

## **Financial, Public and Regional Economics**

### **The Economic Component of National Security – Current Issues**

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**Abstract:** The main purpose of this paper is to underline the main current approaches regarding the economic component of national security, with conclusions focused on the globalization effects on the national economies and the national security of the states. The dynamics of the unfolding political and economic events determines the need for the analysis – further developed in the paper - of the relevant variables and of the way these are involved in the intricate equations describing the current political, economic and social environment. One of the main results of the analysis is that national security represents a goal for any country wishing to provide sustainable welfare for its citizens, and this sustainable welfare cannot be achieved without sustainable economic security and development.

**Keywords:** economy; trade; imbalances; national security; resources; energy security

**JEL Classification:** F52; F13

#### **1. Introduction**

The concept of national security has traditionally been synonymous to that of military security, referring to the defense of a country against an external military threat. In the second half of the 20<sup>th</sup> century, a rapidly evolving international security environment has given rise to new threats and risks, leading to the need to extend the concept of national security to cover these new challenges. Thus, national security now covers not only military security, but the areas of economic security, state and public security, food security, cyber defense, human security, environmental security etc. Within these areas of security, the importance of economic security has increased, especially in the years following the economic crisis of 2008, which affected manifested itself at global scale and whose aftermaths are still a challenge to overcome by many countries of the world.

The objective of this paper is to provide an overview of the main ways national

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security and economic issues are interconnected. The scope of this paper is by no means exhaustive, as it focuses on just a few of the multitude of factors, correlations and relations between economic issues, social issues and national security issues, following the research directions mentioned below:

- the concept of economic security;
- trade and payment imbalances as issues for national security;
- the challenge of natural resources availability and control.

## **2. Economic Security Components in the Current Global Environment**

The concept of economic security is not a new one, as it has been present, in an incipient form, since the creation of the GATT (the General Agreement on Tariffs and Trade). Although GATT has encouraged its member states to reduce some tariffs and trade barriers, in order to promote freer trade on a mutually advantageous basis, some critics have viewed the Agreement as a threat to the economic well-being of the countries, by exposing the domestic producers to unfair competition. As a result, some countries have taken steps to limit the expansion of free trade in situations when they considered that their national security was under threat.

An illustrative example refers to the US Trade Expansion Act of 1962, which stipulates in section 232 “prohibition on decrease or elimination of duties or other import restrictions if such reduction or elimination would threaten to impair national security”. The most obvious area of industry that falls under this type of reasoning is the domestic defense industry, in the broad sense, with many of the developed countries taking steps towards protecting the domestic manufacturers of goods destined for national defense (ranging from weapons to electronic components and even footwear). For instance, France stipulates in its Law of Military Programming 2003-2008 (The French military planning law 2003/2008) that it must „develop the resources of protection against new threats and to preserve an industrial base ..to manufacture major defense systems”.

In the same line of thinking, Russia, in its National Security Strategy, considers as one of the main sources of problems for its national security „the adoption of discriminatory measures the intensification of unfair competition with regards to Russia, and likewise due to crisis phenomena in the global financial-banking system”.

Other approaches view threats to national security in a broader sense, covering also the impact that competition from foreign companies may have on the national economy functioning and development. In this sense, the implications of foreign competition on the national industries, and also „any substantial unemployment,

decrease in revenues of government, loss of skills or investment, or other serious effects resulting from the displacement of any domestic products by excessive imports” (US Trade Expansion Act of 1962, section 232) are considered factors that have to be analyzed and countered in the effort to ensure the economic component of the national security.

In the Polish National Security Strategy, economic growth is considered a key component of national security, along with the development of the domestic defense industry, the provision of energy security and the trade of strategic goods and services.

In this respect, the Global Risks Report 2014 has identified, from a list of 31 risks, the fiscal crises in key economies and structurally high unemployment /underemployment as the first (respectively the second) highest risks facing the world in 2014. Other economic risks identified by the Report, though not as pressing, are still a major source of concern in regard to security: failure of a major financial mechanism or institution, liquidity crises, oil-price shock to the global economy, failure/shortfall of critical infrastructure, decline of importance of the US dollar as a major currency. Several of these risks already became a reality in the past and history has shown the high vulnerability of economies to such events as an oil price shock (or a sharp decrease in supply), or liquidity crises.

Even though the Report mentioned only the decline of the importance of the US dollar, the decline of other major currencies would be equally threatening to the nation’s security. Following the economic crisis and the ensuing sovereign debt crisis in Europe, there was a real risk of euro failure, with some EU members giving up the currency, with difficult to quantify negative consequences on the entire continent, ranging from weakened national currencies, failure of bank systems and other financial institutions, rise in unemployment, rise in prices, to government default and deepened recession in Europe, US and even other areas of the world.

