



AP/Wide World Photo (Achmed Ibrahim)

# *the* **Global Redistribution** *of* **Economic Power**

This collection of three articles is an edited version of the authors' chapter contribution to *Global Strategic Assessment 2009: America's Security Role in a Changing World*, edited by Patrick M. Cronin (NDU Press, forthcoming).

Economic power is the bedrock of sustainable military and political power. The severity and expected duration of the financial crisis that gripped the world in 2008 make it all the more imperative to understand the national security implications of U.S. and global economic trends. The following collection of three short articles focuses on selected economic issues from a broad strategic perspective. The topics are diverse, but together they illustrate a key theme: the global redistribution of power.

# What Is Economic Power?

By ELLEN L. FROST

There is general agreement that in the 21<sup>st</sup> century, economic power is an important strategic asset. But what is economic power? How is it changing? And how can it be measured?

*Economic power* can be broadly defined as the ability to control or influence the behavior of others through the deliberate and politically motivated use of economic assets. *National economic power* implies that a government is in a position to use, offer, or withhold such assets even when they are in private hands (for example, by mandating trade embargoes or imposing controls on exports to targeted countries). In fact, the exercise of economic power may well have economic costs because almost by definition it entails interfering with decisions made for economic reasons.

Economic power can also be thought of as the ability to *resist* external control or influence because dependence on external suppliers is sufficiently diverse to preclude vulnerability to outside pressure. The United States, for instance, imports about two-thirds of its oil from foreign sources and is thus vulnerable to oil exporters as a group (although not to any one country). But what is sometimes forgotten is that sellers need markets. If the United States were to significantly reduce its appetite for foreign oil, it would gain relative economic power over these suppliers. Persuading others to establish a “consumer cartel,” as some have suggested, would have an even greater effect on the balance of economic power.

An extreme example of the ability to resist external control is economic self-sufficiency. Certain great empires of history, such as imperial China, were almost entirely self-sufficient. But in today’s world, the pursuit of economic self-sufficiency results in lower levels of technology and productivity

and a greater degree of poverty than would otherwise be the case (North Korea is a perfect example). If market forces are allowed to operate, some countries will be more self-sufficient than others, but none will be completely self-sufficient in all sectors.

National economic power has often been used to punish other governments. Whenever another government behaves in a way that violates international norms, a common U.S. response is a call for economic sanctions. Certain “smart sanctions”—such as denying U.S. visas to family members of dictators and freezing their bank accounts—may have some effect. But efforts to apply trade embargoes and other forms of economic coercion to influence another country’s political or military behavior fail more often than not, especially when the targeted regime perceives that the reforms sought by the outside world threaten its survival. Worse still, economic sanctions often end up enriching elites, who have ready access to the black market, and impoverishing everybody else.

### **Globalization and Economic Power.**

Throughout much of recorded history, the assets associated with economic power consisted primarily of land, natural resources, and the ability to spend more than one’s adversaries on weapons and wars. In a global economy, these elements, while still important, contribute less to overall economic power than what societies and governments can create for themselves: sound financial and macroeconomic policies, an educated and adaptable work force, market-based competition, a supportive infrastructure (including transportation, communications, and energy distribution), and a stable and welcoming investment climate backed by good governance and predictable rules.

These self-created assets virtually guarantee a competitive niche in the global economy. They fueled the remarkable performance of Japan and the “four tigers” (South Korea, Taiwan, Hong Kong, and Singapore) during the 1970s and 1980s. Similarly, the reforms launched by Deng Xiaoping in the late 1970s transformed China from an autarkic economic backwater to the economic powerhouse it has become today. Thanks in part to China-centered production networks and widespread pro-market reforms, Asia has experienced robust growth. Its success should not be exaggerated, however; the region suffers from a variety of economic, political,

---

*self-created assets virtually guarantee a competitive niche in the global economy*

---

and demographic weaknesses. It is highly dependent on the global economy and remains vulnerable to internal and external shocks.

