

Peterson Institute for International Economics

Transatlantic perspectives on US-China geoeconomic competition

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[00:05:28.05] - Mary E. Lovely

Good morning, everyone, and thank you so much to those of you who are here in person and those of you who are joining us online. It's, it's really a dream come true for me to be hosting this conference today. It's been over a year in the works, and I think it's incredibly timely even though we're meeting at a very difficult time to discuss transatlantic cooperation and alignment. I think it's very important for us to be tackling these issues at this time. So let me welcome you here on behalf of the Peterson Institute for International Economics. Um, and, uh, just briefly to introduce the topics that we'll be covering today. Today we're looking at transatlantic perspectives on US-China geoeconomic competition, but I think most of our authors have taken the approach of looking at how the US and EU can cooperate, uh, more effectively to deal with challenges that are coming from China's rise. Uh, in particular, we're going to be looking at 3 topics in depth. The first will be technology cooperation, particularly around export controls. The second will be responding to challenges from Chinese overcapacity, particularly in the electric vehicle space, but in other spaces as well.

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And lastly, looking at challenges to dollar dominance and new payment systems. So I think we've got a very rich menu, uh, ahead of us. We're going to have short presentations from our policy brief authors, and I believe we have QR codes available for those of you who are here in person for the policy briefs. For those of you who are online, the policy briefs will be available a few weeks after this event because our authors are going to respond to the comments of the discussants, and we are incredibly blessed to have a really incredibly well-informed group of discussants. So I think that they're going to bring a lot of value, and our authors have asked to be able to incorporate that into the final draft. So the policy briefs will be available on both the PIA website and the website of our partner. And I just want to say a word about our partner, which is the Center for Security, Diplomacy, and Strategy. From the Brussels School of Governance. Dream partners, incredible institution which has grown at a remarkable rate, I think

because of the quality and just incredible hard work of the people who are involved in the center.

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And we couldn't be happier. I met their center director, Louise Simon, who I'll introduce in one minute, last summer in Brussels. And I was struck by how much his center and our center have in common. And in particular, I'm going to just point out 3 quick characteristics. One is a realization and a commitment to the role of civil society in the policymaking process. So recognizing the importance of having independent, nonpartisan scholars in academia, outside of academia, think tanks, participating in the policy process. The second is a commitment to empirical-based, fact-based research, something we here at the Peterson Institute value very highly. And lastly, a desire for open and fair exchange of ideas. And that's what we're going to be doing today. We know that these are hard issues. We're not going to come up with a set of recommendations where everybody's going to say, "Clicks." that's it. We need to continue to think about these, and we're committed to this continuous dialogue. So we are incredibly pleased at the Peterson Institute to have as our partner today the Center, and I would like to briefly welcome to the podium Louise Simon, the director of the Center for Security, Diplomacy, and Strategy.

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Louise, please.

[00:09:40.12] - Luis Simón

Good morning and thank you, Mary, for the very kind introduction. You actually introduced our center much better than I possibly could, so we're going to borrow a few lines from your intro. And thanks to your colleagues, of course, for the hard work and the excellent welcome. At CSDS, we're really delighted to partner with Peterson to tackle this question of transatlantic perspectives on US-China geoeconomic competition. China now occupies a prominent place in transatlantic debates, I think. And this is understandable given the centrality of China, not only in the context of US grand strategy, but also in global geopolitics. Of course, we know that the transatlantic relationship sort of transcends the China file. In the sense that bilateral EU-US issues, and we'll talk about that, continue to feature quite prominently when it comes to debates on transatlantic economic relations. And both bilateral issues related to defense spending, burden sharing, but also how to deal with the threat posed by Russia also sort of pretty much dominate security debates in the context of the transatlantic relationship. However, there is this realization that what happens in the European region and in the transatlantic relationship is

increasingly shaped by broader geopolitical and geo-economic dynamics, and not least as the center of gravity of military and technological competition sort of appears to be shifting towards the Indo-Pacific.

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And I think that explains China's rising profile, not only in transatlantic relations, but also on debates on European foreign policy and European economic policy. So China has— Europe's interest in China and the Indo-Pacific has sort of skyrocketed in recent years. So I think with the beginning of a new political cycle, you alluded to that, with the new administration here in Washington and also a new team in Brussels, with a new political cycle in the EU, what we want to do today, as Mary was saying, sort of take stock of the nexus between China and the transatlantic economic relationship, and ideally also perhaps discuss some possible ways to strengthen transatlantic economic coordination on China. I think that's it from my side, just to thank you again for the warm welcome and looking forward to the event. Thank you.

[00:12:13.12] - Giulia Tercovich

Good morning, everyone. My name is Giulia Tercovich. I'm Deputy Director at the Center for Security, Diplomacy, and Strategy, and today I have the great pleasure of moderating this first session titled Transatlantic Perspective on US-China Geoeconomic Competition. This is a very timely and important subject, as was already mentioned in the introductory remarks, and evolving dynamics between the United States and China really continues to shape global trade, security, and technological policies in profound ways. As the US and China competition continues, the EU faces growing pressure to align its strategies with the US. However, with Europe's substantial trade ties with China, this alignment is far from being straightforward. So today we have the privilege of having three distinguished speakers with us, and with them we will discuss and we'll try to shed light on the key issues that are at the core of this debate. Let me introduce them. So we have Jeffrey Schott. He's a senior fellow at the Peterson Institute for International Economics, and his expertise on trade, especially in the context of US-China relations, will be crucial for today's conversation. We'll then have Antonio Calcara, who is the head of Geopolitics and Technology Program at CSDS.

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And Antonio will particularly focus his remarks on the relations to— on export control and the their impact on European policies. And then we'll have the pleasure of having Philip Luck. He's the Director of the Economic Program International Business Chair at the Center for Strategies and International Studies, CSIS. And he will provide some insight into the broader picture of US-

China geoeconomic competition and its implication for transatlantic alliance as well. So the Our speakers will discuss this, all this topic, all this point. They don't have that much time. They will do their presentation in 7, 8 minutes. So we'll have a lot of time after for questions. So please be ready with your question. And we will kick off with Jeffrey and Antonio. They will build their presentation on a policy brief they are working on, which is titled "Highlighting U.S. and EU High-Tech Trade and Sanctions Policies Toward China." And after that, we'll give the floor to Philip, who will act as discussant and will provide some comments on the policy brief, but also expanding on other elements. So as I said, after this initial remark, we'll open the floor for questions. Again, be ready with your questions, otherwise, you know, you will feel you lost an opportunity after.

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So, Jeff, floor is yours. Thanks a lot.

[00:15:15.29] - Jeffrey J. Schott

Good morning, everyone. It's a great pleasure to be here working with our European colleagues. It's a great venture for both institutions, and hopefully this project will lead to more and more U.S.-Europe interactions and joint research in the future. Ah, now on our paper, Antonio and I have faced a real challenge in, in, ah, in putting forward the first draft. Ah, we're not sure, ah, what and how much additional economic pressure, ah, President Trump will put on China and whether new U.S. trade restrictions, ah, would be put on Europe as well. Ah, what we do know is that the Trump administration is likely to continue its aggressive U.S. stance towards China, putting increasing pressure on its European allies to align with U.S. policies. But the more the U.S. restricts China trade, the more Chinese exporters will look to European and other markets to sell its manufactured goods. And increased competition from Chinese imports in Europe especially in the auto sector, could in turn propel a political backlash that weakens support for US-EU cooperation on China policy. So it is very complicated. US and Europe both conduct substantial amount of trade with China, and transatlantic firms are heavily invested in the Chinese economy.

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Both the U.S. and Europe run large trade deficits with China in the range of about \$275 to \$300 billion annually. So it is a big issue for both the U.S. and European economies. The Trump administration plans to raise barriers against Chinese imports while also expanding export controls to blunt Chinese access to those technologies that can accelerate Chinese economic advance and expand and deepen its military capabilities. So the— Europe also has a more

aggressive Chinese policy, but it's more nuanced and it sees China as both an economic partner, a competitor, and a systemic rival. Ah, now I should note that there— this is such a big area of international economic interactions that there are a few things that we're not going to be able to assess or discuss in this paper. One is the potential impact of across-the-board 10 to 20% tariffs on all imported goods that President Trump talked about a lot during the campaign. Tariffs against friend and foe alike. Such tariffs would certainly affect relations with European countries and consequently whether and how they would follow the U.S. lead towards China. And second, we will not be looking at how U.S. and European policy alignment is affected and influenced by the evolution of the, of the conflict in Ukraine.

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The— this is a very, very important issue and it will certainly— the U.S. has certainly put a lot of attention to it, if only because of Beijing's direct and indirect support for Moscow. Now, the U.S. and Europe have had success in aligning restrictions against Russia. In recent years. But the situation with China is much more complicated because our economic relationship as well as our political relationship is much more complicated and much deeper and intertwined as I mentioned before.

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to address the differences, the U.S. and Europe established a technology— a Trade and Technology Council. That has had some success in, in discussing industrial policies and in particular cooperating, coordinating sanctions against Russia and in cooperating on critical minerals policy to limit dependence on China. But on tariff policy, it hasn't been so successful, including on the tariffs that were imposed by the United States on steel back in the first Trump administration. Uh, so I will say a few words on tariffs and then turn to Antonio, uh, to discuss export controls and our tentative conclusions. Uh, on tariffs, uh, existing U.S. tariffs on China already have blunted trade and led China to exploit other export markets. And the first Trump administration initiated a tariff war, raising U.S. average tariffs from about 3% to about 19%. And Chad Bown has documented this and assessed this very well on a number of papers on the PIIE website.

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Trump promised to increase U.S. bilateral tariffs against China by 50 or 60% during the campaign, but more recently only talked about a 10% tariff. Additional tariff on China, much less than tariffs threatened versus Mexico, Canada, Colombia, and Denmark.

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so it's unclear what's going to happen or when. If there were across-the-board tariffs, as Trump discussed during the campaign, we assume that Europe would respond in kind, as it did when Trump assessed the Section 232 steel and aluminum tariffs 6 years ago. But even if Trump initially foregoes across-the-board tariffs against the trade of U.S. allies, he may still target particular sectors and countries with whom the U.S. runs a large deficit. And there he could target auto imports, a sector which accounts for about 25% of U.S.— of the U.S. merchandise trade deficit. And so it's critically important, and this is a big area of friction between the United States and Europe. Uh, and here we're supposed to be talking about aligning US and European policies against China when actually a big threat is also on deepening divisions between, uh, the transatlantic allies. Uh, so this is, is critical. Uh, US measures would certainly have an impact on European carmakers given the extensive EU-China auto trade and investment. And U.S. policy and European policies differ quite substantially in this area. The United States has imposed 100% tariffs on EVs and, and has pressured Mexico and Canada to follow suit.

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Europe is using trade statutes consistent with WTO obligations to constrain EV imports from China while keeping open Chinese FDI in European production of batteries and vehicles. In October, Europe imposed definitive countervailing duties for 5 years on EV imports and ranging from about 7.8% to over 35%, depending on the company. While Chinese investment in Europe is generally declining, greenfield investment in the automotive and electric battery sectors is increasing. And I think this is another source of potential friction in the future for U.S.-European relations because it could create friction in U.S.-EU auto trade if the U.S. imposes more stringent origin and ownership rules as a condition of access to the U.S. market for all auto imports. So as you can see from my comments, I spent less time talking about U.S. restrictions against China and more about the potential and risk of U.S. restrictions against Europe. And

that's one of the problems of using tariffs. But there's much more in terms of U.S.-European policy on export controls, and for that I turn the floor over to Antonio.

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Thank you.

[00:24:06.17] - Antonio Calcara

Thanks, thanks a lot. Thanks a lot, Jeff. It has been a great pleasure to work with you on this, on this policy brief. Also, thanks to the Peterson Institute for the, for the invitation and for organizing this event together. It's been a great, a great pleasure. In my, in my remarks, I would like to focus on, on 3 points, trying to complement what, what Jeff said about our policy brief. The first point will be about the export control different approaches between the US and Europe using the example of semiconductors. Second point, I would like to talk about the recent US framework for artificial intelligence diffusion and what are the implications for Europe. And then third and final, I would like also to talk about potential future prospects and then perhaps opening some avenues for questions in the Q&A. So let me start with— with export control, because I think here we also see different approaches between the United States and Europe. So the United States really placed unilateral export control as a sort of priority in order to stop or to curb or to obstacle at least the Chinese technology growth in critical sectors. I think the United States, they soon realized that given the global nature of most of the value chains of these technologies, They needed some sort of coordination with, with allies in order to make this export control more, more, more effective.

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European countries historically approach export control in a different way as a sort of tool that we have along, for instance, sanctions in order to restrict trade that we have with states that are violating international rules. And Russia is a case in point. But they have been historically very cautious of using export control as a way to curb the economic or technological growth of another country. In Europe, there is also a problem of competence when we talk about export control, given that, for instance, the dual-use regulation is part of the EU trade policy, so it's supranational in nature. But the dual-use regulations also contain some requirements that actually delegate responsibility to the member states when it comes to license, for instance, or also enforcement. So sometimes it's difficult also the internal coordination within Europe when it comes to export control. In the policy brief, we discussed the semiconductors case because we think that this is emblematic of some of the difficulties in coordinating a transatlantic approach towards China. So the United States has tried to really persuade the Netherlands, and

especially because they— in the Netherlands, there is ASML that is a fundamental player when it comes to the production of lithography machines that are really needed to produce advanced semiconductors.

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To place export control on China. SML and the Netherlands, they called for a more European coordinated approach in order to face increasing pressure from the United States. But this has been complicated not only by the competency problem that I mentioned earlier, but because there are fundamental internal different preferences among the member states vis-à-vis the China rise. Basically, there is a stark division between those who think that China technological rise can actually impact negatively also on the European push for technological sovereignty. And those who think that this is too late to stop, to stop China basically investing in critical, in critical technology. And I think the discussion that right now we are having about whether European carmakers will demand, for instance, R&D agreements or even domestic content requirements to the Chinese carmakers or to demand the Chinese carmakers to invest more in Europe is part of the same, of the same discussion on how to tackle the fact that the Europeans, they perceive that they are lagging behind actually in critical, in critical technology. The European problems are also compounded by the extraterritoriality of the US restrictions. So some European manufacturers, semiconductors manufacturers were forced, SML as well, were forced actually to stop selling their most advanced equipment on the Chinese market because of the extraterritoriality rules.

