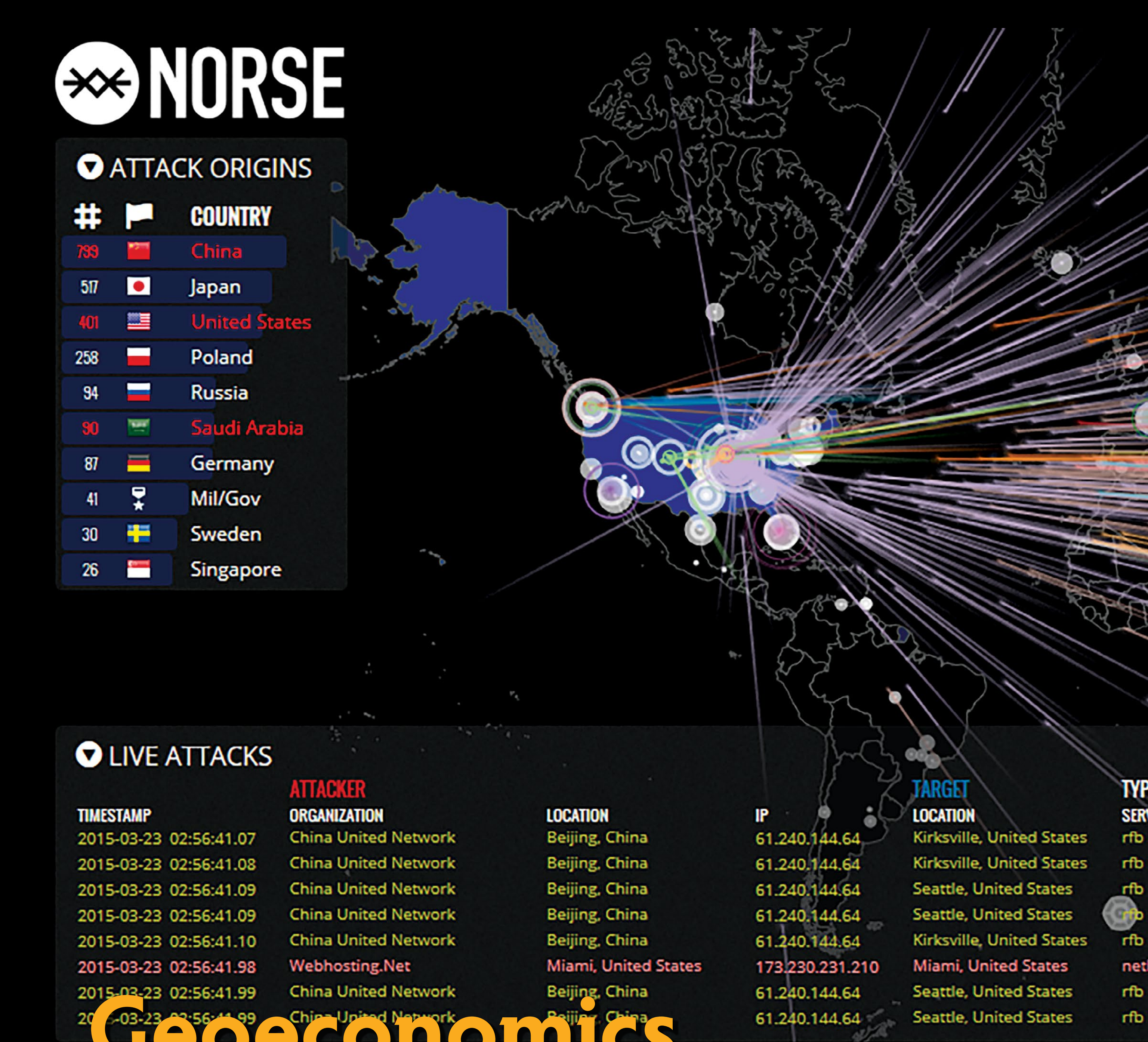
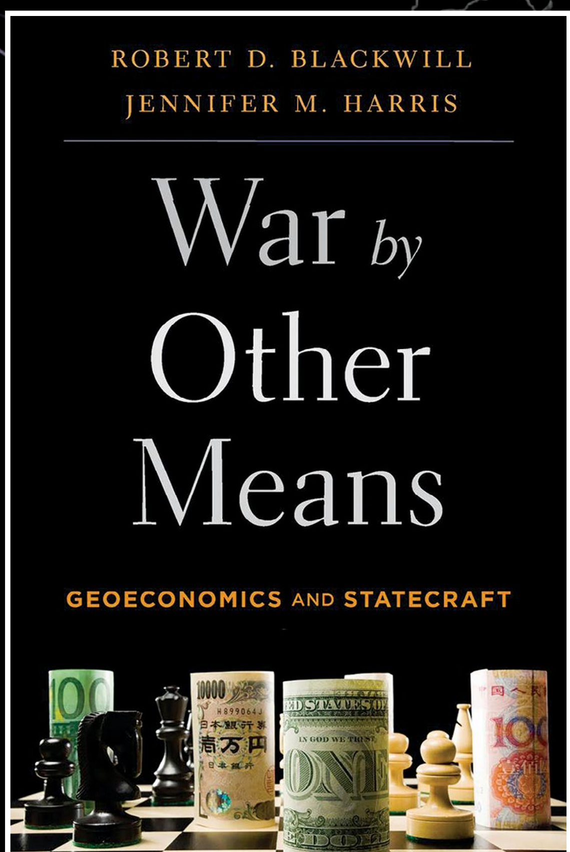


Geoeconomics

Col. John F. Troxell, U.S. Army, Retired

Editor's note: *When* Military Review *asked Col. John Troxell from the Army War College to review the book* War by Other Means: Geoeconomics and Statecraft *by distinguished scholars Robert Blackwill and Jennifer Harris, the intent was to publish a book review essay evaluating the merits and relevance of the book. However, the project evolved from a mere book review into a detailed, full-length analysis that expanded in a kind of "variation on a theme" of the timely topics treated in the book. As a result,* Military Review *has elected to lead its January-February 2018 edition with this hybrid article: part book review, part independent research. The article is particularly salient because it is being published almost coincidentally with the publication of the new* U.S. National Strategy*, which identifies China and Russia as the greatest potential challengers to the United States, and close on the heels of discussion with regard to the changing nature of war being conducted at the highest levels of the Russian defense establishment. (See General of the Army Valery Gerasimov, Chief of the General Staff of the Russian Federation Armed Forces, "The Value of Science Is in the Foresight: New Challenges Demand Rethinking the Forms and Methods of Carrying out Combat Operations,"* Military Review *96, no. 1 [January-February 2016]: 23–29).*



Above: A screenshot from the Norse website, which monitors in real-time global efforts by hackers to break into international databases, highlights the cyber conflict between China and the United States. China-based hackers lead the world in numbers of attacks against other nations, including against the United States, which is the most frequent target of internet attacks. The vast majority of such attacks are aimed at economic and financial institutions, technology development firms, and government departments of administration. (Photo courtesy of Norse, http://www.norse-corp.com/)

Left: *War by Other Means: Geoeconomics and Statecraft*, Robert D. Blackwill and Jennifer M. Harris, Harvard University Press, Cambridge, Massachusetts, 2017, 384 pages

To subjugate the enemy's army without doing battle is the highest of excellence.

