Economics and National Security: Six Questions for the Next Administration

Introduction

We take it as a given that U.S. economic strength and growth are *sine qua non* of U.S. national security and the projection of U.S. power and values. This is true in both absolute and relative terms. Without a strong economy, the U.S. will be less equipped to protect itself from threats, let alone muster the popular support needed for a foreign policy that actively promotes U.S. interests globally. Weak economic growth in relative terms, meanwhile, will reduce America’s ability to persuade other nations to form common cause with it—or take more forceful action when necessary. As the 2015 National Security Strategy report states, American leadership depends upon a “strong, innovative, and growing U.S. economy in an open international economic system that promotes opportunity and prosperity.”

While some have argued that U.S. foreign policy has in recent decades broken from tradition by failing to accord enough weight to economic interests, the recognition that such interests are an integral component of national security is uncontroversial. Thus, 50 U.S.C. 404, which mandates an Annual National Security Strategy Report, provides that each such report “shall include a comprehensive description and discussion of . . . the proposed short-term and long-term uses of the political, *economic*, military, and other elements of the national power of the United States to protect or promote the interests and achieve” the “worldwide interests, goals and objectives of the United States that are vital to the national security of the United States” (emphasis added).

Various executive orders indicate the same understanding. For example, Executive Order 13636 defines critical infrastructure as “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters.” Likewise, Executive Order 13694 states that when the President declares a national emergency under the International Emergency Economic Powers Act, the Secretary of the Treasury shall block the property of responsible persons whose cyber-enabled activities “are reasonably likely to result in, or have materially contributed to, a significant threat to the national security, foreign policy, or economic health or financial stability of the United States and that have the purpose or effect of” doing “significant” cyber damage to critical infrastructure.

With this understanding, we turn to whether the USG is adequately organized to meet economic challenges to American national security interests. Our focus is on several particularly important challenges, which are discussed in more detail below:

- A rapidly evolving global economy characterized by highly connected markets, global supply chains, enormous capital flows, widely disparate tax treatment of corporations, and climate-related issues
- Cyber threats to U.S. firms and the U.S. economy more broadly
- Issues posed by state capitalism, reflected in the corporate, finance, investment, and cyber realms
The evolution of existing and new multilateral financial institutions
Laws and regulations that may need updating

As the “protect or promote” language in Title 50 of the U.S. Code above indicates, these challenges fall into two basic categories. Some threaten our ability to safeguard vital assets such as U.S. critical infrastructure (much of which is in private hands), technology, and access to critical resources. Others threaten our ability to utilize all of the elements of statecraft to influence nations, corporations, individuals, and non-state actors. The line between the two categories is not always sharp.

Below we provide a brief overview of these challenges and discuss some ways in which they might be addressed from a strategic and structural perspective, together with the associated potential advantages and disadvantages.

I. Strategic Perspective

Questions

1. **Should an early national security directive or policy paper directly address the issue of economic challenges to U.S. national security?**

Globalization, technological change, and geopolitical shifts have dramatically altered the international landscape, enlarging the threat landscape in significant ways. U.S. economic, financial and technological supremacy is being challenged. Vast amounts of capital flow across the world, as interconnected markets instantaneously discount evolving local conditions and changes in expectations. Cybersecurity has also had a multiplicative effect on the threat attack profile. Targets include government secrets, critical infrastructure, intellectual property, and more. Cybersecurity now permits broadly applied actions on a “micro” scale against private sector actors, as opposed to just a “macro” scale against governments.

The increasing prominence of state capitalism poses another potential challenge to U.S. national security. State capitalism manifests itself in corporate, financial, investment, and digital form. As a group, countries with state-directed economies and higher levels of state participation in markets have become more important in international affairs and this trend appears likely to continue, at least in the short term. It is impacting the system of multilateral financial institutions, as well as many other areas.

The U.S. presently lacks a doctrinal basis for thinking about economic challenges to national security. While economic statecraft, or geoeconomics, is not a new concept—a major economic statecraft initiative was undertaken several years ago at the State Department—and highly targeted financial sanctions (an element of so-called financial statecraft) have become an important piece in the American diplomatic tool kit since the 9/11 attacks, an integrated approach has not been applied across the government as a whole. Such an approach needs to take into account the fact that the more effective economic statecraft is, the more likely other countries and global actors are to institute countermeasures, use similar tools against the United
States, and develop new ways to threaten U.S. interests. It is unclear whether the appropriate institutions and structures are in place to address all of these challenges effectively.

