

Rethinking Risk and Global Power with Jake Sullivan

>> Welcome to PGIM's The Outthinking Investor, exploring the forces shaping global markets past, present, and future. Join Daleep Singh as he talks to economists, policy makers, technologists, and veterans of global financial markets to explore what could happen next and why it matters. Now, over to Daleep.

>> There's a specific feeling about the state of the world that we're all trying to name right now. For almost 30 years, we operated under a set of assumptions that felt almost like a law of nature. Geopolitical strategists called it the unipolar moment in which US-style democratic capitalism had ascended. Economists called it the great moderation of inflation, of interest rates, and market volatility. It was a world in which geopolitics and economics were kept in separate lanes so were national security and economic policy. It was a world in which economic interdependence was seen as a shield against military conflict, and where history, at least in terms of the notorious -isms of the 20th century -- nationalism, authoritarianism, communism -- seemed to have ended, but if you look at the world today and the return of great power rivalry, the return of economic warfare, the resurgence of industrial policy, of fiscal dominance over central banks, and the race to secure critical supply chains and to dominate cutting-edge technologies, it's clear to me that we're back to what I call the old normal. It's the idea that we aren't moving to a brand-new future.

We're actually reverting to a much older historical baseline that defined the long sweep of history before the Cold War ended. It's a more contested, more fragmented world in which economics, geopolitics, technology, and markets, they're all part of the same conversation. My guest today, Jake Sullivan, didn't just witness that shift. He broke down silos to meet it. He rewired the connection between national security and economic policy. He's the person who helped me realize that supply chains are now front lines, that a line of code is now a diplomatic lever, that economic interdependence can become a strategic liability. Today I want to bring on my former boss, my friend, Jake Sullivan, to do something very specific, which is to connect the dots. Jake, welcome to the show.

Jake, we spent years in your West Wing office debating hard questions at every one of those intersections. It's great to pick up the conversation. Thanks for coming on.

>> Hey, thanks for having me and congrats on your podcast. You've joined the ranks as I have of podcasters. It's an august crew. Maybe not quite the same as being a public servant on behalf of the United States but let's say it's a close second.

>> It's easier to count the number of people that don't have a podcast than those that do.

>> That's true.

>> Let's see how this one goes.

>> Right. People are going to have to start going by not a podcaster. I'm not a podcaster. Yeah, that's right. That's right.

>> It's a shorter list. Look, I'm tempted to start with whether your Vikings letting Sam Darnold walk will go down as one of the worst risk management debacles in recent memory, but I do want to turn to a different high-stakes decision. The US military intervention in Venezuela --

>> Bless you. Bless you.

>> -- you can draw the connection between the TV life but let me frame it this way. You and I, I think we're the same age. We graduated college at the so-called end of history in the late '90s when many thought ideological convergence was inevitable and irreversible. Now, at least to me, it feels like we've reached the end of the end of history and we seem to be returning to a much older normal where great powers get to make the rules in their own backyards and the world fragments into regional spheres of influence. Do you agree? Is this the equilibrium we're drifting towards? Is it stable, and what are the costs and risks relative to the counterfactual?

>> First, just a brief anecdote, in the Obama administration, I work for Secretary of State Hillary Clinton, and she went to a meeting of the leaders of the major Asian countries in Hanoi, Vietnam, in 2010. The subject of the conversation was Chinese aggression in the South China Sea. Secretary Clinton organized the number of those countries to put out a strong statement basically pushing back against that. The Chinese foreign minister sat down at the table, looked around the table, and then looked squarely at that foreign minister from Singapore and said, "There are big countries in the world and there are small countries, and that's just a fact." Secretary Clinton reacted to that quite strongly with principle to say, no, there are rules of the road, and we're going to marshal a coalition of countries and rally the world to respond to that. That was 15 years ago.

