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**THE POTENTIAL
FOR EXPANDED
U.S. TRADE
WITH
MIDDLE INCOME
COUNTRIES**

NATE OLSON AND ROBERT BERG

The Potential for Expanded U.S. Trade with Middle Income Countries

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Table of Contents

Foreword	4
Executive Summary	5
1. Introduction	7
Objectives and Scope of Analysis	7
Methodology	7
2. Sizing up the Stakes	9
Market size and growth potential	9
Changes in wealth and consumer demand.	9
Global reach.	9
Trade-investment symbiosis	10
Competition to write the “rules of the road”	10
The security dimension	11
3. High-Value Targets for Policymakers	13
Regulatory cooperation and “behind-the-border” issues	13
Digital trade and e-commerce	14
The Asia-Pacific (Indo-Pacific)	15
Trade capacity building	16
4. Assembling and Deploying the Toolkit	18
Organizational posture	18
Near- and long-term priorities.	18
High-level imperatives	18
Strategy and policy development	19
Existing U.S. statutory tools	20
5. Conclusion and Recommendations	21
Annex 1: Interviews	23
About the Stimson Center, the New Majority Program, and the Authors	24

Foreword

This is the second policy briefing paper in our series, “Working with the New Majority,” which addresses the relationships between wealthy countries, particularly the United States, and the majority of the world’s countries and peoples – the middle income countries.

In no area has the U.S.-Middle Income Country relationship been more dramatically changed than in trade policy, with the abrupt shift from the multilateral and regional approach of the Obama Administration to the bilateralism of the Trump Administration. The paper points out that the switch to the latter policy has been very slow to start and faces pitfalls. There are substantial mutual gains available from a more active and internationally engaged trade policy, which the paper outlines.

We invite your interest in the issue of relationships with the Middle Income Countries. These countries are where the major opportunities for global social and economic progress are. And as such, solid relationships with these countries hold the highest potential gain for the wealthy countries, like the U.S.

I am pleased to acknowledge the fine work of Nate Olson and Bob Berg, distinguished fellow and director of our work on Middle Income Countries, in producing this briefing paper.

Brian Finlay
President and CEO
The Stimson Center



Executive Summary

Middle income countries collectively represent an approximately \$35 trillion marketplace. By 2030, this could reach \$50 trillion.¹ Some nations are acting to seize those opportunities, recognizing that the potential payoff merits a massive political and financial investment. By contrast, the U.S. falls further behind in this competition with each passing day.

This paper builds on a recent Stimson report to consider the potential for expanded trade between the U.S. and middle income countries.² After outlining the stakes, economic and otherwise, it highlights several areas where U.S. decision-makers should focus their attention and resources for the most effective trade policy and country engagement. It then considers what strategy and organizational toolkits are needed to pursue those priorities.

While the closely related issues of international investment relationships are also discussed, they will be the focus of a subsequent paper.

We suggest several relevant priorities for recalibrating the U.S. government's policy and organizational approach, along with some guiding principles and concrete steps to chart the way:

- With the support of Congress, the executive branch must act with urgency to forge a clear strategy for broadening and deepening trade relations with middle income countries.
- Regional and plurilateral trade agreements must return to the agenda. Bilateral agreements should be pursued judiciously – and even then, the longer-term goal should remain larger integration and harmonization with other trade partners.
- Congress and the Administration must provide commensurate resources for the number and caliber of personnel needed to develop and execute a proper strategy.
- U.S. commercial diplomacy programs need to build on lessons learned quickly enough to keep pace with 21st-century commerce, to learn from past successes and failures generally, and to tailor the trade and economic objectives outlined in this paper more specifically. This type of institutional learning will be essential.
- There is an opportunity – or, more candidly, an urgent need – to enhance commercial diplomacy by more effectively empowering and supporting ambassadors and country teams. The country team is best positioned to ensure

¹ Homi Kharas, *The Unprecedented Expansion of the Global Middle Class: An Update* (Washington, DC: Brookings, February 2017) 2, 8, , accessed December 14, 2017, https://www.brookings.edu/wp-content/uploads/2017/02/global_20170228_global-middle-class.pdf.

² Richard Ponzio and Robert Berg, *Engaging the New Majority: U.S. Perspectives and Experience* (Washington, DC: Stimson Center, August 2017), accessed January 9, 2018, <https://www.stimson.org/sites/default/files/file-attachments/Engaging%20the%20New%20Majority.pdf>.

that commercial diplomacy and trade capacity building initiatives are well targeted and properly implemented.

- Expanding trade with middle income countries need not come at the expense of trade with other countries. The two goals can be pursued in tandem, as a whole that becomes greater than the sum of its parts. But doing so requires sound strategy, organization, and understanding of the ever-evolving global business landscape

1. Introduction

The 108 countries presently classified as middle income is as eclectic as it is dynamic. It includes both emerging and established economic powers reaching across all regions of the world – from Argentina and Brazil in Latin America, to South Africa, Nigeria, and Morocco in Africa, to China, Vietnam, and Indonesia in Asia.³ While these countries continue to churn, change, and grow, U.S. policy is at serious risk of getting stuck in neutral.