Advantages:
- Examining U.S. vulnerability to economic statecraft and other economic threats is a proactive measure which can lead to a focused and integrated plan to anticipate, meet, and mitigate these challenges
- Thinking holistically about these threats will help policymakers better understand their different aspects (offensive, defensive, etc.), increasing the chance that US policy is well thought out and effective
- A directive or policy paper on the economic challenges to U.S. national security would fit neatly within NSC’s traditional role of helping the President develop strategy, set policy priorities, and define the limits that should guide execution

Disadvantages:
- The process may get bogged down in doctrine or magnify a problem that is being addressed elsewhere
- It will (or should) take an extensive review period before a national security directive or policy paper can be completed
- Many of these issues are likely to be resolved only through international practice and consensus

2. Should the U.S. Undertake a Comprehensive Review of its Policy Toward International Economic Institutions?

The basic rules under which the international economic system operates reflect the Bretton Woods system set up at the end of World War II. Bretton Woods had several components: the International Monetary Fund, which instituted a system of fixed exchange rates tied to the dollar (and ultimately to gold); the World Bank (originally the International Bank for Reconstruction and Development), which has focused on developmental lending and aid to poorer countries; and the General Agreement on Trade and Tariffs (now the WTO), which has provided the forum for eight successive rounds of multilateral negotiations that have resulted in a substantial reduction in global trade barriers. While these institutions have evolved, they still define the international economic regime. In particular, the fixed exchange rate system broke down in 1971 as a result of the United States no longer holding enough gold to back foreign-owned dollars. This eventually ushered in an era of floating rates (for the most part) and led the IMF to shift its focus to assisting members on macroeconomic matters.

America’s ability to exercise leverage internationally is magnified by Bretton Woods’ rules-based international economic order and the governance structure of its institutions. However, as a result of the ongoing shift in the geopolitical environment, certain less developed countries have made clear their desire to play a more active role in setting the rules of global economic interaction. Without some accommodation of the enhanced importance of such nations, particularly China, the Bretton Woods institutions risk becoming anachronistic or superfluous.
The expansion of the G-7 system to the G-8 in 1997 (when Russia got a seat at the table) and more importantly to the G-20 in 2008, represents a positive adaptation to new global realities. However, the Bretton Woods institutions have been slower to adapt. It is important to note here that the term “adapt” is not intended to signify a retreat from U.S. leadership but rather the flexibility to take a tactical approach that will arguably result in maximizing American influence over the longer term.

The U.S. has indicated an openness to institutional change. For example, the 2015 National Security Strategy states: “We remain committed to governance reforms for [the institutions of the international financial and economic system], including the World Bank and the International Monetary Fund, to make them more effective and representative.” However, the process has been slow—it took five years (until end of 2015) before IMF quota revision approval made it through the U.S. Congress.

Recent developments raise the question of whether U.S. efforts have been “too little, too late”. Other nations, with China in the lead, have been creating new institutions that have the potential to undercut the Bretton Woods system. For example, in July 2014 the so-called “BRICS”—Brazil, Russia, India, China, and South Africa—announced the creation of the BRICS New Development Bank (NDB) to fund infrastructure and development programs. Simultaneously, the BRICS announced the signing of a treaty to establish a BRICS Contingent Reserve Arrangement, which would exercise IMF-like functions. The CRA entered into force in July 2015, with capital of $100 billion.

In October 2014 the Asian Infrastructure Investment Bank (AIIB) was launched. Fifty seven prospective members (not all of which had ratified) were signatories by the end of 2015, when the AIIB’s Articles of Agreement entered into force. China, which first proposed the AIIB, will have the largest voting share, potentially around 36%. Most observers believe the U.S. was slow to respond to this initiative, was caught off-guard when many of its close allies signed on, and is still searching for how best to respond.

