2021-12

# ECONOMIC STATECRAFT, DOMESTIC POLICIES, AND A PATH TOWARD STABLE COMPETITIVE INTERDEPENDENCE BETWEEN THE U.S. AND CHINA

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http://hdl.handle.net/10945/68743

# NAVAL POSTGRADUATE SCHOOL

**MONTEREY, CALIFORNIA**

# THESIS

**ECONOMIC STATECRAFT, DOMESTIC POLICIES, AND A PATH TOWARD STABLE COMPETITIVE INTERDEPENDENCE BETWEEN THE U.S. AND CHINA**

by

Barney R. Schmidtke

December 2021

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| REPORT DOCUMENTATION PAGE | | | *Form Approved OMB No. 0704-0188* |
|---|---|---|---|
| Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington, DC, 20503. | | | |
| **1. AGENCY USE ONLY** ***(Leave blank)*** | **2. REPORT DATE** December 2021 | **3. REPORT TYPE AND DATES COVERED** Master's thesis | |
| **4. TITLE AND SUBTITLE** ECONOMIC STATECRAFT, DOMESTIC POLICIES, AND A PATH TOWARD STABLE COMPETITIVE INTERDEPENDENCE BETWEEN THE U.S. AND CHINA | | | **5. FUNDING NUMBERS** |
| **6. AUTHOR(S)** Barney R. Schmidtke | | | |
| **7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)** Naval Postgraduate School Monterey, CA 93943-5000 | | | **8. PERFORMING ORGANIZATION REPORT NUMBER** |
| **9. SPONSORING / MONITORING AGENCY NAME(S) AND ADDRESS(E**S) N/A | | | **10. SPONSORING / MONITORING AGENCY REPORT NUMBER** |
| **11. SUPPLEMENTARY NOTES** The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government. | | | |
| **12a. DISTRIBUTION / AVAILABILITY STATEMENT** Approved for public release. Distribution is unlimited. | | | **12b. DISTRIBUTION CODE** A |

**13. ABSTRACT (maximum 200 words)**

The United States, formerly an uncontested world power, is experiencing a churning international political and economic landscape as China's growth challenges U.S. economic primacy, alliances, and prosperity. This paper finds that the U.S. has become overly reliant on coercion and should instead increase its focus on partnerships and cooperative international action to secure its national interests. The U.S. can achieve this by adopting domestic policies that make it a more attractive partner than China. The U.S. can further signal its attractiveness compared to China by strengthening and expanding its current alliances and economic agreements. This paper will examine the instruments of economic statecraft and domestic policy available to the U.S. that are able to affect these changes. These include greater emphasis on renewable energy, multilateral trade agreements, investments in its infrastructure and citizens, addressing its national debt, and decreasing the use of financial freezes. International relations theories and economic literature will serve as lenses to evaluate the effectiveness of economic statecraft instruments and the global repercussions of domestic policy. Only through careful use of economic statecraft and domestic policy can the U.S. simultaneously increase economic power and positively impact alliance behavior to sustain the liberal world order that the U.S. has benefited from for nearly a century.

| **14. SUBJECT TERMS** economic warfare, economic statecraft, economic competition, strategy, great power competition | | | **15. NUMBER OF PAGES** 95 |
|---|---|---|---|
| | | | **16. PRICE CODE** |
| **17. SECURITY CLASSIFICATION OF REPORT** Unclassified | **18. SECURITY CLASSIFICATION OF THIS PAGE** Unclassified | **19. SECURITY CLASSIFICATION OF ABSTRACT** Unclassified | **20. LIMITATION OF ABSTRACT** UU |

NSN 7540-01-280-5500

Standard Form 298 (Rev. 2-89)
Prescribed by ANSI Std. 239-18

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# ECONOMIC STATECRAFT, DOMESTIC POLICIES, AND A PATH TOWARD STABLE COMPETITIVE INTERDEPENDENCE BETWEEN THE U.S. AND CHINA


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Submitted in partial fulfillment of the
requirements for the degree of

**MASTER OF BUSINESS ADMINISTRATION**

from the

**NAVAL POSTGRADUATE SCHOOL**
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# ABSTRACT

The United States, formerly an uncontested world power, is experiencing a churning international political and economic landscape as China's growth challenges U.S. economic primacy, alliances, and prosperity. This paper finds that the U.S. has become overly reliant on coercion and should instead increase its focus on partnerships and cooperative international action to secure its national interests. The U.S. can achieve this by adopting domestic policies that make it a more attractive partner than China. The U.S. can further signal its attractiveness compared to China by strengthening and expanding its current alliances and economic agreements. This paper will examine the instruments of economic statecraft and domestic policy available to the U.S. that are able to affect these changes. These include greater emphasis on renewable energy, multilateral trade agreements, investments in its infrastructure and citizens, addressing its national debt, and decreasing the use of financial freezes. International relations theories and economic literature will serve as lenses to evaluate the effectiveness of economic statecraft instruments and the global repercussions of domestic policy. Only through careful use of economic statecraft and domestic policy can the U.S. simultaneously increase economic power and positively impact alliance behavior to sustain the liberal world order that the U.S. has benefited from for nearly a century.

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## LIST OF ACRONYMS AND ABBREVIATIONS

| | |
|---|---|
| ASEAN | The Association of Southeast Asian Nations |
| CEEC | Committee of European Economic Cooperation |
| CINC | Composite Indicator of National Capabilities |
| COP26 | United Nations Climate Change Conference 2021 |
| COVID-19 | Novel coronavirus 2019, or SARS-CoV-2 |
| CPTPP | Comprehensive and Progressive Trans-Pacific Partnership |
| DOD | United States Department of Defense |
| DoS | United States Department of State |
| DSB | Dispute Settlement Body within the World Trade Organization |
| ERP | European Recovery Program |
| EU | European Union |
| FRED | Federal Reserve Economic Data |
| FTA | Free Trade Agreement |
| FTAAP | Free Trade Area of the Asia Pacific |
| FY | Fiscal Year |
| GATT | General Agreement on Tariffs and Trade |
| GDP | Gross Domestic Product |
| ICBM | Intercontinental Ballistic Missile |
| IR | International Relations |
| MAD | Mutually Assured Destruction |
| NDS | United States National Defense Strategy |
| PPF | Production Possibility Frontiers |
| PRC | People’s Republic of China |
| PTT | Power Transition Theory |
| R&D | Research and Development |
| SOE | State-owned Enterprise |
| TAA | Trade Adjustment Assistance Program |
| T Bond | U.S. Treasury Bond |
| USSR | Union of Soviet Socialist Republics |
| WTO | World Trade Organization |

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# ACKNOWLEDGMENTS

To my smart and lovely girlfriend, Erin. Without you, Monterey wouldn’t be the same.

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# I. INTRODUCTION

## A. THE FUTURE LANDSCAPE

China's economic and military growth during the last two decades challenges U.S. supremacy in both measures. The world order established after World War II, which placed the U.S. in a position of primacy and allowed it to reap the benefits of its political and economic dominance for nearly a century, has already begun to change. Given the intense level of economic interdependence, the foreseeable future will be characterized by competition and cooperation.

As of 2020, the U.S. and China's shares of global GDP were larger than the next three economies in the world combined. As seen in Figure 1, just since the end of the Cold War, China's share of global GDP has steadily grown and surpassed Japan, Germany, and the United Kingdom. China's share of global GDP has grown steadily since the early 1990s, when Deng Xiaoping instituted significant economic reform and China began to increase economic exchange with the world (Lin et al., 2003). While GDP is not a perfect proxy for global power—it does provide a rough approximation of a nation's production possibility frontier, its measurement of economic strength remains one of the best predictors of military and diplomatic strength (Tammen et al., 2017; Organski & Kugler, 1980).

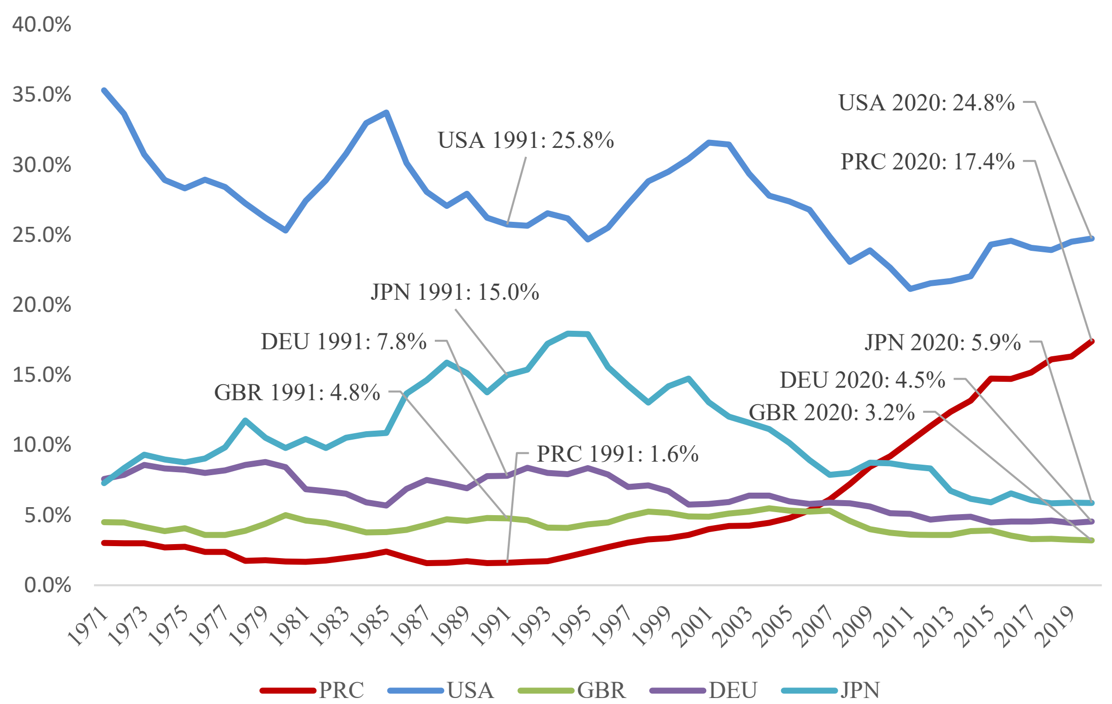


Figure 1. Five largest economies as percent of global GDP since 1971. Data from World Development Indicators | DataBank.

Figure 2 shows the percent of GDP the U.S. and China have spent on military expenditures during a similar period. China and U.S. expenditures on military have each remained well under 5 percent of GDP since the late 1990s. This could indicate constant perception of opportunity cost, China and the U.S. have decided they do not want to spend any more, or less, on their militaries compared to other activities. The furthest right column in Figure 3 also shows this constant percent of GDP on China’s military spending.

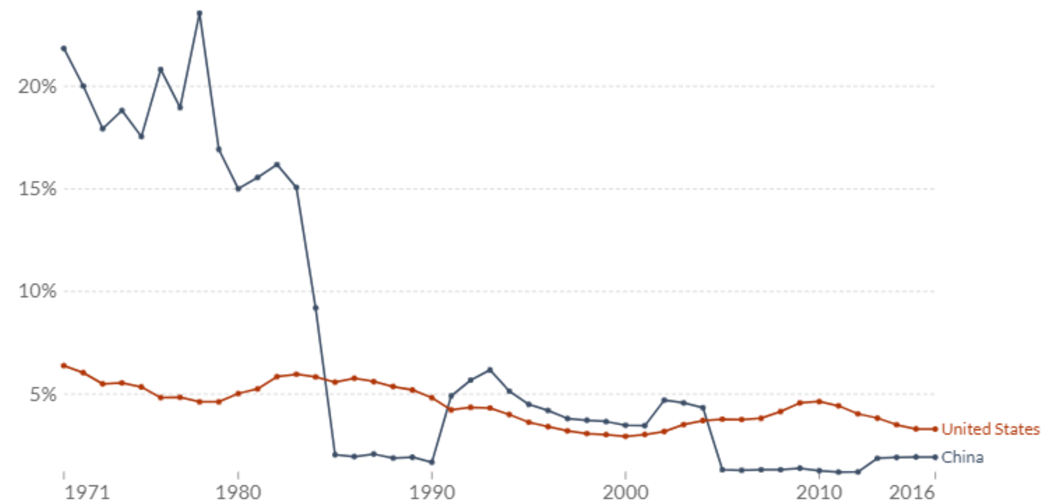


Figure 2. U.S. and China percent of GDP on military expenditures. Source: (Roser & Nagdy, 2013)

Figure 2 shows the significant decrease in the share of China's GDP spent on its military, however, since China's GDP has grown so much the absolute value of its military spending has grown significantly as seen in Figure 3. China's 2021 military budget was of $209 billion (Funaiole et al., 2021). China ranks second worldwide in military spending behind the U.S., who's defense budget was nearly $704 billion in fiscal year 2021 (Roser & Nagdy, 2013; *The Department of Defense Releases the President's Fiscal Year 2022 Defense Budget*, 2021). Except China's GDP has grown a lot more than the US's and as can be seen in Figure 3, China's absolute expenditures on defense have more than doubled since 2010.

Spending figures are billion yuan at current prices.

| | Official national defence budget | Old SIPRI estimate | New SIPRI estimate | New SIPRI estimate as a share of old estimate (%) | New SIPRI estimate as a share of GDP (%) |
|---|---|---|---|---|---|
| 2010 | 533.3 | 783.4 | 714.4 | *91* | *1.7* |
| 2011 | 602.8 | 891.5 | 809.5 | *91* | *1.7* |
| 2012 | 669.2 | 993.5 | 916.1 | *92* | *1.7* |
| 2013 | 741.1 | 1 114 | 1 017 | *91* | *1.7* |
| 2014 | 829.0 | 1 233 | 1 119 | *91* | *1.7* |
| 2015 | 908.8 | 1 335 | 1 224 | *92* | *1.8* |
| 2016 | 976.6 | 1 438 | 1 320 | *92* | *1.8* |
| 2017 | 1 044 | 1 545 | 1 424 | *92* | *1.7* |
| 2018 | 1 128 | 1 676 | 1 538 | *92* | *1.7* |
| 2019 | 1 213 | 1 803 | 1 660 | *92* | *1.7* |

GDP = Gross domestic product.
*Sources*: Chinese State Council, 新时代的中国国防 [China's national defence in the new era], Defence White Paper (Chinese State Council Information Office: Beijing, July 2019); and SIPRI Military Expenditure Database, May 2020, <http://sipri.org/databases/milex>.

Figure 3. Chinese military expenditures as reported in official budget and estimated by SIPRI. Source: Tian and Su (2021).

