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Foreign Policy

The Currency of Power

Robert Zoellick

November 2012 -- Earlier this year, Bob Carr, Australia's foreign minister and a longtime friend of the United States, observed with Aussie clarity: "The United States is one budget deal away from restoring its global preeminence." He added a caution: "There are powers in the Asia-Pacific that are whispering that this time the United States will not get its act together, so others had best attend to them." Carr's insight -- that the connection between economics and security will determine America's future -- is sound and persuasive. Yet ever since the rise of "national security" as a concept at the start of the Cold War, economics has become the unappreciated subordinate of U.S. foreign policy. Today, the power of deficits, debt, and economic trend lines to shape security is staring the United States in the face. Others see it, even if America does not. Carr, a student of U.S. history, would probably not be surprised to learn that his warning echoes words drafted by Alexander Hamilton, America's first Treasury secretary, for President George Washington's farewell address: The new nation, Hamilton urged, must "cherish credit as a means of strength and security." Ironically, it took an admiral -- Mike Mullen, then chairman of the U.S. Joint Chiefs of Staff -- to recall Hamilton's warning about the link between credit and security. Mullen seized attention not by pointing out a danger to the fleet, but by telling CNN, "The most significant threat to our national security is our debt." Mullen's observation should not come as a surprise, because strategists in uniform often look to history as their laboratory. They also have to match means and capabilities to achieve ends. Officers at staff colleges may be inspired by the exciting chapters on Napoleon Bonaparte's bold campaigns, but the
astute also discover that the key to Britain's victory in the Napoleonic Wars is found in the dry accounts of the budgets of William Pitt the Younger, the chancellor of the Exchequer and prime minister. By restoring Britain's credit after its costly imbroglio with the American colonies, Pitt enabled his country to fight a long war -- and even repeatedly finance coalition partners -- without choking Britain's economy. In contrast, consider the foreign-policy debates of this U.S. election year. Journalists and commentators expound about wars and rumors of wars, political leaders and upheavals, human rights and duties to intervene, missiles and their defense. All serious and important topics. But how about a question on the eurozone crisis that threatens the integration of Europe, one of the 20th century's greatest security-policy achievements and America's closest ally and partner? What about America's connections to growth in East Asia, where economics is the coin of the realm? The reply is that these topics concern economics, not foreign policy! America's security strategists seem to have lost the ability to integrate the two. Their perspectives on economics do not extend much beyond sanctions policies and paying for defense budgets. At best, the role of economics is assumed, not analyzed. We scarcely understand its effects on power, influence, diplomacy, ideas, and human rights. At worst, economic problems have become a justification for a "come home, America" isolationism. And economists -- absorbed with mathematical models and debates about quantitative easing and stimulus policies -- are content to operate in their separate universe. Some, on the left and the right, disparage the role of economics in foreign policy as crass commercialism, narrow business interests, or, worse, affording undue influence to bankers. Others view international economics and trade policy as narrow specialties involving technical negotiations that just aggravate domestic constituencies. Yet this separation of economics from U.S. foreign policy and security policy reflects a shift from earlier American experience. For its first 150 years, the American foreign-policy tradition was deeply infused with economic logic. Unfortunately, thinking about international political economy has become a lost art in the United States. How did this happen?
IN 1773, A TRIBE of Bostonians threw 342 chests of tea into the harbor - without damaging other property, I should add -- to protest taxes imposed to bail out the nearly bankrupt British East India Company. Their protest still inspires a political movement in our time. The incident was the most dramatic of waves of colonial "nonimport-ation" policies dating to the 1760s, early American efforts to employ trade as a tool of policy.