Both the NDB and AIIB state that their purpose is complementary to that of existing multinational development banks. While they represent a challenge to U.S. leadership on the international stage, the argument that previously existing institutions do not meet all of the tremendous infrastructure, development, and other needs of Asia and other regions has some force. From a U.S. perspective, major questions include the transparency and governance of these new institutions, and how they might work with, as opposed to at cross-purposes to, existing institutions.

Both the NDB and the AIIB are obviously still works in progress. The NDB has modest capitalization of $50 billion of initial subscribed capital and initial authorized capital of $100 billion. The AIIB also has $100 billion in authorized capital.

Another major recent Chinese-led initiative is the Eurasia-focused One Belt, One Road Initiative. Its key components are the land-based Silk Road Economic Belt and the sea-based Maritime Silk Road. The former is aimed at regional infrastructure development and has already been funded to
the tune of $40 billion via the Silk Road Fund, a special reserve established by the Chinese government.

How all these institutions will operate in practice and how they will interact with other multilateral bodies remains to be seen. Individually and collectively, however, they represent a potential challenge to the existing multilateral system that the U.S. has led for seven decades. The U.S. needs to act sooner rather than later in order to maximize its influence over the institutions and rules that govern the international economic order. This includes considering how to reform older institutions and whether to join or otherwise work with new institutions.

Advantages:
- Participating in one or more of these new institutions is the best way to exercise some influence with respect to issues such as transparency and governance
- Working with these institutions is the best way to ensure that they work most effectively with existing institutions
- Taking no position or action is likely to be counterproductive, particularly since many long-time U.S. allies have not sat on the sidelines

Disadvantages:
- Participation in, or substantial interaction with, new institutions may undercut existing ones or the reform thereof. Focus should be on reforming existing institutions
- Possibility of overreacting to the creation of alternative structures whose purposes remain vague and which may take years to play out, and which may collapse under their own weight due to internal contradictions
- Healthy competition and cooperation with the Asian Development Bank, World Bank, and other international institutions should be welcomed

3. **Should the Administration Undertake a Comprehensive Review of Potential Legislative and Regulatory Fixes Related to Economic Challenges to U.S. National Security Interests?**

It is essential for a law-based society to have up to date rules governing how to identify and meet the economic challenges posed by globalization, technological change, and geopolitical shifts. Government needs the appropriate authorities while at the same time the private sector must be supported and fundamental rights protected.

In certain cases, such as cybersecurity, it is obvious that the law has been unable to keep up with changes in technology. In others, such as investments, trade, and international institutions, it is less clear whether or how existing laws, executive orders, or regulations should be amended or new laws adopted. While some legislation such as the Cybersecurity Act of 2015 has been passed, a variety of other measures have also been proposed. Specific examples include:

- Proposed legislation that would require revelation of beneficial ownership of corporate entities formed or operating in the United States.
- Recommendations to amend the CFIUS. The Commission on the Theft of American Intellectual Property recommended in 2013, for example, that CFIUS add “an additional
evaluative criterion to the review process that assesses the manner in which a foreign company obtains IP [to] help improve IP-protection environments”

- Proposals relating to the ability of private American companies to engage, directly or indirectly, in “hacking back” against malevolent cyber actors.

Advantages:
- A comprehensive review will give the Administration a better shared understanding of legislative gaps and initiatives
- This approach allows for more better prioritization
- A review will help make the case for Congressional support where it is presently lacking
- A review will ultimately foster better executive-legislative coordination on national security issues

Disadvantages:
- A comprehensive review is too ambitious and will distract policymakers in an environment where certain high priority issues are already known and need to be addressed immediately
- A review is intellectually divorced from the practicalities of which pieces of legislation are likely to receive enough Congressional support to pass
- A review is more appropriately initiated by Congress

II. Structural Perspective

Questions

1. **Should a directorate focused on economic statecraft be added to the NSC, possibly as a replacement to the longstanding International Economics Directorate?**

The National Security Act of 1947 created the National Security Council “to advise the President with respect to the integration of domestic, foreign, and military policies related to the national security so as to enable the military services and the other departments and agencies to cooperate more effectively in matters involving the national security” and to perform “other functions the President may direct for the purpose of more effectively coordinating the policies and functions of the departments and agencies of the government relating to the national security.” The lack of a specific reference to “economic” policies—there were only five references to “economic” or “economy” in the original legislation, primarily relating to conditions of mobilization or war—reflects the traditional political/military focus of the NSC. However, in practice economic statecraft was a key element of postwar U.S. diplomacy.

