BASC NEWS

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BASC Staff

Vinod K. Aggarwal, Director
Andrew Reddie, Deputy Director
Margaret A. T. Kenney, Associate Director
Ishana Ratan, Assistant Director
Bettina Boelk, Project Director

Shantanu R. Kamat, Research Assistant
Ellen Wu, Research Assistant
Luca Zislin, Research Assistant

DIRECTOR'S NOTE

Dear Colleague,

Thank you for your continued interest in the Berkeley APEC Study Center (BASC). Through your readership, we are excited to continue being part of an interdisciplinary conversation regarding the dynamics of the increasingly critical Asia-Pacific region.

The articles in this newsletter reflect the work that BASC has been doing on these fronts over the last year. To begin, we are pleased to present an adapted version of a published article by *Asia and the Global Economy* that is a part of our "New Economic Statecraft Project." I join BASC Deputy Director Andrew Reddie in examining the new reality of economic statecraft in the twenty-first century and its unique consequences for international institutions.

We are also excited to present a series of research analyses that examine the range of strategic, economic, technological, and energy concerns that BASC has been addressing. Associate Director Margaret Kenney discusses how U.S.-China tensions are affecting the structure of international political economy through the prevention of mergers and acquisitions and the breakup of multinational firms. Our undergraduate Research Assistant, Shantanu Kamat discusses the U.S.-Taiwan Initiative on 21st-Century Trade, arguing that this project could serve as an example of "benign economic statecraft." Project Director Bettina Boelk then provides an analysis of the European Union's Foreign Subsidies Regulation, with a focus on how this regulation will affect both the internal and external markets in an era of increasing subsidies worldwide. Finally, undergraduate Research Assistant Luca Zislin responds to the idea of managing U.S.-China tensions through "collective resilience."

We hope this newsletter will enhance your understanding of the Asia-Pacific region. BASC is especially grateful for the generous support from the Institute of East Asian Studies, the Social Science Matrix, the Center for Chinese Studies, and the Center for Korean Studies for our cooperative projects. We are also deeply grateful for the UC National Laboratory Fees Research Program's sustained support and our collaboration with the UC Institute on Global Conflict and Cooperation and the Taipei Cultural and Economic Office in San Francisco. Finally, we are also deeply grateful for the sustained support of the Korea Foundation, Institute of the National Interest at Chung-Ang University, the Center for Global Partnership of the Japan Foundation, the Ron and Stacey Gutfleish Foundation, the Notre Dame Pietas Foundation, and our ever-expanding group of former BASC alums.

Through our supporters, collaborators, and colleagues like you, BASC has the privilege of advancing the discussion on a range of critical economic and security issues in increasingly unprecedented times. We look forward to continuing our dialogue for years to come.

Vinod K. Aggarwal
Director, Berkeley APEC Study Center
Distinguished Professor and Alann P. Bedford Chair in Asian Studies, Travers Department of Political Science;
Affiliated Professor, Haas School of Business

Searching for Global Equilibrium:

How Economic New Statecraft Undermines International Institutions

By Vinod K. Aggarwal and Andrew W. Reddie

Graphics Credit: REUTERS/Phil Noble

Governments have increasingly intervened in markets with the goal of advancing their foreign policy objectives. In previous work we have labeled this trend "new economic statecraft."[1] Specifically, in our research we have focused on how government–firm relations affect geostrategic competition—rather than the older literature's focus on economic statecraft that emphasizes policies related to economic sanctions. From our perspective, understanding variation in how different countries pursue new economic statecraft is of key importance.[a] But of even greater import is the question of the future of the global economy in a world characterized by high levels of state intervention. Thus, this paper's goal is to understand the extent to which we might be able to constrain this neomercantilist turn through some types of international agreements—be they sectoral or overall bilateral, minilateral, or multilateral accords.

We begin by presenting our theoretical framework to explain the determinants of state intervention in high technology industries. To this end, as our dependent variable, we outline three types of state intervention: behind the border, at the border, beyond the border, and the drivers of state intervention. We then turn to the central thrust of this paper, with an eye to evaluating the likelihood of successful management of

[a] Yet distinguishing between what might simply be seen as traditional domestic lobbying by rent-seeking firms versus "strategic" intervention by states is not a simple matter. As *The Economist* (2020) notes, the key question facing policymakers is which economic activities have strategic consequences for the state—with the attendant risk of all economic activities being designated as important for international security.

new economic statecraft in the global economy via different kinds of international arrangements.

State Intervention in Trade and Investment[b]

How might we understand state intervention in technology markets? Scholars have pointed to various types of state intervention in national markets that have effects on the global economy including economic sanctions, tariffs, quotas, subsidies, and industrial policies.[2] Rather than treat each of these measures individually, this article, building on our previous work, outlines three types of trade and investment policies—at the border, behind the border, and beyond the border—that encapsulate interventions that are both collectively exhaustive and mutually exclusive.

Trade Policy

Trade policies *at the border* "discriminate against foreign goods, companies, workers and investors."[3] These interventions can take a variety of forms including import-taxing tariffs which make domestic goods more competitive than their foreign counterparts. Governments may also tax exports if they want to keep specific types of goods inside the country. Quotas operate similarly in that they limit goods arriving in, or exported from, the country. Customs regulations represent an additional border measure that adds friction to the trade process—with attendant consequences for the competitiveness of imports and advantages for local firms.

In addition to these policies at the border, there are several *behind-the-border* measures that affect trade patterns. Often, these are described as measures used to drive "backdoor" or "murky" protectionism.[4] The most obvious behind-the-border trade measure is a regulatory environment manipulated to discriminate against a foreign good or service. Regulatory standards, whether binding or voluntary, have an impact on market access as do localization rules.

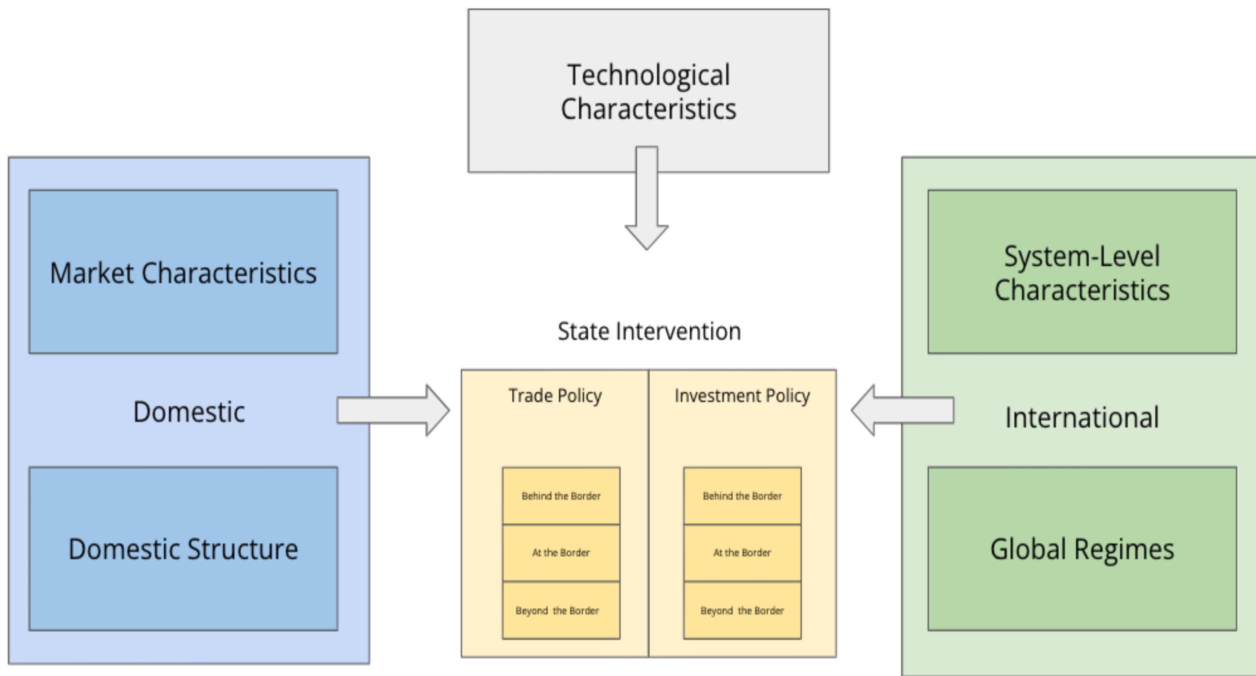
States also act to shape trade policy *beyond their border*—via institutional arrangements at the regional or global level or through various investment or trade promotion efforts. Institutions can shape the rules governing various types of intervention—with some institutions being more or less restrictive in terms of what policies member states are expected to adopt and which actions they are expected to avoid. Trade promotion efforts often take place through a variety of export promotion agencies to help national exporters penetrate foreign markets.

Investment Policy

Investment policy offers a second vehicle for states to intervene in their domestic markets. The most obvious intervention *at the border* are rules concerning foreign direct investment. Governments might limit shareholding of a publicly held firm to a specific percentage or review foreign acquisitions of domestic firms based on national security considerations. For example, in the United States, the Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018 expanded the jurisdiction of the Committee on Foreign Investment in the United States (CFIUS) to address mandatory filing requirements for investments involving foreign governments, as well as foreign investment in firms deemed to represent critical infrastructure.[5]

Governments also influence direct and indirect investment *behind the border*. Traditionally, this type of state behavior has been captured in the context of industrial policy.[6] In terms of direct investment, governments often involve themselves directly in specific sectors of the economy or create state-owned vehicles that operate on their behalf. Governments

[b] Currency intervention can also influence technology, but here we focus on trade and investment.



may also identify specific firms in which to invest and regulate both within the home country and abroad. And governments also pursue indirect investment in strategic industries through human capital development programs.

States also act to shape investment policy *beyond their border*. For example, states may play a role in third-party markets by dictating rules for market access for firms beyond their borders. For example, a state might only provide market access to a foreign firm if it creates a local subsidiary or otherwise adds value to local labor markets. In addition, global and regional institutions can be used to influence technology policies as we will see later in this article.

The Drivers of State Intervention

In an attempt to explain this variation, we suggest that domestic politics (e.g., bureaucratic politics), market dynamics (and particularly firm-state relations), technological characteristics of a given industry, dynamics of the international system (e.g., polarity), and the contours of international cooperation (via intergovernmental organizations) combine to shape the types of interventions that we see across various domains—from cybersecurity markets to the markets for nuclear energy. Figure 1 illustrates our conceptual framework.[c]

3. International Agreements and Constraining New Economic Statecraft

Neoliberal economists argue that states should eschew the temptation to intervene in their domestic markets. If they follow this advice, then we will also find ourselves in a global equilibrium, with the global economy consisting of firms competing "fairly" in both domestic and international economy.

To the extent that states might be tempted to intervene—say under pressure from domestic lobbies or for strategic objectives—from a neoliberal institutional approach, they would be constrained by the institutions developed in the 1940s—the GATT (and the WTO after 1995) and the IMF. Over time, however, we have seen increasing intervention in the domestic and international economies, thus putting

[c] For a more thorough discussion of these factors see Aggarwal and Reddie, 2020.

Table 1: Classifying Trade Agreements

		Bilateral		Minilateral		Multilateral (globalism)
		Geographically concentrated	*Geographically dispersed*	*Geographically concentrated*	*Geographically dispersed*	
PRODUCT SCOPE	**Few products (sectoral)**	US-Canada auto agreement (1965)	US-Japan digital agreement (2019)	European Coal and Steel Agreement (1952)	Multi-Fiber Arrangement (1974) Information Technology Agreement (1997)	International Telecommuni-cations Union
	Many products (broad)	US-Canada FTA (1987)	Korea-Chile FTA (2003)	European Union AFTA (ASEAN Free Trade Agreement) (1993) USMCA (2020)	CPTPP Comprehensive and Progressive Agreement for Trans-Pacific Partnership (2018) RCEP (Regional Comprehensive Economic Partnership) (2022)	WTO (World Trade Organization)

increasing pressure on the WTO. The refusal of the Trump and Biden administrations to appoint appellate judges has led to a major crisis of the dispute resolution mechanism, calling into question the ability of global trade institutions to manage conflict.

The question we now consider is: if we continue to see the pursuit of new economic statecraft by states, what are the prospects for the management of the global economy? Put differently, is there some obvious equilibrium in light of a turn to neomercantilist policies? To address this issue, we begin by presenting a framework to think about institutional arrangements, and then address both sectoral and overall bilateral, minilateral, and multilateral options to constrain new forms of economic statecraft.

