

GLOBALIZATION AND THE DECLINE OF THE UNITED STATES
ECONOMIC INSTRUMENT OF POWER

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APPROVAL

The Undersigned certify that this thesis meets master's level standards of research, argumentation, and expression.

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ABSTRACT

In the post-Cold War era, the economic instrument of power has been one of the primary means the US uses to influence international actors. This study seeks to determine if globalization has had an impact on the US's ability to leverage economic power in international relations, and whether that impact has been positive or negative. While the US uses a variety of economic tools to influence international actors, this study looked at the two most common, sanctions programs and trade policy. The main argument of this thesis is that globalization, especially in the post-Cold War era, has had a negative effect on the US's ability to leverage its economic power in international relations. First, while globalization has facilitated the growth of an international financial system that the US can leverage to gather financial intelligence and implement targeted, as opposed to broad, sanctions programs, it also provides nefarious actors with a growing number of alternative avenues to circumvent sanctions. In addition, the recent success of US sanction programs against terrorist networks and Iran prompted developing countries, like China and Russia, to develop tools to undermine US influence. Second, with respect to trade policy, while the US continues to wield heavy influence in international institutions like the World Trade Organization, the WTO has failed to reach agreements on new globalized trade policy, prompting states to engage in bilateral and multilateral trade agreements, further reducing US economic influence in global economic relations. Both of these factors are leading to a relative decline in US economic statecraft.

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Chapter 1

Introduction

Strategy is a form of economy, a function of scarcity: unlimited resources render strategy unnecessary.

Walter A. McDougall

In his introduction to the 2015 United States (US) National Security Strategy (NSS), President Barack Obama stated, “America’s growing economic strength is the foundation of our national security and a critical source of our influence abroad.”¹ A few years earlier, the US Chairman of the Joint Chiefs of Staff (CJCS), Admiral Mike Mullen, suggested that debt, not a sophisticated military capability, was the greatest threat to US national security. In an interview with *Forbes* magazine, Mullen made the link between the US economy and US international prestige, demonstrating that a healthy and growing economy generates positive results around the globe. He stated, “In the past 10 or 15 years, the economic linkage we have is probably more than we really understand.”² In fact, the founding fathers understood the clear link between economic health and national security. In his farewell address to the nation, President George Washington emphasized the importance of strengthening mutually beneficial “commercial relations” while limiting political alliances in US foreign policy.³

In this thesis, I examine the evolving role of economic power as a foreign policy tool for the United States. Specifically, I seek to address how globalization impacts the use of economic power in the areas of sanctions and trade policy. My research suggests that globalization makes sanctions incredibly challenging, even when they are “targeted.” Conversely, trade policy potentially remains a useful tool for the United States to help shape the behaviors of other states; however, the international institutions governing trade have not kept up with the changing environment of the global economy. As such, the continuing reliance of the US on targeted sanctions seem misplaced as does the idea the US limiting its trade policies.

¹ “National Security Strategy” (The White House, February 2015).

² “Adm. Mike Mullen: Debt Is Still Biggest Threat to U.S. Security,” *Fortune*, accessed March 29, 2017, <http://fortune.com/2012/05/10/adm-mike-mullen-debt-is-still-biggest-threat-to-u-s-security/>.

³ “Farewell Address [Ushistory.org],” accessed March 28, 2017, <http://www.ushistory.org/us/17d.asp>.

Economic power is wide-ranging and comes in at least three forms. First, economic power can be the capability to translate economic health and size into military capacity. The idea that economic health and size is fungible with military capacity was especially popular after World War II (WWII). Second, economic power can be the strength to resist external influence. In the current interconnected international environment, economic size and diversity in trade partnerships can increase resilience to external influence.⁴ Finally, the third aspect of economic power, and the focus of this paper, is the conduct of economic statecraft in order to shape the international environment during peacetime. Stated more accurately, statecraft involves using US economic policy to influence or change the behavior of states, non-state groups or specific individuals operating within the international system.

Economic statecraft is not new. In fact, use of the economic instrument of power (IOP) is present in history as early as the Peloponnesian War. In 432 BC, the Athenians levied the Megarian Decree on Megara, citing their trespassing on sacred land and the sheltering of Athenian runaway slaves as their reasoning. The Megarian Decree, equitable to today's trade sanctions, barred Megarians from using Athenian harbors and from participating in the Athenian Market.⁵ Although Thucydides downplayed its effect, some believe it was one of the primary reasons for the Peloponnesian War.⁶ In fact, economic objectives are often at the heart of, or a precursor to, the decision of nations to go to war.

In the US, economic statecraft was present as early as the 1760s when Americans attempted to use trade and "nonimportation" policy as a diplomatic tool in British relations.⁷ According to Robert Zoellick, early American foreign policy aligned closely with US economic interests, a trend that he says the US has abandoned since the beginning of the Cold War. In fact, Zoellick believes that economic statecraft has

⁴ Stephen G. Brooks, *Producing Security: Multinational Corporations, Globalization, and the Changing Calculus of Conflict*, Princeton Studies in International History and Politics (Princeton, NJ: Princeton Univ. Press, 2007).

⁵ Thucydides et al., *The Landmark Thucydides: A Comprehensive Guide to the Peloponnesian War ; with Maps, Annotations, Appendices, and Encyclopedic Index*, A newly rev. ed. of the Richard Crawley transl (New York: Simon & Schuster, 1998). 79-80.

⁶ Juan Carlos Zarate, *Treasury's War: The Unleashing of a New Era of Financial Warfare*, First Edition (New York: PublicAffairs, 2013).

⁷ Robert Zoellick, "The Currency of Power," *Foreign Policy*, no. 196 (November 2012): 67-75.

become a lost art of foreign policy.⁸ This of course begs the question: how does the US employ economic statecraft as a national security tool in the post-Cold War era, and is it effective as an instrument of grand strategy?

The tools of economic statecraft are numerous. The US utilizes foreign aid, foreign direct investment, and monetary policy, in many instances to effect change. In this paper, however, I focus on two other tools that are also well known in their application: sanctions and trade policy. I focus on these two because they are tools that the US has come to rely upon when dealing with the shaping of the international system both in terms of security and the global economic architecture. Indeed, sanctions and trade are very much wedded to the US's overarching national security strategy and thus represent what tends to be perceived as the most useful economic levers to create change in the behaviors of others.⁹

The use of such tools can be understood in a broader historic context. Since the end of WWII, US foreign policy, and more specifically US economic policy has rested on the foundation of the international system established during the Bretton Woods conference. As John Ikenberry describes it, the Bretton Woods system established an “open and multilateral system of trade and payments...in a way that would reconcile openness and trade expansion with the commitments of national governments to full employment and economic stabilization.”¹⁰ In addition, the conference established the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), which developed into the World Bank, and the conference laid the groundwork for the General Agreement on Tariffs and Trade (GATT), which became the World Trade Organization (WTO) in 1995.¹¹ Finally, and probably most importantly, the US committed the US Navy to underwriting the security of the Bretton Woods system, policing the global commons.

⁸ Zoellick, “The Currency of Power.”

⁹ Other tools of economic statecraft include foreign aid, foreign direct investment and monetary policies. These are beyond the scope of this paper.

¹⁰ G. John Ikenberry, “A World Economy Restored: Expert Consensus and the Anglo-American Postwar Settlement,” *Int. Organ.* 46, no. 1 (1992): 289–321.

¹¹ Peter Zeihan, *The Accidental Superpower: The next Generation of American Preeminence and the Coming Global Disorder*, First edition (New York: Twelve, 2014), 28.

On the foundation of the Bretton Woods system, the US employs economic statecraft to pursue a wide range of foreign policy goals. The US seeks to improve environmental, trade, and economic policy, while deterring war, aggression, and weapons proliferation. The US also wields economic power to strengthen (or weaken) alliances and promote ideological shifts and regime change.¹² The US primarily uses these positive (carrot) and negative (stick) incentives to influence the behavior of international actors. Trade, and access to the US market, is the most common positive incentive used to increase long-term ties, while sanctions are the primary short-term, often negative tool, the US uses for coercive purposes.

Historically, the use of such tools seemed to make sense. The US dominated the global economic and security arenas during and immediately after the Cold War. Despite such dominance, the efficacy of economic sanctions always seemed questionable, and highly dependent on the desired objective.¹³ Trade policy seemed less vulnerable to such criticism as entry into US markets provided a tangible benefit for states seeking greater participation in the Bretton Woods system. As the international system enters the 21st century, however, the impact of globalization and the concomitant shift in differential growths of power are arguably limiting the utility of both of these tools.

Globalization, although a relatively new term, is not a new concept. In its simplest form, globalization is the process of international integration, or inter-connectedness, which stems from the increased speed and capability of transportation and communication.¹⁴ Globalization affects the environment, culture, political systems, economic development and prosperity, and the physical well-being of societies around the world. Thomas Friedman attributes transformation of the Cold War bipolar international system to globalization, saying “the integration of free markets, nation-states and information technologies to a degree never before witnessed, in a way that is

¹² David A. Baldwin, *Economic Statecraft* (Princeton, N.J: Princeton University Press, 1985), 40–41.

¹³ “Critics say sanctions are often poorly conceived and rarely successful in changing a target’s conduct, while supporters contend they have become more effective in recent years and remain an essential foreign policy tool. Sanctions have become the defining feature of the Western response to several geopolitical challenges, including North Korea’s nuclear program and Russia’s intervention in Ukraine.” Jonathan Masters, “What Are Economic Sanctions? - Council on Foreign Relations - Economic Sanctions Described.pdf,” *Council on Foreign Relations*, February 8, 2017, file:///C:/Users/Josh/Desktop/SAASS/SAASS%20690/Economic%20Sanctions%20Described.pdf.

¹⁴ Martin Albrow and Elizabeth King, eds., *Globalization, Knowledge, and Society: Readings from International Sociology* (London ; Newbury Park: Sage Publications, 1990).

enabling corporations and countries to reach around the world farther, faster, deeper, and cheaper than ever before.”¹⁵ Farther, faster, deeper and cheaper are the aspects of current globalization that make today’s phenomenon different than previous periods. More specifically, globalization has facilitated a highly connected, and Westernized, international financial system. These aspects initially seemed to allow the US to employ a targeted versus broad sanction regime in addition to effectively utilizing trade policy to influence other states. Recently, the US has become more reliant on targeted sanctions than any other tool in the economic quiver. While some experts argue that increased inter-connectedness has facilitated the US’s ability to target economic sanctions, others argue that globalization allows connected international actors to more easily circumvent these sanctions.¹⁶ The same can be said of trade as well. Globalization seems to limit the dominance of US trade policy given that the number of potential trading partners has increased significantly over the last two decades.

In conjunction with globalization, the international system has undergone a shift in power relationships, especially in the last decade. According to Zoellick, developing countries were responsible for two-thirds of international economic growth from 2007-2012. Zoellick went on to say that developing nations have become a major “source of economic ideas, development models, investment, and even foreign aid,” shifting international power dynamics.¹⁷ The increase in economic power of developing nations has directly contributed to a differential growth of power, challenging the current international system. Gilpin, for example, explains how economic and technological developments have the capability to shift the international balance of power. Gilpin argues that once a shift occurs, “those actors who benefit most from a change in the

¹⁵ Thomas L. Friedman, “A Manifesto for the Fast World,” *The New York Times*, March 28, 1999, <http://www.nytimes.com/1999/03/28/magazine/a-manifesto-for-the-fast-world.html>.

¹⁶ “this greater degree of globalization (and the somewhat reduced centrality of the nation-state) ought to have an adverse impact overall on the effectiveness of sanctions. A target state now has more potential suppliers and markets—and a would-be sanctioner has many more entities to enlist before sanctions are likely to be effective.” Richard Haass and Council on Foreign Relations, eds., *Economic Sanctions and American Diplomacy* (New York: Council on Foreign Relations, 1998), 5–6.

¹⁷ Robert Zoellick, “Why We Still Need the World Bank: Looking Beyond Aid,” *Foreign Aff.* 91, no. 2 (April 2012): 66–78.

social system and who gain power to effect such change will seek to alter the system in ways that favor their interests.”¹⁸

If such logic is accurate, revisionist or dissatisfied states that acquire power are better able to resist the US’s use of the Economic IOP, specifically targeted sanctions and trade policy, in an attempt to undermine US economic influence, and/or reshape their regional or even the global international system. Given these possibilities, the remainder of the thesis fleshes out the impact of globalization and power shifts on the use of sanctions and trade policy. My contention is that these two factors make the use of sanctions very problematic but that trade policy still has significant impacts on behavior, particularly as it relates to broader interests in terms of US national security.

To evaluate my claims, the remainder of the thesis progresses as follows. Chapter Two describes the US economic instrument of power. It will define economic power and economic statecraft, discuss the traditional tools that the US uses to conduct economic statecraft, and then take a look at the US Executive Branch of the government where a majority of economic statecraft is conducted. Chapter Three describes globalization, first, from a broad perspective, then specifically how it has effected the global economy. The next two chapters will look at how globalization has impacted finance and trade specifically. Chapter Four discusses the impact of globalization on the US’s ability to conduct successful sanctions programs. It will also look at some of the methods that developing nations are countering or circumventing US influence in the global financial market. Chapter Five looks at the effect of globalization on US trade policy. Specifically, the international system established at Bretton Woods has not kept up with the changing international trade environment. The US withdrawal from the Trans-Pacific Partnership and the breakdown of the Doha round of WTO trade negotiations are indicative of a larger trend. That is, international institutions inability to reach a consensus or keep up with the changing global economy.

¹⁸ Robert Gilpin, *War and Change in World Politics*, Transferred to digital printing (Cambridge: Cambridge Univ. Press, 2002), 9.

Chapter 2

Economic Power and Roles within the US Government

A nation that is boycotted is a nation that is in sight of surrender. Apply this economic, peaceful, silent, deadly remedy and there will be no need for force. It does not cost a life outside the nation boycotted, but it brings a pressure upon the nation, which in my judgement, no modern nation can resist.

President Woodrow Wilson, 1919

Economic Power

What does one mean by the term economic power? Ellen Frost lists the components of economic power as “a strong and stable currency, adequate foreign exchange reserves, inflows of foreign investment, rising productivity, manageable inflation, and a declining level of poverty” in addition to social indicators like education level and healthcare quality.¹ Joseph Nye describes power as “the ability to effect the outcomes you want and, if necessary to change the behavior of others to make this happen.”² Nye lists the ingredients of power as strength in population, natural resources, and economic size and health, and comments that these qualities equate to “holding the high cards in the international poker game.”³ The common themes are using a stable and healthy economy to exert influence. It is important to understand how to determine economic size and health and consider whether or not, and how, that translates directly to economic power and influence.

When asked to define economic power, many economists, like Nye, equate power to economic size, often represented by a country’s gross domestic product (GDP).⁴ GDP represents the total market value of all goods and services produced domestically for a specified time. There are three different ways to calculate GDP. The income method is the sum of total compensation to employees, gross profits for firms, plus taxes minus any government subsidies. The second method, the production approach, is “an aggregate

¹ Ellen L. Frost, “What Is Economic Power,” *Jt. Forces Q.*, no. 53 (2009): 9–11.

² Joseph S. Nye, “Limits of American Power,” *Polit. Sci. Q.* 131 (Summer 2016): 267–83.

³ Nye, “Limits of American Power.”

⁴ Frost, “What Is Economic Power.”

measure of production equal to the sum of the gross values added of all resident and institutional units engaged in production.”⁵ The most common method, the expenditure method, represents the total value of consumption plus investments, government spending, and net exports.⁶ In fact, the Commerce Department’s Bureau of Economic Analysis (BEA) uses the expenditure GDP calculation to evaluate United States (US) economic health. While quantity in economic size does have a quality of its own, GDP is just a snapshot and must be evaluated over time to determine relative economic growth or decline in order to determine health (see table 1).

Table 1: National Economic Indicators

	FY 2016	FY 2015
Real GDP Growth	1.7%	2.2%
Residential Investment Growth	1.5%	13.0%
Average monthly payroll job change (thousands)	209	227
Unemployment rate (percent, end of period)	5.0%	5.1%
Consumer Price Index (CPI)	1.5%	0.0%
CPI, excluding food and energy	2.2%	1.9%

Source: *The US Treasury Secretary’s Financial Report: FY2016*
Financial Report of the United States Government FY2016, Annual Report (The Treasury Department, January 12, 2017), [https://www.fiscal.treasury.gov/fsreports/rpt/finrep/fr/16frusg/01112017FR_\(Final\).pdf](https://www.fiscal.treasury.gov/fsreports/rpt/finrep/fr/16frusg/01112017FR_(Final).pdf)

While GDP is a good indicator of domestic economic growth and health, there are several factors to consider when using GDP to evaluate comparative economic size and strength in the global market. First, GDP does not accurately account for inflation, deflation, or currency valuation differences making it an inaccurate tool to gauge comparative size. Purchasing Power Parity (PPP) is the solution for valuation inaccuracies. PPP evaluates how much the same basket of goods would cost if purchased in different countries. In this manner, PPP is able to account for disparities in exchange rates, inflation, and trade disparities. Figure 1 shows an example of real GDP compared to PPP to demonstrate how PPP valuation can change the calculus of economic size and strength. One example demonstrating the importance of PPP is the argument that while China’s 2015 official defense budget was \$144.2B (or 2 percent of GDP), the Chinese

⁵ “Gross Domestic Product - Wikipedia,” accessed March 8, 2017, https://en.wikipedia.org/wiki/Gross_domestic_product#Expenditure_approach.

⁶ Stephanie H. McCulla and Shelly Smith, *The 2016 Annual Update of the National Income and Product Accounts*, Annual Report (Bureau of Economic Analysis, 2016), https://bea.gov/scb/pdf/2016/08%20August/0816_2016_annual_nipa_update.pdf.

defense budget adjusted for PPP was much closer to \$374B.^{7,8} In reality an accurate representation of the Chinese defense budget is difficult to discern, and the applicability of PPP has been questioned. Because the basket of goods used to calculate PPP does not include defense equipment, and because major defense procurement transactions are often conducted across borders at international market price, defense experts are skeptical of PPP valuations of defense spending.⁹ PPP typically favors developing countries with reduced domestic production costs; so, it is not a stretch to say that the Chinese defense budget adjusted for PPP is higher than the figures released to the UN. This is especially true as the Chinese defense industry produces more domestically.



Figure 1: GDP Based on PPP Valuation

Source: “How China Overtakes the US Economy,” *Wali Zahid*, April 11, 2016, <https://walizahid.com/2016/04/how-china-overtakes-the-us-economy/>.

Both the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) use PPP evaluations to formulate economic

⁷ “Blog: China and Russia Combined Now at Military Spending Parity with US,” accessed May 8, 2017, http://www.americanthinker.com/blog/2016/04/china_and_russia_combined_now_at_military_spending_parity_with_us.html.

⁸ “What Does China Really Spend on Its Military?,” *ChinaPower Project*, December 28, 2015, <http://chinapower.csis.org/military-spending/>.

⁹ *Modernizing China’s Military: Opportunities and Constraints - RAND MG260-1.pdf*, accessed May 8, 2017, http://www.rand.org/content/dam/rand/pubs/monographs/2005/RAND_MG260-1.pdf.

policy and make economic predictions.¹⁰ Also, GDP does not account for products and services produced by multinational companies operating overseas. Gross National Product (GNP), does account for overseas production, which has grown exponentially due to globalization and the proliferation of multi-national corporations. Therefore, GNP is arguably a more accurate measurement of economic size. However, while GDP, GNP, and PPP can be effective tools for measuring economic health, growth, and relative size within the international system, these attributes do not necessarily translate directly to economic power.