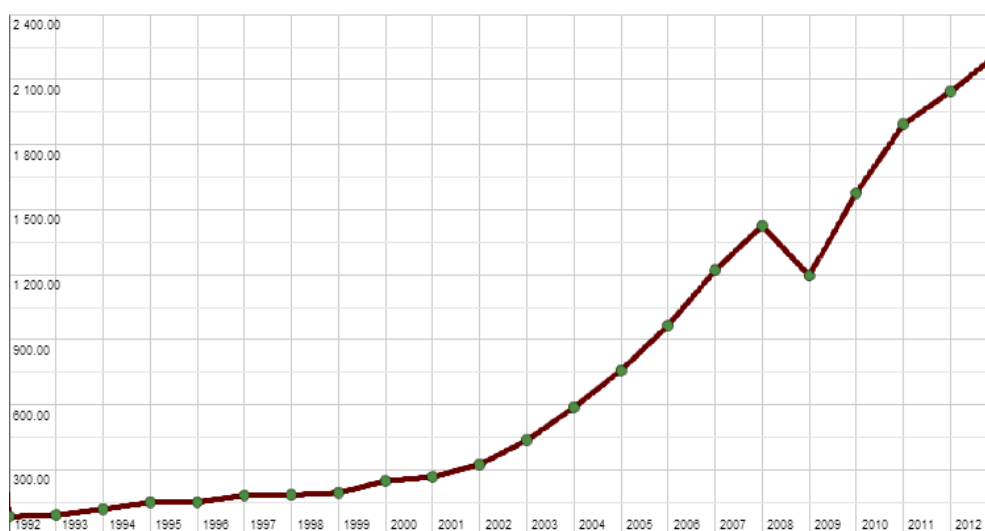
### **2.1. Trade and Payments Imbalances**

As in the globalized environment, no country stand completely on its own, invulnerable to the problems of other economies, one of the most significant economic risk situations (due to its size and potential implications on the national security of many countries), relates to the trade and payments deficits. Traditionally, these deficits are run by developing countries, which import a lot of manufactured goods and export raw materials, but a current and serious matter of concern in this issue refers to the trade imbalances between the developed

economies (especially United States, European Union, Japan, South Korea) and China.

As China's fast development in the recent decade has been strongly supported by exports (with a contribution to GDP ranging from 14% of GDP in 1993 to 27% in 2012 and 26% in 2013, according to the statistics provided by the World Bank), conquering export markets became a priority, and many countries became markets for Chinese imported goods. Fueled by low prices (achieved through low labor prices, but also the manipulation of the Chinese currency), Chinese exports can be found all over the world, with main destinations in 2012 United States (17.2% of China's exports), European Union-27 (16,3%), Japan (7.4%) and the Republic of Korea (4,3%), according to the World Trade Organization statistics.

#### Exports in goods (value) s.a., in billions of US dollars



**Figure 1. The evolution of China's exports, 1990-2013**

*Source: OECD statistics, <http://stats.oecd.org/index.aspx?queryid=167#>*

The figure above clearly presents the remarkable and consistent increase in China's exports over the last two decades, from 83.95 billion USD in 1992 up to a staggering 2214.77 billion USD in 2013, according to the OECD statistics, providing a visual reference of how, gradually, China started to dominate the world trade.

Following the recent economic crisis, free trade, advocated as one of the ways to economic development in the world, has proven also its limitations, as many world economies have been affected not only by the trade imbalances, but also by their

effects on their national economies. An illustrative example is that of the relations between the US and China. As Chinese manufactured goods got access on the American markets, US companies, in search of higher profits, also benefited from the access to the Chinese markets, with tax breaks, subsidies and the cheap labor. Many US multinational companies moved their production facilities in China, while China benefited from their know how and modern technologies. According to some authors (Xing, 2010), China was the biggest recipient of foreign direct investments of all the developing countries and the third recipient in the world of FDI, in the last 30 years.

As a result, China's companies begun to produce high amount of cheap, manufactured goods (including technological advanced product), flooding the US markets. The result for the US was first of all a serious trade imbalance: for the 17.2 % of China's exports to US, the US exports to China are of only 7.4% of the Chinese imports. In real terms, this meant an increase of the US imports from China from 15,237.4 million USD in 1990 to 293,863.1 million USD in 2014, equivalent to an impressive increase of 1828,6% (in accordance with the data provided by the United States Census Bureau).