Table 1 provides an approach to classify economic accords, focusing on trade agreements for presentational purposes.[d]

The table has two dimensions, actor scope (bilateral, minilateral, and multilateral) on one axis, and product scope on the other (few products or sectoral and many products). In looking at types of agreements, we can also further distinguish between geographically dispersed and geographically concentrated accords, which is an important dimension from a political standpoint, but we which do not investigate in detail here. To illustrate the types of agreements, we provide examples in each of these cells.[e]

[d] This table is adapted from Aggarwal, 2001, without "unilateral" approaches to trade as this paper focuses on agreements. For an example that includes monetary arrangements, see Aggarwal and Dupont, 2002.

[e] Note that agreements in trade in each cell can be liberalizing or restrictive.

4. Bilateral Approaches

Below, we begin by examining bilateral approaches to dealing with trade issues with examples. Under Article 24 of the GATT/WTO, free trade agreements and customs unions are allowed, but the countries must "substantially" eliminate tariffs and other trade barriers on "substantially all the trade" between them. This implies that the agreement should cover a significant portion of the trade, and exceptions are allowed but should be limited. This restriction has generally served to dissuade countries from pursuing sectoral agreements, and for the most part, FTAs have met the Article 24 provisions. We first look at sectoral approaches, before turning to broader agreements.

4.1 Bilateral Sectoral Approaches

In October 2019, Japan and the U.S. signed a free trade agreement enhancing market access for specific agricultural and industrial products.[7] Specifically, the United States agreed to reduce or eliminate 241 tariffs primarily on industrial goods—a measure essential to the continued viability of the Japanese automotive sector. In return, Japan agreed to provide increased access to U.S. agricultural products, including beef, pork, wheat, dairy products, and certain fruits and vegetables. The agreement also sought to deal with some of the challenges associated with digital trade, with the parties agreeing to ensure the free flow of data and provisions on preventing data localization requirements.

4.2 Bilateral Broader Approaches

Currently, the United States has concluded twenty bilateral or trilateral FTAs. It also has forty-eight bilateral investment treaties.[8] Both of these types of agreements are reasonably comprehensive and fit into the "broad" category of Table 1.

Reflecting some of the quid pro quo aspects of the bilateral sectoral approaches above, the U.S.-China trade deal of 2020 followed three years of acrimonious negotiations between Beijing and Washington before arriving at a "phase one" trade deal on January 15.

The "phase one" deal responded to developments since March 22, 2018, following the US Trade Representative's determination under Section 301 that Chinese practices and policies related to technology transfer, intellectual property, and innovation are unreasonable and discriminatory. The United States argued that China uses unfair trade practices and intellectual property theft to bolster its economy, while the latter believes that the United States is trying to curb China's rise as a global economic power. As part of this dispute, the United States imposed tariffs on $375 billion of Chinese goods and had threatened to impose tariffs on $160 billion on 15 December 2019. For its part, China had retaliated with tariffs on more than $110 billion of US products.

The deal focused on intellectual property protection, U.S. exports to China, and monetary flows. It also included a bilateral dispute resolution mechanism. Some specific industries that were the subject of the agreement were pharmaceuticals, financial services, and food and agriculture. In addition, the deal addressed forced technology transfer and more broadly, macroeconomic policies and exchange rate matters and transparency. Most significantly, the deal calls for China to increase manufactured goods by $77 billion, agriculture by $32 billion, energy by $52 billion dollars, and services by about $38 billion, for a total of $200 billion.[f]

What was left out? Most tariff reductions were left to the future (and most tariffs have been continued under the Biden administration). The deal did not lessen U.S. pressure on Huawei, ZTE, and other Chinese firms. This despite the fact that the Chinese government was unequivocal about wanting the United States to drop its sanctions on Huawei and other Chinese technology firms while relaxing restrictions on Chinese investments in the United States.[9] In particular, with the new U.S. Foreign Investment Risk Review

[f] See Annex 6.1 of the Phase One Agreement

Modernization Act (FIRRMA) procedures that enhance CIFIUS review (Committee on Foreign Investment in the US), the Chinese investors face significant and new barriers to investment in Silicon Valley—a vehicle that the U.S. alleges Chinese government-affiliated firms leverage to siphon intellectual property.

With the advent of COVID-19 amid increasing tensions between Washington and Beijing, China did not meet obligations under the deal: it "purchased 62% of the manufactured products, 76% of the agricultural products, and only 47% of the energy products it committed to under Phase One."[10]

Importantly, both forms of bilateral engagements sought to liberalize and avoid protection in circumstances where governments recognized a mutual interest in doing so. Given the broader context of rising competition between Beijing and Washington, the latter example is particularly interesting—though its subsequent performance provides fodder both to the agreement's supporters and detractors.

5. Minilateral Approaches

As with bilateral agreements, minilateral accords have also been both sectoral and multiproduct. The classic minilateral regional sectoral agreement was the two-sector European Coal and Steel Agreement of 1952, that set in motion the creation of the European Union. In addition, the oldest product specific accord that spanned regions was the agreement on textiles and apparel. This multilateral accord began with the 1961 Short Term Arrangement on Cotton Textiles (STA), eventually becoming the Multi-Fiber Arrangement in 1974, and then started to be phased out at the beginning of 1995 (and eliminated in 2005). On a minilateral sectoral opening basis, the Information Technology Agreement (ITA) came into being in 1997, and then was championed as a model for other sectors. For example, the Global Agreement on Basic Telecommunications, has been in effect since 1998, and the Financial Services Agreement (FSA) to liberalize trade in banking, insurance, and securities, in effect since April 1999.

Minilateral mega-FTAs such as the Trans-Pacific Partnership (TPP), the proposed Transatlantic Trade and Investment Partnership (TTIP) with the U.S. and EU, and the Regional Comprehensive Economic Partnership (RCEP) with 14 countries in 2022 are increasingly common in light of the problems of the WTO, which we discuss in Section 6. The logic of sectoral liberalization within minilateral institutions is that industry specific accords might decrease the problem of broader geopolitical conflict.

5.1 Minilateral Sectoral Approaches

The agreements on textiles and apparel are instructive on how unilateral and bilateral measures in the pursuit of new economic statecraft might evolve into a sector specific regime.[11] Briefly, in the 1950s, increasing imports of Japanese and Hong Kong textiles and clothing spurred the United States, the United Kingdom, and several European countries to impose unilateral restrictions or negotiate bilateral agreements with exporters. The United States successfully persuaded the Japanese to restrain their exports of cotton textiles and clothing, putting export diversion "pressure" on other countries. The United Kingdom also pressed India, Pakistan, and Hong Kong to commit themselves to a slower rate of British market penetration. Finally, the continental European countries, simply slapped import quotas against all "offending" LDC suppliers.

Following negotiations among importing and exporting countries, the STA was created as a stopgap in 1961 and was succeeded the following year by the Long Term Arrangement on Cotton Textiles (LTA). This sector-specific international regime, nested within the GATT, proved to be a negotiated outcome that met American goals and political constraints. The regime called for guaranteed growth rates in imports of 5 percent or negotiated bilateral agreements that

could allow more. Since the LTA only regulated intervention in cotton products, however, exporters shipped more wool and man-made fiber products. With such imports growing, developed country domestic producers responded by successfully pressuring their governments to impose restraints on these goods. Faced again with the prospect of growing numbers of bilateral and unilateral measures, the U.S. government sought to expand the LTA to encompass trade in man-made fiber and wool-based products. In 1974, the Multi-Fiber Arrangement (MFA) replaced the LTA. It was renewed in 1977 and 1981, and then set on a trajectory for elimination in 1995 with conclusion of the Uruguay Round of the GATT. By 2005, trade in textiles was opened up completely for the most part. (China continued to restrict exports for some years as part of the deal.)

Similarly, the Information Technology Agreement (ITA) focuses on the elimination of tariffs and trade barriers for information technology products. The idea of an international agreement to liberalize trade in IT products began to take shape in the 1980s. Governments and industry representatives recognized the increasing importance of the IT sector and the need for a global framework to promote the flow of IT products across borders. During the Uruguay Round of the GATT, however, progress was slow. The ITA officially came into being in 1996 with twenty-nine members, with negotiations taking place outside the WTO framework. The initial signatories of the ITA included major economies such as the United States, the European Union, Japan, Canada, and others. Over time, the agreement gained support from an increasing number of countries (currently eighty-two members), with members committing to eliminating tariffs on a broad range of IT products. In 1997, the ITA was brought under the umbrella of the WTO. In 2015, the ITA expanded to include additional products and now covers 97 percent of global trade in IT products.[12]

5.2 Minilateral Broad Approaches

More recently, states have turned to minilateral approaches that go far beyond single sectors. For example, the Trans-Pacific Partnership (TPP) of twelve countries built on the 2006 Trans-Pacific Strategic Economic Partnership (P4) among Brunei, Chile, New Zealand, and Singapore.[13] The TPP was ambitious and wide-ranging from multiple vantage points, including numerous issue areas and types of goods and services covered in its thirty chapters, with attention to tariff and non-tariff trade barriers, and a large portion of the world economy represented.

The TPP included many digital trade concerns reflecting the centrality of trade in technology to regional and global markets. For example, Chapter 14 of the TPP addresses cross-border data flows. Other articles in Chapter 14 prohibit localization requirements for servers and data centers, by which a government would require a company "to use or locate computing facilities in that Party's territory as a condition for conducting business."[14]

Despite its thoroughness, or maybe because of it, the TPP was not to be. In his presidential campaign, Donald Trump blasted the TPP and free trade, and upon assuming office, withdrew the United States from the agreement in January 2017.[15] The next year, led by Japan, the remaining eleven countries finalized the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP).[16] The agreement went into force for six countries in December 2018, with the five other countries formally becoming party to the agreement between 2019 and 2023.

The CPTPP shares most of its provisions with the TPP, and the two agreements can be considered nearly identical.[17] However, the CPTPP suspends twenty-two provisions of the TPP. For example, government procurement and labor rules have been altered. The scope of investor-state dispute settlement was also narrowed. The vast majority of the provisions in the agreement, however, were unchanged including chapters about e-commerce and provisions about digital trade—such as those that promote the free flow of information across borders and prohibit computing facility data localization requirements.

In terms of future membership, South Korea is widely seen as a likely applicant to join, and Thailand and Colombia may consider applying as well.[18] So far, China, Costa Rica, Ecuador, Taiwan, Ukraine, and Uruguay have all applied to join the CPTPP. China applied to join in September 2021, which was seen as a symbolic slight to the United States, which initially served as an architect of the TPP in part to counter Chinese economic influence in the Asia-Pacific via its own minilateral initiatives. In the short term, however, it is unlikely that China will be granted membership. The United States has shown little interest in rejoining the agreement that it pioneered. The first new member to successfully join the original CPTPP grouping was the United Kingdom, which became a member in July 2023.

A second key mega-FTA is the Regional Comprehensive Economic Partnership (RCEP), trade among 15 countries in the Asia-Pacific region, including ASEAN member states and five other countries—Australia, China, Japan, New Zealand, and South Korea. Despite being involved in negotiations, in the end India chose to withdraw from RCEP owing mainly to concerns about the competitive threat to its agriculture and manufacturing sectors. The agreement creates an integrated market, spanning over 2.3 billion people, with a combined GDP of $26.3 trillion.[19] The agreement also includes provisions for intellectual property rights, aiming to provide comprehensive and high-standard protections.[20] Moreover, RCEP includes commitments to facilitate cross-border data flow, which is crucial for e-commerce activities.[21]

The RCEP pact has clauses that pertain to e-commerce. Recognizing the escalating role of digital tech in boosting international trade and investment, the agreement seeks to encourage the utilization of digital platforms and tools within the region. For instance, Article 13.1 of RCEP specifies that no customs duties or additional fees should be levied on electronic transmissions, including those for e-commerce. It also contains clauses concerning data movement and data localization. RCEP disallows data localization mandates, except under particular conditions.

Interestingly, many of the provisions included in the TTP have close cousins within RCEP—for example, even intellectual property received a provision (18.3) within RCEP, despite long-held claims that China has been engaged in efforts to undermine the intellectual property of firms and governments in the West (whether via local joint transfer requirements for foreign firms to receive market access or more surreptitious efforts to get access to IP).

While it would be unfair to characterize RCEP as wholly benefitting China (indeed, all states party to the agreement have to be convinced to sign it), its rules tend to be looser than arrangements that might involve the United States and European states, while also focusing on trade issues of proximate concern to China.

