CHAPTER 11

ECONOMICS: AMERICAN ELEMENT OF POWER OR SOURCE OF VULNERABILITY?

Clayton K. S. Chun

The early Romans worshipped Janus, one of their many panoply of gods. Janus, the god of beginnings, was frequently depicted as two-faced. One face looked at new beginnings, while the other looked to the past. In many respects, the economic element of national power is like Janus. Economics has two faces: one as a dominant element of power and the other as a source of potential susceptibility to the nation. Economic activity provides a potent source of power that includes the ability to produce goods and services, influence, a tool to weaken a possible foe, and an objective to protect in terms of a national asset. The United States is blessed with a rare combination of labor, capital, raw materials, and geography that has allowed it to become the leading global economic power. Conversely, economics is also a source of vulnerability or weakness for a nation. The nation can exist without international trade; however, the standard of living for its citizens and its wealth would certainly suffer. This nation's economy is inexpiably linked to countries large and small throughout the world. We purchase many finished goods and raw materials from around the world. Similarly, we get capital from foreign nations, businesses, and individuals to help finance governmental and commercial ventures. Real and perceived disturbances in the global economy can certainly affect actions that reach this country's shores.

Economics, for many people, is a complex subject. The topic can entail highly mathematical models or arcane issues that, on the surface, do not seem to have much relevance to national security. However, the world does revolve around economics. Economics is simply the study of the use of constrained resources. One of national leadership's main concerns involves the acquisition of additional resources or trying to maximize the use of the nation's resources. In this respect, the United States tries to expand its ability, within these constrained resources, to make goods and services and extend its access around the world to get more. These objectives naturally come into conflict from a host of domestic and international sources. On the domestic side, members of Congress and the President might disagree about how much we will spend on military or healthcare programs. More interesting are international issues. A nation's ability to get strategic raw materials necessary for its economic security is vulnerable to potential rivals that that may refuse access to those materials.

This chapter explores economics as an element of national power. The most potent and flexible ability of the United States to influence events worldwide may not be military, but economic. Increasingly, national leadership may find exercising military power difficult to accomplish. A basic understanding of the scope of the nation's economic power will help the reader think about how the country can use it along with other elements of power—political, military, and informational. The chapter addresses what makes an economy strong and how the nation can use its economic power to achieve its national interests. Although the it focuses on the United States, much, if not all, of this discussion is applicable to other countries. This examination can help the reader evaluate the economic capabilities and limitations of nation-states.

What Makes an Economy Strong?

The United States is fortunate that its economy is, at present, the preimminent one in the world. The nation's businesses and her people can draw on a host of resources that they can convert to capabilities expressed in to an effective military or other element of power. What does a nation require to do so? One can certainly use the United States as an example to analyze. No matter what the size or strength of national economies, they have certain common characteristics that allow them to flex their economic power. No matter what problems a nation has, most have some ability to use their resources to conduct economic activities.

Every nation in the world has some type of national resource that it can parlay into economic power. For some, it might involve a natural resource like oil or some other type of raw material. However, not all countrys have the luxury of self-sustaining supplies of raw materials. Instead, a nation might have the benefit of other types of national resources that can compensate for basic raw materials. Three types of resources might allow a nation's industry to provide value-added activities that transform the worth of raw minerals or components into a product or service that allows that state to extract economic gain and allow it the wherewithal to provide national security. Human, capital, and technological resources are some of the most visible means that nations can use to strengthen their economies and where they might be vulnerable.

Human resources involve the skill and abilities of labor and management. A highly educated and motivated labor force can increase the capabilities of an economy through improved productivity or flexibility to change scope or direction of activities. Additionally, management of firms that provide leadership, innovation, and acceptance of risk, coupled with a labor force, can introduce new or better products. Nations such as Singapore have compensated for the lack of geography and raw materials to become a regional economic power in Southeast Asia. Singapore's economy depends of its biggest resource, people, to provide value to the nation's production of finished goods from consumer to high-tech products, like electronics, that depends on skilled labor.

Increasingly, capital resources have become very important assets that allow a nation to control the investment or production of goods and services. Capital can take the form of physical plant or financial assets. Physical plants, the traditional image of industrial might, allows a nation to transform raw materials into goods. Financial resources allow for the construction of new or modifications of existing physical plants in the country. More frequently, countries rely on financial resources to acquire means of production by building or purchasing productive capacity or other activities outside of their borders. Such investment in the form of foreign-owned businesses is often welcomed by countries with other resources, but little capital or technical knowledge.

