

## Unedited Event Transcript

### Release of US Trade Policy Options in the Pacific Basin: Bigger Is Better

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PIIE Webcast, Washington, DC  
February 16, 2017

Adam Posen: Welcome back to the Peterson Institute for International Economics. I'm Adam Posen, the Institute's president. And it's my pleasure today to host the release of our new policy brief by senior fellow, Jeffrey Schott, "US Trade Policy Options in the Pacific Basin: Bigger Is Better."

If I could come up with one line that I would hope would appeal to the new administration about trade, bigger is better is a good one. So thank you, Jeff. More seriously, it is great that Jeff's study has already received some coverage and noticed and that we have such a strong turnout today not only in numbers but obviously in quality today.

We're grateful to the Korea Institute for International Economic Policy, a think tank and foundation in Korea which we have worked with recurrently through the years and have done joint work both in recent years on macro, but especially on trade. And our friend, [inaudible 0:00:58] is with us here today and many other representatives for their support of this.

I want to before introducing our speakers and letting them present to say a couple of words about the context. So obviously in some sense, this policy brief and much of the discussion many of the people in this room are engaged with is about what next for TPP? What instead of TPP? And there will be those on the left, on the right. There are post-fact people with regard to trade in both parties who will try to say, well, TPP was a terrible idea. And then for some reason, Peterson and other people just won't let it go.

And what I want to say is, no, we're willing to let go any particular trade deal. We're willing to let go any particular initiative at a given time. What we're not willing to let go is the basic interest of the US in remaining economically engaged in Asia, in being part of the leadership with the world economy in setting the rules, and in having an alternative to either

lack of integration or integration that exquisitely shuts out the US and is of low quality and has bad rules.

And what we're not willing to let go are the fundamental arguments for about trade deals. And so occasionally I'll hear the joking response, oh there's never been a trade deal you haven't liked. Well, we've liked some more and some less. But the reason there's never been a trade deal we haven't liked, so to speak, is because trade deals generally are good.

And so I took the liberty of also distributing today my introduction from our TPP volume from last year. Trade deals aren't for what you think they are for because the point of a trade deal isn't just about market access. It isn't just about making sure steel industry employees have jobs. The point of a trade deal is ultimately to have resources go to their most productive issues to enable technological change and innovation to put competitive pressures on your own economy and companies so they are as good as they can be and thereby increase the incomes of your country. And that applies as much to the US as it does to any emerging market.

And so in that context that's why we're still here and still at it on whether it's TPP or other deals. And yes, some deals are better or worse and no deal is perfect. But the basic idea that making them forward with trade deals particularly with emerging Asia and Latin America which our friend, Jason Furman, now our colleague and others in the Obama administration I think rightly pursued is valid.

So let me turn to the specifics of today's program. I'm delighted. We have two excellent discussants to follow on Jeff's presentation. But of course, we're going to start out with a presentation by Jeffrey Schott who's been a senior fellow here at the Institute longer than I have, in fact, much longer than I have. But he still has more hair.

And Jeff is, of course, our expert on the details of trade deals and trade negotiations and especially FTAs and regional pacts. He with Cathleen Cimino-Isaacs had led our work on TPP that we published over the last couple of years and, of course, as part of our broader team working on these issues; Gary Hufbauer, Chad Bown, Caroline Freund, Marcus Noland, many others.

Jeff, in particular, has been one of our experts on trade relations with Korea and the Korean economy, which of course provides a way in to thinking about the broad strategic issue of how inclusive versus how bilateral the US strategy should be in trade deals.

We're going to follow that with some remarks by Dr. Il SaKong. For those of us in the international economics biz, SaKong is a legend not just in

Korea. He is, of course, chairman and CEO of the Institute for Global Economics. But he has previously served as a minister of finance, senior secretary to the president for economic affairs, and chairman of the G20 Summit Coordination Committee in his native Korea.

He has been, in the sense, the eminent person overseeing Korea's continued interactions at an intellectual and policy coordination level with the rest of the world and led Korea's efforts in the G20. He's an old friend of the institute. He and Fred Bergsten, of course, collaborated directly on some G20 and APEC measures through the years. And we're delighted to welcome him back to the Institute on this occasion, which leads to, of course, our third speaker today, my predecessor and the co-founder of the Peterson Institute, Dr. C. Fred Bergsten.

Importantly for today, I think the thing to remember is that he was chairman of the Eminent Persons Group of the Asia Pacific Economic Cooperation forum from 1993 to 1995, has continued to set forth a vision for free trade in the Asia Pacific and Americas, and is very much a trade strategist. And in many ways, I think some of Fred's most important contributions have been in that area including his creation of the idea of competitive liberalization as a practical policy strategy. And that of course raises interesting questions about the arguments both that Jeff will make today and that our new administration seems to be taking on trade policy.

So thank you all for joining us. This should be a fascinating discussion. Jeff, the floor is yours.

Jeffrey J. Schott:

Thank you very much, Adam. And I also want to start by thanking my colleague, Cathleen Cimino-Isaacs. She's been an integral part of our trade team for the past couple of years and central to all the work that we have done on Asia Pacific economic integration, co-author and co-editor of our assessment of the Trans-Pacific Partnership and a very big supporter and helped me on this work on this policy brief. So Cathleen, thank you very much.

