Carla Hills: I have found the “ssh” to be more effective than the clinging, clinging, clinging. But welcome to all of you. I’m Carla Hills. I have the privilege of sitting on the Board of the Peterson Institute for International Economics, and I want to welcome all of you to this program, to celebrate the launch of Fred Bergsten and Gary Hufbauer’s outstanding new book, *Bridging the Pacific: Toward Free Trade and Investment Between China and the United States*.

Let me say at the outset, I’m sorry that Hank Greenberg could not be with us. He planned to be and then business interrupted so he had to reschedule, and that took him away because he’s been a strong proponent. I think Fred would even say a visionary on the concept of opening US-China trade and investment.

And some people in this room may think that a free trade agreement with China is a step too far, but I recall some many months, even years ago, Fred sharing with me the fact that Han Duk-Soo, then Finance Minister of South Korea, and subsequently Prime Minister, and then Korea’s Ambassador to the United States, raised with him the possibility of negotiating a Korea-US free trade agreement. And that started a discussion and the Peterson Institute in its usual first-class manner did an analysis and the idea sprouted wings and we now have KORUS to the benefit of both South Korea and the United States.

And *Bridging the Pacific* may well have the same and even perhaps a faster impact with respect to our trade with China. But in considering the launch of any trade negotiation we need to carefully weigh the pluses and the minuses. And it would be impossible in my view, truly impossible, to find two more qualified economists to assess the various ways to enhance economic collaboration between the world’s two largest economies and to consider the costs and the benefits.
Fred Bergsten, Founding Director of the Peterson Institute, serving in that role from 1981 to 2012 and now a Senior Fellow, is a member of the President’s Advisory Committee on Trade Policy Negotiations. He served as Assistant Secretary for International Affairs, the US Treasury Department, and coordinated US Foreign Economic Policy in the 70s, as an Assistant for International Economic Affairs for Henry Kissinger. He was Chair of the Eminent Persons Group in the Asia Pacific Economic Forum, APEC, which authored three reports that recommended free and open trade in the region, a recommendation that was enthusiastically adopted at the APEC leaders’ summits in 1993 and 1994 and is now finally being considered in the Trans-Pacific partnership, just two decades later. So some great ideas take some time.

Gary Hufbauer is the Regional Jones Senior Fellow here at the institute. Earlier he served as the Maurice Greenberg Chair, and Director of the Studies at the Council on Foreign Relations as the Marcus Warrenberg, Professor of International Finance Diplomacy at Georgetown University, and Director of the University’s International Law Institute. He also served as Deputy Assistant Secretary for International Trade and Investment at the US Treasury Department. And he has written extensively on international trade, investment and tax issues, including a highly regarded book entitled *US-China Trade Disputes: Rising Tide, Rising Stakes*.

Now the format for today’s program is we will start by asking Fred to give a summary of the main analytical conclusions and policy recommendations set forth in *Bridging the Pacific*. He will be followed by Gary who will focus on the specific rationale that supports the recommendations that have been set forth. And after their presentation, which will take us just about to noon, we’ll break for a very quick lunch; you’ll have to hurry. We will resume the program as close to 12:15 as we possibly can with a wonderful panel led by Myron Brilliant, the Executive Vice President and Head of International Affairs at the US Chamber of Commerce, and he will moderate the group.

In addition to Fred and Gary the other panelists will include Professor Peter Petri, who is the Carl J. Shapiro Professor of International Finance at Brandeis International Business School. He’s a Senior Fellow at the East-West Center in Honolulu, and visiting Fellow here at the Peterson Institute. And Alan Wong who is with us, Executive Director of the Hong Kong based China-United States Exchange Foundation. So let me invite Fred to the podium, and we’re in for a treat. Fred.

Fred Bergsten: Thank you Carla for those very kind comments and for leading it off. And also thanks enormously to my colleagues who contributed to the study: Gary Hufbauer, who’s been one of my closest colleagues now for about 40 years, as co-author. Two of our younger colleagues, Sean Miner and Tyler
Moran, without whom we could not have done it. Peter Petri and Robert Lawrence, who did guest chapters, as you’ll see in the book on very important topics. This was a team effort and I want to start by just thanking all of the people who made such a major contribution to it.

As Carla said, this is a big book, over 400 pages on a very big topic. It’s about the possibility of moving toward free trade and investment between the two biggest national economies in the world; between the traditional hegemon in the international system, and the rising global economic super power, and between the country with by far the largest international reserves and creditor position and the country who issues most of those reserves and in the process has become the world’s largest debtor country.

Now this would be a truly historic undertaking in a number of ways if it were to proceed, and as Carla said, the objective of the exercise is not to suggest that something begin tomorrow by way of a negotiation on this issue, but to start a discussion; to try to lay a foundation and a basis for considering what we regard as potentially the most important trade agreement ever. Therefore, we want to start that discussion with an analysis; hopefully a clear-headed, objective, balanced, honest analysis of what the economics of it might look like, how it might relate to the overall foreign policy and national security considerations of the country and therefore, why we at least conclude that the idea should start being considered, recognizing that it would bear fruit, if at all, only over time.

Now as Carla said, the idea was really first proposed by our friend Hank Greenberg about five years ago. Now Hank of course would, a former CEO of AIG, more importantly for this context, I think probably second only to Henry Kissinger, is regarded as the most experienced and expert US Statesman vis-à-vis China. And therefore, I think brought a real feel for what might be worth considering.

Now when the idea was proposed five years ago it clearly was not propitious to be considered. We were at the trough of the Great Recession, the imbalances between China and the United States were at their peak and there was much harangue over the exchange rate and re-balancing issues. The US, really at the start of the Obama Administration, had no trade policy agenda at all. The Chinese were not exchanged, really in any major trade liberalizing enterprises and there were no real indications of economic reform in China at that time.

So when the notion was first bruited by Hank and a few others, I think it was not propitious for discussion to pursue. Now none of those problems have been solved totally, but five years later, right now, we think the time has come that it is propitious to start considering the idea. The US
economy is not booming, but it’s certainly doing a lot better, recent travails notwithstanding. Unemployment’s down below 6%.

China, while people worry about a slowdown, that’s a slowdown to seven percent, not bad by global standards. Nick Lardy thinks China will continue to grow at 7%-8% for the next decade, and I think that’s quite likely.

The imbalances have come way down; the Treasury’s latest semi-annual report issued yesterday acknowledges that whereas there are still problems, there has been huge reduction in the imbalances, huge adjustment of the exchange rate, significant progress on that front as well.

But as we look at our study we identify what we think are three particularly important changes that we believe do now make the issue one that ought to be discussed. The first, from the US standpoint, is that our country is now pursuing its most ambitious trade agenda, in my view, forever. Carla may disagree with that, she had a pretty ambitious agenda when she was at USTR; it amounted to the Uruguay round at NAFTA and that wasn’t a bad package. I would argue it’s even more ambitious now. The US, of course, leading the two big mega-regional negotiations, the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership.

In the middle of half a dozen major plurilateral negotiations in the WTO or around it, the Trade and International Services Agreement, the Environmental Goods Agreement, the ITA-II, the reforms of the Government Procurement Agreement. So now it is not a matter of creating a new trade agenda for the United States, but rather trying to consider how China can best fit into that agenda and carry it to the next stage of evolution from the advanced level which it has already achieved. Even more important perhaps, China is engaged in all of those plurilateral talks and the other trade liberalizing initiatives that it has been taking itself.

Now the signals that we get, as we try to do this study from China, are decidedly mixed. Its contributions on some of the prolaterals have not always been totally constructive, and indeed as many of you know, the negotiations on both the ITA-II and the TISA have been held up because China’s offers to participate have not yet been deemed adequate by the other participants. But China’s engaged and it wants into the TISA, it has joined the Environmental Goods Agreement, and has taken several big initiatives of its own. It’s about to conclude, probably fairly soon, its most ambitious bilateral FTA ever, that with Korea. It is pursuing the Regional Comprehensive Economic Partnership, the RCEP, with the 10 plus 6, basically headed toward an East Asia free trade agreement. It has proposed a free trade agreement with the European Union in recent discussions in Brussels. It’s energized the Bilateral Investment Treaty with the United
States; Gary will talk more about the specifics of that later. So China too has a very active trade agenda, seems to be injecting itself more actively and constructively into the international trade talks. And so again, we think begins to tee things up.

Most importantly from this context that I’m talking about, China, we believe, recognizes that it will be heavily and very negatively impacted by these mega-regional agreements that the United States is now negotiating. This chart, which has a lot of information in it and I’ll come back to later, that’s in the book, indicates that among other things completion of the TPP with its current and slightly expanded membership would cost China over $100 billion per year at lost exports; that’s trade diversion. The IFO Institute in Munich, in its exhaustive study of the Trans-Atlantic Trade and Investment Partnership, concludes that China would lose another $100 billion or even more from the new preferences between the United States and Europe, which after all are China’s two largest markets.

So a critical development in the global trading system is that the moving ahead of other countries in the other agreements, the mega-regional agreements, places substantial adverse impact on China, creates pressure on it to join the game. This is the thesis of competitive liberalization that I have enunciated almost 20 years ago and has driven trade policy thinking a lot since that time, this is a crystal-clear case in point where China, we understand is being importantly motivated by this kind of consideration.