How has the U.S. perceived this new environment? The 2018 U.S. National Defense Strategy provides the following characterization of the risk and challenge posed by China:

> China is leveraging military modernization, influence operations, and predatory economics to coerce neighboring countries to reorder the Indo-Pacific region to their advantage. As China continues its economic and military ascendance, asserting power through an all-of-nation long-term strategy, it will continue to pursue a military modernization program that seeks Indo-Pacific regional hegemony in the near-term and displacement of the United States to achieve global preeminence in the future. The most far-reaching objective of this defense strategy is to set the military relationship between our two countries on a path of transparency and non-aggression…Another change to the strategic environment is a resilient, but weakening, post-WWII international order. In the decades after fascism's defeat in World War II, the United States and its allies and partners constructed a free and open international order to better safeguard their liberty and people from aggression and coercion. Although this system has evolved since the end of the Cold War, our network of alliances and partnerships remain the backbone of global security. China and Russia are now undermining the international order from within the system by exploiting its benefits while simultaneously undercutting its principles and "rules of the road". (Mattis, 2018, p. 2)

In 2018, the U.S. was clearly worried about an ascendent China. The U.S. perceived China's intent to reduce U.S. influence and power in the Indo-Pacific and erode the liberal international order the U.S. developed after WWII and continued to benefit from. The Interim National Security Guidance from March, 2021 provided a similar assessment of U.S. strengths, need for alliances, and the importance of global institutions. However, it also focused on domestic issues that the 2018 NDS did not address as thoroughly. The following excerpt from the Interim 2021 NDS is a good example of how the U.S. understands its ability translate domestic economic policy into national security:

> We have an enduring interest in expanding economic prosperity and opportunity, but we must redefine America's economic interests in terms of working families' livelihoods, rather than corporate profits or aggregate national wealth. That places an imperative on an economic recovery grounded in equitable and inclusive growth, as well as investments to encourage innovation, strengthen national competitiveness, produce good-paying jobs, rebuild American supply chains for critical goods, and expand opportunities for all Americans…We can do none of this work alone. For that reason, we will reinvigorate and modernize our alliances and partnerships around the world. For decades, our allies have stood by our side against common threats and adversaries, and worked hand-in-hand to advance our shared interests and values. They are a tremendous source of strength and a unique American advantage, helping to shoulder the responsibilities required to keep our nation safe and our people prosperous. Our democratic alliances enable us to present a common front, produce a unified vision, and pool our strength to promote high standards, establish effective international rules, and hold countries like China to account. (Interim National Security Strategic Guidance, 2021, p. 9-10)

Not examined in either of these passages is the deep level of economic interdependence between the U.S. and China. In 2020, the U.S. imported $434.7 billion in goods from China and exported $124.5 billion on a nominal basis (US Census Bureau Foreign Trade, n.d.). According to the U.S. Trade Representative, China is the US' largest goods trading partner and foreign direct investment between the two countries totals over $150 billion. Ryan Hass, chair of foreign policy at the Brookings Institution, described the U.S.-China relationship as "competitive interdependence" (Hass, 2021). Competitive interdependence does a better job of capturing the relationship than the U.S. NDS and Interim NDS. Yes, the U.S. and China are each competing for resources, partners, and global prestige, but their economic success and growth are intrinsically connected. The

U.S. needs to adopt a long-term strategy that accounts for its dependence on economic exchange with China to successful maintain its security and the world order and alliances lauded by both NDSs.

The U.S. will have to use sources of national power other than military violence to achieve the aspirations stated in each NDS. The U.S. cannot create a relationship of transparency and non-aggression with China purely through threat of violence. Similarly, the U.S. cannot strengthen the post-WWII international order, or the U.S. economy through unilateral threat of force. The focus on domestic issues in the 2021 NDS are more suited to these challenges. Economic statecraft, and the deliberate cultivation of economic capacity with domestic policy, create a competition space for both cooperation and coercion that is more suited for achieving these long-term strategic goals (Baldwin, 2020).

This paper will examine how the U.S. can use economic statecraft and domestic policy to develop and bolster the instruments of statecraft necessary for the U.S. to maintain a strong global position in the future. U.S. policy must be suited to face three principal challenges in this era of competitive interdependence. First, domestic policy must be able to ensure the U.S. capable of acting as an attractive international partner economically, politically, and militarily. Second, the U.S. needs to actively expand and strengthen current alliances and economic relationships. Third, translate success in the first and second areas into a stronger bargaining and coercing position to affect economic and political change within China that is beneficial to the US.

## B. WHAT IS ECONOMIC STATECRAFT?

Blackwill and Harris provide the following definition of economic statecraft in their book, *War by Other Means Geoeconomics and Statecraft*,

> The use of economic instruments to promote and defend national interest, and to produce beneficial geopolitical results; and the effects of other nations' economic actions on a country's geopolitical goals. (Blackwill & Harris, 2017, p. 20).

This definition will be the accepted meaning of the term "economic statecraft" throughout this paper, as Blackwill and Harris' definition is inclusive and subsumes a wide variety of economic activities, domestic and international, that a nation may take for its geopolitical advantage. The competitive interdependent relationship between the U.S. and China is too complicated to use a myopic or exclusive definition that might preclude the consideration of a worthwhile strategy. Blackwill and Harris' definition has another unique feature which is rare for a definition of economic statecraft: is straightforward and simple.

David A. Baldwin, author of *Economic Statecraft* (2020), takes a meandering approach to defining economic statecraft. Rather than succinctly defining economic statecraft he describes its features and characteristics. He provides tables listing positive sanctions (e.g., aid or investment) and negative sanctions (e.g., embargos, boycotts, or freezing assets), and mentions purchase, free trade, and tariffs as "some not-so-obvious forms of economic statecraft" (Baldwin, 2020, p. 42). The most concise description of economic statecraft Baldwin provides of is, "[T]he concept of economic statecraft employed here is intentionally broad, as it must be if it is to subsume all of the economic means by which foreign policy makers might try to influence other international actors" (Baldwin, 2020, p. 39). Despite his obtuse description, *Economic Statecraft* does provide the most comprehensive review of economic statecraft, how it can be applied, and how to measure its success.

An important consideration Baldwin acknowledges is the international impact of domestic economic policies (Baldwin, 2020; Mastanduno, 1999). However, while he acknowledges the importance of domestic policy on international affairs, he proceeds to deliberately exclude analyzing their impact. The closest he gets is an anecdote about slicing pie to describe the zero-sum nature of constrained global resources. The link between domestic policies and their wider effect is an important relationship and domestic policies should be considered more seriously as instruments of economic statecraft (Mastanduno, 1999). Baldwin warns of the unintended negative consequences of domestic policy, but this perspective misses how the U.S. can deliberately use domestic policy to create positive international effects. To stick with Baldwin's pie example, how could the U.S. use domestic policy to help grow the global resource pie? Or decrease global pollution of the pie? Possibilities and strategic options that myopic perceptions and definitions of economic statecraft fail to promote.

The myopic conception of economic statecraft, for example on as a coercive implement to be wielded against competitors and allies, will only doom the U.S. in the future. A broader understanding of economic statecraft, and how economic power can be cultivated, is needed for the U.S. to achieve its strategic goals. The U.S. needs to reimagine how economic statecraft and domestic policies can make it a favored partner globally, strengthen and expand alliances and economic relationships, and translate growth and partnerships into additional strength relative to China without upsetting the deep economic interdependence between the two. A constrained understanding of economic statecraft will critically hamper creative applications and policies for economic and national growth necessary for success in these challenges.

## C. SCOPE AND METHODOLOGY

Michael Mastanduno provides research advice in *Economic statecraft, Interdependence, and national security: Agendas for research* (1999). First, to resist framing questions in yes/no, winner/loser formats, and instead seek to frame research questions in contextualized formats. Next, he suggests any study of economic statecraft must be founded on a solid foundation of domestic level analysis. Third, he states the separation of economics from geopolitics during the Cold War was an abnormality and the connection between economics and security should be accepted as normal again. Finally, he believes historic examples, even those preceding the Cold War, are worth examining for insight today. This paper will be informed by existing literature that evaluates the efficacy of economic statecraft, international relations (IR) theory, and theories and models from economics that analyze the role of government in markets to determine how the U.S. can best approach its future relationship with China and the global community. Historical examples of good and bad uses of economic statecraft will provide insight into the situations when U.S. policy options can be most effective. Further, economic statecraft will also be compared to other obvious policy alternatives like military force to evaluate their impacts on alliance behavior.

There are many instruments of economic statecraft available to the U.S., this paper will try to determine which have the most positive influence on alliance behavior. This paper will not seek to quantify the efficacy or impact of economic instruments, as there is a large body of research on these topics (Baldwin, 2020; Blanchard & Ripsman, 1999; Drezner, 1999b, 2003, 2019; Hufbauer et al., 1985; Pape, 1997, 1998, 2021) Rather, in line with Mastanduno's advice above, domestic items like energy, investment, and fiscal policy will be examined for their international effects, impacts on alliance behavior, and how the U.S. can use them to increase the effectiveness of its economic statecraft.

## D. RESEARCH QUESTIONS

Primary research question explored:

- How can the U.S. use economic statecraft and domestic policy to positively effect alliance behavior?

An underlying research question is:

- How can the United States attain and maintain a broad spectrum of economic statecraft capabilities?

## E. BENEFITS OF RESEARCH

Research on economic statecraft has received a resurgence in the last few decades (Baldwin 2020; Mastanduno, 1999). However, the preponderance covers international relations and statecraft perspectives and does not address the impact of domestic politics appropriately. Another major issue with economic statecraft literature is that it's infatuated with sanctions, coercion, and efficacy without considering the opportunity cost of other alternatives like force. This paper will take a more wholistic, applicable approach to provide U.S. policy makers an actionable strategic framework for the future.

It is also important to note that the U.S. and China are the two strongest countries in the world. If competition and strategic communication through bargaining and coercion only exist in a military and threat of violence context, the risk of unintended escalation and conflict during crisis is much higher. Economic competition, while it has costs just like violent competition, provides a space with increased time for de-escalation. This paper will seek to build on economic statecraft literature and determine domestic policies that can provide the U.S. the greatest capacity to compete in a less violent space.

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# II. ACADEMIC FOUNDATION

Economics and international relations (IR) are disciplines fundamental to examining the US' current competitive interdependent relationship with China. Economics and IR each include extremely varied topics, not all of which are germane to the U.S.-China relationship. From IR, realism, liberalism, alliance behavior, and power transition theory (PTT) are the theories most useful for analyzing economic statecraft. The role and impact of governments in markets and the impact of international trade provide the greatest insights into the global and domestic economic forces impacting the effectiveness of economic statecraft.

The combination of these IR and economic theories creates the framework necessary for developing a U.S. strategy appropriate for its current and future relationship with China. Economic policies need to be updated to meet the current global situation, not the Cold War or the world without the internet. The U.S. is not a unipolar power and must consider alliance behavior and PTT more seriously when exerting or relying on its national power. While this seems obvious, the U.S. has not been very effective at translating economic growth and dominance into geopolitical success (Blackwill & Harris, 2016; Drezner, 2019). Only by applying economics and IR cohesively can the U.S. use the correct blend of instruments of economic statecraft to effectively manage its competitive interdependent relationship with China.

## A. INTERNATIONAL RELATIONS THEORIES

### 1. Realism and Liberalism

Realism and liberalism each seek to define the structure and impetus for interstate relationships and objectives. The two tables in Figure 4 succinctly capture each theories main points. The differences between liberal and realist preferred international orders and the characteristic instruments of national power they identity create the primary rift in accepted uses of economic statecraft. Constructivism is listed in each table of Figure 4. However, concepts from realism and liberalism are more pervasive in economic statecraft literature and therefore constructivism will not be used to analyze or develop U.S. strategy.

Realism suggests that each nation has sovereign control over its resources and should wield them in whichever way makes that nation more powerful than others. Mercantilism is the most radical form of realist economic policy and is characterized by an extreme nationalist focus and concern over potential relative gains of other nations, though especially a prospective trading partner. Alternatively, liberalism emphasizes the importance of institutions and how states can increase their absolute gains through collective security and trade liberalization. Post-WWII institutions like the World Bank, World Trade Organization (WTO), and International Monetary Fund (IMF) are the best historical examples of a liberal world economic order.

The end of the Cold War created a contentious time for realist and liberal academics debating the future of the "victorious" liberal Western world order. An exchange that occurred in the journal International Security between 1994 and 1995 is a perfect example. In the winter edition John Mearsheimer published the paper, "The False Promise of International Institutions" and in the following volume Robert Keohane and Lisa Martin published, "The Promise of International Institutions." IR literature in the 1990s was struggling to contend with the future of geopolitics with the U.S. as a unipolar power.

| COMPETING PARADIGMS | REALISM | LIBERALISM | CONSTRUCTIVISM |
|---|---|---|---|
| **Main Theoretical Proposition** | Self-interested states compete constantly for power or security | Concern for power overridden by economic/political considerations (desire for prosperity, commitment to liberal values) | State behavior shaped by élite beliefs, collective norms, and social identities |
| **Main Units of Analysis** | States | States | Individuals (especially élites) |
| **Main Instruments** | Economic and especially military power | Varies (international institutions, economic exchange, promotion of democracy) | Ideas and discourse |
| **Modern Theorists** | Hans Morgenthau, Kenneth Waltz | Michael Doyle, Robert Keohane | Alexander Wendt, John Ruggie |
| **Representative Modern Works** | Waltz, *Theory of International Politics* Mearsheimer, "Back to the Future: Instability in Europe after the Cold War" (*International Security*, 1990) | Keohane, *After Hegemony* Fukuyama, "The End of History?" (*National Interest*, 1989) | Wendt, "Anarchy Is What States Make of It" (*International Organization*, 1992); Koslowski & Kratochwil, "Understanding Changes in International Politics" (*International Organization*, 1994) |
| **Post–Cold War Prediction** | Resurgence of overt great power competition | Increased cooperation as liberal values, free markets, and international institutions spread | Agnostic because it cannot predict the content of ideas |
| **Main Limitation** | Does not account for international change | Tends to ignore the role of power | Better at describing the past than anticipating the future |

| | *Realism* | *Liberalism* | *Constructivism* |
|---|---|---|---|
| Main Actors | States | States, multinational corporations, and international organizations | States, transnational knowledge communities, and moral entrepreneurs |
| Primary Goals of States | Pursuit of national interest; power maximization (offensive Realism); survival and security (defensive Realism) | Cooperation and coordination to achieve collective goals; world peace | Community building through interactions and shared normative frameworks |
| Preferred International Order | A balance of power system underpinned by self-help and alliances to maintain international order | A collective security system underpinned by free trade, liberal democracy, and institutions | Global and regional security communities forged through shared norms and collective identity |
| Primary Mode of Interaction between Units | Strategic interaction backed by causal ideas and military and economic power | Two-level (domestic and international) bargaining backed by causal ideas; trade and other forms of functional institutionalization | Socialization through principled ideas and institutions |
| A Major Variation | Neo-Realism: distribution of power decides outcome | Neo-Liberal Institutionalism: international system anarchic, but institutions created by states in their self-interest do constrain anarchy | Critical Constructivism: challenges the state-centric Constructivism of Wendt |

Figure 4. Left: Stephen Walt's table of IR paradigms. Right: Acharya's table of IR Paradigms. Source: Acharya (2014), Walt (1998).

Mearsheimer's conclusions about liberalism and international institutions is simple: institutions do not alter state behavior. Their stated purpose is to induce cooperation and there by peace. Institutions fail to do this, and therefore realism is a more appropriate theory of IR for the U.S. to do adopt. Keohane and Martin obviously come to different conclusions. They acknowledge that there are plenty of examples of intuitions failing to affect state behavior. However, they suggest that states still have incentive to form institutions because they facilitate cooperation between states. Keohane and Martin determine that because institutions facilitate cooperative gains between nations, they will continue to exist (Keohane & Martin, 1995). Liberal institutions are also durable because of how the diffuse power to multiple leaders, they incentivize cooperation and integration, and participants experience increase economic prosperity (Ikenberry, 2018).

Quantitative testing economic statecraft's efficacy should be impartial. However, the results are typically mixed, and liberalism and realism influence whether those results are viewed in favor or against economic statecraft. Realist authors, emphasizing state action, see economic statecraft as another way states exert power and the exercise of power is more the point (Baldwin, 2020; Blackwill & Harris, 2017). Liberal authors, valuing free trade, view mixed results as not worth impinging free trade on an effort that is not clearly advantageous (Pape, 1997, 1998, 2021). There is a larger group of realist and liberal authors who propose the efficacy of economic statecraft is more dependent on target type and the situation (Blanchard & Ripsman, 1999; Drezner, 1999a, 1999b; Førland, 1993; Mastanduno, 1998).

Economic statecraft is typically viewed as a realist lever of national power because of highly nationalistic mercantilist policies that were prevalent from approximately 1500–1750 (Baldwin, 2020). For example, even if trade and exchange of goods benefited a nation, they may not consider it a positive outcome if the country they were trading with benefited even more than they did. Trading away relative gains is counter to realist concerns over balance of power, self-interest, or relative economic and military powers described in Figure 4. Economic statecraft does not have to be viewed so myopically. Blackwill and Harris' definition of economic statecraft includes the use of economic instruments to promote national interest, and is not limited by nationalism, trade balances, relative gains, or stock of precious metals. Economic statecraft can include establishing global institutions and expanding trade liberalization. Joining the WTO to benefit from easier trade with more partners is economic statecraft. Through the Bretton Woods Agreement, the U.S. was able to put itself at the most influential economic position in the new world order by establishing the World Bank, IMF, and the General Agreement on Tariffs and Trade (GATT). Economic statecraft should not be viewed as only a realist conception because of its history. A broader conception of economic statecraft that considers its potential roles in a liberal world order is required to develop a strategy that is appropriate for the modern applications.