This report builds on a recent publication by Stimson Center experts Richard Ponzio and Robert Berg.⁴ Their paper set out a conceptual framework and research agenda focused on middle income countries as an emerging center of influence across economic, political, security, cultural, and scientific domains. It also recommended targeted steps for U.S. policymakers, including the designation of a joint National Economic Council/National Security Council focal point on policy regarding middle income countries.⁵ This report further explores the economic realm. More specifically, this paper examines U.S. trade relationships with middle income countries, including but not limited to formal free trade agreements.⁶

Objectives and Scope of Analysis

We explore three central questions related to U.S. trade with middle income countries:

- What are the stakes?
- What are the key trade-related priorities in view of the stakes?
- What strategy and organizational toolkits are needed to pursue those priorities?

In response to these questions, we aim to highlight the most important factors for current and future U.S. trade relationships, along with high-level principles that can inform more prescriptive analysis. Above all, we hope to prompt wider recognition of the vital importance of these issues and jump-start a new wave of serious policy discussions and stakeholder engagement.

While the closely related issues of international investment relationships are referenced several times, they are not the focus of this paper.

Methodology

We define middle income countries as per the World Bank's fiscal year 2018 income threshold levels – that is, the 108 countries with a per-capita gross national income between

³ World Bank, *World Bank Country and Lending Groups*, accessed January 18, 2018, <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519>.

⁴ Ponzio and Berg, *Engaging the New Majority*.

⁵ Ponzio and Berg, *Engaging the New Majority*, 13.

⁶ For an overview of U.S. free trade agreements, see: James Jackson, *U.S. Trade with Free Trade Agreement (FTA) Partners* (Washington, DC: Congressional Research Service, November 2016), accessed January 10, 2018, <https://fas.org/sgp/crs/misc/R44044.pdf>. See also: U.S. International Trade Commission (USITC), *Economic Impact of Trade Agreements Implemented Under Trade Authorities Procedures, 2016 Report* (June 2016), accessed January 9, 2018, https://www.usitc.gov/publications/332/pub4614_old.pdf.

\$1,006 and \$12,235.⁷ In some instances, we also speak of the “middle class” in discussing relevant data and analysis. We have taken care in these cases to ensure the scope of analysis is not substantially different. As needed, we distinguish which group of countries we refer to.

In addition to a literature review, we collected data from the World Bank and interviewed a number of subject matter experts, practitioners, and other stakeholders, including:

- Congressional staff;
- companies and trade associations representing the information technology, manufacturing, financial services, agricultural, transport/logistics, and chemical sectors;
- former executive branch staff; and
- current and former secretariat staff for several relevant international organizations and specialized agencies, including the World Bank, World Trade Organization (WTO), and the UN Conference on Trade and Development (UNCTAD).

Annex 1 lists organizations from which these senior-level stakeholders were interviewed.

⁷ World Bank, *World Bank Country and Lending Groups*

2. Sizing up the Stakes

It is important first to establish why trade with middle income countries belongs on the policy agenda. The sheer numbers seem to suggest as much – after all, middle income countries represent a cohort of five billion people, or roughly 70 percent of the world’s population. But more specifically, why should these countries, either individually or as a bloc, figure more prominently in U.S. trade policy? Much of the business community already recognizes a compelling value proposition while policymakers tend to have a more uneven appreciation. Here are a few key trends and observations that help establish a baseline for determining whether middle income countries merit more attention – and for considering relevant alternatives for policy, strategy, enforcement, and organizational posture.

Market size and growth potential

The raw numbers arguably speak loudest in highlighting the economic potential of middle income countries. In 2015, the countries collectively amounted to roughly a \$35 trillion marketplace (as measured in 2011 prices).⁸ Just as significant, many of them are poised for significant growth in the coming years – a stark contrast with virtually all of the world’s advanced economies. In fact, there is strong evidence that we are now in the midst of “the most rapid expansion of the middle class, at a global level, that the world has ever seen.”⁹

Changes in wealth and consumer demand. A crucial subtext of the growing marketplace represented by middle income countries is rising consumer demand. Changes in consumer demand have always affected trade patterns. But the scale of the consumption shifts now underway worldwide, driven by new concentrations of wealth both within and across countries, underscores a true trade megatrend.

To be clear, from an equity perspective, not all of these changes in wealth are necessarily “good.” In some cases, they reflect increased inequality in national or sub-national segments where income disparities were already large. But in many other cases, they reflect a newly ascendant middle class whose tastes – and disposable income – often drive up demand for foreign goods and services. More specifically, the largest relative spending increases are being seen in countries on the lower end of the middle income spectrum, such as India, Indonesia, and Vietnam. In these countries, consumption is growing at annual rates approaching double digits. By 2030, their markets could be \$15 trillion larger than they are today.¹⁰

Global reach. The breadth of opportunities for trade with middle income countries is truly global. Recent U.S. trade policy achievements only begin to illustrate this breadth. Notably, all six U.S. trading partners under the Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) are middle income countries. CAFTA-DR is one of only two

⁸ Homi Kharas, *The Unprecedented Expansion of the Global Middle Class: An Update* (Washington, DC: Brookings, February 2017), 2, accessed December 14, 2017, https://www.brookings.edu/wp-content/uploads/2017/02/global_20170228_global-middle-class.pdf.

⁹ Kharas, *The Unprecedented Expansion*, 13.