Last year, I was on this podium several times talking about the Trans-Pacific Partnership, assessing the value of the TPP for the United States and its partners. And as Adam said, our assessment was not uncritical. It noted both the highlights and the defects of the pact and ways that it could be fixed or improved. But the overwhelming conclusion was that advancing US trade ties with the Pacific basin served both our economic and strategic interests. And we made that case very forcefully. And it was not adopted by any of the major candidates of political parties in the presidential election but especially by Donald Trump.

And so, it was not surprising when Mr. Trump took office on January 28th that soon after he formally asked the United States trade representative to withdraw from the Trans-Pacific Partnership. And the objections to the TPP were widely stated and perhaps somewhat misunderstood. He argued that the TPP was typical of bad trade deals, maybe not the worst possible trade deal. That was NAFTA. But actually TPP was NAFTA on steroids according some critics. But the real concern was mounting trade deficits and a devastated manufacturing base in the United States.

Members of the administration also argued that the United States paid much too much for the TPP in terms of trade concessions and got too little from other countries. There were loopholes and various rules including rules of origin that gave China and other countries a free ride. And that enforcement provisions were too weak. And instead, the strategy was to negotiate bilateral deals and use the muscle of the US market to pry more concessions from our trading partners. What I would be arguing today is that both the TPP critique is flawed and the bilateral strategy to replace it is doomed to failure that the strategy just is not positioned to bear fruit.

So looking at that, I conclude that the rational alternative is to revisit the regional initiative, not necessarily pick off where the Obama administration left off, but to try to find a new, better, bigger, improved deal that serves the interest of the United States in both economic and strategic terms.

That's a position that actually has been strongly supported by most business and farm groups and Republican leaders in the Congress that want a regional deal that fixes some of the flaws in the TPP and improves upon the TPP, but solidifies the US engagement in the Asia Pacific region. And so what I will be proposing is to negotiate a revamped, enlarged, and probably renamed Asia Pacific pact. TPP can be improved upon. That's one of its areas that's easy to do. But reopen and restructure it into something bigger and better with more countries providing a larger payoff for US firms and workers.

Now what's wrong with Trump's view of the TPP? Essentially, he's exaggerating the impact the trade agreements have on US economic activity. But if you look at our trade balance with TPP countries with the 11 other countries, we did have an overall trade deficit of about \$176 billion in 2015 and even a larger deficit in manufacturers. 75 percent of the deficit with TPP countries was with Japan and Mexico. And so logically who was President Trump talking to right off the bat? Japan and Mexico.

But if you look at the manufacturing deficit which is even larger, about one-third of it is taken up by autos from Japan and the NAFTA countries.

And interestingly, the TPP, despite lots of negotiating on the topic, the TPP made little change in foreign access to the US market for autos. And so trying to say that the TPP exacerbated this problem or caused this type of deficit, I think, is a bit of a stretch.

The other concern was that there was an erosion of the manufacturing base in the United States. We've done a lot of work on that here. I'm not going to summarize the extensive analysis of my colleagues. But there's just one table that—one chart here that makes the point very simply.

The green line is employment. The blue line is output. Output has been going up, up, up. And it's now at near or at record levels US manufacturing output. Employment has been going down for a long time. It actually hit bottom at the depth of the recession in 2009 and just picked up a little bit after that a couple of million workers. But the US manufacturing is not in decline, but there is a decline in US manufacturing jobs. Fewer people making a record amount of goods.

The next criticism is more in my sweet spot I'd say to say that the US paid too much for the TPP and got too little from other countries. Actually, USTR is filled with lawyers who are really misers. They don't like to change anything in the United States. The Congress tells them not to change any US policies. And they're pretty obedient to their congressional masters.

So if you look at the TPP, there was very little change in the auto tariff, almost no change for a long period of time. And the 2.5 percent tariff doesn't disappear for 25 years. Protections for US dairy and sugar remained largely intact. And there was no additional coverage of government procurement contracts at the sub-federal level. So we didn't change very much.

In return, the United States got paid not once, but twice by our trading partners. We got paid for the reciprocal concessions in each other's markets. And then we got a bonus payment because essentially other countries got access to other TPP markets that they would not have been able to do in the absence of the US participation at the TPP because we were there. We broke down the barriers to the Japanese market that let Australia and New Zealand and others gain a better deal than they otherwise would have. And they paid us for that in terms of additional support for both liberalization and rule-making that was in the United States' interest. That doesn't happen in a bilateral negotiation. The dynamics of a regional deal was played to the US advantage.

So the takeaway from this is that the TPP would have yielded large US gains, substantial US gains, with few US concessions. The deal was not

going to change very much in the United States. But it would have made life a little better for US exporters and investors abroad.

Now, the next argument is on—gets deep into the weeds of trade policy. But it says that there are loopholes and China would get a free ride. It's mainly focused on autos and the very detailed rules of origin that allowed for or qualify a good to receive a TPP tariff preference. But if the tariff preference is only 2.5 percent, how much are you actually going to do to change your supply chains and to undertake the paperwork for qualifying for that 2.5 percent preference, which in the case of Japan doesn't really come into place for 15 to 25 years. It doesn't actually affect the operations of the companies very much at all in the United States. And it's been very exaggerated with regard to the import of cars into the United States.

I could go into much more detail. This is mainly a Japan-specific charge. But as we saw in the original table, Japan and Canada and Mexico supply almost all the cars from the TPP region into the United States. And Canada and Mexico already have preferences under NAFTA. So that's, I think, one of the reasons why nothing is changed in the TPP in this important barrier.

The last critique of TPP is that the enforcement provisions are too weak. And here the critique is not well defined, but the Trump administration commits to tougher enforcement using more laws particularly those that involve the unilateral discretion of the executive branch. Perhaps they are also focusing on the criticism of investor-state dispute settlement provisions. That's gotten a lot of debate in the TPP in other negotiations around the world.

