Chapter 11

"First, Do No Harm"

Foreign Economic Policy Making under Barack Obama

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It was the first full week of the Obama presidency. On Monday, January 26, 2009, U.S. businesses announced plans to lay off more than 55,000 workers—a huge economic hit for a single day. On Tuesday, the president journeyed to Capitol Hill for nearly three hours of meetings seeking support from congressional Republicans for massive economic stimulus legislation. On Wednesday, the House passed its $816 billion bill, with zero Republicans voting in favor. Thursday brought front-page news that that bill contained a provision requiring projects that it funded to use made-in-America steel, posing a frontal challenge to U.S. trade policy. On Friday, the Commerce Department reported that the U.S. economy had declined 3.8 percent in the fourth quarter of 2008, the worst performance since 1982, with expectations of an even greater decline for the first quarter of 2009.[2] That same day, the president was forced to telephone Chinese President Hu Jintao to disown a statement, submitted by his tax-embattled Treasury secretary nominee during confirmation hearings, that the new administration had concluded that Beijing was "manipulating" its currency for trade advantage. Meanwhile, multiple global leaders—notably the premiers of China and Russia—were denouncing, at the world economic forum in Davos, Switzerland, the U.S. role in precipitating the worst international economic crisis since the Great Depression.

All in all, it was a rugged week.

To address these matters, Obama had been assembling his own high-powered team, which would lead the eclectic welter of U.S. trade and economic policy agencies in some form of policy renewal. Yet his early presidency would exemplify a paradox. As a person, he was the epitome of globalization:

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father from Kenya; childhood years in Hawaii and Indonesia. Yet in the economic sphere, his focus was overridingly domestic. The international economic issues he would address in his first fifteen months were, by and large, not issues that he chose but issues that were thrust upon him.

And his responses to these issues were minimal. He took care not to move backwards, not to seriously impede present and future international cooperation. In the words commonly attributed to the ancient Greek physician, Hippocrates, Obama would "first, do no harm." But he would not embark on the type of bold new initiatives that were otherwise characteristic of his early presidency. To put Obama's challenge in context, we must go back into history, into how the United States came to have the government he inherited for the conduct of international economic policy. At least four historical imperatives generated today's official institutions.

The Institutional Prologue: Depression, War, and Economic Challenge

The first imperative was represented by the Bretton Woods Conference of 1944, where officials from Allied nations met to build the basis for the postwar international economy. To avoid a repeat of the economic malaise of the interwar (1919–39) period, they agreed to create two global institutions: the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (now "the World Bank"). In the U.S. implementing legislation, the Department of the Treasury was assigned the task of representing the United States at these two institutions, a responsibility it has retained to this day. There was a subsequent conference at Havana that sought to establish a parallel body, the projected International Trade Organization. This proved stillborn when Congress failed to ratify its charter. But an "interim" organization, the General Agreement on Tariffs and Trade (GATT), proved surprisingly effective in establishing rules within its sphere over the first forty-five years after World War II, until at last the World Trade Organization (WTO) opened its doors in January 1995.

The second U.S. imperative was essentially domestic—to legislate policies and institutions aimed at preventing a recurrence of the Great Depression. Reflecting the new doctrine of Keynesian economics, the Employment Act of 1946 made it the responsibility of the federal government to "promote maximum employment, production, and purchasing power." To propose policies to achieve this, the Act established a three-person Council of Economic Advisers (CEA) in the Executive Office of the President, which would report annually to a Joint Economic Committee of the Congress also established in the legislation. Both institutions were just advisory, and a more potent role in achieving this objective would be played by the Federal Reserve Board (the Fed) and its chair. But the Employment Act laid down a marker: Americans

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would henceforth hold the federal government responsible for keeping the economy running at full steam.

The third imperative began as a response to the postwar economic crisis in Europe. Faced with a continent ravaged by war and a particularly cruel winter in 1947, the United States responded with the Marshall Plan, a uniquely far-sighted program that put resources in the hands of Europeans, provided they joined in a coordinated reconstruction effort. Abroad, this sowed the seeds of what would eventually become the European Union. For the United States, it established a new policy sphere under the generic label of "foreign assistance." The Eisenhower and Kennedy administrations shifted priority to the developing nations—with bilateral programs under what became the U.S. Agency for International Development (USAID) and multilateral aid through the World Bank and the United Nations.

Fourth, and particularly important for the evolution of U.S. foreign economic policy making, there was the challenge posed by the nations who became our economic competitors. First it was the uniting Europe, then Japan, then East Asia more generally. In the early postwar period, U.S. manufacturing had been globally dominant, and the U.S. economy was remarkably self-contained. In 1950, U.S. imports and exports were each about 5 percent of domestic goods production. But this would rise, using rough figures again, to 9 percent in 1970, 20 percent in 1980, and 29 percent in 2000.[3] The political response would rise also. U.S. producers thought it acceptable for international economic policy to be a handmaiden of foreign policy—as long as they were not overly affected. However, the internationalization of the U.S. economy led logically to greater domestic concern over, and influence on, U.S. economic transactions with the world.

An early harbinger came in 1962, when President John F. Kennedy sought expanded statutory authority to negotiate reductions in trade barriers, particularly with Europe. Legislators were reluctant to grant this if State Department officials continued to lead the negotiations, as they had done since the Reciprocal Trade Agreements Act of 1934. Those diplomats were competent enough, said House Ways and Means Committee Chair Wilbur Mills, but they didn't understand U.S. industry and were not sensitive to its needs. So Kennedy agreed, reluctantly, to the creation of a "special representative for trade negotiations" in the Executive Office of the President to lead the negotiations. The office would expand over the years—gaining Cabinet status in 1975 and a more permanent-sounding name in 1980—United States Trade Representative. It would also become, over those same years, more and more responsive to U.S. domestic economic interests.

A bit later began a parallel trend—the movement of responsibility for coordinating international economic policy away from the National Security Council to institutions created to give priority to the economic side of these issues.

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The dollar crisis of 1971, highlighted by President Richard Nixon's decision to abandon our currency's link to gold, led to establishment of the Cabinet-level Council on Economic Policy (CEP) under Secretary of the Treasury George Shultz, which operated parallel to Henry Kissinger's National Security Council (NSC). Subsequent administrations established comparable Cabinet-level committees. Bill Clinton renamed and elevated this function by establishing the National Economic Council (NEC) in 1993 (Destler 1996), and his successors retained that organization. Its focus was domestic as much as international, but both institutionally and practically it highlighted the economic policy links between the two and diluted somewhat the links between international economic policy and international security.

