

# THE EMERGENCE OF STRATEGIC CAPITALISM

GEOECONOMICS, CORPORATE STATECRAFT AND  
THE REPURPOSING OF THE GLOBAL ECONOMY

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## GEOECONOMICS, CORPORATE STATECRAFT AND THE REPURPOSING OF THE GLOBAL ECONOMY

The global economy is gradually drifting in the direction of strategic capitalism. In contrast to the free market capitalism prevailing in past decades, by resorting to geoeconomic measures, governments are imposing conditions on which goods, services and technologies can be transacted and which foreign economic partners are deemed trustworthy. Companies try to preserve their businesses as far as possible while at the same time recognize they have limited control over the unfolding geoeconomic shifts. The resulting market behaviour is a nuanced attitude that could be called corporate statecraft: companies are both constraining and stimulating state geoeconomic measures. The article describes this dynamic, in which the rise of China plays a central role, and argues that the dynamic between state geoeconomic measures and corporate statecraft will define how far the global economy will depart from the current market orientation and how much it will be subject to national strategic choices.



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# THE EMERGENCE OF STRATEGIC CAPITALISM

## GEOECONOMICS, CORPORATE STATECRAFT AND THE REPURPOSING OF THE GLOBAL ECONOMY

### INTRODUCTION

The global economy is gradually drifting in the direction of what could be called *strategic capitalism*.<sup>1</sup> States increasingly intervene in the production and flow of goods, services and data, as well as in the development and diffusion of technologies. Corporations, key stakeholders in the globalized economy, are trying to preserve their bottom lines in this new strategic context, but occasionally support some level of state economic interventionism. The combination of these forces is repurposing economic relations in a way that significantly challenges the market-oriented principles that have prevailed for over two decades.

Great power competition as well as vulnerabilities emerging from market-led economic interdependence are leading states to step in to make sure market transactions do not imperil the bases of national economic power. These actions contrast with the recent past, when national economic policies played the supporting role of promoting national firms to turn profits for their shareholders in a cost-effective manner.

Whether backed by claims of national security,<sup>2</sup> resilience,<sup>3</sup> economic sovereignty<sup>4</sup> or self-reliance<sup>5</sup>, there has been an uptick in state policies designed to safeguard “strategic assets”, “critical infrastructures” or “emerging technologies” from the free interplay of market forces – and ultimately from transferring control over these assets to foreign “strategic competitors” or “systemic rivals” through market mechanisms. Governments are thus more actively scrutinizing foreign investments, seeking to redesign supply chains, fostering the creation of national – and even foreign – “champions” as well as criticizing their national companies that do business with rival countries.

By actively interfering in economic relations to pursue strategic goals, states are acting in a *geo-economic* manner.<sup>6</sup> Yet geoeconomics is only part of the story vis-à-vis what is happening in the global economy.

While it sheds light on the *rationale* guiding states’ behaviour – certainly the key driver of the current shift – it leaves the corporate side of this story unaddressed. Given the significant level of global market integration, it is crucial to also look at corporate attitudes in order to grasp how much states’ geoeconomic action can re-shape economic relations.

One of the defining features of the liberal economic order now being challenged is that states deliberately provided the conditions enabling firms to take the front seat in globalizing the economy. Rules and institutions disciplining trade, investment and finance flows allowed companies to lead the process that resulted in the complex web of interdependent ties that shape the existing architecture of the global economy. Trade and investment liberalization are products of economic statecraft.<sup>7</sup>

But now states are reclaiming control over this process and firms are consequently being displaced as the main decision-makers in a number of economic areas. On the one hand, governments are determining that an increasing number of assets are excluded from market rules in view of their strategic nature and that certain countries are unreliable partners for a number of transactions. On the other, companies try to preserve their businesses as far as possible while at the same time recognize they have limited control over the unfolding geoeconomic shifts.

The resulting market behaviour is a nuanced attitude that could be called *corporate statecraft*: as would be expected, firms are pushing back against geoeconomic measures; but, on certain occasions, they are also advocating government intervention to safeguard strategic assets. Companies are thus both constraining and stimulating state geoeconomic measures.

*Strategic capitalism* is the term we use to capture the transformation in the logic underpinning the global economy – away from the prevailing market orientation and driven by the interaction of state geoeconomic measures and corporate statecraft. The dynamic between these forces will define how much the global economy will depart from market principles and to what extent economic relations will be subject to national strategic choices.