From the NSC’s inception, staff handled international economic issues and were supported by the President’s Council of Economic Advisors. Over time, however, presidents experimented with other means of addressing international economic issues within the EOP. President Nixon, for example, created an interdepartmental Council on International Economic Policy while President Ford later established an Economic Policy Board. The most important and sustained effort in this regard was President Bill Clinton’s establishment of a National Economic Council in January 1993, with the additional twist that some staffers were dual-hatted to both the NEC and the NSC. This structure remains in place, with a Deputy Assistant to the President for
International Economics/Deputy National Security Advisor reporting to both the National Security Adviser (Assistant to the President for National Security) and the NEC Director (Assistant to the President for Economic Policy).

The centrality of economic issues to U.S. national security is reflected in President Obama’s first Presidential Policy Directive, which directs the NSC to “advise and assist me in integrating all aspects of national security policy as it affects the United States – domestic, foreign, intelligence, and economic (in conjunction with the National Economic Council).” Operating under its original Executive Order (with amendments not relevant to this point), the National Economic Council remains responsible, among other things, for “coordinat[ing] the economic policy-making process with respect to . . . international economic issues.” This language suggests that “economic statecraft” (as opposed to economic policy more broadly) is not a focus of either the NSC or the NEC. Steil and Litan have usefully distinguished between “foreign economic policy” (i.e., international economic policy), which “encompasses means which may or may not be economic in the service of economic ends” and economic statecraft, which “applies economic means to ends which may or may not be economic.” The latter is of greatest relevance in the national security context.

Since 1947 the first national security directive of each new President, issued under a new title (e.g., the National Security Decision Directives of President Reagan or the Presidential Policy Directives of President Obama), has outlined the NSC structure. An economic statecraft or geoeconomics directorate would provide a forum to examine economic challenges to national security systematically and to coordinate Administration policy in this area.

Advantages:
• The International Economics Directorate has traditionally focused on foreign economic policy rather than economic statecraft, which is more closely related to national security.
• A new directorate would be better positioned to address current and emerging challenges related to economic warfare, cybersecurity, state capitalism, etc.
• A new directorate would cut across departments and agencies more broadly, benefiting in turn from staffing from a broad range of agencies.

Disadvantages:
• International economic issues still need to be addressed and should remain a key focus of the NSC.
• The focus at this stage should be on reducing the overall size of the NSC not (potentially) expanding parts of it.
• Cyber issues already are addressed fully by a number of NSC (and other) staff members.

2. Should there be greater inclusion in the NSC process of senior officials responsible for overseeing financial markets?

Pursuant to the National Security Act of 1947, as amended, the President, Vice President, Secretary of State, Secretary of Defense, and Secretary of Energy are members of the NSC while the Chairman of the Joint Chiefs of Staff and the Director of National Intelligence are statutory advisors. However, most if not all Presidents have also designated certain other senior officials...
as Council members. The aforementioned PPD-1 designates the Secretary of the Treasury as one of these officials, continuing a practice that has been used by some but not all Presidents since Harry Truman.

There is an increasing economic component to the national security challenges we face given globalization and the strategic use of economic instruments by other nations. The U.S. likewise needs to consider how best to utilize its economic strengths in pursuit of national security objectives. In addition, the financial system is part of U.S. critical infrastructure, and indeed should be considered critical infrastructure of the global financial system as well.

From a structural perspective, proactively considering issues of economic leverage, coercion, and warfare can best be accomplished through measures such as enhancing the role of the Secretary of the Treasury and incorporating the expertise of one or more market regulators. With respect to the former, in addition to continuing the practice of inclusion on the NSC by designation, the President should consider formal inclusion (by Executive Order) of the Secretary of the Treasury on the Principals Committee. As for market regulators, the President should include financial regulators on the NSC or, at the very least, ensure their frequent and proactive input into the NSC process.