There are three mainstream ideas about what comprises economic power. One common description of economic power, especially prevalent during and after WWII and among realists, is the ability to translate economic size into military strength. The efficacy of transferability is predicated on access to resources and human capital, technological capability, and most importantly industrial capacity.¹¹ During WWII, at the height of the industrial age, this equated to the ability to turn these resources into military capacity. In fact, some experts believe it was the overwhelming size and strength of the US economy, not strategy or military prowess, that was responsible for Allied victory in WWII.¹² As war has become extremely costly, and in most cases counterproductive to desired political and economic ends, especially with the advent of nuclear weapons, there are new ideas emerging, or rather resurging, about economic power and influence beyond the ability to translate economic strength into military capability.

Another way to consider economic power, for example, is as the strength to resist external influence attempts. The extreme example of this would be economic self-sufficiency as in the case of North Korea.¹³ However, in a globalized economy, economic self-sufficiency can have damaging side effects, not the least of which are deficiencies in technology and industrialization, and a higher degree of poverty.¹⁴ In

¹⁰ "Purchasing Power Definition | Investopedia," accessed March 8, 2017, <http://www.investopedia.com/terms/p/purchasingpower.asp>.

¹¹ Foster, Harry, "Coercive Complementarity: Integrating the Military and Economic Instruments of Power" (Thesis, School of Advanced Air and Space Studies, 2003), <http://www.dtic.mil/get-tr-doc/pdf?AD=ADA425661>.

¹² The main premise of Tooze's *Wages of Destruction* was that the German economy was never strong enough to compete with the allied powers. J. Adam Tooze, *The Wages of Destruction: The Making and Breaking of the Nazi Economy* (New York: Penguin USA, 2008).

¹³ Frost, "What Is Economic Power."

¹⁴ Brooks, *Producing Security*.

order to receive the benefit of the interconnected global economy while not becoming vulnerable to outside economic pressure, a country must diversify its international trade relationships. There are three ways to achieve economic diversity. First, states can diversify trading partners to ensure critical goods and services do not all come from one supplier. Second, states can diversify the geographic sources of supply to ensure that a global crisis cannot completely cut off the import of a critical commodity. Finally, maintaining domestic industrial production capability ensures that a state can produce goods in the absence of critical imports. In addition to trade diversity, the ability to grant or deny access to a market can be a considerable bargaining tool.

The third aspect of economic power, and the focus of this paper, is the conduct of economic statecraft in order to shape the international environment. Stated more accurately, this entails the ability of a state to use its economic size and health to influence or change the behavior of states, non-state actors and specific individuals. David Baldwin defines such use as economic statecraft, and places emphasis on the means of government influence, specifically taking action to manipulate an adversary's market price through trade or sanction policy.¹⁵ This definition puts primary focus on the means used to influence, not the desired ends, which could include a wide range of possible economic, political, or even military objectives. Baldwin dissects some of the nuanced terms similar to economic statecraft such as: foreign economic policy, international economic policy, economic diplomacy, economic leverage, economic sanctions, economic coercion and even economic warfare in order to lend credence to his selected moniker and description.

Due to the focus of this paper on economic sanctions as an instrument used to change adversary behavior, the term economic warfare deserves additional attention here. Robert Loring Allen defines economic warfare as “state interference in international economic relations for the purpose of improving the relative economic, military, or political position of a country.” In addition, Yuan-Li Wu defines economic warfare as “economic measures that enhance the strength of a country relative to an actual or potential

¹⁵ David A. Baldwin, *Economic Statecraft* (Princeton, N.J.: Princeton University Press, 1985), 30.

enemy.”¹⁶ Finally, Thomas Schelling defines economic warfare as “economic means by which damage is imposed on other countries or the threat of damage used to bring pressure on them.”¹⁷ In the end, while there is a warlike nature to economic coercion, economic statecraft is the best description.

The most recent attempt to label and define the political use of the economic IOP comes from Blackwill and Harris employing the term *geo-economics*. While not the first to use the term, they are the first to define it in a way that encompasses both a form of political statecraft in addition to a method of analyzing the global economic landscape. Blackwill and Harris define *geo-economics* as “the use of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results; and the effect of other nation’s economic actions on a country’s geopolitical goals.”¹⁸ These definitions of economic statecraft, economic warfare, and *geo-economics* further demonstrate the wide range of ideas about use of the economic instrument of power (IOP) and more importantly the broad range of terms and definitions used to describe it. For the purpose of this paper, similar to David Baldwin’s definition, economic statecraft is the use of economic means by the government to produce a desired political effect.

US Economic Statecraft

The US employs economic power to pursue a wide range of foreign policy goals. As mentioned in the introduction, such goals include backing up political influence, improving environmental, trade, or economic policy, deterring or punishing drug trafficking or the harboring of terrorists, containing military action or deterring war, deterring weapons proliferation, promoting democratic growth, and strengthening or weakening alliances and promoting regime change.¹⁹ The primary tools of US economic statecraft are trade and finance, and more specifically the regulation of import and export of goods and services. Based on the sheer size of the US economy, with GDP estimated to be \$18.6T, and exports and imports totaling \$2.2T and \$2.7T respectively, restricting

¹⁶ Baldwin, *Economic Statecraft*, 36–37.

¹⁷ Baldwin, *Economic Statecraft*, 36–37.

¹⁸ Robert D. Blackwill and Jennifer M. Harris, *War by Other Means: Geo-economics and Statecraft* (Cambridge, Massachusetts: The Belknap Press of Harvard University Press, 2016), 20.

¹⁹ Baldwin, *Economic Statecraft*, 40–41.

or granting access to the US market can be a powerful and persuasive tool.²⁰ With \$2.7T in imports being larger than all but the top four national GDPs, the US use of positive and negative effects merit further discussion. Below, I briefly address each in order to provide a better context for understanding the role of sanctions.

Long-Term “Positive” Economic Strategic Tools

In 1944, delegates from the Allied powers met in Bretton Woods, NH to determine the nature of the post-WWII international order and to avoid repeating the mistakes of the Versailles treaty.²¹ Although the US had the overwhelming advantage of power entering negotiations at Bretton Woods, they compromised with British and European counterparts to establish the foundation of today’s international system, an open world economy based on US ideas about free trade and British requirements to maintain domestic economic protection. On the foundation of the Bretton Woods agreement, the US has pursued a policy of free trade in order to strengthen global military alliances, ensure US access to production materials, stimulate economic development in Third World countries, and create new and open markets for US exports in the hope of spreading democratic capitalist ideals.²² The overall effect of such actions allowed the US to increase its long-term global influence.

Participation in and leadership of global economic development and expansion has been a major component of US global influence since Bretton Woods. While the IMF and IRBD were created at Bretton Woods as global economic stabilizing institutions, the conference also laid the groundwork for the General Agreement on Tariffs and Trade (GATT) which was signed by 23 nations in 1947. The GATT was established to reduce barriers to trade between its signatories, and later would become the WTO. Established by the Marrakesh Agreement in April 1994, the WTO’s purpose, as an extension of the GATT agreement, is to facilitate open trade among its now 164 members. In addition to facilitating trade, the WTO establishes agreed-upon rules to minimize negative effects of

²⁰ “Gross Domestic Product: Fourth Quarter and Annual 2016 (Second Estimate),” *Bureau of Economic Analysis*, accessed March 8, 2017, https://www.bea.gov/newsreleases/national/gdp/2017/pdf/gdp4q16_2nd.pdf.

²¹ Peter Zeihan, *The Accidental Superpower: The next Generation of American Preeminence and the Coming Global Disorder*, First edition (New York: Twelve, 2014), 2-4.

²² Baldwin, *Economic Statecraft*, 40-41.

open trade on developing nations and provides a forum for member states to settle trade disputes.²³ Most importantly, membership guarantees member states most favored nation (MFN) status. MFN status “requires that a product made in one member country be treated no less favorably than a ‘like’ good that originates in any other country.”²⁴ Essentially, MFN status grants all members of the WTO equitable trade conditions, ensuring that countries are not employing discriminatory trade activity against member states. The only exception to MFN status’ requirement for equitable trade conditions applies to free trade areas and preferential treatment designated to developing nations who are often at a disadvantage in trade relationships.²⁵

The US uses multilateral and bilateral free trade agreements to expand on the trade relationships established by the WTO. According to the US Constitution, the President has authority to negotiate treaties predicated on the advice and consent, given by two-thirds ratification, of the US Senate.²⁶ Typically, these trade agreements are coordinated to develop long-term relationships with trade partners while producing, or increasing, US global prestige. One example of an effective multilateral trade agreement is the North American Free Trade Agreement (NAFTA). Established in 1994, NAFTA was negotiated to eliminate most trade barriers between Mexico, Canada, and the US. More importantly, it established a reliable network for trade and investment, creating stability and confidence among members in order to facilitate long-term trust and investment.²⁷ In fact, in addition to the MFN status associated with the WTO, the US has multi or bi-lateral trade agreements in place with twenty countries.²⁸

Another positive tool the US uses to establish long-term influence in the international environment is foreign aid. In fact, supplying bi-lateral developmental assistance, military aid, and humanitarian aid are the most transparent tools for promoting US

²³ “WTO | Understanding the WTO - What Is the World Trade Organization?,” accessed March 8, 2017, https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm.

²⁴ Bernard M. Hoekman, Aaditya Mattoo, and Philip English, eds., *Development, Trade, and the WTO: A Handbook* (Washington, D.C: World Bank, 2002), 41.

²⁵ Hoekman, Mattoo, and English, *Development, Trade, and the WTO*, 41.

²⁶ Linda R. Monk, *The Words We Live by: Your Annotated Guide to the Constitution*, Revised paperback edition (New York, N. Y: Hachette Books, 2015), 63.

²⁷ Foreign Affairs and International Trade Canada and NAFTA, “North American Free Trade Agreement | NAFTANow.org,” accessed March 8, 2017, http://www.naftanow.org/about/default_en.asp.

²⁸ “Trade Agreements,” accessed March 8, 2017, <https://ustr.gov/trade-agreements>.

strategic influence.²⁹ This practice also has its origin in the post-WWII European recovery effort. President Truman recognized the strategic influence gained through the overwhelming success of the US-financed post-WWII recovery, and elected to keep foreign aid as a primary US strategy.³⁰ The Marshall Plan, which provided over \$12B in aid to Western Europe, in conjunction with the International Bank for Reconstruction and Development (IBRD) and the UN Relief and Rehabilitation Act (UNRRA), spawned multiple organizations that are now at the heart of US and UN aid programs.³¹ The UNRRA spawned the UN High Commission for Refugees (UNHCR) and the UN International Children's Emergency Fund (UNICEF), which represent the core of long-term US and UN humanitarian efforts. The Marshall Plan, administered by the Organization for European Economic Co-operation (OEEC), became the Organization for Economic Co-operation and development (OECD) responsible for helping "governments foster prosperity and fight poverty through economic growth and financial stability" while ensuring "the environmental implications of economic and social development are taken into account."³²

The use of foreign aid carries through to the present period. One recent milestone is illustrated by President Obama's signature on the first-ever Presidential Policy Directive (PPD) on Global Development, PPD-6, primarily focused on foreign aid. This PPD signified the recognition that "development is vital to US national security and is a strategic, economic, and moral imperative of the United States."³³ Accordingly, foreignassistance.gov, the website dedicated to providing transparency for US government foreign assistance spending, The State Department, in conjunction with USAID, shows that \$36.5B is allocated for foreign aid in FY 2017.³⁴ These funds support democracy and human rights, peace and security, health, economic development, education, and humanitarian assistance.³⁵ While \$36.5B is significantly less than 1% of

²⁹ Blackwill and Harris, *War by Other Means*, 68.

³⁰ Stephen Browne, *Aid and Influence: Do Donors Help or Hinder?* (London ; Sterling, VA: Earthscan, 2006), 17.

³¹ Browne, *Aid and Influence*, 15.

³² "What We Do and How - OECD," accessed March 8, 2017, <http://www.oecd.org/about/whatwedoandhow/>.

³³ "PRESIDENTIAL POLICY DIRECTIVE/PPD- - Global-Dev.pdf," accessed March 8, 2017, <https://fas.org/irp/offdocs/ppd/global-dev.pdf>.

³⁴ "ForeignAssistance.gov," accessed March 8, 2017, <http://beta.foreignassistance.gov/>.

³⁵ "ForeignAssistance.gov."

the US annual budget, it is not insignificant in terms of the international market. The US will continue to use bilateral and multilateral trade agreements, influence and participation in international financial institutions, and foreign aid to increase its long-term global influence.

Short-Term “Negative” Tools

While diplomacy through positive inducement is an important aspect of US economic statecraft, this paper is more concerned with trade and financial tools used in economic coercion. More specifically, it is concerned with those tools used by the US to influence a change in a targeted country’s behavior. Recently, several critics of US grand strategy have complained that the US too often employs the military instrument of power rather than diplomatic or economic means to influence international actors, especially in the post-Cold War era.³⁶ In reality, the US has significantly increased its use of economic sanctions, especially after the 11 September 2001 terror attacks on the US and the development of a targeted sanction infrastructure.³⁷ As the post-Cold War global hegemon, the US uses sanctions liberally, often to demonstrate willingness to act and to reassure allies of US commitment to uphold international norms (see Figure 2).³⁸ In a 2016 report published by the Center for a New American Security, the authors argue that sanctions have become a primary policy tool since 9/11.³⁹

³⁶ Blackwill and Harris, *War by Other Means*, 1.

³⁷ Haass and Council on Foreign Relations, *Economic Sanctions and American Diplomacy*, vii.

³⁸ Gary Clyde Hufbauer, ed., *Economic Sanctions Reconsidered*, 3rd ed., Expanded ed (Washington, DC: Peterson Institute for International Economics, 2007), 5–6.

³⁹ Elizabeth Rosenberg et al., *The New Tools of Economic Warfare: Effects and Effectiveness of Contemporary US Financial Sanctions* (Center for a New American Security, 2016), <https://s3.amazonaws.com/files.cnas.org/documents/CNASReport-EconomicWarfare-160408v02.pdf>.

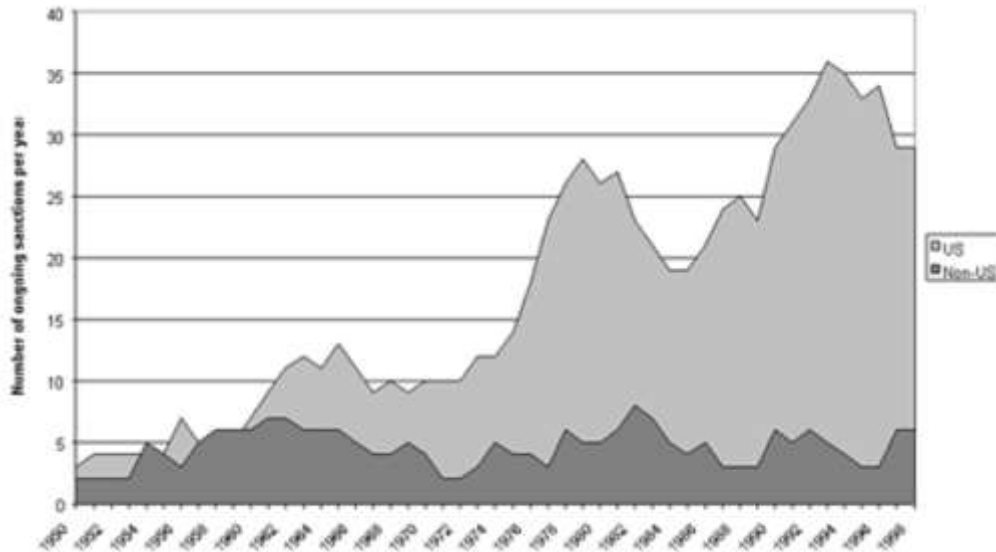


Figure 2: Number of Sanctions, 1950-2000

Source: “Economic Sanctions Gallery” accessed May 8, 2017, <http://keywordsuggest.org/gallery/388303.html>.

According to Robert Eyster, economic sanctions are “diplomatic acts used to change a foreign government’s political policies, where sanctions act as if they are macroeconomic policies transmitting coercive effects from senders to targets.”⁴⁰ He goes on to say sanctions encompass both trade and financial tools available to a sender for use in an attempt to change the behavior of the target nation.⁴¹ Richard Haass argues that the purpose of sanctions can be to punish, signal, deter, or coerce and they are currently “used by the United States to discourage the proliferation of weapons of mass destruction and ballistic missiles, promote human rights, end support for terrorism, thwart drug trafficking, discourage armed aggression, protect the environment, and replace governments.”⁴²

The US employs a wide array of sanctions, but they generally fit into three categories: restricting imports, limiting exports, or disrupting target financial flows, including asset freeze or seizure. Most sanctions will utilize a mix of both trade and

⁴⁰ Robert Eyster and Palgrave Connect (Online service), *Economic Sanctions: International Policy and Political Economy at Work* (Basingstoke: Palgrave Macmillan, 2008), 4–5, <http://public.eblib.com/choice/publicfullrecord.aspx?p=370358>.

⁴¹ Eyster and Palgrave Connect (Online service), *Economic Sanctions*, 4–5.

⁴² Haass and Council on Foreign Relations, *Economic Sanctions and American Diplomacy*, 1.

finance measures.⁴³ From the end of WWII through the Cold War, trade, specifically export control, was the most common form of economic sanction.⁴⁴ The most common trade tools used are embargo, blacklist, tariff discrimination or increase, quotas, license denial, dumping, preclusive buying, or boycott (see Table 2). Some sources, including the Threat and Imposition of Sanctions (TIES) study, add blockade to the sanction repertoire, however, as a military instrument it will not be included here.⁴⁵ Revoking or declining MFN status is another tool, but it has become significantly more difficult to employ with the growth of the WTO and its guarantee of MFN status to member nations. In most cases prior to the end of the Cold War, and into the mid-1990s, sanctions were employed in what some have termed “wrecking ball fashion,” versus the target state.⁴⁶ However, there was a growing sense that authoritarian regimes were able to shift the cost of broad sanctions onto an already oppressed population and continue the sanctioned behavior, while, more importantly using the sanctions as propaganda to gain support.⁴⁷



⁴³ Hufbauer, *Economic Sanctions Reconsidered*, 46. 153 of 204 cases studied between WWI and 2007 used a combination of trade (typically export controls) and financial sanctions.

⁴⁴ Hufbauer, *Economic Sanctions Reconsidered*, 44–45.

⁴⁵ “Threat and Imposition of Sanctions,” accessed March 11, 2017, <http://www.unc.edu/~bapat/TIES.htm>.

⁴⁶ “Evolution of Economic Sanctions: Where Do We Stand with Financial Sanctions? - YouTube,” accessed March 11, 2017, <https://www.youtube.com/>.

