THE ECONOMIC INSTRUMENT OF POWER

1. **The U.S. government has a limited ability to use its economic instrument of power, unlike the political/diplomatic and military instruments, which it controls.**
    A. First, like all states, it must operate within the world economic system, which is primarily a market system, dependent upon the forces of supply and demand.
    B. Second, in a society where most of economic behavior is determined by private citizens and almost all of the production of goods and services is controlled by private firms, the U.S. government, unlike some other states, cannot directly control that economic behavior.

2. **The economic instrument of power as a resource.**
    A. Economic power provides a basis for creating other instruments of power, especially the military instrument.
        1) An example is WW II. The Japanese admiral Yamamoto argued against the war because he believed that, though he could be successful for about six months, once the U.S. economic giant had been awakened, the U.S. would produce a military capability that Japan could not. At the time of Pearl Harbor, the U.S. had eight large aircraft carriers. By the end of the war, less than four years later, the U.S. had twenty-eight large carriers and more than seventy smaller carriers. This was only a part of the total US war effort.
        2) Another example are the U.S. overseas diplomatic program and its intelligence community. Both are the largest in the world.
    B. The government has, during the time of war, moved toward a command (centrally-planned) economy, one where the major economic decisions are made by the state. This was to ensure that resources went to the war effort and not private interests.
    C. The government gets its ability to create instruments of power primarily through taxes and borrowing, the revenue of which is allocated by the national budget.

3. **The US government wields the economic instrument of power directly through:**
    A. Negotiations with other states
    B. Tariffs and quotas
    C. Domestic regulations
    D. Economic sanctions
    E. Economic incentives
    F. Foreign economic aid

4. Negotiations with other states
    A. The primary use of the economic instrument of power is through negotiations. This diplomatic process is the basis for economic relations between states and international institutions. Out of this process arise the economic treaties, creation fo institutions, cooperative relationships, coordinated use of the economic instruments of power, and efforts to coordinate economic policies.
    B. Although the State Department has overall oversight of US foreign policy and

economic issues are very much the responsibility of Congress, the US has two agencies with direct responsibilities for foreign economic polices: the Office of the Special Trade Representative in the Executive Office of the President and the Treasury Department, an agency in the Executive Branch.

1) The Office of the United States Trade Representative is the government agency responsible for developing and recommending United States trade policy to the President of the United States, conducting trade negotiations at bilateral and multilateral levels, and coordinating trade policy within the government.

2) The Treasury Department leads the development and implementation of policies in the areas of international finance, trade in financial services, investment, economic development, and international debt. It also leads the U.S. participation in the International Monetary Fund (IMF), the World Bank, and the other multilateral development banks (including the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, and the European Bank for Reconstruction and Development). Its Under Secretary coordinates financial market policy with the G7 industrial nations.

B. Multilaterally, the government primarily works through international organizations to further its economic interests. The major institutions, which the U.S. helped to create at the end of WW II, are a basis for the world economic system. In addition to their specific roles, the World Trade Organization (WTO), the International Monetary Fund, and the World Bank are fora where states negotiate agreements and try to influence world economic activity.

C. Some additional institutions under the UN are: The International Labor Organization (ILO), The Food and Agricultural Organization (FAO), The United Nations Industrial Development Organization, and The United Nations Commission for Trade and Development.

D. The Organization for Economic Co-operation and Development (OECD) is an economic organization of 32 countries. It brings together the governments of state committed to democracy and the market economy:

1) to compare policy experiences, seek answers to common problems, identify good practices, and coordinate domestic and international policies of its members, with emphasis on: sustainable economic growth, employment, living standards, financial stability, assistance in economic development, and growth in world trade.

2) It has arrangements with more than 100 other states, some of whom may join the organization.

E. The G-7 is a group of seven industrialized nations (Canada, France, Germany, Italy, Japan, United Kingdom, and the US). The finance ministers of these states meet several times a year to discuss and try to coordinate economic policies.

F. In addition to international organizations, the US works bilaterally with every state on economic issues of mutual interest. A significant bilateral relationship is with the European Union (EU), which is an economic and political union of 27 members. Although not a state, the EU has developed a single market through a standardized system of laws, which apply in all member states and ensure the free movement of people, goods, services, and capital. It also maintains common policies on trade, agriculture, fisheries, and regional development. Sixteen member states have adopted a common currency, the euro, constituting the Eurozone.