¹⁰ Kharas, *The Unprecedented Expansion*, 14-16.

plurilateral trade agreements to which the U.S. is party, the other being the North American Free Trade Agreement (NAFTA). The vast majority of middle income countries hold further economic potential that can be unlocked with free trade agreements.

Trade-investment symbiosis

It bears at least brief observation that trade and investment can often grow together in a virtuous cycle. In the simplest terms, sustaining an expanded trade relationship with a given country can increase inward investment flows from that trading partner. It can also attract investment from a third country that anticipates increased returns as the original bilateral trading relationship grows. These dynamics should not be overlooked vis-à-vis middle income countries. Just as shifts in wealth are translating to changes in consumer spending, pools of efficiency-seeking investment capital are growing in middle income countries.¹¹

Competition to write the “rules of the road”

The potential of deeper trade relationships with middle income countries is widely acknowledged. Many other nations, including America’s staunchest economic and strategic competitors, have moved aggressively to secure major trade advantages. Their overtures have come in a variety of forms. Some mirror steps the U.S. government is also pursuing at present – for instance, bilateral free trade agreements, trade capacity building measures, and public-private trade missions.

But these competitors are also investing substantial time, funding, and political capital in other types of initiatives that the U.S. government has recently demoted or disavowed entirely. The clearest example is the pursuit of regional, plurilateral, and multilateral trade agreements, whether in an ad hoc group or under the auspices of the World Trade Organization (WTO).

Multi-party agreements certainly have downsides. Large groups make for complex and time-consuming negotiations. Additionally, a multi-party pact is usually more difficult to monitor and enforce.

But there are compelling upsides, too. Wider country participation typically means a larger total economic pie and, thus, more opportunities for mutually beneficial trade. Increasingly, countries are also seeking to leverage such vehicles to align national regulatory standards, technical specifications, and other “behind-the-border” aspects of public and private governance. One of the most ambitious efforts to date in forging a multi-party trade deal, of course, is the Trans-Pacific Partnership, or TPP. Its sweeping range of governance-related directives include provisions on labor rights, environmental stewardship, and transparency of domestic administrative processes.

The Trump Administration has emphatically and consistently declared a preference for bilateral negotiations. *However, as of now, not one country has yet to take up the offer to launch negotiations with the U.S. on a new bilateral agreement.* (The changes announced in

¹¹ UNCTAD, *World Investment Report 2017*, June 2017, accessed January 10, 2018, http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf.

March 2018 to the U.S.-Korea Free Trade Agreement, or KORUS, do not mark an end to this unfortunate track record.) And though the Administration is well over a year old, only recently did the Office of the U.S. Trade Representative (USTR) initiate a serious staff review of priority countries for bilateral engagement.¹²

Supposing that a number of middle income countries eagerly came to the table tomorrow, a strategy wedded to seeking bilateral trade pacts would remain deeply problematic. Pursuing multiple bilateral agreements concurrently requires substantial time and resources on the part of USTR. The last time the U.S. aggressively pursued multiple new bilateral deals was the early 2000s, when USTR Robert Zoellick at one point oversaw seven simultaneous negotiations, including with key middle income countries Morocco and Malaysia.¹³ Ultimately those efforts had mixed results (e.g., the U.S. concluded a bilateral agreement with Morocco, but not Malaysia), and they offer at least two useful lessons. First, the U.S. saw fit to pursue the array of bilateral deals in tandem with – not in lieu of – robust engagement at the regional level and at the WTO. Second, the intensified negotiating agenda strained available resources, especially personnel.¹⁴ Seeing any appropriate trade strategy through to success requires that Congress and the Administration provide USTR commensurate resources for the number and caliber of personnel needed. As we discuss below, the same goes for other agencies with important roles in trade.

The absence of the U.S. from multi-country trade deal-making does not mean other nations are standing down. Some of the other “megadeals” now being pursued include middle income country heavyweights. The European Union is nearing a major agreement with the Mercosur group of South American countries that includes Argentina and Brazil. China is spearheading a 16-member Regional Comprehensive Economic Partnership (RCEP) that may not be as substantively ambitious as TPP, but it stands to project Chinese influence across other countries such as India, Indonesia, Malaysia, Myanmar, and the Philippines.

We recommend immediately restoring regional and plurilateral trade agreements as preferred vehicles for advancing the U.S. trade agenda. Bilateral agreements should be pursued judiciously in rare cases only – and even then, the longer-term goal should remain larger integration and harmonization with other trade partners.

The security dimension

The use of trade pacts to jointly shape and align various governance standards, as discussed above, also implies a larger geopolitical and security dimension. Robust trade and investment can help international relationships stay resilient amid political frictions that otherwise could sow conflict. Nearly a half-century ago, Thomas Schelling argued, “[T]rade

¹² Robert Lighthizer, U.S. Trade Representative, testimony before the House Ways and Means Committee (Washington, DC: March 21, 2018). accessed March 28, 2018, <https://waysandmeans.house.gov/event/hearing-u-s-trade-policy-agenda-2/>.

¹³ The authors thank Bill Reinsch of the Center for Strategic and International Studies for this insight.