⁴⁷ Juan Carlos Zarate, *Treasury’s War: The Unleashing of a New Era of Financial Warfare*, First Edition (New York: PublicAffairs, 2013)

Table 2: Negative Trade Sanction

Negative Trade Sanctions			
Tool	Description	Authority	Oversight Agency
Embargo	an official ban on trade with a target country or of a particular commodity.	Executive/Legislative	Treasury Dept, OFAC
Deny MFN status	decline/revoke most-favored-nation status	Executive/Legislative	Treasury Dept, OFAC
Blacklist	ban on conducting business with firms that trade with target country	Executive/Legislative	Treasury Dept, OFAC
Tariff Increase	increase import tax on goods from target state.	Executive/Legislative	
Tariff Discrimination	favor imports from one country over another	Executive/Legislative	
Quotas	quantitative restrictions on a particular import/export	Intl Trade Cmsn, Dept of Commerce, Ofc of US Trade Rep	Homeland Security, Customs & border ctrl
License Denial	refuse permission to import/export particular goods	Intl Trade Cmsn, Dept of Commerce, Ofc of US Trade Rep	Homeland Security, Customs & border ctrl
Dumping	deliberate sale of exports below mkt value - disrupt tgt economy by artificially depressing price.		
Preclusive Buying	purchasing a commodity to deny it to the target country		
Boycott	prohibition on imports--not typically an official sanction, normally a form of social/political protest.		

Source: Author's recreation from Hufbauer's "Economic Sanctions Reconsidered"

More recently, US use of financial sanctions has increased. This is part of a more general shift to employing "targeted" or "smart" sanctions to reduce the second and third order negative effects of broad sanctions on already oppressed populations. Targeted sanctions allow the sender to single out specific regimes, groups, or individuals and apply pressure. The Clinton administration is credited with the increased popularity of targeted sanctions, when the US used them against Serbian leader Slobodan Milosevic in 1993.⁴⁸ Since then, the US has employed targeted sanctions against malign authoritarian regimes, drug cartels, terrorist organizations, and hundreds of individuals and companies responsible for nefarious international activity. The most typical medium of targeted sanctions is financial. According to Hufbauer, Schott, Elliott, and Oegg, financial sanctions "offer the potential for greater effectiveness as a foreign policy tool because they are relatively easier to enforce, harder to evade, and may spur market reinforcing effects."⁴⁹ In fact, since 2003, the US has utilized the international financial system to

⁴⁸ Zarate, *Treasury's War*, 6.

⁴⁹ Hufbauer, *Economic Sanctions Reconsidered*, 47.

apply direct financial pressure to North Korea, Iran, Iraq, Syria, and even non-state actors including Al Qaeda and ISIS.⁵⁰

The major force allowing the shift to targeted sanctions is globalization. More specifically, it is the effect of globalization on the international financial system that allows sender states to effectively target, track, and isolate bad actors in an effort to conduct sanctions without having the associated sweeping negative second and third order effects. In post 9/11 efforts to isolate terrorist support networks, the US Treasury leveraged the interconnected global financial system to its advantage. Because virtually all bank accounts, wire transfers and lines of credit are executed via the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network, based in Belgium, the US is able to target and isolate rogue actors with great fidelity.⁵¹ This thesis will provide greater detail on the effects of globalization on the international financial network in Chapter Three and the coercive use of economic sanctions and trade in Chapters Four and Five, but it is first important to identify who is responsible for conducting Economic Statecraft in the US.

US Executive Branch

There are several agencies in the executive and legislative branches of the US government responsible for domestic and international economic policy. Each agency has different authorities, goals and motivations, and very likely, different constituencies they represent and aim to please. In order to understand how the US conducts economic statecraft, it is important to look at the agencies responsible. As this paper is primarily concerned with short-term negative employment of the economic IOP, the following discussion will focus on the agencies responsible for the threat and implementation of these negative tools, while only briefly mentioning peripheral agencies concerned with broader economic policy.

The US Executive Branch is at the heart of all economic statecraft. According to Article II, Section II, of the US Constitution, the President “shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the

⁵⁰ Zarate, *Treasury's War*, 46.

⁵¹ Blackwill and Harris, *War by Other Means*, 58.

Senators present concur.”⁵² Article I Section 8 of the Constitution also gives Congress the power to “regulate Commerce with foreign nations.”⁵³ However, while Senate ratification is required for normal operations, there are laws in place that allow the President to act unilaterally under certain conditions. The Trading with the Enemy Act of 1917 gives the President authority to restrict trade with hostile countries during wartime. In 1933, the act was amended to give the President authority to declare an emergency and then restrict trade accordingly.⁵⁴ The International Economic Powers Act (IEEPA), enacted in 1977, grants the president even broader power. IEEPA authorizes the President to declare “an unusual and extraordinary threat...to the national security, foreign policy, or economy of the United States,” and “block transactions and freeze assets to deal with the threat,” even outside wartime.⁵⁵ The only caveat, pursuant to the National Emergencies Act (NEA) is that the emergency declaration has to be reviewed and renewed on an annual basis.⁵⁶ As of 2014, the president had declared 52 “national emergencies,” many of which have been renewed on an annual basis (see Figure 3).⁵⁷ This is the primary authority under which the executive branch conducts most sanctions.

⁵² Monk, *The Words We Live by*, 63.

⁵³ Monk, *The Words We Live by*, 48.

⁵⁴ “Trading with the Enemy Act of 1917,” *Wikipedia*, January 24, 2017, https://en.wikipedia.org/w/index.php?title=Trading_with_the_Enemy_Act_of_1917&oldid=761810601.

⁵⁵ “International Emergency Economic Powers Act,” *Wikipedia*, February 22, 2017, https://en.wikipedia.org/w/index.php?title=International_Emergency_Economic_Powers_Act&oldid=766795109.

⁵⁶ “International Emergency Economic Powers Act.”

⁵⁷ Gregory Korte, “Special Report: America’s Perpetual State of Emergency,” *USA Today*, October 22, 2014, <https://www.usatoday.com/story/news/politics/2014/10/22/president-obama-states-of-emergency/16851775/>.

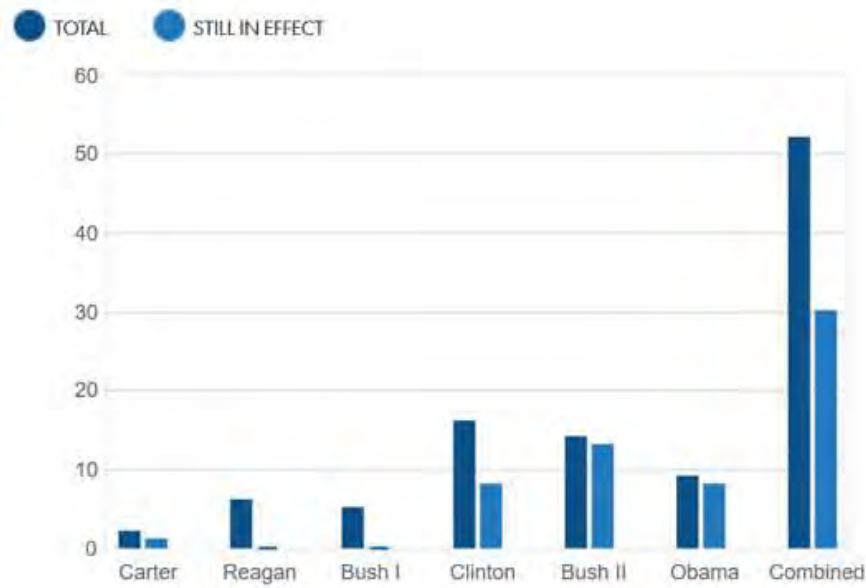


Figure 3: United States Declared States of National Emergency by President

Source: Korte, “Special Report: America’s Perpetual State of Emergency.”
Congressional Research Service

Within the Executive Branch, there are several organizations with a vested interest in international economic affairs. The Executive Office of the President, the National Security Council (NSC), the Council of Economic Advisors, the Office of the US Trade Representative (USTR), and the White House Office all have international economic interests (see Figure 4). Within the White House Office itself, the National Economic Council (NEC) and the National Security Advisor (NSA) play a prominent role. In addition, reporting agencies, including the Department of Defense (DoD), Department of State (DoS), and the Treasury Department especially, also have a primary stake in international economic affairs. The Department of Agriculture, Department of Commerce, Department of Energy (DoE), and Department of Homeland Security (DHS) also have peripheral interests in economic statecraft.

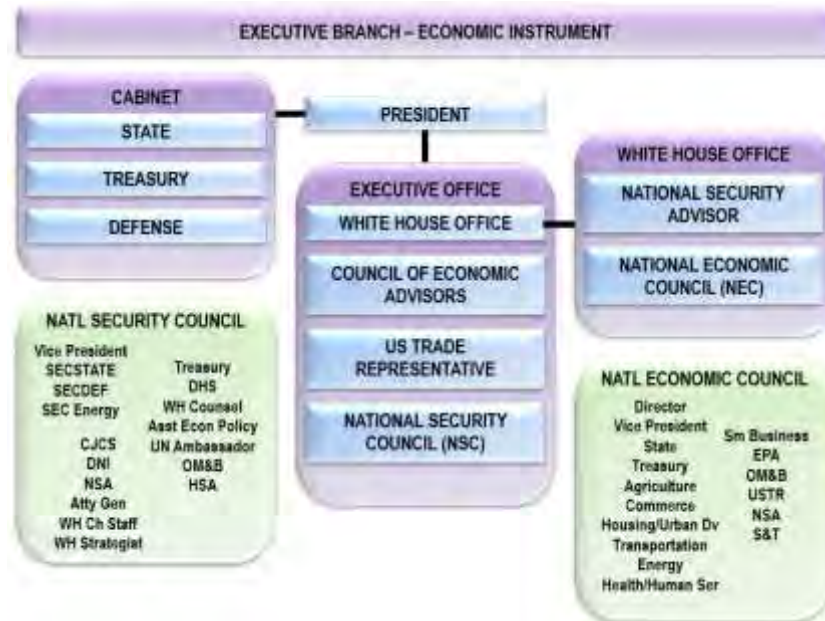


Figure 4: Executive Branch Agencies with International Economic Interest

Source: Authors adaptation

In the Executive Office of the President, there are four primary organizations responsible for conducting economic statecraft. The first organization is the NSC. The NSC is the principal forum the President uses to conduct and coordinate national security and foreign policy. As such, the NSC plays a significant role in the decision to implement economic sanctions, often in conjunction with other IOPs, in the conduct and implementation of US national security objectives. When economic initiatives are being considered by the NSC, The United States Trade Representative (USTR), The Secretary of Commerce, and The Assistant to the President for Economic Policy are invited to attend NSC meetings.⁵⁸ These invitations are in addition to the regular attendance of the Secretary of the Treasury, a non-statutory member of the council.

The second entity in the Executive Office of the President charged with providing the president with “objective economic advice on the formulation of both domestic and international economic policy,” is the Council of Economic Advisors.⁵⁹ The Employment Act of 1946 established the council, which is primarily responsible for

⁵⁸ “Presidential Memorandum Organization of the National Security Council and the Homeland Security Council,” *Whitehouse.gov*, January 28, 2017, <https://www.whitehouse.gov/the-press-office/2017/01/28/presidential-memorandum-organization-national-security-council-and>.

⁵⁹ “About CEA,” *Whitehouse.gov*, March 7, 2017, <https://www.whitehouse.gov/cea/about>.

producing the annual Economic Report of the President. While the advisors have a traditionally domestic concentration, they are appointed by, and close advisors to, the President, on both domestic and international economic agendas. In fact, the CEA chairman is considered a cabinet-level position.⁶⁰ The third entity advising the President in the Executive Office is the USTR, who is principally responsible for administering US trade agreements.⁶¹ In addition to facilitating US trade relationships, the Office of the USTR is responsible for monitoring commodity trading and producing direct investment policy.⁶² The USTR Chief, appointed by the President and approved by the Senate, is a cabinet level advisor to the president on bilateral and multilateral trade agreements. Although the USTR is not primarily responsible for conducting sanctions, the Chief has a seat on the NSC, is a principal advisor to the President, and has a vested interest in US trade relations. Both the USTR ambassador and the CEA chairman are considered cabinet level positions.

The fourth entity within the Executive Office of the President is the White House Office (WHO). There are two agencies in the WHO with an interest in international economic affairs, the National Security Advisor (NSA) and the National Economic Council (NEC). The NEC, established by the Clinton administration by Executive order 12835 in 1993, is the WH's primary instrument for economic policy development.⁶³ Realizing that the post-Cold War instrument for diplomacy was primarily economic, the Clinton administration set up the NEC to act as a "clone" of the NSC, and become one of three executive councils that also includes the Domestic Policy Council.⁶⁴ The President appoints the NEC Director who does not require Senate confirmation. The NEC Director is also the Assistant to the President for Economic Policy and is responsible for advising the president on domestic and international economic agendas and ensuring that the staff understands and follows the President's economic agenda.

⁶⁰ "About CEA."

⁶¹ "Trade Agreements."

⁶² "Mission of the USTR," accessed March 12, 2017, <https://ustr.gov/about-us/about-ustr>.

⁶³ Charles Blahous, "The Importance of the National Economic Council," *Economics21*, November 21, 2016, <https://economics21.org/html/importance-national-economic-council-2144.html>.

⁶⁴ David J. Rothkopf, *Running the World: The inside Story of the National Security Council and the Architects of American Power* (New York: Public Affairs, 2006), 344.

The primary agency responsible for planning and implementation of economic sanctions is the Treasury Department, specifically the Office of Foreign Assets Control (OFAC), which currently resides under the Office of Terrorism and Financial Intelligence (TFI). OFAC was created in 1950 during the Korean War to control Chinese assets, but its predecessor, the Treasury’s Office of Foreign Funds Control, known as “The Control” was actually established during WWII to control German, Japanese, and Italian assets.⁶⁵

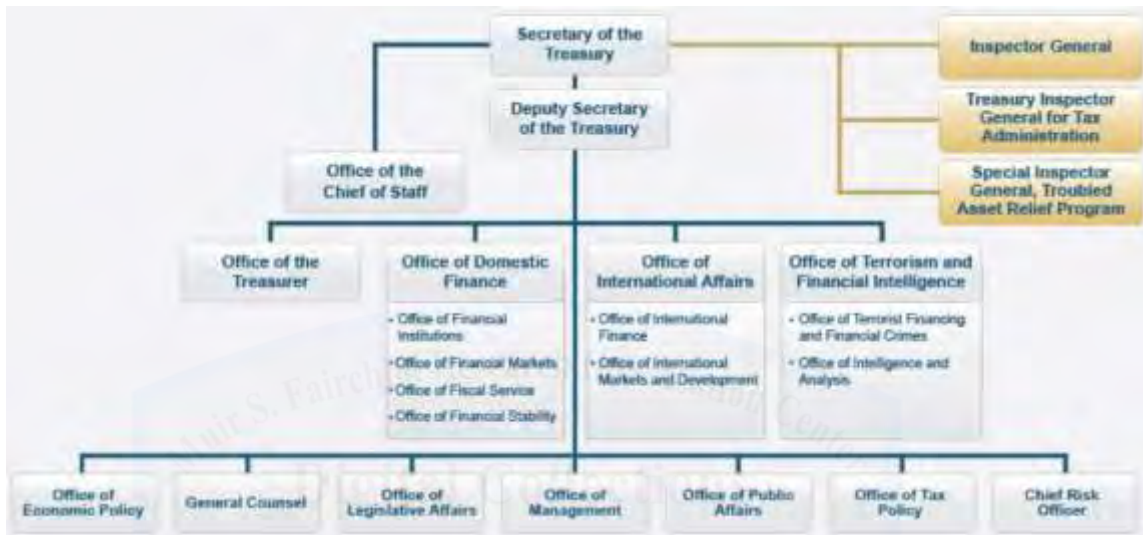


Figure 5: US Department of the Treasury

Source: Treasury.gov “Organizational Structure”

The OFAC is a 170-person team housed under the Office of Terrorism and Financial Intelligence. Its purpose is to “administer and enforce economic and trade sanctions based on US foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, [and] those engaged in activities related to the proliferation of weapons of mass destruction.”⁶⁶ It achieves this by producing a public list of Specially Designated Nationals (SDN). Individuals and companies labeled as SDNs are essentially blacklisted from participating in the US financial system. As globalization increases interconnectedness, the US financial system is representative of the global financial system, and companies and organizations that

⁶⁵ Zarate, *Treasury’s War*, 22.

⁶⁶ “Office of Foreign Assets Control - Sanctions Programs and Information,” accessed March 21, 2017, <https://www.treasury.gov/resource-center/sanctions/Pages/default.aspx>.

wish to remain in good standing, heed the SDN list, which is why targeted sanctions have become so popular. Juan C. Zarate, the first Assistant Secretary of the Treasury for Terrorist Financing and Financial Crimes following the organizations establishment post-9/11, wrote, “If you want to be a serious international institution with the ability to work globally, you have to access New York and the American banking system.”⁶⁷ In order to do that you have to abide by OFAC’s SDN list. The OFAC war room has been described as the “front line” of the United States’ economic instrument of coercion where economists and lawyers are referred to as “targeters.”⁶⁸ The call for sanctions typically initiates in the White House and/or the National Security Council, but the OFAC is responsible for the research and implementation associated with how to carry them out.

Although the Executive Branch is responsible for the initiation and planning of a majority of the sanctions the US enacts, Congress has acted to encourage sanctions more often since the 1970s. First, Congress can pass laws aimed to target negative behavior. This in turn allows, and encourages, the Executive Branch to implement sanctions when a violation of the law has occurred. For example, in the 1970s and 1980s, Congress passed amendments to the Foreign Assistance Act of 1962 and Trade Act of 1974 mandating sanctions against countries that harbor international terrorists, violate human rights, or abet drug production and distribution.⁶⁹ Second, Congress has the authority to pass and/or amend appropriations bills that limit or deny aid to specific countries. Finally, Congress has the authority to pass laws that directly affect trade with a specific country, essentially implementing an economic sanction by law.⁷⁰ These tools are often used to portray Congress as the “bad cop,” allowing the President, and the Executive Branch, to play “good cop” in holding back sanctions or granting waivers to reward positive behavior.

The US has primarily relied on trade, and more recently financial tools of the Economic IOP, since establishment of the Bretton Woods System; however, the economic instrument’s integration and effectiveness toward accomplishing national

⁶⁷ Zarate, *Treasury’s War*, 24–25.

⁶⁸ “After Success on Iran, U.S. Treasury’s Sanctions Team Faces New Challenges,” *Reuters*, April 15, 2014, <http://www.reuters.com/article/us-usa-sanctions-insight-idUSBREA3D1O820140415>.

⁶⁹ Hufbauer, *Economic Sanctions Reconsidered*, 135.

⁷⁰ Hufbauer, *Economic Sanctions Reconsidered*, 133–34.

security strategy has recently been questioned. In addition, the last 40 years of globalization have changed the global economic landscape, introducing additional actors, increasing economic inter-connectedness, and changing the economic landscape. The next chapter will address the implications of globalization on the international system and then take a deeper look at how globalization has effected the US's ability to use both trade and finance in national security strategy.



Chapter 3

Globalization and the Economic IOP

It has been said that arguing against globalization is like arguing against the laws of gravity.

Kofi Annan

Globalization is not new. Although globalization is a relatively new term, popularized in the 1980s, the underlying social phenomenon is extant as early as the Middle Ages and the famed Silk Road, when people sought ways to shrink distance in order to facilitate trade and interaction. Recently, however, the idea of globalization has received significant attention. The information revolution, and specifically the last twenty years of exponential growth in computing power, has seen a dramatic increase in the low-cost ability for individuals to communicate and collaborate regardless of geographic distance. Coupled with the ubiquity of communication and computing technology, globalization has fused the world across political, security, health, social, cultural, environmental and especially economic dimensions.¹ While there are many scholars and policymakers who see great benefit in globalization, there are just as many who see danger. The reality is likely somewhere in the middle.