Now you can imagine an American Secretary of State, or certainly an American president, sit down at the table and say those exact words that the Chinese foreign minister said 15 years ago. There are big countries, and the big countries dictate terms. The small countries have to go along, and in particular, the big countries should have dominion in their own neighborhoods. That is a big part of this Trump corollary to the Monroe Doctrine, which says, basically, the US runs the Western Hemisphere and everybody else has to fall in line. If it requires military coercion, so be it. To your question, is this a kind of clear direction of travel as we look out over many years, I think that's still contestable. If your question is this the policy of the current administration and the reality of, certainly, in the next three years, the answer is unequivocally yes. The United States sees itself as the biggest, most potent actor, but it also shows great respect for the other major actors, particularly Russia and China. If you look at the national security strategy, those two countries are described in terms of us having to have, basically, a stable, positive relationship with them. The rest of the world is subject to our will and coercion. Will it snap back or will it change in the future?

What I actually expect is there's going to be this pendulum swing between MAGA foreign policy, which is this style foreign policy, and something more traditional, which will create its own unpredictability, but it does suggest to me that it is not inevitable that American foreign policy over the next 25 years will have this as the touchstone.

>> We have choices to make, and so do our adversaries and non-aligned countries. If this is multiplayer, multi-stage game theory, what do you think is the signal that Beijing and Moscow are taking? Do you think they're going to hedge and wait to see how this equilibrium settles or do you expect to see either one of those capitals testing new limits?

>> Let's start with China, because I think the conversation in Beijing right now would be surprising to an American audience. I think they look at what happened in Venezuela, the military operation to grab Maduro and his wife and extract them from the country, and they think two things. First, they're impressed. They're impressed by the sheer skill of our special operators and I think a little jealous, but second, it confirms something deep that Xi Jinping believes. He believes America is in imperial decline. And his view is that the pathology of a declining empire is to lash out at weaker, immediate neighbors.

He sees Venezuela in a way as confirmation that the United States is fading, is a spent force, and really is going to now have to busy itself with messing about with the likes of Venezuela or Cuba or Mexico or Colombia. It is not an accident that in the last several days you've had China floating much tougher rare earth controls on Japan. I think China does believe that this spheres of influence concept is going to give it greater freedom of action. I think for Vladimir Putin, he's a bit less certain about what this exactly all means. I think he has confidence that he can ultimately get a good deal in Ukraine from President Trump, but I think he is still a little bit unsettled about the unpredictability of Trump's policy to know exactly how to shape his larger strategy. Certainly, the overall proposition of a spheres of influence world is something that appeals to him deeply.

He's been trying to sell that bill of goods for the last 25 years, and I think he would like to see that, but I think he's still waiting to understand exactly what the implications of this are going to be for him.

>> Okay. Let's stay on the theme of fragmentation and let me zero in on China. You've described our frictions with China as a chronic condition that we should manage responsibly rather than a disease that we can cure with a grand bargain. First, is that still your diagnosis?

>> Yes.

>> Okay. One of the key guardrails, just taking that as a premise, that we built during our time in office was the small yard/high fence, export controls on technologies like AI chips that we believe are foundational for national security and economic growth

potential. The goal was to protect our lead without waking up in a moated fortress completely decoupled from the world's second largest economy, but that brings me to the decision to license Nvidia's H200 chips to China in exchange for a revenue cut.

It feels like the right metaphor is now more like a toll drawbridge where access to our technological crown jewels can be granted at a price. Now, just to be fair, proponents of the decision say, look, it may lock China into the American AI ecosystem and fuel Nvidia's capacity to innovate, but what's your take on how this alters the AI race, and do you think we've just gifted China a generational leap in building more cost effective data centers to train and run frontier AI models?

