CALENDAR OF EVENTS

June 2013

Thursday, June 6 (LOCATION: Royal Netherlands Embassy; 3:30 p.m.)
**Free to NEC Members, check to see if there is availability at this time; No Walk-ins are permitted**
RSVP not later than June 3

NEC Ambassador's Invitational Address
John B. Taylor
Mary and Robert Raymond Professor of Economics at Stanford University
George P. Shultz Senior Fellow in Economics at Stanford University's Hoover Institution
“Why Has the Recovery Been So Slow and Is Economic Policy To Blame?”

The U.S. economy has recovered at a much slower pace than during earlier recoveries from deep recessions and financial crises. This talk will first establish this fact—which itself is controversial—and then consider various explanations that are at the center of current controversy from economic policy with too much austerity on one side to economic policy with too little fiscal and monetary discipline on the other.

The Address will be given each year at a different embassy. Dr. Taylor's address will be followed by a reception. He is the Mary and Robert Raymond Professor of Economics at Stanford University, and the George P. Shultz Senior Fellow in Economics at Stanford University's Hoover Institution. He has been Under Secretary of the Treasury for International Affairs, a member of the President's Council of Economic Advisors, and Senior Economist at the Council of Economic Advisers. He has also taught at Columbia and Princeton Universities. Dr. Taylor is perhaps best-known for his eponymous Taylor Rule and the related Taylor Curve and Taylor Principle.

Noon – 1:30 p.m., unless Otherwise Specified
*Chinatown Garden Restaurant—618 H St NW, Washington DC, Floor 2 (Just east of the H Street exit from Chinatown/Gallery Place Metro Stop)
- $16 Members, SGE, Wharton Club of DC and Press (if choosing to have lunch), $25 Non Members

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THE NATIONAL ECONOMISTS CLUB

Thursday, June 13  (Chinatown Garden)
Lawrence Yun
Chief Economist
National Association of Realtors
"Housing Shortage . . .For How Long?"
A recovery in housing demand along with a cumulative impact of underproduction of new homes has suddenly brought about an inventory shortage. Home prices have naturally responded with near double-digit rates of appreciation. How long will it last and is the fast rising home prices necessarily good for the country?

Thursday, June 20 w/SGE  (Chinatown Garden)
John Schmitt
Senior Economist
Center for Economic and Policy Research
John Schmitt is a senior economist with the Center for Economic and Policy Research in Washington, DC. He has written extensively on economic inequality, unemployment, labor-market institutions, and other topics for both academic and popular audiences. He has worked as a consultant for national and international organizations including the American Center for International Labor Solidarity, the European Commission, the Inter-American Development Bank, the International Labor Organization, and the United Nations Economic Commission for Latin America. Schmitt's research has focused primarily on inequality in the US labor market and the role of labor-market institutions in explaining international differences in economic performance, particularly between the United States and Europe. Schmitt has co-authored (with Lawrence Mishel and Jared Bernstein) three editions of The State of Working America (Cornell University Press) and most recently co-edited (with Jerome Gautie) Low-Wage Work in the Wealthy World (Russell Sage Foundation, 2010). His writing has appeared in The American Prospect, The Boston Review, Challenge, Dissent, The Guardian, The International Herald Tribune, The Washington Post, and other newspapers and magazines. Schmitt was a Fulbright scholar at the Universidad Centroamericana "Jose Simeon Cañas" (San Salvador, El Salvador) in 1992-93. Since 1999, he has been a visiting lecturer at the Pompeu Fabra University (Barcelona). He has an undergraduate degree from the Woodrow Wilson School of Public and International Affairs at Princeton University and an M.Sc. and Ph.D. in economics from the London School of Economics. Please consult www.thenationaleconomistsclub.shuttlepod.org as details become available, the event will be updated.

Thursday, June 27  (Chinatown Garden)
Craig Lewis
Chief Economist
U.S. Securities and Exchange Commission
Craig M. Lewis is Chief Economist and Director of the Division of Risk, Strategy, and Financial Innovation at the U.S. Securities and Exchange Commission. He is currently on leave from Vanderbilt University where he is the Madison S. Wigginton Professor of Finance at the Owen Graduate School of Management. He first served at the SEC as a visiting Economic Fellow from January 2010 through July 2010, and subsequently returned in the same capacity in January 2011. Lewis has conducted research on volatility in stock and futures markets, margin adequacy, corporate earnings management, corporate financial policy, executive compensation, selective disclosure, and herd behavior by equity research analysts. His research has been published in the Journal of Financial Economics, Review of Financial Studies, Journal of Econometrics, Journal of Financial and Quantitative Analysis, among other places. He is associate editor of the Journal of Corporate Finance, Journal of Business Accounting and Finance, and the North-American Journal of Economics and Finance, and has been associate editor of the Journal of Financial Research. Please consult www.thenationaleconomistsclub.shuttlepod.org as details become available, the event will be updated.
Jennifer Harris is responsible for global markets, geo-economic issues and energy security. Prior to joining Policy Planning, Jennifer was a five-year member of the National Intelligence Council, where she helped to produce National Intelligence Estimates (NIEs) and the NIC’s Global Trends 2025 Report. A Truman and a Rhodes Scholar, she holds degrees in Economics and International Relations from Wake Forest University (B.A.) and Oxford University (M.Phil), and a J.D. from Yale Law School.