¹⁴ U.S. General Accounting Office, *Intensifying Free Trade Negotiating Agenda Calls for Better Allocation of Staff and Resources*, January 2004, accessed April 10, 2018, <https://www.gao.gov/assets/250/240903.pdf>.

is what most of international relations are about. For that reason, trade policy is national security policy.”¹⁵

This trade-security nexus has only become stronger and more complex in the 21st century. At the strategic level, former U.S. Defense Secretary Ash Carter echoed Schelling’s observation by equating TPP’s importance with an additional aircraft carrier in the Asia-Pacific.¹⁶ At the operational level, the private sector’s cross-border trade and production networks have not only driven the kind of wealth generation that is traditionally the focus of trade policymakers. They also have empowered criminals and terrorists, who co-opt the tools of international trade in ways that harm both public security and legitimate commerce.

In short, it is altogether appropriate that the security imperatives voiced by the Defense Department, State Department, and other agencies enter into the rationale for expediting coherent and robust trade relationships, specifically with middle income countries. Smart trade policy is indeed a building block for public security – and vice versa.

¹⁵ Thomas C. Schelling, *Statement to the U.S. Congressional Commission on National Security Considerations Affecting Trade Policy* (Washington, DC: 1971).

¹⁶ Ash Carter, *Remarks on the Next Phase of the U.S. Rebalance to the Asia-Pacific* (Tempe, AZ: April 6, 2015), accessed February 5, 2018, <https://www.defense.gov/News/Speeches/Speech-View/Article/606660/remarks-on-the-next-phase-of-the-us-rebalance-to-the-asia-pacific-mccain-instit/>.

3. High-Value Targets for Policymakers

In view of these factors, where should policymakers devote their attention and resources? Here we suggest some broad priorities for policy, strategy, enforcement, and organizational posture.

Regulatory cooperation and “behind-the-border” issues

Until recently, most trade agreements focused overwhelmingly on economic esoterica – namely, tariff levels on a long catalogue of products. Today, tariff-related market access issues have begun to recede into the background for at least two reasons. First, tariffs on the whole have fallen substantially after decades of liberalization. Second, a more complex global economy has spawned more complex trade agreements. Modern trade pacts are genuinely multi-purpose vehicles that shape governance across a growing swath of domains. Our interlocutors repeatedly call out specific regulatory issues as both “offensive” and “defensive” goals for the U.S. trade agenda. In other recent studies, American companies likewise have cited sector-specific regulation as a top priority for U.S. trade/commercial diplomacy.¹⁷

Most topics falling under this rubric are obscure and uncontroversial – though some, such as protections for intellectual property and dispute settlement mechanisms, have become major lightning rods. They are likely to remain key elements of trade (and investment) negotiations in the coming years. Moreover, some of them, such as provisions governing technology transfers, are likely to grow in relevance for U.S. trade with middle income countries.¹⁸

A regulatory agenda can transcend narrow economic impacts and advance strategic and public-interest goals. One important example here with clear relevance for middle income countries is labor protections. Every trade agreement that the U.S. has entered into over the last 25 years has addressed labor rights in some way. The first was NAFTA; subsequent agreements generally have included greater more expansive or more enforceable labor commitments.¹⁹

While large plurilateral and multilateral trade deals are rightly associated with these regulatory alignment efforts, they are not the only possible vehicle. In fact, our interlocutors stressed several times that the same objectives can be pursued at the working level, in the day-to-day conduct of trade and commercial diplomacy – that is, without establishing a new vehicle. As needed, these arrangements can be further codified in due course through appropriate trade/investment agreements.

Many of these issues are highly technical and sure to continue evolving. Recruiting, training, and deploying personnel with the right breadth and depth of expertise will be an

¹⁷ A report of an industry survey for the American Academy of Diplomacy and the Una Chapman Cox Foundation. See: *Support for American Jobs: Requirements for Next-Generation Commercial Diplomacy Programs* (March 2016), 18, accessed January 10, 2018, <https://www.academyofdiplomacy.org/wp-content/uploads/2016/01/SupportForAmericanJobs.pdf>.

¹⁸ Ponzio and Berg, *Engaging the New Majority*, 10.

¹⁹ USITC, *Economic Impact of Trade Agreements*, 20.

ongoing challenge that demands resources as well as entrepreneurial thinking. To take one example, the U.S. Commerce Department has recently made modest strides toward adapting its role in commercial diplomacy with its “digital trade attachés.” Under that pilot effort, appropriately trained Foreign Commercial Service officers at select foreign embassies focus on supporting U.S. competitiveness and market access objectives in the digital realm. Some of the companies and trade associations we interviewed encouraged Commerce to expand the program and improve its linkages with relevant manufacturing and services sectors. **Whether a matter of trade negotiations or day-to-day trade diplomacy, we recommend that technically skilled staff be engaged from the U.S. side.**

Digital trade and e-commerce

As the advent of a digital trade attaché program suggests, the digital economy is increasingly the heart of the modern global economy. Cross-border data flows and electronic platforms are allowing firms in middle income countries to more easily plug into global value chains and penetrate foreign markets. They likewise are enabling U.S. firms to streamline production processes and tap new consumer markets. These opportunities cut across both goods and services sectors.

