

THE BROOKINGS INSTITUTION

A NEW DAWN FOR PROTECTIONISM?  
FROM TRADE WARS TO MEGA-REGIONAL TRADE AGREEMENTS

Washington, D.C.  
Monday, October 8, 2018

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## P R O C E E D I N G S

MS. SOLIS: Good afternoon, everybody. My name is Mireya Solis. I am the director of the Center for East Asia Policy Studies. It is a pleasure to welcome all of you to today's program, a new dawn for protectionism? Between the trade wars and the mega trade agreements.

You have probably noticed that we have a lot of cameras in the room today. Today's program will be broadcast later on by NHK World in their series Global Agenda. And I would like to take a moment to thank NHK for the generous support that helped make this event possible, but also to our reiterate Brookings commitment to independence, and underscore that the views represented here today are of the speakers only.

So we have a terrific group of experts today willing to share their expertise. They come from very different fields, so I think it's going to be a very rich discussion from economics, from political science, law, journalism. Let me introduce them briefly for all of you.

Toshihiro Nakayama, is a professor at Keio University in Tokyo, Japan. Soumaya Keynes is a U.S. economics editor at The Economist, Edward Alden is a senior fellow at the Council on Foreign Relations here in town, Hylke Vandenbussche, is a professor at the University of Leuven in Belgium, and Mark Wu is a professor at Harvard Law School in Boston -- in Cambridge, actually -- sorry.

So let me take a couple of minutes to set the scene to highlight some of the important trends and issues that the speakers will be discussing in much more detail. And we will certainly be taking questions from the audience so that we can engage with you as well.

I don't think it's too much of an exaggeration to say that we live in extraordinary times. Frequently we don't know where the world is heading, and certainly

we don't know where the international trading system is going. Due to negotiation paralysis in the World Trade Organization, the WTO, you could say that the rulebook on international trade and investment has not been updated for the last almost 25 years. At the same time, there is concern that the actions and policies of the two largest economies in the world could also undermine the multilateral trading system.

China's rise has not seen the emergence of a market economy -- quite the opposite. Many of its market distorting policies have created very significant irritants in trade. I'm talking about industrial subsidies, state owned enterprises, overcapacity issues, theft of intellectual property -- the list is long, and I'm sure we're going to get to that in today's discussion.

At the same time, the Trump administration is calling for a complete reset of U.S. trade policy. He's skeptical of multilateral trade agreements, argues that negotiating one-on-one is best for the United States, and has also been very critical of the World Trade Organization, making the case that it has not been fair to the United States. The Trump administration has reverted to what we call managed trade tactics, and that is he's trying to set outcomes to try to reduce bilateral trade deficits. And it is very clear that the tool of choice is a tariff. So there's going to be a lot of discussion today I think on tariffs and quotas. And, of course, we all know that the U.S.-China trade war has escalated very, very rapidly.

Now, while all of this is going on, while we see tariffs and quotas increasing, it is also very true that countries are very actively, governments are very actively negotiating trade agreements. So Japan and the European Union have made the case that they still believe that multilateral trade agreements are best, and they have actually negotiated some very large -- what we call mega trade agreements. You have comprehensive --

SPEAKER: Progressive.

MS. SOLIS: -- TTP (laughter), and of course the Japan-EU trade agreement. The Trump administration was not very happy with the Korea-U.S. trade agreement or with the North America Free Trade Agreement, but did not terminate these agreements, it actually renegotiated them. And we're going to try to discuss what has changed or not changed.

And there is, of course, now much more discussion about WTO reform. So there is a lot happening in the world of international politics and we're going to try to address here some of the most important issues and what should we expect going forward.

Now, having laid out that background, let me then turn to the panelists and, first, I think it will be important to take stock as to how come we are at this juncture in international trade politics? Why is protectionism on the rise? Now, when you say "protectionism", what first comes to mind are tariffs and quotas. And President Trump is very fond of tariffs. He talks about them often and in a positive way.

So I would like to first get a sense from the panel here about what is President Trump trying to accomplish, and do you agree that tariffs are an effective, powerful tool to bring about that resetting of U.S. trading relations.

So who would like to get us started? Why does President Trump like tariffs so much?

MS. VANDENBUSSCHE: Well, I think tariffs could be an important instrument in this negotiation because size matters in this respect. The U.S. has a very large internal domestic market, the Chinese exports go for 20 percent to the U.S., the U.S. is importing 20 percent of its imports from China. The other way around, China is less reliant in terms of the U.S. for its imports, but the U.S. is very reliant on China for its imports. In terms of export markets, the U.S. is not so reliant on China. So I think that sets a scene where the U.S. is the larger market, and in that respect I think retaliation

through a tariff could bring about the changes that the U.S. is asking for, meaning to level the playing field. I think that's why they also ask for the reforms at the WTO. There have been some occasions where the Chinese have not been respecting some rules regarding lax enforcement of intellectual property rights or some subsidization industrial policy mechanisms that the U.S. has not been happy about. They have been asking for reforms for the past decade already, so I think it's something that didn't start with the Trump regime, but actually occurred already earlier under Obama and so forth.

And the EU and the Japanese have given it a lukewarm welcome so far. I think the bargaining positions for them vis a vis the Chinese are also somewhat different. And I think the U.S. is in a position where they say well, we're going to use the tariff instrument as a way to pressurize the reforms that they want at the level of WTO and at leveling the playing field with respect to China.

MR. ALDEN: I would say I just think we all need to be clear that this is a historic gamble by the Trump Administration. The U.S. government made the decision, and it came after many years of heading in that direction, the mid-1990s to push for the creation of binding dispute settlement in the World Trade Organization, the belief that U.S. interests were better served within a system where market power wouldn't determine outcomes, where all countries, regardless of size, would behave by a common set of rules. That was an amazing thing for a country like the United States, the largest and most powerful economy in the world, to support.

We have now changed direction on that and gone back to an earlier notion that because we're the biggest kid on the block, because we have the largest market, we can push others around to our benefit. That may well be true, but we shouldn't underestimate what a radical change that is from where the U.S. essentially spent 45-50 years after the second World War arriving at.

MS. SOLIS: Soumaya?

MS. KEYNES: I'd just like to share my experience of sometimes people come to me and they explain to me that what the President wants is tariffs, he just wants tariffs. And then 20 minutes later someone else will come up to me and they'll say, you see, Soumaya, the President really likes deals. And so I think we need to bear in mind that when thinking about the President's objectives or the President's strategy, that can be volatile, it can be changeable, but also just remember always when we're having this kind of debate, that the Trump Administration is a collection of individuals, each of whom is vying for influence. And at the moment it seems like the China hawks are in the ascendency, the likes of Robert Lighthizer, you know, with more tactical processes. It seems like they're dominant in terms of their influence on the Trump Administration's agenda. But previous instances, like when we saw the steel tariffs, that reflects a slightly different side, and that could become more important at a later time.

MR. NAKAYAMA: I guess at the heart of it, this is political I guess because the MAGA -- you know, Make America Great Again, going against trade is at the heart of President Trump's message. And of course, many of the trade agreements are multilateral and he is extremely skeptical, and even antagonistic about this multilateral sort of trade agreement. And it's not just trade, UN, ICC, EU, everything related to trade. So I think going against trade is at the heart, at the core of the Trump agenda. So we would have to somehow sort of try to sort of tame Mr. Trump's political agenda and try to treat this beyond just a trade issue. And I guess we have to see the political side of it as well.

MS. SOLIS: Thank you. You want, Mark, to join? Or should I --

MR. WU: Sure, I'll just add one last thought here. I think what's been most shocking probably to many people has been willingness of the Trump Administration to go after stalwart U.S. allies. So imposing tariffs against Japan, the EU, Canada, and so forth. And the one thing I'll add here is certainly I agree with everyone --

what's been said here, that part of this is political, part of this is a geostrategic competition against China, but the other thing, going back to your opening comments, Mireya, is part of this is just also frustration that U.S. allies have not been pushing a reform agenda at quite the same speed. And as Hylke mentioned, EU interests, Japanese interests are different vis a vis China, but also in terms of how they've configured their supply chains. And I think part of what tariffs are designed to do is to get allies on board with the U.S. reform agenda. Whether or not this is effective, we'll see in the coming months.

