Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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America responsible for its foreign economic policy in disarray

When it comes to US foreign economic policy, President Donald Trump's administration has two problems on its hands.

Following what has become something of a pattern for this administration, both problems are of its own making.

In South America, Trump & Co. are heavily exposed to a dubious effort to stabilize the Argentine peso, a task to which they have committed more than $20 billion.

In Asia, they are engaged in an on-again-off-again trade war with China, in which Chinese President Xi Jinping has the upper hand.

Argentina's President Javier Milei has made good on his promise to take a chainsaw to his country's budget deficit.

But to reinforce the fall in inflation, he has propped up the peso's dollar exchange rate, which has hurt exports and slowed economic growth, leading to uncomfortably high unemployment.

The question is whether a restive public will continue to support Milei's policies indefinitely.

History suggests that it will not, notwithstanding last month's legislative elections, which provided a temporary respite.

Temporary is the operative word: public opinion could turn again. To paraphrase my Berkeley colleague Maurice Obstfeld, Argentina is a graveyard of unsuccessful exchange-rate-based stabilizations.

More than once, variants of this policy have collapsed in a heap of political dysfunction.

Can Argentina repay the US Treasury?

Given this, Milei's strategy also creates doubts about whether Argentina can repay the US Treasury.

Senior creditors like the International Monetary Fund, which went into Argentina earlier, stand to be paid first out of the country's limited foreign exchange.

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Even if Argentina somehow repays the US Treasury but the government falters in the 2027 election, Treasury Secretary Scott Bessent, who made supporting Milei official US policy, will be left with egg on his face.

A pattern for the future

In the case of China, Trump thought he had a leg up in any trade dispute because the US buys more from China than China buys from the US.

And because the US is the more advanced designer of cutting-edge semiconductors, Trump thought he had more leverage from export embargoes than anything China could threaten.

The reality, of course, is the opposite. China can simply divert its exports of merchandise and commodities from the US to other parts of the world, as it had begun doing even before Trump's return to the White House.

It can import advanced semiconductors from third parties or soup up last year's model.

And when provoked by the addition of more Chinese companies to the US Entity List, the blacklist of companies barred from access to

advanced technology, China can embargo exports of the rare earths that are essential inputs for consumer electronics, motor vehicles, and, not least, US military hardware.

Seen in this light, Trump's climbdown following his recent meeting with Xi is no surprise.

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Xi made an empty commitment to buy more American soybeans, just as he has in the past. He suspended his rare-earth embargo but left that sword of Damocles hanging.

Trump for his part agreed to scale back his punitive tariffs, suspend port fees on Chinese ships, and delay the planned expansion of the Entity List that had provoked China into threatening rare-earth controls in the first place.

Importantly, this negotiation sets a pattern for the future. The next time Trump threatens China with tariffs, port charges, or export controls, Xi will threaten rare-earth export controls, and Trump will chicken out.

China's rare-earth monopoly won't last forever, but it will outlast the Trump administration.

Economic and financial mess

In the case of Argentina, where it was a mistake to make an unconditional commitment in the first place, the Trump administration should require the Milei government, as a condition of continued US support, to allow the peso to depreciate, eliminating its overvaluation, after which the currency should be allowed to float more freely.

Argentine producers will then be able to export more, helping to stabilize growth and employment while ensuring that the government can repay what it borrowed.

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Admittedly, inflation will come down somewhat more slowly than previously programmed, because import prices will rise more rapidly.

But disinflation will be more politically sustainable, because it will cause less unemployment and social dislocation.

There will be less likelihood of the public repudiating the policy – and Milei – in 2027.

Milei has shown no sign of seeing the light, instead doubling down on his risky monetary strategy.

And while Bessent, who knows his way around currency crises, could force Milei's hand, he is showing no willingness to do so.

Best of all would be for the US authorities, in their wisdom, not to create this kind of international economic and financial mess in the first place. Don't hold your breath.

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