For all its proven value and unrealized potential, the digital economy is also something of the Wild West. The relative dearth of mature, widely adopted rules on digital trade and e-commerce presents risks - not only to commercial interests, but also to security and privacy interests. Various countries and allied blocs are seeking first-mover advantage. China and the European Union, for instance, are both working aggressively to embed their desired digital trade regimes into their respective growing networks of trade agreements. To be sure, the substantive particulars they advocate often differ substantially. Middle income countries represent a vast figurative battleground on which these competing visions are coming into conflict. **We recommend that as part of its mandate under section 163 of the Trade Act of 1974, USTR annually detail a proactive U.S. vision and strategy for the global digital trade agenda, with special attention to the landscape in middle income countries.**

In some cases, the advent of the digital economy is also creating important opportunities for individual citizens of middle income countries: It is providing them a new avenue for employment. Economist Kaushik Basu describes the effect of these “labor-linking” technologies:

“What this new technology has done is to make it possible for nations that are not yet rich and industrialized, such as the low-income economies and lower middle-income economies, to connect workers with corporations in industrialized nations. If these nations are moderately well-organized and have basic infrastructure such as power and digital connectivity, their

workers can do well by working for companies and customers in rich and upper-middle-income nations.²⁰

Stakeholders in advanced economies sometimes consider such foreign labor a threat to domestic jobs. In many cases, though, leveraging these technologies is consistent with U.S. economic interests, as it enables access to new or expanded labor pools that did not exist before. And particularly for middle income countries, where employment prospects can be slim for economic or demographic reasons, this should be a win-win that is promoted in trade diplomacy.

The Asia-Pacific (Indo-Pacific)

As emphasized above, middle income countries are a global force in every sense of the term. Failing to understand this is tantamount to leaving money on the table. Geographically, though, there is little doubt that the locus of middle income country influence is the Asia-Pacific. The region's middle income countries are important players in each of the other "high-value target" areas we highlight here, but they merit a separate call-out. In addition to their ballooning consumer markets and their obvious proximity in a geopolitically crucial neighborhood, many of them are members of the relatively advanced economic cooperation regimes of the Asia-Pacific Economic Cooperation forum (APEC) and the Association of Southeast Asian Nations (ASEAN). The U.S. role in APEC and ASEAN will likely continue to merit further investment of political capital.

The Trump Administration already has articulated a new security policy centered on an "Indo-Pacific" conceptual framework, under which the U.S., India, Japan, and potentially Australia would jointly guarantee freedom of shipping from India to Korea.²¹ While there are echoes of a Cold War strategy in this, it is interesting to note that safe sea lanes in that neighborhood primarily benefit China. Since China is an enormous, indispensable part of U.S. trade and is the leading trade partner in the area envisioned by the Indo-Pacific idea, it is clear that living constructively with China is not only reasonable but essential to U.S. security and trade. The U.S. should approach trade policy in the region as requiring the involvement of China, India, and other rising powers. In fact, the U.S. will need to play catch-up on this, since the trade void left by the U.S. withdrawal from TPP is being filled by China. Unfortunately, even in the context of the Indo-Pacific, the Administration so far has simply reaffirmed its preference for bilateral engagement on trade. This is a missed opportunity. **We recommend the Administration move quickly to elaborate the economic complement of its vision for the Indo-Pacific – one focused on regional engagement.** This not only offers a more efficient path to concrete outcomes in trade negotiations with middle income countries,

²⁰ Kaushik Basu, *Globalization of Labor Markets and the Growth Prospects of Nations* (World Bank Group, March 2016), 3, accessed January 11, 2018, <https://openknowledge.worldbank.org/bitstream/handle/10986/23929/Globalization00prospects0of0nations.pdf>.

²¹ Rex Tillerson, U.S. Secretary of State, *Remarks on Defining Our Relationship With India for the Next Century* (Washington, DC: October 18, 2017), accessed February 2, 2018, <https://www.state.gov/secretary/remarks/2017/10/274913.htm>.

but it also offers the most logical path to compete with ambitious economic powers across the world.

Trade capacity building

Several interviewees stressed trade capacity building as a priority for U.S. engagement of middle income countries. Such assistance covers a wide range of partner country capacities. The principal focus is usually operational – that is, increasing efficiencies of import/export flows by improving logistics and modernizing physical infrastructure. However, trade capacity building can bring many additional benefits. For instance, it can facilitate partnerships among national customs administrations and advance anticorruption efforts.

In the near term, implementation of the WTO Trade Facilitation Agreement presents especially valuable opportunities in this regard. Concluded at the December 2013 WTO ministerial in Bali, and in force since February 2017, the agreement commits all WTO members to make best efforts toward meeting specific customs and border management performance thresholds. At the same time, it creates an essentially global framework for trade capacity building, with lower and middle income countries receiving financial and technical assistance to implement the pact's commitments. The Global Alliance for Trade Facilitation is a novel public-private entity created solely to provide such support; it is led jointly by the Center for International Private Enterprise, the International Chamber of Commerce, and the World Economic Forum, with funding from the governments of Australia, Canada, Germany, the United Kingdom, and the United States. A number of international organizations, from the World Bank to the World Customs Organization, are also poised to offer assistance with their own tailor-made initiatives.

According to the 2015 Trade Facilitation Indicators published by the OECD, lower middle income countries stand to be one of the agreement's primary beneficiary groups as measured by overall reductions in trade costs (assuming full implementation of the agreement). The benefits possible for upper middle income countries do not lag far behind. For both lower and upper middle income countries, the OECD finds that the biggest value-add areas of the agreement include streamlining border procedures and automating trade and customs processes.²² One of the very useful services the Federal government provides through the U.S. Trade and Development Agency (USTDA) is technical assistance to trading partners for such improvements. It also provides technical assistance to facilitate specific transactions. Both are important services for trade promotion and contributors to U.S. competitiveness.

