Empowering U.S. Economic Statecraft

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Introduction

Chairman Mast, Ranking Member Meeks, Subcommittee Chairwoman Kim, Subcommittee Ranking Member Bera, and members of the committee & subcommittee, I thank you for the opportunity to speak today on the topic of "Economic Statecraft and Advancing US Interests Abroad." My comments today are my own; I am not representing my employer, Texas A&M University, nor the Bush School of Government & Public Service. This testimony represents my own views and does not reflect the endorsement or perspective of any other organization with which I am (or have been) affiliated.

In an age of Great Power competition, economics will be determinative, and America's key comparative advantage is our dynamic and innovative private sector. We need to design national economic policies, institutions, and processes that strengthen and enhance that capability, building off that source of strength without hampering it. My testimony today explores considerations to guide U.S. efforts for exercising our economic tools of national power. I hope to share with the Committee some of the concepts and insights I have developed through the Economic Statecraft Program at the Bush School of Government and Public Service (an academic research program that I direct) at Texas A&M University.

Any effort to use economic power to advance our national interests fundamentally depends on government's ability to shape the incentives facing the private sector. America's rise to prominence in international affairs has been abetted by the dynamism of American enterprise and our government's ability to harness this to advance our foreign interests. As we seek to enhance and leverage American economic power, we must do so in a way that is politically and economically durable and redounds to our considerable natural strengths.

Road Map

This testimony begins with a few big picture ideas related to the general competitive dynamic that the US finds itself in. Next, I look at the where the US government is today in terms of economic statecraft. Then, I would like to share a few concepts and frameworks from the Economic Statecraft Program that might be constructive for the Committee as we consider how to best proceed in this emerging domain of 21st century economic statecraft. That discussion starts with an innovative way of thinking about economic statecraft, itself. Then, we will look at the various ways that economic activity can impact national security before highlighting some of the current needs of the country as I view them. This testimony concludes by suggesting principles to guide the practice of American economic statecraft and the appendices provide some specific recommendations for policymakers to consider.

Harnessing the Private Sector to Empower U.S. Economic Statecraft
American economic statecraft fundamentally depends on the dynamism and innovation of our private sector. Firms—not the government—conduct the vast majority of international economic activity, including cross-border trade and investment. These private sector interactions can have important implications for U.S. strategic and foreign interests.[2] The government can structure the incentives facing private firms in order to encourage or discourage particular effects or patterns of economic behavior that generate outcomes that are conducive to our foreign interests.

Any effort to use economics to advance our foreign policy goals fundamentally relies on the government's ability to shape the incentives facing the private sector.

Across history, however, the United States has rarely been strategic and systematic about how we develop and wield our tools of national economic power. Instead, the U.S. (and Delaware case law) has generally preferred to leave commerce in the hands of private corporations—purpose-built institutions whose explicit goal is to maximize share-holder value through profit-seeking, market expansion, returns on investment, etc. The role of government vis-à-vis the U.S. economy has been principally at the macroeconomic level—for example, by ensuring a stable monetary supply, regulating in the public interest, addressing market failures, and taxation/fiscal policy, etc.

In the twenty-first century, the United States faces a host of new international economic challenges. Our competitors and adversaries use state-owned and directed firms to manipulate international markets and tilt competitive landscapes in favor of their interests. They have further studied our economic, educational, and political systems and now seek to exploit some of the very qualities of openness, transparency, and collaboration that have made America so successful.

We need to innovate in government, but our economic statecraft (for example, our efforts to "derisk" in the aftermath of the post-COVID supply chain shocks, and the intensifying economic competition with China) has thus far remained principally reactive to international dynamics. The USG has been leveraging authorities, institutions, legislation, and capacities which were often built in a different era and for a different purpose (e.g., the 1950 Defense Production Act, the International Emergency Economic Powers Act of 1977, Trading with the Enemy Act of 1917). The U.S.'s export control regime is another good example of this. Export controls were initially designed during the Cold War to prevent the transfer of military technology to adversary nations.[3] The expanded application of export controls in the semiconductor realm as part of a larger effort to hamstring China's technological prowess and maintain U.S. leadership over key "dual use" technologies of the future has resulted in an over-extension of institutions like the Export Control Review Committee.

Economics will be determinative in the Great Power competition to come. The U.S. now faces a formidable competitive global environment that requires innovation in government doctrine, tools, and capacity. Critical national objectives—from securing supply chains, to coordinating with allies to foster innovation and grow new markets, from facilitating trading capacity in new partners, to maintaining a competitive innovation engine at home that produces the world's industry-leading companies—all demand that we take a hard look and undertake to reinvent our economic statecraft tools. In all this, the American private sector will almost *always* be three steps ahead of government, and private enterprise remains our key comparative advantage in any long-term competition. *To harness this potential, we need to design governing arrangements that shape the incentives such that private firms (when they optimize for their own self-interests) will end up behaving in a way that redounds to the national interest.*

Today's State Capacity

The U.S. Government's ability to upgrade our economic statecraft toolkit faces some daunting obstacles. The various authorities used to conduct economic statecraft are scattered across more than 1,400 different offices in 10 agencies and 13 departments with no single integrating lead organization other than the National Security Council. These individuals are typically too busy putting out fires in their in-boxes to have the space to think proactively and strategically. Many across the interagency lack the information and ability to do economic statecraft campaign planning, contingency modelling, strategic forecasting, or meaningful economic statecraft analysis. Most critically, the government has very little by way of organizational mechanisms for working collaboratively and constructively with private enterprise—despite the fact that the private sector is *the* way that the United States "does" economics internationally.

