

Discarding a Utopian Vision for a World Divided

The Effect of Geopolitical Rivalry on the World Trading System

Thoughts for a [Symposium](#) at King's College London

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Executive Summary

The greater danger for the world trading system is not that it is at present being divided into two camps, one led by the United States and the other by China, but that the two largest trading countries, by their lack of adherence to and support for the multilateral trading system, may seriously damage it. Both rivals act outside the existing trade rules, creating negative examples that are not lost on other WTO members who may also choose to act outside of the system's rules.

The relationship between the United States and China is destined to be increasingly fractious. The two countries occupy geopolitical tectonic plates, the movement of one unavoidably generating friction with the other. It is an open question as to how much the world economy, where the market has largely determined trade flows to date, will be reshaped to reflect geopolitical forces.

Global trade figures in gross terms do not reflect the growing geopolitical rivalry.

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Despite being strong allies of the United States, for Germany,² Japan,³ and Korea⁴, China is the largest trading partner. In this still undivided world economy, the US, EU, Japan, and the Republic of Korea accounted for 42% of Chinese merchandise exports in 2021. In 2022, the EU, Taiwan, the Republic of Korea, Japan, and US supplied 43% of Chinese imports.⁵ Not even the invasion of Ukraine by China's closest friend, Russia, has caused the trading system to divide into two camps – one led by Beijing and the other by Washington.

The overall numbers tell only part of the story. While the volume of trade between the US and China remains high, bilateral strategic decoupling is proceeding.⁶ This is a US-China bilateral phenomenon. It is reflected in the trade of others only selectively. For America's allies, the US-China trade war had been a spectator event only. Two exceptions began to occur – one for supplying geostrategic-relevant goods, services and technology, and a second the result of identifying sources of geostrategic relevant supplies. Where the US pressed Japan and the Netherlands to join in restricting exports to China of semiconductor production equipment, they have done so. Separately, learning from the European experience with excess dependency on Russia for fossil fuels, Western capitals have begun planning the diversification of sourcing of critical minerals, to avoid dependency on a single country, particularly China.

Any decoupling that does occur between China and the West will likely be substantially “made-in-China”, that is caused by China's own policies. US preaching in favor of supply chain resilience would fall on deaf ears were there no concerns generated by China with respect to its reliability as a supplier of critical materials.

The general trade policies of the two rivals will also shape trade flows. China is aggressively moving to lower barriers to its trade with others, first through RCEP and then applying to join CPTPP. The United States has moved in the opposite direction, failing to deepen economic relationships with even its avowed friends. In fact, through its recent trade measures it has tended to alienate these trading partners.

Other factors, not traditionally the subject of trade agreements, will contribute to fragmenting the trading world. The contest over global standards has yet to play out – setting standards regarding 5G telecommunications, internet protocols, privacy, AI, electric vehicles and other products at the frontiers of technology may divide markets. Potential effects on trade can be expected as a result of the debt owed to China by the

² "China Remains Germany's Main Trading Partner For Seventh Year." Reuters. February 8, 2023. <https://www.reuters.com/markets/china-remains-germanys-main-trading-partner-seventh-year-2023-02-08>

³ "Japanese Foreign Trade in Figures." Santander. <https://santandertrade.com/en/portal/analyses-markets/japan/foreign-trade-in-figures>

⁴ "South Korean Foreign Trade in Figures." Santander. <https://santandertrade.com/en/portal/analyses-markets/south-korea/foreign-trade-in-figures>

⁵ "Trade Profiles 2022." World Trade Organization. https://www.wto.org/english/res_e/publications_e/trade_profiles22_e.htm

⁶ Chad P. Bown. "US Imports From China Are Both Decoupling and Reaching New Highs. Here's How." Peterson Institute for International Economics. March 31, 2023. <https://www.piie.com/research/piie-charts/us-imports-china-are-both-decoupling-and-reaching-new-highs-heres-how>

beneficiaries of the Belt and Road Initiative (BRI) and China's other development programs. For example, the need to repay debt has enabled privileged Chinese access to raw materials, a phenomenon just beginning to be witnessed. The exponential growth of Chinese overseas investment, which will affect trade, is likewise at an early stage. Another factor is the RMB perhaps taking on a more central role as a global currency. All of these economic and financial variables may play a part in shaping world trade.

None of the aforementioned influences may prove to be as consequential for world trade as the deterioration of the multilateral trading system itself. The immense increase in global economic prosperity made possible by international trade over the last three-quarters of a century has depended in very large part on the certainty provided by the rule of law. As the two largest trading countries begin to ignore the existing structure of rules, this could become a tipping point, seen in retrospect as the end of an era and the beginning of another, a darker one. If the rules are increasingly ignored, the new age would more likely than not be characterized by slower economic growth and fragmented trade.

This is not to suggest that either of the two contesting powers have a conscious plan to discard the current trading system. Neither appears to have reached the conclusion that an end to the multilateral trading system would be in its interest. It is possible that neither is fully conscious of the spreading damage caused by their acting at cross purposes with the current rules. But their conduct is telling. In the case of the US, the departure from the international rule of law is demonstrated by ending binding WTO dispute settlement by blocking Appellate Body appointments, applying tariffs at odds with its contractual commitments (tariffs on trade with China in general and embracing a national security rationale to restrict steel and aluminum imports from all sources), and unapologetically subsidizing domestic industries without regard to any international rules. China's departure from the rules is at one and the same time more overt and more opaque. China uses trade measures for purposes of coercion and denies that market forces must govern competitive outcomes as it increases the role of the state and the Communist party in its economy.

Neither Washington nor Beijing has declared an end to its adherence to the WTO-administered multilateral trading system. The reverse is the case. Perhaps current conduct at odds with the system is an aberration. US officials state that there is no general policy of decoupling from the Chinese economy. China's policy of working towards "dual circulation" has not been accompanied by it announcing a retreat from global trade. What is clear is that each wishes to be less reliant on trading with the other. The world has seen nothing like this in inter-hemispheric trade since US measures toward the Empire of Japan in 1940-41, and no analogy with the past is a sufficient guide to the future.

The game changers for the global trading system consist of the adoption by the United States and China, for domestic reasons, of economic nationalism as a controlling factor in formulating their foreign economic policies. In the US the Trump

Administration embraced economic nationalism primarily with rhetoric. The Biden Administration made the rhetoric reality in its major economic legislative initiatives. For China, nationalist policies were evident in its statements about achieving dominance in key industries of the future and the episodic deployment of trade measures for purposes of coercion. China's domestic concerns for regime stability and its contest with the United States led it to support Russia during its invasion of Ukraine. Its priorities blinded it to the inevitable Western reaction. Neither nation has room in its current world view for actively supporting multilateralism.

Most other countries continue to steer an uncertain, non-aligned course, which may increasingly be governed by ad hoc determinations of self-interest.⁷ The world's largest trading bloc, the European Union, has called for a policy of "strategic autonomy". Whatever this turns out to be, it is not a vote to join Beijing or Washington in a trading bloc, nor is it a declaration in favor of the multilateral trading system. As for some of the others, one would not expect to hear from India nor South Africa that adherence to the existing multilateral trading system is a national priority. Neither are there any indications whatsoever of any country, including these two, aspiring to join a trade bloc.

The bottom line: world trade is not at present coalescing into two trading blocs, but the center, the multilateral trading system, is under stress. The question increasingly asked in academic symposia is whether it will hold.⁸

Key words: international trade, sanctions, China trade, geopolitics, geoeconomics.

JEL codes: F02, F13, F15, F51, F52, H12, K33, P33.

⁷ This paper was stimulated by a probing question put by two conference sponsors, King's College London and the London School of Economics. The conference was originally scheduled for February but was moved to June 2023. My initial reaction is contained in the opening sentence of this summary. There followed on my part a continuing reflection on the subject in the ensuing weeks and months, as the era's great power rivalry continued to be revealed in policy choices that the two have made. Nothing like this international contest has existed since the 1930s, and so, for all of us alive today, the relationship of geopolitical competition to trade is a question of first impression. There is nothing certain about the future but that it will present greater tests than governments face today. As for seeing the future with clarity, humility requires acknowledging the validity of the comment by Yogi Berra "It's tough to make predictions, especially about the future."

⁸ William Butler Yeats, *The Second Coming*, "Things fall apart; the centre cannot hold;... The best lack all conviction, while the worst Are full of passionate intensity."

Introduction

For China and the United States, the two largest trading countries, trade policies for the foreseeable future are going to be shaped by its existential concerns – domestic and international. For the United States under President Biden’s administration, the two primary concerns consist of the durability of democracy at home and internationally the geopolitical rivalry with China. There is a parallel set of concerns for China under President Xi. China gives the highest priority to the survival of its regime at home and internationally success in its rivalry with the United States. These dual sets of concerns will play out across the international trading system, with few other matters having the same degree of urgency, until at some point perhaps they are superseded by something greater, such as climate change forcing itself as a topmost priority of policymakers in both countries. Not even the COVID-19 pandemic, with some seven million deaths worldwide,⁹ caused the two powers to alter their single-minded focus on their primary concerns to find ways to manage their relations in order to deal with that common challenge.

King’s College London and the London School of Economics, two convenors of a conference on the subject of this paper, put forward the question of whether the vortex of the fraught relations between China and the United States will divide world economic relations into two opposing camps. This paper concludes that this is not happening, and for a variety of reasons, is unlikely to happen.

Trade War

If the two largest trading nations, China and the United States, are not at war, neither are they completely at peace. Their respective armed forces are on alert to address any probe, any incursion by the other into their territory or areas of interest. Each shapes the growth in its military capabilities mainly in response to the threat seen as emanating from the other. The frayed geopolitical relationship has an inevitable impact on the trade policies that each applies to the other.

The most obvious and bluntest of the trade actions between the two countries was initiated by President Trump in 2018, who placed additional tariffs of 25% on a broad range of Chinese imports. Soon after, China responded in kind. Chinese imports of agricultural products from the US were cut in half, from \$28 billion in 2014 to \$15 billion in 2018.¹⁰ There followed over the next several years numerous exchanges of increased tariffs and various roll-backs and exceptions to these increased duties by each with respect to the trade of the other.¹¹ During the Trump Administration, the

⁹ "WHO Coronavirus (COVID-19) Dashboard." World Health Organization. <https://covid19.who.int/>

¹⁰ "China’s Retaliatory Tariffs on U.S. Agriculture: In Brief." Congressional Research Service. September 24, 2019. <https://crsreports.congress.gov/product/pdf/R/R45929>

¹¹ The South China Morning Post has a timeline of various tariff measures and countermeasures from July 2018 to August 2021.

"Explainer | US-China Trade War Timeline: Key Dates and Events Since July 2018." South China Morning Post. August 29, 2021. <https://www.scmp.com/economy/china-economy/article/3146489/us-china-trade-war-timeline-key-dates-and-events-july-2018>

motivation for the increased tariffs seemed to be largely resentment over the bilateral trade imbalance rather than being part of a targeted attempt to gain a geostrategic advantage. In an attempt to avoid further trade hostilities, a "Phase One Agreement" was signed by the two governments on January 15, 2020,¹² in which China agreed to buy US products worth an additional \$200 billion. Apparently none of the gains in trade took place during the period stipulated in the agreement.¹³ It had no discernable positive impact.¹⁴

At Davos, in January 2020, President Trump announced that "Our relationship with China has now probably never, ever been better."¹⁵ It wasn't.