Another visible result was in the form of domestic problems, related to rising unemployment and falling wages in the industries directly threatened by the Chinese competition. The competition from Chinese imports had as result a diminished manufacturing employment in the local labor market, but also a decline in wages manifested beyond the manufacturing sector, leading to a significant reduction in the average household incomes, and also to an increase in transfer payments for federal disability, in-kind medical transfer payments, unemployment insurance and income assistance programs (Autor, Dorn and Hanson, 2011). Based on the analysis by the Economic Policy Institute analyzing costs of China's growing trade deficit, the implications of the US trade deficit with China meant more than 2.7 million jobs losses between 2001 and 2011. Unemployment, lack of consumer faith in the economic perspectives, falling incomes are ingredients to rising social problems (increase in crime rate, alcohol and drugs abuse, increased popularity for radical movements etc), with potential negative implications on the national security.

## **2.2. Resources Availability and Control**

During the entire history of mankind, countless conflicts have been fought over the control and availability of natural resources, and this trend is still present in the modern world, as an intricate interaction exists between national security, potential tensions and even conflicts and the natural environment and resources.

Natural resources are often the hidden cause of conflicts and tensions, due to their increased scarcity or unavailability, but also to the need to control sufficient resources used to finance armed forces or sustain economies.

Particularly in the case of the developing countries, one of the main risks to the national security comes from the use of an economic development model based on the export of raw materials. The narrower the range of products exported and the bigger their share of contribution to the GDP, the higher the risks for national security. Countries relying on a narrow range of raw materials (such as cocoa, coffee, timber, diamonds, iron ore etc) can be seriously affected if the prices of these commodities go down, triggering political instability, economic downturn, unemployment and other negative economic effects, which in turn may lead to social unrest, violence and tensions.

The desire to control natural resources has been known, over time, to directly cause armed conflict. From the colonial conflicts of the 19th century, to the present day conflicts in many developing countries, natural resources have always been a source of tension, sometimes considered a form of „natural resources curse”. Factors present in many developing countries, especially in Africa, such as weak governments, poor economic and living conditions, high unemployment, ethnic diversity, combined with rich natural resources, have often led to conflicts over who controls these resources, leading to civil war or even conflicts between states. For example, the conflict in Sudan that raged between 1983 and 2005 was largely fueled by oil, the events in Sierra Leone from 1991 to 2000 by the intention of the warring factions to control resources of diamonds, cocoa and coffee, and the seemingly never ending series of conflicts in Democratic Republic of Congo, between 1996-1998, 1998-2003, 2003-2008 has been fueled by the desire to control the extraction and trade of copper, coltan, diamonds, gold, cobalt, timber and tin.

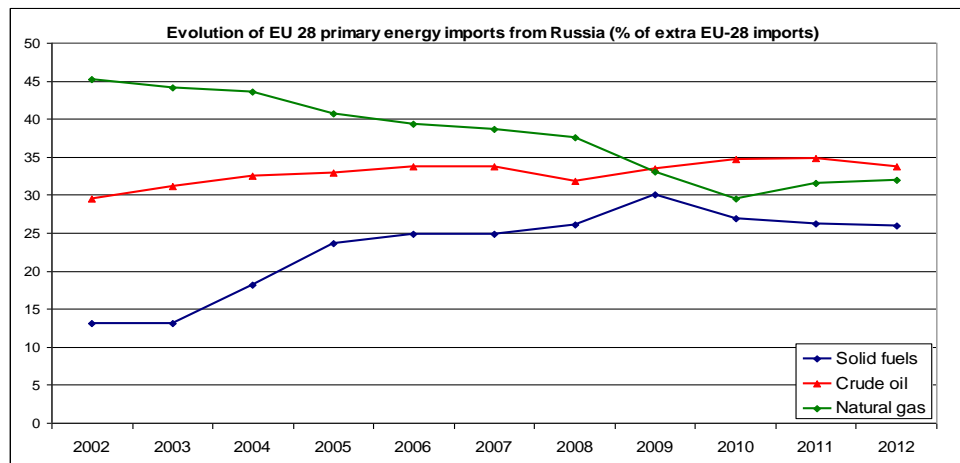
Another result was the involvement of many unscrupulous foreign companies in the extraction and trade of such resources (timber, oil, precious gems, minerals such as coltane etc), with sometimes dubious business practices and profits and returns which provided low benefits for the local economies, as they were mostly repatriated to the country of origin.

### **2.3. Energy Security**

One of the most important resources that makes the subject of national security concerns refers to securing the access to energy sources (mainly oil and natural gas), vital for the functioning of an economy. As a result, the issue is featured even in various free trade agreements, as an exception. For example, within NAFTA,

member countries may invoke article 607 (National Security measures), of Chapter 6 Energy and Basic Petrochemicals, in order to „adopt or maintain a measure restricting imports of an energy or basic petrochemical good from, or exports of an energy or basic petrochemical good to, another Party ... to the extent necessary to: a) supply a military establishment of a Party or enable fulfillment of a critical defense contract of a Party; b) respond to a situation of armed conflict involving the Party taking the measure” (North American Free Trade Agreement, chapter 6, article 607).