There is very little institutional capacity in the USG to deliberately design and sustain strategically coherent, coordinated economic statecraft. No single federal department or agency is tasked as the USG's lead for exercising the economic tools of national power, despite clear agency leads for the other elements of power. The Department of State handles diplomacy and the Department of Defense is in charge of our armed forces. But there is no definitive lead agency or department to exercise America's economic tools of national power. The Department of Commerce has a largely domestically focused, commercial mission and Treasury's center of gravity is squarely focused on macroeconomic management and regulatory tasks. The State Department has an Economic Bureau, but commercial diplomacy is only one dimension of economic statecraft. Few of the government (or quasi-government) agencies that house the various economic statecraft authorities are regularly coordinated for a comprehensive, sustained, strategic effect that advances U.S. foreign and security goals.

The United States simply has no Department of Economic Statecraft. Instead, we rely on *ad hoc* authorities and interagency implementation that is frequently poorly coordinated by an overstretched White House team which is often—appropriately—focused on the crisis of the day.

Most of the interagency offices responsible for some aspect of U.S. economic statecraft will wait for clear direction from above before exercising their authorities. Although this is somewhat understandable, the aggregate result is a tendency toward inertia and siloed economic statecraft in the face of myriad and complex challenges.

There is, moreover, a lack of common economic statecraft doctrine and literacy across the executive and legislative branches of government. Despite its rising importance, there is no single, interagency doctrine of economic statecraft—a collection of distilled wisdom (grounded empirically) about what does or does not work in the domain of economic statecraft. Instead, economic statecraft is understood to be different things to different people. For example, some might consider economic statecraft and sanctions to be the same thing. Others might think of economic statecraft as being inherently coercive. Still others would include sanctions, export controls, development aid, and commercial diplomacy as all being specific instantiations of a broader, holistic concept of economic statecraft. Often, these conceptions are deeply shaped by where one finds oneself in the bureaucracy. Where you sit (and what authorities your particular office controls) determines how you think about economic statecraft. If your authorities are all hammers, then everything looks like a nail.

To begin to address this need, I would like to share a few concepts that my academic research program at Texas A&M University has been working on.

The first contribution is to define how we conceptualize economic statecraft, itself.

An Innovative, Useful, & Accurate Definition of Economic Statecraft

Private sector actors are at the heart of exercising economic tools of national power. Unlike other forms of national power, exercising economic power requires working *through* commercial actors. Their interests are fundamentally more narrowly self-serving than the national interest. These commercial actors cannot be expected to act in any way other than to maximize their own (e.g. profit, returns on investment, fiduciary responsibilities to shareholders, etc.) interests. Although the aggregate macro-level results of this narrow pursuit of firms' self-interests fuels the wealth of nations, you cannot count on firms or sectors to "look out for the national interest," "do the right thing," or "to be patriotic." It is simply not a part of what they do. While individual CEOs or some board members may wish to "do what's right for the country," their job is to maximize returns for shareholders. This is a feature (not a bug) of our system. We should *not* try to change it or wish it were otherwise. Instead, we need to design effective US economic statecraft with this divergence of interests in mind. Rather than fighting uphill against these self-interested proclivities, it is the responsibility of policy makers to design innovative systems and strategies that harness these incentives and identify creative ways to have them work to advance the national interests.

In order to properly understand economic statecraft, we must first understand how and under what conditions "economics" occurs. States, strictly speaking, do not actually conduct the vast majority of today's international economic interaction — this role is occupied by the firm. Companies are the entities that decide what and how much to buy and sell internationally.

Portfolio managers fluidly allocate capital across time zones. Chief Financial Officers evaluate the feasibility of building a new factory abroad. Of course, nation-states engage in some international economic activity directly, but this direct participation in the global economy represents a small fraction of the commercial activity that comprises most international economic activity.[4] In some instances, states may directly engage in economic transactions (foreign aid, procurement, etc.); but for the most part, states merely write the rules of the game and define the conditions under which firms operate.[5]

There are three parts to my definition of economic statecraft. First, one must recognize that commercial actors (not states) conduct most of the interactions in international economics. Commercial actors–not states themselves–are the chief agents in the realm of international economics. It is these entities that actually carry out international economic transactions (e.g., buying and selling commodities, establishing supply chains, making investments, selling products, building factories, purchasing assets, employing workers, etc.).

Second, these interactions may generate security consequences for states. I call these security consequences stemming from economic activity 'security externalities' and they constitute the second conceptual part of the definition. In the next section below, I will expand on what these security externalities are and how they can be used to more precisely understand how various economic activities relate back to national security.