Early in her tenure as Secretary of the Treasury in the Biden Administration, Janet Yellen said "My own personal view is that tariffs were not put in place on China in a way that was very thoughtful with respect to where there are problems and what is the U.S. interest."¹⁶ Nevertheless, the Biden Administration largely kept the increased tariffs in place. China and the US still apply approximately an additional 20% tariff on a majority of trade with each other.¹⁷ By comparison, the two countries' tariffs on imports from other countries are on average 6.5% in the case of China and 3.0% for the US. The primary long-term effect of the Trump trade war appears to be that each of the combatants are diversifying their trade away from the other.¹⁸

Aside from the exchange of tariffs, other bilateral trade-restrictive measures have been put into place. In 2020, the United States banned imports of cotton from Xinjiang Province on the announced grounds that they were harvested and/or made using forced labor. In 2022, the restrictions were expanded by Congress, now applicable to all products from the region and

¹² "Rebalancing United States-China Trade." United States-China Phase One Trade Agreement. <https://ustr.gov/phase-one>

¹³ Chad P. Bown. "China Bought None of the Extra \$200 Billion of US Exports in Trump's Trade Deal." Peterson Institute for International Economics. July 19, 2022. <https://www.piie.com/blogs/realtime-economic-issues-watch/china-bought-none-extra-200-billion-us-exports-trumps-trade>

Chad P. Bown and Yilin Wang. "Five Years Into the Trade War, China Continues Its Slow Decoupling from US Exports." Peterson Institute for International Economics. March 16, 2023. <https://www.piie.com/blogs/realtime-economics/five-years-trade-war-china-continues-its-slow-decoupling-us-exports>

¹⁴ Chad P. Bown. "US-China Phase One Tracker: China's Purchases of US Goods." Peterson Institute for International Economics. July 19, 2022.

<https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods/>

¹⁵ "Trump on China's Xi: 'We Love Each Other'." Politico. January 21, 2020. <https://www.politico.eu/article/trump-on-chinas-xi-we-love-each-other/>

¹⁶ "Yellen Says China Trade Deal Has 'Hurt American Consumers'." New York Times. July 17, 2021. <https://www.nytimes.com/2021/07/16/us/politics/yellen-us-china-trade.html>

¹⁷ Two-thirds (66.4%) of Chinese exports to the United States and 58.3% of US exports to China were covered by the additional tariffs. The average US tariff on Chinese goods became 19.3% and the average Chinese tariff on US goods rose to 21.1%.

Chad P. Bown. "US-China Trade War Tariffs: An Up-to-Date Chart." Peterson Institute for International Economics. September 20, 2019. <https://www.piie.com/research/piie-charts/us-china-trade-war-tariffs-date-chart>

"Trade in Goods with China." United States Census Bureau. <https://www.census.gov/foreign-trade/balance/c5700.html>

¹⁸ Chad P. Bown and Yilin Wang. "Five Years Into the Trade War, China Continues Its Slow Decoupling from US Exports." Peterson Institute for International Economics. March 16, 2023. <https://www.piie.com/blogs/realtime-economics/five-years-trade-war-china-continues-its-slow-decoupling-us-exports>

goods made in part in Xinjiang.¹⁹ Further evidence of the growing rift in trade relations is seen in a US requirement that goods manufactured in Hong Kong be labeled to identify the origin as “China” in order to enter the United States. The US claimed that its national security interests justified this action, citing the degree of control China exercises over the city.²⁰ A WTO panel found that the US in imposing this requirement had acted inconsistently with its WTO obligations. In response, the United States filed a *pro forma* appeal with the non-existent Appellate Body, freezing further WTO disposition of the case.²¹

In the field of technology, the US has banned domestic sales of Huawei telecommunications equipment and urged other countries to avoid dependency on that company.²² Since last fall, the US has also imposed export restrictions on shipments to China of high-end semiconductors as well as the equipment for making advanced semiconductors.²³ The US has similarly sought to prevent its personnel from servicing that equipment.²⁴ These targeted actions, were they challenged in WTO dispute settlement, would no doubt be justified by the United States as necessary in pursuance of its “essential security interests”. National security is increasingly claimed as an exemption under the WTO’s rules, which generally require non-discrimination and ban other trade restrictions. Nonetheless, China has initiated a WTO case against the US’ semiconductor-related measures.²⁵

Simultaneously, the US continues to issue new sanctions against Chinese entities with some regularity, particularly over human rights or national security concerns.²⁶ Further export controls are now being considered by the Biden Administration with respect to technologies and products related to AI capabilities. Proposals are being framed to screen outbound US investment in China as well.²⁷ Broad legislation is envisaged to further curb trade and investment flows

¹⁹ "US Bans Imports From China’s Xinjiang Region Over Forced Labor Concerns." CNN. June 21, 2022. <https://www.cnn.com/2022/06/21/us/us-import-ban-xinjiang-goods-forced-labor-china-intl-hnk/index.html>.

“DS597. United States — Origin Marking Requirement.” World Trade Organization.

https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds597_e.htm

²¹ "United States - Origin Marking Requirement: Communication From Hong Kong, China WT/DS597/10." World Trade Organization. February 2, 2023.

<https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/DS/597-10.pdf&Open=True>

²² "Washington Asks Allies to Drop Huawei." The Wall Street Journal. November 23, 2018.

<https://www.wsj.com/articles/washington-asks-allies-to-drop-huawei-1542965105>

²³ "U.S. Semiconductor Exports to China: Current Policies and Trends." Center for Security and Emerging Technology. October 2020. <https://cset.georgetown.edu/publication/u-s-semiconductor-exports-to-china-current-policies-and-trends/>

“US Bans Intensify Chip-Making Equipment Competition" Asia Times. April 26, 2023.

<https://asiatimes.com/2023/04/us-bans-intensify-chip-making-equipment-competition/>

"The Biden Administration Issues Sweeping New Rules on Chip-Tech Exports to China." Protocol. October 7, 2022.

<https://www.protocol.com/enterprise/chip-export-restrictions-tsmc-intel>

²⁴ Chad P. Bown and Kevin Wolf. "National Security, Semiconductors, and The US Move to Cut Off China."

Peterson Institute for International Economics. November 22, 2022. <https://www.piie.com/blogs/realtime-economics/national-security-semiconductors-and-us-move-cut-china>

²⁵ "United States - Measures on Certain Semiconductor and Other Products, And Related Services and Technologies WT/DS615/1, G/L/1471." World Trade Organization. December 15, 2022.

<https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/DS/615-1.pdf&Open=True>

²⁶ "Here Are All The U.S. Sanctions Against China." Forbes. February 8, 2023.

<https://www.forbes.com/sites/anthonytellez/2023/02/08/here-are-all-the-us-sanctions-against-china>

²⁷ "White House Scales Back Plans to Regulate U.S. Investments in China." Politico. February 27, 2023.

<https://www.politico.com/news/2023/02/27/white-house-investments-china-00084473>

between the two countries.²⁸ In turn, Beijing launched a national security investigation of US firm Micron Technologies and banned the use of its chips in key technology products.²⁹

Are the Economies of the Two Largest Trading Nations Decoupling?

In gross numbers, economic decoupling has not occurred. According to the US Department of Agriculture, “U.S. agricultural exports to China in fiscal year (FY) 2022 were \$36.4 billion and surpassed the previous year’s record with China as the largest US export market for the second consecutive year.”³⁰

Despite an intensification of trade friction between the two, total US imports from China were up 8% year-to-year, 2022 over 2021, and were 44% above 2019 levels,³¹ despite a subsequent drop in the first quarter of 2023. US exports to China were about the same year-to-year 2022/2021 (up 1%) but are 21% above pre-pandemic levels (2019 trade).³²

The bilateral trade relationship in terms of measures and rhetoric is on a downward and perhaps slippery slope, even if not reflected in the overall numbers. If there is any decoupling, it is targeted, incremental, and narrowly focused. The two economies are diversifying their trade away from dependence on each other.³³ Absent some triggering geopolitical event that causes a substantial cut-off of bilateral trade, such as China crossing a line into active lethal support of Russia’s invasion of Ukraine or a military move against Taiwan, a gradual deterioration in bilateral trading relations appears likely to continue.

The Great Geopolitical Fracture

Harvard political scientist Graham Allison wrote in his book, *Destined for War: Can America and China Escape Thucydides’ Trap?*: “Unless China is willing to scale back its ambitions or Washington can accept becoming number two in the Pacific, a trade conflict, cyberattack, or accident at sea could soon escalate into all-out war.”³⁴ The glide path of US-China political, military and economic relations is steadily downward.³⁵ Echoes are found in

²⁸ "New Legislation to Counter China Pushed by Senate Democrats." AP News. May 3, 2023.

<https://apnews.com/article/senate-china-bill-semiconductors-taiwan-2988750a5751d22cb72e0f33b09090d1>

²⁹ "Tech War: US Chip Firm Micron, Currently Being Probed in China, Names New General Manager For Country." South China Morning Post. May 12, 2023. <https://www.scmp.com/tech/big-tech/article/3220396/tech-war-us-chip-firm-micron-currently-being-probed-china-names-new-general-manager-country>

"China Bans Major Chip Maker Micron From Key Infrastructure Projects." BBC. May 22, 2023.

<https://www.bbc.com/news/business-65667746>

³⁰ "Record U.S. FY 2022 Agricultural Exports to China: International Agricultural Trade Report." US Department of Agriculture - Foreign Agricultural Service. January 6, 2023. <https://www.fas.usda.gov/data/record-us-fy-2022-agricultural-exports-china>

³¹ "Trade in Goods with China." United States Census Bureau. <https://www.census.gov/foreign-trade/balance/c5700.html>

³² Ibid.

³³ Chad P. Bown and Yilin Wang. "Five Years Into the Trade War, China Continues Its Slow Decoupling from US Exports." Peterson Institute for International Economics. March 16, 2023. <https://www.piie.com/blogs/realtime-economics/five-years-trade-war-china-continues-its-slow-decoupling-us-exports>

³⁴ Graham Allison. 2017. *Destined for War: Can America and China Escape Thucydides’ Trap?* Boston: Houghton Mifflin Harcourt.

³⁵ A catalogue of points of potential military confrontation is contained in Annex 1.

history of the instances where preserving peace between a rising power challenger and the established incumbent were unsuccessful. A question beyond the scope of this paper is whether Kevin Rudd in his book *The Avoidable War* is correct in his qualified optimism that “managed strategic competition” can prevent war, or whether what Fred Bergsten characterizes as “a conditional competitive cooperation arrangement” could succeed in preserving peace.³⁶ The only rational response to these suggestions is that they are worth trying.

The Likely Future of US-China Economic Relations

During the Cold War, it was easier to have a divided world – the West versus the Communist world consisting of the USSR, its satellites, China, and North Korea, with a non-aligned group of nations not taking part – than it would be at present. In 2022, the largest democracies sought to isolate the Russian economy over its invasion of Ukraine. This policy has only been partially successful.³⁷ Isolation of China would be much harder to achieve and far more costly were it to be attempted. China’s position in the world economy is far different from what Russia’s is now or what it was during the Cold War. At its peak, the bilateral US-Soviet trade flow accounted for only 1 percent of each other’s total trade by value. That is not the case with respect to the US and its allies vis-à-vis China.