## 2. Alliance Formation

Alliance formation and behavior will be one of the US' greatest future challenges. Immediately following the Cold War, and for nearly the next thirty years, the U.S. was by far the most powerful country. For the last few decades, the U.S. was the only option if another country was looking to establish a relationship with a huge economy and military with cutting edge technology. This is no longer true. As Figures 1 and 2 show, China's incredible growth during this period challenges U.S. primacy today. Given the size and benefits of trading with each, most countries (and companies) in the world would prefer to continue working with both the U.S. and China. The U.S. should not be oblivious to the possibility that it could act in such a way as to shift global preferences drastically in favor of China. The positive and negative impacts of economic statecraft and domestic policy on alliance behavior will be especially important to the U.S. as it navigates its competitive interdependent relationship with China.

The U.S. can avoid creating an environment that works against its long-term strategic goals by constantly considering the impacts of its actions on alliance behavior. In, *Alliance Formation and the Balance of Power* (1985), Stephen Walt's description of the forces during the Cold War is still prescient today. Walt analyzes the effects of three factors that influence alignment decision. First, he looks at whether states balance or bandwagon base on the perception of threats. Next, he looks at the effects of ideology. And finally, he examines the influence of aid, propaganda, and penetration. While his paper is set in the Cold War, comparing the U.S. and USSR, Walt's perspectives help describe U.S.-China competition today.

Walt suggests the most powerful force driving alliance behavior is power. He suggests threats from power are comprised of one state's assessment of another's aggregate power, proximate power, offensive capabilities, and offensive intentions. When faced with a threat, states either form alliances to balance against power, or bandwagon with power. Bandwagoning is characterized by nations being drawn towards more powerful ones. While balancing is seen when nations combine forces to oppose a greater one. Steven David argues that power and external threats are not the only one's countries must balance against. Leaders of weaker countries will calculate what external relationships will help them stay in power (David, 1991). He highlights the internal threats and domestic politics that effect weaker states, particularly in the third world if that state is seen as less legitimate at home due to the way the government assumed and maintained power.

The U.S. is the currently a status quo power and would like other nations to balance against the rise of China. Since the U.S. still has the largest economy and military budget in the world, China would like other countries to balance against the U.S. The U.S. and China are not weak countries, and they may not be worried about revolts like David (1991) describes. However, those in power will still need to be conscious of domestic political sentiment and will within their respective countries. This tension will continue to a central challenge for each country as they try to align countries and domestic constituencies with their interests while they each strive to be the strongest country in the world.

Walt condenses the influence of aid, propaganda, and political penetration into "Bribery and Penetration." The former suggests that, "the more aid, the tighter the resulting alliance" (Walt, 1985, p. 27). However, there are many examples of Third World countries changing alliances despite aid like Egypt in the 1970s (David, 1991). Aid may be helpful, but it typically does not outweigh the other forces driving alliance behavior. Penetration involves how much political influence a nation, or ideology, has in another state. The danger is that overt forms of penetration might be perceived as subversion. For example, Russian interference in the 2016 U.S. Presidential election. In this way, Walt (1985) and David (1991) each suggest that alignment of small countries may have little to do with aid and depend more on the leader's perception of domestic and international threats.

Walt claims balance of power relationships are the most common in history. He suggests there are two reasons to develop of balance of power relationship: to mitigate the influence of a hegemon and survive, or to create an alliance that would give the state greater relative power in the relationship. By creating a balance of power alliance, a nation can better resist a hegemon and ensure their relative importance in the alliance by joining the weaker side. Balance of power alliances create a more stable environment and support the status quo (Walt, 1985).

Bandwagoning is less common but certain scenarios may provide greater motivation for a nation to adopt this strategy. A state electing to bandwagon may do so to appease a stronger nation, or at the end of a conflict to join the winning side and share the spoils. Walt claims bandwagoning is inherently more unstable than balancing because the goal is to join the stronger side, not resist change. However, Goldgeier and McFaul argue that the modern strong countries responsible for the liberal world order, what they refer to as the core, will bandwagon to maintain the status quo (Goldgeier & McFaul, 1992; Ikenberry, 2018). Bandwagoning in the Goldgeier McFaul context may be more common today than balance of power.

Ideology and the influence of aid, propaganda, and political penetration are examined as popular, but less important, forces that drive alliance behavior. They are commonly mentioned, or employed, by nations and are therefore worthwhile examining. These traits can either serve either to drive, or discourage alliance behavior. Democratic peace theory, for example, suggests that liberal democracies with market economies are less likely to have conflict and work together. However in other forms of political and economic ideology, "when the ideology calls for a single leader, then all regimes save the one that emerges on top will find their autonomy threatened *by the other members of the same movement*" (Walt, 1985, p. 21 emphasis in the original). Goldgeier and McFaul suggests that the liberal ideology and power has created *core* countries in the world, incentivizing the western nations leading the international world order to continue to cooperate (Goldgeier & McFaul, 1992).

### 3. Power Transition Theory

Within the last twenty or thirty years, nearly every paper on the U.S.-China relationship discusses PTT. The US' long standing global hegemony and China's incredible rise during the last few decades make this an obvious connection to study. Graham Allison (2015), Tammen and Kugler (2006) and Tammen et al. (2017), Yves-Heng Lim (2015), Kang and Ma (2018), and Johnston (2019) each provide a broad set of lens and vernacular to dissect the U.S.-China relationship. PTT cannot tell us which country will be the most powerful in the future. However, PTT provides us insight into how the U.S. and China may perceive each other and react as each try to be the strongest.

National power is described as, "…the ability of one nation to advance policy goals by altering the policies of other nations" (Tammen et al., 2017, p. 3). Three contributing factors to national power are commonly accepted: population, productivity, and political performance (Tammen et al., 2017). This wholistic approach provides a better measure of national power which is more predictive across size and level of development. Population, productivity, and political performance provide a more nuanced approach than just looking aggregate measures like CINC or GDP.

One of the more popular PTT essays is *The Thucydides Trap Are the U.S. and China Headed for War?* by Graham Allison. Published in 2015, Allison argues that given the current interaction and global structure war between the U.S. and China is more likely than sustained cooperation. Allison and his team analyzed the 16 cases of global power transition listed in Figure 5 below. They looked at circumstances like Sparta going to war to fight a rising Athens that occurred during the last 500 years and found only four ended without war.

Kang and Ma (2018) point out that the cases listed in Figure 5 only occurred in Europe and completely exclude the rest of the world. They suggest that if the scope were appropriately broadened, other lessons would be gleaned from power transitions in Asia. Rather than most periods of transition being violent, Kang and Ma find the following lessons during the same period in Asia, "First, power vacuums are often as dangerous as power transitions. Second, internal decline is often more damaging to hegemons than are external challengers. Third, challenges often came from the smallest powers, not the largest powers" (Kang & Ma, 2018, p. 138). The U.S. and China both face significant domestic challenges, and neither is guaranteed continued growth or dominance in the future (Kang & Ma, 2018). Like Allison, they suggest that despite what history may say, the U.S. and China must carefully manage their relationship and find ways to coexist.

Graham's essay identifies key factors of the Thucydides trap that lead to war rather than peaceful transition. First, the rising power feels, "growing entitlement, sense of its importance, and demand for greater say and sway" (Allison, 2015, p. 2). Second, the established power feels, "fear, insecurity, and determination to defend the status quo." From Graham's point of view the Thucydides *trap* is aptly named. Conflict is structurally difficult for the powers to avoid, though Graham does provide hope stating early in his essay that conflict is not inevitable. However, Graham gravely warns that serious conflict will be difficult to avoid without special care and consideration from the U.S. and China.

Tammen & Kugler (2006) and Tammen et al., (2017) provide broader perspectives. In each of these, the characteristics measured to analyze interactions between states are, "power, hierarchy, satisfaction and the probability for war and peace" (Tammen & Kugler, 2006, p. 38). Drivers of power and hierarchy are examined in detail in the 2017 piece. In 2006, variables of satisfaction (and dissatisfaction) are analyzed specific to the U.S.-China relationship. Unlike Allison's Thucydides Trap, where forces are external and must be acknowledged and managed by leaders. Tammen and Kugler (2006) and Tammen et al. (2017) describe and accept characteristics and forces as internal to states. The relationship between the U.S. and China is guided by internal forces of each state that can be affected and changed by policy.

**Thucydides Trap Case Studies**

| | Period | Ruling Power | Rising Power | Result |
|---|---|---|---|---|
| 1 | First half of 16th century | France | Hapsburgs | War |
| 2 | 16th–17th centuries | Hapsburgs | Ottoman Empire | War |
| 3 | 17th century | Hapsburgs | Sweden | War |
| 4 | 17th century | Dutch Republic | England | War |
| 5 | Late 17th–early 18th centuries | France | Great Britain | War |
| 6 | Late 18th–early 19th centuries | United Kingdom | France | War |
| 7 | Mid-19th century | United Kingdom, France | Russia | War |
| 8 | 19th century | France | Germany | War |
| 9 | Late 19th–early 20th centuries | Russia, China | Japan | War |
| 10 | Early 20th century | United Kingdom | United States | No war |
| 11 | Early 20th century | Russia, U.K., France | Germany | War |
| 12 | Mid-20th century | Soviet Union, U.K. France | Germany | War |
| 13 | Mid-20th century | United States | Japan | War |
| 14 | 1970s–1980s | Soviet Union | Japan | No war |
| 15 | 1940s–1980s | United States | Soviet Union | No war |
| 16 | 1990s–present | United Kingdom, France | Germany | No war |

Figure 5. Case studies from Allison's *Atlantic* article. Source: Allison (2015).

Tammen and Kugler (2006) suggest the most important strategy for the U.S. is to help China grow into a satisfied county. Most importantly that the Chinese elite become satisfied with China's place and role in the global hierarchy and world order. The greatest policy challenge for the U.S. will be to achieve this strategic end state without appeasing China in areas of contention today. The greatest external challenge would be a revivalist nationalist elite class in China so unsatisfied that two irreconcilable wills lead each other to war. In the event that cooperation and non-appeasement are unable to achieve U.S. strategic objectives, "only a strengthened Western alliance composed of the U.S., Western Europe, India and Japan would be powerful enough to avert conflict and even then the world may find the consequences exceedingly unpleasant" (Tammen & Kugler, 2006, p. 55).

## B. ECONOMICS

Economics, like IR, is an extremely broad field and not every model and theory is directly related to economic statecraft in the U.S.-China relationship. However, there are some topics that are particularly germane: international trade and its effects on domestic labor markets, government roles in addressing market failures, and government opportunities to encourage economic growth. These are the primary economic challenges the U.S. will face in developing a national strategy that attracts partners, strengthens current alliances, and helps the U.S. in its relationship with China.

### 1. The Government's Role in an Economy

In a laissez faire capitalist system, the market is left to find its own equilibrium with no government regulation or manipulation. The idea being that rational actors in a market will eventually reach the most optimal distribution of resources. Adam Smith described this force that pushes markets to equilibrium as the "invisible hand" in *The Wealth of Nations*. Governments do not need to create regulation because, through the power of the invisible hand, the market will create regulatory, or quality assurance, bodies like Consumer Reports if one is needed. The idea of laissez faire is that the invisible hand of market forces is strong enough to create an efficient equilibrium regardless of other structural hindrances like externalities or asymmetric information.

In reality, nearly every government is involved in varying degrees in regulating the economies and economic activity and no laissez faire economies exist. How government involvement, or deliberate non-involvement, helps or hinders economic performance will impact which policies should be used to affect economic statecraft. Unfortunately, the relationship between governments and economies is so complex there is still a lot of debate about the exact nature of causality between the rule of law and economic growth (Haggard & Tiede, 2011). However, there is a significant amount of literature that suggests that governments can support economic growth through civil liberties, protecting property rights, enabling veto players to change the status quo, physical infrastructure, and information symmetry (Haggard & Tiede, 2011; Valeriani & Peluso, 2011). Some of these effects, like physical infrastructure, come from quality basic governance, others like protecting property rights require more deliberate policy and structural approaches (e.g., court systems and federal prosecutors) to mature successfully.

Areas of economic exchange that suffer from market failures require more input than the invisible hand to achieve equilibrium. Economists like John Stuart Mill, Henry Sidgwick, Paul Samuelson, and others, believe the government can and should act as this additional force. Market failures exist in many situations. For example, when it is hard to assign cost (pollution), discriminate those who receive a benefit (lighthouse), there is public need but little incentive to provide it (healthcare), or information asymmetry (lemons market). Each of these market failures can be addressed centrally by a government to make up for an ineffective invisible hand.

Global warming has made managing market failures like pollution more salient. If one nation creates pollution while producing an item, persons around the world are negatively affected by the pollution cannot be individually identified and compensated. Gillingham and Sweeney wrote in 2010 on the complexities of using different policy instruments to address the externalities of pollution. Their contribution to the book, *Harnessing Renewable Energy in Electric Power Systems: Theory, Practice, Policy*, provides actionable suggestions on how to internalize negative externalities and incentivize goods like R&D tax incentives, product standards, transparency laws, and carbon markets (Gillingham & Sweeney, 2010).

Healthcare firms face several market issues. First, they suffer from only attracting high risk individuals because sick people need health insurance and healthy people would rather not pay premiums. Further, healthcare firms, like every other firm, exist to make a profit. Chronic, incurable diseases that affect affluent populations are the most profitable for healthcare firms to address. Curable diseases that affect marginalized communities in developing nations are far less profitable and do not receive adequate attention. The incentive schemes and balance of risk in healthcare create market failures. Just like pollution, government funded and subsidized research can help bridge the gap by assuming the burden of basic and applied research where the risk of not making profit is higher but the fruits of the research can save lives. Governments can also use regulation to increase participation and decrease the risk pool in the health care market.

Government involvement in markets can create dead weight loss, which is when the optimal amount of a good or service is not produced. Governments create dead weight loss by manipulating markets and creating artificial scarcity with price ceilings, taxes, subsidies, or minimum wages to name a few. Governments can also incentivize over production of goods or services which limits those resources from being used elsewhere creating dead weight loss in another market. The government regulation shifts the optimal price for consumers and producers, and the truly desired amount is not created or used. Economic statecraft, which inherently involves government manipulation of markets forces for geopolitical ends, has the capacity to create large amounts of unnecessary dead weight loss if used frivolously. Dead weight loss will likely occur in any application of economic statecraft, but the government should ensure it is receiving greater geopolitical benefits than economic losses it creating.

Government involvement in markets must be carefully applied and moderated to ensure any dead weight loss created is appropriately offset in some other area. Some functions of the government, like rule of law, create very little dead weight loss and are more likely to contribute directly to economic growth. Internalizing externalities is another area of regulation where government action can create more benefits than harm, or at least it can ensure any harm becomes the burden of those creating it. Other forms of government involvement in the market, like tariffs, can create dead weight loss but no corresponding benefit to society and are especially harmful. Nearly all instruments of economic statecraft, and the policies that enable it, require this special balance of impacting markets while extracting benefits in some other area.

### 2. International trade and labor markets

Comparative advantage forms the main argument for global free trade and is one of the reasons economists are typically in favor of liberal institutions. The concept of comparative advantage, attributed to David Ricardo, is one of the most basic theories in economics (*Comparative Advantage*, n.d.). Instruments of economic statecraft can have beneficial, or deleterious, effects on international trade. Therefore, the impetus for international trade, its benefits, and challenges for domestic labor forces, and how it can be cultivated are important to understand how to employ an economic statecraft strategy.