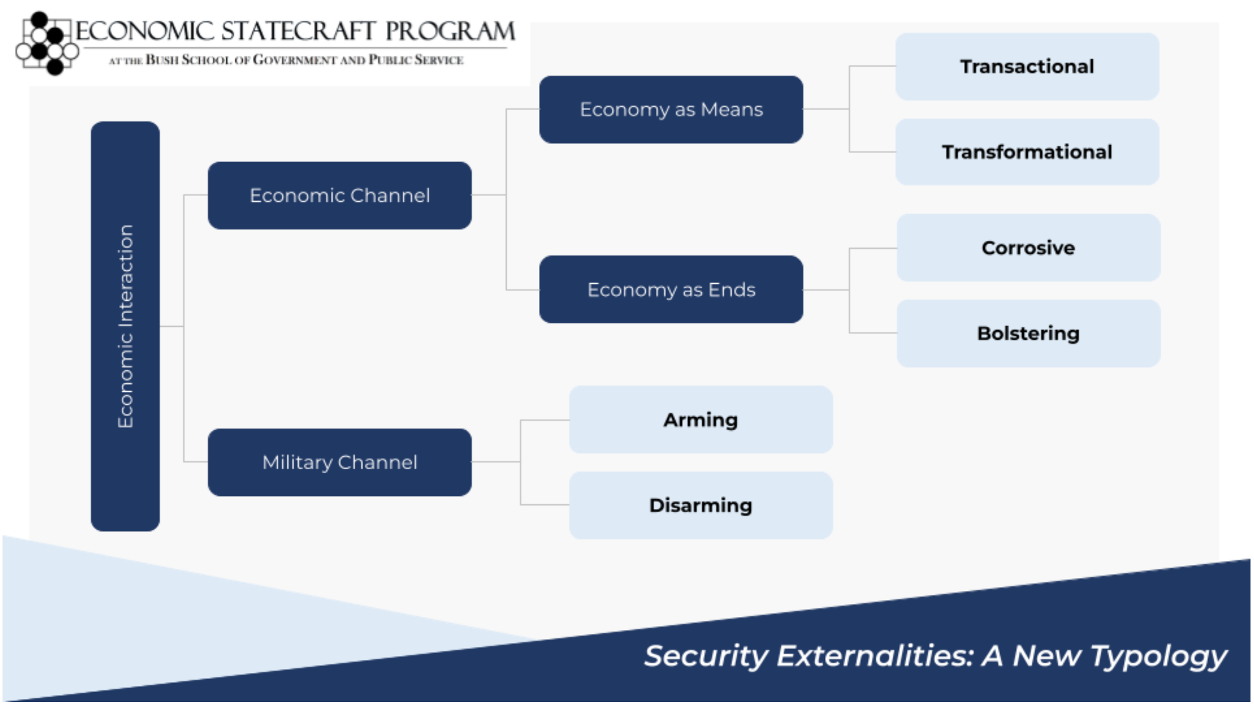
Finally, states can manipulate the incentives facing commercial actors so as to encourage (or discourage) patterns of behavior that generate security externalities conducive to a state's strategic interests. This state manipulation of incentives facing commercial actors is the third part of a bottom-up approach to defining precisely what economic statecraft is. **Economic statecraft is thus defined as the intentional attempt of a state to deliberately incentivize commercial actors to act in a manner that generates security externalities conducive to the state's strategic interests**. Framing the relationship between economic interaction and national security as one of "security externalities" highlights the importance of commercial actors and calls attention to the strategic ramifications of their activities. Under this paradigm, I will stress the necessity of working through commercial actors to do *anything* in the domain of economic statecraft. This incentives-based approach provides an empirically accurate understanding of the role of the USG *vis a vis* the private sector when it comes to the exercise of economic power. It should also infuse some humility into our sense of the proper role of the state in matters of economic statecraft.

From Tools to Effects: Re-orienting Our Strategic Approach

The second concept from the Economic Statecraft Program that I would like to share is to convert the US from a "tools"-based approach to economic statecraft toward a more strategic, effects-based approach.[6] This approach connects economic activity back to national security and is reflected in the typology below. This typology maps out the range of possible ways economics can affect security, highlighting the causal pathways that connect the micro-economic, firm-level behavior of autonomous commercial actors with macro-level strategic security effects for nations. Framing the relationship between economic interaction and national security as one of "security externalities" highlights the importance of commercial actors and calls attention to the strategic ramifications of their activities. Taken together, the typology answers the question 'In what manner does economics affect security?'

Organizing the intellectual space of economic statecraft along the lines of security externalities categorized on the basis of their effects on a target (rather than by the particular tools such as sanctions or export controls) allows us to be mutually exclusive in our categories (which are based on distinctive causal logics linking the economic activity back to its security effects) and collectively exhaustive across the categories—the two key features of a good typology; although it should be noted that any given policy or act of economic statecraft might entail more than one of these logics in practice. This framework also provides a specific vocabulary clarifying precisely what a state is worried about and/or how a sender is thinking about its strategy to achieve its objectives using economic tools of national power.

Figure 1.1 Typology of Security Externalities



Broadly speaking, there are two channels via which economic interaction can impact a nation's security: Military and Economic. In this typology, there are six types of security externalities which map onto these two broad categories: those acting through primarily economic channels and those externalities with direct military effects.

Those externalities acting via the Military Channel share the common causal logic that a nation's direct war-fighting capacity can be directly strengthened or weakened by economic statecraft. Similarly, we can think about strengthening or weakening a nation's economy more broadly (rather than just its military-industrial base specifically). These effects reside on the other main branch of the typology that houses those externalities that affect a state's security primarily by way of economic channels. For this family of externalities, security ramifications are often the second-order consequences of the economic interaction (as opposed to the military effects branch of the typology in which the economic interaction directly contributes or detracts from a state's ability to wage war).

The economic branch is subdivided into two groups: 1) the types of externalities that affect the overall health of the target economy as an end in itself and 2) those security externalities in which the economic interaction plays an instrumental rather than teleological role. In this first group, there is one category of externalities that weaken the target's economy (for example, through measures like the US embargo of Cuba) and there is another type of externalities that strengthen the target's economy (for example, the Marshall Plan).

In the "Economy as Means" group there are two distinct strategic logics. The economic interaction may generate externalities that are primarily transactional (e.g. sanctions, freezing bank accounts, etc.). This strategic logic is one that merely seeks to alter a target's behavior. Another type of security externalities are those designed to actually transform the interests of the target. Engagement strategies often reflect this type of logic.

By focusing on the terminal nodes of the typology, we are left with six distinct types of security externalities which cover the full range of possible security externality categories.

Conclusion

We have our work cut out for us. The United States faces unprecedented challenges in the form of a long term competition with a near-peer great power that is deeply integrated into the global economic system. To meet this challenge, we need to both put forward a vision for a new, durable international economic order and to rebuild our own domestic institutional capacity to do economic statecraft more effectively. This ought to be done bearing in mind the central role played by the private sector as the primary agents for any American economic tools of national power. My work suggests the need for a set of recommendations to more effectively coordinate the economic statecraft authorities currently scattered across the more than 1,400 different offices spread among 13 departments and 10 federal agencies.