5. Tariffs and Quotas
    A. Tariffs, duties placed on goods and services to increase their price within the US, and quotas, limits placed on the amount of goods that can be imported into the US, are means to try to influence the behavior of other states and their producers and to protect specific US industries.
    B. Although the usual purpose is economic, tariffs and quotas can also be aimed at non-economic state behavior and policies.
    C. The effect of such controls is usually a two-edged sword. Import controls can help some industries, but others that rely on imported supplies can suffer. Additionally, such controls raise the price of goods for all consumers.

6. Domestic Regulations
    A. The primary purposes of domestic regulations are to control domestic economic activity and protect Americans. These can include safety, health, labor, market power, patents, control of technology, among many other purposes.
    B. These regulations also affect international trade. The effect can sometimes appear to be similar to that of tariffs and quotas.

7. Economic Sanctions
    A. Economic sanctions are the withdrawal or threat of withdrawal of trade or financial relations with a state. The purposes are to cause changes in the political or military policies of the sanctioned state through compellence or deterrence.
    B. States, working alone, in ad hoc coalitions, or through the UN, impose sanctions to achieve of foreign policy goals. Examples are the sanctions on Iraq prior to the US invasion, sanctions on North Korea, and sanctions on Iran. These were/are all aimed at nuclear non-proliferation and limiting military capabilities.
    C. Sanctions, however, are used even when there is no expectation of change and the effect on the sanctioned state is secondary. These purposes are:
        1) demonstrating resolve and signaling displeasure to the sanctioned
        2) assuaging domestic constituencies, making moral and historical statements, and sending warnings to future offenders of the international order.
    D. States often decide that the alternatives to economic sanctions are unsatisfactory; military action would be too violent and unpredictable and diplomatic protest too meager. Sanctions can provide a satisfying theatrical display, yet avoid the high costs of war. This is not to say that sanctions are costless, just that they are often

less costly than the alternatives. Some call this the least-bad policy.

E. Types of sanctions are:
   1) blockades, stopping all external commerce with the sanctioned state
   2) embargoes, limiting exports to the sanctioned state
   3) boycotts, limiting imports from the sanctioned state
   4) freezing financial assets of the sanctioned state
   5) banning private bank lending and direct foreign investment to the sanctioned state

5. Economic Incentives

A. Whereas sanctions try to cause change by negative means, economic incentives try to cause change by positive means. The purpose is to get the receiving state to do something in exchange for economic benefits.

B. The three primary approaches, other than foreign aid, are:
   1) providing economic assets. We will see when we study the unification of Germany how providing economic assets to the USSR by Germany helped the movement to agreement.
   2) granting access to our markets. This approach played a significant role in the Nixon-Kissinger policies toward the USSR and China in the 1980s.
   3) granting access to international economic institutions. This approach has been part of the US policies toward Russia and China.

6. Economic Foreign Aid

A. There are five major categories of foreign assistance: bilateral development aid, economic assistance supporting US political and security goals, humanitarian aid, multilateral economic contributions, and military aid. Due largely to the recent implementation two new foreign aid initiatives -- the Millennium Challenge Corporation and the Global AIDS Initiative -- bilateral development assistance has become the largest category of US aid.

B. The United States provides some form of foreign assistance to about 150 countries. Since the late 1970's, Israel and Egypt have been the largest recipients. The importance of the Latin America counter-narcotics efforts has made Bolivia, Peru, and Colombia major US aid recipients. The use of foreign aid to support the "war on terrorism" is significant part of our relations with Iraq, Afghanistan, Pakistan, Turkey, Jordan, and Indonesia.

C. The United States is the largest international economic aid donor in dollar terms but is the smallest contributor among the major donor governments when aid is calculated as a percent of gross national income.

D. The U.S. Agency for International Development (USAID) manages the bulk of bilateral economic assistance; the Treasury Department handles most multilateral aid; and the Department of Defense (DOD) and the State Department administer military and other security-related programs.