral negotiations than the advanced countries.[106] Moreover, the rising powers may believe that they do not have much to gain by giving up protection of their markets for goods and services because U.S. and European markets are already quite open.[107] Concurrently, the United States, European Union, and Japan, beset by slow growth and high unemployment, were simply not willing to accept what appeared to be small and unbalanced concessions, especially by advanced developing countries, to salvage a trade round.

According to former U.S. Trade Representative Susan Schwab, countries such as China, Brazil, India, and South Africa have hidden behind the WTO's long-standing practice of allowing "developing countries" to undertake significantly fewer obligations than developed countries.[108] Ms. Schwab argued that these countries shielded themselves from making market-opening concessions by seeking maximum flexibility for developing countries. Another diplomat described this process as "the elephants hiding behind the mice." Under this perspective, the fact that these rising and heavily populated economic powers, for the most part, will have low per capita incomes for many decades raises serious concerns that they will continue to resist

[105] Technically dubbed the Doha Development Agenda, the round was supposed to end in 2005, but that deadline and four others have been missed.

[106] J. Michael Finger and Julio J. Nogues, "The Unbalanced Uruguay Outcome: The New Areas in Future WTO Negotiations," 25 *the World Economy*, 321, 333, 2003.

[107] According to USTR, under a 2008 draft agreement, China would be allowed to exempt up to 420 industrial products from tariff cuts, India would offer no new market access for 97% of its total tariff lines covering industrial products, and Brazil would be shielded from increasing market access on nearly half of its industrial products. Nor did any of these countries offer to provide any significant liberalization of their services sectors. See remarks by Ambassador Miriam Sapiro at the European Policy Centre, February 10, 2011, found at http://ustr.gov.

[108] The concept known as "special and differential treatment" had its origins in the 1960s Kennedy Round of multilateral trade negotiations. Part IV of that agreement provided that developed countries did not expect reciprocity for tariff reductions or the elimination of other barriers by developing countries. In 1971, GATT members granted a waiver that permitted them to abrogate the most-favored-nation (MFN) obligation in providing developing countries with non-reciprocal tariff preferences under the General System of Preferences. The waiver became a permanent component of the GATT system in 1979 and has not been changed since.

supporting the open trading system from which they have accrued substantial economic benefits.[109]

The biggest *REPs* also worked together as a bloc to alter the negotiating dynamics of the Doha Round. In response to a U.S.-EU proposal on agriculture, Brazil and India helped create a negotiating group at the 2003 WTO Ministerial meeting held in Cancun. The proposal encompassed Brazil's and India's respective agricultural liberalization and development goals and received backing from China, but did little to advance the negotiations.[110]

From the perspective of the *REPs,* the United States and other advanced countries are as much to blame for the Doha stalemate as they are. Officials from these countries maintain that advanced countries have wanted them to make one-sided concessions because they have been unwilling to reduce their own trade and regulatory barriers, especially in agriculture.

Few observers now believe that, given the history of the round, a large and meaningful agreement is likely to be forthcoming in the near future. For a robust agreement to come to fruition, the United States, the European Union, and China, the largest trading countries in the world, would likely need to put additional significant offers on the table. Absent movement in this direction, some observers maintain that consideration should be given to "harvesting" already achieved gains or concessions. These could include agreements or offers on trade facilitation and the phase out of farm export subsidies, among others.[111]

Plurilateral Agreements

Given that the *REPs* exercised their growing influence to prevent a successful conclusion, as well as to alter the dynamics of the Doha Round, further progress on trade liberalization within the WTO may require alternatives to existing multilateral processes and practices. It has long been suggested that principles that have guided multilateral trade negotiations in the past, such as unconditional most-favored-nation (MFN) and special and differential (S&D) treatment, may need to be reexamined.[112]

The unconditional MFN principle, for example, served as a foundation stone of the original GATT (1947). Unconditional MFN thwarts discrimination between alternative foreign suppliers and thereby promotes both economic efficiency and harmonious relations between states. Whatever its virtues, unconditional MFN creates an open door for "free riders" and an exit path from reciprocity, especially when concessions among a few countries are extended without cost to all WTO members, as they were for much of the history of the GATT and WTO. If "free riders" are developing countries that account for a relatively small amount of international trade, it may

[109] Susan Schwab, "After Doha: Why the Negotiations are Doomed and What We Should Do about It," Foreign Affairs, May/June, 2011.

[110] Amrita Narlikar and Diana Tussie, "The G20 at the Cancun Ministerial: Developing Countries and their Evolving Coalitions in the WTO, 27 *World Economy*, 2004, p.947.

[111] Gary Clyde Hufbauer and Jeffrey J. Schott, "Will the World Trade Organization Enjoy a Bright Future? *Peterson Institute for International Economics*, Policy Brief, May 2012.

