

Economic Statecraft in the 21st Century: Implications for the Future of the Global Trade Regime

By Vinod K. Aggarwal and Andrew W. Reddie



Graphics Credit: Cameron Venti on Unsplash

This article is abridged from our introduction to a special issue of *World Trade Review* (2021) that examines the effects of strategic competition on the future of the global trade regime.²

“Strategic competition” is once again a salient feature of the international system, with far-reaching implications for the stability of the existing security, political, and economic order. Amid this shift, the World Trade Organization (WTO) has increasingly faced pressures. The trade war between the United States and China, protectionist unilateral actions taken by the United States, and the U.S. rejection of the appointment of judges to the appellate body are representative of these challenges. Although we are

guardedly optimistic that these issues can be addressed, we argue that a longer-term concern is how global economic regimes will cope with the challenges of national industrial policies in the context of this renewed strategic competition. Such policies include both traditional industrial policy as well as new forms of regulation on investment that go beyond the WTO’s Agreement on Trade-Related Investment Measure’s (TRIMs) mandate. In addition, they include trade measures undertaken by states based on national security considerations and the dual-use nature of new technologies.³

“‘Strategic competition’ is once again a salient feature of the international system, with far-reaching implications for the stability of the existing security, political, and economic order... Although we are guardedly optimistic that these issues can be addressed, we argue that a longer-term concern is how global economic regimes will cope with the challenges of national industrial policies in the context of this renewed strategic competition.”

Our work examines the use of economic statecraft across the globe and suggests that the use of these tools is emblematic of strategic competition—a subject of increasing importance following the lessons learned from the 2020 Covid-19 outbreak. The articles within the special issue outline how states are using these tools and point to the implications of this turn for state interaction in the global economy. To this end, we argue for a renewed focus on economic statecraft given the fact that contemporary industrial policy tools, trade restrictions, and new legislation designed to impact cross-border investment, mergers, and acquisitions have become increasingly salient aspects of great power competition between the United States and China. Rather than focusing on economic sanctions and foreign aid, as the existing literature has done, we investigate how changes in the distribution of power across the global and increasingly contested government-firm relations affect geostrategic competition. Together with the move away from negotiations through the WTO, we argue that understanding the impact of new trends on global economic governance requires us to focus on the rapid evolution in technology markets with dual-use potential.

Economic Statecraft in Practice: Industrial Policy, Trade Restrictions, and Investment Rules

From our perspective, economic statecraft must examine industrial policy, trade measures, and investment regulation. Although many of these instruments have been used in the past, we argue that what distinguishes their use in the contemporary environment is a more systematic focus on seeking advantage in sectors of the economy deemed to be strategically important.

Industrial Policy

Arguments about the need to promote nascent industries are often tied to the impact of this industry on a host of allied industries.⁴ Recent fears surrounding the consequences of relying upon Chinese suppliers of 5G technology—and the under-supply of domestic alternatives—in Europe and the United States are emblematic of this concern.⁵ This contributes to a variety of efforts both to proscribe market access to firms that compete with domestic industry as well as incentives to bolster nascent firms in the 5G marketplace.

In the cybersecurity industry, a number of states have used industrial policy to address the under-provision of cybersecurity goods and services. These efforts

include providing venture capital for firms working in the cybersecurity sector, providing government markets for cyber goods, and supporting human capital development for strategic sectors of the economy—even if those trained workers supported by these programs work for private firms.⁶ Governments are also increasingly using regulation (via import and export controls) to address supply chain vulnerabilities—addressing foreign components and applications on the basis of national security.