1 While we concur with the strategic backdrop that led Richard D’Aveni to devise this concept (D’Aveni, 2012), we deploy it here in a different manner, namely to describe the ongoing transformation in the functioning of the global economy.

2 Yang and Fontanella-Khan, 2020.

3 Borrell and Breton, 2020.

4 Pisani-Ferry and Wolff, 2019.

5 Daye, 2019.

6 Roberts, Choer Moraes and Ferguson, 2019, p. 655.

7 Baldwin, 1985, p. 46; Gilpin, 1975, p. 39.

It remains unclear where the states–markets balance will ultimately be struck. Still, developments in the past years are widespread enough to suggest the market capitalist logic is gradually and consistently losing ground to economic policies guided by a strategic *rationale*. This phenomenon extends beyond the US–China relations, it affects a host of economic areas other than the tech sector and it is being justified by broad strategic goals, and not only by national security concerns. For all these reasons, as discussed below, geoeconomic actions cannot be circumscribed to “state capitalism”, just as corporate statecraft amounts to more than geopolitical risk management.

In order to make sense of strategic capitalism, we begin by looking at the re–emergence of geoeconomics with the goal of identifying its causes as well as how it is taking shape in a number of government measures that ultimately diminish the role of the market in the global economy. We then analyse corporate reactions to this geoeconomic environment and point out how the shift toward strategic capitalism is transforming how states and markets interact.

## THE RE–EMERGENCE OF GEOECONOMICS: PRESERVING THE NATIONAL “SILVERWARE”

Strategic capitalism implies that market forces will not dictate as freely as before the way in which a number of international economic transactions unfold. Instead, in the instances where strategic assets are at stake, states are intervening to determine if and to what extent these transactions will come to pass. A suite of geoeconomic policies adopted or being considered in recent years provides compelling evidence that states are carving out an expanding scope of economic areas from market rules. This flurry of geoeconomic decisions is in stark contrast to states’ “policy of purposeful benign permissiveness regarding (...) the forces of globalization” that has prevailed until recently.<sup>8</sup>

Geoeconomics, understood as resorting to economic policies and instruments to achieve strategic goals, is certainly not a new idea.<sup>9</sup> This concept was crafted in the immediate aftermath of the Cold War to describe the arena in which the US needed to play if it wanted to successfully tackle an economically rising Japan.<sup>10</sup> This was also a period, predating by a few years

the advent of the World Trade Organization, in which commentators could argue that “[w]e are witnessing today a continuation of the same prosaic struggles for national commercial advantage that have characterized the world trading system since the days of Colbert and Clive (...)”.<sup>11</sup>

As it happened, however, the geoeconomic view of international politics was overridden by the market–driven policies and discourse that inspired the commitments agreed by states at the Uruguay Round of trade negotiations, from which emerged the WTO and the rules it was entrusted to manage. Placing constraints on the economic nationalism built into the geoeconomic *rationale*, the institutionalized economic regimes agreed at the time – along with remarkable technological advancements – paved the way for companies to structure their operations on a truly global scale, thereby leading to what Richard Baldwin called “globalization’s second unbundling”.<sup>12</sup> The integration of national economies was seen in a predominantly positive light, as expressed by a former director–general of the WTO in 1999: “[o]ur independence is best guaranteed by interdependence”.<sup>13</sup>

## A new geoeconomic cycle

If resorting to geoeconomics is not new, it is nonetheless re–emerging in the shape of an unprecedented profusion of policies deployed by a growing range of countries. The current geoeconomic cycle is leading to an intense regulatory activity that breathes life into old policy tools and pushes forward novel types of rules.

Traditional geoeconomic measures, such as sanctions and export controls, are being imposed on an increasing number of products that extend beyond the defence realm.<sup>14</sup> The 2018 reform of US export control points to a step change by directing the US government to focus on “emerging and foundational technologies”.<sup>15</sup> These concepts are currently being fleshed out by the US government, but their broad sweep signals the intention to address one of the criticisms levelled against export controls, namely their “backward–looking” nature in the specification of technologies considered critical.<sup>16</sup>

