



22-15 How to Save the WTO with More Flexible Trading Rules

Robert Z. Lawrence

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INTRODUCTION

The World Trade Organization (WTO) is in trouble. Despite significant progress at its 12th ministerial meeting in June 2022, with steps forward on fisheries, patents, export controls, and other matters, the organization's dispute settlement system remains debased because the United States refuses to appoint judges to the Appellate Body. The United States also retains tariffs on China that clearly violate the WTO's principles of bound most favored nation (MFN) rates, and thus far the Biden administration continues to insist China meet the managed trade goals it agreed to with the Trump administration.

Meanwhile, China and many other countries are imposing retaliatory tariffs against the United States that were not authorized by the WTO. Increasingly, countries have broken WTO norms against the use of trade to coerce others. Sanctions have been used previously in a few circumstances, against South Africa because of apartheid and against Cuba by the United States. But trade and economic sanctions have become more common, driven by war (sanctions against Russia), human rights (US sanctions against Chinese production by Uyghurs), and even the opinions expressed by other WTO members who disagree with them publicly (e.g., China's trade sanctions against Australia and Lithuania). Many of these politically motivated actions probably should not be addressed through trade pressures—they are better left for negotiation or resolution in other forums. Trade is being used not because it is likely to change behavior but because it seems to be the least bad tool available to pressure other countries.

This Policy Brief argues for a rules-based trading system that steers between two extremes: "deep integration," a single undertaking in which all WTO members are expected to adhere to all rules regardless of their preferences and

Robert Z. Lawrence, nonresident senior fellow at the Peterson Institute for International Economics, is the Albert L. Williams Professor at the Harvard Kennedy School.

circumstances, and “decoupling,” in which groups of countries centered on the United States or China limit trade with each other. Instead, the system should have a “variable geometry” that allows open plurilateral agreements among self-selected members that desire deeper integration on particular issues while allowing members that prefer to implement distinctive domestic policies to remain outside some of these agreements and follow a set of more limited rules. The universal rules would permit diversity but still promote trade between all countries through measures such as safeguards that would deal mainly with the most harmful systemic frictions. If the multilateral system is not up to the task of creating this type of approach, it is likely to lose its relevance as differentiated regional or topic groupings become increasingly dominant.

UNDERSTANDING CURRENT WTO DYNAMICS

Given the diversity of membership in the WTO, it was remarkable that the Uruguay Round of trade negotiations culminating in the organization’s establishment in 1995 achieved a single undertaking with common binding rules that applied to all but its least developed membership. But perhaps this success set a bad precedent and contributed to the problems in negotiating multi-issue agreements in the failed Doha Round that followed. These problems suggest that the WTO now needs a system based on a variable geometry. Many countries still believe in an approach that tries for a single undertaking that places constraints on the behind-the-border policies of all WTO members (deeper integration). But these efforts are likely to fail because members have very different policy preferences in areas such as foreign direct investment (FDI), e-commerce, industry, and labor and environmental standards. Nonetheless, some members are eager for additional trade rules on these issues.

During the Doha Round negotiations, which started in 2001 and effectively collapsed seven years later, countries opposing deeper economic integration prevented negotiations on the issues noted above by using the consensus rule—requiring unanimous agreement on changes—and thus kept these issues off the WTO agenda. But their opposition failed because they drove some members to find alternatives outside the WTO ambit. The demand for deeper integration results from strong functional and political imperatives in many countries, and the members who faced resistance to their introduction formed “coalitions of the willing” to bypass the WTO and negotiated deeper rules in bilateral and regional agreements.

The pressure to conduct business outside the WTO has been exacerbated by “the clash of systems” that has resulted from China’s WTO accession in 2001. Over the two decades since, the trading system has faced a major problem:¹ the persistence of China’s unique economic system, which the Chinese call “market socialism with Chinese characteristics.” When China joined the WTO, it was recognized that the country retained many of the practices and institutions that were part of its communist history, but it was expected that after a transitional period China would converge toward the economic systems typical of most western economies. In its WTO accession agreement, China accepted numerous

1 For a prescription for accommodating the differences between the United States and China, see Bergsten (2022).

obligations that were supposed to encourage this evolution.² But although China has engaged in extensive trade and investment opening, many features of its system have remained distinctive, with the state rather than market forces prominent in guiding resource allocation (Wu 2016). Under President Xi Jinping, the communist party, state-owned enterprises, and extensive industrial policies have become increasingly important in influencing economic activity (Lardy 2019).

