



4.4 PUTTING ECONOMICS BACK AT THE CENTER OF NATIONAL STRATEGY ATTACKS

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INTRODUCTION

An imperative for our national security policy, which has become well publicized but I think not fully digested, is getting economics back to the core of national strategy and national security strategy. If you look at our successes and problems as a nation, they revolve very heavily around economics.

Why are we number one in the world? We are number one because of our economy, which started out a couple hundred years ago as every European economist's example of a very poor, primitive, lawless, and divided place but subsequently became the biggest and most advanced economy. One by one, our big competitors—Britain, Germany, and the Soviet Union, fell away.

How did we win the Cold War? We had a strategy that, in Europe, revolved around the Marshall Plan, rebuilding the

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economies and institutional structure of Europe—protected by the military. In Asia, we had the Japanese economic miracle succeeded by the Asian economic miracle—protected by the military. Had we not had the economic and institutional success, all our military power would have been for naught. The military's vital role was to protect the core economic and institutional strategy in order to give it time to work. It did work. Conversely, the Soviet Union had a completely ineffectual, self-defeating economic strategy that eventually led to its total collapse despite a formidable military machine.

THE RISE OF THE PACIFIC BASIN

The core of my professional interest has been the rise of the Pacific Basin. I wrote a paper for the Pentagon in 1972 discussing how it was not so much the Vietnam War or Association of Southeast Asian Nations (ASEAN) or Asia Pacific Network of Science and Technology Centres (ASPAC) or Maphilindo that would save Asia from communism. It was a great economic take-off, which I alleged—to much ridicule at the time—was in the process of happening. That rise has not only saved Asia from the spread of communism but also has fundamentally altered the way geopolitics works, and we have not yet absorbed that.

I think in the last eight or nine years, we forgot about the central role of economics until our senior military commanders in Iraq, followed by Secretary of Defense Robert M. Gates, reminded us. I think we never absorbed the real lesson of the Pacific Basin, which was an historic shift. Japan was suddenly taken seriously as a major power, virtually without a military, because they learned to grow—for a while—at 10 percent a year. Nobody in history had ever done that. Britain took over half the world when they learned to grow two percent a year. We did better on a little more than that.

When Japan learned to grow 10 percent a year and other countries learned from that, it changed the way the world of rising powers works. In particular, it put economics rather than traditional territorial and military aggrandizement at the core of Asian national strategies. The second rising power in Asia was

South Korea. In the 1950s under President Syngman Rhee South Koreans put all their money into the military. They fell farther behind North Korea, which at the time seemed politically more stable, militarily more powerful, and economically more successful. Then, General Park Chung-hee abandoned that failing strategy; he drastically cut the military budget and bet everything on economic development. Today, as a result of Park's economically-focused strategy, the South Korean economy is between 20 and 30 times the size of the North Korean economy. It is clear which strategy won. The point here is not that military power is unimportant; to the contrary, it is absolutely essential but it is essential in the role of protecting a strategy founded on the acquisition of economic superiority.

South Korea's success was followed by the rise of Thailand and Indonesia. Indonesia claimed all of Southeast Asia under Sukarno, and it was headed toward becoming a failed state. Then, under Suharto, they gave up virtually all their territorial claims on other countries and focused on economics, and they became the rising power and the leader of ASEAN and Southeast Asia. Thailand's case was less dramatic than Indonesia's, but half a century of rapid economic growth changed Thailand from a hapless, backward country radically inferior to Vietnam into the deputy leader of ASEAN, far more respected than Vietnam. Subsequently, Vietnam has moved to an economics-focused strategy and is rapidly increasing its regional stature.

In the late 1970s China, under Deng Xiaoping, looked around and asked, "How come everybody else is doing so much better than we are?" Shortly thereafter, they simply copied the South Korean strategy: They radically reduced the military's share of the economy—from around 16 percent to around three percent. They gave up most of their territorial claims. They settled 12 of their 14 boundary disputes to the satisfaction of the other parties. They gave up trying to change other countries' politics, instead focusing everything on economics.

As a result of all this, every country in Northeast and Southeast Asia understood that the world had changed. Once you could grow seven–nine percent consistently, you could become a big

power very quickly, but only if you put your resources into economic development at considerable expense to any territorial and military ambitions you might have for the time being. I do not think we have digested that. Most of the time our scholars and strategists are still looking at Bismarck's Germany and 1930s Japan.

We have also been slow to digest the collapse of Japan as a partner and as a leader of Asia as they have mismanaged their economy from the 1980s onward. The 2000 Armitage Report claimed that we were focusing too much attention on China and that we needed to revert to a posture of making Japan the sun and the moon of our policy in Asia.

