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Economics & Security in American Foreign Policy: Back to the Future?

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Introduction: Connecting Economics and Security

I appreciate this opportunity to be with you this evening.

As a former student at the Kennedy School, a Senior Fellow at the Belfer Center, and the long-time beneficiary of many contributions by Kennedy School scholars and students, I am delighted to be here to share some ideas on a topic I have been pondering for a while.

This evening I'll offer a strategic perspective on the connection between economics and security. In doing so, even as we look ahead, I'll draw on an earlier American foreign policy tradition to offer a revision to the standard post-World War II history.

Let me start with an anecdote that helped crystallize my thinking.

Earlier this year, Bob Carr, Australia's Foreign Minister and long-time friend of the United States, observed with Aussie clarity: "The United States," he said, "is one budget deal away from restoring its global pre-eminence." And he added a caution: "There are powers in the Asia-Pacific that are whispering that this time the United States will not get its act together, so others had best attend to them."

Bob Carr is the founder of the Chester A. Arthur society – named after America's not-so-renowned 21st President – a proud assembly of Australians who appreciate obscure U.S. political history and humor.

So Carr would probably not be surprised to learn that his warning echoes words that Alexander Hamilton drafted for President George Washington's farewell address: that the new nation must "cherish credit as a means of strength and security."

Ironically, it took an Admiral – Mike Mullen, then chairman of the U.S. Joint Chiefs of Staff, to recall Hamilton's warning about the linkage between credit and security. Mullen seized attention not by pointing out a danger to the fleet, but by telling CNN, "The most significant threat to our national security is our debt."

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Mullen's observation should not come as a surprise, because strategists in uniform often look to history as their laboratory. And they need to match means and capabilities to achieve ends. Officers at staff colleges may be inspired by the exciting chapters on Napoleon's bold campaigns, or the Royal Navy's counterstrikes, but the astute also discover that the key to Britain's victory in the Napoleonic Wars is found in those dry accounts of William Pitt the Younger's budgets. By restoring Britain's credit after its costly imbroglio with the American colonies, Pitt enabled his country to fight a long war – and even repeatedly finance coalition partners – without choking Britain's economy.

Yet America's security strategists seem to have lost the ability to integrate economics into foreign policy. The usual security perspectives on economics do not extend much beyond sanctions policies and paying for defense budgets.

At best, the role of economics is assumed, not analyzed. We scarcely understand its effects on power, influence, diplomacy, ideas, and human rights. At worst, economic problems have become a justification for a "Come Home, America" isolationism. Economists – absorbed with mathematical models – are content to operate in their separate universe.

Some – on the left and the right – disparage the role of economics in foreign policy as crass commercialism, narrow business interests, or worse, affording undue influence to bankers. Others view international economics and trade policy as narrow specialties involving technical negotiations that just aggravate domestic constituencies.

Yet this separation of economics from U.S. foreign and security policy reflects a shift from earlier American experience. For its first 150 years, the American foreign-policy tradition was deeply infused with economic logic. Unfortunately, thinking about international political economy has become a lost art in the United States. It's time to look "Back to the Future."

The American Foreign Economic Policy Tradition

As some of you may recall, in 1773 a tribe of Bostonians threw 342 chests of tea into the harbor – without damaging other property, I should add – to protest taxes imposed to bail out the nearly bankrupt East India Company. Their protest still inspires a political movement in our time. The incident was the most dramatic of waves of colonial "nonimportation" policies dating to the 1760s, early American efforts to employ trade as a tool of policy.

The new American Republic was born amidst a world of mercantilist empires. Navigating around the trading monopolies of the seasoned, established powers – and later blockades and bullying – the former colony fought continually for "freedom to trade." This principle was not "free trade" as we understand it today, but was definitely a challenge to the old order.

The young United States, under President Thomas Jefferson, tried to exert leverage of its own with nonimportation acts and even a disastrous Embargo of foreign commerce in 1807 to pressure Britain on neutral trade and the impressment of sailors. Ironically, it took the failure of American trade sanctions, and the War of 1812, for the United States to start to develop the manufacturing base that Hamilton sought and Jefferson opposed.

Britain was not the only object of the U.S.'s economic security policy. From 1801-05, in the face of the Barbary Pirates' attacks on U.S. ships, Jefferson rejected demands for tribute and instead sent the U.S. Navy to the shores of Tripoli. As the U.S. Marine Corps Hymn has memorialized, this Libyan expedition was not "led from behind."

In an age where power arose from territory, resources, people, and then commerce, the implicit American strategy understandably concentrated on the North American continent and open immigration. Land and settlement provided security.

