Bush's Spectacular Failure

A former Clinton policy adviser argues the Bush team has failed miserably at global economic leadership.

BY JEFFREY FRANKEL

Charles Kindleberger passed away last year. One of his major contributions to our understanding of international relations was the notion that the world economic system works best if a hegemon exists who is willing and able to take the initiative to supply "public goods" to the world economy: a stable international currency, leadership of a system of free trade, international lender of last resort, and so forth. The curse of the interwar period was that the United Kingdom had lost the wealth and capacity to play that role, while the United States had not yet acquired the will to do it. The blessing of the postwar period was that the United States acquired, not just the ability, but also the willingness to play the role of hegemon of the global economy. The United States was determined not to repeat the mistakes made after the first World War when traditional American isolationism had proven disastrous. Some of the U.S. actions after World War II were unilateral, such as opening its markets to trade and giving foreign aid. Some were bilateral, such as the Marshall Plan. But measures taken were primarily multilateral: The United States was the guiding force behind the founding of such multilateral institutions as the General Agreement on Tariffs and Trade, the International Monetary Fund, and the World Bank—institutions that embodied liberal economic values and a system of rules under which all could play and prosper.

Intellectually, it was understood throughout the postwar period that taking a leadership role, both in these institutions and otherwise, served many important purposes—interests of the United States as well as of other countries, economic goals

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Bill Clinton was able through hard work to achieve NAFTA, normalization of trade with China, and a number of other accomplishments. But despite a record-performing economy, his best efforts and his eloquence, he was never able to convince the American people and the Congress to give him fast-track negotiating authority. Clinton was unable to overcome the intransigence of Senate Foreign Relations Committee Chairman **Jesse Helms (R-NC)** over paying the arrears in U.S. dues to the United Nations, and unable to gain congressional support for the Mexican rescue package or a BTU tax or the Kyoto Protocol.

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as well as foreign policy. Domestic politics in the end would generally reach the same conclusion. True, some U.S. special interests when exposed to import competition would often speak more loudly—especially via their members of Congress—than the majority of Americans who stand to benefit from free trade. But U.S. presidents would exercise the leadership that is supposed to go with the office, and rally the necessary political forces to accomplish what was in the national interest overall. Often they would successfully invoke the Cold War to win the extra votes. Everyone understood the desirability of working in the tradition of the aftermath of World War II—of Bretton Woods and the Marshall Plan—and avoiding Versailles and 1920s isolationism, the model of the aftermath of World War I.

With the fall of the Soviet Union in 1991, the foreign policy arguments for free trade were perceived to have diminished sharply, and the political and bureaucratic forces on that side of the table diminished. Bill Clinton was able through hard work to achieve NAFTA, normalization of trade with China, and a number of other accomplishments. But despite a record-performing economy, his best efforts, and his eloquence, he was never able to convince the American people and the Congress to give him fast-track trade negotiating authority. Clinton was unable to overcome the intransigence of Senate Foreign Relations Committee Chairman Jesse Helms (R-NC) over paying the arrears in U.S. dues to the United Nations, and unable to gain congressional support for the Mexican rescue package or a BTU tax or the Kyoto Protocol. And so on. Whether because of the end of the Cold War or the passing of the 1940s generation from positions of leadership, the necessary domestic support for internationalism had faded.

Now forward to September 11, 2001. The war on terrorism should have presented George W. Bush with the same opportunity for international leadership that the Cold War gave Presidents Truman through Reagan. The importance of international leadership should have been familiar from his family background. The domestic politics were more conducive to Bush's success on the international front than any in years. The American people were primed to be told what difficult steps would need to be taken. The public was begging to know what economic sacrifices it would have to make. It would have been relatively easy after September 11 to explain to the American public why America must free up imports of textiles and apparel from Pakistan, Turkey, and other developing countries; why taxation should be shifted onto fossil fuels to reduce dependence; why multilateral organizations deserved U.S. support. Instead, what was the President's answer to the public's request for guidance? Encouragement to go to the shopping mall.