Though there are some advantages for having this type of protection for investors against actions by foreign governments that amount to indirect expropriation of their property. This process also brings with it a lot of political baggage from groups concerned about the bias towards corporate over consumer interest.

And in many of the countries involved in the TPP, those countries want to do everything they can to encourage investors to come. Why would they take actions that set up a yellow or red flag for investors to come into their country? So I'll get back to this in a moment. But I think that type of issue has been overplayed in the public debate and probably isn't critical to a trade agreement.

Now, bilaterals have been put forward as an alternative. Deal with Canada and Mexico either together or separately. Deal with Korea by updating the Korea-US free trade agreement. That hasn't been the priority at the start of the administration. But it has been the subject of a lot of criticism from the

Trump trade team. And they'd focus on autos. They'd focus on steel. They focus on financial services and rice and currency provisions. And they'd want more from Korea in any negotiation like that.

Similarly, with Japan while the Japanese have expressed interest in a bilateral deal driven largely by their security concerns, but their trade offer is unlikely to be as generous as the TPP because in the TPP they were able to make concessions that Japan never made before in agriculture and other areas because they got benefits in other markets because of the United States. Japan also benefitted from the United States knocking down some doors in the Asia Pacific markets.

That's going to be harder to sustain if the US wants more from Japan and is offering less than it did in the TPP. And in fact that I think is the fundamental reason why bilateral deals are not going to work. Why would other countries want to offer more concessions in return for less when they already have good access to the US market?

The answer is the Trump administration is making threats that they will withdraw that access or rescind US commitments in existing trade pacts. How credible is that threat? That depends on how it affects US interests. And as we were finding out in the threats with regard to NAFTA, a lot of companies have been coming forward most very quietly saying, "Well, this is going to affect our supply chain. This is going to raise our costs. This is going to make it more difficult for us to maintain US employment and to maintain US competitiveness abroad."

That is a big problem. So that threat is a good one as long as the stick is kept in the closet. But if your trading partner knows that that stick can't be taken out of the closet without doing a lot of harm to your own economy, it becomes less of a negotiating leverage. And so that is a problem.

There's another bilateral that had been discussed, but more quietly and that's with Taiwan. And that's certainly something that has been on the discussion on bilateral relations for some time. But a bilateral deal between the United States and Taiwan would likely cause major ruptures in US-China relations. I think there's a recognition now in the White House that the One China policy has to be maintained. But Taiwan is a member of APEC. And so there are other options that can be pursued going forward to strengthen trade and investment ties with Taiwan.

And the final point is a very simple one. With the problem of bilaterals that has always come up in the past. And that is for each bilateral you have to go to Congress. And how many times do you want to go to Congress and put forward legislation and have it go through that mill? And I think as the White House staff gets more experience in dealing with Congress,

they'll recognize that there are nicer ways of spending your afternoons than going up on the hill and trying to get majorities in both houses in support of a trade agreement.

So the takeaway on this is better bilaterals require bigger concessions. And are we willing to go forward and make a bigger deal with our trading partners? If not if we don't want to put more US restrictions on the table, then the bilateral option is likely to fail.

So that leads me to conclude that, well, once you've gone through all of these considerations, it leads you to think. Well, regionalism isn't such a bad idea after all. And so what I would suggest for the White House in using an analogy that might be appropriate is that President Trump should take them all again and tee up a new and bigger and better Asia Pacific trade deal. It doesn't have to be the same deal, but something that would begin to fix the problems of TPP.

Improve upon them. Take care of the concerns that were addressed last year in Congress on specific provisions of the TPP that were being renegotiated in the context of White House congressional discussions. Deal with concerns about fading US competitiveness when US stays out of deals and other countries continue to develop new trade agreements that provide preferences for each other, but not for their US competitors. And to reinforce strategic interest in the Asia Pacific.

Because what we have seen already from the day that -- the day after President Trump was elected was that many countries recognizing that he was going to pull out of TPP said, "Well, we're going to have to maintain a presence in the region. We're going to have to maintain some type of regional initiative." And they're going to have to maintain and probably deepen their existing trade ties with China.

That's led a number of countries either to say we want to launch new trade agreements with China. Canada has done that and others. Some who have trade agreements want to augment those agreements that have been less comprehensive than the TPP and build a better and deeper trading relationship with China. That can't help the United States being left on the sidelines when all of these action is going forward. The Asia Pacific region is a very dynamic one and one where sitting on a standing path means you're going to fall behind.

So would Pacific basin countries agree to reopen and restructure the TPP into something bigger and better or different? Last year, the answer would have been no. There was too much concern that that type of exercise would have led to an unraveling of the basic compact and that possibly could have been the case.



But in 2017 or 2018, the baseline is quite different. The unraveling has already begun. That's the default position. You have an unraveling of the Asia Pacific trade agreement. So those countries are likely to be willing to do more to change some obligations. Add or delete others and possibly add new participants.

Doing so, I think, would mean going big. New content and new players. Such a strategy would help fix some of the flaws of the TPP. It could include adding enforceable currency provisions that were included in a side agreement, a joint declaration of macroeconomic policy officials that was signed about a month after the TPP negotiations concluded in November of 2015.

It could draw on the provisions in US law that were enacted subsequent to the TPP in this area. And interestingly under the US law, none of the TPP countries would be found to be manipulating their currencies. So it wouldn't require any change in existing policies. But it would set up a deterrent against a reversal to the types of policies that were in some evidence in Asia about a decade or so ago.

