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CAN AMERICA STILL LEAD IN THE GLOBAL ECONOMY?

Lael Brainard
David Lipton

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"Leadership and learning are indispensable to each other."

John Kennedy (remarks prepared for Nov. 22, 1963)

THE NEED TO LEAD

From the vantage point of 2008, some of the most memorable initiatives of U.S. international economic leadership—the Paris and Louvre Accords, the support for Poland and Russia after the fall of communism, the Uruguay Round, and the Mexican Financing Loan—seem like quaint reminders of a simpler time. In the coming years, the exercise of international economic leadership will surely prove more complex than in the past. The very success of the American vision of a global spread of vibrant and competitive markets has created a huge, rapidly integrating private economy of trade and finance much less amenable to guidance, let alone control, by governments. Unlike in diplomacy and defense, where non state actors are growing in importance but still a side show, in international economics, households, corporations, labor unions, and non-profits are now the dominant players in most parts of the world. While they respond to national laws and policies, their interests are varied and their operations often span borders.

And while uni-polarity may still be debatable in the security ream, multi-polarity is a reality in the security realm. Following 35 years in which the share of world output commanded by the G7 leading economies remained stable around 65 percent and the so-called BRIC (Brazil, Russia, India, China) economies around 7 percent, in the past five years, the BRIC share has risen to over 11 percent and the G7 fallen to 58 percent, and by 2030, the two groups will converge towards parity at around one third of world output each, according to Brookings scholar Homi Kharas. The rapid growth of the rising powers is creating enormous opportunities but also putting considerable strain on resources from food to water to energy, just as humanity is waking up to the urgent need to wean the economy from its centuries-long dependence on carbon. Growing global integration also creates growing interdependence and mutual vulnerability. To borrow a phrase from the recent banking crisis, we are now all too interconnected to fail. Threats to growth and stability now reverberate broadly, whether from financial market excesses, food shortages, pandemics, or vortexes of conflict and poverty.

At this moment of consequential challenges that even the most powerful nations cannot resolve on their own, there is greater need than ever before for leadership to help manage growing international economic linkages. And at a time when the rising powers are flexing their economic muscle but not yet prepare to take on the burdens of global leadership, the need for the United States to provide leadership continues undiminished.

But while the need for U.S. leadership in the global economy is clear, the capacity is less so. How well prepared are we to lead—especially when it will require doing so through cooperation and persuasion and by example? How prepared are our political leaders—especially when many Americans believe they are victims rather than beneficiaries of global competition? The remainder of this paper will explore the changing context for U.S. international economic leadership, review our economic goals, and discuss the adequacy of the instruments available for pursuing those goals.

THE GLOBAL ECONOMY: SEVEN CHALLENGES

If the United States is to rise to the leadership challenge, we will need to have a clear-eyed view of how the global context is changing:

1. Dispersion of Economic Power: The rest of the world no longer depends on the United States as the engine of global growth as in the past. The emerging market countries are booming, integrating into the global economy, and learning to assert their interests more forcefully. Europe, with $17 trillion in 2007 GDP (before the recent rise of the Euro) is a formidable economic bloc and a complex political unit with which to interact. The U.S. economy, while fundamentally sound, is now about one-fourth of the global economy, a fraction that is falling. Although in reality most major economies are deeply coupled rather than decoupled through multiple transmission channels, the sheer size and vibrancy of demand from emerging market economies are large enough to propel the global economy even when the U.S., European, or Japanese economies falter—though not if they fail.

The changing pattern of national income shares is emblematic of a growing global dispersion of wealth and economic dynamism. In contrast to the shift of the world's financial epicenter from the City of London to Wall Street in the interwar period, stock markets and commodity exchanges are currently proliferating in multiple financial centers and in 2006, 18 of the 20 largest IPOs took place outside the U.S. and were spread out among 11 exchanges. Indian and Brazilian multinationals are grabbing the headlines each day with major acquisitions of flagship European and North American brands. And whereas the IMF provided $20 billion (in today's dollars) of official financing to stabilize Asian economies in the last quarter of 2007, a decade later, sovereign wealth funds from many of the same Asian economies and their resource rich suppliers provided $30 billion in capital to shore up shaky financial companies in the United States and Europe.