—Sun Tzu

A few years ago, in testimony before the Senate Foreign Affairs Committee, Henry Kissinger highlighted the frustration that America feels. Despite possessing the world's largest and most vibrant economy, and fielding the best and most capable military establishment, the international security environment is more troubling now than ever before. "The United States finds itself in a paradoxical situation. By any standard of national capacity, we are in a position to achieve our objectives and to shape international affairs. Yet, as we look around the world, we encounter upheaval and conflict. The United States has not faced a more diverse and complex array of crises since the end of the Second World War."[1]

Just a few months ago, Secretary of Defense James Mattis echoed the claim of a worsening global security situation: "Our challenge is characterized by a decline in the long-standing rules-based international order, bringing with it a more volatile security environment than any I have experienced during my four decades of military service."[2] Compounding this concern is that much of the geopolitical challenge buffeting the United States is facilitated by efforts and methods outside of the traditional political and military domains of geopolitical competition.

The most prominent of these domains impacting geopolitical competition are information, cyber, and economics. A 2017 report from the Center for American Progress focuses on the weaponization of information and claims, "Liberal democracies across the globe are under attack. They are being attacked not by traditional weapons of war but by disinformation—intentionally false or misleading information designed to deceive targeted audiences."[3] The U.S. political system remains in an uproar over the alleged Russian disinformation campaign associated with the 2016 election.[4] Cyber represents an even more threatening domain. Former Secretary of Defense Leon Panetta warned of a "cyber Pearl Harbor" that would shock and paralyze the Nation.[5] Director of National Intelligence Dan Coats, in 2017 testimony before the Senate, listed cyber as the top global threat and stated, "Our adversaries are becoming more adept at using cyberspace to threaten our interests and advance their own, and despite improving cyber defenses, nearly all information, communication networks, and systems will be at risk for years."[6]

Finally, the United States is confronting the consequences of a dramatic shift in relative economic power. China's rise since the initial reforms of Deng Xiaoping has been unprecedented; *The Economist* labeled it "the most dynamic burst of wealth creation in human history."[7] China has become the number one manufacturing and trading nation, and its gross domestic product is the second largest in the world, the largest if measured by purchasing power parity.[8] This economic shift in power has become even more ominous for the United States in light of the great financial crisis of 2008. Recovery from the crisis has been slow and steady, but the damage done to perceptions has greatly diminished the efficacy of U.S. relational power—the ability to command or co-opt.[9] China, on the other hand, has taken great advantage of these changed circumstances, and is described as the "leading practitioner of geoeconomics" and a "maestro" at playing the new economic game.[10]

Information warfare, cyberwarfare, and international economic competition are not necessarily new approaches or methods for states to pursue national security objectives, but the context in which they are being applied and the prominence that they have assumed is significantly new. Information communications technology and social media connections and the more thoroughly integrated and globalized economy, coupled with a desire to avoid existing U.S. asymmetric military power, have channeled revisionist and rejectionist opposition to the U.S. supported rules-based international order into these nontraditional domains.

Challengers to the existing order have taken Sun Tzu to heart and are attempting to win without fighting. They are operating in the now familiar gray zone—"the uncomfortable space between traditional conceptions of war and peace."[11]

A great deal of effort has been undertaken to examine and potentially counter the impact of information and cyber operations, but according to Robert Blackwill and Jennifer Harris in their 2016 book *War by Other Means: Geoeconomics and Statecraft*, the United States through "large-scale failure of collective strategic memory" has allowed the global geoeconomics playing field to tilt dangerously against it, and "unless this is corrected, the price in blood and treasure for the United States will only grow."[12] The authors go on to claim that "[m]ore and more states are waging geopolitics with capital, attempting with sovereign checkbooks and other economic tools to achieve strategic objectives that in the past were often the stuff of military coercion or conquest."[13] Memory loss by the United States and a greater willingness by rising powers to utilize economic instruments to achieve geopolitical ends means that the United States must rethink and "reorient its foreign policy to succeed in an era importantly defined by the projection of economic power."[14]

Regardless of your response to the argument of this essay, all national security professionals should read *War by Other Means*. As Henry Kissinger notes on the back cover: "Robert Blackwill and Jennifer Harris do policymakers a service by reminding them of the importance of geoeconomics tools. In a world increasingly affected by economic power, their analysis deserves careful consideration."[15] One final encouragement for readers to broaden their understanding of the nexus between economics and national security is provided by Leslie Gelb:

> Most nations today beat their foreign policy drums largely to economic rhythms, but less so the United States. Most nations define their interests largely in economic terms and deal mostly in economic power, but less so the United States. Most nations have adjusted their national security strategies to focus on economic security, but less so the United States. Washington still principally thinks of its security in traditional military terms and responds to threats with military means. The main challenge for Washington, then, is to recompose its foreign policy with an economic theme, while countering threats in new and creative ways.[16]

The United States should focus on the opportunity presented by an increasingly interconnected global economy, ruled by institutions and rule sets we created, and in which the U.S. inherent economic strengths represent the strongest hand.[17]

Blackwill and Harris address four questions in their analysis, designed to enhance understanding of and thought about geoeconomics:

1. What is geoeconomics, and why is it growing in importance?
2. What are the instruments of geoeconomics?
3. How are China and the United States performing in this geoeconomics domain?
4. What is a more effective U.S. geoeconomics strategy?[18]

This essay will expand on their answer to the first; highlight a few salient points about the very thorough discussion of the geoeconomic instruments; summarize the discussion of China's geoeconomic prowess, with a few caveats, and take issue with the authors' critique of U.S. geoeconomic performance; and finally, challenge their concluding thoughts on geoeconomic strategy.

What is Geoeconomics?

Before focusing on the what, let us briefly consider why the concept has grown in importance. The shift in emphasis began as the Cold War was ending. During this time, Edward Luttwark was commenting on the waning importance of military power, observing that "the methods of commerce were displacing military methods—with disposable capital in lieu of firepower, civilian innovation in lieu of military-technical advancement, and market penetration in lieu of garrisons and bases."[19] Writing a few years later, Samuel Huntington argued to raise economic considerations to prominence in interstate relations: "Economic activity … is, indeed, probably the most important source of power, and in a world in which military conflict between major states is unlikely, economic power will be increasingly important in determining the primacy or subordination of states."[20] The emphasis on economic power is even more prevalent with today's rising powers, as noted by Blackwill and Harris: "Today's rising powers are increasingly drawn to economic instruments as their primary means of

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projecting influence and conducting geopolitical combat in the twenty-first century."[21] The first factor that accounts for the growing tendency to focus on economic instruments is the bleak alternative of challenging U.S. military primacy: "The logic of challenging the United States in a large-scale war is growing more remote."[22] The authors note the skeptics on this point and recognize China's ongoing military modernization program and Russia's challenge in the gray zone, but conclude that "none is even attempting to challenge American military primacy in a comprehensive way."[23]

A second factor is that many rising states have adopted degrees of state capitalism and thus have the economic means at their disposal to pursue geopolitical objectives and contest certain aspects of the existing international system. State capitalism represents a hybrid economic structure in which large segments of the economy are controlled by the state but operate side-by-side with a largely market-oriented private sector. China is the main practitioner, and according to *The Economist*, the Chinese "think they have redesigned capitalism to make it work better, and a growing number of emerging-world leaders agree with them."[24] State control is exercised through national oil and gas corporations, state-owned enterprises (SOEs), state-sponsored national champions, sovereign wealth funds (SWFs), and state-controlled banks. In contrast to states operating with a significant state-owned component of their economy, much of Western economic power is held by the private sector. Private sector profit and loss calculations driven by the market make it highly unlikely that these corporations will respond to national geopolitical objectives.