In 2022, 6.5% of total US exports were to China (US\$198 billion), and 14.25% of total US imports were from China (US\$537 billion).³⁸ Even these figures undoubtedly understate the importance of each economy to the other. And for the EU, America’s largest ally, almost 10% of its exports in 2022 went to China, totaling nearly USD 240 billion. More than 20% of the EU’s imports came from China, making China the EU’s largest partner for imported goods.³⁹

The rhetoric and reality about trade relations diverge. Each side has issued policy pronouncements pointing toward separation. President Xi Jinping has called for “dual circulation”, reducing China’s dependency on foreign products. The US is urging its allies not to supply China with leading technologies that could be useful in war. US Treasury Secretary Janet Yellen has called for friend-shoring,⁴⁰ a not very veiled reference to assuring the resilience of supply chains by moving them out of China. Over time, these policy positions will likely have an effect, but a sharp change in trade flows is not easy to achieve.

In 2001, pursuant to an act of Congress,⁴¹ the United States decided to grant “permanent

³⁶ Bergsten’s book recommends ten policy steps to be taken toward bringing this about. See n. 67.

³⁷ Jeffrey J. Schott. "Economic Sanctions Against Russia: How Effective? How Durable?" Peterson Institute for International Economics. April 2023. <https://www.piie.com/publications/policy-briefs/economic-sanctions-against-russia-how-effective-how-durable>

³⁸ “2021 Statistical Analysis of US Trade with China.” U.S. Department of Commerce – Bureau of Industry and Security. April 29, 2022. <https://www.bis.doc.gov/index.php/country-papers/2971-2021-statistical-analysis-of-u-s-trade-with-china/file>

³⁹ "European Union Trade." World Integrated Trade Solution. <https://wits.worldbank.org/CountrySnapshot/en/EUN/textview>

⁴⁰ "Remarks by Secretary of the Treasury Janet L. Yellen on Way Forward for the Global Economy." US Department of the Treasury. April 13, 2022. <https://home.treasury.gov/news/press-releases/jy0714>

⁴¹ "Normal Trade Relations for the People's Republic of China." Congress.gov. October 10, 2000. <https://www.congress.gov/106/plaws/publ286/PLAW-106publ286.pdf>

normal trade relations” to China.⁴² Twenty-two years later, those trade relations are neither normal nor permanent. However, in 2022, China accounted for over \$2.7 trillion worth of world imports, reflecting an increase in import value by more than 1% compared to the previous year.⁴³ China’s integration into the world economy is irreversible, whatever a Xi, Trump or Biden administration might wish.

Where does all this lead? While the policies of the United States and China continue to promote economic distancing from each other, this does not necessarily imply that the trading world will move towards division into trading blocs, one China-centered and the other US/West-centered. The world trading system does not appear to be dividing into two exclusive spheres of influence. A primary reason that this will not occur is that neither Beijing nor Washington is offering strong inducements for affiliation,⁴⁴ nor is their mutual bilateral disaffection sufficient to drive countries into joining the opposing camp, were there one. In fact, their self-serving economic behavior is counterproductive to creating bonds with others.

America’s International Economic Policy

The US has little on offer in terms of what may be taken as its foreign economic policy – limited engagements with Europe through the Trade and Technology Council (TTC), in Asia with the Indo-Pacific Economic Framework (IPEF),⁴⁵ and in this hemisphere, with an initiative for the Americas known as the Americas Partnership for Economic Prosperity (APEP). These do not promise deeper economic integration despite occasional administration pronouncements in favor of fostering “friend-shoring”. The bilateral talks with Asia, Europe and the Americas are to address regulatory alignment – standard setting (such as digital technologies), labor and environmental standards, climate change, decarbonization, the digital economy, agriculture, transparency, competition policy, trade facilitation, supply chain resilience, tax and infrastructure. Without the promise of improvement in market access, there is little economic interest in these initiatives among government officials or their private sector constituents. Foreign government officials talk privately of entering into the talks because the relationship with the US is important, not due to a commercial motivation.

Running somewhat at cross purposes with the three initiatives is the major set of industrial policy measures contained in the Inflation Reduction Act (IRA), with a requirement of US assembly and US content with respect to electric vehicles and batteries. US policy to date has looked more like on-shoring than friend-shoring (before being called to account by its allies). This followed Trump’s national security restrictions that included coverage of the trade of allies, and a Biden infrastructure bill that the President has said is aimed at total Buy American

⁴² "President Grants Permanent Trade Status to China." The White House - President George W. Bush. December 27, 2001. <https://georgewbush-whitehouse.archives.gov/news/releases/2001/12/20011227-2.html>

⁴³ "World’s Top Exporters And Importers." World Options. February 4, 2022. <https://uk.worldoptions.com/news/worlds-top-exporters-and-importers>

⁴⁴ This statement is true with respect to China’s relations with developed countries. It may be that China’s strong presence in the developing world through the BRI may cause trading relationships to become more exclusive over time, more bloc-like, but that is not immediately apparent.

⁴⁵ Talks with Australia, Brunei Darussalam, Fiji, India (which has opted out of the trade discussion), Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand, and Vietnam.

procurement. US actions have strained what should be close economic relations with friends and allies.

In connection with IPEF and TTC, the US states that it is pressing for supply chain “resilience”, which is often taken to mean reduction by the participants of their reliance on Chinese sources of supply. This policy can be backed up with direct measures when the opportunity is present. This occurred, for example, with adoption of a more restrictive rule of origin incorporated in the renegotiation of NAFTA to convert it into a US-Mexico-Canada Free Trade Agreement (USMCA) that discourages sourcing from China. The Agreement raises the North American content requirement from 62.5 to 75% for automobiles.^{46 47 48} The direction of US policy is clear: to exclude Chinese content where possible through rules of origin.

Biden Administration officials have condemned prior free trade agreements as having devastating domestic effects, stating clearly that the US will not negotiate traditional trade liberalizing agreements with any other country.⁴⁹ In fact, rather bizarrely given that the average US tariff is well below that of almost any other trading country, it has declared as US policy that it will not enter into trade negotiations with other countries that aim at lowering tariffs. In this vein, the Biden Administration has shown no interest in rejoining the CPTPP (the current version of the Trans-Pacific Partnership, the Obama Administration’s attempt to counter China’s economic interest in the Pacific from which President Trump withdrew). It is not a subject that can even be mentioned by American officials, a stance that has allowed China to apply to take America’s place in the agreement.

The main thrust of US economic policy is nationalism, on display in the IRA’s local content rules and preferential subsidies and in the Buy American policies in the rebuilding of America’s infrastructure. This was given voice by President Biden in his heralding in his 2023 State of the Union speech: “Tonight, I’m also announcing new standards to require all

46 "The United States-Mexico-Canada Agreement: Tariffs, Customs, and Rules of Origin." Rice University's Baker Institute for Public Policy. February 21, 2019. <https://www.bakerinstitute.org/research/united-states-mexico-canada-agreement-tariffs-customs-and-rules-origin>

47 To further tighten this requirement, the US has argued that the foreign content of a core vehicle component (such as an engine) is not to count toward a finished vehicle’s regional value content, even if that core component contains enough North American content to qualify as originating within the FTA itself.

"The Expert Take - USMCA Rules of Origin Disputes." Wilson Center. September 23, 2021.

<https://www.wilsoncenter.org/article/expert-take-usmca-rules-origin-disputes>

⁴⁸ A USMCA dispute settlement panel has rejected this US interpretation.

“USMCA Panel Rules Against US Position in Automotive Origin Dispute.” PwC. January 2023.

<https://www.pwc.com/us/en/services/tax/library/usmca-panel-rules-against-us-position-in-auto-origin-dispute.html>

⁴⁹ "Remarks by Ambassador Katherine Tai at the Roosevelt Institute's Progressive Industrial Policy Conference."

Office of the United States Trade Representative. October 2022. <https://ustr.gov/about-us/policy-offices/press-office/speeches-and-remarks/2022/october/remarks-ambassador-katherine-tai-roosevelt-institutes-progressive-industrial-policy-conference>

The sentiment of acknowledging the negative effects of past US trade agreements was also highlighted in National Security Advisor Jake Sullivan’s more recent speech at the Brookings Institution.

"Remarks by National Security Advisor Jake Sullivan on Renewing American Economic Leadership at the Brookings Institution." The White House. April 27, 2023. <https://www.whitehouse.gov/briefing-room/speeches-remarks/2023/04/27/remarks-by-national-security-advisor-jake-sullivan-on-renewing-american-economic-leadership-at-the-brookings-institution/>

construction materials used in federal infrastructure projects to be made in America.”⁵⁰ Nothing was said about American international economic leadership, which a functioning multilateral trading system requires.

China’s Foreign Economic Policy

China seeks to increase its influence in the Global South and beyond through its Belt and Road Initiative and its pro-developing country posture at the WTO. It has invested trillions of dollars in recent years in building bilateral relationships, mostly with developing countries. China is also seeking to engage more deeply with the Pacific region through regional trade agreements. In 2022, a Regional Comprehensive Economic Partnership (RCEP) Agreement with twelve other countries – Australia, Brunei Darussalam, Cambodia, China, Japan, Korea, Laos, Malaysia, New Zealand, Singapore, Thailand and Vietnam – was put into place. The agreement will halve existing regional tariffs over a period of 20 years and provide greater access for exports of services among the signatories. While the agreement is significant, intra-regional trade was already subject to low tariffs due to numerous existing preferential trade agreements.⁵¹ In addition, as noted, China has applied to join the more ambitious Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which would further integrate China and Australia, Canada, Japan, Mexico, New Zealand, Singapore, Vietnam, Peru, Malaysia, Brunei, and Chile. In 2021, the United Kingdom, Taiwan, and Ecuador applied to join the CPTPP, and Costa Rica and Uruguay applied in 2022. Others, including South Korea and Thailand, are considering applying.⁵²

The CPTPP is a more substantive free trade agreement (FTA) than RCEP, both in terms of its depth in tariff cuts and broader set of obligations. Almost all tariff lines would end up with zero tariffs, cross-border data flows would be free, and forced localization of servers would be prohibited. The agreement also contains commitments with respect to protecting the environment, privacy, intellectual property and labor rights. The CPTPP liberalizes services and investment and regulates the conduct of state-owned enterprises.

China’s relationships with third countries have both centripetal and centrifugal elements.

⁵⁰ "Remarks of President Joe Biden – State of the Union Address as Prepared for Delivery." The White House. February 7, 2023. <https://www.whitehouse.gov/briefing-room/speeches-remarks/2023/02/07/remarks-of-president-joe-biden-state-of-the-union-address-as-prepared-for-delivery/>

⁵¹ The ASEAN-Australia-New Zealand Free Trade Area (2010); the ASEAN-China Free Trade Area (ACFTA 2003); the ASEAN-Japan Comprehensive Economic Partnership (AJCEP 2008); the ASEAN-Republic of Korea Free Trade Agreement (AKFTA 2007); the China-Australia Free Trade Agreement (ChAFTA 2015); the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP 2018); the Republic of Korea-Australia Free Trade Agreement (KAFTA 2014); the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA 2013); the China-Republic of Korea Free Trade Agreement (CKFTA 2015); the New Zealand–China Free Trade Agreement (NZCFTA 2008); and the New Zealand–Republic of Korea Free Trade Agreement (NZKFTA 2015).

