TYPOLOGY OF SECURITY EXTERNALITIES MEMO

Occasional Paper No. 1

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ECONOMIC STATECRAFT PROGRAM

TWO PAGE TYPOLOGY OF SECURITY EXTERNALITIES MEMO

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Summary

The subject of "economic statecraft" asks security-oriented questions that economists tend not to consider, while at the same time requiring economic intuition and analytic toolkits that most security specialists do not possess. Without a coherent framework for thinking about the exercise of economic tools of power, it is hard to assess the effects and limitations of such tools on national security and foreign policy objectives. Moreover, a lack of such framework inhibits the structure and processes of the national security apparatus to generate complete options to the President for consideration.

To guide our thinking about economic statecraft, first note that **commercial actors** (not states) conduct most of the interactions in international economics. These interactions may generate security consequences for states; namely, **security externalities**. States can **manipulate the incentives** of commercial actors to encourage (or discourage) patterns of behavior that generate security externalities conducive to a state's strategic interest. Economic statecraft, is thus the intentional attempt of a state to deliberately incentivize commercial actors to act in a manner that generates security externalities conducive to the state's strategic interests.

This memo provides a typology of security externalities that specifies the full range of ways by which economic interaction may be used to generate security consequences for states. The objective is to provide a more precise vocabulary and analytical framework for thinking about the relationship between economics and national security. Doing so illuminates the strategic consequences of various economic interactions and specifies the mechanisms states can use to pursue their grand strategic objectives.

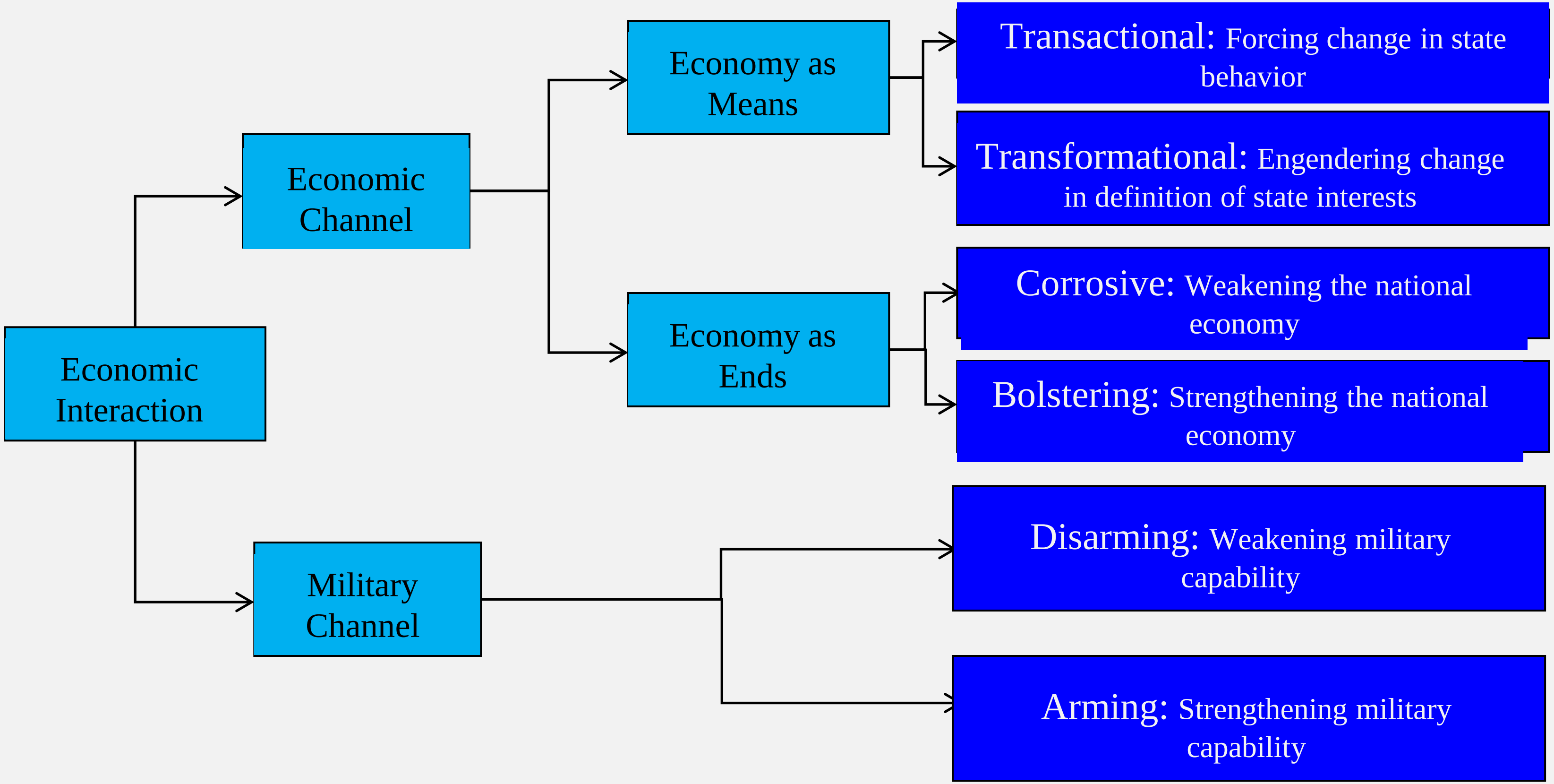
What are the various causal pathways through which the actions of firms can generate strategic consequences for a state's security? To answer that question, I offer a typology of the economics-security nexus. This typology maps out the range of possible ways economics can affect security, highlighting the causal pathways that connect the micro-economic, firm-level behavior of autonomous commercial actors with macro-level strategic security effects for nations. Framing the relationship between economic interaction and national security as one of "security externalities" highlights the importance of commercial actors and calls attention to the strategic ramifications of their activities. Taken together, the typology answers the question 'In what manner does economics affect security?'