The final factor is the increasingly globally integrated economy. Despite the growing populist backlash against globalization, the twenty-first century version remains alive and well.[25] The underlying drivers of globalization are still extant: reduced transportation costs, the information technology revolution and increased interconnectedness, relaxed capital markets, the proliferation of free-trade agreements, and organizations that regulate international trade such as the World Trade Organization.[26] In fact, national economies are even more integrated as manufacturing has been disaggregated, commoditized, and reliant on integrated global supply chains of intermediate components.[27]

Increasing interdependence of national economies through globalization creates varying degrees of dependency and vulnerability and, according to Joseph Nye, "Manipulating the asymmetries of interdependence is an important dimension of economic power."[28] All of these factors work together to generate an increased proclivity for states to employ economic instruments of power as a first-choice option.

To capture this emerging tendency of state reliance on economic power, Luttwark first coined the term "geoeconomics" in his 1990 essay, "From Geopolitics to Geo-Economics." He states, "Geoeconomics … the best term I can think of to describe the admixture of the logic of conflict with the methods of commerce—or as Clausewitz would have written, the logic of war in the grammar of commerce."[29] The term has since become a bit muddled, and Blackwill and Harris wanted to clarify the concept and narrow its focus. Thus, they present the following definition:

> Geoeconomics: The use of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results; and the effects of the other nations' economic actions on a country's geopolitical goals.[30]

The authors indicate that their analysis is focused on the second element of this definition, the use of economic instruments as means to achieve geopolitical ends. Before going deeper into their examination of the economic aspects of statecraft, it is important to consider at least briefly the full scope of the relationship between economic power and geopolitics. Three specific dimensions are relevant to this consideration: a nation's macroeconomic performance, international economic policy, and economic instruments applied in pursuit of geopolitical ends (the emphasis of *War by Other Means*).

Hal Brands notes in his essay "Rethinking America's Grand Strategy" that "grand strategy begins and ends with macroeconomics, and perhaps the single most important insight from the Cold War is that geopolitical success is a function of economic vitality."[31] The classic historical analysis on this principle is Paul Kennedy's *The Rise and Fall of Great Powers*, in which he concludes that a great power needs a "flourishing economic base."[32]

Both President Barack Obama, with his emphasis on nation building at home, and President Donald Trump's focus on "making America great again" recognize the need to sustain and build a strong domestic economy. Policies to generate economic growth are communicated through budget decisions directing

The economic development paradigm employed by China differs sharply from that employed by the United States, which relies on the concept of economic growth stemming primarily from private investment. In contrast, China operates as a corporate state and command economy that relies heavily on targeted state investment to manage the direction of economic growth and trade. Consequently, the Chinese government is directly involved in shaping strategic economic policies that treat economic competitors as virtual economic enemies. (Photo courtesy of Wikimedia Commons; graphic by Arin Burgess, *Military Review*)

revenue generation and resource allocation and sound financing of government activities.[33]

The three most recent chairmen of the Joint Chiefs of Staff have all expressed concern about these issues. Adm. Mike Mullen claimed that "our national debt is our biggest national security threat"; Gen. Martin Dempsey noted the emergence of economic issues as a major concern and perhaps a focus of his tenure at the Joint Chiefs; and Gen. Joseph Dunford has expressed his concern about the impact of future budget dynamics on resources for defense.[34] None of these concerns have been resolved as the Budget Control Act remains in effect and another debt extension debate is fast approaching.

The second dimension is international economic policy in which economic instruments are used in support of economic ends. The distinction between the pursuit of geopolitical and economic ends can sometimes be "fuzzy"; as Blackwill and Harris admit, "States can and often do design geoeconomic policies that simultaneously advance multiple interests—geopolitical, economic, and otherwise."[35] While some of the most contentious issues between the United States and China may have geopolitical overtones, they are really focused on economic outcomes. Two that immediately come to mind are the theft of intellectual property facilitated by cyber-enhanced economic espionage, lack of enforcement of intellectual property rights (IPR), and heavy-handed technology transfer policies; and the closely related issue of industrial policy and the ongoing Chinese support for national champions.

Trump announced in 2017 a "zero-tolerance policy on intellectual-property theft and forced technology transfer," and directed an investigation of the impact of Chinese practices on U.S. commerce.[36] China, reportedly, accounts for most of the $600 billion a year intellectual-property theft costs to America.[37] The IPR and technology transfer issue bleed into China's very active industrial policy: "As the Chinese government tries to make China a world leader in technology-intensive industries like semiconductors, driverless cars, and biotechnology, the fear is that it will plunder its foreign partners' intellectual jewels, and then get rid of them."[38] Two years ago, China kicked off its newest industrial policy initiative, "Made in China 2025," that targets ten key industrial sectors with the goal of advancing these sectors to the highest parts of global production chains.[39]

A 2017 headline from the *Wall Street Journal* highlights the intensity of the subsequent global competition associated with China's industrial policy: "China Unleashes A Chip War: The Global Semiconductor Industry is Succumbing to Fierce Nationalistic Competition."[40] The Chinese are employing a government-backed fund, one of the typical geoeconomic assets mentioned above, in their efforts to dominate this critical industry.[41] Intensifying geopolitical competition fueled by economic means is being accompanied by just as intense economic competition fueled by those same means. As a prominent Australian think tank noted in a recent report, "if you want to try to understand many of the most important strategic developments facing the world over the next couple of decades, then you are going to need to devote a reasonable amount of time to thinking about what's going on in the international economy."[42]

	Positive	Negative
Trade	• Grant access • Free trade agreements • Government purchase • Licenses	• Sanctions—deny access • Embargo/boycott/quotas • Deny licenses • Subsidies • World Trade Organization dispute settlement
Finance	• International financial institution (IFI) contributions • Open capital markets • Bailout packages • Debt forgiveness	• Freeze assets • Capital controls • Currency manipulation • Financial sanctions —secondary sanctions • Sell foreign debt holdings
	Monetary policy	
Aid	• Official Development Assistance • Private contributions • Public health programs	• Conditional aid • Tied aid
Policy	Regulation	

(Graphic by author; IFI: International Monetary Fund, World Bank, Multinational Development Banks, etc.)

Figure. Economic Instruments

In a broader sense, economic power and geoeconomic instruments buttress a country's national security by contributing to a strong economy, enabling effective international economic policy, and returning to the authors' focus, the third dimension of geoeconomics, the application of economic statecraft to the accomplishment of geopolitical objectives.

