Chapter 10

Economics and National Security: The Dangers of Overcommitment

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As the global economy races ahead, more and more demands for U.S. security services are surfacing throughout the world. With this rapidly evolving scenario comes a pressing need for the United States to study the situation carefully and develop a comprehensive strategy in this arena. How best to proceed, from an economist's point of view, is explored in this chapter.

The crux of the problem is the growing connection between the global economy and security policy, including defense plans. The fact that such a connection exists should come as no surprise, for national policy saw these entities as connected during the Cold War. During that conflict, containment strategy sought to bottle up the Soviet bloc and employed a strong defense effort to support it. In tandem, U.S. policy also sought sustained economic growth across the entire Western alliance system, both to achieve prosperity and to build strategic strength for containment. In the current era of globalization, policies for security and economics must still be blended, but in ways different from those of the past. The United States has an interest in fostering worldwide economic growth as one way to help promote peace. It also needs an active security policy to address the turmoil and dangers that have bubbled up in the wake of the Cold War. A strong U.S. defense posture will be needed. It should be guided by economic thinking not only in using scarce resources wisely but also in being selective about military involvement and in prodding allies to contribute more to common defense burdens.

The focus of U.S. defense economics has shifted dramatically in the past 5 decades. In the 1950s, the shortages of World War II were still paramount in the thinking of most analysts. The United States was still essentially an industrial economy, and the Paley Commission report to President Harry Truman did an impressive job of projecting materials requirements and identifying countries and regions that were the source for vital American inputs.[1] The concentration on minerals and access to oil were also key factors in the way that strategists ranked defense priorities.

By the 1960s, the United States was at full employment, and the principal defense economics issue was how to get greater efficiency out of defense spending while still maintaining nuclear deterrence and a 2½ war conventional force strategy.

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These circumstances and the soaring costs of the Vietnam War strengthened the position of Secretary of Defense Robert McNamara and his systems analysts. Defense economics thus shifted predominantly to a focus on budgeting and micro issues.[2]

As the Vietnam War wound down, however, it became clear that the United States faced a continuing global competition with the Soviet Union, and there was renewed interest in the relationship between economics and global strategy.[3] As the Reagan defense buildup proceeded in the 1980s, there was intense controversy over the macroeconomic effects of defense spending[4] and increased interest in ways to encourage Allies to pay a larger share of defense burdens.[5]

It was not until the 1990s and the end of the Cold War, however, that economists started linking structural changes in the global economy to more fundamental questions about strategy. For example, if production and assembly of "American products" were going to be done on a truly global basis, where should the lines be drawn between vital and merely important interests? Also, if the defense industry was going to be downsized, to what extent could the Department of Defense rely on foreign suppliers for vital parts and cooperation during a war?[6]

Neither the Bush nor Clinton administrations made much progress on developing a grand strategy to replace containment as an overarching set of guidelines for U.S. security policy.[7] The Bush administration recognized that, after 1989, the probability of a global military conflict had declined significantly and thus turned its attention to regional flashpoints that could potentially escalate to major wars. The East Asian strategy initiative was designed to reassure states in the Pacific Basin that the United States was not withdrawing its defense guarantees, and the Persian Gulf War of 1990–1991 promptly illustrated that U.S. power would still be used to protect access to vital fuel supplies.

On balance, however, this still left the United States without a clear set of international security priorities. The Clinton administration never faced a decision about a major war and used the military primarily to defend the no-fly zone in Iraq and to participate in a series of humanitarian interventions in Somalia, Haiti, Bosnia, and Kosovo. These latter interventions alerted observers to the virtually unlimited supply of ethnic and religious animosities around the globe that could flare into violence and lead to calls for troops to restore order.

Demand for troops is rising because the United States currently dominates the international stage in a truly unprecedented manner. It is the world's leading trading state, has the world's largest capital markets, and is the principal source of technical innovation in the globe's fastest growing business sectors (that is, telecommunications, computers, Internet-related business, and biotechnology).[8] In addition, American culture is widely accepted around the globe, especially by the young who will shape trends in future decades; the U.S. political system, particularly open democracy, is broadly respected; and American civil society, with its large number of nongovernmental organizations, has had a profound influence on the press and the nature of international public discourse.[9] Academics have long debated how to define hegemony, but there is little doubt that a state dominant economically, politically, and militarily is able to shape the world agenda.

The Perspective of Defense Economics

Within the broader patterns of economic change discussed earlier, two major developments in the 1990s fundamentally altered the way a defense economist would see the security calculus.

Clearly, the most critical change was the disintegration of the Soviet Union. Although Russia still possesses a vast arsenal of nuclear weapons, it no longer has the economic strength to project conventional power beyond its borders. This means that defense choices can be made without an ever-present worry about a threatening response from Moscow.[10] American defense economics is thus freed from the constraint of bipolarity and can concentrate on choosing an optimal force size with long-term structural objectives in mind.