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A special thanks goes out to our Sponsors for the Annual Dinner and to The Embassy of Canada for their hospitality in hosting the event. It was an evening we will long remember in the history of the NEC.

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NABE NewsDigest

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Register now to attend the 2013 Transfer Pricing Symposium at the Sheraton Crystal City in Arlington, VA. Or, invite your firm's transfer pricing or tax staff to attend at the member rate! The 2013 Transfer Pricing Symposium gathers leading professionals from business, government and consulting to discuss and debate some of the most relevant economics topics in the field of transfer pricing. Participants will be able to engage with an outstanding assemblage of panelists and enjoy ample opportunities to network with transfer pricing colleagues from many organizations and perspectives. Featured speakers include Marlies de Ruijter, Head of the Tax Treaty, Transfer Pricing and Financial Transactions Division, Centre for Tax Policy and Administration at the OECD, and Michael Lennard, Chief, International Tax Cooperation Section Financing for Development Office at the United Nations Department of Economic and Social Affairs. Register by June 28 and save!

EXHIBIT, SPONSOR, OR ADVERTISE AT THE 55TH NABE ANNUAL MEETING, SEPTEMBER 7-10, SAN FRANCISCO, CA
The 55th NABE Annual Meeting will take place this year September 7-10 at the Hyatt Regency San Francisco. Arranged around the theme, "Navigating the Information Economy: Creative Destruction in Business and Economic Thinking," the conference provides a number of opportunities for your firm to connect with the more
than 400 professionals expected to attend the conference and the more 10,000 who will receive event information from NABE between now and September. For more information on exhibiting, sponsoring, or advertising at the NABE Annual Meeting, contact Tom Beers at tbeers@nabe.com. Confirm your firm's participation soon as e-marketing begins after Memorial Day.

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NABE will again conduct a "mission" to Europe this September, and you are invited to join the delegation! The group will make stops in London, Paris, and Stockholm to meet with senior government officials, corporate economists, business leaders, and industry groups to explore the key issues, trends, and policy debates impacting the U.S. and European economies. Register soon as the delegation is limited to just 15 delegates, and only 4 spots remain! A trip fee of $2,700 (approximately) covers hotel, Intra-Europe travel, ground transportation, and transfers but not transatlantic flights or transfers. You can reserve your space with a deposit of $500. For details call Tara Munroe at 202-463-6223.

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The next offering of NABE's popular Certificate in Time-Series Analysis and Forecasting Program will be August 12-15, 2013, in Washington, DC. Designed to aid economic forecasting, this seminar presents advanced statistical techniques, modeling and applications. The course is for people who are seeking knowledge of recent developments in economic methodologies and quantitative analysis. The emphasis is on forecasting and time-series analysis with applications in business.

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Information for Business Economists from NABE

This page of links is a guide to useful and interesting information in the field of business economics. We try to do more than just point you to the home page of many of these large, sprawling web sites- we also try to take you directly to the most relevant pages, for data and analysis. The Tools page will link to both free information and to commercial tools and services. The other pages in this section will link to free websites, or to the free information available at commercial sites.

Other Items of Interest

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NEC SPEAKER LINKS PAGE
LINKED IN Networking Opportunity

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Wharton Club and NEC partner for some events. This allows them to attend our events and us to attend theirs at either Member rates or preferential rates. Please check their website for any offerings open to NEC Members. [http://www.whartondc.com/](http://www.whartondc.com/) Click on Events.

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- National Association of Realtors [http://www.realtor.org](http://www.realtor.org)
- George Mason University, School of Public Policy [http://policy.gmu.edu/](http://policy.gmu.edu/)
Thank you to these institutions for their continued support year after year!

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Please see the website for positions available. We make every effort to ensure timeliness and accuracy of the positions posted.
“How has the Measured Unemployment Rate Performed during the Great” Recession?”
Summary of remarks by
Keith Hall
Mercatus Center, George Mason University
April 11, 2013

The unemployment rate is one of the most widely used, yet widely criticized, economic statistics. The Bureau of Labor Statistics (BLS) made an estimate of unemployment in its first annual report in 1885. Since then, this statistic has come to serve as a measure of labor market slack, a determinant of market health, a figure used for hardship, an indicator of inflationary pressures, and a marker for recessions. The strength of the current approach for measuring this figure is sound given the easy measurability, limited objectivity, and general consistency with other economic measures.