There is significant variation across multiple disciplines seeking to define globalization and evaluate its impact. Disputes over its nature, origin, dynamics, and economic and political implications have fueled great disparity among scholars seeking to measure its effect on international relations.² Debates about the effect of increased international inter-connectedness began in the 1960s, but globalization as a term emerged in the 1970s. Since then, scholars and policymakers have engaged in wide-ranging debate, from globalization's influence on western art to its influence on international relations and the impending death of sovereignty and the nation state.³ While it is an important and ongoing debate, this paper seeks to build a foundation by defining globalization as it pertains to the current and future international economic landscape.

¹ Michael D. Intrilligator, "Globalization of the World Economy: Potential Benefits and Costs and a Net Assessment," *Milken Institute*, January 2003, 1, http://assets1b.milkeninstitute.org/assets/Publication/ResearchReport/PDF/globalization_pb.pdf.

² Nick Bisley, *Rethinking Globalization* (Palgrave Macmillan, 2007), 11.

³ Bisley, *Rethinking Globalization*, 11.

In its simplest form, globalization is the process of international integration that stems from the increased ability to communicate and trade globally.⁴ According to the Levin Institute, global integration is the interaction “among the people, companies, and governments of different nations, a process driven by international trade and investment and aided by information technology. It effects the environment, culture, political systems, economic development and prosperity, and human physical well-being in societies around the world.”⁵ Thomas Friedman also awards responsibility for globalization to technology, markets, and information systems. Friedman says globalization has effectively shrunk the world.⁶ He further pronounces globalization has taken the place of the cold war bipolar system and involves “the integration of free markets, nation-states and information technologies to a degree never before witnessed, in a way that is enabling corporations and countries [and individuals] to reach around the world farther, faster, deeper and cheaper than ever before.”⁷

Although Nicholas Kristof disputes Friedman’s claim that the international economy is more connected than ever, he agrees that increased economic interdependence is responsible for greater free trade, increased capital flows, greater movement of labor, an increase in multinational corporations (MNC), increased communication and decreased communication cost in addition to effectively reducing trade barriers between countries.⁸ From a purely economic standpoint, Michael Intriligator defines globalization as “increases in worldwide trade and exchanges in an increasingly open, integrated, and borderless international economy.”⁹

These definitions provide a demonstration of the current debate regarding the nature of globalization. Despite variation in how some authors define the phenomenon, it is

⁴ Martin Albrow and Elizabeth King, eds., *Globalization, Knowledge, and Society: Readings from International Sociology* (London ; Newbury Park: Sage Publications, 1990)

⁵ “What Is Globalization? | Globalization101,” accessed March 22, 2017, <http://www.globalization101.org/what-is-globalization/>.

⁶ Thomas L Friedman, *The Lexus and the Olive Tree: Understanding Globalization*, 2012.

⁷ Friedman, “A Manifesto for the Fast World.”

⁸ Nicholas D. kristof, “The World: A Better System in the 19th Century?; At This Rate, We’ll Be Global in Another Hundred Years - The New York Times,” *New York Times*, May 23, 1999, <http://www.nytimes.com/1999/05/23/weekinreview/world-better-system-19th-century-this-rate-we-ll-be-global-another-hundred-years.html>.

⁹ Intriligator, “Globalization of the World Economy: Potential Benefits and Costs and a Net Assessment,” 2.

important to point out that they all focus on an increased connectedness among actors in the international system. For this thesis, the phenomenon of globalization begs the question of how has it influenced the US's ability to wield the economic IOP? Part of this answer lies in the evolution of globalization through the current period.

According to Thomas Friedman, there have been three periods of globalization. Globalization 1.0 began when Christopher Columbus set sail to open trade between the Old and New Worlds and ended around 1800. He categorizes this as the “age of muscle,” when global integration, driven by religion and imperialism, was dependent on how much horsepower, wind power, and later steam power a country could creatively use to connect to the global environment.¹⁰ The second era, Globalization 2.0, lasted from the early 1800s to 2000. The Industrial Revolution and reduced transportation costs fueled globalization in the 19th century, while a decline in telecommunication costs associated with the “telegraph, telephones, the PC, satellites, fiber-optic cable and the early version of the World Wide Web” fueled growth in the 20th century.¹¹ Friedman says the power driving Globalization 3.0, since the year 2000, is the decrease in barriers to individual collaboration, through technological advances. Other scholars see globalization as two distinct periods, pre-WWI and post WWII, however, most agree on the driving vehicles of globalization, advancements in transportation and communication technology.¹² This paper will briefly discuss the Industrial Revolution and growth in global transportation, but is more concerned with globalization as it pertains to the post-WWII growth of intergovernmental organizations, and the post-Cold War era, and the shifting landscape of trade and finance facilitated by the Information Revolution.

Industrial Revolution

A common quip by historians, scholars, and economists, when talking about the inherent benefits or drawbacks of globalization, is that the world is less interconnected than at the end of the 19th century. According to Katrin Sjursen, “We need look no

¹⁰ Thomas L. Friedman, *The World Is Flat: A Brief History of the Twenty-First Century*, Further updated and expanded; release 3.0 (New York: Picador [u.a.], 2007).

¹¹ Friedman, *The World Is Flat*.

¹² Kevin H. O'Rourke and Jeffrey G. Williamson, *When Did Globalization Begin?*, Working Paper (National Bureau of Economic Research, April 2000), 2, doi:10.3386/w7632.

further than the empires of the 19th century to find heavy exchanges of raw material (from the colonies) and manufactured goods (from the protectorate nations).”¹³ Nicholas Kristof, writing for the *New York Times*, demonstrates labor is actually less mobile today, citing census statistics that 14 percent of the US population was born overseas in 1900 compared to only 8 percent in 2000.¹⁴ Kristof also demonstrates that exports represented 7 percent of GDP between the 1860s and 1870s and only 8 percent of in 2000, only a marginal increase.¹⁵ Many British scholars and historians suggest that the hype surrounding globalization is just a return to the time of Pax Britannica and the pre-WWI international system, when mercantilism, the colonial system, and international trade fueled open borders, large migrations of people, and capital.¹⁶

Primarily, pre-WWI advancements in transportation fueled the initial period of globalization. Despite national protectionist policies enacted to defend domestic production in the US and Europe, a significant reduction in transportation costs established a commodity price convergence that spurred growth in international trade.¹⁷ Specifically, advancements in steamship transportation and the widespread availability of railroad transportation made both international and intra-national transportation more affordable.¹⁸ These advancements, in addition to completion of the Suez Canal, drastically reduced international freight costs. At the same time, several Asian nations, including Japan, China, Korea, India, Siam, and Indonesia, willingly or through colonial coercion, opened their economy to free trade.¹⁹ Many experts compare the pre-WWI era of globalization to the one the world is experiencing in the early 21st century based on volume of trade and capital flow relative to GNP; however, the initial era of globalization

¹³ Katrin Sjursen, ed., *Globalization*, The Reference Shelf, v. 72, no. 5 (Bronx, N.Y: H.W. Wilson Co, 2000), 41.

¹⁴ kristof, “The World: A Better System in the 19th Century?; At This Rate, We’ll Be Global in Another Hundred Years - The New York Times.”

¹⁵ kristof, “The World: A Better System in the 19th Century?; At This Rate, We’ll Be Global in Another Hundred Years - The New York Times.”

¹⁶ Intrilligator, “Globalization of the World Economy: Potential Benefits and Costs and a Net Assessment,” 3.

¹⁷ jonas, “What Were the Main Effects of the 19th Century Globalization on the World Economy? | JonasNg.com,” accessed March 22, 2017, <http://jonasng.com/2012/03/what-were-the-main-effects-of-the-19th-century-globalization-on-the-world-economy/>.

¹⁸ O’Rourke and Williamson, *When Did Globalization Begin?*

¹⁹ O’Rourke and Williamson, *When Did Globalization Begin?*, 11–12.

came to an end in the early 20th century mainly as a result of WWI, the Russian Revolution, and eventually the Great Depression.²⁰

Post-WWII Establishment of International Institutions

Economic and trade liberalization are characteristics of the second era of globalization. Two world wars and the great depression blunted globalization in the early 20th century. In fact, some argue that aggressive nationalism and protectionist policies designed to slow globalization actually contributed to the Great Depression and led to WWII.²¹ The Bretton Woods Conference is credited with establishing the international system that reinvigorated globalization. Of particular importance at that conference was the development of the IMF and World Bank, but more importantly, the goal of developing an international system to remedy many of the faults of the interwar system.

The IMF currently boasts 189 member nations. The IMF's primary mission is to stabilize the international monetary system by introducing capital to reduce market perturbations and facilitate sustained economic growth.²² Since 2005, this has primarily meant reducing the negative effects of globalization for developing countries through surveillance, lending, and capacity development.²³ The IMF surveils the financial and economic policies of its 189 members, lends to countries with balance of payment problems, and provides training and assistance to developing countries to strengthen growth and institutional capacity.²⁴ The US maintains an ability to influence the organization's strategic direction and lending policy. First, the US Executive Director of the IMF is one of only 24 members, some of whom represent multiple countries, who have voting rights on the IMF Executive Board. The executive board is responsible for setting the organization's strategic direction. Second, policy voting weight is established by contribution quotas updated every five years or so. Currently, the US quota guarantees the US 16.5 percent of the overall voting share.²⁵ The next closest countries

²⁰ Friedman, *The Lexus and the Olive Tree*, xvii.

²¹ "Globalization: A Framework for IMF Involvement -- An IMF Issues Brief," accessed March 23, 2017, <https://www.imf.org/external/np/exr/ib/2002/031502.htm>.

²² "About the IMF," accessed March 23, 2017, <http://www.imf.org/external/about.htm>.

²³ "Globalization: A Framework for IMF Involvement -- An IMF Issues Brief."

²⁴ "About the IMF."

²⁵ SDR, or special drawing rights, is defined by the IMF and represents a basket of international currencies. The current composition is 41.73% US Dollar, 30.93% Euro, 10.92% Renminbi, 8.33% Japanese yen,

are China and Japan, each with 6 percent of the voting allocation. Most countries have representation well below one percent of the vote.²⁶

The World Bank Group, which operates under the United Nations (UN), is a conglomerate of five organizations: The international Bank for Reconstruction and Development (IBRD); The International Development Association (IDA); The International Finance Corporation (IFC); The Multilateral Investment Guarantee Agency (MIGA); and The International Center for Settlement of Investment Disputes (ICSID). The former two, the IBRD and IDA make up the World Bank.²⁷ The primary focus of the World Bank is “long-term investment projects, institution-building, and on social, environmental, and poverty issues.”²⁸ While reduction of poverty is a primary concern, the World Bank’s commitment to foreign investment, international trade, and capital investment demonstrate its Western tilt towards the benefit of globalization. Like the IMF, the size of a country’s contribution to the World Bank organization determines its share of the voting rights. Again, as the largest contributor of 189 member nations, the US exercises approximately 16.5 percent of the vote, while the next two closest countries, Japan and China exercise 7 percent and 4.5 percent respectively (See Table 3).²⁹ In addition, because it is the largest shareholder, the US is the only country to hold veto power over any organizational structure changes. The US Executive Director is nominated by the President and confirmed by the Senate and is supported by representatives from the Treasury, State, Commerce, and the US Agency for International Development.³⁰

8.09% British pound. “Press Release: IMF Executive Board Completes the 2015 Review of SDR Valuation,” accessed March 23, 2017, <http://www.imf.org/external/np/sec/pr/2015/pr15543.htm>.

²⁶ “IMF Members’ Quotas and Voting Power, and IMF Board of Governors,” accessed March 23, 2017, <http://www.imf.org/external/np/sec/memdir/members.aspx>.

²⁷ “About the World Bank,” accessed March 23, 2017, <http://www.worldbank.org/en/about>.

²⁸ “Globalization: A Framework for IMF Involvement -- An IMF Issues Brief.”

²⁹ “IBRD Country Voting Table,” *World Bank*, accessed March 23, 2017, <http://siteresources.worldbank.org/BODINT/Resources/278027-1215524804501/IBRDCountryVotingTable.pdf>.

³⁰ “Office of the Executive Director for the United States,” *The World Bank*, accessed March 23, 2017, <http://www.worldbank.org/en/about/leadership/directors/eds01>.

Table 3: 2010 IMF & World Bank Quotas & Voting Allocation

	IMF Quota & VP		World Bank VP		GDP		Trade	FXRs	Population									
	Quota	VP	IBRD	IDA	Current	PPP												
US	1	17.09	1	16.77	1	16.36	1	12.16	1	24.61	1	20.42	1	10.68	23	0.62	3	4.56
PRC	6	3.72	6	3.66	6	2.78	13	1.86	3	8.47	2	12.56	2	8.85	1	29.44	1	19.82
Japan	2	8.12	2	8.02	2	7.85	2	8.53	2	8.75	3	5.96	4	4.54	2	12.23	10	1.89
India	13	1.91	13	1.89	7	2.78	7	3.13	11	2.13	4	5.05	17	1.64	7	3.17	2	17.81
Germany	3	5.98	3	5.88	3	4.48	3	6.30	4	5.79	5	4.02	3	8.29	34	0.45	16	1.22
UK	4	4.94	4	4.86	4	4.3	4	5.37	6	3.77	6	3.06	8	3.37	32	0.47	22	0.92
Russia	10	2.74	10	2.69	7	2.78	50	0.31	12	2.12	7	3.02	14	2.08	3	4.98	9	2.10
France	4	4.94	4	4.86	4	4.3	5	4.04	5	4.62	8	3.02	5	4.13	42	0.34	21	0.93
Brazil	18	1.40	18	1.38	13	2.07	14	1.60	8	2.72	9	2.88	24	1.15	9	2.85	5	2.84
Italy	7	3.25	7	3.19	7	2.78	9	2.57	7	3.66	10	2.49	8	3.27	38	0.42	24	0.89
Mexico	18	1.45	18	1.43	20	1.18	24	0.74	14	1.51	11	2.10	16	0.92	14	1.15	11	1.60
Korea	19	1.35	19	1.33	22	0.99	27	0.88	15	1.44	12	1.95	10	2.75	6	3.25	26	0.72
Spain	17	1.40	17	1.39	15	1.74	21	0.89	9	2.53	13	1.95	15	2.05	58	0.18	27	0.68
Canada	9	2.93	9	2.89	7	2.78	8	2.69	10	2.31	14	1.84	11	1.32	27	0.52	36	0.50
Indonesia	23	0.96	23	0.95	23	0.94	22	0.87	18	0.93	15	1.38	30	0.85	20	0.74	4	3.44
Turkey	36	0.55	36	0.55	36	0.53	28	0.63	17	1.06	16	1.26	29	0.97	19	0.85	18	1.05
Australia	15	1.49	15	1.47	17	1.52	15	1.23	13	1.72	17	1.22	20	1.28	37	0.40	49	0.32
Iran	29	0.69	29	0.69	18	1.48	141	0.08	29	0.57	18	1.19	36	0.54	171	0.00	17	1.10
Taipei, China	—	—	—	—	—	—	—	—	25	0.65	19	1.05	18	1.52	5	4.27	47	0.34
Poland	33	0.63	33	0.63	30	0.69	10	2.10	21	0.74	20	0.89	26	1.12	17	0.90	33	0.57
Netherlands	11	2.37	11	2.34	12	2.21	11	2.02	16	1.37	21	0.94	7	3.28	64	0.11	59	0.24
Saudi Arabia	8	3.21	8	3.16	7	2.78	6	3.30	26	0.64	22	0.85	19	1.34	4	4.87	45	0.38
Argentina	22	0.97	22	0.97	24	1.12	25	0.73	30	0.54	23	0.84	42	0.38	26	0.53	31	0.60
Thailand	39	0.50	39	0.50	45	0.41	38	0.39	33	0.46	24	0.77	23	1.15	12	1.84	19	0.99
South Africa	25	0.86	25	0.85	26	0.85	64	0.30	32	0.50	25	0.72	35	0.54	38	0.40	25	0.73
Egypt	43	0.43	43	0.44	41	0.45	33	0.49	43	0.32	26	0.67	55	0.27	40	0.38	16	1.14
Pakistan	41	0.48	41	0.48	33	0.59	20	0.92	46	0.29	27	0.62	61	0.19	62	0.12	7	2.43
Colombia	58	0.36	53	0.36	44	0.41	32	0.50	36	0.40	28	0.58	66	0.26	45	0.28	29	0.67
Belgium	12	2.12	12	2.09	14	1.8	17	1.13	20	0.81	29	0.55	9	1.49	67	0.10	72	0.16
Malaysia	30	0.68	30	0.68	37	0.52	37	0.40	42	0.33	30	0.55	25	0.88	15	1.14	44	0.41
EU		32.39		31.85		28.54		52.40		29.39		21.19		35.71		8.39		7.39
G20		79.14		77.87		76.85		72.18		67.84		63.24		75.00		74.00		65.76
East Asia		14.57		14.43		14.44		14.85		22.23		26.02		26.43		58.85		31.67

Note: VP= voting powers; GDP (current) = at current prices in the US dollar; GDP (PPP) = at PPP international dollar; FXRs = foreign exchange reserves; EU= European Union; UK= United Kingdom; US= United States.

Source: IMF, *World Economic Outlook*, April 2010 database; IMF, *International Financial Statistics*, CD-ROM; IMF and World Bank, website.

Source: Masahiro Kawai and Peter A Petri, *Asia's Role in the Global Economic Architecture*, Working Paper, ADBI Working Paper Series (Asian Development Bank Institute, August 2010)

In theory, a greater number of participants in the global market, defined as both nations and multinational corporations, bring a commensurate increase in the volume of economic activity and trade.³¹ The IMF, the World Bank, and the WTO were established to promote global trade while monitoring developing nations to ensure that inequalities created by globalization are minimized and global growth is beneficial to all. Not every nation agrees that these inequalities are addressed by these institutions, and in fact some view the IMF and World Bank as tools for control and influence rather than instruments for leveling the playing field.

One additional aspect of globalization needs to be taken into account: the information revolution of the last three decades. Since the early 1990s, the world has witnessed an unprecedented level of technological change. The doubling of computing

³¹ Haass and Council on Foreign Relations, *Economic Sanctions and American Diplomacy*, 5–6.

power every two years, called Moore's Law, has allowed information technology to expand into "every sphere of existence."³² Henry Kissinger attributes the information revolution with the ability to bring individuals and processes together in the same medium, the internet, and communicate using the same "technological language" in real-time.³³ Kissinger credits real-time global communication capability for the increased competition in the global marketplace, regardless of geographical restraints, and argues that technology has had the strongest influence on globalization. The ability to communicate globally, in real time, has shifted the focus of individuals, and more importantly MNCs and non-governmental organizations (NGO), from local markets to global markets, allowing MNCs and NGOs access to global markets on both sides of the supply and demand curve.

Implications of Globalization on Economic Statecraft

In evaluating the evolution of globalization, especially in the post-Cold War era, there are three developing trends that affect the methods and ability of the US to conduct economic statecraft. The first key trend is an increase in the number of participants, both state actors and non-state multinational corporations (MNCs), in the global economy. The drastic reduction in transportation and communication costs has reduced the cost of participation for both developing nations and MNCs. In addition, a significant reduction in traditional trade barriers facilitated by the WTO, and increasingly through bilateral and regional trade agreements, has increased both the number of actors and the interconnected nature of the global economy. This increase in the number of actors has decreased US relative influence in the global economy.

One indicator of growth is the increase in membership to international organizations, including the IMF and WTO (see Figure 6). For example, membership of the WTO has increased from the original 23 signatories of the GATT in 1947 to 164 members today.³⁴ The increase in WTO membership is indicative of the larger trend of more states participating in the global economy. This fact has significant implications for

³² Henry Kissinger, *World Order* (New York: Penguin Press, 2014), 341–42.