[112] In addition to the "developing country" lesser obligation practice, the Doha Round has also operated according to a "single undertaking requirement." This means that all countries must agree to the whole package of commitments for any agreement to be finalized. As presently formulated, this requirement provides individual countries with considerable leeway to block forward movement.

not be a big problem for the trading system.[113] This was a situation long tolerated in the GATT system. But the prospect of "free riders" the size of Brazil, India, or China arguably presents a more formidable challenge for the functioning of most multilateral agreements.[114]

Plurilateral agreements may offer one way to get around the unconditional MFN and "free rider" problem. Similar to the codes adopted in the Tokyo Round multilateral trade negotiations in the early 1970s, such agreements apply to a number of WTO members, but not all members. By incorporating a conditional MFN clause, plurilateral agreements aim to prevent countries from gaining benefits without undertaking obligations. More positively, the conditional MFN framework is designed to create incentives for reluctant trading partners to join in preferential schemes over time.

A group of 47 countries is now negotiating an international services agreement. Only Mexico and Turkey among the *REPs* have joined the discussions. Services negotiations are as important to the United States as they are difficult. Given a strong U.S. comparative advantage in areas such as publishing, software, communications, finance, accounting, and engineering, liberalization of services trade offers potentially large economic benefits. But because services sectors are highly regulated, both at the national and sub-national level, they tend to be politically difficult.[115]

According to one analyst, plurilateral agreements could "end the simplistic distinctions between developed and developing countries and allow members from both groups to adopt rules that met their interests."[116] Other plurilateral agreements could be proposed to address issues such as foreign investment restrictions, currency undervaluation, and disciplines on state-owned enterprises.[117]

China, India, Russia, and Brazil have generally opposed the negotiation of plurilateral agreements within the WTO on the grounds that they would sacrifice the understanding of a "single undertaking" for the Doha Round. This principle, which requires agreement on all provisions being negotiated or no agreement at all, greatly strengthens their negotiating leverage.[118]

Strengthening the WTO Dispute Settlement Understanding

Whether future multilateral negotiations will occur or how they might evolve remains uncertain given that the advanced countries and the *REPs* are currently at loggerheads over the revision of

[113] Free riding under one definition occurs when a country lets other countries pay for a good or a service, or lets them do the work when the country cannot be excluded from consumption of the good or benefitting from the concession. In the context of multilateral trade liberalizing negotiations, "free riding" may be more of a political issue than an economic issue if one assumes that liberalization benefits the reformer the most.

[114] Gary Clyde Hufbauer and Jeffrey J. Schott, "Will the World Trade Organization Enjoy a Bright Future?" Peterson Institute for International Economics, May 2012, p.2.

[115] Gary Clyde Hufbauer, J. Bradford Jensen, and Sherry Stephenson, "Framework for the International Services Agreement, Peterson Institute for International Economics, April 2012, p. 2.

[116] Robert Z. Lawrence, "How Can Trade Policy Help America Compete? *Peterson Institute for International Economics*, Policy Brief, October 2012.

[117] Gary Clyde Hufbauer and Jeffrey J. Schott, "Will the World Trade Organization Enjoy a Bright Future?" Peterson Institute for International Economics, May 2012.

[118] Ibid. p. 15.

existing rules or the creation of new rules. Within this context, the WTO dispute settlement mechanism (DSU) has become the linchpin for maintaining global economic order.[119]

Both the *REPs* and advanced countries (United States and European Union) have tended to be the largest users of the DSU both as complainants and defendants. Of the 896 disputes that have been handled in the DSU from 1995 to 2011, the United States has been a party to 24% of the cases, the *REPs* (excluding Russia) 18%, and the European Union 17%.[120] By definition the largest economies have large volumes of trade (imports and exports) and greater exposure to complaints about domestic policies or market access barriers.

On one level, the system has been quite successful in diffusing conflicts, resolving differences, and obtaining compliance with rulings. Many disputes are even resolved in consultations before a panel is formed. Most countries that "lose" cases bring their laws or practices into conformity with their WTO obligations, rather than paying damages or permitting retaliation.[121] On another level, the DSU provides the *REPs* with considerable leeway to violate the letter and spirit of WTO obligations due to the facts that cases can take up to three years to complete and remedies are not retrospective. Under these circumstances, by the time a case is resolved, the market has been drastically altered and the aggrieved company may have has lost market share forever.[122]

Despite shortcomings, the WTO's DSU is likely to remain a key tool for managing trade relations in the years ahead. For the United States and other advanced countries, the DSU is a way to engage the *REPs* directly about their responsibilities for upholding a system of multilateral trade rules. For the *REPs,* the DSU provides a way to challenge advanced countries' market access barriers and protectionist threats. Combined with rising levels of economic integration that deter countries from taking actions that would damage each other, the DSU, thus, can provide a key forum for managing trade relations during an era in which both global economic power and leadership are in transition and uncertain.[123]

Bilateral and Regional FTA Negotiations and Other Bilateral Initiatives

Increasingly, U.S. trade policy (as well as the trade policies of the other major trading countries) is becoming dominated by bilateral and regional negotiations to establish FTAs.[124] These agreements offer opportunities between pairs or groups of countries to reduce trade barriers and construct new rules in an effort to generate economic growth through trade expansion.

U.S. FTAs have typically removed almost all tariff and border barriers to trade, liberalized services trade, bolstered intellectual property protection, opened up government procurement

[119] Gregory Shaffer and Charles Sutton, "The Rise of Middle-Income Countries in the International Trading System," p. 26.

