Will US trade policy become protectionist under President Obama?

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This is a short briefing note on US trade policy in the coming years. Anything said at this point in time about what Obama is likely to do is based on a big dose of speculation. This note is no exception.

Carter or Clinton?

What will Obama do with US foreign economic policy? I would pose the question like this: are we looking ahead of a Carter style Presidency or a Clinton style Presidency? I think there is a clear risk that the former is a likely scenario. As all presidents Obama will be a pragmatist interested to be reelected. He is a politician. The chief influence on Obama's policies will be events (remember Harold Macmillan's response to what would set his government off track: "events, dear boy, events") – that is, developments the US has to respond to, regardless ideology or previously held views. As all presidents, he will be hostage to these developments, and also to the way in which other countries respond to them.

The financial crisis and the economic recession are the prime events that will shape Obama's economic policies in the first years. The policy response, so far, has not been a 1930 style increase in protectionism. I find such a scenario unlikely. I think we, rather, are seeing a 1970 style crisis response: A strong "shock" is responded to by not directly protectionist measures but with policies that subtly and indirectly will have consequences for US external relations and its global economic integration.

Firstly, there is a new, strong push for domestic regulatory agenda – for new regulations of capital markets, in particular. In the US there is also likely to be a push again from regulations of the labour market (yes, Obama will have to deliver on his promise to the trade unions). There is a raft of other legislations discussed as well, and the financial crisis has spirited people who believe in regulations and/or big government. Most domestic regulations have implications for a countries' economic relation to other countries. The brewing domestic regulatory agenda in the US will affect its trade and trade policy (capital account as well as current account), but not directly. The effects will be indirect and more subtle. Overall they will enforce the existing trend of an economically defensive, inward-looking America.

Secondly, the crisis/recession has set off a tit-for-tat subsidy race. Industrial sectors and businesses receive subsidies (not only the financial sector) to weather the economic storm, but as one country props up some sectors/firms others are inclined to follow for the simple reason that their producers are in the same position and will get negatively affected by other countries' subsidies. Likewise, as one sector receives subsidies others sectors within the same country will demand it, too, to avoid negative effects on them. This process has already started, in the US as well as in Europe. It is also what happened during the 1970s. Carter inherited such an agenda, partly created it.

Thirdly, Obama will be strongly pushed by key constituencies in his party to expand government programs on social security, especially at a time of economic recession and high unemployment. Carter was constrained by economic conditions but led an expansion of social security and government. Clinton, remember, went in the other way after his first-years agenda collapsed, and declared in 1993 “The era of big government is over”. Regardless the merits for government programs, they tend to enforce an inward-looking mentality. Depending on their design, they could also impede on job creation. Obama leans much more to the Carter view.

The 1970 policy response to the crisis became a precursor to the “long decade” (mid 1970s to early 1990s) of “managed trade”, the view that guided US trade policy and prompted the raft of actions against other countries, primarily Japan, under antidumping legislation and the so called super 301 provision (US could unilaterally “punish”- or retaliate against – other countries without necessarily respecting global trade rules). The managed-trade idea is clearly in ascension again. This time it is not Japan that is in the limelight, it is China (see more below on US China policy).

Carter also had a democratic majority in Congress. His party pushed him to the left, made him weak and prevented him from taking decisions. Carter ended up in the knees of the trade unions, which are notoriously protectionist in the US. Obama, too, is faced with an increased Democratic majority, and it is certainly a sign that the policy director of the AFL-CIO claims to be the architect of Obama’s trade policy views in the campaign (this is what she – Thea Lee – recently claimed at an AEI conference). There are many differences between the two men – and I first hesitated to associate him with Carter. But the question is: will such differences matter? Obama will have to choose carefully the areas in which he takes a fight with the Hill. I believe he will let the trade and globalization agenda be one of the currencies he will use to get the Congress’s support for other decisions he wants to take and that do not go down well with democratic constituencies.

What speaks against this hypothesis is that Obama seems inclined to surround himself with people from the Clinton presidency – also on the trade front. Dan Tarullo, a former Clinton aide, has been Obama’s chief trade-policy adviser and it has been speculated in the media that he is line to become the next USTR. Tarullo is overall solid (although with some typical prejudices that run against free trade). Lael Brainard, also a former Clinton economist, is also rumored to be on the short list for the USTR. Currently an economics director at the Brookings Institution, she is overall a pro-trade person, but she is more to the left of the party than Tarullo.

Effects on the Doha Round?