Following that recommendation of reversion to Cold War priorities, we replaced the key assistant secretaries and the Asia Director at the National Security Council (NSC) and so on, many of whom were China experts, with Japan specialists. Subsequently, we found ourselves dealing with North Korea. We sat down with the Chinese and came up with the least bad strategy and pursued it over the opposition of Japan. Likewise, for a wide variety of other key Asian issues—the war on terrorism, regional crime, regional drugs, regional free trade, regional freedom of investment, and agricultural free trade we found that China was our principal partner. Take genetically modified crops, a key U.S. agricultural interest. We are number one in the world in genetically modified crops; China is number two. The adversaries were Japan, India, and Europe, who just want to keep genetically modified seeds out of their countries. The economics determines who is going to be important, who is going to be our partner, and who can get things done. China's success and economic priorities make it a stabilizing factor and a crucial partner. Japan's economic decline entails diplomatic decline. While many of our respected strategists are yearning for a return to Cold War verities, including a focus on Japan, and, based on obsolete models, obsessing about the risks of the rise of China, they are missing the great dilemmas created for us by the inexorable decline of Japan. They are missing the opportunities, including forward movement on Taiwan, stabilization of the Korean Peninsula, addressing global warming,

and joint efforts to recover from the global financial crisis, that can arise from embracing partnership with China.

A crucial example is the war on terrorism. If we are going to contain Islamic fundamentalist terrorism, the key is to spur the development of Africa. In 1965, Islamic terrorism and fundamentalism concentrated in Indonesia, which had more Islamic fundamentalists, political figures, and movements than the rest of the world combined. It has simply faded since Indonesia's economy started developing rapidly. Notice that some of the Islamic fundamentalism revived after the 1998 crisis but has since been contained. The key to containing the global Islamic terrorism problem is to achieve in sub-Saharan Africa what we achieved long ago in Indonesia.

Until recently sub-Saharan Africa was experiencing negligible or negative per capita economic growth. The extraordinary suffering entailed by that bleak economic trend made the continent the perfect breeding ground for a spread of Islamic and other forms of fundamentalist violence that could have been expected to dwarf the terrorism problem that we face today. But in the last few years a remarkable turnaround has occurred. Prior to the current, hopefully transient, global economic crisis, sub-Saharan African economic growth rose to around six percent. For the first time polls showed a majority of people in these countries saying that their lives would be better in the future than now and that their children's lives would be better than their own. What has made the difference between Africa having negative rates of growth and six percent until this crisis set in? Chinese demand.

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That African growth and the associated change of people's expectations is the key to our success at what President George W. Bush thought was the core national strategic issue. The positive Chinese economic relationship to Africa is key to our prospects for success in stabilizing the continent. However, if you

look at our national security literature about China in Africa you see nothing but disparagement and fear. Much of that literature treats China as if it were the old Soviet Union, seeking to change African politics and to acquire African military bases. But China is not seeking to rebuild African polities in its own image, and as a matter of principle it abstains from seeking military bases. We rarely see the real connection between Chinese involvement in Africa and our national interests because we do not see the economics.

We have a long way to go in getting economics back to the core. As we do that, I think there are some risks that we do not face. Contrary to a paper that has been prepared for this conference, our macro economy cannot be successfully attacked and manipulated from abroad. You cannot collapse the U.S. currency and manipulate the stock market by an initiative from abroad. You cannot lever up small investments into something that will have a huge macro effect on the U.S. economy.

You can bring the U.S. economy down if we collapse into protectionism. You can destroy the U.S. currency if we debase it. You can wreck our financial markets if we encourage excess liquidity and lack of regulation. These things cannot be manipulated from abroad. The markets are too big and too deep. Of course, there are real economic risks: classic industrial espionage, water and food contamination, cyber attacks, and power grid disabling that previous speakers have talked about.

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I would underline what was said about cyber warfare. I think cyber warfare is the 21st Century equivalent of nuclear war. We need a macro strategic debate similar to what we had about nuclear war, for instance considering options like massive retaliation, tit for tat, and so forth. We need the cyber-equivalent of Herman Kahn's book, *On Thermonuclear War*, as an overarching

guide to how we handled all these individual tactical issues being addressed at this symposium.

Supply chain security is a big issue. Wal-Mart and a Hong Kong company called Li & Fung are the best people who know how to manage supply chain security. We have a great deal to learn from them. We also need to learn how resilient supply chains actually are from history in general. In the Korean War, we needed tungsten for our tanks. We had an embargo on trade with China. China had the tungsten. China needed money. Somehow, the tungsten got out of China into the hands of Union Carbide. The Chinese made the money they needed, and we got the tungsten we needed to make tanks to shoot Chinese in Korea. The resilience of these supply chains is remarkable. We need to improve our understanding of both their resilience and their vulnerability.

RESOURCE VULNERABILITY

I would like to separate two things. One is the vulnerability of our logistics in a war, which Captain Jan van Tol talked about in Roundtable 2.

