Peterson Institute for International Economics

All things US trade with Jeffrey J. Schott

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[00:00:18.10] - Anjali Bhatt

Hi, and welcome to PIIE Insider Live. I'm Anjali Bhatt, Communications Manager and Research Fellow here at the Peterson Institute for International Economics. I often say that one of my favorite parts of my job is that I can walk into the offices of some of the world's top economics experts and ask them anything, and they answer. So with PIIE Insider Live, you're coming with me to ask those questions and get those answers that you won't get anywhere else. Today we're speaking with Jeff Schott, one of PIA's longest-tenured senior fellows. Before we start, if you're watching on Zoom, feel free to put your questions in the Q&A box. So, hi, Jeff. Thanks for joining us.

[00:00:50.10] - Jeffrey J. Schott

My pleasure.

[00:00:51.11] - Anjali Bhatt

Okay, so You've been at the Peterson Institute since 1983, and for about 10 years before that, you were an official at the US Treasury Department. That's a lot of trade watching. You know, the obligatory, you've been doing this longer than I've been alive, etc. So I have two questions for you to start out. One is maybe a little bit easier than the other. But so one, what's changed the most in US trade policy since you started in your career? And then two, What stayed the same?

[00:01:25.14] - Jeffrey J. Schott

Well, that's actually not an easy question to answer. When I started working at the US Treasury, the US was the dominant international economic force in the world, and we were working with our allies to help rebuild from the destruction of World War II. To build stronger trade and investment linkages as part of our economic reconstruction and development, but also as a stronger economic defense against the Communist Bloc. We were working closely with these countries, and we were also trying as much as possible to support the economic development of poorer countries. Through building international institutions, including the General Agreement on Tariffs and Trade, which handled trade relations, but also the work here in Washington at the World Bank and the International Monetary Fund, among many other international institutions. So that was the U.S. leadership and working with, with our partners. And that seems to be fraying a bit. That's the simple answer.

[00:02:50.04] - Anjali Bhatt

So that's changed. What we used to, you know, build these institutions with our allies and partners and work together with them. And that's not really happening anymore. Has anything stayed the same?

[00:03:02.28] - Jeffrey J. Schott

Well, I mean, one additional point. After the war, there was a lot of restrictions. On international commerce. And the task was, how do you progressively reduce those barriers to trade and investment to open up new opportunities for economic growth for both— for all the partner countries? And that seems to have reached a point of diminishing returns in a political perspective, not necessarily an economic perspective. And the risk that we have is rollback. And we've seen some of that with the Trump tariffs.

[00:03:55.04] - Anjali Bhatt

So you mentioned the General Agreement on Trade and Tariffs, the GATT.

[00:03:59.19] - Jeffrey J. Schott

Tariffs and trade.

[00:04:00.07] - Anjali Bhatt

Tariffs and trade. Oh, my bad. And so that was sort of the precursor to the WTO. So you worked on the GATT when you were at Treasury along with our colleagues Gary Huffbauer and Fred Bergsten, who are also here at the Institute. And then when you guys came to the Institute, you also worked on the— so it was the Tokyo Round in the '70s that set up the GATT. And then it was—

[00:04:24.29] - Jeffrey J. Schott

No, the GATT was already established. But what we did in the Tokyo Round was develop additional agreements to broaden the scope of international trade governance.

[00:04:37.07] - Anjali Bhatt

So what was the goal of those agreements? What did broadening the scope mean?

[00:04:43.25] - Jeffrey J. Schott

Well, to develop new rules and enforcement mechanisms so that there would be greater certainty about the conduct of international trade, greater, basically, fairness in the trading system and coverage of new domestic policies like subsidies that Gary Hufbauer and I and Fred Bergsten worked on, subsidies that were domestic policies that had impacts on international relations, international competitiveness. And so we tried to set down at least the initial rules of the game in what became to be known as the GATT Subsidies Code.

[00:05:34.01] - Anjali Bhatt

So then, so the GATT Subsidies Code and then the GATT as a whole laid the groundwork for the WTO, which came up through the Uruguay Round in the '90s. So moving from the GATT to the WTO, What changed there? What made the WTO come to be?