One of our top US Trade officials said to me recently, not a week goes by when we don’t get an expression of interest from China about the TPP, what’s going on, wanting to know about it. This is a total change. Two years ago China was quite openly hostile toward the TPP; its view on it has changed. It’s even made a counter-proposal at the APEC. which it chairs this year, its proposed a move directly to negotiate or at least consider a free trade area of the Asia Pacific that would include TPP but go beyond it, indicating again, China’s active participation.

Last week we hosted here at the institute China’s Vice Minister of Finance Zhu Guanyao, who headed China’s delegation to this year’s IMF and World Bank meetings. When we asked him about this exact topic he said the following, and I’m quoting Vice Minister Zhu, “The Trans-Pacific Partnership is not complete if it does not include China. We welcome any new proposal from the United States to promote trade liberalization in the Asia Pacific.”

So two big changes that have occurred over these recent years, the adoption of an aggressive, active trade agenda by the United States, adoption of an active trade agenda by China, and the increasingly apparent
need to find ways to blend them together and work toward some accommodation between these two largest economies in the world. Now all this we think is closely related to what may be an even more important change than the ones I’ve mentioned, which are the economic reforms being undertaken in China by the government of President Xi Jinping.

As you know, those reforms aim to promote domestic consumption, as opposed to the previous focus on investment. They intend to promote the services sector more than the traditional over-emphasis on heavy industry. At a minimum, it seems to us in our analysis; these reforms in China permit increased and renewed emphasis on trade liberalization and could even promote new trade liberalization.

Recall that the last generation of Chinese economic reformers, President Jiang Zemin, Premier Zhu Rongji in the late 1990s early 2000s, consciously used their joining the World Trade Organization to promote domestic economic reform in China. Their chief negotiator Long Yongtu described it to me back in the day that once they joined the WTO he spent three days a week going around China telling the provincial governors, the party chairman, “Here’s the new rulebook fellows. You may or may not like it, but these are the new rules and this is what motivates our economic reform.” And the leadership in China did it explicitly for that reason. Zhu Rongji said that many times in public, including in this country.

So the question arises, might a similar kind of linkage occur again in the thinking of the Chinese leadership? As I say, the signals are mixed to this point. I don’t claim that we see any clear determination from the leadership to do that, but I will again quote Vice Minister Zhu. When he was here last week, he said not once but twice, that Chinese officials have gotten his words, “Very clear instructions from the top to promote greater integration of China into the world economy, greater trade activism and the like.”

So this is a very new setting and we do think it puts at least in the realm of possibility what we outline in the book. And in looking at that rationale, we suggest from a US standpoint, but we think it’s more broadly applicable to both countries, indeed the world as a whole, half a dozen reasons to pursue what we call a China-United States Trade and Investment Agreement, CHUSTIA, to coin an acronym that may or may not survive our effort to put it into the lexicon today. Most importantly, and I’m only going to stress three or four of those rationales, the rest of it is in the book, perhaps most important from a US perspective are the foreign policy and national security payoffs, we believe, from moving toward a new comprehensive economic agreement between our two countries.
Keep in mind that every major US trade agreement in history has been driven not primarily by economics and trade, but primarily by foreign policy and national security considerations. President Kennedy did the Kennedy Round to cement the Atlantic Alliance in the 1960s. NAFTA was pursued, not only for economic reasons, but because of the need to enhance US national security vis-à-vis Mexico. And as I understand it from the people who finally sold the deal to the Congress in 1993, the clincher came from General Colin Powell, at the time Chairman of the Joint Chiefs, who went to the Senate and said, “Gentlemen, if you don’t sign this I or one of my successors will probably have to put five divisions on the southern border of the United States.” At which point, the senators said, “Where do we sign, General?” Again, national security considerations.

Why did President Obama, against many of his own instincts, reinsert the United States into the TPP negotiations in 2009? Because of his pivot to Asia and the need to have an economic dimension to that pivot to make it credible to his Asian partners. So foreign policy and national security is always a critical element in driving US trade agreements.

We put on the back of the book as the top blurb from my old boss Henry Kissinger deliberately a relationship to the national security and foreign policy parts of it. The Kissinger Thesis, as many of you know, is that China will only negotiate seriously on an issue if it first has an overall understanding of where it and its partner negotiators are headed in an overall, aggregate, conceptual and generalized sense. They want to discuss the overall policy framework.

First, before going into details on specific issues, we think that probably applies to trade as well as to everything else. An implication of that is that the current case-by-case approach of trying to deal with US-China economic issues one-by-one as they arise will not work; as it is not working very well now. The Kissinger View has been echoed recently by Ken Lieberthal, our good friend across the street in his seminal study two years ago of US-China mistrust, which he and his Chinese colleague Wang Jisi, indicated is getting worse, is pervasive in both countries, and raises the risk of poisoning the relationship if it is not turned around by some new, broad, far-reaching agreements.

In the latest foreign affairs, Jim Steinberg and Michael O’Hanlon say very much the same thing. The bottom line being, and we don’t dwell on the detail in the book, it’s not our comparative advantage, but the risk that the security and foreign policy relationship between the United States and China is fraught with risk. It could worse, it could have global consequences. And the economic dimension, at the moment we fear, is probably adding to those overall bilateral risks. However, it is our view that that could be turned around. If the economic dimension could be
converted into a positive element that would promote stronger relations between the countries. Building on our high and rising economic interdependence provides some insurance against potential downsides on the military and political sides.

In other words, use an economic instrument to promote broader, overall national foreign policy and security goals. A BIT, as the European has done for 50 years, using economic integration to overcome the terrible political and security history of that part of the world. This is a big picture idea. We think it should motivate the entire discussion and all of us on the economic side must keep it very much in mind as we pursue discussions on this topic.

Our second and related reason is to suggest that the economic relationship itself is highly unsatisfactory at this point in time. It’s clearly deteriorating. Jeremy Waterman, who’s here, testified last year on behalf of the Chamber of Commerce, speaking to the US business community, that the economic relationship between China and the United States is clearly deteriorating. And in the book we lay out all the specific issues that go into that. Gary will address those in more detail.

Now some conflict is of course normal between any two major trading partners like the US and China, and we’ll have them, but lots of the cases are now leading the conflict; they are not able to be resolved through the WTO or elsewhere. And this, we fear, is likely to get worse when you project the economic prospects for our two countries, and particularly China’s dynamic growth. There’s much debate now, is China bigger than the United States? Has it passed the US at GDP? All we can tell you is 10 years from now, 20 years from now, China is going to be much bigger than the United States. Its share of world trade is going to be several times that of the United States. In short, China is going to become increasingly exponentially more important to the United States in economic terms than it is now. And unless we provide a constructive framework to deal with that these issues can only become more worrisome.

There is also, to go back to my table, the issue of increasing discrimination against each other. If nothing is done to offset it the new US mega-regionals, the TPP, the TTIP, are going to have these big negative effects on China, increase our discrimination against them. Likewise, their regional agreements, [inaudible 00:24:09] mentioned, particularly RCEP, will have less but still some discriminatory effect against the United States. So the two countries, rather than getting closer together will be increasingly discriminating against each other.

And just to nail it down, we know that a number of China’s policies are highly costly for the United States, cyber-espionage, continued theft of intellectual property, preferences for state-owned enterprises, and yes
currency manipulation, all these cost the United States, on our estimates and those of many others, hundreds of billions of dollars per year. Again, this is big stuff. We’re not talking here about marginal numbers, we’re talking about numbers that affect even a huge economy like the United States, issues that are of deep seriousness cannot be ignored must be dealt with going forward.

As I say, the book has chapters on each of these and how a trade agreement between our countries could address them. Gary will describe that in detail. The key point here is we need a new and better economic framework to address this huge and growing agenda.

Now let me turn to the more positive side of the agenda, the economic benefits that we believe would occur from the negotiations. In this first chart, just to look at one other column of it or the same column, the one on the TPP, you can see that the US would gain export expansion of something like almost $400 billion a year from the CHUSTIA; China would gain slightly more, close to $500 billion. These are very big gains on the export side that would be achieved from going to the kind of agreement that we have in mind. This is a summary for both countries of the overall economic benefits they would gain. In the US export side, the US exports to China would double. Our global exports would go up something like 13%; China’s would go up 10.

US GDP, national income, would expand by more than $100 billion; China’s by much more, $300 billion. Why is that? Why would China gain more than the United States? Well, the answer is simple. China has much higher trade barriers than the United States. And remember, the gains from increased trade come largely from the import side, because you would give yourself better products at lower prices, improving your productivity. So when you’re coming from higher levels of trade barrier, and therefore you liberalize more in moving to free trade, you are the bigger beneficiary. The US still gains a lot, but has lower barriers and therefore would not gain as much. So for those in China who think this would be a deal somehow benefiting the United States unevenly, there is your answer.

Productivity in both countries would rise significantly. In the US by a full percentage point, almost a full percentage point; China almost two full percentage points. The trade balance issue is more complicated, I won’t go into it in detail, we can do it later if you want. Only to say that we do feel that if the trade imbalance between the two countries has not been fully resolved by the time all this got going, which it may well, we would have to associate it in some way with the trade agreement, perhaps in the trade agreement or perhaps as a side agreement. The same way the US has negotiated on agriculture and autos with Japan in side agreements to the
TPP, you could do something like that on the broader issues in the context of a CHUSTIA.