>> So look, the US and China are in a competition for the cutting edge of artificial intelligence, and that competition really has two elements. One element is who's going to lead at the frontier? Who's going to produce the most capable models? The second is who's going to build the backbone upon which the world runs their AI applications? Both of those require an enormous amount of computing power. China has every other input you need. They have the energy, they have the talent, they have the resources. What they lack is the compute. The United States has a massive advantage in that. A decision to sell China advanced GPUs, the H200s, that allows them to close the compute gap, not entirely because the United States still has much more advanced chips, including the Rubins that have just been announced, but still, to get this massive amount of compute allows them to chip away at America's advantages on both those fronts. One, it allows them to build data centers overseas with H200s that can serve Chinese models, and two, it allows them to train far more advanced models than they would otherwise be able to train to compete with the United States at the frontier. This is basically taking China's major disadvantage and giving them the tools to solve it. To me, that makes absolutely no sense. Now, you alluded to the arguments for doing this, and I think there are three. One is that if we don't let Nvidia sell in China, they'll make less money, they'll innovate less. Jensen Huang made the case to us back in 2022, when we put the first controls in place on the A100 and the H100, that if we did this, Nvidia would tank. I think Nvidia's market cap at that point was \$380 billion. Nvidia's market cap today, you will know better than me, but it's a little bit higher than \$380 billion in order of magnitude.

>> At least.

>> Right.

>> Meanwhile, its share of revenue from China has fallen from 25% to about 5%.

>> Exactly.

>> And yet its revenues have exploded, and why? Because the demand for compute is so dramatic, and in fact, they have more orders for their chips than they can sell their chips. So to me, the argument that they need to sell into China doesn't hold water. Second argument is, if we don't sell these chips, China will be motivated to try to indigenize its stack. Before we ever came to office in 2021, Xi Jinping had gone out and said that his paramount priority was to create a Chinese chip ecosystem totally independent of the West. He said that out of his own mouth. He said that in every party document you could imagine, and they poured \$150 billion into it, so they were racing to indigenize whatever we did. Then the third argument is one you also raised, which is, can't we just get them addicted to Nvidia and then they will be locked in some way? First of all, China has already shown exactly what its strategy is. They will force their companies to purchase domestic chips up to the point that they have them and they only have limited supply. Then they'll use Western chips, basically, to fill the gap until they have caught up. I find this just patently at odds with the evidence that we have.

>> It's not even theoretical, right? Beijing has already issued binding directives to purge US chips from critical infrastructure as soon as possible.

That's not speculation, that's reality.

>> And you now see the way that they are metering their approvals of H200s. Basically, they're getting the major AI labs in China to buy Ascend chips, the Huawei chip. When those run out, they've said, basically, okay, now we'll put in a bunch of bids for H200s, but that H200 is not there to be a core part of their stack. It's there basically to be a stopgap so that they can keep pace

with the United States during this critical window in the AI race. When you sum all of this up, there are a lot of 51-49 calls in US foreign policy. I'll be the first to acknowledge that. This is not one of those.

>> It puzzles me too, Jake, because if there is infinite demand for frontier chips, what this decision appears to do is prioritize Chinese demand over US demand for the most valuable strategic asset in the world, arguably. What I wonder is the US hyperscalers, who are already supply constrained as it relates to frontier chips, I wonder why they haven't spoken out more publicly, loudly.

>> I have a couple thoughts on this. If you think about this from the point of view of the US national interest, it makes absolutely no sense. If you think about it from Nvidia's interest, they are facing one challenge that is becoming more acute. That is, they don't just have to worry about a Chinese stack being developed to compete. They also have to worry about alternative suppliers in the United States. AMD has been doing these deals with OpenAI and others. Google has its TPU that has been proven to be a very effective chip for training and inference. There's Amazon's Trainium. I think what Nvidia is thinking is, we need the Chinese market because even though there's infinite demand in the West, there's now many more competitors in the West. If you're one of those other hyperscalers, you're also looking at a circumstance in which the dominance, the sheer absolute almost hegemony of Nvidia, there are more options, there are more alternatives. That's one big point in this. The second big point is David Sacks, who leads AI policy for the administration, has joined Jensen Huang in this argument that we should sell these chips to China. I believe that none of the hyperscalers want to get on the wrong side of David Sacks, so they don't speak up.

>> He's the czar.

>> Yeah, he's the czar. He's the czar, and so, it doesn't make sense for them to rock the boat. Even during the Biden administration, the hyperscalers were cautious in what they would say publicly against US policy until the transition when Trump had won and was coming in and they felt like they could just then open season.