The second development is the liberalization and rapid growth of the world economy. As barriers to trade have fallen and the global transfer of capital and technology has soared, there is no question that the very nature of the world economy has been transformed. As recently as three decades ago, it was reasonable for economists to assume that countries had relatively fixed endowments of land, labor, and technology and that these "givens" could change only gradually through specialization in trade or from new investments.[11] Today there is dramatic evidence of how improvements in finance, communications infrastructure, and the process of transferring technology have made it possible for formerly agricultural states to be producing high-technology products.

The scale of the transformation is stunning. World trade in goods and services grew at an annual average of 4.7 percent in the 1980s and accelerated to a yearly growth rate of 6.1 percent in the 1990s. Even accounting for the volatility of the past few years, real gross domestic product (GDP) annual growth rates in the developing countries increased from an average of 4.2 percent in the 1980s to 5.4 percent in the 1990s.[12]

The driving force behind this transformation, and the destination for many of the world's exports, has been the United States. The openness of the American economy, the breadth and versatility of its capital markets, and the extraordinary rate of technical innovation have led most countries to plan their economic expansion on access to American markets. The current account deficit (goods and services plus net transfers) has skyrocketed from $4.1 billion in 1991 to an estimated $300+ billion in 2000. This pattern, where the United States is the sponge for the world's goods, is not sustainable in the long run. Yet, shutting U.S. borders would throw the world into recession and raise prices for consumers. Consequently, adjustments need to be gradual and carefully thought out.

The Pros and Cons of Being the World's Dominant Economy

The United States has two enormous advantages at this moment in time, as the world's economy is being globalized. First, our domestic currency is the world's primary medium of exchange. This means that the United States can run trade deficits and many foreign individuals, corporations, and governments are willing to accept U.S. dollars in payment. This currently allows the United States to consume more than it produces. At some point, the rest of the world's appetite for dollars will drop. Until that time, most Americans have an artificially higher standard of living than they would otherwise.

Second, being the dominant economy allows American firms to set the standards in fast-growing industries like software, microprocessors, and biotechnology. Even where foreign suppliers may have superior technology, American firms have a significant edge because the scale and openness of the economy means that few producers will risk going against standards set in the United States. Moreover, since there are supernormal profits to be gained by being the first in many knowledge-based industries (because the incremental cost of producing is much lower than the cost of the first unit), American firms are likely to reap above-average returns until there is a true technological challenger. This permits high rates of research and development spending, which helps maintain economic dominance. Most residents in the United States do not fully appreciate these advantages but benefit from them nonetheless.

There are two distinct disadvantages in the current position, however. The most immediate concern is the soaring current account deficit. In the 1980s, many economists took the position that the trade deficit was not overly worrisome because the United States was the world's leading exporter of services, from architectural design to financial management. It was widely claimed that the deficit in traded goods was being overemphasized and that surpluses on services would counterbalance deficits on trade. Surging imports in the 1990s and growing payments to foreign lenders and investors discredited the naïve optimism of the 1980s, and the United States now runs massive trade and current account deficits. This matters because American profligacy is piling up hundreds of billions of dollars held by foreigners. These dollars are essentially IOUs. As long as overseas holders of American dollars prefer the dollar to other currencies, the United States can continue to print little green pieces of paper and take other countries' goods in return. At some point, this officially sanctioned approach will be fully understood, and many holders of U.S. dollars will sell them. Then, the dollar will drop in value; imports will go up in price, causing inflation; and the average U.S. citizen will experience a drop in his or her living standard.

The second major disadvantage of the current U.S. global dominance is that most Americans think this is a normal situation. It is not, and it will not last.

The danger in thinking that preeminence is normal and will continue indefinitely is that it leads to overcommitments of resources and resentment by less powerful states. Overcommitment of resources can be self-correcting; however, once coalitions of resentful nations are formed, they could last for long periods and persistently pursue measures to inhibit U.S. actions and values.

The following discussion will distill these introductory remarks into seven propositions and then attempt to relate the broader trends experienced in globalization to specific implications for U.S. security policy.

Seven Propositions

Before laying out the propositions, it is necessary to define some terms. *Globalization* will be used to mean the creation of truly worldwide markets on the input side for labor, capital, and technology and on the output side for final products and services. Although it may be true that trade accounted for a higher percentage of world GDP during several decades of the 19th century than is the case today, that is not central to the issues before us now. It is the change in the character and the extent of international interaction that make globalization today more intrusive and more important than the forms it took in the Victorian period.[13]

Specifically, there are two aspects of globalization today that make it different from past periods of open trade: the pervasiveness of outside political and cultural influences makes it extremely difficult for non-Western cultures to preserve their autonomy,[14] and the speed with which orders for trade, capital, and technology are carried out makes it much harder for governments to respond when a crisis develops.[15] Since open capital markets often put unsustainable stress on the banking, insurance, and regulatory sectors of developing countries, it is not surprising that countries like China, India, and Malaysia have chosen various forms of capital controls and resistance to aspects of economic globalization.

