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Reimagining U.S. Economic Statecraft

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Madam Chairwoman, Mr. Ranking Member, Members of the Subcommittee, thank you for this opportunity to offer my thoughts on national economic security, economic statecraft, and advancing U.S. interests abroad, particularly in the vital Indo-Pacific region.

Let me start with my bottom line: The global economic order created and championed by the United States for decades has been turned on its head—and not only because of the Trump administration's tariffs. To protect U.S. economic security and advance other U.S. interests in this new era, we need—more than ever—smart economic statecraft and a State Department empowered to carry it out.

Today's Global Economic Landscape and U.S. Interests

Today's global economy is marked by growing risk and uncertainty. For all its benefits of efficiency and lower cost, the globalization of the past several decades created new vulnerabilities. These were exposed most vividly by COVID-related supply chain disruptions and clear signs of overdependency on our chief global competitor, China. Other risks loom larger as well. Climate change is putting severe strains on economies and societies. Technology and national security are intertwined in new, complex ways.

In a world of greater risk, there is a new premium on resilience and policies that promote it. This has given rise to a term gaining currency in Washington and other Group of Seven (G7) capitals: "economic security"—or as used in the title of this hearing, "national economic security" (presumably to differentiate it from the personal economic security that comes from having a job with a good wage, savings for retirement, and so on). In the context here, the term broadly refers to managing economic-related risks to national security or to the foundations of the economy. I will come back to economic security later, but let me just note here that the [Council on Foreign Relations (CFR) is currently convening a high-level task force] to explore this topic and propose ways to sharpen the tools of economic security—including export controls, investment screening, and supply-chain resilience measures—while trying to define reasonable, limiting principles for their use.

Other important features of today's unsettled economic landscape include the fact that the multilateral institutions historically championed by the United States, notably the World Trade Organization (WTO), as well as the rules they oversee, are no longer fit for purpose. And the domestic consensus within the United States for constructive American leadership of the global order is gone. The Trump administration has seized on these new realities to further disrupt the old order through broad-based, on-again-off-again tariffs and radical cutting back of U.S. capabilities to engage in traditional international economic policymaking.

In the face of all these risks and disruptions, it is easy to forget that the United States still has enduring interests in engaging affirmatively in the global economy. These interests fall in three main categories: economic, strategic, and what I call "strategic economic." Economically, U.S. interaction with other countries through two-way flows of trade and investment supports growth and opportunity for U.S. companies, workers, and consumers. Three-quarters of the world's gross domestic product (GDP) and 95 percent of its people lie outside the United States, offering enormous opportunities for U.S. exporters and related companies and workers. (As this committee knows well, these opportunities are especially rich in Asia.) Imports, meanwhile, give American consumers access to a wider array of affordable goods and services and can create healthy competitive pressure in the United States. And foreign investment supports growth and American jobs.

There are three important caveats about the economic benefits of trade and investment. First, as the new concerns about economic security highlight, global economic integration can create overdependencies and risks. Second, the competitive playing field internationally is uneven, as countries use subsidies, regulations, and other policies to favor domestic producers and exporters. And third, the gains from trade are not always evenly distributed across the domestic economy. However, these market failures are not an argument for stopping trade and investment—thereby giving up their substantially positive benefits—but rather for targeted government interventions to protect economic security, promote fair competition, and ensure more even distribution of the gains.

The second category of interests advanced by international economic engagement is strategic. The United States is the world's leading military power, and the security and stability this provides is vital to our allies and partners. But these countries are uncomfortable with a United States that only engages in the world through force or threat of force; they want us to participate constructively in global economic affairs. Our large consumer market, our high-quality products and services, and our innovative technologies are all enormous sources of leverage for the United States. Again, as this committee knows well, nowhere is this truer than in Asia, where U.S. economic engagement through trade and investment has complemented our security presence in the region and made us a more credible regional player.

Finally, what I call "strategic economic" interests are the benefits that come from championing our preferred economic rules, norms, and standards in the world. That was the logic that lay behind the Marshall Plan and establishment of the Bretton Woods institutions after World War II and later inspired initiatives like the Trans-Pacific Partnership (TPP) and the Asia-Pacific Economic Cooperation (APEC) forum. Using the economic leverage mentioned in the previous paragraph, the United States has historically been able to incentivize others to adopt our preferred rules, norms, and standards—to our enormous economic and strategic advantage.

Other countries—China primarily but not exclusively—are now challenging U.S. leadership of global economic rulemaking and norm-setting. Yet rather than stepping up our game in the face of this challenge, we are withdrawing from the fight—and even turning against our closest allies and partners. The result is likely to be a global economy governed by rules that are written by others and do not maximize U.S. interests.