However, there are clear limitations of the measure itself, as evidenced by the fact that countries worldwide define active labor forces differently. The ‘active labor force’ fails to take into account those searching for jobs in newspapers or online. Moreover, the figure only takes into account job seekers who have filed within the past week as all others are not considered to have a current status. As a measure of market slack, the figure assumes all jobs are created equal. As a determinant of market health, the figure does not give any indication of hours worked, whether skills have been effectively matched, the difficulty of entering the job market, or the adequacy of job creation. The figure provides no comparison of what normal conditions would entail. As a figure used for hardship, the unemployment rate does not reveal anything about other factors that would impact hardship, such as household savings, the amount of unemployment compensation, or the number of members in a household. Lastly, with regards to inflationary pressures, the unemployment rate offers little correlation with non-accelerating inflation rate of unemployment (NAIRU).

As the labor market has developed and new technologies have advanced, the unemployment rate has failed to change accordingly. The unemployment rate has become less useful over time as women have joined the work force, temp work has become an increasing trend, and teenagers have lost prominence in the work force. Ideally, the labor supply would be acyclical in order for the unemployment rate to be an accurate measure of market health. While the unemployment rate has fallen since the end of the recession, dropping from 10 percent to 7.6 percent, the employment ratio, defined simply as the share of the population with employment, has remained fairly constant at 58 percent. Instead, the unemployment rate has fallen as labor force participation has declined. Were this figure to actually be acyclical, detailed labor force projections made by BLS prior to the recession match actual reported figures. However the inability to predict the actual labor force participation rate suggests that the figure is in fact procyclical. Alternate measures of unemployment accounting for labor force underutilization such as U3 and U6 follow the same trend as the unemployment ratio and thus do not offer any insight into this conundrum.

Thus, while the unemployment rate offers valuable insight into the economy, it should be recognized as a crude measure. Too much is expected from the rate alone. To understand an accurate picture of the economy, other factors such as the employment ratio and the labor force participation should also be examined.
**Keith Hall** is a Senior Research Fellow at the Mercatus Center at George Mason University. Prior to that he served as the thirteenth Commissioner of the Bureau of Labor Statistics, held the title Chief Economist for the White House Council of Economic Advisors, and spent ten years at the U.S. International Trade Commission.

**Rapporteur: Dunja Panic**
Dissenting View: The 2008 Financial Crisis

Summary of Remarks by
Peter Wallison
American Enterprise Institute
May 2, 2013

In July 2009, Peter Wallison was chosen to serve as a member of the commission set up by Congress to investigate the reasons behind the 2008 financial crisis. Establishing the cause of the crisis is important because it says something about the recurrence. If the crisis had been caused by the instability of the free market system, it can be prevented by greater regulation, like Dodd-Frank. But, if as Wallison asserts in his dissenting view, an exogenous event led to the recession, then there was no need for the Dodd-Frank Act because the free market system is inherently stable.

Instead of a thorough investigation into all possible causes to the recession, the commission only looked at facts that upheld preconceived notions. The report cited greed, risk, the financial system, and Wall Street as the root causes of the crisis. Rather than talking about all possible causes, the report ended up creating a ‘just-so’ case of how the crisis unraveled. In a dissenting view, Wallison found that US government housing led to the 2008 financial crisis. In 2008, before the crisis, there were 28 million subprime loans in the US financial system—a half of the mortgages. Seventy-four percent of these were on the books of government agencies, especially Fannie Mae and Freddie Mac. This shows where the demand for the subprime mortgages came from. Only 25% of subprime mortgages were held by private institutions, yet these are the same institutions blamed for the crisis.

When unprecedented numbers of these mortgages defaulted, they created huge losses, weakening the financial institutions and causing market uncertainty. Between 1997 and 2007, the US experienced the largest housing bubble in history. America had experienced other housing bubbles, but when they deflated none caused a financial crisis. In 2008, 50% of mortgages were subprime, but in previous bubbles, subprime mortgages never exceeded 10% of total mortgages. In its report, the Congressional commission noted the weakness in the financial systems and awareness of the vast amount of subprime mortgages. However, the commission did not investigate the causes or look for a reason why they were there.