The term *industrial democracies* is self-defining and will be used as synonymous with the members of the Organization for Economic Cooperation and Development. All of the industrial democracies are intricately linked to the global economy. The term *transition states* will be used, in its economic sense, for countries that are partially integrated within the global economy.[16] Transition states are typically ones that have a vibrant modern sector of high per capita incomes and modern technology coexisting with a traditional sector of agriculture and extractive industries. Governments of the transition states, which include a mixture of authoritarian and democratic states, are often deeply ambivalent about how closely they want to be linked to the global economy and frequently attempt to limit the influence of outside economic, political, or cultural influences.[17] *Traditional states* will be defined as those in Asia, Africa, the Middle East, Latin America, and parts of the former Soviet Union that often have low incomes, low levels of technical skills, and only rudimentary links to the world economy.

The seven propositions that form the core argument of this chapter are the following:

1. In the next decade, fundamental security challenges (those that threaten large parts of the American population) are likely to come only from the large transition states that have the economic strength and technical prowess to inflict widespread physical damage or massive economic disorder.

2. Smaller transition and traditional states, as well as assorted terrorist groups, might be able to damage selected areas of the United States but are unlikely to be able to threaten the basic integrity of American society.

3. Overall globalization is an accelerating trend with such a large number of complex interactions that it is impossible to adequately model or accurately predict the full range of its social, political, and military implications.

4. However, the economic aspects of globalization have been under way for a sufficiently long time that the United States can probably make acceptable estimates of the likely direction and impact that world economic integration is having and ways in which the character of the world economy will evolve in the next decade.

5. Current levels of U.S. defense spending do not significantly detract from the long-term growth potential of the economy; given the plausible challenges of the next decade, the United States is fully capable of defending itself against direct threats to its population and national integrity.

6. Nevertheless, because the United States is so dominant economically and militarily, its allies and many other nations expect it to provide stability and security protection in large parts of the globe where vital national interests are not involved. Much of the future debate about linkage between economics and security will thus be focused on the extent to which American taxpayers should provide systems maintenance for the world.

7. If the current trend of increasing U.S. involvement in police actions and maintenance of order in the Third World continues, military readiness will be affected; also, it will be harder to maintain military superiority and research and development levels necessary for military dominance. Hence, it will be essential to develop criteria for deciding when to participate in police actions and limiting the tendency of allies and independent states to free-ride on the provision of global security protection.

To put the current problems associated with globalization in perspective, it is useful to review briefly how the United States developed policies to smooth the effects of business cycles and limit instability in the financial sector. It took the United States almost 140 years to develop resilient financial institutions and several generations (between the 1890s and the 1960s) to develop a consensus on the appropriate role for the United States in the international economic arena. This is critical for policymakers and security analysts in Washington to understand because Americans are often impatient with developing countries that resist opening their traded-goods and capital markets.

In most cases, the Department of Defense (DOD) does not need to formally intervene in Government deliberations on macroeconomic policy toward the Third World. However, the economics profession has been chastened by the havoc wrought by capital market liberalization in East Asia in the early 1990s, when few countries were adequately prepared for it. Thus, it is helpful to understand the problems that the United States had in developing sound financial institutions and a consistent direction for its international economic policy.

U.S. Economic Policy in Historical Perspective

It is hard for present-day Americans to understand how vulnerable the American economy was to external shocks and financial panics before the establishment of a competent central bank and a Federal commitment to full employment. Countries in the Third World must develop sufficiently resilient institutions so that they, too, can weather the vicissitudes of inevitable shocks from fluctuations in financial flows and assorted business collapses.

Although it is well known that in the 19th century there were long-standing differences between the American states of the North and of the South regarding tariffs,[18] the most bitter economic policy debate at the time was over whether to establish a central bank. Secretary of the Treasury Alexander Hamilton and the Federalists favored a Bank of the United States, while Thomas Jefferson and James Madison opposed it.[19] The Bank was established, but subsequently its charter was revoked. For much of the 19th century, individual banks issued their own currencies, and there were frequent bank panics. Banking regulation was intermittent until 1913, when the Federal Reserve System was established. Moreover, it was not until the end of World War II that the principle of Federal Reserve independence was fully accepted.

Trade policy in the United States has gone through similar swings in sentiment, at times favoring free trade but also having long periods of protectionism. By the 1890s, American manufacturing was booming, the United States began to run a trade surplus, and many businessmen favored a mercantilist strategy. As a Congressman, William McKinley pushed through a highly protective tariff, and protectionist sentiment dominated even through the Progressive Era up to the enactment of the Smoot-Hawley Tariff of 1929.[20]

The panic of 1896 made the public aware that a completely unregulated economy was prone to dangerous cycles, but the free silver movement and deep skepticism about concentrating power in Washington still prevented the creation of an American central bank for another two decades. Thus, it should come as no surprise today if developing countries have difficulty in deciding how to regulate their financial sectors.

Interestingly, however, it was in the 1890s when the United States developed its first modern conception of the links between economic and security policy. Alfred Thayer Mahan was a prominent advocate of using sea power to project American values and influence,[21] and there was growing acceptance of the need to develop sophisticated capital markets and gain access in foreign countries for American exports.[22] This approach clearly influenced Congressional and executive branch thinking at the time of the Spanish-American War and during the advocacy of the open door policy toward China.

The mercantilist worldview dominated until the downward spiral of the Depression in the 1930s. It was only with the intellectual ferment over how to deal with the devastation of the Depression and how to restructure international trade and finance after World War II that the current liberal synthesis was developed. United States economists and financiers took the lead in 1945 in creating a sharply different conception of how the United States should interact with the world economy.