While the rapid growth of the middle class in countries such as China and India is helping to fuel the global economy, it is also contributing to a broad commodity price boom that is further redistributing wealth globally and contributing to global inflationary pressures. Growing demands for grains both for feedstocks and biofuels have led to an astonishing reversal of decades of progress on food security with attendant risks to political stability.

2. Diminishing Power of Policy: The size, complexity, and integration of capital markets are complicating economic policy management. The proliferation of new financial instruments and institutions is proceeding faster than the regulatory apparatus can adapt, impeding our ability to preserve financial stability. The size of private financial holdings and flows dwarfs the resources that the U.S. government and its official partners (including the international financial institutions) can deploy to stabilize exchange rates or other key asset prices. Moreover, financial markets blanketing the globe are responding instantaneously and continuously to news and public policy pronouncements, leaving little time for planning and execution and razor thin margins for error, and leading to the conundrum that while U.S. and other officials have unprecedented power to move the markets (witness the swings that follow minor recalibrations of message by Fed Chairman Bernanke), they are practically powerless to sustain those movements unless their statements reflect meaningful policy action (e.g. the Fed's ability to alter short-term interest rates). Official cheerleading with no policy behind it is more likely to undermine credibility than achieve any meaningful change.

3. The Inflation-Recession Conundrum: The global macro-economy will continue to be buffeted by inflationary and contractionary forces in the coming years, leading many countries to be self-protective and less receptive to collective initiatives. With no quick fix in sight, the housing and banking sector crises that are slowing growth in the United States and Europe are likely to sap economic vitality for years. The sharp and broad commodity price increase is helping commodity exporters, but hurting importers while posing a dilemma for monetary authorities. Some countries are reluctant to react forcefully to rising inflation for fear that slowdown is around the corner, while others are reluctant to react to slowdown for fear that inflation will take hold.

In short, the days when U.S. official entrée and clout came from the prospects of some advice and an IMF loan are mainly gone. Most emerging market countries have been managing their domestic economic policies far better than ever before.

4. The Anti-Washington Consensus: Economic orthodoxy peaked in the 1990s and is unlikely to return to fashion anytime soon. Quite apart from rising resentment about the United States—itself an important matter—skepticism has grown over the liberalization agenda, once loosely shorthanded as the Washington Consensus. China's heterodox growth model is enjoying considerable allure in light of its stellar performance. And governments have come to power in emerging markets on the basis of a wide range of different economic policy platforms. Indeed, it is remarkable that macroeconomic policymaking has remained so orthodox in so many countries. Lula, the AKP, and the ANC are all running budget surpluses, probably reflecting the still-fresh scars of the stabilization crises of the 80s and 90s. But in many countries an embrace of liberalization and integration in the microeconomic realm has fallen out of favor.

Moreover, the ongoing banking and capital markets turmoil will likely color global attitudes on financial market liberalization for years to come. The proliferation of aggressive lending practices and innovative financial instruments in the United States and Europe sparked a run on credit and credit products, producing record losses in banking institutions and a slowdown in the macro-economy. Most of the emerging market world was spared direct damage chiefly because their countries were beyond the pale of settlement of the financial engineers. Officials and market participants in those countries will be reluctant to heed calls for untrammeled financial sector liberalization for fear of importing what might be termed "mad banker" disease, at least until we show that our regulatory system is capable of maintaining financial stability.

In short, the days when U.S. official entrée and clout came from the prospects of some advice and an IMF loan are mainly gone. Most emerging market countries have been managing their domestic economic policies far better than ever before, after suffering instability in the 80s and 90s. With public finances strong after years of strong global growth and better policies, the threshold for a public debt problem arising from either domestic or international shocks is much higher and the need for external official support programs far less likely than in the past. And with the officials running the finance ministries of emerging market countries in many cases as talented and experienced as anywhere, they are more likely to provide meaningful and valid critiques of U.S. views and policies than to seek guidance. (That said many countries are pursuing exchange rate and macro policies that seem ill-advised even from their own standpoint, so there is ample reason for the United States to engage them.)

Related, we are likely to see more private sector distress, which will be less amenable to official action. The dismantling of interventionist subsidy schemes, the privatization of banks and non-financial corporations, and the adoption of more flexible exchange rate regimes (not to mention the accumulation of record foreign exchange reserves) all help take public finances off the front lines of economic conflict. In this setting, adverse economic and political events that push around market prices and affect the cost and availability of capital will in the first instance hit the private sector. We are beginning to see the impact of food and energy price increases and the impact of stock, bond, and housing price declines on households and companies in emerging market economies. Depending on governments' reactions, we will either see a period where private sector distress sets the context for the global macro-economy, or where renewed subsidization by governments eventually erodes public sector finances. The U.S. should be prepared to cope with both situations.

