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**"Tonight, President Obama will give his annual State of the Union address."**

**1) Political update - Congress and White House reassess 2010**

Tonight, President Obama will give his annual State of the Union (SoTU) address. Pity his poor speechwriters: they must have been working frantically over the weekend, since - from a DC perspective - the world changed dramatically last week. The unexpected victory of Republican Scott Brown in Massachusetts meant that the Democrats lost their 60-seat supermajority in the Senate. The political agenda for 2010, we are told, has thereby been thrown into confusion.

Well, somewhat. Losing that crucial one seat will indeed make things harder for President Obama. But being realistic - they were never going to be easy! To pass his signature healthcare reform bill, for example, Democrats in the Senate had literally no margin of error: every single member of their party had to vote for it. In the House, they'd already had to cut some egregious deals to get enough votes to push the bill through. And nobody really knew how they were going to match up the two versions of the legislation.

Perhaps more important than the loss of the Senate supermajority is the psychological impact on the Democratic Party. They were already nervous about the mid-term elections in November; now, many of them are clearly running scared. This will impact both the issues they choose to work on (jobs being the most important) and how they address them (populist measures, e.g. punishing the banks, are definitely likely).

In items 2-5 below, we explore the likely outlook for four policies of particular relevance for CBI members. Our final comment on last week's political turmoil: it was most fun for Brits based in DC, who were all very much amused by headlines saying "Brown in shock election victory"....

## 2) Financial services - Obama acts to punish banks

The most immediate legislative response to the Massachusetts election seemed to be in financial services reform. To recap: both Houses are already looking at reform packages, including various measures to address systemic risk regulation, consumer protection and the institutional framework of regulators. In broad terms, the House approach (Chairman Barney Frank) was more incremental and in line with the White House; the Senate (Chairman Christopher Dodd) more radical. Additionally, the White House had already acted to claw back money given to the banks under the TARP programme via a bank levy, and had created a 'pay czar' to oversee executive compensation at banks that were bailed out.

After Massachusetts, Obama seemed to switch to a more populist, anti-bank stance. Saying "We're going to ensure that Wall Street pays back the American people for the bailout... we're going to rein in the excess and abuse that nearly brought down our financial system..." he announced dramatic new measures:

- # banks to be banned from running their own proprietary trading desks, and from owning, investing in or sponsoring private equity or hedge funds. (The so-called 'Volcker rule').

- # limits on size of banks. No details yet, but "The President's proposal will place broader limits on the excessive growth of the market share of liabilities at the largest financial firms, to supplement existing caps on the market share of deposits".

Commenting on the proposals, CBI Director General Richard Lambert noted both the unilateral and politically-driven nature of the proposals. He said "A unilateral move of this nature undermines the considered G20 approach for effective global reform. The world economy is in a very fragile state. An overtly populist approach of this nature, setting out only vague proposals, is potentially damaging."

The measures will require congressional approval. Barney Frank, Chairman of the House financial services committee, said he would support new rules if they allowed banks to dispose of newly banned operations over three to five years and thereby prevent a "fire sale". Republicans responded coolly, but did not reject the proposals out of hand.

The CBI is consulting its members on the impact of the measures, and in particular the way in which they would interact globally with other reform proposals in the UK and the EU, and those being discussed by the Financial Stability Board at the request of the G20.

## 3) Employment - jobs bill likely to include 'Buy America' clauses

The Massachusetts election has dramatically improved the prospects for one piece of legislation - a jobs bill, or second stimulus package. Obama is seen as having paid insufficient attention to double-digit unemployment - he'll definitely try and remedy that in this evening's SoTU address. Meanwhile, the Senate is likely to take up a version of the bill, which was passed by the House last December.