So by the time Obama came to office, authority over foreign economic policy was being exercised by an eclectic set of institutions and actors—and only one of primary actors (Treasury) was a department headed by a "Secretary." Interestingly, this meant relatively little attention to Obama's economic appointments by a press fixated on who would be named to the fifteen "Cabinet" positions.

But Obama did not just inherit institutions—he also inherited what was arguably the worst economic situation confronting any new U.S. president since Franklin D. Roosevelt.

The Subprime Prologue

The crisis had been years in the making. Among its broader causes was a global credit explosion, fueled by undersaving in the United States and oversaving in East Asia. The United States ran huge trade deficits, requiring foreign capital to finance them. China and Japan in particular provided this capital, which was generated by their large international surpluses. This mass of capital needed specific destinations, vehicles where it could be placed and rest secure and/or earn good returns. U.S. Treasury bills met part of this need. But private financial institutions rushed into this market also by developing higher-yield securities. They also developed instruments that allegedly protected investors from loss, such as the now-infamous "credit default swaps" pioneered by the insurance giant American International Group (AIG).

A particularly creative area for new investment vehicles was real estate. Rapid appreciation of U.S. home prices through the mid-2000s generated unprecedented demand for investment in home mortgages. Banks and financial houses responded by packaging mortgages in securities that they marketed worldwide. To expand the market further, lenders lured financially marginal buyers by offering initially low, "subprime" interest rates, which would typically rise sharply after a few short years. Some loans were truly egregious—dubbed "Ninja loans" by industry insiders since the recipients allegedly had "no income,

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no job." But because these loans were packaged together and marketed to unsuspecting investors, those who originated them did not bear the risk.

The securities were solid only if prices continued to rise. But in the second quarter of 2006, U.S. home prices peaked. They declined moderately for the next year, then more severely.[4] This put holders of mortgage-based securities at risk. By late 2007, the market was facing serious problems. The Federal Reserve responded aggressively. It reduced the federal funds rate by a full 1 percent in the last four months of that year and an additional 1.25 percent in the single month of January 2008. It also poured money into banks and investment houses, this action capped perhaps by the government takeover of AIG in September 2008. Congress passed a $168 billion stimulus bill in February, and when bank credit froze in September, it enacted, reluctantly, a financial rescue package of $700 billion aimed at saving banks whose balance sheets were laden with bad mortgage debt.

The George W. Bush administration had responded aggressively (if somewhat belatedly) to the crisis, with Treasury Secretary Henry Paulson in the lead, but its economic stewardship was discredited nonetheless. In the three presidential debates, the cool and cerebral Obama gained support vis-à-vis his more impulsive and less informed adversary, John McCain, and the Illinois senator rode to a decisive 365–173 electoral victory in November. He also became the first Democrat in the past ten presidential elections to carry a majority of the popular vote. Obama set to work immediately to assemble a strong Cabinet and White House staff, with particular emphasis on the economy. And he engaged selectively in influencing policy during the 76-day transition period.

Still, Obama entered office under the bleakest economic circumstances confronting any president since the Great Depression. And what started as an *American* crisis centered on *finance* had become a deep global economic downturn, as it turned out that many foreign banks had been similarly egregious in making unsafe real estate-based investments. The International Monetary Fund (IMF) would report that the world's "advanced economies experienced an unprecedented 7½ percent decline in real GDP during the fourth quarter of 2008" (IMF 2009, xv).

Each nation necessarily viewed the Great Recession first and foremost in terms of its own dire situation, of course. And national measures were aimed primarily at turning things around at home. But there was broad recognition of the need for international cooperation. It was not just Ben Bernanke, economic historian of the Depression years and now chair of the Federal Reserve Board, who recalled the "lessons" of the 1930s—the Smoot-Hawley Tariff and its foreign emulators; Franklin Roosevelt's torpedoing of the London Economic Conference of 1933. Both were viewed, with benefit of hindsight, as "beggar-thy-neighbor" efforts of nations to fuel recovery at others' expense—through new trade barriers and manipulation of exchange rates that ended up making

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world recovery harder. Obama's predecessor had recognized this when he invited twenty heads of state and government to Washington in November 2008 to consult and coordinate their responses. Obama would play a lead role in two such G-20 meetings in 2009—the London conference of April and the gathering in Pittsburgh that he hosted in September.

The new president faced other serious international economic challenges as well. The Doha Round of international trade talks, launched in 2001 under the auspices of the World Trade Organization (WTO), remained stalled, notwithstanding eleventh-hour efforts by the Bush administration to break the impasse. There were also three bilateral free trade agreements, controversial within Obama's Democratic Party, which the Bush administration had signed but Congress had not ratified. This unfinished business came after a year when public anxiety over globalization appeared on the rise and support for trade liberalization seemed to be waning—a Pew Center poll the previous year had found that 48 percent of Americans believed free trade agreements to be a "bad thing" for the country, the first time a plurality had taken that position since Pew began asking the question in 1997 (Pew Research Center for the People & the Press, 2008b).[5] Reflecting this chilly political climate, the advisory report of a twenty-two person advisory group convened by C. Fred Bergsten, director of the Peterson Institute for International Economics, a group that included two former U.S. trade representatives, highlighted "the political backlash against further trade liberalization" caused, in part, by "the lack of a national strategy that responds effectively to economic dislocation." The recommended response gave priority to measures in pursuit of such a strategy: not until page 9 (of its 12-page report) did the group address the specific topic of trade policy (Trade Policy Study Group 2008).

Looking Homeward

Like the typical Democratic presidential candidate, Barack Obama emphasized the domestic impact of trade policy during his campaign. Mainly in response to an opponent, Hillary Rodham Clinton, who had broad appeal to labor unions and globalization skeptics, he expressed opposition to Bush's free trade agreements in their present form and called for renegotiation of the North American Free Trade Agreement (NAFTA). He did not emphasize trade once he secured the nomination, however, and his Republican opponent, John McCain, was not able to use his earlier statements against him. But the world was wary. The problem, however, was not that Obama would prove to be a "protectionist." Rather, it was where trade and international economic policy would rank on his list of priorities. His first purported choice for U.S. trade representative, House Ways and Means Committee member Xavier Becerra (D-CA), withdrew with the unhelpful but revealing observation that for Obama

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this policy issue "would not be No. 1, and perhaps, not even priority No. 2 or 3" (interview with editorial board of *La Opinion,* quoted in "Becerra" 2008).