8 Kirshner, 2006, p. 4.

9 Scholvin and Wigell, 2018.

10 Luttwak, 1993.

11 Howell and Wolff, 1992, p. 2.

12 Baldwin, 2016, p. 5.

13 Moore, 1999.

14 U.S. Department of Commerce, 2020.

15 United States Export Control Reform Act, 2018.

16 Brown and Singh, 2018, p. 24.

The same trend towards more rigorous and wider scrutiny is also visible in regard to investment screening mechanisms, another set of policy tools being dusted off. Until recently, national economies would fight for foreign direct investments (FDI), to the point where states would not hesitate to grant foreign investors the right to challenge national policies before international private arbitrators. Now, a growing number of restrictions seek to keep certain foreign investors from acquiring even minority stakes in assets considered strategic. UNCTAD reports that, from January 2011 to September 2019, at least 13 countries introduced new investment screening legislation while at least 45 “significant amendments” to existing mechanisms were enacted.<sup>17</sup> According to the same UN agency, twenty foreign takeovers exceeding US\$ 50 million were blocked or abandoned globally for national security reasons between 2016 and September 2019, of which all but four involved Chinese investors.

On the side of innovative regulatory approaches, the European Union is working on new antitrust remedies to counter subsidized foreign investments.<sup>18</sup> By expanding to foreign actors the application of existing EU state aid rules, this proposal represents a pragmatic response to counter what would otherwise amount to legal acquisitions of assets in the European market.

Another break from the recent past is identifiable in governments’ attempts to actively redesign supply chains. The transition from the “state-centric Washington Consensus model of development” of the 1990s to a “global-value-chain framework”<sup>19</sup> meant that companies replaced states in setting the direction and pace of economic globalization. In this latter stage, corporations defined how to organize their production geographically, based on cost-effectiveness criteria – hence the global value chains sprawling across the world. Now, states are invoking strategic reasons to dent this liberty enjoyed by companies. Thus, for instance, Japan announced subsidies for the relocation of Japanese firms outside of China.<sup>20</sup> The French government is reported to be considering financial support for the reshoring of the production of paracetamol.<sup>21</sup> And the US government is going out of its way to prevent Chinese companies from catching up with American and especially Taiwanese companies that lead in the

production of semiconductors.<sup>22</sup>

States are also actively promoting or preserving national economic capabilities. In the US, proposals for a robust industrial policy are touted as a response to ‘Made in China 2025’, China’s very own package of geoeconomic policies;<sup>23</sup> the Trump administration offered Kodak a loan of over US\$ 760 million to re-engineer part of its expertise in producing chemicals for films into the local manufacture of pharmaceutical products;<sup>24</sup> and senior American officials have raised the possibility of subsidizing the Finnish Nokia and the Swedish Ericsson as part of the effort to unseat China’s Huawei from its leading position in the race to implement 5G infrastructures.<sup>25</sup>

With a possible difference in style, the EU and its member states are inching forward in the same direction. In a push to boost Europe’s “technological sovereignty”, the European Commission is proposing measures to foster a European cloud service industry with a view to reducing Europe’s “technological dependencies in (...) strategic infrastructures (...) at the centre of the data economy”;<sup>26</sup> and while the EU’s most senior competition official was making the case for member states to buy stakes in companies to stave off Chinese takeovers,<sup>27</sup> the German government was doing precisely that – but to prevent a US government-led acquisition of a German vaccine-maker. “We do not sell our silverware”, quipped Peter Altmeier, Germany’s economy minister.<sup>28</sup>

The financial sector is also being targeted by government decisions that impact the functioning of markets to varying degrees – decisions whose timing certainly suggests the concern to affect economic rivals. Accordingly, the US Senate and the Trump administration are pressing ahead on the enforcement of audit obligations required of Chinese companies listed in the US, which might ultimately lead to their delisting from the American stock market.<sup>29</sup> The US government is also acting to deflect certain investments away from China. After being cautioned against national security preoccupations as well as unnecessary risks to investors, a government pension fund decided to halt its investments in Chinese companies earlier in 2020.<sup>30</sup>

17 UNCTAD, 2019.

18 Fleming, Espinoza and Peel, 2020.

19 Gereffi, 2014.

20 Reynolds and Urabe, 2020.

21 Abboud and Peel, 2020.

22 Blank, 2020.

23 Rubio, 2019.

24 Rampton, 2020.

25 Stacey, 2019.

26 European Commission, ‘A European strategy for data’, 2020, p. 9.

27 Espinoza, 2020.

28 Miller and Cookson, 2020.

29 Rapoza, 2020.

30 Sevastopulo, 2020.

The measures described above are only a few examples of the intense geoeconomic activity that has taken place in recent years. While they certainly show the visible hand of the state trying to direct economic relations, these cases cannot be reduced to instances of “state capitalism”. By seeking to preserve national security or the national control of assets considered strategic, states are not using “markets primarily for political gain” or “to create wealth that can be directed as political officials see fit”.<sup>31</sup> Although the two notions might occasionally overlap (e.g. the use of state-owned enterprises for non-economic purposes), geoeconomics encompasses broader objectives and measures not captured by state capitalism, such as the imposition of export controls or investment screening in order to safeguard the domestic control of certain assets.