>> So there is a factor, I think. They're cautious about public statements in this regard, but I do think part of it also is this fact that they see alternative sources of supply coming online and being proven out in ways that change the landscape from their perspective on the Nvidia question. Okay, fair enough. Let's pivot away from punitive tools, controls to the positive tools of economic statecraft, and I'd argue, as you know, that since today's great powers are mostly nuclear powers, the risk of mutually assured destruction is channeling direct conflict away from the battlefield and into the arenas of economics, technology, energy, where confrontation is not existential. Despite having the world's most dynamic financial system, the US hasn't figured out how to play offense, how to harness long-term, patient capital in ways that advance national interests like supply chain resilience or rebooting our industrial base or safeguarding energy security, particularly in deep tech investments like fusion or robotics or advanced geothermal or even old economy sectors like shipbuilding or mining.

Towards the end of the last term, you and I began talking about sketching out a vision for a US sovereign wealth fund to crowd in the private sector, one that's insulated from the political cycle but still democratically accountable. You've had a year to reflect on those initial conversations. Where are you now, and more generally, do you think we as a country are still over-indexing on punishing rivals rather than building our own strengths?

>> The very last question, I think the answer is yes. I think we've gotten much better at the protect side of the agenda than the promote side of the agenda and that we do not have the right set of tools marshaled and deployed to be able to ensure that we're making the investments in our own innovation and our own capacity to build that speed and scale.

Look, there are two problems that we need to solve from my perspective. You mentioned one of them, which is supply chain resilience. We have to be able to diversify our sources of supply for critical inputs that power our economy and power our national security enterprise, and the rare earths episode of last year is an absolutely stark reminder of that. Then second, your point about deep tech, America's capital markets are remarkable, but for certain kinds of investments that may or may not pay off over time, that require a lot of upfront capital and locked-in capital where the bet may not work to go basically from concept to scale, our capital markets are not as great at that. That is where on those two issues, I believe we need a strategic investment fund, a source of capital that is public, that is insulated from politics, but that can be put to work to crowd in private capital to de-risk transactions, both for supply chain resilience and for scaling technologies in critical sectors.

That could go, as you said, from old-school shipbuilding to clean energy, certain elements of biotech, certain elements of the semiconductor and supercomputing ecosystem. I think the United States of America needs that tool. The UK has now developed a tool along these lines. Australia is beginning to experiment with the tool along these lines. I think the US needs it as well. That is not the only thing we need.

There are issues associated with policy signal, with permitting. I do still think tax credits play a critical role, as they did in the Inflation Reduction Act, but if we have this extra element, a fund that could provide the necessary catalytic financing to scale new technologies and to ensure supply chain resilience and diversification, combined with those other policy tools, I think the United States would be in a much better position to succeed in the long-term technology and economic competition with China, and I'll make one more point. If we do not do this, I think China's current model is going to produce what David Autor has called "China Shock 2.0." I think they have a model, which is not the model I would adopt -- I would adopt an American model -- that has deep government involvement in trying to control the commanding heights of all of these frontier technologies. Left to their devices, just relying purely on the markets alone is going to lead to a series of market failures on our side and allow China to succeed in its strategy of dominating these new sectors.

Yeah, to generalize what you're saying, you're calling for more American economic firepower.

>> Absolutely.

>> And it's not just in one tool, not just one institution, it's a different mindset, and it can be applied across a range of technologies and supply chains. I do wonder if critics were listening to us speak right now, they probably would say, there they go again. These folks want to amass more power in the hands of the government and expand the role of the state. Inevitably, this is going to become a political piggy bank from both parties that leads to national embarrassment. What would you say in terms of the ways in which governance can help address some of those concerns?