³³ Kissinger, *World Order*, 342.

³⁴ "WTO | Members and Observers," accessed May 12, 2017, https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

the US's ability to leverage successful sanctions programs. While the interconnected global economy allows the US to leverage the international financial network to gather intelligence and more accurately target nefarious actors, the growth in participants also means there are a growing number of alternative networks available to targeted actors to circumvent US sanction programs. This is especially true of unilateral sanction programs, but also true of multilaterally supported programs. While targeted sanctions were effective in isolating Iran, they will be less so against more connected sovereign states.³⁵ Accordingly, Hufbauer, Schott, Elliott, and Oegg found that sanctions are only successful at achieving limited policy goals, and only one third of the time.³⁶ US sanctions efficacy will be discussed in greater detail in Chapter Four.

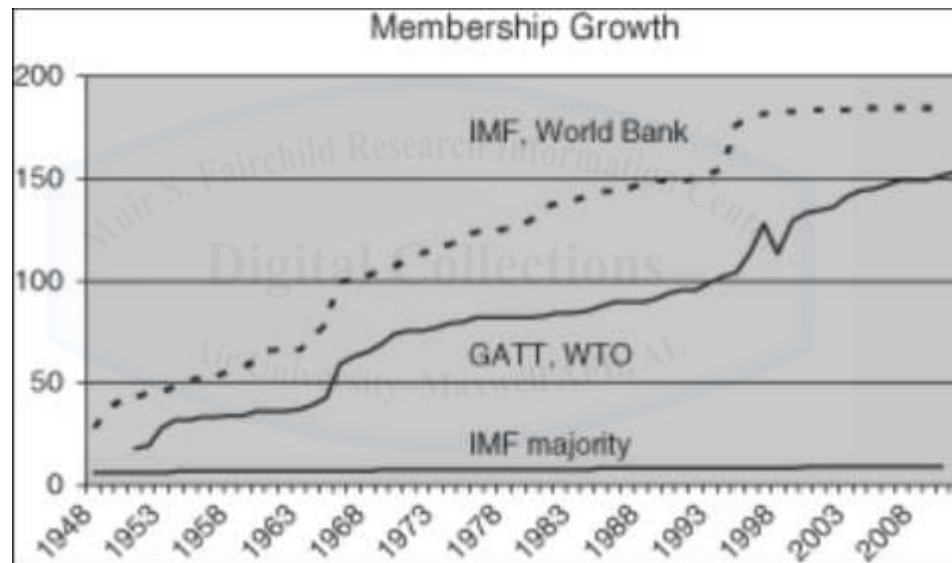


Figure 6: Membership Growth, IMF, World Bank, & GATT

Source: Kawai and Petri "Asia's Role in the Global Economic Architecture"

In addition, the growth in the number of MNCs operating in the global economy has prompted debate about the future role of sovereign states in the international system. One indicator of the power of MNCs was the significant role MNCs played, as opposed

³⁵ Robert D. Blackwill and Jennifer M. Harris, *War by Other Means: Geoeconomics and Statecraft* (Cambridge, Massachusetts: The Belknap Press of Harvard University Press, 2016), 221-223.

³⁶ Gary Clyde Hufbauer, ed., *Economic Sanctions Reconsidered*, 3rd ed., Expanded ed (Washington, DC: Peterson Institute for International Economics, 2007), 5-6

to government actors, in the Trans-Pacific Partnership (TPP) negotiations. In fact, one of the primary complaints of detractors was the secrecy of the agreement, facilitated by MNC attorneys, and the likelihood MNCs would be favored over developing governments. While MNCs have been a major source of Foreign Direct Investment (FDI) since the Cold War; increasingly, state-owned MNCs are a major source of foreign investment. Today, state controlled MNCs supply more than one third of FDI from emerging markets and “include some of the world’s biggest companies, backed by some of the globe’s largest pools of capital, and can claim over half of the world’s top ten IPOs over the last six years.”³⁷ In conjunction with the growth of MNCs, is the increasingly fluid nature of the global economy, shifting from primarily merchandise trade to financial trade.³⁸ This fact allows state-owned MNCs to inject and withdraw major investment flows predicated on political agendas. Because the US does not have the same ability to direct MNC foreign investment, it has lost relative power to conduct economic statecraft through FDI.

The second key trend, partly influenced by the increased number of participants in the global economy, is the decreasing influence of the international organizations established after the Bretton Woods conference, especially the WTO. Debate about the efficacy of the WTO has been present almost since its creation in 1995. The first major call for reform came after the breakdown, due to widespread protests, of the Seattle Ministerial Conference in 1999. Then, after the 2008 global financial crisis, critics again questioned the ability of the WTO to manage and sustain an open global trading system.³⁹ The primary concern of critics and protestors is the underrepresentation of the developing and transitional economies in the international system. Looking back at Figure 3, one can see that while the membership to the IMF and WTO has increased considerably, the number of majority stakeholders in the IMF (and WTO) has not changed. After conducting a literature review on WTO reform, Carolyn Birkbeck found that “the majority of attention has been on reform of the WTO’s negotiation process, as well as its

³⁷ Blackwill and Harris, *War by Other Means*, 54.

³⁸ Blackwill and Harris, *War by Other Means*, 53.

³⁹ Debra P. Steger and Centre for International Governance Innovation, eds., *Redesigning the World Trade Organization for the Twenty-First Century*, Repr., Studies in International Governance (Waterloo, Ontario: Wilfrid Laurier Univ. Pr. [u.a.], 2011), 11.

dispute settlement process and the appropriate relationship and balance between the two.”⁴⁰ However, Birkbeck also identified developing nation participation in the global economy as a key “crosscutting” tension among WTO critics.⁴¹ Underrepresentation of developing nations was partially responsible for the breakdown of the Doha Round of trade negotiations in 2012, after 11 years of negotiations, a development indicative of increasingly complex global trade relationships.

The Doha Round of Trade Negotiations was the most recent round (of a total of eight rounds) of trade negotiations conducted by the WTO, and under GATT before it became the WTO. The agenda of the Doha Round, or Doha Development Agenda, focused on agriculture, services trade and regulation, intellectual property, environmental implications of expanded trade, and WTO rules, and was meant to be a major overhaul of global trade relations. Whereas forty years ago, 90 percent of international trade consisted of mercantilist goods; today, 90 percent of international trade is in the financial industry and services.⁴² The initial purpose of the GATT was to reduce tariffs on manufactured goods allowing free-flowing trade; however, the bulk of today’s global trade consists of services, and the WTO has failed to keep up. In fact, a majority of the Doha agenda items were unresolved issues leftover from the previous Uruguay Round of negotiations which concluded in 1994. Disagreements about agriculture trade, data services, and intellectual property rights were a few of the major impediments left unresolved by the latest round of trade negotiations. After multiple rounds of trade negotiations spanning 11 years, the Doha Agenda was also left unresolved. Because the WTO has been unable to reach an agreement on contentious trade issues, states have increasingly resorted to bilateral and regional trade agreements. By divesting global trade agreements across multiple trade agreements, international institutions like the WTO, and the major stakeholders like the US, have lost relative influence in the global market. This will be discussed in greater detail in Chapter Five.

⁴⁰ Steger and Centre for International Governance Innovation, *Redesigning the World Trade Organization for the Twenty-First Century*, 13.

⁴¹ Steger and Centre for International Governance Innovation, *Redesigning the World Trade Organization for the Twenty-First Century*, 11–18.

⁴² Blackwill and Harris, *War by Other Means*, 53.

Finally, the third development facilitated by globalization and limiting US, and western, influence in the global economy is the development of alternative financial networks and tools by developing nations, most notably China. Three developments in particular are worth mentioning and are indicative of the larger trend of developing nations seeking to increase economic influence while undermining western control. The first example is the Chinese development of an alternative to the Society for Worldwide Interbank Financial Telecommunications (SWIFT) network called the Cross-Border Inter-Bank Payment System (CIPS). While SWIFT is the backbone of the western financial network, CIPS allows China and its trading partners to utilize SWIFT language and infrastructure where necessary, but also offers an alternative network backbone for its trading partners when the SWIFT system might be compromised by sanction programs. In addition, the CIPS network allows Chinese companies to facilitate timely transactions with the renminbi, increasing the Chinese currency's use and value and elevating the likelihood it could compete to become a recognized reserve currency. In a second effort to decrease the influence of the IMF and World Bank, China, in conjunction with Brazil, Russia, India, and South Africa, often referred to as the BRICS nations, has established the New Development Bank (NDB) as an alternative lending institution to developing nations requiring financial stability or investment for infrastructure projects, specifically renewable energy.

While development of CIPS and the NDB can be viewed as tools to decrease US, and western, influence in the global economy, developing nations are also utilizing new tools to strengthen their own influence in the global economy. The two most common are state-owned enterprises (SOEs) or state-owned MNCs and sovereign wealth funds (SWFs). The ability of SOEs to inject and withdraw FDI in conjunction with political objectives was discussed above. SOEs have become extremely powerful tools as over one third of outbound FDI is controlled by state-owned MNCs.⁴³ SWFs offer the controlling government a similar capability to invest and withdraw funds in a timely fashion based on political climate and goals. As an example, Moscow invested one sixth of its SWF to Kiev in 2013 as a bailout package on the condition that the Ukraine remain

⁴³ Blackwill and Harris, *War by Other Means*, 54.

“tethered” to Russia.⁴⁴ Both SOEs and SWFs will be discussed in greater detail in Chapter Five. While these funds are fairly new, and primarily economically driven by profit, their recent use as a political instrument has considerable sway in the global economy as an instrument of foreign investment.

In summary, globalization’s generalized effects on US economic power are threefold. First, the expansion of trade, due to the exponential decrease in communication and transportation costs, coupled with the accelerated speed of both, has led to an increased number of states participating in the global economy. In addition to the increased number of states is the increased number of multinational corporations, which arguably wield more influence than state actors in the global economy. While some countries, most notably China and Russia, have leveraged state owned MNCs to take advantage of the growing influence that MNC FDI provides, the US is unable to leverage this tool. Second, globalization and the information revolution have created a global economy that has outpaced the international institutions that were established at Bretton Woods to regulate it, most notably the IMF, World Bank, and WTO. The recent breakdown in the Doha round of WTO trade negotiations is indicative of a larger problem of the inability of international institutions to keep up with current trade practices and establish new trade relations. Finally, as developing countries gain relative power and seek a greater role in the global economy, they are seeking ways to update and leverage the current international system to circumvent out of date and western leaning institutions. As a result, such effects should speak to specific patterns with respect to both finance and trade. I address these in turn over the next two chapters.

⁴⁴ Blackwill and Harris, *War by Other Means*, 55.

Chapter 4

Globalization and Finance

Ambitious ideological projects and impressive territorial conquests have less enduring influence on the leverage of states than the mobilization and management of capital...National power is fundamentally financial.

Jeremy Suri

On November 9, 1989, the Berlin Wall came down and drastically changed the international system, accelerating the globalization of the international financial system. Not only did the fall of the Berlin Wall signify an end to the bipolar international system, but the end of the Cold War allowed former communist and socialist countries to recognize the global possibilities of democracy and free-market capitalism. According to Friedman, “The fall of the Berlin Wall didn’t just help flatten the alternatives to free-market capitalism and unlock enormous pent-up energies for hundreds of millions of people in places like India, Brazil, China, and the former Soviet Empire. It also allowed us to think about the world differently—to see it as more of a seamless whole.”¹ Coupled with the information revolution, the exponential increase in computing power, and the decrease in real-time or near real-time communication costs, the fall of communism drastically changed the international economy. This chapter will look at the globalization of the international financial system, the transformation of US sanction implementation, and the international response.

International Financial System

According to the IMF, four main forces are responsible for the globalization of international finance: growth and development of information technology, globalization of national economies, liberalization of national financial and capital markets, and global

¹ Thomas L. Friedman, *The World Is Flat: A Brief History of the Twenty-First Century*, Further updated and expanded; release 3.0 (New York: Picador [u.a.], 2007) 54.

competition among providers of intermediary services.² These four trends were directly responsible for the exponential growth in number of participants, both state and MNCs, in the global economy. This section will address each of the four individually as they pertain to the international financial system and implementation of US sanction programs, beginning with the growth and development of information technology. One of ten accelerants of globalization in the post-Cold War era identified by Friedman was the confluence of the development of the internet, creation and democratization of the World Wide Web, and development of the first web browser by Netscape.³ While Friedman attributes the beginning of the dot-com bubble to the meeting of these three developments, it was equally important to the global financial system because it led to the birth of electronic commerce, or the e-commerce industry, and dramatically increased the speed of financial transactions. In addition, as start-up companies scrambled to invest in the dot-com industry, there was a significant investment in the fiber-optic infrastructure that would underpin democratization of the growing technology.⁴ The global growth and adaptation of technology, which required standardization of technology and computing language, led to the ability for countries to “measure, monitor, and manage financial risk; to price and trade the complex new financial instruments; and to manage large books of transactions spread across international finance centers in Asia, Europe, and the Western Hemisphere.”⁵

The second force driving an increase in interconnected financial relations is the globalization of national economies primarily through the growth of MNCs. In the period between 1983 and 1992, world exports of goods and services averaged \$2.3 billion a year, in 2001 that figure jumped to \$7.6 billion and has continued to climb exponentially since.⁶ While MNCs are not new, since the early 1990s they are “the primary movers and shapers of the global economy.”⁷ In fact, Stephen G. Brooks, Assistant Professor of Government at Dartmouth College and author of *Producing*

² Gerd Hausler, “The Globalization of Finance,” *Finance Dev. FD* 39, no. 1 (March 2002), <http://www.imf.org/external/pubs/ft/fandd/2002/03/hausler.htm>.

³ Friedman, *The World Is Flat*, 74.

⁴ Friedman, *The World Is Flat*, 74.

⁵ Hausler, “The Globalization of Finance.”

⁶ Hausler, “The Globalization of Finance.”

⁷ Peter Dicken, *Global Shift: Transforming the World Economy*, 3. ed., reprinted (London: Chapman, 1999), 177.

Security: Multinational Corporations, Globalization, and the Changing Calculus of Conflict, demonstrates that MNCs have replaced trade as the primary integrating force in the global economy stating that while “trade flows are still very important...international production by the massive number of MNCs (65,000 with 850,000 affiliates) is now much more significant as a driver of commerce.”⁸ Brooks attributes the expansion of MNCs with technological shifts and improvement in communication technology that allow dissemination of contract specifications and financial data across the globe allowing companies to take advantage of locational benefits.⁹

The third driver of financial globalization, according to the IMF, is liberalization of national finance and capital markets. In order to effectively leverage the technological advances and regulate the increase in cross-border financial transactions without stifling economic growth, countries have adopted liberal rules and reduced barriers to trade in financial services.¹⁰ One requirement, was the creation and adoption of a universally recognized financial transaction system and language, which came from SWIFT. With over 30 million cross-border financial transactions occurring daily, the SWIFT network has become increasingly important and the fact that SWIFT is sympathetic to western ideals makes it instrumental in how the US gathers intelligence and implements current sanction programs.

The final driver of globalization of the financial system is global competition among providers of intermediary services. According to Hausler, “The regulatory authorities in many countries have altered rules governing financial intermediation to allow a broader range of institutions to provide financial services, and new classes of nonbank financial institutions, including institutional investors have emerged. Investment banks, securities firms, asset managers, mutual funds, insurance companies, specialty and trade finance companies, hedge funds, and even telecommunications, software and food companies are starting to provide services similar to those traditionally provided by banks.”¹¹ Financial trade was further facilitated by the WTO’s inclusion of

⁸ Stephen G. Brooks, *Producing Security: Multinational Corporations, Globalization, and the Changing Calculus of Conflict*, Princeton Studies in International History and Politics (Princeton, NJ: Princeton Univ. Press, 2007) 16.

⁹ Brooks, *Producing Security*, 27.

¹⁰ Hausler, “The Globalization of Finance.”

¹¹ Hausler, “The Globalization of Finance.”

financial services after the Uruguay round of trade negotiations in 1997. The agreement facilitated trade in insurance, banking, and financial information.¹²

These four trends led to the globalization of the international financial system and an increase in both state and MNC participation in the global economy. In response, the US updated and streamlined its sanction program implementation strategy.

Evolution of US Economic Sanction Programs

The first post-Cold War evolution of the Economic IOP occurred during the Clinton administration. The Clinton administration made two significant changes to incorporate the economic IOP into the national security agenda. First, in January 1993, with executive order 12835, President Clinton established the National Economic Council (NEC). President Clinton placed high priority on both domestic and international economic growth during his presidential campaign, and he emphasized the opening of foreign markets to US business.¹³ While many of President Clinton's predecessors had an equivalent body of economic advisors, he was the first to formalize an agency to fuse economic and security agendas. In fact, during his campaign, presidential candidate Clinton introduced the NEC initially calling it the National Economic Security Council, citing the need to protect US economic global interests and insinuating its equivalent importance to the NSC.¹⁴ The NEC's objective is to advise the president on domestic and international economic policy and ensure implementation of the administration's economic agenda.¹⁵ The NEC director, appointed by the president, and known officially as the Assistant to the President for Economic Policy, carries out these duties.

In addition to establishment of the NEC, President Clinton signed Presidential Policy Directive (PPD) 2 in January 1993 outlining the organization of his NSC. Continuing the effort to integrate economic and national security strategy, President

¹² "Successful Conclusion of the WTO's Financial Services Negotiations," *WTO News*, December 15, 1997, https://www.wto.org/english/news_e/pres97_e/pr86_e.htm.

¹³ "The Clinton Presidency: Historic Economic Growth," accessed April 2, 2017, <https://clinton5.nara.gov/WH/Accomplishments/eightyears-03.html>.

¹⁴ Sarah Rosen Wartell, "The White House: National Economic Council," *American Progress*, 2008, 16, http://images2.americanprogress.org/CAPAF/2008/changeforamerica/WhiteHouse_03_Wartell.pdf.

¹⁵ Blahous, "The Importance of the National Economic Council."

Clinton added the Treasury Secretary, the US Representative to the United Nations, and the Assistant to the President for Economic Policy (the NEC director) as non-statutory members of his NSC.¹⁶ Although the Treasury Secretary was often an attendee of the NSC before PPD 2, non-statutory status signified an increase in importance. In fact, in 1949 President Truman directed the Treasury Secretary to attend all meetings; however, historically it is more common for the Treasury Secretary to attend by invite only.¹⁷ The current administration's NSC also includes the Treasury Secretary as a non-statutory member of the council, but dictates that the US Trade Representative, the Commerce Secretary, and the Assistant to the President for Economic Policy only attend meetings when international economic issues are on the agenda.¹⁸ This signifies a separation of interest between the NSC and NEC and makes it less likely that the economic IOP will play a role in national security foreign policy decisions.

The debate over how much of a role the Treasury Secretary will play in national security is not new. In 1975, President Ford vetoed a bill that proposed upgrading the Treasury Secretary to a statutory member of the NSC. President Ford said the Treasury Secretary would participate in all NSC matters with significant economic implications, but did not see the need to change statutory status.¹⁹ The debate resurfaced again at the end of the Cold War when the expectation was that the economic IOP would be the primary tool used in coercive foreign policy. In fact, during the Clinton administration, there was a growing perception that economic and financial policy were superseding the military IOP in capability to influence the international environment. More recently, Robert Kimmitt, a former deputy Treasury Secretary, made an argument to update the NSC to include the Treasury Secretary among statutory members. Kimmitt says, "The concept of national security has broadened considerably since the NSC's early decades, elevating economic and financial issues to crucial elements to our nation's security,

¹⁶ President William Clinton, "Presidential Policy Directive 2" (The White House, January 20, 1993), <https://fas.org/irp/offdocs/pdd/pdd-2.pdf>.