The post-World War II conception was based on three elements: (1) careful bank regulation and an active monetary policy guided by the Federal Reserve System, (2) countercyclical fiscal policy and a commitment to full employment, and (3) open markets and efforts to stimulate world economic growth, using the World Bank and International Monetary Fund.[23]

There was a consensus among economists that the Federal Reserve had been too contractionary in the 1929–1935 period, so it needed to see growth and inflation as tradeoffs and aim for an appropriate balance. The Full Employment Act of 1947 was a key commitment to lower income workers, demonstrating that their interests would be considered if they would go along with a less protectionist, open economy.[24] The international financial institutions (World Bank and IMF) were to help moderate the type of mercantilist behavior that had deepened the Depression.[25]

In summary, it took the United States almost 60 years from its rise as an industrial power, until 1945, to settle on a consistent conception of how it should deal with the world economy. Since then, there have been various efforts at shifting U.S. policy in a more protectionist direction, but there has been a broad consensus that U.S. interests are best promoted in an open-trading and financial system. Clearly, countries that have less competitive industry and fragile capital markets will be threatened by an open, globalized economy. Unless they can develop adequate domestic employment growth and sufficiently resilient banks, they will continue to prefer mercantilism for themselves and a free trade stance by the United States.

Formal Links between U.S. Economic and Security Policy

Many texts on defense economics concentrate first on microeconomic issues and then present the connection between defense topics and the broader economy.[26] In the following discussion that process will be reversed, as American trade, capital, and technology have a far greater effect on the world economy than do specific choices about U.S. defense spending.

The U.S. Global Presence

Concerning U.S. security policy, it is absolutely essential that the U.S. role in the world economy be appreciated as a key asset for leverage. To put it bluntly, most of our allies and many of our antagonists need us far more than we need them.

Although there is no question that the United States benefits from an open world economy, those countries that trade with the United States benefit even more. China, for example, sends over 40 percent of its exports to the United States alone and currently has a $60 billion annual trade surplus with the United States. American exporters would be hurt if trade were cut off with China, especially in the aircraft, machinery, and power equipment sectors. However, China's entire economic development strategy would be crushed if it were denied access to the American market.[27] Unfortunately, in the process of pursuing open global markets (which is definitely in the long-term interest of the United States), U.S. policymakers often neglect the specific bilateral influence that the United States has.[28]

The size and openness of American markets is an enormous inducement for other countries to cooperate with the United States. Similarly, American influence in the World Bank and IMF provides an indirect but substantial form of additional inducements. Recent protests in Seattle against the World Trade Organization and in Washington against the World Bank and IMF may appear to undercut the legitimacy of these international organizations but in fact are a true sign of their power, as it is pointless to protest against an entity that has no influence.

The United States also has three forms of bilateral assistance that can be used to strengthen its security position: aid, investment guarantees, and export financing. The U.S. Agency for International Development, the Overseas Private Investment Corporation, and the U.S. Export-Import Bank can all provide key resources to vital countries.

Thus, in addition to its political, military, and cultural influence, the United States has a truly unmatched range of economic options for dealing with cooperative or antagonistic states. In the future, security planners need to look more closely at the tradeoffs between using military or economic options. Both have costs and both can generate adverse reactions, but they should increasingly be seen as complements, not supplements.

The Defense Industrial Base

True globalization of trade, capital, and technology flows provides both opportunities and difficulties for maintaining the American industrial base. On balance, it makes the process of getting standardized parts far easier because they are available from a greater variety of vendors. It also improves interoperability with allies, as globalized markets reward interchangeable parts and compatibility in software.[29]

By the same token, however, globalization makes it easier for antagonists of the United States to get American technology, to train with it, and—presumably—to learn how to foil it. This places a premium on keeping a U.S. lead in essential defense technologies and having the wherewithal to tell even close allies that certain items simply cannot be shared.

Jacques Gansler provides sensible advice in noting that adapting to the post-Cold War environment requires major adjustments on the part of both government and business, by allowing contractors more flexibility in sourcing; continuing to emphasize technological leadership; and upgrading the quality of the U.S. workforce at all levels.[30] The implications of these trends are explored below. It is clear that the military services will need to develop a greater capacity for working directly with a broader range of private contractors (domestic and foreign) in peacetime and wartime.

Natural Resource Planning

As the United States has shifted from an industrial to a service economy, the livelihood of its citizens depends less on imported raw materials than it did at the time of the Paley Commission. The United States is less worried about chrome from East Africa or copper from Chile than it once was. Also, as materials science has become more sophisticated, it has yielded a host of synthetic products that can directly substitute for natural ones or prior manufactured ones.[31]

The principal exception to this pattern is oil. In the highly suburbanized society that the United States has become, there is still no substitute for gasoline. Natural gas could, eventually, heat most homes. Also, at some point there may be cars with combination battery-powered and internal combustion engines. Yet, unless there are some unforeseen major technological breakthroughs, the United States will remain highly dependent upon imported oil and the world will be increasingly dependent upon Persian Gulf oil.