Hence, unlike his two Democratic predecessors—Jimmy Carter and Bill Clinton—Barack Obama did not begin his presidency with a strong focus on *foreign* economic policy. He had, during his campaign, pledged a renewal of American global leadership, with an emphasis on multilateralism. But the spotlight had been on Bush administration unilateralism in diplomacy and international security—Bush had in fact embraced multilateralism on trade. Obama recognized, of course, that the crisis he inherited had become global. But his first duty was to Americans, and that was his focus.

The big appointments were Timothy Geithner, president of the New York Federal Reserve Bank, as secretary of the Treasury, and former Treasury secretary Larry Summers to head the NEC as Obama's assistant for economic policy. Both were controversial. Summers's outspokenness on sensitive issues had led to his resignation in 2006 as president of Harvard University. Geithner carried two burdens—participation in pre-Obama economic rescue efforts that were criticized as overly generous to banks and a mishandling of income on his tax forms, which became a prominent issue during the confirmation process. Both, however, quickly became the dominant administration figures for this key policy sphere. Both were internationalists by conviction, but both necessarily gave priority to the domestic side. Other important economic appointments included Peter Orzsag, then head of the Congressional Budget Office, to direct the Office of Management and Budget, and Berkeley economist Christina Romer to be chair of the Council of Economic Advisers. She would prove to be exceptionally good at public articulation of economic policy issues. And towering over them all, perhaps, was Fed chairman Ben Bernanke, whose bold rescue efforts would later win him recognition as *Time* magazine's "Person of the Year" for 2009 (Grunwald 2009).

"The Fed" is normally thought of as an overridingly domestic policy institution, and its mandate—to be sure—is to protect and enhance the *U.S.* economy. But it operates in an era when the markets that it targets are globalized. When Bernanke collaborated with Bush's Treasury Secretary Hank Paulson and then-New York Fed President Geithner to rescue AIG in September 2008, a key decision (much criticized later) was to make whole the assets of those institutions that had unwisely placed their bets on the insurance giant. These included "nearly every major financial institution in the world . . . *Societe Generale,* the big French bank, had $4.1 billion at stake" (Wessel 2009, 192). To allow AIG to fail, Bernanke told Congress in March 2009, would have been "devastating to the stability of the *world* [emphasis added] financial system" (Wessel 2009, 195). To limit action to American holders of these assets would have been neither pragmatic nor effective. While taking these steps, in October 2008, with the crisis deepening and spreading, the Fed chair was also orchestrating a coordinated

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interest rate cut by the world's major central banks and winning, through Paulson, a commitment by the Group of Seven finance ministers to protect and restore financial markets worldwide.

These and the broad range of bold Bernanke measures were taken in 2008, prior to the Obama presidency. The Fed chair devoted 2009 to consolidating and extending these actions—maintaining the zero-to-0.25 federal funds rate set by the Fed's Open Market Committee during the presidential transition; targeting provision of credit to markets that weren't functioning, such as housing, student loans, and consumer credit. The magnitude and scope of these actions, taken largely on Bernanke's own authority (albeit in cooperation with administration leaders), turned the spotlight on the enormous power the Fed possessed. And though a strong case can be made that he deployed this power with extraordinary courage and effectiveness—keeping the Great Recession from becoming a second Great Depression—he also exposed the institution to political attack and potential congressional action to curb its powers. Hadn't the end result been to reward the bankers who had caused the catastrophe—Wall Street—while on Main Street, unemployment grew to 10 percent? To his many admirers, this seemed like the fulfillment of an old Washington rule: "No good deed goes unpunished." But he took more heat than any Fed chair in decades, placing his institution clearly in harm's way.

For the Obama administration, these political problems were unwelcome to say the least. Through 2009 and into 2010, frustration over the economy grew, and it became less and less useful and effective to blame the Bush administration. Bernanke worked well with the new team, Geithner in particular: they had gone together through the fire of fall 2008 and established deep mutual respect and trust. But trust between central bankers could only reinforce public suspicion that the rich of Wall Street had been saved while Main Street continued to suffer. (Bernanke took to the public media to rebut this argument: the only reason for the rescues had been to prevent a financial collapse far more devastating to Main Street than what had occurred.) His relationship with Summers was necessarily more complicated for one simple reason: his four-year term would expire on January 31, 2010, and Summers was generally thought of as the most likely choice if Obama decided to make a change. This created what must have been a certain tension between the two until the president resolved the matter with his August announcement that he would renominate Bernanke to a second four-year term.

The public controversy continued into January, and there was a day or two when opposition to Senate confirmation seemed to grow. The incumbent was attacked by Socialist Bernie Sanders (VT) and populist Russ Feingold (D-WI) from the left and by Richard Shelby (R-AL) and James DeMint (R-SC) on the right. But in the end Bernanke won broad bipartisan support: 77–23 to break the filibuster against his nomination and 70–30 to confirm. Solid majorities of

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both parties voted in favor, though the number of "nays" was the largest in the history of the office.

The G-20 Summits

One place where the president had to address international economic policy was at the meetings of the leaders of the world's major economies convened to address the global crisis. The first of these had been hosted by President Bush in November 2008, shortly after Obama's election victory. The second came on April 2, 2009, in London. Obama arrived there as the United States ended its worst economic quarter in decades, with GDP shrinking at a 6.4 percent annual rate. In his London press conference at the meeting's conclusion, he acknowledged the dire situation:

> The global economy is contracting. Trade is shrinking. Unemployment is rising. The international finance system is nearly frozen. Even these facts can't fully capture the crisis that we're confronting, because behind them is the pain and uncertainty that so many people are facing. We see it back in the United States. We see it here in London. We see it around the world: families losing their homes, workers losing their jobs and their savings, students who are deferring their dreams. So many have lost so much. Just to underscore this point, back in the United States, jobless claims released today were the highest in 26 years. We owe it to all of our citizens to act, and to act with a sense of urgency (Obama 2009e).