The Logic of the Typology

This is a typology of the security effects of economic interaction. Organizing the intellectual space of economic statecraft along the lines of security externalities categorized on the basis of their effects on a target (rather than by the particular tools such as sanctions or export controls) allows us to be mutually exclusive in our categories (which are based on distinctive causal logics linking the economic activity back to its security effects) and collectively exhaustive across the categories—the two key features of a good typology; although it should be noted that any given policy or act of economic statecraft might entail more than one of these logics in practice. This framework also provides a specific vocabulary clarifying precisely what a state is worried about and/or how a sender is thinking about its strategy to achieve its objectives using economic tools of national power.

The 6 Types of Security Externalities (see attached slide)

A TYPOLOGY OF SECURITY EXTERNALITIES



Broadly speaking, there are two channels via which economic interaction can impact a nation's security: Military and Economic. In this typology, there are six types of security externalities which map onto these two broad categories: those acting through primarily economic channels and those externalities with direct military effects.

Those externalities acting via the Military Channel share the common causal logic that a nation's direct war-fighting capacity can be directly strengthened or weakened by economic statecraft. Similarly, we can think about strengthening or weakening a nation's economy more broadly (rather than just its military-industrial base specifically). These effects reside on the other main branch of the typology which houses those externalities that affect a state's security by way of primarily economic channels. For this family of externalities, security ramifications are often the second-order consequences of the economic interaction (as opposed to the military effects branch of the typology in which the economic interaction directly contributes or detracts from a state's ability to wage war).

The economic branch is further subdivided into two groups: 1.) the types of externalities that affect the overall health of the target economy as an ends in itself and 2.) those security externalities in which the economic interaction plays an instrumental rather than teleological role. In this first group, there is one category of externalities that weaken the target's economy (for example, through measures like the US embargo of Cuba) and there is another category of externalities that strengthen the target's economy (for example, the Marshall Plan).

In the "Economy as Means" group there are two distinct strategic logics. The economic interaction may generate externalities that are primarily transactional (e.g. sanctions, freezing bank accounts, etc.). This strategic logic is one that merely seeks to alter target's behavior. Another type of security externalities are those designed to actually transform the goals and interests of the target. Engagement strategies often reflect this type of logic.

By focusing on the terminal nodes of the typology, we are left with six distinct types of security externalities which cover the full range of possible security externality categories.

Analytical Advantages

As was mentioned earlier, the purpose of this effort to create a typology is to provide a useful theoretic tool for categorizing and more precisely specifying the various security-related consequences of economic interaction.

Much of the current economic statecraft policy apparatus is largely organized on the basis of authorities and the specific types of tools that can be used. This results in at least three drawbacks:

1. Economic policy and stakeholders are rarely/poorly integrated into national security strategy since portfolios are drawn along economic *or* security lines; few places that actively seek to integrate security *and* economics.
2. Difficult to coordinate strategically across the interagency since various stakeholders view economic statecraft largely through the lens of their specific toolkit. If all an organization has is a hammer, then everything looks like a nail.
3. Tool & authority-based organizational design may not be ideal for thinking strategically and proactively about questions of economic statecraft.

Possible organizational/process design innovations may follow from this approach to economic statecraft.