In 1990, mortgage standards required prime mortgages and a 20% down payment. Freddie Mac and Fannie Mae had a delinquency rate of less than 1% on these mortgages. In 1992, the government made affordable housing a priority and moved Freddie and Fannie away from stricter requirements. Beginning in 1992, the Department of Housing and Urban Development (HUD) required Freddie and Fannie to allot 30% of all mortgages to customers at or below median income of the neighborhood where they were buying the house. The percentage increased to 42% in 1996, 50% in 2000, and 56% in 2008. Freddie and Fannie were able to raise funds easily and dominate the housing market because market participants thought they were backed by the government HUD pressed for greater homeownership. In 1991, homeownership remained at 64% of Americans, a percentage that had remained stable over the last 30 years. By 2004, the percentage homeownership reached 70% (post-crisis, the percentage has dropped back to 64%). Freddie and Fannie had to lower standards in order
to reach the HUD goals. In 1991, buyers had to put down 20% of purchase, in 1995, it was 3%, and by 2000 often no down payment was required.

As Fannie and Freddie lowered their standards, other firms also began lowering their standards for mortgages. By 2007, 40% of mortgages from all firms required only a 3% down payment.

The US government created and prolonged the crisis by fostering a market for private subprime mortgages. By late 2007 the crisis was a foregone conclusion. The market was calmed by the bail out of Bear Sterns but this created a moral hazard. Market participants thought the government would save major companies, but when Lehman brothers was allowed to fail the market was shocked and a financial panic began.

Lack of regulation of the financial market was not the cause, but rather the government, so Dodd-Frank was not necessary.

Peter Wallison is the Arthur F. Burns Chair in Financial Market Studies and co-director of American Enterprise Institute’s program on financial market de-regulation. Prior to joining AEI, he practices banking, corporate, and financial law at Gibson, Dunn & Crutcher in Washington, DC and New York. He has held a number of government positions including, general counsel to the Treasury Department under Ronald Reagan, White House counsel to Ronald Reagan, and counsel to Nelson A. Rockefeller when he served as both New York governor and Vice President.

Rapporteur: Corinne Tomasi
Let me begin my discussion of innovation and global trade by asserting that we, as Americans, should be highly attuned to these issues for several reasons.

Starting with the numbers, and treating the use of our intellectual property system as a proxy for innovative activity, it is clear that innovation is critical to our modern economy. As of 2010, 25% of U.S. industries were intellectual property-intensive, or “IP-intensive”. These “IP-intensive” industries directly accounted for 27 million American jobs and indirectly supported 13 million American jobs. Overall, that’s an impact of 40 million American jobs, or about 28% of all jobs at that time in the U.S.

And that’s not all. In 2010, IP-intensive jobs added roughly 5 trillion dollars of value to the U.S. economy. Economic research suggests that IP-intensive jobs are associated with approximately three-quarters of the economic growth experienced by the U.S. since the mid-1940s. As of 2011, the total value of intellectual capital in the U.S. economy was 8-9 trillion dollars.

IP-intensive industries play a major role in U.S. trade because the U.S. is one of the world’s innovation leaders. In 2010, the U.S. exported about 775 billion dollars worth of IP-intensive goods. The same year, it imported IP-intensive goods worth 1.3 trillion dollars. An important clarification is that IP-intensive imports include those produced by U.S.-owned companies operating overseas and by foreign companies under U.S. licenses. In 2009, American industries received about 90 billion dollars in royalties and license fees, while paying foreigners only 25 billion dollars, yielding a 65-billion-dollar trade surplus for the U.S. in IP licensing.

These figures are not only of interest to policy makers, they also capture trends that intimately affect the American public. Almost everything we buy, sell, and use as consumers is traceable to trade and innovation. A typical automobile sold in America offers technology unavailable a decade ago—for example, Bluetooth connectivity between smart phones and car stereos. An Escape Hybrid made by Ford, an iconic American company, has an engine from Mexico and a transmission from Japan, although it is assembled in the U.S. On the other hand, a Sorento made by Kia, a Korean company, not only is assembled in the U.S., its engine and transmission come from here, too.

The American public also benefits from the creation and expansion of markets driven by trade and innovation. These new and larger markets provide opportunities for U.S. investors, and many of us have a financial stake through the stock market in the success of those investments. Also, according to the Peterson Institute for International Economics, American real incomes are 9% higher than they would have been without the trade
liberalization that has occurred since World War II. As of 2011, that 9% represents nearly 1.4 trillion dollars in additional American income. Lastly, our children will live in a highly globalized, innovation-rich world and must prepare for the attendant opportunities and challenges.

Piracy, one of those challenges, poses a real and present danger to an IP-intensive, global trader like the U.S. According to the General Accounting Office, “counterfeiting and piracy have produced a wide range of effects on consumers, industry, government, and the economy as a whole.” Piracy exposes U.S. consumers to health and safety risks and low quality goods. It causes U.S. companies to suffer lost sales, lost brand value, increased IP protection costs, and reduced incentives to innovate, although industry effects vary widely among sectors and companies. Because of piracy, the U.S. government endures lost tax revenue, increased enforcement costs, and risks to supply chains with national security or safety implications. Overall, piracy undermines the U.S. economy in terms of lower growth and innovation, as well as lost trade opportunities with countries reluctant to enforce IP rights.