MS. SOLIS: Great. So this is a wonderful beginning. Now, I'm a little bit surprised when I asked you all what does the President want to achieve with tariffs, that two of the most standard explanations did not come up, were not at the center of the conversation. And one is to reduce bilateral trade deficits, and whether that's actually doable or not, so a trade agreement -- or meaningful if you're talking just about the bilateral trade deficit. And then closer to what Toshi was saying, we need an agenda of economic nationalism to bring home the supply chain, to be a force that's not an advocate of globalization, but actually of renationalization. It could also be that, as Mark was saying, that it's about pushing allies to take a side. And as Hylke was saying, for them to be really serious about WTO reform.

Now my opinion is that the President is not really doing this because he believes that he needs to be tough to get others be fair and to open their markets, he's not pushing for free trade it seems to me, because I look at the outcome of the U.S.-Mexico-Canada trade agreement and I see that the metal tariffs remain. So it's not really about eliminating the protection it seems to me.

So reactions to this? Soumaya?

MS. KEYNES: So I'd add another objective, which is to raise lots of tax revenue, which he seems very excited about and is probably not going to be a primary result of the tariffs.

So on the trade deficits point, I think there it's possible that the trade deficits was helpful in terms of -- not helpful, but it was the thing that led to him identifying the trading partners that he would go for, rather than it being a result that he is hoping to get out of a trade negotiation. So I think early in the NAFTA negotiations it looked like the Trump Administration was going to be asking for something in the deal that would related to the bilateral trade deficit, some kind of clause that would specifically reference that. And that isn't in the final deal. So it almost seems as though in the practical negotiations, perhaps some within the Trump Administration have realized it's not something you can write into the trade deal.

And our famous last words, maybe they'll try to put it into some of the other trade deals, but I think it led to identification of the people to pick on.

MR. ALDEN: I mean I think this is -- there's no question of your point about economic nationalism. I think this is certainly in part about increasing production in the United States. I think you have to look at the tariffs and the pressure on trading partners as part of a larger strategy that includes the tax cut. Of course the center piece of the tax cut was a big cut on corporate taxes. It makes the United States potentially a much more attractive investment location. And the regulation initiative, again designed to make it cheaper and easier for companies to invest in the United States. So I think there is a strong economic nationalist agenda here. I think the Administration believes that the scales have been tilted in global trade rules against the United States, has made it too attractive for companies to outsource, to invest in other places, and export back to the United States. I think they're trying to push the scale in the other direction.

MS. SOLIS: Toshi?



MR. NAKAYAMA: Well, I think there's a sense that U.S. is being ripped off, and especially along people who support Trump. And he came to Washington and said that I'm going to fix thing. And that's what he was precisely saying during the election and that's what he's supposedly in the White House today as well. So it's an important political message to his supporters that I am going to reduce the deficit. So I think he's going to keep on saying that and it's going to be a symbolic message. But whether that would sort of really turn things better, I think that's a totally different story.

MS. SOLIS: So let me build from that, Toshi, because it is true that there was a political instinct behind the Trump Campaign in the sense that the trade message resonated with enough people that it's part of, you know, his style of governing, how he's going to move along U.S. foreign policy. And what I'm trying to get at here is that President Trump might not be an outlier, but actually the culmination of a longer-term trend. And we know that trade has become a more divisive issue in the United States. I think, Ted, you have remarked in the past that trade agreements and trade bills used to be approved on a bipartisan basis, and that seems like such a remote world today.

But what is striking also is that if you think about one country that helped shape the post-war trading system, it is the United States. And the United States now seems to be willing to step out. As you said, there has been now this very, very important shift that the United States will not be constrained as much by dispute mechanisms, you know, that market size will determine the outcomes.

So for audiences here, but also abroad I think, they're trying to understand why has the United States gotten cold feet, why is it no longer backing its own creating, and why it's now perhaps the country that is very actively now trying to shake things around and disrupt the way in which we have been conducting business. So what's happening in the United States that makes the Trump Administration seem less of an outlier or more the culmination of a trend?

MR. WU: I think there's two things, especially for an overseas audience, that's important to realize. One is while all advanced economies have been hit by the technological changes and the off shoring of jobs, the domestic support policies in the United States when it comes to particularly healthcare, but also redistribution, retraining, and so forth, the United States is really an outlier compared to many other advanced economies, and that's led to a much larger sizeable portion here that is upset for the reasons Ted is talking about, right. Not necessarily just on trade, but also feeling as though they are being left behind.

I think the other thing that has change though, of course, is the impasse at the WTO. It used to be global trade rules were updated at least every roughly decade or so, that dispute settlement, at least in the United States' view, was not quite as aggressive about paring back trade revenue tools. And from where the U.S. sits, that's been a major change as well.

So I think those are the two major shifts if I look at what's changed today from say the 1990s when the U.S. was really a leader in multilateralism that may not be quite apparent to folks overseas because in terms of where the WTO appellate body has been paring back trade revenue laws. Other than Europe, right, other countries have not necessarily felt the brunt of that to quite the same extent as the United States.

MS. VANDENBUSSCHE: I was also thinking protectionism is a very powerful tool. As economists we know this. With protectionism you can create domestic manufacturing, you can pull inward FDI, you can bring manufacturing business back home. So for a politician to use protectionism to their advantage is something we know as economists works. So I'm pretty sure that the U.S. will be in a bit better shape on the books within a couple of years because of the protection policies.

It's very difficult for a general audience to understand the benefits of free trade. If you see people losing their jobs, especially specific areas being targeted and --

well, this is I think due by and large a number of issues, but Mr. Trump is pinpointing China as one of the guilty actors in this play, and so protectionism vis a vis China will bring certain benefits. It's just these are short-run gains. We know that, as economists again, in the long run there is a lot of risk involved, which is why we're having the debate today.

So I think getting re-elected and using protectionism to your advantage as a politician I think is definitely part of the agenda.

MS. SOLIS: Ted, you want to jump in?

MR. ALDEN: Yes. I mean I think in the long run, as you said, we have seen this erosion of support for trade agreements over the years in the United States. You go back to 1979 when the Tokyo Round Agreement was voted on by the Congress it passed in the House of Representative by a vote of 395 to 7, and in the Senate by a vote of 90 to 4. I mean that's how popular trade was. Even at the end of the 1970s, when we had begun to see the impact of Japanese competition. Over the last two decades most of these agreements have squeaked through by a handful of votes.

So there was this steady erosion. But I think the other thing that happened was the 2000s, the Great Recession and its aftermath. I mean if you look at manufacturing jobs in particular, manufacturing as a share of U.S. employment has been declining steadily for years. That's mostly an automation story. But the actual numbers fell off a cliff in the 2000s. We went from 7 million jobs to about 11 million jobs. And the places that got hardest hit, Ohio, Pennsylvania, Michigan, North Carolina, Wisconsin, was where the places where the peculiarities of the electoral college system Donald Trump won the 2016 election. So a lot of that I think was a delayed reaction to the economic impacts of the 2000s.

MS. SOLIS: Yes, Toshi.

MR. NAKAYAMA: On that point, it reminds me sort of the relations within NRA and gun control. Because basically the U.S. public is for some sort of gun control, but NRA is politically really effective. And if you see the recent Chicago Council on Global Affairs poll, people are basically for trade, but there's intense opposition being organized I think. And Mr. Trump was very effective in sort of organizing and making that into his political power. So I think that's the reason why we feel like the protectionism is on the rise, but generally speaking, people are for it. But it's the same logic that sort of NRA prevents gun control.