The new American republic was born amid a world of mercantilist empires. Navigating around the trading monopolies of the seasoned, established powers -- and later blockades and bullying -- the former colonies fought continually for what historian Philip Zelikow has called "freedom to trade." This principle was not "free trade" as we understand it today, but a challenge to the old order nevertheless. The young United States, under President Thomas Jefferson, tried to exert its own leverage with nonimportation acts and even a disastrous embargo on foreign commerce in 1807. Ironically, it took the failure of Jefferson's trade sanctions, as well as the War of 1812, for the United States to start developing the manufacturing base that Hamilton sought and Jefferson opposed. Britain was not the only object of U.S. economic security policy. From 1801 to 1805, in the face of the Barbary pirates' attacks on U.S. ships, Jefferson rejected demands for tribute and instead sent the U.S. Navy to the shores of Tripoli. As the U.S. Marine Corps' hymn has memorialized, this Libya expedition was not "led from behind." In an age when power arose from the expansion of territory, resources, people, and commerce, America's implicit strategy understandably concentrated on the North American continent and open immigration. Land and settlement provided security, especially when buffered by two vast oceans.

Wielding a tool of diplomacy lost today, the United States resolved disputes by buying lands: Louisiana; Florida; old New Mexico, California, and the Gadsden Purchase; Alaska; and even the Virgin Islands at the start of the 20th century. (Admittedly, in some cases use of force led to price discounts.) In another touch of irony, Jefferson needed Hamilton's Bank of the United States and credit system, which Jefferson had opposed, for his greatest achievement, the Louisiana Purchase. The theme of Western Hemispheric integration -- a partnership of young democracies, not an
empire--was advanced by Secretary of State Henry Clay in the 1820s, revived in the 1880s and 1890s, and found first fruits a century later in the North American Free Trade Agreement (NAFTA) and then five more U.S. free trade agreements with Latin America. Today, the partners in those free trade agreements account for more than half of the hemisphere's non-U.S. GDP. In the 21st century, comprehensive free trade agreements could turn out to be the ties that bind, like the alliances of old. The Federalist Papers, the touchstone of American constitutionalism, are replete with references to the need for a strong federal government to secure the United States' place among foreign countries, including through healthy commerce and credit. The founders understood the link between economics and security. In a prescient example, John Jay, in Federalist No. 4, cautioned in 1787 that trade with China and India could one day draw the United States into conflict with competitors. It was no coincidence that the first U.S. forays into international relations were called treaties of "Amity and Commerce." The oceans that were barriers to armies became highways for the U.S. Navy and American mariners seeking markets. In 1854, Commodore Matthew Perry "opened" Japan to trade. By 1899, Secretary of State John Hay was resisting carving up China, as Africa had been, in favor of an "Open Door" policy to secure equal commercial opportunity. This race through U.S. foreign economic policy is not intended to suggest that the American system was all about peaceful commerce. To the contrary, even if the connection was driven by interests and not explicit planning, the economic and security policies worked hand in hand. These interests were infused with a healthy dose of what those generations called spreading "civilization," and what we call "values." With trade and the flag came missionaries and their schools. After the defeat of the Boxer Rebellion in 1900, the United States pragmatically used its share of the indemnity imposed on China--which the United States had opposed--to found Tsinghua University in Beijing and fund scholarships for Chinese students to attend universities in the United States. As the United States settled its home continent around the opening of the 20th century, a debate arose about expansion to territories beyond U.S. shores. Some wanted markets or coaling stations, and others
sought to carry "civilization" to foreign peoples. Some simply wanted to keep strategic places out of the hands of others. But "imperialism" did not sit well with many Americans, who proudly recalled that their new nation had freed itself from old empires. The U.S. war with Spain in 1898, precipitated by conflicts over Cuba, led the United States to acquire the Philippines (for $20 million) to keep the islands from being grabbed by others whose fleets were hovering -- but the United States did not take Cuba. President Theodore Roosevelt stirred up a revolt in Panama so he could build a canal that linked the two great oceans, commerce, and fleets of the U.S. Navy. America's foreign economic policy also helped spur early interest in international law -- what we now call "rules-based systems" -- to resolve disputes. The United States was an active participant in the 1899 Hague Conference and lent its support to a convention to resolve disputes peacefully through third-party mediation, international commissions, and a Permanent Court of Arbitration. Secretary of State Elihu Root negotiated arbitration treaties with 25 countries early in the 20th century.

