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I appreciate the invitation to be with you and to see many good friends.

I understand that you've had a full day considering issues in Asia and NBR's important research agenda.

So I thought this evening I'd step back a bit to offer a wider perspective.

I'd like to suggest that America's foreign policy strategy should be founded on the recovery of a lost tradition.

For America's first 150 years, U.S. foreign policy was deeply infused with an economic logic.

But with the rise of the “national security concept” at the start of the Cold War, economics became the unappreciated subordinate of U.S. foreign policy.

At best, the role of economics in U.S. strategy is assumed, not analyzed.

We scarcely understand its effects on power, influence, diplomacy, ideas, institutions, 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 on QE and stimulus polices—are content to operate in their separate universe.

It wasn’t always this way….

So let’s look back a few years… say—240 years.

In 1773, a tribe of Bostonians threw 342 chests of tea into the harbor to protest taxes imposed to bail out the nearly bankrupt British East India Company. The incident was the most dramatic of waves of colonial “nonimportation” policies dating to the 1760s, early American efforts to employ trade as a tool of policy.

The new American republic was born amidst a world of mercantilist empires. Navigating around the trading monopolies of the established powers, the former

American colonies fought continually for “freedom to trade.”

The young United States, under President Thomas Jefferson, experimented 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 the new country’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 lost tool of diplomacy, the United States resolved disputes by buying lands: Louisiana; Florida; old New Mexico; California; 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 the Virginian had opposed, for Jefferson's 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 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.

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. history 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 also 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.

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 so-called “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.

The decades that followed continued the pattern of melding U.S. economic interests with foreign 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.

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. 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. The dawn of the nuclear age and the face-off between communism and the West required a new approach: a national security strategy. For the first time, the United States maintained a large conventional army, a significant part of which was based in Europe, with hundreds of thousands of other troops fighting in Asia over decades.

Counter to 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.

I think we need to rewrite economics back into the narrative of the Cold War and then consider the applicability to US strategy today.

Even as World War II raged, the United States 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. 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. It assumed economics was about static sources of resources for the accounting and balancing of power.

This 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.

President Dwight Eisenhower understood this distinction. He invested political capital in balanced budgets, controlling the size of government, and sound monetary policies. He recognized the underlying strength generated by investments in national highways, education, and science.

In the 1970s, 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. As the U.S. economy faltered, so did American influence.

Ronald Reagan intuitively understood the connection between national economic revival and foreign policy. His priority was to revive capitalism at home—and then extend it to the world.

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. Yet this very disruptive quality enables capitalism to respond flexibly and continually to technological and other changes.

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.

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, concluded that he had to reform communism. But his "perestroika" didn't work.

Reagan believed that international institutions should boost growth, opportunity, and human rights. Moreover, at a time of economic flux, the international economic system needed to adapt. Reagan did not want international rules to constrict domestic economic revival, and he stirred controversy by rejecting counterproductive international schemes.

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 WTO. Bush also initiated the Asia-Pacific Economic Cooperation (APEC) forum and negotiated NAFTA, which Clinton enacted.

The economic revitalization of the West helped to achieve its national security aims in Europe with hardly a shot fired. Europe was reunited. 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. Large movements of capital, trade, and people—all spurred by new technologies—created a new era of globalization.

Yet the adaptation to markets on a truly global scale, integrating developed and developing countries alike, was bound to be complicated and disjointed. In the late 1990s, countries in East Asia and Latin America faced harsh financial blows and painful restructurings.

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. 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. In the 1990s, The economic firefighting of the IMF and World Bank made them principal targets of an anti-globalization movement. 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 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 special privileges. 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.

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.

So how might a revival of an integrated approach to economics and security guide America's strategy today? Let me close by suggesting 6 ideas.

First, the United States needs healthy economic growth to be able to lead.

This imperative is more than a matter of generating economic resources and preserving America's good credit, although both are vital.

America's very identity on the global stage depends on its economic dynamism and ability to reinvent itself.

The U.S. has had a tepid recovery despite America's traditional power of innovation—to be seen in energy, software, bio-engineering, and robotics.

The U.S. Government has been preoccupied with stimulus policies—fiscal and monetary—and has not paid enough attention to structural and productivity reforms that would boost the handoff of growth to the private sector.