From the perspective of transatlantic business, the problem is that the bill is likely to be riddled with 'Buy America' clauses. The first stimulus package required all projects funded to use only American-made iron, steel and manufactured goods. But it also allowed the state and local government authorities to waive that clause. Now, Congress wants to make it substantially harder to get waivers. All waiver requests will have to

be published on a website. The contracting authority will have to prove that they waited sufficient time for an alternative US supplier to come forward. They'll have to publish an assessment of the impact of their waiver on the US manufacturing base. All measures that will make procurement officers extremely reluctant to look at non-US bids.

Last year, the CBI joined forces with other international business associations to oppose 'Buy America'. We are currently consulting on how to deal with the issue again this year.

#### **4) Climate change - what next after Copenhagen?**

Massachusetts was probably the final nail in the coffin of US cap-and-trade legislation in this Congress. Senate leader Harry Reid has attempted to suggest otherwise, but a 2010 Senate floor vote on a bill that its opponents can label as a 'job killer' is unlikely. With this in mind, supporters are eyeing other approaches—from folding cap-and-trade provisions into the jobs bill described above to adopting a scaled-back approach that would apply only to power plants—in hopes of making incremental progress this year toward broader climate legislation.

A second challenge to action on climate change is a bill that would prevent the EPA from acting on its 'endangerment finding' of last year. Senator Lisa Murkowski (R-Alaska) has introduced a resolution calling for the Senate to strip the Environmental Protection Agency of its authority to regulate greenhouse gas emissions under the Clean Air Act. The bill is unlikely to pass - although Murkowski says she has the support of 35 Republicans and at least 3 Democrats, that's still some way from 50. And even then, the House would have to pass a similar resolution, and the President would have to sign it. However, it's a strong signal of Congressional disapproval of the EPA's action.

The CBI continues its efforts to stress a more positive reaction to the challenge of climate change. CBI Washington hosted a visit by Professor Michael Grubb, Chair of Climate Strategies at Cambridge University and former Chief Economist at the Carbon Trust. He came to DC to discuss their upcoming report, 'Tackling Leakage', a major piece of research on how cap-and-trade schemes can best be designed to prevent carbon leakage. Professor Grubb met with a variety of businesses and key staff in the Senate.

We were able to further emphasize our messaging on effective carbon markets when we hosted a delegation of US Congressional staff at our HQ in London. They were so interested in our climate group's presentation that they stayed for an extra half hour and were very late to their next meeting! Prospects for legislation may be dim in the US, but there is still a considerable appetite for information about the European experience with cap-and-trade and other aspects of the shift to a low-carbon economy.

#### **5) Fiscal policy - forcing politicians to behave well**

A final policy area that will feel the effect of the Massachusetts election is the budget. In addition to unemployment, the election result was partially blamed on the ballooning federal deficit, and citizens' worries about 'big government'. Congress will have to take an extremely uncomfortable vote within the next few days to raise the federal debt ceiling by \$1.9 trillion to \$14.3 trillion. (Liberal blog The Huffington Post asks how big that really is: "A 1.9 trillion-mile trip is about the same as 8 million trips to the moon... the world

population is currently about 6.7 billion, so 1.9 trillion people would be enough to populate some 284 worlds.")

Partly as a response, President Obama proposed a bipartisan commission on the federal budget, charged with making recommendations about changes to the tax code and to entitlement spending programmes like Medicare and Medicaid. Only yesterday, the Senate failed to muster the votes needed to set up such a commission. Expect to see President Obama return to the idea in the SoTU address tonight, along with his call for a three-year freeze on discretionary government spending.

## **6) Campaign contributions - will companies donate more?**

Whilst Congress and the White House were reeling from the Massachusetts result last week, the other branch of government - the judiciary, in the form of the Supreme Court - caused a parallel sensation in the political world. The Court voted 5-4 to overturn longstanding bans on companies making political donations, saying they ran counter to the Constitution's provisions on free speech.