[120] World Trade Organization Annual Report, 2012, pp. 86-87.

[121] Bruce Wilson, "Compliance by WTO Members with Adverse WTO Dispute Settlement Rulings: The Record to Date, *Journal of International Economic Law,* 10:2 397, 2007.

[122] Gregory Shaffer and Charles Sutton, "The Rise of Middle-Income Countries in the International Trading System," p. 26.

[123] Guy de Jonquieres, "The Multilateralism Conundrum: International Economic Relations in the Post-hegemonic Era," p. 6.

[124] As of January 15, 2012, 515 bilateral and regional trade agreements have been notified to the WTO, 319 of which are currently in force.

markets, liberalized foreign investment restrictions, and provided for the enforcement of core worker rights, among other provisions. FTAs may be particularly advantageous when they can address trade barriers not adequately covered by WTO rules (e.g., intellectual property rights, state-owned enterprises, export restrictions, trade facilitation, discriminatory regulatory practices, services, foreign investment, effects of trade on small-and-medium-sized businesses, and the effects of FTAs on global supply chains) or include obligations that go beyond current rules.

Since the North American Free Trade Agreement (NAFTA) went into effect in 1994, the United States has concluded 12 FTAs with 17 countries, including the regional Dominican Republic-Central American Free Trade Agreement (DR-CAFTA).[125] These agreements have been comprehensive in scope and have comprised high standards. They have not only eliminated tariffs on goods and agricultural products but also covered intellectual property, direct investment, government procurement, service sector trade, and regulatory, labor, and environmental issues.[126]

Since NAFTA, U.S. FTAs have been concluded with relatively small trading partners (South Korea excluded). Post-NAFTA U.S. FTA partners, including South Korea, account for less than 9% of total U.S. trade.[127] For a number of reasons, the United States has not negotiated FTAs with large and more significant trading partners, such as China, India, and Brazil.[128]

One reason may be that these countries have not been prepared or have shown little interest in negotiating an FTA with the United States. Brazil, for example, wants openings for its agricultural exports and India wants greater labor mobility and new opportunities for its service providers, but neither country may be willing to liberalize in other areas of interest to the United States. Nor would they likely accept inclusion of labor and environmental provisions that are now part of the U.S. FTA template. In this changed world, the United States may need to consider deviating from its FTA template, as well as putting remaining U.S. trade barriers, particularly agriculture, on the negotiating table, if it is to secure the strategic and economic advantages of agreements with these larger countries.[129]

At the same time, the Obama Administration has made considerable progress on negotiating the complex free trade agreement known as the Trans-Pacific Partnership (TPP). Currently, the United States is negotiating this regional trade agreement with Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. U.S. negotiators envision the proposed TPP as a "comprehensive and high-standard" FTA that will liberalize trade in nearly all goods and services and include commitments beyond current WTO obligations. For example, the negotiation aims to improve the environment for the operation of regional supply chains and establish disciplines on issues such as the role of state-owned or state-controlled enterprises, and foreign investment that could serve as a model for future negotiations. A successful conclusion to

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[125] These countries include Australia, Bahrain, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Jordan, Morocco, Nicaragua, Oman, Panama, Peru, and South Korea. In addition, the United States has an FTA with Israel which went into effect in 1985.

[126] U.S. trade negotiators often refer to the FTA template utilized as being the "gold standard."

[127] Based on U.S. Census Bureau trade data, South Korea accounted for 2.7% of total U.S. trade and the remaining U.S. FTA partners (excluding Israel, Canada, and Mexico) accounted for 6.1% of total U.S. trade in 2011.

[128] In the early 1990s, the United States proposed the creation of the Free Trade Area of the Americas (FTAA) as a way of linking NAFTA with the other FTAs in the region. Brazil was not receptive to the proposal, and as a result it failed to gain acceptance.

[129] Robert Z. Lawrence, "How Can Trade Policy Help America Compete," *Peterson Institute for International Economics,* October 2012.

these negotiations could encourage China and other non-participating countries to offer similar rules and opportunities, especially if it also attracts additional countries to join.[130]

The inclusion of Vietnam and Malaysia in the TPP negotiations, two countries that are direct competitors with China for foreign direct investment, could possibly influence China. If these two countries were to agree to high standards and comprehensive WTO-plus provisions that allowed more competition in product and labor markets, and gave liberalized restrictions on foreign investment in return for greater access to the U.S. market, China may feel greater pressure to liberalize its economy over time or join the negotiations out of fear that foreign investment could be diverted.[131]

The possible negotiation of a comprehensive U.S. FTA with the European Union (EU) could also have strong competitive liberalizing effects. According to press reports, negotiations on such an agreement may be launched in 2013. Given that the U.S.-EU economic relationship is the largest in the world, a successful negotiation could establish de facto international standards in a range of sectors through the convergence of regulatory processes or through the mutual recognition of each side's standards. Combined with other possible preferences built into the agreement, a U.S.-EU FTA could serve as a strong incentive for the major non-parties to the agreement to view multilateral negotiations more favorably.[132]

Beyond bilateral and regional trade negotiations, U.S. policymakers have an array of trade and diplomatic tools available to expand engagement with the *REPs* in an effort to influence their support for an open and non-discriminatory, rules-based trading system. On the trade side, these tools include Trade and Investment Framework Agreements (TIFAs) and other high-level joint commissions and dialogues that serve as a forum for government leaders at all levels to meet and discuss issues of mutual interest with the objective of improving cooperation and expanding trade and investment. On the diplomatic side, approaches could include increased official exchanges and expanded investments in education and language training.[133] In addition, export promotion measures, particularly export finance, could be reinforced to make sure U.S. exporters and investors are not disadvantaged by similar efforts from third country competitors.