The decades that followed continued the pattern of melding U.S. economic interests with foreign policy and security policy. "Dollar diplomacy," as historians have dubbed the strategy, sought to support U.S. enterprises in Latin America and East Asia through what we now call transnational actors -- but in those days were railroad and mining engineers, bankers, and merchants. In World War I, Britain shrewdly played on the U.S. commitment to neutral rights on the seas to draw President Woodrow Wilson to its side against Germany and its U-boats. After the war, reacting against what the United States viewed as the old European politics of perpetuated hostilities, America withdrew from European military security. Yet even during the 1920s and 1930s, the United States relied on banker-statesmen to negotiate debt and reparations to revive broken economies. To secure peaceful seas, the United States even launched the idea of global naval arms control in the 1920s. Reeling from the Great Depression, however, America withdrew from the world economy, enacting the Smoot-Hawley tariff wall to block imports and subverting a last-gasp effort for international economic cooperation at
the 1933 World Economic Conference. Political-military isolationism followed. Then came 1941, and the United States again learned, through harsh experience, that economics and security were linked. The United States had imposed embargoes on the sale of petroleum and scrap iron to Japan in response to Japan's invasion of China and its threats to Southeast Asia. Imperial Japan responded with a surprise attack, in part to secure its sources of oil and raw materials. The United States, caught unprepared, paid a terrible price. WORLD WAR II AND the opening of the Cold War led to a sharp break in the American foreign-policy tradition. At least that is the impression left by the masters of mid-20th-century security studies. In their narrative, the dawn of the nuclear age and the face-off between communism and the West required a new approach: a national security strategy. The traditional aims of amity and commerce seemed quaint and outdated in a world of superpower confrontation and containment. For the first time, the United States maintained a large conventional army, a significant part based in Europe, with hundreds of thousands of other troops fighting in Asia over decades. Instead of Milton Friedman's idea that economic freedom is an end in itself and an indispensable means toward achieving political freedom, economics became a resource factor -- and the handmaiden of the strategic policy process. The U.S. National Security Act of 1947 is full of references to new offices to mobilize people and resources for total war. Yet the act did not even make the Treasury secretary a statutory member of the new National Security Council. Ever since, the U.S. government has struggled to integrate economics into its national security strategies. The transformation of U.S. foreign-policy priorities signaled a change in the training of the stewards of American foreign policy. The new specialties were Soviet studies, political-military affairs, defense policy, and eventually Middle East policy. Short of homegrown talent on the central front, America even outsourced security strategy to immigrants from continental Europe --Henry Kissinger and Zbigniew Brzezinski -- who had grown up in a world of threat and the complications of balancing power in Eurasia.
Now, we need to rewrite economics back into the narrative of the Cold War and all that follows. We need a fuller appreciation of the links between economics and security to match the times. The world continues to struggle through a global economic crisis that began in the United States. Fears, fragilities, and failures fuel tensions within and among countries. Leaders are under protectionist and nationalist pressures -- in trade, but also regarding currencies, investments, resources, and the oceans. These frictions risk a downward economic spiral and even conflict. Because the United States has not faced up to its economic problems at home, its voice on international economics does not carry, its power has waned, and its strategic designs drift with the currents of the day's news. Without healthy economic growth, the United States will be unable to lead. Just as dangerously, it will lose its identity on the global stage if it loses its economic dynamism. America's unique strength is the ability to reinvent itself. To better appreciate the political economy story -- and its significance for security -- it is helpful to consider three phases since the end of World War II: from the creation of the Bretton Woods system to its breakdown in the 1970s; then, a capitalist revival from the late 1970s through the end of the Cold War; and on to the rise of globalization in the 1990s, extending to the crash of 2008. We are now stumbling into a fourth phase that is vital for the United States to shape. To do so, America has to look "back to the future" to recognize the critical connections between economics and security.

