

HEYWOOD FELLOWSHIP LECTURE

The future of economic statecraft - reflecting on the response to Russia's invasion of Ukraine

Thank you for joining my first lecture as Heywood Fellow.

As a Civil Servant of 20 years who is used to being neither seen nor heard, it is, to say the least, counter cultural to be standing on a public platform.

But it is a pleasure to do so – and I want to thank the Heywood Foundation, the Blavatnik School and Hertford College, the Economic and Social Research Council, as well as the Civil Service, for supporting the Fellowship.

It is also a privilege – and to hold the Fellowship established in memory of Lord Heywood. For any Civil Servant of my generation, Jeremy was the dominant figure - the culture he championed and the standards he set reached everyone, and were an inspiration to us all. Above all, in my experience, Jeremy championed a culture of policy making as problem solving. Indeed there wasn't a problem that wasn't there to be solved.

The overall challenge: policy making at the intersection of our economic and security interests

The aim of the Fellowship is to capture that confidence in the problem-solving power of policy making and to provide space to think about a systemic policy making issue – not so much the “what” of policy itself, but the “how” of the policy making.

The issue I – or more to the point we as I am benefiting from the direct support of excellent people as well as the indirect wisdom of many more – are exploring for this year is this: the intersection of national security and economic prosperity interests, and the step change in policy making needed for new era of complexity and uncertainty, driven by geopolitical and wider global trends, where those interests are more intertwined than ever before.

There is much to say about this but for tonight's purposes I want to focus on one angle: economic statecraft and specifically its role in response to the security crisis arising from Russia's invasion of Ukraine.

I want to start by briefly setting out the broader context and why, in my view, for countries like the UK, this intersection between economic and security interests, defined in the broadest sense, and the associated intertwining of international and domestic interests, is the systemic policy making challenge of our time.

Certainly in my time as the UK's G7 and G20 Sherpa, economic security went from being an add on to the top of the agenda.

When we were first preparing for the UK's Presidency of the G7 in 2021, we proposed a report from an expert panel on economic security for G7 leaders - and I'd like to commend Lord Sedwill and the panellists for what is in many ways a prescient report. But it is fair to say there was some caution, even concern, from some partners and within our system about whether at a time of Covid and climate crisis, this was a sufficiently high priority for the G7 to be focused on, or whether indeed this was as profound a trend as the establishment of this panel supposed.

Fast forward just two years and today economic security was the centre of this year's summit in Hiroshima.

It increasingly dominates the agenda around the table not just at international summits, but in individual country Cabinet rooms and indeed company boardrooms.

It is already challenging key aspects of established policy.

We are seeing the most significant reorientation of domestic economic policy in four decades as governments grapple with pricing security into much more active industrial and innovation policy.

At the same - and this is the focus of this lecture - in the most significant security crisis in Europe for eight decades, we have seen economic levers at the very core of the response.

With the trends that are driving these changes likely to, if anything, intensify further, we can expect this increased complexity and uncertainty to become the new normal.

So while it is beyond the remit of the Fellowship, with established policy in flux there is an important policy and political debate to be had about what the new policy equilibrium for this new period should be - and how we find that in a way that protects the principles that make us distinct as democracies.

That debate has evolved fast even in the year of this Fellowship, for example, with new emphasis on “de-risking”. It needs to keep going as these concepts become defined in practice.

It matters. How intersecting interests are captured coherently in policy, will inform not just economic and security policy itself, but also policy on the most systemic challenges like demographic, climate and above all technological change, and ultimately determine our future peace and prosperity.

The “how” of policy making matters too. Indeed in a context of complexity and uncertainty where policy is in flux and there aren’t fixed formulas to follow, it matters more than ever.

However, just as these trends are challenging established policy, they also challenge policy making.

This is not a minor challenge for governments: both structurally and psychologically policy is traditionally approached around economic and security interests as core domains.

In an age where global interconnectedness means economic, security, international and domestic interests intersect as never before, and where geopolitical competition means we are seeing a return to strategic statecraft, there are major questions for the way we think about and go about doing policy. All countries are going to need to get much better at thinking strategically, across interests and over time, about systemic policy choices and their approach to using every lever of the state in an integrated way.

This is why in this crowded debate on the “what” of policy I hope the Fellowship and its focus on the “how” can make a distinct contribution. I look forward to discussing these conclusions when we set them out later in the year.

The specific case: economic action in an acute security crisis - Russia’s invasion of Ukraine

For the rest of this lecture, I want to focus on economic statecraft in the context of, as I have described, the most acute security crisis in Europe in eight decades.