[00:05:55.02] - Jeffrey J. Schott

Well, I think there was the desire to have greater certainty in the enforcement and particularly dispute the enforcement of the rules. And so there was much more work done in that area. Another one of our colleagues, Alan Wolf, who worked with us during the Tokyo Round, was also very important in the development of these legal aspects of the trading system, deserves a lot of credit for that. But the one thing that a negotiator can't do is when you have an agreement to tell the government officials, well, you actually have to live by it and don't try to sneak around the corners. Or if you do that, you know, do it very discreetly. But the problem was, is there going to be enforcement? And in the past, enforcement under the GATT rules was subject to all sorts of ways which countries could delay, defer, and avoid penalty. And here in the new WTO system, the objective was to have a more regular, a more efficient, expeditious settlement of disputes so that one could continue and build on with some faith that money that you're investing in either promoting commerce or developing new production facilities to engage in international commerce will meet your expectations and provide benefits for both sides.

[00:07:52.26]

And that was the hope coming out of the Uruguay Round, but one where it isn't as easy as it looks.

[00:08:03.29] - Anjali Bhatt

I think that's a great way of putting it. It's not as easy. You know, that all sounds great, but it's not as easy as it as it sounds. So, and so one of the things that the WTO was supposed to do was make dispute settlement more efficient. We've seen in the last, you know, sort of 20-ish years that the dispute settlement mechanism has slowed down considerably. And since like 2019, I think it hasn't had enough judges.

[00:08:33.22] - Jeffrey J. Schott

It could be, I don't know.

[00:08:34.16] - Anjali Bhatt

Something like that. And so even though the WTO was set up to settle these disputes, we're seeing it's not quite as efficient as it was intended for a variety of reasons. But the WTO isn't really the forum that it used to be, but we're seeing that there are other agreements that countries are participating in to govern their trade. You know, and they have all of the the acronyms of the USMCA and the CPTPP and all of those things. Can you say a little bit more about these alternate or supplemental trade agreements that are happening?

[00:09:16.25] - Jeffrey J. Schott

Let me first add a supplemental note because you said the WTO isn't what it was meant to be. Any international agreement has to be a living agreement, has to reflect the changes in the trading system and adapt to new challenges that come up from different policies that are used. And so the problem with the WTO system was the weakness in the adaptation and the some of the cumbersome elements of dispute settlement that impeded the expeditious resolution of disputes, particularly among major trading countries. And that breeds frustration and also saps political support for engaging or investing in new initiatives to supplement the rules, because if the rules if you spend all this effort to negotiate new rules on investment or whatever, and then the rules sit there and cannot be effectively enforced, then why did you go through the process to begin with? And so this is what has challenged the WTO system almost from the beginning for both economic and political reasons. And so in response, in various parts of the world, countries have gotten together with their close neighbors or trading partners in the region to develop rules and relationships that complement and supplement the international system in the WTO.

[00:11:19.18]

And there, of course, we've been doing that in North America for the past 30-odd years with the North American Free Trade Agreement, now the US-Mexico-Canada Agreement. And so that, that's something that we have been strongly involved in. But of course, the Europeans have been doing this much longer, developing the European communities into the European Union. And more recently, there has been activities in the Asia-Pacific as well, across the Pacific, including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which the United States initially was interested in, but did not participate in at the end of the day. But it has recently had a new member, the United Kingdom. So, the sort of the geographic reach of that agreement is spread beyond the Asia-Pacific.

[00:12:22.20] - Anjali Bhatt

So why did the UK want to join the CPTPP? What's— it's quite big. It has quite a few countries sort of across the Pacific. And the UK saw this regional agreement and wanted to join. Why? What's special about the CPTPP?

[00:12:39.18] - Jeffrey J. Schott

Well, it is an agreement that is trying to go beyond what is in the WTO in certain areas, but it is among countries that have important trade and investment relationships already. And so this is a way of creating some greater certainty on the conduct of trade and investment, the economic partnerships among the 12 countries of the CPTPP. This is something, again, that complements and supplements their obligations towards each other in the World Trade Organization, but it has a much more immediate impact. And it probably is easier to think about using that facility to tweak the rules, expand the rules in certain areas, or to make sure that there's effective consultation so that there is more support for ongoing trade and investment among the partner countries.