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So informal rules, informal formats such as the Trade and Technology Council that Geoff mentioned have been helpful in framing this discussion, especially in the Working Group Number 7 that was especially devoted to export control. In that format, for instance, the European propose a new multilateral regime, some sort of "Bolsonaro agreement minus one," so without the Russians, in order to have more multilateral coverage when it comes to export control. The problem with this strategy is that really the US has put export control at the top of their agenda regardless of this multilateral coverage. And the Europeans, they're not ready to— they're not prepared for this. Third point, another interesting case that we discuss in the paper is the recent US framework for AI diffusion that basically placed some restrictions on, on the, on the chips that are used for artificial, for artificial intelligence. This— the US has created these three-tier licensing systems. In the first tier, you have all the members of the G7 and also key US allies in the Indo-Pacific, but also in Europe. For instance, the Netherlands, that will have unrestricted access to US computing capability and entire number 3 that of course includes China.

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There will be full restriction. I think there is— there are two, two very interesting aspects there for, for, for Europe. The first, the first aspect, the first aspect that I would like to underline is that basically some European states will face no restrictions. Because they would be in Tier 1, but other European states would be in Tier 2, for instance, Estonia and other, and other countries, for instance, other Baltic, Baltic countries. And this could actually weaken the coherence of the European position or could actually lead some European countries to diversify their suppliers, given that they will, will face increasing restrictions when it comes to US computing power. Second, and more in the, in the long-term perspective, I think in In Europe, there is some worrying that the US administration can actually use the entire system in order to move up or move down European countries on whether they will, whether they will align or not with the US, with the US preference. For instance, in the conclusion, me and Geoff recommended Washington to move all or most European countries in entire, entire one. In order actually to tie European push for being more competent in technology to the US computing capabilities to try to impede European countries to diversify their suppliers if they will face increasing restriction in accessing actually US computing capability.

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And also we suggest a more active role of the European Commission, also some sort of supervisory role in order to centralize the communication that could be also extended to tariffs and export control. A final consideration more about, about the future. It's very difficult. It was very difficult for us to predict actually what the Trump administration will do vis-à-vis, vis-à-vis, vis-à-vis China. But we expect actually new regulations in order to control AI, AI models. And I think here The recent facts about DeepSec force us to reflect not only on the effectiveness of export control— and we can debate later about this— but also on what needs to be controlled. And I think DeepSec has managed actually to do a lot with very little computational power, but also taken advantage of open-source models that are produced by Alibaba and also and also, and also Meta. So I think the US has done a lot in order to try to restrict, to control access to computing power, also remotely, but try to restrict software, pose some sort of technical challenges also related with the simple fact that software is intangible, difficult to inspect, and also because open source groups have actually been very beneficial to the US AI innovation, innovation ecosystem.

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I think all this discussion will impact inevitably on Europe for the simple reason that we are also lagging behind when it comes to computing power. So in Europe, we are looking with a lot of interest to what the Chinese are doing because this could be— there could be a possibility to do more with less computing power. But the Europeans will need input on open source. So we— I think we therefore expect very little incentive for the Europeans to follow the US in creating more restrictive framework when it comes to AI capability, especially when it comes to software. I will finish here, but I will be happy to elaborate more on these points in the Q&A. And I'll give the floor to the discussants for some thoughts about our paper.

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Thanks a lot.

[00:33:40.11] - Philip Luck

Great. Well, thank you so much for the organizers, especially Mary, for inviting me today and for the opportunity to discuss this really excellent policy brief. You know, it's— this is a fun exercise for me to get out of my sort of government head. I was in the State Department until about 3 weeks ago and I found myself getting reflexively angry at the Europeans several times in this. So there's obviously no mistaking that we're in a economic and geostrategic competition with the PRC, the US is, and the US and the transatlantic relationship is being tested in certain ways as a result of that. What I want to focus on is, you know, I think I agree wholeheartedly with the vast majority of what the authors have to say. Mainly what I'd like to do here is add what I think is potentially a little bit of context from someone who spent a lot of time sort of within the US government and talking with my European counterparts about these issues for the better part of 3 years. The first thing I want to point out is I think there's much more alignment on the way we think about this problem than is sometimes seen both in, you know, news clippings and things like that.

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I think there's, you know, just like there— the EU doesn't have a monolithic view of these things, neither does the United States. And I think there's quite a bit of overlap in both of those sort of conversations. The degree to which there's large or seemingly large gaps in sort of our approaches to things, I think those come down to— and I think the authors would agree entirely with me here— that come down to the differences in our economic relationships with the PRC and also to some degree the differences in our institutions. So, you know, we were talking— we'll talk a little bit more about the challenges of things like export controls, right? There are institutions are different, and that creates challenges in how we move forward. I'm going to

focus my conversation sort of on a few things. The first I'm going to talk about is sort of the way in which we collectively use sanctions and export controls in potentially different ways, the way in which we think about sort of trade alignment and misalignment, sanctions export— sorry, for the case of Russia. And lastly, I want to talk about sanctions and export controls— sorry, export controls in the technology realm.

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You know, I think, as was very well pointed out, the way we are using our export controls with relation to the PRC now is different than some historical uses of export control. So I almost want to put those into two separate bins. There's the export controls that we are using that are much closer to the Boston R agreement and things that we're trying to stop common high-priority priority goods getting into places like Russia, Iran, North Korea, and others. And then there's, you know, restrictions on things that are meant to keep a lead within certain key technologies. To me, those are fairly separate, um, and, and should be sort of thought about separately as well. Um, you know, I think one area where there's quite a bit of alignment, for, for obvious reasons, is in our economic relationship. Both the Europeans and the United States vis-à-vis Russia. Right now, I think the degree to which we've seen movement towards a closer position to the US within the EU has to do— with respect to China— has to do a lot of the increased appreciation for just how impactful PRC support for Russian economy has been.

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Right.

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The PRC is the Russian economic lifeline.

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Right.

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And that is a— that is And that is something that is not— is appreciated by our European counterparts. About 75% of common high-priority goods that get into Russia come from the PRC. About 90% of the semiconductors that get into Russia are going through the PRC. About half of those are Western-produced or Western-branded. They're not only the largest producer of goods, common high-priority goods going into Russia, they are the largest transshipper of

those goods. So, you know, this is a huge problem. And I think there's decent alignment on that basic point. There's less alignment to date on how we handle that, right? The United States has been much more forward-leaning in using its sanctions authorities and using export controls by listing entities on entity lists, right, to stop them from being able to access key components that are going to be sent on to Russia.

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Right.

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So I think, you know, in terms of opportunities for greater alignment, I think this is an enormous area where there's great opportunities for more alignment. You know, the European Union using export controls and sanctions more on the PRC in order to make clear just how much— how seriously they take the PRC's support for Russia. Will have an impact on that support and is probably, you know, in terms of impacting the Russian economy, the most impactful thing that we can collectively do. So that's a big area again. But I would say, you know, to the degree to which there is misalignment, you know, we're always focused on the things that we're— where we still need to make progress. We've made an enormous amount of progress there. We are incredibly aligned, you know, the EU, the US, our other partners who imposed sanctions, the UK and Japan. There's an incredible amount of alignment, but there is specifically with respect to the PRC role here, there's, there's a large opportunity for greater alignment. Um, on the misalignment on trade issues, um, you know, the one thing I would say about the, the brief is, you know, I think, um, at least from my perspective, and, you know, that's of course, uh, colored by my, my experience, you know, I think the issues around the IRA are, are not quite as acute as they once were.

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You know, we've—

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the United States through Treasury, through the rulemaking process, did a lot to relax the constraints of the requirements on subsidies, whether it was through making all leases commercial vehicles, which was a fun little trick that Chad has shown some really excellent charts about, or whether it's sort of increasing sort of a— just other ways to relax. You know, European carmakers do have a decent access to those subsidies at this point. Is it perfect? Is it WTO consistent? No. But I think a lot of those issues have been smoothed out. Now, the one

thing I will say there, there's an enormous opportunity potentially for greater alignment on trade issues. This is by no means assured. My, you know, the only sort of the silver lining to potential trade fights to come is those also create an opportunity for, you know, new areas of cooperation and agreement. The Trump administration, the first Trump administration was fond of making deals of some sort or another. So I think if both sides can come to this with open minds about types of, you know, deals we can make, I think that could be useful. The one thing I will say is, and then this is, you know, I think our European counter— my European counterparts are thinking about that way, in that way.

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What I would say is that, you know, both sides do need to come to these issues where they're understanding the priorities of the other side. So for the European counterparts, you know, the— it is clear from testimony from the new USTR and others that rules of origin and embedded PRC content that may be highly subsidized is going to be an issue, right? So any trade agreement between the United States and the EU or anything that's going to lower trade barriers, it's going to have to address embedded content. That, of course, has a lot of complications, but we're going to have to have sort of these frank conversations. And I do hope the Trade and Technology Council can be a— I hope that continues and can be a place to have these conversations. The last thing I'll say on sort of the technology export controls is, you know, I think here again we have a lot of areas for possible alignment. To the brief's point, you know, there's differences in competencies across member states in the EU. And, you know, obviously when it comes to the semiconductor manufacturing equipment, that has largely been negotiations between the US, Japan, and the Dutch individually.

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But of course, there's areas where we need to be sort of focusing more broadly. And here, I would say two things. I'll say one thing about just export control enforcement and licensing first, and then I'll move on to the new AI rules. On enforcement and licensing, these are, generally speaking, member state competence agencies. We should see if that— that may not be sufficient going forward, especially on enforcement. You know, the EU really doesn't, as far as I can tell in the conversations I've had, there's limited capacity to do enforcement. End-use checks basically don't exist. And as a result, it's very hard to enforce export controls. Now, it's a little easier on very very high value, very low quantity semiconductor equipment? Yes. Is it, you know, is it easy for things like ball bearings, which are also controlled on the common high priority list? No, right? So we're going to need to have more ability to do enforcement, and that probably makes more sense as an EU competency. And then the last thing I'll say on the

export, the new AI rules, I'll say two things. One, I completely agree that the splitting of the European Union across Tier 1 and 2.

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We'll see if it's economically impactful. I think it certainly could be, but diplomatically, it's certainly impactful. You know, I was talking with a member state government official a few days afterwards and they referenced the degree to which it kind of made— looked similar to the Iron Curtain. And so that's not the best. You know, and again, you have my colleague reference Estonia or sometimes called Eastonia, right, a very high-tech economy. It being in Tier 2 in a country that has excellent export controls, I might add, you know, that is a diplomatic problem if nothing else. The other thing I would say on this point is, and this comes to the sort of the market structure and deep sync issue is, You know, the rules are largely— so this was a process that didn't have a lot of rules around it. So the issue you have about, oh, the US could potentially, you know, coercively move countries from Tier 1 to Tier 2, those are not your words, but they could do that already in the sense that we already had licenses for all of these things. So they had that ability. In some sense, I'm hoping that this puts a little more structure on a process that kind of didn't have structure before it.

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That having been said, the fact that 50% of this compute has to be done within the United States, that is both clearly intended to increase the sort of data center buildup in the United States. It also, from a competitive standpoint, probably is very helpful for large firms that are currently in this industry, the Big Seven.

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Firms.

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Well, compare that to DeepSync, right? So, you know, look, why did we not have a DeepSync? Well, we have a very concentrated market, right? You know, if we're going to do— put policy in place that, you know, entrenches those interests, we may not have the sort of like future unicorns that we have now. Whether DeepSync is one of those, we'll see. My colleague Greg Allen pointed out that the \$6 million was just for the training run that worked.

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Right?

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That's like saying the cost of the drug is the trial that worked, right? That's— so it's not really exactly the right comparison. But that being said, we should think, both the United States and the EU, about how the rules that we're putting into place that are, you know, intended to sort of keep our competitiveness in sectors have impacts on market structure and have impacts on competition that again may be counterproductive in the long run. So I think— and this is an area where I hope both digital regulation and digital policy and services is something where we can get closer together because we're quite far apart at the moment. So I'll stop there, and thank you very much.

[00:46:01.24] - Giulia Tercovich

Yeah, thanks a lot to Jeff, Antonio, and Philip. I think there is a lot of food for thought that they already introduced in these initial remarks. Now it's time for questions. So if you have a question, you can just go to the center of the room, stand there. Don't forget to introduce yourself, state your name, your affiliation, and then ask your question. We're not going to have that much time, so I'm going to try to collect a few. Yeah, please.

[00:46:40.07] - Audience

Moderating. Yeah, I'm Federico Steinberg. I'm a visiting professor at Georgetown. I'll be moderating the next panel, well, the second panel. And I had two related questions. The first one is about— we were just discussing about the latest US regulations on export controls. I would be interested in knowing what was the thinking at the State Department, or if there was no realization that the fact— to the fact that the single market might be distorted, or that this could create this diplomatic frictions you mentioned? Because at the end of the day, you know, these are the small things that at the end of the day maybe the Europeans think, well, the U.S. didn't think through our own process, our own institutional our European limitations. So if you could develop that a bit more. And the other one is about Chinese investment in Europe and in the US. Here there are very different approaches, and I would wonder— I was wondering to what extent you can see how they could be reconciled, or to what extent, you know, particularly the European new position of trying to attract investment and try to exchange it for technology transfer from China is something that is worrisome.

[00:47:54.05]

Thank you.

[00:47:55.06] - Giulia Tercovich

Good. Thanks a lot, Federico. And while we see if there are additional questions, let me maybe add one more for you. And this will build on your presentation, Antonio. You said, you know, it's really difficult to make any prediction. And Jeff Adden said several times, guys, it's really complicated. But still, I will try to ask you this question, which is we have now a new administration in the US. We also have a new leadership in the EU. So let's say, which are the pointers, let's say, that will tell us that this— there is more alignment or misalignment between the US and the EU going forward? So what— which are the elements that you will look in the next months and that will tell you we are going in this direction rather than that direction? I don't see any question for now. So maybe I'll give the floor to the— back to the speakers and Then we can maybe start from— yeah, we will follow the same order, maybe. OK, Philip first, and then we'll go reverse, so Jeff and Antonio.