6. Global Approaches

By and large, in trade, the WTO has been the dominant arrangement to manage global trade and address disagreements among state parties. In investment, no broad international agreement has been developed despite various efforts to do so with the Multilateral Agreement on Investment (MAI). Discussion of such an accord began in the early 1990s under the auspices of the Organization for Economic Cooperation and Development (OECD). The goal was to create a comprehensive international agreement that would standardize rules for the treatment of foreign investors across participating countries. Opposition from various NGOs and governments, however, led to the collapse of the proposed accord in 1998.

Aside from the WTO, we have seen sectoral specific accords, with the International Telecommunication Union serving as a prime example. There have also been efforts to expand the purview of the WTO to include intellectual property and investment measures. We turn to these issues now.

6.1 Global Sectoral Approaches

The ITU traces its roots back to the International Telegraph Union, established in 1865 to promote international cooperation in telegraphy. As technology advanced, telephony and radio communication became prominent. The ITU expanded its scope to include these new technologies, leading to the International Telecommunication Convention in 1932. In 1947, the ITU underwent a major restructuring after World War II. The International Telecommunication Convention of 1947 established the ITU as a specialized agency of the United Nations.

The ITU continued to expand its purview in the post WWII period. In the 1960s, the advent of satellite communication brought new challenges and opportunities. The ITU played a crucial role in coordinating the allocation of satellite orbits and frequencies, ensuring the efficient use of these resources. In the 1980s-1990s, the ITU adapted to the digital revolution, addressing issues related to the standardization of digital communication technologies, including ISDN (Integrated Services Digital Network) and later, the development of standards for video conferencing over the internet.

The move toward the privatization of state-owned telecommunications companies in the 1990s led the ITU to focus on creating a regulatory framework that could accommodate these changes while ensuring fair competition and access to telecommunication services. It also played a role in internet governance after 2005, serving as a forum for discussions surrounding internet governance, including the role of governments, the private sector, and other stakeholders.

In recent years, the 193-member ITU has been actively involved in promoting the deployment of broadband infrastructure and facilitating the transition to 5G technologies. It continues to work on global standards for telecommunications to ensure interoperability and connectivity. While some might see this type of organization as a model for addressing the challenges of new economic statecraft, it is worth noting that there are significant fears that "global" arrangements can be captured by the interests of particular states. This was particularly pronounced in light of proposed changes to the internet governance regime in the early 2010s, with the United States and European states favoring the maintenance of the existing multi-stakeholder governance model via ICANN and its associated institutions (that ostensibly put governance in the hands of scientists and engineers), while China and Russia favored moving the responsibility for internet governance to the ITU where they might be able to better to influence governance arrangements.

This also raises the question of whether there are potential sectoral arrangements that might avoid the worst excesses of economic statecraft by shifting responsibility of governance arrangements to technical bodies. For example, the International Standards Organization has a standing committee for artificial intelligence technologies that is likely to play a significant role in setting the standards for red-teaming and model disclosure for the private sector (though, notably, not for military applications).

6.2 Global Broad Approaches

In contrast to sectoral approaches, the WTO remains the premier venue for global trade concerns. Can the WTO provide an avenue to address the rise of industrial policy and the various other tools of economic statecraft? Currently, the United States has blocked the appointment of judges to the appellate body of the WTO, and a number of trade measures that it has used are clearly a violation of WTO norms, if not rules.

The WTO's challenges are prominently centered around a deadlock in rulemaking and negotiation processes and a perceived inadequacy in addressing contemporary trade issues—particularly as it relates to digital trade, intellectual property rights, labor standards, environmental sustainability, and non-tariff barriers (e.g., phytosanitary standards). Efforts to negotiate new trade agreements and update the WTO's rulebook have faced stagnation due to conflicting interests among member nations, particularly the

divergence between developed and developing countries. The organization's effectiveness in navigating these pressing issues has been called into question, contributing to concerns about its ability to fulfill its role as a promoter of free and fair global trade.

7. Conclusion and Prospects

Can new economic statecraft be constrained through bilateral agreements or international institutions? To be blunt, the success of existing global institutions appears unlikely to succeed in the context of rising industrial policy in China, the United States, and Europe. So where might progress be made? Let us review the options.

First, 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. This would essentially mean no constraints of an international arrangement.

Second, we could imagine a strictly bilateral approach along the lines of the U.S.-China Phase One agreements. We did see *sui generis* accords in the past, and we could see an imitation of the strategic arms control agreements between the United States and Soviet Union in the Cold War in which additional parties were viewed as unnecessary. Relevant to U.S. concerns about technology and investment, the agreement obliges China to address intellectual property and concerns surrounding technology transfer—particularly in relation to acquisitions, joint ventures, or other investment transactions. But the Chinese have shown little interest in implementing this accord, and 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.

A third scenario is a minilateral overall or sectoral approach. Currently, however, the United States is not a member of either the CPTPP (which China has shown interest in joining) and is also not a member of RCEP. Instead, the United States has embarked on a new strategy to engage with the Asia-Pacific region via the Indo-Pacific Economic Framework for Prosperity (IPEF) proposed by President Joe Biden in May 2022.[22] Critically, however, IPEF does not cover market access, owing to U.S. domestic conflicts over trade liberalization. The only international accord in which both the United States and China participate relevant to new economic statecraft (aside from the WTO) is the Asia-Pacific Economic Cooperation forum. It may be possible for issues related to economic statecraft to be brought up in this grouping, but APEC has not been known for any binding agreements. But it could be a starting point.

Finally, we can envision two scenarios involving multilateral institutions.[23] The first would be to adapt an existing institution like the ITU, independent of the WTO, to address NES issues on a market-by-market basis. Alternatively, in this vein, one could image some kind of issue specific agreements on key issues areas such as cyber, AI, synthetic biology, and quantum on a primarily technical basis. In this case, we would see concerns over the need to globally manage "strategic industries" and "frontier technologies," but each with its individual characteristics.

A second multilateral scenario would involve the modification of the existing WTO to incorporate new issues relating to economic statecraft. At present, as academics have noted and as U.S. policymakers such as Peter Navarro and Robert Lighthizer under Trump noted, the WTO has failed to reign in a variety of Chinese industrial policy efforts. How might this be done? One approach would be an expansion of the issue scope of the GATT 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 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.

A third multilateral approach would be the creation of sector specific agreements in NES issues that would be nested within the WTO (as in the case of the STA/LTA under the GATT), with a separate modified meta-regime of principles and norms and a different set of rules and procedures.[24]

Optimism on this score might come from the successful negotiation of three open sectoral agreements: the Information Technology Agreement, the Financial Services Agreement, and the Basic Telecommunications Agreement.[25] As in the case of the STA/LTA and its successor, the MFA, this would be an example of nested multilayered regimes.

This article was originally published by *Asia and the Global Economy* in December 2023, which can be found here.

The Geopolitical Impacts of Investment Restrictions and The Liability of Being Multinational

By Margaret Kenney

Graphics Credit: Anthony Wallace/Agence France-Presse/Getty Images

On 9 August 2023, the Biden administration released a long-awaited executive order detailing new investment rules for private equity and venture capital firms in "countries of concern."[26] In this case, Biden is referring specifically to the risks of investing in China, Hong Kong, and Macau. The rules ban investments in certain Chinese high technology companies within the semiconductor, quantum computing, or AI sectors.[27] In addition, the order creates a notification regime if private equity or venture capital firms would like to invest in Chinese high technology companies. The United States has never before placed explicit bans / restrictions on outbound investment, instead focusing on incoming funds; therefore, some are dubbing the bill "reverse CFIUS." The order will enter a period of notice and comment before taking effect, offering industry, government, and civil society (among others) an opportunity to provide feedback. In its current form, the executive order is particularly narrower than previously expected; Republican legislators expressed frustration following its publication that the order did not go further in regulation of more industries / sectors. However, the order leaves the door open to the addition of more industries that could become politically sensitive and important for national security.

With the Chinese economy already in a difficult position following the COVID-19 pandemic and the crackdown on U.S. companies internally, there are significant concerns about how this executive order could impact China's ability to sustain firm innovation and performance. Prior to this action, FDI into China had fallen by 89 percent from the previous year.[28] Beijing, with an unequivocal denunciation of the

order, called attention to its anti-competitive and anti-free market nature. The PRC spokesperson stated that: "the move's real aim is to deprive China of its right to develop and selfishly pursue US supremacy at the expense of others." In the remarks, Beijing also reserved the right to respond, leaving U.S. investors nervous about the potential for backlash specifically in export controls of rare minerals (as one example).[29]

This investment restriction will have significant implications for the structure of the international system and international political economy. Namely, the crackdown on international cooperation may result in the localization of firms and a "liability of being multinational." With heightened tensions between the United States and China, firms are increasingly being caught in the crossfire of their geopolitical conflict with major impact on their business operations and profit margins.

Strange (1996) argues that "the internationalization of production is slowly but surely undermining the whole concept of nationality" (57). Despite these scholarly discussions that companies are becoming increasingly multinational and "stateless" as a result of globalization, Wellhausen (2014) demonstrates that nationality is still salient to firms as it provides them cover (through BITs) from foreign government expropriation. I argue that the recent developments in the U.S.-China trade war will only heighten the localization of firm's identity and increase the liabilities of operating as a "stateless" MNC. It may instead be preferable for the firm to divide into concentrated domestic firms, rather than operating as a worldwide conglomerate. Localization will occur through two mechanisms: (1) the breakup of multinational investment firms into regional or localized firms to avoid scrutiny and (2) the decrease in mergers and acquisitions of high technology firms because of a lack of cooperation between the United States and China.

Regardless of the Biden administration's assurances that they are not pursuing decoupling, the localization of firms to avoid U.S. or Chinese scrutiny will have significant policy implications. There will be significant effects on the investment environment, as firms face increased operating costs and avoid the Chinese market due to potential liabilities. In addition, the breakdown of firms will permanently cement the increasing lack of consensus and cooperation in the business community. Finally, the response of U.S. firms to this executive order will provide insight into business's willingness to cooperate with Biden's economic statecraft: a record that has proven so far dismal. A new administration could roll back these controls fairly easily, given that they take the form of an executive order rather than congressional statutes; however, once firms begin to fragment and localize, there will be path dependency given the costs and difficulties of undertaking these large-scale changes. In addition, national security concerns in regard to China are one of the few bipartisan issues in the highly polarized American political system; Biden maintained the majority of Trump's orders in regard to China. Therefore, these policy implications will have long-run consequences for the structure of the international system and U.S.-China conflict.

Mechanisms

Firm localization

The new investment restrictions incentivize localization to avoid scrutiny of high technology investments in both the United States and China. Many firms may prefer to break up operations into multiple entities, rather than removing all investment in China, given the potential payoffs of Chinese startups (e.g. success with ByteDance) and their large consumer market. With the potential for the executive order to expand into additional sensitive sectors, investment firms will have to weigh the costs of complying with the costs of operating separate national entities in comparison to the threats of the investment bans and notification regime.

As an example, Sequoia – a venture capital (VC) firm – has already initiated this localization process (prior

to the EO). Sequoia had been under significant scrutiny due to their investment practices in China. The VC firm had invested in an artificial intelligence startup which eventually became a contractor for China's People's Liberation Army (PLA).[30] Although perhaps unexpected by the VC investors, this situation highlights the U.S. concerns with investment in sensitive technologies and how they can be operationalized outside the commercial context to heighten China's military stature. Firm behavior and national security are now inextricably linked due to dual use technologies.

In part because of the pushback as a result of geopolitical tensions, Sequoia announced that they would separate into three separate businesses: Sequoia Capital (US), HongShan (China), and Peak XV Partners (India and Southeast Asia).[31] The partners of these three companies stated: "To deliver on our mission, we have decided to fully embrace our local-first approach."[32] Once the businesses separate in March 2024, they will no longer share a back office, infrastructure, or profits.[33] Although the firm predicts that its investor base will continue to stay the same after the split, the increase in operational costs will surely have an impact on the firm's capabilities and investment potential.[34]

With the U.S. now implementing explicit limitations on investment in sensitive sectors, it is likely that other venture capital and investment firms will face similar trade-offs and even greater pressure to avoid risky cross-national investments. To evade U.S. scrutiny and investigation, these businesses may choose to disentangle their multinational business portfolios (like Sequoia) and localize, rather than test the boundaries of the investment regulations.

