CHARTING THE U.S. ROLE IN THE WORLD ECONOMY

Economics Enables Strategy

The strength of the United States' economy supports its international power, making the next administration's economic choices among its most crucial. RAND economist Howard J. Shatz has identified the country's most pressing economic issues and offers recommendations on:

- 🌐 Challenges to world institutions
- 🌐 China's growing economic power
- 🌐 Bolstering weakened partners

Shatz's overarching conclusion: The United States—and Americans—stand to gain more from strengthening global institutions and engaging with the world's growing economic powers than from pulling back. Failure to assert leadership will open the door to greater uncertainty for both the U.S. and global economies. Shatz explores these themes in the RAND research report, *U.S. International Economic Strategy in a Turbulent World*.

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U.S. Strengths—and Vulnerabilities

More Debt, Fewer Options

The United States has largely recovered from the worst financial crisis since the Great Depression and is performing well by several measures. However, there are a number of serious challenges. As of 2015, U.S. federal debt stood at 74 percent of gross domestic product, the eighth-highest ratio in history. Debt projections hit 103 percent of gross domestic product (GDP) by 2040.

The Stakes for America

A large increase in net U.S. debt could leave the nation unable to fund programs that advance Americans' well-being and to finance national strategy—including defense.

Recommendation

Even if more-rapid economic growth materializes, spending cuts and revenue increases must be enacted. Increasing revenue will require repair of the U.S. tax system.

Caveat

There is no political consensus on how to raise money more efficiently or achieve fiscal balance. While faster economic growth will ease the problem, it's not a solution in itself.

Debt May Exceed GDP by 2040

When will servicing debt crimp U.S. policy options? The Congressional Budget Office estimates that in 2040, interest payments could absorb more than 20 percent of all federal revenue, gobbling up funds that could be invested in domestic advances and international efforts. Source: Congressional Budget Office.

In Workers' Woes, Slower Growth

Positive headlines about a falling unemployment rate and job growth are accompanied by different, troubling signals. Real median weekly earnings have been flat for 26 years, labor-force participation is declining, and jobs for middle-skill workers have been disappearing. Together, these trends have made it more difficult for some people to achieve the kind of middle-class lifestyle that can drive broader economic growth.

This brief's focus on international economics precludes making specific recommendations to address these issues. However, Shatz notes that the most common policy prescriptions include improving education and skill development and reevaluating labor market regulations and other policies that might be suppressing participation.

U.S. Strength, Though Less Momentum

The world economy faces fresh challenges in 2016. Growth is slowing, an important international trade negotiation has failed, and global debt is increasing. Relative to other countries, the United States is on firmer footing, carrying forward its historical momentum—and providing it with policy options that others lack. A look at two measures tells the tale of the United States' strength and interactions with the global economy.

Better Trade Trajectory

The current account balance, an important indicator of economic health, reveals an area of resurgent strength for the United States. The U.S. current account deficit (which largely results from the country buying more from abroad than it sells to the rest of the world) has narrowed to -2.2 percent of GDP in 2014 from almost -6 percent in 2006. Foreign purchases of services from U.S. companies are helping to stanch the deficit, revealing an area of resilience. Source: Bureau of Economic Analysis.

U.S. GDP Poised for Growth?

The United States' share of the world's economic output declined by a total of 3.5 percentage points between 1991 and 2014 but increased slightly in the last three years of that period. The country is likely to remain the world's largest economy for many years, confirming its leadership role in the international economic structures it played the largest part in creating. Note: Figure shows each country's or group's share of global GDP, as measured in current U.S. dollars. BIRS = Brazil, India, Russia, and South Africa. Source: World Bank.

New Tests for an Old System

The world's economic structures—groups like the World Trade Organization, the International Monetary Fund, and the World Bank—have helped create opportunity that enabled countries to raise incomes and reduce poverty by historic magnitudes. Now those structures are fraying, and rising powers want more influence in them. Those countries also are creating new institutions that may rival U.S.-dominated bodies. How should the United States respond?

Recommendation

The United States should strive to maintain and improve the current system. That means integrating growing economic powers, improving rules to foster free exchange, and spurring growth so that countries find a U.S.-led system a desirable one in which to participate. It's difficult to conceive of a different system that will deliver the same gains as the existing system. The United States must lead in reforming and expanding the existing global economic structures.

An Era of Rapid Growth

The world economy has grown almost fivefold in the past 50 years under a set of economic institutions established by the United States and its partners, increasing from \$9.9 trillion in 1960 to \$58 trillion in 2014. Note: Figures are in constant 2005 U.S. dollars. Source: World Bank.

Threads in a Web

Existing global economic organizations and treaties haven't kept up with changes in the global economy, and faster-growing countries want a bigger say. The United States faces choices on how to ensure that the evolution of the world economy does not result in more barriers to trade and investment.

