ARGUMENT

America Needs a New Economic Philosophy. Foreign Policy Experts Can Help.

The United States cannot get grand strategy right if it gets economic policy wrong.

By **Jennifer Harris** and **Jake Sullivan**

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U.S. foreign-policy makers now face a world in which power is increasingly measured and exercised in economic terms. Authoritarian capitalism is challenging market democracy as the prevailing model—and technological disruption, climate change, and inequality are straining the compact between governments and their people. In such a world, economics, at least as much as anything else, will determine the United States' success or failure in geopolitics.

This is especially true when it comes to dealing with China, which has already reached a level of economic strength and influence the Soviet Union never enjoyed. While military power will still matter, the emerging great-power competition between the United States and China will ultimately turn on how effectively each country stewards its national economy and shapes the global economy.

Looking to U.S. history, from the early years of the republic to the era following World War II, shifts in grand strategy have from time to time necessitated a change in economic philosophy—from mercantilism to laissez-faire absolutism to Keynesianism to neoliberalism—and national security arguments have proved critical to securing that change. The same is true today as the United States enters a new era of great-power competition and grapples with powerful forces like inequality, technology, and climate change.

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past, the United States needs to move beyond the prevailing economic ideology of the past few decades (sometimes imperfectly termed neoliberalism) and rethink how the economy operates, the goals it should serve, and how it should be restructured to serve those goals—and this is a geopolitical imperative as well as an economic one. And as in the past, the national security and foreign-policy community should play a proactive role in this domestic economic policy debate, advocating for and helping to deliver the needed reforms.

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This has produced a marked shift in the debate on issues including worker power, the taxation of capital, anti-monopoly policy, and the scope of public investment. While foreign-policy hands have started to focus more on what it will take to enhance U.S. competitiveness, they haven't had the same kind of basic reckoning. The time has come for foreign-policy professionals to develop a sharper and more systematic sense of what needs to change in their own economic assumptions, both domestic and international.

Over the past three years, in an effort to deal with the national emergency that is Donald Trump, Democrats and anti-Trump Republicans who work on foreign policy have come together to defend a core set of important propositions on alliances, values, and institutions. In doing so, they have tended to elide differences on hard economic questions or to avoid answering them. And over the past 30 years, foreign-policy professionals have largely deferred questions of economics to a small community of experts who run international economic affairs.

Partly, this deference has come from a view that economics and foreign policy ought to be kept distinct, as if mixing the two would taint economics, long cast as an objective science, with the self-interested influences of geopolitics. And partly, it is because the foreign-policy elite, like much of the rest of U.S. society, internalized this economic orthodoxy and came to believe it to such an extent that delegation was a matter of mere convenience. This explains, for example, why the Barack Obama and George W. Bush administrations had such different approaches to domestic economic policy but nearly identical approaches to foreign economic policy, from the Trans-Pacific Partnership (TPP) to the International Monetary Fund.

But foreign-policy experts need not, indeed they should not, stay on the sidelines in emerging economic policy debates. In the past, U.S. grand strategy has been built around economic theories matched to the moment—and strategists were central to the conversation. For example, in the country's earliest days, the United States was fending off empires built on mercantilism. Well aware that it couldn't beat established players like France and the United Kingdom at this game, the country rejected mercantilism and instead adopted—and then helped spread—a free trade model. Indeed, the United States' early love affair with Adam Smith and David Ricardo was in part about geopolitical survival.

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yielded a similar story. The U.S. government used a recipe advocated by the British economist John Maynard Keynes to grow its economy in the decades following World War II at a pace that the Soviet economy could not match. This involved a formula of stimulating consumer demand and industrial production through public investment and monetary policies favoring full employment. And while history tends to condense the rise of Keynesianism in those years into an obvious, inevitable response to the Great Depression and a world war, it was hardly clear in the earliest days of the Cold War that this approach would consolidate itself into orthodoxy.

It happened because a range of voices—including U.S. national security voices like Cordell Hull, who was secretary of state from 1933 to 1944, and the veteran diplomat George Kennan—made the case that out-competing the Soviets called for discarding the laissez-faire economic philosophies that had dominated in the decades preceding the Great Depression. In pressing his case for a more expansionary economics during the early years of the Cold War, Kennan pointed to a generation earlier, arguing that the foreign-policy horrors of the 1930s could be traced to the "lost opportunities" of the 1920s.

History is again knocking. The growing competition with China and shifts in the international political and economic order should provoke a similar instinct within the contemporary foreign-policy establishment. Today's national security experts need to move beyond the prevailing neoliberal economic philosophy of the past 40 years.

This philosophy can be summarized as reflexive confidence in competitive markets as the surest route to maximizing both individual liberty and economic growth and a corresponding belief that the role of government is best confined to securing those competitive markets through enforcing property rights, only intervening in the supposedly rare instance of market failure.

