Pressures on Obama at the G-20 in Pittsburgh

C. Fred Bergsten suggests that Obama may welcome pressure on the United States from summit partners to disavow protectionism and rein in the federal deficit in coming years.

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Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics. It's a pleasure to have C. Fred Bergsten, director of the Institute, today to give us a preview a few days ahead of time, of the G-20 Summit leaders in Pittsburgh. Thanks for joining us, Fred.

C. Fred Bergsten: Good to be with you, Steve.

Steve Weisman: Fred, what do you think are the most important things that the G-20 will be dealing with?

C. Fred Bergsten: I think there are really three big issues for Pittsburgh. One is to agree on whether to continue the economic stimulus programs that have been rescuing the world from the deep recession. Some countries are eager to begin with exit strategies to start reining back on fiscal and monetary stimulus. That's the core issue. I think they'll agree to keep their foot to the accelerator for now, but there may be some preliminary discussions of when, and under what conditions, to start reining back, and that's an important discussion.

Steve Weisman: Let me interrupt you. Should they start taking their foot off the accelerator or even putting on the brakes? Or is it too early?

C. Fred Bergsten: It's definitely too early to step on the brakes now. I'm pretty optimistic about the pace of the US and world recovery over the next year and a half. So I think it's reasonable to contemplate some reining in of expansionary measures next year. But certainly it would be premature now and it would send the wrong signal to markets, to start pulling back on the expansionary programs at this point.

Steve Weisman: Okay, next.

C. Fred Bergsten: The second big issue, which is important for the recovery but also for the long-run sustainability of global growth, is the rebalancing, as it's called, of the global economy.

One reason we got into the crisis was the huge imbalances. The United States being consumer of last resort, running massive trade deficits, relying on huge inflows of foreign capital that built a very liquid and easy credit US economy that brought on the underpricing of risk, the extensive excessive lending that was an underlying cause of the crisis. On the other side, the next three largest economies—China, Japan, Germany—have relied excessively on export-led growth, building and maintaining large trade surpluses that were a flip side of the US deficit.

It's very important, even as the recovery picks up, to avoid reviving those imbalances. The United States has said that it intends to avoid going back to being consumer of last resort and running big trade deficits. The Chinese have said they are intending themselves to rebalance, relying more on domestic demand. And indeed, their trade surplus is now coming down sharply. But it remains to be seen if they will continue to do that. And neither Germany nor Japan has even said that they intend to do that. Indeed, Germany has said it likes the export growth model and wants to go back to it.

So there's a real question of whether the fundamental growth strategies of the major countries will fit with each other. The G-20 needs to discuss that very directly, needs to appoint somebody, presumably the International Monetary Fund, to monitor whether there is a consistency between the growth strategies of the major countries; or else we may not have much of a prolonged recovery even if we get one here in the short run.

Steve Weisman: What does history tell us? You've been watching these economic meetings from their inception in the 1970s. What's the track record on these big meetings?

C. Fred Bergsten: The track record in the late 1970s, and the middle 1980s, was very good.

There were very explicit commitments taken by all the big countries in the late 1970s. They followed through on them quite faithfully. The second oil shock threw the progress off a bit but it was almost a prototypical example of how to coordinate recovery strategies.

Likewise, in the middle of the 1980s, when exchange rates and trade balances had gotten completely out of hand, the Plaza Agreement, led by Jim Baker, then US secretary of the Treasury, worked out commitments to substantially reduce the currency misalignments, the trade imbalances. And then over the course of the next year or two, they worked out a lot of commitments on underlying economic policies to implement those strategies in a broader sense. Again, it did not work out perfectly but it certainly got rid of the huge misalignments and international imbalances and consequent trade policy protectionist pressures of the middle 1980s in a very successful way.

The record since then has been much less impressive. The G-7 governments essentially agreed to what I call a mutual non-aggression pact in the 1990s—you don't criticize me, I won't criticize you. And so, the whole effort to coordinate internationally went out the window. That has now, of course, become bad with the global crisis.

This was the first truly global crisis since World War II. All countries went into the tank together late last year. So it was a matter of necessity to coordinate responses. Countries did. They moved in the same direction. They moved with reasonable degrees of consistency. And to this point, the recovery looks pretty good.

It now gets a lot trickier because it's not obvious that you expand demand from both fiscal and monetary sources. You have to calibrate. You have to decide when to exit. You have to decide how your fiscal and monetary and financial regulatory policies interact. And you have to get this structure, this rebalancing, right, as I mentioned before. So it'll get tougher and we'll have a test. But certainly there have been periods in the past where it has worked very nicely.

Steve Weisman: Let's talk about financial regulation. Do you see much chance of progress on aligning global financial regulation of the financial sector at this summit?

C. Fred Bergsten: The first question is what we mean by aligning financial regulation. I think it's a three-part process. The major countries need to agree on best practices: the model that they're

shooting for in trying to improve their national regulatory regimes.
The second step is to reform national systems of financial regulation, to come as close as possible to those internationally-agreed norms. The implementation has to be done at the national level. That's where the regulators are. That's where the legal authority is. That's where the enforcement mechanisms take place. So it has to be done at the national level, but within an international framework.