[00:13:47.09] - Anjali Bhatt

So these regional agreements, I mean, the CPTPP isn't necessarily regional anymore, but that's okay. The CPTPP—

[00:13:54.28] - Jeffrey J. Schott

Mega regional.

[00:13:55.17] - Anjali Bhatt

Mega regional. The USMCA And there are also other sort of bloc agreements like the EU Mercosur agreement and some of the other agreements between, you know, different groupings of countries. So these are, so as we like to say here, like-minded countries getting together to agree on these rules. And so, as we said, they complement and supplement the WTO rules. But by and large, are they more stringent than WTO rules or are they just sort of different?

[00:14:31.17] - Jeffrey J. Schott

Well, I think they're more targeted towards the particular trade and investment activities of the partner countries. So within the Mercosur, of course, you have that in the southern cone of Latin America. But what makes it interesting is the interest in the cross-regional ties.. And these are not always the easiest things to do. Some of them are between developed and developing countries, and so they have an element of development assistance attached to them, which makes the investment relationship very, very important. But this is— excuse me— this is an area where ideally Everything could be done in Geneva at the, at the center, but in the real world, you, it's often better for people who have relationships with each other to build on that and then provide good examples for others to emulate.

[00:15:43.06] - Anjali Bhatt

So is that happening? Are some of these countries that are working together and signing deals with each other? Are they going to Geneva and saying, hey, we should do this in the WTO too, or are these sort of separate processes?

[00:15:59.22] - Jeffrey J. Schott

Well, they're separate processes because the prospect for advancing big new initiatives in Geneva are daunting. And that has to do in part with some of the key large members of the WTO. Who are not willing to invest resources or open up their own economies to the extent necessary, or are concerned about the enforcement of any new agreements as well as the old agreements, as we discussed earlier.

[00:16:35.04] - Anjali Bhatt

Okay, so we might see more regional happening before the WTO maybe adopts some of, some of the rules that the regional agreements have.

[00:16:44.29] - Jeffrey J. Schott

I think, and the bigger the regional groupings, the more influence they could have. And so one of the interesting possibilities is the renewed interest in the European Union in talking with the CPTPP countries. Now, that's interesting from a number perspective. It doesn't mean necessarily EU membership in the CPTPP, but developing a partnership involves countries that account for a lot of trade and investment. And it also links with Britain back in the CPTPP. It creates an interesting turnaround with Europe, which it had left. So I think it's positive. In most respects, I regard it as a very positive development, and one that complements and supplements what's going on in Geneva, and at least provides, you know, some interesting ways forward once we get to a point where we can link the mega regionals together or bring the major countries back to Geneva to do what the United States, Mexico, and Canada are now doing in the USMCA, which is review the operations of the agreement with the view towards updating and improving the operations and enforcement of the agreement.

[00:18:29.14] - Anjali Bhatt

Agreement. It would be funny if EU-UK trade ended up becoming more integrated because of the CPTPP. That would be pretty funny. Okay, so we mentioned the USMCA, and so you'll be talking about that more in depth tomorrow with our colleague Cecilia Malmström on Tradewinds. So we won't get too deep into this. But as we said, the USMCA is up for review now between the US, Mexico, and Canada. What are some of the big issues that will be up for review between the three countries?

[00:19:04.00] - Jeffrey J. Schott

Well, I mean, obviously there's a concern about the tariffs and the new restrictions imposed by the Trump administration, but it will focus not primarily, but importantly, on the auto sector, which accounts for a good deal of industrial activity among the three countries. And here there is a concern in the United States about growing Chinese participation in the supply chains, both through trade of parts and investment in facilities in Mexico and possibly Canada. The U.S. wants to restrict that, wants to restrict what Mexico and Canada could do with regard to Chinese trade and investment. And one of the ways to do that is by changing the rules of origin, the content requirements. And so right now there are rather restrictive content requirements that to qualify for the USMCA duty-free trade, or what used to be duty-free trade, that 75% of the goods needed to be sourced from North America. The US wants to increase that even more and add an additional sub-requirement that a percentage or a significant percentage, some say even up to 50% of the goods have to be sourced from the United States.