Companies and unions have been banned from giving money to election candidates since 1947. They get round the ban, partially, by setting up Political Action Committees (PACs), but these are highly regulated, and restricted to donations of no more than \$5,000, given by particular employees of the company. Now, companies will be able to fund advertising directly, rather than through a PAC. (Note that the Court's decision doesn't address a ban on companies giving money directly to candidates.)

There has been a strong backlash against the decision, which seems highly likely to increase the amount of money flowing into political campaigns. Although many companies will be wary of running ads directly in favour of or against candidates, they will feel more comfortable sponsoring 'issue ads' than before - and they're expected to give more money to trade associations such as the US Chamber, which will then run ads supporting or attacking candidates. (The CBI Washington office has still not decided whether to be envious of this likely boost to trade association coffers, or horrified by the prospect of even more attack ads on TV.)

One specific aspect of concern: opponents of the decision have been highlighting the way it would allow foreign governments (Venezuela and Saudi Arabia are frequently cited) to fund candidates and campaigns, via US subsidiaries of their companies. This has led some members of Congress to call for a ban on campaign contributions from any company with a foreign parent. Long-standing British foreign investors would therefore be banned from using the same communications strategies as their US competitors.

## **7) Latest economic data**

The final quarter of 2009 was a mixed bag, according to government economic data. US manufacturing activity climbed to the highest level in more than three years last month, as a surge in new orders continued to fuel factory output. The volume of container traffic going into big North American ports in December showed its first year-on-year rise since the US started sliding into recession two and a half years ago.

But the economy shed 85,000 jobs in December, as the nation's unemployment rate stayed above 10% for the second month. The job losses were higher than expected by many analysts, and may be due to the

government working through a pre-holiday backlog of filings.

Another weak point in the economy is still housing. Sales of existing US homes plunged more than anticipated in December. Purchases slumped 17% the month after a government tax credit was originally due to expire, the biggest decline since records began in 1968. New US residential construction slipped during a wintry December as well. A surge in building permits gave some hope that more building could be in store, according to Commerce Department figures - but it was pretty much cold comfort for a cold month in the construction sector.

#### **8) Richard Lambert to visit Washington DC in March**

The CBI's Director General will visit Washington from 8-10 March. Planning for his programme is under way, with the focus likely to be on financial services regulation, climate change and corporate reputation / trust in business. If you or your company would like to be involved in the visit in any way, please get in touch - we will be looking to put together roundtables with US interlocutors on all these topics, as well as high-level meetings with CBI members and government officials.

#### **9) Cargo security - 10+2 rule now in place**

Note that The Bureau of Customs and Border Protection started the New Year with a determined push on cargo security. From 26 January, they will be entering full enforcement of their controversial "10 + 2" rule, that requires importers and carriers to submit additional maritime cargo data electronically to CBP before the cargo is brought into the United States. For more information please go to: [http://www.cbp.gov/xp/cgov/trade/cargo\\_security/carriers/security\\_filing/](http://www.cbp.gov/xp/cgov/trade/cargo_security/carriers/security_filing/)

#### **10) HIV / AIDS - US lifts ban on travel**

The United States has lifted a 22-year old ban which stopped anyone with HIV/Aids from entering the country. Anyone who declared on their visa application, or their I-94 visa waiver form, that they had the infection, was previously turned away at the border. This put the US in uncomfortable company: only 11 other countries, including Libya and Saudi Arabia, have such bans. The ban was also jeopardising the 2012 World Aids Conference, which is due to be held in the US.

#### **11) Your game cards for tonight...**

Plenty of options for those who want to watch the SoTU address this evening. Here in DC, we'll mostly be in bars. But for UK-based insomniacs, options include a live feed to the White House website - [www.whitehouse.gov](http://www.whitehouse.gov) - or politics channel C-SPAN - [www.cspan.org](http://www.cspan.org)

To make it more interesting, why not play SoTU bingo? Listen out for particular words, phrases and gestures, and cross them off your card. Download bingo cards from <http://www.politicalbingo.com/index.php> and have fun!!