Potential New Economic Structures	Best Move
Trans-Pacific Partnership (TPP) The TPP, covering 12 Pacific Rim nations that as of 2014 accounted for 36 percent of world GDP and 24 percent of world exports of goods and services, has been signed by trade ministers. Now, fights over ratification.	Approve a Pacific trade deal and create eventual onramps for new members.
Transatlantic Trade and Investment Partnership (TTIP) The TTIP, currently under negotiation by the United States and the European Union, would ease trade rules and harmonize regulations.	Complete a U.S.-Europe deal to help spur growth among partners with slowing economies.
World Trade Organization The most recent negotiations to reaffirm the WTO fell through.	As agreements such as TPP and TTIP are forged, consider how the WTO could leverage them into the basis for a new round of global trade talks.

Keeping China Close

Smart Deals Can Bind China to the World

As China's economy has grown, so too has its desire to play a more prominent role in a world economic order dominated by established powers. While not exiting existing institutions, China is building parallel institutions, which it leads. The Asian Infrastructure Investment Bank and the New Development (BRICS) Bank, which respectively aim to support development regionally and globally, demonstrate China's ability to wield wider influence.

The Stakes

An ascendant China—while a potential source of U.S. economic growth as a trading partner—can establish parallel institutions that could be productive for the world but could also change global rules or, potentially, undermine U.S. interests.

Recommendation

Engage China more deeply in the world's rules-based liberal economic order to maximize benefits to the United States—and give China greater incentives to play by global rules.

The Bonds of U.S.-China Trade

Agreements and organizations can provide the United States with leverage to influence China's economic behavior—and power mutual growth.

Entities and Deals		Best Move
U.S.-China bilateral agreements A bilateral investment treaty has been under negotiation since 2013. Sticking points include access to sectors for investment.		A good deal will vastly improve access to the Chinese market for U.S. investors and help spur China's needed reforms. China's willingness to open its market adequately raises questions, as does the issue of enforcement. A well-conceived bilateral investment treaty will provide further mechanisms for binding China to an enforceable rules-based system.
TPP China is not a party to the agreement, which has been signed by Pacific Rim trade ministers and awaits ratification votes.		Create an onramp for China to eventually participate in this agreement. It would empower reformers in China and keep the country in a system that also benefits the United States.
Asian Infrastructure Investment Bank and New Development Bank Developing countries, led by China, own a majority of the shares in these funding institutions, giving them power to finance beneficial projects.		Extending the U.S. policy of having opposed the AIIB is inferior to other options. For both banks, policy options include monitoring and reporting on their activities, offering technical assistance, encouraging partnerships with other international financial institutions, and partnering directly through U.S. development institutions.

Old Friends Fading

Demographics and Economic Growth Propel New Powers

Both the IMF and World Bank expect poorer countries to grow faster than the United States and economically advanced countries.

Recommendations

United States

Get the United States' economic house in order to set a better example, better fund international efforts, and increase global growth and market demand for goods and services from the world.

Europe

Complete a U.S.-European Union trade and investment agreement and broaden it to include all of North America and Europe.

Japan

Further integrate the U.S. and Japanese economies through steps such as a broad Pacific trade deal, recognizing the domestic political difficulties that make achieving a bilateral deal difficult.

International

Maintain or increase levels of contributions to international financial institutions and developing countries while evaluating them for effectiveness and being open to experimenting with new forms of assistance.

Developed Partners Losing Ground

While the United States and the European Union tracked annual average world per capita GDP growth between 1991 and 2014, Japan lagged for the whole period, and the EU slowed dramatically at the end of the period. Assembling the political forces to foster faster growth is the main challenge with these long-term partners. Note: Data show average annual growth of real per capita GDP in 2005 U.S. dollars. Source: World Bank.

Two years ago, amid war fatigue at home, tumult in the Middle East, and trepidations about Russian and Chinese intentions, I asked Ambassador Richard Solomon to lead a team of RAND colleagues in taking a fresh look at America's role in the world. With the United States heading into a presidential election campaign, I saw both a need to offer evidence-based, feasible policy options to inform the electoral debate and an opportunity to discuss larger strategic questions on which there is little consensus today.

What are America's international ambitions? What level of international engagement is the public prepared to support, and what can be sustained? How might the next president exercise international leadership in a tumultuous world, and to what end? And is there a coherent "grand strategy" for diplomacy and defense that would align the wide array of U.S. interests with the means to achieve them?

The result is our "Strategic Rethink" project. We pulled together some of our best minds to produce a guide for policymakers and citizens, educators and the media, on the most critical global choices and challenges that this president and the next will likely face—whether the public has yet focused on them or not.

—Michael D. Rich
President and CEO, RAND Corporation

The Strategic Rethink series reports are available for free download at
www.rand.org/research/projects/strategic-rethink.html

The Strategic Rethink Series

This research brief summarizes the fifth volume in RAND's Strategic Rethink series, in which RAND explores various elements of national strategy for the conduct of U.S. foreign policy in a turbulent world. This brief describes research documented in *U.S. International Economic Strategy in a Turbulent World*, by Howard J. Shatz, RR-1521-RC (available at www.rand.org/t/RR1521), 2016. To view this brief online, visit www.rand.org/t/RB9918. This project results from the RAND Corporation's Investment in People and Ideas program. Support for this program is provided, in part, by philanthropic contributions from donors and by the independent research and development provisions of RAND's contracts for the operation of its U.S. Department of Defense federally funded research and development centers.

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