Prevention of mergers and acquisitions

Along with the breaking up of companies, U.S.-China competition has prevented the concentration of industries and consolidation of companies through mergers and acquisitions. China, the United States, and the European Union have created extensive regimes to regulate antitrust. New amendments to China's 2007 Anti-Monopoly Law called for increased scrutiny of potential monopolistic behavior and raised fines for participating in monopolistic behaviors in 2022.[35] If the merger involves firms that make more than $117 million per year in China, they are required to undergo review by the Chinese State Administration for Market Regulation.[36] There are certainly legitimate reasons to deny a proposed merger and acquisition, particularly if it would violate antitrust rules and create a monopoly within an industry. However, this lever of power seems to have been politicized based on geopolitical tensions and may continue to be used as such. In addition, the increase in staff and concentration of review inside the Chinese State Administration for Market Regulation make it clear that these developments are not merely a result of unintended slow bureaucracy, but a purposeful slowdown to impact U.S. business interests.[37] Given the number of firms that meet the threshold for Chinese antitrust review, the agency's actions will have far-reaching consequences.

As one example, Intel (a semiconductor manufacturer based in the United States) had hoped to acquire Tower, an Israeli chip manufacturer, to expand its production of chips. Despite approval by U.S. and EU antitrust regulators, Beijing refused to provide a ruling on the transaction.[38] Intel had allocated extensive efforts toward liaising with Chinese officials to move the transaction forward, with the CEO visiting China in July 2023 in a final push to receive a ruling on the merger.[39] However, the Chinese anti-monopoly regulators never responded to the request and the merger expired, requiring Intel to pay a $353 million fine for failing to close the deal.[40]

The merger would have allowed Intel an opportunity to expand its chip manufacturing and production; given the sensitive nature of this technology and its applications, especially with the concentration of production in Taiwan's TSMC, it appears that the Chinese government was nervous about the United States continuing to build these capabilities and preventing their export to Chinese markets. With the CHIPS Act simultaneously providing significant

funding to Intel's chip development,[g] this merger appeared to be another threat to China's desire for military and technological growth.

In addition, the merger between U.S.-based Broadcom Inc. and VMware faces similar bureaucratic hurdles in China. With the merger slated to close on 30 October 2023, Broadcom announced that the deal will "close soon" after missing this initial deadline.[41] The effects on investment are not trivial; the failure to close the deal has resulted in investors feeling spooked and a significant loss in stock market value.[42] Beyond the case of Intel and Broadcom/VMWare, other examples of China's silence on merger and acquisition approval include Qualcomm's 2018 attempted purchase of NXP. Similar to the other two cases, the chipmakers did not receive China's approval ahead of the merger deadline; "the failed deal was considered a victim of the growing U.S.-China trade tensions at the time."[43] With the continuation of these trade tensions, it appears that China's willingness to retaliate via non-approval of mergers and acquisitions will have long lasting effects.

China appears to have slowed its review of U.S. mergers and acquisitions across the board. As a potential precondition to approval, the agency has requested that firms under review "make available in China products they sell in other countries in a bid to counter U.S. exports controls on China."[44] These developments are viewed as retaliation for the U.S. restrictions on China's tech industry.[45] In addition, this economic statecraft lever is viewed as a "relatively subtle and low-cost way to pressure foreign companies and by extension, their governments."[46]

This delay in M&A review may have a "chilling effect" on investment; further, companies "may need to choose between having operations in China or carrying out mergers and acquisitions across the globe."[47] With the benefits of operating in China and the sunk costs that companies have already invested there, these delays in merger review could limit consolidation and leave firms more localized (rather than multinational) in the long run as U.S.-China tensions remain heightened. In addition, these changes may result in divestment and lack of expansion in China because of the increased costs of doing business and the difficult regulatory environment.[48]

Policy Implications and Conclusion

The breakup of MNCs into smaller, localized firms will have significant effects on the operating environment of firms and the international political economy. Rather than being able to share bureaucratic and administrative apparatuses, the individual firms will have to maintain separate departments, such as compliance. Overhead costs will increase and, coupled with high interest rates, could deter the growth of investment. Subsequently, important innovation in startups and other firms may be deterred. In addition, without the ability to undertake mergers and acquisitions in high technology sectors, consumers may face higher prices as firms are prevented from reaching economies of scale and consolidating redundant functions through partnerships with other firms.

Next, inter-firm coordination and communication will be complicated even further as localization continues, exacerbating collective action problems amongst firms. Since the breakup of the "inner circle" of American business as a result of bank regulations, there has been limited political consensus and communication between firms.[49] This breakdown has been detrimental to business' ability to pursue coordinated action on broad based and moderate policies that benefitted the public. By decomposing relationships between firm leadership even more by

[g] The CHIPS Act offers subsidies to domestic chip factories; with Intel currently building two fabs in Arizona and two in Ohio, "it stands to be the biggest beneficiary. Its payouts will likely total several billion dollars or more, arriving gradually through 2031." See Oregon Live. 2022. Biden signs $280 billion CHIPS Act; Intel stands to be the biggest winner - oregonlive.com. Oregon Live. Available at <https://www.oregonlive.com/silicon-forest/2022/08/biden-signs-280-billion-chips-act-intel-stands-to-be-the-biggest-winner.html>. Accessed 22 August 2023.

localizing firms and breaking down MNCs, consensus will grow exceedingly more difficult. Although business advocacy is often associated with single-minded profit maximization, American business leaders were able to advocate for the public good and offer helpful policy recommendations to the government at the height of their power in the twentieth century. [50] Permanently altering these relationships could permanently break down communication channels and make collective action problems for business more difficult. In the difficult geopolitical environment amidst U.S.-China tensions and the Ukraine War, the present time requires more coordination, not less, amongst business to solve problems and increase profit margins across the board.

Finally, localization would be another substantiation of the issues that the U.S. government faces when attempting to implement economic statecraft to protect state security through economic levers. Namely, U.S. companies are largely unwilling to accede to the demands of the government when it negatively impacts their business interests.[51] When comparing the United States to "strong states" (China, Japan, South Korea, and Singapore) that are pursuing economic statecraft, it is unlikely that the United States will be able to compete using these levers, without a centralized decision-making system and supportive firms.[52] Given the attempts to circumvent policies through costly measures – the breaking up of companies – it is clear that firms are likely to find ways around U.S. national security protections to continue inflating their profits rather than cooperating with efforts to protect national security. For economic statecraft to work, the United States will need to invest significant efforts into cultivating stronger relationships with business leaders and taking their feedback into account prior to policy publication (rather than initiating notice and comment periods to hear their thoughts in the aftermath).

In conclusion, the rise in economic statecraft and U.S.-China competition will have profound structural consequences for the international system. In this article, I discuss the potential for firm localization as a result of new U.S. investment restrictions and Chinese hostility to mergers and acquisitions – at the very least in high technology industries, but perhaps beyond as well. Future research should track the empirical response to these policy changes, as well as pay attention to China's potential retaliatory response.

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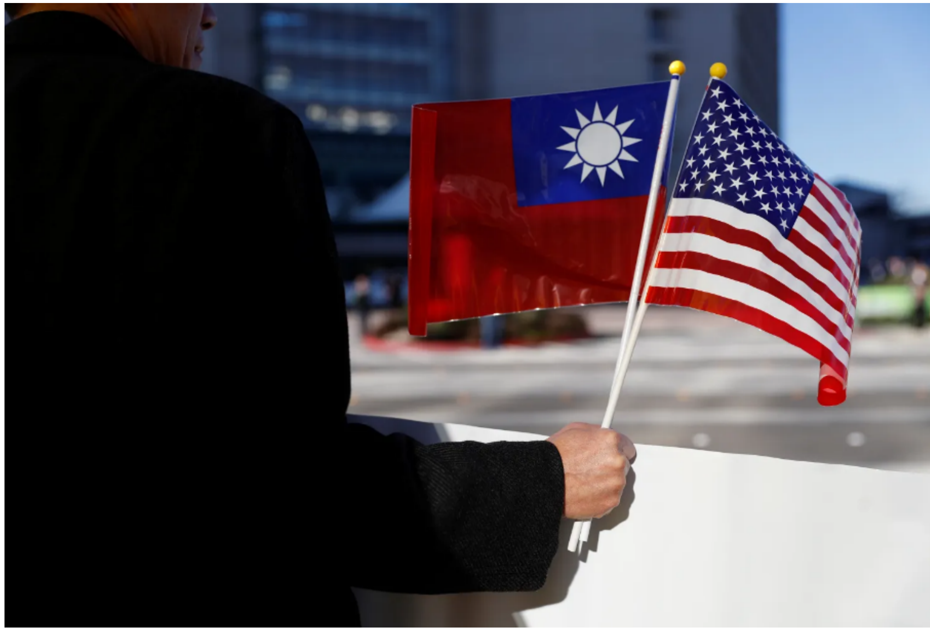
The United States-Taiwan 21st-Century Trade Initiative: A Model for "Benign Economic Statecraft"?

By Shantanu R. Kamat



Graphics Credit: REUTERS/Stephen Lam

In this article, I provide a brief overview of the United States-Taiwan Initiative on 21st-Century Trade, negotiations conducted under its purview, and its deficiencies. Then, I introduce "benign economic statecraft," an approach that harnesses liberal tools to achieve national security objectives that states have frequently turned to more interventionist policy instruments to achieve. The "benign economic statecraft" approach will be considered as a means to pursue security interests, while preserving the liberal international order and promoting liberal institutions. I analyze the merits of expanding the U.S.-Taiwan Initiative into a broad free-trade agreement that contains market access provisions and reduces tariffs and other barriers to trade. Such an FTA could be a way to deploy economic statecraft to counter China's actions, without undertaking the herculean task of complete decoupling from the Chinese economy or advancing the deleterious goal of rejecting free trade and international economic liberalization. Finally, I analyze how a U.S.-Taiwan FTA could serve as a model for "benign economic statecraft" and how that would offer the United States the opportunity to reorient how it engages with the liberal international order.

United States-Taiwan Initiative on 21st-Century Trade

On 1 June 2022, the United States and Taiwan[h] launched the United States-Taiwan Initiative on 21st-Century Trade (hereinafter "the Initiative") to deepen cooperation, facilitate trade, and create a framework

[h] Acting through the American Institute in Taiwan (AIT) and the Taipei Economic and Cultural Representative Office (TECRO).

for negotiations down the road.[53] The Initiative was announced in the United States ten days after Taiwan was snubbed from the Indo-Pacific Economic Framework for Prosperity (IPEF), which forms a large part of President Joe Biden's East Asian strategy.[54] The non-inclusion of Taiwan in IPEF[i] created extra momentum within business, scholarly, and policymaking circles for separate international economic arrangements with the island economy.[55] The Initiative has elicited comparisons to IPEF and not only because of its development as an alternative way to foster U.S.-Taiwan cooperation. Nine of the eleven areas[j] identified by the Initiative for prospective negotiation overlap with IPEF provisions, with only the pillars concerning state-owned enterprises and non-market policies and practices lacking IPEF counterparts.[56] The Initiative and IPEF are also similar in what they leave out: market access commitments. Liberal economic policy scholars, as well as industry leaders, cite this exclusion as a reason that negotiations may be less fruitful than they otherwise could be.[57] Furthermore, the value of the Initiative could be attenuated by the fact that much of it is duplicative with other forums for U.S.-Taiwan dialogues on economic relations such as the Trade and Investment Framework Agreement (TIFA), the U.S.-Taiwan Economic Prosperity Partnership Dialogue (EPPD), and the Technology Trade and Investment Collaboration (TTIC).[58]

Despite these worries, one concrete agreement has been reached under the auspices of the Initiative. Agreed to in May 2023 and signed on 1 June 2023, the agreement directly addresses four of the eleven Initiative pillars that were laid out the previous year. It does so by committing the parties to a set of trade facilitation and customs administration measures, increases transparency regarding regulations, establishes anticorruption measures, and encourages SMEs in the United States and Taiwan to trade and invest in the other country.[59] The trade facilitation measures make up the bulk of the changes that the agreement sets into motion. Those measures simplify customs and border procedures and expedite trade through digitization of a whole array of processes.[60]

Nevertheless, the agreement falls short in several respects. Again, it contains no tariff reduction or market access provisions. Multiple commentators described the scope as limited to "low hanging fruit."[61] Trade policy scholar Inu Manak, for example, lauded the speed with which policymakers concluded the agreement (only one year after the Initiative's framework was put in place), but noted that contentious areas like agricultural trade barriers were avoided in negotiations.[62] Previously discussed paths forward like the elimination of double taxation on Taiwanese businesses operating in the United States to incentivize investments flows also failed to make their way into the final agreement.[63]

A second round of negotiations was launched in August and is ongoing.[64] According to a press release from the Office of the United States Trade Representative, the two parties have had productive discussions on agriculture, labor, and the environment.[65] However, it remains to be seen whether consensus can be reached on those issue areas.