MS. SOLIS: I'm glad that you bring that up. You know, in my reading of what has happened in the United States is that the United States basically embarked on globalization on the cheap. And that is that it opened markets, but it did not provide that safety net to allow people to cope with a faster pace of change because of technology, because of trade. And it's very clear, you look at the numbers, and the United States does not invest in what we call active labor market policies, does not invest in workforce training. And it's true that with these huge macroeconomic shocks, the global financial crisis, there are many, many communities out there that not only feel, are vulnerable, and that's why they're going to respond this way.

And we also know that protectionism can gain traction politically because it promises short-terms, because the costs in terms of how much consumers are paying, in terms of hurt competitiveness, take longer to be realized, and it's harder to make the case for why free trade matters for the competitiveness and for the consumer welfare.

And then people look at the popularity levels of the President and they hear the President say in his inaugural speech that protection leads to prosperity. And I think in my conversations when I travel abroad, I do hear this question that gets to what Toshi was referring to, and I would like to bring the rest of the panel in. And the question is, does the American public support protectionism, is the American public on board with

the tariff war? Or, you know, we know about these polls, you know we know that in the last two years actually the support for trade has gone up, but then how come the President is not experiencing high heat because he is pursuing these tariffs. He actually seems to be pleasing a lot of people in doing this.

So how do we explain this discrepancy between what polls tell us and what we see happening politically in terms of the President being supported by his base? How do we square that?

MS. KEYNES: So I'm not 100 percent up to speed with the polling on the latest trade actions, but I will say that there is a big difference between people's answers when you say do you like trade and do you like trade deals. So people are much more skeptical of trade deals than they are of trade.

So, interestingly, there was a recent Pew poll that found that republican voters are now more in favor of trade than democrats, which is very surprising. And it is essentially because people like trade whenever their guy is in power, whereas if you look at people's attitudes toward past trade deals, republican voters are much more skeptical relative to democrat voters. So that's one of the kind of circles squared.

MR. WU: We live in such a polarized country today that I think it's so hard to disentangle what the President is doing on trade with support for the President overall. And I recognize I live in Cambridge, Massachusetts, which is not anywhere close to emblematic of the rest of America (laughter), but I will point out two things that I think on this point.

I think, one, there is a difference of attitude among the American public about actions on trade generally, and whether or not there's a need to get tougher vis a vis China. And so I think when the polling doesn't sort of disentangle that, there is some of that which is captured there.

The second point that I'll just add is that I think when it comes to looking at the President's actions there are many people, particularly in the heartland who believe getting tough is part of a tactic to eventually getting us towards a deal. And right now it's too early to tell whether or not his deal is going to happen, but for the general public, they just saw two deals that were just done in the last month, so they think this tactic is working even if it's hurting them. If more deals aren't forthcoming, then that might look at it differently.

But at least on your question, why is this message resonating? It's because people are seeing a tactic and they're seeing results and they don't go into the greater details beyond that other than to think, all right, this is a president who got tough, who got more done vis a vis other who did not. And so I think that's driving some of it. But at the end of the day, it's still about this polarized view of do you like Trump or do you not.

MS. SOLIS: Thank you, Mark. And I'm so glad that you bring China up, because we need to move from talking just about the United States and talk about China as an actor in the international trading system. And frequently China's integration into the trading system is described as a shock. And in town we hear more and more voices saying that it was a mistake to let China join the WTO.

So what are your views on that? What kind of opportunities, what kind of challenges has the emergence of China as an export powerhouse and now as a very large foreign direct investor and so forth had on the system. And was the deal made at the WTO accession a good or not?

MS. VANDENBUSSCHE: Well, my view on that is that trade policy is not a substitute for competition policy. And I think the world trading order has come to realize that. What do I mean by that? When China entered in 2001 WTO there were no guarantees on its competition policy. You have to understand the World Trade

Organization is an organization about trading rules. Let me just give you an example of the European integration, not to say that European integration doesn't have any flaws, but one thing they did very well was before they entered the ex-communist countries of Central and Eastern Europe into the single market, they made sure that these countries rewrote their competition policies. So they made sure that the rules on competition these countries had were in line with what Brussels was having, and all the other countries were having. It's only after that they could enter the single market. And nowadays, to be honest with you, we hear very little about some conflict with former Eastern European countries, which were also communist countries.

Now, what happened with the China case, China got access to a club, a club of free trade countries called the WTO, but there were no guarantees on who it would handle its competition policy. And the notion was that open markets will bring this about. Trade policy will be a substitute for competition policy. But now we're 20 years down the road and we're seeing that China is still subsidizing its companies. And I think that's where part of the problem lies. The World Trade Organization is not a world competition authority. So by and large you have competition policies that are still very much under the auspices of the national governments. And China is doing in that respect what it wants. The trade partners do not have any instrument to tackle that because it's under the national policy of these countries. The only thing by construction the WTO would allow you to do is to use tariffs to countervail that. So if you're finding out that China is subsidizing on very particular products you can use an anti-dumping tariff, for example, to counter that. But you have to know that anti-dumping is only one or two percent about trade. All the products that are covered by anti-dumping cases -- which the U.S. is using a lot, which the EU is using a lot -- but it's only one percent of trade. So I think what the Trump Administration now is doing is saying, well, we're going for a much larger basket of goods, but we're trying to get that same leverage, meaning we're going

to countervail (inaudible) subsidization policies in the hope that it will level the playing field, and you're going to stop doing that, and that's what we want you to do.

That's my understanding of really what's going on.

MS. SOLIS: Very interesting, Hylke. I'm sure there are other views.

MR. ALDEN: Yes. And I'll defer to Mark on the China end of it. But it's been interesting to watch the debate here in the United States, which I've done quite closely going back to the Tiananmen Square and Bill Clinton and the aftermath. The United States made a historic gamble with respect to China. The decision was made to welcome China into the existing trading order on the hopes that China would embrace it and over time in a way become more like us.

You know, this was Bob Zelek's notion of China as a responsible stakeholder. If you go back to the debates over China's entry in the WTO and the debates in Congress about whether to give China permanent normal trade relations, the Clinton officials talk quite openly about this. You know, Graham Allison has a new book out called "The Thucydides's Trap", all about the challenge of integrating rising powers into the system. They were all quite conscious of this. And if you look at the debate now, there are a lot of folks in Washington who seem to me they feel like jilted suitors. You know, we reached out to China, we offered China a stake in this wonderful system, and China has rejected it. They've become less like us, they've become less of a market economy, they've become more state dominated, less of a civil society, less free. And it seems to me quite sudden, but it's been growing for a long time, a shift in the opinion in official Washington. This is not republican versus democrat, this is quite wide. That China just didn't pan out the way we expected. And that's where you get the debate over was it a mistake even to encourage them to join the WTO in the first place.



I mean I think the United States had no choice, but the fact that that question is even asked tells you sort of the depth of the angst here in Washington over what transpired.

MS. SOLIS: Toshi and then Mark.

MR. NAKAYAMA: In 2001 there as this hope that we could sort of shape the rise of China. But this notion I think is collapsing in a very rapid speed. And I think just last week, Larry Kudlow here in DC, used this term, trade coalition of the willing, to contain China. So I think there's this emerging consensus here in Washington that -- of course before that people were talking about China being different from Soviet Union, that, yes, in terms of security there are some worries, threats. But in terms of economy and trade, it's a possibility. And we can use that leverage and then sort of shape China in a positive direction. I think that notion is collapsing at a rapid speed and the Trump Administration is sort of jumping on that notion.

And it's not just, like you said, a republican thing. I see sort of a consensus -- there's of course difference in nuance -- but an emerging consensus about being tough on China. And trade is a very important component of that.

MS. SOLIS: Mark.