Japanese support would be very critical in this area. But again if the provisions were structured in a way that did not implicate quantitative easing policies as manipulation which the United States would insist on in any event, then I think you could find Japanese support for the addition as well.

There would be concern about revising or dropping investor-state dispute settlement. In the case of financial services, there are already special provisions for the use of that. Those could be extended more broadly or the entire process could be dropped in favor of state-to-state procedures perhaps with additional safeguard to ensure that there's effective enforcement of the obligations.

Other provisions could be incorporated in a new deal to address some of the concerns that were raised by Congress last year. Though in some of those areas, there are cross-cutting interests. And on the biologics in the pharmaceutical area, it's very difficult to see how you get to a different result than what was done in the TPP which was a compromise. But there could be some room for additional negotiation there.

One area that would be more difficult in a new agreement going big on content would be to deal with some of the areas where TPP liberalization was inadequate or only partial. And in some of those areas that was because of USTR because they were told by Congress don't touch our dairy program. Don't touch our sugar program. Don't touch procurement.

I think I said last year you reap what you sow. And in areas where the United States pulled back and demanded exceptions, we got less than we wanted on dairy and other reforms in other countries. There would have to be a decision. Do you go big and put some of the US restrictions on the table? Or do you maintain the balance that was achieved in the TPP?

If US negotiators want more liberalization in these areas, they would need to revisit US exceptions. And I think in some of those areas clearly with what the Trump administration has said about by American and government procurement what Speaker Ryan has said about dairy, I don't think there's room for many new US concessions in those areas.

The other way to go big is to provide new members. And reopening trade talks and bringing in Korea, Taiwan, Colombia, for example, would make the pie bigger and richer for all of the participants. The cumulative GDP of just those three countries is about \$2.5 trillion. And adding them would open up significant new opportunities for US firms and workers. And you may say, "Well, wait a second. We already have a trade agreement with Korea and Colombia."

But the TPP would augment that with update and expand in areas that go beyond what is in the current bilateral agreements. And indeed that's one of the benefits of going the regional approach. You can do this updating and fixing dealing with implementation problems and upgrading the existing bilateral deals to fill in the holes that were left out in the initial negotiations and do it in a broader context where some of the political frictions that would normally arise in a bilateral negotiation could be avoided.

It also provides a broader option for expanding trade ties with Taiwan in a regional context, something that we have been committed to doing in APEC for a long, long time. And this is a stepping stone in that process towards a broader free trade area of the Asia Pacific.

But perhaps most important, US withdrawal from the TPP had opened the door for China to assert a more pronounced leadership role in the region via new or expanded trade ties with TPP countries and through acceleration of the negotiations of the Regional Comprehensive Economic Partnership or RCEP, a negotiation in which 7 of the 12 TPP countries currently participate. This would help restore US economic engagement in the Asia Pacific and strengthen US strategic alliances at a time where the strategic importance of US participation and engagement particularly in northeast Asia cannot be underestimated.

So in conclusion, some may say that I have rose-colored glasses about TPP. I'm not talking about TPP. I'm talking about something bigger and

better. But if you think about it like Wagner's music, the TPP isn't as bad as it sounds, but you got to think about it. And it is much better than it has been described by the Trump administration.

So what can be done is to take the opportunity to deal with our important trading partners to put together a deal, a broader deal. Rename it. We can have a contest here at the Institute on what would be a better name than what exists already. Certainly expand the value of the original deal. Achieve greater regional integration. And expend less political capital, US political capital, than on a country-by-country bilateral approach.

It would allow us to fix some of the flaws that had held up support for the Asia Pacific deal in the Congress last year. It would allow us to add new obligations on currency manipulation among others. And importantly, a new mega-regional deal would reinforce US strategic leadership in the Asia Pacific region at a most critical time. Thank you very much.

Il SaKong:

Good afternoon, ladies and gentlemen. Thank you very much, Adam, for a very kind introduction. It is always so delightful to be back to PIIE which is really my home base in Washington. Particularly today, I'm sharing this podium with my long-time friends, Fred Bergsten and Jeffrey Schott. I'm so glad to see you all here this afternoon.

As you've just heard, actually, I was passing through the Washington. So I was lucky enough to be here and to get invited to this luncheon. So I'm very thankful for inviting me to this luncheon. As you just heard from Jeff's presentation, as always typical of him, it's a very, very comprehensive, but very, very detailed analysis of what he recommends based on very persuasive logical presentations. So given his very detailed presentation and very limited time, what I would like to do is I'll just make a couple of general comments and then a few comments on some specific Jeff's suggestions.

Again as you just heard, Jeff's main point is that the revisiting TPP or expanded and modified TPP is desirable for the interest of the United States. I'm sure you're all with me. But I must say that I just cannot disagree anymore on this point. In fact, resuscitating the TPP is not only good for the United States, but also Asia and the rest of the world. So, it is really not very good idea for the United States both economically and strategically withdrawing from the TPP.

On economic front, as Jeff already alluded to according to ADB, already and about 60 percent of global growth comes from Asia. And it will reach almost 70 percent from 2014 to 2015. So the Asian economic dynamism will be continued. So I don't see why US want to miss the opportunity there.