I don’t think Obama will have any considerable influence, positive or negative, on the Doha round. Obama is a multilateralist, but not so much on trade issues. He has issued some notes of skepticism about whether a Doha deal is to be preferred. More importantly, the Doha round is in such a bad shape that it would not matter much if Obama actually desired revived negotiations and a serious result - in line with what the Bush administration has desired and called for. The round will not be revived until early 2009 – at the earliest. India goes to election in the spring, and nothing will change in their policies until the election is over. The Congress party has a weak coalition, a weak leader, and its trade minister is as “Old Congress” as they come. He also has higher political ambitions, and knows he won’t get them fulfilled if he signs a Doha deal shortly before the election. Peter Mandelson’s departure from Brussels, and the appointment of a new trade commissioner in Europe, prevents any efforts by Europe to take the lead to revive Doha negotiations, and nothing will change in Europe till the new Commission comes in next autumn.

If Obama agrees to revive the negotiations, he will have to get a Trade Promotion Authority (fast track mandate) before his administration can participate in a meaningful way. Bush's TPA expired last year, but he has continued to negotiate in the belief that a deal could be signed before he leaves and that his successor will be "forced" to put all his efforts behind an attempt to get the Congress to ratify it in an up-or-down vote. This belief was wildly unrealistic when it was designed, and even more so now.

At some point Obama will take up issues related to trade negotiations, and perhaps ask for a TPA, but I have a hard time seeing that he will emphasize the WTO agenda in that TPA – especially at a time when also the main business coalitions (let alone the trade unions) are going cold on Doha. NAM, the manufacturers association, have clearly stated it is dissatisfied with the likely Doha deal since it doesn't give them any new market access to emerging markets. CSI, the services association, have been cold on Doha for a long time since services generally have been off the agenda. The farmers with an export interest are currently unhappy with what's on the table. So – who would help Obama to get a TPA through the Congress?

Free Trade Agreements

Obama's voting record in the Senate suggests he is not a friend of the FTAs that are up for ratification in the Congress. The US has finished deals with Korea, Columbia, Peru and Panama – and all of them have been blocked by the Democratic House majority. There has been a lot of politics behind, and some of the politicization has gone away.

However, if Obama is true to his promises, these finished deals will be sent to renegotiation before he will submit them to the Congress. It probably won't be difficult to renegotiate them and integrate some labour and environmental standard as long as they are not strong provisions with clear effects on trade. There is a view saying the Democrat's want to have labour and environmental provisions to enforce an establish practice to have such provisions in an US FTA – to continue to set examples. Thus, they are principally not there to press for regulations that seriously would impede trade. I believe it is possible get some of these provisions into these FTA agreements without them having any significant effect on trade.

Renegotiating with Korea will be difficult. Korea will probably be offended by requests by the US to introduce such provisions when Korea already is a signatory to most international labour and environmental agreements. Nor is Korea inclined to agree to add another element of market access liberalization in the car sector (US car makers want a better deal and Korea is a car protectionist).

Furthermore, the support for the agreement has also weakened in Korea. The new president is not as strong as he hoped to be, and there have already been plenty of demonstrations against the deal, primarily on the ground that it will subject Korean beef farmers to greater competition. The beef also have a longer story as Korea recently blocked a delivery of American beef on the grounds it had sanitary problems. Also, remember that a Korean beef farmer committed suicide during the WTO meeting in Cancun 2003 because the new competition a trade deal would mean to him would kill him anyway.

So, a new negotiation with Korea is bound to lead to further problems preventing a new deal to be done.

Despite his previous positions, Obama cannot resist getting a ratification of the agreement with Columbia. It is one of few friendly countries in the region and the US cannot afford to lose Columbia and push it towards the anti-US, Chavez camp. I think the Peruvian agreement will get through the Congress as well. It would be too embarrassing to US foreign-policy ambitions in Latin America if it could not ratify the deal.

Will NAFTA be revisited?

Obama cannot backtrack on his promise to take an initiative to open up NAFTA for renegotiations. This request is bound to come during 2009. I am still not certain what Obama has been playing at – if anything – in terms of real substance. There are many US trade scholars that call for an <u>updated</u> NAFTA. But an update NAFTA is not a NAFTA that dilutes current trade openness and take away existing trade. But my interpretation of Obama's view on NAFTA (and his views are conflicting) is different: he wants a renegotiation that introduces new regulation (also enforceable labour and environmental standards) of trade and restrictions on investments.