My reflections tonight are very much personal reflections from my perspective as Deputy National Security Adviser and the senior official responsible for coordinating the economic part of the UK’s response in the year of the invasion.

[Before I come to these, I want to pay tribute to the many colleagues I worked with on Ukraine, and indeed those before I came to it and since. To our military who have worked with their Ukrainian counterparts for the best part of a decade. To our intelligence agencies whose information and assessment was so decisive. To the many officials across Whitehall who worked tirelessly after the invasion. And to our brilliant and brave colleagues in Moscow and Kyiv, led by our excellent Ambassadors there. But above all I want to pay tribute to the people of Ukraine whose resolve and resilience is an inspiration to us all. They have paid a terrible price for

Russia's aggression and its attempt to redraw borders by force and bring Europe back to something we hoped we had left behind].

We should be cautious about drawing too many lessons from a particular crisis – and Russia is indeed a particular case.

But crises tend to force policy innovation and shake up systems in a way that just doesn't happen in normal times, and it is important to learn from that and indeed sustain it.

It is important too to learn from past precedent and their parallels for policy making. So investigating the evolution of UK economic statecraft in the inter-war period is a core part of the Fellowship's research - and that research has shown there is much from past practice that we can learn from.

The starting point is that economics has been a central feature of this security crisis, both in terms of action and impact: while the military conflict has been comparatively contained, the economic, and of course geopolitical, implications are genuinely global. Managing these implications – both international policy development and the international political dynamics – dominated much of my year following the invasion, not least in the run up to the G20 Summit in Bali, where as Sherpa I led the UK's efforts to reach an agreed outcome. It has continued to do so for my successors this year, again not least in the run up to this year's G20 Summit in Delhi. The process of negotiating the Summit statements highlight the complexity geopolitical dynamics: importantly Russia's relative isolation and real concern about implications of its actions for the fundamentals of the international system, but also concern about the wider implications, including caution about the economic statecraft deployed by all parties. This complexity of geopolitical attitudes is one of the most important reflections I take from my time as Deputy National Security Adviser.

For its part, Russia has been willing to use all its economic advantages, particularly in food and in fuel. With respect to the former, it has done so with a determination and indiscriminate that should shock if sadly not surprise us, actively using the international importance of Ukrainian food supply and sacrificing those dependent on it in its efforts to undermine Ukraine. With respect to the latter, energy, this should surprise us less, not least because it is aimed directly and those it sees itself as in conflict with. There is of course a salutary lesson about leaving oneself exposed to such risks. But from a wider statecraft perspective, that Europe has weaned itself off Russian hydrocarbons and with such speed is incredibly important for the future. In doing so, governments were willing to throw the full weight of their sovereign balance sheets – the total value of the energy support schemes Europe were greater than the value of the Lend Lease programme – showing the degree to which the crisis has fully drawn in all aspects of state capacity.

For the UK and its allies, the use of economic instruments has, of course, been at the forefront of the response. Sanctions have been a feature of the global architecture for over a century: they were the principal enforcement tool envisaged by the League of Nations after the first World War, and its successor in the UN Charter. While used relatively sparingly during the Cold War they have been increasingly used since by many countries both inside and outside of the framework of the United Nations – including most recently by ECOWAS in response to the coup in Niger. There is always a risk arguing something has reached its zenith – indeed at the time, thinkers called the 1990s the 'sanctions decade' – but this, starting with the measures in 2014 after Crimea, is the first time that sanctions have been used at such scale and against an economy of such a size, never mind a permanent member of the UN Security Council.

The innovative features of economic statecraft against Russia

I could spend many hours expanding on the process we went through developing, deciding on and deploying the economic actions we took, but I will spare you that and instead use a few minutes to highlight what I think are the key features of the action taken that may be relevant to the future, including limitations on what was possible. Here I have four points.

The first is scope, scale and speed. In total the UK has designated over 1,600 Russian entities and individuals and has introduced trade controls reducing Russian imports and exports by over 99% and 75% respectively. That there was no modern precedent meant there was no established play book to follow. While there was preparation for the measures introduced on the day of the invasion, political appetite and practical reality quickly meant that was exhausted and that policy was being developed, decided and delivered in real time. And it was being done so facing a leader who wanted to overwhelm his neighbour in hours and days, not weeks and months.