### **The current geoeconomic cycle and the shift towards strategic capitalism**

Widespread geoeconomic measures portend a shift towards *strategic capitalism* in which the space for market-led transactions is constrained by state strategic concerns. A growing number of sectors considered strategic are being subtracted by governments from the operation of market forces. Additionally, governments are increasingly vetting transactions to make sure states considered “rivals” do not reap benefits from these operations.

As revealed by the suite of geoeconomic measures seen earlier, this seems to be a sustained change in the logic underlying economic relations. It is not only about US-China relations, it is not limited to the protection of national security, and it extends beyond the tech sector.

The expansion in the scope of geoeconomics poses an important challenge for businesses: it might be straightforward to view emerging technologies as a strategic element in national economic power, but what about face masks and paracetamol? A clear-cut delimitation of strategic assets is far from obvious and harks back to what David Baldwin called the “strategic goods fallacy”, namely the misunderstanding that some goods are intrinsically more strategic than others.<sup>32</sup> The indeterminacy surrounding the boundaries of “strategic assets” – and in consequence the parameters to determine what can be hollowed out from the

market rules – makes it harder for economic agents to assess the risks involved in market transactions.

Testament to the continued pertinence of Baldwin’s argument is the current debate on whether Hollywood movies represent some sort of US strategic asset. As Chinese investments in this industry lead American studios to self-censor the content of their movies,<sup>33</sup> US authorities are alerting to the risks associated with having its entertainment sector enlisted as an arm of the Chinese government’s propaganda in “American theaters to American audiences”.<sup>34</sup>

Strategic capitalism also affects the operation of the market in an additional manner. The notion of “strategic assets” is not only open for states to flesh out; it is also a *relative* one: transactions involving such assets might be allowed with some partners while not with others. A strategic capitalist environment is one marked by increased scrutiny over the transfer of assets to certain third parties and their countries. Where to draw the line?

One alternative is to leave the decision entirely to the discretion of government agencies, an option that also comes with costs in terms of certainty for businesses. Another is to attempt some level of objectivity in the criteria for discerning which partners might be considered acceptable and trustworthy. Thus, in seeking to assess the risk profiles of equipment suppliers for 5G networks, the EU recommends member states to take into consideration “[t]he likelihood of the supplier being subject to interference from a non-EU country”. This marker can be assessed by the presence of, among other things, “a strong link between the supplier and a government of a given third country”, “the characteristics of the supplier’s corporate ownership” and “the ability for the third country to exercise any form of pressure (...)”.<sup>35</sup>

The US opts for a different approach in determining the target of its actions, but the outcome is equally aimed at excluding some partners from transacting with American actors. The recent expansion of the “Clean Network”, for example, focuses on countering “aggressive intrusions by malign actors, such as the Chinese Communist Party”.<sup>36</sup>

Important consequences for the functioning of economic relations stem from these geoeconomic

31 Bremmer, 2010, p. 5.

32 David Baldwin, 1985, p. 216.

33 Raustiala, 2020.

34 U.S Department of Justice, 2020.

35 European Commission, ‘Report on EU coordinated risk assessment on cybersecurity in Fifth Generation (5G) networks’, 2020, paragraph 2.37.

36 U.S. Department of State, ‘Announcing the expansion of the Clean Network to safeguard America’s assets’, 2020.



measures. First, the country from which companies and investors originate becomes a key factor in corporate risk assessment, irrespective of whether these actors have any relation whatsoever to their national governments, as the US measures against Chinese app TikTok reveal.<sup>37</sup> Second, the distinction between countries that are considered trustworthy and those that are not implies a bifurcation of markets: economic relations are allowed only for those considered reliable.