On the geopolitical and strategic front, again given the geopolitical situation in Asia especially in East Asia, I don't think the US want to leave the vacuum for their leadership and its influence there. What I mean by the current geopolitical situation in Asia is to include the potential rivalry between China and Japan and the ongoing North Korea and Korean Peninsula issue and, in addition, a newly rising India and its influence in the region. So the region needs a balancer particularly the leadership exerted by the United States to keep the regional level of geopolitical stability, which is essential for the continued dynamism of the East Asian economy.

So without very active US engagement in Asia, of course, the Chinese that regional influence and dominance will grow very, very fast. And it will try to fill the gap of vacuum left by the US leadership, which is not necessarily always bad, but given Xi Jinping's achieving—the national goal of achieving Chinese dream which is a far cry from Deng Xiaoping's let's keep low profile and wait until we get stronger.

China already, as you know very well, became very, very assertive in the global forums, climate change, and many other economic ideas. China has been very, very assertive and actually a very active participant in the multilateral forum. Even more so in the region and some countries in the region read about the US leadership vacuum there because with the national goal of achieving Chinese dream, which is all Chinese people's aspiration getting the old glory back to mean that to get the Sinocentric middle kingdom sort of world order, of course, in more than diversion. In some of the areas and some views, there are some tendencies of this showing already.

If you talk to Korean policymakers or some business, the people engaged in activities in China may complain that they run some problems because of some of the security issues particularly for defending South Korea from North Korean missile attack and nuclear attack and so forth. So again for this strategic balancing fact again, we need US presence there, which would not only help the region, but the rest of the world. As I said, the Asia will be the source of global growth, 70 percent of global growth. Nobody wanted to disturb that in the coming decades.

So what is needed is the continued US presence and its conscious effort to cooperate and collaborate and to engage with China and Chinese leadership role there. In that regard when I was here two years ago, I'm telling my colleagues here that it is very silly for the US government not to join AIIB or discourage Korea and Australia not to join rather than encourage to join the newly launched AIIB. And in fact, I was telling my

Chinese friends that you should invite US to join just like ADB includes the US.

And One Belt, One Road project also which is really grand regional, it's almost global project for China very ambitious. The US should actively participate in and try to participate and to collaborate with China and the rest of the countries; almost 60 countries involved for the project. So this is the way US should engage in the region and by working closely with the countries and particularly with China.

And on specific points of Jeff to persuade the new administration and Congress, Jeff recommends the inclusion of currency manipulation presenting the currency manipulation clause in the expanded TPP. I'm looking forward really to read Fred's book. He has a new book on this very subject. But as you know and as many of you would agree that the first resolution for this issue is if we can do something about -- by the WTO in cooperation with IMF. But WTO is non-existent nowadays, so this is a second resolution or second best option.

But in fact, I don't think anyone would defend the currency manipulation for their own country's interest -- I mean for those countries involved because sometimes currency manipulations tend to delay necessary structural reforms and structural adjustments to fundamentally improve the economic competitiveness and sometimes conceal the necessity of reforms. So in the long run, it not only hurt the competitors, but the countries involved themselves. Having said that, economic theory tells us that it's very difficult to figure out that the trade deficit was accountable for the exchange rate changes with currency manipulation because trade deficit is determined by many other factors, more importantly by real factors, not just the exchange rates alone.

And also some prominent economists including Gregory Mankiw was found to say that increase in US trade deficit is a sign of a stronger US economic strengths rather than weaknesses because he focuses his attention on the flipside of trade deficit, which is capital flow side because trade deficit would affect interest rates and other macroeconomic areas. So they affect consumption and investment. And through that affects the economic growth and employment situation can be improved. But in any case, my point is that at the practical level it would be quite difficult to sort it out. How would you implement that clause on [inaudible 0:50:54]?

And then regarding the quantitative easing, I read Fred's and Jeff's chapter on this currency manipulation and the exchange rate -- I mean the quantitative easing and the exchange rate idea. You're right that the market integration for exchange rate changes and the quantitative easing are different. QE does not have direct and immediate trade divergent effects.

However, Korea for example, when BOJ (Bank of Japan) first implemented what they call quantitative and qualitative easing by Governor Kuroda, Prime Minister Abe publicly said that that will help change Japanese yen value. So there was headline in Korea. How do you think that would affect the Korean business leaders whose businesses are competing with Japan for the same products or same services? And there is immediate impact and divergent effect.

However even in Korea in those days, I always say that, well, Japan is one of the largest economy in the world after all. And if Japan does well, then it will benefit Korea, of course, that is true. However, but those companies affected by the Japanese actually have reasons to complain.

So on this thing what I've been emphasizing is the international cooperation and collaboration. Grassroots G20, for example, macroeconomic cooperation is very, very important in this regard. Sooner or later, Japan will have to engage in tapering off the QEs. And soon, US interest rate will probably increase and that will have a disturbing effect on the international capital flows. And many emerging countries will get into trouble.

So, anyway, so I have a few other points, but since time is limited, if I make just one more point that is regarding RCEP. I don't think RCEP can be an alternative to TPP. First of all, RCEP is a much lower standard at the regional FTA and there's no leadership. And they started the negotiation in 2012 and it already is at the 16th round of negotiation, but it didn't make much progress. So I don't think RCEP can replace TPP. So I'm all for TPP resuscitation. Well, thank you very much it took too much time.

C. Fred Bergsten: Well, time is short and I will just make two basic points. First of all, to say I thought Jeff's paper was terrific. I, for one, always think bigger is better so I'm for that. And I'm delighted that Jeff has finally come to the view that currency issues should be included in trade agreements. It was about time.