THE TWO EXTREME RESPONSES TO THE CLASH OF SYSTEMS

Two extreme responses emerged in this clash of systems. One is to negotiate new agreements that would improve transparency and limit the scope of subsidies and the activities of state-owned enterprises, regulate the actions of Chinese banks and firms as public bodies, and agree on stronger and more precise disciplines requiring stricter adherence to market-based principles. The hope is that such measures will achieve the convergence of these economies to a more common model.³

However, rather than relying on negotiations of new WTO rules to realize this convergence, the Trump administration launched an initiative against China under Section 301 of the Trade Act of 1974 both to achieve more balanced trade and to force such changes. Although it succeeded in obtaining Chinese commitments to buy more US products and services in a so-called phase one agreement, these were not honored (Bown 2022). Moreover, the Trump initiative did not resolve the more fundamental issues relating to China's nonmarket practices, which were left for talks at some time in the future.

The Biden administration has retained many of the Trump tariffs and continued to demand that China honor its purchase agreements. But its policies have shown no evidence of a coherent strategy that would effectively change Chinese practices such as those on technology transfer and intellectual property that the United States and other countries find problematic.⁴ Instead the United States has chosen to pursue a new initiative (the Indo-Pacific Economic Framework) that excludes China. As a result, both the wounds of the Trump policies and the underlying problems persist.

The other extreme response, among economic and security experts who argue that the Chinese and US systems are fundamentally incompatible, calls for "decoupling." The idea is to sever trade, supply chain links, and investment and technological ties with China to the maximum extent possible and form alliances

2 The Marrakesh Ministerial Declaration of April 1994 at the end of the Uruguay Round states that the ministers are "[d]etermined to build upon the success of the Uruguay Round through the participation of their economies in the world trading system, *based upon open, market-oriented policies* and the commitments set out in the Uruguay Round Agreements and Decisions" (emphasis added). But according to Hillman (2022), China refused to go along when in September 2020 the G20 trade ministers sought to renew this pledge.

3 See Bown and Hillman (2019) and Hoekman and Nelson (2020). Bergsten (2022) describes the joint effort of the United States, European Union, and Japan to expand the list of prohibited subsidies to include those that "distort capacity" and to shift the burden of proof from accusing countries to those accused of subsidizing to show that their subsidies are doing no harm. See Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States, and the European Union, Washington, January 14, 2020.

4 These are detailed in the annual reports on China issued by the Office of the US Trade Representative.

of like-minded countries to achieve greater reliance on each other while limiting economic ties with others. One version of this approach has been dubbed “friendshoring,” in which countries would concentrate supply chain interactions only with countries that agree to play by their alliance rules. More extreme versions of decoupling are supported mainly by those who prioritize national security and by new cold war warriors who see China as a US enemy and view all economic relations between the United States and China as adversarial.

These two extreme responses each have major disadvantages. The deeper integration approach is politically impractical and may run counter to the policies that countries believe are appropriate for their development. China will continue to implement policies that target and promote key industries by giving a central role to its state-owned enterprises and emphasizing the development of indigenous technologies. And China is likely to take only the liberalizing steps it believes are in its interest rather than succumb to pressures from others. While it has applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Chinese government is probably unlikely to simply sign on the dotted line and agree to the current predetermined rules that would constrain its state-owned enterprises and subsidies and require adherence to strong labor and environmental standards. Moreover, as shown by the failed experiences of trying to introduce rules for the so-called Singapore Issues (foreign investment, competition policy, transparency in government procurement, and labor standards) during the Uruguay Round, many other WTO members are also not willing to yield policy space in these areas.

Decoupling could significantly reduce the gains from trade and investment that have been extremely beneficial to both China and its trading partners and would essentially destroy the multilateral trading system. Estimates by the WTO (2022) indicate that a decoupling of the world economy into US- and China-centered blocs would reduce world GDP by 5 percent, with especially adverse effects on developing economies.⁵ Such decoupling may delay China’s rise and make it more costly, but eventually as China reduces its use of foreign technologies, its strategic autonomy could be increased. Moreover, as China’s angry response to the Indo-Pacific Economic Forum indicated, giving China a sense that other countries are allying against it increases the risks of acrimonious conflicts based on China’s perception that many in the rest of the world are adopting exclusionary policies to prevent its rise as a global power. Decoupling would also place many countries in the uncomfortable position of having to choose between alliances when they have strong economic relationships with both sides.