Channeling support towards critical infrastructure in energy and transport sectors to the greatest extent possible would add further value.²³ Unlike the Chinese Belt and Road mega-initiative that will finance hundreds of billions of dollars into infrastructure and likely wind up with Chinese management of ports and hubs throughout Asia (and lesser but still

²² OECD, *Implementation of the WTO Trade Facilitation Agreement: The Potential Impact on Trade Costs* (June 2015), accessed January 10, 2018, <https://www.oecd.org/tad/policynotes/implementation-WTO-trade-facilitation-agreement.pdf>.

²³ Ponzio and Berg, *The Unprecedented Expansion*, 3.

major Chinese infrastructure initiatives in Africa and Latin America), the U.S. has no bilateral capability to compete in creating trade infrastructure in middle income countries. But the U.S. does have influence in multilateral organizations, particularly the World Bank, which historically and in its planning hopes to continue as a large organizer and financier of trade infrastructure. Particularly in Asia, it should be expected that there would be a robust trade-related initiative, including promotion of trade infrastructure, to augment the Administration's initiative to promote the free flow of commerce through the military protection of shipping in South and Southeast Asia.

The problem is that the Administration holds positions against both its best technical and capital assistance options to promote trade infrastructure. It has proposed eliminating USTDA and it is opposing a capital increase for the World Bank.²⁴

We recommend that the Administration prioritize trade capacity building and infrastructure in support of implementing its obligations and interests under the Trade Facilitation Agreement.

²⁴ David Malpass, Under Secretary of the Treasury for International Affairs, *Statement to the Subcommittee on Monetary Policy and Trade, House Financial Services Committee* (Washington, DC: November 8, 2017), accessed February 5, 2018, <https://financialservices.house.gov/uploadedfiles/hhrg-115-ba19-wstate-dmalpass-20171108.pdf>.

4. Assembling and Deploying the Toolkit

Organizational posture

Nineteen different federal agencies play a role in U.S. trade and commercial policies and programs. By law, USTR has the lead role in developing and coordinating implementation of U.S. trade policy, as well as negotiating trade agreements.²⁵ But a number of other agencies have important roles in policymaking, enforcement, and trade promotion. These include the Export-Import Bank, the Overseas Private Investment Corporation (OPIC), USTDA, the Commerce Department's International Trade Administration, and the State Department. One vehicle sometimes used to coordinate these agencies is the Trade Promotion Coordinating Committee (TPCC), chaired by the Commerce Department.

Near- and long-term priorities. For these agencies to better advance U.S. trade with middle income countries, whether individually or through an interagency effort, they must first be adequately resourced and maintained. The current Administration has proposed – and in some cases, carried out – budgetary and bureaucratic steps to scale back most of them. Its FY 2019 budget, for instance, requests just \$12 million for USTDA for "an orderly closeout."²⁶ It similarly seems determined to hamstring the Export-Import Bank.

To date, Congress has maintained funding for most of these agencies. Yet a significant number of lawmakers support the Administration's stance. Their opposition to U.S. trade promotion agencies often comes down to a defense of the free market. Market forces, they say, will facilitate worthwhile commercial opportunities for U.S. firms. This argument is flawed for several reasons, but the most practical is that many other countries and economic blocs have similar agencies that are well-resourced and WTO-compliant. For all the talk of demanding reciprocal trade and a level playing field, the U.S. is sadly content to pull its punches on this front.

We recommend a continuation of full funding for these agencies and a whole-of-government effort to chart options for a longer-term recalibration of roles and responsibilities. The latter should be part of the National Economic Council-led process we describe below.

High-level imperatives

The U.S. must move beyond its dogmatic attachment to bilateralism and "reciprocity" as organizing principles for its trade agenda. It is possible to both support multilateralism and acknowledge that it is often a frustrating exercise. In the trade realm, that frustration is concentrated in the WTO.

In over twenty years, the WTO has produced only one genuinely multilateral (consensus) agreement: the aforementioned Trade Facilitation Agreement. As stressed above, the Trade Facilitation Agreement is a meaningful accord, but it has not been nearly enough to

²⁵ 19 U.S.C. § 2171.

²⁶ White House, *An American Budget: Major Savings and Reforms – Fiscal Year 2019 (February 2019)*, 105, accessed April 4, 2018, <https://www.whitehouse.gov/wp-content/uploads/2018/02/msar-fy2019.pdf>.

quell a growing chorus of existential questions about the WTO's utility – particularly its negotiating function. Most observers consider the WTO's dispute resolution mechanism more valuable, if imperfect and severely overstretched.²⁷

As such, it might well remain tempting for U.S. officials to disavow the WTO, and the rules-based trading system more generally, for the foreseeable future. This would be an egregious mistake for many reasons. Fundamentally, a mature, global, rules-based trading system is an essential precondition for the U.S. to advance its long-term economic and strategic interests. Even in the short-term, a level playing field allows U.S. policymakers and U.S. companies to plan and execute on “offensive” market goals and to pursue a robust enforcement agenda – including rolling back market access barriers in middle income countries when there are legitimate grievances.