5. The Pause that Retrenches: Growing integration on the real side of the global economy is similarly complex. While trade ministers sign all manner of bilateral and mini-lateral trade agreements, and global trade flows are going gangbusters, multilateral and major regional trade negotiations are going bust. A newly assertive group of developing countries has been effective at blocking any deal offered by the rich countries, but this group has yet to find sufficient common ground to forge an agreement. Meanwhile, as trade ministers dither, entire swathes of economic activity are going global through the click of a mouse rather than the signing of a treaty—subjecting entire occupational categories to stiff foreign competition for the first time. This off-shoring of services and a dramatic 20 percent decline in manufacturing jobs over the past 5 years have contributed to a growing distrust of trade among an ever broader segment of the American public, leading to unprecedented single-vote margins for trade deals during a period of unified Republican rule. Meanwhile, there has been wholesale neglect of key domestic policy priorities central to restoring American's confidence in competing globally, such as innovation and infrastructure policy, healthcare reform, training, unemployment insurance, and wage insurance.

6. Aid Not Trade: While polarization has grown on trade, convergence has been the order of the day on global development—at home and around the globe. In the U.S., the evangelical community joined popular culture celebrities and NGOs to advocate successfully first for debt relief and subsequently for massive funding for HIV/AIDS and more modest gain in areas such as malaria and primary education. In parallel, recognition has grown in U.S. military and foreign policy circles that as we prepare for a world where seemingly distant threats can metastasize into immediate emergencies, the fight against global poverty is becoming a fight of necessity—not only because personal morality demands it, but because national security does as well. These two converging strands have helped provided the biggest boost to foreign assistance in decades along with a proliferation of uncoordinated institutional arrangements to administer it.

7. A Changing Climate for International Finance, Trade, and Development: Looking forward, every one of these challenges will be further complicated by the belated and patchwork attempts to mitigate and adapt to a changing climate. A fundamental transformation of the economic paradigm away from the carbon foundations of the past nearly two centuries will require intermediation of vast global flows of technology and capital. And to the extent that rich countries move much faster than developing countries to impose a tax or a cap on carbon, there will be pressure to deploy trade mechanisms to address competitiveness concerns. In addition, introducing an effective global carbon tax or cap would throw into doubt the manufacturing-export-led development strategy that has proven to be the quickest road out of poverty for hundreds of millions without providing a viable alternative path. Poverty reduction approaches too will require a fundamental rethink. For those poor countries on the front lines, development interventions must be redesigned to help insure against, plan for, and build resilience to the contingencies climate change will bring.

U.S. LEADERSHIP: SEVEN OBJECTIVES

To set the stage for a discussion of the instruments available for the exercise of U.S. international economic leadership, it is helpful first to review our goals. At a basic level, our key international economic goals remain:

- To promote prosperity for all Americans by making the most of the positive-sum-game opportunities afforded by the global economy, and
- To stop globalization from transforming into a negative sum game by taking action to prevent economic, financial, climate and security instability from undermining the global economy.

Of course as one elaborates those goals into specific actionable objectives, greater complexity and room for significant policy disagreement emerges, particularly between those objectives that advance American interests directly and those that advance them indirectly through greater stability and prosperity abroad. Rather than address all of the many extant issues in international economics, here is an annotated list of objectives to support our goals:

1. Promote Resilient, Adaptable Systems to Facilitate Global Flows: Without minimizing the difficulty, progress will require ensuring that the gains from the growth of global markets are believed to be shared widely by a much broader group of Americans while also balancing the many competing interests of all trade partners, and incorporating environmental and labor issues into agreements. To strengthen legitimacy, the rules must not only be signed but also enforced. And the rules governing global commerce will need to keep up with the dynamism of the market itself. To make significant progress, we will have to take on the complex issues around agriculture and commodity subsidization worldwide. Increasing attention will also need to be devoted not only to the quantity but also the quality of trade world wide to ensure the integrity of global supply chains and guard against risks to health, safety, and the environment.