PHASE 1: From Bretton Woods to the 1970s
Even as World War II raged on, the United States and Britain began creating new international economic institutions to address currency exchange rates, trade, reconstruction, and development. The United States and Europe then launched the Marshall Plan -- and Europe created an economic community -- to shore up the free world's economic foundations. The United States exported capital and imported goods to boost recoveries in Europe, Japan, and then South Korea and other developing countries. The economic internationalists of the Bretton Woods system and the European Economic Community were not driven primarily by a plan for "containment" or to counter the Soviet Union. That
came later. Indeed, a primary architect of Bretton Woods, Harry Dexter Whitê, was later doomed by his sympathies for the Soviet Union. These strategists were trying to avoid a repeat of the economic causes of the political and security breakdown in the 1920s and 1930s. Only over time did the imperatives of the Cold War lead to a pragmatic convergence of the national security planners and the economic designers. Still, the national security model treated the economy as a source of benefits to be exchanged to support security aims. Trade concessions. Foreign assistance. Military aid. The ends were not necessarily inclusive growth, good governance, and open, competitive markets. The national security logic assumed economics was about static sources of resources for the accounting and balancing of power.

The national security perspective of state power overlooked a vital reality: that sound economic policies are the underpinning of both individual freedom and national power -- not only military power, but also the dynamism, innovation, and influence of the economy and society. The 20th-century concept of national security also overlooked how economic change can be a powerful force of its own in international relations. Economics is the study of a continual dynamic, so its concepts of "stability," "balance," and even "regime change" reflect very different perspectives from those of most security strategists. President Dwight Eisenhower understood this distinction. He invested political capital in balanced budgets, low taxes, and sound monetary policies. He recognized the underlying strength generated by investments in national highways, education, and science. On the international stage, as British Prime Minister Anthony Eden learned to his sorrow in the Suez crisis, Eisenhower would even use the power of the U.S. dollar over the British pound to stop the use of force in Egypt. In the 1970s, a new generation of international relations thinkers, led by Robert Keohane and Joseph Nye, questioned the realist power model of Hans Morgenthau that accompanied the Cold War national security concept. They did not dismiss power; indeed, they recognized the vital role of military force. But Keohane and Nye supplemented realism with a description of complex interdependence. Their framework reinserted economic and other
considerations not involving force into foreign policy. Their attention to diverse regimes that govern relationships of interdependence and international organizations was timely, given the breakdown of the Bretton Woods system of fixed exchange rates and the rise of oil power through OPEC in the 1970s. Keohane and Nye were also describing how the first phase of the post-World War II international economic system came to a messy close. As the 1970s limped to an end, the world economy stumbled toward a new reality of floating exchange rates, oil shocks, big bank loans of petrodollars to developing-world sovereigns, and stagflation. It is intriguing to observe that Kissinger -- the master strategist of classic realism -- struggled to integrate these seminal economic events into his Weltanschauung during his time as U.S. national security advisor and secretary of state. Some critics even argued that Kissinger's lack of understanding of economics led to a balancing strategy based on the flawed assumption of a Spenglerian decline of the West. From the dominant national security perspective, however, Kissinger had shrewdly extricated the United States from military defeat in Vietnam while opening relations with China as a counterweight to his Soviet foe. Keohane and Nye recognized that they had a blind spot too. As presenters of a "framework for using international factors to explain change and stability in world politics," they acknowledged that they did not examine the connection between domestic and foreign policies. They focused on international systems -- rules, norms, regimes. Yet critical domestic choices, particularly economic ones, will infuse foreign policy and shape the principles, practices, and diplomacy of those international systems, for good or ill. It took the rise of a singular statesman -- and one tough stateswoman -- to turn the intellectual connection between domestic strength and international influence into action. PHASE 2: The Revival and Success of Capitalism British Prime Minister Margaret Thatcher and U.S. President Ronald Reagan intuitively understood the connection between national economic revival and foreign policy. Their priority was to revive capitalism at home
and then extend it to the world. In doing so, they defined a second phase of the postwar international economy. The promotion of global capitalism seemed to be disruptive to many, the antithesis of rebuilding an international economic system still reeling from the shocks of the 1970s. After all, Joseph Schumpeter had explained that capitalism is "creative destruction." Yet this very disruptive quality enables capitalism to respond flexibly and continually to technological and other changes. There are risks to overregulation -- just as there are to weak supervision. Zealous social protections, though perhaps well intended, can add costly rigidities.