States in the Persian Gulf area that are members of OPEC are expected to increase their daily exports of oil from 25 million barrels per day (mbd) in the year 2000 to 45 mbd in 2020.[32] Even with secondary and tertiary recovery techniques being employed, most other areas of the world will see only modest changes in levels of production. This means that the Persian Gulf will remain an absolutely vital region of U.S. security concern and, by some measures, could become even more important in our calculus than it is today.

So, although materials in general will be less important in shaping security priorities in the future than now, maintaining stability in the Persian Gulf and an adequate strategic petroleum reserve (SPR) will warrant even greater attention. Since our principal allies (Europe, Japan, and South Korea) are far more dependent on Persian Gulf oil than we are, this natural resource vulnerability will require extensive future discussions on burden-sharing.

Implications of Economic Globalization for Security Interests

Economic globalization has three principal implications for U.S. security interests: the distinction between the defense sector and the economy at large is diminishing and will require DOD to adopt more efficient techniques for gaining the benefits of links to the global economy; more preparations need to be made for dealing with the effects of market disruption; and there are various unresolved policy dilemmas that will affect the way the United States deals with economic issues in developing countries. Although the military services will not have the lead in shaping these initiatives, DOD needs to be attentive to them.

Adapting to the New Economy

United States private sector firms are now spending hundreds of billions of dollars to upgrade their computer and information handling systems. This, in turn, is fundamentally reshaping the way "just in time" production, warehousing, and distribution is done.[33] If DOD does not stay current with these changes, it will not be able to gain the full advantages of lower cost supplies and wider availability of parts.[34] Business-to-business Web sites now offer thousands of standardized and customized products in such diverse areas as steel plate and dynamic random access memories.

Not only will DOD need to use these sources for its own purchasing, but also it will need to develop adequate intelligence methods for ensuring that its products are not contaminated, while at the same time figuring out the weaknesses of its antagonists' supplies. Adjusting to these changes is already under way, but it will remain a costly and ever-present feature of DOD operations because the training involved and the assorted downtimes associated with systems failure are likely to be more costly than the equipment itself.

The U.S. Government as a whole must also become more realistic about sanctions. When parts can be bought anonymously or with fake identifications, it will be increasingly difficult to impose effective boycotts. This, combined with the greater speed of technology transfer through the Internet, could mean ironically that the

United States may need to overwhelm certain antagonists with quantity because quality differentials in weapons have been reduced.

Preparations for Market Disruptions

The oil shocks of 1973–1974 and 1978–1979 led to the creation of the International Energy Agency and various strategic petroleum reserves in the major industrial countries. This has had a calming effect in the intervening two decades as businesses and consumers were reassured that basic needs could be met in new crisis periods.[35] Obviously, the United States needs to keep its SPR at adequate levels, given anticipated future demand.

The more difficult issue is how to deal with financial contagion. Former Secretary of the Treasury Robert Rubin is now publicly acknowledging how close the world came to a financial sector implosion in 1997–1998 as the East Asian crisis spread to Russia and Brazil and as highly leveraged hedge funds such as Long-Term Capital Management collapsed. Dealing with these issues will always be primarily a Treasury function, but DOD needs to have staff who understands the issues and can analyze the implications of such crises for U.S. security commitments. There also may be instances where DOD short-term interests are hurt by efforts to achieve longer term stability of the financial system. For example, it may be more important to build up crisis stabilization funds at Treasury and IMF than it is to write off specific country debt under DOD loan programs.[36]

Unresolved Policy Dilemmas

The globalization trend has spawned at least three policy questions that provoke fundamental disagreement among specialists: Should lower income countries try to maximize their economic growth rates? How far should countries go in opening their capital markets? Will greater integration with the global economy reduce or accentuate inequality within traditional and transition states?

For the last half of the 20th century, most economists assumed that countries should try to maximize, or at least increase, their GDP growth rates. Although there have been sharp differences over how to achieve greater equity in income distribution, the general presumption was that more growth and a larger GDP were better.[37] Moreover, by the middle 1990s, there was broad agreement among Western development economists that a common set of policies was likely to achieve promising results. According to this view, the emphasis should be on balanced budgets, low inflation, high savings and investment rates, and the use of open markets as a means to force efficiency in the economy. Because the World Bank, IMF, and the U.S. Government supported this view, it became known as the Washington Consensus.