Nations can also replace or substitute products through technological advancement. A nation's ability to provide resources to research, develop, and further educate their people can lead to new applications of science and knowledge to solve problems—in other words, technology. Technological advances can replace existing weapon and support systems to enhance or expand warfighting capability. Acquiring technology through a nation's own human resources or with capital resources can allow the nation to make great leaps in economic progress. The People's Republic of China attracted billions of dollars in foreign direct investment through favorable business terms, e.g., cheap labor or taxes, and aggressively seeking critical knowledge through activities like sending graduate students to nations that possess desired technology. Foreign business ventures allow technology transfer through design, production techniques, and management skills.

A nation's government has a significant impact on the performance on an economy. Government policies to improve business and labor activities can motivate market activities that may lead to innovation or the motivation to compete. These actions can allow the nation's population to develop the state's economic power. Similarly, the government can fund activities to improve common public infrastructure that provides a foundation for growth to include roads, utilities, and other basic services to operate an economy. Governments can also send a message to their people on how they will treat business activities. Will the government operate publicly owned enterprises that compete unfairly with private business? Does the government punish business with onerous taxes or uncompetitive labor laws? These and other activities can challenge the economic future of a nation. Indeed, government plays a large role in the domestic economy, but it also affects international events. National governments might agree to international standards of the World Trade Organization, support regional alliances, or encourage the free flow of goods, services, and capital that may affect economic relations with other states.

Not all nations possess all of the aforementioned resources. They use a combination of these resources to convert those assets they have or can acquire into a capability. Even though the United States dominates over all individual nations economically, it is not self-sufficient today for all raw materials, goods, services, and capital. The nation must import many components to sustain its economy. The subsequent trading relationships have forced greater reliance on and interest in events around the world that can create pressures on other resources and the economy itself. Nations that have historically had little impact because of trade relations or possessed raw materials of limited value in the past are now capable of influencing American foreign policy actions. These nations have either a direct linkage to or indirectly affect America's economy. For example, the United States has attempted to seek oil sources from other than Persian Gulf nations. Some of the largest sources of available oil imports are from Venezuela and Nigeria. This reliance on Venezuelan and Nigerian oil gives those nations a heretofore unknown influence on U.S. foreign policy. Failure to consider them or problems within their region can produce hefty economic penalties to the nation and the global economy. Although the amounts are smaller than Saudi Arabia or some other oil producers, oil prices can spike up throughout the world that directly "taxes" production costs due to higher prices at the gas pump and for many products. However, the effect does not stop there. Higher world oil prices also threaten the economic health of many small nations. This, in turn, affects their ability to produce exported goods and services and can seriously reduce their ability to buy imported American goods.

Economics as an Element of Power

National power is a very topical issue today. Countries that desire to achieve certain goals or objectives can do so in many ways in this complex world. Although most people equate national power with military power, many situations in international politics are not appropriate for the sole use of military means to solve a problem. Often, a combination of other elements, with or without the military, might accomplish the objective faster and with better results. Perhaps one way to think about national power is the capacity to create capabilities that a nation can use to undertake actions to achieve its national interests. In this light, a strong economy provides the means to allow national leaders the ways to attain desired ends. The economy does this through a number of measures by providing the goods and services necessary to carry out selected actions.

A nation could either produce those goods and services themselves through domestic production, or acquire them through international sources. The United States has been able to mobilize its economy to fight wars and to provide resources to her allies. Certainly, the United States was able to significantly aid in the defeat the Axis powers in World War II through its role as the "arsenal of democracy." American-made aircraft, tanks, small arms, clothing, and food helped arm and feed the armed forces and liberated peoples around the world. American business and labor leaders were able to transition the economy from a depression-era subsistence production level to a fully mobilized economy that made military and, albeit limited, civilian goods and services available. Times have changed. Today, with the globalization of the economy, the United States and other nations must progressively go beyond their shores to get products. Trade access and the financial wherewithal allows the country to get those goods that are not available in the United States either because they are not manufactured here or the domestic economy does not produce enough of the item for our nation's use. The nation could purchase them from a foreign source or finance the building of productive capacity as a foreign subsidy.