He then went on to underscore how the recession was a world event, reflecting the fact that "our economies are more closely linked than ever before." Nations had "prolonged and worsened" the Great Depression "by turning inward." But "we've learned the lessons of history" and "rejected the protectionism that could deepen this crisis." He then highlighted the steps states were taking and had agreed to take: to stimulate their economies, to deal with toxic assets still held by banks, and to enhance IMF funding to help developing countries navigate the crisis (Obama 2009e).

The G-20 summit was Obama's first major international conference as president and, hence, his debut on the global stage. He would go directly from there to the NATO summit in Strasburg, France. He was preceded, of course, by the extraordinary European reception to his election—"Obamamania" had swept the continent (Meunier 2010, 41).[6] Deploying the remarkable global public standing his campaign and election had brought him, he effectively allayed concerns about the depth of his internationalism. He benefited from the fact that he was *not* George W. Bush. But he benefited also from another fact: that, as the months passed and the crisis deepened, nations and peoples began to

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recognize that their own financial institutions had been willing accomplices—the crisis was not simply "made in America." And Obama's words in fact echoed those in the communiqué signed by all participants. In response to "the greatest challenge to the world economy in modern times," the leaders committed to measures that would "constitute the largest fiscal and monetary stimulus and the most comprehensive support programme for the financial sector in modern times." The aim was "restoring growth and jobs" and "strengthening financial supervision and regulation" to avert a future crisis. The language on trade was briefer, but the leaders promised "to refrain from raising new barriers to investment or to trade in goods and services," and they declared themselves "committed to reaching an ambitious and balanced conclusion to the Doha Development Round" (London Summit 2009). By joining in these sentiments, the Obama administration bought time to focus primarily on other matters, as noted above.

Still in his honeymoon period, Obama could gain points abroad by using the right language in communiqués and press conferences and then return to his preoccupations at home. The same was true, to a somewhat diminished extent, when the president hosted the next G-20 summit in Pittsburgh the following September. But the Obama administration accomplished more there.

The "Leaders' Statement" began by declaring the world to be "in the midst of a critical transition from crisis to recovery," a nice recognition that economies were beginning to bounce back. A particular achievement for Obama economic officials was inclusion of a new "Framework for Strong, Sustainable, and Balanced Growth": a commitment, at least in principle, to a more balanced pattern of growth and trade among the major nations. As spelled out in the Annex, "All G-20 members agree to address the respective weaknesses of their economies.

- "G-20 members with sustained, significant external deficits pledge to undertake policies to support private savings and undertake fiscal consolidation while maintaining open markets and strengthening export sectors.
- "G-20 members with sustained, significant external surpluses pledge to strengthen domestic sources of growth. According to national circumstances this could include increasing investment, reducing financial markets distortions, boosting productivity in service sectors, improving social safety nets, and lifting constraints on demand growth" (*Leaders' Statement: The Pittsburgh Summit* 2009, Annex 2).

In addition to this global rebalancing, the statement also included commitments to coordinated regulation of financial institutions—less detailed and firm than some Europeans would have liked but significant nonetheless. And the leaders made formal and permanent the demise of the old G-7/G-8, dominated by advanced industrial economies and grossly overrepresenting Europe—by

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"designat[ing] the G-20 as the premier forum for our international economic cooperation" (*Leaders' Statement: The Pittsburgh Summit* 2009, Preamble 19). They announced plans to meet in Canada in June 2010 and Korea in November 2010, with annual meetings thereafter beginning with France in 2011.

The international summits—and the ongoing domestic economic trials—put Obama's economic advisers at the center of his policy process. Presidential economic adviser Larry Summers was less in the public eye, but his role remained central. Always controversial, and sometimes fueling the controversy with smart but ill-considered comments, he nevertheless retained the president's confidence. Treasury Secretary Geithner, of course, was essential to both issues—to developing and defending internationally the U.S. position on bank regulation and to shaping, explaining, and defending the financial "rescue" to hostile home audiences. Alone among Obama's team, he had been central to the actions taken in 2008 as well as 2009. The "bailout" of the banks had always been virulently unpopular. And he was vulnerable to challenge on details—like paying back American International Group (AIG)'s bank creditors 100 cents on the dollar. He had to balance efforts to limit end-of-the-year bonuses paid by financial firms with concerns of principle (not abrogating contracts) and limits on his power. It didn't help that he looked boyishly younger than his 47 years and that his brilliant public service career was largely in "insider" positions that had ill prepared him for the rough-and-tumble of public politics. He had warned Obama, prior to his appointment, that his 2008 engagement could prove a liability to the administration (Lizza 2009). And so it seemed to be, even as he employed the crisis—and his particular powers at Treasury—to make a series of tough decisions: developing "stress tests" for the banks, encouraging them to pay back their government loans, standing firm against the calls of influential experts for nationalizing them (Solomon 2010). By early 2010 he was rebuffing Republican calls for his resignation, arguing that administration actions had in fact brought the economy back from the brink. But the fact that Geithner was *perceived* to be losing power owing to his unpopularity could not but hurt him. And this view seemed reinforced when President Obama endorsed, in the wake of the surprise Republican capture of Ted Kennedy's Massachusetts Senate seat, proposals by former Fed chief and now presidential adviser Paul Volcker to limit the trading activities of large banks (Paletta and Weisman 2010). Geithner had been reported to be skeptical of some elements in the proposal.

And trade? Obama was not unique in making the United States Trade Representative one of his later cabinet-level appointments—most of his predecessors had also. And his choice—former Dallas mayor Ron Kirk—had a certain promise. The first African American to hold the post, he had political skills of the sort that had built success for USTRs like Robert Strauss under Jimmy Carter and Bill Brock under Ronald Reagan. But lacking both trade policy and Washington experience, he would depend particularly on a strong mandate

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from the president. Before Kirk was confirmed on March 18, 2009, after resolution of some minor tax problems, Obama would face his first serious trade policy challenge.

"Buy American"—and "Health Care"

One of the less-noticed impacts of the Great Recession was its sharply negative effect on trade. Beginning in August of 2008, and continuing through April of 2009, the value of U.S. exports dropped 26 percent, and the value of U.S. imports plunged 35 percent.[7] (U.S. Census Bureau 2010). Unlike some of the trade decline during the 1930s, this was not the product of "protectionism" or of any trade policy actions at all. Some of the import plunge grew out of the sharp drop-off of oil prices from their mid-2008 peaks. But the rest was simply a product of the fall in U.S. and global demand (and some adjustment in the value of the dollar).