"Benign Economic Statecraft"

Vinod K. Aggarwal and Andrew W. Reddie define "new economic statecraft" to encompass forms of "state intervention to influence trade, investment and industrial policy," instead of the old economic statecraft's focus on certain instruments like

[i] Many have speculated that the exclusion of Taiwan from the Indo-Pacific Economic Framework (IPEF) was done "in a nod to China's sensitivities about Taiwan being treated as a sovereign nation" and at the behest of certain Asian countries that were reluctant to fan the flames of mainland China's ire. See Palmer (2022) and Smith (2022).

[j] The Initiative's eleven specified issue areas are the following: trade facilitation, regulatory practices, agriculture, anti-corruption, supporting SMEs in trade, digital trade, "worker-centric" trade, environment and climate action, standards, state-owned enterprises, and non-market policies and practices. See Office of the United States Trade Representative (2022).

sanctions.[66] The goal is to use levers of state power to bend or influence international outcomes, especially in conditions of geostrategic competition.[67] Seeing insufficiencies in both neoliberal perspectives that focus on international economic growth to the exclusion of security, as well as neorealist views that highlight military power to the exclusion of international economic contestation, Aggarwal and Reddie offer "new economic statecraft" as a way to encapsulate the whole gamut of states' real-world actions today.[68] "New economic statecraft" can enrich our understanding of great power competition, especially in the twenty-first century context of a China whose rise has troubled much of the world and modern technologies which have worrying dual-use potential.[69]

The forms that "new economic statecraft" can take are as diverse as states' toolbox of economic policy levers, including industrial policy, strategic investments in what the state identifies as key industries (for instance, semiconductors and artificial intelligence), promotion of national champions, trade restrictions, export controls, investment restrictions and review procedures, and regulatory regimes.[70] What these interventions share is a departure from a rough postwar consensus on international economic liberalization, which took the form of tariff reduction; alleviation of onerous trade barriers; promotion of the flow of goods, services, data, and investment across borders; and international institutions like the World Trade Organization to facilitate this shift to an open and globalized world.[71] This departure is understandable in a world in which the United States faces China, a formidable peer competitor that is unafraid to use every economic tool at its disposal to gain a leg up on the United States. Nevertheless, the economic distortion that results from "new economic statecraft" is regrettable. As liberal economists have persuasively shown, moves away from free trade and toward protectionism have contributed to economically suboptimal outcomes, while also often failing to achieve the policies' purported national security objectives.[72]

The dilemma then is as follows: how can American policymakers simultaneously harness the benefits of a liberalization, globalization, and free trade, while also doing what is necessary to protect national security interests and best position themselves in a strategic game against China? I suggest one class of solutions here and discuss it in the context of U.S.-Taiwan trade relations. I introduce the concept of "benign economic statecraft," which is distinct from "new economic statecraft" but shares its major goals, including but not limited to national security, supply chain resilience, and strategic advantage vis-à-vis adversaries. "Benign economic statecraft" is defined here as the use of liberal institutions and/or instruments – such as free trade agreements, tariff and non-tariff barrier reduction, market access provisions, trade facilitation, etc. – to achieve the aforementioned objectives.

Unlike "new economic statecraft" which is inimical to principles and institutions of the liberal international order[k] (hereinafter "LIO"), "benign economic

[k] The precise definition of the liberal international order (LIO) is contested.
G. John Ikenberry identifies five necessary components that a liberal internationalist order must have: (i) openness (i.e. to international engagement and trade), (ii) international relations bounded and/or coordinated by rules and institutions, (iii) some form of security cooperation, (iv) acceptance of the possibility of reform and mutual benefit, and (v) global movement toward liberal democracy.
See Ikenberry (2018), 11: Ikenberry, G. John. 2018. "The end of liberal international order?" *International Affairs*, 94(1), 7–23. https://doi.org/10.1093/ia/iix241.
In addition to the international and rules-based aspects of the LIO, David A. Lake, Lisa L. Martin, and Thomas Risse emphasize the liberal components, combining political liberalism, economic liberalism (in either its classical liberal or "embedded liberal" form), and liberal internationalism (in John Ruggie's words, a multilateralism "which coordinates relations among three or more states on the basis of 'generalized' principles of conduct," which often involves foregoing short-term interests for long-term economic growth and stability). See Lake, Martin, and Risse (2021), 227-232: Lake, David A., Lisa L. Martin, and Thomas Risse. 2021. "Challenges to the Liberal Order: Reflections on *International Organization*." Challenges to the Liberal International Order: *International Organization* at 75 [Special issue]. *International Organization*, 75(2), 225–257. https://doi.org/10.1017/S0020818320000636.

statecraft" aims at the same goals, while preserving and in fact deploying liberal tools to achieve those ends. In that sense, "benign economic statecraft" could be a best of both worlds, in which liberal economic goals and security goals are pursued in parallel, with the pursuit of one not necessarily harming the pursuit of the other. Whether "benign economic statecraft" alone is sufficient to meet the global security challenges of the twenty-first century will not be conclusively resolved here. Rather, this piece introduces it as a theoretical contribution and perhaps something that policymakers can add to their toolkit as an alternative to more heavy-handed instruments of state power.

A U.S.-Taiwan Free Trade Agreement and U.S.-China Strategic Competition

During Xi Jinping's reign over the last decade, China has pursued economic statecraft more than ever, a development which has been reinforced by the era of strategic competition in which great powers find themselves.[73] Although China's economic statecraft efforts are far from universally efficacious, their scope, coercive nature, and dangers to the rules-based liberal international order (LIO) have concerned leaders and stakeholders around the world.[74] U.S. policymakers are faced with a seemingly intractable dilemma: they must actively compete with China's barrage of "new economic statecraft" policies, while also ensuring that their actions do not hasten the ongoing ossification of the global trading regime.

American policymakers have devised strategies that aim to thread the needle between respecting liberal economic goals and advancing security objectives. One suggestion goes under the name "selective decoupling," which Representative Mike Gallagher, Chair of the House Select Committee on Strategic Competition between the United States and the Chinese Communist Party, identified as one of three pillars[l] of a whole-of-government strategy to counter China.[75] Complete economic decoupling of the American and Chinese economies is impractical and would deprive Americans of the benefits of market access including lower prices and the ability to trade goods across borders.[76] However, Gallagher and Select Committee Ranking Member Raja Krishnamoorthi concur that in response to Chinese economic coercion, the United States should take proactive measures in certain sensitive sectors[m] including de-risking and diversification of those supply chains and industries that have a nexus to U.S. national security.[77]

However, de-risking and diversification cannot be achieved without an alternative to Chinese suppliers. Gallagher said, "You cannot selectively decouple, in my opinion, if you do not simultaneously deepen your economic engagement and technological collaboration with the free world at the same time to try and reduce our dependence on China."[78] The two – tackling the China challenge and increasing economic ties with other Asian countries – go hand in hand. And the latter should include traditional liberal institutions and tools like market access and free trade with peaceful economies. Gallagher's suggestion is consistent with adding "benign economic statecraft" to the American policymakers' toolbox. Not only can it in many cases be an alternative to damaging exercises of economic statecraft to counter China, but it can make attempts to counter China more fruitful, by enabling a gradual shift away from reliance on Chinese markets and suppliers. Moreover, it may also be an expedient way to generate buy-in from a business community that would otherwise be unwilling to countenance the economic disruption produced by an overly expansive departure from Chinese markets.[79] Gallagher added,

[l] The other two pillars that Mike Gallagher identified are hard power and ideological competition. See Gallagher (2023).

[m] In particular, Gallagher believes that U.S. economic policy should distinguish between trade in soybeans, textiles, and other goods without a clear nexus to national security, and those like critical minerals, pharmaceutical ingredients, and microelectronics, for which dependency on a strategic competitor could pose risks. See Gallagher (2023) and Ratnam (2023).

"And it should not be just the free world, as that's traditionally defined. We also have to get closer with some nontraditional partners."[80] Deeper economic cooperation in the Asia-Pacific should include expanding the United States-Taiwan Initiative on 21st-Century Trade into a true free trade agreement (FTA), which could be a potent tool of "benign economic statecraft."[81]

A U.S.-Taiwan FTA is not a new idea[n], but has received renewed attention in the last five years, given the salience of U.S.-China competition in American politics. During the Trump administration, however, Taiwan had fallen to the backburner in bilateral trade agreement talks.[82] A U.S.-Taiwan FTA would be a good deal for both parties. For the island economy, the commercial access it could obtain would assist its growth and survival.[83] For the United States, an FTA would achieve a dual objective: "secure better terms of trade while deepening strategic partnerships with China's rivals."[84] Despite Taiwan's small size and diplomatic isolation, it plays a large role in global trade, especially in key technology industries like semiconductors (which have dual-use capabilities and are critical for defense systems) and communications. Ashley J. Tellis noted that a "U.S.-Taiwan pact would accelerate the reorganization of Asian supply chains away from China and reduce China's ability to coerce America and its East Asian allies in times of crisis."[85]

Despite the U.S.-Taiwan Initiative's tremendous shortcomings, it does advance Taiwanese and American cooperation, which in turn bolster their positions vis-à-vis China. Former U.S. trade negotiator John Veroneau averred that the Initiative could hold powerful diplomatic significance, notwithstanding its relatively minimal economic impact.[86] I argue that using liberal economic tools to advance the sort of collaboration needed in the broader geopolitical arena – a centerpiece of the "benign economic statecraft" approach – is an especially worthwhile endeavor in the case of Taiwan. WTO data show that the United States was Taiwan's fourth largest recipient of merchandise exports in 2021, with the United States in turn being the second largest source of Taiwanese imports.[87] China is number 1 in both respects.[88] Expanding the Initiative into a free-trade agreement could be the beginning of a concerted effort to alter the balance.

For Taiwan, a U.S.-led trade agreement would allow a decades-long shift away from dependence on China. In the words of John Deng, Taiwan's minister without portfolio, "If our economy can not be strong enough, then there's only one place that we can go — China."[89] To preclude China from fomenting even more dependence on the part of Taiwan, the United States should present itself as a credible economic partner and bring Taiwan into the fold of an American-led rules-based trade order.[90] In addition to direct economic benefits, an FTA could pave the way for other advanced economies to seek greater economic relations with Taiwan or even join the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), for which has already Taiwan has submitted a pending application.[91]

"In the past, the United States has 'friend-shored' by signing trade agreements with like-minded countries that eliminate tariff and non-tariff barriers to trade, thereby making it easier for goods, services, and capital to flow between them," writes Tori Smith.[92] Of late, by contrast, policymakers have put forth "anti-market policies associated with onshoring and nearshoring," whereby manufacturing, supply chains, and operations are returned to the United States or a proximate country. Given that "free trade agreements are a proven model for friend-shoring in a pro-market way," I argue that is amenable to be part of a "benign economic statecraft" approach.[93] Large-scale government interventions like the CHIPS and Science

[n] For example, a 2002 U.S. International Trade Commission report estimated the likely impact of such an agreement at the request of the Senate Finance Committee and the House Ways and Means Committee. See United States International Trade Commission. 2002. "U.S.-Taiwan FTA: Likely Economic Impact of a Free Trade Agreement Between the United States and Taiwan." Publication 3548, Investigation No. 332-438. https://www.usitc.gov/publications/docs/pubs/332/pub3548.pdf.