Wielding a lost tool of diplomacy, the United States resolved disputes by buying lands – Louisiana; Florida; old New Mexico, California, and the Gadsden Purchase; Alaska; and even the Virgin Islands at the start of the 20th Century. Admittedly, in some cases use of force led to price discounts. In another touch of irony, Jefferson needed Hamilton's Bank of the United States and credit system – which Jefferson had opposed – for his greatest achievement, the Louisiana Purchase.

The theme of Western Hemispheric integration – a partnership of young democracies, not an empire – was advanced by Secretary of State Henry Clay in the 1820s, revived in the 1880s and 90s, and found first fruits a century later in NAFTA and then five more U.S. Free Trade Agreements with Latin America. Today, those free trade agreements encompass over half of the hemisphere's non-U.S. GDP. In the 21st Century, comprehensive free trade agreements could turn out to be ties that bind, like the alliances of old.

The Federalist Papers, the touchstone of American Constitutionalism, are replete with references to the need for a strong, federal government to secure the United States' place among foreign nations, including through healthy commerce and credit. Indeed, John Jay cautioned in 1787 that the growing trade with China would one day draw the United States into conflict in the Far East. The United States' first forays into international relations were called Treaties of Amity and Commerce.

As a maritime country, the U.S. Navy looms large in America's foreign economic policy. In 1854, Commodore Matthew Perry "opened" Japan to trade. By 1899, Secretary of State John Hay was resisting carving up China, as Africa had been, in favor of an "Open Door" policy to secure equal commercial opportunity.

This race through U.S. foreign economic policy is not intended to suggest that the American system was all peaceful commerce. To the contrary, even if the connection was driven by interests and not explicit planning, the economics and security policies worked hand-in-hand. These interests were often infused with a healthy dose of what those generations called spreading "civilization," and which we call "values." With trade and the flag came missionaries – and their schools. After the defeat of the Boxer Rebellion in 1900, the United States pragmatically used its share of the indemnity imposed on China – which the United States had opposed – to found Tsinghua University in Beijing and fund scholarships for Chinese students in the United States.

As the United States settled its home continent around the opening of the 20th Century, a debate arose about expansion to territories beyond U.S. shores. Some wanted markets or coaling stations, and others sought to carry "civilization" to foreign peoples. Some simply wanted to keep strategic places out of the hands of others. But "imperialism" did not sit well with many Americans, who proudly recalled that

their new nation had freed itself from old empires. The U.S. war with Spain in 1898, precipitated by conflicts over Cuba, led the United States to acquire the Philippines – for $20 million – to keep the islands from being grabbed by others whose fleets were hovering—but the United States did not take Cuba. Teddy Roosevelt stirred up a revolt in Panama so he could build a canal that linked the two great oceans, commerce, and fleets of the U.S. Navy.

The American foreign economic policy helped spur early interest in international law – what we now awkwardly call "rules-based systems" – to resolve disputes. The United States was an active participant in the first Hague Conference of 1899 and lent its support to the Permanent Court of International Arbitration. Secretary of State Elihu Root negotiated arbitration treaties with 25 countries early in the 20th Century.

The decades that followed continued the pattern. "Dollar Diplomacy" sought to support American enterprises in Latin America and East Asia, through what we now call trans-national actors – but in those days were railroad and mining engineers, bankers, and merchants.

In World War I, Great Britain wisely learned a lesson from a century before, and shrewdly played on the U.S. commitment to neutral rights on the seas.

After World War I, reacting against what the United States viewed as the old European politics of perpetuated hostilities, the country withdrew from European military security. Yet even during the 1920s and 1930s, the United States relied on banker-statesmen to negotiate debt and reparations in Europe and Mexico to revive broken economies. To secure peaceful seas, the United States even launched the idea of global arms control through the Naval Disarmament Conferences of the 1920s.

In the depths of the Great Depression, however, the United States withdrew from the world economy, and political-military "isolationism" followed.

Then came 1941, and the United States again learned, through harsh experience, that economic and security interdependence were linked. The United States had imposed embargoes on the sale of petroleum and scrap iron to Japan in response to Japan's invasion of China and its threats to Southeast Asia. Imperial Japan responded with a surprise attack, in part to secure its sources of oil and raw materials. The United States, caught unprepared, paid a terrible price.

The Rise of the National Security Concept

World War II and the opening of the Cold War led to a sharp break in the American foreign policy tradition. At least that is the impression left by the masters of mid-20th Century security studies.