Geoeconomic Statecraft

Statecraft refers to the means by which governments pursue foreign policy, and can be categorized into four primary instruments: diplomacy (negotiations and deals), information (words and propaganda), military force (weapons and violence), and economics (goods and money).[43] Then Secretary of State Hillary Rodham Clinton, in a series of speeches on the topic of economic statecraft, identified two parts, the first is "how we harness the forces and use the tools of global economics to strengthen our diplomacy and presence abroad"—applying economic means to achieve geopolitical ends. The second part transformed the geopolitical ends into means to help accomplish the ends of domestic economic prosperity.[44]

Blackwill and Harris enumerate seven tools suitable for geopolitical application: trade policy, investment policy, economic and financial sanctions, financial and monetary policy, aid, cyber, and energy and commodities.[45] The first five tools are readily recognized as economic activities, and energy and commodities could just as easily be considered a subset of trade policy—representing perhaps a more critical category of tradeable goods. Cyber's inclusion as an economic instrument seems a bit problematic. The standard economic instruments are shown in the figure (on page 10), highlighting various applications typically designed to provide positive inducement (carrots) or negative actions (sticks). Negative actions are often referred to as coercive economic measures.[46]

Trade remains perhaps the most readily applied economic tool both as positive inducement through negotiated free-trade agreements and through normal trade relations granted by nearly universal membership in the World Trade Organization, and as a coercive instrument as sanctions denying the free flow of goods. Free-trade agreements continue to proliferate, both on a bilateral and regional basis, with objectives that are predominantly focused on economic issues, although the geopolitical residual effects of improved economic relations are always possible. Coercive sanctions imposing embargoes against the free flow of goods and services remain a centerpiece of economic statecraft, despite a strong consensus that they do not work. The negative humanitarian effects of the United Nations-imposed comprehensive sanctions against Iraq in the 1990s led to the development of targeted sanctions against specific individuals and groups. Targeted sanctions, also referred to as smart sanctions, included "asset freezes, travel bans, restrictions on luxury goods and arms embargoes."[47]

International investment flows now far surpass cross-border trade flows, and according to the United Nations, the global direct outward investment position was $26 trillion in 2016.[48] Developing countries that need capital for growth now turn to the international markets for the vast majority of their needs. Tom Friedman describes the combination of short-term investors and multinationals investing for the long term (foreign direct investment [FDI]) as the "electronic herd," and the markets that broker these investments as the "supermarkets." He concludes that the "supermarkets have replaced the superpowers as sources of capital for growth."[49]

Most FDI is based on market-driven decisions, and thus, their only geopolitical consideration is the stability of the market they are entering. However, the advent of large and growing SOEs, SWFs, and internationally active state-owned banks has begun to tilt the playing field away from pure market-fundamentals decision-making. Blackwill and Harris note that "SOEs are far more politically pliant than most private firms," and geopolitical motives can also be operative with certain SWFs.[50]

Western firms and nations ask for transparency in financial decision-making to ensure investments are made on the "basis of economic, market-driven logic," and SWFs are supposed to comply with the Santiago Principles that are designed to "increase transparency and guard against political investments," but the level of state ownership in these institutions cannot help but "endow them with unique political levers."[51] In addition to the very real potential for geopolitical leverage associated with outbound investment, a country's control over inbound investment may act in a similar manner. A country could deny access to critical sectors, control the degree of foreign ownership allowed, or conduct case-by-case approval for foreign investments based on national security considerations, which could be real or contrived.[52]

Financial sanctions represent the next step in the evolution of sanctions regimes; they are designed to restrict access to the global banking system and international capital markets.[53] After 9/11, the United States conducted a concerted effort to go after terrorism financing and eventually convinced the Society for Worldwide Interbank Financial Telecommunications (SWIFT), which is a clearing house messaging system with a virtual monopoly as the switchboard of the international financial system, to cooperate. As Juan Zarate, in his excellent book *Treasury's War* notes, SWIFT and the ubiquity of the U.S. dollar in international markets became the "cornerstone of our ability to wage financial warfare more broadly."[54] This topic will be discussed in greater length in the next section.

Similar to the potency of financial sanctions based on the ubiquity of the U.S. dollar, the efficacy of financial and monetary policy as a tool of geoeconomics is largely dependent on the role of a country's currency in the international monetary system. Currency wars are fought between central banks, either manipulating their currencies for competitive advantage or conducting unconventional domestic monetary policy by implementing quantitative easing programs.[55] Or, a central bank discussing the end of quantitative easing could cause emerging market interests rates to rise, resulting in debt roll-over issues.

A similar chain of events preceded the collapse of the Yanukovych government in Ukraine in 2014, resulting in the most serious geopolitical crisis in Europe since the end of the Cold War.[56]

This is an immensely important and complex topic. The current global footprint for the U.S. dollar completely underpins the strength of the U.S. economy and the ability of the U.S. government to sustain its growing national debt, and it enables significant U.S. application of geoeconomic tools. The Chinese renminbi (RMB) is perhaps an up-and-coming challenger, but the odds of its success are not in its favor. We will revisit the dollar and the RMB in the next section.[57]

Economic assistance consists of military aid, humanitarian aid, and bilateral economic development assistance, also referred to as official development assistance (ODA). It is fairly clear that there can be significant geopolitical strings attached to ODA, and in addition to China, other major geoeconomic players using this instrument include the Gulf Cooperation Council members and Japan. China has utilized ODA to gain adherents throughout Africa and Latin America for the one-China policy, and it is also known for providing conditions-free aid that does not impose burdensome good-governance considerations or requirements for progress on human rights. There are also a host of state-owned development banks that have begun to compete with the existing lineup of Western created and backed development banks.[58]

National policies governing energy and commodities could be considered an example of trade policy, but Blackwill and Harris choose to highlight these as a separate collective instrument. Energy resources in the form of oil and natural gas certainly represent critical resources needed to run the global economy, and ever since the creation of the Organization of Petroleum Exporting Countries (OPEC), the geopolitical implications of the energy trade have been abundantly clear. The key concern is energy security: availability at a reasonable price.[59] States dependent on imports seek to mitigate their vulnerability through diversification of both source and transit route.[60]

The biggest geopolitical actor in this sector is Russia, having engineered natural gas cutoffs several times at the beginning of this century.[61] But despite many geopolitical disputes that might seem prime candidates for geoeconomic actions, the robust globally integrated energy market, infused by increased supplies courtesy of the ongoing march of technology and innovation, seem to have given the market the upper hand.[62]

This does not mean that geopolitics is completely divorced from the energy sector, but major suppliers recognize their strong interest in demonstrating reliability to their customers, otherwise incentivizing the search for alternative sources. Blackwill and Harris devote an entire chapter to the "geoeconomics of North America's energy revolution" and conclude that the United States will be in a strong position to support allies and friends in countering geoeconomic pressure from adversaries, to engage with China and Asia in an expanded energy infrastructure featuring the export of liquefied natural gas and oil, and to sustain the global economy through the twenty-first century.[63]

The final instrument is cyber. The authors include an extensive section to discuss and offer recent examples of cyberattacks. They note that not all cyberattacks are geoeconomic and thus propose a very specific definition: "Geoeconomic cyberattacks are those making use of economic or financial market mechanisms and seeking to impose economic costs as part of a larger geopolitical agenda."[64]

This definition, however, seems to diverge from the narrower approach specified earlier: economic instruments as means to achieve geopolitical ends. Cyberattacks designed to cause economic harm that in turn may support a geopolitical objective sounds similar to an example cited earlier in their book that bombing a factory "should be excluded from any conception of geoeconomics."[65] A cyberattack against critical infrastructure can certainly harm an economy, but it is not the application of economic means to a geopolitical end.[66] The concern about the theft of IPR has already been discussed, but as mentioned, those attacks seem to be conducted for an economic end. Cyberattacks clearly represent a significant security threat, and in many cases, these attacks target critical components of economic infrastructure

> China's export-driven economic miracle depends on imports. … China cannot cut off this flow, or risk disrupting it through conflict, without crippling its economy.

and industry, but the examination of this aspect of statecraft should have its own platform and not necessarily be considered a geoeconomic event.