I believe it is highly unlikely Canada and Mexico will agree to such negotiations. I also believe Obama's passion for renegotiation will be tempered by the fact that the two NAFTA partners are the two biggest foreign oil suppliers to the US. The US also has preferential access to oil deliveries under NAFTA, and Obama must be prepared to give these preferences away if he opens serious negotiations. Regardless Obama's dislike for oil, a new spike in oil prices he is not wishing for, especially not on the brink of a deep recession.

US China policy

The China policy is one area where Bush actually achieved some good results. But China policy will be revisited under Obama. He has made strong pledges on China protectionism and I don't think he could neglect them entirely during his first term. But his views will be tempered, primarily by two factors.

Firstly, the economic China strategy set up by Hank Paulson has worked well. China bashing in the Congress has been contained in the last two years (no new calls for a general 27,5 tariff on all Chinese exports to the US) and the US has managed to get improved market access to China's protected services markets, plus other improvements, such as in IPR enforcement and environmental technology. Paulson's Strategic Economic Dialogue has been one part of the new strategy. The other one have been using the WTO dispute settlement system to get change in some of China's dubious practices (hidden subsidies, IPR violations, tariff increases, etc). Obama will probably want to put his own touch on this approach, but if changes track he does it at the clear risk of not getting anywhere with China. Paulson's record stands in stark contrast to the non-achievements in the years prior to the new strategy.

Secondly, the US government and firms need good relations to China to have continued access to its capital reserves and to ensure low interest rates. Furthermore, turning towards China protectionism at a time when money supply has been growing at unprecedented rates (financial crisis response) and when inflation is bound to be pushed (will take some time, though) by all the measures pumping liquidity, is close to economic madness. Nuff said.

There is likely to be a move against China's exchange-rate policy (code word for currency manipulation), and the alleged ensuing current account deficit, but that will probably come through the various meetings coming up on a Bretton Woods II system. When Wall Street and Alan Greenspan no longer can be charged with all the bad things that have happened in the world of finance, the focus will again be directed towards the capital surplus countries and their "flooding" of the world with cheap cash in the last years

Transatlantic economic relations

Transatlantic relations will be at its high point in the coming months. But I don't see that an Obama administration will have any significant effect on current economic relations. There are a few disputes between the EU and the US in the WTO system that will mature in the years to come. The big one is between Boeing and Airbus, and that has already become a bloody fight. I don't think there is a legal solution to this dispute – and a legal ruling favouring one of the sides would hardly be respected by the other party. Obama will not be more inclined than Bush to lower US subsidies to Boeing, if they are ruled against, and any move that would hurt Boeing is unlikely as it is such a big company with too many Democratic-leaning workers.

Another case coming up is on EU's tariff reclassification of technology products, and Obama is likely to push for American interests if needed. The group and the law firm behind the US complaint also have strong Democratic connections (this law firm has on its staff a former USTR under Clinton and a former Clinton deputy USTR) and have already used them.

There might be a new push in the Transatlantic Economic Council. So far the work in this council has been a great disappointment. After almost two years of work on regulatory harmonization, the two parties are still debating regulations for how to wash chicken (could chlorine be used or not?). Interest has been declining on both sides. When I met with the US sherpa for these talks some time ago he clearly indicated that he was not interested in this issue. On the European side the leadership has been far too weak and uncoordinated. Ideally, a new administration could revitalize these talks, but that will not happen until the new Commission has arrived in late 2009.

Climate change policy

Obama will certainly press ahead with a new climate change/carbon reduction policy and sign an international agreement with obligations to that end. A domestic initiative is likely to come before we will see the contours of a post-Kyoto agreement. There is already a bill in the Congress, the Lieberman-Warner bill, but it was shelved some time ago. It is highly likely to be brought up again soon. This bill establishes a cap-and-trade system along the same lines as EU's Emission Trading Scheme.

There is likely to be a clear trade effect coming from new initiatives on carbon reduction. In fact, false perceptions of trade effects from climate change initiatives are likely to become the mother of 21st century protectionism. Lieberman and Warner suggested to introduce a carbon tariff (or border-tax adjustment as it is popularly called) in this cap-and-trade system. It seems likely that a new proposal will have such a mechanism, especially if China, India and other merging countries do not agree to bind their carbon emissions in a new global agreement. A carbon tariff, however, will have no effect whatsoever on the climate – it is there to limit damages on the competitiveness of firms – and is thus unlikely to stand the test of WTO legality. Obama will have to engage in a fight with his party, however, if he decides to avoid a WTO conflict and heads for a cap-and-trade scheme without trade-restrictive measures.