In their narrative, the dawn of the nuclear age, the faceoff between Communism and the West, required a new approach: a national security strategy. Understandably, in a world of Superpower confrontation and containment, the traditional American foreign policy aims of amity and commerce seemed quaint and outdated.

For the first time in its history, the United States maintained a large conventional army, a significant part based in Europe, with other troops fighting in East Asia in the 1950s, ‘60s, and ‘70s, and in Southwest Asia in the ‘90s and for the past decade.

Instead of Milton Friedman’s idea that economic freedom is an end in itself and an indispensable means toward achieving political freedom, economics became a resource factor in the national security state. And economics became the handmaiden of the strategic policy process. The U.S. National Security Act of 1947 is full of references to new offices to manage the mobilization of people and resources for total war. Yet the Act did not even make the Secretary of the Treasury a statutory member of the new National Security Council. Ever since that time, the U.S. Government has struggled to integrate economics into its national security strategies.

The transformation of U.S. foreign policy priorities – from a fusion of economics and security to national security policy – signaled a change in the training of the stewards of American foreign policy. The new specialties were Soviet studies, political-military affairs, defense policy, and eventually Middle East policy. Short of home-grown talent on the central front, America even outsourced security strategy to immigrants from continental Europe – Henry Kissinger and Zbigniew Brzezinski – who had grown up in a world of threat and power balance in Eurasia.

Reintroducing Economics Into the Post-World War II Narrative

We need to rewrite economics back into the narrative of the Cold War and all that follows.

We need a fuller appreciation of the links between economics and security to match the times. The world continues to struggle through a global economic crisis that began in the United States. Fears, fragilities, and failures are fueling tensions within and among countries. Leaders are under protectionist and nationalist pressures—in trade, but also regarding currencies, investments, resources, islands, and the oceans. These frictions risk a downward economic spiral and even conflict.

To better appreciate the political economy story—and its significance for security—it is helpful to consider three phases since the end of World War II: from the creation of the Bretton Woods system to its breakdown in the 1970s; then, a capitalist revival from the late ‘70s through the end of the Cold War; and on, to the rise of globalization in the 1990s, extending to the crash of 2008. We are now stumbling into a new, fourth phase that is vital for the United States to shape.

Phase One: From Bretton Woods to the 1970s

Even as World War II still raged, the United States and Great Britain met in Bretton Woods, New Hampshire, to begin creating new international economic institutions to address currency exchange rates, trade, reconstruction, and development. The United States and Europe launched the Marshall Plan – and Europe created an Economic Community – to shore up the economic foundations of the free world. The United States exported capital and imported goods to boost recoveries in Europe, Japan, and then Korea and others in the developing world.

The economic internationalists of Bretton Woods and the European Community were not driven primarily by a plan for "Containment" or to counter the Soviet Union. That came later. Indeed, one of the prime architects of the Bretton Woods institutions, Harry Dexter White, was later doomed by his sympathies for the Soviet Union. These strategists were trying to counter the economic causes of political and security breakdown in the 1920s and '30s. Only over time did the imperatives of the Cold War led to a pragmatic convergence of the national security planners and the economic designers.

Yet there is a crucial difference in the way the 20th Century national security model embraced economics: The national security focus on resources of the state treated international economic issues as benefits to be exchanged to support security aims. Trade concessions. Foreign assistance. Military aid. Not necessarily inclusive growth, good governance, and open, competitive markets.

This difference is important. The national security perspective of state power risks overlooking an important reality: That sound economic policies are the underpinning of both individual freedom and national power – not only military power, but also the dynamism, innovation, and influence of the economy and society. The 20th Century concept of national security also overlooked how economic change – within economies and internationally – can be a powerful force of its own in international relations.

President Eisenhower understood this distinction. He invested political capital in balanced budgets, low taxes, and sound monetary policies. He recognized the underlying strength generated by investments in national highways, education, and science. On the international stage, as Anthony Eden learned to his sorrow in the Suez Crisis, Eisenhower would even use the power of the U.S. Dollar over the British Pound to stop the use of force in Egypt.

In the 1970s, a new generation of international relations thinkers, led by Robert Keohane and Joe Nye, questioned the realist power model of Hans Morgenthau that accompanied the Cold War national security concept. They did not dismiss power, and indeed recognized the vital role of military force. But Keohane and Nye supplemented realism with a description of complex interdependence, including economics. Their attention to diverse regimes and international organizations was timely, given the breakdown of the Bretton Woods system of fixed exchange rates and the rise of oil power through OPEC in the 1970s.

Thus, during the 1970s, the first phase of the post-World War II international economic system came to a messy close. The world economy stumbled toward a new reality of floating exchange rates, oil shocks, big bank loans of petro dollars to developing world sovereigns, and stagflation.