2. Restore American Confidence to Compete Globally: Americans feel most secure about global engagement when they are well equipped to compete and have some insurance against economic risks. The backlash against globalization in recent years stems in part from perceptions that trade and off-shoring have surged forward at a time when the domestic foundations of competitiveness and social insurance have been neglected, leaving families and businesses to shoulder a disproportionate share of risks and investments. This agenda, again easier to elaborate than execute, includes investments in economic competitiveness—lifelong learning, innovation, infrastructure—while at the same time developing effective and portable insurance systems for unemployment, health, pension, and wages to provide some degree of economic security in the face of job dislocation.

3. Encourage Capital Market Development and Integration alongside Regulatory Enhancements: While further gains would likely follow from a more efficient allocation of global capital, acute sensitivities will remain regarding the stability of an interconnected global capital market and the implications of cross-border ownership, particularly by sovereign wealth funds. Progress on liberalization will depend on the success of regulatory reform to make our balkanized and outmoded U.S. regulatory system as modern as our rapidly evolving markets and promote comprehensive regulation of internationally active financial firms.

4. Promote Economic and Financial Stability. If we experience a persistence of slowdown, banking sector problems and commodity price disruptions, as seems likely, the United States will have to place a greater emphasis than in the past five years on promoting strong global growth and low inflation. Those efforts could involve policy dialogue or explicit coordination. There is also a heightened risk, given the ongoing banking turmoil, that institutional failure in the financial system might create the need for significant clean-up efforts, possibly involving the appropriation of significant public funds for rehabilitation or recapitalization. The technical and political complexity of such a task would be considerable, and could require international coordination. In the European Union, where the so-called single market does not extend to banking, some subset of the 27 national regulators and finance ministries could have to act together and we would need to work with them to contain the global fallout that could ensue. Nor can we lose sight of the link between security threats and economic stability. As we have seen recently, mere rumors of conflict with Iran move commodity and financial markets, reinforcing global strains. Economic and security policymaking should weigh those interactions when assessing what is at stake for the United States.

5. Promote Standards and Codes for Good Global Citizenship. Some Americans' concerns about globalization reflect resentment that governments of systemically important economies continue to pursue narrow self interest, leaving us to bear too much responsibility and cost for the health and stability of the global system. There are concerns that other countries take advantage of supplies of scarce commodities, manipulate currency values, threaten to dump financial instruments for political purposes, deploy sovereign wealth fund investments to gain political advantage, and will ignore the environmental and climate impact of their economic policies. U.S. international economic policymakers will need to work with other countries through international and regional fora to secure adoption and monitoring of standards of good global citizenship. Thus, for instance, concern over the rise of Sovereign Wealth Funds (SWFs) could in part be addressed by international investment standards that provide for clear rules and processes governing host country investment oversight, such as the CFIUS process, in return for transparency and disclosure on the part of SWFs, as well as commitments by key trading nations to modify the exchange rate policies that are feeding the vast buildup of reserves underlying some SWFs.

Nonetheless, in dealing with SWFs, we will have to reckon with two sobering realities. First, we need to accommodate the recycling of financial surpluses being accumulated in SWFs by the oil exporting countries and the Asian countries with huge balance of payments surpluses. We can perhaps influence the form of the recycling, but cannot block recycling without dire consequences, not the least of which would be higher interest rates and the decline of our financial system. Second, will have to maintain suitable relations with the SWFs via their governments in order to be ready if need be to have emergency discussions with them in a situation in which a threat to financial stability arises and the investment behavior of the SWFs is critical to the maintenance of stability, because of the scale and concentration of their funds. In doing so, we will certainly empower SWFs and their governments, not to mention provide an incentive for countries to accumulate national wealth in state institutions. In some cases, that will mean empowering governments with which we have conflicts, and more generally that empowerment will contradict our basic value of private savings and ownership by individuals.

6. Take Action to Address Global Sustainability: Along with the medium-term goals of promoting growth and stability, we also need to work on the longer-term challenge of forging a global consensus on how we will share an increasingly crowded planet. The big issues to tackle include the strains of global population growth, environmental damage, the alleviation of extreme poverty, and the climate crisis. The latter will require mustering the political will to take meaningful action on climate at the national level while also working to forge international agreement so that markets and regulatory policy provide a consistent set of incentives to move away from carbon intensive methods of production and transport. It will require a delicate balance of suasion and pressure to induce the fastest growing emitters to take action in the face of concerns about growth. It will require large transfers of assistance and financing to help the most vulnerable nations adapt. And it will inevitably risk trade frictions as competiveness concerns come to the fore in countries that take on obligations ahead of their trade partners.