The reform of capitalism was not just an Anglo-American venture. West Germany's commitment to sound economic policies and export competitiveness demonstrated that social market economies can work. East Germans watching West German TV saw the stark contrast between their grim existence in a "workers' paradise" and the lifestyles of their wealthier cousins. Japanese manufacturers responded to the oil shocks with a huge increase in energy efficiency. Together, those domestic economic policies enabled the West to adjust to the 1970s breakdown of the post-World War II economic security system. The Soviet Union could not adapt to its economic challenges. It could not cope with changing information technology, new drivers of productivity and competition, and eventually $15-a-barrel oil. The U.S. intelligence community, geared toward the Cold War calculations of national security, largely missed the story. Soviet leader Mikhail Gorbachev, facing the combination of the democracies' economic regeneration, the U.S. military buildup with advanced technologies, and transatlantic solidarity over euromissiles, concluded that he had to reform communism. But his perestroika didn't work.

Reagan believed that the regimes and institutions of interdependence should be tested for effectiveness in boosting international growth, opportunity, and human rights. After all, those were the standards of economic freedom he was applying at home. Moreover, at a time of economic flux, the international economic system needed to foster adaptation. Reagan did not want international rules to constrict domestic
economic revival, and he stirred controversy by rejecting counterproductive international schemes such as the United Nations' New World Information Order and New International Economic Order, and the deep seabed mining regime in the Law of the Sea treaty. Still, after a pause, the United States would lead, with pragmatism and compromise, inreshaping international economic relations. In Reagan's second term, the United States steered the International Monetary Fund to a new role in the Latin American debt crisis. It led a major recapitalization of the World Bank to support developing countries' economic reforms and debt reschedulings -- until banks could write down losses. In 1985, Treasury Secretary James Baker launched a process of international economic coordination in the G-7. The United States pushed to expand global trade through the launch of the Uruguay Round of trade talks, completed much of that negotiation under President George H.W. Bush, and closed the deal under President Bill Clinton to create the more influential and liberalized World Trade Organization (WTO) out of the old GATT. Bush also initiated the Asia-Pacific Economic Cooperation (APEC) forum and negotiated NAFTA, which Clinton enacted. The end of the Cold War and its immediate aftermath brought the second phase of the postwar international economy to a close with astounding success as renewed economic vitality led to a vast expansion of private markets and advances in international economic regimes based on market principles and openness. The national security aims of the Cold War in Europe were achieved with hardly a shot fired. It may not be coincidental that the principal U.S. secretaries of state in this period -- George Shultz and Baker -- had served as Treasury secretaries too.

PHASE 3: Globalization's Promise and Perils

The end of the Cold War reunited Europe. The European Community became a deeper, wider union and launched its own currency. Just as importantly, China, India, and other developing countries moved from planned socialism and import-substitution schemes to market competition. Over a decade, the number of people engaged in or actively affected by the world market economy surged from about 1 billion to four or five times that. Information technology swept ahead. Capital raced around the
globe. Rather than the world economy of Bretton Woods, the earlier era of globalization before World War I -- with its large movements of capital, trade, and people, spurred by new technologies in transport and communication -- seemed to offer a closer parallel. Yet the adaptation to markets on a truly global scale, integrating developed and developing countries alike, was bound to be complicated and disjointed. It was. In the late 1990s, countries in East Asia and Latin America faced harsh financial blows and painful restructurings. Almost all are now stronger for the experience.

But the recovery strategies of some developing countries planted the seeds of a new problem: "imbalances" -- whether of savings, reserves, trade accounts, or other dimensions. Developing economies in East Asia saved and exported more, and the United States and some European countries increased borrowing, consumption, and imports. Interventions to lessen the value of Asian currencies constrained their imports and expanded exports. Some economists maintain that the low prices of goods available from new suppliers led central bankers to persist in easy monetary policies for too long, risking widespread asset-price inflation, especially in real estate markets. Then the bubbles burst.

The institutions of the international economic system adapted incrementally, often with difficulty. The economic firefighting of the IMF and World Bank made them principal targets of an anti-globalization movement in the 1990s. The continuing boom almost put the IMF out of business. Unfortunately, neither international nor domestic supervisors of financial markets kept up with the innovations -- or the frauds and foolishness that inevitably come with long boom periods.