It is intriguing that Henry Kissinger – the master strategist of classic realism – struggled to integrate these seminal economic events into his Weltanschauung. Some critics even argued that Dr. Kissinger's lack of understanding of economics led to a balancing strategy based on the assumption of a Spenglerian decline of the West.

From the dominant national security perspective, however, Kissinger had shrewdly extricated the United States from military defeat in Vietnam while opening relations with China as a counterweight to his Soviet foe.

Keohane and Nye recognized that they had a blindspot, too. As presenters of a "framework for using international factors (emphasis in the original) to explain change and stability in world politics," they acknowledged that they did not examine the connection between domestic and foreign policies. They focused on international systems – rules, norms, regimes. Yet critical domestic choices – particularly economic ones – will infuse foreign policy and shape – for good or ill – the principles, practices, and diplomacy of those international systems.

Phase Two: The Revival and Success of Capitalism

Margaret Thatcher and Ronald Reagan understood intuitively the connection between national economic revival and foreign policy. Their priority was to revive capitalism at home – so as to extend it to the world. In doing so, they defined a second phase of the post-War international economy.

The promotion of global capitalism seemed to many to be disruptive, the antithesis of rebuilding an international economic system that was reeling from shocks. After all, Joseph Schumpeter had explained that capitalism is creative destruction. Yet this very disruptive quality enables capitalism to respond flexibly and continually to technological and other changes.

The reform of capitalism was not just an Anglo-American venture. Germany's commitment to sound economic policies and export competitiveness demonstrated that social market economies can work. East Germans saw the stark contrast with their existence. Japanese manufacturers responded to the oil shocks with a huge increase in energy efficiency.

Together, the domestic economic policies of the Trilateral partners enabled the "West" to adjust to the 1970s breakdown of the post-World War II economic security system.

The Soviet Union could not adapt to its economic challenges. The USSR could not cope with change in information technology, new drivers of productivity and competition, and eventually $15 a barrel oil.

The combination of the democracies' economic regeneration, the U.S. military buildup with advanced technologies, and trans-Atlantic solidarity over Euromissiles led Mikhail Gorbachev to conclude he had to reform Communism. But his Perestroika didn't work.

Reagan believed that the regimes and institutions of interdependence should be tested for effectiveness in boosting international growth, opportunity, and human rights. After all, those were the standards of economic freedom he was applying at home. Moreover, at a time of economic flux the international regimes needed to foster flexibility and adaptation. Reagan believed that the international rules definitely should not constrict domestic economic revival.

Reagan saw the link between the national and international. His Administration worked to shape the post-war international economic system after the 1970s upheaval. At first, the United States drew criticism by rejecting some international schemes – UNESCO's New World Information Order, the UN General Assembly's New International Economic Order, and the deep seabed mining regime in the Law of the Sea Treaty.

Still, after a pause, the United States would lead in reshaping international economic relations. In 1985, Secretary of the Treasury James Baker launched a process of international economic coordination in the G-7. The United States steered the IMF to a new role in the Latin American debt crisis in the 1980s. It led a major recapitalization of the World Bank to support developing countries' economic reforms and debt reschedulings – until banks could write down losses.

Under President Reagan, the United States pushed to expand global trade through the launch of the Uruguay Round, completed much of the negotiation under President George H.W. Bush, and closed the deal to create the World Trade Organization under President Bill Clinton. President George H.W. Bush helped initiate APEC to foster economic ties across the Pacific after the Cold War and negotiated NAFTA, which President Clinton enacted.

The end of the Cold War and its immediate aftermath brought the second phase of the post-War international economy to a close with astounding success. The national security aims of the Cold War in Europe were achieved with hardly a shot fired. It may not be coincidental that the principal U.S. Secretaries of State in this period – George Shultz and James Baker – had served as Secretaries of the Treasury, too.

Phase Three: Globalization's Promise and Perils

The huge changes in the world economy in the 1990s precipitated yet a third phase in the post-War international economic system.

The end of the Cold War reunited Europe. The European Community became a deeper and wider Union, and some of its members even launched a common currency.

Just as important, China, India, and other developing countries moved from planned socialism and import substitution schemes to market competition.

Over the course of a decade, the number of people engaged in or actively affected by the world market economy surged from about one billion to four or five times that. Information technology leapt ahead. Capital raced around the globe. During the 1990s, the earlier era of globalization before World War I seemed to offer a closer policy parallel than did the world economy of Bretton Woods.

Yet the adaptation to markets on a truly global scale – integrating developed and developing countries alike – was bound to be discontinuous and fraught with challenges.