[00:48:55.29] - Philip Luck

Excellent. I'll be very quick on this. So on the, did we think about this issue? So obviously, there's a very long deliberative process. It was a very long deliberative process. I will tell you, though, that the NATO desk was not consulted, so if that helps. So no, I don't think— I think there are issues there where this was not— I think we could have thought about that more. On different policies around investment, I totally agree on that. I would say the only thing I'll say is, you know, I think what I've always tried to encourage the US policymakers to think about is what precisely is the concern you have and how— what is the best way to solve that concern?

[00:49:36.29]

Right?

[00:49:37.12]

So we are now in a situation where we have both inbound and outbound investment controls. I think there'll be more focus on other types of investment, including private equity going forward. And in both of those cases, we're concerned about, you know, competitors learning things by their investments in the United States, or our competitors learning things by how we invest in their market, right? You know, there's obviously obviously a flip side to both of those coins, which is the obvious opposite direction. And so I think— and of course there's economic cost of all those things. So I think that the first thing for the— to increase alignment is to be very clear to both ourselves and our partners precisely this— the scale, scope, and nature of the concern.

[00:52:00.10] - Jeffrey J. Schott

I'm very sorry. I'm not going to repeat all the things I just said.

[00:52:06.05] - Giulia Tercovich

They were brilliant though.

[00:52:07.21] - Jeffrey J. Schott

They were really brilliant. I wish you could have heard them. But I think if I'm looking at the transatlantic relationship, one of the first indicators is how seriously the Trump administration looks at dealing with the Ukraine war, because that is a higher priority in Europe than it is seemingly in the White House. But one way the United States could be constructive is by putting some pressure on China to moderate its support for Russia. And with a view— and people like Nick Lardy and others in the room might have more insights into this— the Chinese actually share some interest with the United States and Europe in moderating that war, if for no other reason than to slow down the the interrelationships or the alliance between Russia and North Korea. And that, I think, is a big concern in Beijing and something that the Trump administration could use as a way of seeking a tempering of tensions in both Europe and in East Asia.

[00:53:29.27] - Giulia Tercovich

And Jeff, Antonio.

[00:53:31.10] - Antonio Calcara

Yeah, just to complement what my fellow panelists said, and I would like to touch upon Federico's question because I think that's very interesting from a more European perspective, because Federico, as you know, there is also discussion in Europe if the single market, if the rules of the single market that we have now are enough for us to be competitive, right? There is a lot of discussion on competitiveness, the Draghi report, and so on and so forth. So this will be crucial for me in the next few years. So for instance, to see whether the European Commission will relax rules on mergers, state aid, what will be the position of the European Commission vis-à-vis the potential creation of European champions, for instance, in some of the technological sectors that we were mentioning before. For Giulia, yeah, I brought here Ukraine. Ukraine, because I think that's about— but Geoff already touched that point. A very interesting point that we didn't mention in the policy brief, but I think we should in the next iteration, that for me would be crucial to test the potential for alignment and misalignment, would be the relationship between the Trump administration and the US big tech.

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Because right now, for instance, Trump has as sort of declaratory level, try to push the European Union to relax certain rules that we have vis-à-vis the big tech. And here Europe can take two approaches, either to accommodate to Trump preferences and to relax these rules also for the sake to access more capabilities of this big tech, or this is the approach that is advocated by someone in the European Union to take a more firm stance when it comes to big tech penetration and to push more for technological sovereignty. And this is also related with a very interesting discussion about antitrust consideration. Because in the past, at least in the last administration, there was some sort of convergence between the US and the European Union on antitrust considerations. I'm not sure that there will be the same degree of convergence with the new, with the new European Commission and also the new administration in Washington.

[00:55:43.15] - Giulia Tercovich

Good. Thanks a lot to all of you. It's been a great pleasure. I think this is the first session. So it's— we are just entering into the debate. There is still a lot that we need to discuss. I mean, touching upon other allies, for example, other countries that play an important role and how the US, Europe will try to coordinate with those countries. I mean, we mentioned Japan, Korea. There is India as well, that now in Europe is pretty high on the agenda as well. So there is still a lot that we could discuss here today. But let me thank our speakers and also our audience for some of the questions. I'm sure there will be a lot that we can unpack in the next session. But please first join me with a round of applause to our speakers. And please stay with us. Now we will move into the second session in a few minutes. Thanks. Thanks a lot.

[01:06:12.00] - Jeffrey Anderson

I'm a professor at the School of Foreign Service at Georgetown University. Also have a position in the government department and it's a great honor to be here. Uh, I am the moderating the second panel session, which is entitled Combating Unfair Trade Practices in the Context of a Rules-Based System. Um, it's my privilege to introduce, uh, the members of the panel. First, uh, Mary Lovely, who is well known to all of you here at the Peterson Institute. She's the Anthony M. Solomon Senior Fellow, uh, here at the Peterson Institute. Her research has focused on Chinese foreign direct investment, U.S. tariff policy toward China, and global supply chains. By the way, for all our participants, you can get a much more extensive biography in, in the program notes. Also appearing is Luis Simon, who you've also heard from already, the director of the CSDS and research professor at the Brussels School of Governance. His research has focused primarily on geostrategic issues relating to Europe, most recently US-China competition

and implications for European Union strategic autonomy. Our discussant today is Chad Bone. Discussant— he is the Reginald Jones Senior Fellow at the Peterson Institute, and his research focuses on international trade policy, laws, and institutions.

[01:07:35.03]

The paper or policy brief that Mary and Luis are presenting is entitled— there's also another co-author, sorry, Salih Bora, who should be mentioned as well. He's from the CSIS. The title of the policy brief is "Destined for Division: U.S. and European Responses to the Challenge of Overcapacity." A very interesting paper which starts with a diagnosis of the Chinese non-market overcapacity problem, then moves to U.S. and European responses. And the, the title they've given that section is "Similar Tools, different approaches. We'll be hearing more about that. And they conclude with a question: Can cooperation between the US and the European Union via the rules-based international system be encouraged? Big question mark. So I'll ask perhaps Mary to come first, and we'll have our panel.

[01:08:39.12] - Mary E. Lovely

Thanks so much, Jeff. And— oh, wonderful, just in time delivery on our slides, I love that. So as Jeff mentioned, this is a paper co-authored with Sally Bora and with Lee Simon who will be up here shortly for the second half of the presentation. So we entitled our piece "Destined for Division?" It's a question mark. We certainly hope the answer is not necessarily. But I think that the past record— the record of the past 8 years is not all that encouraging, unfortunately, but maybe will point us in directions that can help us in the future. So first, in thinking about overcapacity, we ask, is EU-US cooperation in overcapacity even possible? Both of them agree that there's a need to respond to Chinese non-market overcapacity. But they've used differences in approaches. And these, in fact, these differences are causing negative spillovers one to the other. And we believe that these differences in approach and the negative spillovers that they promote also cripple competition—

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cooperation.

[01:09:44.12]

They have been frictions that have limited our cooperation. Phil Luck in the previous session was very articulate about talking about ways in which there is alignment and I think we should all take that, you know, as a very important note here. Nevertheless, there are still many, I think, many issues that need to be resolved. We think there are significant gains to coordination here,

coordinating defenses against Chinese overcapacity, and significant risks to unilateral action. And so we're very eager to see pathways for future cooperation to be preserved even if, as Geoff alluded in the last session, we have 4 years of more turbulent relationships. I think from the European perspective, and Luis will amplify this, the US— I mean, the EU can do more than just hedge for the next 4 years. It can begin to build a foundation for wider cooperation within the US-led alliance. That doesn't lock the US out in the future. So looking ahead and trying to preserve what we think will be to the benefit of both regions. Now, we do see a new urgency. We have Chinese— surging Chinese surpluses. Most of you would have seen in the paper that recently China's trade surplus soared to a record-breaking \$992 billion.

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I guess in the current environment, we could call it a trillion. A trillion here, a trillion there. Pretty soon, you've got real money, right? As they say in Washington. And that's a big increase, 21% increase from the previous year. Just through November, the US purchased \$3 worth of goods from China for every \$1 that it sold to China. For the EU, that number is 2 to 1. And for increasingly anxious population, these numbers no longer seem to make sense. There seems to be something behind them. Chinese monthly export price index has remained below 100 since June 2003. In other words, it is having inflationary pressures on its export prices, and that puts enormous pressure on manufacturers and exporters around the world. And these pressures create demands on policymakers to respond to those pressures. Now, I think a very visual example of what we're talking about is, uh, Chinese EV exports. We see here that starting from January 1919 and through the, the pandemic year of 2020— obviously the pandemic influence beyond that— but if we look, we can see the tremendous growth in Chinese EV exports in a very, very short period of time.

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And for many people who have a memory that stretches back to, say, 2000, this looks eerily like what we saw with Chinese PV solar, where it went from virtually zero to really global dominance within a very short period, a decade or less. Another thing we can see from the graph is that the EU is the destination for many of these EVs, that is the green section of these segments. And the— their export to Japan and to the U.S. is very, very small. You have to kind of squint to see the blue, light blue, and the dark blue segments there. Of course, much of the developing world, middle-income countries in particular, are the locus or the destination for many of these EV exports. And that's the rest of the world, the yellow bar, and many of these countries welcome them and do not see them as competitors to their local production because they don't have local automobile sectors. So it's not that everyone is afraid of this, but we do

have legacy industries in the US and in the EU which form an enormous impediment to, quote-unquote, "do something about this problem." Now, what is the problem?

[01:13:57.28]

In fact, it turns out that defining non-market overcapacity is a very difficult thing to do, and I think it has hindered cooperation over the— over the past decade. Now, if we look at one definition, it's about is China being forced to export this overcapacity? And if we look in the aggregate, China's export-to-GDP ratio has risen since 2017. And that means that production growth has outpaced consumption growth. And that, that is a reversal of a long-term downward trend. This graph is just from 2007. And you can see that Chinese manufactured exports as a share of its domestic production fell steadily, um, until about, um, 2016, 2017, and has since been on an upward slope. Um, now when we dig into specific sectors, we can see, um, deeper, uh, problems with overcapacity. But I want to raise a flag— this is not a simple, uh, kind of test for overcapacity. If we look, for example, at Chinese EVs, which is the focus of a lot of attention, Chinese exports as a share of production has not really changed that much. If we think about another definition of overcapacity, one that has been embraced by researchers in multilateral organizations, does the— do the export surge place downward pressure on global prices?

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The answer to that is that's also a difficult thing to look at. If we look at Chinese EV exports, export prices, we've seen that they have risen steadily throughout this period. Of course, that report— that reflects the increasing quality and amenities that are built into Chinese EVs as China has moved up into higher and luxury segments of the EV market. So defining overcapacity is no easy task. We could also talk about how we would define non-market capacity. And in that sense, I don't have time to talk about it, but I will recommend a paper that Chad has written with Jennifer Hillman, which goes into the idea how would we define and remedy reform subsidy disciplines at the WTO. So there's division over the meaning of overcapacity. China, for example, will say this is not overcapacity, this is what the world needs. And that resonates with many, I think, states around the globe because when the US went ahead and initiated its own industrial policy, in particular the IV— IRA, sorry, one of the arguments that the US made to claims that US was subsidizing and sucking in investment that would have been destined for other regions The answer is, well, this is something where we all need to invest in, you know, climate problem.

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So add your own subsidies and encouraged the Europeans to add their own subsidies. So everybody should have subsidies, just not China, I guess. So that is a problem and not only in terms of narrative, but in terms of, I think, how other countries view this problem. So there are differences in how to combat this. The broad agreement that WTO rules on subsidy and countervailing measures is not fit for purpose. It has a very narrow definition of public intervention— what is a subsidy coming from the government— and there are slow and complex investigations that are needed to be WTO consistent. Um, the EU and the US see the need to adhere to rules differently, and quite so. The U.S. does not see the need to adhere to the WTO rules, whereas the WTO has— I mean, I'm sorry, the European Union has just invested an enormous amount of resources and time in carrying out a detailed firm-by-firm subsidy investigation, ending in the subsidies that we heard about in the last session, which many people might be surprised to know, are firm-specific and come from that detailed investigation. Luis, may I invite you to the podium? Thank you.

[01:18:31.25] - Luis Simón

All right.

[01:18:32.01]

Thanks, Mary, and hello again. Thanks to Mary and Jeff. Just a few words from from my side, perhaps specifically on how the EU and the US have responded to the challenge posed by China's non-market overcapacity, sort of building, and some thoughts on the way forward as well, sort of building on what Mary has already said. And bottom line up front, as Mary was saying, we actually see a pretty decent degree of convergence between the EU and the US when it comes to both diagnosing the problem and and how to respond to it in the sense that both the European Union and the United States are— have sort of turned to trade and industrial policy to deal with it, but also lack of coordination in the responses. Now, on the trade front, briefly, both the EU and the US have resorted to tariffs. The Trump administration, of course, launched a trade war on China in 2018 with new tariffs and counter-tariffs, eventually accounting for more than 50% of bilateral trade by 2019. And Chad has also written about this. The Biden administration then sort of maintained many of the Trump-era tariffs and even escalated the tariff war, especially in EVs, going up to 100%.

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And the EU has also resorted to tariffs, most notably and most recently on EVs, but they are significantly significantly lower. So tariffs play a different role. I think Antonio touched on this as well, and Geoff in the previous panel. They seem to play a different role in a US context and the

context of US policy and EU policy. In the US case, they are prohibitively high and seem to be aimed at blocking China from the US market in certain sectors. In the EU's case, it's about leveling the playing field. It's about the margins, right? And so therefore still allowing some, some degree of market access to EVs produced in China. So for the EU, not only is the, is the yard smaller, the fence is also, is also lower. Right. Of course, we know, and Jeff again touched on this, that the Trump administration also imposed tariffs against many close allies, including the EU.

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Right.