MR. WU: I think the debate that is playing out, at least in the West, a realization -- to use Toshi's language -- that the international rules or international law is not going to constrain or reshape the rise of China. And what I sense from my travels overseas is that especially in Asia people sort of look at you to say how naive of you to have ever believe that that could have ever been the case. But there is a difference now in terms of tactics as to what to do now that this realization has come to fore. And in most of Asia I think no one ever expected that was ever going to be the case. And there is a much longer time horizon, so there is much more of a sense of at least this type of

engagement, but caution and sort of hedging against a China supremacy. That's the right type of approach. And they would like for the U.S. to maintain that type of hedge.

And I think here in the U.S. there is a debate as to whether that's correct or not, or whether the U.S. is just being played by others. At the end of the day, the U.S. does not want to return to a sovereignty based trading order, or if it is going to return to that inevitably, the sense here in the U.S. is well, we might as well as play our cards while we still have the upper hand.

So I think that's the debate that's being played out here. But what I sense from my own travels is that overseas there was not that same type of recognition that China was going to somehow engage in this type of economic regime change simply because they joined the WTO and that a rules-based system could do that. And I think in the U.S. we're just coming to terms with that.

And my sense is also in Europe there is -- Hylke, as you mentioned -- also a sense of now that the Chinese are moving up the supply chain into actually invention driven industries and using these types of policies, what does that mean for Europe's own security as a whole as well, that Europe never debated vis a vis China, only vis a vis Russia.

MS. SOLIS: You know, and I want to move into the confrontation or the economic tension between the United States and China that preoccupies us so much.

But before I do that, Mark, I know that you've written extensively on this, and that's why I want to bring it up to the discussion here. On the China challenge for the WTO and the sense that -- if I remember correctly what you wrote -- that there have been non market economies that were incorporated into the multilateral trading system and the system could cope with them. But that the nature of the Chinese challenge is different and therefore the WTO is particularly challenged in trying to bring discipline to China's non market policies.

Could you elaborate a little bit on your argument?

MR. WU: Sure. So as Hylke mentioned, the WTO has brought in lots of different types of economies, but the last major time it faced a challenge of this sort was when the Soviet economy started to enter into the GATT. And it created this duality in terms of archetypes of market economies and non-market economies. Market economies being that like ourselves here in the U.S., but also even more corporatist economies where at least market forces are dominant. And then it had non market economy, which is basically a command and control or Soviet style types of economies. And that was the duality. And that was more than 50 years ago.

And what we've seen in the emergence of a third archetype, which doesn't quite fit full market forces. Market forces are at play, but the state retains key control over capital and other type of infrastructure. And now the trading system is struggling over what to do with that third archetype that can't fit into the rules quite as tightly. And I think that's a lot of what's at the tension here and why the rules today can't quite work with that.

There are a lot of other flaws with the structures of the rules, but these can be managed over the course of time. But that's what I see at the heart of the tension, is that there's this third type of economy that has emerged that the rules haven't really anticipated.

MR. ALDEN: And just quickly, it's important not to miss the big picture here, China is really large. And therefore, if you can't incorporate China, the potential for disruption of the global trading system is so much bigger than with any other country that we've ever dealt with.

MS. SOLIS: Yes, yes. And when you have the two largest economies in the world now locked into this trade war, we're trying to figure out what's going to come out of it.

You know, tactics, clearly the tariff, and they have escalated very, very quickly. Sometimes it feels like the Trump Administration will tell them we're going to impose this tariff and if you retaliate we'll escalate this much, and the tariff materializes in just a few weeks. It's very hard to even make sense of what's happening because it's moving so fast. It's hard also because I think for a time there was no clarity as to what is the end goal. You know, President Trump talked a lot about bilateral trade deficits because he cares about them. Then he also talked about especially the USTR in its investigation of China's theft of intellectual property, talked a lot about an industrial policy run amuck. And now, you know, with Toshi's remark about Mr. Kudlow saying that we're trying to build a coalition of the willing to contain China, then we now seem to be talking about disengagement. Engagement has been the policy that the United States has pursued vis a vis China for decades, and now perhaps we may be at that critical juncture.

So are we there on the verge of a cold war, an economic cold war with China? And if that's the case, there won't be any talks forthcoming. Is this the new normal?

MR. NAKAYAMA: There was this speech by Vice President Pence at the Hudson Institute, which came very tough on China. And some people say this is the Iron Curtain moment. It might be.

So if the target is China, I think it's more effective to do it multilaterally. So TPP in a sense as a more effective tool. But I guess for the Trump Administration these multilateralism frameworks would not work.

So what is emerging is sort of a new type of consensus on China policy within the Trump Administration. And that consensus involves the geostrategic component, the protectionist component, sort of like the human rights component, the (inaudible), the religious freedom, which Vice President Pence is interested in, and sort of

the basic hawkish sort of attitude, sort of represented by John Balta. And what Mike Pence laid out last week at Hudson sort of represents this tough policy on China.

So I think this is a constant. Since this is a consensus, I think we would have to deal with it for a certain period of time.

MS. SOLIS: Hylke, yes.

MS. VANDENBUSSCHE: Can I point out that the WTO's problem is not just related to China I believe. Even before China's entry in 2001 there were already issues because look how long it took to conclude the Uruguay Round. It took about 10 years to conclude these trade talks in Geneva. So we have to look into the deeper causes of what are the institutional things are just not working at the WTO.

Part of the reason I think is that about 50 years ago there were about 5 players around the table, countries that participated in the global trade arena. You had the European Union, the U.S., you had Japan, maybe Australia and Canada. It was relatively easy to strike a deal with five countries, but then you had other players that were also sitting at the table and having their demands. Those that newly entered the world trade arena, like Brazil, India, China, you know, they all wanted their say, they all wanted also to be the rules favorable for them. We know from public choice theory that to strike a deal with a much larger number of players around the table is so much more difficult, which is why it became an issue of -- concluding the talks took so long.

There are some people that say we should maybe look into a different model of trade talks altogether. We are doing now the multilateralism, but there is an alternative. People have suggested stepping stone theories, where you first build trade agreements with the largest players in the world, say the largest exporters, and then you slowly take on board other countries that are sort of less important in terms of their trade share. Is that a good alternative or not? I don't know. But I think we should ask ourselves the question, is multilateralism still viable today being the case that every

country, U.S. but also EU and other countries, are doing a lot of free trade agreements on their own. We just concluded one with Japan, we have concluded one with South Korea not so long ago. So we're all doing that. So Richard Baldwin in Geneva has called it the spaghetti bowl of agreements. So basically the multilateralism has been under stress for a much longer time. It's not just the fault of China. I think China is just seeing what's wrong with the rules and using it to their advantage. But I think there are deeper issues to consider.

MS. SOLIS: Thank you, Hylke. And that's a very good point, because we should not assume, as I was perhaps doing in this conversation, when you talk about tensions in the international trade system it's just the United States and China. There's a larger context and clearly WTO has in my mind some design flaws. And the fact that it's very difficult to negotiate beyond the border, regulatory matters that touch deeply now on how societies work when you're talking about 160 plus countries, and when you have a dispute settlement mechanism that does matter and therefore means that you have to abide by the rules.

But, nevertheless, I think the fact that the two largest economies are pursuing these trade tensions and then in the way eroding a confidence in the multilateral trading system is significant, particularly if we think that this is evolving into a longer-term conflict of adversaries looking at each other in that manner.

What do we know about how China is thinking about this? How is china responding to the Trump Administration's messaging? Started on trade, started on deficits, started in tariffs. Now, after the Hudson speech, you know, it's different seen all together. So how is China responding to this?

MR. ALDEN: I mean I can talk a little bit about the trade piece, which has been very interesting, because I think China's response out of the box was to retaliate equally against the United States and target their retaliation, particularly the

agricultural sector, in ways they thought would create some political pressure on President Trump to change direction. I mean that led to this scandal of the advertisements in the Des Moines paper about -- so -- but that's what all trading partners do when they retaliate. The Chinese weren't unusual there. I think that did not have the effect that they hoped for. I mean Mark has talked about how even in farm country in the United States there is a fair bit of support for the President being tough.