The foreign-policy establishment need not come up with the next economic philosophy; the task is more limited—to contribute a geopolitical perspective to the unfolding debate on what should follow neoliberalism and then to make the national security case for a new approach as it emerges.

Toward this end, the foreign-policy community needs to shed a number of old assumptions. Whereas the most damaging elements of the previous approach are being discarded from mainstream economics, certain tropes still linger in the foreign-policy conversation.

First, policymakers should recognize that underinvestment is a bigger threat to national security than the U.S. national debt. At annual gatherings both inside and beyond Washington, senior national security experts still inveigh against the debt as a top national security threat. Generals and admirals testify to this effect before the U.S. Congress on a regular basis. But by now it should be beyond argument that secular stagnation (whereby satisfactory growth can only be achieved through unstable financial conditions), not debt, is far and away the more pressing national security concern. After all, the world has now had a 10-year live experiment showing how austerity and lack of investment in the face of low growth produce destabilizing autocrats in the mold of Hungary's Viktor Orban and Brazil's Jair Bolsonaro.

This is not to suggest debts and deficits never matter. Rather, it is to emphasize the distinction between good debt and bad debt—a point now widely embraced in economic circles. The U.S. national security community is rightly beginning to insist on the investments in infrastructure, technology, innovation, and education that will determine the United States' long-term competitiveness vis-à-vis China. With growth, inflation, and interest rates all lagging, policymakers should not be intimidated by arguments going back to the Simpson-Bowles commission (and likely to return if a Democrat takes office in 2021) that the United States cannot afford these investments.

Bad debt, though, does create risk without enhancing medium- and longer-term growth potential. The Trump administration's 2018 tax legislation, with a price tag of between $1.5 trillion and $2.3 trillion (two or three times what the 2009 stimulus cost), serves as an expensive lesson. There are now too many nails in the coffin of trickle-down tax cuts for corporations and the wealthiest Americans to view it as anything but a zombie ideology that is redistributing trillions of dollars from lower- and middle-income Americans to the wealthiest—and the foreign-policy community should likewise dismiss it.

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Second, advocating industrial policy (broadly speaking, government actions aimed at reshaping the economy) was once considered embarrassing—now it should be considered something close to obvious. Despite a 40-odd-year hiatus, industrial policy is deeply American. Alexander Hamilton's vision for U.S. manufacturing was the first American industrial policy, a tradition carried forward throughout U.S. history—from Henry Clay's American System to Dwight D. Eisenhower's interstate highway network and Lyndon Johnson's Great Society—until it lost favor in the 1980s.

A return to industrial policy shouldn't simply pick up where the country left off a few decades ago. Rather than focusing on picking winners in specific sectors, there is an emerging consensus that suggests governments should focus instead on investing in large-scale missions—like putting a man on the moon or achieving net-zero emissions—that require innovations across many different sectors.

The biggest geopolitical reason to get back to industrial policy is climate change. It cannot be addressed by taxing carbon alone. It will take a surge of deliberate and directed public investment that underwrites a shift to a post-carbon U.S. economy through research and development, deployment of new technologies, and development of climate-friendly infrastructure.

Another good reason is that others are doing it, especially the United States' competitors. President Xi Jinping's Made in China 2025 strategy is a 10-year blueprint aimed at catapulting China into a technology and advanced manufacturing leader in both the commercial and military domains. Good estimates are elusive, but China's subsidies alone reach into the hundreds of billions of dollars. And these investments have already paid off handsomely in several areas, like artificial intelligence, solar energy, and 5G, where many experts believe China is on par with or already outstripping the United States.

U.S. firms will continue to lose ground in the competition with Chinese companies if Washington continues to rely so heavily on private sector research and development, which is directed toward short-term profit-making applications rather than long-term, transformative breakthroughs. And the United States will be more insecure if it lacks the manufacturing base necessary to produce essential goods—from military technologies to vaccines—in a crisis.

Third, policymakers must move beyond the received wisdom that every trade deal is a good trade deal and that more trade is always the answer. The details matter. Whatever one thinks of the TPP, the national security community backed it unquestioningly without probing its actual contents. U.S. trade policy has suffered too many mistakes over the years to accept pro-deal arguments at face value.

The Nobel laureate and economist Paul Krugman has recently issued something of a mea culpa on this issue, noting that he "missed a crucial part of the story" when it came to the impact of China's entry into the World Trade Organization on communities in the United States. He was partly responding to work by David Autor, David Dorn, and Gordon Hanson, which documented a dramatic loss of U.S. jobs to China—an outcome that had been dismissed by traditional economists during the debates in the late 1990s.