Comparative advantage is a simple model. Take for example, country A and B. Country A's geography and climate are conducive to making wine, and country B's raising sheep. In this simplified scenario, when we overlay the production possibility curves of each country on the same axis they show country A can produce wine more efficiently than country B, and country B can raise sheep more efficiently than country A. Rather than using a lot of resources to raise sheep in a poorly suited environment, country A can generate more utils by focusing on wine and exchanging wine for sheep with country B. In this simplified model, each country can make the most efficient use of their available resources by trading.

Comparative advantage explains, in an economic sense, why country A and B should always choose to trade and increase their absolute gains. If country A's utils increase from 10 to 15 units and country B's utils increase from 7 to 21. In the economic model, country A should not care that B's utils have become relatively greater than theirs because their utils have increased by 50 percent. The comparative advantage model explains why economists typically support liberal IR theory (emphasizing absolute gains from free trade) over realism (concerned with relative power).

But what about the sheep farmers in country A? They may not have been producing sheep as efficiently as country B, but it is how they made their living. Now the sheep farmers of country B are taking money from farmers in Country A, they are flooding country A's market with underpriced lamb chops undercutting domestic sheep farmers. Country B is taking good paying jobs away from Country A. Isn't this a bad thing for country A's sheep farmers? These are just a few of the problems commonly highlighted about international trade.

Autor, Dorn, and Hanson explore the impacts on the U.S. manufacturing labor force due to increased trade with China in their piece, "The China Shock." They find that geographic specialization made certain communities particularly susceptible to labor market contraction. Not only did the labor market contract locally for the manufacturing site affected by production moving to China, the labor market in the rest of the community contracted as well. International trade with China created a localized recession these communities. They also found the negative impacts of labor market contraction was further compounded because the labor mobility was lower than expected. The typical economic assumption with global trade is that those who lose their jobs will just find new ones. However, this study found labor mobility was too low to make up for the impacts to communities negatively impacted by manufacturing moving to China (Autor et al., 2016).

Other research suggests that automation and technological change has had an even greater impact on the U.S. labor market than international trade (Clausing, 2019). Despite their negative effects, international trade and technological innovation both positively impact the U.S. economy and standard of living in aggregate. Not to mention, "in a typical year, millions of job are eliminated, but slightly more jobs are created, and so U.S. employment expands" (Hanson, 2021, p. 24). However, labor immobility has created an environment in the U.S. where a rising tide has not been raising all boats (Clausing, 2019; Hanson, 2021). This environment has engendered domestic resistance to economic activity, international trade, and innovation in automation that is in general beneficial to the U.S.

Clausing and Hanson provide similar suggestions on how the U.S. might continue to benefit from international trade and automation while mitigating their negative effects. Clausing summarizes her suggestions as policies that ready workers for a modern, global economy (Clausing, 2019). These policies include: updated trade agreements, improved support for workers and communities, investment in education, R&D, and infrastructure (Clausing, 2019). Hanson concurs, stating simply, "evidence show that active labor-market programs, designed to help young and disadvantaged workers succeed in the labor market, are a good bet" (Hanson, 2021, p. 27).

Elements of economic statecraft, like trade, can have positive effects in aggregate for the economy while negatively impacting specific communities. Governments can use policies like Clausing and Hanson suggest to mitigate these negative impacts and ensure that economic statecraft does not create political backlash domestically. Similar to war, economic statecraft requires a political will to engage in and endure the costs and dead weight loss over time. Nations must balance their geopolitical goals with their domestic political climate to ensure they can continue employing instruments of economic statecraft that are benefiting the country overall.

# III. ECONOMIC STATECRAFT AS A LEVER OF NATIONAL POWER

Economic indicators like GDP and CINC are often used to approximate national power (Tammen et al., 2017). So how effectively do nations translate economic power into geopolitical power? This section will explore literature and cases to inform how the U.S., the largest economy in the world, can best employ economic statecraft to translate its economic power into geopolitical power. Before attempting to answer this question, economic statecraft will first be compared as a lever of national power to the military options also available to the U.S. Next, the efficacy of different economic statecraft styles will be compared through an examination of relevant literature. Lastly, how well these styles of economic statecraft performed in the following cases will be evaluated: U.S. sanctions on North Korea, the Marshall Plan, and the CPTPP.

## A. ANOTHER SPACE FOR COMPETITION

Despite its great cost, war, violence, and the threat of violence will likely remain key strategic options to resolving conflict between nations. However, as the destructive capabilities of nations increase, the reasonableness of employing any such measures decreases. Mutually assured destruction (MAD), a term coined by Donald Brennan in 1962 during the Cold War illustrated the limits of violence. The destruction wrought by nuclear weapons as seen in the aftermath of the bombings of Hiroshima and Nagasaki and the new reality of potential nuclear retaliation proved too destructive and unthinkable to serve as believable threats between the U.S. and USSR (Schelling, 1980). Nuclear weapons are good deterrents because they provide the ability to answer an attack with an overwhelming response. However, they do not serve as credible threats because nations have displayed aversion to being the first to use nuclear weapons first in a conflict. The lethality of modern weapons means any military conflict between China and the U.S. would be incredibly destructive and threats of violence are so risky they become ineffective.

MAD succeeded in preventing nuclear conflict during the Cold War, but competition between the U.S. and USSR spilled into other conflicts like the Korean War and Second Vietnamese War. With advancements in weapons, even proxy wars between the U.S. and China could escalate and wreak Armageddon-level destruction. Economic statecraft can serve as an alternative way the U.S. and China can exercise their national power to bargain, threaten, impose and incur costs to show commitment, and develop alliances and partnerships.

PTT literature cites the high cost of war as a reason for nations to navigate changes in relative power carefully. If competition and jockeying for global influence is only performed in concrete measures via military means, the risk of catastrophic escalation of violence between the U.S. and China increases significantly. Economic statecraft therefore is a more practical lever of national power because it bears real costs, but those costs move slower than ICBMs and are not immediately lethal.

Unfortunately, there is a lacuna of quantitative comparative analysis of the costs of violent conflict and economic conflict in economic statecraft literature. For example, *Economic Statecraft* (2020) by David A. Baldwin deliberately avoids comparing instruments of economic statecraft to policy alternatives like military force. Baldwin is not the only one. When studies compare economic statecraft policies that create dead weight loss only to economic policies with slightly less dead weight loss it is easy to find fault with economic statecraft. However, if the costs of economic statecraft were compared to the costs of maintaining large standing armies, economic degradation through the destruction of infrastructure, and perhaps most salient, the loss of life, a different optimal balance of costs may become apparent. There is a lot to learn from the literature evaluating economic statecraft, but national strategies should be compared to common alternatives.

The efficacy of economic statecraft should also be compared to the efficacy of other policy alternatives. For example, has the U.S. been as efficacious with its use of violence since WWII? Political objectives and end states have become less well-defined, and violence has proved so costly and unpopular that the U.S. has had to halt its efforts prematurely. In the Korean War, Second Vietnamese War, and Iraq and Afghanistan in the 2000s, the U.S. had overwhelming military superiority yet failed strategically. Developing different levers of national power can hopefully decrease loss of life and dead weight loss because policy options available to leaders will be less constrained.

To suggest that the U.S. choose economic statecraft before violence because it is less costly is not to say that the U.S. should engage in economic statecraft flippantly. The costs and dead weight loss can be destructive for the U.S. and its target. Prescient words from the Cold War still ring true today, "…because balancing is the dominant tendency in international politics, the United States should worry less about its allies defecting and worry more about how it provokes opposition through misplaced belligerence" (Walt, 1985). Economic statecraft is less costly than violence, however, it must be employed judiciously for the U.S. to reap the benefits it seeks.

## B. EFFICACY OF ECONOMIC STATECRAFT

During the last few decades there has been a flurry of studies about when, why, how, and if economic statecraft is actually effective at achieving its stated policy objectives (Blanchard & Ripsman, 1999, 2008; Chan & Drury, 2000; Clemens, 2013; Collins, 2009; Drezner, 1999a, 1999b, 2003, 2019; Krustev, 2010; Morgan & Link to external site, 2019; Pape, 1997, 1998, 2021; Peksen, 2019). The literature examining economic statecraft deals with outcomes but does not measure the inputs and costs that a nation must endure to affect the policies tested. Insights from the existing literature examining the political efficacy of economic statecraft must be combined with economic models to develop a qualitative balance of costs and benefits for the U.S. to strike in its economic statecraft strategy.

Literature measuring outcomes and geopolitical success of economic statecraft are typically focused on coercion and inducements, colloquially known as carrots and sticks. This is likely because the mechanisms involved (e.g., demands, sanctions, gifts, bribes, etc.) are easier to measure quantitatively and they pair well with a binary successful or not successful outcome. Sanctions are easier to test and measure than "The use of economic instruments to promote and defend national interest, and to produce beneficial geopolitical results; and the effects of other nations' economic actions on a country's geopolitical goals" (Blackwill & Harris, 2017, p. 20). Unfortunately, the efficacy literature's focus on coercion is a serious limitation on studying economic statecraft because there are many other instruments to test.

A commonly used data set examining the efficacy of coercion was assembled and published by Hufbauer, Schott, and Elliot. Their 1990 work included a list of 115 cases of economic coercion that occurred from 1914 to 1990. They categorized each event as successful from the sender's perspective depending on a one to four scale meant to capture the overall policy result and the degree that economic coercion played a part. By their assessment, economic coercion achieved a 34 percent success rate and they determined is therefore a useful instrument at achieving geopolitical goals. However, when reviewing the same data others like Robert Pape find:

> An examination of the 40 cases in which HSE claim economic sanctions were successful reveals only 5 clear successes. The remainder are accounted for by 4 classes of errors: 18 were determined by force, not economic sanctions; 8 are failures, in which the target state never conceded to the coercer's demands; 6 are trade disputes, not instances of economic sanctions; and 3 are indeterminate. (Pape, 1997)

Pape, who is currently a political science professor at the University of Chicago and has written extensively on economic coercion, finds only 5 percent of the 115 cases were successful. Pape's full comments on all 40 'success' cases are included in the appendix to this thesis. Pape firmly believes, based on the empirical evidence available and through a liberal world view, that economic coercion is not effective and should not be a part of any nations strategy for achieving foreign policy goals (Pape, 1997, 1998, 2021). Neither 34 percent, nor 5 percent, are encouraging outcomes for economic coercion. Combined with the negative impacts on alliance behavior through belligerent policies, economic coercion is not only ineffective at achieving its short-term objectives, but it also makes the sender appear as a difficult nation to ally or partner with. Despite all these obstacles, the U.S. regularly imposes unilateral economic sanctions.

Those in favor of economic coercion have also found faults in Hufbauer, Schott, and Elliot's findings. Drezner argues the empirical examples only capture imposed sanctions and exclude successes when the mere threat of coercion was successful, he finds the U.S. had a success rate of just over 52% when combining threatened and imposed sanctions (Drezner, 2003). Others argue that economic coercion can be effective when it is applied against the correct target state. Blanchard and Ripsman assess that economic coercion is most effective when it creates a high political cost on the target country.

Governments that can shift the burden of economic coercion toward opposition groups within their domestic populace and find external third party support to evade sanctions and further reduce costs are less susceptible to economic coercion (Blanchard & Ripsman, 1999).

Economic inducements receive less attention than coercion (Drezner, 1999b). This is unfortunate because the similarities and differences between coercion and inducements appears to create a natural experiment to test if you really can 'catch more flies with honey.' One challenge to inducements that coercion does not face are the salience and persistence of costs borne by the sender. Comparatively, threats of coercion are relatively cheap so long as they do not have to be enforced. Inducements also require greater levels of trust between sender and recipient (Chan & Drury, 2000). The sender of inducements does not want their target to use the transferred relative gains against them. Inducements also suffer from similar attenuating factors as coercion. For example, when the target can mitigate the leverage of the sender with a third party both coercion and inducements become less effective (Blanchard & Ripsman, 1999; Bueno de Mesquita & Smith, 2016). Like coercion, the literature on inducements suggests that they are not always effective but certainly have a place in achieving geopolitical objectives.

Coercion and inducements are the most common ways states attempt to use economic statecraft to achieve geopolitical goals. However, economic statecraft includes all the ways economic instruments are used to promote and defend national interests (Blackwill & Harris, 2017). Since WWII, international trade, intergovernmental trade institutions, and the capitalization on comparative advantage have become integral to how the U.S. promotes and defends its national interests abroad. Decreasing tariffs and other barriers to trade allowed the U.S. access to cheaper goods and services and economies of scale overseas. Trade was intentionally used during the Cold War to help grow the economies of Japan and U.S. partners in Europe to make the USSR weaker compared to them. By making its allies stronger and the USSR relatively weaker the U.S. was able to further its geopolitical goals (R. E. Baldwin & Kay, 1975).

There is less literature quantitatively analyzing the positive geopolitical impacts of trade as there are studies on coercion and inducements. However, this does not mean there is not good qualitative evidence. "An embargo on trading "strategic goods" to the Soviet Union or a boycott of Iranian oil is a front-page news item, but trade policy can be used to promote foreign policy goals in less obvious—and often more successful—ways" (Baldwin, 2020, p. 214). Trade can even be used as a basic inducement by extending comparative advantage and reducing trade barriers with another state. Trade can also be used to complicate relations between dependent states by increasing third party options available (Baldwin, 2020).

There are several stark historical examples of how these theories have been used effectively and poorly. U.S. sanctions against North Korea intended to inhibit their nuclear ambitions will be used to explore the effectiveness of coercion. The Marshall Plan will be tested to see how trade and aid impacted U.S. objectives in Europe after WWII. The Cooperative and Progressive Trans-Pacific Partnership (CPTPP) is very new and not enough time has not passed to fully evaluate its effects, however it does provide insight into how states perceive their prospects in a modern regional trade relationship. These three cases and the proceeding literature provide useful insights into how the U.S. should tailor its economic strategy to compete with China while both nations are deeply interdependent and interactions will persist for decades.

## C. QUALITATIVE TESTING

### 1. United States versus North Korea

The U.S. has sought to curb North Korea's nuclear ambition and aggression with economic sanctions since June of 1950. Despite decades of U.S. economic sanctions and spurts of amenable relations and productive discourse, North Korea has developed nuclear weapons and missiles capable of carrying them. North Korea developed a nuclear complex in the 1980s and announced in 2002 it would renew its nuclear weapons program. U.S. sanctions against North Korea have unequivocally failed. North Korea achieved nuclear armament through its social and political structure and its ability to leverage third parties to mitigate U.S. economic influence.

U.S. sanctions against North Korea are composed of 13 U.S. laws and a variety of Presidential Proclamations and other U.S. regulations. Despite this incredible legislative and economic effort by the most powerful country in the world, North Korea has persisted and developed nuclear weapons and delivery systems, going so far as to proliferate chemical weapons to the Assad regime in Syria (Mallory, 2021). North Korea has been selected to test coercion and inducement theory because of the government's incredible resilience and ability to mitigate the intended effects of sanctions.

There have been periods where relations appear to become less cold between the U.S. and North Korea. These "warm-ish" periods have been rare and short lived. There were significant diplomatic efforts during the Clinton administration, Six-Party Talks at the end of the W. Bush administration, and high level talks during the Trump administration (Boghani, 2019). Each of these periods of cooperation ended with North Korea resuming its efforts to produce nuclear weapons and delivery systems. The framework established under the Clinton administration collapsed early in the 2000s when President George W. Bush made a major diplomatic mistake when he included North Korea in the "axis of evil" in his speech. The Six-Party Talks were intermittent multilateral negotiations between China, Japan, North Korea, Russia, South Korea, and the U.S. with the goal of dismantling North Korea's nuclear program. These ended when North Korea decided to no longer participate, and they completed one-kiloton nuclear tests in 2006 and 2009. Since the Trump-Kim meetings North Korea has massively increased its missile testing as is evident in Figure 6 (Boghani, 2019; Sang-Hun, 2021). Neither periods of amenable relations, nor coercion have been enough to stop North Korea from developing nuclear weapons or delivery methods.


Figure 6. North Korean missile tests by type and year. Source: CSIS Missiles of North Korea (2021).