To put the cost of piracy into perspective, the value of the global merchandise trade was a record 18.2 trillion dollars in 2011. Although estimates of piracy rates vary widely, assuming a conservative piracy rate of only 2%, that is 364 billion dollars of value captured by pirates instead of innovators. One could compare this number to the economic losses associated with the earthquake and tsunami that devastated Japan in 2011, which are expected to reach as high as 300 billion dollars. Indeed, one could say that every year the U.S. and other innovative countries are hit by a tsunami of piracy.

I will turn back to how we combat piracy, but let me first address the symbiotic relationship between innovation, trade and economic growth. Trade and innovation create new markets and expand existing ones. Consumers benefit from cheaper goods flowing from cost savings gained through innovation, as well as international specialization facilitated by trade, and everyone benefits from goods improved by innovation and subsequently shared through trade. Employees, in particular, benefit from the diverse mix of high-paying, capital-intense, productive industries that characterize highly innovative economies. Innovatively stunted economies, on the other hand, tend to be commodity-driven with jobs that are low-wage and concentrated in lower portions of the value chain.

Between 1995 and 2006, worldwide patent filings grew by an average annual rate of 5.3%. During the same period, world trade grew by an average annual rate of 7.2%, and the world economy expanded, on average, by 3.6% per year. Of course, these worldwide data come from a diverse mix of countries, including innovative but mature economies like the U.S., emerging but innovatively immature economies like Vietnam, and economically and innovatively challenged least developed countries. Despite this diversity, we observe a clear trend associating trade and innovation with economic growth.

The trend is magnified when we focus on countries that amass the most intellectual property. In 2006, applicants from Japan, the United States, South Korea, Germany and China accounted for 76% of patent application filings worldwide. Similarly, 73% of granted patents issued to applicants from Japan, the United States, South Korea and Germany. Three of these countries—Japan, Korea and China—have fueled an economic explosion in Asia, which has increased the continent’s share of global GDP by 10% over thirty years. Similarly, the United States and Germany are exceptions to the economic doldrums of the West, which has seen Europe’s share of global GDP dip by 10% during the same period.

The relationship between innovation, trade and economic growth is particularly stark in China, a country whose dramatic economic rise is largely attributable to manufacturing and trade. Between 2000 and 2006, the number of patents granted by intellectual property offices around the world to applicants from China grew by 26.5% per year. China’s State Intellectual Property Office is now the world’s largest, as measured by number of applications received per year. Non-resident applications filed in China from 2007 to 2011 increased by 20%, demonstrating the attraction of China as a destination for innovation-minded foreign investors. Yet, China is the
world’s largest patent office not because of foreigners, but due to a sharp increase in applications from Chinese nationals.

India, on the other hand, presents a cautionary tale. Both India and China have around 1.3 billion people. Yet, only 42,000 patent applications were filed in India in 2011, as compared to approximately 500,000 in China. Although both countries suffer from lax intellectual property enforcement, the U.S. Chamber of Commerce recently scored China 46% higher than India in an index measuring “both momentum toward and impediments to creating robust IP environments.” Having pursued an export-oriented economic strategy, China has surpassed the United States as the world’s largest sovereign trader. According to the World Trade Organization, China leads the world in merchandise exports and is the 4th largest exporter of services, whereas India is 19th in merchandise exports and 8th in service exports.

The results speak for themselves. While entrepreneurs in both countries face pervasive corruption and intrusive governmental bureaucracies, India has struggled to compete with China in terms of attracting foreign investment. Perhaps most striking, GDP growth averaging about 10% per year in China has graduated more than 600 million people from poverty. India, by contrast, has more impoverished people than any other country.

These differences have dire consequences. Life expectancy is 14% higher in China than in India. A child under five is 3.5 times more likely to die in India than China. The average Indian attends school for 4.4 years, compared with 7.5 years in China. China’s adult literacy rate is 94%, compared with India’s 74%. While not fully accounting for these disparities, trade and innovation have helped China fuel the economic growth necessary to distinguish itself from India in terms of development.

Shifting from countries to industries, let me share some specific examples of how innovation and trade foster economic growth. The first example comes from the burgeoning energy industry in the U.S. Thanks to innovative technologies that allow us to extract oil from previously inaccessible places, the U.S. will become a net oil exporter by 2020 and energy independent by 2035. Thanks to innovation, we’ll pump more oil than Saudi Arabia by 2017.

Another example comes from the telecommunications industry, where Deloitte conducted a study on mobile phone usage across 14 countries, each classified as developed or one of the BRICs—Brazil, Russia, India and China. The study found that a doubling of mobile phone data usage correlates to a 0.5% increase in GDP per capita. In developing markets, a 10% expansion in mobile phone penetration increases productivity by 4.2%. That’s an astounding development for a world that not long ago relied upon stationary, rotary phones.