China and the United States in the Geoeconomic Arena

The next major section of *War by Other Means* examines the geoeconomic performance of China and the United States. It should be clear that there are a number of geoeconomic practitioners plying their trade (i.e., Russia and several members of the Gulf Cooperation Council), but focusing on China and the United States seems appropriate given that the relationship between these nations is likely to define the twenty-first century.

Since China finds itself less outmatched by the United States in the geoeconomics domain, the competition between these two nations will play out in the geoeconomic arena.[67] According to Blackwill and Harris, there are four structural features, or geoeconomic endowments, that dictate the effectiveness and degree of economic leverage that countries can achieve through the employment of geoeconomic instruments. The first is the ability to control outbound investment. Countries with large state-owned sectors (i.e., SOEs, SWFs, and state-owned banks) have a distinct advantage.[68] The second is the size and ability to control access to one's domestic market. All businesses want to be successful in the largest consumer markets and will often bend over backward to comply with government demands such as technology transfers, joint ventures, and establishing local research-and-development centers. The third is influence over commodity and energy flows, and the fourth is the global footprint of a country's currency.[69] As will be shown, China has some important advantages in the geoeconomic arena, but perhaps not as dominant as the authors claim.

Blackwill and Harris use six case studies to demonstrate China's geoeconomic prowess and to support their claim that "Beijing builds and exercises its power projection not primarily through the deployment of military assets (except in the South and East China Seas) but rather through coercive and incentivizing geoeconomic policies toward its neighbors."[70] The most interesting case concerns the territorial dispute with Japan over the Diaoyu/Senkaku Islands. This is particularly interesting as it pits the second and third largest economies against each other. In 2010, the Chinese responded to an at-sea collision by halting the export of rare earth metals to Japan. China claimed that it was merely a slowdown in processing export orders due to resource depletion and environmental concerns. At the time, China produced over 90 percent of the global supply.

Although this had an immediate cautionary effect on Japan and other consumers of rare earth metals, a resulting price increase unintentionally drove a revival of global rare-earths production, thus lessening China's monopoly power and geopolitical leverage. As a Council on Foreign Relations report noted, "Beijing all too often underestimates market forces."[71]

The second incident occurred two years later in 2012, when the Japanese government purchased one of the disputed islands, and China responded with nationalists' riots that boycotted Japanese products and forced the shutdown of Japanese manufacturers located in China. But as Richard Katz wrote in *Foreign Affairs*, the disruption in production was relatively short-lived before *mutual assured production* kicked in. China badly needed what Japan was selling because "China's export-driven economic miracle depends on imports. … China cannot cut off this flow, or risk disrupting it through conflict, without crippling its economy."[72] Economic interdependence can trump geopolitics.

China has also employed geoeconomic instruments in its standoff with Taiwan. It has used economic aid and investment to encircle Taiwan by enticing other nations to end diplomatic relations with the breakaway province and to support mainland positions in international institutions, further isolating Taiwan. It has also pursued penetration by liberalizing cross-strait relations to heighten Taiwan's economic dependence on China. However, there are limits to China's penetration as "Taiwanese citizens are becoming acutely aware of their deepening vulnerability to Chinese geoeconomic pressure." But despite this pushback, Blackwill and Harris conclude that, "Beijing will inevitably continue to use geoeconomic tools to influence Taipei," in its efforts to guide the island to eventual reunification.[73]

Geoeconomic inducements are also at work in support of the nine-dash line in the South China Sea (SCS). China has become the number one trading partner for all of the surrounding countries, in most cases displacing the United States. China's recent package of loans and investments offered to President Rodrigo Duterte of the Philippines is an excellent example of geoeconomics at work. China offered Manila more than $9 billion in low-interest loans for infrastructure and other projects; also completing economic agreements valued at an estimated $13.5 billion. In return, Duterte agreed to set aside the Permanent Court of Arbitration ruling on the SCS and claimed that the long-term U.S. defense alliance was at risk.[74]

David Shambaugh adds some perspective to China's geoeconomic position in the SCS: "Viewed more broadly, China's share of regional trade and investment is far from dominant. Beijing's investment in many Southeast Asian countries ranks below that of Japan, the European Union, or the United States, while its trade does not exceed 30 percent (usually 15 to 20 percent) of any individual Asian nation's total trade."[75] And, as John Ikenberry argues, there are limits to geoeconomic inducements: "Countries want the benefits that come from the rise of China. But, they also want to guard against Chinese domination of the region. This, in turn, is a major reason America's extended alliance system in the region is welcomed."[76]

The next case study concerns South Asia with a brief look at relations with India and Pakistan. Blackwill and Harris argue that China's desire to avoid escalating military tensions in this volatile region pushes them to focus more on geoeconomic tools. Chinese investment is the major tool in this region and its emphasis is on the China-Pakistan Economic Corridor as an important component of the One Belt One Road (OBOR) initiative.[77] An excellent summary of the OBOR initiative is provided by the Lowy Institute that concludes that the

> OBOR is President Xi's most ambitious foreign and economic policy initiative. … There is little doubt that the overarching

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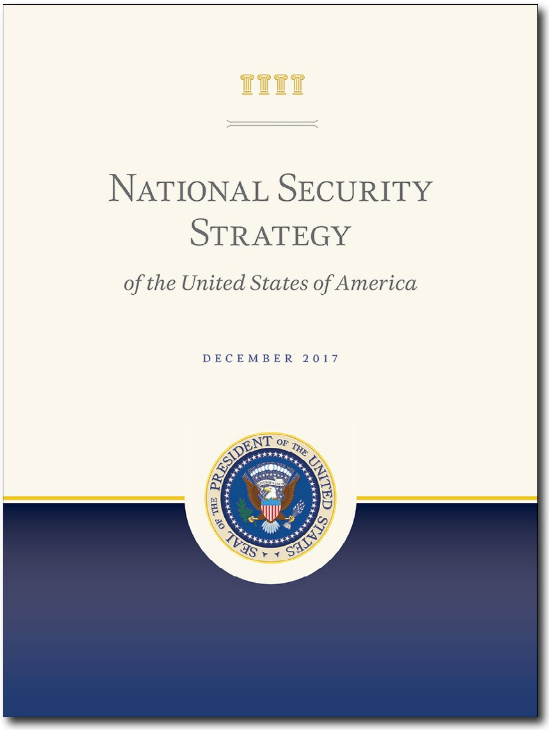
National Security Strategy
of the United States of America
DECEMBER 2017
SEAL OF THE PRESIDENT OF THE UNITED STATES

The strategy addresses key challenges and trends that affect our standing in the world, and singles out China as a particular threat. It notes, "China and Russia challenge American power, influence, and interests, attempting to erode American security and prosperity. They are determined to make economies less free and less fair, to grow their militaries, and to control information and data to repress their societies and expand their influence." It also asserts that these states "use technology, propaganda, and coercion to shape a world antithetical to our interests and values."