A THIRD WAY

As has been emphasized by a group of prominent Western and Chinese economists (US-China Trade Working Group 2019), it is desirable to find a third way that represents a compromise between these responses and provides an intermediate solution for governing trade and investment. The aim of this

5 With the world divided into “Western” and “Eastern” blocs, the WTO (2022, 21) estimates that over the long run the United States would lose 1 percent of GDP, the European Union 4 percent, China 7 percent, India 9 percent, and Russia 10 percent.

solution would be a rules-based system in which all WTO members agree to improved rules that deal primarily with harmful systemic frictions, for example, by avoiding beggar-thy-neighbor policies and trade policies that cause serious injury, while leaving scope for differentiated national policies that reflect deeply rooted domestic preferences.⁶

This type of approach should be a focus of the core WTO rules but not be the only rules through which the organization regulates trade. It should also be possible to complement a set of rules to which all members subscribe with other agreements among groups of WTO members (both developed and developing) willing to agree to deeper trade-related agreements.

In the proposed system, the WTO would no longer be primarily a single undertaking; its architecture would be what the Europeans call “a variable geometry.”⁷ In some issue areas coalitions of the willing might choose to pursue deeper integration and have more demanding rules. Ideally this would occur through open WTO plurilateral agreements, which could include more rules for the treatment of FDI, e-commerce, subsidies, state-owned enterprises, export controls, and even labor and environmental standards. Ideally membership in such agreements would not be confined to the same group of countries, and in some cases, as its application to join the CPTPP indicates, China might find membership quite attractive.

But what types of rules should all agree to? The problems in designing an intermediate system are not new. Indeed, they closely resemble the issues that China and other WTO members faced when China joined the WTO in 2001. At that time, it was understood both that China’s growth could be disruptive in the labor markets of other WTO members and that the country was not yet ready to operate fully under WTO rules. Accordingly, in its accession agreement protocol, several special rules were implemented that would apply until China adapted its system to conform to market-oriented practices. These rules were premised on the idea that trade with China should be allowed but special measures were needed to address its more interventionist practices if these proved harmful to other WTO members.

Two of the provisions concern unfair trade. One used the approach that had been used earlier with communist countries such as Poland, which were treated as “nonmarket economies” where prices were not freely determined by supply and demand. In these cases, costs from surrogate countries, rather than those based on the accused country’s own data, could be used in antidumping cases. Moreover, although initially China claimed it was entitled to market economy status after 2016, it later dropped the WTO case seeking it. There were also

6 The US-China Trade Policy Working Group (2019, 1) emphasizes “the need to maintain a set of trade rules that prevent countries from deploying what economists call “beggar-thy-neighbor” policies—policies that produce benefits to the home country only through the harm they impose on other countries.” The authors make the case for prohibiting practices such as reaping monopoly price gains, and they also discuss policies that have harmful impacts on other countries that can be addressed through bargaining, practices in which harmful effects can be mitigated by domestic actions (e.g., trade protection against exports), and actions that require a multilateral solution. Some of these could be dealt with through safeguards.

7 See, for example, Institute for Comparative Federalism, Differentiated Integration, <https://www.feelingeurope.eu/Pages/variable%20geometry.html>.

provisions in its accession protocol that made it easier to apply countervailing duties on imports from China if distorted market conditions in China presented “special difficulties” in identifying and measuring subsidies.⁸

Probably the most relevant rule for an intermediate system, however, was the special safeguards mechanism for disruptive trade. The Transitional Product-Specific Safeguard Mechanism allowed a WTO member to invoke a selective safeguard on imports from China if they were being imported “in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products.”⁹ Market disruption was defined as occurring when the imports were increasing rapidly, either absolutely or relatively so as to be “a significant cause of material injury or threat of material injury to the domestic industry.”¹⁰

This special safeguard differed from the normal safeguards in important respects. It did not require “unforeseen developments” or proof that imports were “due to an obligation assumed under a trade agreement.” It could be kept in place as long as necessary to prevent the injury. It could be selective (i.e., directed against the country causing injury rather than MFN) and the injury standard was less onerous than the “serious” injury required for safeguards in GATT Article XIX.¹¹ Also unique to the safeguard was a provision that allowed third countries to take action if the imposition of a special safeguard in one country deflected imports to them. Strikingly, these third countries could impose their own safeguards without even undertaking an injury investigation.