Peter Petri, who’s joined us, in his chapter two in the book, which lays out the data on which much of this is based, also creates very instructively what he calls an accelerated re-balancing strategy in which a concentrated move by the two countries to eliminate their big global trade imbalances would add significantly to the economic benefits from the whole package and would be highly complementary in fact, to the trade agreement itself, mutually reinforcing a valuable component of the overall agreement. In the event, the basic point here is simply to say that the economic gains are considerable and significantly to the foreign policy and national security benefits I already mentioned, in building the case for CHUSTIA.

Now of course, there are also adjustment costs. Any country going into a trade agreement, or in fact any dynamic new economic policy, realizes there are costs as well as benefits. There are losers as well as winners. And we go into that very carefully in the book. We’re extremely sensitive to that from the United States standpoint. We asked Robert Lawrence at Harvard, who has worked on this topic extensively in the past to do a very careful, in-depth analysis, bottom up analysis, to complement Peter Petri’s top-down analysis, to try to assess the impact on the US labor force of a CHUSTIA.

The conclusion is that about 170,000 US workers per year would probably have to change jobs as a result of such an agreement. About one-third of those job shifts, mainly from manufacturing to services, would be voluntary, so we’re left with about 100,000 workers, that’s the conclusion from the Lawrence Input-Output analysis, about 100,000 involuntary separations per year for the 10-year phase-in period of the agreement. In total, about 1 million workers over a 10-year period. Now, the US labor force has about 150 million workers, of which about 50 million turnover every year, including about 20 million involuntary separations.

So what we’re talking about here, while it’s certainly not insignificant in absolute terms, represents involuntary separations of about one-half of 1% of the expected total in the United States, a cumulative impact on the labor force well under 1% of the total labor force, a roughly equal impact on US labor that has been occurred as a result of our increased trade with China over the last 10 to 20 years, as analyzed by David Autor, Gordon Hanson and their colleagues in the seminal work that most everybody uses to analyze those effects. There’s also a wage impact. Again, building on the work of Autor Dorn and Hanson, US overall wages would—the increase of US wages, and remember here we’re talking about a long-term period with steadily rising trends of everything, that rise would be tempered probably by a couple of percentage points, in terms of the aggregate annual wage by a deal of this type, again, very similar to what we’ve
experienced over the last 10 to years as a result of our increasing trade with China to date.

So those are the adversities that have to be acknowledged and dealt with. There are big offsets, however. As Peter Petri’s work showed the increase in exports, and I pointed that $400 billion per year, would create new jobs, we think of a roughly equal number to those that would be lost on the import side. Export wages, of course, are considerably higher than the nation average by 10%-20%, depending how you calculate it. And so there would be a net increase in the national wage compliment. As I said, about half a million workers over time would shift from manufacturing to services and contrary to what you may think, that would tend, as Brad Jensen’s work has shown in detail, to increase the annual incomes of most of those folks. And if we were able to do an accelerated re-balancing program along with the trade agreement and reduce the US and Chinese trade imbalances significantly as well, that would create many jobs in the United States, well offsetting everything else, but even just through the trade agreement itself.

The conclusion from our analysis is that the US economy would gain $1.4 million of national income for every job lost. The benefits would be 12 times the losses and those benefits would occur on a permanent basis and would be with us every year for eternity, whereas the adjustment cost or one-time cost as the new equilibrium is founded.

I don’t know what happened to my chart, it’s still up there, t’s not there. I won’t worry about it.

The bottom line of course is that we would need to deal with the adjustment cost, even if they’re modest in comparison to the gains. So we suggest extending the phase-ins of the liberalization to insensitive sectors to minimize the difficulties in any given time period. We suggest a multiplication of the program of trade adjustment assistance, maybe tripling it from where it is now, to deal with the people on that side of the equation. But we do believe that the net benefit cost ratio is extremely favorable, extremely positive for the country, and that again, adds to the idea being worth considering.

So the final goal in the book, and I’ll quickly come to an end so Gary can take over, the final part of the book suggests not a single recommendation for how to proceed with all this, because it is a long-term prospect and it does need to be considered, obviously in a whole range of political and economic context, but rather to lay out a menu of options, a variety of possibilities for going down this road.

In the bilateral context between the US and China for example, if it’s done bilaterally, it could be a traditional, all-in FTA where you put everything
on the table together and negotiate a single understanding, to use WTO terminology, or it could be a step-by-step, sequential process dealing with individual issues sequentially over time. In that construct one could view the current BIT negotiation, the Bilateral Investment Treaty, as being step one. We’re dealing with the investment issue in the BIT. And in the book we identify specific issues, tariffs, maybe government procurement, maybe even agriculture, which could be dealt with on a standalone basis, rather than in an overall package, adding up over time to something comprehensive if it panned out that way, but if not being worthwhile on its own merits.

The other thing we suggest is the possibility of doing it not on a bilateral basis, but rather by extending the current multilateral and plurilateral discussions to improve the trade relation between our two countries. The most obvious would be, according to China’s recent indications of interest that I mentioned before, would be an enlargement of the Trans-Pacific partnership at a second stage for China to join, and probably other Asian countries to join as well. We’ve been impressed how the engagement of Japan in the current TPP talks has not generated anything like the political opposition of this country that one might have expected from past US-Japan trade battles, rather it’s going down pretty well.

We suspect the same thing might be the case in a US-China pursuit, that to do it via a regional framework might be more acceptable, more politically doable than going at it bilaterally. But if it would be too much for China just to accept the TPP and join an agreement negotiated by others, you can envision a meshing of the TPP and the RCEP that China itself is leading, or per China’s own proposal in this year’s APEC meetings, one could imagine negotiating a separate free trade area of the Asia Pacific that encompass the TPP and possibly the RCEP if it came along in time, would be a separate agreement but would encompass many of the same templates, objectives and outcomes that could be done through a bilateral or TPP extension.

The point being, and if one believes as we do that this is incredibly important to pursue, should even start being discussed now, there are many different ways to do it and it would be up to the governments obviously to negotiate what might be the best way to do it.

I’ll just close by elaborating on one point that Carla made at the outset. She was quite right to remember that the then the Trade Minister of Korea came to me back in 2000 and said, “Do a study of a US-Korea trade agreement to see whether it might make sense.” At that time there was absolutely no discussion of a US-Korea agreement, either in Korea or in the United States. To the extent there was there was total hostility toward it. The Korean business community was against it, their agricultural
community of course, was deaf on it, and in here in the United States, nobody thought Korea could be an FTA partner.

But their trade minister had a vision, we did do the study, as Carla said it became the basis for a lot of discussion. Fast forward 12 years later, it took a while, but we had an agreement and KORUS now exists, and it’s probably the most important bilateral trade agreement the United States and certainly Korea have ever negotiated. The point being, patience is required, but you only get down the road, I think to quote a famous Chinese proverb, by starting one step at a time.

So that’s the objective of this study. In it, as I said at the outset, I’ve had enormous cooperation, help, leadership from Gary Hufbauer, our younger colleagues Sean Miner and Tyler Moran, and I’d like to now turn the podium over to Gary to explain what it would mean in practice. Thank you very much.

Gary Hufbauer:

Well, thank you very much Ambassador Hills and Fred, for that great presentation. The subject is so hot it had burned out the bulb that would have showed it on the screen. Most people have the PowerPoint in rather small type, and—oh, it’s come back. Oh my gosh we changed the bulb, okay. We’re here. I guess Fred was going to just look at those two rows of income gains which emphasize what Fred said about the export gains. And let me just start with this.

But before I start with this, let me just say that this slide, which again is thanks to Peter Petri who’s here, as are all the other numbers on the income and export slide, summarizes the payoff in terms of exports. Not in terms of income, but in terms of exports is very useful.

Now, for those in the room who follow District of Columbia elections, you know that Proposition 71 will legalize Marijuana and you may think that Fred and I have taken an early toke with our dreams of a China-US free trade agreement, but we want to assure you that as Fred said, this study is grounded in reality and we haven’t got the hard issues.

Now, over the past year and more, our colleague Sean Miner has worked really day and night on this. Sean please stand up. Where are you Sean? Don’t hide. He’s worked very, very hard. There he is at the back. And he will be a scholar on China-US issues for years to come, and he was over-worked to a certain extent that we had also drag in his colleague Tyler Moran to help us with the numbers. I don’t know what’s happened to Tyler; maybe he’s taking a rest today. But in any event, this took a lot of work.

Now, there are difficult issues, as Fred said, and I guess the bulb has gone out again, so I invite you to turn to the small-type PowerPoints as I go
through them. The starting point, if you have the PowerPoint, is that Chinese barriers, as Fred said, are considerably higher than US trade barriers, and this is particularly true for non-tariff barriers. Tariffs on both sides are actually quite low. But non-tariff barriers is where the action is, and Chinese agricultural barriers, we estimate the tariff equivalent, when I say we, I mean Peter Petri, at about 33% ad valorem tariff equivalent. But that’s small compared to what’s going on in services, where we estimate it’s an almost 80% tariff equivalent. And those very high numbers would come down in the modeling work that Peter and his colleagues did, but we’re not assuming that they are eliminated; they are reduced by about 40% of their figures, their baseline figures. And that is an important driver on the agriculture and services side of the benefits that we see.