The Bush Administration has squandered some tremendous opportunities. Consider the record:

Spending Spree

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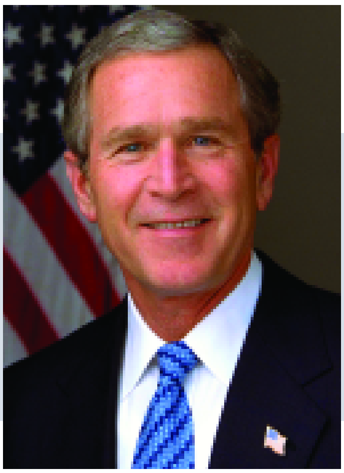

TRADE

While the Bush people attacked the Clinton Administration for giving in to protectionism, their own record while in office is far worse. As libertarians will tell you, President Bush turned protectionist more strongly than any other postwar president. The list of new distortionary measures includes steel tariffs, softwood lumber protection, increased agricultural subsidies, and new quotas on clothing from China, among other items. The Administration tried to rationalize these moves as politically necessary in order to get congressional support for fast track authority. But the Republicans control Congress. Furthermore, the progress to date in international trade negotiations, and the future prospects, appear too meager to justify the heavy price that the Administration has paid. Other national governments are not encouraged to overcome their own domestic political trade opponents when the Doha Round is kicked off by the sorry spectacle of the U.S. government pandering to domestic interests without a fight.

The steel tariffs in particular undermined leaders in other countries who tried to argue in favor of free trade and the American model, including Brazil, Russia, Korea, and the countries of the European Union. The Bush Administration must have known the tariffs were illegal under the World Trade Organization. When steel mill owners and unions came to ask the Clinton Administration for tariff protection, they did not get it, even though they were supposed to be Democratic constituencies. President Clinton decided steel protection was not in the national interest, and that it did not meet the legal tests required for safeguards protection. But at least imports were increasing at the time, which is one of the necessary legal tests. A few years later, the Bush Administration gave the steel people what they wanted, at a time when imports had been decreasing—an obvious failure of the legal test for protection. Now that the WTO has ruled against the steel tariffs, the White House has little choice but to agree to comply with the WTO ruling. Presidential adviser Karl Rove now realizes the electoral votes that Republicans stand to gain by keeping the barriers (from steel interests) are outweighed by the votes they stand to lose (from steel users such as the auto industry and export industries who face retaliation from our injured trade partners that is warranted under the WTO). But returning to where we started is not without cost. Compliance with the WTO panel ruling will further erode domestic political support for the WTO, something the Administration probably failed to factor in ahead of time.

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The Administration should have picked one mantra and stuck to it for a while.

The Bush White House would have done better with a more principled stand on these trade issues—not the sort of free trade purism of academic economists, which ignores all political constraints, but rather the intermediate pragmatism of the Clinton Administration. Developing countries served notice at talks in Cancun that their interests now must be taken more seriously in multilateral negotiations. Over the next few years, rising imports of textiles and clothing from developing countries will put political pressure on whoever is president to fully open U.S. markets in this key sector. If the U.S. president reneges on past promises (in the Uruguay Round, and China's accession to the WTO), U.S. free-market rhetoric will lose any remaining credibility in the rest of the world.

EMERGING MARKET CRISES

When the Clinton Administration took the international leadership to organize rescue packages for Mexico (1994), Korea (1997), Russia (1998), and others, the Republicans attacked it for fostering moral hazard. Thus when the Bush Administration came to office, it adopted tough "no bailout" language. Then it spent the next three years bailing out everybody. U.S. Treasury comments undermining confidence in South American economies might be rationalized as a necessary side effect of a new regime. But the Bush Administration soon changed its mind when it realized that defaults in South America might have bad consequences. The effect of the earlier rhetoric was merely to raise the cost of the ensuing bailouts.

In 2003, the Bush Administration even pushed the IMF, against its better judgment, to continue lending to a new Argentine president who was not willing to concede to the standard conditions. At least in earlier controversial bailouts, where the agreed macroeconomic conditions were more likely to be missed than not, there were plausible geopolitical rationales. The last package for Russia in the spring of 1998 might be justified by nuclear geopolitics, and Turkey in 2001 by its position in the Muslim world. Even the ill-fated package that Bush agreed to for Argentina itself in 2001 could be defended with the argument that if the country that had enacted so many good reforms in the 1990s went into a sharp recession, Latin America's other reformers would lose heart.

No such rationale remains for the recent decision to continue IMF lending to Argentina, whose economic collapse had already occurred and whose new government was unwilling even to talk the talk. A dangerous precedent—that the IMF will lend merely to prevent a threatened default on earlier IMF loans—has now been set. Bush and his Treasury lacked the guts that Clinton and his Treasury showed in the summer of 1998 when they finally told Russia that enough was enough, precipitating that country's devaluation and default but demonstrating to international financial markets that there were limits to IMF largesse.

Furthermore, the Bush Administration has been unable to set a consistent course on other aspects of the international financial architecture. It repeatedly sent conflicting signals regarding the IMF's Sovereign Debt Restructuring Mechanism. More consistency is required. Some at the international financial institutions who used to resent the firm guiding hand from the Clinton Treasury now long for the good old days.