National leadership can take several approaches to addressing potential security concerns. In most cases, a government concentrates on three approaches for security policy. Economics is a vital element as a part of these security discussions. A government can use an instrument or combination of instruments of power to persuade, coerce, or defeat an adversary.[1] A nation could try to persuade or use influence to change what a power might believe or value. Similarly, a country might want to change certain of its adversary's behaviors. A state could then use coercion to force modifications of selected behaviors. Finally, the nation's government might try to eliminate another power's ability to take certain actions or capabilities through defeating them in some endeavor. Economics can be used in all three cases independently or along with political, military, and informational elements of power.

A government can persuade or influence another state that perhaps what they value or believe is fundamentally flawed.[2] The United States could illustrate the benefits or costs of taking a particular position. Instead of maintaining closed markets or limiting the production of products or raw materials, better economic gains or prosperity would result by allowing more open trade. One might use examples of nations that allowed increased privatization of state-owned enterprises or eliminated high import tariffs that led to increased standards of living.

Economic success and gain are easily seen. Improved standards of living manifested in material and financial wealth, mortality rates, education, and other measurable means are very powerful as evidence of economic growth. In our hemisphere, many nations in Central and South America have seen the success in many areas of the North American Free Trade Agreement. Not only has it improved industry and increased jobs across borders, but it has helped improve intergovernmental relations in many respects. Central American nations might also see political benefits through improved cooperation between themselves by using a similar agreement as a device for better relations.[3] Mexico and Canada have seen increased investment in their countries by U.S. businesses that have directly advanced their country economically. Other nations could easily see the potential benefits from economic integration.

Coercion takes on a more ominous image than persuasion. Instead of trying to voluntarily change behavior from within, coercion attempts to force changes in measured behavior. A nation can take two routes to coerce another: deter or compel.[4] Deterrence involves getting an opponent to realize that if it takes a certain action, then any result from that action will become more costly to it than any potential gains. For example, a nation might use the threat of force to dissuade another from taking a contemplated action. Nations could also deter other nations by getting them to join an alliance or agreement to force them to accept certain standards of behavior and reject others. Similarly, a nation could compel other states to take certain actions. Nations can use threats or more positive means to force adversaries to take a particular avenue to solve a problem.

A government can use economic means to deter or compel another to take certain actions. The United States could use her economy to deny essential goods or services from a potential adversary. The nation can simply refuse to sell certain items to that country, outbid rivals for the sale of the items so that the targeted country cannot purchase the items, deny them the ability to sell good and services that would reduce their ability to buy certain resources, or get other countries to act against the state in question. A strong economy has a great say among producers and consumers around the world. In some respects, even if the nation is concerned about buying a product from another country, the United States could moderate the seller's behavior. Suppose the seller of a raw material decides to export that product to an American adversary. We could use our purchasing power to buy or use the threat to buy all of the surplus; pressure the seller not to allow the sale of the product to the adversary by threatening to buy the product from someone else; or withhold sales of a product to the selling nation. Certainly, the options are numerous, given the strength of the economy compared to a weak economy that lays that country open to many vulnerabilities.

A nation can also use its economy to try to defeat another power. The nation can use its economic power in attempts to destroy a target's capability to take certain actions or destroy its ability to project power. Although physical defeat of the enemy is more often associated with military operations, economic means are also viable to support the elimination of a nation's ability to take certain actions. These economic measures could allow only one course of action open to the adversary, one chosen by the power that destroyed the economy.

Perhaps a nation could target a particular segment of an opponent's economy for destruction that would render it vulnerable to other actions. Let's suppose that a nation relies primarily on manufacturing for domestic and international sales. Further, this manufacturing capability is tied to steel production. A nation or combination of nations can try to limit a raw material used in its steel production; out-produce the target and sell the raw material at a low price; convince others to boycott the adversary's products; or find some other way to choke off vital manufacturing capability to permanently destroy the capability to make steel. As mentioned earlier, this nation lent vital economic aid to allied countries during World War II. Some might argue that it was American economic power that out-produced the Axis powers' economies in terms of armaments to defeat them. The United States, as the world's largest and most diverse economy, has many options it can take in using its ability to influence, coerce, and defeat a foe with economic means.