Just as globalization has altered the content of economic power, so has it limited the sovereignty associated with it. A single nation has only a partial ability to claim autonomous economic power and to use it unilaterally. China, for instance, still depends heavily on markets in North America, Europe, and Japan. This means that China’s national economic power cannot be wielded autonomously and at will because doing so would undermine the confidence of foreign investors and thus retard the economic growth that the Chinese leadership needs to maintain its legitimacy. China’s alleged “dollar weapon” is not a weapon at all.

Until fairly recently, products were made in one country and sold to customers

---

Dr. Ellen L. Frost is an Adjunct Research Fellow in the Institute for National Strategic Studies at the National Defense University and a Visiting Fellow at the Peterson Institute for International Economics.

in another. But thanks to the revolutions in transportation and information technology, most of the world's biggest companies now operate in numerous countries. Although the components of a product may come from multiple sources, that product's label usually records only the point of final assembly and shipment. Interdependence also characterizes the operation of international financial markets. The first decade of the 21<sup>st</sup> century has witnessed a major shift in financial power from the West to other parts of the world, particularly Asia. Countries in the region hold roughly two-thirds of the world's foreign exchange reserves. Well over half of those reserves are denominated in dollars, and much of that is recycled back into the U.S. economy. Foreign governments therefore have a large financial as well as a commercial stake in the health of the American economy.

Security ties help to explain the continuing predominance of the U.S. dollar as a major reserve currency. Other governments' decisions to accumulate dollar reserves and to link the management of their currencies to the movement of the dollar rest in part on the belief that the United States remains the predominant, if not the sole, provider of security. They watched in dismay as the fall in the value of the dollar caused the value of their dollar-denominated assets to tumble. In the future, their mix of reserve currencies may well continue to shift toward the euro and the yen. Nevertheless, security ties with Washington will likely prevent them from tilting too far in this direction.

What governments can do to exercise financial power is extremely limited compared to the burgeoning size, speed, and pace of innovation in private capital markets. In the past, finance more or less followed trade flows, but financial flows now occupy a separate and ever-expanding universe. Private capital resources dwarf anything that governments and international institutions such as the World Bank and the International Monetary Fund (IMF) can provide. Governments with sufficiently good credit ratings prefer to borrow from private sources, thus avoiding the politically onerous conditions often placed on support packages negotiated with the IMF or the World Bank.

Financial flows provide needed liquidity (ready cash) to international markets, but they can be extremely destabilizing. As Asians learned in the financial crisis of 1997–1998,

the sudden withdrawal of private capital can topple governments and send economies reeling. The proportion of Indonesians living in absolute poverty, for example, doubled almost overnight, from 13 to 26 percent. The credit crisis of 2008 stemmed from risky behavior on Wall Street, but stock markets around the world plunged.

**Measuring Economic Power.** The national security implications of economic power transcend the ability to finance a higher defense budget and field expensive weaponry. Signs that a country is on the road to economic power include a strong and stable currency, adequate foreign exchange reserves, inflows of foreign investment, rising productivity, manageable inflation, and a declining level of poverty. Other indicators reflect the degree of urbanization, levels of education, social indicators such as life expectancy, and others. All of these can be measured.

The most common indicator of economic power is the size of a country's *gross domestic product* (GDP), defined as the sum of consumption, gross investment, government spending, and exports, or alternatively, as the sum of all goods and services produced in a given year. GDP is calculated in two ways: by measuring output in terms of prevailing exchange rates, or by calculating the purchasing power parity of each currency relative to some standard (usually the U.S. dollar). To simplify, one measures how much a nation's output is worth abroad (usually in

---

*as a rule, developing countries grow faster than highly industrialized ones, provided they have reasonably good economic policies and a functioning government*

---

dollars), and the other measures how much people in one country have to pay for a given basket of goods compared to the price in other countries.

The rate of GDP growth is also a key measurement. As a general rule, developing countries grow faster than highly industrialized ones, provided they have reasonably good economic policies and a functioning government in place. Such countries start from a low base; double-digit growth, while impressive, is not uncommon.

GDP per capita is also widely used. Economists have predicted that several decades from now, China's GDP will surpass that of the United States. This achievement certainly signifies China's growing economic power. But because of its huge population, when this threshold is crossed China's GDP per capita will likely be only about one-quarter to one-third of the U.S. level. Which figure matters more to perceptions of economic power? The answer will vary according to the values and goals of the observer.