Act and other industrial policy measures frequently misallocate resources, underdeliver on promised benefits, and invite other countries to pursue distortionary interventions, like subsidies and export controls, of their own.[94] By contrast, an alternative that would encourage the private sector to better manage geopolitical risk and deal with supply chains disruptions amid strategic competition with China is to expand market access and lower barriers to the flow of goods and services.[95] A tried and tested way to do this is by offering FTAs to friendly economies, especially those that are strategically significant in key industries like semiconductors.[96] The United States has fallen behind in making FTAs, which means not only foregone economic benefits but a missed opportunity to assert itself in establishing the rules of the road and setting standards for the global economy.[97]

A U.S.-Taiwan FTA would incentivize friend-shoring in a place which adheres to important norms of the global trading system. In doing so, an FTA could help achieve the House Select Committee on the CCP's vision of de-risking, diversification, and selective decoupling from China. "The best way to incentivize companies to shift supply chains out of China is to create alternative markets for them that are economically viable and help them mitigate rising security concerns in China."[98] One study estimates that an expansive U.S.-Taiwan FTA that slashes tariffs and reduces non-tariff barriers across several industries would increase total trade by $6.2 billion for the United States and $3.8 billion for Taiwan.[99] Such an agreement would also reduce both the United States and Taiwan's economic ties to China, without adversely harming their economies. Taiwanese exports to China would decrease by $1.8 billion, and their imports from China would decrease by $323 million.[100] Furthermore, U.S. imports from China would decrease by $775 million.[101] China's total trade volume would fall by more than $1 billion annually, with a negative effect on Chinese GDP.[102]

Kurt Tong, former U.S. Ambassador for APEC, gave three key reasons in advocating for a U.S.-Taiwan FTA: (i) Taiwan's role in strategic trade, (ii) Indo-Pacific "economic geopolitics," and (iii) trade policy agenda setting.[103] All three indicate that the opportunity is ripe for the United States to pursue "benign economic statecraft." Taiwan's importance to the semiconductor industry[o] and the opportunity for the United States to demonstrate a commitment to the political economy of the Indo-Pacific region means the United States are strong reasons for American policymakers to leverage the Initiative and begin negotiations with Taiwanese authorities for a free-trade agreement.[104] Despite the fact that a lack of political will, especially in the United States, has been a critical impediment to securing an FTA, circumstances could be changing to make that prospect more propitious.[105] Although there has recently been bipartisan hostility to international trade, Taiwan seems to be an exception to the rule. A U.S.-Taiwan FTA could plausibly pass Congress, given legislators' hostility toward China, a bipartisan recognition of Taiwan's strategic importance, and members of both parties urging the executive branch to begin negotiating with Taiwan.[106] With the July 2023 passage of the United States-Taiwan Initiative on 21st-Century Trade First Agreement Implementation Act (H.R. 4004), Congress retroactively approved the agreement reached under the auspices of the Initiative, and appended reporting and consultation requirements for future negotiations.[107] In doing so, Congress ensured that it can effectively perform its role in international commerce and demonstrated a keenness to pursue further trade and investment relations with Taiwan.[p]

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[o] In particular, Taiwan is home to the Taiwan Semiconductor Manufacturing Company (TSMC) which produces high-end chips.

[p] H.R. 4004 will make U.S.-Taiwan trade negotiations more enforceable, transparent, predictable, and durable, and by so doing, will "strengthen[] economic ties with Taiwan for mutual benefit—emphasizing the past U.S. commitment to reciprocity in trade, whereby the United States would grant access to its market in exchange for similar concessions from its trading partners." See Manak (2023).

Implications for the Future of the Liberal International Order

I posit that a U.S.-Taiwan FTA can serve as a model of "benign economic statecraft," which can advance American security interests in an era of strategic competition with China, while also reaping the benefits of the liberal international order (LIO) which has promoted global economic growth since the 1950s. This approach is especially important in light of recent developments in U.S. economic policy. Consider the following.

The Trump administration's foreign economic policy toward East Asia was marked most prominently by his withdrawal from the Trans-Pacific Partnership (TPP) in 2017 and by his trade war with China – developments that were harmful to free trade and the LIO.[108] Hopes that President Biden would reverse the bulk of these policies have proven incorrect, with the endurance of economic statecraft and protectionist policy indicating that the LIO will continue to fragment.[109] The Indo-Pacific Economic Framework for Prosperity (IPEF), the Biden administration's signature policy framework for the Asia-Pacific, to which the U.S.-Taiwan Initiative looks similar, is weak and unlikely to advance either its putative economic or security goals.[110]

I contend that a new orientation of international economic policy is sorely needed, and this is where "benign economic statecraft" can play a role. As Mike Gallagher stated in an interview, "There's no trade agenda right now in Washington in either party, and that's a huge gap in our overall strategy."[111] The United States should be willing to pursue bilateral and minilateral regional FTAs in the Asia-Pacific so that countries reap the benefits of American market access and come to regard the United States as a valuable economic partner. Expanding the Initiative into a genuine U.S.-Taiwan free-trade agreement can serve as a model of how this approach can work. This is especially crucial in a world facing the bifurcation of investment, trade, and global value chains.[112] Bilateral FTAs, like one between the United States and Taiwan, would simultaneously acknowledge this reality, while managing to promote trade in a world in which the West will have to look beyond China for imports and investment.

The "benign economic statecraft" approach, which a U.S.-Taiwan FTA could help pave, can be applied to trade agreements with other countries and regions. The lessons can be applied to southeast Asia, for example, where countries have been upset with insufficient U.S. economic engagement and dithering on market access commitments.[113] The Biden administration has failed to capitalize because it does not appreciate that such commitments are the key lynchpin in securing countries' participation in a U.S.-led liberal order, rather than falling into the hands of China.[114] In Latin America too, countries such as Uruguay have moved to increase trade with China after and as a result of insufficient engagement from the U.S. to secure FTAs.[115] The United States should put in the work to assuage the fears of middle powers around the world to secure allegiance to the West and to forestall Chinese manipulation and influence.

In conclusion, policymakers in the United States should consider crafting a free-trade agreement with Taiwan, instead of merely pursuing weak policy vehicles under the extant U.S.-Taiwan Initiative on 21st-Century Trade. In doing so, they should add "benign economic statecraft" to their arsenal and be willing to deploy it in other instances with the primary goal of advancing American security interests in an era of strategic competition with China, while also reaping the benefits from trade partnerships that have been integral to global economic growth for more than seven decades.

The EU Foreign Subsidies Regulation: New Economic Statecraft of the EU or Business as Usual?

By Bettina Boelk

Graphics Credit: REUTERS/Yves Herman

The war in Ukraine, the war in Israel, Covid, tense trade relations with China, disrupted supply chains, and also the changes in relations with the United States, to name just a few prominent examples, are forcing the European Union ("EU") to rethink its own position in the world economy.

The reaction of many countries to these events is protectionist measures. Subsidies are one of the simplest protectionist measures. Subsidies have more than tripled worldwide in the last decade.[116] To name just one prominent example: In August 2022, U.S. President Joe Biden announced the Inflation Reduction Act ("IRA") – $1 trillion in subsidies including tax incentives. [117] French President Emmanuel Macron responded to the IRA by saying that it would be a "killer for our industry."[118q] Another example is the global race to boost the green industry through subsidies.[119]

Subsidies are often highly debated in the world trading system.[120] The EU is therefore also quickly tempted to react with subsidies in order to protect its own

[q] See also Nelson (2023), who also quotes the British and South Korean position on the IRA: "dangerous" because it "could slip into protectionism."

See Nelson, Eshe. 2023, January 21. "At Davos, European Distress Over a 'Made in America' Law." *The New York Times*. https://www.nytimes.com/2023/01/21/business/davos-europe-inflation-reduction-act.html?searchResultPosition=11.

market.[121][r] The opposite of protectionist measures is the market-based approach including free trade and free investment. The fundamental conditions for this are political will and ensuring that the market functions properly.

The aim of the EU is to "ensure a level playing field in the EU's Single Market."[122][s] A competitive, strong, and open single market enables EU companies to compete and operate globally. [123] The European Commission ("Commission") describes in its white paper on leveling the playing field as regards foreign subsidies that economy's resilience can only be achieved through openness to trade and investment.[124] However, the basic prerequisite is that trade and investment are accompanied by "fairness and predictable rules."[125] The Commission gives a few examples of unfair practices such as "shielding industries from competition through selective market opening, licensing and other investment restrictions, as well as providing subsidies which undermine the level playing field to both state-owned and private sector companies."[126]

So how to react to such unfair practices? The EU decided to regulate third-country subsidies through the Foreign Subsidies Regulation ("FSR"). My work analyzes how the FSR closes a gap in the EU economic statecraft and preserves the competitiveness of the EU internal market.

Gap in EU Economic Statecraft

The main objective of the EU is to establish an internal market.[t] The internal market is a system designed to protect competition from distortions.[127] Distortions of competition in the EU internal market have so far been prevented by the following economic statecraft: EU State Aid Law, Foreign Direct Investment Screening ("FDI Screening"), and Merger Control.

EU State Aid Law

In the EU, state aid granted by Member States to companies is subject to strict control. The aim is to ensure fair conditions for all companies to carry out their activities in the European internal market.[128] Art 107 (1) TFEU establishes a general prohibition of aid.[u] Paragraphs 2[v] and 3[w] set out exceptions to this rule. Member States have transferred extensive competition competences to the EU.[x] Consequently, there is no further regulation by the member states in this regard. Furthermore, EU state aid law only affects the EU internal market, and in fact only "domestic" EU companies are affected. Thus, EU state aid law is a behind-the-border EU intervention.

FDI Screening

Foreign direct investment can be a great opportunity for countries, but at the same time the country must ensure that its national security interests are not affected.[129]

The EU has no competence to regulate FDI screening uniformly at-the-borders of the EU. Consequently, twenty-seven member states regulate more or less restrictive FDI. In fact, the EU Commission only has the right to issue an opinion.[130] However, the opinion is not binding for the respective member state. It could be argued that FDI screening did not play a major role in the past because it was usually not a major issue or no notification requirement was necessary. But with

[r] The Economist (2023, February 9) calls it "the copycat trap."
[s] Fixed term *see i.e.* European Commission (2020, February 28) is the enforcement body pursuant to the EU Treaty.
[t] Art. 3 (2) subsection 3 TEU; Art. 3 (1) b) TFEU (exclusive competence of the EU).
[u] Article 107(1) of the TFEU defines both aid and implements a fundamental prohibition on aid: "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."
[v] Article 107(2) TFEU lists exceptions to aid considered compatible with the internal market, i.e. repair of damage caused by natural disasters.
[w] Article 107(3) TFEU in turn lists further exceptions that may be considered compatible with the internal market, i.e. to remedy a serious disturbance in the economy of a Member State.
[x] Art. 3 (2) subsection 3 TEU; Art. 3 (1) b) TFEU.

the Ukraine war and the tightening position towards China, some member states have also tightened the FDI screening or make / want to make more use of their screening competence.[131] In 2022, for example, Slovakia introduced a new FDI screening process, and eight other member states tightened their FDI screening process.[132]

Thus, the FDI screening takes place at the border of each individual Member State and the EU has no competence in this regard; the FDI Screening is an at-the-border of each Member State intervention.

Merger Control

The EU's legal instruments with regard to corporate competition rules include a ban on cartels (Art. 101 TFEU), the ban on the abuse of a dominant market position (Art. 102 TFEU), and EU merger control.

Merger control is a split competence: if certain criteria are fulfilled, an exclusive competence of the EU Commission is established. If these criteria are not fulfilled, responsibility remains with the individual member states. The establishment of exclusive EU jurisdiction is based on turnover thresholds of the merging companies and on the notification requirement[y]. Furthermore, there is the ability for a referral to be made by the EU Commission to national antitrust authorities and vice versa. Consequently, merger control is carried out either by the EU Commission or by the respective member state.

The merger control is carried out for domestic companies as well as for companies from third countries when entering the EU single market or the domestic market of the respective member state. Consequently, it is an intervention behind-the-border with regard to the EU internal market or the individual market of the member state.

Description of the Gap in Legislation

The EU's goal is to ensure a "strong, open and competitive internal market."[133] The internal market is threatened by third-country subsidies. Whenever companies receive financial support from governments, this financial support allows them to gain a competitive advantage over their competitors. For example, financial support may allow a company to offer low prices and unfairly disadvantage competitors, or they may facilitate the financing of acquisitions of EU companies. Companies can also undermine the level playing field in public tenders by helping subsidized companies undercut their competitors.

The EU State Aid law prohibits, with very few exceptions, subsidies from EU member states within the EU. Until now, however, companies from third countries have been allowed to invest in the EU, even though they have received substantial subsidies from third countries. This can and has led in the past to considerable market distortions in the EU internal market. FSR as an instrument "at the border" of the EU should prevent such distortions in the future.

That is why FSR was created. FSR is a separate pillar in addition to merger control, FDI screening, and state aid law. It should be emphasized, however, that FSR affects the regulatory content of all the three aforementioned interventions.

On 12 January 2023, the FSR regulation became effective, but was not applicable until 12 July 2023.

Working Mechanism of FSR

FSR creates 3 new tools for the Commission to audit financial contributions received by companies operating in the EU from third countries:

(1) "A notification-based tool to investigate concentrations involving financial contributions

[y] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation).

granted by non-EU governments, where the acquired company, one of the merging parties or the joint venture generates an EU turnover of at least €500 million and the transaction involves foreign financial contributions of more than €50 million;

(2) A notification-based tool to investigate bids in public procurement procedures involving financial contributions by non-EU governments, where the estimated contract value is at least €250 million and the bid involves a foreign financial contribution of at least €4 million per third country; and

(3) A general tool to investigate all other market situations, where the Commission can start a review on its own initiative (ex-officio)."[134]

From this previous description it is clear that FSR is an intervention of the EU at the border. Compared to the previous interventions, this is a measure that always takes place at the EU external border – at-the-border EU intervention. Consequently, a screening for distortions of competition is carried out at the external border.