China's reaction to the second round of tariffs was very interesting. They did not respond in equal measure, the proportion of tariffs were much smaller, and they also sent out quite a deliberate message to U.S. companies -- we want you to stay invested in China. You know, there had been the fear that they were going to go after U.S. companies in various ways, and instead they began to send the opposite message. We want you to stay here, we want foreign investors to stay here. I think there's a lot of worry in China about investment leaving to try to escape the U.S. tariffs. So the Chinese changed direction quite interestingly in the second tranche. And they've also in every way they can put out the signal that they want to negotiate. I mean they're floating ideas all the time, you know, would this satisfy the Americans, would this satisfy the Americans.

So the Chinese do not want this fight, but it's not clear that there's any way out of it at this point. I certainly at the moment don't see one.

MS. SOLIS: Mark?

MR. WU: I think there's a debate that's playing out in Beijing over what are the Americans after. The debate that the Chinese are asking themselves is pretty much this, right, are the Americans out for economic regime change. Because if that's what the Americans are asking, that's just the first step that what they seek here is political regime change. And so there's a group that I think things if that's the case, there's no point to negotiate, we should just stand firm, and we should try to drive wedges

between the U.S. and its allies. But also, at the end of the day, China benefits from a stable rules-based system, to try to maintain that.

So I think there's that group in China and then there's another group that worries -- to use your language -- that this is the new normal. And if this is the new normal, even if China stands firm, this is going to constrain China's ability to carry out its own absolutely vital economic reform agenda, particularly in terms of containing its debt levels, but also driving movement away from investment-led to consumption-led growth models. And you can see that that group then says well, we need to negotiate because if we don't do so that's going to cripple our long-term ability to sort of stay on task with the economic agenda.

But between those two debates the point that shouldn't be lost is right now the amount of trade, even at the levels of 10 percent, even if this antes up to 25 percent, even if this third tranche comes on board, the Chinese economy is not quite as dependent on exports, and particularly on the U.S. market, as it once was. So it can stomach this in the near-term, but the bigger question is what is the U.S. out after and what impact is this going to have on China's own reform agenda and its ability to carry through on what it needs to keep its economy charging again.

MS. SOLIS: Thank you, Mark. And I think a key question is the time horizon. As you said, if this is perceived as a short-term, before the midterms for maximum political message, is one thing. If you think that the tariffs are now going to be in place for the long-term, then you start talking about changes to the supply chain. And the question is, does this mean that these companies will come back to the United States or will they just relocate somewhere else in Southeast Asia and the goal of the Trump Administration of trying to create uncertainty to bring back domestic manufacturing may be harder to achieve.



So my question to all of you -- truly I don't have the answer to this and I find it puzzling -- is why if the language now is so harsh and the competition is highlighted on so many different fronts from the U.S. side, why is the stock market discounting the impact of this rising tension between these two very large actors in the system? Not that I'm wishing for the stock market to react, but I think it's puzzling that despite the fact that we keep hearing how this is going south, markets are find.

Does anybody have an idea of what's happening here?

MS. KEYNES: Well, first of all, caveat when reading the stock market. It's tea leaves. There are parallels. So first, I'm going to pivot slightly and talk about the way that there seems to be this disagreement among economists that you actually need to hit the economy with fairly severe assumptions of autarky before you start to see a macroeconomic effect of your trade war. So there's a bunch of papers out there that say if you have tariffs at a zillion percent, then you'll get this sizeable effect on growth, but these trade shocks really seem to be much more extreme than anything that is going to be put into place yet. China is a fraction of American trade. So in context to the U.S. economy, there is just the simple point that Chinese trade is not that large. The kind of counterpoint to that is to say well, so far if this stays as a tariff war, if this stays as a kind of conventional war of tit for tat tariffs, then maybe the downside isn't so bad in the long run.

The big uncertainty is whether things start to become more dangerous and whether you see -- so imagine if the Chinese said we're going to restrict sales of medicines or supposing they put bans on exports of (inaudible) that go into smart phones. So the moment we're thinking in terms of conventional tariff tax war, where things become a little bit more expensive. If this changes into something where you have binary on/off switches, then I think it is possible that particularly some companies could be worse affected the markets are assuming.

MR. WU: I'll just add one thought here. I mean our stock markets are doing fine here in the U.S., in Europe, and elsewhere. In fact we're seeing new records hit. And that's precisely for the reason that Soumaya is articulating. The amount of share of the economy that's being affected is not that large yet. And what business really dislikes is uncertainty. But we shouldn't lose track of the fact that the Chinese stock market is in bear territory. And if you look at many other key emerging economies -- anyone here who is holding an index fund that's primarily pegged toward emerging economies, those are being hit by this. And that's where these shocks are playing themselves out in the supply chain.

So what we're really seeing is two different effects playing out in different parts of the world.

MS. SOLIS: Okay. A question for all of you. Is there a coalition of the willing to contain China? I say this because allies have been hit by tariffs, articulating national security risks, and they impose tariffs on metal and aluminum. There is the potential they could even be imposed on automobiles. We're talking about very high economic stakes. That creates some division.

I think that Japan and the EU are working closely with the United States in codifying new rules to address China's market distorting policies. And there's an effort that looks at industrial subsidies, state-owned enterprises. So they want to work on the rules side, but they might not necessarily buy into a tariff war, they might not necessarily buy into a war that's about containing China and not just addressing the market distorting policies. And, you know, everybody is talking about -- at least in town -- the U.S.-Mexico-Canada new trade agreement, or revised trade agreement, having these clauses that have been described as an anti-China clause, basically making it harder for Canada and Mexico to consider negotiating with China. Japan and the EU, they don't have yet an agreement with China, they're negotiating with the United States. It's conceivable that

the United States will tell them hands off on trade negotiations with China. Are they going to say yes given that they're being hit by tariffs, given that they may not want these larger geopolitical struggles, given that they may want to protect the autonomy in the trade policy?

MS. KEYNES: So I think the tariffs are very much part of this trilateral initiative. So the European Union and the Japanese governments would never say that they support the policy of tariffs, but the European Union and Japan have wanted changes in the rules to address their issues with China for a while. The problem is that there's been nothing to get the Chinese to the table. The tariffs are the thing that gets them to the table. So while they might not endorse that policy themselves, they are a helpful instrument in making that plan get any results.

MS. SOLIS: When it's a three on one vis a vis China, right. But when it's the metal and aluminum and they're being hit for automobiles --

MS. KEYNES: Sure, but so far we've seen -- it's been impressive the level of compartmentalization of those issues. I think so far essentially the EU and Japan have managed to separate those things out. I don't think it's been helpful, but I don't think it has interfered at a practical level. I think if there were to be tariffs on autos, then that could change. That would be a blow of a different order of magnitude, but I think so far it has been an irritant rather than a block.

MS. SOLIS: Very good. Other views on how allies are looking at the U.S.-China trade war?

MR. NAKAYAMA: Well, I guess so far Japanese government has dealt with the Trump pressure quite effectively. In terms of tariffs on cars, we've sort of managed to marginalize the issue for now. And also, since we're a direct neighbor to China, I think the threat perception -- not just in terms of trade and economy, but in terms of security -- the threat perception is larger than other countries.

So when Vice President Mike Pence reacted in a very tough manner last week, there was a sense of welcome in Japan. And, yes, whether the tools that Mr. Trump is utilizing, is that effective or not -- we're not sure, but there is a sense that at least now in the White House you see a tough President who is trying to sort of deal with China in a very serious way, in a very different way as the other leaders used to.

So it's a very ambivalent sort of feeling, but there is a certain sector, especially in the security and diplomatic community, that is quite comfortable, although there are worries about the coming issues on tariffs and the bilateral negotiations on trade.