Within the UK, a sub group of the National Security Council was stood up bringing together officials from departments, intelligence agencies and enforcement bodies across the economic and security spectrum, under the coordination of the Cabinet Office and policy leadership of Foreign Office and Treasury. The limitation on what was introduced was not political appetite, the flexibility of the system or indeed policy imagination – measures like the central bank sanction introduced in the days after the invasion or later the oil price cap were genuinely far-reaching innovations in international policy making that few would have considered possible before the invasion. Rather the constraint was what was practically possible for our systems to absorb – which is why, for example, in the UK emergency legislation was passed to accelerate the ability to designate and additional investment is being put into enforcement capabilities.

The second feature, is a balance to the first, the degree of effort put into avoiding unintended consequences, on people in our own countries, but in particular on those countries outside of and least able to afford the global implications of Russia's conflict. The design of the oil price cap is the most important example of that.

With respect to our own countries, democracies have a responsibility and indeed a requirement, that autocrats can disregard, to sustain public support. Indeed in the event people have absorbed a significant squeeze on their standard of living knowing in part it has been a result of standing up to aggression and defending our values. There I think there is a lesson for those who think there is comfort in the decadence of democracies.

I think we probably did get this balance right. But there is, of course, an open question that we will never know the answer to whether sharper action with its inevitable impact may nevertheless have been shorter lived and smaller in cumulative terms, if it had helped to end the conflict sooner.

With respect to other countries beyond our borders, this was one of the most complex aspects of the whole agenda internally, and of course one of the most debated externally. The complexity is not new - indeed concerns around the third country impacts of imperial Germany's immediate disconnection from the global economy led the British to resile from its total blockade at the start of the World War I. This is also an area where the approach evolved as experience enabled more sophistication. In practice, rightly in my view, and unlike as I referred to for Russia with respect to food, it was a significant limitation on taking more far reaching measures.

The third feature is their role as a core component of a comprehensive strategy that also included security assistance to Ukraine, humanitarian assistance to Ukrainian people in and out of country, as well as diplomatic action against Russia. Implicit in that is a recognition of the limitations of what sanctions can achieve in isolation. This is relevant to how their impact should be assessed, and I will come on to that. But it is also relevant to how they evolved, not as a short and sharp decision, but rather ratcheted up, as part of the most intensive period of conducting statecraft comprehensively across capabilities in a crisis since the Cold War. From the start, decisions on sanctions were made by the National Security Council or, when invasion first started, the COBR emergency committee alongside and not in isolation to everything else.

The fourth feature is the extent to which sanctions were implemented in unity across the G7+ allies. Of course the limitation – and it is an important one that I will return to – is that even with that unity it only accounted for around half of the global economy.

But it is worth pausing on the coordination that did take place and on the role of the G7 in particular, as it was not a given. While all members have their own legal regimes and therefore detailed measures, each wave of

sanctions was always coordinated. To illustrate the point, G7 Sherpas would traditionally routinely meet around once a quarter, for much of last year we met weekly, in some cases more often, as we worked across the timezones in the Far East, Europe and on the other side of the Atlantic. Not since the financial crisis have I been involved in such detailed coordination of international economic action.

I think we will see informal groupings and the variable geometry they bring play an increasingly important role in crises, balancing the need for unified action and agility. There was a time after the financial crisis when it was assumed the G7 would wane as the G20 emerged as the principal forum for global economic coordination.

Rather, from just two years ago in 2020 when there was no G7 Summit under President Trump, through the UK's Presidency in 2021 which I think did re-establish its purpose, it became the principal forum allied for coordination during the crisis. That is partly for practical reasons – the Sherpas in Leaders' offices and Political Directors in Foreign Offices were the key officials. But it also reflected political preferences, not least of the US who I think have come to see the G7, and the Quad in the Indo-Pacific, as their preferred fora for cooperation with allies, with the US National Security Adviser describing the G7 as “the steering group for the free world”.

I highlight these four points – a broader and deeper range of economic tools, targeted to avoid unintended spillovers, considered as part of a comprehensive security strategy, and in coordination with others – because I think they form the basis for how economic statecraft is likely to evolve into the future.

The impact of economic statecraft against Russia

That will depend also on how we come to assess its impact in this crisis. It is of course too early to do that, but it would be a cop out from this lecture not to offer at least some perspective.

Any comprehensive assessment needs to be not of sanctions so far or in isolation, but of the role they play over time and as part of an overall strategy with respect to Russia's calculus.

That assessment needs to look at the individual measures both differentially and collectively: financial measures designed to create a short-term shock, designations of individuals designed to pressure elites, trade measures designed to degrade the economy and military capacity over time, and energy measures designed to restrict revenues, but all designed to impose costs on Russia, constrain its capacity to wage war and cumulatively shape that calculus.