I certainly agree that the rejection of TPP is a huge mistake, a huge mistake for the United States. But we have to recognize it wasn't just President Trump. The Democratic candidate was against it. Her main competitor for the nomination was against it. A number of Democrats in the Congress claimed that they had already deep-sixed it before Trump got elected. So there's a lot of opposition out there.

Nevertheless, I would submit these people are all on the wrong side of history. TPP would have brought huge economic benefits to the United States. Our own studies show well over \$100 billion a year. Not many

government programs can do that. The foreign policy gains have been mentioned already many times that are huge. The US cannot absent itself from Asia and just turn the region over to China.

So I think it will come back. And the issue is how does it come back? How do we work our way back in that direction? I think we should not be too discouraged by this further delay. And I'm going to deliberately call it a delay, not a demise. I submit it will be a delay. After all, it took 10 years. Adam mentioned my Eminent Persons Group in APEC that originated the idea back in the mid-1990s. It took 10 years from that to starting to negotiate TPP. President Obama, remember, came into office, waited almost a year until Lee Kuan Yew told him that unless you go into Asia you're turning it over to the Chinese. Another delay. Our Korean friends know it was 5 years ago from the negotiation, of course, to its implementation. So these delays are nothing new. We should not despair. We have to be patient. And we have to work in the interim to try to get back to the kind of solution that we want.

So what should we do in the interim to try to move at least as positively as we can, but keeping an eye on the ball in the longer run? And this is the one point where I disagree with my friend and close colleague, Jeff. I think the bilateral alternative which he characterizes as doomed to failure and unlikely to bear fruit is in fact likely to bear fruit and is the right way to go as an interim strategy. And I don't mean a whole lot of bilaterals. I'm thinking particularly of the US-Japan bilateral FTA.

Keep in mind that our own studies show that at least two-thirds of the economic payoff from TPP was because it amounted to free trade between the United States and Japan. In some broad sense, TPP was an FTA between the United States and Japan. So it's not a big segue to move from pushing TPP off for at least a while to move in the direction of a FTA with Japan.

Now, Jeff says that the US won't get as much out of Japan in a bilateral as it would have in TPP. And he may be right about that. Just one more cause of giving up the TPP. He may be right. But I would submit that Japan given this new environment clearly will want a bilateral with the United States, would want an insurance policy against the risk that this administration or some future US administration could take nasty negative protectionist steps that would adversely affect it. And Prime Minister Abe still wants to use the trade liberalization to pursue his domestic reform agenda in Japan.

So for a variety of reasons, I think it's on if our own government will do it. Remember, President Trump has not said he's against trade or against trade agreements. He said he's against certain trade agreements from the

past. He has different criteria in mind. But to me, the slate is open to move in this direction.

We also should remember that bilateral agreements often tee up regional agreements or in some cases even global agreements. The US and Canada had a bilateral before we had NAFTA. The Europeans started with a Coal and Steel Community and then did the common market of the 6th and then 12, 15, now 28. TPP started with a little Pacific 4, became 8, 11, then 12. So moving through a bilateral at the outset by no means rules out, indeed may even promote moving them back to the more desirable regional framework and even pave the way for global agreements.

So since it's always desirable for liberalization to be moving forward whether you call it a bicycle or not, it's always desirable to move forward. I think a US-Japan agreement given the current political context both here and abroad is the most likely alternative that could bear fruit. I hope and expect that may be the way to go and I hope we will do it.

The one other key interim step and this may be the most difficult of all is to start building in the US a more sustainable domestic foundation to promote globalization and trade liberalization over time. We know we've been grossly inadequate in building safety nets for the costs to losers. We know we have failed to put in place adequate worker training and education programs. We know that we have not provided a sustainable domestic foundation.

The political dilemma is that the people in the Congress who particularly like free trade are the people who don't like government intervention to help on these other fronts and vice-versa with other folks. So we're going to have to come to a grand bargain internally in order to provide a foundation. But in the meanwhile, let's move with Japan. Let's try to restart the momentum. And let's see if that, over time, can lead us back to the preferred outcome of some global Asia Pacific agreement ala if not call that TPP. Thank you.

Adam Posen:

Thank you very much, Fred, for clear concision as always. Could I ask Dr. SaKong and Jeff also to come up; Jeff in the middle. I'm going to open up directly to questions. I just want to make two observations very quickly following on Fred.

First as ever, we have even among close colleagues very lively debate here at Peterson. I assure you what you see in public is less lively than what you'll see in private. Just as is with border tax and with quantitative easing, issues of bilateral versus multilateral strategies will remain something we're going to discuss.



Just as an input and my second point to that is I have to remind Fred that the list of examples he just gave of small deals becoming big, every single one of them was multilateral not bilateral. There were no bilateral deals in that list.

C. Fred Bergsten: US-Canada.

Adam Posen: US-Canada. Okay. So we're going now to turn it off to—given the time to our audience. As usual, we have a mic in front with Tarnisha. And we have a standing mic at the back. Please wait to be recognized and please identify yourself when recognized. Who would like to go first? The gentleman being blocked by the camera.

Doug Palmer: Hi, I'm Doug Palmer with Politico. I also kind of wanted to ask Jeff about this idea that the bilateral strategy is doomed to failure. Could you just elaborate on that a little bit? I mean do you think it's doomed to failure because he won't be able to find other willing countries that will negotiate trade agreements? Or even if he finds partners the negotiations won't successfully conclude? Or if they conclude they won't get approved by Congress? I mean how is it exactly doomed to failure?