To view the complete *National Security Strategy of the United States of America*, please visit https://www.whitehouse.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf.

> objective of the initiative is helping China to achieve geopolitical goals by economically binding China's neighboring countries more closely to Beijing. But there are many more concrete and economic objectives behind OBOR [as well].[78]

The China-Pakistan Economic Corridor calls for an investment of $46 billion, and the entire OBOR network will have projects worth more than $890 billion.[79] In addition to significant financing concerns, the "lack of political trust between China and some OBOR countries, as well as instability and security threats in others, are considerable obstacles."[80] Other countries have proposed similar infrastructure investment networks for the Asia-Pacific region, and India claims that OBOR "is a unilateral initiative" that it will not buy into "without significant consultation."[81] Blackwill and Harris suggest that the joint U.S.-India "Indo-Pacific Economic Corridor" could address India's wariness toward China's plans and constitute its own maritime silk road.[82]

Korea is the final case study. The current crisis, generated by the ultimate military weapon, has turned it into a geoeconomic battlefield. For a bit of context, China should have tremendous leverage over North Korea, as it accounts for nearly 85 percent of North Korea's total trade volume. Even more important is the stranglehold China has on over 90 percent of the North's energy imports.[83] Despite this nearly unsurmountable geoeconomic position, China claims it has no effective leverage. According to a Brookings Institution strategy paper, "China has no leverage to convince this foreign nation to stop its nuclear program."[84] From the U.S. perspective, Obama called North Korea the "most sanctioned" country in the world.[85]

Yet, most analysts conclude that sanctions will never succeed in getting North Korea to give up its nuclear weapons. The first round of the current geoeconomic battle was fired by the United States in the form of a grand bargain that proposed to go easy on trade with China in return for Chinese pressure against North Korea. Recently, having judged that effort to be lacking, the United States fired round two by initiating a trade investigation against Chinese technology transfer policies and theft of IPR.[86] In the meantime, South Korea agreed to the deployment of the Terminal High Altitude Area Defense (THAAD) system on its territory, and it was time for China to fire a geoeconomic round. Government-controlled news media urged boycotts of South Korean products and mainland travel agencies canceled group trips to South Korea.[87] "The sales of Kia and its parent Hyundai Motors Co. in China fell 61 percent from March to June," and the plants are operating at only 30 percent capacity.[88] Once again, however, the geoeconomic effect missed the mark as the THAAD system is now completely operational and South Korean reaction to Chinese bullying has gone down badly. For the first time, opinion polls suggest they hold China in lower esteem than Japan.[89]

The United States is now expected to press for China to impose a complete oil embargo on North Korea.[90] To incentivize this request, the United States could impose secondary sanctions to "compel China to sever North Korea's international economic lifelines. This would involve threatening access to the U.S. financial system for foreign firms that do business" with North Korea.[91] Battles are always unpredictable, and thus it is uncertain how this geoeconomic battle will conclude, but this short account clearly demonstrates the tendency for the United States and China to resort to geoeconomic pressure.

U.S. Geoeconomic Statecraft

The preceding review of the standoff over North Korea's nuclear program indicates that, contrary to the authors' claims of U.S. hesitancy and ineffectiveness in the geoeconomic arena, the United States remains a very active contestant in this critical domain. U.S. outbound FDI is the largest in the world, and although not directed by the U.S. government for specific geoeconomic purposes, the global presence of U.S. corporations helps sustain relational and reputational power.[92] As an example, concern expressed about Chinese economic penetration into Latin America is countered by the fact that more than 53 percent of the total FDI in the region in 2016 came from the European Union, while 20 percent came from the United States. China, on the other hand, contributed only 1 percent.[93] The United States is also actively engaged in vetting inbound investments through the Committee on Foreign Investments in the United States (CFIUS).[94] The CFIUS is an interagency organization charged with reviewing foreign investments for national security implications. Because of the concern that the growing number of Chinese investments may be directed and subsidized by the Chinese government, to include potential acquisitions associated with sensitive technologies, and due to a lack of reciprocity in allowing U.S. firms to freely invest in China, the CFIUS has significantly toughened the scrutiny of these deals.[95]

The United States is the number two trading nation in the world, and due to the size of its domestic consumer-based economy, it remains an extremely attractive market for global producers to engage. The Trump administration's populist-driven trade policies have sent a chill through free-trade enthusiasts around the world, and the withdrawal from the Trans-Pacific Partnership (TPP) trade agreement is viewed by many as an economic setback but even more of a geostrategic error. Blackwill and Harris include an extensive discussion of the TPP and argue that the TPP should have been negotiated with much more of a geopolitical focus.[96] But, they nevertheless conclude that "U.S. failure to conclude this deal is far more likely to be seen by our allies and non-allies alike as foremostly a geopolitical failure and a negative test of U.S. staying power in the region."[97]

A recent study on trade in the Asia-Pacific urged the United States to reconsider its position on the TPP, encouraged other countries to adhere to the high standards contained in the TPP, and welcomed other countries to try and bring the agreement into force, if necessary, without the United States.[98] The administration is actively engaged in various trade initiatives, and it remains to be seen if its current policy bent will moderate. The president has stated, "We are going to have a lot of trade deals."[99]

The carrot aspect of the trade instrument may be a bit blunted for the time being, but the stick is very active and increasingly effective. U.S. economic sanctions are now largely associated with financial sanctions. As mentioned above, these sanctions are focused on constraining access to the global banking system. The size of U.S. capital markets and the role of the U.S. dollar in international transactions mean the "United States has had a near monopoly on the use of targeted financial pressure over the past ten years."[100] Financial sanctions have also created significant incentives for third parties (e.g., banks) to abide or risk severe consequences, both monetary and reputational.[101]

These sanctions, referred to as "secondary sanctions" or "extraterritorial sanctions" can be extended to foreign companies that continue to trade with the targeted country.[102] U.S. sanctions have recently been effectively employed against Iran and Russia.[103] The lack of sufficient impact to date against North Korea is based on overreliance on the minimally effective U.N. Security Council resolutions. As noted above in the discussion of the geoeconomic battlefield over the Korean peninsula, wide-ranging financial sanctions, to include secondary sanctions, may assist in getting favorable results.[104]

> The United States is the number-two trading nation in the world, and due to the size of its domestic consumer-based economy, it remains an extremely attractive market for global producers to engage.