Appendix 1: Principles to Guide American Economic Statecraft

As we proceed forward and navigate these reform efforts in the architecture of American economic statecraft, there are a few principles that we might wish to consider to guide our efforts. In many ways, this will be uncharted territory for the United States. As we proceed, we will be well-served to keep efforts grounded in long-standing values and principles that have been a key part of the U.S. success story.

All strategies rest on principles or assumptions that guide them. Below are several principles derived from our unique strengths and assets as a nation. These have been suggested as helpful jumping off points for crafting U.S. economic statecraft doctrine and tools. They are based on discussions over the past five years between the private sector, academia, and former and current U.S. government officials.

1) As general rule, we ought to design economic statecraft in light of the commercial incentives that drive the private sector. Use government policy to work with and harness these interests by incentivizing them—rather than trying to fight against this grain or trying to wish them away. Successful economic statecraft *must operate through incentives* to shape and leverage the scale, ingenuity, and vibrancy of American enterprise. Work with the American private sector, not against it.

2) Our national power ultimately derives from U.S. economic growth and innovation. Increasing long-run productivity gains is key to succeeding in any international competition. Real gains in productivity come from innovation. The sustained capacity for radical innovation is *the* key competitive advantage for the U.S. Such innovation can completely change the "rules of the game" with a new way of doing things, novel technologies, or sometimes entire industries that result. This kind of creative destruction is a hallmark of our adaptable, entrepreneurial, free market system. The pillars of our innovation system—including world-class higher education, our research ecosystem, legal infrastructure, markets, data, human capital—ought to be explicitly fostered, preserved, sustained, and shielded from deliberate efforts to undermine them.

3) When it comes to designing industrial policy, we must be constantly on guard against "capture." Our political system (especially when it interacts with business) is prone to what social scientists call "capture" which means that groups with fairly narrow agendas and preferences will tend to dedicate resources and efforts to lobby Congress to advance their particular interests whether or not that is actually in the nation's best interest.[7] We need, therefore, to be very careful about industrial policy, protectionism, or other sorts of market-distorting measures as these can easily become politically in-grained and lead to inefficiencies and a failure to innovate.

4) The U.S. should have a preference to rely on market-oriented solutions since those tend to be most efficient and sustainable over the long term. Government initiatives are most effective when they are focused simply and directly on addressing market failures.

5) U.S. economic statecraft should maximize scale and legitimacy by coordinating and leveraging the power of allies and partners. Such aggregation would provide scale for markets that would help drive innovation and offset the draw of China's large internal

market. But such international economic statecraft coordination provides an additional benefit. It would also include legitimacy that comes from coalitions and multilateral support for U.S. actions. This strategic aggregation of leading nations is an unmatched, and sustainable comparative advantage for the United States—especially *vis a vis* China.

6) The U.S. enjoys a big "incumbency advantage" in any long-term competition. The United States wrote the rules of today's voluntary, open, transparent, and improvable global economic order. We are, as a consequence, the dominant nation in global affairs. Although we face rising challengers, we should force those challengers to make the case for why things would be better when they get to write new rules for international commerce. Fear of the unknown can help tip nations that might be sitting on the fence toward that to which they are already accustomed. This inertial tendency to go along with what is already widely known and accepted can work to the U.S. advantage. We should preserve and take advantage of our dominant influence. By deliberately forcing challengers to justify any changes, we also call attention to the inherent benefits of the current order and its improvability.

7) As we move forward in the economic statecraft domain, it is crucial to focus on the various ways that government and diplomacy can support different kinds of business, investment, and trade to help create jobs for fellow Americans and new opportunities for American businesses. We need to grow the U.S. economy in ways that are not just reflected in the stock market, but also in terms of jobs and wages. America has always stood for the advancement of equality and liberty, but it will be impossible to realize these noble aims at home or internationally if the underpinning economic success is not in place to support them.

Appendix 2: Mechanisms for Better Public-Private Integration

One of the areas in which academia can provide a useful catalytic capacity for economic statecraft is in convening public-private partnerships that creatively tap into the knowledge and expertise resident outside of government. My Economic Statecraft Program is willing to host tabletop exercises that engage corporate board members and C-suite leaders of companies with significant operational or revenue risk exposure to geopolitical shocks in Asia. We have found such business-government exercises to be very helpful in prompting firm-level de-risking evaluations. If funding is forthcoming, would like to host about half dozen of such exercises around the country (in the cities where these firms are headquartered). As a nation, we have outstanding talent in our private sector, but it can be mechanistically difficult for the government to access and leverage that skillset.

Another concept is to create advisory bodies that draw from the private sector to help inform and weigh-in on possible USG moves and strategies in the economic statecraft domain space. Building this public-private partnership capacity is not something that would need to be invented whole cloth. There are several archetypes of relatively successful public-private cooperation. Some possible models to consider for inspiration are the President's Foreign Intelligence Advisory Board (PFIAB), the Defense Science Board, the National Academies of Science, Office of Strategic Capital, DARPA program managers, In-Q-Tel, the JASONs, and the Defense Innovation Unit. A PFIAB-like advisory body could be attached to OFAC (the Office of Foreign Asset Control) at Treasury to help keep USG personnel apprised of the most recent financial innovations and current trends in family offices and the private equity world. Financial engineering and forensic accounting expertise could be similarly associated to the Bureau of Industry and Security at Commerce. Technical knowledge from Silicon Valley and academics doing work at the cutting edge in emerging fields can keep the End-use Review Committee apprised of basic research and novel breakthroughs that might have national security implications. Appropriate insights from hedge fund and asset managers may also feed into the CFIUS detection capacity.