To offer just a few examples, tax reform and disciplining the growth of entitlement spending would unleash a new surge of growth.

An immigration reform that encouraged the world's talent to come to America would be good for both economic and foreign policy.

And more competition, choice, and private sector investment in education and training services would help the American people develop their capabilities to the fullest while contributing to a larger national good.

Second, the U.S. should build a strong continental base through deeper North American integration.

Consider the global weight of 3 democracies, of almost 500 million people, with energy self-sufficiency and exports, more integrated infrastructure, complementary manufacturing and service industries, and a shared effort to develop human capital—through education, linked to workforce skills, and pro-growth immigration policies.

Third, the U.S.—and I hope North America—needs a combined economic and security architecture that connects us with our principal partners on the western, eastern, and southern borders of Eurasia.

The TPP and TTIP could provide such an economic foundation if the Administration can translate its rhetoric into the willpower to close and pass deals.

The complementary security challenge is to devise new strategic military postures that assure stability—based on new technologies and capabilities—embedded in alliance ties, especially with Japan, Korea, Australia, and ASEAN partners.

Concepts such as AirSea Battle have stimulated debates over strategy, technology, equipment, and positioning—just as the Defense Department is facing budget cuts.

The vital challenge for Secretaries of Defense in this decade is to press the military services—and the Congress—to face these choices with a strategic concept, not incrementalism. Back office and acquisition costs need a major overhaul.

Fourth, the U.S. needs an international economic strategy to partner with rising developing economies seeking to overcome the Middle Income Trap.

The initiative should combine trade liberalization efforts—in WTO negotiations and bilaterally—with innovations in multilateral development institutions and private sector investment.

There are huge opportunities and needs, for example, in infrastructure, including through PPPs; in human capital, including though educational innovation and support for girls and women; in private sector services, including in areas traditionally seen as public, such as education, health, and water; and in financial markets, so capital is invested productively.

The World Bank's China's 2030 Report highlights these issues in the context of China's structural reforms.

But the challenges also apply to India, Brazil, Indonesia, and others.

The U.S. should customize political economy approaches to each major MIC and with groups of countries—such as the Pacific Alliance of Mexico, Colombia, Peru, and Chile; ASEAN; and subregional groups in Africa.

Fifth, as the U.S. closes out over a decade of war in SW Asia, we should handle our security obligations responsibly, but with a greater recognition that our military capabilities need to be directed principally towards the security of the U.S. and its allies.

Societal transformations depend on people assuming responsibility for their own future. We can encourage. They must decide.

For example, ultimately, the Muslim world will need to face up to violent Islamic radicalism. We cannot solve that problem for Muslims, but we can support those who try.

Economic opportunity can assist societal and political change, but economic development requires local ownership of policies and decisions.
Fortunately, there are now a host of successful experiences from which others can learn and then customize for their own circumstances; the U.S. and multilateral institutions can assist in sharing this comparative experience.

Economic openings will not solve all problems, but they are an important start.

Economic openness and expanding middle classes can also offer a route to advance America's values, the rule of law, political liberalization, and democracy.

Finally, the U.S. needs to develop a satisfactory working relationship with China, which is in the midst of an historic transformation.

We cannot predict the course of change in China.

I continue to believe that the two countries have a shared interest in China's effective integration within the international economic, political, and security system that the U.S. led in creating—so that China would become a "responsible stakeholder" in that continually evolving system.

Of course, the U.S. and China will have differences to manage.

And cooperation will be accompanied by hedging and balancing.

If China acts aggressively, it will provoke counter- reactions, and the US needs to be positioned to offer appropriate reassurances to Asian friends under pressure.

But there are many mutual interests, too, for example connected to China's structural economic reforms.

To manage China's rise, the U.S. needs to maintain its <u>own</u> power: through a strong, dynamic U.S. economy, with debt under control and sound credit; in a powerful North America; with alliances, partnerships, and institutions that extend U.S. power and influence cooperatively across the Pacific and Atlantic; and by encouraging an innovative, expanding U.S. private sector that connects Americans and their liberties with others around the world.

In sum, we need to rediscover the lost American tradition of integrating economics and security in our foreign policy.