In the United States, special Chinese safeguards were implemented as Section 421 of the Trade Act of 1974. Several US International Trade Commission (USITC) investigations were concluded under Section 421 during the George W. Bush administration. In four of these cases (pedestal actuators, wire hangers, ductile water works fittings, and circular welded nonalloy steel pipe), the USITC made affirmative determinations of market disruption. However, President Bush declined to provide relief in all of the cases on the grounds that doing so was not in the national interest. It was only in 2009 that a special safeguard was implemented by President Barack Obama for “certain passenger vehicle and light truck tires” (Grimmett 2011, Hufbauer and Lowry 2012). In response, in September 2009 China brought a case against this safeguard to the WTO,¹² but its case failed on all counts; it was rejected by a panel report in December 2010, and the panel’s judgments were affirmed on appeal by the Appellate Body.¹³

8 There was also a provision (until December 3, 2008) limiting China’s textile and apparel exports to amounts no greater than 7.5 percent (6 percent for wool products) above the previous year’s amount if Chinese imports were impeding “the orderly development of trade.”

9 Accession of the People’s Republic of China, WTO WT/L/432, Decision of November 10, 2001, paragraph 16.4, page 9.

10 Ibid.

11 Accession of the People’s Republic of China, WTO WT/L/432, Decision of November 10, 2001, paragraph 16.1.

12 *United States—Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tyres from China*, WT/DS399, 2009.

13 China also sought to retaliate against the US Section 421 safeguard by initiating antidumping (AD) and countervailing duty cases on cars and chickens, but lost the AD cases when these were challenged by the United States at the WTO. See Bown (2019, 13).

Although the United States was a reluctant user of the special safeguards provision, “at least ten different WTO members initiated investigations under the new China-safeguard policy between 2002 and 2009, with at least six of those countries imposing new trade barriers on products as varied as float glass, polyvinyl chloride, and porcelain tiles (Turkey); tires (U.S.); soda ash and aluminum (India); as well as textiles and clothing products (U.S., EU, Peru and Colombia)” (Bown and Crowley 2010). Moreover, “[i]n the midst of the global financial crisis in 2009, India alone initiated five different investigations under its China-safeguard policy” (Bown and Crowley 2010).

In sum, the lesson from the failure to invoke safeguards was not a failure of the design of the special safeguards agreement. In the tire case, the USITC was able to establish causation and injury to the satisfaction of the Appellate Body. Instead, the failure to use safeguards was the result of deliberate political decisions made by President Bush. Nonetheless, the experience with the special safeguard and the fact that when applied by the United States it withstood scrutiny by the WTO dispute settlement system suggest that it could serve as a model for a safeguard provision that could regulate disruptive trade without having to investigate and prove the sources of the disruption.

TOWARD A MORE VIABLE SAFEGUARDS RULE

The WTO Agreement on Safeguards should be revised so that the focus is solely on export surges that cause serious injury. The sources of rapid Chinese export growth are often conflated. Sometimes the reasons for the rapid growth in Chinese exports can be traced to increases in Chinese productivity that reflect market forces and sometimes to the country’s industrial policies and subsidies. These have led to global excess capacity in industries such as steel and granted other nonmarket advantages to Chinese firms, such as preferential access to important inputs (e.g., energy and land), or—according to some—maintained an undervalued exchange rate. But disentangling these sources of Chinese export growth is highly problematic. *It would be much simpler when applying a safeguards mechanism to focus only on the degree of harm caused by such trade rather than trying to account for its origins.*

A focus on outcomes will entail elimination of the outdated and ambiguous requirements, currently enforced by the WTO dispute settlement process, that import surges be due to “unforeseen developments” and/or result from “obligations due to trade agreement.”¹⁴ The only relevant issue should be whether imports are a cause of serious injury. The requirement that imports be the most important reason for the injury would also be dropped.