Several yardsticks have been developed to measure various other contributors to economic power, such as market-oriented policies and low levels of corruption. The World Economic Forum's *Global Competitiveness Report* measures "the productive potential of nations." Top marks in 2007 went to Switzerland, Denmark, and Sweden, while China weighed in at 34<sup>th</sup> and India 48<sup>th</sup> out of 131 countries polled. The International Finance Corporation's 2007 report on the ease or difficulty of doing business abroad names Singapore, New Zealand, and the United States as the top 3 among the 181 economies that were ranked, with Guinea-Bissau, the Central African Republic, and the Democratic Republic of Congo bringing up the rear; China and India are ranked 83<sup>d</sup> and 120<sup>th</sup>, respectively. Another index, produced by the Heritage Foundation and the *Wall Street Journal*, measures "economic freedom": top winners in 2008 are Hong Kong and Singapore, with the United States ranked fifth.

Good governance is a key pillar of durable economic power. Politicians who demand huge bribes and send millions of dollars to foreign bank accounts stunt their countries' development in multiple ways. An index developed by Transparency International measures perceptions of corruption. Based on a scale of 1 to 10 (10 means least corrupt), top prizes in 2007 went to the Nordic countries, New Zealand, and Singapore. The United States trails at 7.2 points, and China and India are tied at 3.5.

Concern for the environment has given rise to several indices of "sustainability." The idea here is not only that the environment should be protected, but also that GDP growth will falter if a government depletes its natural resources and sickens its people.

Small countries may get high marks in these various contests, but size matters.

Executives from Big Three manufacturers and United Auto Workers union testify before Senate Banking Committee on auto industry bailout, December 2008



It used to be said, for example, that a large population of poor people was a liability. But as markets grow, large numbers of people who are eager for jobs, education, and training are now seen as an asset. From this perspective, China, India, the United States, Russia, and Indonesia all carry economic weight no matter what they do.

Finally, two related elements of economic power are popularity and prestige. If a given country is highly anti-American, resistance to U.S. economic power will be stronger. A trade minister from a country whose press spews forth daily attacks on the United States will have less freedom to make trade “concessions” than a trade minister from a country where the United States is admired and liked.

Prestige has been a longstanding American asset. Thanks to its huge market, skilled manpower, and ever-growing stock of leading-edge technology, the United States is still an economic powerhouse. But huge trade and budget deficits, heavy dependence on imported oil, record-high consumer debt, and rising levels of protectionism have tarnished America’s economic reputation and undermined U.S. influence abroad.

American prestige suffered a further blow in 2007, when the U.S. subprime

mortgage crisis sent many major U.S. financial institutions to Asian banks for relief. In September 2008, the crisis ballooned. The dramatic financial crash and associated bailouts shook Wall Street to its foundations and seriously undermined America’s economic image. Although the shakedown can be seen as a healthy corrective, it has diminished America’s near-term economic power.

***Economic Power and National Security Strategy.*** In today’s world, economic power has become largely synonymous

---

*strategic planners must understand global economic trends and incorporate them—not as an add-on, but as a core element of their analysis*

---

with successful engagement with the global economy. Paradoxically, the greater such engagement becomes, the more limits governments face when they contemplate using their country’s economic resources as a coercive tool to influence the behavior of other governments.

Used constructively, however, U.S. economic power bolsters Washington’s influence abroad. But sustaining such influence depends critically on sound policies at home. The risky behavior and lack of oversight that ultimately ignited the financial crash of 2008 damaged America’s relative power and influence. Restoring them requires paying heed to the old adage, “Physician, heal thyself.”

Sustained economic power is at the root of sustainable military power. Strategic planners need to overcome stovepipe thinking that consigns economic and security issues to different mental boxes. They must understand global economic trends and incorporate them—not as an add-on, but as a core element of their analysis. Drawing on this broader concept of national security, America’s elected leaders will be better equipped to make decisions about using economic power. They will also understand that America’s economic vitality, flexibility, and spirit of innovation are the true foundation of U.S. economic power, and that adopting the right mix of policies to sustain them is a national security imperative.