Advantages:
- Way of making sure that key economic issues affecting national security get in front of the NSC and are given full attention
- In the case of the Secretary of the Treasury, this step would be consistent with (albeit an extension of) existing practice in an area where there has been no real disagreement among Presidents of different parties
- Reflects the importance of financial stability and the financial infrastructure to US economic health and national security

Disadvantages:
- Might exacerbate perception of some that the NSC is too large and has taken on too much of a policymaking role
- Spreads the NSC too thin, blurring the line between domestic economic policy and national security policy
- Mandatory inclusion of the Secretary of the Treasury could unnecessarily lengthen NSC meetings and waste Treasury resources
- Could raise the perception that the independent agencies are too involved in the NSC process

3. **Should any major structural changes be made to U.S. departments or agencies to address economic challenges to U.S. national security interests?**

Some observers believe existing departments do not adequately meet economic challenges to U.S. national security interests. Structural changes in government are infrequent although as part of its economic statecraft initiative the State Department did create a new Undersecretary for Economic Growth, Energy, and the Environment, a new Bureau of Energy Resources, and its first-ever Office of the Chief Economist. Some have suggested similar changes in other parts of the government aimed at better meeting strategic economic challenges such as an Office of
Policy Planning at Treasury focused on the broad use of sanctions and other tools of economic statecraft (as opposed to implementation of sanctions in particular cases).

Advantages:
- Aligning departmental structures to meet current national security challenges is the logical way to identify, analyze, and meet such challenges
- This approach ideally would result in the creation of a richer set of strategic options that could be utilized at the appropriate time
- Acting at the outset of an Administration creates the greatest likelihood of success

Disadvantages:
- As shown (on a much larger scale) by DHS, structural changes can end up costing an enormous amount of time and distract from, rather than further, the main goal
- Structural changes can also mean more bureaucratization and can blur lines of authority
- Reorganization should not be the first priority of an Administration (particularly if there is a change from one party to the next) given the need both to get up to speed and to address a range of more immediate issues

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1 Seth Hurwitz is the Founder and CEO of Global Investment Strategy and Solutions LLC. He served as Counsel to the President’s Intelligence Oversight Board under President George H.W. Bush
3 “Improving Critical Infrastructure Cybersecurity” (Executive Order 13636) (February 12, 2013)
4 “Blocking the Property of Certain Persons Engaging in Significant Malicious Cyber-Enabled Activities” (April 1, 2015)
5 Our discussion here is confined to organizational challenges most directly related to economics and national security. From a broader perspective, almost anything that significantly affects the U.S. economy can be viewed as a national security issue. One example is the state of the global economy—something over which the U.S. has limited influence. Another, which is purely a domestic political issue, is the continued lack of a comprehensive budget deal.
6 Economic statecraft is the use of economic means in support of foreign policy goals.
7 Blackwill and Harris prefer the term “geoeconomics,” arguing that it captures a means of analysis in addition to the traditional purposive nature covered by” the definition of economic statecraft. Robert D. Blackwill and Jennifer M. Harris (War by Other Means: Geoeconomics and Statecraft (Harvard, 2016)). We use the more common term “economic statecraft” in this report.
8 Financial statecraft is a key component of economic statecraft. Stein and Litan have defined it as “those aspects of economic statecraft that are directed at influencing capital flows” (p. 4). BENN STEIN & ROBERT E. LITAN, FINANCIAL STATECRAFT, THE ROLE OF FINANCIAL MARKETS IN AMERICAN FOREIGN POLICY 4 (Council on Foreign Relations & The Brookings Inst., Yale University Press 2006). Post-9/11 U.S. financial statecraft has included legislation (e.g., Know Your Customer) and tools related to the global financial system. Prominent examples include sanctions against North Korea, Russia, and Iran. For a comprehensive account, see Juan C. Zarate, Treasury’s War: The Unleashing of a New Era of Financial Warfare (PublicAffairs, 2013).
We focus on lending and financial institutions here but obviously the new Administration will need to make important decisions on outstanding trade negotiations since their outcome will have national security implications.

This is an observation, not an effort to ascribe blame to any parties.

This paper was drafted prior to the November 2016 presidential election and therefore does not take into account recently announced plans of the incoming Administration such as the creation of a National Trade Council (NTC). The questions below will need to be considered in light of the planned division of responsibilities among the NSC, NEC, NTC, and Homeland Security Council.


Presidential Policy Directive-1 (February 13, 2009)

Stein and Litan, Financial Statecraft, p. 2.