My last example is the Internet, an innovation that approaches a borderless trade route. According to McKinsey, the Internet has created 21% of GDP growth over the last 5 years among developed countries, accelerating from 10% of GDP growth over the last 15 years. Most of the value created by the Internet falls outside the technology sector, with 75% of economic benefits captured by companies in more traditional industries. The Internet is also a job creator—among 4,800 small and medium-size enterprises surveyed by McKinsey, the Internet created 2.6 jobs for each lost to technology-related efficiencies.

Of course, to be fair, trade and innovation have potential drawbacks, too. Each can lead to the spread of diseases and pests, which pose potentially costly environmental, health, and economic impacts. Agricultural pests spread through trade include Wheat Rust, African Army Worms, Cassava Bacterial Blight and the European Grapevine Moth. Likewise, trade can facilitate environmental degradation in countries with relatively lax environmental standards. U.S. recyclers, for example, have cutting-edge technology for safely breaking apart lead-acid car batteries to smelt the lead for reuse. Yet, the business is going to plants in Mexico, where lead emissions standards are one-tenth as stringent as U.S. standards.
In terms of public safety, trade and innovation have made it easier for non-state actors to foment conflict and practice terrorism. The improvised explosive device or IED has quickly become the primary weapon of choice for terrorists. Since 2007, IED incidents outside of Iraq and Afghanistan have increased to more than 500 per month and include more than 10,000 attacks in 112 countries. Sadly, now we can add Boston to that list.

It is also true that there is disagreement within the international community regarding the virtues of trade and innovation and the best policies for promoting these objectives. For example, opponents of the Anti-Counterfeiting Trade Agreement or ACTA, contend that it forces Internet service providers to police users, threatening privacy rights. Previous drafts of the Agreement would have required providers to disconnect users who repeatedly downloaded copyrighted material without permission. Another controversial measure, allowing searches for counterfeit goods at border crossings, has been explicitly limited to commercial goods after many objected that it would apply to the contents of personal laptops and MP3 players.

A final example of international dissonance over trade and innovation arises from Europe’s concern about the safety of genetically modified crops. Recognizing that there is no scientific basis to exclude such crops, a World Trade Organization panel ruled that European Union policies towards them constitute an illegal “de facto moratorium” on the planting of genetically modified seeds. Yet, four years later, discriminatory treatment continues. Although a small but growing number of European countries allow some cultivation of genetically modified crops, only two genetically modified seeds have made it through the European Commission’s seed approval process.

Despite disparities among countries in terms of wealth, sophistication and geopolitical might, and the risk that modern technologies and commercial freedoms will be misused, the benefits of expanded innovation and global trade vastly outweigh the costs. Although this is true for every nation— rich and poor, alike—it is imperative that as the world’s superpower, we lead the way. The last topic I will address today concerns strategies and tools for promoting innovation and global trade.

The first strategy is insistence upon strict enforcement of intellectual property rights or IPRs, at home and abroad. Held by individuals and enforced by governments, IPRs protect creations of the mind: inventions, literary and artistic works, and symbols, names, images, and designs used in commerce. They create an incentive to innovate and, in most cases, to reveal innovation to others. They provide companies assurances that permit international deployment of capital and technology based on demands of the marketplace, not fear of piracy.

Another strategy for promoting global trade and innovation is the removal of trade barriers, including tariffs and non-tariff barriers. You are probably familiar with tariffs, which expressly increase the cost of traded goods. Non-tariff barriers, on the other hand, add costs and inefficiencies in less obvious ways. They include quantity restrictions, price controls, subsidies, unwarranted customs procedures, currency manipulation, discriminatory application of technical standards, controls on foreign direct investment, forced technology or IP transfer as a condition of market access, forced local production as a condition of market access and weak intellectual property protection. A recent study published by the Institute for International Economics found that trade barrier elimination in conjunction with related development policies would achieve poverty alleviation over the next 15 years for an additional 500 million people – more than the entire population of the United States.

Our policy makers eliminate trade barriers and protect intellectual property rights on a global scale through multilateral agreements such as international treaties. The TRIPS Agreement, for example, is an IP protection mechanism that applies to all 159 members of the World Trade Organization. In addition, the World Intellectual Property Organization administers 25 treaties related to IP protection, including the Paris Convention for patents and the Berne Convention for copyrights. The Paris Convention and Berne Convention have been ratified by 174 and 166 countries, respectively. I previously mentioned the Anti-Counterfeiting Trade
Agreement, which is an international instrument for targeting counterfeit goods, generic medicines and copyright infringement on the Internet. Although 31 countries have signed this agreement, it remains dormant because only Japan has ratified it.