The key to all of this would be to create the ability for private sector expertise to serve in the national interest. It would be great to be able to better inform the USG about the state of the art more easily observed from the private sector. Such exchanges could help anticipate and detect emerging threats to national security. The specific modalities of such mechanisms can vary depending on the context and it might be necessary to try something for a period of time with the expectations to adjust as needed. Under these kinds of conditions of uncertainty it is a good idea to build in an explicit capacity to objectively evaluate a new structure after two or three years, at which point adjustments could be made. The challenges our nation faces are too important to wait for a perfect solution. Better to build in the capacity to experiment and gracefully fail than spin our wheels.

One natural partner in drawing on private sector expertise is likely to be industry associations and firms themselves. While these can be excellent reservoirs of market data and a wealth of insight, any such partnering would need to give serious consideration for how to best insulate these advisory relationships from a natural inclination for firms and associations to lobby or to seek to advocate for policies that might redound to their narrow interests. It is very important to think through potential conflicts of interest and leverage naturally-occurring incentive structures to check any untoward activity that might spring from closer business-government collaboration. The institutional challenge is to design mechanisms to tap into the expertise and talent that resides in the private sector without providing an avenue for untoward influence, pursuit of narrow interests, or an inside track for lobbying.

To mitigate these negative possibilities, we need some mechanisms that would ensure the integrity of this effort. For example, should this activity be subject to congressional oversight or IG supervision? What about the possibility of future FOIA requests? It might be a good idea to require private sector participants to sign Non-Disclosure Agreements and perhaps some would need to hold clearances for some of these envisioned advisory capacities. Ensuring that such private sector contributions are properly sanitized can include common-sense, traditional ideas as well as more creative ones. For example, participating individuals should take an oath clarifying their duties in an advisory capacity. Like the Aggie Honor Code at Texas A&M University, this should come with a requirement to report suspected violations or conflicts of interest. Another, innovative concept is to leverage "competitive transparency"—a system that empowers vested interests who would directly stand to lose as a result of untoward behaviors. These stakeholders (e.g. competitor firms or rivals) should be able to monitor and perhaps even audit the leveraging of the private sector in national service. This would harness the naturally-occurring incentives in the system to help ensure integrity and sustainability. Another idea could be to limit participation in some of these advisory bodies to retired private sector leaders rather than current CEOs. These individuals would still possess relevant industry knowledge but would be one level removed from direct conflicts of interest as they bring their knowledge to bear in government service. There should be a standard expectation of recusal if there are any possible conflicts or potential for self-gain. Ideally, we would want to find ways to align private sector's narrow self-interests with the needs of the USG (e.g. national security) whenever possible (e.g. bilateral investment treaties). For instances when this is not possible, the integrity of any public-private partnership effort needs to be protected. Once public trust is lost, it would be very difficult to regain.

Appendix 3: Some Specific Recommendations for U.S. Economic Statecraft

Much work needs to be done to enhance the way in which the United States wields its economic tools of national power. One of our key challenges is to maximize private sector opportunities at a time when the economic landscape is more contested and markets are less stable. It is critical for policymakers to ask how best we can maintain the world-class strength of the U.S. business community while also advancing our other security and foreign interests. Such efforts should include and aim to optimize the full panoply of capabilities rather than relying on coercive measures like sanctions alone.

Economic statecraft fundamentally depends on the private sector. It will be important to keep American business sharp—in a way that it remains globally competitive for decades to come. It will be critical to conscientiously incorporate the important role of the private sector in American economic statecraft. The vast majority of trade, investment, and human capital flows are the result of microeconomic decisions made by firms. The government's unique economic statecraft capacity is to shape the incentive structures facing those firms. This is how economic statecraft is actually done in practice. Our current governmental institutions are poorly suited to coherently conducting twenty-first century economic statecraft. The nation needs specific solutions to these problems.

1. <u>Improve information flows in the domain of economic statecraft.</u>

A first step for improving coordination between the USG and private sector around issues of economic statecraft is to get both sides to better appreciate the depth, heterogeneity and complexity of the other. The private sector tends to view the government through its narrow, particular lens largely driven by how that sector of the business world interacts with or conceptualizes "the government." For example, some industries view government as a regulator, or "the tax man," or a slow-moving bureaucratic obstacle to be avoided, or as a compliance issue or a legal responsibility. Often it is a novel idea to think about the USG pursuing the national interest on behalf of Americans—let alone the idea that the private sector might play an integral role in advancing national security interests! On the other side, the USG all too frequently compresses the wide range of commercial actors into a thin, monochromatic abstraction called "THE Private Sector." This glosses over important heterogeneity and eschews the wide range of differences between mom-and-pop small businesses and the oil and gas industry majors or how either of those contrast with Silicon Valley tech giants or Wall Street banking as opposed to biotech start-ups and Instagram influencers.

Improving the flows of information across the USG and between the USG and the variety of private sector actors would go a long way toward improving our economic statecraft. There may be a need for a less balkanized information sharing system across the interagency. Shared information could facilitate more accurate forecasting, economic statecraft campaign design and execution, as well as better understanding of tradeoffs involved in taking one course of action over another.

We also need better information sharing between government and private sector industries. Policymakers need to appreciate how their decisions affect the private sector so as to avoid unintended harmful consequences. The White House and Congress need to make decisions, but in many cases, they have no reliable way of knowing how those decisions will influence the private sector. What might be some better ways to facilitate the exchange of information and how can the USG best harness the latent capacity of the U.S. private sector?

One practical idea would be to design “private sector testbeds” that could create a venue for possible economic statecraft modelling and experimentation/gaming. Such public-private partnerships could provide ways to check whether specific USG economic statecraft actions and possible activities would actually be likely to result in the sort of behaviors and responses that they are designed to induce from the private sector. Such testbeds could be organized on a sectoral basis and would provide yet another way to improve the flow of information between the commercial actors and economic statecraft policy makers. Improved situational awareness would also help both sides to more proactively identify positive instances to advance U.S. foreign interests (including business opportunities).

