

Globalization and Its Implications for U.S. Strategic Interests
CSIS Board of Trustees Meeting
May 25, 2004
Executive Summary

Globalization is reshaping employment, technological leadership and U.S. security. The underlying concern is that globalization will erode America's strength, as jobs, manufacturing and technological leadership appear to flow from the United States in response to the demands of the international market.

The U.S. is not the only country affected by international economic integration. European countries have reacted with government bailouts of ailing firms and a call to build "European champions." Globalization has cost China (in sheer numbers) more manufacturing jobs than the U.S., as its once-protected state industries face international competition. Foreign firms, facing the same pressures and opportunities as American companies, have outsourced millions of jobs to the United States.

Global economic integration will continue to increase. First, technological change in communications and transportation has created unprecedented mobility for goods, money, people, and ideas. Technological change reinforces economic integration. More importantly, globalization is the result of long-standing U.S. policies – policies to promote free trade, open markets and the rule of law as the basis for a stable international order. The U.S. and its allies created international institutions (the UN, IMF, OECD and WTO) that reduce risks for international economic activity. Success for these policies has been gradual and iterative, but they have created strong integrative forces in the global economy.

CSIS held five workshops (summarized in this paper) on the challenges for policy created by globalization. Each session was led by CSIS scholars and drew on experts from the research and business communities. The workshops were:

- o **Economic Forces Behind Outsourcing** examined market forces and the trade and financial policies that affect outsourcing decisions and the long-term implications for the national economy.
- o **Geopolitical Issues** looked at the effect of economic change on national security and how economic internationalization is creating new competitors.
- o **Homeland Security and Globalization** looked at the challenges globalization creates for homeland security and the trade-off between security policies and economic strength.
- o **Rising Powers** looked at the emergence of India and China as global powers.
- o **Challenges and Opportunities for the Defense Industrial Base** examined how America maintains its military strength when it depends on a global supply chain.

Economic Forces Behind Outsourcing – We Are Not Being 'Hollowed Out'

Manufacturing jobs are not a good measure for 'hollowing out,' economic strength or technological leadership. They have been in decline since the 1970s, because of both

increased productivity on the factory floor and because of trade and international competition. Banning outsourcing or other protectionist measures to preserve these jobs might avoid short-term losses, but at the cost of foregoing long-term economic improvement.

Fears of a jobless recovery now seem overstated, given an increase of over 600,000 jobs in the first four months of 2004, but anxiety persists. These anxieties may reflect broader concerns over issues like health care or primary education. Such issues affect national competitiveness, but there is little consensus on how to proceed. In the near term, it may be better to manage outsourcing's political costs through mitigation policies that provide new skills and ease unemployment. Additionally, policies that encourage American companies to build on their strengths in innovation and high-value services rather than try to compete in the manufacture of commodities will produce greater returns over the long run. The U.S. has a \$60 billion trade surplus in services. To take advantage of this strength, however, the U.S. will need to do more to open world markets, particularly in India, Brazil and China.

Preserving our ability to innovate is more important than keeping manufacturing or call-center jobs. Innovation of new ideas, goods and services is the key to economic growth and crucial for military strength. In relative terms, other nations will increase their share of innovation compared to the U.S. Additionally, financial pressures, government policies and the shift from manufacturing may result in an absolute decline in the pace and scope of innovation in the U.S. Technological superiority is crucial to the U.S. global position and we cannot contemplate its loss lightly.

Geopolitical Issues – Continued U.S. Leadership Needs Both Technology and Ideas

For some, globalization means Americanization and is therefore suspect. There is some truth to this notion. The U.S. has been the most forceful international advocate for open markets, democratic government and the rule of law. These ideas are a source of American strength and have become international norms, even for those who do not observe them domestically. The larger political issue is that if globalization diminishes the U.S. capacity to advance these ideas, no other nation or group of nations has the commitment or vision needed for continued progress. For this reason alone, the U.S. should maintain its influence and leadership.

U.S. leadership springs from our values and culture and from our strength in technology. Continued international influence will rest on both the ability to advance these values and to protect our technological lead. Technological leadership gives the U.S. an advantage internationally. Despite growing foreign strength in technology, the U.S. can maintain leadership with continued support for universities and basic research and with improved abilities in DOD and the intelligence community to identify and take advantage of commercial technological innovation (whether from U.S. or foreign sources).

Homeland Security – Can We Find a Balanced Response

International networks for communications, travel and finance enable globalization. Groups like Al Qaeda are parasites, exploiting these networks for their own ends. Globalization gives terrorists a global presence and enables actions that they could not take a decade ago. Despite

this, the benefits of global networks outweigh the risks created by terrorist use. Our goal should be to exploit our superior knowledge and control of global networks to better understand and disrupt their operations.

