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by
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Firms have two major ways to service foreign markets: they can produce at home and export their goods and services ("cross-border exports"), or they can establish themselves in foreign markets, produce there and then sell their goods and services in those markets or elsewhere (what could be called "establishment trade"[1]). World establishment trade is estimated to amount to US$31 trillion, considerably exceeding world cross-border exports, at US$23 trillion, in 2017.[2]

Accordingly, assessing the performance of a country's firms requires looking at cross-border trade and establishment trade together, to obtain a more holistic picture of the international competitiveness of firms, as reflected in firms' market share and, ultimately, profitability.

Establishment trade (i.e., the sales of foreign affiliates) is the result of FDI, typically undertaken on the basis of superior technology, marketing and managerial talent, as well as other competitive ownership advantages held by parent firms: they establish affiliates abroad primarily to better access these markets and avail themselves of local resources. Doing so helps firms to strengthen their international competitiveness. This objective is shared by every country in which firms are headquartered, because strengthening their firms' competitiveness is a precondition for creating more employment, increasing wages and continuing to export.

The choice between cross-border exports and establishment trade—both typically controlled by parent firms—depends on what is more profitable for firms when seeking to service foreign markets and strengthen their international competitiveness. Moreover, the two types of trade are intertwined: cross-border exports can lead to FDI (e.g., when exports become uncompetitive and hence production is delocalized), and FDI can lead to cross-border exports (e.g., when foreign affiliates import components or headquarters services from the home country to produce their goods and services). A caveat needs to be made, however, for services: since most services still need to be produced when and where they

are consumed, service firms typically have to undertake FDI to sell in foreign markets, thus generating establishment trade.

This reality applies to all countries, including the China-US trade relationship.

Using 2016 data published by the Bureau of Economic Analysis of the US Department of Commerce,[3] US cross-border arm's length exports of goods and services to China amounted to US$156 billion; to this, one would have to add US$266 billion in arm's length sales generated by majority-owned US affiliates in China (excluding sales of such affiliates in China to other US affiliates in China and to other countries), for a total of US$422 billion in trade. During the same year, US cross-border arm's length imports of goods and services from China amounted to US$461 billion;[4] to this, one would have to add US$26 billion in establishment trade generated by majority-owned Chinese affiliates in the US (excluding sales of goods of such affiliates in the US to other countries), for a total of US$487 billion.

Thus, looking at the trade relationship between the US and China on the sole basis of cross-border trade leads to a 2016 US deficit of US$308 billion. But taking a holistic view of this relationship by looking at cross-border and establishment trade together, that deficit is only US$65 billion, or 7% of the total trade volume—not that big a figure. This underlines the importance of establishment trade for the international competitiveness of US firms—this is where their strength lies.

What are policy implications if the US administration wishes to help the country's firms strengthen their international competitiveness? Since all other developed countries, and more and more emerging markets, also have substantial outward FDI they should ask themselves the same question. Countries need to play to the strength of their firms and, therefore, focus on the facilitation of (sustainable) FDI to boost establishment trade and the global value chains connected with it, beginning with recognizing this issue and formulating appropriate policies.

As it happens, structured discussions aimed at a framework on investment facilitation are conducted in the WTO. They seek to facilitate FDI and, with that, establishment trade. The US, along with other developed countries, should participate actively in these discussions (as China and other developing countries already do), with a view toward achieving, soonest, a multilateral framework on the facilitation of sustainable investment.

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[1] The concept of "establishment trade" was developed in reference to the General Agreement on Trade in Services to denote the sales associated with commercial presence (Mode 3), basically FDI. See also J. Steven Landefeld, Obie G. Whichard and Jeffrey H. Lowe for a discussion of "Alternative frameworks for U.S.

international transactions," *Survey of Current Business*, December 1993, pp. 50-61. "Establishment trade" is used here to refer to sales of all foreign affiliates, regardless of sector.
[2] UNCTAD, *World Investment Report 2018* (Geneva: UNCTAD, 2018), p. 20.
[3] See, US Bureau of Economic Analysis, https://www.bea.gov/international/usdia2016p.
[4] This amount includes imports from non-US foreign affiliates in China.

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