2. Invest in building up our economic statecraft professionals.

Far too few career civil servants have direct professional experience in the private sector. At the same time, rising talent from the private sector rarely gets an opportunity to serve in government and to see how foreign economic policy is made from the inside. There is a need to devise employment and hiring procedures that allow greater movement between private sector and government. We also need creative public-private partnership mechanisms that facilitate the flow of people and information between the private sector and the USG. This will help drive innovation and ensure that government expertise stays current and maintains American leadership in the key industries of the future.

One tactical idea for consideration is whether the creation of a “Fellows of Excellence” program at places like the Department of Commerce’s field offices might help the USG to tap into human capital excellence resident locally in the private sector. This kind of a program can provide a sabbatical experience to help augment the Department of Commerce’s ability to stay abreast of a broad range of fast-moving, strategically consequential industries like artificial intelligence and biotechnology. Such an experience ought to be flexible (in terms of duration, frequency, compensation, etc.) to maximize the USG’s ability to access the best people from the private sector. A similar kind of program could bring private sector expertise into the regional bureaus of the State Department.

3. Bring procedural rigor—doctrine, planning, and analysis—to the economic statecraft domain.

In addition to these efforts to improve the flows of information and human capital, we should consider formally adopting a doctrine of economic statecraft—one that focuses on “security externalities.” We lack a coherent, scalable, consistent approach to economic statecraft both across government agencies and between government and the private sector. Common definitions, language and understanding are a pre-requisite to any meaningful effort to design strategy and doctrine around economic statecraft. Momentum is growing across the aisle both on the Hill and in the executive branch. There is growing recognition of a need to more strategically employ our economic tools of national power. This effort needs to begin by officially establishing a common foundation of terms and definitions. These would be fairly easily adopted and are important pre-requisites for establishing a common operating picture.

There is also a need to complementarily develop sophisticated modeling and campaign planning tools in the economic statecraft domain. Just as the use of our military or diplomatic tools of power depends on deliberate planning and exercises, we should generate operational plans for likely economic statecraft contingencies and concerted economic statecraft campaigns. Again, as is the case with their military or diplomatic equivalents, such plans might be classified or made public and available to Congress so leaders can be informed. Such mechanisms can help educate both public officials and private sector leaders as they plan for the future.

Perhaps it would also be worthwhile to write a classified and a public economic statecraft strategy. This could draw on a dynamically evolving empirical understanding of what does and does not "work" in economic statecraft. Today, American economic statecraft is organized primarily around the multitude of authorities and specific policy tools that exist. This colors how we see the phenomenon and how economic statecraft is understood—where you stand depends on where you sit. But this is not good for designing coherent strategy. Instead, we may wish to consider focusing less on the specific economic statecraft tools being used and more on the ends being sought. An outcomes or effects-based approach would facilitate coordination and bring several different kinds of economic and other statecraft tools to bear on achieving the common, desired outcome. In this way, the symphony of economic power (the multitude of positive and negative measures, trade, monetary, and financial tools, etc.) could be made a bit more harmonious and strategically coherent. The organizational exercise of writing something like the National Security Strategy often helps a presidential administration crystalize its strategic logic and signals its priorities to the various implementing departments and agencies. The development and writing of a national economic statecraft strategy could be nested into that NSS effort to ensure complementarity.

As part of this strategic shift toward a deliberate and coherent economic statecraft policy process, there are several follow-up activities that might be worth considering. For one, it would be helpful to establish a Task Force to conduct an explicit review (modelled on Treasury's 2021 formal review effort) of all the tools of economic statecraft currently available to the USG. Then, based on this snapshot of USG capabilities, it may be productive to conduct a systematic gaps analysis to determine what new instruments might be desirable in the USG economic statecraft toolkit.

4. <u>Leverage the talents and capacity of academia in the nation's service.</u>

All of this work will require the concerted help of the considerable talent and resources in America's universities. Such an effort will naturally be focused on providing the intellectual capital necessary for enhancing the U.S. economic toolkit. This research effort should be galvanized by public and philanthropic support around important questions and lines of inquiry driven by real-world challenges. Supporting basic research in the national interest has long been an effective use of federal dollars. But in this effort, the academy should also remain true to its teaching and service obligations as well. We will need to design programs to educate future generations of public servants to ensure that they have the necessary skills to operate effectively across business and government in the dynamic geopolitical context. At the undergraduate and graduate levels, the U.S. academy has a large role to play in designing a thoughtful curriculum that imparts valuable skills bridging economics, security studies, business, international relations, and other fields to properly equip graduates for the future. Initially, we can rapidly achieve scale by leveraging technology to coordinate class offerings to a select group of economic statecraft students across various pockets of expertise that are currently scattered across a number of scholarly institutions. Such a curriculum would need to be coordinated nationally and could be supported by a professional academic membership consortium. This would be a cost-effective way to stand-up a talent pipeline and quickly scale up our national capacity to conduct effective economic statecraft.