¹⁷ Richard A. Best Jr., "The National Security Council: An Organizational Assessment," *Congressional Research Service*, 14, accessed April 2, 2017, <https://fas.org/sgp/crs/natsec/RL30840.pdf>.

¹⁸ "Presidential Memorandum Organization of the National Security Council and the Homeland Security Council," *Whitehouse.gov*, January 28, 2017, <https://www.whitehouse.gov/the-press-office/2017/01/28/presidential-memorandum-organization-national-security-council-and>.

¹⁹ Best Jr., "The National Security Council: An Organizational Assessment," 27.

alongside the traditional diplomatic and military issues.”²⁰ Kimmitt argues that even when economic issues are not on the NSC agenda, economic and national security issues intersect in ways that only a Treasury Secretary might recognize, and if he or she is not present, an opportunity could be misidentified or wasted entirely.²¹

In addition to the Clinton administration’s emphasis on the economic instrument of foreign policy, the second major evolution of the post-Cold War economic IOP came in response to the 9/11 terrorist attacks on the United States. Although the Clinton administration first used targeted sanctions effectively against Serbian President Slobodan Milosevic from 1993 to 1995, and later against individuals associated with the South American drug trade, broad sanctions continued to be the economic instrument of choice until the early 2000s.²² In the early 2000s, post 9/11 terror attacks, the treasury founded the Office of Terrorism and Financial Intelligence (TFI). According to Jacob Lew, the US Treasury Secretary from 2013 to 2017, TFI was established to attack the financial foundation of terrorist organizations. However, over the past 10 years its role has morphed to include expert financial intelligence analysis, implementation of policy to combat money laundering and financial crimes, cooperation with foreign governments and promotion of international financial transparency, and implementation and enforcement of sanctions against terrorist networks and organized crime.²³ The mission of TFI is to marshal “the department’s intelligence and enforcement functions with the twin aims of safeguarding the financial system against illicit use and combating rogue nations, terrorist facilitators, weapons of mass destruction (WMD) proliferators, money launderers, drug kingpins, and other national security threats.”²⁴ The TFI’s role has been

²⁰ Robert M. Kimmitt, “Give Treasury Its Proper Role on the National Security Council,” *New York Times*, July 23, 2012, sec. Op-Ed, <https://www.nytimes.com/2012/07/24/opinion/give-treasury-its-proper-role-on-the-national-security-council.html>.

²¹ Kimmitt, “Give Treasury Its Proper Role on the National Security Council.”

²² Juan Carlos Zarate, *Treasury’s War: The Unleashing of a New Era of Financial Warfare*, First Edition (New York: PublicAffairs, 2013) 6-8.

²³ Jacob Lew, “Treasury Department Role in National Security, Secretary Lew Remarks,” Conference, *TFI@10: Evolution of Treasury’s National Security Role* (Center for Strategic and International Studies: CSpan, June 2, 2014), <https://www.c-span.org/video/?319687-1/treasury-department-role-national-security>.

²⁴ “Terrorism and Financial Intelligence,” accessed April 1, 2017, <https://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Terrorism-and-Financial-Intelligence.aspx>.

significantly enhanced through the globalization and increased interconnectedness of the international financial system.

In the book *Treasury's War*, author Juan Zarate attributes the success of TFI to three trends in the international financial system. First, was the increased emphasis on anti-money-laundering in the international financial system. In the late 1980s and 1990s, several governments passed anti-money-laundering regulations facilitating information sharing and financial transparency among international financial institutions.²⁵ Second, was the development of financial tools specifically geared towards intelligence collection. Finally, was a new understanding of how to exploit the interconnected international financial system to collect intelligence and take action against criminal actors.²⁶ With the threat of being disconnected or blacklisted from the western international financial system, private companies had an incentive to identify and disconnect rogue or nefarious actors from the system. This made it much easier to identify and isolate terrorist finance networks. Since the creation of TFI, the US has leveraged that organizations success against rogue terrorist networks and applied targeted sanction campaigns against state actors, most notably Iran and North Korea, and more recently Russia.

Targeted Sanctions

Two factors underpin the US's ability to implement targeted sanctions. First is the predominance of the US economic system. It is estimated that over \$1.2 trillion flows through the New York currency market each day.²⁷ The US is the global hub of the financial market, the US dollar is the global reserve currency, and it is the currency of choice in international trade. "With this concentration of financial and commercial power comes the ability to wield access to American markets, American banks, and American dollars as financial weapons."²⁸ It is because of America's dominant and central role in the global financial market, the US Treasury department is able to leverage

²⁵ Zarate, *Treasury's War*, 8.

²⁶ Zarate, *Treasury's War*, 8–10.

²⁷ Intrilligator, "Globalization of the World Economy: Potential Benefits and Costs and a Net Assessment."

²⁸ Richard Haass and Council on Foreign Relations, eds., *Economic Sanctions and American Diplomacy* (New York: Council on Foreign Relations, 1998), 5–6.

sanctions with a credible threat of isolating facilitating institutions from the US-led economic system.²⁹ The size and health of the US economy, and controlling access to it, is the primary method that the US can wield its economic IOP.

The second factor underpinning US targeted sanction implementation is the existence of the SWIFT network. Because SWIFT is responsible for virtually all global electronic banking transactions, and is domiciled in a western leaning country, the US has considerable leverage to exploit it.³⁰ In addition to the SWIFT network, the USA PATRIOT Act gives the Treasury the legal authority required to exploit the network and target rogue actors and organizations. Although there has been some pushback in the international community, which led to the establishment of a third SWIFT operations center in Switzerland (outside US jurisdiction), the treasury department still has authority to exploit nefarious activity and transactions that transit the US data center. According to Zarate, the USA PATRIOT Act “provided the legislative mandate that Treasury needed to extend anti-money-laundering requirements to a range of commercial and financial actors; to expand financial information sharing between the government and the private sector...and to develop more tools to enforce expanded policies and regulations.”³¹ In addition, the US leverages the ability to gather intelligence on nefarious financial activity in order to encourage international financial institutions to find, report, and discontinue activity with targeted actors for fear of being isolated from the US economy or international financial system (in the case of multilateral sanctions).

Because targeted sanction programs were so successful at isolating terrorist financial support networks after the 9/11 terror attacks on the US, the treasury department expanded their use against nation states, most notably with success against North Korea and then Iran. While Iran has been the target of broad US (and multilateral international) sanction programs almost continuously since the seizure of the US embassy there in 1979, the new targeted sanction regime has been credited for prompting Iranian participation in the 2015 Iran nuclear disarmament deal. A study conducted by the Peterson Institute for International Economics demonstrated the effectiveness of

²⁹ Robert D. Blackwill and Jennifer M. Harris, *War by Other Means: Geoeconomics and Statecraft* (Cambridge, Massachusetts: The Belknap Press of Harvard University Press, 2016), 59.

³⁰ Blackwill and Harris, *War by Other Means*, 58.

³¹ Zarate, *Treasury's War*, 30.

sanctions on the state controlled oil industry in Iran, showing a drop of oil exports from \$81 billion in 2011 to \$38 billion in 2013, a 54 percent decline.³² The significant decline was a result of SWIFT, under pressure from the US, agreeing to drop 30 Iranian banks, including Iran's central bank, in 2012. In fact, the US Treasury Department began targeting Iranian banks, specifically Bank Saderat which was associated with funneling state money to Hezbollah, as early as 2006. Zarate describes the Iranian sanction program as "a virtuous cycle of isolation that would reduce Iranian access to the international financial system more and more over time. The more the Iranians tried to hide their identities or evade sanctions, the more suspect their transactions would appear and the riskier it would become for banks and other financial institutions to deal with them."³³ Success in Iran and North Korea, in addition to success against non-state terrorist networks and drug cartels, have driven to a greater reliance on implementing sanctions program when diplomacy calls for action; however, future effectiveness is questionable.

In the most comprehensive study of the effectiveness of sanctions conducted to date, Hufbauer, Schott, Elliott, and Oegg found that from the interwar period to 2007, sanctions were effective 34 percent of the time (see Table 4). By separating sanctions by the stated goal for implementation, the authors found that sanctions were more than twice as effective at achieving modest policy changes as they were in effecting regime change or disruption of military adventure.³⁴ Hufbauer, Schott, Elliott, and Oegg found that sanctions normally fail for three reasons. The policy goal of the sanction program is such that a regime will accept the pain rather than acquiesce. The reason for sanction implementation was to appease domestic calls for action rather than effect an international change in behavior. Finally, in the case of multilateral sanctions, the sender countries have different objectives.

³² Euijin Jung, "Iran Sanctions: A Successful Episode," *Peterson Institute for International Economics*, January 29, 2016, <https://piie.com/blogs/trade-investment-policy-watch/iran-sanctions-successful-episode>.

³³ Zarate, *Treasury's War*, 292.

³⁴ Gary Clyde Hufbauer, ed., *Economic Sanctions Reconsidered*, 3rd ed., Expanded ed (Washington, DC: Peterson Institute for International Economics, 2007), 158-160.

Table 4: Sanction Success by Policy Goal 1933-2007

Sanction Policy Goal	# of Cases			Success (percent of total)
	Success	Failure	Total	
Modest policy Changes	22	21	43	51
Regime change/democratization	25	55	80	31
Disruption of military adventure	4	15	19	21
Military Impairment	9	20	29	32
Other	10	23	33	30
TOTAL CASES	70	134	204	34

Source: Author recreation from Hufbauer, “Economic Sanctions Reconsidered.”

Adversary Response to Targeted Sanctions

Based upon the success of targeted sanction programs in the last two decades, the US has expanded the use of targeted sanctions to include programs aimed at Russia and China. However, as the US has developed the capability to conduct targeted sanctions programs against adversary financial networks and benefitted from unfettered access to the international financial system through its close relationship with SWIFT, developing nations have taken notice and established counterbalancing international institutions to ensure they cannot be isolated by US, or UN, implemented sanctions. In addition, the driving force behind the US’s ability to leverage sanction programs is the predominance of the dollar. The first development is the Cross-Border Inter-Bank Payment System (CIPS), also known as the China International Payment System. CIPS, established in October 2015, provides a means for users to have direct access to the China National Advanced Payment System (CNAPS) allowing real-time transactions using renminbi payments. The launch of Phase I in 2015 connected 19 commercial banks and 176 financial organizations in more than 50 countries.³⁵ CIPS operates on a timeline commensurate with Pacific and European banking hours, using the same universally accepted financial language as SWIFT, allowing direct transactions with Chinese banks and greatly expanding the role of the renminbi in the global financial market.³⁶ More importantly, it offers an alternative to the western controlled SWIFT network, the

³⁵ Nicholas Borst, “CIPS and the International Role of the Renminbi,” *Federal Reserve Bank of San Francisco, Pacific Exchange Blog*, January 27, 2016, <http://www.frbsf.org/banking/asia-program/pacific-exchange-blog/cips-and-the-international-role-of-the-renminbi/>.

³⁶ Borst, “CIPS and the International Role of the Renminbi.”

primary institution the US uses to gather intelligence and carry out targeted financial sanctions.³⁷

In addition to the development of CIPS, in 2014, the BRICS states established the BRICS development bank, now known as the New Development Bank (NDB). The mission of the NDB is to “support infrastructure and sustainable development efforts in BRICS and other underserved, emerging economies for faster development through innovation and cutting-edge technology.”³⁸ The bank controls a \$100 billion reserve fund, with \$41 billion from China, \$18 billion each from Brazil, Russia, and India, and \$5 billion from South Africa.³⁹ Although predominately seen as an alternative to the IMF and World Bank Group for emergency lending and infrastructure development, it is not an attempt to reshape the international system. In fact, the NDB signed a memorandum of understanding with the World Bank Group in September 2016 to strengthen cooperation between the two entities.⁴⁰ The NDB is, however, an opportunity for the BRICS countries to distance themselves for the opportunity to leverage emergency and infrastructure lending on compliance with western ideals and demands. In a similar move, countries are leveraging state-owned development banks to fuel infrastructure projects in developing nations, increasing their economic influence. China created the Asian Infrastructure Investment Bank in a further effort to reduce reliance on the western dominated financial market.⁴¹ The China Development Bank (CDB) and Brazil’s Development Bank, or BNDES, are other institutions with significant lending power.

³⁷ “The use of new currencies and technologies outside the formal financial system, through the internet, with less and less accountability and transparency undercuts the ability to track money flows with traditional means. At the same time, rogue actors are coalescing around a common goal of circumventing and undermining US financial pressure and using financial weapons themselves.” Zarate, *Treasury’s War*, 394.

³⁸ “Our Identity,” *New Development Bank*, accessed May 12, 2017, <http://www.ndb.int/about-us/essence/mission-values/>.

³⁹ Samuel Oakford, “Developing Nations Now Have an Alternative to the World Bank and the IMF,” *VICE News*, July 15, 2014, <https://news.vice.com/article/developing-nations-now-have-an-alternative-to-the-world-bank-and-the-imf>.

⁴⁰ “World Bank Group, New Development Bank Lay Groundwork for Cooperation,” Text/HTML, *World Bank*, accessed May 11, 2017, <http://www.worldbank.org/en/news/press-release/2016/09/09/world-bank-group-new-development-bank-lay-groundwork-for-cooperation>.

⁴¹ Patrick Gillespie, “Russia and China Have Had Enough of Western Banking,” *CNNMoney*, May 4, 2015, <http://money.cnn.com/2015/05/04/news/economy/russia-approves-brics-reserve-bank-imf/index.html>.

BNDES controls four times more lending capacity than the World Bank, and the CDB controls a financial portfolio worth over \$980 billion.⁴²

Other Economic Tools

Creation of CIPS and establishment of alternative international banks and lending institutions directly affect the current employment mechanisms of the US economic instrument of power. The creation of CIPS decreases the US's ability to leverage SWIFT to gather intelligence and isolate rogue actors from the international financial system. The development of the NDB and Asian Infrastructure Investment Bank limit US ability to leverage international institutions to impart conformation to western ideals. In addition to weakening US capability to leverage financial power in the international system, developing countries have leveraged two additional tools to increase their own economic power.

The first instrument is state-owned enterprises (SOEs). While the US's economic leadership role is in relative decline, developing nations have leveraged SOEs to increase their strategic economic influence. This is especially true in China and Russia.⁴³ According to Zarate, "China's largest SOEs—many of them global competitors and Fortune 500 companies—make their largest purchases and overseas investments at the direction of the Chinese government, often with geopolitical objectives and conditions."⁴⁴ In the last six years, more than half of the world's top ten IPOs have been state controlled companies, and today over one third of all outbound FDI is from state owned MNCs under the direction of the government.⁴⁵ In addition to outbound FDI, in 2012 developing companies also received more inbound FDI than developed countries, the first time that had ever happened.⁴⁶ While SOEs provide the government an avenue to inject

⁴² Blackwill and Harris, *War by Other Means*, 73.

⁴³ Zarate, *Treasury's War*, 386.

⁴⁴ Blackwill and Harris, *War by Other Means*, 136–37.

⁴⁵ Blackwill and Harris, *War by Other Means*, 54.

⁴⁶ "Developing countries take the lead---In 2012 – for the first time ever – developing economies absorbed more FDI than developed countries, accounting for 52 per cent of global FDI flows. This is partly because the biggest fall in FDI inflows occurred in developed countries, which now account for only 42 per cent of global flows. Developing economies also generated almost one third of global FDI outflows, continuing a steady upward trend." *World Investment Report 2013: Global Value Chains: Investment and Trade for Development* (New York: United Nations Conference on Trade and Development, 2013), http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf.

direct investment into another country, they also offer the government a means to withdraw investment if the state in question makes an ill-advised policy decision.⁴⁷

In addition to SOEs, several countries have established sovereign wealth funds (SWFs) as another tool for direct investment. Currently, nine of the ten largest SWFs are controlled by other than liberal democracies. These funds can be used to “gain control of strategic assets in areas such as telecommunications, energy, and finance, and perhaps...to destabilize financial markets in times of crisis. Again, these SWFs offer the holding government a direct tool to either inject or withhold funds based on the political situation. As one of the largest operators of SWFs, China has a majority of its \$3.5 trillion foreign exchange reserves tied to two SWFs, the State Asset Foreign Exchange and the China Investment Corporation.⁴⁸

In conclusion, globalization has played a significant role in shaping the current US implementation of sanctions programs. The four forces driving globalization of international finance: growth of information technology, globalization of national economies, liberalization of capital markets, and globalization of financial services, have significantly increased the number of participants in the global economy and the level of interconnectedness among them.⁴⁹ Because of this trend, the US has successfully shifted from a broad sanction regime to more targeted tactics. This allows the US to target nefarious actors in the financial sector without imposing unnecessary costs on the civilian populous and innocent bystanders. The interconnectedness afforded by globalization also significantly enhances the US’s ability to gather intelligence and isolate targeted actors. However, the effects of globalization are not all positive. The increasing number of actors participating in the global economy makes unilateral sanctions increasingly difficult, if not impossible against all but the most isolated regimes. In addition, multilateral sanctions require increasing buy in from the international system, a feat that becomes more difficult as more participants are present.

However, the effects of globalization have not all been positive. While targeted sanctions have proven highly effective when supported by a multinational effort,

⁴⁷ Blackwill and Harris, *War by Other Means*, 87–88.

⁴⁸ Gary Clyde Hufbauer and Kati Suominen, *Globalization at Risk: Challenges to Finance and Trade* (New Haven: Yale University Press, 2010), 224.

⁴⁹ Hausler, “The Globalization of Finance.”

developing nations have observed western tactics associated with sanction implementation and have developed systems, like CIPS and the NDB, to shield them from attempts at financial isolation. The increased number of participants in the global economy provides sanctioned actors with more opportunity to circumvent the sanction programs. In addition, some countries, most notably China and Russia are leveraging SOEs and SWFs to increase their relative influence in the global economy.

While globalization has limited the US's ability to leverage effective sanctions, recent trends in trade relations have also facilitated a decline in US global influence. The next chapter will look at globalization and US trade policy. Specifically, it will look at the cancellation of the TPP, the national security implications in the Pacific region and the larger trade trends signified by the breakdown in the Doha round of WTO negotiations.



Chapter 5

Globalization and Economic Trade Policy

A nation that is boycotted is a nation that is in sight of surrender. Apply this economic, peaceful, silent, deadly remedy and there will be no need for force. It is a terrible remedy. It does not cost a life outside the nation boycotted but it brings a pressure upon the nation which, in my judgement, no modern nation could resist.

President Woodrow Wilson

On January 30, 2017, in a letter to the TPP Depository, the acting US Trade Representative, Maria L. Pagan, formally withdrew the US from the Trans Pacific Partnership (TPP) Agreement.¹ The cancellation was in response to a January 23, 2017 presidential memorandum signed by President Donald Trump citing his intention to “deal directly with individual countries on a one-on-one (or bilateral) basis in negotiating future trade deals.”² Since WWII, and implementation of the Bretton Woods agreement, the US has employed a national security strategy dependent on stability of the international system created through growth of interconnected economic interests by participation in global trade. The cancellation of the TPP represents a deliberate shift away from the use of international economic interdependence as a tool in pursuit of US national security objectives and is indicative of the larger trends resulting from globalization. With bilateral and multilateral trade agreements becoming more prominent, the US withdrawal from the TPP only further decreases US influence in the international economy, especially the Pacific region. While the economic implications of the TPP on the US economy generated significant debate, the debate on security implications was notably absent. This chapter discusses the impact of globalization on US trade relations. It will look at the evolution of the post-WWII international trade system from the GATT to

¹ Maria L. Pagan, “USTR Letter to TPP Depository,” January 30, 2017, <https://ustr.gov/sites/default/files/files/Press/Releases/1-30-17%20USTR%20Letter%20to%20TPP%20Depository.pdf>.