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And this obviously created some frictions in the transatlantic so not, not everything is China-related bilateral relationship, which was of course further compounded by the fact that, um, by the abandonment of the Transatlantic Trade and Investment Partnership negotiations between the EU and the United States, right? Now it's true that the Biden administration sort of de-escalated, um, or tried to de-escalate bilateral tensions, um, trade tensions, through temporary agreements on aviation and steel aluminum. And of course the creation of the TTC that you also touched upon, Jeff and Antonio. But these fixes, we are arguing in our paper, these fixes were either temporary or modest or probably both, right? Now another important difference, and Mary again touched on this, between the US and the EU when it comes to trade policy are their attitudes towards the WTO. Of course, the US seems to be convinced that the organization is, is really unsuited to deal with the China problem, not just overcapacity, but China problem more broadly, and has de facto neutralized the appellate body, which is the beating heart of the organization. And here again, we see continuity between the Trump and Biden administrations. And the EU, for its part, while recognizing knowing that there are many problems with the WTO, particularly when it comes to dealing with the China overcapacity issue, tries to still hang on to this idea that the WTO can play a role, which is, I guess, consistent with its belief that economic cooperation with China is still possible.

[01:22:25.05]

Now, another important element of the transatlantic response or responses to the Chinese overcapacity capacity problem is industrial policy. And of course, you've talked already at some length about the IRA, which sought to direct nearly \$400 billion in federal funding towards clean energy. And a key impetus, it seems, behind the IRA was China's growing dominance in new energy equipment, particularly EVs.

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Right.

[01:22:54.02]

However, the IRA also contained funding and rules that favored domestic producers over those from other trade partners, including the EU. And we also, we also talked about that at length. The EU, for its part, when it comes to industrial policy, also responded to the challenge of Chinese overcapacity, as well as also partly challenges associated with the IRA, which was a big deal in Brussels at the time, with a reform of state aid rules for enabling a more activist industrial policy. And this has allowed member states to sort of implement vertical industrial policy measures that had previously, as you know, been prohibited by EU competition rules and competition policy. And again, and this is a key issue that again, Stefan Antonio touched upon, the reform of state aid rules in the EU has affected benefited the member states unevenly. It has led to fragmentation internally with those obviously having a greater capacity benefiting disproportionately a lot more, and this has created tensions. Some member states have repeatedly warned about the fragmentation of the single market and the dangers of an intra-EU subsidy race in addition to a global subsidy race, right? So like a two-layered race.

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Now, as a potential solution to this problem, European Commission has proposed to step up EU-level funding, came up with this idea of European Sovereignty Fund. But there are several member states who oppose expanding the EU's fiscal resources. So I think as things stand right now, a global subsidy race presents a lot of risks for the European Union due to the fragmentation it actually agrees internally within the single market. However, economic decline and deindustrialization is seen as a far greater danger in Europe. So I think we should expect industrial policy initiatives to continue regardless of whether there are common fiscal capacities or not. Just a few words on the, on the way forward. And Mary already touched on this, and I want to end on an optimistic note, actually. And of course, the prospect of economic and trade frictions between the EU and the US will surely complicate any efforts to coordinate on China economically. That said, I'm personally optimistic, or at least I want to sketch some reasons that lead us to optimism. First, both the EU and the US agree that Chinese overcapacity poses a threat to their economic competitiveness. And the EU has actually reached this conclusion on its own, not due to US pressure.

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US pressure has accompanied the process, but the EU has reached— has come to this conclusion on its own. And it actually— the EU's views on China have hardened much beyond the overcapacity problem. Also, when it comes to foreign policy, security, Jeff touched on that in the previous panel. So we are seeing a broader transatlantic convergence on China that is political as well as it is economic. And second, the EU and the US need each other.

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And you—

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we already touched on the fact that the United States is aware that having Europeans, or for that matter, some allies in Northeast Asia on board is important for any economic strategy vis-à-vis China to be effective. But also the EU actually needs the US quite, quite badly. Not only is it critical to the security of the United States, and again, we were talking about Ukraine and how that sort of mediates a lot of Europe's perceptions. But also, I would say that any EU economic strategy that is built on or premised on decoupling from the United States is actually likely to lead to big internal divisions within the European Union. So I think my sense is that the objective should be to revamp transatlantic coordination on, on China, that this is option A, and this is the only option that I see with a view to the long term, uh, whether in the context of the TTC or some new body. Some people have talked about the reformed G7 to bring in Japan and others. Uh, that said, of course, the current political climate might complicate the process. So in the interim, as Mary was saying, we, we sort of expect the EU to push ahead in two directions, and von der Leyen alluded to this in her Davos speech.

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One, to build the EU's own internal capabilities, particularly industrial policy, and when it comes to technology, technological sovereignty. And second, working with other US allies or other like-minded partners within the US alliance ecosystem. I'll end there. Thank you.

[01:27:55.08] - Chad P. Bown

Hi. So I'm Chad Bown. I'm the discussant. I have my phone here. Now back in the 2017 to 2020 period, it was acceptable to bring your phone up even when you were presenting something because something in trade policy land might be announced on Twitter that you had to constantly be checking. And so, I want to— but this time, I want to reassure you I'm not checking Truth Social to see if that's the case today. I'm actually just setting a timer to make sure I don't talk for too long. So, thanks to Mary. Thanks to the organizers for the opportunity to

be part of this. It's a huge pleasure. And this paper is fantastic, and it's a wonderful wonderful—I don't want to say distraction. I've not been allowed to think about these topics since January 20th. But it's a wonderful distraction because I want to reassure you that every day of my life for the previous year before January 20th, I was thinking about these topics all the time. And so, I really like this framing of this is an opportunity for us to take stock about kind of where we are and we should think hard about a number of the lessons learned from this overall experience and especially on this issue of overcapacity in non-market economies.

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So, I'm going to ask maybe 3 or 4 questions for the authors to think about. And some of this is already touched on a little bit in their paper, but I think some additional clarity would be useful. But also, rest assured, I don't think there's there's really any easy answers to the questions that I'm going to pose. It's just something that I myself was finding that I had to continually grapple with as I dealt with this issue. So, the first is, when we're thinking about overcapacity and in the broad theme of geoeconomic competition or economic security, what are we worried about, right? And this goes to, I think, a point that Phil raised in the last panel as well. And I think that's probably really important because it— when you're starting to think about the remedies or the policies or the coordination necessary to achieve some objective, you got to figure out, well, what is the objective? What is it the thing that we're ultimately concerned with? So let me list a couple and there may be others as well, but here's some that come to mind. One is maybe we're worried about excessive, at the end of the day, excessive of market concentration geographically.

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And then some point off in the future, China having such market dominance in something, being essentially having monopoly power in something, that while these products today look great and super cheap, in the future they can restrict output, raise prices, and we're sort of all worse off, right? And weaponize weaponize it somehow. So is that the concern? For an industry like electric vehicles, there's also a related question about connected vehicles, right? These things are— and it's not just EVs, you know, even internal combustion engine vehicles nowadays are essentially computers on wheels. They collected a lot of data. They've got cameras on them. Can the products themselves be weaponized that pose some sort of security threat. Is that what you have in mind here? Um, or is it something like— Mary, you know, told us the story about, uh, solar PVs, and she showed this amazing chart for EVs essentially going from zero to, uh, you know, a huge, huge share of the global market in a really short period of time. Is it the sheer speed and the size of, um, of the economic impact of China and its non-market policies and practices and its non-transparency, right?

[01:31:48.17]

It's, it's hard to see this stuff coming, and yet we now have substantial empirical evidence in the United States, the China shock literature. I don't want to get into the debate of the, of the, of the specifics there, but politically this still resonates in the United States. If we're thinking about a sector like autos, where you start to think about local supply chains and there's hundreds of thousands, if not millions of jobs at stake in, in, for generations, right, in the United States, in Europe, oftentimes in politically sensitive areas, uh, that could be wiped out almost instantly, right, due to this, this juggernaut. Is that what you have in mind when you're thinking about economic security? Security concerns. Uh, or is it even something like the way that this process was, was carried out on the Chinese side when the European Union, uh, the arguably best WTO citizen out there in the world, following a WTO-consistent procedure of a trade defense instrument investigation under its anti-subsidy countervailing duty law, and yet, uh, faced retaliation, whether it was in the form of export restrictions on graphite, and then going after French cognac, and then going after pork, dairy, uh, right?

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Is that what you have in mind as well, right?

[01:33:06.14]

So there's a—

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there's kind of questions there about what do you mean when you're thinking about economic security. Second, what are the lessons to be learned from the way the, the Commission conducted the EV investigation here. Um, as an, as a nerd who's somebody who, who has studied, uh, anti-dumping CBDs for a very, very, very long time, I'm just fascinated. How do they come up with these numbers, right? Um, because we all know now that, that the way China subsidizes, quote unquote, under under, you know, what would traditionally be the countervailing duty procedure. It's not just simple government payments to firms that are transparent and you can easily count them in some way, right? It's some combination of policies. It may be free land, right? It may be access to subsidized credit. It may be, you know, local content requirements, right? Their whitelist policy, right? There's a combination of interactive policies but none of which leave an obvious paper trail to be able to compute these kinds of numbers. So, how did the EU do it in this particular instance and what are the lessons learned there? In the economics research literature, we're starting to see some really exciting

research to try to frame this kind of question and to try to put some numbers on it from an economic perspective.

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And so, what I have in mind here is shipbuilding, right? This amazing paper by Myrto Kalapzidi at Harvard and her co-authors, or the recent work by Penlei Dzhabarik at Wisconsin and her co-authors on EVs and batteries in the supply chain there. And what they essentially do is they build structural IO models and economics. They get really detailed data about inputs and outputs. They recognize they're not going to have access to detailed inputs about the subsidies, but they sort of know about the timing of the subsidies. And given the way that these models work, they can back out estimates of the size of the subsidies given their timing, right? Well, that's a really exciting, informative approach that economists have come up with to be able to deal with this kind of challenge. Do we see any sense that the Commission or other trade Defense Instruments Authorities might develop something like that? Probably not, right? So, how did they do it here? Is it a lot of reliance on third country benchmarks? That's really like the Commerce Department has historically done in the United States. That's controversial in and of itself and lends to lots of discretion.

[01:35:44.20]

It's relatively difficult to do. But in any case, you know, what are the lessons learned from how the EU did this in this particular instance? My own conversation with EU officials after they went through this is I asked, you know, "Could you do this again?" And there was sort of like a, "That was so hard. We can't do that again," right? And so, if you think, while this is just one industry, there's going to be lots and lots of industries like this in which you might want to have to do these TDI investigations. How do you set up an institutional infrastructure if you're the commission and to try to do so in a WTO-consistent way, right? This is a really, really challenging set of questions. Makes you think that maybe one should think about an alternative approach, shifting the burden of proof. Come up with a number, right, and say to China, "Refute the number. You do the work to tell me why this number is wrong." Right? Some countries come up with a number like 100%. "Tell me why this number is wrong." Won't name any countries, but you know, you can imagine. Okay.

[01:36:44.25]

But in any case, I think there's some big institutional questions there. Now, on the, on the question of instruments, right, um, the Commission has developed a tremendous set of new instruments over the last couple of years to deal with a number of these challenges, right? And

not all of them are China-specific, obviously. Uh, one is the anti-coercion instrument, um, the, the— in addition to these TDIs, right, the trade defense instruments, the foreign subsidies regulation, um, stuff on procurement. Um, and now there's, there's talk and I'm not sure this is going to be an instrument— but that the EU might force Chinese firms to transfer their technology in exchange for market access or foreign direct investment rights or something like that. So it's interesting. The EU is traditionally thought of as doing things in a WTO-consistent way. Some of those instruments, I'm not sure they sound all that WTO-consistent, or at least there's no explicit WTO rules explaining how you do WTO-consistent ACI or a foreign subsidies regulation, let alone forced tech transfer, right? And none of these have been litigated. So, kind of an interesting question out there. And then, on another question on instruments that kind of came to my mind when thinking about the EV example, and I wrote this up in a paper that I wrote before I went into government, so I'm not revealing any state secrets about anything that happened while I was in government.

[01:38:05.28]

This is a public paper, but it was sort of a hypothetical example of how a world with lots of Chinese investment in your market poses different security challenges than one without it, right? So think of the EV investigation. Uh, so the commission announced, uh, the, the formal initiation of the investigation, I think it was in October of 2023. Within 2 or 3 days, uh, the Chinese government said, we're going to impose export restrictions, a licensing program on graphite, right? So graphite is a critical thing, and I'm an expert on all this stuff, clearly, a critical thing you need for anodes, cathodes to be able to make the batteries that go into the electric vehicles, okay? And China has, you know, upwards of 90, 95, 97% of the world's graphite, at least processing goes through China. So, they have market dominance there. Now you look at the Chinese, the major Chinese battery companies like the CATLs of the world. They have got big battery investment projects in Europe, including in Hungary. So could you imagine a world in which now China says it's going to allow graphite exports to the CATL plant in Hungary? Right. They're going to license those.

[01:39:22.29]

Those, but they're not going to allow the graphite exports to maybe another firm in Hungary. It might be a European firm or Northvolt in Sweden or one of Samsung, you know, one of the Korean firms elsewhere or the Japanese firms elsewhere in Europe, right? So the ability to weaponize export restrictions once you have Chinese subsidiaries operating in that market could also end up distorting, right, economic activity and who is who's ultimately going to be a successful EV firm in the European market as well. And that's something that one needs to think about. Now suppose they did that, right? Does the EU currently have a policy instrument that

could tackle it? So I'm going through the list of TDI, and it's already there. Maybe this foreign subsidies regulation thing, because to an economist, right, giving and allowing the exports to go to one firm but not another is sort of like a subsidy. That firm gets preferential access to that input, so it's like subsidized for them, but not everybody else. So, could you use the foreign subsidies regulation and claim that the Chinese-invested firms in Europe are getting a subsidy and sort of tackle it that way?

[01:40:31.05]

I don't know, right? But this raises a whole lot of additional complicated questions when you have a world with Chinese foreign direct investment in a country that has now been seen to weaponize exports of some of these inputs in potentially strategic ways.

[01:40:48.08]

Okay.