Two important factors have enabled North Korea to resist bending to coercion are its domestic social and political structure and third parties. Third parties have helped North Korea blunt the full effect of sanctions with external resources and access to global markets. North Korea's authoritarian political structure provides elites with the ability to easily diffuse the negative impacts of sanctions to broader society while insulating its political decision-makers and strategic military programs. Together, these mitigating factors have enabled North Korea to resist U.S. pressure.

North Korea's authoritarian regime has created an environment with attributes that help its political elite endure outside coercion: stability, limited opposition, autonomy, and redirection opportunity (Blanchard & Ripsman, 1999). Redirection opportunity is a qualitative measure of how easily elites can shift the burden of sanctions within their society. While some may contest the relative stability of the North Korean regime, the reality is that the Kim family has been in power since 1948. Minimal political opposition within North Korea and the extreme autonomy of the Kim family amplify their redirection opportunity. These domestic factors are part of how North Korea has been able to frustrate U.S. economic sanctions since 1950.

North Korea has been effective at mitigating the impact of U.S. economic sanctions via third parties by generating hard currency, acquiring dual-use and restricted technologies, smuggling, and money laundering (Mallory, 2021). North Korea conducts trade with over 100 countries, so it is not extremely difficult for the country to generate hard currency from export (Chang, 2006; Mallory, 2021). They can use these same trade channels, legal and illegal, to acquire dual-use and restricted technologies. For example, South Korean officials determined the majority of dual-use components in a North Korea missile recovered from the Sea of Japan originated from the U.S. (Mallory, 2021).

North Korea's ability to evade and mitigate economic sanctions is not inimitable and offers clear insight into how a country like China, with large SOEs and currency reserves and many trading partners, could also elude them. North Korea is particularly capable of redirecting costs because their entire society is powerless, and the regime has demonstrated a willingness to allow its population to live in squalor. Also, U.S. sanctions against other states like Iran and Venezuela have incentivized trade between the effected nations and created an "others market" outside the US-Western liberal economic sphere. While North Korea is particularly well suited to avoiding sanctions, every country has similar capability to some degree. The more a nation can diffuse the negative impacts of economic sanctions to marginalized groups without political upheaval and leverage external resources to lessen the burden on high priority populations and projects can replicate North Korea's successes.

The U.S. has been employing sanctions and coercive economic statecraft against North Korea for so long that this environment has become the status quo rather than the exception. At this point, any decrease in sanctions is likely to be viewed as a carrot instead of a return to normal. At best, these sanctions have produced short-term pauses in North Korean weapons development. Economic coercion has not only failed to produce the desired results, but it has also created an impasse where any change to U.S. sanctions could be mistaken as condoning North Korean efforts.

Given the depth of economic relationship between the U.S. and China, and the potential duration of their competition, coercion and inducements are not the best instruments of economic statecraft for the U.S. to adopt. The U.S. tariffs on Chinese goods enacted under the Trump administration demonstrated that simplistic coercion efforts actually hurt the U.S. more than they hurt China (Drezner, 2019). The relative size of China's economy compared to the US' makes inducements appear even more untenable than coercion. Any inducement large enough to change China's behavior would be too expensive for the U.S. to offer let alone sustain. Rather than fruitlessly attempt to coerce or induce China unilaterally, the U.S. could decrease China's relative power by helping its allies and partners increase their economic power relative to China's with trade, just like the U.S. did to manage the USSR immediately following WWII (R. E. Baldwin & Kay, 1975). Increasing trade with other partners would have the added effect of simultaneously decreasing U.S. dependence on China and is far less costly to sustain than coercion or inducements. Coercion has not helped the U.S. deal with North Korea, the U.S. needs to rely on different instruments of economic statecraft, like expanding existing trade deals and helping allies grow stronger, to compete with China.

### 2. The Marshall Plan

After defeating Nazi Germany, U.S. attention quickly transitioned to combating the spread of communism. The U.S. viewed Western Europe, including West Germany, as a vital geographic, economic, and political spaces to compete with the USSR. Economic recovery in Western Europe had been slow following WWII, causing political and social turmoil for U.S. partners and threatening U.S. anticommunist strategic interests. The Marshall Plan, named for the U.S. Secretary of State at the time, was a primarily economic and trade program, but it was designed to produce political and military outcomes favorable to the U.S. fight against communism in Europe.

Melvyn Leffler, Edward Stettinius Professor of History Emeritus at the University of Virginia, describes three geopolitical and military goals the U.S. had for the Marshall

Plan. The primary and most obvious goal was economic growth in Western Europe. Reviving West German industry, infrastructure, and natural resources and creating binding economic and political relationships with the rest of Western Europe was the second goal. And the third, least central goal, was to sew discord between Soviet bloc countries (Leffler, 1988). Europe became a battle ground once again. However, the U.S. had changed its implements of national power and hoped to achieve its strategic objectives while avoiding nuclear and conventional conflict with the USSR.

The Marshall Plan represented the first deliberate effort by the U.S. to link economic growth and political stability (Tarnoff, 1997). The U.S. intended to affect change in three areas in each participating country to encourage political stability through economic growth; increased production, expanded trade, and policy reform centered on economic stability (Tarnoff, 1997). Four varieties of assistance were provided under the Plan to stimulate economic and political stability: direct aide in the form of grants, requiring counterpart funds, technical assistance, and guaranties for U.S. companies investing in Europe. The Marshall Plan was mostly an aide program by value, 90% of funds were in the form of grants, the other forms of assistance created an incentive scheme built to increase investment and intra-European trade.

The Marshall Plan was more than a simple aide program, it was a collaborative investment plan. Closely integrated planning between the U.S. and participants made the nearly $13 billion spent under the Marshal Plan far more effective than the estimated $11 billion spent in the two and a half years prior. The initial plan was generated between the U.S. DoS and 16 European countries who created the Committee of European Economic Cooperation (CEEC) at the first conference on June 12, 1947, in Paris. After developing a plan with the CEEC, Secretary George C. Marshall and the DoS cleared the next major hurdle by securing funding legislation from the U.S. Congress under the European Recovery Program (ERP). Included in the plan and legislation were measures that ensured close coordination and oversight on how funds were spent.

Three conditions under the Marshall Plan gave the U.S. significant control over spending and ensured the recipient was making large investment expenditures. First, each recipient of Marshall Plan funding was required to sign a bilateral agreement with the U.S.

committing to balancing their budget, restoring internal financial stability, and maintaining exchange rates within reason. Second, each expenditure of Marshall Plan funding by a recipient had to be approved by the U.S. The third condition required recipients of Marshall Plan funds to match grants with equal dollar value of their domestic currency; projects resourced with this counterpart funding *also* required approval of the U.S. The counterpart funding conditions gave the U.S. control over double the value of U.S. aid funding.

The collaboration and detailed involvement by the U.S. under the Marshall Plan provided an additional factor the governments in Europe and previous aid programs had not been able to provide. Confidence in the future. Eichengreen, Uzan, Crafts, and Hellwig described the European economy, paralyzed by fear, as suffering a "marketing crisis" (Eichengreen et al., 1992). Long term investment, loans, and R&D all involve risk and require trust in government, businesses, and the future. The European economy had many of the structural components it needed for success but was missing the trust required to ease the transfer of cash and goods.

The Marshall Plan provided the structure and infusion of cash to get European trade and investment flowing and trust in the system growing. Fear of massive inflation had caused investors to avoid government bonds and banks to fear lending long term concerned they would lend at too low a rate. Suppliers feared shipping goods to market when inflation would reduce their purchasing power by the time they received payment. Farmers, facing inflation in other goods, struggled while produce prices were held artificially low by government regulation (Eichengreen et al., 1992). These supply chain issues caused individual citizens to face food insecurity and lack basic goods. Discontent populaces created the political instability and predilection for communism the U.S. feared.

The Marshall Plan's effects are important qualitatively and quantitatively. ERP goals were to increase aggregate production above 1938 levels by 30% in industry and 15% in agriculture. By the end of 1951, aggregate industrial production was 41% above 1938 levels and aggregate agriculture production was 9% above prewar levels. Industry had exceeded its goals, however the combination of not achieving agriculture goals and a population increase of 25 million people meant Europe still had food insecurity (Tarnoff, 1997). Some argue that when compared to states not participating in the Marshall Plan, it is difficult to prove causation between the Marshall Plan funding this growth (Eichengreen et al., 1992). Rather, Eichengreen et al. believe the trust and confidence inspired by the Marshall Plan solved the "marketing crisis" and enabled European recovery.

Whether attributed to direct investment and grants, or inspiration, the impacts of the Marshall Plan are evident. For example, the Marshall Plan has been strongly linked to the formation of NATO (Kunz, 1997; Leffler, 1988). The defense pact enabled to U.S. and European allies to protect what they had just committed billions of dollars to. The NATO alliance also cemented the U.S. commitment to stop the spread of communism in Europe and deter USSR geographic aspirations in Germany (Leffler, 1988). In addition to military cooperation, it is easy to see how European economic integration encouraged under the Marshall Plan led to the formation of the Coal and Steel Community in 1952 and the EU today (Tarnoff, 1997). The strong correlation between the Marshall Plan, the EU, and NATO suggests the Marshall Plan directly contributed, at least in some small fashion, to the long era of relative peace and prosperity on the European continent.

Most studies about the Marshall Plan argue over exactly how successful it was, and which parts are most responsible for the success. However, they nearly all agree the Marshall Plan was successful. After 80 years, Europe has been extremely prosperous economically and has enjoyed very little conflict. From the U.S. perspective, countries supported in the Marshall Plan were critical allies and trading partners during the Cold War and remain so today. The Marshall Plan fomented the formation of NATO, the US' first permanent alliance and still one of its most important (Kunz, 1997). The exact successes, its scope, and the appropriate time range to measure it in will be left to other studies. Given a wholistic perspective, this paper will accept it as a successful use of economic statecraft.

U.S. economic partners and allies are not suffering from the same obstacles to economic growth today as they were in Western Europe following WWII. However, there are some similarities. For example, the financial crisis in 2008 created distrust in the U.S. led global financial system and the COVID-19 pandemic has illuminated the dangers of complicated global supply chains feeding just-in-time logistics infrastructures. More germane than the economic symptoms the Marshall Plan tried to fix, are the strategic objectives it achieved. The U.S. was able to make its primary opponent relatively weaker compared to its allies and translated increased economic exchange and interdependence into a collective security outlook. Additionally, the Marshall Plan incentive methods were sustainable and persisted long after the aid from the Marshall Plan ended.

Even though the world is in a drastically different situation than 1947, tenets of the Marshall Plan and its outcomes are still beneficial to the U.S. today. The U.S. NDS from 2018 and 2021 make it very clear that the U.S. views China as its primary competitor, and its apparent from its experience with North Korea the U.S. will not be able to sanction or tariff away the Chinese threat. However, the U.S. could make a concerted effort to decrease China's relative power by helping other nations within the liberal economic world order become more powerful through political stability via economic growth; increased production, expanded trade, and policy reform centered on economic stability. Trade based competition policies like the Marshall Plan are especially attractive because comparative advantage means their incentive schemes are inherently included. Sanctions against North Korea have existed for over 70 years, and competition with China can be expected to persist for a long time as well. A cooperative, trade based economic statecraft strategy appears to have the best chance of success and long-term viability for the US.

### 3. The Comprehensive and Progressive Trans-Pacific Partnership

The CPTPP is a modern example of how powerful and attractive multilateral economic partnerships can be. The CPTPP is relatively new, first signed in January 2018 so there is no 50-year panel data set available to support regression analysis to measure the effects on member countries compared to non-member countries. However, The CPTPP is still a useful example of economic statecraft because of its origins, what it tries to accomplish, and its growth since inception.

The proceeding agreement to the CPTPP was the TPP signed in 2016. TPP partnership was comprised of 12 countries and at the time accounted for 38 percent of global GDP (Schott, Jeffrey J., 2018). However, the TPP suffered an early catastrophe when the U.S., a large portion of than 38 percent of global GDP, elected to remove itself in 2017. The remaining TPP signatories determined their future prospects were still better within an multilateral structure and moved forward and established the CPTPP.

The constructors of the CPTPP wanted to make a trade pact that was appropriate to the 21st century. The GATT which was signed in 1947 and the WTO that was founded in 1995 were insufficient for the internet and modern technologically driven production, exchange, funding, and delivery of goods and services (Schott, Jeffrey J., 2018). The CPTPP is written to address these shortcomings by accomplishing five objectives of the TPP:

> First, as in any commercial accord, the partner countries sought to strengthen economic growth through policy reforms that would encourage trade and investment and spur innovation and productivity gains in each economy across the region… Second, TPP members used the regional negotiations to efficiently upgrade existing bilateral FTAs with other TPP participants… Third, the TPP was designed to modernize the trade rulebook. It established new trade rights and disciplines that fill important holes in the WTO rulebook and that update and expand WTO obligations in other areas… Fourth, with its open-ended accession clause, TPP members sought to build an agreement that could set out a comprehensive template for broader Asia-Pacific economic integration and create the most viable pathway toward a Free Trade Area of the Asia Pacific (FTAAP) that APEC members have been pursuing for the past decade. Importantly, any country can join the pact, not just APEC members or other nations in the Asia-Pacific region… Finally, as envisaged by Lee Kwan Yew, the TPP was designed to reinforce foreign policy and national security relations in the Asia-Pacific region. For Asia-Pacific nations that depend on open and secure sea lanes for their commercial prosperity, and those that face the threat of North Korean missiles and adventurism, the TPP was regarded as critically important to ensure strong U.S. economic engagement and ongoing military presence in the region. (Schott, 2018)

These five objectives were compelling enough for the original signatories to overcome their differences in GDP, development levels, and population size. Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam are all very different but were able to look past their differences because of their expected benefits from the CPTPP. To increase its broad appeal, exceptions were allowed for politically sensitive goods to preserve domestic political economy so countries would be more amenable to signing (Schott, Jeffrey J., 2018). As of September 2021, both the UK and China submitted formal applications to join the agreement (Hill, 2021; Hopewell, 2021). Even without years of data proving efficacy, two of the top five largest economies in the world believe the CPTPP will benefit their economies and citizens.

The structure and provisions of the CPTPP are unique from other trade pacts. For example, the CPTPP does not include exceptions for the less developed members. This was done so less developed countries in the agreement would be more attractive to foreign direct investment (Schott, Jeffrey J., 2018). The CPTPP is exceptional in Asia because it also focuses on reducing tariffs on agricultural exchange which are particularly politically sensitive goods. The CPTPP even has provisions on SOEs to create a more competitive environment between private firms and SOEs.

With 11 members and two prospective applicants, the future growth of the CPTPP seems promising. Current members of the CPTPP can still expect additional real GDP growth of 0.075 percent, or US$13.5 billion by 2035 (Ciuriak et al., 2017). The CPTPP simplifies the web of bilateral trade agreements within the region (Ciuriak et al., 2017; Schott, Jeffrey J., 2018). The concessions and exceptions required to complete the CPTPP were designed for the original members, it will be interesting to see if the multilateral FTA for the modern era will retain the same character in the future or with broader membership.

There have been a lot of news stories in the U.S. about China requesting to join the CPTPP. These news story's primary concern is the influence that China could exert as part of such an agreement. Additionally, the U.S. is likely already worse off than it would otherwise be while not part of the CPTPP (Ciuriak et al., 2017). This is what makes those in the U.S. concerned with China joining the CPTPP doubly worried. China in the CPTPP could make even greater relative gains on the U.S. economy while the U.S. is not a participant.

The opportunity cost of not being part of the CPTPP is very high for the U.S., it is missing out on economic and security benefits it could be receiving. Within the CPTPP, the U.S. could help other signatories grow economically and decrease China's share of global GDP. Even if China joins the CPTPP, the provisions on SOEs and not making concessions for less developed countries mean China would not have all the advantages they currently benefit from in the WTO. While the CPTPP may not be the catalyst that fosters the Pacific-NATO, it would tie the U.S. closer to regional security concerns about shipping lanes and vessel traffic than it is now. Security cooperation of any kind would be beneficial for the U.S. by developing communication channels and familiarity between defense organizations. The CPTPP is exactly the kind of trade relationship and mechanism the U.S. should capitalize on to achieve Marshall Plan like outcomes in the Pacific.