As demonstrated by ACTA, given their size and diverse signatories, multilateral agreements have proven somewhat unwieldy to negotiate and enforce. The Doha round of WTO negotiations, for example, is widely considered a failure because of unresolved impasses between wealthy and low-income countries. Wealthy countries are hesitant to reduce or eliminate farm subsidies, and low-income countries are hesitant to liberalize their markets and welcome foreign investment. To overcome these difficulties and continue advancing its innovation and trade agenda, the U.S. negotiates Free Trade Agreements or FTAs. Often bilateral agreements between the U.S. and one other country, FTAs can be negotiated more quickly and with enhanced levels of IP protection as compared to traditional treaties. All 14 FTAs signed to date by the U.S. contain stringent intellectual property protections. I hope this streak continues in the Trans-Pacific Partnership (TPP), a multilateral FTA under negotiation by the U.S. and 10 other nations, and the recently launched Transatlantic Trade and Investment Partnership (TTIP).

Yet, legal frameworks are only as effective as the people implementing them. When they breakdown following disputes or atrophy from lack of enforcement, the U.S. takes steps to protect itself and its investments. In its annual Special 301 report, the United States Trade Representative (USTR) identifies countries that deny adequate and effective protection for IPRs or deny fair and equitable market access for persons that rely on IP protection. Countries whose policies or practices are the most egregious or have the greatest adverse impact are deemed “Priority Foreign Countries,” making them subject to investigation and possibly sanctions. Since 2010, USTR has published the Notorious Market List as an Out-of-Cycle Review, separately from the annual Special 301 Report. The Notorious Markets List identifies select markets, including those on the Internet, that exemplify marketplaces dealing in infringing goods and helping to sustain global piracy.

Many countries, including those on the Notorious Markets List, want to export goods to the U.S. market, the largest of any country in the world. Section 337 of the Tariff Act of 1930 prohibits unfair competition in the importation of goods, including those that violate U.S. intellectual property rights. Section 337, enforced by the International Trade Commission, makes it unlawful for any person to import such goods into the U.S., to sell them for importation, or to sell them within the U.S. after they are imported. The primary remedy for violation of Section 337 is an exclusion order banning the goods from entry into the U.S., which is enforced by Customs and Border Protection.

For all the reasons I have discussed, innovation is critical to the modern economy. Yet, successful innovation is inextricably linked to the enforcement of IPRs. We currently have a strong IPR enforcement system, but I fear that it is under attack both domestically and internationally. Although I could spend another hour identifying the disturbing signs of IPR erosion, let me just focus on one of its causes—misguided critiques of our IPR system.

If you have picked up a newspaper or turned on the TV over the last few years, you have probably heard about “The Smartphone Wars.” Some portray the litigation between the various handset makers as an example of a patent system out of control. By some estimates, as many as 250,000 patents cover the technical and design elements of a typical smartphone. Each patent is potentially an opportunity to sue, and in the smartphone industry alone, as much as 20 billion dollars has been spent in the last two years on worldwide patent litigation and patent purchases—an amount equal to eight Mars rover missions.

Although I would not disagree that a lot of money has been spent by many companies on lawyers, I don’t think innovation has been a victim in this “war.” Analysts estimate that the smartphone market will be worth 1.6 trillion dollars by 2018, a figure that dwarfs the 20 billion dollar litigation price tag. Global cellular subscriptions have risen from approximately 738 million in 2000 to almost 6 billion today. There are more phones than people on Earth! This is a bonanza for successful smartphone companies such as Apple, Samsung
and HTC. These companies were not smartphone pioneers, but late entrants to the market who leveraged innovation and value to woo customers from former leaders RIM and Nokia. Given the vast size of the smartphone and telecommunications industry, its growth potential, the extraordinary changes in technology, and rapidly shifting market positions, an outbreak of lawsuits over IPR was perhaps inevitable. Instead of asking whether we should reflexively change our IPR system to pander to inflammatory newspaper headlines, we should be questioning whether, under a weaker IPR regime, the world would have benefited from the smartphone revolution in the first place. I don’t know about you, but I don’t want to find out.

When innovative smartphone companies enforce intellectual property rights, they create an ecosystem in which other companies must innovate or capitulate to compete. The escalating innovation driven by this dynamic is what makes our products better and cheaper. A good example from the smartphone industry is Microsoft’s Windows Phone operating system. Another equally beneficial byproduct of IPR enforcement is technology licensing among companies, some of which are fierce rivals. As explained by Microsoft’s general manager of IP licensing, “There’s no one that can build a great product these days without using the ideas of other companies.” Many products from Apple, for example, contain semiconductor chips manufactured by its biggest rival, Samsung. Because of licensing deals inked by Microsoft and Android manufacturers, Microsoft receives royalties from 80 percent of the Android smartphones sold in the U.S. and more than half of those sold worldwide.