The prevalence and success of financial sanctions has generated important mitigation activities: banks are de-risking (terminating accounts, or pulling out of correspondent relationships in risky areas), and countries are developing alternatives to the dollar.[105] According to Blackwill and Harris, "Certain financial sanctions … are effective only because these entities deal in U.S. dollars. But stakes change if countries begin to settle transactions in … other currencies."[106]

In terms of the current focus on U.S. and Chinese geoeconomic prospects, this leads to the discussion about the role of the U.S. dollar and the Chinese RMB. The dollar has enjoyed a position of exorbitant privilege in the global economy based on its dominant use in international transactions and its service as the principle reserve currency.[107]

Dollar dominance is represented by the following circumstances: oil is priced in dollars; most commodities are priced in dollars; two-thirds of international bank loans are in dollars; 40 percent of international bonds are issued in dollars; and 60 percent of foreign exchange reserves are held in dollars.[108]

China, among other nations, chafes at the exorbitant privilege accorded to the dollar and the significant financial leverage that this confers on the United States, and it has thus embarked on a program to internationalize the RMB. Effective 1 October 2016, the International Monetary Fund included the Chinese RMB as one of the five currencies comprising its basket of reserve currencies. However, China continues to resist establishing a fully market-determined exchange rate, and it has not opened its capital account to allow free cross-border capital flows.[109] In a superb book on the Chinese currency, *Gaining Currency*, Eswar Prasad concludes, "the RMB is hitting constraints that result from the structure of its domestic economy and will limit its progress as a reserve currency. Moreover, given the nature of its political system, it is unlikely the RMB will attain the status of a safe-haven currency. Thus, although it is likely to continue its ascent, the notion that the RMB will become a dominant global reserve currency that rivals the dollar is far-fetched."[110] The U.S. ability to employ geoeconomic financial weapons seems safe, at least for the time being.

Before leaving this subject, there is one final issue to address that has implications for geoeconomic leverage, China's holdings of U.S. debt. China and Japan have been neck-and-neck as the top holders of U.S. Treasury securities, and in June 2017, China nudged out Japan as the top holder of U.S. Treasury securities at $1.1 trillion.[111] The typical scenario is that in a crisis China would attempt to send the dollar into a downward spiral through a sudden sell-off of U.S. treasuries. Blackwill and Harris note, however, that there is general agreement that due to the strength of the U.S. bond market and anticipated counterintervention by the U.S. Federal Reserve, the likely result of a sudden sell-off by China would be the significant depreciation of China's remaining holdings, thus "China's holdings are on balance a liability for Beijing."[112] This relationship is often referred to as *mutual assured financial destruction*—reminiscent of the Cold War term referring to the U.S. policy of mutual assured destruction that would involve a massive doomsday exchange of nuclear weapons attacks with the Soviet Union—and is somewhat akin to the earlier mention of mutual assured production. These concepts meld into the notion of mutual assured economic destruction that recognizes that increasingly interdependent economies tend to diminish geoeconomic leverage.[113]

Both China and the United States are active players in the geoeconomic arena, and each possesses some unique advantages. This review of cases and the application of various economic instruments validates the conclusion reached by Zarate in *Treasury's War*: "We have entered a new era of financial influence where financial and economic tools have taken pride of place as instruments of national security. The conflicts of this age are likely to be fought with markets, not just militaries, and in boardrooms, not just battlefields. Geopolitics is now a game best played with financial and commercial weapons."[114]

Geoeconomic Grand Strategy: Small Ball vs. Big Ball

Blackwill and Harris conclude their tour de force on geoeconomics by addressing the future of U.S. grand strategy. They argue that the United States needs to "use its geoeconomic power with much greater resolve and skill" to resist geoeconomic coercion being practiced by China and other like-minded states.[115] They claim that the United States has been too focused on the security dimension of American foreign policy and thus defaults to military and political instruments, rather than recognize that inherent economic strengths should be more readily employed in pursuit of geopolitical outcomes—adopting a more economics-centered foreign policy.[116] In addition, the United States is too wedded to the existing rules-based international order (RBIO), which tends to constrain its willingness to employ economic instruments in pursuit of geopolitical objectives for fear that "the mere invocation of threats to the existing rules-based order" will end the policy debate on the use of geoeconomic instruments.[117]

The United States has created and nurtured an international order based on commercial liberalism since the end of World War II, which called for the spread of capitalism and open markets. This global order generated global economic growth, prosperity, and economic interdependence, and was buttressed by the establishment of various institutions (the International Monetary Fund, World Bank, eventually the World Trade Organization) and their rules-based operational construct that facilitated cooperation and collective problem solving.[118]

The end of the Cold War greatly expanded the geographical application of the RBIO and even included the adoption of more prescriptive economic policies that should be followed by each country, known as the Washington Consensus. These policies included sound macroeconomic policies, market-based domestic structures, and integrated and open trade and investment policies.[119] The RBIO and its economic components are based on the proposition that economics is a positive-sum game, as opposed to the zero-sum nature of geopolitics. But, that only holds if the role of the state in the economy is greatly reduced, laissez-faire liberalism is practiced, and geopolitical motivations are minimized when it comes to influencing economic policy.[120]

However, Blackwill and Harris argue against this principle. They contend that the RBIO is delivering less and less, and rising powers are undercutting it. The self-imposed constraints on the use of geoeconomic approaches means that "Washington will probably never be capable of using trade and investment tools to advance its foreign policy interests in many of the *short-term transactional* or coercive ways that suit other countries [emphasis added]."[121] To their credit, there is a great deal of discussion in the book on this point, and the authors do a commendable job in presenting both sides of the argument. They acknowledge that the United States "may well have a greater geopolitical interest than other states in keeping the geopolitically motivated uses of certain economic instruments to a minimum," and perhaps, "upholding the rules-based system still remains the best strategy for maximizing present U.S. geopolitical objectives."[122] But, they remain unconvinced and conclude, "so long as upholding the rules-based system is still seen as geopolitically advantageous for the United States, most forms of geoeconomic power will need to be at least neutral in their impacts on the rules-based system for them to pass muster. Adhering to this standard will constrain the United States far more than many other states, especially in more coercive, shorter-term cases."[123]

There are two problems with their conclusion. First, their purported "grand strategy" is to make greater use of economic instruments to achieve geopolitical objectives (geoeconomics) in support of U.S. national interests. The argument in the preceding paragraph captures the emphasis on short-term, tactical, and transactional uses of economic instruments. This is all about means, not strategic ends, and certainly not a grand strategic vision. The authors actually introduce the analogy of small ball (tactics) versus big ball (strategy).[124] It should not be a big surprise to the reader that a book titled *War by Other Means* is focused on the means (small ball), not the ends. It represents an excellent review of the various economic instruments of statecraft and their application, but it adds little to considering how to employ these tools in support of an effective grand strategy. The second problem is that continued support of the RBIO remains the most appropriate grand strategy (big ball) for the United States. Economic instruments need to be employed occasionally in support of geopolitical objectives, but their use should take into consideration the potential negative impact it may have on the continued acceptance of the RBIO.