The WTO added many new members. The trading system even withstood terrorist attacks -- and fears of more. But the travails of the WTO's Doha Round of trade negotiations, launched in 2001, signaled a new challenge. The traditional developed economies wanted the middle-income countries -- China, Brazil, India, and others -- to assume more responsibility for lowering barriers to trade, while all would offer special treatment for Africa and the poorest. The major developing economies, in turn, pointed to their large numbers of poor people and wanted to maintain the
privileges of what WTO practice refers to as "special and differential treatment." This debate reverberates not only in trade, but in monetary affairs, investment, development, energy, and the environment.

The 9/11 attacks concentrated America's attention on terrorism, homeland security, and the long wars that followed. Yet the connections of economics to the new security threats are also strong. When al Qaeda targeted the United States, it aimed for the World Trade Center -- its twin towers the symbols of American capitalism -- as well as Washington. In addition to shock and destruction, the terrorists wanted to strangle economic and political freedom. As Osama bin Laden boasted in 2004, his aim was "bleeding America to the point of bankruptcy."

Even as America fought in Iraq and Afghanistan and against terrorist threats around the globe, other forces of history did not stand still. China, India, and other emerging economies began to change the landscape of power. The failed political and stunted economic systems of North Africa and the Middle East sparked upheavals that will shake the region for a generation.

PHASE 4: After the Crash

The crash of 2008 has ushered in a fourth phase of the post-World War II economic experience. Global financial capitalism now faces a new crisis -- of credit, conduct, and even confidence.

After harsh blows, the advanced economies are struggling to reduce debt and revive jobs and productivity through structural reforms.

Unemployment is up. Confidence is down. Protectionism is rising. Publics are anxious. Politicians are struggling. Conflicts and tensions within and between countries are building. Developing economies have been hit too, though many have fared relatively better. In a profound shift, the 60-year leadership of developed economies is in question.

Will the eurozone and the historic success of Europe's peaceful integration survive -- and with it, Europe's influence in the world?

Will the high-growth developing countries overcome the so-called "middle-income trap" to become high-income countries and "responsible stakeholders" in an international system that has benefited them -- but that they did not design?
Will the poorest -- the "bottom billion" -- have an opportunity to prosper too, or will they be breeding grounds for transnational insecurities? Will the new political systems of the Middle East and North Africa lead to new economic policies for inclusive growth and peaceful integration into the world economy? Will the United States show leadership -- at home and internationally -- in reviving its core economic strength while simultaneously leveraging those capabilities through an activist economic diplomacy? Will the United States connect its foreign economic policy with security interests in freedom of the seas, open skies, and protection of cyberspace? FOREIGN MINISTER CARR'S warning about America's need to resolve its budget mess is correct: The United States must restore its credit, both for its own health and to enable it to lead. But the United States does not need just any budget deal. It needs one that rebuilds the fundamentals of long-term growth. It needs to limit government spending. It needs to encourage private-sector innovation and productivity. It needs inclusive growth that empowers all its citizens to fulfill their potential. It needs to revive a free trade agenda that has stalled in recent years. It needs to favor makers over takers.

By restoring America's credit and reviving growth, the next president and Congress would add to the country's power and influence in reinforcing ways. Strong, sustainable growth would boost public and private resources, while disciplining the debt would halt the burdening of future generations to pay for current excesses. Greater public resources would pay -- not borrow -- for vital purposes, starting with national defense, but also including the public goods of education, research, infrastructure, and the environment. A comprehensive budget and growth deal would also remove the weight of costly uncertainty from the private sector. Success at home would strengthen America's standing around the world as a can-do country with the means, ideas, and willpower to reinvent capitalism yet again.

In his classic study, The World in Depression, 1929-1939, the economist Charles Kindleberger argued that it was critical for one major power to take the lead in shaping an international economic system. This power
could not dictate, but instead needed to invest in encouraging a shared approach to trade, capital flows, currencies, and reliance on markets. Kindleberger described how during the Great Depression, the United States had the means but not the will to lead, while Britain had the will but no longer the means. If the United States does not lead now, who will?

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