## D. COERCION, INDUCEMENTS, FTAS, AND GLOBAL INFLUENCE

The U.S. faces a new challenge from China, but the nature of the issues the challenge creates are not new. Sanctions on North Korea and the Marshall Plan were selected to be representative examples of how costly, effective, and sustainable coercion, inducements, and trade could be. The CPTPP shows that states are still seeking and creating new economic statecraft opportunities to further their nation's interests. The U.S. has many geopolitical tools at its disposal, and as Mastanduno suggests a plethora of historical examples to learn from (Mastanduno, 1999).

The rise of China, their Belt and Road Initiative, and their interest and activity in multilateral organizations like the WTO and CPTPP create a competitive dynamic different from the Cold War. Further muddling this competitive environment, China is the US' largest trading partner making up nearly 15 percent of all U.S. trade in 2020 (US Census Bureau Foreign Trade, 2020). This is the core of what Hass describes as competitive interdependence. Each nation has benefited greatly from their relationship, both want to be the strongest nation in the world, and because of their interconnectedness neither can achieve that by 'cutting their nose off to spite their face' (Hass, 2021). Given this unique environment, the challenge for the U.S. today is determining which instruments of national power to rely on most in the future.

From a realist perspective, the U.S. goal is to remain the most powerful nation in the world and should only worry about itself. However, the U.S. has spent the decades since WWII investing in and developing global institutions like the UN, WTO, IMF, and World Bank. Even as U.S. relative power declines, the liberal world order the U.S. helped to establish is likely to persist because of its self-reinforcing characteristics like shared leadership, integration, and distributed economic gains (Ikenberry, 2018). Additionally, the U.S. economy and quality of life are tied inextricably to China through comparative advantage and high volumes of trade. Any strategy the U.S. adopts to compete in this environment must acknowledge the sources and limitations of U.S. national power and durability of the liberal world order.

The U.S. should focus on a strategy that capitalizes on its commanding position in global institutions, the self-reinforcing nature of the liberal world order, and the incentives inherent to comparative advantage to attract more partners than China. The U.S. can ensure it is an attractive partner with domestic policy that promotes economic growth, encourages an economic transition that meets the current state of world affairs (e.g., continued globalization and climate change), and reinforces U.S. dependability as a partner and ally. At the same time, the U.S. can signal its attractiveness as a partner nation by making the effort to expand and strength current alliances and economic partnerships. Progress in these two efforts will provide the U.S. the national power and position of strength it needs to successfully manage its competitive interdependent relationship with China.

# IV. PATH TO ACHIEVING ADEPT ECONOMIC STATECRAFT

Empirical evidence and history demonstrate that the most powerful forms of economic statecraft and domestic policy enable nations to work together and benefit from each other's strengths. Whether the relationship is based upon shared liberal institutions or realpolitik calculations, the incentives for cooperation are the same. To be competitive globally and sustain the system that has benefited it greatly, the U.S. should address the following policies and instruments: trade, energy and development, investment, financial and monetary policy, and economic and financial sanctions. The goal for each instrument should be to bolster the US' attractiveness as a partner, expand and strengthen U.S. alliances and economic relationships, and maintain a position of strength relative to China.

## A. TRADE POLICY

Establishing domestic policy that lowers barriers to trade and establishing multilateral trade agreements are the strongest ways the U.S. can signal its attractiveness as a global partner. Securing trade routes and ensuring the safety of U.S. goods has been integral to U.S. security policy for over 200 years. A federal navy capable of ensuring the safety of overseas commerce was an early argument advanced in the Federalist Paper Number 11 (Hamilton et al., 2003). Securing trade routes to Asia has been a major U.S. concern since the Treaty of Guadalupe Hidalgo in 1848, when the U.S. annexed the territory of what is now present-day California from Mexico, subsequently gaining access to west coast ports (Field, 1978; Osborne, 1981). Today, the US's San Francisco system of bilateral alliances throughout Asia, also referred to as a hub-and-spoke system, and its exit from the TPP has impaired its ability to coordinate trade policy with multiple partners at the same time. This impairment increasing the US' vulnerability by ceding the opportunity to the next largest economy, China. Supply chain shocks and redundancy issues during the COVID-19 pandemic highlighted once again the importance of a robust trade policy. However, rather than shrink from the world, the U.S. should redouble its efforts to be an attractive trading partner, join the CPTPP, work to establish a multilateral trade agreement within the Quadrilateral Security Dialogue, or the "Quad" (i.e., Australia, India, Japan, and the US), and coordinate its policy objects more with ASEAN.

While the U.S. should be primarily concerned with its own trade policies, China's alleged practices are important to note. There are concerns that China uses manipulative economic practices to its advantage, including coercive sanctions, import quotas, devaluation, and stealing intellectual property (Fortnam, 2019; Laurenceson et al., 2020; Muzinich, 2021; Brander et al., 2017). There are also fears that China pressures international institutions into altering data for its benefit (*World Bank Group to Discontinue Doing Business Report*, 2021). Regardless, unilaterally confronting China will only cause concern for current allies and make the U.S. a difficult partner for the many countries in the world who conduct significant trade with China and the US.

The U.S. should heed Walt's advice and, rather than negatively impacting alliance behavior through coercion and belligerence, focus on partnerships. Joining the CPTPP and developing a formal trade relationship with the Quad, or at least increasing trade with Quad members, would enable a "China plus one" strategy (Basu & Ray, 2021). China plus one does not mean the U.S. must replace all supply chains from China, rather that it should incentivize companies to create redundancies in additional countries. Additional sources of supply further strengthened by multilateral trade agreements would decrease U.S. dependency on China. This in turn would decrease costs challenging China in the WTO Dispute Settlement Body (DSB), boycotting Chinese goods, and would mitigate the effects of supply shocks like COVID-19 or an economic downturn in China.

In addition to negatively impacting alliance behavior favorable to the U.S., the main issue with unilateral coercive economic actions like tariffs, is their propensity to cause tit for tat reactions from the target. The Smoot Hawley Tariff Act of 1930, which raised tariffs on over 20,000 goods, is a perfect example. The act initially intended to protect certain domestic sectors quickly grew from political logrolling. The tariffs prompted global responses from many U.S. trading partners causing a nearly 50 percent decrease to U.S. trade during the next two years (Irwin, 1998). The unilateral tariffs during the Trump administration similarly resulted in an estimate $3.3 trillion decrease in aggregate U.S. firm value, nearly 8 percent decrease to U.S. well-being, and failure to achieve major geopolitical goals (Anderson, 2021; Drezner, 2019). These numbers will continue to fluctuate as data is refined and updated, but the impact from the Trump era tariffs is unequivocally downward. Unilateral tariffs and coercion appear to be concrete ways to make political statements, but they create negative economic effects, dead weight loss, and cause negative sentiment and alliance behavior towards the US.

Without coordination through a body like the WTO, tariffs quickly cause tit for tat responses. The optimal tit for tat strategy is a grim trigger strategy (Axelrod, 1980). In a grim trigger strategy, the player begins by cooperating and then copies the other player's last action. If grim trigger strategy were applied to the U.S.-China trade war, one party should elect to change their action from punish to cooperate, anticipating the other would follow suit and each could continue to benefit from trade. Unfortunately, domestic politics make tariffs sticky. After tariffs have been imposed, domestic politics make it hard to be the first party to cooperate because nations do not want to lose face and appear to give up relative gains they perceive to be withholding through tariffs. This is despite the obvious economic costs, obstruction of the benefits comparative advantage, and the grim trigger strategy suggesting the best response by both parties is to cooperate rather than maintain tariffs after the other has removed them. Rather than punishing with tariffs that create dead weight loss and sticky political quagmires, the U.S. should use multilateral trade agreements to create incentives for cooperation and relative gains from comparative advantage. Trade relationships and a China plus one strategy are also difficult to replicate and are therefore less liable to be met with a tit for tat response.

## B. ENERGY AND DEVELOPMENT

*"Climate change is reshaping the geostrategic, operational, and tactical environments with significant implications for U.S. national security and defense."*
— DOD Climate Risk Analysis. October, 2021.

Shifting from fossil fuels to clean energy production will enable the U.S. to grow its own economy because of the vital role energy plays in economic growth and the existential risk of climate change. Being a net energy exporter has also provided the U.S.

a great deal of independence and leverage abroad (Blackwill & Harris, 2017; Hass, 2021). Developing clean energy production capabilities of partner nations can also serve as an instrument of economic statecraft by enabling them to benefit from increased energy production, energy independence, and combatting global warming. Clean energy from renewable resources will be integral to any U.S. competition with China because energy production has a causal relationship with economic growth, climate change has a negative effect on GDP, and climate change is arguably one of the greatest, if not the greatest, threat to U.S. national security (Kompas et al., 2018; Lieven, 2021; Stern, 1993). By assisting India, Indonesia, and the Philippines with the development of domestic renewable energy production capable of fueling their economies will enable the U.S. to signal its commitment to nations facing barriers to change and extreme impacts from climate change. Also, just like the Marshall Plan, helping others grow and develop decreases China's relative strength in the region. Clean energy production and export is a powerful way for the U.S. to develop, and assist the development of its partners, to ensure a position of strength in its competitive interdependent relationship with China.

The U.S. has strong incentive to engage in collaborative clean energy development projects with nations that are critically important to future U.S. national security and competition with China like India, Indonesia, and the Philippines. Shared climate interests and the possibility to mutually benefit economically and geopolitically from joint clean energy projects offers enticing rewards for such countries to cooperate with the U.S. India, the second most populous country in the world, is a member of the Quad, a proximate nuclear power and geographic competitor to China, and has a strongly vested interest in confronting its growing carbon emission levels and mitigating the impacts of climate change on its pathway to becoming one of the world's largest economies. Indonesia, another economic and geopolitical powerhouse in the region and nation of over 17,000 islands has a critical need to confront the impending effects of climate change. While the U.S. and the Philippines have had a tumultuous relationship over the last 130 years, the two countries share many strategic interests, especially in the peaceful settlement of South China Sea disputes. The Philippines, disaster-prone archipelago like Indonesia, also shares a similar interest in a cooperative effort against climate change.

Similar to the Marshall Plan, the development and implementation of these projects should be highly cooperative and larger geopolitical and climate goals should be well-articulated up front. Renewable energy is an excellent issue to collaborate on with developing nations and large carbon emitters because it strongly signals the intention to form long-lasting partnerships, as climate change has presented itself as a long-lasting issue. Clean energy provides the U.S. and its future partners an opportunity to benefit greatly from each other in trade of renewable energy equipment and resources and the exchange of ideas. Hopefully these result in close economic relationships resulting from increased volumes of trade and political exchange. India, Indonesia, and the Philippines are the three influential countries in the Indo-Pacific the U.S. should engage with first to build mutually beneficial clean energy relationships.

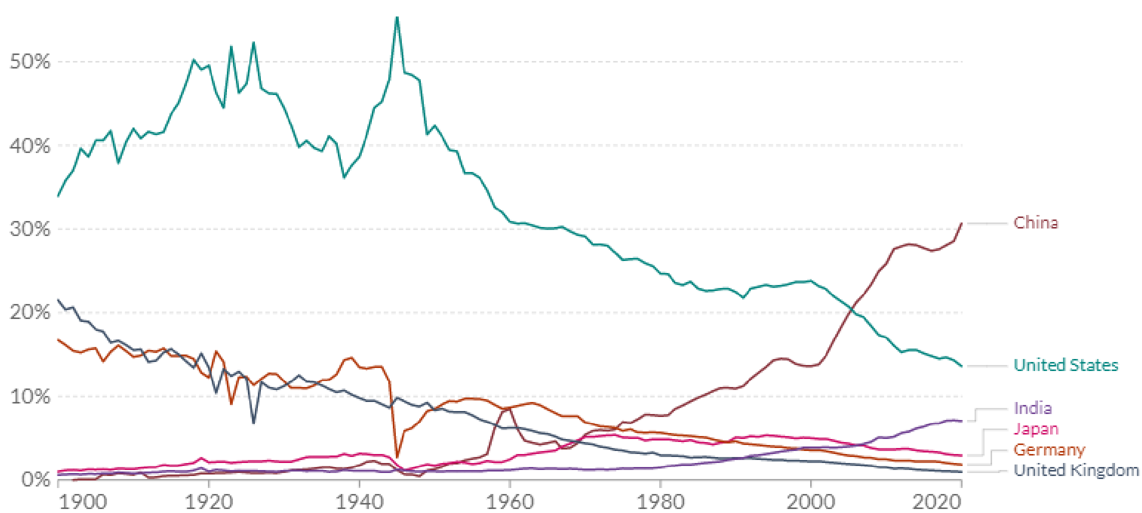



Figure 7. Annual share of global $CO_2$ emissions. Source: Ritchie and Roser (2020).

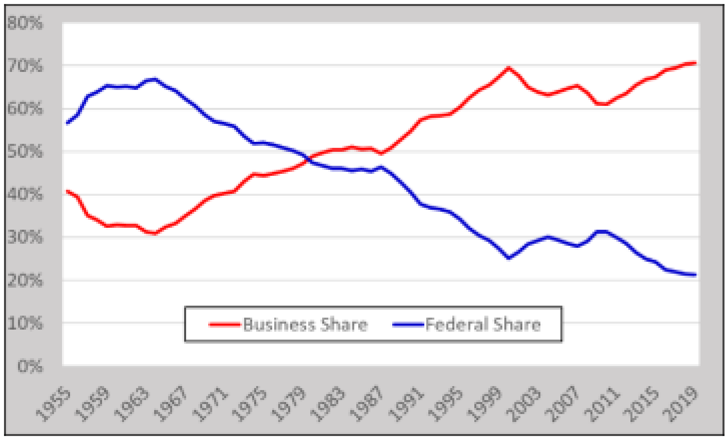
Clean energy and climate change are spaces in which the U.S. can both compete and cooperate in. China's primary sources of energy fueling their economy are coal, oil, and gas, much of which is imported (Ritchie & Roser, 2020). This energy insecurity makes targeting energy resources a tempting coercive lever. However, the U.S. should not waste effort and resources trying to restrict China's access to energy as a weapon to achieve relative gains. China is already the second largest economy in world. Instead, by assisting

China with a faster transition to renewable energy and cutting its carbon emissions, the U.S. can strongly demonstrate its commitment to combating climate change and positively impact alliance behavior towards the U.S. This is a far preferable option for the U.S. compared to the marginal gains of using energy insecurity to coerce China and risking the perception that the U.S. is a belligerent country deliberately impeding global efforts against climate change. Through clean energy development projects and assistance, the U.S. can help China decrease its carbon emissions and simultaneously make China relatively weaker by assisting the economic growth of regional competitors like India, Indonesia, and the Philippines.

## C. INVESTMENT POLICY

Perennial investment in infrastructure, technology and innovation, and citizens is imperative in the battle to stay competitive in the global economy. One challenge, or constraint, the U.S. experiences here compared to China is the relationship between the economy and the government. Since the 1980s, the U.S. has been averse to admitting and embracing the role the federal government can have in investment and development (Block, 2008). This is particularly true in innovation and research. However, federal and state government's roles in infrastructure like highway maintenance remains relatively undisputed. The shift to green energy, previously discusses, will likely be a part of the laws and funding passed with other forms of investment. There have been some meaningful bills in both chambers of Congress during 2020 and 2021, but the U.S. needs to adopt a more coherent and encompassing strategy.

While not a perfect analogy, the later years of the USSR provide some insight into the perils of poor national investment strategies. The soviet industrial base, economy, and citizens all suffered from a government that did not invest to create an environment that engendered success (Gel′man, 2015; Hoffman, 2011; Plohìj, 2017). Enthusiasm for market fundamentalism appeared during the Reagan administration and has remained a strong political sentiment (Block, 2008). Figure 8 shows the decrease in relative R&D funding between the U.S. federal government and corporations. The U.S. needs to reevaluate market failures, its social contract, and the federal government's role in investment and research to avoid the failures experienced by the USSR. Effective and coherent strategy, laws, and policy cannot be enacted until the U.S. accepts the Federal government's role in regulating markets and creating incentive schemes that foster economic growth.