In a strategic capitalist environment, market operators are likely to be seen as associated with their home governments.<sup>38</sup> Their businesses risk being contaminated by frictions in the political relations involving their national governments. As expressed by the president of the European Union Chamber of Commerce in China, “[i]t is not beyond the realms of possibility that a company that is in favor one year, may suddenly fall out of favor the next if its home-country government comments on an issue that is deemed to be sensitive”.<sup>39</sup>

An economic order where companies need the green light from their governments before doing business with foreign partners is not necessarily a retreat into self-sufficiency, but it certainly suggests a fragmentation of the global market along strategic lines – and this of course imposes a number of important changes in the way that companies conduct their operations.

## A GEOECONOMIC CHAIN REACTION: PUTTING THE RE-EMERGENCE OF GEOECONOMICS IN CONTEXT

The fact that all of the geoeconomic measures described above took place in the space of the last years is no coincidence. These measures are *reactions* to essentially two interrelated events: the impact of China’s development model in the global economy, itself heavily reliant on geoeconomics and, to a lesser extent, the perception that market-driven globalization excessively based on interdependent, fragmented production poses risks that were disregarded until recently – as demonstrated by the shortages of medical supplies in the wake of the Covid-19 outbreak.

The measures examined in the previous section are thus not fortuitous. They are part of a *geoeconomic chain reaction*.

In recent years, a consensus consolidated, first in

the US<sup>40</sup> and later in other major Western economies, that China’s development model would not confirm the expectation held since the early 2000s whereby it would adopt reforms that would ultimately grant foreign market actors equal opportunities to tap into the Chinese market. Instead, what became increasingly apparent was that China benefited from largely unrestricted access to global markets without according similar conditions to foreign companies in its economy.

Lack of reciprocity for foreign companies persisted over the years as a frustratingly unresolved irritant in bilateral relations with China, but economic ties with China were still viewed favourably – the Chinese market was, and remains, an important source of revenue for a significant number of foreign businesses.<sup>41</sup> It was, instead, the Chinese geoeconomic policies calling for increased self-sufficiency (and consequent discrimination in favour of Chinese companies) that raised the concerns of Western countries to a strategic level. These policies cast the lack of reciprocity and the discriminatory treatment against foreign companies in China in a substantively different light.<sup>42</sup> Borrowing Albert Hirschman’s terminology, these developments revealed that China was not pursuing policies “trying to maximize national income” (driven by economic imperatives) but rather economic policies to “maximize national power” (guided by a strategic, power politics logic).<sup>43</sup>

This is also the period when China became more outspoken about staying its course, which further reinforced the perception that the expectations of its convergence to a market economy model were misguided. China came forward to advance a narrative in favour of a diversity of market economy options. Its position on WTO reform, for example, calls for “respect [for] members’ development models”, criticizing members that “point fingers at other members’ legitimate developmental models and policy measures, such as state-owned enterprises and industrial subsidies”.<sup>44</sup>

Therefore, persistent corporate grievances compounded by government anxieties tilted the domestic political balance in Western countries towards a change in tack in dealings with China. China’s geoeconomic

37 White House, ‘Executive Order on Addressing the Threat Posed by TikTok’, 2020.

38 Luttwak, 1990, p. 22.

39 Wuttke, 2020.

40 White House, 2020, *United States Strategic Approach to the People’s Republic of China*.

41 See, for example, AmCham China, 2020.

42 See for the US: Office of the United States Trade Representative, 2018, pp. 4, 43, 147 and 171; for the European Union: European Commission and High Representative of the Union for Foreign Affairs and Security Policy, 2019, p. 5.

43 Hirschman, 1945, p. 20.

44 Ministry of Commerce, People’s Republic of China, 2018.



behaviour would increasingly be met with geoeconomic reactions. Commentators have called for the US and other Western democracies to double down on their values in order to respond to China's rise,<sup>45</sup> but so far most democracies are replicating China's geoeconomic stance – at least in their relations with China. Whether they will be able to maintain their values in their relations with third countries remains an open question.