[00:20:41.02] - Anjali Bhatt

So not North America, but specifically from the US.

[00:20:43.19] - Jeffrey J. Schott

Yeah, to add a US content requirement. Now, that has been discussed in press stories. Right now, the existing agreement requires a review at its 6th anniversary to see if the agreement should be extended for another 16 years, or whether there needs to be changes or adaptations, additions, improvements in the agreement to deal with problems that have come up in the interim or new challenges that the three countries need to address. That's what the three countries have been discussing already. The 6-year anniversary is July 1st. It's likely that talks will be continuing and hopefully will not involve new threats of increased protection among the trade and investment of the three countries. But that's something that needs to be worked on and hopefully avoid the imposition of additional tariffs.

[00:21:56.00] - Anjali Bhatt

So if the U.S. put stipulations into the USMCA that in the auto supply chain, in a car, it has to have, say, you know, 50% US-sourced products, and that's all of the little, little inputs in cars that go in. Does the US— do we produce all of those things? Do we have the capacity to do that?

[00:22:19.07] - Jeffrey J. Schott

Well, I mean, I think US officials who are pushing for this hope that by having this requirement, that it will incentivize companies to invest in the United States to produce these goods. But if they aren't doing it now, there's a good reason for that. And it's likely that doing it in the United States would yield products that are more expensive and thus undercut the competitiveness of North American-produced vehicles. That may or provide second thoughts in other auto-producing nations that maybe instead of working through Mexico and Canada and producing in North America, they should just export directly to the United States and pay the tariff.

[00:23:17.03] - Anjali Bhatt

So it might be—

[00:23:17.27] - Jeffrey J. Schott

It depends on the cost.

[00:23:18.28] - Anjali Bhatt

Yeah. So it might be that producing these things in the US to reach the USMCA local content requirements doing so might be so expensive that it would actually make more sense to just produce those things elsewhere, import them, and pay the tariff.

[00:23:35.13] - Jeffrey J. Schott

I mean, it could be counterproductive. So to the extent that— and businessmen can, you know, they have a head for numbers. They can look and they can see if the price is going up, will that increased price, you know, make it through in the marketplace or will they lose sales? If they lose sales, they may have second thoughts about making those investments. And so I, for one, think that there's a real risk that we could be shooting ourselves in the foot and not being able to put the foot down on the gas pedal.

[00:24:14.27] - Anjali Bhatt

Okay, well, we'll have to see what— you said the anniversary is July 1st, so we're coming up there, but we'll have to see what happens.

[00:24:22.07] - Jeffrey J. Schott

I think we're going to speed past it.

[00:24:24.00] - Anjali Bhatt

Yeah.

[00:24:24.12] - Jeffrey J. Schott

And the question will be, uh, can we make it through the review this year without significant new increases in intra-USMCA protection, uh, that would encumber the supply chains and, uh, perhaps create disincentives to more investment? And that's something that we don't want.

[00:24:50.14] - Anjali Bhatt

Okay, well, you'll get more into the USMCA tomorrow with Cecilia, so we won't go any further there. But one of the other countries that you've worked quite a bit with on US trade is Korea. There was a Korea-US Trade Agreement, KORUS. I know that given the Liberation Day tariffs and sort of all of the other stuff that's happening, that trade agreement isn't necessarily fully enforced right now. But what, what are the state of US-Korean trade and investment, and why is Korea an important partner for us?

[00:25:26.19] - Jeffrey J. Schott

Well, Korea is an important partner for both economic and political security reasons. And I wrote a book some time ago noting how we could advance our US and Korean interests in all three areas by promoting a free trade agreement that was consistent with the original NAFTA in North America.

[00:25:50.19] - Anjali Bhatt

Oh, so it would be like NAFTA but with Korea, kind of.