"An Assessment of the Regional Comprehensive Economic Partnership (RCEP) Tariff Concessions." United Nations Conference on Trade and Development. December 2021. https://unctad.org/system/files/official-document/ser-rp-2021d16_en.pdf

⁵² Jeffrey J. Schott. "Which Countries Are in the CPTPP and RCEP Trade Agreements and Which Want In?" Peterson Institute for International Economics. April 3, 2023. <https://www.piie.com/research/piie-charts/which-countries-are-cptpp-and-rcep-trade-agreements-and-which-want>

China already has considerable influence with its debtor countries and by offering the world access to its very large market. Its trade and investment can lead to increasing degrees of dependency, creating some resistance to being drawn closer to a country that uses its economic relationships to coerce alignment with what it sees as its interests. China has not been shy in using its economic leverage for political purposes, including suppressing foreign criticism of its more controversial policies. Instances of trade coercion include actions taken against products from Australia when it sought answers to the origins of COVID-19, Lithuania when it allowed a Taiwan Representative office to be established eponymously, or Korea deploying Terminal High Altitude Area Defense (THAAD) missiles.⁵³ Countries in debt to Beijing for infrastructure projects may find themselves losing some scope for independence in the policy positions that they adopt.⁵⁴

A potential game-changer for Europe, a major market for China, is its verbal backing for the Russian invasion of Ukraine. Europe would prefer a middle course, not too aligned with the United States and benefitting from its commercial relationship with China. The first substantial Chinese misstep revealing overpowering nationalism in its motivations was to sanction European Members of Parliament in connection with the Lithuanian-Taiwan issue. China's backing of Russia in Ukraine is a major blunder in foreign economic policy, sharply eroding trust in an EU still raw from its experience of relying on another autocratic government for much of its energy supply. For Western businesses, the reining in of high-tech entrepreneurs is another lesson that state-capitalism must be dealt with carefully. Europe is altering its defensive instruments as these lessons come home. A secret of China's growth was the stability for foreign firms doing business in China. The creation of uncertainty through abrupt changes in policy is likely to repel both foreign direct investment and reliance on China as an export market of a source of imports.⁵⁵ The result will tend towards an increasingly divided world, at odds with the one created by the WTO and GATT.

Economic Effects of Different Approaches to Trade Negotiations

Like all FTAs, both RCEP and CPTPP discriminate against goods from non-signatories. Products of the United States face higher tariffs as compared with those of FTA participants, unless the United States already has its own bilateral FTA with said trading partner. Among RCEP and CPTPP participants, the US has FTAs with Singapore (2004), Australia (2005), and Korea (2012). For other countries in the region, if and when China joins the CPTPP, China's goods will face much lower tariffs and benefit from preferential access as compared with US goods. The average agricultural tariff of both Japan and Vietnam is 17%, 16% for the United Kingdom, and 13.8% for China.⁵⁶ Under the CPTPP, these tariffs will be slashed over time (for

⁵³ Alan Wm. Wolff. "WTO 2025: Enhancing Global Trade Intelligence." Peterson Institute for International Economics. April 2022. <https://www.piie.com/sites/default/files/documents/wp22-6.pdf>

⁵⁴ In terms of comparative influence, the US failing to garner sufficient votes in the UN Human Rights Council to initiate an investigation of forced labor allegations in Xinjiang is perhaps illustrative.

⁵⁵ Jamie Dimon: <https://www.ft.com/content/5f389a80-96f1-4979-8eeb-fe484dc10cad>

"If you have more uncertainty, somewhat caused by the Chinese government . . . it's not just going to change foreign direct investment," Dimon told Bloomberg TV, in response to questions on China's Covid-19 policy and its crackdowns on consultants and the tech sector. "It's going to change the people here, their own confidence."

⁵⁶ "Trade Regulations of China." HKTDC (Hong Kong Trade Development Council) Research. March 3, 2022. <https://research.hktdc.com/en/article/MzM0NTEzMzcy>

one-third of the tariff lines, CPTPP participants immediately eliminate tariffs).⁵⁷ Meanwhile, full tariffs will remain in place for US agricultural exports to CPTPP countries.

None of this is good news for US commercial interests, but tariffs are not the only nor even the primary determinant for most trade. Although in the US view, Western democracies should rely less on China as a source of supplies and as an export market, the gravitational pull of economic interests will continue to favor an increasingly strong trading relationship between China and America's allies. China is the world's largest trading nation. The dominant feature of the economic landscape is that the largest trading partner of America's key allies in Asia is likely to remain China.

Third countries not only will find it difficult to distance themselves from China economically but have only a limited desire to do so. There is no sign of a willingness or ability on the part of those engaged in commerce, even in the closest US ally, to join in decoupling their home economy from China's. While Canada's Deputy Prime Minister Chrystia Freeland has called in the strongest possible terms for friend-shoring among democracies,⁵⁸ bilateral Canada-China trade, both export and imports, reached an all-time high in 2022.⁵⁹ India, a member of the political-military Quad (with the US, Japan and Australia), sees no reason to join a Western camp for trade even though it has its own security and economic concerns with China. India has even opted not to join the trade pillar of the IPEF discussions.⁶⁰

The US and China's inability to sufficiently attract or repel third countries to overcome their largely self-contained national interests will leave most countries to follow whatever commercial policies they think best, without any of them seeking an exclusive alignment with either Washington or Beijing. While the US did press the Dutch and Japanese to limit technology and exports of semiconductor manufacturing equipment (and had the leverage to obtain this parallel action from its allies),⁶¹ this is an exception in the otherwise burgeoning bilateral trade between China and America's allies. Instances of policy alignment with the US trade measures based on objectively valid national security concerns will likely occur, but they will probably remain selective.

The Bottom Line

⁵⁷ "Global Tariff of the United Kingdom (UK) on Imports of Selected Product Groups As of 2021." Statista.

<https://www.statista.com/statistics/1127901/global-tariff-rates-of-the-uk-on-selected-products/>

"CPTPP and Canada's Agriculture and Agri-Food Sector." Government of Canada.

<https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cptpp-ptpp/sectors-secteurs/agri.aspx>

⁵⁸ "Remarks by the Deputy Prime Minister at the Brookings Institution in Washington, D.C." Deputy Prime Minister of Canada. October 11, 2022. <https://deputyprime.gc.ca/en/news/speeches/2022/10/11/remarks-deputy-prime-minister-brookings-institution-washington-dc>

⁵⁹ "Canada-China Trade Breaks Record, As Imports Hit \$100B." Bloomberg. February 27, 2023.

<https://www.bnnbloomberg.ca/canada-china-trade-breaks-record-as-imports-hit-100b-1.1888782>

⁶⁰ "India Stays Out of Indo-Pacific Trade Pillar." India Times. September 10, 2022.

<https://timesofindia.indiatimes.com/business/india-business/why-india-opted-out-of-joining-trade-pillar-of-ipef-for-now/articleshow/94106662.cms>

⁶¹ "The U.S. Imposed Semiconductor Export Controls on China. Now a Key EU Nation is Set to Follow Suit."

CNBC. March 9, 2023. <https://www.cnbc.com/2023/03/09/asml-netherlands-to-restrict-semiconductor-machine-exports-after-us-pressure.html>

Far from trending toward a divided world with two trading blocs, there is no evidence of any country wishing to make China or the US its exclusive trading partner. In fact, relying too heavily on a single country as a market for exports or a source of supply for critical imports is increasingly contrary to governmental policy. China is the number one trading partner with many Asian countries, including Korea and Japan, as well as the EU and Germany.⁶² For these countries, it is a foreign policy imperative to remain militarily allied with the United States, but there is little economic incentive to reduce trade with China or increase it with the United States. On the contrary, all of them would like to expand trade with the two superpowers.

China's magnetic field repels as much as it attracts. While it is the world's single largest market, showing resilient growth, its human rights situation raises concerns among Western democracies. Many of these concerns have implications for trade (for example, with respect to products from Xinjiang). Many countries are wary of investments in critical technologies in China as well as investments from Chinese firms in their own countries, thus considering increased screening of inbound and outbound investment. For example, the EU has decided to regulate inbound investment that is subsidized.⁶³ While the EU has an anti-coercion instrument, which notionally could have a depressing effect on its trade with China to some extent, it is not clear that the EU Member States will have the political will to apply it.⁶⁴

Other than these selective elements, the bulk of global trade is not seen as either values-based or driven by national security interests. Most trade is based on whether it is profitable, or in some cases, such as processed rare earths, currently necessary. World commerce remains driven to a very large extent by commercial considerations – wherever government intervention does not prevent it from doing so.⁶⁵ The EU's foresight exercise predicted in 2019 that the world in 2030 would not be bipolar. It would not have poles at all. Rather, the world would be “poly-nodal”, with cities, regions, companies, and transnational movements having sway depending on the issue at hand. Quality of relationships and soft power would be the dominant features of the international landscape.⁶⁶ This is a comforting notion when faced with big power rivalry. Perhaps there may be some regional upswelling in importance – this can certainly occur in specific locations excelling in innovation or production, in a Silicon Valley or the High-Tech Campus Eindhoven (HTCE). Having local centers of increased economic growth does not exclude the shaping of the world economy by geopolitics.

⁶² "German-Chinese Trade Relations: How Dependent is the German Economy on China?" EconPol Europe. June 2022. https://www.econpol.eu/sites/default/files/2022-06/EconPol-PolicyReport_38.pdf

⁶³ "Foreign Subsidies Regulation." European Commission. 2023. https://competition-policy.ec.europa.eu/foreign-subsidies-regulation_en

⁶⁴ "The G7 Struggles to Find Unity Over China's Bullying." Financial Times. May 10, 2023. <https://www.ft.com/content/3cb5d246-caa1-4702-9914-b4b9b9313db3>

⁶⁵ "Siemens Chief Vows to 'Defend and Expand' Market Share in China." Financial Times. May 24, 2023. <https://www.ft.com/content/e985f675-88e5-4bd5-9a44-7228a7525b39>

"Chip Wars With China Risk 'Enormous Damage' to US Tech, Says Nvidia Chief." Financial Times. May 24, 2024. <https://www.ft.com/content/ffbb39a8-2eb5-4239-a70e-2e73b9d15f3e>

⁶⁶ "Global Trends to 2030 - Challenges and Choices for Europe." European Union Institute for Security Studies. April 8, 2019. <https://www.iss.europa.eu/content/global-trends-2030-%E2%80%93-challenges-and-choices-europe>

The global trading system is not currently splitting in two, with contending spheres of economic influence each led by one of the two rival powers. Not only is this not occurring at present, but it is also not threatened to any great extent and may not occur at all.

The most pronounced division of world trade may occur when the two rivals use their influence to press third countries to exclude trade with the other (for example, with respect to 5G, semiconductors, critical minerals). In addition, there will be some impact of preferential trading arrangements that are being collected by China (in RCEP, potentially in CPTPP, and through BRI influence) but are being avoided by the United States.

In the long run, none of the divisive trade policy measures are likely to overcome in gross terms the market forces that work towards efficiency – willing sellers providing goods and services to willing buyers.⁶⁷ And in any specific period, the macroeconomic factors, such as relative levels of growth in demand in national economies will determine trade flows. The two dominant powers are not dividing the world of trade in two. They are, however, disrupting the multilateral organization of trade.