The need to provide energy security may manifest itself through the protection of the energy supply from foreign attack, providing protection of critical infrastructure, reducing dependency on energy imports, but also through the attempt to secure the necessary energy at reasonable prices. In this context, reasonable prices means the appropriate level of prices necessary to avoid negative effects on the national economy, such as reduced productivity, increased inflation, diminished consumption, increased production costs, etc. Reducing dependency on energy imports, especially in relation to solid fuels, crude oil and natural gas, is one of the most important issues faced by many developed and developing economies, as it is a source of large costs to the economy and a source of national security challenges. As the figure below illustrates, EU (at 28 members) is a good example of such dependence and vulnerability, with imports from Russia in 2012 at a level of 25.9% for solid fuels, 33.7% for crude oil and 32% for natural gas (according to Eurostat statistics, online data codes nrg\_121a, nrg\_122a, nrg\_123a, nrg\_124a).



**Figure 2. The evolution of EU’s primary energy imports from Russia, (% of extra EU-28 imports)**

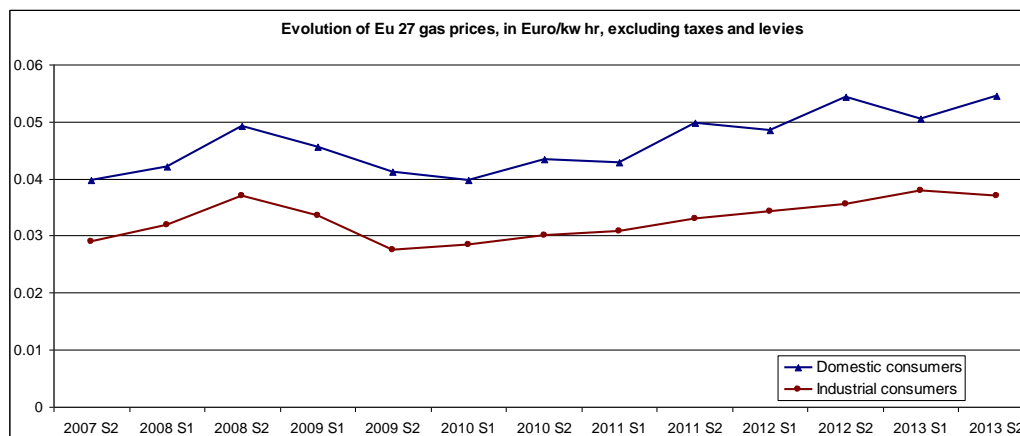
*Source: Eurostat, online data codes nrg\_121a, nrg\_122a, nrg\_123a, nrg\_124a*

The figure also illustrates the attempt of the EU to reduce its dependence on imports from Russia in regard to natural gas (with Norway among the most important alternative sources), but at the same time its increased dependence on imports of solid fuels and crude oil.

One of the first implications of energy dependency is the adverse effects the increase in prices shall have on the trade balance of the importing country, directly proportional to the share of imports in total energy consumption.

A second implication derives from the particular increase in oil prices, as they are closely linked to the transport costs, which in turn influences (in the sense of increase) the prices of almost all the goods and services in an economy. Even though each country's economy may respond differently to an increase in fuel prices, depending on specific factors, generally speaking this situation may lead to decreased consumption, higher inflation and cause a slowdown of the entire economy.

In the figure below, the evolution of the EU gas prices features the increasing trend of this type of energy, with the exception of the period following the onset of the economic crisis, which generated a significant drop in demand and a decrease in the prices.



**Figure 3. The evolution of EU's gas prices**

*Source: Eurostat, online data codes nrg\_pc\_202, nrg\_pc\_203*

The long term depletion of energy resources at global level, coupled with an unsustainable (on long term) consumption-based economic development model used by many developed countries, with potential serious environmental consequences, shall promote energy security as one of the most important challenges for national security in the 21st century



### 3. Conclusion

In the aftermath of the greatest economic crisis faced by the world in the last half a century, the world economy has still yet to recover. Among the many problems preventing this recovery, one may mention the fall in the aggregate demand, fuelled by the financial crisis and the recession, which generated high unemployment and falling incomes and defaulting debt. Many of the world's developed and developing economies are still struggling with public debt crises, high unemployment and low wages increase (sometimes exacerbated by the austerity measures designed to solve the debt problems in the first place). The aforementioned factors, coupled with the economic effects of globalization, may pose in the near future new and serious challenges to the national security of many countries in the world. Due to the interconnections deriving from globalization, no country is totally independent and immune to such challenges.

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