**Source:** CRS analysis of National Science Foundation, *National Patterns of R&D Resources: 2018–19 Data Update*, NSF 21-325, Table 6, April 9, 2021, https://ncses.nsf.gov/pubs/nsf21325.

**Notes:** 2019 data are preliminary and may be revised.

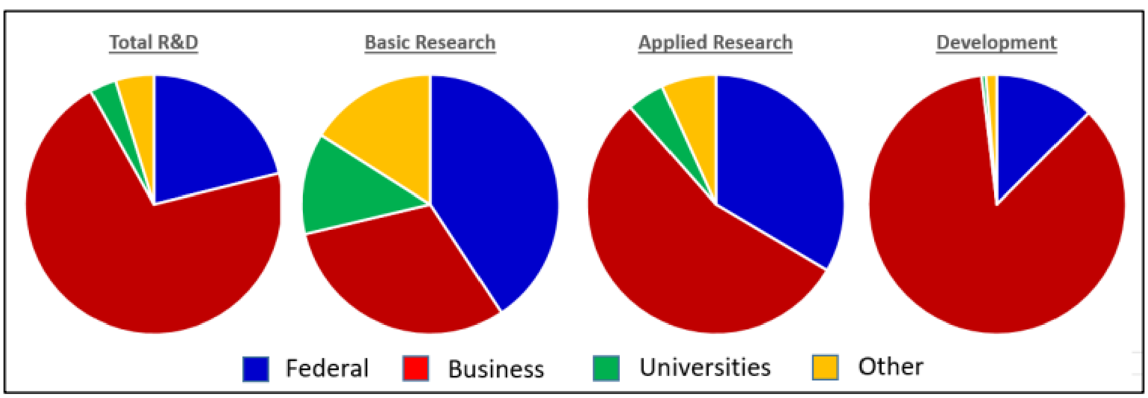
Figure 8. Federal and business shares of U.S. R&D expenditures, 1955–2019. Source: U.S. Research and Development Funding and Performance: Fact Sheet (2021).

The USSR demonstrated it is possible to have a strong military, but the state ultimately collapse from a crumbling economy. Market fundamentalism cannot solve every investment issue faced by the USSR, if the U.S. fails to invest in itself it will go into economic decline. The federal government's role in domestic investment has become obscured in the last few decades; to remain competitive and relevant the U.S. will need to reinvigorate its political and legislative environment around federally funded research and investment.

### 1. Technology, Infrastructure, and Innovation

The U.S. and China are outpacing the rest of the world when it comes to developing new technology. Leading technological innovation provides military, economic, and ideological power (Hass, 2021). The role of technology in warfare and its impact on the revolution of military affairs has become increasingly evident (Adamsky, 2010; Brose, 2020). Technology provides advantages in every competition space between the U.S. and China. Stimulating innovation requires more than just funding. It requires an encouraging and stimulating national environment.

Federal funding and research are especially helpful in transitioning nascent technologies into mature developments which private industry is less suited to doing. Firms conduct research, but their primary goal is profit, so they focus on lower risk mature technological innovations. Federal research funding helps complete the innovation and development ecosystem in the U.S. Federal focus on early research is evident in Figure 9, where most of the funding for basic research is federal.




**Source:** CRS analysis of National Science Foundation, *National Patterns of R&D Resources: 2018–19 Data Update*, NSF 21-325, Tables 6-9, April 9, 2021.

**Notes** 2019 data are preliminary and may be revised.

Figure 9. U.S. R&D funding by character and sector. Source: U.S. Research and Development Funding and Performance: Fact Sheet (2021).

Federal endeavors into technology, infrastructure, and innovation have recently received a resurgence in the U.S. The Build America Act, the Infrastructure Investment and Jobs Act, and the INVEST in America Act were all introduced in the 117th Congress indicating the legislative branch of the U.S. government is taking this challenge seriously. The INVEST in America Act authorizes a total of $494 billion over the next five years: $319 billion to highways, $105 billion in transit investments, $60 billion for rail investments, and $10 billion for passenger vehicle and commercial vehicle safety investments including electric vehicles. These investments focus on the basic government functions that aid economic growth like moving people, goods, and information around the country, but they do not solve the R&D imbalance apparent in Figure 9.

The U.S. currently has several advantages through rule of law that it should maintain and continue to rely on like the strength of the U.S. judiciary, integrity of intellectual property rights, and many high-quality universities. Increasing federal funding for R&D to balance federal and business investments would create additional propensity for innovation within a system that already has many beneficial attributes. The U.S. has the legal, educational, and corporate frameworks already—it must acknowledge the innovative achievements and vast progress that federally-funded research has provided previously and contribute greater investments to a process that has enabled long term domestic growth.

### 2. Human Capital

International trade and automation will remain important drivers of economic development and growth. However, while these benefit the U.S. economy in aggregate, they can negatively affect specific communities and create social unrest and domestic resistance (Autor et al., 2016; Clausing, 2019; Hanson, 2021; Hass, 2021). The U.S. should not adopt domestic policies that eschew critical components of economic progress and attempt to regulate the existence of superfluous economic activity. ATMs replaced many bank tellers, and renewable energy will replace many jobs in the fossil fuels industry. The U.S. government should focus on helping those displaced members of the workforce easily transition to new careers rather than subsidizing unnecessary jobs. Multilateral trade agreements like the CPTPP and automation will continue to be critical components of U.S. economic statecraft and the US's ability to compete with China. The U.S. must adopt domestic policies that mitigate the negative economic effects of global engagement to sustain a domestic labor force that, at the minimum, does not actively oppose the U.S. increasing international partnerships and trade.

There are a variety of ways a government can "invest" in the welfare of its citizens. COVID-19 and the China Shock to U.S. manufacturing made two of these policy areas more salient: universal healthcare and labor market programs designed to offset the impacts of international trade and automation. The health system within the U.S. shows poor cost benefit performance compared to other large countries. Compared to the UK, Japan, and Germany, shown in Figure 10, the U.S. spends significantly more per person with a significantly lower life expectancy. The China Shock caused a backlash from manufacturing-based communities around the U.S., as they suffered the impacts of globalization while the rest of the U.S. benefited (Autor et al., 2016; Hanson, 2021). The U.S. has clearly done a poor job ensuring its health system is as effective and efficient as possible and ensuring that its labor force can adapt quickly to changes in a modern and international economy. These two areas are mutually supporting and should be the primary focus of U.S. domestic policy to ensure its citizens and work force are equipped to sustain the instruments of economic statecraft, like multilateral trade agreements and renewable energy investment.

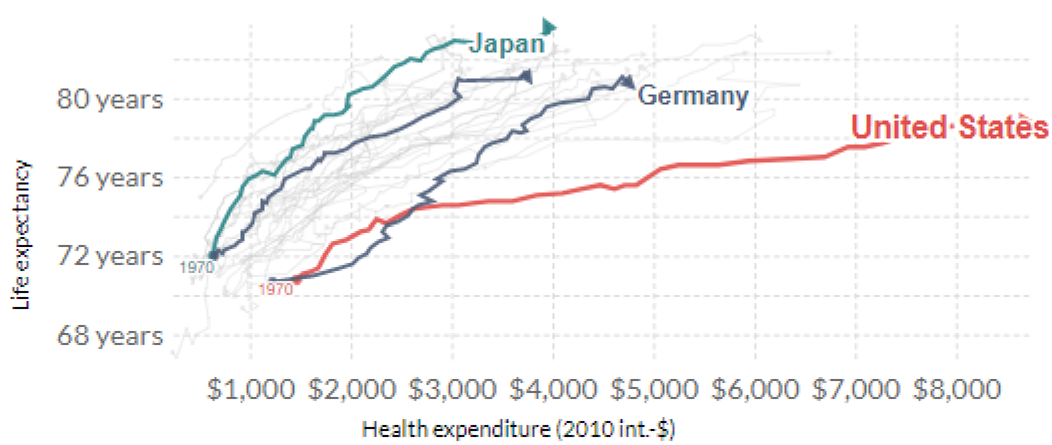



Figure 10. Life expectancy vs. per capita health expenditure, 1970 to 2015. Source: Life Expectancy vs. Health Expenditure (2021).

Instruments of economic statecraft that can positively effect alliance behavior, like trade and energy, can have negative impacts to some sections of the domestic population. Gordon Hanson expects the next labor market shock to effect petroleum and fossil fuel production (Vanek Smith & Rosalsky, 2021). Clean energy production is the best way the U.S. can ensure its national security and engage in partner building with India, Indonesia, and the Philippines however this will exacerbate the labor market shock predicted by Hanson. Employer based healthcare and under performing laws like the Trade Adjustment Assistance (TAA) program from 1962 did not decrease labor market friction enough to mitigate the impact of the China Shock (Autor et al., 2016; Fuchs & Emanuel, 2005; Hanson, 2021). Universal healthcare and more comprehensive education programs will be needed for the U.S. to make the shift to renewable energy necessary for the U.S. to remain competitive globally.

Improved mobility of the labor force helps the U.S. economy in a variety of more generals dimensions as well as mitigating the impacts of renewable energy to those in the petroleum sector. The current U.S. health system increases labor market friction and creates negative incentives for members of the workforce to seek new or different employment (Fuchs & Emanuel, 2005). In the current healthcare system, an individual may be averse to leaving a job with healthcare benefits because of the obvious risks and costs associated with being uninsured, or poorly insured. Similarly, health has serious impacts on capacity to work, wages, and labor force participation (Currie & Madrian, 1999). Decoupling health care coverage from employment would remove friction from the labor market and allow firms and employees to optimize time, effort, and expense more in line with preferences.

Updating the health care and professional retraining legislation can prevent the detrimental domestic impacts of international trade and shifting to renewable energy from impeding the geopolitical incentives the U.S. needs generate to stimulate positive alliance behavior. The U.S. can benefit doubly by investing in its citizens. These policies enable the U.S. to generate influence internationally through economic statecraft and generate national power domestically through productivity. That U.S. will not be successful economically focusing on bygone industries to generate short term populist fervor. Rather, the U.S. must improve and expand programs and safety nets that create incentives to seek employment, improve job readiness, and help people find work (Posen, 2021).

## D. FINANCIAL AND MONETARY POLICY

The U.S. should use financial and monetary policy to project stability at home and generate trust in U.S. systems abroad. U.S. financial and monetary policy has this critical influential power because the dollar has been a popular reserve currency since 1940 (Carbaugh & Hedrick, 2009). The global nature of investments, and popularity of the U.S. dollar as a reserve currency means the U.S. dollar effects the risk level of every market in the world. The U.S. dollar is so pervasive, the lower the risk on U.S. Treasury Bonds (T Bonds), the lower the risk of every other investment (Vanek Smith et al., 2021). With great trust comes great responsibility, the U.S. is limited on its monetary and fiscal policy options because so many countries, banks, and investors are depending on the stability of the U.S. dollar (Aliber, 1964; Easterly & Rebelo, 1993; Salant, 1964). However, this trust is also a strong signal from the international community that the U.S. still has the strongest and most dependable economy and government.

If the U.S. abuses the powerful position of the dollar, as they have been doing, global preference for the dollar will shift to the next most secure and stable currency (Carbaugh & Hedrick, 2009). U.S. financial and monetary policy can directly impact how other nations perceive U.S. reliability as a partner and whether the world prefers the dollar, euro, pound sterling, or renminbi. Maintaining the U.S. dollar's special place in global trade is the most important thing Congress, the Treasury, and the Federal Reserve Bank do together to preserve and grow U.S. national power.

### 1. The Debt Limit

The U.S. national debt, and the debt ceiling in particular, are the greatest fiscal and monetary dangers to long term U.S. security and stability. U.S. Treasury bonds extend trust between the U.S. government and its debt holders. The extremely low U.S. borrowing rate is a signal of worldwide trust of the U.S. The low interest rate signals the U.S. is reliable and trusted. The U.S. Legislative and Executive Branches need to make preserving this symbol of trust and national prestige a priority. The U.S. should not take draconian measures to pay off and eliminate the national debt. This would negatively impact investment, the importance of which has already been thoroughly discussed. The Executive and Legislative branch need to take simple steps to ensure interest payments can always be made and return the debt to GDP ratio to a historically consistent level to signal the U.S. is a low risk, dependable nation.

Standard and Poor's downgraded the U.S. credit rating below AAA in 2011 after legislative squabbling over increasing the debt limit. This downgrade occurred even though U.S. has never defaulted on its debt. This long track record of dependability once made U.S. T bonds one of the safest investments in the world. However, politicization of the debt limit has threatened this reputation. The Standard and Poor's credit rating report stated the debate and brinksmanship made the U.S. appear, "less stable, less effective and less predictable" (Goldfarb, 2011). The U.S. most recent case of debt limit brinksmanship has yet to impact the U.S. credit rating, but did rattle investment markets, increased T Bonds interest rates, and only delayed potential default a few months (Cochrane, 2021). The debt limit is superfluous, dangerous, and questionably constitutional. Congress needs to formally abolish the debt limit with legislation.

Given the current debt to GDP ratio following COVID-19 stimulus packages, a higher borrowing rate would prove extremely expensive to taxpayers and make all forms of doing business more difficult for the U.S. government. Myopic political maneuvering threatens to cause decades long impacts to U.S. citizens and federal budgets. Loss of international prestige and loss of trust with its population would also negatively impact the US' ability to enact and affect other forms of foreign policy. The debt limit only creates issues with the outcome of the budget. The debt limit does not actually limit appropriations or obligations, it only limits how much the U.S. can borrow to service its budget deficit. Its real purpose has become to serve as a domestic political weapon.

Not only is the debt limit useless and dangerous as demonstrated above, but it is also arguably unconstitutional. The debt limit in its current legal framework has existed since 1939 (Druke et al., 2021). Section 4 of the 14th Amendment to the U.S. Constitution reads:

> The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.

The first sentence is the most important in this case. “The validity of the public debt of the United States, authorized by law…shall not be questioned.” The debt limit could cause the U.S. to default on its legal obligations and invalidate the debt held by bond owners. Since the U.S. has never defaulted on its debt, this section of the 14th Amendment has never been challenged in the courts. Congress should not default on the debt and have the Supreme Court decide whether the debt limit is constitutional or not. The risks and long-term harm to the U.S. and its interests are too great. Congress should act now and abolish the debt limit.

The debt limit is a simple, well intended law, that has become a dangerous political brinksmanship weapon. Bonds represent the most basic form of trust the U.S. government can extend, and the U.S. should not squander its reputation over a legal formality that does not need to exist. U.S. Congress should abolish the debt limit and ensure there are no legal impediments to the U.S. paying its debts on time in accordance with good sense and the 14th amendment. While it is a simple domestic policy issue, the debt limit has the propensity to cause serious issues with allies, partners, and ordinary people around the world.

### 2. Debt to GDP Ratio

The U.S. debt to GDP ratio since 2008 has sustained at a much higher rate than at any other time in history. The debt to GDP ratio does not have to be maintained at a perfect level. However, if it is sustained at a high level for an extended period of time it may signal a change in risk and create a positive feedback loop of increasing interest rates and ever growing debt (Alcidi & Gros, 2019). A persistently high debt to GDP ratio could signal that a nation has extensive crises that its unable to overcome and must borrow a lot, or it may indicate that a nation has done poorly in recovering from a crisis and is struggling to return the ratio to pre-crisis levels. Some studies have found that economic growth rate begins to slow once the public debt to GDP ratio exceeds 77 percent (Caner et al., 2010). Others find that short periods of a high ratio do not negatively affect growth, but sustained periods do (Chudik et al., n.d.). Lowering its debt to GDP ratio will enable the U.S. to be ready for whatever the next global crisis may be. The U.S. also has an opportunity to be a more attractive and capable partner than China, whose debt to GDP ratio is estimated to be over 250 percent (Cho, 2021).