As a country, we should want IP and business systems that reward companies for innovating away from existing products and punish companies content to misappropriate the hard work of others. We also want sharing through licensing in lieu of mutually assured destruction.

Another area where critics are attempting to demonize IPR owners is the over inclusive targeting of non-practicing entities, known as NPEs. You might have heard stories about patent “trolls” abusing IPR rights by buying low quality patents and using them to terrorize mature industries whose inclusion of an infringing product feature, while of minimal market value, might be technically or logistically difficult to remove. While there has been much ink spilled about victims of “trolls,” I would caution you against generalizing from the anecdotes and hype.

First, beware of labels. You can hear four experts provide seven different definitions of what constitutes a “troll.” This lack of a controlling definition is because NPEs encompass diverse operational styles and business models. NPEs include manufacturers whose products do not practice the asserted IP, research institutions, start-ups, individual inventors, companies who purchase licenses and companies who sell licenses. Many NPEs serve as a vehicle for IP enforcement, perhaps on behalf of an inventor or a small company without the resources to confront infringers. Some NPEs have a business model focused on purchasing and asserting patents. Other NPEs have a business model of purchasing defensive patents. A one-size-fits-all label ignores these nuances and marginalizes productive IPR holders.

Second, beware of solutions that focus on business models rather than abusive practices. Laws should discriminate between good and bad behavior, not types of businesses. If you object to abusive litigation tactics, focus your energy on eradicating those tactics, not foreclosing a particular business from the due process guarantee of dispute resolution through litigation. The reality is that any entity, whether a traditional manufacturing business, a technology startup, or an invention capital company that someone has labeled a “troll,” can engage in abusive litigation tactics. Also, all companies, including “trolls,” survive by creating value for customers, partners and society. Whenever a so-called “troll” is successful in litigation, ask yourself, “How much more advanced would the technology in dispute have been if the adjudged infringer targeted by the ‘troll’ had transcended the asserted patent through innovation instead of infringing it?”

My final piece of advice on this topic is to focus on the facts rather than the hype in evaluating the problem. Certain interest groups have misrepresented that the International Trade Commission or ITC, where I served as Chairman for two terms, is a friendly litigation venue for patent trolls. As discussed above, defining a “troll” is
difficult, but the ITC focuses not on the definition, but on the facts in a specific case. Under law that has governed ITC litigation since 1988, only NPEs making a substantial investment in a patent’s exploitation, including engineering, research and development, or licensing, can establish the Section 337-required existence of a domestic industry and obtain relief. Further, the ITC has explained that "revenue-driven licensing"—as opposed to "industry-creating, production-driven licensing"—is entitled to less weight in the domestic industry analysis. Consequently, since August 2011, only one NPE has proved the existence of a licensing-based domestic industry. The ITC’s proven ability to adapt to new conditions, such as litigation brought by NPEs, is among the reasons why I oppose current legislative efforts to weaken the ITC. Purportedly designed to target abuses, the proposed changes would compromise the ITC’s ability to deter piracy.

Having addressed false narratives that threaten to weaken our IPR system, I want briefly to address a problem with our IPR system that actually warrants attention. As I previously stated, the primary remedy in ITC ligations is an exclusion order that directs U.S. Customs and Border Protection to block the importation of infringing goods. These orders are currently vague, prompting Customs to make its own infringement determinations regarding the legitimacy or piracy of goods subsequently imported by an adjudged infringer, without input from all affected parties and the ITC. In some litigations, this practice imperils the raisons d'être for ITC litigation, which is a swift halt to the market damage cause by pirated imports. My firm, Adduci, Mastriani & Schaumberg, has been leading the effort to rectify this problem.

The foregoing are examples of valuable introspection and debate that make our innovation and trading systems freer, fairer and more effective. On these issues, and many others, the world is closely listening to our words and watching our actions. By simultaneously improving our own systems and promoting trade and innovation abroad, I believe that we can create and grow markets that not only increase wealth, but also foster poverty alleviation and overall quality of life. That is a legacy that we will be proud to own.

I conclude by reiterating what I said at the beginning: we, as Americans, should be highly attuned to trade and innovation issues. In terms of making the world a commercially freer and more innovative place, we have made great progress, but a lot of work remains. Going forward, we should not let the perfect be the enemy of the good. While not perfect, global trade and innovation offer economic and non-economic benefits that greatly outweigh costs. Not everyone in the world agrees, and we should remain mindful of legitimate concerns raised by naysayers. Yet, it is critical that we maintain and even enlarge America’s competitive advantage in this lucrative arena for ourselves and our children.
**NEC Welcomes New Members**

New NEC Members since publication of the May 2013 Newsletter:

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<td>Sr Economist</td>
<td>Delegation of the European Union</td>
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*Denotes Institutional Member*