Now, there are a number of difficult issues, again as Fred said, and we have a chart, if you look and read the small print. We just list on a chart some of the difficult issues. In our next few remarks I’m going to talk about just a couple of them as teasers if you have time to tear yourself away from John Grisham you can read the details on your next airplane ride.

Now, service exports from the United States will be a big part of the story going forward. The United States has a strong comparative advantage in services, by which I mean business services, principally. The actual barrier numbers you see for the United States in the previous slide are probably too low, but that doesn’t make much difference. The US just has a very strong comparative advantage in this realm. The baseline forecast is that the United States will export almost a $1 trillion of services in 2025, but CHUSTIA would increase that by about 18%, as the numbers previously showed. That’s a big increase.

The US outward stock of foreign direct investment in services, and I think this is not well-known, it’s about three quarters of US outward foreign direct investment. We’re not a big outward—we are a big outward in absolute terms, but proportionately our big outward foreign direct investment is in services, not manufacturing. And agriculture is really quite small.

So the projected US services exports to China, we tried to divide it between activities, that’s a very rough division. You have a chart on that, I won’t go through it. But right across the board in business-type services the US would have a big increase under CHUSTIA, with some substantial liberalization, but not complete liberalization in China.

China has free trade agreements with Costa Rica and Chile, which have services chapters, but they are not nearly the depth and the extent as US services chapters, for example in NAFTA, with Singapore in what will be
anticipated in TPP. So that’s one level of difference which hopefully CHUSTIA or some comparable agreement would overcome.

China has historically listed or negotiated its service barriers on a so-called “Positive list” basis, where it enumerates services that are open to foreign investment and foreign trade that very recently, in fact not yet quite ratified by Canada, but the China-Canada investor protection agreement, its BIT, will be the first on a so-called “Negative list” basis, where Canada did its best to reduce the accepted service sectors. Even in the Canada agreement, cross-border trade in many areas is still quite restricted by China Digital Legal Finance, and of course foreign direct investment in services is comparably restricted.

Let me say a word if you’re following in on the slides, a quite surprising feature which is noted by our Congress, is that the foreign bank market share in China is no different now than when China entered the WTO back in 2002, 2%. And there are very strong promises in China’s succession protocol to liberalize banking, but they haven’t been delivered and 2% is where we have it. Another restriction, or a very concrete restriction, is that a foreign bank must have $10 billion worth of assets in China in order to do business there and it can only accept deposits over a million RMB. So these are pretty heavy restrictions, and then you can talk about ATMs and so forth. Cross-border electronic trade and financial services with China just does not exist. So concretely that means that Fidelity and Vanguard cannot sell their funds to Chinese residents.

Now, turning to foreign direct investment in both directions, I think everyone knows that the United States is a huge attractor of foreign direct investment coming in as well as going out and China is a huge attractor for foreign direct investment coming into China and also increasingly going out. However, the direct Chinese-US foreign direct investment numbers are just surprisingly small. The official statistics on the US side are completely inadequate, but our colleagues [inaudible 00:47:09] have done some better numbers. The Chinese stock in the US is probably only about $40 billion now, which is quite small, given that we have $2 trillion of inward foreign investment. And the US has only about $50 billion of investment stock in China and the Chinese numbers are better, so that’s probably a better number. We estimate, we forecast, that with more liberalization the China stock in the United States could reach maybe $120 billion; US stock in China could maybe go up $160 billion by 2020, just six years from now.

If you look at the current composition of foreign direct investment, the US direct investment in China is really concentrated in manufacturing; that’s about 60% of the total. Again, it’s in the slides. But I want to contrast that number with US foreign direct investment worldwide, where it’s not all
services, it’s three quarters services, 70%. And that just goes to this under-representation of US services companies in China. I mean, they can’t get in because of the barriers. Of course, Chinese foreign direct investment in the United States is concentrated in energy manufacturing and food stuffs, it's Smithfield’s deal. In the future infrastructure could be a big number for China coming into the United States, because China’s infrastructure capacity is just top of the line; it’s world class.

Now why is investment so low in both directions? And that’s what we call the CHUSTIA Trade and Investment Agreement. Well, national security restrictions do limit investment in certain sectors, in transportation, communications, natural resources are there. China interprets national security quite broadly and in fact, there's a national economic interest test which the United States with sticks with national security and that is fairly limiting. There are political objections on both sides; there are probably more in China than the United States, on mergers and acquisitions. China would like our [inaudible 00:49:26] to apply the same standards to China as we do to Britain, that’s not true today as we outline in the book. You can find concrete examples to the contrary. Maybe as trust grows we can take a more liberal attitude towards Chinese investment.

But turning to Chinese barriers to US foreign direct investment, domestic firms in China receive more favorable tax treatment, but also they’re quite favored in procurement. There, as I’ve said, a long list of restricted and prohibited sectors and then there, where it's open less than 50% ownership is permitted by foreign companies. Very importantly as the Chamber of Commerce’s, Jeremy Waterman and his colleagues have shown, is the Chinese application of the anti-monopoly law. They’ve turned out a terrific report at the Chamber. I’ve not seeing it rebutted by Chinese authorities, which I think convincingly shows that the Chinese authorities are using the anti-monopoly law in a discriminatory way against foreign companies, not just US companies, against foreign companies in a lot of dimensions, and that needs to be dealt with, and the approval process is quite opaque.

As Fred said, the Vice Minister of Finance Zhu Guanyao was here just recently and for the bilateral investment treaty he made the very optimistic statement that it should, and we agree with this, it should be wrapped up next year. It’s in a negotiation for quite a period of time and it would deal with some of those problems they talked about. So in Fred’s concept of a step-by-step the bilateral investment treaty would really be an important step, particularly if it was a first-class agreement. These talks started in 2008, so 2015 is seven years later, but this would be an important step.

It has to be said and recognized that if it comes forward as a treaty that means ratification by the senate and that means a two-thirds vote and everyone here knows the politics of a two-thirds vote. And there are now several BITs backed up in the Senate. So it’s not that it’s just on the
Chinese side, the US side has its own difficulties, maybe it would be converted into a bilateral investment agreement requiring both the House and the Senate, but by majority votes to approve. But in any event, that would be a very constructive step.

There is a slide, I won’t go through it for reasons of time, that goes to the US goals in the BIT. I think I've pretty well mentioned them. The anti-monopoly feature is certainly a big one, the negative list is certainly a big one, pre-establishment rights are very big, that’s where a company goes in and can explore before they invest. So there are things that will be done in that.

Let me almost wrap up with the state-owned enterprise issue and this was mentioned [inaudible 00:52:44].

Now Nick Lardy just published a very impressive book, dramatic new information on and is titled is Markets Over Mao, So the title tells you what’s going on. And Nick’s research shows that China has become a very capitalist country and in some respects it’s more capitalist than the US. And the role of state-owned enterprises has gone down, down, down. However, of the top 10 enterprises in China about nine are state-owned enterprises. They’re subject to oversight by SASAC and the state council chooses the top leaders of the 100 biggest. So there’s quite a concentration of power and those big ones are in industries where US firms in the services industry would like.

So what’s the US wish list for state-owned enterprises? And this is now being tried out in the TPP? We’ll see how far the TPP gets; our book goes into some speculation on that. But it’s important to emphasize, particularly for Chinese in the room, that the United States is not on a privatization binge. We’re not asking state-owned enterprises to be quickly or slowly or whatever privatized, but we do want a more level playing field. And it’s not only China, I mean, Vietnam is obviously the frontier country at the moment, but this is an issue with Europe as well and Mexico and others.

So what do we want? We want transparency in financial statements. They ought to be the same as GM or whatever, Shell. We want disclosure of preferential treatment. That means subsidies, that means offsetting cost by lower public service tariffs and so forth. We want effective competition rules on SOEs, and there I go back to this anti-monopoly issue. As far as we can see SOEs are not even examined by a monopoly authorities in China, or barely lightly touched, but they are the monopolies. So an SOE should not be able to expand into a line that a private company cannot, for example.

The SOEs should make their decisions based only on commercial considerations; and that is already in the WTO, but it ought to become true
practice, not just kind of a wish list. And importantly, the SOEs ought to be subject to the government procurement agreement in the sense that they open their procurement to the same extent as a government agency.

Let me finally go to dispute settlement. In this institute, at least I and I think some of my colleagues, we really believe in strong dispute settlement as a cornerstone of any meaningful trade or investment agreement. And some of us are old enough to remember the old Friendship Commerce and Navigation Treaties which the United States had as a series from the 1920s until the 1960s even. These were nice agreements, but there are no dispute settlement in any of them and none of them had any effect on anything in terms of trade rights or investment rights or indeed anything else. And as you know, the WTO finally got the meaningful dispute settlement with the Uruguay Round in the Marrakesh agreement.