The third step is to go back to the international level, put in place some monitoring mechanism, which the IMF has actually had in place for emerging markets for the last 10 years. That will try to encourage countries to meet the international norms and standards as best they can, push, prod, encourage, guide them to do so when they don't accomplish [it] in their initial go-rounds.

So a three-part process of that type is what's needed. There's already been some discussion of it at previous G-20 summits. I suspect there will be more here. I don't think anything specific will be agreed because the issues are very technical and most of what's being done is at the Financial Stability Board, the group that brings together regulators of central banks, and finance ministries for that purpose.

However, the G-20 should come to some agreed compromise between the different priorities of the different countries. The United States is stressing an expansion in capital requirements at the major financial institutions. The Europeans are harping more on compensation issues, bonuses, salary structures, and the like. Obviously, both are needed. And I think what the G-20 can do is put both of them into the overall pot that needs to be implemented at the first stage by international best practices agreements.

Steve Weisman: Fred, President Obama, this will be his second G-20 Summit, but it will be the third G-20. The previous two have all given ringing declarations in favor of free trade, or at least not coming to a round of protectionism. Now, the president is coming into this meeting with a furor in the United States over his latest trade actions imposing duties on Chinese tires. What do you think is his standing right now on this issue and what do you think is going to be the priority attached by the other summit leaders to this issue?

C. Fred Bergsten: I think President Obama will be criticized pretty roundly for his protectionist action on tires from China, coming just two weeks before the G-20 Summit. All of the G-20 countries, almost all the G-20 countries, have violated the standstill on protectionism that they solemnly agreed at the last G-20s. But they have not done so very blatantly. They have not done so in ways that raise the kind of international alarms that the president's policy on China has done.

The reason it's so serious is that the action he took on tires from China could easily be taken on six, eight, 10 other industries under the same very loose provisions of US law. It's a provision that is a goldmine for industries seeking protection. President Bush avoided using it precisely to deter any efforts to do so. President Obama has implemented it. In the first case, it came across his desk for a tiny industry even alleging to protect only 5,000 jobs out of an economy of 140 million jobs. So it's an open invitation to more protection and I think that will rightly raise lots of alarms in other countries.

Hopefully, the G-20 Summit will issue another strong statement against protectionism. But this time, it'll have to be stronger and President Obama will have to embellish it with some explicit indications that he does not intend to replicate what he just did for other sectors.

Steve Weisman: Do you think President Obama will welcome the kind of public pressure that might occur at the summit on him—both on this issue of trade but also on the fiscal exit strategy, thinking ahead a year or two, when the issue of the US budget deficit is going to face him?

C. Fred Bergsten: Skillful national leaders always try to use constructive external pressures to overcome internal resistance to doing things they know are right. China joined the World Trade Organization 10 years ago in order to use the rules of that organization to overcome domestic resistance to policy reform. Japan even has a word for it, *gaiatsu*, that they used for many years to characterize US pressure to improve their economic policies. And many Japanese prime ministers invited the United States to exercise *gaiatsu* for exactly that purpose.

Steve Weisman: So are we going to see Obama channel his inner zen on this?

C. Fred Bergsten: I would hope that President Obama would follow those healthy precedents to use the concerted wisdom of the rest of the world to push policy in the right direction. It may strike some Americans as fanciful to think that, but it has happened many times before.

For example, President Carter used the G-5 Agreement that I referenced earlier in the late 1970s to overcome congressional resistance to abolishing price controls on oil and gas in the United States. The United States made a deal with the other G-5 powers. They all agreed on measures to expand their economies, reduce the US trade deficit; and the quid pro quo was that the United States agreed to stop controlling energy prices. That was terribly important to the world economy because decontrolled US energy prices were absolutely vital to reduce US and global demand for energy and take the pressure off the oil prices, which at that time were skyrocketing. It worked.

Steve Weisman: Can you think of a president who did that, who then got reelected?

C. Fred Bergsten: Well, I don't think President Carter's failure of reelection [was] for that reason. Lots of presidents have cooperated internationally on trade issues, on currency issues. President Reagan, through Jim Baker, his secretary of Treasury at the time, accepted the foreign desires to realign exchange rates, bring down the big trade deficits of the day. He was in his second term, but his vice-president, George Bush 41, got elected in his wake. And so, at least in that case, it was not lethal.

Steve Weisman: And also, he did something about the federal deficit… Bush.

C. Fred Bergsten: Yeah, President Bush 41 did use external complaints about the big US budget deficit to add to the arguments for bringing them down. Even before that, Jim Baker did make some progress toward the end of the second Reagan administration in reversing their big budget deficits. I remember asking Baker at the time how much the foreign input contributed to that. And he said, well, 10 to 20 percent. That's not the majority but neither is it inconsequential. And so, it shows that those kinds of efforts do sometimes pay off.

Steve Weisman: Fred, thanks very much. That's very interesting. Thanks for joining us today.

C. Fred Bergsten: Good to do it.