It is also worth noting that firms may also lobby the government to secure benefits that may have little to do with market failures or security considerations and avoid competition. In the cybersecurity industry along with a number of high technology industries, given the obvious concerns about export control, the temptation to engage in rent-seeking behavior is particularly high.⁷ Thus, we do not claim that industrial policies guarantee any kind of an optimal outcome. The political and economic dynamics of industrial policy are complex and not our focus in this paper.⁸

Trade Measures

As well as industrial policy measures, governments also use various trade measures to manage strategic sectors of their economies. Upon coming into office, it appeared that Trump would slap an across-the-board tariff on Chinese imports as he had threatened to do so as a candidate.⁹ Instead, the Trump administration began with a sector-specific approach.¹⁰ The Trump administration then followed up with a Section 301 (1974 Trade Act) request to the U.S. Trade Representative to explore China’s violation of U.S. intellectual property rights. In March 2018, following a finding an “adverse effect” on the United States, Washington implemented a series of tariff measures, and the Chinese retaliated. Eventually, the U.S. and China reached an agreement on January 15, 2020.

Investment Regulation

From Washington to Berlin and Brussels to Beijing, governments are increasingly turning to new and enhanced regulations in the name of national security to review and block cross-border mergers and acquisitions (M&A). These new review procedures are likely to change global patterns of FDI.

In 2018, the U.S. passed legislation known as the Foreign Investment Risk Review Modernization Act (FIRRMA) to expand the oversight procedures of the existing Committee on Foreign Investment in the United States (CFIUS). The change means that even minority stakes in American companies—including those from venture capital and private equity firms will be subject to scrutiny. Specifically, FIRRMA lowers the threshold for investigating foreign investment to include any foreign “non-passive” investment in companies involved in critical technology.

Although China passed a new law to address concerns about forced technology transfer in 2019, it still has significant oversight of foreign investment through its 2015 National Security Act, focusing on cybersecurity and critical technology.

In continental Europe, France has regulated and blocked FDI since 1966. Its 2019 PACTE Law expands its sectoral overview to AI, data, space, cybersecurity, dual-use goods, robotics, and the like. The bill gives the government the right to suspend voting rights and dividend distributions, appoint a trustee in the company to oversee French interests, and sell French assets. In Germany, previously very open to FDI, the government in 2017 expanded the purview of a 2004 law in the aftermath of concerns about a 2016 acquisition effort by a Chinese company of a German industrial robotics company and a proposed chip company acquisition. Now the scope of review has been expanded to include critical infrastructure, cloud computing, telematics, and some key software. The 25 percent threshold was lowered to 10 percent



Graphics Credit: Peace Palace Library

for sector-specific acquisitions that might impinge on national security, and the scope was expanded to include the media in December 2018.

The UK has also moved forward to strengthen national security reviews of investment, rather than only relying on the existing Competition and Markets Authority (CMA), which is based on a 2002 law that allowed the government to examine mergers based on national security considerations. The new approach, proposed in a July 2018 White Paper, specifies triggering events based on varying levels of shares and assets.¹¹

Prospects for Multilateral Management of Economic Statecraft

Can the WTO or other international institutions play a role in managing this relatively new trend? Given the serious problems that the WTO faces with the failure of the Doha Round and rise of unilateralism, bilateralism, and minilateralism, as well as the crisis of the WTO appellate body, seeking a path for the

WTO to deal with strategic and political competition may seem naïve at best. Yet, there well may be an opening for the creation of international arrangements to play a role in managing the negotiation of bilateral agreements and unilateral controls that create negative externalities. And if created, how these might fit with existing international institutions is also an interesting question.

Managing Economic Statecraft: Unilateral/Bilateral or Multilateral Cooperation?

The first scenario is fairly simple. Economic statecraft can be handled as it is currently being addressed with unilateral industrial policy, trade restrictions, and the creation of domestic regulations on foreign investment—all in the name of national security. It could also be dealt with on a strictly bilateral basis in which agreements like the U.S.-China Phase One agreements are sui generis—mirroring the strategic arms control agreements between the United States and the Soviet Union in the Cold War in which

additional parties were viewed as unnecessary. This story reflects both a lack of demand for the creation of a regime to address economic statecraft, and a lack of a hegemonic supplier interested in addressing industrial policy, trade restrictions, and discriminatory investment rules.