Well, as a result of that agreement the United States and China, big parties as Fred has emphasized, we’ve had a lot of cases against each other and for the most part they have been satisfactorily resolved. That is China actually—I don’t mean to sound patronizing, China really observes negative findings by the WTO, influence them to a very high extent. And the United States has a, I would say not a perfect record, but a very good record. So the cases that have been decided have been pretty well resolved and there are a lot of cases and there will be more in the future. We think any agreement, CHUSTIA, TPP, we have to see what TPP will have in dispute settlement, FTAAP, but it has to have a meaningful dispute settlement. If it’s not in the agreement the agreement isn’t worth very much.

So finally, let me wrap up on an issue which is a hot one today and would be important in a China-US, any China-US accord, and that is Investor State Dispute Settlement. There’s a big backlash and I would say an uninformed backlash against Investor State Dispute Settlement today in TTIP, possibly in TPP and in some individual countries. The Investor State Dispute Settlement system could be improved with more transparency, but this would be a critical element in the BIT which might soon be negotiated and in any future agreements between the United States and China. Thank you very much.

Carla Hills: We’re almost on schedule. We’re about to start a wonderful panel, and I’m going to ask, because we have limited time. We said we were going to finish at 1:30; we might go over 10 minutes. Turn off your phones and I’m going to turn to Myron Brilliant to introduce this panel.

Myron Brilliant: With high efficiency, Carla. Let me just say a couple of things at the outset. We’ve praised a number of people today for their contributions on US-China relations, but I get the chance to praise Ambassador Carla Hills
who not only sits as a Board Member of this fine institution, but her work with CFR and with the National Committee on US-China Relations and many other organizations. So it’s indeed a privilege to get that brief introduction by Carla Hills. But I want to just say that her contribution over many decades to this relationship is on par with any of the people that have been described before. So let me begin there.

Secondly, I know Adam Posen’s not here, but of course he is now the head of IIE and I do want to recognize him.

Then turn, of course to Fred and Gary. Fred, in your very outstanding description of why the institute undertook this project to look at the possibility of a US-China free trade agreement, I think it’s fair to say that you’ve been the architect of many great ideas. A person who has contributed over your tenure, not only as the head of the IIE, but your tenure in Washington, you’ve contributed to many, many great ideas and at times many of them have actually gone through. So this may be a sign of an opportunity that we should all take very seriously in this room.

I know that when Fred referenced his US-Korea FTA story he left at a part that the US Chamber would like him to talk about, which is he did raise this idea in 2000, but it was the US Chamber of Commerce in 2004, 2005, working with the American Chamber of Commerce, then Tami Overby the head of it, that began to really advocate it for publicly. So it’s the partnership between the thoughtfulness and the economic understudy that has been done by institutes like IIE, combined with an advocacy effort that makes these things come to life.

And I remember specifically sitting outside of a State Department meeting where Rob Portman was and tackled him basically to say this is a great opportunity for you as now the new USTR, because his predecessor who’s not here to defend himself, Bob Zoellick another member of IIE was never an advocate of a US-Korea FTA. So this shows you that there are moments of opportunity and this is one, I think, that is an important on behalf of the US-China relationship.

I also want to acknowledge Gary Hufbauer because Gary did a lot of the hard lifting in this book and I know Professor Petri did the economic analysis as well. But Gary had to attend a lot of meetings at the US Chamber and with others in the business community to get their take and of course, had to do all the writing and support, Fred as well. So I want to make sure Gary gets his due. And I know that Jeremy Waterman from my team, who works for Tami, who runs the US Chamber’s China program, provided a lot of avenues to companies to get their input for a lot of the chapters that were conducted or put together for this report.
Carla Hills and Fred have mentioned Hank Greenberg. It is true that Hank was a pioneer, not only in the US-China relationship. I like the reference to Kissinger and of course Secretary of State Kissinger stands apart, but there is no question that Hank Greenberg over his tenure at AIG and of course, his continued support of this relationship, played a pivotal role in raising consciousness about the idea of a US-China free trade agreement. Not only did he talk this up at the National Committee for US-China Relations and the US-China Business Council, but he harassed Tom Donahue and myself over many, many meetings and calls. And of course, as [inaudible 01:02:39] and others know, was successful in getting us to be strong advocates of it, in the context of a US Chamber track two dialogue that we do with our friends in China. And I can say that it has been the subject of much discussion in that context.

Alan Wong is with us who is the Executive Director of the China-US Exchange Foundation. This is a foundation that was started by Tung Chee-Hwa, the former Chief Executive of Hong Kong. Many of you know that Tung Chee-Hwa has been another strong advocate for the US-China relationship and Tung Chee-Hwa was a supporter of this study that IIE undertook. And I would just say that the Peterson Institute would acknowledge that C. H. Tung played a great role. Fred spent a lot of time with him, so did I and many others as this project was being developed. And I’m sorry he’s not here today to participate in today’s forum. But Alan has himself a great deal of experience, having not only served as the head of this foundation for Tung Chee-Hwa, but also in his role at the Hong Kong Trade Development Council, where he not only served with distinction in Hong Kong, but served in many posts in the United States and has a long history as well.

Now, this is after all, a Peterson study, but I thought it would be useful to just hit a couple of points and I want to reiterate everything that Fred said, because I want to make sure that we have plenty of time for a discussion here today from all of you to participate to the great panelists we have. But I do want to acknowledge a couple of key points and why we were supportive of this study.

We’ve come a long way in US-China relations since 1972 when diplomatic relations were started, when President then Richard Nixon and of course Secretary of State Kissinger, with their counterparts Chairman Mao and of course, Premier Zhou. The relationship at that time was a fragile one, but there was a shared understanding and commitment to a future in the relationship that would be deeper and stronger over time. Now we have many strains in our relationship. We have many challenges in our relationship, some of them are economic, some of them in the geopolitical area, and perhaps our strategic vision has changed over time, but everyone understands there are mutual benefits to this relationship and
that we need to advance these benefits, not just for the United States and for China, but because these two countries play such a dominant role in global affairs. They’re not just the largest two economies in the world, it’s not just that China’s rise is inevitable, it’s the important role that they will have in global institutions. And so it’s very important that we get this relationship right.

As it continues to mature, this relationship, we have to overcome distrust in the relationship and we have to have a shared strategic vision for how we can energize this relationship through thick and thin. We’ll have our disagreements; we have them today. We’ll have our strains over commercial issues, some of which was discussed by Fred and Gary and they're important issues to be resolved for sure. But at the senior levels of government and in the business community we have to have advocates that understand that the long-term vision for this relationship has to be one built on trust and mutual respect.

And it’s in this regard the US Chamber, the largest business federation in this world and the largest certainly business organization in this country, we feel very strongly that advancing trade and investment ties between these two countries is critical. It has been a bedrock of this relationship for decades and it will continue to be an important part of this relationship. And so we have wanted to support, not only the study, but the economic reform opportunities that exist and the economic openings that can be, I think, developed by a stronger economic partnership.

Now, President Xi Jinping and Premier Li, through the Third Plenum and other recent discussions, have talked about the process of reform and opening that needs to take place in China. I don’t think that it’s possible without them thinking about what they need to do domestically. And how to drive that domestic reform, I think has to be done in the context of how they conduct their foreign policy.

A number of factors, I think, will be considered as the Chinese look at how they want to promote trade and investment and how they want to develop their economy. But certainly from our standpoint in this moment of time I would just point to four or five quick areas that we look to as an opportunity. One, we know China, as I said, is looking at unprecedented reforms in its economy that will include how they want to encourage foreign direct investment. And so that is important as they consider opportunities for advancing trade relations and through such vehicles as a free trade agreement and of course the bilateral investment treaty, which I will talk about as well.

Second, both the United States and China, and Fred alluded to this, are negotiating separate deals, separate regional architectures, we’re doing
TPP, the Chinese are doing RCEP and they’re looking at a number of free trade agreements as well. And if we don’t look at ways to pull these things together or talk about how we want to work together constructively, then we’ll work separately and that would not be to the benefit of our mutual relationship, but not also, it would also not be to the benefit I think of global trade.

Third, China has increasingly expressed interest in joining the Trans-Pacific Partnership and the Trade In Services Agreement, TISA and is negotiating, as I said, a number of FTAs. And so, I think this context is very important to how they might look at the prospects long-term of a free trade agreement between our two countries.

I add the importance of the BIT negotiations because you need to have a strategic overarching vision, but a step in that direction would be China and the United States finishing up their bilateral investment treaty negotiations. Something the two governments are talking about, but now is a question of how quickly they can move to put that into action. We’ll see soon, because the Chinese have an offer to make on the negative list that was referenced by Fred and Gary and we’ll see how robust that list is and how serious they are.

The Peterson Institute study is a big initiative and we need to vest in big initiatives in this relationship. We need to be committed, as I said, to a long-term vision for how we can reinvigorate the relationship. And so we are very proud and supportive of the study. I won’t go through all the notes I have here. What I will say is that the study was very consistent, as I noted earlier, within the context of our own US-China, CEO and former senior officials dialogue in which we, with our partners in China, the China Center for International Economic Exchange, CCIEE, which is chaired by the former Vice Premier of China, Zeng Peiyan. And Zeng Peiyan and the Chamber and the participants in that dialogue have been, I think, at the forefront of supporting a strategic vision that would incorporate at some point an FTA between the two countries. Lots of hurdles, lots of obstacles, short-term for that, but you’ve got to have a vision and this gets back to one of the things that I remarked about Fred and his work over many decades.

