Introductory Remarks by Gary Hufbauer*

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Thanks. Let me just check first that you can hear me. Can the people in the back hear me? You cannot? Well, I'll try shouting a bit louder. How are we doing now? Better. Okay. Well, I'll try to shout directly into these microphones.

I'm Gary Hufbauer with the Peterson Institute. On my immediate right is Michael Smart with Rock Creek Global Advisors, which gives advice to companies all over the world on trade and investment issues. To his right is Warren Maruyama, former general counsel of the U.S. Trade Representative (USTR) and now with Hogan Lovells, a very well-known firm and a very well-known person. To his right is Rachel Brewster, now a professor of law at Duke University, previously a colleague of Warren's in the USTR office.

And on the far right is Aaditya Mattoo, who is extremely well known in WTO circles and in the World Bank, where he now works as one of the leading experts on services trade in the world economy, and generally on international trade. So he's an economist, Michael is an economist, I'm an economist, and we have two lawyers in the middle, I guess where they should be.

The way we're going to try to run this little panel is, first, Aaditya is going to speak. He is with an international organization, the World Bank. He doesn't want to get involved in U.S. politics, for obvious reasons. So he is going to give us a background on the backlash against globalization, which everybody here is well aware of, and what might be done to revive a spirit of international cooperation. After that, I'm going to field questions to the panelists and they'll all answer each of the questions but I'll choose a lead panelist to start off on each of them. And we expect to have a good twenty-five minutes, thirty minutes at the end for questions and comments from the audience, so we hope that at least we provoke something in this very interesting time.

So, Aaditya, please lead us off.

Remarks by Aaditya Mattoo*

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Thank you very much, Gary. Thank you for inviting me today, Julie. I'm going to make four quick points—first of all, that the backlash has a certain sense of historical inevitability but it's fortunately very narrow in scope. Second, that it's not just against trade, which is the conventional wisdom. It's also against misplaced redistribution. Third, that if we are going to aim for more inclusive growth, in the sense that Oonagh spoke about, we need more, not less, globalization. And we also need more, not less, international cooperation, but it will need to take new innovative forms.

First of all, just one historical reference. Through most of the nineteenth century, when Britain was globally dominant, you might have expected it to trade on preferential exclusive terms with its colonies and with other countries. It didn't. It was a paragon of free trade imperialism, and for the most part trade followed nondiscriminatory most favored nation (MFN) principles. It's only when Germany and the United States got up toward the end of the nineteenth century and the beginning of the twentieth century that Britain abandoned this free trade and nonpreferential regime and reverted to, for example, the famous imperial preferences.

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So perhaps there are these century-long cycles in trade policy and the United States, in the post–World War II economy was again the bulwark of multilateralism and played mostly by MFN on nondiscriminatory rules, and it's the catch-up of China that has now induced this relatively—how should I say it?—I don't want to say protectionist because it hasn't reverted much to protectionism yet, but at least a greater emphasis on bilateralism.

Now for the most part, when you think about globalization, it has been a force for growth, the reduction of poverty, and global inequality. Over the last thirty years or so, the share of trade, goods trade and GDP, increased from about roughly one-third to a half, average incomes across the world grew by 24 percent, poverty declined dramatically, the head count going from about 35 percent to less than 10 percent, and the incomes of the poorest 40 percent increased by 50 percent.

So most of the world today is celebrating globalization. It's in this narrow Western segment, and in particular the Anglo-Saxon Western segment that you've seen the strongest backlash. And there are good reasons for it, because it is true, and recent evidence convincingly demonstrates, that globalization has had an effect on inequality. Regions where manufacturing was concentrated have been hit hardest in terms of employment and wages.

Now that's what was happening, but in many ways, when you think of the policies of the Obama administration, and this is as far as I'll go in terms of talking about U.S. politics, they were classical prescriptions. The size of the cake was being maximized by choosing, by and large, open policies and pursuing trade agreements that should have led to greater openness, and at the same time there was an effort to ensure that the gains from globalization would be distributed more equally, whether it was the bailout of the car industry, whether it was the Affordable Care Act, or minimum wages, or cheaper college loans.

So it's a puzzle. Why did voters reject this economically optimal package of maximizing the cake and distributing it more equally? And I think part of the reason is the way redistribution happened. Let me show you one picture. That is a picture of U.S. counties. The darker colors indicate the counties where you saw the biggest shift from the Democratic to the Republican world. As you notice, a lot of it is concentrated up there in Michigan, Wisconsin, in Pennsylvania.

Now let me show you another picture, and this will show you a picture of where people were already well insured. They had good access to health insurance. So the lighter colors are the counties where you had pretty good health insurance to begin with, and this is work in progress but you see a striking fact, that the switches were strongest where people were already well covered by a social safety net, in terms of health insurance. And that points to a key aspect of what happened under the Affordable Care Act, that it was essentially a cross-subsidization scheme where the burden of higher premiums was felt most, in proportional real terms, by the income groups who were just above the subsidy-entitled threshold.

So a lot of this expansion in care came at the expense of the middle class, and that is the central point that I want to make, that the redistribution burden—and I'll give you another example in a minute—has fallen disproportionately on the middle class. So the backlash is not just against globalization, it's also against misplaced redistribution.

What is the solution? When you think of, for example, the cost of healthcare, which is one of the biggest and central problems that we face, what would reduce it? And I think the research we have done shows very convincingly that greater globalization, for example, of services like healthcare would lead to dramatic reductions in costs, and whether it is by allowing better access to Filipino nurses or Indian doctors or whether it's allowing greater portability of health insurance so that people can exploit the same huge gains from trade that we have seen in other areas, it is something that we need to explore much more closely. But there is undoubtedly great scope for reduction in health costs through greater globalization.