Republicans: Hypocritical, Incompetent, and Worse

Princeton Professor **Paul Krugman** and Nobel Prize winner **Joe Stiglitz** have bought the argument of some University of Chicago economists that the Bush fiscal policy is a subtly calculated plan to create a fiscal crisis in the future, and thus force future cuts in spending. That rationalization may not accurately describe thinking in the White House. If the Republican goal were actually to cut the rate of growth in spending, what better time to do it than now, when they control all branches of government? A simpler explanation is that the Republicans are doing nothing more than going after campaign contributions and electoral votes. They may not be sufficiently competent to think ahead and realize the magnitude of the fiscal crisis that they are probably creating for themselves later this decade.

Krugman and Stiglitz warn that the Bush Administration is pushing the country far to the right, roughly speaking in the small-government free-market direction. But the main problem is different, and in a sense worse. The overarching pattern appears not one of excessive and rigid commitment to any particular ideology so much as one of hypocrisy and incompetence.

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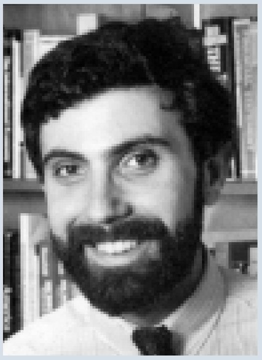

Paul Krugman *and* **Joe Stiglitz:** *Both give the GOP too much benefit of the doubt.*

MANAGEMENT OF THE DOLLAR

Dollar depreciation has both advantages and disadvantages. The proper response is not to switch weekly between strong dollar statements on the one hand and support for depreciation on the other. Yet this is what the current U.S. Treasury has done. Worse, it sometimes takes both positions at the same time, driving dollar policy with one foot on the accelerator while the other pumps the brakes. The Administration should have picked one mantra and stuck to it for a while. (In light of unsustainable U.S. current account deficits, it would have made sense to abandon the strong dollar mantra three years ago, in favor of "the exchange rate is determined by the markets." This would leave open the option of switching mantras in the future if and when the depreciation is in danger of going too far.) The financial markets want from the U.S. Treasury a sense of consistency and reliability.

ENERGY POLICY

The United States should be trying to reduce consumption of oil and other fossil fuels. True, complete energy independence is a chimera. But some reduced dependence on imported oil and some moral leadership on international energy policy would go a long way toward strengthening the U.S. hand in the Middle East and elsewhere. The Bush Administration energy policy has instead sought basically to accelerate the depletion of domestic supplies. The energy bill now stuck in Congress consists largely of more handouts for special interests and seeks to increase rather than decrease consumption of fossil fuels. Even leaving aside the environmental implications, to justify "Drain America First" in terms of the national security objective of decreasing long-term dependence on foreign oil is perverse.

MULTILATERAL AGREEMENTS

The hallmark of Bush international policy has been opposition to almost all multilateral agreements, angering everyone. The latest scuffle is over methyl bromide. The Montreal Protocol on stratospheric ozone depletion is generally considered the best example of a successful international environmental treaty. It was successfully negotiated, with teeth, and has actually worked as advertised, reducing the hole in the ozone layer that was going to give us all skin cancer. The new development is that the Bush Administration wants to punch a big hole in the Protocol by adding an exemption for methyl bromide. What is the argument? If American strawberry farmers (among others) aren't allowed to continue to use this chemical, then they may lose business to more competitive Mexican strawberry farmers. That's all. Apparently, the Bush Administration is not even bothering to go through the usual false characterizations of the state of scientific opinion or the usual nonsense language about unfair trade. Do they realize that they have already lost all credibility with all other countries, so there is no point bothering with these arguments? Or, on the contrary, have they come to believe that they can get away with anything, no matter how irresponsible?

The big question is, are we eventually going to start paying a price for our neglect?

FISCAL POLICY

The Bush Administration threw away the record surplus it inherited, with no prospect of getting it back. Bush's tax cuts have eliminated what was claimed in 2001 would be a $5 trillion surplus over the next ten years. It is now likely to be a deficit of more than $5 trillion, although the Bush Administration has barely admitted to anything more than the disappearance of the surplus. Those who think that the 2001 recession bears respon-

The Hallmark of the Irresponsible Bush Policies

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sibility for the failure of the Bush fiscal forecasts need to realize that the fall in growth since 2000 has not been as large a factor as the excess optimism in the original Bush revenue forecasts. Those who think a new need for defense spending created the deficit should remember that the Administration had already been planning to launch an expensive increase in defense spending based on strategic missile defense. Those who think homeland security created the deficit need to recognize all the pork-barrel spending in low-risk states that is now masquerading under that title, or the acceleration taking place even in the rest of domestic spending.