[00:25:54.12] - Jeffrey J. Schott

Well, that's what we did.

[00:25:55.11] - Anjali Bhatt

Yeah.

[00:25:56.02] - Jeffrey J. Schott

And the Korea-US Free Trade Agreement, the KORUS FTA, has helped in both the economic, political, and security areas. The Trump tariffs have gotten in the way, but I think Korean officials, including the trade minister, a former PIIE colleague—

[00:26:19.24] - Anjali Bhatt

who has sat right here—

[00:26:21.24] - Jeffrey J. Schott

who has preceded me on this program, a very distinguished fellow, and he went back to serve his country. He doesn't have an easy job, but I think he and other officials of the government, but importantly in the Korean business community, recognize that you don't want to take rash actions, that there is a very strong and important foundation of US-Korea economic integration that has been building. Through the KORUS FTA, and we have to find ways to manage that, that, that relationship so that there is continued Korean investment in the United States in important areas and an important maintenance of U.S. commitments, both economic and security, to Korea.

[00:27:20.24] - Anjali Bhatt

So when we were talking about this earlier, you had mentioned that Korea is not a part of the CPTPP. Why is that?

[00:27:30.04] - Jeffrey J. Schott

Well, Korea has important trading interests with the United States and with China, and it has important interests with Japan, but also a history, more recent history with Japan that creates, that still has some political implications.

[00:27:57.12] - Anjali Bhatt

And so— and Japan is in the CPTPP.

[00:27:59.11] - Jeffrey J. Schott

And Japan is in the CPTPP. But the relationship is very important. And as Korea looks at its relationship with China and doesn't want to get too dependent on the Chinese, the way to work around that is both to ensure the stability and strengthening of the US-Korea relationship and also to look at how it could expand its economic partnership with the CPTPP countries, including Japan. And it may be it's easier to do it through the CPTPP than through a bilateral agreement with Japan. And they're looking at critical minerals that are produced in some CPTPP countries and other important aspects of the relationships that Korea has with those countries. I think it makes sense to see how you could expand the mega-regional relationship without having to without having to break ties with the United States and as a means of trying to gradually phase down a bit from the levels of dependence with China.

[00:29:26.21] - Anjali Bhatt

I feel like Korea is always caught in the middle there. Okay, well, we— wow, that went quickly. We are almost at time, Jeff. So let's wrap up here. What will you be watching for in the next sort of 3 to 6— besides the USMCA review, which is, I guess, in less than a month, what will you be watching for it in the next 3 to 6 months?

[00:29:46.20] - Jeffrey J. Schott

Well, I think the question is, do we go steady state now on what we have in terms of the new protection and see how we can begin to wind down that or create new incentives for investment and new trade flows with important partners. That I think will depend on a lot of things, but security interests are part of that. I think the US-European relationship is very important in this regard, and hopefully there will be some progress and improvements learning from past experience, both the good and the bad, and the mistakes that were made. And I think that will— there will be some caution as we're approaching the midterm elections in only a few months. And those midterm elections could send important signals about how broad a scope of— for new activity might be possible in the final 2 years of the Trump administration, given what happens in Congress. So I think foreign countries are looking at that, and I know the administration is planning to put forward an economic strategy that gives them the flexibility that they want. To promote economic growth in the United States. But that, I think, requires a partnership with our key allies and goes back to where we were at the start of this discussion, where we had had a strong basis of economic partnership, U.S. leadership, but recognizing that we do better when our partners do better as well.

[00:31:55.06]

And we need to get back to that mutual beneficial policy framework.

[00:32:02.01] - Anjali Bhatt

Couldn't have said it better myself. All right. Well, thank you so much, Jeff. And thank you to all of you for joining us for this edition of PIIE Insider Live. What did you think? What do you want to see next? Let us know at meetings@piie.com. And if you're not already subscribed to PIIE Insider, the newsletter at piie.com/subscribe. Thanks again to Jeff.

[00:32:22.05] - Jeffrey J. Schott

Thank you very much.

[00:32:23.06] - Anjali Bhatt

And thank you all for joining us. We'll see you at the next one.