Moreover, good-faith participation in the multilateral system does not preclude engagement of middle income countries in other fora. As our Stimson colleagues noted in a previous report, “it is often far more efficient and effective if the United States engages these countries both formally and informally through sub-regional, regional and global groupings and bodies.”²⁸ This certainly holds true in the trade domain and is borne out by recent experience. **We recommend the U.S. remain committed to the WTO as it engages regional groupings such as ASEAN and APEC, as well as other organizations key to the trade agenda, such as the G20.**

Strategy and policy development

It is vital that the U.S. government institute an interagency process through which it can formulate a coherent strategic framework that includes trade with middle income countries. Such an overarching framework would provide clear direction and enable more coherent pursuit of multiple policy goals, while remaining flexible enough for adaptation and targeted engagement in bilateral or multi-country settings. **We recommend the National Economic Council and National Security Council drive this strategy-setting process, with USTR playing its statutorily prescribed role on all trade-related elements.** The Trade Promotion Coordinating Committee could also play a facilitating role when appropriate.

We further recommend the empowerment of country teams for consistent and broad-based implementation of larger strategic goals. There is an opportunity – or, more candidly, an urgent need – to enhance commercial/trade diplomacy by more effectively empowering and supporting ambassadors and country teams. The country team is best positioned to ensure that commercial diplomacy and trade capacity building initiatives are well targeted, properly implemented, and carefully monitored. Unfortunately, a bureaucratic disconnect continues to hamper potential benefits. Our Stimson colleagues captured the frustration of a former U.S. principal:

²⁷ Carlos Primo Braga and Bernard Hoekman, “Future of the Global Trade Order,” in *Future of the Global Trade Order* (Hoekman and Primo Braga, eds.), European University Institute, 2016, 1-13.

²⁸ Ponzio and Berg, *The Unprecedented Expansion*, 8-9.

[A] former U.S. ambassador explained that it is a duty of an ambassador and relevant assistant secretaries of state to facilitate and employ specific tools that exist (e.g., the U.S. Trade and Development Agency, OPIC, Ex-Im Bank, etc.) to help a middle income country counterpart better address particular economic challenges. However, the State Department’s regional bureaus tasked with supporting ambassadors often failed to properly understand the tools available.²⁹

Existing U.S. statutory tools

Building on existing statutory tools, some U.S. trade preference programs could be leveraged to support two-way trade with middle income countries. For example, the African Growth and Opportunity Act (AGOA) was enacted in 2000 to expand unilateral trade preferences for designated beneficiary countries in sub-Saharan Africa. It was re-authorized for 10 years in 2015. Former U.S. officials and other experts believe AGOA has laid a foundation for the U.S. and partner countries to move beyond the program’s unilateral preferences to more robust, two-way trading relationships.³⁰ U.S. Trade Representative Robert Lighthizer furthermore said recently that he believed the U.S. should soon launch bilateral trade negotiations with a “properly selected” African country.³¹ This is far too modest an approach given the trade opportunities of a whole continent.

We recommend that USTR and Congress work jointly to identify a concrete policy and/or negotiating goal for reciprocal trade with African countries in 2018.

²⁹ Ponzio and Berg, *The Unprecedented Expansion*, 8.

³⁰ USITC, *Economic Impact of Trade Agreements* 81-86.

³¹ Megan Cassella, *Lighthizer’s African Dream*, Politico Morning Trade, February 1, 2018, accessed February 1, 2018, <https://www.politico.com/newsletters/morning-trade/2018/02/01/lighthizers-african-dream-090158>.

5. Conclusion and Recommendations

We are convinced of the economic and strategic value of placing a higher priority on middle income countries in U.S. trade and diplomatic initiatives. Expanding trade with these countries need not come at the expense of trade with other countries; indeed, the two goals can be pursued as complements. But this will require sound strategy, organization, and understanding of the ever-evolving global business landscape. We are under no illusions about the difficulty of fulfilling this report's recommendations, however earnestly the goal might be embraced. Several high-level imperatives emerge from the discussion above, and likewise were threaded throughout our interviews.

- With the support of Congress, the executive branch must act with urgency to forge a clear strategy for broadening and deepening trade relations with middle income countries.
- Regional and plurilateral trade agreements must return to the agenda. Bilateral agreements should be pursued judiciously – and even then, the longer-term goal should remain larger integration and harmonization with other trade partners.
- Congress and the Administration must provide commensurate resources for the number and caliber of personnel needed to develop and execute any appropriate trade policy agenda.
- Longer time horizons are needed for trade-related country engagement. U.S. commercial diplomacy programs need to internalize and build on lessons learned quickly enough to keep pace with 21st-century commerce, to learn from past successes and failures generally, and to tailor the trade and economic objectives outlined in this paper more specifically.³² It is also a necessary condition for advancing to next-generation approaches, such public-private and entirely non-governmental modalities.³³
- From the perspective of U.S. interests, it is important to strive for sustained “return on investment” from commercial diplomacy efforts even after direct engagement has concluded. As a group of distinguished experts in U.S. foreign assistance recently advised, it is imperative that today’s practitioners “develop transition strategies in middle income countries and others as appropriate that ensure sustainability of prior U.S. investments and leave behind meaningful institutions and relations.”³⁴ This is arguably a more difficult task in trade relations, where market forces sometimes come between the best of friends, but it is no less important.