Rivals as Global Citizens

Atlas Shrugged

Although the United States was the driving force behind the creation of the world trading system and was, as hegemon, the guarantor of its existence, U.S. trade policy has changed dramatically. The United States no longer styles itself as the champion of the liberal trading order. There seems to be no realization in Washington that post-war security policy included an enlightened foreign economic policy. The Pax Americana created an increasingly globalized, more prosperous world. This success was due in large part to trade and investment being allowed to cross national borders as seamlessly as possible.⁶⁸

With the Trump Administration's devaluation of its alliances and the Biden administration's hasty departure from Afghanistan, other countries became unsure of the reliability of U.S. security arrangements. The Biden Administration substantially eased this doubt with its support of Ukraine's resistance to the Russian invasion. The invasion brought the United States back into a leadership position as the prime defender of democracy. The US

⁶⁷ Whatever US policies are adopted with respect to its strategic competitor, as Fred Bergsten noted in his book on US-China economic competition: "China is too large and too dynamic to be suppressed and few, if any, other countries would join the United States in an effort to do so." Readers of this piece will find very useful Fred Bergsten's recent book on the bilateral relationship.

Fred Bergsten. 2022. *The United States vs. China: The Quest for Global Leadership*, Cambridge: Polity Press.

⁶⁸ Alan Wm. Wolff, Robert Z. Lawrence, and Gary Clyde Hufbauer. "Have Trade Agreements Been Bad for America?" Peterson Institute for International Economics. December 2022.

<https://www.piie.com/publications/policy-briefs/have-trade-agreements-been-bad-america>

Alan Wm. Wolff. "America's Global Leadership is Being Undercut by US Economic Policies." Peterson Institute for International Economics. February 13, 2023. <https://www.piie.com/blogs/realtime-economics/americas-global-leadership-being-undercut-us-economic-policies>

supplies over half the military aid to Ukraine and half the economic support.⁶⁹ On the other hand, doubts remain about America's commitment to international economic arrangements, particularly the multilateral trading system embodied in the WTO. The only new substantial economic arrangement proposed by the United States in the last two decades, the Trans-Pacific Partnership, was cancelled by the Trump administration and shunned by the Biden Administration. There has not been a revival of US international economic leadership.

US foreign policy, whether dealing with defense issues or economic engagement, had in the post-WWII era always been conceived of as promoting national interests in a broad sense, which meant fostering global well-being. This was true in feeding Europe just after the war, in the Marshall Plan, and a wider foreign aid program in subsequent years. These measures were taken because national interest was defined to encompass the reconstruction and economic development of the rest of the world. America would benefit not tangentially but directly and substantially from global economic growth. National interest at present appears to be part of a more cramped vision, a revival of American industry and science limited to the geographical confines of the country, with others' prospering not an objective or even a consideration.

While the United States continues to maintain that it supports the multilateral trading system, this so far consists of statements not backed up by its actions, which appear to move in a contrary direction. The US demolished the WTO's dispute settlement system, which even as the result of being provoked beyond endurance (to counter overreach), has not been replaced with any US proposals for an improved system that it could or would support. Once a primary proponent of the international rule of law through binding dispute settlement, the US has placed cases with unfavorable outcomes on hold, sort of in an international sock drawer, by "appealing into the void", filing a sham appeal with a body that does not exist and quite possibly never will in order to forestall having to live up to its obligations. Even if one agrees that some matters of national security ought not to be justiciable,⁷⁰ the US has demonstrated that international decisions need not be obeyed and that there is no penalty for acting inconsistently with one's international obligations.

There is always the hope that side-stepping the rules would not lead to contagion. However, the European Union, the world's largest trading entity, responded to American import restrictions on steel and aluminum by retaliating with measures that have only the thinnest veneer of WTO legitimacy. The EU is putting into place an arsenal of its own trade remedies and is considering the adoption of a carbon border adjustment mechanism (CBAM) that may not be seen by those whose trade is adversely affected as being legitimate under WTO rules.

There was hope when Trump was soundly defeated in the 2020 election that there would be a full restoration of America's international leadership. This has only been partially realized – on the military side in support of Ukraine. When it comes to international economic policies,

⁶⁹ "How Much Aid Has the U.S. Sent Ukraine? Here Are Six Charts." Council on Foreign Relations. May 19, 2023. <https://www.cfr.org/article/how-much-aid-has-us-sent-ukraine-here-are-six-charts>

"Military Assistance to Ukraine Since the Russian Invasion." UK Parliament - House of Commons Library. May 23, 2023. <https://commonslibrary.parliament.uk/research-briefings/cbp-9477>

⁷⁰ Warren Maruyama and Alan Wm. Wolff. "Saving the WTO From The National Security Exception." Peterson Institute for International Economics. May 2023. <https://www.piie.com/publications/working-papers/saving-wto-national-security-exception>

early statements by Secretary of State Antony Blinken and others reaffirming support for multilateralism is a pledge that has not yet been redeemed unless they were only referring to active participation in military alliances and not international economic cooperation.

International Trade with Chinese Characteristics

The nature of the Chinese economy with its state-capitalist model was known when China applied to join the WTO. Its accession process was both long and intensive, stretching over fifteen years. America's China hawks now look upon the entry of China into the WTO as a mistake. However, excluding one-fifth of humanity from the world trading order was not a reasonable option.⁷¹ Isolation would not in fact have been feasible, and if it had been, could have been disastrous, creating a North Korean kind of polity of much greater size and danger to world peace.

Strenuous efforts were made by the negotiators of China's accession to the WTO to assure that this great leap forward in international integration would work. Transitional safeguards and trade remedy measures were granted to China's trading partners for 12 years for safeguards and 15 years for antidumping, respectively. China changed thousands of potentially non-conforming laws and regulations to qualify for membership. It made specific commitments that its state-owned enterprises would buy and sell based on commercial considerations.⁷² When the first WTO case was brought against China, showing a clear violation of the rulebook,⁷³ China withdrew the measure after initial consultations, rather than going through what became the norm in WTO litigation, to defend the indefensible for as long as possible.

In short, there was every indication at the outset that China would be a good international citizen when it came to trade, that the reforms of Deng Xiaoping would continue, and that the role of the Party and therefore the state would recede to the point of allowing market forces to determine competitive outcomes. The outgoing tide of state involvement clearly appears to have been reversed by the current Chinese government. The reliance on state involvement in commerce is very much present.⁷⁴ The heavy hand of the state has been revealed in numerous instances, for example, of trade coercion, with China using trade as a cudgel to serve political ends. The WTO rulebook and dispute settlement proved to be ineffective in the face of heavy

⁷¹ 1.258 billion out of 6.144 billion people in the year 2000.

⁷² "Report of the Working Party on the Accession of China WT/MIN (01)/3." World Trade Organization. November 10, 2001. https://www.wto.org/english/thewto_e/acc_e/wp_acc_china_e.doc
See paras. 46 and 47 of the Working Party Report on China's Accession to the WTO.

The representative of China further confirmed that China would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g., price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement. The Working Party took note of these commitments.

⁷³ "SD309: China — Value-Added Tax on Integrated Circuits." World Trade Organization. https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds309_e.htm

⁷⁴ "China's Palace Politics: Xi Jinping Loyalists Compete for Power." Financial Times. January 24, 2023. <https://www.ft.com/content/flddaa1-7077-4e0a-bdc4-55205e4d2657>

subsidization where state ownership, control, and influence were present. Foreign companies selling in the Chinese market are increasingly concerned that they are becoming residual suppliers, with market share eroding quickly once substitute products from Chinese producers became available. Foreign companies selling goods in the Chinese market do not have confidence that state interference will not increase to their detriment.⁷⁵

At the WTO, China has denied that the trading system is based on “market principles”. This is not a semantic issue; it is fundamental to the world order. Few of the system’s rules can deliver the intended results if sales and purchases are determined more by state influence than market forces. Denying the centrality of market principles is contrary to China’s undertakings upon joining the WTO.⁷⁶ China’s stance that the WTO is not market-based and its accompanying measures have stimulated a debate in private circles in Western countries of whether according to China the full rights of the WTO is sustainable.⁷⁷ This is an existential crisis for the WTO, even if the threat has yet to be fully understood.

The most serious challenge to world economic growth is not the restrictive trade measures China and the United States impose on each other, stimulated by their rivalry, but by their self-serving conduct that undervalues the current world trading system.

What is it that is in danger of being lost?

A Utopian Vision

⁷⁵ "The Party vs. Shareholders: What Drives Corporate Governance in China?" Peterson Institute for International Economics. February 22, 2023. <https://www.piie.com/events/party-vs-shareholders-what-drives-corporate-governance-china>

"Chinese Communist Party Cells in Private Companies: Though Not Yet Universal, Increasingly Situated to Play Greater Roles in Corporate Governance." Sayari. April 7, 2021. <https://sayari.com/resources/chinese-communist-party-cells-in-private-companies-though-not-yet-universal-increasingly-situated-to-play-greater-roles-in-corporate-governance/>

⁷⁶ "Report of the Working Party on the Accession of China WT/MIN (01)/3." World Trade Organization. November 10, 2001. https://www.wto.org/english/thewto_e/acc_e/wp_acc_china_e.doc

See paras. 46 and 47 of the Working Party Report on China’s Accession to the WTO.

⁷⁷ "Reform at the WTO — Fundamental Divisions Continue on Key Issues for U.S." Washington International Trade Association. October 18, 2020. <https://www.wita.org/blogs/reform-at-wto-divisions-continue/>

See “Statement of China Amb. Zhang Xiangchen on Item 7”.

"U.S., China Spar at WTO Over ‘Market-Oriented Conditions’." Inside US Trade – World Trade Online. July 24, 2020. <https://insidetrade.com/daily-news/us-china-spar-wto-over-%E2%80%98market-oriented-conditions%E2%80%99>

"China Joined the WTO 20 Years On: From The Man Who Negotiated It." CGTN. May 15, 2021.

<https://news.cgtn.com/news/2021-05-15/China-joined-the-WTO-20-years-on-From-the-man-who-negotiated-it-10hKq3QMHD2/index.html>

Former Chinese negotiator of WTO accession claims that China only committed to a *socialist* market system.

“U.S. Targets Non-Market Economies in Draft WTO Decision.” Inside US Trade – World Trade Online. February 21, 2020. <https://insidetrade.com/daily-news/us-targets-non-market-economies-draft-wto-decision>

China has pushed back against the U.S. attack, arguing that reforming the WTO means respecting “divergent economic models” like China’s. In the same vein: [U.S., China spar at WTO over ‘market-oriented conditions’ | InsideTrade.com](https://insidetrade.com/daily-news/us-china-spar-wto-over-%E2%80%98market-oriented-conditions%E2%80%99). [China joined the WTO 20 years on: From the man who negotiated it - CGTN](https://news.cgtn.com/news/2021-05-15/China-joined-the-WTO-20-years-on-From-the-man-who-negotiated-it-10hKq3QMHD2/index.html); Former Chinese negotiator claims that China only committed to a *socialist* market system. [U.S. targets non-market economies in draft WTO decision | InsideTrade.com](https://insidetrade.com/daily-news/us-targets-non-market-economies-draft-wto-decision): *“China has pushed back against the U.S. attack, arguing that reforming the WTO means respecting “divergent economic models” like China’s.*

The basis for the trading system the world has today is the one conceived by two world leaders at a time of maximum peril. In August 1941, when the Second World War was long advanced in Asia and two years old in Europe, but the United States was not yet formally a combatant, Franklin Roosevelt and Winston Churchill met at Argentia Bay, Newfoundland, to discuss war aims. They issued a joint statement to the press, known later as the Atlantic Charter, which included their view on how trade in the post-war world should be conducted. It reads in relevant part:

The President of the United States of America and the Prime Minister, Mr. Churchill, representing His Majesty's Government in the United Kingdom, being met together, deem it right to make known certain common principles in the national policies of their respective countries on which they base their hopes for a better future of the world.