Obama came to office with a plan that would help reverse this decline, not a trade policy measure but his economic stimulus legislation. With the economy still shrinking, Summers had prepared a fifty-seven-page transition memo to the president addressing the full range of economic challenges Obama would face. This served as background for a December 16, 2008, meeting at Obama's transition headquarters in Chicago, orchestrated by Summers, in which the president-elect's main economic and political advisers assessed the depth of the economic threat, the appropriate magnitude of the U.S. response, and the limits of the size of a stimulus bill Congress could be expected to swallow. None of the economic challenges highlighted in the Summers memo was international. He knew that territory well—his first position in the Clinton Treasury had been under secretary for international affairs, and he had recently been named chair of the Advisory Committee at the Peterson Institute for International Economics. But he also knew the president's—and the nation's—priorities.

With enhanced Democratic majorities in both House and Senate, the administration put forward a $825 billion package (reduced by Congress to $787 billion) of enhanced government spending and tax cuts. It was enacted expeditiously—Obama signed it exactly four weeks after his inauguration—with no Republican votes in the House and just three in the Senate.

Before it was enacted, however, the stimulus bill would provide Obama with his first trade policy test. House members added to the legislation passed on January 28 a restrictive "buy-American" provision, specifying that governments receiving the funds must buy only iron and steel products made in the United States. A Senate draft extended this restriction to all U.S. manufactures. There was an immediate international uproar, particularly from Canada, whose factories had long supplied inputs to construction projects in northern U.S. states. And the United States had international obligations under WTO agreements to

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open certain procurement to international bidding. The issue was more complex than it seemed—there were other U.S. "buy-American" laws already in place, other nations frequently employed the same practice, and U.S. international obligations in this sphere were limited if real. It was also true that such provisions would make projects more expensive and subject them to procedural delays related to enforcement of the provisions. And they were unlikely to save very many American jobs (Hufbauer and Schott 2009).

Obama had an overloaded agenda and wanted to defer trade policy, but he could not duck this one. He declared in several early February interviews that the United States could not replicate its protectionist response to the Great Depression 79 years earlier: "I think it would be a mistake . . . at a time when worldwide trade is declining for us to start sending a message that somehow we're just looking after ourselves and [are] not concerned about world trade" (Obama 2009d). The Senate modified its draft language to require observance of international trade agreements, though it rejected a John McCain amendment to remove the buy-American provision entirely. The Canadians were still adversely affected. A year later, however, Kirk was able to negotiate a deal that opened more U.S. procurement to firms north of the border in exchange for greater access for U.S. firms to procurement by Canadian provinces (Office of the U.S. Trade Representative 2010).

As Norman Ornstein has noted, the Obama stimulus bill itself contained a plethora of notable legislation—more than a typical administration will achieve in a typical year (Ornstein 2010). In the trade-specific area, for example, it included a far-reaching expansion of Trade Adjustment Assistance, the program for workers displaced by import competition. Among other reforms, it extended eligibility to service workers, to workers producing an input to a final product whose market was hurt by trade, and to workers whose employers had shifted production to any foreign country. It also extended the allowed time for retraining programs during which the trade-displaced worker could receive a stipend, raised the percentage of health insurance premiums the government would fund for such a worker, and removed or loosened a number of restrictions that had undercut the effectiveness of the program. Ironically, this reform went largely unnoticed, though a prominent reason why free-trade liberals had long supported such action was that it would alleviate worker anxieties over trade's impact on jobs.

The stimulus included a range of other major policy reforms: "green energy" was among the big winners, and funds contained in the bill enabled Secretary of Education Arne Duncan to launch a new competitive process to encourage school innovation across the nation. This legislation alone should have been a source of pride for the president and the 111th Congress. However, the administration's legislative ambitions went much further: to an energy/climate bill (which passed the House in June), reform of financial regulation, and—above

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all—the issue that would dominate the second half of 2009. In August, as this author was preparing to fly to Australia to address a conference on Obama's trade policy, he asked an expert colleague what he should say. The answer? "You should say two words: 'health care.'"

The Democrats had won seemingly healthy congressional majorities in the 2008 election. In the House, they expanded their margin to 256 to 178. To increase their margin, they had accepted ideological diversity—courting relatively conservative candidates to run in swing districts where liberals were not likely to triumph. The result was a Democratic caucus with a preponderant majority to the left but with a healthy number of centrists as well. In the Senate, Democrats moved from tenuous control (51 votes, counting socialist Bernie Sanders [VT] and independent Joe Lieberman [CT]) to 58 after the election, 59 in April when Arlen Specter (PA) switched parties, and then 60 at the end of June when the Minnesota Supreme Court declared Democrat Al Franken the winner in the bitterly contested Senate race there. In a Senate where the minority party increasingly employed "extended debate" to block measures it opposed, the 60 votes gave Democrats a "filibuster-proof" majority—provided they could stick together. But it also inflated the power of moderate Democrats and independents on controversial legislation, for if the Republicans stuck together, the Democratic leadership needed the support of every member of its flock to prevail. And Republicans in both houses had settled on a policy of noncooperation. This was part tactical political decision and part substance—overall, the parties had become quite distinct ideologically (Binder 2003). The annual *National Journal* congressional vote ratings for 2009 would find that over the year "long-standing ideological divides" persisted, and in some respects "even deepened" (Cohen and Friel 2010).

With Republican support unlikely, Obama, Pelosi, and Reid had to keep their somewhat fractious troops in line. This meant concentrating on the top-priority issues and deferring any that might inflame intraparty divisions. Trade policy was such an issue, particularly within the House Democratic Caucus.

