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WILL THE OBAMA ADMINISTRATION CHANGE TACK ON PROTECTIONISM BEFORE THINGS GET WORSE?

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The new American government under President Barrack Obama is not the biggest cheerleader for free trade. With its own domestic economy entering this steep downturn, talks of protectionism in one form or another have been voiced every now and then. Catchy buzzwords like “Buy America” are gaining traction. The temptation to turn inwards, driven by the obligation to votes is growing stronger.

America’s trade partners and goods suppliers are looking with growing concern at the spectre of protectionism raised by the new government. The pall is cast not only on low-cost manufacturers in Asia Pacific, the chill is also being felt in America’s own backyard, when a recent annual report by the White House to the US Congress suggested “improvements” to the North American Free Trade Agreement. Protection is also happening in other forms: financial institutions, like Bank of America, have withdrawn job offers for non-Americans.

The reluctance to promote free trade, seen as a main source of economic woes facing Main Street America, is understandable: unemployment is expected to edge higher to peak eventually at 9.5%; the US economy is expected to sink by up to 6% this year, and the recession is likely to last until the second half next year, said Joel Stern, Chairman & CEO of Stern Stewart & Co, in a recent seminar, organised by the Singapore Management University’s (SMU) International Trading Institute.

“I am not at all optimistic, the last time I felt this way was when (Jimmy) Carter was the president (in 1976). An advice I got as a young man, ‘don’t forecast bad news, if you get it wrong, people will let you forget it; if you get it right, people will blame you’,” said Stern, who will be teaching a class on “Theory and Policy of Modern Finance” at this year’s SMU MBA programme. Without hesitation, “bad” and “serious” were some of the words he used to describe the current crisis.

Difficult Decisions

“Obama is well meaning and compassionate, but he should not make the same mistake like (former President George) Bush Senior of extending unemployment insurance. By doing so, the unemployment situation is likely to take longer to work through,” said Stern, referring to one of the key labour market policies that the US government wants to enhance.

There are also strong doubts over Obama’s choice of officials holding key economic appointments. “The people Mr Obama brought in are the ones who caused all the problems,” said Jim Rogers, a high-profile American investor now based in Singapore, at the same seminar. “We have a new Treasury Secretary (Timothy Geithner) who was head of the New York Federal Reserve Bank for the last several years and the New York Fed was supposed to be supervising Wall Street and all those banks, and this was supposed to be the man who seeks to save us,” said Rogers. “Woe is me, woe is us; it’s going to be bad in the US for some time to come.”

To be sure, Stern and Rogers are not the only market commentators who disagree with the Obama administration. In a survey of 49 economists done by *Wall Street Journal* published on March 12, the majority of them are dissatisfied with the progress of economic policies put in place by this government. Their main grouse is on the delay in enacting key parts of the rescue plans for the banks. President Obama scored an average of 59 out of 100 in the poll, while Geithner, the Treasury Secretary, was given an average rating of 51 points.

While cooler, rational and non-partisan heads will continue to argue for free trade, America’s economic managers have their hands full. The backing of free trade is but just one of the issues they have to deal with. For example, the core of the financial system -– the banks, are seeing no end to the severe pressure caused first by toxic debt, then the credit crunch, and now, a worsening economy. They need to raise more money, despite the billions already pumped in by taxpayers, said Rogers, who, along with many others, took issue with the allocation of public funds. “The government is taking assets from competent people and giving them to incompetent people. They say (the banks) should be allowed to fail (or) we are going to have a bad year or two; we already have a bad a year or two,” he added.

Rogers believes there are greater fundamental issues at hand. Whether or not governmental assistance is given to the weakened financial institutions, there stands a chance that these institutions may not recover quickly enough to stem larger economic woes. He cites the longstanding inertia experienced by the Japanese banks that somehow have never managed to return to the heydays of the 1980s. The continuing weakness in the banking and financial industry has resulted in fear that some American banks might be nationalised -- a hitherto unthinkable development in a free market capitalist system. But, to Rogers, “there’s nothing ideological or not but just what works and what won’t. The key issues, the shortage of capital, they are going to get worse.”