5. <u>Get supply chains right.</u>

Another important area that still requires additional work is in the supply chain security arena. One relatively easy recommendation would be to identify supply chain vulnerabilities and find ways to match those vulnerabilities with market opportunities. For example, the United States might not consider fertilizer as something that is all that strategic or directly critical for American national security. But in 2022 Japan identified fertilizer as one of 11 critical materials.[8] By identifying elements that trusted partners and allies worry about from an economic security standpoint, we might uncover some items that American businesses can easily provide. Facilitating reliable, secure supplier relations between American companies and Japanese customers not only creates an economic opportunity for American firms, but also serves to strengthen U.S.-Japan alliance relations even as it helps assuage an ally’s supply chain vulnerability. There are likely a host of other products that we might not consider as all that strategically significant (e.g. agricultural exports, energy, industrial equipment, electronics, bio-medical products) but would help partners and allies feel more secure knowing that they could rely on American sources for these goods that they categorize as a matter of economic security. Across another broad range of goods, the United States *and* our partners and allies might both share supply chain concerns. While we might not be able to meet each others’ needs, improved economic diplomacy and allied coordination might still allow us to achieve common economies of scale. Such pooling and coordinating of demand can make stockpiling, redundancy, and resiliency commercially viable. This joint approach is already being piloted in areas like critical minerals and semiconductors. Similar efforts might yield beneficial economic statecraft results across other industries as well. Oil, AI, renewable energy, and a number of emerging technology frontiers could benefit from smart governmental initiatives to catalyze commercial actions and enhance American competitiveness for decades to come.

What kinds of public-private partnerships have been shown to unleash private sector dynamism? What would be required to advance our national security interests through the actions of the private sector? For example, should the USG subsidize the creation of a strategic stockpile for specific critical minerals?

6. Integrate economic statecraft more effectively into our diplomacy.

We need to be more creative and innovative with how we orchestrate our diplomatic tools toward a desired strategic and economic effect. For example, joint US-EU, "5 Eyes," AUKUS, or US-Japan-ROK innovation funds could be established to support collaborative basic research in key emerging technologies. Such government underwriting can serve to incentivize and crowd-in private capital while also reinforcing our critical diplomatic alliances. These kinds of mechanisms create sustainable partnerships with nations who share our values. They also enhance our collective ability to conduct cutting edge research and develop technologies even as it facilitates the comparative advantages of our free and open system.

Critical minerals, energy, or other key materials may not always be located in nations that have the institutional capacity that OECD countries have. What can the USG do to better support American competitiveness in areas of the globe where we might not have trusted relationships? How can the USG better catalyze U.S. private sector engagement in the developing world in ways that benefit American workers even while improving lives in those partner nations? What tools can the USG use to promote U.S. business interests internationally while strengthening U.S. industries at home?

The State Department's "Deal Teams" were country team-led efforts to coordinate across the USG to identify, source, and help land commercial opportunities for U.S. businesses in key markets worldwide. It would be useful to conduct a systematic review of what has been working (or what did not work & why) from this tactical effort at the host-nation level. This knowledge can then be used to expand the best elements and improve the integration of Deal Teams with our other tools of economic statecraft.

Commercial diplomacy and the strategic use of American business interests are an underutilized element of national power. There is important work to be done on educating corporate leaders on how their business endeavors can impact national security even as we seek to build an appreciation for how geopolitical dynamics can shape their commercial decisions.

All of this diplomatic work ought to take place under a broader strategic communications refrain that forces would-be challengers to make the case for why things would be better if they were to re-write the rules of international relations. Many nations have benefitted (and are likely to continue to reap self-interested rewards) from the stability, openness, transparency, fairness, and adaptive nature of the global system that has been built and cooperatively led by the United States. One of our big advantages is that what is in U.S. best interests is often also in the best interests of many of our partners and allies. We should deliberately harness and leverage this significant "incumbency advantage" as we improve our diplomatic outreach.

7. Innovate our USG institutional design to facilitate more effective economic statecraft.

A larger set of issues for policymakers to consider is whether we have the right institutional design, funding, and human capital to "do" economic statecraft effectively. The authorities for conducting economic statecraft are scattered throughout more than 1,400 offices spread across

10 federal departments and 13 agencies. This makes the coordination of our economic statecraft difficult.

We also need to improve interagency coordination and leadership on matters of economic statecraft. This will likely require imaginative thinking and a willingness to experiment with innovative institutional designs and processes. The system currently looks to the National Security Council as the ultimate interagency coordinating body. While the NSC policy processes and mechanisms can be made to work for economic statecraft, the reality of the necessity of prioritizing “the urgent” at the White House level of our system often means “the important” must take a back seat. The result is a largely *ad hoc* set of efforts that lurches American economic statecraft in a reactive fashion from one crisis to the next. The whiplash is felt by private sector firms as they struggle to keep up and maintain compliance.

A dedicated institutional body that is properly resourced and with the appropriate authorities could design and implement a more sustainable and enduring U.S. economic statecraft strategy and toolkit. Such a body would also serve as a repository of institutional memory for exercising economic tools of national power. Eventually, the USG could even cultivate a professional corps with the appropriate skillset for pursuing our strategic objectives via economic tools of power.

8. As we reorganize, build in the capacity to deliberately evaluate & adjust as needed

This effort to more effectively “do” economic statecraft is going to plunge us into relatively uncharted territory for the United States. We should proceed with a strong dose of humility as we retool for this long run competition. The stakes are too high for us to simply continue with business as usual. We must (and we will) try a variety of new things. Some of these ideas will work well and others will need to be adjusted, tweaked, or stopped all together. Under these circumstances of high stakes uncertainty, it is a good idea for Congress to build in an explicit capacity to objectively evaluate new structures, efforts, and initiatives after two or three years, at which point adjustments could be made. The challenges our nation faces are too important to wait for a perfect solution. It is better to build in the capacity for the United States to experiment and gracefully fail than to spin our wheels.

9. First, do no harm: Innovation and how not to kill the private sector geese that lay the golden eggs.

Perhaps the most important challenge for U.S. economic statecraft is the preservation and sustainment of the decades-long track record of American innovation. We sit astride a $30 trillion dollar economy! This success and continued growth is fundamentally driven by sustained innovation. The United States has demonstrated a remarkable capacity for innovation that reshapes entire industries. The innovation ecosystem that the United States has built is the envy of the world. Our world-class research universities attract the brightest minds from across the globe even as our dynamic venture capital community nurtures creative new companies. How can the USG best strengthen the U.S. innovation ecosystem? This is our key comparative advantage: the ability to radically innovate and the entrepreneurship to commercialize and scale that innovation. Ensuring its continued global leadership will be a central economic statecraft challenge in years to come.