7. Make a Long-term Commitment to Global Development: Promoting development in the world's poorest nations helps to advance American national interests, security, and values. Investing in the education, health, livelihoods, and security of the world's poorest not only makes Americans feel good about ourselves but the world feel good about America. It is critical to capitalize on the upsurge of support for global development among the U.S. public evidenced in increased advocacy, service, and individual giving in order to make sustained investments in lifting up the lives of the poor. It is critical to increase not only resources but also the impact of each dollar spent.

THE INSTRUMENTS AND INSTITUTIONS OF INTERNATIONAL ECONOMIC LEADERSHIP: SEVEN REFORMS

Finally, it is useful to review how well-equipped the U.S. government is from an institutional standpoint to achieve its goals. Our internal governmental structures and the international institutions at our disposal were created in different times for different purposes and, while they have evolved somewhat as globalization proceeds, there are deficiencies we must address. It is instructive to ask if we were starting from scratch whether we would create the existing institutions and processes to address today's key challenges. The answer in a few cases below is a clear no suggesting the need for reform.

Most legislated responsibility for international economic and development policy is split among the Departments of Commerce, State, and Treasury, as well as the Office of the Trade Representative and the U.S. Agency for International Development. The division of labor among these agencies is relatively sensible and clear (with a few important exceptions), though the need for cooperation and coordination is growing with the complexity of the global economic agenda.

Surveying U.S. government capabilities against the changing international economic landscape highlights a few key reform principles: elevating policy interaction with the rising powers bilaterally and multilaterally, improving policy coordination and joint planning and implementation, strengthening government capacity to address new challenges whether oversight of growing trade and investment flows or complex financial instruments, elevating development and strengthening civilian capabilities, and leveraging the capabilities of the U.S. private and nongovernmental sectors.

1. Improving Policy Coordination: The growing complexity and interconnectedness of policy challenges puts a premium on policy coordination. Many international economic challenges require true integration across domestic economic and foreign policy. For instance, the slow response to the food security challenge reflects in part the separation of domestic farm and biofuels policies, trade policy, development programs, and foreign policy. Meeting the climate challenge will similarly require extensive coordination between domestic economic and energy policies designed to achieve climate goals, trade and development policies, international climate negotiations, and foreign policy. And if more Americans are to gain confidence about competing globally, there has to be more robust integration between our domestic competitiveness and social insurance policies on the one hand and our trade policies on the other.

Re-energizing a National Economic Council (NEC) at the White House to facilitate the policy coordination role and provide political guidance seems a logical choice. A trickier question is the role of economic agencies in the National Security Council (NSC) and the division of labor between the NSC and NEC. One sensible approach might be to add an International Economics Committee at the Principals level similar to the Deputies level to function as a de facto executive committee. It makes little sense to consider economic and security issues separately at the level of assessing national priorities and setting broad policies. For example, our economic and security approach to China must be jointly designed and executed to avoid inconsistencies that undermine effectiveness. Moreover, to make sensible and consistent policy, economic and security practitioners need to spend time together to have a general grasp of each others' issues and approaches. On the other hand, much of the subsequent, detailed policy formulation can be done by a policy coordination subgroup with specialized membership.

There is clearly a need to strike a sensible trade-off between the conceptual integrity of joint decision and the efficiency of specialization, but one that errs on the side of joint action.

An effective policy coordination function spanning NEC and NSC should also have responsibility for overseeing development and humanitarian assistance policies. Several recent task forces have highlighted the high cost of current coordination deficiencies and called for both elevation and better coordination of development, humanitarian, and post conflict civilian operations (see below).

2. Strengthening Official Relationships with the Rising Powers: The political realm tends to lag substantially behind the fast moving market. Policy processes, personnel, and strategic attention need to be reoriented to the countries who are contributing most to changes in the world economy and to those who post the greatest risks to the global financial and trading systems rather than the established powers. In State and Treasury, this implies promoting or recruiting the most capable people with deep experience with the rising powers as well as developing bilateral and multilateral processes to ensure regular high level engagement and promote cooperation.