U.S. Unilateral Initiatives to Encourage *REP* Reforms

U.S. unilateral initiatives traditionally have taken the form of threats to restrict a trade partner's access to the large U.S. market in order to induce the partner to open its market to U.S. exports and investment or to cease other practices that burden U.S. commerce. While the United States employed this approach of imposing unilateral sanctions primarily in the 1980s and early 1990s against Japan, this tool is largely unavailable today. This is because in the WTO Uruguay Round Agreements, which were concluded in 1994 and greatly expanded the scope of multilateral trade rules, the United States and other countries largely agreed to end unilateral trade action in favor of a WTO dispute resolution system based on binding rulings on violations of WTO world trade obligations. The proliferation of global production chains also makes it more difficult today to

[130] CRS Report R42344, *Trans-Pacific Partnership (TPP) Countries: Comparative Trade and Economic Analysis*, by (name redacted).

[131] Howard Schneider, "U.S., Asian Nations in Trade Talks without China," *Washington Post*, September 21, 2012.

[132] CRS Report R41652, *U.S.-EU Trade and Economic Relations: Key Policy Issues for the 112th Congress*, by (name redacted).

[133] Daniel M. Kliman and Richard Fontaine, "Global Swing States," p.32.

impose a measure of economic hardship on a trading partner without adversely affecting one's own economic interests.

In today's more interdependent world economy, unilateral initiatives take the form more of "carrots" or incentives than "sticks." Possible unilateral initiatives include measures that strengthen the U.S. economy so that the United States sets an example for the rest of the world, as well as U.S. proposals that resonate with the *REPs*' own evaluations of their economic self-interest.

Reinvigorating the U.S. economy to achieve more rapid long-term growth could be the most important unilateral initiative with a favorable impact on *REP* reform initiatives.[134] With the financial and housing markets being repaired and new strengths being found in exports and shale gas, some observers believe that the United States could be just one budget agreement away from strengthening those long-term economic fundamentals needed to preserve a preeminent global economic position.[135] If this were to come to fruition, the U.S. economic model based on free markets and democracy could regain much of its appeal to the rest of the world.[136]

A stronger U.S. economy spurred primarily by market forces, in turn, could weaken *REP* justifications and defense of a more muscular role for the state, as well as provide a competitive dynamic and example for others to liberalize their own markets as well.[137] Moreover, Brazil, Russia, India, and China, operating in the context of their *BRIC* grouping, tend to be united more by a shared desire to raise their political profile on the global stage than any other shared interests.[138] They also want to modernize their own economies according to their own economic policies, and not ones dictated by the United States or any other country. Thus, in the long run, whether the U.S. market-based version of capitalism or more state-centered forms of capitalism prevail could be determined by economic performance. Momentum could rest with the model that produces faster growth, combats inequality more effectively, and protects citizens better against the volatility of the modern marketplace.[139]

Given that both a full restoration of U.S. economic vitality and robust unilateral reforms by the *REPs* are unlikely in the near term, the United States most likely will continue efforts to open *REP* markets via negotiations. While U.S. negotiating priorities are likely to be for rules in which the private sector or shareholder-owned companies are the primary economic actors, the *REPs* are likely to insist on language that will preserve more discretion for government action. The question of the appropriate role of government has contributed to many trade disputes in the past and is unlikely to be resolved permanently by any future trade negotiation.[140]

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[134] The Economist, "America's Economy Is Once Again Reinventing Itself," July 14, 2012.

[135] Robert Zoellick, "American Exceptionalism: Time for New Thinking on Economic and Security", Institute of Strategic Studies, London, July 25, 2012.

[136] U.S. Department of State, "Economic Statecraft," Remarks of Hillary Clinton, October 14, 2011, and Charles A. Kupchan, *No One's World: The West, The Rising Rest, and the Coming Global Turn,* Oxford University Press, 2012.

[137] There are many strategies other than reliance on free market forces that are advocated for competing against the *REPs*. For one dubbed "strategic capitalism, "which advocates greater U.S. government intervention and guidance of markets, see Richard D'Aveni, "It's Time for U.S. Business to Talk Tough, Act Tough," *Washington Post,* October 14, 2012.

[138] Many observers maintain that the *BRICs* have few common issues that unite them except opposition to U.S. economic and military supremacy.

[139] David Rothkopf, *Power, Inc.,* p.26.

[140] Council on Foreign Relations, "U.S. Trade and Investment Policy," p. 47.