[01:40:49.26]

To conclude, and again going back to, I think, the title of this particular panel and what it is that this paper is contributing, I think we economists— and Mary, you know, put some slides up there to show this— we economists like to work with lawyers to define specific things that we can measure, right? To say, here's a measure of overcapacity so that we can say, ah, you can see it here. You don't see it here. This is when you need to worry about, when you don't need to worry about, right? Or subsidies, right? This is when you need to worry about. This is when you don't need to worry about it. Having now been in government again, and knowing about our access to data and lack of real-time data and the detailed data that you really need, let alone conceptually, right? And I think to Undersecretary Jay Shambhava's credit in that speech that he gave on overcapacity, you know, last July, you know, he indicated the U.S. government was looking at kind of a comp— wasn't any single indicator, right, that we're was being looked at. It was a combination of things. It was loss-making firms.

[01:42:03.25]

It was capacity— low capacity utilization rates in certain sectors. It was the export data that you indicated. It was the falling export prices data that they— but the upshot is, it's really hard to measure this stuff and to find it ex ante when we're starting to think about these challenges of China. and the response that government policymakers are now doing, our knee-jerk reaction as economists, because we were trained this way for 70 years, is to say, "This is protectionism. It's got to be protectionism." But I think it's more complicated than that. In fact, I'm sure it's more

complicated than that, that there are actually some security challenges out there that we do need to think about and reflect on and deal with. And so there's certainly a massive role for us economists and lawyers to be able to continue to play in this space. But I don't want us to define ourselves out of the conversation by trying to come up with overly precise ways of capturing the things that we're worried about. That if they don't show up in a given metric, that, you know, and then somebody sees that and realizes it was a problem, that they stop paying attention to us altogether.

[01:43:23.04]

This is a Herculean task, I think, that we're being challenged with. I don't have a lot of good answers for how it is that we're going to deal with it, but I wanna make sure that we're, we still have a seat, we economists, uh, and legal scholars and political scientists have a seat at the table when the policymakers are addressing it.

[01:43:40.14]

Thanks.

[01:43:51.28] - Jeffrey Anderson

Great.

[01:43:52.05]

We'll move to the Q&A. If I could ask the panelists to take their seats up on the stage. So I'm going to get things started just by asking a very simple question. But maybe not such a simple answer, which essentially asks the panelists, and I'd also be interested in Chad's input on this as well, to develop one of their policy prescriptions that they touched on briefly in the presentation but didn't really elaborate on. Um, you all state very categorically that without allies, the U.S. approach to China, which revolves around tariffs and technology restrictions, cannot work, which then suggests the U.S. is going to need allies, whether the current administration realizes that or not at this point. Your recommendation is that the EU should work— and you did mention this— work within like-minded— with like-minded partners within the U.S. alliance network to begin reform of the rules-based system. You talk about a grand bargain of sorts, one that would limit Chinese exports of strategic products and also guide Chinese investment and tech transfer to members within this broader US alliance-based network. And I'm just curious, what does that look like? Because it sounds like initially this working within a US alliance network is going to happen without the US.

[01:45:18.00]

And so what, what does that look like? And then over the longer term, what is the strategy for bringing the US back into its alliance network? Does that mean just waiting out Trump for the next 4 years? Does that mean convincing him that he needs to engage with the Europeans? I'm just curious how that plays out a little bit. It's a really interesting idea using— and this is not the Transatlantic Partnership, this is the broader, I guess we could call it the Western alliance— kind of a problematic term, but suggest something else. It sounds like using that broader alliance, the network there, but not the principal partner. How does that work?

[01:46:04.29] - Mary E. Lovely

So I guess I can open. So I think we're here now, Jeff, into creative thinking, right? We're moving beyond. And so anything I say is sort of speculative and we're here for discussion. And so, I think it's the kind of thinking we need to be doing right now. I think there are two serious issues. One is, there's a lot of laws that can be flaunted but economic laws in the end do carry a whammy. And in that sense, I think we have to look at what does U.S. auto industry look like if the U.S. really goes a very different route than the rest of the world, including Europe. The U.S. is a very large, rich country, so certainly we can have our ICE vehicles for as long as we like, knowing that the rest of the world will transition and we will not have an export-based industry. And then at some point where transition becomes essential, and we can argue whether that's ever going to happen. I would argue that it is. What is the health of the industry? And I would argue that a key motivator for this is to protect the industry, is that for many people, myself included, it is unthinkable that the US and the EU would not have a healthy transportation equipment sector.

[01:47:31.08]

So this, I see this as necessary. but we also have to guarantee that it will be healthy down the road. So at some point, the US is going to have to— and here comes my second point— the rest of the world exists. And for Europe, maybe that's easy to see. In the United States, especially from this city, a lot of times, you know, the world ends at our shores. But the rest of the world will move forward. Many countries are eagerly accepting and welcoming Chinese vehicles. Renewables as part of their energy transition. They want to be part of the larger network that will serve those production— that production, whether it's located in the EU or in China or in Thailand or in other places. So how does the U.S. then reintegrate into that? But that network, those folks, I think, are the ones who may be willing to talk to the EU about restraints on Chinese dominance here. Clearly tariffs have a role to play, so does industrial policy, and perhaps domestic content rules and other rules that economists have reflexively said no, no, no, right? But I agree with Chad, if you start to look at these overcapacity measures, you realize,

you know, something's going on, but it's very hard to say that's the thing that, you you know, what in economics we always— the money chart.

[01:48:53.18]

That's the thing that's going to prove that this is— I could have convinced you there was no overcapacity if I wanted to, I think, just by showing you some other charts about Chinese EV surge. So I think that we have to find vehicles for that. Some of that we discussed in the paper include the TTC, but that's just the transatlantic relationship. But clearly G7 and to echo something that, of course, I am good friends with Jeff Schott and he often talks about the CPTPP, the EU applying to join the Trans-Pacific Partnership, joining together not just with Japan but also welcoming in South Korea into that framework and developing new frameworks, but making sure that it's an open agreement and that the US could join in the future?

[01:49:49.11] - Luis Simón

Thanks.

[01:49:49.21]

Thanks, Jeff. I mean, that's a great question. And perhaps I'll try and also link it with— by the way, great, great question. Impossible questions. I'm going to try and link it, link your question with Chad's first question, which is what are we actually worried about, right? I'm a political scientist, so I'm just going to bring politics and security back in, because I don't think you can disentangle the two elements, right? You cannot disentangle the Ukraine file from the China file from the European perspective, as Jeff was saying first in the first panel. The answer to your question, actually, how can you strengthen ties or connectivity within the US-led alliance architecture without the principle? Well, my answer answer to that question would be you can't, right? You can't. But, and that sort of links me to Chad's question, because I think while the EU and the US agree that— and I'm curious about how you see it yourself— agree that the Chinese non-market overcapacity poses a problem, I think they think it poses a problem for different reasons. Both probably worry about deindustrialization as a result of unfair competition. They may also agree that there are supply chain risks.

[01:51:11.03]

So that's the economic security piece. And I think the EU has sort of come closer to that view in recent years. But the United States also looks at this from a national security prism, right? Because it sees China as a security threat. As a security threat, and it's engaged in a— in the US national security language, long-term strategic competition with China. And that competition

also has a very strong military dimension, right? Neither the EU nor its member states are there. They do not look at this as a national security problem. They look at it as a competitiveness problem, and at most as an economic security problem. And I think this explains why the higher fence or the prohibitively high fence when it comes to some products. You said, is it about the product being weaponized? Well, in some cases, yes, I think. And now on the other thing, going back to your— now having said that, I'm going back to your question. I don't think you can, but I think we're going to see— from a European— I'm not going to get into US domestic politics, but from a European perspective, All I would say is we shouldn't get ahead of ourselves in terms of how US policy, the direction of policy, particularly insofar as the transatlantic trade relationship is concerned.

[01:52:27.04]

A lot of what we are hearing or fearing could be tactical and attempt to renegotiate. So I think some signaling on the European part, which— and here I think there might be similar— the Europeans, the Japanese, the Koreans might be in a similar boat because there is uncertainty uncertainty about the direction of US economic policy towards them and trade policy. So there's a signaling element as well, which is about, you know, not being totally at the mercy— because the US has a lot of leverage, I think, and particularly with Europeans right now, but not only with Europeans, right? Because of the security and economic, and economic link, and the fact that— and I think if there's anything that US allies have in common is that they will all try to sort of maximize their autonomy or whatever you want to call it because they want more autonomy, because they want more status or because what have you. But I think they all agree that there is no— they all recognize that there is no security outside the framework of the alliance with the United States. I think that applies to the European That applies to Japan.

[01:53:34.06]

That applies to Australia. That applies to the ROK. So I guess the answer to your question is I don't think there is a solution right now outside— without the principal. But you need to manage or try to manage the relationship with the principal as best as you can.

[01:53:53.11] - Jeffrey Anderson

Chad, did you want to add anything?

[01:53:56.01] - Chad P. Bown

I wanted to add one other quick thing. Which in terms of this coordination question that I think is relevant here too, since we're expanding the set of policy instruments beyond tariffs, export

controls, we really haven't gotten into— you mentioned it a little bit— is industrial policy. Like if we're, if we're now going to be a lot more active in, in going and promoting certain sectors. And some of that is clearly in response to the Chinese model and our worries, some security-related worries about market concentration, I think, which is, which is a potential concern. And so you saw it in, in IRA and you see it in CHIPS Act in the United States and what partners and allies, certain European member states are doing and subsidizing. When there's a common diagnosis of the underlying challenge, we're worried about excessive concentration of production in East Asia and we want more geographic diversification. It's happened. It's happening. We sort of acquiesce to what each other is doing. There's kind of loose coordination between governments about sharing information and there's actually been stood up at the OECD, I think, much more information shared than I think folks in the outside world have recognized.

[01:55:12.10]

But that being said, that's different than coordinating ex ante. Proactive things on industrial policy. Right. And so the blowback to IRA was one thing. There's probably been perhaps more coordination when it's come to chips. But even then, that's different from, okay, suppose we're successful, quote unquote, on reorienting some supply chains so that we get more geographic, geographic diversification of, of manufacturing in a way that leads to more resilience. What do you do to sustain it? So what happens in market downturns when all of a sudden now there's political pressure for tariffs to do something about it? Do we share the pain amongst ourselves, or does that cooperation break down and we start going after each other? If we just rely on trade defense instruments, there's a long history of going after each other. It's very industry-driven. We haven't thought through those kinds of questions yet either. So the long-term cooperation when we're in a world of industrial policy, I think is important to contemplate as well. You have a very long paper that you two have to—

[01:56:17.01] - Luis Simón

And you want us to make it longer?

[01:56:18.09] - Chad P. Bown

Yeah.

[01:56:18.23]

No, no, it has to be even longer in a good way.

[01:56:22.05]

Very good.

[01:56:23.28] - Jeffrey Anderson

Let's open it up. I see Federico. Would you like to as well?

[01:56:26.29]

Please.

[01:56:27.09]

Yeah. If you just line up there. I will say you should really develop this argument. I think it's fascinating. When I ran across the reference to the US Alliance Network, I thought of a kind of intervention in an extended family where the matriarch or patriarch is suffering from mental illness or substance abuse, and everyone comes together to help pull them back in. So take it for what it's worth. Federico.

[01:56:53.24] - Audience

Thank you. I'll be short. It's a long queue. So my question is about the WTO. To what extent, given the diplomatic resources are scarce, should the EU and the US dedicate to try to renew it? Or also related to that, does it really matter? Because in the last 5 years we've had a very weak WTO with problems in the dispute settlement mechanism and the appellate body, and still the fragmentation of the global economy is, I would say, limited. So do business care about this or not? So what's the future of WTO in line with the transatlantic relationship?

[01:57:33.12] - Jeffrey Anderson

Why don't we take these questions in two groups of two? That'll give you a little time to reflect on them as well. So please.

[01:57:39.08] - Audience

Nick Lardy, Peterson Institute. I want to expand on what Mary talked about and Chad alluded to briefly, and that is the difficulty of defining excess capacity, particularly non-market market excess capacity. And I'm not an expert on the Chinese auto industry, but I look at it a little bit and it seems to me what we've seen in the auto industry is a dramatic technical transformation in which the share of EVs in the domestic market has gone, you know, from 0 to 50% in a very

short period of time. Most of these EVs are being made by new entrants, companies like Tesla, BYD, and a number of others. And where we really have excess capacity is in the internal combustion engine sector of the auto market. There's massive excess capacity, but it's inevitable when you have such a rapid pace of technological change and change in demand. And I don't have the exact data at my fingertips, but I think it is the case that China is exporting more internal combustion engine cars than EVs. EV exports obviously have gone up rapidly, but from a very small base, and the share of EV production that's getting exported is still pretty small.

[01:58:58.10]

So the automobile industry in China strikes me as very competitive. A lot of new entrants, uh, and the excess capacity is a function of technological change, and I think it's a pretty market-driven sector.

[01:59:17.15] - Jeffrey Anderson

Take a crack at those first two questions, the WTO and market changes in the auto industry.

[01:59:23.07] - Mary E. Lovely

I'll just respond quickly to Nick, and I think, Nick, you're raising very important questions which we've just really begun to surface. In terms of Chinese, uh, difference between the PV solar case and the EV case is actually that China's domestic consumption of EVs happened at the same time. And so you saw this incredible market penetration of EVs in the Chinese domestic market. That was completely different than what happened in PV solar, where virtually no solar work was installed in China until about 2010, 2011, or past there. So really very different pattern, but it does invoke some of the same fears, unfortunately. And as far as the ICE vehicles, it's an excellent point. I think we should be doing more digging to see what the numbers are there. So on the first point about Federico and fragmentation hasn't happened so why do we care about the WTO. It's an important point. I think that if we are serious about de-risking the global economy, though, we do need to have some way of steering private firms who actually at the bottom of this make these global value chains. And that does require state intervention. So it could be in the form of plurilaterals or groupings.

[02:00:55.10]

We talked about the TPP, but some way to reduce the risk of investments outside China, recognizing that other countries, at least in the short run or even the medium run, are going to

be much higher-cost locations. So the government— governments have an important role to play in de-risking, and that does require alliances.