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In goods trade, Fajgelbaum and Khandelwal have shown something really interesting. When you look at the bundle of consumption, if you were to shut off all trade the richest people would lose purchasing power by about a third, but the poorest 10 percent would lose purchasing power by two-thirds. So, in a way, access to foreign goods disproportionately benefits the poor because their consumption patterns, especially in the United States, are oriented toward imported goods. So there's no question that there are big benefits to be had from further globalization, but there is a problem, and one of the problems we face is that perhaps the reason this redistribution has taken the perverse form of unduly punishing the middle class has to do with globalization itself.

Very interesting work by Peter Egger and others has looked at the structure of taxes in countries and what you see is quite striking. Those red and green lines reflect the tax rates on the top 1 percent and the corporate tax rate—I said this in reverse—in about sixty-five countries, and there's been a striking decline in these tax rates over the last thirty years. And, instead, what has happened is that the tax rates on the median worker, the middle class, have actually increased over the period.

And what is very nice about this work, it asks the question, how much of this is politically driven and how much of it is actually evidence that national tax regimes are disproportionately hurting the immobile middle class and progressively lightening the burden on those with capital and skills that can escape to other lower tax jurisdictions? And their evidence suggests that that increase in tax rate might be as much as a percentage and a half on the middle class and a lower tax rate of at least a percentage and a half on the higher income groups. That is the part that they think is directly attributable to the pressure of globalization.

Now that raises the question, if you're going to cooperate internationally, should we stick to the old mechanical, reciprocal liberalization that really seems to have run out of steam, or should we focus on these areas? For example, international taxation policy. Gary knows more about this than anybody else. But, for example, a lot of tensions that are being seen today about the perceived asymmetric treatment of indirect taxes and direct taxes cry for greater international coordination and cooperation so that we don't have this race to the bottom in tax regimes. And that is an example of where I think greater emphasis needs to be in international cooperation.

But more generally, when you think of the world as it is—and this is the past point I'm going to make—you can think of the current period as an age of insecurity. There is a range of concerns, whether it's about health and safety standards, whether it's about digital trade and informational insecurity, or about financial internationalization and what that does to financial instability, about people moving insecurity, and all of these are inextricably linked to trade. And the problem is that the conventional, you open your markets and I'll open my markets way of negotiating doesn't really address these concerns. We need to think of new ways of international cooperation that take this legitimate concern about what globalization does into account, and what I would suggest is that we need a different approach. The conventional approach has really been a negotiation of I'll open my markets and tie my hands against future protection if you will do the same.

People have talked about regulatory cooperation, but I would suggest that we need to think of new ways in which exporting countries can provide regulatory reassurance to importing countries in return for openness. And just one example of how this might work relates to data flows. You know, data flows between the European Union and the United States could have been completely cut off, and even now there is a sword of Damocles that hangs over them because the Europeans said that their privacy regulation is not adequately respected in other jurisdictions, especially the United States, which has relatively lax privacy regulation. The solution was a bargain. It wasn't a trade bargain. It was a bargain between the United States and the European Union, where the United States didn't raise its own privacy standards. It just promised to adhere to European standards for European consumers. And that happened under what was first the Safe Harbor Agreement and then took the form of the EU-U.S. privacy shield.

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That's the best part of the TPP agreement and that's the part we shouldn't lose. It created obligations to allow data to flow but it also imposed unprecedented obligations, which you, as lawyers, will understand better than I do, on exporting countries to protect foreign consumers from fraud and privacy. How that's going to be enforced I think is one of the most interesting questions, but, in principle, that's the kind of international cooperation I think is needed to preserve openness.

Thank you.

Gary Hufbauer

Aaditya, thanks very much for that terrific start and stage setting. The first question I'm going to toss out is the question whether Trump has now entered a go-slow phase on trade policy. China is no longer a currency manipulator. The administration has not yet given Congress formal notification of NAFTA renegotiation. We have a one-hundred-day agenda for negotiations with China on a variety of undisclosed issues but all trade issues, trade friction. So this is a very different set of happenings than we heard in the campaign about disastrous trade deals and so forth.

To start us off on this question, I'm going to ask Warren Murayama to give us a start and then Michael and Rachel to follow on with their observations.

I have to correct what I said right at the beginning. Michael tells me he's actually a lawyer. He had fooled me. I thought he was an economist.

Okay, Warren. Over to you.

Remarks by Warren Maruyama*

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Well, thanks, Gary, and thanks to the American Society of International Law for convening this panel. And I guess we should also thank Donald Trump, because whatever one may think about his policies, he's been great for trade lawyers, trade professors, trade consultants, trade experts. And even tax people, who never had the time of day for us trade types, now have to listen to us go on and on about these obscure parts of WTO law regarding border tax adjustments, which are just as incomprehensible as my tax return.

I think Gary's question is a good one and I think it is accurate, because whatever Trump's provocative America First trade rhetoric on the campaign trail, his actions so far have been comparatively restrained. I would put this down to some of the realities of being president of the United States and sitting in the Oval Office starting to sink in, because when you get there, just from my low-level experience on the White House staff in Bush 41, I think what presidents and most people in the White House realize is that the reason you get to be president is because there are a lot of tough decisions and the reason they're tough is that there is no good option. And I think with Mexico you've seen a major pullback from the idea that NAFTA was the worst trade agreement in the history of trade negotiations. As Gary pointed out, they haven't actually notified a NAFTA renegotiation yet. The idea of a 35 percent tariff on U.S. companies has been scaled back, except for beating up on Ford and Carrier, and really not that much has happened there.

If you start parsing carefully the administration's draft NAFTA notification, which was circulated by USTR a couple of weeks ago, it's also comparatively restrained. There are some things in there that are going to be very interesting, like eliminating Chapter 19's binational review of

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