They will endeavor, with due respect for their existing obligations, to further the enjoyment by all states, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity; ...

The two leaders had had senior roles in their respective governments when the folly of war (World War I, then known as “The Great War”) and the failure of peace had been experienced. They were determined that this pattern would not be repeated. What they sought was intended to be a model not only for their own countries but for all. Compared with any alternative order for global commerce, their vision was truly utopian – equal access to markets and supplies for all participants. Four years later, when the war ended, the two countries joined with others to convert the vision into reality, with the negotiation of the International Trade Organization (ITO) and its companion General Agreement on Tariffs and Trade (GATT).

The foundation of the system is simplicity itself. It is built on non-discrimination and transparency. It incorporates binding obligations, starting with locking in tariff levels and prohibiting the use of quotas. Trading relationships were to be reciprocal. All nations joining the system had to contribute, begin to open their markets, and live by the rules provided. For the participants in the new trading order, the system was to provide fairness. To be sure, the system never attained perfection; nothing can. But under its aegis, we now know that global economic recovery was assured.

The system stimulated unparalleled economic growth. Before it existed, real GDP took seven decades to quadruple, moving from US\$1.92 trillion in 1870 to US\$7.81 trillion in 1940.⁷⁸ Over the next seven decades, world GDP grew by 14 times, from US\$7.81 trillion in 1940 to USD 108.12 trillion in 2015.⁷⁹ Hundreds of millions of people have been raised from poverty. Global production and trade have expanded dramatically. Human life expectancy has increased

"World GDP Over the Last Two Millennia." Our World in Data. <https://ourworldindata.org/grapher/world-gdp-over-the-last-two-millennia?time=1500..2015>

GDP data is adjusted to US\$ at 2011 levels.

⁷⁹ Ibid.

over this period by 62 percent due in large part to this organization of the world economy. While the contribution of individual causes of global economic growth cannot be separated and weighed, there is a strong correlation between improvement in the lot of humanity and the existence of the multilateral trading system.

Over time, the order was supplemented by a number of additional values, including fostering economic development and working towards sustainability.⁸⁰ The use of exceptions also multiplied, and in many instances, participating countries did not live up to the rules. But on the whole, the record of the multilateral trading system was positive and impressive.

The multilateral world order for international trade was created and exists today not just because the United States emerged as an unchallenged world power in the mid-twentieth century and was in a position to impose the system on the world economy. The 75-year-old system endures because it made and continues to make economic sense. It accords with the aspirations of those engaged in commerce. It permits them to engage in economically rational behavior by providing an environment in which willing sellers can sell to willing buyers with as few government-imposed restrictions as possible, consonant with good public policies. The multilateral trading system was adhered to not solely due to a philosophical commitment to open trade (assuming that did play a role); it was supported as being in the enlightened self-interest of all countries.

There were alternatives. Global trade could have taken place with no fixed structure. Players could have relied on power to dictate the terms of trade, or they could have pursued mutually agreed bilateral arrangements without a broader framework. Undiluted mercantilism, exporting finished goods, and importing raw materials could have been mandated. In prior eras, imperial powers could and did impose preferential systems on their colonies, primarily for the benefit of the home country. (And indeed, even in the Atlantic Charter, in the document they issued that gave voice to the world the two leaders sought, Churchill wished to preserve Britain's imperial preferences). Economic nationalism could have been the only guiding principle for those countries in a position to pursue and act on at that time. They chose not to do so. (see Annex 2).

The story of the founding of the liberal international order, once common knowledge for the generation that fought the war and the one that grew up in its aftermath, gradually began to be less well-remembered. The copious effusion of blood in the two world wars took place a long time ago. The dire circumstances and pressing needs faced by the founders of the liberal international economic order and its trading system became distant. Largely forgotten is why they were so strongly motivated to create a stable and productive world economy to undergird the new hard-won and fragile peace. In the first half of the 20th century, humanity discovered how very easy it was to slip from peace into conflict and war, and how difficult it was to recover from the devastation caused by armed conflicts. The lessons need now to be recalled. The story needs to be retold, as the system itself is in danger of being eroded to the point of being preserved in form but not in substance.

⁸⁰ "DDG Wolff: Openness, Balance and Trust are Underlying Values of the WTO." World Trade Organization. June 25, 2020. https://www.wto.org/english/news_e/news20_e/ddgaw_25jun20_e.htm

Globalization is now seen by its critics almost entirely in negative terms. They contend that global growth was bought about at too high a cost. Openness to trade is viewed as eliminating jobs and creating income inequality. The objection is made that the WTO, the embodiment of the multilateral trading system, is far from being a utopia and is actually the reverse, that its costs far outweigh its benefits. Even for ardent supporters of the WTO, there is dissatisfaction.

The bill of particulars of troubles of the trading system is long. It includes the fact that differing economic systems do not co-exist well under the same set of rules. Even the most basic of concepts – whether the system was and is to be “market-oriented” – is disputed by China. Major successful efforts at trade liberalization disappeared a generation ago, before the WTO was created, leaving disparities both in levels of contribution and benefits. Deliberations now, to the extent they exist, often no longer lead to timely and effective conclusions, even when the subject is dealing with existential challenges such as a global pandemic or climate change. The dispute settlement system is no longer binding (that is, rendering final judgments) for all WTO members. For the least developed countries, the pace of improving economic conditions is too slow. It is said, correctly, that inequality of capacity on the part of developing countries cannot readily lead to equality in results. Even the most basic of deliverables, peace, is not assured, it is argued, given that the existence of open trade did not deter the outbreak of war in Europe through the invasion of one WTO member by another (Russia’s incursion into Ukraine).

The rise of populism and geopolitical tensions have given rise to calls for something far more fundamental than a minor course correction. While the defenders of the system see its flaws, they do not give it a full-throated defense.⁸¹ Before seeing the system erode due to inattention and a lack of leadership, national policymakers should pause to reflect on the value of what they have in hand in the current system. They should assess what needs to be improved and unite to make the necessary changes.

The Future of the Trading System in a World of Great Power Rivalry

It was already very difficult to make much progress in the WTO before China emerged as one of the largest trading nations. A falling out between China and the United States (or China and the West) can make what is difficult edge toward the impossible. The commercial aspect of the Sino-American contest differs greatly from the one that existed between Japan and the United States in the last third of the 20th century, from the late 1960s to the mid-1990s, when the strong perception was that Japan was the rising commercial power and America was the established one. There was then no question of a geopolitical rivalry. Japan was an American ally, sworn against military engagement by its constitution, and protected by the United States.⁸² That economic rivalry had very large costs in terms of manufacturing jobs in the United States. In some respects, Japan was even more of a non-market economy than China has been, with

⁸¹ As Edmund Burke may have written (the provenance is disputed): “The only thing necessary for the triumph of evil is for good men to do nothing.”

⁸² Paul Volcker and Toyoo Gyohten. 1992. *Changing Fortunes: The World's Money and the Threat to American Leadership*. New York: Crown Publisher.

In fact, there was an assumption in Japan that being an ally of the United States freed Japan of any obligation to also be a market for US goods. The *quid pro quo* for trade was political, it was thought in Tokyo, not reciprocal market access.

policies that resulted in very low import penetration of manufactured and agricultural goods.

Both Japan and the United States managed their trade conflicts through means outside what the rules of the trading system allowed. The US employed a full panoply of trade restrictions, including unilateral use of Section 301 for which there was no clear GATT justification. The two negotiated agreements providing for “voluntary export restraint” by Japan and preferential market access for American and sometimes foreign goods generally. Very little of this management of trade worked to achieve its immediate aims, although it did prevent broader protectionist measures being employed. However, neither did it prove to be destructive of the global trading system. In effect, the US and Japan took their fight out into the parking lot of the GATT and WTO, and the system went on about its business. It is an open question as to whether the trading system can be sustained given the conduct of the two current largest trading nations.

The solution to the US-Japan trade crisis was a solution “made in Japan” through the evolution of the Japanese economy to one that was consistent with the multilateral trading system. At present that does not appear to be the direction that China is taking. Nor has a new Sino-US *modus vivendi* been attempted after the collapse of the Trump Administration’s Phase One Agreement.

What Will the Future Hold for Trade Relations?

There will be no broad decoupling for the foreseeable future, and there isn’t any now.⁸³ To the extent that it occurs between the two protagonists, it has economic limits (short of there being the outbreak of a war between the two). China’s production is extensively intertwined in global value chains. While many nations’ policymakers will for critical materials seek to have their industries diversify their sources of supply and avoid overdependence on any single foreign market, their policies will only slowly change world trading patterns, if the policies are effective at all. Drug companies in the West may look for active pharmaceutical ingredients from sources outside China, but this cannot be achieved overnight. China is completely dominant as the source of ingredients for many antibiotics and vitamins.⁸⁴ Apple’s investment in human capital, 1.5 million workers in its global supply chain, is mainly centered on China. Observers have estimated that it would take a decade or more to shift that supply chain out of China.⁸⁵ Currently, car companies are heavily dependent on China for components and will continue to rely on Chinese suppliers for parts of vehicles to be sold in China, as they begin the process of finding alternative sources for sales in other markets. That, too, will largely be a gradual process, although the content rules of USMCA seek to accelerate that change in the location of supply chains.⁸⁶

⁸³ Chad P. Bown. “Four Years Into the Trade War, Are the US and China Decoupling?” Peterson Institute for International Economics. October 20, 2022. <https://www.piie.com/blogs/realtime-economics/four-years-trade-war-are-us-and-china-decoupling>

⁸⁴ “The Great Medicines Migration: How China Took Control of Key Global Pharmaceutical Supplies.” Nikkei Asia. April 5, 2022. <https://asia.nikkei.com/static/vdata/infographics/chinavaccine-3/>

⁸⁵ “What It Would Take for Apple to Disentangle Itself from China.” Financial Times. January 17, 2023. <https://www.ft.com/content/74f7e284-c047-4cc4-9b7a-408d40611bfa>

⁸⁶ Articles 3(1)-(5), (7) and Article 4.2(b) of the (Autos) Appendix to Annex 4-B of Chapter 4 of the USMCA.

With respect to the US-China competition, countries have not been forced to choose sides, and are not overtly doing so. Dependence on the United States for security has largely not been considered by these countries to require curtailing trade relations with China.

Resilience – a code word for avoiding excessive dependence on any country for supplies – involves a price that is acceptable only up to a certain level. A new equilibrium will be struck between resilience and efficiency, but there are real limits to the degree to which efficiency can be ignored. In short, under current conditions, the world is not edging toward the creation of two trading blocs. Overall, trade-distorting Chinese policies have not (yet) offset the attractiveness of the Chinese market. At the same time, the US is doing nothing to make its market more accessible, and in some instances, US policies are making it less so. On the whole, firms are neither being driven nor are they being attracted to an American camp by the two adversaries' policies. Nor are they pressed to be in a Chinese camp in terms of their trade relations. Their preference is to sit on the fence as much as possible and for as long as they can do so.