² “Presidential Memorandum Organization of the National Security Council and the Homeland Security Council,” January 28, 2017.

more recent bilateral and multilateral trade agreements. Finally, the chapter will look at the national security implications associated with cancellation of the TPP and the need to elevate security considerations when considering international economic policy.

Globalization and Trade

The primary difference between pre-WWI trade and post-WWII globalization is the role and involvement of international organizations. Blaming a lack of international governing institutions for the mistrust and ruinous protectionist trade policies of the post-Versailles era, Bretton Woods participants sought to establish an international system that would facilitate global trade while limiting opportunity for mistrust and limiting the negative side effects of trade, especially growth inequality. While the primary motivation for establishment of the Bretton Woods system was economic, it had three significant implications for US national security. First, by committing the US Navy to secure the global commons for *all* international trade, the US effectively disincentivized major military spending and competition, most notably among European powers.³ Second, establishing an accepted international exchange system, with the US dollar at its foundation, ensured US hegemonic status in the international economic system. Finally, and most important, by opening up the US market to international trade, the US not only encouraged trade and interconnectedness, but underwrote it with US military strength and economic stability, cementing US position and power in the global system.

As previously discussed, the Bretton Woods conference was also responsible for creation of the GATT and, eventually, the WTO. Originally signed in 1947, the GATT's purpose was to create a multilateral trading system and reduce barriers to global trade. The original agreement negated over 45,000 tariff concessions affecting one fifth of the world's trade, valued at \$10 billion.⁴ Between 1950 and 1973, the export market grew 8 percent annually. Growth slowed slightly in the period following the Vietnam war due to

³ Peter Zeihan, *The Accidental Superpower: The next Generation of American Preeminence and the Coming Global Disorder*, First edition (New York: Twelve, 2014), 3.

⁴ "WTO | Understanding the WTO - The GATT Years: From Havana to Marrakesh," accessed April 20, 2017, https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm#top.

oil price shocks and the disintegration of the fixed exchange rate system, but trade continued rapid expansion due to the growth of information technology and the increasing number of multinational corporations.⁵ The GATT was highly successful in promoting commodity trading but over time was lacking in provisions governing services, agriculture, textiles, and other trade implications of the information revolution and the growing number of signatories, which had ballooned from 23 to 128.⁶ In 1994, GATT was updated to include governance of the exponentially expanding global service trade and the World Trade Organization (WTO) was created in an attempt to govern the increasingly complex international economy.⁷

For the past 70 years, the GATT, in conjunction with the WTO, has governed international trade relations, however, the WTO has arguably fallen behind in its ability to regulate and facilitate international trade. In fact, the 2008 financial crisis prompted a refinement of the international institutions governing finance and trade and there are three main drivers complicating global trade relations. First, the rapid rise in number and power of multinational corporations has stretched the definition of sovereignty in international trade relations. Next, the increasingly protectionist national policies governing agricultural, in conjunction with increasing concern about global climate change regulation and intellectual property rights concerns are contentious issues that split WTO members.^{8,9} Finally, an outdated voting and decision-making structure that underrepresents the rapidly growing economies of China, India, and Brazil, in favor of the western creators of the Bretton Woods institutions. These three developments leave the WTO lacking credibility and capability as an international governing institution.¹⁰ The Warwick report on multilateral trade agreements reports “that a malaise afflicts the multilateral trade regime [and] is suggested not only by the impasse in the Doha Development Agenda negotiations but also by other symptoms in the contemporary

⁵ Robert Zoellick, “Globalization, Trade, and Economic Security,” Speech (National Press Club, October 1, 2002), <https://2001-2009.state.gov/e/eeb/rls/rm/2002/14014.htm>.

⁶ Hufbauer and Suominen, *Globalization at Risk*, 7–8.

⁷ “WTO | Understanding the WTO - The GATT Years: From Havana to Marrakesh.”

⁸ Hufbauer and Suominen, *Globalization at Risk*, 215.

⁹ “The Doha Round...and Round...and Round,” *The Economist*, accessed April 29, 2017, <http://www.economist.com/node/11848592>.

¹⁰ Steger and Centre for International Governance Innovation, *Redesigning the World Trade Organization for the Twenty-First Century*, 4.

global economy linked to the global trade agenda, including the protests that accompany the ministerial meetings of the WTO; near permanent rumblings of discontent by diverse groups of countries from within the organization and growing resort to alternative forms of economic governance, including bilateral and regional PTAs.”¹¹

With the GATT and WTO deficiencies noted above, there has been significant growth in bilateral and regional trade agreements (RTA). As an example, between 1948, when the GATT began operations and 1994 124 RTAs were created; however, since the WTO was established in 1995 over 400 RTAs have been identified by the WTO.¹² The WTO is not exclusionary to RTAs. While non-discrimination is a core principle of the WTO, members are permitted to enter into RTAs under conditions of three rules: GATT 1994 Article XXIV – stipulates that trade agreements can promote improved trade relations, but should not enmesh discriminatory policy; the Enabling Clause allows preferential trade agreements that favor developing nations; and the General Agreement on Trade in Services (GATS) Article V – adds services to the equation.¹³ Many of these bilateral and regional agreements are enacted to compensate for gaps in relations that are not regulated by the WTO. While many of these new agreements are bilateral, the TPP was an example of a multilateral agreement that would open trade among participants in the Pacific region, while answering contentious questions that the WTO has not been able to regulate.

Before discussing the national security implications of the US backing out of the TPP and the larger global trade trends affecting US capability to leverage economic power, it is worth revisiting the US post-WWII strategy of national security through an interconnected global economy.

¹¹ Warwick commission, ed., *The Multilateral Trade Regime: Which Way Forward? ; the Report of the First Warwick Commission* (Coventry: Univ. of Warwick, 2008), 8.

¹² “WTO | Regional Trade Agreements - Scope of RTAs,” accessed April 20, 2017, https://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm.

¹³ “WTO | Regional Trade Agreements - Scope of RTAs.”

Security Implications of Inter-connectedness

In the book, *Foreign Policy Begins at Home*, Richard Haass suggests there are four strategies the US could choose to guide foreign policy: promotion of democracy, humanitarianism, counterterrorism, or integration.¹⁴ Of the four strategies, Haass suggests that integration is the “most appealing foreign policy compass for the long term.”¹⁵ Integration, as described by Haass, is adopting a foreign policy focused on cooperation among international actors through promotion of rules and international institutions that facilitate peaceful and mutually beneficial interaction. While he understands that integration cannot be the only tenant of a comprehensive grand strategy, he recommends that the US continues to pursue a foreign policy that incentivizes participation from international actors, especially China.¹⁶

The debate whether interdependence facilitates peace or conflict is not new. As early as A.D. 100, Plutarch is credited with associating cooperation and friendship with international commerce; however, globalization, particularly in the late 19th and 20th centuries, breathed new life into the debate.¹⁷ While it is beyond the scope of this paper to recreate that debate, there are a few points worth covering. The debate typically falls between the liberal and realist camps of international relations. While liberals emphasize the mutual benefits of trade through increased dependence and increased cost of instigating conflict, realists suggest the increased dependence leads to more points of friction and a greater probability for conflict. In reality, the answer lies in between the two, but most scholars and experts believe the benefits of interdependence outweigh the cost.¹⁸ In the 1997 article “Interdependence and Conflict,” Susan McMillan conducted a review of 20 case studies of interdependence and discovered that “it is reasonable to conclude that liberalism – tempered with concern for the potential costs of

¹⁴ Richard Haass, *Foreign Policy Begins at Home: The Case for Putting America’s House in Order*, Paperback edition (New York: Basic Books, a member of the Perseus Books Group, 2014).

¹⁵ Haass, *Foreign Policy Begins at Home*, 103.

¹⁶ Haass, *Foreign Policy Begins at Home*, 101.

¹⁷ Stephen G. Brooks, *Producing Security: Multinational Corporations, Globalization, and the Changing Calculus of Conflict*, Princeton Studies in International History and Politics (Princeton, NJ: Princeton Univ. Press, 2007), 1.

¹⁸ Susan M. McMillan, “Interdependence and Conflict,” *Mershon Int. Stud. Rev.* 41, no. 1 (May 1997): 42.

interdependence – works better than the realist arguments for explaining the [historical] link between interdependence and war.”¹⁹

Stephen Brooks reaches a similar conclusion to McMillon, stating, “trade linkages between states reduce the likelihood of conflict.”²⁰ Brooks, however, recognizes the growing importance of multinational corporations in the creation of interdependent relationships. Brooks concludes, “globalization of production has led to major changes in the global security environment that collectively improve the security climate in some regions...by changing the capabilities, incentives, and nature of [international] actors.”²¹ He argues, democratization of technology favors interconnected producers over isolated actors, and globalization of production and access to resources has drastically reduced the incentive of military conquest. Finally, Brooks argues that interdependence, through regional integration, creates relationships that can shape the nature and interests of interconnected international actors.²² The stronger the relationship the less likely disagreement will lead to conflict.

A recent example of the US executing an integration strategy, was the Clinton administration’s push to accept China into the WTO. In President Clinton’s 2000 State of the Union address he pressed for Chinese membership to the WTO stating, “Congress should support the agreement we negotiated to bring China into the WTO, by passing Permanent Normal Trade Relations with China as soon as possible...[because] *it will plainly advance the cause of peace* in Asia (emphasis added).”²³ The US National Security Strategy sought “a stable and prosperous” Pacific region, and Secretary of State Colin Powell said, “Trade with China is not only good economic policy; it is good national security policy.”²⁴ While there is significant debate about the US economic benefit of China joining the WTO 16 years ago, the degree of interconnection, and inherent security benefits are widely accepted. William Overholt, Director of the Center

¹⁹ McMillan, “Interdependence and Conflict,” 43.

²⁰ Brooks, *Producing Security*, 2–3.

²¹ Brooks, *Producing Security*, 5–6.

²² Brooks, *Producing Security*, 6–7.

²³ Brooks, *Producing Security*, 2.

²⁴ Lieutenant Colonel Gilbert A. Griffin, “What Are the Consequences of China’s Membership into the WTO?” (US Army War College, 2002), 1, file:///C:/Users/Josh/Downloads/ADA400855.pdf.

for Asia Pacific Policy at the RAND Corporation, states “China has transformed itself from the world’s greatest opponent of globalization and greatest disrupter of the global institutions we created, into a committed member of those institutions and advocate of globalization.”²⁵ As a consequence of China joining the WTO, Overholt stipulates that China “has effectively become an ally of US and Southeast Asian promotion of freer trade and investment.”²⁶ As an example, the measures discussed in Chapter Four that China has taken to reduce US capability to leverage sanctions, namely development of CIPS and creation of the New Development Bank, were efforts to compete inside the current international system, not recreate it.

In fact, integration was a central component of US grand strategy during the Cold War. From creation of international institutions to promote stability in East Asia and Europe to the Marshall Plan and foreign direct investment (FDI), the post WWII security strategy of the US has been to engage and stabilize the international system while incentivizing participation in a western dominated global system of governance. While it has had significant setbacks, notably global financial crashes in 1997 and 2008, Overholt asserts that the US’s integration foreign policy of the Cold War is “one of the most successful geopolitical strategies in human history, so much so that it has entangled our former enemies as well as our allies in the web we wove.”²⁷ Towards that end, Brooks states, “No matter whether the ultimate goal is power, security, prestige, or wealth, the geographic dispersion of MNC production has structurally shifted the scales against any great power that tries to overturn the fundamental nature of the system through force.”²⁸ It is because integration has been such a key feature of the US’s post-WWII foreign policy that the withdrawal from the TPP should be viewed as a major reversal in US foreign policy and has the potential to have significant national security implications.

²⁵ William H. Overholt, *China and Globalization* (RAND, May 2005), 4, http://www.rand.org/content/dam/rand/pubs/testimonies/2005/RAND_CT244.pdf.

²⁶ Overholt, *China and Globalization*, 4.

²⁷ Overholt, *China and Globalization*, 4.

²⁸ Brooks, *Producing Security*, 11.

Return to Nationalist Tendencies

The TPP, touted as “the most ambitious trade deal since the North American Free Trade Agreement” by the *New York Times*, was signed on February 4, 2016 by twelve nations: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US (until 23 January 2017), and Vietnam.²⁹ According to the TPP Ministers’ statement, the “TPP brings higher standards to nearly 40 percent of the global economy” and will “promote economic growth, support higher-paying jobs; enhance innovation, productivity and competitiveness; raise living standards; reduce poverty in our countries; and promote transparency, good governance, and strong labor and environmental protections.”³⁰ The partnership, part of President Obama’s strategy to “pivot to Asia,” was negotiated to firmly establish US presence as a leader in the Pacific region and to challenge China to conform to western trade standards.³¹



²⁹ Kevin Granville, “The Trans-Pacific Partnership Trade Deal Explained,” accessed April 5, 2017, <https://www.nytimes.com/2015/05/12/business/unpacking-the-trans-pacific-partnership-trade-deal.html>.

³⁰ “Trans-Pacific Partnership Ministers’ Statement,” October 2015, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/october/trans-pacific-partnership-ministers>.

³¹ “FACT SHEET: Trans-Pacific Partnership’s High-Standard Rules Promote U.S. Interests and Values,” accessed April 5, 2017, </about-us/policy-offices/press-office/fact-sheets/2016/may/fact-sheet-trans-pacific-partnership%E2%80%99s>.

Trans-Pacific Partnership Countries



Figure 7: Total Goods Traded with the United States in 2015

Source: Granville, “*The Trans-Pacific Partnership Explained*”

Formal negotiations for the TPP began in 2010, but some experts attach the roots of the TPP to the Trans Pacific Economic Partnership Agreement, or P4, signed in 2005 by New Zealand, Singapore, Brunei, and Chile. Even with the more conservative date of 2010, negotiations took six years to complete. The details of the agreement were released in a 5,000 plus page document spanning 30 chapters after agreement was reached by all signatories in late 2015. The highlights of the TPP include: an extension of free trade in the region through negotiation of over 18,000 tariffs and taxes; environmental protection through adherence to the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES); a 20-year increase in protection of intellectual property rights, including medical patents; rigorous labor standards; allowance for cross-border data flows; and regulation of state owned enterprises.^{32,33}

The US International Trade Commission was tasked by Congress to fulfil the requirements stipulated by the Bipartisan Congressional Trade Priorities and

³² “The Trans-Pacific Partnership @ USTR.gov,” *The Trans-Pacific Partnership @ USTR.gov*, accessed April 6, 2017, <http://www.ustr.gov/tpp>.

³³ The TPP also covers regulatory provisions covering: investment; government procurement; customs facilitation; sanitary measures; competition policy; and technical trade barriers. *Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors* (Washington, DC: US International Trade Commission, May 2016), 25, <https://www.usitc.gov/publications/332/pub4607.pdf>.

Accountability Act of 2015; to assess “the likely impact of the agreement on the US economy as a whole and on specific industry sectors, including its impact on gross domestic product; exports and imports; aggregate employment and employment opportunities; the production, employment, and competitive position of industries likely to be significantly affected by the agreement and the interests of United States consumers.”³⁴ The Trade Commission found that the TPP would have a net positive effect on the US economy, albeit small. According to the report, “By year 15 (2032), US annual real income would be \$57.3 billion (0.23 percent) higher than the baseline projections, real GDP would be \$42.7 billion (0.15 percent) higher, and employment would be 0.07 percent higher (128,000 full-time equivalents).”³⁵ In addition, the commission found that imports and exports would raise 1.1 percent and 1.0 percent respectively. In addition to the Trade Commission, the World Bank and the Peterson Institute for International Economics both produced reports expecting similar net economic gains for all signatories.³⁶

Of course, not all predictions of the TPP’s net impact are positive. Most notably, the Global Development and Environment Institute (GDAE) at Tufts University released a working paper titled “Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement,” which used the United Nations Global Policy Model to predict that “the benefits of economic growth are even smaller than those projected with full-employment models, and are negative for Japan and the United States.”³⁷ The Tufts report concluded that the TPP would lead to 770,000 jobs lost globally, primarily in the US, and a reduction of US GDP by 0.5 percent.³⁸ According to

³⁴ *Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors*, 19.

³⁵ *Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors*, 21.

³⁶ *Potential Macroeconomic Implications of the Trans-Pacific Partnership* (World Trade Organization, 2016),

<https://web.archive.org/web/20160212030617/http://www.worldbank.org/content/dam/Worldbank/GEP/GE/P2016a/Global-Economic-Prospects-January-2016-Implications-Trans-Pacific-Partnership-Agreement.pdf>.

³⁷ Jeronim Capaldo, Alex Izurieta, and Jomo Kwame Sundaram, *Trading Down: Unemployment, Inequality, and Other Risks of the TPP*, Working Paper (Medford, MA: Tufts University Global Development and Environment Institute, January 2016), <http://www.ase.tufts.edu/gdae/Pubs/wp/16-01Capaldo-IzurietaTPP.pdf>.

³⁸ Capaldo, Izurieta, and Sundaram, *Trading Down: Unemployment, Inequality, and Other Risks of the TPP*.

the Congressional Research Services report, opposition to the TPP is mainly concerned with US inability to regulate health and food safety concerns and environmental policy, in addition to the potential for job loss in import-sensitive industries.³⁹ In addition to those concerns, critics were unhappy with verbiage in the TPP that would allow companies and investors to challenge national governments at World Bank or United Nations tribunals on discriminatory trade policy.⁴⁰ Essentially, opening the door for companies and investors to sue the US Government for trade policy they perceive as harmful or discriminatory to their business.

While there are predictions to support both sides of the argument, for or against the TPP, the Trump administration's reason for pulling the plug on the Trade Agreement is unclear. Of course, it is possible that Congress would not have ratified the multilateral trade deal even without intervention by President Trump. What is clear, however, is the shift from the Obama administration's expansion of free trade in support of economic and security interests to a policy more protectionist of domestic job retention and growth. In reality, the move represents a significant shift in US global engagement, which has been pushing for expansion of free trade and development of international governing institutions since the end of WWII and implementation of the Bretton Woods Agreement. President Trump told reporters after he signed the order, "Great thing for the American worker, what we just did." President Trump's goal is to protect American workers from competition with low wage workers in Vietnam and Malaysia and incentivize the return of US manufacturing companies.⁴¹ President Trump was also worried China, although not party to the agreement, would benefit relative to the US. At the Republican presidential debate in Milwaukee, then Presidential candidate Trump said "The TPP is a horrible deal. It's a deal that was designed for China to come in, as they always do,

³⁹ Ian R. Fergusson, Mark A. McMinimy, and Brock R. Williams, *The Trans-Pacific Partnership (TPP): In Brief* (Washington, DC: Congressional Research Service, February 9, 2016), summary, <https://fas.org/sgp/crs/row/R44278.pdf>.

⁴⁰ Jonathan Weisman, "Trans-Pacific Partnership Seen as Door for Foreign Suits Against U.S.," accessed April 29, 2017, <https://www.nytimes.com/2015/03/26/business/trans-pacific-partnership-seen-as-door-for-foreign-suits-against-us.html>.