U.S. trade with middle income countries represents a set of lucrative economic opportunities over the near, medium, and long terms. Some nations are acting to seize those

³² Ponzio and Berg, *The Unprecedented Expansion*.

³³ Ponzio and Berg, *The Unprecedented Expansion*, 4.

³⁴ *Redesign Consensus: A Plan for U.S. Assistance* (October 2017), 5., accessed January 10, 2018, <http://modernizeaid.net/wp-content/uploads/2017/10/Redesign-Consensus-Plan-for-U.S.-Assistance.pdf>.

opportunities, recognizing that the potential payoff merits a massive political and financial investment. By contrast, the U.S. falls further behind with each passing day.

We combine here the specific, targeted recommendations this paper has made for the U.S. to begin the process of earnestly re-engaging in this critical enterprise:

- We recommend immediately restoring regional and plurilateral trade agreements as preferred vehicles for advancing the U.S. trade agenda.
- Whether a matter of formal trade negotiations or day-to-day trade diplomacy, we recommend that technically skilled staff be engaged from the U.S. side.
- We recommend that as part of its mandate under section 163 of the Trade Act of 1974, USTR annually detail a proactive vision and strategy for the global digital trade agenda, with special attention to the landscape in middle income countries.
- We recommend the Administration move quickly to elaborate the economic complement of its vision for the Indo-Pacific – one focused on regional engagement.
- We recommend that the Administration prioritize trade capacity building and infrastructure in support of implementing its obligations and interests under the Trade Facilitation Agreement.
- We recommend a continuation of full funding for all U.S. trade/commercial diplomacy agencies and a whole-of-government effort to chart options for a longer-term recalibration of roles and responsibilities.
- We recommend the U.S. remain committed to the WTO as it engages regional groupings such as ASEAN and APEC, as well as other organizations key to the trade agenda, such as the G20.
- We recommend the National Economic Council and National Security Council drive a process to set clear strategic directions for U.S. trade with middle income countries, with USTR playing its statutorily prescribed role. We further recommend the empowerment of country teams for consistent and broad-based implementation of the goals identified in this process.
- We recommend that USTR and Congress work jointly to identify a concrete policy and/or negotiating goal for reciprocal trade with African countries in 2018.

Annex 1: Interviews

The authors conducted background interviews for this study in October and November 2017 with current and former senior officials from the following organizations:

- Bankers Association for Finance and Trade (BAFT)
- BSA | The Software Alliance
- Coalition of Services Industries (CSI)
- DowDupont
- eBay
- FedEx
- Information Technology Industry Council (ITI)
- Internet Association
- National Association of Manufacturers (NAM)
- Office of the U.S. Trade Representative (USTR)
- Overseas Private Investment Corporation (OPIC)
- UN Conference on Trade and Development (UNCTAD)
- U.S. & Foreign Commercial Service (US&FCS), U.S. Commerce Department
- U.S. House Financial Services Committee
- U.S. Senate Banking Committee
- World Bank
- World Trade Organization (WTO)

About the Stimson Center, the New Majority Program, and the Authors

The Stimson Center

The Stimson Center is a nonpartisan policy research center working to protect people, preserve the planet, and promote security & prosperity. Stimson's award-winning research serves as a roadmap to address borderless threats through concerted action. Our formula is simple: we gather the brightest people to think beyond soundbites, create solutions, and make those solutions reality. We follow the credo of one of history's leading statesmen, Henry L. Stimson, in taking "pragmatic steps toward ideal objectives." We are practical in our approach and independent in our analysis. Our innovative ideas change the world.

The New Majority Program

The Stimson Center has launched a five-year program, "Working with the New Majority: Reinventing Relations with Most of the World's Peoples." The program examines how the United States and other developed countries are making efforts to engage emerging centers of influence, often called the Middle Income Countries, which are now the majority of the world's countries and peoples. The program emphasizes changing bilateral relationships and encouraging greater shared responsibilities to meet common transnational challenges. The program is directed by Stimson Distinguished Fellow Robert Berg and is supported by a distinguished international Advisory Council.

The program will produce a series of policy papers, of which this is the second. The first paper was: "Engaging the New Majority: US Perspectives and Experience," co-authored by Richard Ponzio and Robert Berg. This first paper highlighted the need for - and the mutual gains to be found in - greater partnership between the U.S. and other wealthy nations and middle-income countries.

The program also includes a lecture series.

The Authors

Nate Olson is principal of All Angles Strategy, an international trade and global affairs consultancy in Washington, DC. He has over a decade of experience designing and leading multi-stakeholder projects to address key economic and foreign policy challenges. He founded and directed the Stimson Center's Trade in the 21st Century Program, and led a landmark Stimson collaboration on trade issues with hundreds of senior industry leaders and practitioners from the manufacturing, financial services, and transport/logistics sectors.

Robert Berg founded the evaluation work of USAID, was founding chair of evaluation for the OECD Development Assistance Committee, has led NGOs, and was senior advisor to four entities of the U.N. (UNICEF, UNDP, UNESCO and the UN Economic Commission for Africa). His work has resulted in changes in core U.N. policies and in greater U.N. system-wide coherence, as well as in U.S. legislation. He is chairman of the Alliance for Peacebuilding. He is a Distinguished Fellow at the Stimson Center.