[02:01:18.23] - Luis Simón

Oh, go ahead. I'll just say, I mean, these are more like economic policy questions, but perhaps something sort of following up on the previous iteration. Obviously in Europe everyone's worried about US tariffs and the prospect of some sort of trade war, whatever you want to call it, right? And the president, President Trump, seems to have a particular interest, it seems to me in Germany and the German automobile sector, right, which is basically a European automobile sector, right, because it's very— it's fairly integrated in terms of the supply chain. So I think one thing to bear in mind, and Antonio and Jeff touched on it in the first panel, is that there has been an effort in the last few years to build some sort of European consensus on the issue of tariffs on Chinese, right? And Chad also touched on that. And it's a fragile consensus. It's probably an imperfect or insufficient one from the US, from a US viewpoint. But there it is nonetheless. And I'm just not sure that the European automobile sector can actually afford to wage a two-front war there.

[02:02:29.20]

You've got a lot of—

[02:02:30.19]

so ironically, a US push And I'm thinking about the point in the previous panel about if you go too hard on China and you're incentivizing China to go to Europe and vice versa.

[02:02:41.10]

Right.

[02:02:41.15]

So ironically, a US push against the European automobile sector or for that matter against the Japanese or the Koreans may actually incentivize— may actually lead this consensus against Chinese to crumble.

[02:02:55.05]

Right.

[02:02:55.10]

Because of European internal, internal politics. So it's just like you have some people in the current administration insisting on the need to establish clear priorities when it comes to security and defense policy and prioritize the larger threat, which is the China threat in the Pacific over the Russia threat in Europe. A discussion on priorities when it comes to trade and tariffs may also be overdue, right, to basically figure out which, which tariffs are more important, right, and go we see.

[02:03:26.06] - Chad P. Bown

I just make one point related. One of the best parts about being an American policymaker is the ability to go to Europe, and you go to Brussels and you get the European-wide perspective, and then you go to each member state. And so back to this question about views on Chinese non-market overcapacity, you get very different views across member states. You'll have some that are worried about— I was in Italy, you know, and they're— Stellantis very worried about job loss. They're announcing, you know, 30,000 jobs in the industry. At the same time, Stellantis and CATL are announcing a new plant or something in Spain. And so they're— and you go to other countries and they're like, we don't have an automobile industry. These cheap Chinese these EVs sound great. Why would we want to put tariffs on something like that, right? And this is even within Europe. It's going to be a very difficult question as well, let alone transatlantic.

[02:04:25.24] - Jeffrey Anderson

Let's take the last two questions, please.

[02:04:27.18] - Audience

Thank you.

[02:04:28.09]

Hi, David Nelson with Global Business Policy. The sectoral issues that you guys are raising are obviously fundamental for political economic discussions. But I wanted to ask a question, a kind of a more macro bigger picture question. So China has this large persistent and apparently growing global trade surplus. The Chinese argue that that's competitive advantage. It's a success of their development model. In Europe and the US and other countries, we argue, well, it's subsidies, it's dumping, to some degree it's exchange rate policies.

[02:05:03.02]

Do those issues—

[02:05:04.12]

do any of those issues actually explain this persistent and growing trade surplus that seems somehow incompatible with classical or neoclassical trade theory, or is there something more fundamental about the Chinese economic model that would require a somewhat different interface between Chinese economy and Western economy?

[02:05:28.17] - Jeffrey Anderson

Please.

[02:05:31.18] - Audience

Hello, Alex Taylor-Fowles.

[02:05:33.22]

I cover China policy at the German Embassy, so a few of your comments made me feel very seen. But I have also a kind of a big picture question, and it sort of refers to what Secretary Rubio said in his confirmation hearing, where he talked about the rules-based international order being obsolete and indeed being weaponized against the US. And that sort of made me think about your— the framing of the this whole session where you talk about, you know, transatlantic cooperation within the rules-based system or within the rules-based international order.

[02:06:04.07]

Do you—

[02:06:04.16]

like, is that a helpful framing anymore in this new era in which I would argue the US views the geostrategic competition with China as being such that it needs to extricate itself from the rules-based system in order to compete properly with China? Can you talk a little bit about that framing and what it means for sort of this rules-based international order to which we all seem to still be clinging desperately?

[02:06:31.17]

Thanks.

[02:06:33.14] - Jeffrey Anderson

A couple of small questions.

[02:06:34.14] - Luis Simón

Yeah, just briefly, I think you sort of answered the first question in a way. I mean, it seems to me, if I understood it correctly, it seems that the Trump administration's view on this is indeed the institutional and normative architecture the structure that we have provided ourselves with is unfit to deal with the China challenge. So therefore, there's no amount of tweaking that will fix that. We just need to pull the plug on the order, right? It seems to me that this is the Trump administration's view. It's not the European view.

[02:07:07.21] - Mary E. Lovely

On the first question on the trade surplus, you know, it's important to know that China hasn't run a continuous surplus for the last 20 years. It was very close to balance at one point. So this does change. None of these micro reasons really work and no micro answers, tariffs are not gonna fix it. It's a macroeconomic imbalance and obviously, or let me just say, most fine studies people look at the balance between Chinese production and Chinese domestic demand and are urging both within China and outside China the government to do things to stimulate domestic demand. It's also why we look at exports, difference between production and domestic demand, to try to get a first pass at overcapacity. Having said that, there's the flip side, which is that the U.S. development model also has its imbalances and we are likely likely to see those imbalances increase rather than decrease as the US enacts— extends the tax cuts that were extended under the first Trump administration, perhaps expanding them, as well as other types of expenditure. So we'll have to see where the US federal budget deficit ends up, where US stimulus of our economy ends up, and look to see whether this imbalance and the dance that these two countries are engaged in actually slows down or quickens.

[02:08:37.11]

So I think we have macroeconomic imbalances on both sides that need to be tackled before we see a sustainable change to the problems of persistent deficit and persistent surplus.

[02:08:51.27] - Jeffrey Anderson

Great.

[02:08:52.05]

That brings us to the end of our second session. Please join me in thanking the panelists for their stimulating discussion.

[02:08:57.14] - Luis Simón

Thank you.

[02:09:00.05] - Jeffrey Anderson

And I think we're just going to make way right away for the third panel.

[02:20:37.25] - Audience

We're going to start the last panel.

[02:20:41.23] - Federico Steinberg

Thank you.

[02:20:42.10]

I'm Federico Steinberg. I'm a visiting professor at Georgetown University and also at Elcano Royal Institute, a Spanish think tank. And I'm going to be moderating this this last panel on currency competition and rivalry between the dollar, renminbi, perhaps the euro. This is a topic that has been discussed for many years, but perhaps the issue of, you know, international reserve currency status and currency competition is becoming even more important for two reasons. The first, that the global economy is more multipolar, people are asking if the currency system should be more multipolar or not. And the second one is that the growing U.S.-China rivalry puts on the table the use of new instruments to perhaps try to internationalize currencies. As we're going to see, the numbers are very clear. The dollar is the global hegemonic currency. There's no real contest. Has stationed there. On the other hand, there are new elements on the table recently. The first one is perhaps the strategy of the Chinese to internationalize the renminbi, particularly on trade issues. And this has, you know, shown some increase in the use of the renminbi, particularly in trade with countries closer to their sphere of influence.

[02:22:13.23]

Also, we're seeing the discussion around sanctions. So how does— how do sanctions from G7 countries affect the trust in private actors on the use of the dollar and the euro? Also, nice developments on the project of the fiscal union in the European Union that everybody understands is, you know, the missing element for the euro to be really trusted and the governance structure to be there clearly present for more use, more international use of the euro, perhaps on a diversifying strategy by central banks. And then finally, the discussion about, you know, the rising levels of US debt and to what extent that, combined with the use of crypto, could also change the the system, right? So these are the issues we're going to be discussing. And we have a paper as well written by Lucas Spielberger and Martijn Tursenpa. And then we're going to have a discussion, Dong He. Let me briefly introduce them. So Lucas is a postdoctoral researcher at CSDS in Brussels. He's an expert in international political economy and in particular on financial issues. And the Chinese swap lines that he's going to be discussing as part of this paper. Martin Tursenpa is a fellow here at the Peterson Institute.

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He's also a China expert. He has written extensively on the financial reforms of China, financial regulation, also export controls. So he has some, some things to say on previous papers as well. Currency competition, And he's going to be spending some time in Europe as well. So he's going to be also looking at the European perspective. And last but not least, our discussion is going to be Dong Hee. He's the Deputy Director of the IMF's Capital Markets Department. He's responsible for global financial stability, which is a big issue, particularly on the discussions about cryptocurrencies and central bank digital currencies. In relation to the standard currencies. And also he has worked on digital money and payments and financial market infrastructure. So let me introduce first Lucas. You can come first. Thank you.

[02:24:38.21] - Lukas Spielberger

All right.

[02:24:46.17]

Thank you, Federico. Delighted to be here, have the opportunity to speak and to contribute to this wonderful conference this morning. Federico has already set the stage a bit in the sense that he mentioned that obviously the US dollar is so far still the hegemonic currency in the international financial system and plays an important role in financial markets and trade invoicing and various other functions that international money perform. But at the same time, the use of international sanctions is not just in the realm of trade, as we've previously discussed, but it's also been a longstanding concern in the realm of financial policies. Very prominent recent

cases obviously been the sanctioning of Russia following the full-scale invasion of Ukraine in 2022 and the exclusion from SWIFT. And concerns about sanctions overreach in the realm of finance predate even the first Trump administration. Administration, and in that sense also a staple of, of the concerns about the international role of the dollar. At the same time, these infrastructures are centered in Europe. So for instance, SWIFT is domiciled in Belgium. So in that sense, there's always a strong transatlantic component to these measures that we try to unpack a bit.

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And in our policy brief specifically, we're interested in the degree to which China can challenge that, because the Chinese have had a very longstanding policy of trying to to promote the RMB as an international currency as well. And the Chinese approach has relied on two pillars. One pillar has been to promote renminbi as an investment currency, make it attractive as a store of value, which has largely been done by Hong Kong capital markets and more recently by banks in Luxembourg. Very arcane topic, don't need to get into that because in our policy brief we focus on the second second leg of the approach, which has been to make the renminbi attractive as an international payments currency, its role in trade and settlement particularly. Now, if we look at this, we see that the role of the renminbi in that realm has increased significantly. In late 2023, the Financial Times reported that the renminbi overtook the euro as the world's second most important trading currency. On aggregate measures, it's still in fourth place, but in, in this realm, the renminbi is playing an important role. Now we see that in the trade with China, it is currently at about a third of all Chinese trades that are being invoiced in renminbi.

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So this is a very significant role. But what Martin and I argue in our policy brief is that this role is not so much a systemic challenge to to the dollar, in brackets, yet, as it is an instrument for Chinese bilateral policy that can be wielded quite powerfully. This can be seen in this chart. This shows bilateral trade between China and the Russian Federation and the invoicing of that. And what we see here is that imports from China to Russia, or Chinese exports to Russia, have since 2023 more than 50% of them have been invoiced in renminbi. So that is basically saying that after Russia was sanctioned by the West, the use of Chinese infrastructures allowed them to keep trading and keep importing all the goods that we heard about in the previous panels on sanctions goods and, uh, and trade. Basically, the financial infrastructures made all of these trades possible after the West tried to exclude them from financial, uh, infrastructures. And what Martin and I look at in our policy brief are specifically 3 strategies that the Chinese have pursued to promote the renminbi as an international currency. And again, our overall thrust that we argue

is that this has been not yet a systemic challenge, but it has definitely had impact in bilateral currency statecraft that Chinese have been able to employ.

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Now, my section, the policy brief looks at the topic of central bank swap lines. Central bank swap lines are basically very fun, a very simple instrument between two central banks. One central bank lends out its own currency, the other central bank provides its currency as collateral. These have been very prominent in U.S. external foreign policy since, since the global financial crisis when obviously the Federal Reserve backstop the global financial system by means of these swap lines, have been reactivated in March 2020 to the tune of, I think, \$600 billion. So it is, it is a very sizable instrument that can, if the Fed does it, basically backstop the global financial system. Now, the Fed has swaps with about 14 central banks and has standing swaps with 5 other central banks that are really at the center of the global financial system. By comparison, the People's Bank of China currently has swaps with more than 40 central banks. So the Chinese have pushed these swaps very, very aggressively, especially after 2014, as an instrument to foster the RMB as an international currency. And initially the idea behind that was to make it more attractive for trade invoicing, was basically saying to a country in the Chinese neighborhood if they were trading with China in renminbi, that through that swap line they would be able to receive renminbi liquidity if they needed that to settle some trades with China.

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Now, this has been studied quite extensively because this program has been going on for a while, and the overall conclusion is that it might have had a small effect but definitely not been an astounding success in terms of promoting the role of the renminbi in trading. Another role that has emerged more gradually over time is that these swap lines have been used as an instrument of bilateral diplomacy, as a tool of bailouts. So here is one of the most egregious cases, which is the swap line that the People's Bank of China has entertained with the Central Bank of Argentina, where we see that after 2014, the Argentines have been drawing on this swap line basically basically on a constant basis. And I may remind you that was a time when Argentina was undergoing a sovereign debt restructuring and they were struggling to negotiate something with the IMF. And we see in the very right-hand column that Chinese credits at some point made up more than 50% of the level of Argentine foreign reserves. Now, this raises a couple of questions. First of all, how much interference from that side do we tolerate when, when it comes to undercutting the global multilateral financial system, right?

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Because there's an IMF program going on. Argentina was in this sovereign debt restructuring, and obviously this was being undermined, particularly after in 2015 the People's Bank of China did not just lend in renminbi, but they also lent in dollars. So they really used these swap lines as tool of keeping the Argentines afloat. And the other question is how the Fed and the ECB will, in their policies, respond, because so far our impression has been that the Fed and the ECB have both looked at swap lines much more from a perspective of ensuring financial stability at a systemic level rather than using them instrumentally at the bilateral level. one reflection that might be taken away. But now I hand over to Martin to discuss the other two elements.