However, much of the defense against terrorist use of global networks relies on restriction. This also creates risks for the national interest. In addressing legitimate security concerns, we have inadvertently restricted travel, finance and the exchange of information that make the U.S. a less attractive destination for investors and researchers. The annual meeting of the American Physical Society, a leading U.S. scientific body, was held in Canada because of visa difficulties. A major aerospace manufacturer complained that it could not get visas for its foreign customers, but they had no trouble going to Toulouse. Globalization has been a source of strength for the U.S. and by cutting ourselves off from, it we face real damage.

Balancing security against trade and the movement of people has been difficult and we have not gotten it right. The Department of Homeland Security knows this, but a degree of inertia seems to propel the U.S. into creating economically damaging restrictions. Finding ways to advance security while avoiding this damage remains an unsolved dilemma for policy.

Rising Powers: Adjusting Markets and Policies to India and China

China and India power the current wave of globalization. They will become leading sources of new technologies and, if they chose, formidable military powers. The U.S. has successfully adjusted to the entry of China into world markets and American companies have benefited by inserting China into their production chains. Now the U.S. economy is adjusting to India's entry. The political implications that result from economic growth – greater assertiveness and influence for China and India – are still reverberating through U.S. foreign policy and in the two countries' internal politics. In the short term, economic interdependence makes managing the political relationship with these countries more complex as we lack the mechanisms for cooperation developed in our longer-standing relations with Europe or Japan.

Counterintuitively, China has unappreciated weaknesses and India has unappreciated strengths. In the long term, India's economy may prove stronger. India has advantages in 'soft infrastructure' - its laws and political system. In particular, India's financial system is better. The percentage of non-performing loans in the portfolio of Indian banks is perhaps a third of those held by China's banks. Weaknesses in the financial system and political interference in investment decisions constrain China's domestic capital market, and there is still a strong element of central planning that hinders growth. China's rapid development in recent years may no longer be sustainable. This has deep political implications. Economic growth, along with appeals to nationalism, has been the primary source of legitimacy for China's leadership and will not be easily replaced.

U.S. Defense Industrial Base – Managing A Global Supply Chain

Strong domestic manufacturing industries have been an integral part of national power. Manufacturing is now global and the U.S. cannot make all the components needed for advanced weaponry. This is not a recent development. It began in the late 1980s as a result

of both international economic competition and the decline in defense procurement. U.S. regulations (especially acquisition regulations and export controls), however, have been slow to adjust to this global industrial base.

The U.S. still has the lead in crucial defense integration skills. Retaining this leadership in the ability to innovate and integrate innovation into complex weapons systems is crucial for continued military strength. Our lead will be challenged as other countries improve their ability to innovate. Globalization will produce this challenge even if the U.S. tries to block technology transfer. A fifteen-year effort to block the Chinese semiconductor industry has failed in the face of economic pressures. The old problem was how to keep defense technology from flowing out of the U.S. The new problem will be how to ensure that the technologies needed for defense can flow in.

‘Foreign dependency’ does not automatically make the U.S. more vulnerable. U-Boats are not going to blockade the Atlantic coast or cut the global supply chain. The U.S. can mitigate risks from globalization for defense if it considers, as part of a larger approach to economic growth, how to compensate for a supply chain that is no longer nationally based and how to protect its ability to innovate. These risks can be managed with the right policies for acquisitions, information assurance, and research and development.

Conclusion – Responding to the ‘Invisible Hand’

As our five sessions progressed, some common themes emerged. These were:

- 1) The economic forces created by globalization are too strong for terror or national policies to stop;
- 2) The global economy centers on the Pacific Rim, which now produces 60 percent of the world’s GDP;
- 3) Globalization's most significant effect for national security may be the leveling of technological leadership, as innovation will increasingly occur outside of America; and
- 4) The issue is not jobs and outsourcing but how to maintain U.S. international competitiveness and technological leadership.

Earlier periods of globalization – Europe’s recovery in the 1960s and the rise of Japan in the 1970s and 1980s -- led to difficult adjustments for the U.S. Each time, however, the U.S. has ultimately prospered, as changes in the behavior of firms and in government policies restored its competitiveness. The challenge of this wave of globalization – the largest yet -- is daunting and complex, but it is not beyond the capacity of the U.S. to respond effectively. For both security and the economy, we will need new policies that take advantage of our economic and political strengths if we are to maximize benefits and minimize risks from global change. Innovation in policy is as necessary as innovation in technology if we are to repeat our success.