Will FSR be a Success?

Initially, EU companies welcomed the FSR project because it should lead to equality of arms:[135] third countries were previously allowed to provide unlimited support to their players. EU member states, on the other hand, are heavily regulated by EU state aid law as to what support they can allow domestic European companies to receive.

In the case of FSR, the Commission chose the consultation procedure for the draft implementing regulation, including the forms. But after the first draft became known, there was a wave of criticism from the corporate world; in some cases, there was talk of horror.[136]

One of the main points of criticism from companies was the enormous administrative burden. The Commission has tried to address this criticism in its implementing regulation.[137] In addition, many terms of the FSR are blurry, i.e. the FSR is not directly based on subsidies for the audit, but on foreign financial contributions.[z]

You cannot call it equality of arms because EU companies can also face major bureaucratic hurdles. In addition, the above-mentioned limits are too high to prevent distortions of competition; for example, the start-up sector is not included. Even an economic market such as Germany, which is based on large SMEs, is only partially covered by the "protection of the FSR." There is also a huge risk that the European single market will become unattractive for foreign direct investment. This applies all the more if other factors are added, such as a high level of interest rates.

Conclusion

In summary, it can be said that FSR serves to protect the European internal market. In this respect, FSR could be classified as a protectionist measure and the EU could be accused of behaving like other countries.

At a second glance, it can be seen that the EU aims to uphold free trade and free investment in the EU internal market and to maintain these objectives for the future. The EU is thus trying to find a third way against protectionism and purely liberal trade and investment. Only time will tell whether a new economic statecraft of the EU will develop from this. In any case, it would be desirable for the EU to continue to push in this direction. In the handling of FSR, care will nevertheless be taken to ensure that bureaucracy does not outweigh the benefits.

[z] The term "foreign financial contributions" encompasses more than the concept of subsidies.

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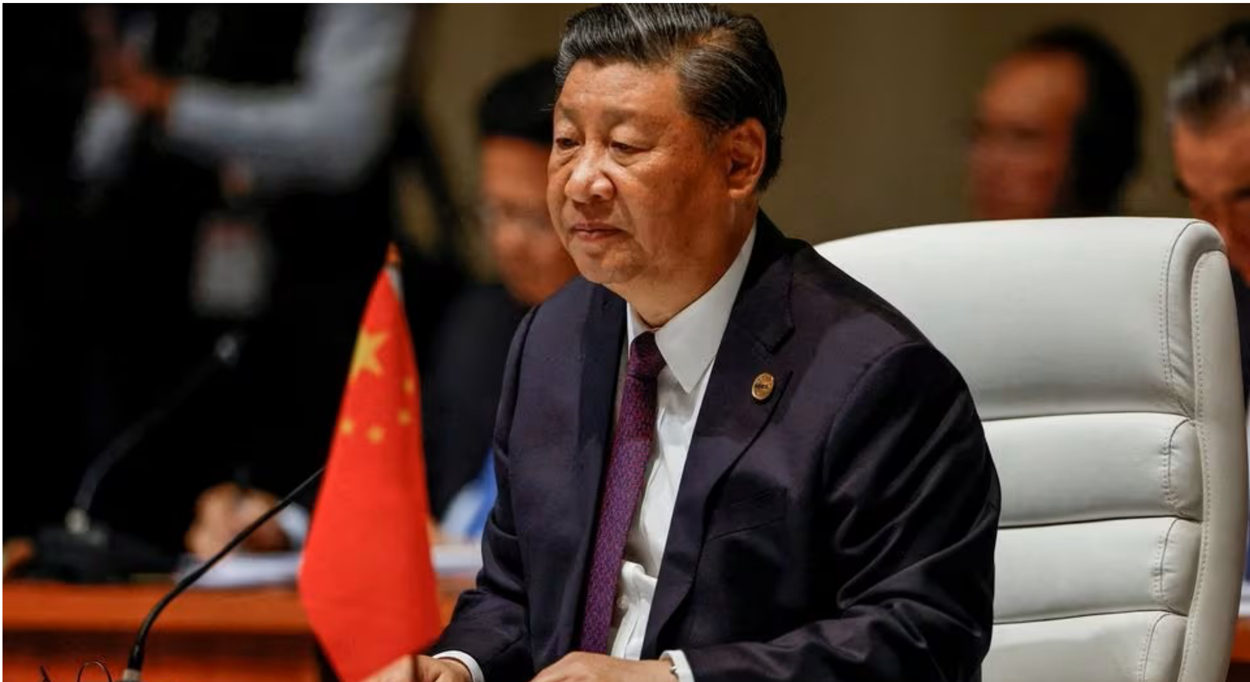
Individual Resistance to Collective Resilience

By Luca Zislin


Graphics Credit: Gianluigi Guercia/Pool via REUTERS

With what severity should we address Chinese economic coercion as to deter future offenses while minimizing the risk of provoking gratuitous and explicit conflict? This is, of course, the million-dollar question for American policy makers. One potential answer proposed by former National Security Council member Victor D. Cha is his doctrine of collective resilience, a policy that in its essence calls for multilateral sanctions on China as a response to economic coercion. As Cha writes, "Collective resilience is a peer competition strategy that promises a multilateral response in the trade space to the prospect of economic bullying by the Chinese government."[138] Under his policy, a bloc of countries ought to band together to collectively punish China and formalize this intended plan of action to deter China from coercive tactics. However, while it is comforting to think that a sanctions cartel could protect the liberal trading regime, I find that Cha grossly underestimates Beijing's resilience while overestimating the extent to which the outlined cartel countries share common interests.

In this article, I make four comments on collective resilience which are intended to provoke revisions to the policy or merely contribute to the policy debate concerning responses to Chinese economic coercion. In my first comment, I simply take issue with Cha's claim that status quo mechanisms against collective resilience lack deterrence capabilities. In my second comment, I introduce what I call the like-minded country problem. This problem alludes to the fact that it is unclear for which issue-areas countries would agree are worth triggering collective sanctions. This inherent problem creates deleterious consequences, the most notable one being self-censorship. In my third comment, I introduce the assurance problem. In order for states to deter economic coercion, the People's Republic of China must not only be convinced that they will be credibly sanctioned; they must also be convinced that they will face no penalty if they are well behaved. However, Cha envisions collective

resilience as a complement to ongoing measures to isolate China from Western economic powers. Resultantly, the lack of credible assurance may lead the Chinese to the conclusion that there is no long-term benefit to curtailing coercion. Finally, I make a simple comment on the tendency to grossly underestimate the perseverance of authoritarian regimes in incurring economic losses for the sake of larger aims.

Reframing the Status Quo

Cha identifies four ways in which states are responding to weaponized interdependence: enhanced disruption detection capabilities, trade diversification, re-shoring/friend-shoring, and ad-hoc mitigation measures.[139] He argues that these measures are insufficient because they are defensive in nature. In his view, reorienting supply chains does not prevent Beijing from attacking another sector or state; diversification does not compel China to change their behavior insofar as no country can completely decouple from such a massive economy. Thus, a competitive strategy is needed to deter predatory behavior.

On an intuitive level, the claim that current measures are not deterrents is dubious given that these measures, specifically trade diversification and de-risking, function on the same implicit logic of collective resilience. The logic of collective resilience is that the defined threat of withholding trade is enough for Beijing to reduce predatory behavior because they are deterred from *temporary* economic disruptions. I emphasize "temporary" because the quality that no country can really decouple from China is still understood within the framework of collective resilience.

The point I am trying to make is that current mechanisms have the same implicit logic. For instance, Cha identifies IPEF as an example of the re-shoring strategy.[140] It is not a secret that IPEF was constructed to counter China's regional influence and promote a set of existing norms.[141] It is implicit that China will lose out on trade if they fail to comply with certain norms. So, while China is not directly losing out on trade, it is losing out on potential trade and networks of agreements if it continues to reject certain practices and values.

Supply chains are already moving out of China as tensions between Beijing and Washington rise, while COVID-zero lockdowns pushed out private enterprises.[142] If the most fundamental logic is that losing out on trade, especially in strategic areas, can compel changes in behavior, then there are existing deterrence mechanisms. This may seem like a petty point or a semantic debate but establishing that trade with China is bound to decrease will become important in setting up my future arguments.

Collective resilience, if properly executed, is a more aggressive strategy. Yet, Cha writes that collective resilience is not "a strategy that advocates escalating a trade war."[143] If we assume that the threat to sanction China is credible, then collective resilience is a strategy that could indeed escalate a trade war. The assertion that the threat of multilateral sanctions does not advocate for escalating a trade war is reflective of one of the core weaknesses in Cha's paper: the inability to properly examine a scenario in which the threat of sanctions is not enough to deter predatory behavior and the sanctions are actually imposed. While Cha finds that it would be highly costly for China to replace most high-dependence goods[144], he does not explore a scenario in which Beijing determines that the high-cost replacement is worth continuing to enforce their agenda by means of economic coercion.

Current mechanisms are preferable on the grounds that states cannot decouple from China. In discussing the Mineral Security Partnership, an initiative Cha acknowledges as friend-shoring, Allan, Gordon, and Wang from the Carnegie Endowment comment, "China's ability to restrict the export of solar inputs and critical minerals demonstrates that crucial clean energy technologies and inputs could become

unavailable to the G7 and its allies. At the same time, excluding China from supplying critical minerals is simply not possible in the short term. Therefore, a clear and coherent strategy for focusing and aligning joint industrial policies among the United States and its partners is needed."[145] Joint industrial policy is preferable to sanctions because the threat credibility of collective resilience is limited by inherent constraints, and the provocative nature of the policy opens a larger Pandora's box of chaotic scenarios.

The Like-Minded Country Problem

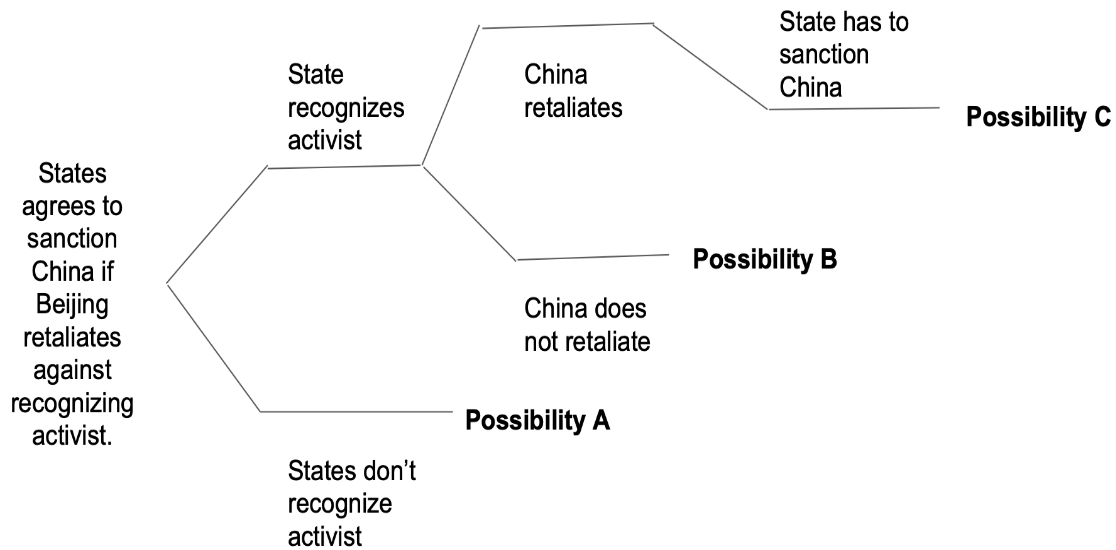
Cha argues that like-minded countries should rally together to sanction China when Beijing engages in predatory behavior. As Cha writes, the recent history of weaponization has unleashed China's "third face of power" in cultivating an environment of self-censorship where states, for example, will not invite the Dalai Lama to visit in fear of economic retaliation.[146] When Cha describes China's predatory liberalism, he groups together instances related to sovereignty disputes, Chinese dissidents and human rights related issues, high risk technology regulation, and Taiwanese sovereignty.