Re-thinking Asia

Meanwhile, governments in Asia are also shoring up their own economies with rescue plans of one kind or another. “Many countries have implemented stimulus packages but I am somewhat sceptical about spending on infrastructural projects,” said Tai Hui, Standard Chartered Bank’s regional economist, at the same seminar. “These are good for the medium to long term, but I don’t think they will be in time to address the immediate challenges,” he said. Putting a positive spin, Hui adds, “The good news is; this will be a catalyst to rethink how Asia works.”

Talks of Asian economies decoupling from the developed markets have all but died down. Until recently, China has been viewed as a growth engine for the rest of Asia, but the country’s own economic woes show very clearly that it is still far from being an end-market by itself. Hui believes this is the time for Asian economies to evaluate its dependency on China and India. “This is an opportunity to re-engineer that kind of trade model, but of course, we need China and India to be consuming more and saving less. Hopefully, over the next 8 to 10 years, intra-region trade will be even stronger. I think Singapore is in a very strong position because of all the free trade agreements signed with emerging markets,” he added, emphasising that intra-region trade is emerging to be the way forward.

Politics and Protectionism

Still, there is no running away from the fact that Asia’s economic fortunes, at least for the foreseeable future, are tied closely to America. Right now, the US government is more concerned with saving its own sinking economy than worrying about other emerging economies.

“Mr Obama is a protectionist, and so is Hillary Clinton, and Mr Obama is going to come out and lash out against the financiers because he doesn’t know what is going on. He is going to blame it on foreigners,” said Rogers. To underscore the inane quality of the blame game, he explained, “Every politician, whenever they’ve got problems, they always blame two groups of people: they always blame foreigners - because foreigners don’t vote. Foreigners have different religions, different languages, different skin colours, so it is very easy to attack foreigners, not just in America, but everywhere. And politicians have also always blamed financiers; everybody hates banks, so it’s easy.”

From Rogers’ point of view, protectionism is not only a growing global concern; it is a mistake that should not be made again. “In the 1930s protectionism resulted in the Great Depression. Maybe they (the Obama government) will catch on when things start collapsing. Protectionism is raising its ugly head all over the world. In Brussels right now, there’s a whole group that does nothing but follow the rise of protectionism,” Rogers said, adding that “It’s going to get much worse before it gets better.”

Stern, on the other hand, predicts that domestic political pressures will soon convince the Democratic Obama government to change tack. Specifically, the US Senate, currently controlled by the Democrats, will be up for elections in 2010. Worsening economic problems might cause Obama’s party to lose their current majority. “Raising that unemployment insurance may just be the killer, not because it is bad for the people but it makes the (unemployment) numbers look bad. If that happens, if he does lose control of the Senate at that time and loses a great deal of his majority in the House, I promise you, he will become much more like a free enterpriser in the last two years of his administration. This is because he does want to be re-elected. First thing every politician wants after he is elected is to get re-elected,” said Stern.

End of the day, the issue of free trade is something that does not need much advocacy in this part of the world. Asian economies have already demonstrated why free trade is beneficial. “Why is Singapore so successful? It is because of free trade. Hong Kong has been so successful because of free trade,” said Stern. According to Stern, China’s economic “miracle” today can, to a certain extent, be attributed to Merton Miller, a Nobel economics laureate and long-time faculty with Chicago’s Graduate School of Business. “Back in the 1980s, Miller advised Deng Xiaoping to allow market forces to operate, start the free market experiment somewhere, and then let it pervade throughout the country. In essence, China was allowing a free trade policy within itself,” he said.

“The Chinese followed a free trade policy inside China; Singapore followed it everywhere; Hong Kong, everywhere. India essentially became successful because it abandoned many of its impediments. They permitted the markets to function properly. In most parts of the world, especially here, we don’t need a lesson on what free trade is all about,” said Stern.