The Importance of Smart Economic Statecraft

To manage the risks and seize the opportunities discussed above—to advance U.S. interests—the United States needs smart economic statecraft. In its simplest definition, "economic statecraft" is the use of both offensive and defensive policy tools to advance a country's economic, strategic, and strategic economic interests. I think of economic statecraft as a two-sided coin: on one side, using diplomacy to promote exports, investment, and other economic activity that contributes to a country's prosperity; on the other, using economic tools—from sanctions to trade negotiations—to shape the behavior of other countries in support of a nation's security and other foreign policy goals.

To be "smart," economic statecraft needs to be both balanced and leveraged. Balance is needed in three respects. First, between defensive and offensive efforts. The defensive side of the ledger involves protecting (national) economic security. As it is being interpreted across G7 capitals, economic security covers a broad range of activities where the government sees a market failure or risk and feels compelled to intervene. Relevant risks include but are not limited to ones clearly related to national security, such as the transfer of sensitive technologies to adversaries or inability to procure items essential to a country's defense capabilities (critical minerals, for example). The term is also used to apply to other risks—from pandemics, climate change, or broader supply-chain vulnerabilities—that may not be directly related to national security but that threaten citizens' livelihoods or the country's economic competitiveness.

The problem with this broad interpretation of economic security is that it can easily become an excuse for the unwarranted protection or weaponization of economic activity. While tariffs can be justified to provide temporary relief to domestic companies and workers or to counter unfair foreign practices, they do not give governments license to protect any favored industry from normal market competition. Similarly, it is reasonable for governments to try to keep certain dual-use technologies out of the hands of adversaries; but where the link to national security is more tenuous, policymakers should be careful not to restrict benign commercial activity based on theoretical or exaggerated risks.

Moreover, economic statecraft cannot only be about playing defense. As suggested above, the United States also needs to play offense in the global economy to promote its commercial interests and shape the rules in our favor. This involves a range of capabilities, from effective commercial advocacy to affirmative trade policies that include incentives to persuade our trading partners to give us what we need. In sum, balance is needed in U.S. economic statecraft between protection and promotion of our interests.

Second, smart economic statecraft requires balancing costs and benefits. No international policy worth pursuing is free. But in recent years, we have tended to act first—particularly in taking defensive measures like sanctions and export controls—before fully weighing the costs and benefits of those actions. In addition to the uncertainty they have created, the Trump administration's broad-based tariffs are likely to impose a substantial cost on U.S. growth, prices, and diplomatic ties, with limited benefits in terms of rebuilding the U.S. manufacturing sector, reducing U.S. trade deficits, or addressing foreign unfair practices.

That said, the Trump administration's approach, like that of the Biden administration before it, highlights the third important element of needed balance in economic statecraft: between international and domestic policies. Although their mix of tools has been very different, both administrations have rightly stressed the need to invest more in economic strength at home, which is a necessary foundation for effective economic statecraft abroad. However, both the Trump and Biden approaches have swung the balance too far toward the domestic—frankly, protectionist—side of the ledger, at the expense of affirmative trade and other international policies that are needed to advance U.S. interests.

In addition to being balanced, U.S. economic statecraft needs to be leveraged. The proposed deep cuts to U.S. agencies, programs, and personnel will do significant damage to U.S. capabilities in foreign policy, including economic statecraft. But even if some of these capabilities are restored, the United States cannot compete with the raw financial firepower that China brings to its foreign economic policy, such as investments under the Belt and Road Initiative. We need to leverage other assets, including the trillions of dollars of U.S. private-sector funds looking for long-term returns. This will require the U.S. government to put some skin in the game, for example through an empowered U.S. International Development Finance Corporation (DFC). Again, CFR is doing work on how reauthorization of the DFC later this year could enhance this leverage and crowd in more private-sector support for government statecraft initiatives.

Another critical form of leverage in U.S. economic statecraft is our ability to work with allies and partners. In a recent *Foreign Affairs* article with former Deputy Secretary of State Kurt Campbell, my CFR colleague Rush Doshi argues that China has important advantages of scale, which the United States can only match by leveraging the support of allies. The combined population of the G7 (including the European Union) is less than 1 billion, compared with China's 1.4 billion, but the G7's collective GDP of around $60 trillion dwarfs China's $19 trillion. More important is the alignment of many critical interests among G7 countries—not least in responding to the challenges that China poses to collective economic security. A smart U.S. economic statecraft would be seeking to leverage these common concerns, rather than pushing allies away through broad tariffs.

The Role of the State Department

Smart U.S. economic statecraft requires a State Department that is mandated and resourced to carry it out. While other agencies of the U.S. government also play important parts in economic statecraft, the State Department has a vital role on both sides of the economic coin: using diplomacy to advance U.S. economic interests and using economic tools to support U.S. foreign policy interests.

The link between economics and U.S. diplomacy is not new—in fact, it arguably predates the founding of the State Department. In February 1784, a ship named the *Empress of China* sailed from New York to Canton carrying a cargo of furs, ginseng, and other American products that was overseen by the man who went on to become effectively the first U.S. envoy to China. Economic statecraft has been an important function of the State Department in the 250 years since. The high-water mark of U.S. economic statecraft—the Marshall Plan to rebuild Europe after World War II—was the brainchild of the first Under Secretary of State for Economic Affairs, William Clayton.