The problem in amalgamating these various issues under the umbrella of predatory liberalism is that it is borderline impossible to imagine a scenario in which each actor of the collective resilience bloc would actually care about each defined issue area to the same extent. What I mean by "care" is the idea that each country would think that it is advantageous, or in the best interest of the nation, to punish every transgression across issue-areas. For instance, I would reason that France would be highly concerned with high-risk technology issues but less concerned about Taiwan given President Emmanuel Macron's related comments. Notwithstanding the broad idea of protecting the liberal international order, it is spurious to think that states would be "like-minded" in the sense required to operationalize collective resilience as Cha imagines the strategy.

This reflects the real-world lack of consensus about how to address a rising China. While it is possible to imagine a scenario where the G7 + Australia partnership commits to regulating high risk tech (which is actively occurring within the European Union[147]), it is more difficult to imagine a bloc that is willing to threaten sanctions after China imposes some measure in response to the Senkaku islands dispute. Even if all actors do not want to continue the paradigm of Chinese economic coercion, it is not assured that all actors are willing to incur economic and political costs in defense of all issue-areas.

The herculean task of uniting dissimilar countries against the vague and multidimensional threat of a rising China is already playing out in the security dimension through dissent within the North Atlantic Treaty Organization. Although NATO mentioned the PRC for the first time in the 2022 Madrid Strategic Concept, its plans to open a liaison office in Tokyo were curtailed by France in an arguably obvious bid to appease Beijing.[148] The parable of the NATO example is the lesson that in order to craft effective action towards China, there must be firm and explicit agreement over what issues are universally important in the sense that states would be willing to incur potential costs.

The amalgamation of non-equivalent issues makes it difficult to envision collective resilience as an operational strategy. While Cha recognizes that it would be difficult to discern the threshold for an attack, it would be worthwhile to confront what motivations for coercion would invoke the threat. As Cha recognizes, Chinese economic coercion is "opaque and does not conform to WTO rules, and it is not based on any legal and legitimate authority. At best, Beijing obfuscates the purpose of the measures, citing unsubstantiated health or safety standards."[149] But given that Beijing obfuscates the motivations for coercive tactics, this would mean that the collective resilience bloc would have to reach a consensus on the supposed "true" intention of the tactic before sanctions are enforced. Of course, it is simple to identify what Beijing's true motivations are. There is no denying



that the import restrictions on Taiwan after then-Speaker of the House Nancy Pelosi's August 2022 visit have nothing to do with pest control. However, the fact that China does not formally assert their intentions could give states plausible deniability to opt out of agreed upon sanctions.

The observation to draw here is that collective resilience requires a high degree of consensus among actors. Yet, the opportunity cost for some issue areas is higher than that of others. It would be easier to envision collective resilience as an issue-specific strategy rather than a broad approach. If collective resilience was implemented as a strategy against the wide array of issues that Cha outlines, it may have a counterintuitive effect. For example, if actors are expected to retaliate for the sake of punishing attempts to give a platform to Tibetan activists, then it may be preferable to stop platforming Tibetan activists. Now, there is a potential double penalty for platforming Tibetan activists: the expected retaliation from China, and the subsequent loss of exports because of the agreed upon sanctions.

This is assuming that the threat to sanction is credible and that there is a non-zero possibility that China is not deterred. Some actors would potentially prefer not to confront these possibilities at all through self-censorship. While actors may agree to punish coercion related to Taiwan and high-risk tech, it is unlikely that actors would commit to the less substantial issues like the visibility of activists. If they did commit, then it is potentially rational to avoid the double-penalty scenario by avoiding the behaviors that trigger Chinese retaliation. The figure above maps the three outcomes of the collective resilience policy from the perspective of the actor that invokes the threat.

As illustrated by the sequential model, for issues of lower significance, it may be rational for states to avoid the actions that could provoke retaliation to avoid the double penalty. States would only be rational in committing to provocative actions if they were sure that possibility B is far more likely than possibility C. For issues of relatively low significance, if we assume that states have to comply and cannot back out of the sanctions, then it is more rational to engage in self-censorship, which is ironically the behavior that Cha aims to reduce. At the very least, actors already make calculations before provocative actions, and collective resilience adds additional negative extremities into

consideration. The two ultimate scenarios are one in which China's behavior is radically transformed and another in which China is willing to suffer the economic costs of value preservation. This will be discussed at length later in this critique but as a matter of intuition, I would bet that the latter is more probable.

The primary insight is that collective resilience requires a high degree of unified commitment within the bloc which would be easier to envision if the issue-area was more defined. Cha discusses political will in relation to an actor's ability to cultivate support back home, but there is a lack of discussion on issue-area preference compatibility. In a defense of collective resilience, there is a burden to either narrow the issue area or explain why states would be compelled to threaten dramatic action for issues of varying importance. In other words, more discussion is needed on what actually makes states like-minded. This is especially true when collective resilience hints at incorporating countries like the Philippines which are arguably aligned against China for strategic rather than ideological reasons. When the Philippines charges activists as terrorists before sanctioning China on grounds of protecting Tibetan activists, it feeds into Beijing's narrative that the West is hypocritical, opportunistic, and hawkish.[150]

Collective resilience has a paradoxical quality. Strengthening the threat requires more countries to join the collective resilience bloc. But as more countries join the bloc, presumably, the requirements for what constitutes action also rise. The threat of collective resilience grows and contracts simultaneously. The logic used to necessitate collective resilience is the logic that can be used to dismantle collective resilience. If it is true that "weaponized interdependence has been accepted as the price of doing business with China," then I cannot understand why actors would agree to a potential double penalty for the highly unlikely possibility that Beijing abandons its favorite foreign policy tool.

In building collective resilience strategy from a theoretical perspective, Cha cites a wealth of literature that pertains to nuclear deterrence theory. The applicability is arguably low. As Cha recognizes, weaponized interdependence has already been widely used and normatively accepted. Perhaps the problem related to the obscurity of issue-areas stem from the decision to model collective resilience off of nuclear deterrence theory. Actors are not "like-minded" in support of the liberal international order in the same way that actors are like-minded against annihilation. In this case, the target actor is actively working to dismantle the liberal international order.

The Assurance Problem: Stop or I'll Shoot, Comply or I'll Shoot!

Coercive interactions have three components: a "looming threatened punishment, a demand communicating what behavior the threat is contingent upon, and an assurance communicating that the punishment will not be carried out if conditions are met…a coercive threat always implies an assurance."[151] In the previous discussion, I alluded to the problems in defining the behavior upon which the threat is contingent. In this section, I will explore the problems in the collective resilience strategy related to credibility and assurance.

Credible assurance is just as critical to successful coercion as credible threat. Cha argues that the threat is large enough to compel deterrence. For this analysis, I will assume that the threat is large and credible. However, if the threat is large enough, there has to be credible assurance that compliance will guarantee non-punishment. As Reid B.C. Pauly writes, "If I am stronger than you, you are more likely to believe that I will punish you if you do not comply with my demands (threat credibility). But, the stronger I am, the more you must be concerned that I will hurt you anyway, even if you comply with my demands (assurance credibility)."[152] Consequently, as Robert Jervis wrote,

"Credible threats can fail because the other side believes the acts will be taken in any event."[153]

The assurance problem related to collective resilience is that there is no scenario with guaranteed non-punishment. Cha makes it clear that collective resilience is a supplement rather than a replacement to de-risking measures.[154] This is to say that regardless of what China does, barring a revolutionary transition to liberal democracy, Western countries are bound to trade less with China. And as aforementioned, countries cannot entirely decouple from China. As the potential for democratic transition is remarkably low, in the foreseeable future, liberal countries will trade less with China.

Assurance cannot be guaranteed because sanctions would be an acceleration of the status quo rather than a unique punishment. Therefore, even if the threat is credible, it may not have deterrence capabilities simply due to the fact that the punishment (i.e., reduced trade with liberal democracies) is inevitable. Cha argues for sanctions on high-dependence exports that have strategic value and low substitutability.[155] He calculates that out of twenty-three high-dependence exports, China could not mitigate the impact of collective resilience on twenty-two.[156] Of those twenty-two, nineteen would be highly costly to replace and three would be costly.[157] There is, of course, a difference between costly and impossible.

Even if all actors comply, there is a scenario in which Beijing decides that the upfront cost of accelerated diversification is preferable to abandoning advancing its global agenda. As it stands, there is already a bifurcation of the world order in which democracies are eroding and authoritarian regimes are emerging. States with aggregate score declines in freedom have outnumbered those with aggregate gains for 16 years.[158] If collective resilience is to set the precedent that no act of coercion will go unpunished, and China is unwilling to give up its global agenda, then the likely outcome is the clear emergence of a bisected trade regime.

In his discussion of President Franklin D. Roosevelt's failure to deter the Pacific War through an oil embargo, Pauly writes, "Washington failed to appreciate that its target might not want to live with a noose around its neck, unsure of when the next jerk might come."[159] In a similar fashion, it is possible to see why Beijing would not want to live in accordance with the threat of strangulation when the slow drip of de-risking is already occurring. Cha proposes that Canada and Australia, for instance, could threaten to act on their exports of nickel powders.[160] Ignoring the fact that Australia would lose its largest export market[161], it is unclear why China could not shift its strategy to its fifth-largest nickel powder export partner Russia or to the sixth largest global exporter Brazil.[162] Even if supply chain diversification and growing the domestic market is highly costly, it may be worth the price of continuing the regime with the added caveat that some degree of decoupling is inevitable.

With the parameters being that decoupling is inevitable and complete decoupling is impossible, then no matter what China does, it ends up between these two fuzzy boundaries. Assurance credibility is dampened by the fact that decoupling occurs regardless; threat credibility is dampened by the fact that complete decoupling is not possible. The structure of the situation poses inherent problems to constructing a coercive action.

The Resilience of Authoritarian Regimes

The final thing that I want to briefly discuss is the tendency for the West to underestimate the resilience of authoritarian states. Collective resilience is asking China to essentially dismantle its regime in its current form. At the opening of the Chinese Communist Party's National Congress in October 2022, Xi Jinping pledged to make China a modern socialist power by 2035 and a world leader in national strength and international influence by 2049.[163] Signaling a historic shift in policy, mentions of "security" eclipsed

"economy" in Xi's report to the party congress for the first time since the party was founded in 1949. Chief China economist at Nat West Peiqian Liu commented, "It definitely reflects the importance of national security, and it comes amid this unfavorable, more challenging external environment…The era of championing growth at all costs is basically behind us." Xi also warned of "dangerous storms" and instructed his colleagues to "demonstrate a 'fighting spirit' in the 'struggle' against corruption and foreign interference."[164]

There could not be more overt signaling that China is willing to suffer for the ill-gotten gains of global dominance and a new international world order. Just last September, China announced plans to unveil a new strategic partnership with Syria after Xi met with Bashar al-Assad.[165] Military intimidation of Taiwan continues to rise at an alarming pace. Today, in reference to the series of military drills, Taiwan Affairs Office spokeswoman Zhu Fenglian commented, "The purpose is to resolutely combat the arrogance of Taiwan independence separatist forces and their actions to seek independence…The provocation of Taiwan independence continues all day long and the actions of the People's Liberation Army to defend national sovereignty and territorial integrity are always ongoing."[166]

The logic of collective resilience naturally provokes a comparison to Russia. Sanctions have clearly failed to bring Russia to its knees. Experts insist that the problem is – big surprise – that there need to be *more* sanctions.[167] Increasing the costs of trading and shrinking industrial capacity cannot stop a revisionist, expansionist power from an existential quest. Of course, the state of affairs in China is not directly comparable. However, we would be wise to draw the observation that when pushed into a corner, some states will recline without hesitation for the sake of maintaining national policy objectives.

Conclusion

What benefits do these comments offer? They save me from being immortalized as a statue, but I digress. Hopefully, they yield some insight into how effective policy could be modified. With regard to the like-minded country problem, the observation to draw is that creating a bloc requires a very clear and strict definition of issue-areas. Perhaps, the more spurious observation is that it would be better to combat China through focused mini-blocs with the hope that the efficacy of such associations would eventually inspire a large and committed faction. As for the assurance problem, potentially there is a scenario where collective resilience is formalized with the caveat that the bloc becomes more trusting of China in the everyday sense. Finally, I would acknowledge that it is unwise to play chicken with authoritarian states. It is within their disposition to lose every battle to win the war – occasionally, in the literal sense. So how do we make sense of such an actor? Certainly not through a strategy that counts on them sacrificing every national ambition to avoid economic strife.

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552 Social Sciences Building
University of California, Berkeley
Berkeley, CA 94720-1970

http://basc.berkeley.edu
basc@berkeley.edu

ENDNOTES

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