After the 2006 elections, the Bush administration had sought to broaden its support base on trade by accepting, in a May 10, 2007, agreement, long-standing Democratic positions on the inclusion of labor and environmental standards in free trade agreements (Destler 2007). This had sufficed to win approval of the Free Trade Agreement (FTA) with Peru in November—but buried in the 285–131 margin was the fact that a plurality of Democrats (116–109) had voted no, even though organized labor had acquiesced. Labor was vehemently opposed to the pending agreements with Colombia and Korea, and the House Democratic leadership was unwilling to take it on. When in April 2008 President Bush sent the implementing legislation for Colombia down anyway for the up-or-down vote required under House rules, Pelosi responded by orchestrating a change in those rules—deleting the 90-day time limit as it applied to approval

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of that agreement. And the Democrats newly elected to Congress in 2008 were, on average, no more trade-friendly. The Obama administration needed to keep the allegiance of these trade-skeptical House Democrats—and that of labor—through the compromises with House and Senate moderates that would be necessary to get the top-priority health care legislation through. So the FTAs stayed on the shelf.

The strategy succeeded. Pelosi won a historic House victory, passing health care legislation by a 220–215 majority on November 7. In the Senate, Majority Leader Harry Reid managed to combine bills from two committees, add and subtract provisions as needed, and win (by identical 60–39 margins) a November 22 vote to take up the bill and a December 22 vote on final passage.

The plan to go promptly to Senate-House conference was derailed by the surprising victory of Republican Scott Brown in the race to fill the seat of the late Senator Edward Kennedy (D-MA). This cost the party its 60-vote majority and unsettled Democrats nationwide. So health care moved temporarily from likely enactment to the endangered list. Obama responded by shuffling the political deck. First he invited Republicans to a bipartisan health care summit. When that failed (as expected) to produce agreement, he set forth his own substantive proposal. Pelosi got it through the House on March 21 in two dicey stages—first accepting the Senate version (so it could go directly to the president), by 219–212, and then passing a "reconciliation" measure, by 220–211, approving a set of budget-related changes that the Senate rules allowed to be enacted by a bare majority. The Senate did so by 56 to 43.

"Time Out" on Trade

All this time, the administration was inactive on trade. This made life hard for U.S. Trade Representative (USTR) Ron Kirk—lack of a serious administration agenda made it difficult for him to build a credible role. By giving priority to other issues, Obama was carrying out, in practice, the "trade time-out" called for by Hillary Clinton during the primary campaign. His administration did make gestures to respond to critics of its inaction. In July 2009, Kirk initiated a two-month comment period on the Colombia and Korea FTAs, inviting affected interests to express their views and signaling to those in favor that this was their chance to strengthen the agreements' prospects. But expiration of the comment period did not lead to further action.

One ongoing negotiation where the USTR *was* engaged was the unfinished Doha Round under the WTO. Launched in November 2001, the talks had long been stalemated over the issue of agricultural protection and subsidies. The targets were the advanced nations. Europe made modest concessions, but the cumbersome EU decision-making process made it hard to do more. The United States had tried to unblock the negotiations in fall 2005 by raising its offer and

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suggesting it could do more if others reciprocated with barrier reductions on products important to U.S. trade. But the gesture yielded little in return, so Kirk's predecessor, Susan Schwab, had refused to go further, saying the United States "would not negotiate with itself." She participated in several high-profile principals-level negotiations, the most recent in June 2008, aiming for a breakthrough. And her deputies made eleventh-hour forays to rising trade powers like China and Brazil, seeking sufficient assurance on specific barrier reductions. President Bush, moreover, would have liked very much to conclude his presidency with a global trade agreement. But Schwab was convinced that unless she could bring home more market-opening concessions from U.S. trading partners, there would not be the votes in Congress to approve any Doha deal. So the matter was left to the Obama administration.[8]

Kirk picked up where Schwab left off—but without the presidential push to close a deal. Substantively, the U.S. position was essentially unchanged: the terms currently available were insufficient to serve U.S. interests and win the support of key constituencies—particularly agriculture and organized business. Procedurally, however, Kirk resisted the efforts of some trading partners and WTO Director-General Pascal Lamy—newly re-elected to a second term without opposition—to move toward addressing Doha at a full-blown ministerial-level meeting. He saw this as a recipe for failure until adequate groundwork was laid in the form of new export opportunities for the United States. Instead, U.S. officials made the rounds of advanced developing nations, conducting what were labeled "bilaterals" to exchange ideas on potential concessions. This in turn irritated some of the parties, including, reportedly, the Chinese. But while all continued to declare their commitment to the round's success, no nation, including the United States, appeared ready to change its negotiating stance in a way that would give it new life.

Meanwhile, there was a surprise shift in U.S. public opinion. As noted earlier, April 2008 had brought a sharp plunge in support for free trade agreements. But April 2009 saw a rebound, Great Recession notwithstanding. Compared to the prior year's margin of 48–35 percent of respondents to a Pew Research Center poll viewing such agreements as a "bad thing" rather than a "good thing," in 2009 the numbers were essentially reversed: 44 percent said "good thing," and 35 percent "bad thing" (Pew Research Center for the People & the Press 2009b). Other surveys—by Gallup, Times/CBS, and CNN/Opinion Research—found similar upticks in support for free trade (Gresser 2009).

Normally, protectionist sentiment rises during recessions and with heightened unemployment. Philip I. Levy of the American Enterprise Institute declared, "This one is hard to explain." The only reason he could come up with was that the 2008 number had been driven down by Democratic presidential candidates who were trashing trade (Levy 2009). Edward Gresser of the

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Progressive Policy Institute stressed the positive side: Obama's early 2009 statements declaring protectionism a threat to recovery might have swayed Democrats (Gresser 2009). Overall, the recovery of the numbers to recently normal levels suggested that, whatever the position of organized groups, the American public was permissive if not enthusiastic about trade.

China

One trade relationship remained visible and controversial—that with the People's Republic of China. The U.S. merchandise trade deficit with that country had risen from $84 billion in 2000 to $268 billion in 2008. Moreover, U.S. purchases of Chinese goods were consistently five to six times the value of Chinese purchases of American goods—an imbalance far greater than that with any other large, non-oil-exporting nation. One clear contributor to the bilateral imbalance—and China's large global trade surpluses—was the exchange rate of the renminbi (RMB, or yuan, the Chinese currency). Alone among major trading nations, China did not allow its currency to float but maintained a fixed "peg" tied to the dollar. Moreover, to stimulate the growing levels of manufacturing employment Beijing saw as essential to political stability, China kept that peg at a rate well below what other nations saw as reasonable or fair. As early as 2005, 67 U.S. senators had backed a proposal by Charles Schumer (D-NY) and Lindsay Graham (R-SC) to impose a 27.5 percent surcharge on imports of Chinese products, reflecting the range (15–40 percent) of expert estimates of how much the RMB was undervalued. Shortly thereafter, Chinese authorities began a cautious, step-by-step appreciation, which brought the value up from 8.3 to the dollar in July 2005 to around 6.8 three years later. But this was halted once the Great Recession began to have a serious impact—as of late June 2010, the rate remained at 6.8. Meanwhile, China had been running larger and larger trade surpluses with the world as a whole, as its relative productivity continued to grow. The recession reduced these surpluses somewhat, but they remained a serious concern.