So we’re not ready for an FTA in our view. The Chamber isn’t here today to endorse an FTA, but we are here to endorse the study and the concept and the foundation behind that study. We want a stronger vision, bold leadership, and we want a committed business community on both sides to working through the challenges that we have. The trade barriers have been discussed, the investment challenges. The fact that so little investment comes in from China today in the United States, that’s changing; the curve is increasing significantly. But we’ve also seen a leveling of US
investment in China that is not a long-term solution to stronger economic partnerships.

So we have a lot of work to do. We have what 65, 66 dialogues between the two governments. The important ones here, of course, are the strategic and economic dialogue, and the JCCT. But I have to say it is the private sector that will be the engine of economic growth between our two relationships, but governments can do everything they can to remove the blocks and the obstacles in our way. None of this will be easy. No one is suggesting that an FTA between the two countries will be easy to launch. And so we have to lay the groundwork, prepare the economic arguments, do the work we have to do around this country to educate people about this relationship. And I would argue the Chinese have to do the same in their country; educate their people about the importance of this relationship. We can always talk about the frictions and the challenges, but we need to talk more about the opportunities for enhancing our economic partnership.

And so as I conclude here with my brief opening remarks, hopefully relatively brief, I just want to say that we’re very delighted that a number of you have showed up here today. It’s the beginning of a new chapter; it’s a discussion we need to have, but certainly no one is suggesting that the new chapter will be closed any time soon. We’re opening up a new dialogue, a new opportunity and it’s important for us to have that dialogue.

So with that, I would like to see if Alan wants to make a few comments first and then I’d like to open it up to the floor for some thoughts and questions and inputs for this robust group of academics and leaders from various fields. So thank you.

Alan Wong: Myron, if I can just sit here.

Myron Brilliant: You may.

Alan Wong: Okay, thank you. Thank you very much Myron for allowing us to participate. As you may remember, the US-China exchange foundation did an economic study last year and this was the result of a tremendous contribution from a number of very well-known institutions as well as personalities and luminaries, including of course, the Chamber and also, I think, Gary contributed also some chapters to our study.

Going back on to the study, the study was about to look at US-China economic relations in the next 10 years. As a result of that we came up with a number of recommendations, one of which was to explore the possibility of a free trade agreement between our two countries. Now that happened also to be the idea of Mr. Hank Greenberg, who happened to be also a member of our steering committee. So we thought that that was a very, very good suggestion and then the Chamber came in and said,
“Look, why don’t we look at this in much more detail and look at how this can be taken a further step?” So given that opportunity, we are very pleased to be part of it.

We do feel, in the China Exchange Foundation, that the cornerstone of US-China relationship is built on economic relations. This doesn’t mean that economic relations is the only foundation, but it is certainly one of the most important one. If you look at, for example, starting from the year 1979 was the year when a formal relationship was established between the two countries. Trade was only about $2 billion then. And now we are talking about $560 some billion; an astronomical expansion of more than 200 times. Likewise in investments, for those of you who are following those figures, I think this is now widely recognized that Chinese investment, FDI to the US is now roughly equivalent or exceed that of Chinese investment into the US.

I think if we look at that to may be 10 years ago or even five years ago, this would be a very, very surprising phenomenon, but now this is now with us. So trade and investment, in a way, not only facilitate this exchange of investment and transfer of monies, but it also facilitates the exchange of people, the exchange of ideas, the understanding of culture, and so on and so forth. So the contribution of trade and investment to the bilateral relationship goes beyond that of itself, of trade and investment.

Now, I want to just raise another point, that in both of our countries people look at globalization, free trade, so on and so forth, with a slightly different angle; some people do that, because it takes away jobs. Both Gary and Fred talked about shifting of jobs from one area to another and loss of jobs or more often the export of jobs.

I like to just take a look at—site the example of Hong Kong. We are a very small city, and in the year, I remember, 1979, mainland China was starting to open up to foreign investments. Our share at that time, the share of manufacturing industry in Hong Kong was about 24% of our total GDP. If you look at the share of manufacturing now in Hong Kong it occupies less than 1.5%. So with that very drastic drop from 24% to 1.5% one would imagine that the loss of jobs will be of disastrous consequences. In the case of Hong Kong in the longer run, we are now achieving something like 3.3% unemployment, which practically is full employment.

Now, what actually happened between those years, 1979 to up to now, is that we have shifted most of our jobs into the services sector. Services sector in 1979, 1980 occupied about 67% of our economy. Now it occupies 93%. So Hong Kong has done a drastic transformation, I would say fairly successfully, without losing jobs, without actually losing jobs. So I think, I just want to cite that example to assure those who are very
skeptical about free trade, who are skeptical about investment, that there are examples, actual examples that such transformation does not need to be disastrous to the employment situation.

Finally, I just want to make another point that at this stage of China’s development China needs very much to transform its economic structure and I think both previous speakers already mentioned that. China needs to change from export-driven and investment-driven growth to internal consumption and higher value-added activities and higher services industries. And I think the discussion of a free trade agreement will certainly facilitate those transformations. Although I think the road ahead will be difficult, will be long, but I think we need to start and accumulate the momentum and move forward.

With that, thank you very much for the opportunity.

Myron Brilliant: Those of you who have not seen the report that Alan’s referencing, it’s an excellent in-depth study of a US-China relationship. C. H. Tung, Victor Fong and others were the principal drivers of that project and there are a number of people who support it; so I highly recommend it.

With that, why don’t we open it up. If you could introduce yourself, but brief intervention, so we can get a lot of questions and ideally take two or three at a time and then invite the panelists to respond. Who’s brave enough to go first? Well, if no one’s brave enough, I’ll jump in. But anyway, go ahead.

Robert Rogowsky: Hi. Robert Rogowsky at the Monterey Institute in Georgetown. I’m going to maybe pick on Fred a little bit, but talking about the FTAAP as a vehicle for doing this, is that a much more reasonable approach for this strategically than just a bilateral FTA? And secondly, strategically does the TTIP and the problems between those two large economies give us any guidance on problems or direction for a China-US FTA?

Myron Brilliant: I’m going to encourage Fred to just put off for one second, because I one, forgot to mention Professor Petri’s up here. I don’t know if I referenced him and if I didn’t I’m sorry. A Professor from Brandeis, who’s been referenced I think, by Fred and others and Carla Hills, who provided economic modeling on this and also might have reflections on that question as well. Anyone else who would like to add and then we’ll go back to the panelists. Go ahead. Right back here.

Liu Jing: My name is Liu Jing from Chinese Embassy. Many thanks and congratulations to Mr. Fred and Mr. Gary. You really selected a really good topic and made a deep and insightful research, so I’m saying that the job is well done. Congratulations.
This is the exact report I’ve been waiting to read for a long time. Your idea to bring US and China together by the CHUSTIA is really wonderful and I think it will help to improve the overall relationship between China and the USA, not only economically, but also in security dimensions.

So I think this will not just benefit the two countries, but also to the whole region and the world at large. So thanks to your significant contributions to the world prosperity and stability. I suggest your team should be the winner of the Nobel Peace Prize next year.

Myron Brilliant: I’m not sure that qualifies as a question, but it does qualify as a compliment for Fred and Gary, so…

Liu Jing: I have a question. My question is also about FTAAP. You mentioned that FTAAP is one of the roots that could bring the two countries together. And I know this year, because China is the host country of APEC and the Chinese government just proposed to launch the process of FTAAP. And a lot of discussions there. And it’s lucky that all the member countries agreed to launch the process, but there is still some argument there about whether we should set a timetable, a schedule of FTAAP. And also should we launch a feasibility study of that? And I think about this kind of ambitious idea of FTAAP, if you don’t have a clear time schedule you will just let a proposal be on the clouds in the sky. You will never get a chance to make it come true. So I think-

Myron Brilliant: [Inaudible 01:29:56]? Just so I can make sure the panelists can respond.

Liu Jing: Yeah. Sure. My question is do you think we should set a clear target and a time schedule for FTAAP? And if you think it’s appropriate, which year do you think should be reasonable for us to realize this kind of idea? Thank you.

Myron Brilliant: So let’s turn to Fred first and then Peter and Gary, if you guys want to add to that and then Carla, if you want to offer a perspective from a former trade negotiating standpoint, by all means jump in. Fred.

Fred Bergsten: Since our friend from the Chinese Embassy nominated us for the Nobel Peace Prize, I’ll gladly accept it. I’ll have to respond to him first and then come back to friend Rogowsky.

I have to admit to some biases in answering your question, because back when I was chairing the APEC Eminent Persons Group over 20 years ago, we actually concocted the original idea for what has now become the FTAAP and we set time deadlines. Those of you with long memories will remember that when APEC got started with its initial summits, 93, Bill Clinton, 94 in Indonesia, amazingly they adopted the report of our
Eminent Persons Group and set a goal of achieving free trade and investment in the Asia-Pacific region by the years 2010 for the developed countries and 2020 for the developing countries. So when the idea was first constructed all these many years ago they did set a timetable.