MR. ALDEN: Quite quickly on Canada and Mexico, which I've been following pretty closely. I think the right language to use would not be a coalition of the willing, but a coalition of the unwilling. I mean I think Canada and Mexico came to feel that they had no choice but to do a deal with the United States. They send upwards of 75 percent of their exports to the U.S. I think they would prefer not to have to choose, to try to be able to maintain a broader network of trade relationships, including with China, but if the United States is going to force them to choose, and increasingly it looks like that's the case, then their choice is a pretty obvious one.

MR. WU: I just had one thought here. I think the three sides in the trilateral share a common diagnosis of the problem, but a disagreement as to how that problem should be addressed.

But to go back to Hylke's point, I think it's important to realize that diagnosis is a problem shared by the trilateral, not necessarily shared by the rest of the world. And so I think on the U.S. there's a sense over this very realist recognition that that's the case, so why bother to work through the WTO when you know that this is going to be held up hostage over a time horizon. And I think Japan and EU have both been much more committed towards a rules-based, procedure based mechanism towards

resolving that. And that I think is at the crux of the disagreement. And we'll see how far they're able to bridge those differences over the coming months as the trilateral continues to work on this issue.

MS. KEYNES: And the point is that you can agree new rules between these three countries, but there's a massive inconsistency between that policy and undermining of dispute settlement in the WTO. So what's the point of agreeing to new rules if you have also gutted your system of enforcing them?

MS. SOLIS: Well, then also the national security tariffs, that at the discretion of the U.S. government you could impose tariffs and you can negotiate rules on a trade agreement, but the Trump Administration retains the discretion to bring up new cases and the tariffs can go up regardless of the deal that was struck with these different partners.

And related to this, the European Union reached a cease-fire -- that's how it's called with the people who follow trade -- with the Trump Administration in July to avoid precisely this dynamic of tariffs and counter tariffs and so forth. Japan also recently agreed to launch the TAG, trade agreements on goods, although the American side likes to call this a full blown trade agreement. So there's an important discrepancy there.

I wonder if Hylke and Toshi and others could tell us about what are the prospects for those negotiations? Are there going to be big negotiations because of the sizes of the economies involved? Because if there is going to be pushback against this watering down of dispute settlement or using export quotas that violate WTO rules -- all these things that are now being weaved into this template of trade agreements -- it might be up to the Europeans and the Japanese because they are larger players. Are they up to the task? Are they going to say no to these things? Or do you think that because they don't want to have that friction with the United States they will make concessions? How are things looking up for these negotiations from your point of view?

MR. NAKAYAMA: Well, before this agreement in TAG, Japanese government was seen as engaged in sort of a delaying tactic because we wanted the U.S. to return to TPP. And the Japanese government is pretty good at sort of delaying things. So that's what we were seen as doing. But now that we're engaged with U.S. -- however you want to term it -- on some sort of trade deals, we do not want it to be a very sort of complex -- and shown as a friction, a difference between the U.S. I would imagine that both governments would want to sort of finish up in a quick manner.

Japan can open up its agriculture market at a TPP standard, would sort of emphasize creating jobs within the U.S. That kind of agreement. And then sort of focus more on the security side, preparing for China's rise. I think that's what the Japanese government intended to do.

And in a much more longer-term, I think we're interested in providing a sort of like re-entry pod where U.S. can come back in the TPP hopefully. But the difficult thing is that if we sort of agree on TAG with the U.S., it would sort of deemphasize the TPP. So that's the dilemma for us. That dilemma is going to remain I think.

MS. SOLIS: Yes. Especially from what I hear in Tokyo is that people are thinking let's wrap the negotiations with the United States quickly. And that's why they insist that the scope is limited, it's a trade agreement on goods, it's a tariff discussion, because they don't want to have a protracted conversation that stands between the two countries, and they want to move past that so they can focus on areas where there is more common views. Certainly, the trilateral effort that we've been discussing on rules and certainly the security agenda.

But, you know, there are issues like currency manipulation that the United States may put on the table. These clauses that try to discourage countries to negotiate with non market economies. Japan is negotiating with China as part of the original comprehensive economic partnership, as part of the trilateral South Korea-China.

And in general, I would imagine that larger countries don't want to be told with who they can negotiate, even if they share the diagnosis on China, it would strike me as a major concession to agree to something like that.

So I think that those are the intentions. Whether it actually plays out, I think that the U.S. and Japan have a history of very protracted negotiations. And I agree with you that the Japanese are very good at deflecting. But it's a very different geopolitical context again, because of the rise of China.

Hylke, how does the negotiations with the United States and the EU look from your point of view?

MS. VANDENBUSSCHE: Well, I keep maybe insisting the point that I believe size matters, size matters for your bargaining position. Some of my own research has shown that you will never trigger a trade war with a country that's bigger than you. Meaning where you know that retaliation can hurt you, which is why the EU has not moved I think. Because it's just simply too small vis a vis the U.S. and too small vis a vis China to make that point.

You were asking earlier about the coalition of the willing. I think in a wider coalition -- and again we don't know what's going to happen, but I think this could be the outcome, that the EU is turning to its old allies, because I do believe that the European Union considers the U.S. despite the Trump regime, so to speak, to still be an old ally, and I do think they want better outcomes than currently today, but they're just not in a position to bargain as much. Because if we look at, for example, German trade to China, Germany is exporting six percent to China, but it's importing ten percent from China. And then vis a vis the U.S., about 10 percent of German exports are going to the U.S. and about 4 percent are coming back. So the U.S. is a very important export market for the European Union, China is a very important sourcing country. So that puts you in a situation somewhat in the middle of the bed I would say. Like I said earlier, the U.S., a

different situation. There the numbers are much more in disequilibrium and they are in position to start a trade war. If you are then looking for a coalition, I think it is easier to go with the coalition for the EU than to sort of take the lead in a coalition of your own.

So I'm kind of hopeful that what we are seeing today is not going to result in a cold war with China. I think it's going to be leverage, leverage to try and ensure that the level playing field is restored. And I'm pretty sure that once that occurs, chances are - - because there a lot of benefits that we have from China entering the global trade arena as well. I think we should point that out too. It's not all bad news. I mean we have a lot of cheap consumer goods now, especially for people with low income, they have access to goods they never had before. China is a big potential export market for our firms as well. So we want Chin to some extent to be part of that world order. It's just we wanted also to play by a good set of rules. And maybe it's their history, maybe it's path dependent. They come from a communist background, but that's been lingering on for the past 20 years. It's time that -- as was mentioned earlier -- they grow up and become more like we and play according to a set of rules that we think are the right set of rules. And that once they do I'm quite hopeful that much of this will pass. Hopefully. Because as you said, for global value chains, this is what we want to happen.

MS. SOLIS: Soumaya.

MS. KEYNES: I'd just like to remind everyone that T-TIP wasn't the most popular thing that the EU ever did. And just supposing there's some kind of negotiation, just to think about the process of getting that passed and to think about how easy it would be for a European politician to stand up and say I'm taking a stand against Donald Trump.

MS. SOLIS: And with all of those elements on the table, how will these play in WTO reform? I think it has been striking that in the last few months we have now much more focused energy on really changing the way in which the WTO is working,



because I think that there is a very widely shared perception that it started with a stalled negotiation process, but now it has moved to also a crisis in the dispute settlement mechanism. And the United States has felt that the appellate board has overreached and therefore it's blocking new appointments. And I think that we have now reached the level where barely the appellate board will continue to function, and it may not in the near future.

Now, there are different proposals out there and there are different countries involved in the conversation. The European Union has released a blueprint; Japan, the EU, and the United States are now talking about WTO reform. Canada I think also had a paper and is convening some countries. And the question I think is what do you change and who should be leading the effort? Is this a conversation where China's part of changing the rules, or would that be difficult and therefore you have other countries draft rules and then see China accept those rules? How do we think realistically about a new WTO? Who is going to deliver it and what will it look like?