In the late 1990s, countries in East Asia and Latin America faced harsh financial blows and painful restructurings. Almost all are now stronger for the experience.

The recovery strategies of some developing countries planted the seeds of a new problem: "imbalances" – whether of savings, reserves, trade accounts, or other dimensions. Some economists maintain that the low prices of goods available from new suppliers led Central Bankers to persist in easy monetary policies for too long, risking widespread asset price inflation, especially in real estate markets. Then the bubbles burst.

The institutions of the international economic system adapted incrementally in the 1990s, often with difficulty. The economic fire-fighting of the IMF and the World Bank made them principal targets of an anti-globalization movement. The continuing boom then almost put the IMF out of business. Unfortunately, neither international nor domestic supervisors of financial markets kept up with the innovations – or the frauds and foolishness that inevitably come with long boom periods.
The WTO added many new members. The trading system even withstood terrorist attacks – and fears of more. But the travails of the Doha Round of the WTO, launched in 2001, signaled a new challenge. The traditional developed economies wanted the middle income countries – China, Brazil, India, and others – to assume more responsibility for lowering barriers to trade, while all would offer special treatment for Africa and the poorest. The major developing economies, in turn, pointed to their large numbers of poor people, and wanted to maintain the privileges of "special and differential treatment." This debate is far from resolved. It reverberates not only in trade, but in monetary affairs, investment, development, and energy and the environment.

The September 11 attacks concentrated America's attention on terrorism, homeland security, and the long wars that followed. Yet the connections of economics to the new security threats are also strong. When al Qaeda targeted the United States, it aimed for the World Trade Center – the twin symbols of American capitalism – as well as Washington. In addition to shock and destruction, the terrorists wanted to strangle political and economic freedom. As Osama bin Laden boasted in 2004, his aim was "bleeding America to the point of bankruptcy."

Even as America fought in Iraq, Afghanistan, and against terrorist threats around the globe, other forces of history did not stand still. China, India, and other emerging economies began to change the landscape of power. The failed political and stunted economic systems of North Africa and the Middle East sparked upheavals that will shake the region for a generation.

Phase Four: What Is To Come?

Now the Crash of 2008 has ushered in a fourth phase. Global financial capitalism – and our countries – face a new crisis.

The advanced economies are struggling to reduce debt and revive jobs and productivity through structural reforms. Unemployment is up. Confidence is down. Protectionism is rising. Publics are anxious. Politicians are struggling.
Developing economies have been hit, too, although many have fared relatively better.

The 60-year long leadership of developed economies is in question.

Will the Eurozone and the historic success of Europe's peaceful integration survive – and with it, Europe's influence in the world?

Will the middle income developing countries – some of which are rising powers – overcome the so-called "middle income trap" to become high-income countries and "responsible stakeholders" in the international system that has benefited them – but which they did not design?

Will the poorest – the "Bottom Billion" – have an opportunity to prosper too, or will they be breeding grounds for trans-national insecurities?

Will the new political systems of the Middle East and North Africa lead to new economic policies for inclusive growth and peaceful integration in the world economy?

Will the United States show leadership – at home and internationally – in reviving its economic strength while simultaneously leveraging its capabilities through an activist economic diplomacy, including a revived push for free trade? Will the United States connect its foreign economic policy with security interests in freedom of the seas, open skies, and protection of cyberspace?

The American Experience and Responsibility

In his classic study, *The World in Depression, 1929-39*, Charles Kindleberger argued that it was critical for one major power to take the lead in shaping an international economic system. This power could not dictate, but instead needed to invest in encouraging a shared approach to trade, capital flows, currencies, and reliance on markets. Kindleberger described how during the Great Depression the United States had the means but not the will to lead, while Britain had the will but no longer the means. If the United States does not lead now, who will?

Bob Carr's warning about America's need to resolve its budget mess is correct: The United States must restore its credit for its own health and to enable it to lead.

Without healthy economic growth, the United States will be unable to lead.

Just as dangerously, the United States will lose its identity on the global stage if it loses its economic dynamism. America's unique strength is the ability to reinvent itself.

The United States does not need just any budget deal. It needs one that rebuilds the fundamentals of long-term growth. It needs to limit government spending. It needs to encourage private sector innovation and productivity. It needs inclusive growth, which empowers all its citizens to fulfill their potential.

Through twists and turns, the American experience has demonstrated that its greatest asset is its openness – to ideas, goods, capital, people, and change. Every country makes mistakes – but open countries are quicker to correct theirs – and to forge ahead.

That's what the United States needs to do now.