Today, there is arguably an even stronger case for a State Department empowered to contribute to smart economic statecraft. As discussed above, risks and uncertainties have grown in the global economy. Economics is at the center of great power competition, and there are many more countries with the economic clout and ambition to shape international economic affairs—often in ways inimical to U.S. interests. We need more nimble diplomacy to manage this more challenging landscape, and that diplomacy needs to be supported by a full range of economic policy tools and resources.

In addition to its expertise in diplomacy, the State Department brings one other important strength to the U.S. government's economic statecraft: "reach." With embassies and consulates in about 175 countries and an ability to operate across government and society in those countries, the State Department has a breadth of perspective that—when applied effectively—can enrich U.S. international economic policymaking. For example, in a bilateral trade negotiation, State Department officers with local knowledge of the counterpart country might help trade negotiators understand what incentives would persuade the other government to comply with U.S. requests or which local actors to target for public diplomacy efforts.

The "E" line at the State Department—led by the under secretary for economic growth, energy, and the environment and including three relevant bureaus—is one of the few components of the U.S. government focused on both the "promote" and "protect" sides of economic statecraft. The E line has long been engaged in affirmative efforts to promote U.S. exports, foreign direct investment, and U.S.-preferred economic rules. Over the past two administrations, the E line has put a new focus on economic security, launching the Clean Network initiative in the first Trump administration and the Minerals Security Partnership in the Biden administration. The E line also oversees the International Technology Security and Innovation (ITSI) Fund created as part of the CHIPS and Science Act.

To be sure, the State Department does not always bring its best game to the practice of economic statecraft. It can be unfocused, reactive, and bureaucratic. In my experience—which includes five years working at a U.S. embassy and a stint in the E front office—I think this has less to do with structural factors—which boxes go where—than with institutional culture and resources.

The State Department culture has historically prized regional over functional expertise, and Foreign Service Officers tend to view work on traditional diplomatic issues as a faster track to promotion than work on economic statecraft. Institutional culture is hard to change and requires leadership. There have been secretaries of state who have taken a particular interest in economic statecraft and empowered their senior officials to build out the department's capabilities in this area. George Marshall, supported by Will Clayton, is one obvious example. George Schulz, a PhD economist and former treasury secretary, also took a particular interest in economic statecraft. In my own experience, Colin Powell, while understandably preoccupied with the aftermath of 9/11, gave his E under secretary, Alan Larson (also a PhD economist and career Foreign Service Officer), great latitude to pursue creative economic statecraft in the first term of George W. Bush. And President Obama's first secretary of state, Hillary Clinton, put a priority on economic statecraft, among other things creating the first office of the chief economist at the department.

Resources are also critical to the department's ability to play an effective role in economic statecraft. While every administration has a right to set priorities and find savings in government operations, the 84 percent cut to international programs in the budget proposal presented by the White House earlier this month would cut deeply into the bone of the department's work on economic statecraft. Even the 15 percent staffing cuts announced by Secretary Marco Rubio last month are likely to have a disproportionately negative impact on the economic capabilities of the department.

More specifically, as the State Department absorbs the previous functions of the U.S. Agency for International Development (USAID), there is an argument for the E line to assume more responsibility for development funding. Historically, Economic Support Funds (ESF) were directed by the department's economic bureaus, but in recent years, much of this authority has shifted to the office of U.S. foreign assistance (F) and USAID. Where these funds are housed is less important than ensuring they are sufficient and deployed in coordination with the department's other statecraft tools, and the E line is arguably best suited to play that strategic coordination role.

While I do think the E line has a central role to play in coordinating economic work across the State Department and should be a more capable participant in interagency work in this area, I do not believe that all the economic statecraft functions of the U.S. government should be concentrated at the State Department. In my experience, there is a useful creative tension in having multiple agencies contribute their respective comparative advantage to interagency work in this area: for example, the office of the U.S. trade representative (USTR) for trade negotiations, the Treasury Department for financial diplomacy, and the Commerce Department for export control policy. Responsibility for coordinating all these efforts across the U.S. government should reside in the White House, in the international economics directorate of the National Security Council staff. That said, U.S. economic statecraft without a capable, resourced State Department and E line will fail to advance broad national interests.

Final Thoughts

Offering proposals on smart economic statecraft in the current environment feels a little like discussing a home renovation in the middle of a hurricane. But for all the disruptions and uncertainty we are seeing in the global economic order today, U.S. national interests endure, and we need to be discussing the best approaches to protecting and promoting those interests after the hurricane has passed. A smarter economic statecraft, supported by a State Department E line with adequate capabilities and resources, is critical to that endeavor.

Thank you for your attention. I look forward to your comments and questions.