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GOOD POLICY STARTS WITH GOOD ANALYSIS

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Upcoming Events

- July 28: The U.S.-Japan Alliance in an Era of Geoeconomic Competition (CSIS)
- August 2: China's Eurasian Century? (CSIS)
- August 8: 50th ASEAN Ministerial Meeting (Manila, Philippines)
- August 16–20: First Round of NAFTA Renegotiation Talks (Washington, DC)

A former under secretary of the U.S. Treasury for international affairs reportedly told his career officials in an internal pep talk that they worked in a place "where rigor meets relevance." He was both warning against an overly academic approach to policymaking and applauding the Treasury tradition of grounding its work in sound economic analysis. In its first six months, the Trump administration has too often ignored or undervalued evidence-based analysis in its international economic policy, to the detriment of U.S. interests and the administration's own objectives.

Good policy starts with good analysis. If rising health care premiums are a problem, you need to understand their causes, as well as the costs and benefits of different government interventions to make health care more affordable. This is what career analysts do. Which approach to take is a decision for political officials, but thorough, evidence-based analysis is essential to their ability to make defensible policy choices.

It was evidence and analysis that neutralized what might have been an early mistake in the Trump administration's international economic policy. On the campaign trail, candidate Donald Trump had promised to label China a currency manipulator "on day one." The fact that this didn't happen, and that Treasury found no manipulation in its semiannual report to Congress in April, was the result of career officials' persuading Secretary Stephen Mnuchin that neither China nor any other country met three clear and specific criteria for manipulation.

In other areas of Trump international economic policy, analytical rigor has too often been lacking. In particular, the administration's obsession with bilateral trade deficits, and the attribution of these primarily to unfair trade practices, may reflect political impulses but is not grounded in economic analysis. Targeting these objectives not only raises the specter of harmful protectionism but also risks undermining Trump's own growth objectives for the U.S. economy.

The fixation with bilateral deficits reflects an outdated view of how the global economy works. Today's global supply chains have made the notion of bilateral trade balances—never a good target for policy—almost irrelevant. Much of the value of products that arrive in the United States on ships from China is not produced in China, but in third countries like Japan and Vietnam; yet the entire landed cost of the product is recorded as an import from China, inflating the U.S.-China deficit. Factoring in the value-added content of goods imports from China would have halved the U.S. bilateral goods trade deficit in 2015 to about 1 percent of gross domestic product (GDP), according to Oxford Economics.

Moreover, trade barriers are not the main cause of trade deficits, as the administration suggests. Fundamentally, a country's overall trade deficit (technically its current account deficit, which includes investment income earned abroad) reflects an excess of domestic investment over domestic savings. Joe Gagnon and Fred Bergsten of the Peterson Institute estimate that the U.S. current account deficit is driven by our fiscal deficit (i.e., government dissaving) and by foreign governments' running large fiscal surpluses and intervening to suppress the value of their currency to make their exports more competitive and imports less so. East Asian and Eurozone economies have persistently invested less domestically than their people and governments save, while these countries' central banks, sovereign wealth funds, and pension funds have channeled these savings into U.S. assets and built up dollar reserves. Unfair trade practices may have contributed a little by suppressing domestic consumption, but it is these global imbalances in savings and investment that have primarily fueled the U.S. trade deficit.

The problem is compounded by analytical flaws in the administration's growth strategy. The administration has set a goal of pushing annual growth of U.S. GDP above 3 percent, up from its recent pace of around 2

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percent. As many economists have pointed out, this is an ambitious—or even fanciful—goal in light of unfavorable demographic trends and sluggish productivity growth. The only realistic way to achieve faster growth is to create a "higher pressure" economy, in which consumers, businesses, and/or governments spend more. Coming into office, the Trump administration rightly identified tax reform and infrastructure investment as keys to boosting domestic spending and growth. The White House and Treasury should put recent distractions behind them and get back to working with Congress on sensible legislation in these areas.

But they also need to get international economic policy right. Suppose the United States does get back on a 3 percent growth path through domestic policy stimulus alone. What is that going to do to the trade deficits that the Trump team so rails against? In the absence of strong, domestic-demand-led growth in other major economies like Germany, Japan, and China, the United States is going to remain the "consumer of last resort," fueling ever-larger trade deficits and debt.

Thus Washington should be using every opportunity to push other big countries to stimulate their own domestic economies. Germany should be a prime target, since its parsimony has contributed to a massive surplus of savings over investment and a related current account surplus of some 8.3 percent of GDP in 2016. President Trump and Secretary Mnuchin had a golden opportunity to lean on their German counterparts at the G20 Summit in Hamburg earlier this month. Instead, they harped on bilateral trade deficits and unfair trade practices and paid mere lip service to correcting the global imbalances that do far more to threaten U.S. growth prospects.

To be sure, the Trump administration is right that other countries make use of unreasonable and discriminatory trade practices. China's restrictions on market access for U.S. agricultural and services exports, its aggressive efforts to acquire foreign technology through any means, fair or foul, its subsidies to state-owned enterprises that fuel overcapacity in sectors like steel and aluminum—all amount to mercantilism that distorts global markets and harms U.S. commercial interests. Washington is right to push back, using a range of legitimate policy tools.

But we should not pretend that curbing other countries' unfair practices will make more than a dent in U.S. trade deficits without underlying macroeconomic shifts in savings and investment. We also need to recognize that using protectionist or managed-trade solutions, as the administration has threatened, will impose a cost on U.S. consumers—directly from higher import prices, indirectly from likely retaliation by trading partners.

Career officials at Treasury and other economic agencies understand all this. But with few if any political appointees between them and the secretary, and a zero-sum mentality on trade in the top echelons of the Trump administration, there is limited scope to sway internal policy debates with compelling, evidence-based analysis. Even to achieve its own economic policy objectives, the Trump team should spend more time listening to its talented career officials.

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Simon Says...

For the first time since the Toronto Summit in 2010, G20 leaders failed to include a substantial discussion of infrastructure in their communiqué following the Hamburg Summit earlier this month. This is especially odd considering that the G20 includes China, which as host of last year's summit in Hangzhou championed collective action on infrastructure investment. Beijing has also been making elaborate efforts to promote its ambitious "Belt & Road Initiative," which it claims will "create a community of common destiny" backed by trillions of dollars of spending on new roads, railways, and ports around the globe.

It makes sense that the penny-pinching Germans would not want to highlight expensive infrastructure investment in this year's communiqué, but why didn't Beijing—a member of the so-called troika of G20 hosts past, present, and future—push harder for recognition of its initiative on this issue? Is this a sign that China has given up on the G20? Or is President Xi Jinping having second thoughts about the costs and risks of his extravagant Belt & Road vision? ■