Congress had required, in its 1988 trade legislation, that the Treasury Department issue a semiannual report on other countries' exchange rate practices and that it name specific countries that it found to be "manipulating" their rates for trade advantage. The George W. Bush administration had declined to so name China, though it conveyed its concerns, and Obama had suggested in the primary campaign that he would take a tougher approach. But as president he proceeded cautiously. When Geithner, in written response to Senate questions during his difficult confirmation process, repeated the campaign statement alleging manipulation, the White House backed off. The Treasury reports of April and October 2009 would follow the Bush practice of stopping short of so naming China.

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Two reasons apparently account for this decision: concern that such naming would be counterproductive and the need for Chinese cooperation across a range of global issues—Iran, North Korea, and the global economy. Beijing had criticized the United States for its role in precipitating the crisis, but it did its part in fulfilling the London and Pittsburgh summit commitments with a large domestic stimulus package. And when China emerged from the downturn with surprising speed, this was a further contribution to the global recovery that all were seeking. So the policy appeared to pay off. In the words of *National Journal* reporter Bruce Stokes, who asked China experts in early 2010 to "grade" the Obama White House on specific aspects of its China policy, "Washington and Beijing get high marks from analysts for their close cooperation at both the G-20 summit in April 2009 and the Pittsburgh meeting in September." Working together at the G-20, moreover, "dovetailed nicely with the Obama team's thinking on how best to nudge China into assuming greater global responsibilities" (Stokes 2010, 23).

There were, however, specific trade issues that the administration could not avoid. Obama and Kirk had, in the early months, placed particular emphasis on "enforcement" of existing trade agreements—partly to buy time, partly to build a record for toughness and hence a political base for possible future action (R. Kirk 2009). And part of the argument for enforcement was the assertion that this administration's predecessor had neglected it. A case in point was an obscure legal provision, Section 421 of the Trade Act of 1974, as amended. As a condition for its accession to the World Trade Organization in 2001, China had agreed to a special "safeguard," effective through 2013, that allowed the United States to impose restrictions if it found that imports of a specific product in "increased quantities" had caused or threatened to cause "market disruption." Under the law, an industry or union could file a case. The U.S. International Trade Commission (USITC)—an independent regulatory body—would determine whether "market disruption" existed and, if so, would propose a remedy. The matter then went to the president, who could adopt, reject, or modify the USITC recommendation.

Four Section 421 cases had gone to President George W. Bush. Four times he had rejected an affirmative USITC finding and refused to impose protection. In the summer of 2009, Obama was confronted with his first case, involving Chinese tire imports. The USITC had found disruption and recommended a stiff penalty: a tariff for three years, beginning at the rate of 55 percent, descending thereafter. Moreover, the statutory timetable required Obama to make his decision by September 17, a week prior to the Pittsburgh summit.

In law, Obama had lots of leeway—he could do anything from applying the full USITC remedy to rejecting it entirely. In practice, rejection was difficult—because of his prior stress on trade enforcement and because of the need for union support on health care. So he decided to impose descending tariffs beginning at 35 percent. Beijing was warned in advance, and the Chinese

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response seemed vociferous. The PRC spoke of taking the decision to the World Trade Organization, asserting (incorrectly, it appears) that the decision was inconsistent with WTO rules. And it announced it was launching investigations of imports of U.S. automobiles and poultry to see if these products were been subsidized by the U.S. government or otherwise sold unfairly. In practice, however, these actions were moderate and limited, signaling that the two nations were able to manage and contain such conflicts.

This incidence of trade protection did not prevent good bilateral cooperation at the Pittsburgh economic summit, where the Chinese signed onto the leaders' statement promising that deficit and surplus countries alike would take steps to reduce future imbalances. The remainder of the year, however, did not seem to go so well. The president's November visit to China yielded no major accomplishments, and the press coverage was largely negative. And when he joined the Copenhagen climate summit the next month, his ultimately successful efforts to salvage an acceptable outcome, employing his "formidable interpersonal diplomatic skills," met visible Chinese resistance, including "a finger-wagging lecture by a Chinese official" (Stokes 2010, 25). Ironically, while Beijing rejected a framework that would have committed the country to binding climate targets, its officials did bring to the table a substantial program for lowering Chinese emissions of greenhouse gasses.

Both nations' economic imbalances dropped sharply in 2009: China's global current account deficit fell by one-third (the first decline since 2001), and the international trade deficit of the United States fell 45 percent to $381 billion, the lowest since 1999. The bilateral trade imbalance also shrank, albeit by just 15 percent. These salutary developments, however, were generally seen as products of the Great Recession, not reflecting durable shifts in economic policies or structures. And as the year ended, the U.S. monthly trade deficit rebounded to $39.9 billion, the highest figure of the year, and was averaging around $45 billion in mid-2010.[9]

China had weathered the downturn remarkably well. Notwithstanding a sharp drop in exports, the nation's growth rate fell only modestly—from 11.4 percent in 2007 and 9.6 percent in 2008 to an estimated 8 percent in 2009. Washington therefore hoped that Beijing would resume allowing the RMB to rise in value. Otherwise, the long-term international economic rebalancing envisioned at Pittsburgh would simply not happen. There was evidence that China was moving in this direction—given credence when Secretary Geithner announced that Treasury would delay its currency report and then made a brief surprise visit to China in May for talks with top officials. Beijing seemed to respond in late June when Chinese authorities announced a return to greater exchange rate flexibility. But RMB appreciation was miniscule through the summer, reigniting moves for legislative action on Capitol Hill. Another way to respond to the China challenge was to develop deeper trade relations with other

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East Asian nations. Obama took a step in this direction on November 14 when he announced readiness to engage in trade talks with the Trans-Pacific Partnership (TPP), a group of seven Asia-Pacific nations moving toward free trade among themselves.[10] In early 2010, he signaled readiness for further trade movement in his State of the Union address.