⁴¹ Peter Baker, "Trump Abandons Trans-Pacific Partnership, Obama's Signature Trade Deal," *The New York Times*, January 23, 2017, <https://www.nytimes.com/2017/01/23/us/politics/tpp-trump-trade-nafta.html>.

through the back door and totally take advantage of everyone.”⁴² Trump’s primary argument against the TPP is in line with general arguments against globalization. Globalization creates competition that favors developing nations in some labor-intensive manufacturing sectors which typically leads to outsourcing of production and a loss of domestic jobs in more developed countries.

The most concrete evidence for the Trump Administration’s exit from the TPP comes from the Office of the US Trade Representative’s website. A click on the tab “for further info on TPP click here” redirects the user to the USTR homepage. The USTR homepage offers Trump’s America First Trade Policy, offering “The Office of the US Trade Representative is committed to ensuring that American workers are given a fair shot at competing across the globe. USTR is working to reshape the landscape of trade policy to work for all Americans. On a level playing field, Americans can compete fairly and win. This new America First trade policy will make it more desirable for companies to stay here, create jobs here, pay taxes here, and rebuild our economy. Our workers and the communities that support them will thrive again, as companies compete to set up manufacturing in the US, to hire young people and give them hope and a real shot at prosperity again.”⁴³ While domestic economic concerns are cited as the primary reason for the US’s exit from the TPP, noticeably absent from the conversation was the debate about the security implication of withdrawing from the TPP.

Security Implications of TPP

After US withdrawal from the TPP, Michael Froman, President Obama’s primary negotiator for the TPP said, “There’s no doubt that this action will be seen as a huge, huge win for China...For the Trump administration, after all this talk about being tough on China, for their first action to basically hand the keys to China and say we’re withdrawing from our leadership position in this region is geostrategically damaging.”⁴⁴

⁴² “Trump Says China Gets an Advantage from the Trans-Pacific Partnership | PolitiFact,” accessed April 29, 2017, <http://www.politifact.com/truth-o-meter/statements/2015/nov/12/donald-trump/trump-says-china-will-take-advantage-trans-pacific/>.

⁴³ “United States Trade Representative,” accessed April 5, 2017, <https://ustr.gov/>.

⁴⁴ Baker, “Trump Abandons Trans-Pacific Partnership, Obama’s Signature Trade Deal.”

The Obama Administration often claimed that the “strategic value” of the TPP, in producing stability and increasing US influence in the region, was just as important as the economic value of the multilateral agreement.⁴⁵ During congressional hearings to decide whether or not to grant President Obama “fast-track” authority to negotiate the TPP, 17 former defense secretaries and high ranking military officers sent a letter to Congress stating, “The stakes are clear. There are tremendous strategic benefits...and there would be harmful strategic consequences if we fail to secure these agreements. In both Asia-Pacific and the Atlantic, our allies and partners would question our commitments, doubt our resolve, and inevitably look to other partners. America’s prestige, influence, and leadership are on the line.”⁴⁶ While US strategic interests were paramount in the seven years of negotiation leading up to the treaty’s signing, they were noticeably absent from the debate on the decision to cancel it.

Experts, both domestic and international, saw negotiation of the TPP as a significant shift from the early 21st century foreign policy that sought integration with China and backed Chinese entry to the WTO. Some went as far as calling the shift a Chinese containment strategy.⁴⁷ US officials, however, emphasized the trade pact’s “open architecture” and hoped that China, and other important Pacific region players like South Korea, would eventually join the TPP.⁴⁸ President Obama responded stating, “there’s been some concern that by doing TPP we’re trying to contain or disadvantage China. We’re actually not. What we are trying to do is make sure that rather than a race to the bottom in the region there’s a reasonable bar within which we can operate, and we hope that then China actually joins us in not necessarily formally being a member of TPP but in adopting some of the best practices that ensure fairness in operations.”⁴⁹ The TPP could have served as an incentive for China to adapt to TPP standards, which included regulation on labor standards, protection of intellectual property, regulation on

⁴⁵ Fergusson, McMinimy, and Williams, *The Trans-Pacific Partnership (TPP): In Brief*, summary.

⁴⁶ Shawn Donnan and Demetri Sevastopulo, “Former Military Chiefs Press US Congress on Trade Deals,” *Financ. Times*, May 7, 2015, <https://www.ft.com/content/cf8737a0-f478-11e4-9a58-00144feab7de>.

⁴⁷ Bill Powell On 4/29/15 at 10:42 AM, “In Washington, a Strategic Shift on China—Toward Containment,” *Newsweek*, April 29, 2015, <http://www.newsweek.com/washington-shift-china-toward-containment-326591>.

⁴⁸ Liam Renn, *Trans-Pacific Partnership: USA - Secret Negotiations* (Kindle Edition, 2016).

⁴⁹ Aaron Connelly, “The TPP Is Not a Containment Strategy,” *The Interpreter*, October 9, 2015, <https://www.lowyinstitute.org/the-interpreter/tpp-not-containment-strategy>.

international data flows, and other contentious trade policy issues separating China and the US. One security implication of the TPP, then, would have been to further liberalize Chinese economic policy with the incentive of increasing interconnection, stabilizing relations with the US, and integrating into the TPP framework.

A second security advantage of the TPP was assurance to our Pacific allies that the US is strategically committed to the Pacific region. According to the Congressional Research Service brief on the TPP, “It is a US policy response to the rapidly increasing economic and strategic linkages among Asian-Pacific nations and has become the economic centerpiece of the Administration’s “rebalance” to the region.”⁵⁰ The TPP signified a commitment of US interest, involvement, and leadership in the region. Now, with the dramatic shift in US foreign policy to a nationalist agenda, Pacific nations and allies have a reason to question US resolve. While the US maintains Regional Trade Agreements with Korea, Singapore, and Australia, bilateral agreements do not carry the same security implications for shaping behavior as multilateral agreements.

US withdrawal from the TPP, unfortunately, facilitates the larger trend of waning US influence in the global economy. Two major factors, largely byproducts of globalization, are responsible for this decline. The first trend is the growing number of states participating in global trade and the growing dissatisfaction with the disproportionate power that the US and western powers wield in international institutions, like the WTO. As an example, the WTO Doha Development Round was originally scheduled to occur in Seattle, but had to be moved to Doha due to widespread protests. Since the early 1990s, the WTO has received growing criticism from developing nations, non-governmental organizations, labor rights activists, and environmentalists claiming that industrialized nations have too much power in the WTO which leads to unequal rules of trade.⁵¹ Partially to blame is the surge in membership from the original 23 members to now 164; however, the main complaint is differential growth in power is not being given commensurate weight in negotiating power.⁵² The second factor is the growing

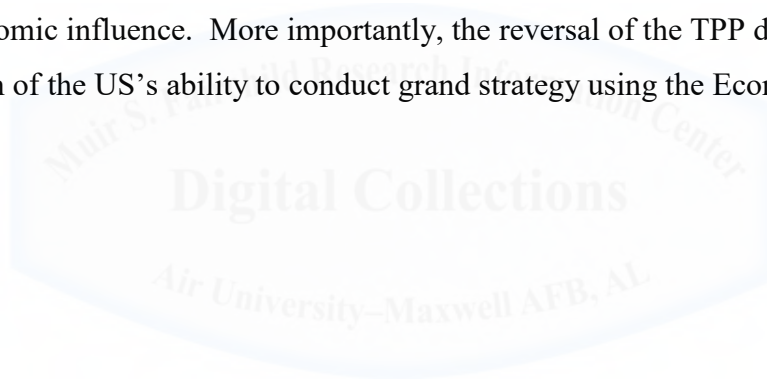
⁵⁰ Fergusson, McMinimy, and Williams, *The Trans-Pacific Partnership (TPP): In Brief*, summary.

⁵¹ Anup Shah, “WTO Meeting in Doha, Qatar, 2001,” *Global Issues*, December 22, 2002, <http://www.globalissues.org/article/296/wto-meeting-in-doha-qatar-2001>.

⁵² “WTO | Members and Observers.”

complexity of trade relations which has pushed states to engage more frequently in bilateral and regional trade relations as opposed to engaging in multilateral negotiations through the WTO. As previously discussed, in both Uganda and Doha, the collapse of negotiations to achieve meaningful reform in areas important to the developing world attests to the increasing irrelevance of this institution.

Returning to the TPP, the dramatic shift in foreign policy objectives signified by reversing a trade deal which required seven years of multi-lateral negotiations signifies the US long-term grand strategy is volatile and highly dependent on current administration preferences and domestic politics. In addition, the reversal of the seventy-year-old US foreign policy of expanding trade relations, accompanied by nationalist rhetoric, leads to questions about future US interest in the Pacific Region. Both of these lead to questions of US resolve and open the door for China to assert regional security and economic influence. More importantly, the reversal of the TPP demonstrates a limitation of the US's ability to conduct grand strategy using the Economic IOP.



Chapter 6

Conclusion

There is one—and only one—law that has been with us since we were hunter-gatherers, outlasted all rival theories, transcended empires and nations, and serves as our best guide to the future: supply and demand.

Parag Khanna

Recently, critics of US grand strategy have recently complained that the US is too quick to employ the military IOP, rather than diplomatic or economic means, to influence international actors.¹ In the 2012 Foreign Policy article “The Currency of Power,” Robert Zoellick argues that US foreign policy strategists have lost the ability to integrate economic power into national security strategy. Zoellick argues, “[US strategists’] perspectives on economics do not extend much beyond sanctions policies and paying for defense budgets... We scarcely understand [economic] effects on power, influence, diplomacy, ideas, and human rights.”² Zoellick attributes the post-WWII national security apparatus, established by the National Security Act of 1947, for the economic IOP’s decline; however, this thesis argues that globalization has significantly reduced the US’s ability to leverage economic power through sanctions and trade. In addition, as rising powers, most notably China, grow in relative strength, they seek ways to influence the international system, primarily through developing alternatives to the western led economic system.

Globalization Limits US Economic Power

¹ Robert D. Blackwill and Jennifer M. Harris, *War by Other Means: Geoeconomics and Statecraft* (Cambridge, Massachusetts: The Belknap Press of Harvard University Press, 2016), 2.

² Zoellick, “The Currency of Power.”

Following WWII, the US has implemented a foreign policy reliant on expansion of trade and promotion of international governing institutions. Implementation of the Bretton Woods agreement, underwriting global maritime trade with US Naval power, and facilitating the Marshall Plan and post WWII European recovery effort, all set the foundation for a US led global economy in the 20th century. In addition, a significant element of the US Cold War strategy to contain the Soviet Union and the spread of communism sometimes meant that the US engaged in deferential trade policy to ensure the expansion and domination of the western capitalist economic model. By virtue of commanding the largest economy in the international system, the US was able to use economic tools, most notably trade and sanction policy, to influence behavior of international actors. Since the end of the Cold War; however, two major trends have contributed to the decline is US capability to wield its economic IOP.

First, in the post-Cold War era, the US has shifted from the use of broad sanction regimes to more targeted use of economic sanctions. There were two main drivers for this shift. One driver was the recognition of the unintended costs and limited effectiveness of broad economic sanctions. Prior to the end of the Cold War, the US largely employed broad sanctions policy against “targets;” however, broad sanctions can have significant unintended costs to both the sender and a target state’s civilian population. In addition, while effective as a signaling device short of military action, sanctions were typically only effective in generating the desired change in behavior one third of the time.³ In some circumstances, the sanctioned state was forced to diversify its economic behavior and even ended up better off and more resilient because of sanctions.⁴ The second, and more important driver of the shift from broad to targeted sanctions, were changes to the international financial system, allowing the US to gather intelligence and target specific actors. Largely facilitated by the information revolution and creation and proliferation of the Society for Worldwide Interbank Financial Telecommunications (SWIFT) network, the backbone of the international financial network, the US can effectively target and isolate individual actors from the global banking system.

³ Gary Clyde Hufbauer, ed., *Economic Sanctions Reconsidered*, 3rd ed., Expanded ed (Washington, DC: Peterson Institute for International Economics, 2007), 101.

⁴ Hufbauer, *Economic Sanctions Reconsidered*, 101–2.

Targeted sanctions have proven highly effective against terrorist networks and isolated regimes, most notably Iran; however, their efficacy against near-peer adversaries like Russia, and potentially China, are questionable. In fact, after observing how the US employs targeted sanctions, rising powers have taken steps to mitigate the US' ability to isolate actors from the international financial network. One example, is the Chinese creation of an alternative financial system to the SWIFT network, the CIPS. CIPS offers an alternative to the western controlled SWIFT network, which the US uses to gather intelligence and carry out targeted sanctions. Another example, is the creation of alternatives to the IMF. In 2015, Russia created a \$100 billion reserve fund to ensure that Brazil, Russia, India, China, and South Africa would have an alternative funding source to the IMF. In a similar move, China also created the Asian Infrastructure Investment bank in a further effort to reduce reliance on the western dominated financial market.⁵

In addition to the limited value of US sanction programs, globalization has also effected global trade relations. As globalization has dramatically increased global interconnectedness, the structure of the global economy has expanded to include a greater number of states and multi-national corporations. These actors have an incentive to bust sanctions and reap greater financial rewards, making targeted, especially unilateral, sanctions much more difficult to employ effectively.⁶ Additionally, the WTO has not kept up with current international economic trends. While GATT and the WTO were originally created with the goal of opening trade, the increase in service and financial trade has exponentially increased global trade relations. Today, data transfer regulation, intellectual property rights, and agriculture trade issues are making compromise more and more difficult among WTO members. In addition, the rise in number of members and the outdated weighted voting system, have caused discontent among some member states. Accordingly, there has been a large increase in bilateral and regional trade agreements. Multilateral agreements are extremely complicated. The decline in power of the WTO for the more accessible bilateral trade deals means that US influence in global trade is in relative decline.

⁵ Patrick Gillespie, "Russia and China Have Had Enough of Western Banking," *CNNMoney*, May 4, 2015, <http://money.cnn.com/2015/05/04/news/economy/russia-approves-brics-reserve-bank-imf/index.html>

⁶ Haass and Council on Foreign Relations, *Economic Sanctions and American Diplomacy*, 5-6.

In conjunction with limited ability to implement successful sanctions, and an increasingly complex global trade system, developing nations have introduced two new and highly effective tools to exert economic influence. The first instrument is state-owned enterprises (SOEs). In the last six years, more than half of the world's top ten IPOs have been state controlled companies, and today over one third of all outbound FDI is from state owned MNCs. This is significant, considering the government can control both implementation and withdrawal of MNC financial flows from developing and developed economies.⁷ According to Zarate, "China's largest SOEs—many of them global competitors and Fortune 500 companies—make their largest purchases and overseas investments at the direction of the Chinese government, often with geopolitical objectives and conditions."⁸

The second tool gaining strength as an economic instrument of diplomacy is sovereign wealth funds (SWFs). Currently, nine of the ten largest SWFs are controlled by other than liberal democracies. These funds can be used to "gain control of strategic assets in areas such as telecommunications, energy, and finance, and perhaps...to destabilize financial markets in times of crisis. Again, these SWFs offer the holding government a direct tool to either inject or withhold funds based on the political situation. As one of the largest operators of SWFs, China has a majority of its \$3.5 trillion foreign exchange reserves tied to two SWFs, the State Asset Foreign Exchange and the China Investment Corporation.⁹ According to Hufbauer and Suominen, "SWFs from the Middle East and China in particular have elicited hand-wringing in some quarters, since they are seen as instruments to advance political goals, not mere investment returns. Perhaps, the critics suggest, they are established to gain control of strategic assets in areas such as telecommunications, energy, and finance, and perhaps...to destabilize financial markets in times of crisis."¹⁰

Recommendations

⁷ Blackwill and Harris, *War by Other Means*, 54.

⁸ Blackwill and Harris, *War by Other Means*, 136–37.

⁹ Hufbauer and Suominen, *Globalization at Risk*, 224.

¹⁰ Hufbauer and Suominen, *Globalization at Risk*, 227.

The effects of globalization have significantly limited the US's ability to conduct economic statecraft to carry out national security objectives. The switch from broad to targeted sanctions has produced a more efficient, and less costly, sanction program, but effectiveness of targeted sanctions is subject to the same considerations as broad sanctions. In addition, developing countries have witnessed US sanction policy in action and have developed systems to render them less effective. At the same time, globalization has facilitated a more congested, contested, and complicated global trade environment. While post-WWII trade policy was focused primarily on reduction of tariffs and expansion of free trade, today's trade environment is complicated by data transfer policy, intellectual property rights, and cross-border financial flows. To add to the complexity, rather than procuring agreement among 23 members, consensus now requires agreement from 164 participants. If the US is to continue leveraging the Economic Instrument of Power short of military action to affect a change in behavior it must take action to implement the economic arm into the national security strategy.

First, the US must align economic policy more closely with national security strategy. Of course this should not be at the expense of sound economic policy; however, while the TFI has developed into a credible tool for the employment of targeted sanctions, the US government, particularly the Treasury Department, needs to better integrate the full weight of the US economy in the effort to improve national security. In a 2012 *New York Times* op-ed, Robert Kimmitt, the Deputy Treasury Secretary from August 2005 to January 2009, wrote that the National Security Act of 1947 needed to be updated to include the Treasury Secretary as a statutory member of the National Security Council.¹¹ Kimmitt asserts that the National Security apparatus has not kept pace with the increasing integration of the military, diplomatic, and economic instruments of US foreign policy. While I agree with his argument, I disagree with his solution. The underlying problem is the lack of a national economic security strategy to coordinate the multiple agencies concerned with both domestic and international policy. I would recommend creation of a national economic security strategy to coordinate the actions of

¹¹ Robert M. Kimmitt, "Give Treasury Its Proper Role on the National Security Council," *New York Times*, July 23, 2012, sec. Op-Ed, <https://www.nytimes.com/2012/07/24/opinion/give-treasury-its-proper-role-on-the-national-security-council.html>.

the Treasury Department, US Trade Representative, and National Economic Council that elevates security concerns and provides strategic continuity across administrations.

Second, the US must continue to engage in the global economy. While the global economy has changed significantly since the Cold War, the US strategy of expansion of trade to create interconnected economies is still applicable. The current nationalist trend has potential detrimental consequences to national security. Eisenhower said to his cabinet in 1959, “We have got to meet the [Soviet threat] by keeping our economy absolutely healthy. Without the health and expansion of our economy, nothing we can do in the long run, domestically or in the foreign field, can help. We are the world’s banker. If our money goes bad, the whole free world’s position will collapse or be badly shaken.”¹² The best way to maintain the strength of the US dollar and continue to have influence in the international economy is to remain engaged. While withdrawal from the TPP was a major setback to US credibility in the global economy, especially in the Pacific region, re-engaging in multi-lateral and bilateral trade negotiations will signify to our allies and partners a commitment to remain engaged and influential in the global economy.

Finally, further research towards the effect SOEs and SWFs are having on the global economy. If the true instruments of power are MNCs in the global economy, especially state owned and subsidized MNCs, how can the US effectively compete and leverage influence in the international system. While globalization has reduced the relative influence of the US in the global economy, the US still controls access to the largest economy in the world. Together, with our allies and partners it is important to continue to develop ways to shape and influence the global economy, rather than back away from it.

¹² Walter A. McDougall, *The Heavens and the Earth: A Political History of the Space Age*, Johns Hopkins paperbacks ed (Baltimore, Md: Johns Hopkins University Press, 1997), 138.

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