U.S. trade negotiators have had much experience in negotiating disciplines on foreign government-directed or -supported practices that provide de facto discrimination against foreign firms. For example, in the case of Japan in the 1980s and 1990s, U.S. negotiators spent considerable time targeting Japanese government-directed measures that protected its market from U.S. competitive exports of products such as auto parts, medical devices, semiconductors, and beef. Preferential government treatment in sectors such as insurance, banking, and express delivery similarly limited opportunities for U.S. firms and workers in Japan.[141]

Some analysts maintain that U.S. trade negotiators made the greatest progress with Japan when their pressure, voices, and concerns worked to reinforce domestic pressures for change. In the context of future negotiations with the *REPs,* the natural allies for such appeals could be the growing numbers of middle-class consumers who are the beneficiaries of a non-discriminatory rules-based trading system, as well as the growing numbers of exporters and investors. Such appeals can be strengthened by reaching out to the European Union and other advanced countries to urge a more rapid opening and liberalization of *REP* markets. Under this view, the *REPs* are most likely to remove trade barriers and otherwise undertake economic reforms that open their economies to greater competition when they see these measures to be in their own economic interest rather than under the threat of sanctions or other demands.[142]

Congressional Role

Based on express powers provided in the U.S. Constitution (Article 1, Section 8), Congress plays a large role in formulating U.S. trade policy. Congress exercises its responsibility to "regulate commerce with foreign nations" in many ways. These include a major role in setting U.S. trade negotiating objectives and priorities, approval of trade agreements, and general oversight of trade relations.

The 113th Congress may consider a number of questions relating to the future direction of U.S. trade policy, particularly if President Obama should ask for a renewal of Trade Promotion Authority (TPA) in 2013. Under TPA (formerly called "fast-track authority"), the President agrees to negotiate trade agreements in line with objectives established by Congress. In return, Congress agrees to consider legislation implementing trade agreements meeting those objectives under expedited legislative procedures (no amendments, strict time limits on debate, and an up-or-down vote).[143]

Congress has renewed TPA several times, but the last grant of authority expired in 2007. Any request from President Obama to renew TPA could be driven by an effort to open new trade negotiations, such as a U.S-EU FTA, or to complete the Trans-Pacific Partnership (TPP), for which negotiations are in progress.

Should Congress decide to consider reauthorizing TPA, a range of trade policy questions affecting U.S. trade relations with the *REPs* could also be examined. These include what kinds of new initiatives can best engage the *REPs,* open their markets further to U.S. exports and investments,

[141] CRS Report RL32649, *U.S.-Japan Economic Relations: Significance, Prospects, and Policy Options*, by (name redac ted).

[142] CRS Report 95-714, *Japan's Response to U.S. Trade Pressures: End of an Era?* by (name redacted).

[143] CRS Report RL33743, *Trade Promotion Authority (TPA) and the Role of Congress in Trade Policy*, by (name redacted) and (name redacted).

and revitalize the WTO. Whether U.S. trade policy should elevate the attention and resources the *REPs* receive is another important question that could be addressed, along with questions relating to the adequacy of U.S. export promotion and commercial advocacy efforts.

Most observers maintain that U.S. trade leadership is bolstered when the President has TPA and a mandate from Congress to negotiate new agreements. In trying to induce the *REPs* with their very different state-led economic models into maintaining and strengthening the market-oriented WTO system, U.S. trade negotiators may need considerable resources, flexibility, and leverage to be successful.

Appendix A. Previous Efforts at Identifying a Group of Rising Developing Countries

Over the past two decades numerous efforts have sought to identify which developing countries will change the face of the global economy.[144] In what was one of the earliest attempts at identifying a group of countries that would be increasingly important to U.S. interests, the Clinton Administration in the early 1990s undertook what was called a *Big Emerging Markets Initiative (BEM).* China, India, and Brazil, three countries with huge populations and land mass, impressive economic progress, and large political ambitions, led the list of 10 countries chosen for the *BEM Initiative.* The "Big Ten" list also included Mexico and Argentina in Latin America, South Africa in Africa, Poland and Turkey in Europe, and South Korea in Asia. Countries were selected not only on the basis of their probable commercial importance to the United States in the decades ahead, but also due to broad foreign policy concerns bearing on security, human rights, and environmental issues. The *BEM* initiative acknowledged that U.S. policy towards these countries ought to have a stronger commercial dimension and advocated cultivating ties with these countries in broader and more systemic ways.[145]

The World Bank's 1997 *Global Economic Prospects Report* was another early attempt to identify a group of rising developing countries. Dubbed the "Big 5," this report projected that Brazil, Russia, India, China, and Indonesia would increase their influence on world patterns of resource allocation, production, and trade by 2020.

In a 2001 report that examined the relationship between the world's leading advanced countries and the world's leading emerging market economies, Goldman Sachs researchers argued that Brazil, Russia, India, and China—four populous and fast-growing countries that they dubbed the *BRICs*—would propel global growth in the decades ahead and that their weight in the world economy would grow markedly, overtaking the six largest Western economies in 40 years.[146]

In 2005, Goldman Sachs designated a next group of developing countries that arguably would have the capacity to play a much larger role in the global economy. This group was dubbed the "Next Eleven," or *N-11* for short, and included Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, South Korea, Turkey, and Vietnam.[147]

The so-called *CIVETS* group of countries—Colombia, Indonesia, Vietnam, Egypt, Turkey, and South Africa—was touted by the Economist Intelligence Unit (EIU) in 2009 as the next generation of "tiger" economies (even though they are named after a shy feline mammal). The

[144] Most previous efforts have labeled the rising developing countries as emerging markets. This report uses the term "rising economic powers" to more clearly signify that many of these countries have already emerged as either global or regional economic powers.