Indeed, economic power has become a very powerful tool to enhance the capabilities of a nation and limit those of an adversary. However, as nations become more intertwined through globalization, they become more vulnerable to disruptions in their economies, manmade or natural, due to reliance on foreign sources of raw materials, components, finished products, or key services. This is especially true for complex, highly integrated economies like the United States. For example, U.S. dependence on energy sources indicates a strong need for imported oil. In 1973, the nation imported 6,256 thousand barrels per day. Ten years later, the amount of oil purchased from foreign sources fell to 5,051 thousand barrels due to much increased emphasis on energy efficiency. Unfortunately, declining domestic supplies, economic demands, and worldwide lower energy prices forced the demand for more imported oil. By 2001, imports had more than doubled to 11,619 thousand barrels. Dependence on volatile imports from Persian Gulf states rose from 8.8 percent of all imports in 1983 to 23.5 percent in 2001.[5] The nation is a net importer of oil. In 2001, American business, government, and citizens used about 19,633 thousands of barrels of oil per day, the largest consumer of oil in the world.[6]

Consequently, the nation has become more sensitive to external events that might affect the future supply of oil. Any reduction in oil production, regardless of its intended destination, affects the nation's economy in several ways. First, if there is a reduction in oil production, prices rise worldwide since buyers bid up prices to meet their demand. This disrupts resource flows and production. Second, poorer nations that cannot afford oil might face internal political strife as their standard of living declines. Third, uncertainty and turmoil about the future threatens long-term investment and consumer confidence due to fears that the nation's economy might slow. This will affect its ability to produce goods and services in the coming years. Fourth, declining oil stocks can affect key trading partners and allies' economies that also rely on access to oil. If those nations do not have viable economies, then they might not produce the goods we need, nor are they capable of buying our exports.

An oil crisis or shortage of some other product, e.g., imported computer microchips, that was caused by a manmade or natural disaster can create a series of political and economic conditions that can severely affect the health of a nation. A reduction in oil supplies creates all types of possible government responses, which may become a cause to use other elements of power to assure that oil flows freely in the world market. One could use, for example, the political element to encourage other states to increase production. Conversely, we could use informational means to persuade oil consumers not to panic and cause additional disruptions in the market. Finally, the country could use military means to create a secure supply line for oil producers to consumers.

Conclusion

Economic interdependence has, on one hand allowed competitive forces to lower prices and increase availability of many goods and services. Economic security, improving domestic employment and wealth, has been aided with international trade. Free trade has helped sharpen the government's ability to achieve national objectives. The promise of access to American and other markets tariff free can help motivate other countries to cooperate with the United States. The increased accesses to markets have also allowed American business to sell products from computers to agricultural items that result in jobs. However, with the enhanced economic relationships have come critics that charge that more international integration has led to the loss of vital industries that have left the country to seek lower cost production elsewhere. This aspect of trade has created less jobs, a hemorrhage of technology, strengthening potential regional rivals, and left the nation more vulnerable to economic disruptions. Manmade or natural disruptions in supply of imported assets may slow the ability to sustain combat operations or alter a decisionmaker's options to involve the country in operations for fear of adverse economic consequences. One of the challenges facing the nation's leaders will continue to revolve around economics as a way to strengthen America's security, while balancing the risk of future involvement in economic relationships that may constrain, rather than enhance U.S. national security.

Economic power has helped shape American foreign policy for decades. This element of power is very flexible. If used wisely in conjunction with the political, military, and informational elements, it is hard to beat. Whether a nation has a large or small military, its leadership does understand economics. Economics is a great tool to create conditions for further action or force a nation to change behavior. As the world further embraces globalization, economics as an element of power will only gain greater influence in the United States and around the world.

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1 David E. Johnson, Karl P. Mueller, and William H. Taft, V. *Conventional Coercion Across the Spectrum of Operations* (Santa Monica, CA: RAND Corporation, 2002), 9.

2 Ibid., 8.

3 "How to Trade Up," *Economist*, February 15, 2003, 36.

4 Johnson , 8.

5 Energy Information Administration, *Annual Energy Review 2001* (Washington, DC: U.S. Department of Energy, 2002), Table 5.4, Petroleum Imports by Country of Origin, 1960-2001, 133.

6 British Petroleum, *BP Statistical Review of World Energy* (London: British Petroleum, June 2002), 9. This country used about 25.5 percent of all oil consumed in 2001. The United States uses more oil per day than Europe. The next largest consumer of oil is Japan at 5,427 thousand barrels per day.