The impact of all will depend on the ability of the allies to sustain what has been put in place and address efforts to get around them, and on Russia's own response and the extent to which it can sustain that. Russia ameliorated the short-term shock with stimulus, but how sustainable is that? Russian defence spending is a third of total spending. It is selling energy, but at a discount with a significant revenue impact, how sustainable is that? Russian energy revenues were down nearly 50% in the first half of this year compared to last. It is getting goods but it is short on key dual use items, how significant will that be on the battlefield and beyond?

The cumulative effect of the actions taken may only be at the margin, but these are circumstances where the margin may matter. Ultimately, notwithstanding all the uncertainties we still face and the choices Russia can make, it will be a more isolated economy with less trade, less foreign capital and less technology – these are not prospects that make for a leading global power.

Any assessment will also eventually need to consider the implications for beyond this conflict and the wider international order, just as Nicholas Mulder has recently done so well in his book charting comparative periods of sanctions development in the first half of the 20th Century.

Most importantly, any assessment needs to be made against the counterfactual of what the other alternative options were with respect to that order. It is an important debate to have about the precedent that actions taken have set, but the alternative debate would have been about the precedent set by no action in response to a P5

country's attempt to redraw its own boundaries by force in clear violation of the Charter, and in a continent who has such a terrible history in this respect, or at the other end of the spectrum the implications of direct military conflict. That we are not having this debate is in my view important. Here the insight of former UN Secretary General Kofi Annan, in a different context, is important – sanctions can play an important role in the gap between words and war. That was the very real choice Leaders faced last year.

It may be a choice they face again. Either way, I believe a new era of economic statecraft is here to stay as we grapple with today's geopolitics and geoeconomics, just as they did in the first part of the last century. This will involve balancing the role interconnectedness can play as a potential deterrent, with the choices but also challenges for statecraft that interdependency presents. The experience of the last century should make us cautious. Equally, we should always be cautious too about the use military force. In the context of greater global instability and geopolitical competition, when faced with a crisis, economic levers may be the first and foremost response we have. So I do believe that if developed carefully economic statecraft has the potential to play a much more central role in our security architecture for defence and deterrence.

The implications of that are profound for both economic and security policy making, both for decision making in a crisis but also for determining our strategic economic and security posture. As I set out in my introduction, above all it will require a much more integrated approach across traditionally separate domains. This will be the underpinning basis for the Fellowship's conclusions later this year.

The implications for future economic statecraft

Before I close, I wanted to offer some specific conclusions for economic statecraft about the experience of policy making over the last year for going forward – both some sensible policy making steps that are worth taking anyway, as well as some wider choices about where policy may go. Again I have four points.

First, we need to put more formal structure around our economic statecraft that inevitably developed informally over the last year. As my former US counterpart Daleep Singh has also proposed, we should develop a doctrine, sitting within our overall security architecture, setting out the principles that guide our approach with respect to economic tools, in a not dissimilar way to what we have on military capabilities. An underreported annex to last year's G7 Summit statement sets out what those principles could be for a cautious approach where core international principles are at stake. Something with structure like this would provide internal clarity for decision making, and also external clarity and comfort on our posture, including those concerned what it otherwise might mean for them.

Here the Fellowship's research is revealing a surprisingly rich history of policy making and precedent that we can draw on, as Britain reflected on its experience in World War I. The Archives at Kew are striking yet seem to have had little attention compared to the more tangible histories of the war on land and sea - this despite Britain's allies appearing to regard its "fourth fighting service", as one British official called it, as its most decisive contribution to the struggle, and very much integrated within the overall strategy.

We see in the records a deep retrospection in the British state in order to, in its own words, "to overhaul the experiences of the late war over a wide range of subjects while memory was still fresh". This gave way to a powerful inter-departmental body called the 'Advisory Committee on Trading and Blockade in Time of War', ministerially-led for 15 years across five successive governments of every persuasion, charged with advising the Cabinet of the day on the use of economic measures in foreign policy. Its work culminated in the production of a 'Handbook of Economic Warfare' by 1938, although a version of it had matured by 1929. The Joint Intelligence Committee we know today has its origins in this time – the fact the central intelligence machinery grew out of a need for raw economic intelligence may surprise some. Together, these were significant capabilities which not only appear to have ensured the lessons of the war were integrated properly in peacetime, but that Britain was better equipped to make the trade offs inherent to the use of economic measures, across every foreign policy crisis of the interwar period and into World War II. There is too much material to digest in this one lecture, but depth and maturity of that thinking, at the very highest levels of government, should inspire our thinking today.