[145] Jeffrey E. Garten, *the Big Ten,* Basic Books, 1997.

[146] Jim O'Neil, "Building Better Global Economic BRICs," Goldman Sachs Global Economics Paper No. 66, November 2001. Between 2001 and 2011 the aggregate GDP of the *BRICS* nearly quadrupled, rising from around $3 trillion to between $11 and $12 trillion, at a time when the world economy was doubling in size. The rapid growth accounted for one-third of world growth over a decade and their combined GDP increased was more than twice that of the United States. They also doubled their share of world trade during this period, rising from 10% to 20%.

[147] Jim O'Neill, Dominic Wilson, Roopa Purushothaman and Anna Stupnytska, "How Solid Are the BRICs?" Goldman Sachs Global Economics Paper No. 134, December 2005.

appeal of these countries is that they all have large, young populations with an average age now of 27 and reasonably sophisticated financial systems, and export a variety of products.[148]

In January 2011 President Obama announced a National Export Initiative (NEI) aimed at doubling U.S. exports over five years. In addition to China, India, and Brazil, this effort identified Colombia, Indonesia, Saudi Arabia, South Africa, Turkey, and Vietnam as "next tier" emerging markets, as well as the Asia-Pacific region as a whole.[149]

In 2011, Jim O'Neil, the head of the Goldman Sachs research team, maintained that the term "emerging markets" could no longer be applied to the four *BRICs* or to four of the *N-11*: Indonesia, South Korea, Mexico, and Turkey. Instead, this group of countries with largely sound debt and deficit positions, strong trading networks, and large labor forces were dubbed "*Growth Markets*."[150]

Citibank analysts in 2011 identified Bangladesh, China, Egypt, India, Indonesia, Iraq, Mongolia, Nigeria, Philippines, Sri Lanka, and Vietnam as the countries with the most promising growth prospects and investment opportunities. Dubbed *3G* or *Global Growth Generators*, these 11 countries were identified base on a weighted average of factors such as savings rates, demographic prospects, health, education, quality of institutions and policies, and trade openness.[151]

Rejecting a primarily quantitative approach for singling out and ranking countries in terms of their economic potential, *Oxford Analytica* in 2012 identified six countries—Turkey, Egypt, Iran, Nigeria, Indonesia, and Mexico—as candidates for the status of *Pivotal Powers.* In a world of increasingly fragmented power, this report argued that these are "countries that by virtue of their strategic location, size of population, economic potential, policy preferences, and political weighting are destined to shape the contours of geopolitics in key regions of the world and constitute important nodes of economic growth."[152]

In November 2012, the German Marshall Fund of the United States (GMF) and Center for New American Security released a new report, *Global Swing States: Brazil, India, Indonesia, Turkey and the Future of the International Order.* In this report, the authors examined how the United States and Europe can partner with these countries to support a new international order.

[148] *Wall Street Journal,* September 18, 2011.

[149] Report to the President on the National Export Initiative: The Export Promotion Cabinet's Plan for Doubling U.S. Exports in Five Years, Washington, D.C., September 2010.

[150] Jim O'Neil, *The Growth Map: Economic Opportunity in the BRICs and Beyond,* Penguin, 2011, p.5.

[151] Citigroup's study of 3G nations, "Global Growth Generator," February 2011 (found at http://www.nber.org/wbuiter/3G.pdf).

[152] *Oxford Analytica,* "Pivotal Powers: Politics and Prosperity in a Volatile World," February 29, 2012.

Appendix B. Methodology for Economic Projections

While the countries identified as rising economic powers have varied, the selection criteria have relied in substantial part on three factors—population or labor force size, capital stock, and what economists call total factor productivity. Of these factors, some projections place more weight on demographics given that only countries with large populations can hope to be one of the largest economies. Others have emphasized underlying political and institutional characteristics that influence total factor productivity as far more important in whether countries rise or fall in the global economic GDP rankings.

The United Nations predicts the global population will reach 9.2 billion in 2050, a large jump from the estimated 6.8 billion in 2009 and 2.5 billion in 1950. During this same period, the global labor force is expected to expand by nearly 1.3 billion. Developing regions will see their workforces expand by 1.5 billion people—more than the current population of developed countries—while the labor force will shrink by over 100 million in developed areas. Developing Africa and Asia will contribute the most to the increase, adding 1.4 billion workers to the global labor force. By contrast, Europe's working-age population will decline by more than 110 million.[153]

Research that weights population size and labor force growth as the most critical factors contributing to economic growth tends to argue that the world's most populated countries should have the largest economies when the productivity of their workers (the more a group of workers can produce with a given set of inputs from time to materials) increases rapidly. Critically, the countries that are playing an increasingly large role in the world economy, displacing many 20th century powers in the GDP rankings, have large populations, large markets, and a growing middle class. Demographics matter because they define a country's economic ability to become a large economic power even if living standards are relatively low. They also enable countries to project power, and, if they are able, to set and implement an agenda for others to follow.[154]