Most of the other provisions of the agreements on safeguards should be preserved. These include the requirements that the remedy be limited to the amount of protection necessary to offset the injury, that it be limited in time, and that any tariff relief decline over time. The provisions for relief from providing compensation if certain conditions are met should be retained. In addition, there should be parallelism between the imports considered to be the source of

14 For a discussion of the problems associated with these provisions, see Li (2001), Sykes (2003), and Raychaudhuri (2010).

the injury and the required protection. If an import surge comes from just one country the safeguard measure could be selective; if the cause is imports from numerous countries, the measure should be applied on an MFN basis.

This proposal could form the basis of an agreement that would facilitate normal trade. Its advantage for China and other countries with unconventional domestic institutions is that it would avoid much of the finger-pointing and acrimony that has heightened trade tensions. It would both provide WTO members with a legal mechanism to moderate the pace of dislocation due to trade and be compatible with most of China's (and other countries') development policies and practices.

More usable safeguard remedies are not a panacea. Although temporary, they are protectionist measures, and they could weaken the commitments countries undertake in trade agreements. Nonetheless, in the current environment, which is fraught with economic and geopolitical tensions, they would serve as a politically feasible mechanism that could facilitate trade and encourage agreements between countries with large systemic differences.

But improving safeguards is not sufficient. Even if they are made more attractive, they do not obviate the need for additional measures to address trade that occasions antidumping or countervailing duty responses. In these cases, however, there is no need for additional action. When it can be shown that domestic Chinese prices are subject to large nonmarket forces, the treatment of China as a nonmarket economy and the use of surrogate country prices in antidumping cases can be continued. Similarly, the provision in China's accession agreement that concerns inadequate information on government subsidies should be used.

These proposed remedies are still limited because they focus only on measures concerning problematic imports. They do not address other economic problems due to the "clash of systems," such as those associated with competition in the Chinese market, measures taken by China to restrict exports to provide downstream industries with cheaper inputs, and frictions related to FDI. Generally, the approach should be to emphasize reciprocal treatment, with access to foreign markets for FDI, for example, mirroring the access China grants to foreign firms and the treatment of Chinese firms investing abroad, contingent on maintaining competitive neutrality between private and state-owned firms in China.

PLURILATERAL AGREEMENTS

In addition to having a more viable safeguards rule, members who seek to deal with issues not yet covered by WTO rules should be allowed to negotiate plurilateral agreements under the aegis of the WTO.¹⁵ Instead of these activities taking place regionally or between selective groups of members it would be far more beneficial if they could be negotiated in the WTO, with the understanding that not all members would be required to sign on to them. Making the WTO the

¹⁵ For an analysis of how these issues could be selected and how the agreements could operate, see Lawrence (2006).

forum helps ensure access for smaller and weaker countries. It also reduces the dangers of global fragmentation and, as noted, in some cases members such as China might be willing to join.

The basis on which agreements would confer benefits on nonsignatories could be determined by those that sign them.¹⁶ Issues such as digital trade and FDI are natural candidates for such treatment. As in the Digital Economic Partnership Agreement (DEPA) signed by Singapore, New Zealand, and Chile, members could agree to some provisions in which they find common ground, while opting out of those to which they are not willing to commit.

Some members will undoubtedly resist the idea that all rules need not apply to all members, but it would be far better to have the WTO play a role in the deeper agreements than to have the world trading system break up into blocs and to have the rules set in forums from which many are excluded.

Plurilateral agreements would reduce but not eliminate the possibility of cross-issue trades in a single undertaking with many issues, in which countries may exchange a concession in one area for a concession by others in another area. This was done, for example, during the Uruguay Round when some members agreed to adopt the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) in return for eliminating textile quotas. But if a number of plurilaterals were negotiated simultaneously, such trades could still be struck albeit to a more limited extent.

A WORD OF WARNING

There are troubling concerns for the trading system about the implications of the clash of economic systems described in this Policy Brief. It is imperative the system return to an inclusive, rules-based international trading order, not only because trade is important but also because if order cannot be maintained in this sphere, there are even greater dangers that the problems in trade spill over into the other geopolitical frictions that plague the broader international system today.

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¹⁶ As Gary Hufbauer has pointed out to me, this is a controversial issue since some members insist on MFN treatment while others want the benefits to accrue only to those joining the agreement. It might require a vote by three-quarters of the members, as allowed in Article XI.2 of the Marrakesh Agreement, to allow conditional MFN in plurilaterals.

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