MS. KEYNES: I think there's a distinction between how the rules are written and then how they are enforced. And so the dispute settlement body is -- so I guess one way to think about it could be to think about this philosophical difference in a way the Europeans think about law and Americans think about law. And I'm going to allow Mark to correct any hideous mischaracterizations. But the American way of thinking about it, it is much more contractual, so you can enforce whatever we signed up to and no more than that. Whereas the European style is much happier to interpret the intent when the people wrote the law. And that, if you're an American, you start to think that the way that the decisions have been enforced is this European style way of thinking that essentially is imposing obligations on that.

All of the proposals that have been released so far, they're a mixture of procedural fixes -- there are some issues that you can change if you want to. I haven't

seen a fix to this disagreement about rights and obligations and this idea that the dispute settlement body is imposing new rights and obligations on America, because of course when you lose a dispute you're annoyed, right. So what is rule relative to what you signed up to is in the eye of the beholder. And so I don't see that there exists a procedural fix to that, which is worrying if you want a long-time dispute settlement with the Americans involved.

MS. SOLIS: And if I understand correctly, Soumaya, the United States wins far more than it loses, right? The record is --

MS. KEYNES: So in the WTO, when you take a case against someone else, you tend to win. The U.S. has lost a particular subset of cases on something called zeroing. It's very painful to quite a few people working in trade policy. I'm going to let Mark add some more to that.

MR. WU: I think when it comes to WTO reform we're still in very, very early stages. And I think there's the appellate body issue, but really this is an issue about how you enforce the rules. And particularly, the thing that's important to remember about WTO law, this is not a normal court where if someone causes you this amount of damage you go to the court, you recoup that. This is a court where you go and basically if they apologize, then we call it a day and they stop doing it. But only when they don't stop doing it are you allowed to take action. And I think that really limits the amount of what you can do vis a vis a trading partner that you believe is acting unfairly. And so that resorts to these other types of unilateral measures involving tariffs, traditionally done through trade remedies. So countervailing duties to anti-dumping duties, for the trade (inaudible) here, that you use on this. But I think the U.S. is concerned that particularly vis a vis China, based on the history of dispute settlement, this is going to get pared back. And so we have two live cases right now that the Chinese are bringing against the

Europeans and the Americans about how they use these tools against Chinese exports into those markets.

So I think that's one of the issues. But we shouldn't lose track of the fact that there are two other ones. One is there's a whole bunch of developing countries that felt like there was a negotiation agenda that was set out in 2001 that people haven't delivered on. So until you deliver on that, we're going to block everything. What's in it for us? It's not just you big powers trying to sort of rebuild up the rules and all that.

And then the last thing that I'll point out is even if you could get these first two pieces worked out -- so even if you could get the Americans and Europeans to somehow bridge the difference that Soumaya just discussed, even if you could address some of these development issues, at the end of the day you have to put yourself in the shoes of the Chinese. And the Chinese are going to say really, are we really talking about the 19th century where the Americans, the Japanese, and the Europeans are going to come into Beijing and tell us what to do? So put yourself in that domestic political situation.

And so I think unless all sides rally ramp it up, I really don't see WTO reform carrying itself out, at least in the next two or three years. But the process of discussion right now -- certainly in every crisis there's an opportunity -- the process of discussion deliberation I think is much more active these days in Geneva that it has been in the last five years. And that's something to be welcomed.

MS. SOLIS: Thank you. Ted?

MR. ALDEN: Just quickly. It won't be a popular opinion, but in March when President Trump announced the steel and aluminum tariffs, I wrote that that was the day the WTO died. I think I was right. I think the WTO is dead. I think it's going to be very hard to revive it. Doesn't mean trade rules are gone, but I think binding dispute

settlement as it was envisioned when the WTO was created was essentially a utopian notion, and I think it's over.

MS. SOLIS: Well, that made my heart stop (laughter), because then we're transitioning to market power rules kind of a scenario.

So then it's the plurilaterals within the WTO? Again, we talk about coalitions of the willing, likeminded countries, a subset of countries within the WTO our outside the WTO that carry today. At the same time that we see countries now resort to tariffs to try to bring about change in others. And with this escalation of tariffs and counter tariffs, it can be a bumpy ride.

Which, last point, if the United States is taking this very different role, if China might not be interested in genuine reform, there's a lot of attention now on what other countries do -- I mean Japan and the European Union in particular -- with these mega trade agreements. I mean big, big surprise was that Japan rescued the comprehensive and progressive TPP and that Japan and the EU managed to deliver a trade deal that covers a third of the world.

Are they really going to carry the torch of trade liberalization? Do we see that leadership potential? Or are they significant obstacles along the way?

And after that I'll bring the audience up for Q&A.

MR. NAKAYAMA: I think it's going to be extremely difficult without the U.S. Japan sort of took the driver's seat on the CBTPP and it was welcomed. It was sort of a surprise for us because we're not really used to sort of taking leadership. And we would continue the EPA with the EU as another. Not just there, there's JCPOA, Paris Accord -- you know, many multilateral forums that Japan is doubling down. Because it's important for us and we think it's important for the world.

But that is premised on the U.S. coming back at some point. We don't think we can carry the burden alone, even with the U.S. So somehow we're trying at

least to maybe -- it would be difficult in a short-term, but in a mid-term our sort of thinking is that U.S. has to return. And without it, it's going to be extremely difficult and very bad times for the multilateral institutions and corporations.

MS. SOLIS: Other comments on this? On who carries the torch?

MS. KEYNES: I think the difference -- you know, there are certain policies of the Trump Administration that will probably expire with his presidency and one of those is his willingness to alienate allies and to rip up the diplomatic playbook. The tension between the U.S. and China is unlikely to expire, but the idea that we're going to have an American president in the future who is going to see the value of these partnerships, I think that will happen.

MS. SOLIS: Great. All right. So you have been very, very patient and it's time to then take your questions. Please wait for the microphone, identify yourself, and a very concrete question so that we have time to entertain many.

I see two gentlemen here. I'll take two questions at a time. And then the gentleman behind him.

QUESTIONER: Thank you. This is for all of the panelists, anyone who cares to answer. In view of the Pence speech and broader tensions, the recent claims of election interference, on tensions in South China Sea, concerns about human rights in Western China, the larger geostrategic implications, do any of the panelists see the Trump Administration perhaps moving beyond just tariffs and into a broader sanctions regime, similar to that on Russia or Iran? And I think there is legislation pending in Congress to that effect.

Thank you.

MS. SOLIS: Thank you. Should we take one more or do you want to answer that?

Okay, we'll go to the gentleman behind you and then we'll --

MR. PARRY: Thank you. My name is Matthew Parry; I'm in the European Parliament Liaison Office here in DC. One day, presumably, the Trump Administration will no longer be there, be in power, and it's easy to see the many ways in which they could do lasting damage to the global trade order. But I wondered if the panel thought they could in some way leave something positive, have some sort of positive effect on the global trade order. I think of the political legitimacy of trade, I think of enforceable labor and environmental standards and trade agreements, ISTS, for example.

MS. SOLIS: All right. Some positive legacies in trade from the Trump Administration, or perhaps a broader set of sanctions vis a vis China. Any comments on that?

MR. ALDEN: I mean I can take the second one if you want.

MS. SOLIS: Mm-hmm.

MR. ALDEN: I mean I do think there could be some positive legacy. There has been a serious breakdown in any bipartisan support for trade, and it's been years and years in the making. And to me the most interesting things about the new USMCA agreement is that almost all of the initiatives are aimed at the complaints we've heard from organized labor, the democratic left, investor-state dispute settlement, the weakening of that, the rules of origin aimed very much at domestic manufacturing workers, the provisions on currency manipulation, again, organized labor has pushed those very strongly. So I think there could be some elements there that will help rebuild some domestic consensus.

I think the other potentially good point is these conversations on China needed to take place. We were in a holding pattern that wasn't going to stay held for very long. And I have criticisms about the tactics, but I think the conversation about how the U.S. and China are going to get along economically is a long overdue one that wasn't

being conducted all that effectively. And so this has definitely shaken the tree. Jack Ma of Alibaba said this is going to be a 20 year negotiation, and I think it needed to start in a serious way.