Treasury should continue to lead regular, high level, multi-agency, in-depth discussions on issues of mutual interest with China and follow a similar model with a few additional economically significant relationships such as with India. This will serve to ensure coordination across key policy areas and that these key relationships remain on the radar screen of key principals. It is also critical to develop a set of back channel relationships that keep informal lines of communication open between the more formal meetings similar to the G8 finance sherpas, sous sherpas and deputies networks.

Generalizing that same principle to the international realm immediately highlights the growing awkwardness of the G8. The G8 countries represent about three fifths of global GDP (and falling). Europe has five chairs, which is an imbalance of power (imagine if the U.S. president were joined at these meetings by the Governor of California, whose economy outranks a few current members). So, even when the G8 acts (which is rare), the rest of the world resents what they view as a presumption of power. The G20 includes a broader and more relevant representation of the global economy and has the potential to make a major contribution, but it seems too unwieldy to be an executive body or to act in times of crisis. An intermediate size, such as a G13, might strike a better balance between legitimacy and representation on the one hand and effectiveness on the other. Much ink has been spilled for many years on how to form another group. Without adding appreciably to the spilled ink, it will be useful to develop a new forum that will help us promote understanding, action, and responsible global citizenship. As for particular economic issues, we will soon need a group with global legitimacy to take up the very pressing issue of the inadequacy of exchange rate policies.

Even when the G8 acts, the rest of the world resents what they view as a presumption of power. The G20 includes a broader and more relevant representation of the global economy, but it seems too unwieldy to be an executive body or to act in times of crisis.

3. Raising Our Game on Technical Expertise and Resources: Within Departments, resources and staffing are not up to the task of international leadership. The complexity of global banking and capital markets stretches the capabilities of civil and foreign services trained in another era. We are not as constrained as many of our G7 partners, because many political ap-

pointees have relevant real world experience and we have more entry and exit in our civil service. But we need to find a way to seed the civil and foreign service with the experience and training required to be effective in the modern global economy. We need to find a way to attract experienced, market practitioners to spend time in the domestic and international side of Treasury. A poll of Treasury staff a year ago would likely have found very few professional staff that could recognize or define an SIV, ARS, or CDO on the eve of their consequential collapse. The size of agency staffs needs review as well. At Treasury, for example, the international affairs staff has less than 150 professionals. And the operating budgets for the agencies need to be reconsidered in an era where information gathering, computerization, communications, and travel are unduly constrained.

USTR benefits from its reputation as a relatively lean outfit. But USTR has been stretched thin with its staff of roughly 250 at a time when the number of trade agreements under negotiation and the volume and complexity of trade flows has grown manifold. Over the past seven years, U.S. trade has grown by over $1.4 trillion. The WTO has expanded to include 12 new members—chief among them the world's fastest growing nation, which lacks adequate capabilities to enforce even its own safety standards, let alone intellectual property rights. The number of countries with which the United States has concluded free trade agreements has expanded by 16, and the scope of those bilateral agreements now extends from investment to services to intellectual property. Yet, GAO analysis points out that fewer than 50 USTR staff are dedicated to monitoring and enforcement—with the result that the number of enforcement actions is declining rather than increasing as the growing volume and complexity of trade would imply. Related, recent product safety scares have highlighted troubling deficiencies in inspection capability relative to rapidly growing trade.

4. Elevating and Resourcing the Development Mission: The past decade has witnessed greatly increased support for development and humanitarian missions among the public and the national security community, along with growing bipartisan agreement on priority missions such as HIV/AIDS. During the past several years, foreign aid dollars have doubled. With each new spending priority has come a new ad hoc institutional arrangement to administer it (PEPFAR, PMI, MCC, S/CRS). As a result, an organizational chart of the U.S. government development and humanitarian apparatus now shows 50 separate government units pursuing a plethora of overlapping missions with little coordination and accountability. And the Defense Department now controls roughly one fifth of foreign aid dollars—a sharp increase over the past 6 years.

Paradoxically, recent years have seen systematic weakening of our operational civilian capabilities while responsibilities and disbursements have grown. As a result, there is a readiness deficit in civilian development, humanitarian, and post conflict missions, and an urgent need to invest in specialized expertise, which Defense Secretary Gates emphasized this need in his recent Landon Lecture. Since the 1990s, the number of professional USAID staff has fallen by a third, and by some estimates, nearly one third of those remaining are eligible for retirement. At a time when the premium is greater than ever on specialized expertise for addressing development challenges, USAID has only 5 engineers on staff, and half of the roughly 1,800 professionals work as generalists.