I remember in the APEC summit when they set the timetable there was some debate as to whether that was a good idea. And President Bill Clinton looked around the group and said, “Come on fellas, this is easy. None of us will be around then, so we can set the date.” There was one exception, the Sultan of Brunei piped up and said, “Well, I expect to be around at that time and so it’s harder for me.” In any event, they set the timetables. Now you can judge whether those timetables had much effect. 2010 has been missed, 2020 is not—I think it’s still too soon to achieve anything of the type we mentioned. So those timetables did not work out so well.

On the other hand, and Carla will testify, in our domestic trade policy here in the United States it has always been useful to set timetables, particularly when the Congress set an expiration date for the Fast-Track or now Trade Promotion Authority, the date when it expired turned out to be an effective deadline, a fairly effective deadline, for conclusion of trade negotiations. And in fact the Korea-US agreement was completed 10 minutes before the Fast-Track Authority expired in June of 2007. Precisely so, it could come under the Fast-Track rules when it came to the Congress as it did, although it was four years later.

So it’s a mixed record, it’s a mixed record to be quite honest. I have always personally liked deadlines for the reason you said, particularly if the leaders will then followup. That’s the key thing. If the leaders, after they set the deadlines will followup and tell their negotiators, their ministers, their officials, that they the leaders mean business and really want to meet those deadlines, then it can be action-forcing. Other things can be action-forcing, big international meetings, annual G20 summits, SNED meetings, as you mentioned. So there are a whole variety of action-forcing events that are useful in trying to push intergovernmental procedures forward.

So I guess on balance, I would support your idea. I’d say it’s worth setting a deadline. The problem right now with choosing the date is that we don’t know how quickly the current negotiations, the TPP and maybe even the RCEP, how soon those building blocks are going to be finished. Then that raises the substantive question that you raised about the FTAAP idea itself. And you said, should there be a feasibility study of an FTAAP?

I think what’s different now, very different now from where it was 20 years ago, even a few years ago is that, as I said in my remarks, other things have happened. I think the TPP will become reality. I’m not sure yet
about the RCEP or how fast it will become reality, but those other pieces that will be inevitably building blocks have to be, I think probably have to be accomplished first. I know the Chinese idea has been to start thinking about an FTAAP simultaneously with the finish of the TPP and I’m all for that; I think that’s a good idea. But it’s hard to know at this point how quickly the TPP will finish. Optimistically, if the TPP finished next year, took a couple of years to ratify, then in the various countries might go into effect say 2018; that would probably be the earliest. Then I think to say that it could be enlarged into an FTAAP by say 2025 it would probably be a reasonable prospect. But something along those lines would be my best guess.

Let me come back to Rogowsky’s initial questions. And it really relates to what our friend from the embassy was saying, would TPP be more strategic than a bilateral agreement?

The original Hank Greenberg idea was for a bilateral agreement on the grounds that that would do more than anything else to offer the possibility of strengthening the US-China bilateral agreement. You do it bilaterally you get to know each other better. Yes, you’ll have problems, but you’ll work through those and if there’s goodwill and political leadership it will strengthen the bilateral relationship.

In our study we actually come out different from Hank Greenberg, because he proposed the bilateral approach, we looked at that. But we came down preferring to do it via an expansion of the TPP on the grounds and this goes back to my first answer, on the grounds that that would be a living agreement, already negotiated, already approved by our own Congress and various parliaments. And as I said in my remarks, that it might be less difficult in the domestic politics of our own country, but I suspect other countries as well, to do it through a regional or multilateral umbrella.

Again, just to repeat for emphasis, I at least have been, pleasantly surprised, by the extent to which Japan’s entry into the TPP has been so widely accepted. Having been a veteran of the Japan bashing era two or three decades ago and remembering how those memories are still fresh in some people’s minds, I would have worried if the US and Japan had gone for a bilateral FTA, I think it would have brought out a lot of those hostilities of the past. Whereas, it seems, at least so far, that Japan and the US doing an FTA via the TPP has been much more acceptable.

It’s interesting, just so you all know, Petri’s study show that something like two-thirds of the economic impact of the TPP is the result of its being de facto a US-Japan FTA, the two biggest countries in the agreement. Likewise then, an expansion of the TPP that would include China would be to a very important extent a China-US FTA. And I think some of the same dynamics in both economic and political terms would play through.
So since I think, as I said in my remarks, as we say in the book, that trying to bring the two countries together to overcome both the economic problems and the strengthen the base for security relations it's so important, find the way to do it that would be most likely to succeed, there’s a big argument for that.

Your other question was whether much is to be learned from the TTIP experiment? My guess is not. The US and Europe are at such equal levels of development, high-income countries, very elaborate regulatory regimes and standards, that the effort there to harmonize regulatory regimes much more than reduced trade barriers, means it’s really a different animal from what a US-China agreement would be, either in negotiating terms or in political terms. We stress in the book that we very candidly talk about the hurdles and recognize the very different levels of development, the different economic systems, the different political systems, all of which means that it’s a different context than the US-Europe. And then of course, the overriding fact the US and Europe have been political and security allies for more than half a century, US and China are not the opposite, but neither are they allies in the same way US and Europe, so it’s a different political as well as economic context, learn whatever we can from the examples that go on, but I doubt that TTIP would be much of a model for what we’re talking about here. I think TPP itself, plus what we’ve learned from the other ASEAN agreements, the RCEP, the other agreements China’s negotiating.

As Gary said, final point, what we do in the book you’ll see when you look at the individual chapters, in every chapter we build on three things: The WTO rules, the previous US FTAs, and the previous China FTAs. We tried to get as much information as we can on all of China’s existing trade agreements, with ASEAN, Gary mentioned Costa Rica, Chile, there are a few others, to try to understand what China has done heretofore in its other trade agreements as one set of guidelines for what might be doable between China and the United States. So I guess I’d look more in those directions than I would to TTIP.

Myron Brilliant: I’d like to chew on and I just want to see if Peter or Gary, do you want to add to it, either of you? Go ahead.

Peter Petri: Just one second. I mostly agree with what Fred said, but I just wanted to let you know that these discussions obviously, are going on quite actively in the academic and policy communities around APEC. In particular there were a couple of very good conferences held in Beijing, which are summarized in the book and much of what that is about is to try to figure out what are the paths to region-wide integrations or back to the Bogor Goals that Fred mentioned?
And I think it’s too early to say that FTAAP will not be it. I mean, it may very well be FTAAP that takes us to the Bogor Goals, or it may very well be that the TPP can be expanded into something like FTAAP and the Bogor Goals. So my guess is it’s a bit too early to say exactly how that’s going to go and it’s too early partly because we don’t really know how the TPP will come out. That may be an excellent pathway or it may leave options open that would have to be negotiated later in more complicated forms. So it’s in a way both a positive statement about how good it is that that issue is now on the table and being discussed and perhaps caution about how precise to make that discussion [inaudible 01:42:51].

Myron Brilliant: Okay, I’ll react at the end to some of these comments. Let’s take two or three more questions from the audience. Go ahead, identify yourself I saw you in the back and then of course, I would never not call on you Pat, you’re third. Go ahead.

Ernie Preeg: Thank you. Ernie Preeg, Manufacturers Alliance. And my question is about the manufacturing sector, the technology-intensive manufacturing sector, because of all the discussion of the huge trade imbalance with China that’s been surging the last five years. We import six times more manufacturers than we export. And this is the story of Hong Kong is not very reassuring. That with free trade with China over three decades, manufacturing by 24% to 1.5%. In the 12 years we’ve gone from 15 to 10, still going up percentage of GDP, while China is way up at 30. So this relates to the problem, which is my question of this major trade-related policy issue we’re discussing, which is Chinese compliance with IMF obligations for exchange rates. There are two: convertible currency and current account and not to manipulate currencies as defined by the IMF, government intervention.

So my question is, particularly to Fred and to Myron Brilliant, is how important is it to make real progress for China to comply with its IMF obligations on exchange rates before we can seriously consider official engagement in going to free trade? Thank you.

Myron Brilliant: Okay. We’ll take the other two questions and then we'll respond. Go ahead.

Jennifer Lee: Thank you. I’m Jennifer Lee, with Hong Kong Phoenix TV. Thank you for the panel giving us very inspiring facts about the two countries' collaboration. I think the benefit of your suggestion is really clear, but in the report you also mentioned a couple of challenges, such as the intellectual property or cyber-espionage. We also see some challenge between the two countries, either at the military side or security side. So I wonder what is the biggest challenge you are seeing right now, so that the two countries won’t collaborate as you suggest?
And then the second question is, in your report there are three modes of
closer collaborations, either forming a CHUSTIA or developed from the
BIT talk they’re doing right now or the third one is the integration within
the TPP and RCEP. I wonder what is the most promising one you’re seeing
at this moment so that the two countries can have a closer cooperation.
Thank you.

Myron Brilliant: Okay. I do think we are going to have to work on that name; that sounds
like a Mexican Taco or something. It doesn’t sound like a US-China free
trade discussion. Anyway, Pat?