The other is war over resources. I think the first is very important. Everything Captain van Tol said was extremely important. Given the shortness of time, let me just make some flat assertions about the second, potential war over resources: First, the range of resources over which serious powers fight is drastically reduced in the modern world. Serious powers used to go to war over cobalt and copper and almost anything. They do not anymore. Basically, oil is the only issue. The world is not running out of resources, Malthusian theory to the contrary. It became popular in the early 1970s to discuss the depletion of resources. I used to visit the War College and debate the people from the Club of Rome, a global think tank that had published a report in 1972, *The Limits to Growth*. It was an entertaining intellectual exercise, but the World3 model the Club of Rome presented, simulating the limits to growth, was flawed. The flawed assumptions of that report, that we are running out resources, that economic progress inexorably depletes resources and worsens pollution, have been thoroughly

refuted time after time, but they keep reviving both in economic literature and now in the national security literature.

Every decade for well over a century we have heard forecasts that we are running out of oil. We are not running out of oil. We have a problem that cheap, convenient oil is located in one unstable part of the world. At something well short of \$100 a barrel, tar sands, oil shale—all kinds of energy—just flood the world with energy. The problem recently has been that the big oil companies have refused to invest on the basis of anything more than \$40 a barrel of oil because they knew the price would collapse, and they know there are so many other kinds of energy available.

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The frequency of resource conflicts over which serious powers go to war, I would argue, has decreased drastically. The kinds of conflict that we allow countries, including ourselves, to engage in over resources have narrowed. A century ago, the Belgians could slaughter huge numbers of people over resources in the Congo. We fought over things like copper and cobalt. In 1980–85, I was involved in some rather rough operations to secure Angolan oil and chrome from Zimbabwe. We do not do those things anymore; it is socially unacceptable.

The Chinese do not even think about sending a platoon to guard one of their oil operations in Africa. They will be careful. They will reluctantly, under international pressure, send a group of military engineers to Sudan to try to keep the peace in certain areas. They do not even think about the possibility of sending a platoon when it could be very useful in protecting their business interests. It is just not in the culture; it is not acceptable. More broadly, resource conflicts are not becoming more prominent. We have drastically reduced the range of resource issues for which we conceptualize military recourse as an option, and the Chinese hardly ever conceptualize resource security strategy in

military terms. (Some territorial waters and seabed issues are an exception to this rule.)

THE RISKS OF BEING OVER-DEFENSIVE

Although we need to worry more about economics, we are at serious risk of overreaction in a number of areas, such as export controls. Some are necessary; we obviously need to stop small nuclear bombs from being exported to North Korea. However, many export controls damage U.S. competitiveness and subsidize the threat we are trying to avert.

Let me just give you an example and follow it through. In 1985, I moved to Hong Kong. In New York, I had an IBM XT computer, first generation. I wrote to IBM and asked, "Can I use this with Hong Kong 50 cycle, 220 current?" They said, "Yes, but it will cost you much more than the value of the computer to get your export license from DoD and Commerce. Throw it away and buy a new one."

So I went to Hong Kong. The market was flooded with knock-off AT computers from China, ten times better than what I was banned from taking with me from New York. Virtually every American, and there were a lot, and many others moving to China, dumped their IBMs, and bought Chinese knock-off models. We created a huge subsidy for Chinese companies to make computers through our export controls. Lenovo, the most successful of those Chinese companies that we were subsidizing through our export controls, later bought IBM Think. There was then a nationalist reaction here not to allow the Chinese company to take over IBM Think on national security grounds. However, there were no national security grounds. Most of these things are made in China anyway. If we had stopped Lenovo's purchase, IBM would have been stuck with a money-losing division and unable to move up into the incredibly successful services business they are in today. As long as they had that Think division, they were linked to Microsoft and could not go into competition with it.

To take another example we ban the export to China of U.S. companies' software that was produced for them by researchers in China. Think about that: Our big companies cannot export to

China software that was developed for them in China. Therefore, the Europeans and the Japanese just go in and take the whole market.

I keynoted one conference where the key people who enforce the export control from around the country were prominent. Afterwards, one of the most senior attendees came up to me and said, "I have got to enforce these laws. As long as I am here, I am going to enforce them. As soon as I have my full pension, I am going to spend the rest of my life trying to change the policies that I can see are damaging our country so much."

"We do not understand our own strength or our own resilience . . ."

We need laws about foreign takeovers and we need some export controls, but we should be very careful about going too far. One of the greatest contributions of some unit of the government would be to pay some objective academics or think tank to create a model that shows us when we are actually achieving our goals with export and investment controls and when we are shooting ourselves in the foot. We are shooting ourselves in the foot terribly by having scared the Chinese off from investing in financial firms and major firms. Citibank was rescued in the previous financial crisis by a Saudi investor. We benefited from that. This time around, it could be rescued by a Chinese investor, but it will not be because we panicked and scared them off. We do not understand our own strength or our own resilience, so we are afraid of things that we do not need to be afraid of.

CONCLUSION

We need to put economics at the core of our strategic thinking. Doing that will transform our perspective on everything from the risks posed by rising powers to the value of traditional alliances to the effects on our interests of Chinese involvement in Africa. It will change the way we allocate our national security resources. It will make us more sensitive to the risks of mismanaging our own economy. At the same time, when we consider

defensive actions to protect our economy we need to understand our own economic strength and have confidence in it.