The World Bank was so confident of this approach that in 1993 it published a primer on how the East Asian states had used this model to achieve their rapid growth rates.[38] However, the slowdown of the Japanese economy in the 1990s and the East Asian crash of 1997 brought more scrutiny to the debate. The linchpin of growth for the East Asian states had been their strategies to emphasize exports (and particularly access to the American market) as a way to generate foreign exchange to pay for imports that modernized their economies. Today, a sizable group of economists is skeptical of the wrenching changes that the East Asian states went through to achieve their export-oriented growth, and there is now interest in strategies that focus more on internal changes and accept lower GDP growth.[39]

The debate over how open an economy should be is a longstanding one. French mercantilists favored protection in the 1700s, the United States was protectionist for long periods, and most developing countries have pursued a mix of some protection and export promotion. In the 1950s, Ragnar Nurkse stressed the problem that raw material exporters faced with the high volatility and low-income elasticity of demand for their products.[40] The East Asian states became even more vulnerable because they tied their growth prospects to foreign markets, foreign technology, and foreign capital. Paul Krugman sees the weaknesses of the East Asian development pattern as relying too much on high savings and investment rates and not placing sufficient focus on selecting efficient investments and improving productivity.[41] Jeffrey Sachs, on the other hand, sharply criticizes IMF and the Washington Consensus for advocating a risky strategy to begin with and then imposing an overly contractionary policy once the 1997 crisis was under way.[42]

A key element in the growth debate is intense controversy over the desirability of linking the small capital markets of traditional and transition states with the large and highly liquid markets found in Tokyo, London, and New York.[43] The Washington Consensus stressed the opening of capital markets as a way to move money to its most efficient use, but many countries have found volatile flows in and out too difficult to handle.[44] Hence, after the East Asian crisis and the turmoil in Brazil and Russia, there is a heightened caution about capital market openness.[45]

These challenges to the Washington Consensus have led to an even broader critique of economic development strategies. Amartya Sen, for example, has argued that democracy is a desirable goal on its own and that enfranchised citizens will press for more equitable growth policies; these, in turn, will ultimately prove a more stable basis for development because citizens will then have both choice and growth.[46]

The growth, market integration, and equity debates are clearly unresolved, but they do bring into question the desirability of U.S. pressure on countries to open their capital markets, unless new kinds of protective buffers can be found for those with fragile economies. It would also be prudent for DOD to anticipate increasing challenges to the argument that globalization is good for all. Growing democratization might also be expected to lead to protectionism and nationalism, rather than to the acceptance of common world standards for economic and social policy as advocated so frequently by some in Washington.[47]

Conclusions

The foregoing analysis of the links between economic globalization and U.S. national security leads to four basic conclusions.

The Military Services and OSD Need Better Economic Analysis

The military services and the Office of the Secretary of Defense (OSD) have long had a small group of systems analysts who are skilled and effective at using quantitative techniques on budgeting questions. As it is clear that global economic issues will be increasingly affecting military choices, DOD should consider two initiatives to improve its capability to deal with economic topics: contracting for economic information tailored to military needs at all levels of the officer corps and civilian leadership and supporting a larger number of officers to obtain training in economics at the M.A. and Ph.D. level so that DOD will have a broader range of trained staff to deal with future economic topics.

DOD Should Acknowledge the Value of Steady, Sustainable Growth in Developing Countries

There is no perfect correlation between economic growth and political stability. In fact, the recent East Asian economic crisis illustrates that rapid growth can be destabilizing. However, in the long run, stability depends upon creating jobs and opportunity for young people entering the job market and a rising living standard for those already working. This requires economic growth.

Steady sustainable growth is important because high variability in growth rates leads to speculative behavior during booms and deep pessimism and resentment during downturns. Hence, DOD and the military services need to recognize that their interests and the interests of vulnerable economies are often intertwined. This may well mean that DOD personnel will need to pay more attention to economic behavior in traditional and transition states, by being more attentive to levels of defense spending, corruption, demography, and ways to dovetail defense programs with broader development objectives.

The United States Should Resist Overcommitment

In the Cold War period, many administrations were prone to overcommitment because they saw global jockeying for power as a zero-sum game with the Soviet Union. The Sino-Soviet split provided an opportunity for more complex brokerage and enabled President Richard Nixon to proceed with the opening to China and the Guam doctrine simultaneously.[48]

The United States has even more maneuverability today. It has no direct military challenge. Unfortunately, however, since 1989 DOD has been asked to take on a growing list of police actions that are not linked to U.S. vital interests. Maintaining the no-fly zone in Iraq is questionable policy, but it is clearly in a vital country. The interventions in Somalia, Haiti, Bosnia, and Kosovo illustrate the fact that crises lead to calls for action and, unless the United States is willing to be strict with its commitments, there will be virtually infinite demand for its police services. In the future, the American economy may not be so vibrant, and the United States will regret its presidents' essentially unlimited commitments of U.S. peacekeepers.

In Somalia, Haiti, and Bosnia, the United States has used essentially main force troops for police functions. Many of the troops were not trained for these tasks. Most importantly, the world was left with the impression that U.S. forces would be available for global police duty. If a conflict is occurring in a country or region of vital interest to the United States, using U.S. troops to enforce peace is legitimate. Policing or peace maintenance should be done by international organizations, however. Otherwise, the United States will get involved in a vast array of inconsequential disputes that no great power can afford. Hence, the United States should see value in supporting competent international peacekeeping forces under United Nations or regional organization command.

The United States Should Minimize Free-Riding

During the 1950s and 1960s, U.S. allies had an incentive to underinvest in conventional defense because they were confident about the U.S. nuclear guarantee or were unsure if a war was worth winning if it was fought on their soil. Only with great effort did the United States ultimately convince its allies that increased spending on conventional forces increased their military options.