As worker productivity is enhanced by additions of machinery, physical capital stocks are the second key driver of growth. These stocks, in turn, are a function of savings rates and rising incomes. Having a high savings pool is important because this finances the investment that leads to future growth. In advanced countries, savings as a share of GDP are declining as populations age. In many developing countries, capital stocks are predicted to rise substantially as the working population ages.[155]

What economists call total factor productivity (TFP) is the third driver of economic growth and may be the most important. This is the extra growth that occurs when labor and capital are added together in an efficient and optimum manner. Rising TFP can come from a variety of factors including political stability, good governance, sound institutions, exposure to new technologies, and the right economic and financial policies. While there are no precise formulas to stimulate growth, some of the key ingredients are thought to include policies that allow the free flow of goods, money, and people; policies that encourage savings and banks to funnel money into productive investments; and policies that stabilize the economy with low inflation and low budget

[153] United Nations, "World Population Prospects," 2010 Revisions.

[154] Uri Dardush and Bennet Stancil, "The World Order in 2050," Carnegie Policy Review, Washington, D.C., 2010.

[155] Ibid. p.4.

and trade deficits. Additionally, the rule of law and protection of property rights is required to attract technology transfers and innovation. Top quality education and training systems are also widely viewed as key components. But there appears to be no magic formula, only a long list of ingredients that offer no real insight into how these factors will or will not combine to produce growth in any given country at any given time.[156]

Given that TFP is substantially about policies and institutions, the past may not be a good guide to the future. As the factors undergirding TFP are inherently unpredictable, long-term forecasts of economic growth are bound to be uncertain as well. China and India, for example, could falter for any number of reasons. China faces internal imbalances, a rapidly aging population, rising wages, and social unrest, among other challenges. India, for its part, must deal with endemic corruption, weak infrastructure, and excessive regulations if it is to reach its economic potential. Conversely, countries such as Iran and Nigeria that now are seeming long-shots to play a large role in the global economy could conceivably address internal political challenges, adopt outward-looking economic reforms, engage with the rest of the world, enter a path of sustained growth, and rise in the global GDP rankings.

[156] George Magnus, *Uprising: Will Emerging Markets Shape or Shake the World Economy*, Wiley, 2011, and Ruchir Sharma, *Breakout Nations: In Pursuit of the Next Economic Miracles,* W.W. Norton, 2012.

Appendix C. Alternative *REP* Groupings

As discussed in the report, there are large differences among the universe of rising developing countries, giving scope for varied groupings and categories. While this report focuses on seven countries identified as *REPs*, it is important to flag other countries that are capable of playing a much larger role in the global economy if they are able to overcome political and institutional constraints. These potential "turnaround" or "long-shot" countries include Bangladesh, Egypt, Iran, Nigeria, Pakistan, Philippines, and Vietnam. There are also at least nine fast-growing developing countries or emerging markets that are providing attractive commercial opportunities, but that are unlikely to become regional or global economic powers because of their relatively smaller populations. This group includes Argentina, Colombia, Czech Republic, Malaysia, Poland, Saudi Arabia, South Africa, Thailand, and Venezuela.

Long-Shot or Turnaround Economies

There are a number of populous developing countries that have enormous economic potential, but must overcome fundamental political and economic obstacles if they are to break out of their economic doldrums. Among the countries that could turn their economic fortunes around with better governance and other institutional and policy reforms are Bangladesh, Egypt, Iran, Nigeria, Pakistan, Philippines, and Vietnam. As shown in **Table C-1**, these six countries all have large populations ranging from 75 million in Iran to over 160 million in Bangladesh, Nigeria, and Pakistan. But they currently have shaky and small economies amounting to only $200 billion-$480 billion in GDP. They also have very low per capita incomes, ranging from a little over $1,000 in Pakistan, Nigeria, and Vietnam to an estimated $4,500 in Iran.

Table C-1. Economic Indicators of Selected "Long Shot" Countries

Country	Population	GDP (current US $ in billions)	Average Annual GDP Growth (2003-2008)	Average Annual GDP Growth (2009-2011)	GDP Per Capita (current US$ 2011)
Egypt	82,536,770	231	5.5	3.9	2,780
Iran	74,798,599	480	5.5	3.1	4,525 (2009)
Vietnam	87,840,000	124	7.8	6.0	1,411
Nigeria	170,123,740	236	7.5	7.2	1,452
Pakistan	176,745,364	204	5.6	3.1	1,194
Philippines	94,852,030	224	5.4	4.1	2,369
Bangladesh	161,083,804	204	6.0	2.6	2,800

Source: CIA Fact book and World Bank data found at http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2.