[02:32:21.22] - Martin Chorzempa

All right. Thank you, everyone. So you've already heard a lot about the role of the US dollar so far. I'm going to talk a little bit about the plumbing that makes that possible and China's potential ways to replace the plumbing. Don't worry, you won't have to get your hands dirty. I've already done it, going really deep into the details, and will hopefully tell you what you need without any sort of mess. So the first element of infrastructure I'll talk about is SWIFT. And SWIFT gets talked about a lot by people, especially around Russia's invasion of Ukraine, when there was all this discussion about de-SWIFTing Russian banks. But it's often not really on understood. Swift is only a messaging system, which means it doesn't actually move money. But what it is, effectively, it's a system of messages and then standards around what's in those messages that allows banks to talk to each other. And if one says, "Send money over here," they know that that's actually a legitimate order. They can automate systems around that to make payments be very efficient. And that, as Lucas mentioned, is not based in the United States. It was pointedly supposed to be a neutral infrastructure based in Belgium.

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And it processes payments, sends payment messages for dollars, and also in renminbi, and many other currencies. The other system is called CHIPS. And that is the Clearing House Interbank Payment System in New York. And the reason for this importance, this is probably one of the largest payment systems in the world. And effectively, if you're taking payments in dollars, you have to know that those dollars actually exist. So unless you're doing it in New York in this system, which has backstops from the Fed, you can't necessarily be sure that someone sending you dollars actually has those dollars. And really, it's this system, the latter more than SWIFT, which gives the US this extraordinary sanctioning power. And what that means is, you know, having these infrastructures be something completely indispensable for using dollars, which is indispensable in the global financial system and trading system, means the US can put conditions on access to that infrastructure. So that allows the US to say, for example, we're not

just going to sanction North Korea, but if a Chinese bank helps North Korea, then we can put what are called secondary sanctions on that bank, say Bank of Kunlun, and And then in effect, then we can say anyone who does business with Bank of Kunlun will also be sanctioned, and you can kind of extend it ad infinitum.

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And what that means is generally any international business or bank that needs to deal with U.S. dollars is going to effectively say that any institution on the U.S. sanctions list are radioactive. So why does this matter for China? Well, China has seen how its Chinese trade with Russia has been severely disrupted by the US sanctions on Russia, especially when the US began to talk about imposing these secondary sanctions on Chinese financial institutions that would be helping Russia. So there's evidence that Chinese banks have pulled massively back from facilitating trade with Russia because they are so afraid of getting themselves sanctioned. And that makes them want to make sure that if they were at some point the target of sanctions in the future, they want to be able to trade, continue to trade with the rest of the world, maybe using renminbi if they no longer have access to the US dollar because of those sanctions. And this is a point I think it's really interesting is that Europe has had some of the same complaints about the United States as China has. When Europe wanted to do trade with Iran, but US reimposed sanctions on Iran, they tried to work out an alternative payment system that would allow them to continue to trade, to not allow the US to stop that.

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But they were unsuccessful, in part because of this extraordinary reach of sanctions. So what are they doing to try and get around it? One of the most discussed elements of this is this Chinese system called CIPS, C-I-P-S. So we have the US chips, which you can't eat, and Chinese CIPS, which you can't drink. And I'll talk about SIPS. So, what's very interesting, SIPS is both more and less than SWIFT. And what I mean by that is that SIPS is more than SWIFT in that it is not just a messaging system, it actually also moves money across. It's called clearing and settlement, the other elements. So, a bank sends a message, "Let's send this money." They batch together generally a lot of small payments by their clients and then big money moves around. System can do that. So it is much more than SWIFT, but it's also less than SWIFT in that most of, if not all of the international participants in this system, this international payment system that uses the renminbi, are actually using SWIFT to send messages, payment messages to each other. So it doesn't replace SWIFT, it actually kind of supplements and works together integrated with SWIFT.

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And thus, I think it's kind of the opposite of the Russia approach. Russia was Fortress Russia. After the initial round of sanctions, it said, let's isolate ourselves completely from the rest of the global financial system, not use SWIFT, not use these other things. We'll have our own systems. And I think the Chinese have taken away, reading some of their commentary, that that actually was counterproductive. It made it very easy to impose financial sanctions on Russia, made it less costly, whereas instead China has what I call the bear hug approach, you call it the panda hug approach, which says get yourself tightly, super tightly integrated. So if they try to blow up China, they'll blow up themselves. You raise the cost to the imposer of sanctions. So CIPS volumes have gone up massively since the Russia invasion. You can see that there isn't actually that much growth in the volume of using renminbi payments through CIPS before the invasion. But then there's a large amount and then it starts to stagnate again. So it's risen quite substantially, but it is a drop in the bucket compared to SWIFT. I wish I could show you the volumes of SWIFT transactions and CIPS, but they don't actually tell us how much money is moved and how much of that is— they do tell you how much is in renminbi, and that number has gone up somewhat, but renminbi is still quite a bit behind.

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So CIPS so far is not really really an alternative to SWIFT, not really to the US dollar either. And in part, that's because about 3/4 of China's trade is still settled in currencies other than the renminbi, and most of that is in dollars. So China remains and will remain in the near future heavily dollar dependent, even though it wants to do some diversification. Now, central bank digital currency subject has been really hot for a long time. See that the chart on the left— this is from a survey of central banks by the Bank for International Settlements— looks at how many institutions, central banks that they survey, are engaged in work related to central bank digital currencies. And that's gone up quite substantially, but you can also see it beginning to plateau. And I think that's actually quite interesting. All these central banks realize they don't want to be left behind by the crypto world, by stablecoins, so they all rushed into to it, and then they realized, well, maybe this is actually harder than it looks. Maybe it might not be as rewarding as it looks either. And so we're now many years into the hype around central bank digital currencies, and no major country has actually launched a central bank digital currency to be used in itself.

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China is one of the most advanced, and it has been in a pilot program for quite a long time and seems to really struggle to find anyone to use it. What we care about, though, from the dollar perspective and the transatlantic perspective is not whether someone in China buys their breakfast with ECNY versus Alipay, but whether this actually represents a new way of handling

payments at the wholesale level between central banks. May there be a system like EMBRIDGE, for example, that the BIS, Bank for International Settlements, was working on with China and some from other central banks that would not need SWIFT and would not need the US dollar and would transact directly. And the main takeaways I want to say on this is that first, because no major central bank has actually implemented one of these, there really is no network to plug into. So there's not really an advantage for China to internationalize an eCNY compared to a regular form of the renminbi, which is also digital, by the way, already. Central banks currently don't do international payments by having somebody run checks around in a suitcase on a plane, moving it from place to place.

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These are all digital payments anyway. So you say digital currency, what is actually the difference? And therefore, it's not really a near-term concern, but it's also an area of divergence transatlantically. So President Trump, one of his first actions was to ban any movement toward a central bank digital currency. And one of the interesting things about this order is it seems like it would actually make it illegal to work on central bank reserves, which everybody already uses internationally to transact, because it just says a digital form of central bank money, which already exists in the world. So it's not necessarily the best worded thing, and it contrasts quite substantially to the ECB, which has done an enormous amount of work trying to push forward on a retail central bank digital currency in Europe. And one of the motivations that they say for that is similar to China. They say, we don't want to be completely beholden to the United States and only US payment companies, which currently dominate Europe's payments market. So you could imagine right now, not much risk to the dollar, but in the future, a system in which maybe Europe and China would be able to transact central bank digital currency to central bank digital currency.

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And the United States doesn't have one. I'll leave it there. Thank you.

[02:42:15.09] - Dong He

Good morning, everybody. Let me first thank Mary for inviting me to be here to participate in this very interesting event. It's a pleasure to be back at the PIIIE. It happens actually today is the Chinese New Year, so let me first wish everybody a prosperous Year of the Snake. Now, I've been asked to play the role of discussant of this policy brief. I think my role as discussant is really to provide some supplementary perspectives on the analysis and arguments. I think I have two main observations. One is that, as you can see from the presentations by Lukas and

Martin, they are really very clear. I think so that one strength of this policy brief is it provides a very clear and clearly written and informative summary of the popular narratives. That's my first observation. The second observation is that I think the paper would benefit from a deeper reflection of the economics of international payments and currency use. So let me elaborate a bit on this second observation. I would have— Three thoughts on the following three points. One is the economics of international currency in the payment networks. What determines the network dynamics of international currency in the payments?

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The second is the role of official policies versus market forces. And the third The second point which I would like to share some thoughts on is how do we really uphold multilateralism and safeguard the continued integration of the global payment system and the smooth functioning of the international monetary system. So first, economics of international payments and currency use. A simple use definition, of course, is international use of a currency means the currency serves as the medium of exchange, store of value, and unit of account in international trade, international finance, and foreign exchange reserves. So it's really an extension of domestic functions. So the dollar here, we are in the United States, the dollar is used for domestic transactions, but the dollar is used in other countries, right, for international trade, international finance, and used as a major reserve asset. So the theoretical literature is quite well developed, points to the safety, liquidity, quality, and the transparency in policymaking, trade links, politics, financial connections, and the geopolitical considerations as factors to explain why some currencies are used disproportionately in cross-border transactions. The price stability and the confidence in the currency's value, both stemming from the credibility of the monetary authority or the central bank and the broader institutional and quality of policymaking of the issuing country are critical for its use as an international currency, since these factors affect the role of the currency as a unit of account and a store of value.

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The more liquid and developed the country's financial markets, the more likely that other countries will use its currency for inter— for intervention purposes or to denominate financial assets. The third aspect is that the larger a country's share in world output and the trade, the more likely other countries will use its currency due to its economies of scale. Here we might note that, for example, the United States probably is the most central nation when you think about the network of international financial linkages when you do a network map, but China is actually the most central node in that network in terms of international trade. So that's an interesting comparison here. Now, the larger countries or the status of international currency is also influenced by the geopolitical relationships, of course, between the issuing state and the

countries that adopt and use the currency. So that's from a theoretical point of view. But the empirical literature is not really very developed after so many decades of working on this issue. So importantly, I think that's because we haven't really had a lot of data points. So as economists, you know, we want to have data to explain the changes, but here we don't really have a lot of data to work on because the United States, the dollar status has not varied that much.

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It has been the leading reserve currency for many decades, at least since the 1940s. So we don't really have a lot of data to work on to explain the variation in the status of a major international currency. So that's the handicap that we have. So as a result, we don't really know how to rank the importance of these various factors. Thus, we cannot be confident enough that geo—

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geo—

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geo-economic fragmentation will override the desirable— desirability for liquidity, for example, in the use of currencies. So we have observed that the use of currencies internationally is affected by strong network effects or externalities. And the leading status of the US dollar has been quite persistent. So we have observed that also cross-border payments based on correspondent banking relationships and centered on the SWIFT messaging system. So Martin really has done a very nice job just now explaining to you the role of Swift, the role of CHIPS, and probably other, uh, and other payment systems. So these have also demonstrated powerful network effects. The network effects really basically occur when the private value of using a service or a product increases when the number of other with the number of other users, right? When everybody else uses the same currency or the same language, I'll come to the use of English language, and then the value of using that, the private value of using that also increases. So once a currency is established internationally, the fact that it is used by many increases the likelihood that others will adopt it. Hence, once a currency gets established as a leading currency, it tends to be in a self-justifying, uh, strong position.

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Nevertheless, some networks also characterized by strong externalities, such as social networks, and even e-commerce networks do change their topology from time to time. So, as

you all know, these days teenagers do seem to switch between different social networks quite easily. And you know some of the big techs, they worry about how dominant or how persistent their the dominance of their networks would be when alternatives get set up, right? So that's an interesting observation there. So are currency and the payment networks more similar to language networks, for example, the international use of the English language, or social networks? There are arguments on both sides. Some argue that technological breakthroughs such as development of real-time translation devices like Google Translator or ChatGPT on your phone whenever you visit a foreign country— would that reduce the dominance of the English language? Others argue that attractiveness of English is inherently linked to the rich and the dynamic cultures of the English-speaking peoples, so hence would not be easily diminished by the mere force of technology. So switching cost, reduction in switching cost with advancement in technology does not necessarily lead to a change in the dynamics of networks. So that's— but there are arguments on both sides.

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So in a nutshell, in a nutshell, our knowledge about how currency and payment networks may shift is still very limited. However, we can be quite confident that the status of a leading international currency is a constellation of all of the factors I've just mentioned above. So my second point is about the role of government policies versus market forces. It's very challenging to target the maintenance or the promotion of the status of one's own currency as the premier international currency. The argument is closely related to the argument above, that is, we don't really know empirically what policy instruments would be effective in directly encouraging the international use of currency. So, for example, if you talk to colleagues in the central bank, you would say that monetary policy works because we understand the relationship between instruments and targets, right? Here, so we don't really have a very good grasp between instruments and targets. While being a major international currency, it does bring certain benefits, for example, allowing the issuing countries' firms and households to better manage risks, it could also incur costs such as larger and more volatile capital flows, which could complicate domestic policymaking. So whereas in comparison, maintaining an integrated, safe, and resilient global payment infrastructure is a worthy public policy goal.

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So in any case, whether or not a currency is used extensively for international transactions, I believe, is primarily determined by market forces. The choice made by market participants, so millions of households and the firms across the globe in their transactions, they lead to a that their choices lead to a general equilibrium outcome that we see at aggregate. So seeing in this light, renminbi internationalization is probably more a process of dismantling Gazant restrictions

against its international use. As you know very well, China has had pretty restrictive restrictions on international transactions, or particularly on the capital account. So basically, the Chinese authorities started to remove restrictions against the use of renminbi in current account transactions since 2009 and have gradually expanded the scope for the use of renminbi in financial account transactions. Still, many restrictions remain in place. So what is the role of the official sector. So my third point touches upon what are the main elements of a policy package to ensure efficient and safe cross-border payments even in an environment of rising risks of geoeconomic fragmentation. I guess that's the theme of this conference. So an integrated, safe, and efficient and resilient global payment landscape does not necessarily doesn't necessarily mean one single system.