So those potentially could both be positive outcomes I think from this.

We'll cross out fingers.

MS. SOLIS: Hylke?

MS. VANDENBUSSCHE: I'm very much with Mr. Alden. I think the path we were on was not a sustainable one. There was going to come a clash at some point. And maybe this is the language that China understands. I don't know. The Chinese economy works in very different ways than in democratic societies. There the leader is really the leader. And, you know, if a leader that's tougher and stronger than you tells you something to do, maybe that goes down better in their society than it would go in truly democratic societies, where you do not accept too much interference from the outside. That's one observation.

The second observation is maybe what we are observing is also some cultural shift -- and this is maybe an opinion that's a bit adverse or not maybe shared by all -- but at least when I look in Europe, in the younger generation there's clearly a cultural shift going on. People have explored the world, the curiosity is somewhat down. So people are valuing much more now than before the local world they live in, the local sourcing patters. It's there slowly, but some signs are it's just suggesting that people are a bit fed up with globalization, meaning that globalization to them has brought some good things, but also some bad things. So there seems to be some culture shift going on, which personally I think is a dangerous thing, because we should not forget all the good things that globalization has brought us.

But when I think of cultural shift, it's also having to do with evolution of societies. You can only think about the higher values, the intangible values when all your

material values have been satisfied. It's okay to care about softer values in life, as long as your material values have been satisfied -- you have a job, you have all the consumption goods in the world at a price that you can afford, you've discovered and traveled the world, there's nothing more to discover. Well, then you sort of retreat and say well, it's not so bad at home after all. So maybe that's the state where the younger generation tends to go toward, but I think what they should not forget is all the wealth and the growth we've seen today is thanks to the global value chains and thanks to globalization.

So to leave that and to say oh, let's just go for a world order in which every country will become more autarchic and every country can to protectionist policies at the favorism of their producers, I think would be the wrong way to go about, but I think that is a path that is in some people's mind at least. At least in Europe -- I can't speak for the U.S.

But that is something I think we should realize ourselves.

MS. SOLIS: Very interesting. Toshi?

MR. NAKAYAMA: I'm not addressing the question itself, but it has to do with the cultural aspect of things. You know, we've been talking about trade and of course, quite naturally, in terms of economy. But I think at the heart of it, this is an identity issue. When people think about trade, especially in like Youngstown, Ohio, the jobs are going abroad, their community is sort of collapsing, jobs are being lost, their sons and daughters are not coming back, their community, their comfortable space is eroding. So at the heart of it, it's an identity issue more than a trade issue to a certain degree.

So there would be a competition of these two totally different cultures. You know, one sort of aspiring force, sort of more global community, but then again this



economic nationalism based on identity is I think quite strong and I don't think we should sort of underestimate the strength of these identity oriented sort of political issues.

MS. SOLIS: Just to add to this. Sorry, Mark, but I can't help myself. The question I think is, is globalization rejected or taken for granted. Because a lot of these youngsters who may be thinking well, local sourcing is best, but everybody, all of us, are carrying our iPhone and we would not want to pay three or four times more for that gadget. So it would also be that we just don't see how embedded we are in this. And, you know, it worries me a little bit that we might not realize the profound costs of protectionism as well. In terms of jobs lost, there have been a number of studies that estimate if partners retaliate, say if the auto issue explodes and there is a counter retaliation, there are going to be a lot of jobs lost in this country as well.

And these inward looking policies I think that one of the things that really drove the desire to create a rules-based system was to try to diminish state friction. And I don't think we should look sight of that. So that inward looking, economic nationalism I agree is powerful but also worries me tremendously.

Sorry. Mark, you had a comment?

MR. WU: I was going to try to attempt to answer the first question.

MS. SOLIS: Thank you.

MR. WU: So I think with anything there's always a chance this war could get worse. But your question is could it bleed over into the non economic realm, and I think that possibility exists. So far all sides have been very cautious to do so, but what might trigger it was one of the questions that you asked, basically if we see some of the cooperation in the other non economic, but particularly security elements deteriorate. Then I think we'll start to see the issue linkages play themselves out, the Korean Peninsula, nuclear proliferation, and the like -- along those lines.

On the second question, one last thought that I wanted to add here is obviously the rosy optimistic version would be to say we all stepped to the brink, but then we all realized what's at stake before we collectively jump. And we might hope that that's the case, but these are complicated political economies. And I think there's a sense well, it's not really a cliff, let's walk down a little bit. (Laughter) Of course the other side, let's give them a little shove to see what's at stake.

The one thing that I think we should all keep in mind is there is a generation of Chinese that have grown up that did not experience the cultural revolution for whom they've taken globalization for granted.

And I think how this crisis plays out will affect their view of what type of stakeholder they want to be in the global system. And so I think that will be as critical towards determining the shape of 21st century global governance, their attitudes. And I think their attitudes are going to be shaped by this trade war that I expect will carry itself out for several years. This will be the defining moment where they think about what's China's relationship to the world.

MS. SOLIS: We have time for two more questions. These two gentlemen in the front and then in the middle.

QUESTIONER: Hello, my name is Max Pone. I'm a student at the George Washington University. I'm curious if you could comment on emerging markets and how the emerging markets play into this trade war and global trend and any vacuum that might be left from less U.S. trade globally, particularly regarding the BRICS, because we saw the BRICS summit this past year that they were very much staunch defenders of international trade and whatnot. So I'm curious if you could just comment on that.

Thank you.

MS. SOLIS: And one more question in the back.

QUESTIONER: Stanley Cober. Recently Christine Lagarde said at the IMF meeting, "If the current trade disputes were to escalate further they could deliver a shock to a broader range of emerging and developing economies". What is the danger of that precipitating another global recession?

MS. SOLIS: We're ending with all the positive notes. Answers from the panelists?

MS. KEYNES: On the first one I just had this memory of being in Buenos Aires for the last WTO ministerial meeting and hearing every leader in the world fall over themselves to name themselves as the new champion of free trade, and don't worry, they were going to step into the void, and it was all going to be fine.

And there was a bit of a gap between the rhetoric in some cases and then what does it mean to be a leader in the global trading system. It means to be putting in a bit more than you're getting out, it means kind of making compromises for the good of the system. And I think in practical terms, looking at statements, I think people are still thinking of their own national interests.

MS. SOLIS: Mark?

MR. WU: So I'll name two, to just get the conversation added. I'm sure these aren't the only two. For the near-term, I think for some emerging economies it's really a capital flow issue, particularly if they have large amounts of dollar denominated or foreign exchange denominated, euro denominated debt, but particularly dollar denominate debt.

So I think we would expect the dollar to strengthen with trade tensions. And as that happens and you see some emerging economies' currencies collapse because their current account position isn't quite sustainable for the currency levels, that's one danger. So there's a danger that what happened in Turkey could filter over into other

areas, and we've already started seeing some warning signs with Argentina, South Africa, and the like.

The second danger of course is much more a slow motion type, but really if you're talking about lots of uncertainty, underinvestment in light of the uncertainty, over what this means for supply chains, demand is going to go down. And if you're a supplier to the upstream parts of that supply chain, demand-wise this is going to deliver a shock, particularly for the commodity driven types of export growth markets, but also for countries looking to embed themselves into supply chains if these supply chains aren't expanding and aren't investing.

But that said, I think there are some countries that are well positioned possibly to benefit from this. So Vietnam, Cambodia, and others are certainly taking an aggressive stance to try to take advantage of the trade tensions, to try to reconfigure supply chains. So it really depends on the particular unique situation of each emerging market.

MS. SOLIS: Thank you so much. This has been a very rich, illuminating discussion. I want to thank all the panelists for sharing their expertise. Thank you all for your questions and for joining us today.

Thanks.

(Applause)

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Expires: November 30, 2020