New thinkers are also looking beyond individual agreements to challenge some of the

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basic premises of trade theory as applied to today’s economy. For example, the idea that trade will necessarily make both parties better off so long as any losers could in principle be compensated is coming under well-deserved pressure within the field of economics. This is especially true given the United States’ terrible track record of harnessing those gains by collecting corporate taxes in the first place, let alone distributing them broadly.

A better approach to trade, then, should involve more aggressively targeting the tax havens and loopholes that undermine many of the theoretical gains from trade. It should also involve a laser focus on what improves wages and creates high-paying jobs in the United States, rather than making the world safe for corporate investment. (Why, for example, should it be a U.S. negotiating priority to open China's financial system for Goldman Sachs?) And it should connect foreign trade policy to domestic investments in workers and communities so that trade adjustment is not a hollow promise.

Done well, a different course should yield strategic as well as economic dividends. To take just one example, provisions against currency manipulation—absent in TPP—would not only help the American middle class but also the United States' strategic position by constraining China's capacity to fund efforts like its Belt and Road Initiative (BRI), a connected set of infrastructure projects designed to enhance Chinese power across multiple continents. (China has funded much of the BRI through its stockpile of foreign exchange reserves—a stockpile it amassed through years of intervening heavily in foreign exchange markets to depress the value of its currency in order to make its exports more competitive.)

Fourth, foreign-policy experts must dispense with the notion that what's good for U.S.-based multinational corporations is necessarily good for the United States. U.S. diplomats travel the world on the taxpayers' dime, advocating for U.S. companies to win contracts and deals in foreign countries. But all too often, the jobs created by these contracts and deals are created overseas, not in the United States, and all or most of the benefit goes to investors, not to U.S. workers or communities.

Take the pharmaceutical industry—the United States is the undisputed leader in drug development, and most U.S. negotiators have regarded pharmaceuticals as a source of export strength (hence all of the generous terms for Big Pharma in U.S. trade deals). The reality, however, is starkly different—the United States owns the intellectual property, but the active ingredients are mostly manufactured abroad. This might sound like an unsurprising fact of globalization. Yet the largest sources of U.S. drug imports aren't low-wage countries but Ireland and Switzerland.

This isn't a case of global capital migrating to low-wage countries; it's happening because of tax sheltering. According to estimates by the University of California, Berkeley economist Gabriel Zucman, the U.S. government loses close to $70 billion a year in tax revenue thanks to U.S. companies shifting their profits to lax jurisdictions like Ireland and Switzerland. That's almost 20 percent of the corporate tax revenue collected annually.

The result, as the economist Brad Setser has shown, is that the U.S. trade deficit in pharmaceuticals now exceeds the country's surplus in civil aviation; indeed, the United States imports more pharmaceuticals than smartphones. It is far from obvious that the U.S. government should be expending so much political capital on an industry that has become so thoroughly divorced from U.S. interests.

Government advocacy for companies is a privilege, not a right. And future U.S. administrations should take tax structures and revenues into account when deciding whether and how to expend diplomatic leverage on behalf of U.S.-based firms operating abroad.

Finally, there are some areas in which the help of foreign-policy professionals will be central to developing the answers themselves. One good example is the lively debate now underway on reinvigorating antitrust policy.

Given the evidence linking economic concentration to low growth, stagnant wages, and growing inequality, a renewed form of antitrust law will be a necessary feature of whatever new economic consensus emerges.

Yet, if the United States breaks up the large technology platforms, for example, some worry this may simply cede global market share to Chinese tech behemoths—unless Washington accompanies a domestic push with a new international antitrust strategy as well. Especially given the array of strategic technologies that hang in the balance, the foreign-policy community should have something to say about where and how they are produced.

More broadly, arguments driven by national security concerns and the leaders who voice them are a potent source of validation, often determining which ideas are deemed worthy or serious and which are not. A new common sense on how to manage and grow the economy will more easily take hold if the foreign-policy community helps make the case.

And, most of all, this matters because a new grand strategy for today's world will only be as good as the economic philosophy behind it. Past assumptions led, among other things, to domestic dislocation and to weaknesses and blind spots in the United States' approach to China. It's time to discard them. The foreign-policy community should actively reach for a new economic model. America's national security depends on it.

Jennifer Harris is a fellow at the Roosevelt Institute and non-resident Senior Fellow at the Brookings Institution. She was a member of the Policy Planning Staff at the U.S. State Department from 2008 to 2014 and served on the National Intelligence Council staff from 2004 to 2008. Twitter: @jennifermharris

Jake Sullivan is a non-resident Senior Fellow at the Carnegie Endowment for International Peace. He was a deputy assistant to President Barack Obama and national security advisor to Vice President Joe Biden

from 2013 to 2014, as well as director of policy planning at the U.S. State Department from 2011 to 2013.

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