Unfortunately, in the post-Cold War period, the United States has lost its leverage with its allies because, with the exception of China, there is no major state that is sharply increasing defense expenditures or seems likely to coerce its neighbors. In this environment, only the states on China's periphery and those in the Middle East have enough concern about being attacked that they will join with the United States to agree on maintaining prespecified defense capabilities.

Consequently, most U.S. allies (except those that feel truly vulnerable) have an incentive to free-ride on U.S. security protection. In fact, even countries that are neutral or hostile to the United States free-ride, enjoying U.S. defense of the sea-lanes and U.S. intervention to calm quarrelsome neighbors. Most Dominicans were privately glad that U.S. troops occupied Haiti; many Ethiopians were pleased when U.S. forces intervened in Somalia; and many Croats and Slovenes appreciated outside troops' restoring order in Bosnia. Yet, none of these countries has the slightest sense of obligation to help defray U.S. expenses. That pattern will not change unless the United States is more sparing in its commitments. Therefore, the United States must make the distinction between vital and peripheral interests. Otherwise, the rest of the world will have an incentive to exhaust American goodwill and resources.

Summary

In sum, it is possible to identify the broad directions that economic globalization is taking. There are strong incentives for producers and consumers to take advantage of the global marketplace. This will make it difficult for countries to cut off the access that their firms and citizens have to outside suppliers of capital, goods, technology, and information.

Nevertheless, if the turmoil caused by massive capital flows is great, if competition against local producers is daunting, and if outside information threatens regimes, efforts will certainly be made to limit the impact of global markets. Thus, it is substantially harder to predict the political, cultural, and security implications of globalization.

Because the current level of DOD spending does not adversely affect the American economy, the United States does not face the kind of built-in limits to defense spending that it did during the Cold War. Hence, it is important for U.S. decision-makers to set limits to U.S. commitments. Otherwise, U.S. resources will be spread around the globe on low-priority problems, and inadequate investments will be made to maintain readiness and military superiority.

Notes

[1] William S. Paley, *The Report of the President's Materials Policy Commission* (Washington, DC: Government Printing Office, June 1952).

[2] Alain C. Enthoven and K. Wayne Smith, *How Much Is Enough? Shaping the Defense Program, 1961–1969* (New York: Harper and Row, 1971).

[3] Charles J. Hitch and Roland N. McKean, *The Economics of Defense in the Nuclear Age* (New York: Atheneum, 1975).

[4] Lester Thurow, "How to Wreck the Economy," *New York Review of Books* (May 14, 1981), 3–8.

[5] David B.H. Denoon, ed., *Constraints on Strategy: The Economics of Western Security* (Washington, DC: Pergamon-Brassey's, 1986).

[6] Jacques Gansler, *Defense Conversion* (Cambridge, MA: MIT Press, 1995), 85–102.

[7] For a discussion of how different nations have developed national strategies, see Paul Kennedy, ed., *Grand Strategies in War and Peace* (New Haven, CT: Yale University Press, 1991).

[8] Council of Economic Advisors, *Annual Report of the Council of Economic Advisors* (Washington, DC: Government Printing Office, January 2000), 7–128.

[9] Robert Keohane and Joseph S. Nye, Jr., "Globalization: What's New? What's Not? (And So What?)" *Foreign Policy* 118 (Spring 2000), 104–118. For example, the number of international nongovernmental organizations has grown from about 6,000 in 1990 to over 26,000 in 2000.

[10] President Vladimir Putin's decision to visit Pyongyang in July 2000 (announced 5 days after his June 2000 summit with President Clinton) is an indication that the Russians intend to pursue an independent foreign policy, which, to the extent possible, maintains Moscow's influence in Asia.

[11] Charles Kindleberger, *International Trade* (Homewood, IL: Irwin, 1963), chapter 7.

[12] These growth rates for trade and services in the 1990s even overcame the effects of the Mexican and Asian financial crises. See International Monetary Fund, *The World Economic Outlook—1999* (Washington, DC: International Monetary Fund, May 1999), 145, 167.

[13] For a debate on these points, see Sylvia Ostry and Richard Nelson, *Techno-Nationalism and Techno-Globalism* (Washington, DC: The Brookings Institution, 1995), especially chapter 1, "The Decline of American Hegemony," 1–27.

[14] D. Nettle and S. Romaine, *Vanishing Views: The Extinction of the World's Languages* (New York: Oxford University Press, 2000).

[15] S. Arndt, "Globalization and the Open Economy," *North American Journal of Economics and Finance* 8, no. 3 (1997), 71–79.

[16] This is a different use of the term *transition* than in the literature dealing with the change from authoritarian to democratic states.

[17] There are some similarities between my term *transitional states* and Paul Kennedy's term *pivotal states*, but they are not identical because, clearly, not all transitional states are pivotal. See R. Chase,

Emily Hill, and P. Kennedy, "Pivotal States and U.S. Strategy," *Foreign Affairs* 75, no. 1 (January/February 1996), 33–51.

[18] The North with a budding industrial sector favored protection, while the South was primarily agricultural and favored free trade (so it could get manufactured imports at the lowest possible prices).

[19] John Garraty and Peter Gay, eds., *The Columbia History of the World* (New York: Harper and Row, 1981), 793.