It is time to elevate development alongside diplomacy and development not just in rhetoric but in reality. The past decade has tested the model of increasing

State Department authority over USAID with disappointing results, culminating in the State/F process, which has been roundly criticized. A 2007 GAO report highlighting serious deficiencies in staffing and skills concluded that the State Department human capital strategy does not adequately address its own foreign assistance responsibilities. It is time to consolidate the handful of core development, humanitarian, and civilian post-conflict capabilities under one strong independent umbrella. There are growing calls to give development a cabinet-level voice, which would ensure a seat at the table for policy and resource decisions, increase accountability, improve recruitment and retention, and make a strong international statement akin to John F. Kennedy's creation of USAID in 1961 and New Labor's creation of DfID in the 1990's. Many of these reforms can be undertaken using existing executive authorities.

5. Leveraging the Private and NGO Sectors: Recent years have witnessed an explosion of involvement of private groups, including NGOs, advocacy networks, corporations, philanthropists, religious groups, and educational institutions, in many aspects of global economic policy. These organizations bring tremendous capabilities to the table, whether the marketing savvy of advocacy organizations, innovative proposals from universities and think tanks, sizeable investments of philanthropic organizations, logistical and technological capabilities of corporations, or the vast field networks of the big international NGOs. Our government is learning how to interact with these groups on a wide range of issues, economic, social, and political. But too often these interactions are ad hoc. Going forward, the international economic and development apparatus should more systematically leverage the rich capabilities outside government through partnerships and collaborations of many kinds. USAID's Global Development Alliance is a promising model, but there are currently only 2 or 3 staff at USAID dedicated to fostering these kinds of partnerships.

6. Improving the Quality of Market Intelligence Securely: Finally, we will need to rethink the quality and security of economic policy information. As the need for international policy discussion and cooperation grows, so does the prospect for leaks of information to market participants. Individuals who obtain insights into government policy intentions through their conversations with government officials will be able to reap huge and near-instantaneous gains. The issues include the security of communications, the trustworthiness of our foreign government interlocutors, and our own discussions with businessmen. On foreign government interlocutors, there is a real risk that governments will pass on information to managers of international reserves or SWFs who will trade on the information. On our own discussions with businessmen, there has always been a need for U.S. government officials to talk to the private sector in order to have the information needed to make good policy. But now, the financial services sector has a sub-industry focused on divining government policy intentions. In principle, the public-private dialogue should be constructed as what has been dubbed a one-way permeable membrane, where government officials listen, but do not convey information. But that is difficult in practice, as even the questions one asks reveal information.

7. Updating the International Financial Institutions: The international financial institutions have been less and less active as fewer countries need their money. The IMF and World Bank are undertaking a re-examination of their role and business model. The IMF has taken on a global economic surveillance mission and responsibility for a range of codes of good conduct, which are valuable if not central to the functioning of the international financial system. As for its more traditional role of supporting stabilization efforts of member countries, it is possible that problems in the global macro-economy will rekindle a demand for IMF loans, but the risk is that any such set of events in the present capital market setting would pose a financing problem too large for the IMF to handle.

The growing call for the provision of public goods will require the development of new organizations and arrangements for governance and finance. The World Bank has been one place where governance and finance arrangements have evolved, in connection with the provision of loans and grants in support of development. It is worth exploring whether the Bank can play a greater role in the provision of global public goods, to take advantage of existing arrangements and the Bank's market financing capabilities.

As we update the roles and responsibilities of the Bank and Fund, it will be critical to revise their governance and management to reflect the shifting economic weights of member countries.

CONCLUSION

The context for U.S. international economic leadership is in flux, as the global economy becomes more complex and enters a troubled time. Yet there is good reason to believe that U.S. leadership can be successful if we are thoughtful and adaptive, willing to change our ways of doing things, and open to true cooperation with other nations. The fundamental drivers of the global economy—savings, innovation, and the absorption of millions of people around the globe into the market economy—will continue to provide an upside potential that we can hold out as the promise of cooperation. And the innate interdependence produced by globalization raises both the risks and rewards to joint action. Even new powers like China are coming around to understand their stake in the orderly functioning of the global economy and in geostrategic stability. While they may not call for U.S. leadership, they and others will appreciate predictable efforts on our part to manage the risks of the global economy and to ensure the benefits are broadly shared.

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