Some of the economic potential and challenges facing several of these countries are highlighted below:

- **Egypt** arguably has the size, history as a Middle Eastern power, and ambition to become a rising economic power. Some of its advantages include the largest population (82 million) in the Middle East and North Africa, well-educated elite, and a sizeable middle class, plus a strategic location on a critical waterway. Its economy has suffered because of its political instability, an unsettled transition to democracy, and legal uncertainties. If new leadership adopts pro-growth policies, opens the economy further to trade and investment, and increases the role of the private sector in the economy, its growth prospects could improve immeasurably. However, the country's new leaders will need to ensure that the benefits of growth are widely distributed to stave off further political conflict.[157]

- **Iran**, a current U.S. adversary, is a country of immense commercial and economic potential. Its population of 75 million makes it the second-most populous country in the Middle East and North Africa, after Egypt. It has a vibrant, well-educated, and entrepreneurial middle class with some of the highest labor participation rates of women in the region. Two-thirds of Iranians are under the age of 33 and one-half under the age of 21. Expatriates of Iranian descent, located mostly in the United States and Europe, have an estimated $1 trillion in assets and could potentially mediate between Iran and global capital and trade markets if the geopolitical environment dramatically improved. From 2003 to 2008, Iran averaged 5.3% growth and maintained a stable macroeconomic environment. Affected by increased international isolation, economic growth in past years (2009-2011) has dropped to just over 3%. Absent a more moderate and responsible leadership and a lifting of international sanctions, rapid growth will likely remain elusive.[158]
- **Nigeria** aspires to become Africa's most powerful and influential country and one of the world's top 20 economies by 2020. It has been growing 7% per year for much of the past decade and its GDP could overtake South Africa's in the very near future. Nigeria's demographic profile lies at the root of its rising economic status. With a population currently estimated at around 170 million but expected to exceed 300 million by the middle of the century, it is Africa's biggest domestic market by far. Its relatively youthful and rising middle class, entrepreneurial culture, and appetite for consumer goods add to its huge economic potential. But its economic management and governance; high unemployment rate; low development indicators, such as infant mortality and literacy; and political conflict and instability in parts of the country remain serious challenges. Progress has been slow in lessening the economy's overreliance on oil, harnessing vast natural gas reserves, reviving its agricultural sector, eliminating a chronic infrastructure deficit, tackling endemic graft and corruption, and overhauling dysfunctional institutions. Success in any one of these areas could herald the birth of a continental power.[159]

[157] CRS Report RL33003, *Egypt: Background and U.S. Relations*, by (name redacted), and U.S. Department of State Background Note: Egypt.

[158] CRS Report RL32048, *Iran: U.S. Concerns and Policy Responses*, by (name redacted), and U.S. Department of State, Background Note: Iran.

[159] CRS Report RL33960, *The Elementary and Secondary Education Act, as Amended by the No Child Left Behind Act: A Primer*, by (name redacted), CRS Report RL33964, *Nigeria: Current Issues and U.S. Policy*, by (name redacte d), and U.S. Department of State, Background Note: Nigeria.

Emerging Markets

There are a number of other developing countries that are providing rising living standards and significant new trade and investment opportunities. All have adopted outwar- looking trade and economic policies and are well positioned for continued future growth. With populations under 100 million, however, none are large enough to become global or even regional economic powers. Argentina, Colombia, Czech Republic, Malaysia, Poland, Saudi Arabia, South Africa, Thailand, and Venezuela are selected countries that can be placed in this long-standing category of emerging markets.

As shown in **Table C-2,** these emerging markets have GDPs ranging from a low of $215 billion (Czech Republic) to a high of $577 billion (Saudi Arabia). With populations generally under 50 million (Thailand at 69 million being the exception), most of these countries will be hard pressed to break the $1 trillion GDP threshold any time soon. While Thailand, with a per capita income of $4,972, is the poorest emerging market, it may also have the greatest upside potential for growth.

Table C-2. Economic Indicators of Selected Emerging Markets

Country	**Population** 2011	**GDP (current US $ in billions)**	**Average Annual GDP Growth (2003-2008)**	**Average Annual GDP Growth (2009-2011)**	**GDP per Capita (current US$ in 2011**
Argentina	40,765,561	445	8.5	6.3	10940
Colombia	46,927,125	332	5.2	3.9	7067
Czech Republic	10,546,000	215	5.2	0.1	20407
Malaysia	28,859,154	279	5.8	3.6	9656
Poland	38,216,000	514	5.2	3.3	13462
Saudi Arabia	28,082,540	577	4.7	3.8	20540
South Africa	50,586,757	408	4.6	1.5	8070
Venezuela	20,047,938	315	7.4	-1.5	10,809
Thailand	69,518,555	346	5.1	1.9	4972
High Income OECD	1,039,496,025	4 1,124	2.1	0.2	38,667

Source: World Bank data found at http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2

On average, these emerging markets grew two to four times faster than advanced countries from 2003 to 2008. Over the most recent three-year period (2009-2011), Argentina, Colombia, Malaysia, Poland, and Saudi Arabia have experienced growth rates averaging 3.3% to 6.3%, thus surpassing the advanced countries' negligible growth of two-tenths of one percent by wide margins. South Africa and Thailand, which grew by 1.5% and 1.9% respectively, also grew significantly faster than the advanced countries. Only the Czech Republic, adversely affected by the Euro zone crisis, and Venezuela, adversely affected by economic mismanagement, performed the same or worse than the advanced countries.

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