>> I think that the political piggy bank issue is a real one and something that we do have to be concerned about. This could be subject to corruption, but so could basically every other tool of the US government as well. My answer on the corruption piece is, if you're intent on misusing public resources, you can do that with basically any tool of the US government, and that shouldn't be a reason to create a tool that has its own unique advantages and capacities. On the political piggy bank piece, I do think we need a robust governance structure, and here we can borrow from history. We have succeeded in doing this in the past. We did this in the context of the run up to and the execution of World War 2 to amass and mobilize capital with a transparent public board running a public corporation that had insulation from the tos and fros of politics and that could be judged by how the investments actually paid out over time. Now, this does require a certain degree of risk tolerance because there will be failures that's inherent in the nature of investment, but I believe that you can build, based on both the experience of other countries like the UK and America's own experience in the past, a sufficient range of governance guardrails to ensure it doesn't become a piggy bank. On the broader question of whether this is the government taking over, the kind of thing we're talking about as a share of America's GDP or as a share of America's private capital investment in technology is extremely modest, but it is the kind of, in a way, special forces, like, targeted, narrow, lethal tool that can help unlock a lot more private capital. I would add that there should be a principle of additionality. The US government shouldn't just say, we're going to go spend a whole bunch of money on this tech if there isn't private money coming along to say there's actually something there that makes sense from a market perspective if it's properly de-risked.

I would argue there has to be an additionality element to this so that the private sector itself is a bit of a check on government stupidity or overreach.

>> Yeah, I mean, you alluded to it. We're now the outlier, even among advanced economies for not having a strategic investment vehicle. The truth is, we have done this before. The Reconstruction Finance Corporation is what fueled the arsenal of democracy. Okay. Your North Star from day one was to craft a foreign policy for the middle class, the idea that what we do abroad should make lives at home better, safer, easier, in tangible ways that people feel. The polls right now leave no doubt, most Americans still feel that the cost of living is unaffordable. In a world of intensifying competition with more barriers being put

up in the name of economic and national security, how can we deliver on foreign policy objectives without de facto taxing American households?

>> I think we do have to acknowledge that national security measures that call for supply chain resilience and diversification, that call for countermeasures against countries that are seeking to swamp the United States with cheap goods that undercut our workers and businesses and so forth, this does have a countervailing impulse to let's just go for the cheapest cost provider. We also saw that going purely with just-in-time supply chains and purely with outsourcing to cheapest cost providers, the brittleness that could produce not just with respect to our national security, but it could shut down our auto industry with a snap. We don't have certain capacity to be able to provide the inputs to our automakers, so I do think that there is a balance to strike here. To me, if we are targeted and we focus only on those most strategic of sectors and industries and do not have these broad based across the board tariffs, and if we combine that with a suite of policies to reduce the cost of education, of health care, of housing, of all the fundamentals that really are the pain points facing Americans, then you're talking about a world in which you're stimulating new advanced industries in the United States that will have profound positive effects for the American economy and you're finding ways to address the cost of living crisis that so many Americans are facing. I think it's a combination of being very targeted and using a scalpel rather than a sledgehammer in your economic countermeasures, creating the kind of stimulus necessary to drive new industries to be created in the United States that, in fact, will help the middle class, not just the immediate folks who work in those industries, but all of the spillover effects. Combining that, you said at the outset, we have to break down the barrier between foreign policy and domestic policy with a robust strategy around the major costs facing American families.

I think that is a formula for American strength that delivers for everyday people in this country.

>> So both limiting principles, strategic anchors around the punitive tools, but a more affirmative, creative, ambitious set of efforts to make lives better at home, okay. Jake, the world I live in now in bond markets, we're measuring risk and basis points and national security risk is measured in lives, right? The stakes can't be compared, but I was always struck by the similarity of your risk management process and what I've experienced in the investment world, constantly pressuring and probing the base case, thinking about the full distribution of probabilities, especially the tails, and then hunting down our own blind spots. We've all got them. The question is, as you look back, were there tools or techniques that you thought were especially useful or especially lacking to make better decisions under the most extreme uncertainty anyone can imagine?

>> I would say three things to me. One is who's in the room and who gets the chance to weigh in on the conversation?

The more people you have around the table from different perspectives around a given challenge, the more likely you are to eliminate those blind spots. One thing I did, as you saw, is I would crowd my office with people, maybe too many people, but on the Ukraine question, so that you had people who were experts on Ukraine, experts on Russia, but also experts in the military, in energy, in technology, and the potential way in which asymmetric lethal technologies could be used at all different levels, not just the most senior people, but more junior people who were touching and feeling these issues in a different way.