Jeffrey J. Schott: Well, the first point is that there are a lot of willing partners. And I think you've seen both Canada and Mexico say they were quite willing and anxious to engage with the United States in updating NAFTA. I say updating and improving it. Japan has said the same. There's no problem there. And Fred's arguments would hold to that extent.

Where Fred and I differ is to what would be the subject of negotiation. And it seems to me that if you're positing a comprehensive deal as comprehensive as TPP or even less comprehensive than TPP, but broad ranging and expect to then get more commitments for reform from your partner and not to offer commitments in the United States. So autos would be one of the principal areas of negotiation. Tighter rules of origin. Steel would be another area. Some deal that would involve market sharing on steel to limit imports into the United States. Who are the primary exporters to the United States? Well, our TPP partners and particularly our NAFTA partners.

So if you limit the content of the deal, then the value of that deal as a precedent for a broader regional approach is less significant. So it may be that I could support Fred's argument if there's a comprehensive deal, which moves forward with Japanese commitments to reform substantially. But I don't think the diet will sustain political support for those types of comprehensive reform in the absence of getting a decent deal from the United States. So that's where we are different. But, again, I've spent 45

years learning from Fred and maybe today is another day in that long journey.

Adam Posen: I would posit that actually Fred and you have gained from two-way trade in knowledge. And it's always possible Fred could learn from you too. Sorry. At the back mic and then this gentleman here.

Shaun Donnelly: Thanks. Shaun Donnelly from the US Council for International Business. Great presentation, Jeff, and I look forward to reading it. I was just distressed that you seem to be throwing investor-state dispute settlement under the bus. And I mean a couple of realities, one, government still do bad things to investors. And the reason ISDS was created back in the 1950s, I think, was because state-to-state or espousal by state wasn't really working.

It also seems to me that much of the opposition to ISDS has been broad political opposition somehow sort of wrapped around broader anti-business kind of thing so not specific problems with the thing. So do you really think throwing ISDS overboard would get more support for a new agreement? Thanks.

Adam Posen: And before you respond just to pick up on a very interesting point, we know there were proposals out there including, I believe, by the German government that the issue wasn't so much to get rid of ISDS, but to replace the tribunal from corporate delegates with government delegates or other appointees so if you could include that in your answer.

Jeffrey J. Schott: The basic question is will it gain more political support? And the answer is yes for the reason you said that it's more of a political issue than a legal and economic issue.

When we did our TPP assessment, Gary Hufbauer wrote a very good chapter in our book noting on how TPP provisions could have been improved a bit in areas where it did improve upon existing NAFTA practice. And those areas you could recommend and indeed the paper does primarily recommend an enhanced and revised ISDS process instead of throwing it under the bus. The investment differences with the European Union were ones between the US government and the European Commission.

Adam Posen: But from a merit-based point of view.

Jeffrey J. Schott: From a merit-based point of view, one could argue that that would be a useful reform.

Adam Posen: Okay. Thank you. Right there.

Male Speaker: [Inaudible 1:08:40] from Korea Institute for International Economic Policy. I'd like to thank Adam and Jeff for this wonderful piece so that we can discuss something sensible in DC.

About this—I mean the debate between Fred and Jeff about the bilateral, I'd like to remind you about why we move from bilateral to the regional mega FTAs. It's because of the rules of origin and the global exchange rate. So I agree with Jeff on the basis of that Japan is going to be less willing to give up in the bilateral because there's no supply chain that can be used in bilateral, I mean, instead of the TPP and some of those countries of the setup. But I agree with Fred on the basis of the security issues. Japan might be willing to do that, but not economical reason.

On that regard, I go back to Dr. SaKong's point of how US should be engaging in the region? I'm talking about China. Jeff is saying that we should be going bigger. Why should we stop there? Korea, Taiwan, Colombia. What about China? What are we going to do?

So I think the TPP is stopped—I mean delayed. Why is it being delayed? Why not we go from the old TPP directly to [inaudible 1:10:18] including both the US and China together based on the TPP text? I mean can we think about this kind of new path. And that's my question. Thank you.

Adam Posen: Thank you very much [inaudible 1:10:32], before our colleagues respond, I think Fred probably should respond first. I just want to remind PIIIE aficionados that roughly two years ago we published a book by Fred Bergsten, Gary Hufbauer, and Sean Moran looking at US-China trade relations. And they set out a path of building on TPP to include China. So that's why I'm turning to Fred first.

C. Fred Bergsten: Yeah. I was going to refer to that. We sort of think it would be desirable and ultimately one cannot have a true Asia Pacific agreement unless the United States and China are both in it. I think the case for TPP without China was to begin the process, go about halfway to the original Bogor goal, and to set standards in place that will be both a challenge to China, but also would be highly valuable for the Chinese themselves to adhere to. Give them a target to shoot at.

It was pretty clear that at this point given US politics and even given Chinese politics, I would say, that it was unlikely to move directly and immediately to US-China agreement either bilaterally or via a regional nexus. But we always have that in mind. I certainly still have it in mind. That would be the only way to complete the original APEC vision.

Now we have an administration whose focus in trade is not like all of us in this room on the level of trade and its economic payoff, but rather on trade imbalances. That is clearly the overwhelming focus of the team that's in there now at least for now. They may learn that they can't do that much about it. They aren't willing to take the steps that would do something about it. So that too I think may change. But for the moment that's their focus.