Regional agreements will continue to flourish. The EU will expand and consolidate the Union itself and continue its proliferation of bilateral preferential trading arrangements. For North American trade, USMCA will continue to function well (with some exclusion of external products). RCEP and APEC will continue to promote Asian economic integration. In particular, it is to be hoped that the African Continental Free Trade Agreement brings greater prosperity throughout that continent and “silences the guns”, and that regional economic integration becomes a force for peace.

There will also be a series of “mini-laterals”, subject-specific agreements such as now exists in the form of the Digital Economic Partnership Agreement among three countries (Chile, Singapore, and New Zealand). There will be affinity groups based on like-mindedness on commercial subjects, such as e-commerce or other themes (e.g., climate clubs) where interests align, none of them having enough buy-in to be part of a global order for trade.

The multilateral trading system, the old and existing order, will not be terminated. It should not be allowed to decline in relevance. It did not become what it was envisioned to be (i.e., equal access to markets and raw materials), but came closer than any other arrangement in history in achieving that objective. It will continue to be the basic platform upon which trade continues, even China-US trade that is not otherwise re-channeled by government measures.

If the WTO is to have a chance at becoming even more relevant, its members must find a way to have open plurilateral agreements accepted as legitimate and administered by the WTO. It must also have the capability to provide true transparency with respect to national measures through an empowered executive branch under its Director-General. It must also be restored as the place where trade disputes are settled with finality, which means binding upon the parties to the litigation. All of this is achievable. It is a matter of leadership, dedication and will.

Much depends on the WTO's three largest trading members.

- First and foremost, for the multilateral trading system to thrive, the United States would have to return to a leadership role in international economic policy as it has in the

geopolitical sphere. This means moderating a policy of subsidizing localization. It would require its not pursuing the false promise of serving labor through trade policies that reject international engagement. Trade policies cannot cure inequality; for that purpose, domestic policies are needed.⁸⁷ It does not serve labor where the result is a more equal share of a smaller pie.

- China would have to invest its energies in making the trading system function that nurtured its growth to world power status. This means paying more than lip service to multilateralism and fulfilling its commitment that market forces (“commercial considerations”), not state influence, will be the primary determinant of competitive outcomes both at home and abroad. It would have to cease to detract from its possible leadership by claiming “developing country status” as a defensive tactic and not continue attacking the basic premise of the WTO that trade must be conducted on a “market-oriented” basis.
- The EU would have to overcome its internal divisions and give the highest priority to making the global system work, turning away from its continuing to invest heavily (if understandably) in serial bilateral preferential agreements that must not be an end in themselves but should be a building block for a better multilateral system. As the world’s largest trading bloc, it should put its shoulder to the wheel and exert itself to a greater extent to make the system work.

Together the three must assure that the extensive divergencies among the 164 members do not make forward movement impossible. It is to be hoped that the multilateral trading system’s aspiration of equal treatment for all will not be replaced by a reversion to “my country first” nationalism. It is incumbent upon the United States and the European Union – and for that matter, China and the middle powers – to demonstrate individual and collective leadership to avoid the system deteriorating along nationalist lines.⁸⁸

It will be argued, with justification, that expecting a positive response to the call to leadership made of any of the three trading partners is simply unrealistic. Even naïve. Not something that will happen now. This downbeat assessment is one that I have come to (temporarily) at the end of depressing conversations with senior trade officials. To march under a banner of damage limitation is hardly inspiring. This led one official to point me to a statement

⁸⁷ Alan Wm. Wolff, Robert Z. Lawrence, and Gary Clyde Hufbauer. "Have Trade Agreements Been Bad for America?" Peterson Institute for International Economics. December 2022.

<https://www.piie.com/publications/policy-briefs/have-trade-agreements-been-bad-america>

⁸⁸ It has been argued that the WTO does not prescribe the kind of economy that a member has. On the contrary, to live with diversity that is incompatible would require a different WTO. If China will not moderate the effects of state capitalism, and in reaction, the US and the EU pursue their own nationalistic policies, there needs to be a renegotiation among the three about the system that will promote global interests. The West needs to meet the challenge with as much resolve as it has demonstrated with respect to geopolitical issues. The democratic capitalist countries and the state-capitalist one would need to hammer out within the multilateral system an arrangement that takes fully into account the two forms of organization of their domestic economies, one statist and the other based on market forces, allowing the different models to function without creating excessive friction. This is a diplomatic problem more complex than reaching a peaceful solution to the war in Ukraine. But all diplomatic problems are in the end solvable.

by Albert Camus. In his dinner speech in 1957 acknowledging his being awarded the Nobel Prize for Literature, Camus said “Each generation doubtless feels called upon to reform the world. Mine knows that it will not reform it, but its task is perhaps even greater. It consists in preventing the world from destroying itself.”⁸⁹ The English translation is interesting. It says “destroyed”, though the actual words in French refer to “se défasse”, which is closer to “getting undone”.⁹⁰ The rules-based world “getting undone” is very much what might be happening today, we agreed.

Camus’ remarks were shaped by the fact that his generation had lived through horrors that none of the immediately preceding generations could even have imagined. When he spoke, the threat of nuclear war between the USSR and the US was very real. We know now with hindsight that nuclear war between the two did not take place and the USSR in fact dissolved. Camus did not in his remarks allude to the creation of the European Coal and Steel Community seven years prior or the creation of the European Economic Community nine months earlier through the Treaty of Rome. Rather than failing to reform the world, and most prominently Europe, which he thought would be the case, his generation succeeded in preventing the world from “getting undone”. It did put into place the necessary reforms.

The current generation has the opportunity to avoid the pessimism that is a hallmark of our time. It must not accept that the world, and its multilateral trading system, cannot be made to work far better. As opposed to the conditions Camus witnessed, the current generation has lived in a time largely of peace and increasing plenty. It falls to us to be once again concerned about the future, and to meet current challenges together. The answer cannot be each nation pursuing narrow nationalistic goals but finding instead the means to cooperate with others for the common good.

In his excellent book *Slouching Towards Utopia*, Bradford DeLong writes of “the long twentieth century... the most consequential years of all humanity’s centuries ... that saw us end our near-universal dire material poverty.” The world has now embarked on the next stage of this adventure, a 21st century in which the most important historical thread may again, one can hope, be the economic one. The multilateral trading system was key to the economic progress experienced during the long last century. We do not know how successful it will be in this century. We should have learned that an integrated, fair, and open rules-based world trading system would serve humanity best. But it will not be handed to us. It is a goal that requires hard work.

Multilateralism will be back because it makes the most economic sense. Willing buyers and willing sellers have been coming together for countless millennia because it served their interests, and in doing so they ultimately served the interests of all.

⁸⁹ "Albert Camus - Banquet Speech." The Nobel Prize. December 10, 1957.

<https://www.nobelprize.org/prizes/literature/1957/camus/speech/>

⁹⁰ *Chaque génération, sans doute, se croit vouée à refaire le monde. La mienne sait pourtant qu'elle ne le fera pas. Mais sa tâche est peut-être plus grande. Elle consiste à empêcher que le monde se défasse*". Albert Camus - Banquet Speech (French)." The Nobel Prize. December 10, 1957.

<https://www.nobelprize.org/prizes/literature/1957/camus/25232-banquet-speech-french/>

Annex 1 – An Indicative List of US-China Potential Areas of Armed Conflict

Professor Graham Allison famously pointed to a Thucydides's Trap, "a deadly pattern of structural stress that results when a rising power challenges a ruling one." Since 2017, when his book *Destined for War: Can America and China Escape Thucydides' Trap?* was published, the United States and China have moved closer to conflict in small increments. China chose to regard a visit to Taiwan by the US Speaker of the House of Representatives Nancy Pelosi as a serious provocation. China's military exercises in the vicinity of Taiwan began to escalate. It had already fortified atolls that could menace world sea routes.⁹¹ China also greatly increased its military spending on ships and weaponry in order, presumably to assure regional dominance. It has denied its people access to Western digital platforms, cordoning off foreign news, and suppressing dissent.⁹²

Launching a "spy balloon" to float across the United States added an additional irritant in bilateral relations, causing cancellation by US Secretary of State Antony Blinken of his visit to Beijing in what would have been a renewal of high-level talks between the two countries. For their part, America and its allies conduct freedom of the seas navigation exercises in the area, which China states is a provocation.⁹³ More than 50% of world trade passes through the Strait of Malacca, the Sunda Strait and the Lombok Strait in the South China Sea. It is a choke point for oil and natural gas bound for Japan and South Korea from the Persian Gulf.⁹⁴ An accidental or purposeful confrontation is always possible in those waters or in the Taiwan Strait. From China's perspective, the US is increasingly engaged in hostile actions, partially banning TikTok, which is taken as another sign that the US is "surrounding China."

Clearly, much depends on the two powers' management of their external relations, their actions and reactions. Each sees in the actions of the other reasons to have a more elevated level of concern, threatening to reduce the sustainability of commerce and relatively normal relations with the West. Americans tend to think that the next provocations will come from China, miscalculations that it might make in its exuberance in viewing itself as the rising power of this century about to triumph over an existing world power.⁹⁵ On both sides, generals plan for

⁹¹ "Fortified South China Sea Artificial Islands Project Beijing's Military Reach and Power, Say Observers." South China Morning Post. November 6, 2022. <https://www.scmp.com/news/china/diplomacy/article/3198504/fortified-south-china-sea-artificial-islands-project-beijings-military-reach-and-power-say-observers>

⁹² Milton L. Mueller and Karim Farhat. "Regulation of Platform Market Access by the United States and China: Neo-Mercantilism in Digital Services." Wiley Online Library. May 23, 2022. <https://onlinelibrary.wiley.com/doi/10.1002/poi3.305>

"Google Shuts Down Translate Service in China." CNBC. October 3, 2022.

<https://www.cnn.com/2022/10/03/google-shuts-down-translate-service-in-china-.html>

⁹³ "Freedom of Navigation in the South China Sea: A Practical Guide." Harvard Kennedy School Belfer Center for Science and International Affairs. June 2017. <https://www.belfercenter.org/publication/freedom-navigation-south-china-sea-practical-guide>

⁹⁴ "China's Growing Assertiveness in the South China Sea." Real Instituto Elcano. November 5, 2015. <https://www.realinstitutoelcano.org/en/analyses/chinas-growing-assertiveness-in-the-south-china-sea/>

⁹⁵ This has manifested as statements from wolf-warrior foreign ministry spokespersons and Xi Jinping's stated goals of Chinese global dominance in a number of industries that will determine future economic strength.

For a view that the rise may not be as fast as Chinese opinion would have it, see:

"China may prove not to be the threat we have come to assume." The Hill. January 22, 2023.

<https://thehill.com/opinion/national-security/3814610-china-may-prove-not-to-be-the-threat-we-have-come-to-assume/>

contingencies.⁹⁶ American generals conclude that they must be ready within a few years to fight with China, while the People's Liberation Army (PLA) of China considers relatively near-term military options for the forceful acquisition of Taiwan.⁹⁷ Nevertheless, while war is a possibility, it is not necessarily a likelihood. In the current national security strategy, President Biden stated the US intention to "manage the competition responsibly".⁹⁸ Viewing China's apparent restraint to date (June 2023) in not providing substantial lethal support to Russia for its invasion of Ukraine, one can assume that China is equally unlikely to intentionally engage in any irretrievable confrontational act.