[20] Thomas Paterson, ed., *Major Problems in American Foreign Policy—Volume I: to 1914* (Lexington, MA: DC Heath, 1989), 353.

[21] Alfred Thayer Mahan, *The Influence of Sea Power on History 1660–1805*, repr. (Englewood Cliffs, NJ: Prentice Hall, 1980).

[22] Robert Beisner, *From the Old Diplomacy to the New* (New York: Harlan Davidson, Inc., 1986), 32–34.

[23] The designers of the World Bank and IMF had hoped to create the International Trade Organization as well, but the U.S. Congress balked at ceding this much power to an international trade body. So, the weaker General Agreement on Tariffs and Trade was formed instead.

[24] President Truman proposed a mixture of pro-labor and pro-business legislation in the early post-World War II years. See Michael Barone, *Our Country—The Shaping of America from Roosevelt to Reagan* (New York: Free Press, 1990), 185.

[25] For an overview of how these institutions were created, see Robert Solomon, *The International Monetary System* (New York: Harper and Row, 1977).

[26] See, for example, Lee R. Olvey, James D. Golden, and Robert Kelly, *The Economics of National Security: Weighing the Costs of Defense* (Wayne, NJ: Avery, 1984).

[27] For discussion of the pros and cons of different types of sanctions, see David Baldwin, "The Sanctions Debate and Logic of Choice," *International Security* 24, no. 3 (Winter 1999/2000), 80–107.

[28] The U.S. decision to enter the World Trade Organization limits the circumstances under which Washington could impose bilateral sanctions, but they are not forbidden if the imperative of national security is invoked.

[29] This may make it less necessary for the United States to subsidize its allies through coproduction and codevelopment programs. For an overview of those programs from the 1950s to 1980s, see D.H. Denoon, *Arms Collaboration, Co-production and Industrial Participation Agreements* (Washington, DC: U.S. Department of Defense, August 1983).

[30] Gansler, *Defense Conversion*, 147.

[31] Carbon-carbon fibers replacing steel and aluminum is one notable example of the growing use of substitutes.

[32] Energy Information Administration, *International Energy Outlook* (Washington, DC: Energy Information Administration, 1999), Appendix D.

[33] For an overview of how high-technology companies are competing and the way in which their services are changing, see David Bunnell, *Making the Cisco Connection* (New York: Wiley, 2000).

[34] As an example of this pattern, it is now known that the Defense Advanced Research Projects Agency was able to get a new "friend vs. foe" identifying system bought and in the field within 16 days during the Persian Gulf War. If the contracting had been done under normal DOD procedures, it would doubtless have taken years.

[35] The oil price increases of 1973–1974 and 1978–1979 led to a widespread set of adjustments: power companies demonstrated that they could switch to cheaper fuels, firms reduced the energy content of their products, and consumers rewarded auto and appliance makers who produced fuel-efficient goods. This served notice to OPEC member-states that it was counterproductive to raise the price of oil to the level where it seriously affected demand.

[36] For a summary of policy options regarding the destabilizing effects of financial flows, see Carmen and Vincent Reinhart, "Some Lessons for Policy Makers Who Deal with the Mixed Blessing of Capital Flows," in *Capital Flows and Financial Crises*, ed. Miles Kahler (Ithaca, NY: Cornell University Press, 1998), 93–127.

[37] For an overview of this debate, see Gerald Meier, ed., *Leading Issues in Economic Development* (Oxford: Oxford University Press, 1995), 3–66.

[38] World Bank, *The East Asian Miracle* (Oxford: Oxford University Press, 1993).

[39] Dani Rodrik, *Has Globalization Gone Too Far?* (Washington, DC: Institute of International Economics, 1998).

[40] Ragnar Nurkse, *Problems of Capital Formation in Underdeveloped Countries* (New York: Oxford University Press, 1953).

[41] Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, no. 6 (November/December 1994), 62–78.

[42] Jeffrey Sachs, "International Economics: Unlocking the Mysteries of Globalization," *Foreign Policy* 110 (Spring 1998), 97–111.

[43] In 1996–1997, the International Monetary Fund designated capital market liberalization as one of its highest priorities.

[44] For an overview of the magnitudes involved and the difficulties that capital flows pose, see Barry Eichengreen and Albert Fishlow, "Contending with Capital Flows: What Is Different About the 1990s," in *Capital Flows and Financial Crises*, ed. Miles Kahler (Ithaca, NY: Cornell University Press, 1998), 23–68.

[45] For an argument that countries do not need open capital markets to get the benefits of trade competitiveness, see J. Bhagwati, "The Capital Myth," *Foreign Affairs* 77, no. 3 (May/June 1998), 7–12.

[46] Amartya Sen, *Development as Freedom* (New York: Knopf, 1998).

[47] See, for example, The White House, *A National Security Strategy for a New Century* (Washington, DC: Government Printing Office, December 1999), 3–4.

[48] In the Guam Doctrine, enunciated in July 1969, President Nixon urged U.S. allies to share a large part of the global defense burden. Nixon promised more military assistance but said the United States would make fewer direct military commitments overseas.