Pat Malloy: Yeah, I’m Pat Malloy. I spent 15 years up on the Hill, so I pay attention to
the politics of this. And my understanding is, I’m not an economist but
I’ve been around economists for many years, that net exports when they’re
negative, they detract from GDP and job growth and when they’re positive
they add to GDP and job growth. And according to the chart here on page
4, under the projection here the US will have a $764 billion trade deficit in
2025 of which $674 billion will be with China and China will be running a
$344 billion global trade surplus, most of that because it’s [inaudible
01:46:38] that will be running a $674 billion trade surplus for the United
States. Am I understanding these figures correctly? And how do you
expect to be able to sell that to the Hill?

Myron Brilliant: Okay. Fred, you answer the economic pieces and I’ll talk a little bit about
politics. Well, go ahead.

Fred Bergsten: As both Ernie and Pat know I have been one of the arch hawks on the
issue of trade deficits for the United States and currency manipulation by
China over the years. So I am very cognizant of the issue that you raised.
And I would refer you to chapter 17 in the book which actually is path-
breaking in the sense that it addresses the currency issue and more broadly
the re-balancing issue in the context of a trade agreement. I agree that for
both economic and the political regions you cite, that any US-China
agreement would have to address the topics that you have raised. The
question of how it address it is I think the big open issue

Remember first of all, that the earliest possible time, at least on my view,
our view in the book, that any of this could start to be discussed would be
several years from now. And hopefully in those several years from now the
issue of the global imbalances of the two countries would be further
reduced or even resolved. As I said in my remarks, there has been, Ernie to
the contrary notwithstanding, there has been huge improvement in the
imbalances issue over the last six or seven years. China’s current account
surplus, global current account surplus, peaked at 10% of its GDP in 2007;
it’s now come down to about 2. The US has dropped from about 6 to 2. So
there has been big improvement. The RMB has gone up over 40% trade
weighted over that period of time, reducing the degree of misalignment.
The IMF says it’s now about 5% to 10%. Our studies here at the institute show a little more, but roughly in that ballpark.

So there has been huge progress; there is still an issue. And in the book we say that it would have to be addressed to make a CHUSTIA or something like it possible, hopefully through multilateral IMF monetary channels, which is the best way to deal with this issues. But if those channels continue to fail and they have not certainly been adequately successful over the last decade, then something would have to be done, either as a side agreement to a CHUSTIA or possibly as part of the agreement itself.

Now, as Patrick implied, he didn’t state it specifically, most of you know that, unusual bipartisan majorities of both houses of Congress sent letters to President Obama last year saying that TPP itself and all future trade agreements, I’m quoting the language of those letters, would have to deal with the currency manipulation question. So I think that underlines the politics, but I would say also the economics of it. These are the two biggest economies in the world, for them to continue to run big global imbalances is a problem.

So chapter 17 in the book spells out in detail how an agreement of that type might be put in place. I don’t have time now to go through it, but you can look at that to be in with great care. However, on the analytics, and Peter may want to come in and add to this, I mentioned earlier on that in chapter 2 in the book that Peter and his colleagues wrote, they devised a very creative and I think constructive scenario that they called “accelerated re-balancing”, that would be a combination of basically internal policy changes in both China and the United States, re-balancing the internal economies, China in the direction of more consumption and services, the US in the direction of more investment and exports, which would further correct those international imbalances. The point being that there are plenty of good ways which both governments have actually committed themselves to do to resolve the remaining parts of the issue.

Under that scenario, the US, and this goes to the domestic politics of it, the US would obtain lots of job creation, because I’ll correct Pat in one sense, it’s not that trade imbalance that creates unemployment, it’s changes in the trade imbalance. But with that caveat, there is a drain on US production and employment in a world of less than full employment when you run a trade deficit. So I’ve advocated strongly for US policy objectives of getting rid of those trade imbalances, particularly when they are created by policy intervention by other countries like China and the exchange markets.

So it will have to be dealt with, we spell out in the book a variety of ways to do it. I think your points are both right that to make it politically feasible here and probably economically sensible, there would have to be a
response to those imbalances, but they might be done before the trade agreement ever started being negotiated. If not we'd have to put it under that same rubric.

Myron Brilliant: So I won’t speak for Fred and I won’t speak for Peter or Gary, the architects of this important study.

Fred Bergsten: You can’t.

Myron Brilliant: I won’t; I just said that. But I can tell you what I can speak to, which is there is no question we need a strategic vision. I think everyone accepts that we need a constructive, pragmatic relationship between the two countries. The question is how to get there? The timing of an FTA or TTP expansion, which has been discussed today, it’s in the book and is discussed frankly, as Peter was suggesting, in forums all around Washington, all around Beijing, and all around China. We just had one with CSIS, so there’s a lot of intent here to begin discussing. I would amend your answer to say we don’t need to wait years to have a discussion about the path for the relationship, nor can we wait years to deal with the challenges in the relationship and currency is just one of the areas where there are challenges on both sides.

One thing that the study tries to do, but it’s difficult, is to capture the impact, not just of exports and imports and lowering tariff barriers, but also the investment changes that could take place by having a different road-map ahead in the relationship. If we can advance investment from China to the United States we’re going to expand jobs in this economy; there’s no question about that. So there are aspects of this relationship that could be deepened and I think that is one of the underlying themes of this study. But from our standpoint, contributions to trying to have a discourse, deal with the practical issues, don’t make an excuse not to deal with them, but to have a discourse about how we have an engagement going forward that is more constructive in tone and posture.

It also requires American leadership and Chinese leadership. The political will has to be there, not just dealing with the issues. The political will and that implied in your question, is the challenge of dealing with the US Congress. Those are issues you have to deal with. You have to educate the Congress about the benefits and this is, I think, a study that begins that discourse. It’s not the only one that will be out there, it’s not the only conversation, but it’s an important contribution.

Fred Bergsten: Myron, let me add one word, because I didn’t answer Miss Lee. I just want to answer her first question briefly, when she said which is the biggest challenge? In the first chapter of the book we lay out half a dozen challenges. They are all important. The specific sectors Gary talked about
are all important. But if I had to identify one greatest challenge it would be the mistrust between the two countries. And one of our fundamental objectives in making this proposal is to try to address that mistrust head on by launching a major enterprise that would try to overcome the mistrust on specific issues, but in the broad as well. And at the end of the day, that’s why we think this is so important, that unless we, as Myron just said, unless we adopt a vision, have a shared commitment to that vision, have political leadership that’s willing to follow through and recognize the importance of doing so, then that mistrust is likely to continue bubbling up and poison a relationship that could be devastating, not just for our countries but for the world as a whole.

Myron Brilliant: So it’s a question of really how, not whether. Peter?

Peter Petri: Yeah. I didn’t quite clearly understand the precise numbers that you quoted. But I want to assure you that there is nothing in this study that says that a trade agreement or this free trade vision would increase US deficits or increase China’s surpluses. The projections show that there will continue to be deficits and surpluses, but they will decline quite sharply and the trade agreement itself doesn’t do anything to those.

Now, in addition to that, as Fred mentioned, there is another scenario in which a trade agreement could be coupled with other policies that would accelerate the re-balancing of both economies which would bring them further down. So the numbers are all going in the right direction in the study and I’m not quite sure about the reference.

Myron Brilliant: Pat, I whispered into Fred’s ear. the study after all, shows a GDP growth for both economies. By definition, that means it’s to the benefit. It doesn’t mean there aren’t losers and winners in a deal like this. You’re talking about the largest FTA probably ever reached, but there is clearly GDP growth for both economies.

Okay, other questions. I know we got to wrap up in a ... Go ahead. Anyone else? Questions?

Participant: So in your study, have you—I’m [inaudible 01:49:48]. My question is, first have you done a study about the implications on third countries, for example on the rest of the world, on Latin America and Europe? And what kind of modeling did you use in your study? Did you have a model or something more innovative? Thank you.

Myron Brilliant: Peter, why don’t you answer that?

Peter Petri: Yes, it’s a CG model. As all models, it’s a model which is based on a lot of uncertainty, a lot of presumptions, but we have done as good a job as I think you can do at this point, including using recent theoretical devices
and a lot of new data. We have done and in the book I believe, we have fairly detailed results for other countries. The results are obviously positive for all the countries that are also included in larger agreements in which the US and China participates and they are negative for countries which are not included in agreements, but that’s as one might expect.

Myron Brilliant: Okay, we’re going to wrap up here. I want to thank Ambassador Carla Hills first and foremost for sort of moderating the opening session and continuing to stay with us through this, and for her strong leadership for the relationship, her board position here.

I want to recognize Alan Wong who flew in the furthest to participate in today’s meeting. And give my regards, and I know Fred and Carla join me in giving regards to C.H. Tung. I thank Hank who was an inspiration to all of us and continues to be for those of us who’ve known him for a couple of decades and certainly Carla and Fred and I have.

And I want to acknowledge Fred and Peter and Gary. Fred, for your leadership as well in undertaking such an enormous task in producing a study that I think is an important contribution to the US-China relationship. And of course, Gary and Peter for your economic assessments and your work in producing this study.

And then finally, I just want to say IIE is always groundbreaking in the way that they produce these studies. We're always going to come to you when we have these kinds of tricky issues and we appreciate the leadership role that IIE plays.

So with that, please join me in thanking all the participants today and we’re very pleased that you are all here to share with us this groundbreaking report.