It is a challenge to figure out what the White House thinks it is doing with its tax cuts at a time of sharply increased spending. Princeton Professor Paul Krugman and Nobel Prize winner Joe Stiglitz have bought the argument of some University of Chicago economists that the Bush fiscal policy is a subtly calculated plan to create a fiscal crisis in the future, and thus force future cuts in spending. That rationalization may not accurately describe thinking in the White House. If the Republican goal was actually to cut the rate of growth in spending, what better time to do it than now, when they control all branches of government? A simpler explanation is that the Republicans are doing nothing more than going after campaign contributions and electoral votes. They may not be sufficiently competent to think ahead and realize the magnitude of the fiscal crisis that they are creating for themselves later this decade.

Fiscal deficits tend to spill over into the international balance of payments. The reason, of course, is that the budget deficit usurps private saving; the shortfall in national saving at home then has to be made up by borrowing from abroad. The U.S. current account deficit is now approaching danger levels. In other words, the twin deficits of the 1980s are back with a vengeance. The long-term macroeconomic implications are serious. Over the coming decade, the United States will find itself increasingly constrained by the need to borrow abroad in a capital-scarce world.

IS IT IDEOLOGY?

Krugman and Stiglitz warn that the Bush Administration is pushing the country far to the right, roughly speaking in the small-government free-market direction. But the main problem is different, and in a sense worse. The overarching pattern appears not one of excessive and rigid commitment to any particular ideology so much as one of hypocrisy and incompetence. Those are harsh words. Are they accurate?

The Bush Administration consistently says one thing and then does another—hence the charge of hypocrisy. They act as if they will do anything for a few votes, even if their behavior is against the national economic and security interests and blatantly inconsistent with things they claim to stand for: small government, free trade, macroeconomic discipline, good neoclassical economics, and so forth. And they will favor political expediency even if it creates big trouble for themselves a few months or a few years down the road—hence the charge of incompetence. Perhaps they are genuinely unable to think ahead. Perhaps they don't realize that if they impose steel tariffs, the virtually inevitable response a year later will be an adverse WTO ruling. Or that if they talk recklessly about not bailing out Brazil because the money will "go into Swiss bank accounts," the cost of the necessary bailout they engage in a few months later will rise. Or if they tell Asia to stop buying U.S. treasury bills, because they think it will help diffuse anger at the loss of jobs in a few key electoral states, then U.S. interest rates will soon go up. Or if they launch a military takeover of Iraq, a bill of a $100 billion or more will come due a year later. Or that if they speak precipitously regarding North Korea, the result in South Korea will soon be to elect an anti-American president and in North Korea to accelerate the nuclear program past the point of no return.

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To be sure in some areas what they have had to say sounds like steps in the right direction: bold proposals for long-run global trade liberalization, increases in foreign aid from its very low levels, and better treatment for Mexican immigrant workers. It is wise to be on the lookout for confirmation of the proposition that nobody can be wrong all the time.

But this Administration's record of broken promises, misleading labels, cynical motives, and foreseeable cost overruns (usually deferred to someone else's term in office) has been so extensive that one can't help but entertain skeptical interpretations even of the initiatives that sound good.

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WHERE ARE WE HEADED?

The big question is, are we eventually going to start paying a price for our neglect of the responsibilities of international economic leadership, and for poor economic policies more generally? Britain's economic and political hegemony did not long survive the loss of its large international creditor position. The record of the United Kingdom in the 20th century (1914–1956) suggests that a great power that becomes a great debtor will, after a few decades, lose its dominance. The United States passed from largest net creditor to largest net debtor in the 1980s. With the re-emergence of the twin deficits, and prospects for continued widening, will we see adverse economic and political ramifications? In the 1960s, Germany was willing to offset the expenses of stationing U.S. troops on bases there so as to save the United States from a balance of payments deficit. In 1991, Saudi Arabia, Kuwait, and a number of other countries were willing to pay for the cost of the war against Iraq, thus temporarily wiping out the U.S. current account deficit for the only time in a twenty-year period. Repeatedly the Bank of Japan, among other central banks, has been willing to buy dollars to prevent U.S. currency from depreciating (late 1960s, early 1970s, late 1980s).

The dollar has fallen sharply over the last year in response to the widening U.S. current account deficit. So far, it has not spun out of control: U.S. interest rates remain very low and securities prices high. Will other countries be willing to help us out the next time there is substantial unwanted downward pressure on the dollar, without setting conditions in return? I fear not. Sometime soon, newspaper stories will begin reporting that central banks in Asia and elsewhere are diversifying out of dollars into euros, and that the dollar is in danger of losing its status as premier international currency. This will be the most obvious symbol of what is already clear: the Bush Administration has failed spectacularly the obligations of international leadership. ◆