>> And often speaking a different language, the language of technology and the language of markets, very different.

>> Exactly. So having those different perspectives and the different layers of the institution, be able to weigh in because the more senior you get, frankly, the more divorced you get from the dirt of the issue that you are confronting. That's one thing. The second thing is to have a framework, to your point, to constantly apply a rigorous set of questions that you are making sure you are walking through almost like a tick list. One of the questions I would always ask is, if an event has happened that we didn't expect, what will we have missed along the way? State an event in the future and then work backward for it, or if an event unfolds that we don't like, what will we have wished we had done today and what are we doing that we wished we would not have done?

>> Almost like pre-mortem, Jake, right? Instead of a post-mortem work backwards from a bad headline or a bad outcome.

>> Precisely, and so, that was one of the elements of the framework that I tried to apply.

Then the third thing, and this is the hardest in my view, and I am not an investor, but in making policy decisions, you have to figure out how to balance between being paralyzed by risk and dismissing risk. On the one hand, saying, oh, that's just not likely to happen; let's barrel ahead full speed; whatever, they're bluffing. You have to have caution at the edge of that, but you equally have to have caution at the other edge, which is there's a possibility that will happen, so we're just not going to do anything. This to me is not about algorithm or mathematical formula, this is about judgment. This is something that comes from experience. It comes from wins and losses. Honestly, you develop, okay, what works, what doesn't? Having almost a sense of the point on the horizon you're aiming for between those two extremes and thinking about how you navigate with that in mind to me is a really important part of being an effective risk manager, right? There is rigor, and there's framework, and there are questions. At the end of the day, though, there's judgment, and you just have to be able to apply it while trying to avoid the shoals on either side of the gap that you're trying to shoot through.

>> I've got to say, Jake, you sound like a grizzled investment veteran. Ever thought about running some money?

>> I wish. My older brother is in the finance industry, and he often says to me, Jake, I don't know, you don't get a lot of money. I'd prefer if it were the opposite for you, my friend.

>> There is, in medicine and national security and finance, there is a common thread in terms of how people think about risk. Maybe they don't talk about it the same way, but there is an analytical through line.

>> Yeah, absolutely.

>> I want to close on this question. I'm going to ask every guest this question. What's the most commonly held belief in your world, however you want to define that world, that you think is just flat out wrong?

>> Oh, man, that is a great question. I think when people look at government and look at big national security decisions, they tend to think of a system producing that decision, and it's just humans all the way down. The first time I went into the Situation Room in the Obama administration, my first thought was, this is it. I'm here. This is incredible. I'm in the Situation Room. Then about 10 minutes later, I was like, wait, this is it? No. There's got to be another room down the hall where the real people are making real decisions, because these are just folks just giving their opinions and doing the best they can. That's not to criticize who was around the table. At the end of the day, this is just people. A lot of foreign policy, a lot of national security, is really contingent. It's on who the collection of people is feeling their way through the issue. If you had a different collection of people, you'd have somewhat different outcomes. Not to say that structure and system and latent power and all these other concepts don't matter. I think people underestimate the human element of decision making, and that goes across the government, frankly. It's just the sum total of human beings with all of their weaknesses and blind spots and all of their strengths and creativity. Until you've sat in those rooms, you don't really recognize the degree to which that reality drives things.

>> That's great, Jake. It gave me a flashback. I think my first time in that room was in 2014. You were in there, I think.

>> Yeah.

>> I nudged our friend Adam Szubin and I said, I have such imposter syndrome right now. He said -- he's the nicest guy in the world -- "So does everybody else."

>> Yeah, yeah. What he said is so true.

>> Yeah, yeah, absolutely.

>> Jake, let's leave it there. It's always a pleasure, and thank you for your decades of service to the country and the world.

>> Thank you, Daleep, really appreciate it. Good luck with the podcast.

>> Okay. That'll do it for this episode of The Outthinking Investor. The world is being reshaped before our eyes. Our greatest asset is our ability to outthink it. See you next time.

5230708