Figure 11 shows a chart from the 2012 Atlantic Article *The Long Story of U.S. Debt, From 1790 to 2011, in 1 Little Chart* which captures the approximate debt to GDP ratio back to nearly the founding of the U.S. Figure 12 shows the debt to GDP ratio since 1965 and its shaded areas are recessions. Together, these two charts show the trends of U.S. debt over time. Debt goes up as the U.S. needs to borrow in time of crisis. Following the crisis, debt is paid off and the U.S. returns somewhere near pre-crisis levels. The debt has typically been paid off quickly. Even after WWII, the debt to GDP ratio was restored rapidly.

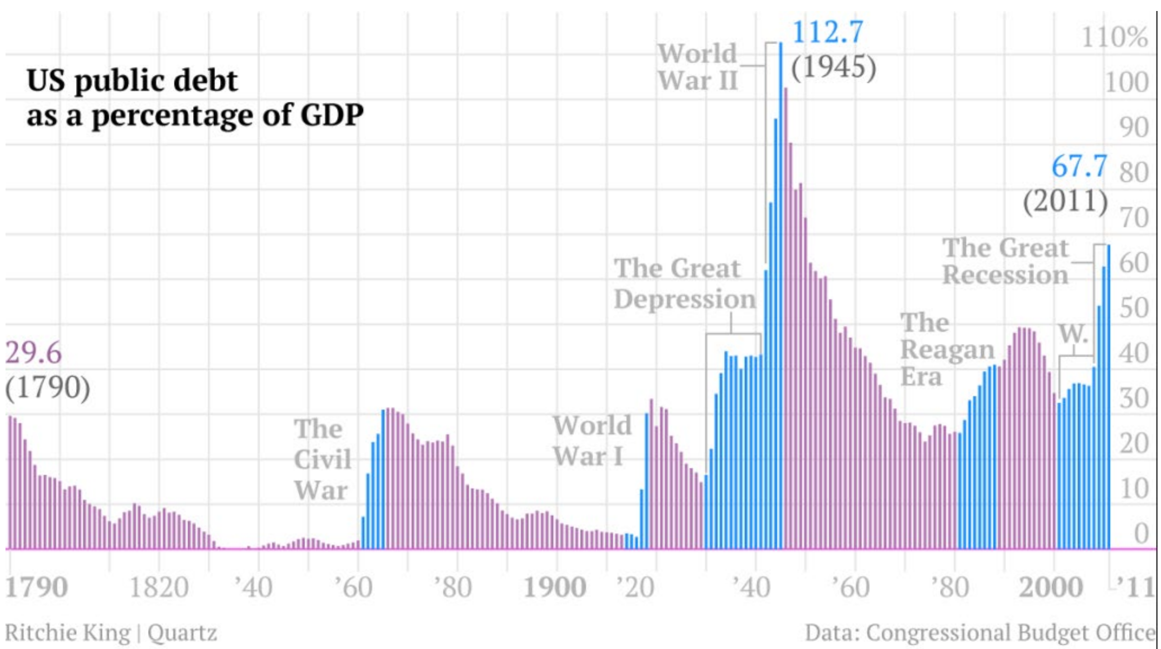



Figure 11. U.S. debt to GDP 1790 to 2011. Source: Phillips (2012).

Unfortunately, the U.S. did not follow its usual trend after the Great Recession. The debt to GDP ratio was approximately 62.7 percent in the fourth quarter of 2007. As you can see from Figure 12, the U.S. has maintained a debt to GDP ratio at or above 100 percent since the second quarter of 2012. At its peak during COVID-19 stimulus spending, debt to GDP was 135.9 percent. It has since fallen slightly to just over 125 percent as of the end of the second quarter in 2021. The last time the debt to GDP was over 100 percent was WWII, see Figure 12.

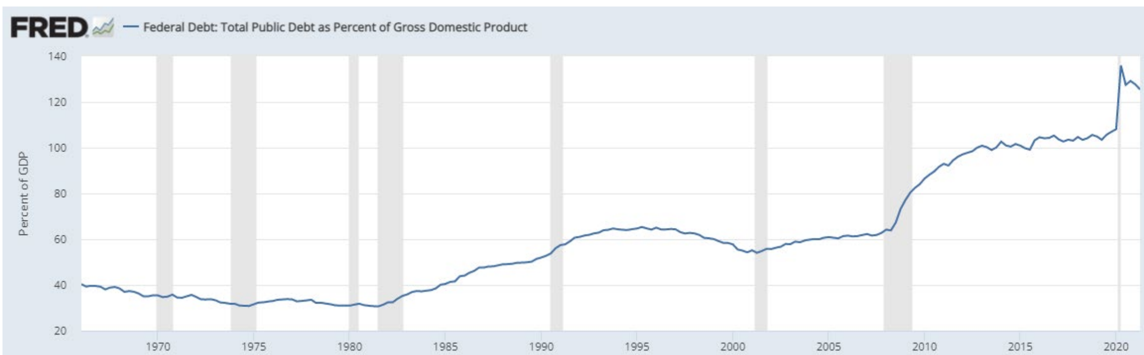



Figure 12. U.S. debt to GDP ratio. Source: Federal Reserve Bank of St. Louis FRED.

A debt to GDP ratio at the US's current level is not necessarily a problem in and of itself. However, not following the historical trend of returning to a lower ratio could make T bonds appear riskier. This poses a similar risk, though less salient, as the debt limit. Not lowering the debt to GDP ratio as the U.S. recovers from impact of COVID-19 may signal that the U.S. is still not recovering economically, even if GDP is increasing and other indicators are move positively.

Lowering the debt to GDP ratio is necessary, however eliminating debt completely creates a new set of problems. T bonds offer a steady base on which all other lending and economic activity can take place. The last time the U.S. paid off all its debt was under the Andrew Jackson administration in the 1830s. The U.S. was able to pay off its debt with instruments unusable today. The Jackson administration was mostly able to pay off the U.S. debt with extremely high import tariffs and selling seized Native American land. On

January 1, 1835, the U.S. Treasury paid of the last bonds to mature, and the U.S. had no remaining debt. Investors looking for safe investments could no longer buy T bonds and were forced to select riskier bonds, effectively raising the risk floor of the entire economy (Vanek Smith et al., 2021). In conjunction with a few other factors, the U.S. suffered an economic crisis a few years later in 1837 and began issuing T bonds again. Though it was successful, it caused larger issues in the market. U.S. policy makers today should take note and not seek to eliminate U.S. debt, just decrease its size relative to the U.S. economy.

The U.S. needs to return its debt to GDP ratio closer to historical averages to remain a low-risk investment. This means the U.S. must work to return its debt to GDP ratio to below 70 percent within the next decade. This would signal long term viability to allies and potential partners. Having a lower level of public debt would also increase U.S. economic growth overall (Caner et al., 2010; Chudik et al., n.d.). Healthy fiscal and monetary policy that enable U.S. economic strength are critical to any form of economic statecraft and will be a key indicator of the U.S. capacity to compete with China.

## E. ECONOMIC AND FINANCIAL SANCTIONS

Economic and financial sanctions will remain staples of U.S. economic statecraft in the years to come, but the U.S. needs to be careful to not overuse them or apply them unilaterally. Sanctions can act as important tools of communication and strategy like any other form of coercion, but the U.S. should only use them in concert with global institutions like the UN and WTO to avoid negatively impacting alliance behavior. Unlike trade or renewable energy, economic and financial sanctions are more beneficial the less they are used.

Even worse than sanctions, U.S. dollars freezes negatively impact alliance behavior and decrease global trust and preference of the dollar. The more the U.S. uses dollars freezes, the risk of holding it as a reserve currency goes up. The less dollars are held and used, the less effective dollar freezes become. Rather than slowly squandering one of its greatest sources of power on small threats and conflicts, the U.S. should cultivate a global financial system that reflects trust in the U.S. and makes weaponizing the dollar as catastrophic as possible if it does become necessary.

The U.S. Treasury is already good at implementing dollar freezes. The U.S. Congress and Executive Brand do not need to change legislation or policy to make the Treasury more effective at it. There are not any immediate substitutes for the U.S. as a reserve currency, so preserving trust in the U.S. dollar is not a salient issue (Carbaugh & Hedrick, 2009). Like economic sanctions, the U.S. has other instruments of economic statecraft to focus on that it can receive greater benefit from pursuing. Economic and financial sanctions will continue to be suggested because coercion, or threats of coercion appear economical in the context of an individual issue or nation. However, in the long run, the negative impact on alliance behavior through belligerence and the detrimental effects on trust in the U.S. make economic coercion less effective than other instruments of economic statecraft. The U.S. should apply its PPF and political economy on the other instruments of economic statecraft previously evaluated, rather than squandering resources and relationships on coercion. Collaboration can propagate U.S. influence, but coercion will slowly isolate and insulate the U.S. from the world.

# V. CONCLUSION AND RECOMMENDATIONS

Economic statecraft provides the U.S. opportunities to compete and cooperate with China while affecting the geopolitical change the U.S. wants to see in the world that other forms of statecraft and military coercion do not. The structures and incentive schemes surrounding liberal institutions and multilateral cooperation are very durable and are likely to persist. They increase the US's relative strength and amplify its ability to project power. Alarmingly however, the U.S. has been withdrawing from the global economy over the last 20 years (Posen, 2021). If the U.S. continues to detach itself from the liberal world order it established following WWII, China's ambitions become irrelevant and their primacy fait accompli.

The U.S. needs to worry less about China and worry more about how it can prepare economically and politically to engage with the international community. Strengthening and expanding international partnerships and passing legislation that creates a stable and adaptive domestic economy are important steps the U.S. needs to take to prepare for cooperation and competition with China, rather than becoming embroiled in nationalism and populist tempers. To sustain the status quo and remain the preeminent world power, collaboration rather than punishment will be the key for U.S. success. The U.S. formed robust economic and security partners in Europe through trade and aid under the Marshall Plan, because collaborative instruments of economic statecraft capitalize on incentives like comparative advantage. However, the U.S. failed to restrain North Korea with economic sanctions and coercion because they can be evaded reasonably easy, and they bear a cost to both the target and the sender. The creation of the CPTPP following the dissolution of the TPP, and the UK and China applying to join, indicate that trade and cooperation can still have a significant impact on state behavior as it did under the Marshall Plan.

The efforts explored in this paper are just a start and are by no means an exhaustive list of all the policy options available to the U.S. that can act as instruments of economic statecraft or ways the U.S. can generate national power through economic activity. Cyberspace and cybersecurity are also critically important to the U.S. economy and trade relationships. Additionally, China has declared cryptocurrency transactions illegal, leaving the rest of the world's population and entrepreneurs to develop and explore its possibilities. The structural trust inherent to blockchains, the revolution in the global transfer of funds, and transparency of transactions are in line with typical U.S. international finances goals. These characteristics and China's ban make cryptocurrency an excellent area for the U.S. to capitalize on. This paper accepted the Blackwill and Harris definition of economic statecraft because it was so simple, broad, and inclusive, the U.S. should keep an open mind and look for new ways to creatively apply economic statecraft in the future.

# APPENDIX

**Table 3. Errors in the Hufbauer, Schott, and Elliot Database by Type.**

| Case | Year | Coercer | Target | Nature of Dispute/Outcome |
|---|---|---|---|---|
| **Outcomes Determined by Force, Not Economic Sanctions: 18** | | | | |
| | *Brute Force Military Victory: 6* | | | |
| 1. | 1939 | Allies | Germany, Japan | Germany conquered; Japan surrendered to invasion threat. |
| 2. | 1948 | India | Hyderabad | Hyderabad conquered by Indian army. |
| 3. | 1967 | Nigeria | Biafra | Biafra overrun by 200,000 Nigerian troops. |
| 4. | 1972 | U.K./U.S. | Uganda | Amin defeated by Tanzanian invasion. |
| 5. | 1977 | U.S. | Nicaragua | Somoza defeated by FSLN guerrillas. |
| 6. | 1982 | U.K. | Argentina | U.K. forces reconquered the Falkland Islands. |
| | *Military Coercion: 7* | | | |
| 7. | 1914 | U.K. | Germany | Germany surrendered when military defeat imminent. |
| 8. | 1921 | League of Nations | Yugoslavia | Yugoslavia retreated from Italian military threat. |
| 9. | 1925 | League of Nations | Greece | No economic sanction; Greece retreated from League naval threat. |
| 10. | 1956 | U.S. | U.K./France | Britain and France retreated from Soviet nuclear threat. |
| 11. | 1960 | U.S. | Dominican Republic | Trujilloistas fled from U.S. invasion threat. |
| 12. | 1965 | U.K./U.N. | Rhodesia | Whites coerced by guerrilla military threat. |
| 13. | 1982 | U.S./Netherlands | Suriname | Bouterse coerced by guerrilla military threat. |
| | *Foreign-sponsored Assassinations and Military Coups: 5* | | | |
| 14. | 1951 | U.K./U.S. | Iran | Mossadegh overthrown in U.S.-sponsored coup. |
| 15. | 1956 | U.S. | Laos | Government overthrown 3 times in U.S-sponsored coups. |
| 16. | 1962 | U.S. | Brazil | Goulart overthrown in U.S.-sponsored coup. |
| 17. | 1963 | U.S. | South Vietnam | Diem assassinated in U.S.-sponsored coup. |
| 18. | 1970 | U.S. | Chile | Allende killed in U.S.-sponsored coup. |
| **No Concessions: 8** | | | | |
| 19. | 1956 | U.K./France/U.S. | Egypt | Egypt refused demands for international control of Suez Canal. |
| 20. | 1963 | U.S. | Egypt | Egypt refused demands for withdrawal from Yemen, other issues. |

Source: Pape (1997).

| Case | Year | Coercer | Target | Nature of Dispute/Outcome |
|---|---|---|---|---|
| **Table 3. Continued.** | | | | |
| 21. | 1965 | U.S. | India | India had already decided to pursue the agricultural policies demanded by the U.S. |
| 22. | 1973 | Arab League | U.S./Netherlands | U.S. and Netherlands refused demands to change policies toward Israel. |
| 23. | 1976 | U.S. | Taiwan | Taiwan continued reprocessing nuclear fuel despite promising not to. |
| 24. | 1977 | U.S. | Brazil | Brazil abrogated military aid agreement. |
| 25. | 1979 | U.S. | Iran | Iran pressured U.S. to freeze shah's assets and to ban U.S. claims against Iran. |
| 26. | 1981 | U.S. | Poland | Poland did not democratize until Gorbachev withdrew Brezhnev Doctrine. |
| **Not Instances of Economic Sanctions: 6** | | | | |
| 27. | 1938 | U.S./U.K. | Mexico | Compensation for expropriation. |
| 28. | 1958 | USSR | Finland | Volume of Soviet-Finnish trade. |
| 29. | 1961 | U.S. | Ceylon | Compensation for expropriation. |
| 30. | 1964 | France | Tunisia | Compensation for expropriation. |
| 31. | 1965 | U.S. | Chile | Price of copper. |
| 32. | 1968 | U.S. | Peru | Compensation for expropriation. |
| **Indeterminate: 3** | | | | |
| | *Overdetermined. Economic Sanctions and Military Threat Each Sufficient to Explain Outcome: 2* | | | |
| 33. | 1948 | U.S. | Netherlands | Netherlands could not afford the loss of U.S. Marshall Plan aid, nor could it defeat the Indonesian insurgents. |
| 34. | 1982 | South Africa | Lesotho | Lesothan economy totally dependent on South Africa; also unable to prevent South Africa commando incursions and arming of insurgents. |
| | *Indeterminate. Insufficient Evidence to Establish Significance of Concessions: 1* | | | |
| 35. | 1977 | Canada | EC/Japan | |
| **Successes: 5** | | | | |
| 36. | 1933 | U.K. | USSR | USSR agreed to release 6 prisoners. |
| 37. | 1975 | U.S./Canada | South Korea | South Korea canceled reprocessing plant. |
| 38. | 1979 | Arab League | Canada | Canada agreed not to move embassy. |
| 39. | 1987 | U.S. | El Salvador | El Salvador agreed not to release 3 prisoners. |
| 40. | 1989 | India | Nepal | Nepal agreed not to buy weapons from China. |

Source: Pape (1997).

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