> . . . the more products we make and sell to other countries, the more jobs we support right here in America. So tonight, we set a new goal: We will double our exports over the next five years, an increase that will support two million jobs in America. To help meet this goal, we're launching a National Export Initiative that will help farmers and small businesses increase their exports, and reform export controls consistent with national security.
>
> . . . If America sits on the sidelines while other nations sign trade deals, we will lose the chance to create jobs on our shores. But realizing those benefits also means enforcing those agreements so our trading partners play by the rules. And that's why we will continue to shape a Doha trade agreement that opens global markets, and why we will strengthen our trade relations in Asia and with key partners like South Korea, Panama, and Colombia. (Obama 2010c)

Those three countries were, of course, the partners in the three Bush free trade agreements that remained unratified. Obama was not yet ready to move them to Congress for action, but he seemed to signal that possibility sometime in the future. This became concrete in June when, after meeting with South Korean president Lee Myung-Bak, Obama announced that the two nations' trade officials would work to resolve differences over the Korea-US FTA in the months leading up to the November 2010 global economic summit to be held in the Korean capital.

Meanwhile, on the other side of the Hill, the House Committee on Ways and Means was getting a new chair. Historically, the committee had been a key partner for presidential free trade initiatives. But Chair Charles Rangel (D-NY), beset with health and ethics problems, had not been in a good position to play this role even if Obama (and Pelosi) had wished it. As the House Ethics Committee completed one chastising report and prepared another, criticism mounted—first from Republicans, then from Democrats worried about being tarred with corruption charges. In early March, Rangel bowed to the inevitable and stepped aside—ostensibly until the problems were resolved. Assuming the role of acting chair was Sander Levin (D-MI), an outspoken critic of Republican trade policies with a mixed voting record on FTAs.

Obama trade policy seemed to be emerging, but very slowly. With ongoing pressure on the international side, movement seemed likely on at least the

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Korean free trade agreement and, less certainly, on Doha as well. But perhaps not until the second half of his term. Meanwhile, there were midyear changes in the Obama economic team. CEA chair Romer resigned (amid reports of tensions with NEC director Summers) to replaced by longtime Obama adviser Austan Goolsbee. OMB director Peter Orzsag had departed also, with his designated successor—Jacob Lew—awaiting Senate confirmation as of early September.

Trade Policy Progress and Prospects?

There is a long-standing proposition about trade politics that goes by the name of the "bicycle theory." In the words of the man who coined the phrase, C. Fred Bergsten, "trade policy has to either be moving ahead, toward greater liberalization, or it topples in the face of protectionist pressures from individual sectors" (Destler and Noland 2006, 17). Such protectionist pressures are particularly fierce, Bergsten and others would argue, during a severe economic downturn. So by this theory the Obama administration *ought to* have applied its every effort to liberalize trade, lest political-economic forces drive the world toward a repeat of the Smoot-Hawley tariff and the protectionism that dogged the 1930s.

Instead, the Obama administration largely stood still. It did not initiate serious trade-restrictive measures, and it joined others in inveighing against them. It "did no harm." But it took few positive initiatives. If the theory held, one would have expected a collapse of the global trade regime as nation after nation strove to protect its own production at others' expense. Instead it was the system that held. It bent a bit,[11] but it surely did not break.

The United States is now in the midst of a slow recovery, with production expanding and unemployment bottoming out but remaining high. The Obama administration has suffered politically because the slump has been so deep and because its measures have not achieved more. Democrats appear certain to take a serious hit in the midterm elections, either losing their House and/or Senate majorities or hanging on by very thin margins. In any case, they will no longer possess, in 2011–12, the healthy working majorities they held in Obama's first two years.

The president, and Congress will be under pressure to enact measures to counter the long-term fiscal squeeze facing the United States. They will also be looking for other measures consistent with that need, initiatives that do not bear major budgetary costs. Trade initiatives fall into that category. As an internationalist leader seeking action, seeking engagement, Obama began in 2010 to move cautiously in this direction. He is likely to move further in 2011 and thereafter. And this is an issue where more Republicans in Congress would actually improve his chances for achievement.

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Notes

1. Saul I. Stern Professor, Maryland School of Public Policy; Fellow, Peterson Institute for International Economics
2. The final estimate of fourth-quarter change in GDP (annual rate equivalent) was even worse—minus 6.8 percent. The figure for the first quarter of 2009 was adjusted downward to minus 4.9 percent (Bureau of Economic Analysis–U.S. Department of Commerce 2010).
3. More precise figures are in Destler, *American Trade Politics* (Institute for International Economics, 4th edition, 2005), pages 45 and 250, taken in turn from statistical tables in *Economic Report of the President* (www.gpoaccess.gov/eop).
4. The Standard & Poor's Case-Shiller national home price index stood at 189.93 in 2Q 2006 (2000 = 100). It fell to 183.16 in 2Q 2007, 155.68 in 2Q 2008, and 111.11 in 2Q 2009 (cited in *Wikipedia*, "Case-Shiller Index" 2010).
5. Just 35 percent found such agreements to be a "good thing."
6. According to a BBC World Service Poll in January 2009, at least 70 percent of British, French, Germans, Italians, and Spanish expected that U.S. world relations would become "better" due to Obama's election. Only 2–4 percent thought they would become worse (see Meunier 2010).
7. These percentages compare the values for July 2008 to those for April 2009. There was recovery thereafter—in December 2009, exports had rebounded to 85 percent of those in July 2008, and imports to 82 percent (U.S. Census Bureau 2010).

   The nine-month drop exceeded, in percentage terms, that of a comparable period during the Great Depression.
8. For a comprehensive, lively, and critical account of the negotiations through 2008, see Blustein 2009.
9. Chinese data are government statistics; U.S. trade data are from U.S. Census Bureau 2010.
10. The original TPP members were Singapore, Chile, New Zealand, and Brunei. Australia, Peru, and Vietnam have recently joined the negotiations.
11. For a compilation leaning toward pessimism, see Simon J. Evenett, "The G20's Assault on World Trade," September 22, 2009, *Vox,* at www.voxeu.org/index.php?q=node/4008.

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