Second and next, alongside this we need to sustain and strengthen the capability we have for determining and delivering our economic statecraft policy – both in order to see through the game of whack-a-mole in enforcing what is in place for Russia, which as I have said will be key to their ultimate effectiveness, and to put ourselves on a stable footing for the future. That needs to include, for example, developing the necessary standing capability of expertise, infrastructure for analysis and assessment, and systems for stress testing and scenario planning.

Here too our inter-war predecessors grappled with the same challenges, and went to great lengths to build the government's capability, whether by bringing in – for the first time – financiers in London; or by establishing entire offices dedicated to working with the maritime insurance industry to curtail enemy shipping; or, as it became in World War II, one of the largest departments of state.

My third point is that we need to think through the implications of how government and business work together in times of acute crisis like this, and on chronic challenges. The intertwining of economic and security interests necessarily has implications for the interface between the market and the state, and so for business and government. Indeed in the extreme case of sanctions, business are at the front line acting as the government's agent. In that respect engagement with business was critical in helping develop and deploy sanctions against Russia. More broadly, today's context means it is essential to ensure the security assessment that only governments can provide is combined with the market insight that business is best placed to bring in determining policy. How this is best done for the future requires careful thought, and will be a core element of the Fellowship's conclusions at the end of the year. Where does it make sense to exchange more information, and how do we do that when some of it might be secret? When does it make sense for government to formally mandate, but how do we do that in way that gets right balance for the role of the state? And between these two things, where might it make sense for government to informally advise?

Fourth and finally, we must also consider how nations better coordinate and cooperate. Countries will always need a backstop to defend their core national interests. But remembering the original insight of the UN Charter, we should reflect on the potential it saw for how countries may coordinate in future through economic means in response to violations of the fundamentals of the international system, and how that could be done in as broad based way as possible.

This matters both because economic tools could play an important deterrence and defence function in a future security crisis, but also because as we have seen over the last year a security crisis can have significant implications for the stability of the global economy. As a contribution to that debate and as part of the Fellowship programme my colleague Jack Connolly is publishing today a paper on the role economic deterrence can play in upholding international stability, including a proposal for an international stability mechanism.

Critically, coordination should look to encompass action against a belligerent state with assistance to other countries affected by the aggression of that state and any unintended impacts of action in response. In many ways this invokes the initial insight that economic statecraft is most effective when the negative sanctions stick was matched by a positive sanctions carrot. It was an important feature of interwar thinking on statecraft in the British system by people like John Maynard Keynes, then a young Treasury official, and indeed that went on to inform the thinking behind the Bretton Woods architecture and the international institutions established post-War. This would require a stronger financial commitment from countries who are able to – as well as those international institutions – to stand behind ameliorating the impact of a belligerent's action, and also a stronger commitment from all to support such a mechanism that stood up for the fundamentals of the international system. None of this is straightforward, and what should be possible in theory will be more difficult in practice, but it is thinking we need to do as we consider how economic statecraft could evolve.

Conclusion

In conclusion, let me come back to the aim we have set for ourselves with the Fellowship – as we face up to the implications for policy of the changed geopolitical context, how does policy making itself need to change for a new era of complexity and uncertainty.

These lessons from developing and deploying economic statecraft over the last year – the importance of clarity on our principles and what a good policy making process looks like; of having the capabilities we need to collaborate effectively across our systems and think about statecraft in the most strategic way; of analysis and assessment of information as an enabler of integrated advice; of the partnership with business in developing and delivering policy; of collaborating with allies doing the same; and of strong structures at the centre that support provision of integrated advice and accountability of decision-making – these lessons apply as much to the wider interface between economic and security interests in the context of the more chronic challenges I discussed at the start. And so we will be drawing on these as we develop the Fellowship's conclusions for how policy making needs to change later in the year.

As a final word, I have inevitably spent much of this lecture talking about risk.

We do need to be clear eyed about the challenges of the geopolitical context we find ourselves in, of the downside risks that go with them and the difficult decisions they imply.

Yet at a time when there are no easy routes to growth, we should also be clear about the upside opportunity. Getting these difficult decisions right can mean our economic and security interests reinforce each other, and reinforce both our future peace and prosperity

So returning to the inspiration for the Fellowship, like Jeremy I believe in the power of excellent policy making to find ways through even the most complex of challenges.

This interface between economics and security is the most complex of them all.

ENDS