The second scenario reflects the potential for the development of one or more international regimes to address economic statecraft. On the demand side, existing bilateral and multilateral commitments to address issues of economic statecraft represent transaction costs—in terms of investor-state dispute settlement, for example—that a global regime might address. The impetus to address these costs may increase if aspects of economic statecraft are to be included in the mooted agreement between China and the European Union in which protections for foreign investment and market access represent two key areas of negotiations.

With respect to control, a multilateral accord could offer mechanisms for states party to the regime to control the behavior of international actors to their benefit. Washington, for example, might address forced technology transfer while Beijing could safeguard a market for Huawei and ZTE. A regime may also better regulate the behavior of domestic firms that currently engage in technology transfer that governments often see as detrimental to their interests in return for market access.

On the supply side, the situation looks more difficult. Unlike the post-WWII liberal economic order that was led primarily by the U.S. but with some support from the U.K., the story of regime creation with two superpower rivals looks more likely to devolve into two spheres of influence with their own institutions as we saw with U.S.-Soviet rivalry. But for now, the current context remains different in that the U.S. and China are highly economically interdependent—a marked difference from the Cold War. Whether

Chinese and American firms benefitting from their cross-border economic exchange will be enough of a driving force to promote U.S.-Chinese cooperation in regime creation remains unclear.

Continuing in a scenario vein, what does the integration of economic statecraft into these regimes mean for the broader global economic regime? The institutional design of regimes can vary in terms of a variety of parameters including membership, strength, scope, flexibility.¹² What are the alternatives for a “fit” with existing international regimes?¹³ Here, we can consider three potential regime types that might address issues of economic statecraft.

The first potential outcome is the modification of the existing WTO to incorporate new issues relating to economic statecraft. How might this be done? One approach would be an expansion of the issue scope of the GATT as was done with services as part of the Uruguay Round negotiations that created the WTO. Indeed, we have already seen the introduction of investment and intellectual property issues into the WTO. Of these, the TRIMs agreement has been less impressive than the TRIPs agreement, with the latter having a very significant impact on issues such as the regulation of access to pharmaceutical drugs. Yet, at present, with the end of Doha Round negotiations, this seems to be an unlikely path for the moment.

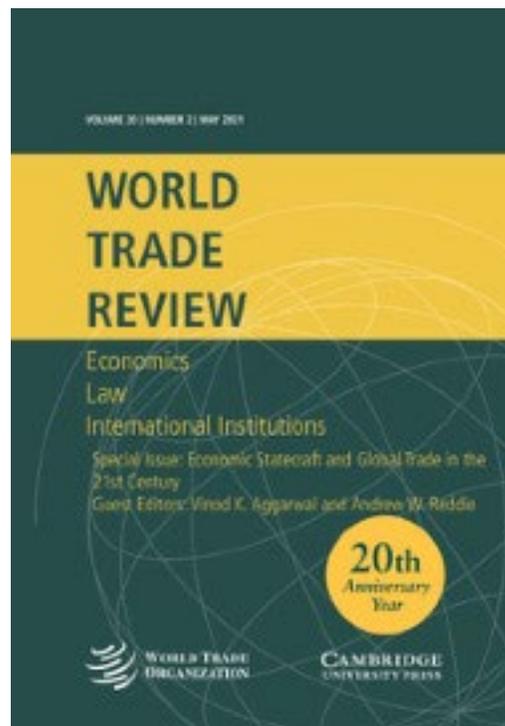
Second, one could envisage the creation of sector-specific agreements in investment and intellectual property that would be broken out of the WTO, with a separate modified meta-regime of principles and norms and a different set of rules and procedures. Optimism on this score might come from the successful negotiation of three open sectoral agreements of the Information Technology Agreement, the Financial Services Agreement, and the Basic Telecommunications Agreement.¹⁴ As in the case of the textiles Long Term Arrangement (LTA) and

its successor, the Multi-Fiber Arrangement (MFA), this would be an example of nested multilayered regimes. It might also be possible to have the creation of regional approaches as was underway with the TPP and TTIP, and the conclusion of the RCEP agreement. Here, the fit with the WTO might be looser.