It is possible to credit both sides with a desire for restraint while worrying that the list of areas of risk keeps getting longer. It was said of the financial crisis that had Lehman Brothers not been allowed to fail, there would have been another triggering event, as there was a lot of dry tinder available in terms of financial mismanagement. In this view, the failure of Lehman Brothers just happened to be the spark that touched off the global crisis, but there would have been other causes, had Lehman not been bailed out.⁹⁹ In the case of the geopolitical rivalry, there is a continuous build-up of concerns. Beyond the militarization by China of atolls in the South China Sea,¹⁰⁰ a year ago a China-Solomon Islands Security Arrangement was entered into.¹⁰¹ Two months ago a Chinese firm was awarded a contract to build out a port in the islands, raising the concern that it will have dual use as a Chinese naval base.¹⁰² Two years ago, the US, Australia and the UK (AUKUS) agreed to build nuclear submarines to strengthen their presence in the Western Pacific. China finds this development ominous, accusing the participants of walking down a dangerous path.¹⁰³ A few days ago, Canada's defense minister expressed an interest in Canada joining AUKUS to share in the development of advanced technologies for defense including AI.¹⁰⁴

⁹⁶ "Air Force General Predicts War with China in 2025, Tells Officers to Prep by Firing 'a Clip' at a Target, and 'Aim for the Head.'" NBC News. January 27, 2023. <https://www.nbcnews.com/politics/national-security/us-air-force-general-predicts-war-china-2025-memo-rcna67967>

⁹⁷ "Is China Planning to Attack Taiwan? A Careful Consideration of Available Evidence Says No." War on the Rocks. December 14, 2022. <https://warontherocks.com/2022/12/is-china-planning-to-attack-taiwan-a-careful-consideration-of-available-evidence-says-no/>

⁹⁸ "National Security Strategy." The White House. October 2022. <https://www.whitehouse.gov/wp-content/uploads/2022/10/Biden-Harris-Administrations-National-Security-Strategy-10.2022.pdf>

Even in the presence of a current war in Ukraine, the utmost care has been taken to avoid escalation (e.g., delaying any decision by 11 months to contribute Abrams tanks).

⁹⁹ "National Security Strategy." The White House. October 2022. <https://www.whitehouse.gov/wp-content/uploads/2022/10/Biden-Harris-Administrations-National-Security-Strategy-10.2022.pdf>

Even in the presence of a current war in Ukraine, the utmost care has been taken to avoid escalation (e.g., delaying any decision by 11 months to contribute Abrams tanks).

¹⁰⁰ "China Has Fully Militarized Three Islands in South China Sea, US Admiral Says." The Guardian. March 21, 2022. <https://www.theguardian.com/world/2022/mar/21/china-has-fully-militarized-three-islands-in-south-china-sea-us-admiral-says>

¹⁰¹ "What the China-Solomon Islands Pact Means for the U.S. and South Pacific." Council on Foreign Relations. May 4, 2022. <https://www.cfr.org/in-brief/china-solomon-islands-security-pact-us-south-pacific>

¹⁰² "China Firm Wins Solomon Islands Port Project as Australia Watches On." Reuters. March 22, 2023. <https://www.reuters.com/world/asia-pacific/chinese-company-wins-tender-redevelop-solomon-islands-port-official-2023-03-22/>

¹⁰³ "'Path of Error and Danger': China Angry and Confused Over Aukus Deal." The Guardian. March 16, 2023. <https://www.theguardian.com/world/2023/mar/16/outrage-confusion-china-reaction-aukus-deal>

¹⁰⁴ "China Firm Wins Solomon Islands Port Project as Australia Watches On." Reuters. March 22, 2023.

The US Navy is increasing its littoral combat capability.¹⁰⁵ China has been making major investments in its anti-access/area-denial (A2/AD) system around the East China Sea, the South China Sea, and the Strait of Taiwan. China's emphasis on building up its navy is designed to alter the balance of power in the region.¹⁰⁶

Both sides are developing the conditions under which a clash could become less manageable and more likely to escalate. Public opinion in both China and the United States has evolved toward a more nationalist stance regarding the bilateral relationship. 80% of Americans view China unfavorably.¹⁰⁷ What would the American reaction be now to a recurrence of a major data breach, as occurred in 2015 at the Office of Personnel Management, if it were assumed that China had sponsored the incursion? What about additional cases of industrial espionage?¹⁰⁸ What blame would be ascribed to China for failing to restrain further aggressive North Korean missile and nuclear developments? What would the future US response be to a Chinese hypersonic missile test near US territory,¹⁰⁹ or to Chinese naval exercises threatening the Senkaku Islands? How threatening will continued Chinese development of anti-satellite weapons systems be?¹¹⁰ What if there were another downed US reconnaissance flight as occurred in Hainan in 2001?¹¹¹

US-China relations are taking place in a virtual minefield. Bilateral trade relations cannot avoid reflecting geopolitical realities. Calling the relationship one of "rivalry" does more to mask the dangers than to expose them, making potential management of the risks more difficult. When does a build-up of defense capabilities move from deterrence and defense to provocation? When will a combination of domestic industrial policy and export restrictions be deemed hostile acts rather than peaceful competition?

There is an effort to ring-fence national security from economic relations. The clearest articulation of US policy with respect to the bilateral economic relationship is contained in a major speech by Secretary of the Treasury Janet Yellen. She stated that the US "will secure our

<https://www.reuters.com/world/asia-pacific/chinese-company-wins-tender-redevelop-solomon-islands-port-official-2023-03-22/>

¹⁰⁵ "US Navy Prepares Major Surge of Littoral Combat Ship Deployments." Defense News. July 31, 2020.

<https://www.defensenews.com/naval/2020/07/31/the-us-navy-is-preparing-a-major-surge-of-lcs-deployments/>

¹⁰⁶ "China's Anti-Access/Area-Denial Strategy." The Defense Horizon Journal. February 9, 2023.

<https://www.thedefencehorizon.org/post/china-a2ad-strategy>

¹⁰⁷ "Some Americans' Views of China Turned More Negative After 2020, But Others Became More Positive." Pew Research Center. September 28, 2022. <https://www.pewresearch.org/short-reads/2022/09/28/some-americans-views-of-china-turned-more-negative-after-2020-but-others-became-more-positive/>

¹⁰⁸ "Industrial Espionage: How China Sneaks Out America's Technology Secrets." BBC News. January 16, 2023.

<https://www.bbc.com/news/world-asia-china-64206950>

¹⁰⁹ "US Defense Officials: China Is Leading in Hypersonic Weapons." Voice of America News. March 10, 2023.

<https://www.voanews.com/a/us-defense-officials-china-is-leading-in-hypersonic-weapons/7000160.html>

"China Hypersonic Test 'Has All of Our Attention,' US General Says." Voice of America News. October 27, 2021.

<https://www.voanews.com/a/top-us-general-calls-china-s-hypersonic-weapon-test-very-close-to-sputnik-moment/6287945.html>

¹¹⁰ "China building ability to hijack enemy satellites: report." DW News. April 21, 2023.

<https://www.dw.com/en/china-building-ability-to-hijack-enemy-satellites-report/a-65392829>

¹¹¹ "Dismantled U.S. Spy Plane Flown Out of China." ABC News. July 3, 2001.

<https://abcnews.go.com/International/story?id=80826&page=1>

national security interests and those of our allies and partners”, with the goal not being “to use these tools to gain competitive economic advantage” but to ensure that “both countries can benefit from healthy competition in the economic sphere.”¹¹² A few days later, National Security Advisor Jake Sullivan stated that “we are protecting our foundational technologies with a small yard and high fence, with “carefully tailored restrictions on the most advanced semiconductor technology exports to China... enhancing the screening of foreign investments in critical areas relevant to national security” and “making progress in addressing outbound investments in sensitive technologies with a core national security nexus”. He added: “We are for de-risking and diversifying, not decoupling.”

There is no need to doubt the sincerity of Mr. Sullivan’s conclusion that the US is “not looking for confrontation or conflict”. However, no evidence shows that China found these statements to be reassuring. As further national security restrictions are imposed by the US, and they inevitably will be, the prospect for greater deterioration in the bilateral relationship will increase.

¹¹² "Remarks by Secretary of the Treasury Janet L. Yellen on the U.S. - China Economic Relationship at Johns Hopkins School of Advanced International Studies." US Department of the Treasury. April 20, 2023. <https://home.treasury.gov/news/press-releases/jy1425>

Annex 2 – Alternatives for Organizing World Trade

A series of alternative means to organize global trade are possible – but all are based on discrimination.

1. Nationalism

A government pursuing “me before you” economic policies:

- can favor domestic production, relegating foreign producers to the status of residual suppliers through a wide variety of means, including imposing local content requirements, product standards, differential subsidies, competition policy etc.
- can favor domestic consumption, relegating foreign consumers to the status of residual purchasers through a wide variety of means, including export controls, subsidies to consumers, pre-emptive purchasing etc., all having the effect of rationing exports after first satisfying domestic needs.
- can reach the same results by organizing its economy and commerce based on state-influenced corporations, which can be relied upon to follow national policy rather than the dictates of a relatively free market.

2. Preferential Trading Arrangements

A government can enter seriatim into discriminatory trading arrangements with other countries, bilaterally or in regional groupings.

3. Friend-Shoring

Discrimination can be more *ad hoc* and serendipitous to fit the moment and the state of bilateral relations. First, definitional questions persist:

- Trade with countries the US is at actual war with (e.g., use of trade sanctions against Russia).
- Trade with countries of dubious reliability to the US (e.g., concerns about resilience vis-à-vis reliance on China can be addressed via some reshoring or reorganization of shoring).
- Trade with countries with political systems the US does not like (e.g., deploying possible trade sanctions to address forced/prison labor issues).
- Trade affected by industrial policy.
- Trade in needed commodities, where need defines friendship.
- The rest of trade in general for which no special considerations apply – trading simply because it is profitable, with no special consideration of the aspects of friendship listed above.¹¹³

¹¹³ Categories derived from comments by PIIE’s Olivier Blanchard.

Second, timing questions are at play:

Who are one's friends? When are they friends? Shifting sands of friendship (e.g., Japan and Germany in 1948 as defeated enemies versus US trading partners today). Over the last few centuries, China has been off and on an American friend, alternatively.

4. Power-Based Trade

The arrangement can be neo-colonial (such as imposing a dominant country's standards, structuring Belt and Road Initiative debt repayment through preferential trading arrangements, or market power). Trade coercion can be used selectively.

Conclusion

None of the aforementioned arrangements can fully replace a global non-discriminatory arrangement, as ultimately market forces – the desire to maximize the benefits to those engaged in individual transactions – proves over-powering.

Promoting open markets can be disruptive. International competition is brought to bear on domestic interests. Tensions will always exist between favoring domestic interests and more efficient international alternatives. In theory and practice, the “my producers first” inclination has been overcome by the utilitarian notion of the greatest good for the greatest number. Advancing market openness over protection is similar to promoting democracy. These are disruptive precepts. They threaten entrenched interests but will ultimately prevail because they are fundamentally in the self-interest of most individuals, whether fostering political or economic freedom.

Human progress is in the long run inexorable. Discrimination of all kinds is sought to be eliminated. Today, 98% of world trade flows largely under WTO rules and about 80% of that trade takes place at the non-discriminatory tariff levels set in that institution. Almost all countries are either WTO members or seeking to become members. The organization's ambition is less lofty than that of the United Nations, which was founded to prevent and eradicate war. But for its purposes, the WTO was remarkably successful.