John Ikenberry, probably the most well-known scholar on the theory, origins, and current nature of the RBIO, makes several cogent arguments about the efficacy of the existing liberal international order. First, the components of this order—multilateral institutions, alliances, trade agreements, and political partnerships—have created the capacities and tools to win the twenty-first-century struggles with geopolitics. Second, China and Russia embrace the underlying logic of the RBIO. "Openness gives them access to trade, investment, and technology from other societies. Rules give them tools to protect their sovereignty and interests."[125] Consequently, the United States should pursue a grand strategy that "ties itself to the regions of the world through trade, alliances, multilateral institutions, and diplomacy. It is a strategy in which the United States establishes leadership not simply through the exercise of power but also through sustained efforts at global problem solving and rule making."[126]

Conclusion

The reader should take away three broad concepts from this article. First, the geoeconomic domain will quite likely be the most critical arena for nation-state competition in the decades to come. Thus, it is important to understand the economic instruments of statecraft and their employment in pursuit of geopolitical objectives, but also to remain cognizant of their limitations. Second, the United States should continue to support the post-World War II liberal institutional RBIO. As Cordell Hall, Franklin D. Roosevelt's secretary of state, reasoned at the end of World War II, "if we could increase commercial exchanges among nations over lowered trade and tariff barriers and remove unnatural obstructions to trade, we would go a long way toward eliminating war itself."[127] Finally, in two concluding thoughts from Blackwill and Harris: "National power depends above all on the performance of the local domestic economy and the ability to mobilize its resources," and "Nothing would better promote America's geoeconomic agenda and strategic future than robust economic growth in the United States."[128] The U.S. position in the world is not dependent on what does or does not happen in China, it depends on the economic policies and direction we set for ourselves here in the United States. ■

Notes

Epigraph. Sun Tzu, *The Art of War*, trans. The Sonshi Group, chap. 03.02, accessed 20 November 2017, https://www.sonshi.com/original-the-art-of-war-translation-not-giles.html.

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2. *Department of Defense Budget Posture, Hearing Before the Senate Comm. on Armed Services*, 115th Cong. (13 June 2017) (testimony of James Mattis, Secretary of Defense of the United States).

3. Max Bergmann and Carolyn Kenney, "War by Other Means: Russian Active Measures and the Weaponization of Information" (Washington, DC: Center for American Progress, June 2017), accessed 8 November 2017, https://cdn.americanprogress.org/content/uploads/2017/06/08052859/RussiaDisinformation-report1.pdf.

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7. "China's Growing Pains," *The Economist*, 19 August 2004, quoted in Ashley J. Tellis, "China's Grand Strategy: The Quest for Comprehensive National Power and its Consequences," in *The Rise of China: Essays on the Future Competition*, ed. Gary J. Schmitt (New York: Encounter Books, 2009), 25.

8. Graham Allison, in his new book, begins with a chapter that starkly relates the growth of China, particularly in relation to the United States. "The Biggest Player in the history of the World," chap. 1 in *Destined for War: Can America and China Escape Thucydides's Trap?* (New York: Houghton Mifflin Harcourt, 2017).

9. Joseph S. Nye Jr., *The Future of Power* (New York: PublicAffairs, 2011), 10–14.

10. Robert D. Blackwill and Jennifer M. Harris, *War by Other Means: Geoeconomics and Statecraft* (Cambridge, MA: The Belknap Press of Harvard University Press, 2016), 11; Leslie H. Gelb, "GDP Now Matters More Than Force: A U.S. Foreign Policy for the Age of Economic Power," *Foreign Affairs* 89, no. 6, (November/December 2010), accessed 8 November 2017, https://www.foreignaffairs.com/articles/united-states/2010-10-21/gdp-now-matters-more-force.

11. Nathan P. Freier et al., *Outplayed: Regaining Strategic Initiative in the Gray Zone* (Carlisle Barracks, PA: Strategic Studies Institute, June 2016), xiii.

12. Blackwill and Harris, *War by Other Means*, 1–2.

13. Ibid., 4.

14. Ibid., 7.

15. In addition to the excellent coverage of the topic in the body of the book, the extensive endnotes represent a wealth of material for those desiring to go deeper into the subject.

16. Gelb, "GDP Now Matters More Than Force," 35.

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19. Edward N. Luttwark, "From Geopolitics to Geo-Economics: Logic of Conflict, Grammar of Commerce," *The National Interest*, no. 20 (Summer 1990): 17. In a book published almost a decade later, Luttwark presents an excellent summary comparing the means and goals of power-politics to geoeconomics, along with some very prescient implications of the transition from one system to the other. Edward Luttwark, *Turbo-Capitalism: Winners and Losers in the Global Economy* (New York: HarperCollins, 1999), 134.

20. Samuel P. Huntington, "Why International Primacy Matters," *International Security* 17, no. 4 (Spring 1993): 72.

21. Blackwill and Harris, *War by Other Means*, 33–34. The most well-known grouping of rising powers is the BRICS—Brazil, Russia, India, China, and now South Africa. Additional conceptions include the MIKTs—Mexico, Indonesia, South Korea, and Turkey (created by Jim O'Neill of Goldman Sachs, who also created the term BRIC). Also refer to Raymond Ahearn, *Rising Economic Powers and U.S. Trade Policy* (Washington, DC: Congressional Research Service [CRS], 3 December 2012).

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23. Ibid.

24. "The Rise of State Capitalism," *The Economist* (website), 21 January 2012, accessed 21 November 2017, http://www.economist.com/node/21543160. With China as the primary practitioner and given its authoritarian government structure, state capitalism is also referred to as authoritarian capitalism. Many other practitioners of state capitalism have authoritarian leanings but not all. Norway, for example, owns the largest sovereign wealth fund.

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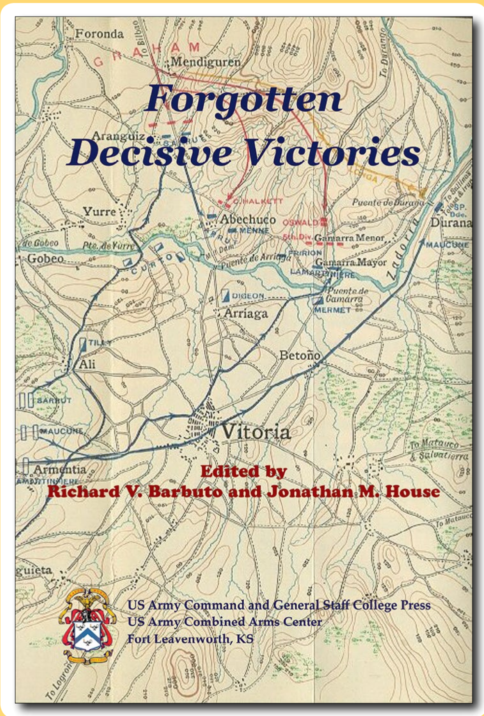

The Army University Press is pleased to announce the publishing of *Forgotten Decisive Victories* by the faculty of the Department of Military History, U.S. Army Command and General Staff College. This anthology is a collection of essays on understudied decisive battles in history, each of which altered the strategic balance between the belligerents in a lasting way. Although many of the battles described herein are less well known today even among scholars, their impact on the lives of the people, armies, and states involved ranged from significant (the Somme) to existential (Pusan Perimeter). The factors influencing the sequence and outcome of each battle are of course unique to each circumstance. It is applicable equally to the military professional, the interested layman, and the student of humanity. All seek better to understand the drivers of human conflict. The study of such conflicts from a wide swath of human history offers the best way to understand those drivers of conflict and thus offers us a chance to mitigate their influence on our world. (From the introduction by Dr. Thomas E. Hanson, Director, Department of Military History, U.S. Army Command and General Staff College.)

To view this publication, please visit http://www.armyupress.army.mil/Portals/7/combat-studies-institute/csi-books/forgotten-decisive-victories.pdf.

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28. Nye, *The Future of Power*, 55.

29. Luttwark, "From Geopolitics to Geo-Economics," 19.

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35. Blackwill and Harris, *War by Other Means*, 27–31.

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