Given that and given the \$350 billion bilateral US-China imbalance, but you get all of us economists say, "Oh that's not relevant. You got to look at global." But the globals are pretty big too. I think it further raises the question of whether you could move very quickly in that direction. But again when I espouse the US-Japan bilateral, I have very much in mind if you have that on top of US-Korea, on top of the other things, the Chinese would start to feel isolated and would want to come in. And that's why I want to keep the momentum going forward.

Adam Posen: I apologize. We're getting near our witching hour. I just want to get in one more question in a moment. I want to refer back in this context. We did an event last week with some new research by Nicholas Lardy and by Caroline Freund on the resurgence of the state sector in China. And so while a lot of these, of course, has been focused on developments internal to the US, there are obviously developments going on in China right now that may not be favorable. As we know in the TPP negotiations whether it was Vietnam or Singapore, state-owned enterprises were a key part of the dispute and that would be a key stumbling block to moving quickly with China. At the back, this would be the last question.

Matthew Goodman: Hi, Matthew Goodman from CSIS. Terrific presentation as always, Jeff. And I'm with you really on the plurilateral versus bilateral. Sorry, Fred, but I just think a Japan bilateral would be really hard, I mean, for two kinds of deal-breaking reasons. One, you put a currency chapter in there. I don't see how Japan would accept that. And secondly, whether they share or not, but I just don't see that they would. And then if you push on the rules of origin, I just don't see how you can especially if you say it's got to be US content not just North America but US. I just don't see how Japan can accept that. But I in general agree with baby steps towards bigger solutions. So I'm with you in spirit. I just think it's going to be really, really hard. And you might as well go big.

But the question I was going to ask was sort of based on what you just said about trade deficits. This team is so focused on trade deficits. Do you think that they could, in some way, or they might -- first of all just predictive -- insist on some sort of quantitative outcomes from an agreement? I can't see them going into something like this without being able to assure the people that supported them that there's going to be some

better balance in trade. I know that's unprecedented. But is there any way that can be true? We all think it's a bad idea. But is there some way that could be negotiated?

Adam Posen: I'm going to ask each. I'll go to Il SaKong, Fred Bergsten, and Jeff Schott for the last word. But if Jeff was not justified in using the word doomed to fail before, targets for trade balances are doomed to fail, but anyway, Il SaKong. Do you want to comment? Okay. Fine. Fred.

C. Fred Bergsten: Well, of course, quantitative targets are not totally unprecedented. The famous free trade Reagan administration put in place some quantitative targets on sector-specific deals not overall trade balances. But sure you can't do that.

My prediction, you want a prediction, is that if they continue to focus on trade balances which with the economy of full employment and doing pretty well they may not. But if they do, they're forced back to the exchange rate because that's the only international tool that has some promise of paying off. And that conjures up images of a Plaza II or some type of effort—I don't know if it could succeed—some kind of effort with the international partners fearing protection as the alternative as with the Plaza 30 years ago to come to some kind of concord on exchange rates to bring down the overvalued dollar.

I would just make one more point about your question whether Japan would do it and whether Japan has economic interest of doing this. Thinking back to that famous US-Canada agreement, the leader of the Canadian opposition at the time, Lloyd Axworthy, they opposed the US-Canada agreement. He came to me and said, "Fred, why should Canada sign this US-Canada trade agreement?"

And I said, "Because it might be useful for you to have an insurance policy against the US going off and doing crazy things at some point in the future." And today 30 years later despite all the hullabaloo about renegotiating NAFTA, I'm sure the Canadians are glad to have that insurance policy. I think that the Japanese might have a similar point in mind and be willing to pay a premium even if they don't like it in order to have that insurance policy against either this or a future US administration doing things that would really hurt them.

Jeffrey J. Schott: You have to know that Axworthy's answer to Fred was we can't afford the premium. And the Canadian dollar was a lot stronger than it is today. But I think—

C. Fred Bergsten: Hey, they paid me.

Jeffrey J. Schott: I think the answer to the question depends a lot on when the negotiations would come to fruition. If you posit a rather quick and dirty negotiation that could be done in the next year or so, then it may be more transactional, much more limited, a few deals that actually doesn't affect macroeconomic balances, but create headlines that are very important in specific communities.

If you're positing a longer negotiation, then not only do you get into bigger substantive issues, but you also go further into the term of the Trump administration when US trade deficit for macroeconomic policy reasons is likely to expand. And that's only going to complicate the problem.

Il SaKong: Well as Fred just said unless this new administration changes its basic direction of trade policy that is the center of the economic policy, I'm afraid that it would run into a vicious circle. And it would generate more protectionist measures because all these protectionist measures will worsen. And targeted protectionist measures will worsen the balance further particularly at a time when the US Fed is about to keep increasing interest rate.

I think that is the reason why I keep emphasizing the necessity of international macroeconomic cooperation because, otherwise, all those emerging economies will run into trouble because of this capital flow side of the trade gap [inaudible 1:19:28] in the United States [inaudible 1:19:34].

Fred, you must remember the [inaudible 1:19:41] analogy saying that in the very volatile sea of [inaudible 1:19:51] like the US is quite different from South Pacific canoes of the small economies. Those small open economies together that we have experienced in recent years can become a problem. And therefore when DOJ and ECB and US Fed withdraw from these QEs and the reverse quantitative easing policies, they need international macroeconomic cooperation. And fortunately, the G20 has something like that. It was called MAP (Mutual Assessment Process) and we should consider that.

Adam Posen: Okay. So we've gone from optimism for TPP to optimism about mutual surveillance in the G20. I'm in favor of both but I think we have reached our optimism quotient as well as our time quotient for today. Please join me in thanking our speakers.