The final candidate is the creation of an international set of regimes to address economic statecraft on a sectoral basis, which would provide a division of labor or horizontal regimes. In this case, we would see concerns over the need to globally manage of “strategic industries” and “frontier technologies,” but each with its individual characteristics. As a result, it is possible that regimes addressing digital technologies, telecommunications, and biotechnology, for example, might be created that are separated from oversight by the WTO. As an example, the ITA 2 and BTA, among others, could exist—independent of the procedures of the WTO rather than being embedded in them.

For a non-abridged version and full reference list, see World Trade Review special issue “Economic Statecraft and Global Trade in the 21st Century”:

<https://doi.org/10.1017/S147474562000049X>



REFERENCES

- [1] University of California, Berkeley: vinod@berkeley.edu; areddie@berkeley.edu. For research assistance, we would like to thank Tim Marple, Ishana Ratan, and Philip Rogers. Aggarwal would like to thank the Ministry of Education and the National Research Foundation of the Republic of Korea (NRF-2017S1A3A2067636) for research support. Both of us are grateful for the support of the UC National Laboratory Fees Research Program.
- [2] For a non-abridged version and full reference list, see the published article at <<https://doi.org/10.1017/S147474562000049X>>.
- [3] For our purposes, dual-use refers to military and civilian uses of the technologies in question.
- [4] Aggarwal, Vinod K., and Andrew W. Reddie. 2018. Comparative industrial policy and cybersecurity: a framework for analysis. *Journal of Cyber Policy* 3 (3). Routledge: 291–305.
- [5] Brake, Doug. 2018. *Economic Competitiveness and National Security Dynamics in the Race for 5G between the United States and China*. SSRN Scholarly Paper. Rochester, NY: Social Science Research Network. Kaska, Kadri, Henrik Beckvard, and Tomáš Minárik. 2019. *Huawei, 5G, and China as a Security Threat*. NATO Cooperative Cyber Defence Center for Excellence (CCDCOE). Kania, Elsa B. 2019. In *Military-Civil Fusion, China is Learning Lessons from the United States and Starting to Innovate*. *The Strategy Bridge*.
- [6] For an in-depth discussion of the use of industrial policy by U.S. policymakers, see Aggarwal, Vinod K., and Andrew W. Reddie. 2018. Comparative industrial policy and cybersecurity: a framework for analysis. *Journal of Cyber Policy* 3 (3). Routledge: 291–305.
- [7] Ho, Catherine. 2014. Number of Companies, Associations and other Groups Lobbying on Data and Cybersecurity Issues Has Tripled. *The Washington Post*, sec. Capital Business.
- [8] For an analytical review of the political and economic benefits and costs of industrial policy, see Aggarwal, Sonia N., and Vinod K. Aggarwal. 2016. *The Political Economy of Industrial Policy*. BASC Working Paper 16-01. Berkeley APEC Study Center.
- [9] Schneider-Petsinger, Marianne. 2017. Trade Policy Under President Trump. *Chatham House*.
- [10] See CRS 2019 for a detailed discussion of these measures.
- [11] Great Britain, and Energy & Industrial Strategy Department for Business. 2018. National Security and Investment: A Consultation on Proposed Legislative Reforms.
- [12] Haas, Ernst B. 1975. On Systems and International Regimes. *World Politics* 27 (2). Cambridge University Press: 147–174. Aggarwal, Vinod K. 1985. *Liberal Protectionism: The International Politics of Organized Textile Trade*. California: University of California Press. Rosendorff, B. Peter, and Helen V. Milner. 2001. The optimal design of international trade institutions: Uncertainty and escape. *International Organization* 55 (4): 829–857.
- [13] Aggarwal, Vinod K., ed. 1998. *Institutional Designs for a Complex World: Bargaining, Linkages, and Nesting*. New York: Cornell University Press.
- [14] Aggarwal, Vinod K., and John Ravenhill. 2001. Undermining the WTO: The Case Against 'Open Sectoralism'. Asia Pacific Issues. Honolulu: East-West Center.