Policymakers should also consider the talent dimension of economic statecraft. How will the U.S. win the longer-term competition for the world's best and brightest? We need to improve the American human capital base, both by cultivating our own skills domestically as well as remaining the preferred destination for so many smart, ambitious risk-takers who choose to emigrate to the U.S. We should seek to build the structure to re-invest and renew our human capital on an ongoing basis. The future global economic landscape will bring significant changes to productivity, and it would be wise to plan for ways to re-cultivate America's human capital base on an ongoing basis.

Our competitive advantage lies in the American private sector and any economic statecraft reforms ought to build off that base without hampering it. As we seek to enhance our ability to leverage American economic power, we should strive to do so in a way that is politically and economically durable and redounds to our considerable natural strengths. For all U.S. economic statecraft, our principles of equality and liberty should continue to serve as our bedrock. These principles are a key source of strength for the U.S. at home and internationally. Historically, they have been a source of our international legitimacy and leadership, and they can continue to serve as a common ground for allies and partners to gravitate toward and coalesce around shared security and economic priorities.

End Notes

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[1] Director of the Economic Statecraft Program at the Bush School of Government and Public Service at Texas A&M University

[2] William Norris, "Typology of Security Externalities" *Economic Statecraft Occasional Paper* No. 1. available on-line at: https://bush.tamu.edu/wp-content/uploads/2021/07/ESP-Occasional-Paper-No.-1.pdf

[3] Aaron Karp. "Controlling weapons proliferation: The role of export controls." *The Journal of Strategic Studies* 16, no. 1 (1993): 18-45; Cindy Whang. "Undermining the consensus-building and list-based standards in export controls: what the US export controls act means to the global export control regime." *Journal of International Economic Law* 22, no. 4 (2019): 579-599; Moyer Jr, Homer E., and Linda A. Mabry. "Export controls as instruments of foreign policy: the history, legal issues, and policy lessons of three recent cases." *Law & Policy International Business* Vol 15 Number 1 (1983): 1-172.

[4] For example, direct government purchases from abroad are estimated at less than 1% of GDP for most developed nations. In 2019, the US spent $7.8 billion on foreign procurement (Lee 2021), about 0.04% of total GDP. Japan's imported share of government procurement was 0.25% of GDP. The EU's share was less than a quarter of one percent, based on 2014 data. See databank.worldbank.org for annual GDP reports (accessed 26 April 2023); see May 2019 Report, GAO, "International Trade: Foreign Sourcing in Government Procurement"; World Bank figures for imports of goods and services (current US$) 2014, and GDP (current US$), for 2014 "World Bank Open Data." World Bank. https://data.worldbank.org/ (accessed 1 September 2020); EU Import Data from Eurostat, given World Bank data does not appear to filter out intra-EU Trade in Goods/Services: Eurostat. https://ec.europa.eu/eurostat/web/main/home (accessed 1 September 2020).

[5] For countries like China, the opportunities for direct state control over economic activity would seem to be much greater given its domestic political economic conditions. For more on Chinese economic statecraft, see Norris, William J. *Chinese Economic Statecraft: Commercial Actors, Grand Strategy, and State Control* (Cornell University Press 2016).

[6] The purpose of this effort to create a typology is to provide a useful theoretic tool for categorizing and more precisely specifying the various security-related consequences of economic interaction. Much of the current US government economic statecraft policy apparatus is largely organized on the basis of legal authorities and the specific types of tools that can be used. This tool-oriented approach results in at least three drawbacks: 1. Economic policy and stakeholders are rarely or poorly integrated into national security strategy since portfolios are drawn along economic or security lines; few institutions actively seek to integrate security and economics. 2. It is difficult to coordinate strategically across the interagency since various stakeholders view economic statecraft largely through the lens of their specific toolkit. For example, the Bureau of Industry and Security in the Commerce Department tends to see economic statecraft through the lens of export controls. As I mentioned earlier, if all an organization has is a hammer, then everything looks like a nail. 3.Tool & authority-based organizational design may not be an ideal approach for thinking strategically and proactively about questions of economic statecraft. Siloed paradigms make it difficult to design and implement integrated strategy that is able to leverage and draw on a number of potentially reinforcing policy approaches.

[7] Laffont, Jean-Jacques, and Jean Tirole. "The politics of government decision-making: A theory of regulatory capture." *The quarterly journal of economics* 106, no. 4 (1991): 1089-1127; Dal Bó, Ernesto. "Regulatory capture: A review." *Oxford review of economic policy* 22, no. 2 (2006): 203-225; Bawn, Kathleen, Martin Cohen, David Karol, Seth Masket, Hans Noel, and John Zaller. "A theory of political parties: Groups, policy demands and nominations in American politics." *Perspectives on Politics* 10, no. 3 (2012): 571-597; Levine, Michael E., and Jennifer L. Forrence. "Regulatory capture, public interest, and the public agenda: Toward a synthesis." *Journal of Law Economics & Organizations.* 6 (1990): 167.

[8] Asahina, Hiroshi, "Japan seeks to release rare earths, 10 other critical items from China's grip," Nikkei Asia 21 Dec 2022 available online at: https://asia.nikkei.com/Spotlight/Supply-Chain/Japan-seeks-to-release-rare-earths-10-other-critical-items-from-China-s-grip. See also: *Act on the Promotion of Ensuring National Security through Integrated Implementation of Economic Measures* English text available online at: https://www.japaneselawtranslation.go.jp/en/laws/view/4523/en