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It does imply that the different systems are interoperable with each other and payers and payees can seamlessly choose the instruments, service providers, and the rails that provide them with the cheapest costs, fastest speed, best transparency, and wide availability. So it means that different systems adhere to the same international standards, such as ISO 20022 for data and the message exchange. So that's, that's a standard that payment system experts would, would love to talk about. And the principles for financial market infrastructures for risk management That is the standard set by, by PFMI, by the CPMI. So that's Committee for Payments and Market Infrastructure of the BIS and IOSCO. And the recommendations, of course, of the Financial Action Task Force for financial integrity. That's a very important piece of the international standards governing payments and many other financial transactions. So that is, in fact, the, the goal of the G20 roadmap to enhance cross-border payments launched in 2020. The G20 roadmap aims to address both current market frictions impeding the efficiency of cross-border payments and, and also to shape the future of payments through the adoption of new technological solutions. So Martin mentioned many of the initiatives that have been going on globally, both in the central banks and in the big financial institutions, of course, also in the startup sphere.

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Of course, the International Monetary System— International Monetary Fund, that's where I work— supports countries in their efforts to improve cross-border payments. The Fund's role is to provide the necessary technical assistance and provide advice to help countries address market frictions and implement international standards. The IMF, of course, has the widest membership in terms of countries, the number of countries. We have 191 countries now. And, you know, with a focus on macrofinancial policies and experience in governance, the Fund is really well, quite well positioned to facilitate discussions on designs of newer solutions such as

platforms, financial platforms. And our report to the G20 published last year in October on financial platforms does exactly that. As you know, financial platforms— actually, Martin and Lucas mentioned quite a few of them in their paper. These are really digital infrastructures supporting the interoperability of money and assets, allowing peer-to-peer payments and trading. What is essential is that these different platforms to be interoperable with each other and have strong governance and wide participation. Of course, as you know, many of IMF member countries are also part of various different group— country groupings, gatherings, and the fora. What matters is that they are all committed to promoting global stability and openness of international trade and the financial system and cooperating to address global economic challenges.

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I think if we have a common goal, then we have some common ground to ensure the interoperability and continued integration of the international monetary system. With that, let me stop here, and of course, I will be happy to take questions. Thank you.

[02:59:44.18] - Federico Steinberg

Well, thank you all. We have about 20 minutes for questions. I'm going to start with some observations and some questions and wait for you to come up to the mic also. Well, the first thing I was thinking about the central bank digital currency, and I remember a conversation with someone from the ECB quite recently that told me that CBDCs were a solution in search of a problem. So maybe there's something there, and that's why, you know, we've had a lot of research, a lot of interest, but then lately not much action. Um, but I, I have two groups of questions, uh, for you three basically. Uh, many of you touched on, on this. So the first thing would be on the literature on the economics of global reserve currencies. You did a great job on analyzing most of the factors, but people like Jerry Cohen always point out that, uh, you know, the elephant in the room at the at the end of the day is the linkage between economics and security and defense. So in a way, you know, this example of at many points in time it was not really a good idea for Saudi Arabia to continue invoicing oil in dollars.

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Maybe they wanted to buy BMWs from Germany. It was perhaps a better idea to sell in euros and avoid exchange rate risk. But they did so because of the security security umbrella. So the question would be, to what extent with this new geopolitical landscape this is an issue or not really? That's something I just put on the table, the, the security umbrella of the U.S., uh, perhaps the changes of the new administration regarding that. Um, the other thing has to do

with, uh, why doesn't the Europeans like secondary sanctions if they seem to be so powerful? And, you know, is that something— maybe Martin, you mentioned it, or Lucas. And the third one, Eichengreen has recently argued that the role of the dollar as a hegemonic currency— and he's perhaps the big name here for everything, the network externalities and the analysis of the rise of the dollar and the exorbitant privilege— to what extent, as he says, any risks to the dollar come from domestic economics and politics, he would argue, and the management of debt and the role of the Fed, etc. So perhaps you can tackle these three as you would like, and then we can open for, for all the other questions.

[03:02:22.14]

So please.

[03:02:24.15] - Martin Chorzempa

I guess I can start on that. Why do the Europeans not like secondary sanctions. I think they sometimes like secondary sanctions, like when they're on Russia. When you agree on the target, then the power of US sanctions are really helpful. When you disagree on the target, you have a lot of friction. And I think that kind of links up with some of the other questions around if US sanctions are perceived as legitimate by much of the international community. For example, in the Russia case, you know, they were joined by every other major major reserve currency issuer except China, which you can say isn't really a reserve currency issuer that much yet. And therefore it didn't really have as much impact. But when the US overreaches, it creates a lot of risk. So the US has so far not used sanctions on China in any major way. They've sanctioned many Chinese individuals, companies, very— we've done some really good analysis here, me and some co-authors, looking at And you can't find a single major Chinese bank or major Chinese company that's on the US sanctions list, which is quite extraordinary restraint considering the frictions in that relationship.

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But that could change. And so I think the greatest risks to the dollar really would be, one, sanctions on China that would be perceived by the international community as going beyond what they would want to do, trying to cut off extraterritorial territorially other countries trade with China. And then secondly, something we're concerned about, independence of the Federal Reserve, credibility of US economy and its centrality in these financial networks. If we start seeing erratic policymaking and kind of runaway inflation because the Fed is, despite inflationary pressure, not raising rates because it's pressured by the president, something like that, that's a major risk to the dollar.

[03:04:14.19] - Lukas Spielberger

As well? I guess so. So, I mean, these are all very important questions. I guess on the link between security policy and currency internationalization, we can emphasize that all the aspects of the Chinese efforts to promote the renminbi that we discussed were not linked to any direct coercion or anything of that kind. So I think if security plays a role, it's more in the background rather than that there's kind of an instrumental way of coercing countries to use our currency. I think that maybe was something in the 19th century, but not sure to which extent we still do that today. The other issue is how much domestic foundation the U.S. is willing to continue to provide, and Europe for that matter as well. In Europe, the wind is shifting in a different direction. The ECB has recently thought about how it can align its stance on the international role of the euro with the EU's general pivot towards what it's now called open strategic autonomy. And this is an ongoing discussion. There was recently a first large report published by the ECB. So this is generally something if we think about how, how if you issue an international currency, you can align that with, on the one hand, central bank independence, on the other hand, conformity with broader international economic policies.

[03:05:29.20]

I think that's the challenge for everybody. And then maybe the Chinese have gone a bit further in terms of coordinating these two than more liberal systems have been to this point.

[03:05:40.29] - Dong He

So I think on your question on the use of instruments for national security purposes, payments availability, I think one way to think about this is that what is important is to have a rule-based system and with minimum uncertainty. I think certainty itself or the ability to stick to rules, I think that's important for financial market infrastructure. So I think there is a— a set of international standards for some under FATF on recommendations of sanctions. As long as these rules are followed, I think from an international payments system point of view, I don't necessarily see a great issue there, but it's important to follow the standards. That's it.

[03:06:45.02] - Audience

I have one question here.

[03:06:46.22] - Lukas Spielberger

Sure.

[03:06:47.10] - Audience

I'm Joe Gagneux, Peterson Institute. My question is for all the panelists, although it relates to something, a section that Martin talked about. And you talk about different metrics of the dollar's role with reserve, share of reserve currency, share of trends, exchange rate settlement, share of invoicing, and the dollar is number one on all those metrics, but it's not above 90% on any of those metrics. It's often well below that. So there are other competitors that people are using already. My question is, if we imagined the role of the dollar and the euro on these metrics being reversed so that the euro was number one and the dollar was number two, would that change the power of U.S. Sanctions to any significant extent? That would be my question. And I— my answer would be no, uh, not at all. Uh, and just make two quick points. One, on the SWIFT and Iran, uh, issue, uh, it's not that SWIFT couldn't use euros to route transactions for Iran. It could. The problem was not a currency issue, but it was an ownership and participation issue of U.S. firms. U.S. firms are owners of SWIFT. They participate in SWIFT.

[03:08:09.23]

And if U.S. law forced them to withdraw, that would be very disruptive. It's about the size and the presence of U.S. firms in SWIFT. Similarly, the CHIPS system that Martin mentioned in New York for foreign exchange transactions into dollars, well, you could imagine that if third countries companies did all their transactions in euros, which they could already, and it isn't much more expensive for them to do that, then they don't have to use chips. What chips really— where it comes into play is if anyone's doing business with a U.S. firm, if they want to make a payment to a U.S. firm or receive a payment from a U.S. firm, they're going to have to do some transaction into or out of dollars. And that will be true regardless of whether the dollar is at all an international currency. It could have a zero share in some of these measures practically. And people are still going to have to make payments to US firms or receive payments from US firms, which are very big. And that's the bite of the sanctions, it seems to me. But perhaps I'm wrong.

[03:09:11.08] - Martin Chorzempa

Really good question. So if you think about the extent to which secondary sanctions supply, I think that's really right. So if the US dollar goes down a bit and we have a multipolar world where the renminbi— let's say, going further in your scenario and say the renminbi and the US dollar are kind of equal, you'd have to have this question of, are there enough firms that are willing to say, I will have no links with the United States and will just trade with China and whatever countries I can deal with that are using the Chinese system, then there's limited, limited ability to get around those sanctions. But I think that's often overly talked about. And then

the ECNY is discussed as sometimes in the US as, oh, this is a sanctions buster, but that's kind of a daring the US Treasury to then sanction the Chinese central bank operating the ECNY. So really that becomes a political question. The reason I'm a little bit hesitant to lean into saying it doesn't matter in your framing is that I think if the US dollar share goes down quite significantly, there could be a bit of a sudden difference.

[03:10:22.06]

So Gopinath and Stein have a really interesting paper where they kind of argue this kind of movement, like Khodong was mentioning earlier, you know, we don't have very many historical examples, but you do. If you do some modeling, you see that movement, because there are so many network effects that are self-reinforcing, if one of those or a couple of those metrics go down enough, you could see a big shift quite quickly. And Eichengreen's work has shown that there was some fluidity between the dollar and the pound at different points. But if there's a lot less need to go through the dollar because, for example, the dollar isn't sitting between a transaction between Malaysia and Korea, or between China and Indonesia, like it is now, then there's a lot less visibility of the US into those transactions. So the US could still try to impose sanctions, but would it even know that the payment is happening? Not clear to me. So it would reduce a lot of US power, and the whole, the threat of losing access to the US would be a lot less potent, I would think, if there were readily available, cheap systems that could be used that were alternatives to it.

[03:11:30.18] - Lukas Spielberg

Well, I mean, my addition to that would be is that if we want to envisage what a multilateral currency order looks like, it's not that countries would neatly separate into blocks, right? But it's much more about their positions within networks, as you said. And then as such, it would be basically about exploring different pathways to executing the same payments. In that sense, the existence of a credible alternative would not per se undermine continued existence of trade links of non-sanctioned entities, but it would just mean that you might effectively within the countries have parallel tracks executed. And to some degree, I think that has been explored in China in the context of the sanctions against Russia, but not at scale.

[03:12:13.28] - Audience

I have another question.

[03:12:15.13]

Nick Lardy again.

[03:12:16.14]

Peterson.

[03:12:17.10]

My question is for Lucas on swap agreements. I know almost nothing about this, but my understanding is that they're kind of contingent agreements and they may be drawn down or they may not be drawn on. And my understanding from listening to your presentation, you were mostly, maybe exclusively, talking about the agreements, and you didn't say very much that I heard about the extent to which any of these agreements are actually exercised. And my question is, is that easy to track and what does it tell us, if anything?

[03:12:51.27] - Lukas Spielberger

Okay, well, yeah.

[03:12:53.16]

So the swaps. On the Chinese side, there was recently a paper by Sebastian Horn and co-authors where they actually went through China's use of these swap lines. So they were very clearly, year by year, through which countries country drew on these swaps. So the main repeat users are Argentina, Russia, but also places like Zimbabwe and Laos. So it is all over the place. And actually, the volume to which these swaps have been used, particularly since 2014, is quite considerable. I think it's more than \$100 billion equivalent. Many of these swap lines, on the other hand, have languished unused, in part because the Chinese have swaps with the Bank of Canada or the ECB or the Bank of England who don't really need that RMB liquidity, if you think about it. But also because other smaller countries actually didn't need it for invoicing in renminbi as much as was thought under kind of this trade hypothesis. And that's why you've had the shift towards more use in bailout. But again, the way in which the Chinese have pushed these and linked these to trade. And very often you also have these announcements when a swap was set up that they said, we had set up the swap and at the same time we create an RMB financial hub here in Budapest or wherever that happened.

[03:14:12.05]

So very often it was also linked to financial diplomacy when it was done. And this is just very, very different from the way in which the Fed and the ECB have set up their facilities, if you think about it, because the— for the the Fed, it was always the main concern of providing liquidity to

the global financial system and to global financial centers, right? And this systemic concern is in that sense less pertinent for the Chinese, who are much more concerned with basically using these swaps as a backstop to further efforts of making their currency attractive.

[03:14:45.19] - Federico Steinberg

Well, thank you very much. Oh, another one. Sorry, Mary.

[03:14:53.05] - Mary E. Lovely

Quick question. So we heard earlier about the issue of the U.S. overall trade deficit and the Chinese surplus. And some observers point to the exorbitant privilege of the dollar and the need for the U.S. to run deficits for the international accumulation of dollar-based assets. So as someone who's a microeconomist, as a microeconomist, not a macroeconomist, can we solve the imbalances and still have the dollar as the dominant currency and, you know, store of exchange function of the dollar?

[03:15:33.19] - Dong He

Thank you, Mary, for that question. It's a commonly asked question. So I think I would I would say really there's no direct linkage between your current account balance and the use of the currency as an international currency. So basically, historically, you could envisage countries like the UK or the US when they provide international liquidity, it's really a financial intermediation at the national level. That does not actually require you supply dollars or the British pound through the current account. So financial transactions themselves would be sufficient to provide the liquidity. So there's not really any direct relationship between the current account status and status of the reserve currency.

[03:16:29.18]

I can talk about it.

[03:16:34.04] - Federico Steinberg

Well, thank you. We are finishing on time, so I would like to thank the Peterson Institute, particularly Mary, for, for putting this together, and also our friends from Brussels coming over. Now we have a lunch. I invite everyone to stay, and to people online, this will be available with the presentations. So thanks a lot, see you next time.