The emergence of the geoeconomic chain reaction gives concrete shape to what, until now, remained only a likely development in the writings of some analysts. Accordingly, in a somewhat deterministic manner, Edward Luttwak's "logic of strategy" posits that "China's continuing rise (...) will inevitably be resisted by geo-economic means – that is, by strategically motivated as opposed to merely protectionist trade barriers, investment prohibitions, more extensive technology denials, and even restrictions on raw material exports to China (...)".<sup>46</sup>

The geoeconomic chain reaction does not necessarily mean the containment of China or that countries are checking its rise. Nor does it determine that China is not entitled to pursue its own development model. Rather, it implies the recognition that China's geoeconomic policies shift the game away from the market orientation that has prevailed until now. Most examples of the geoeconomic measures presented in the previous section seek to reciprocate China's domestic restrictions and shield strategic assets from being accessed by Chinese public and private actors. Thus, what became the EU investment screening mechanism in 2019 had as one of its opening salvos a letter by the economy ministers of France, Germany and Italy to the European Commission expressing concerns "about the lack of reciprocity and about a possible sell-out of European expertise, which we are currently unable to combat with effective instruments".<sup>47</sup> Likewise, the list of representative technology categories<sup>48</sup> being considered in US as possible "emerging technologies" essential to national security reflects the sectors identified as priorities of the "Made in China 2025" initiative.

A second factor driving the geoeconomic chain reaction is a reversal in the prevailing perception of economic interdependence, until recently viewed largely as a source of efficient allocation of resources.

Shortages of face masks and other medical products to respond to the Covid-19 outbreak brought home to many policymakers that market-led supply chain design had moved production too far from home.<sup>49</sup> The pandemic exposed the vulnerable side of interdependence that geoeconomic analysts had earlier been warning about.<sup>50</sup>

Even absent any deliberate intent to weaponize interdependence, it was the very structure of globalized interdependence – fragmented, but concentrated in a small number of sources – that sparked the calls for increased resilience in the supply of certain goods. According to a report by the McKinsey Global Institute, "[m]any low-value or basic ingredients in pharmaceuticals are predominantly produced in China and India". The same report identified "180 products across value chains for which one country accounts for 70 percent or more of exports, creating the potential for bottlenecks".<sup>51</sup>

The anxieties aroused by over-reliance on interdependence are directly associated with the fact that China is a key node in many supply chains, thereby turning into "strategic goods" even products of modest technical sophistication, such as face masks. Of course, the immediate link that associates China with the *malaise* in respect of interdependence should not obfuscate the fact that the existing architecture of production networks – nor China's position in it – is the direct result of corporate decisions, themselves enabled by political decisions promoted by Western countries.

As governments abandon the arm's length approach to markets and try to make sense of how vulnerable their countries are to external shocks, they step into an area with which they have little familiarity, particularly because this process has been led by the market. States are trying to identify on the go where government action is needed and how to proceed, as we discuss in the next section.

### **Balancing dependence: the perceived need to manage interdependence**

As the name implies, most of the geoeconomic reactions thus far are responses addressing individual strategic challenges identified in specific areas (e.g. foreign investment, technology transfer, control over critical

45 Bremmer, 2010, p. 179.

46 Luttwak, 2012, p. 42.

47 Reuters, 2017.

48 US Department of Commerce, 2018.

49 Farrell and Newman, 'Will the Coronavirus End Globalization as We Know It?', 2020.

50 E.g. Leonard, 2016; Wigell, Scholvin and Aaltola, 2018.

51 McKinsey Global Institute, 2020, p. 11.

infrastructures). They do not yet represent thought-through grand strategies designed to adapt to the shift to strategic capitalism. And a central reason why most geoeconomic reactions are knee-jerk reflexes to risks that emerge in different areas is because countries are not fully aware of how interdependent their economies are.

In an attempt to strike the right balance between safeguarding strategic interests while minimizing damage to the economy, we expect that governments will start to give consideration to the *balance of dependence*. As Thomas Wright argued, “[c]ountries will delink from each other where they perceive a strategic vulnerability”.<sup>52</sup> In order to engage in this exercise, a number of questions require definition, which is ultimately a task for domestic politics: (1) Which strategic assets should be subject to delinkage?, (2) Are governments equipped to protect these assets? and (3) Is the government willing to bear the costs associated with the decision to remove these strategic assets from the free interplay of market forces?

What we call the “balance of dependence” is a key step in informing policymakers as governments manage their exposure to interdependence. Also here it is possible to see China leading the way in managing how much it relies on the world economy.

A 2019 study by the McKinsey Global Institute reported that “China is becoming less exposed to the rest of the world, which, in turn, is becoming more exposed to China”.<sup>53</sup> Particularly under the current leadership, China has become more wary of the risks associated with too much interdependence. The concept of “national security” now reflects the “wide scope of industries that Chinese legislators wish to protect and preserve against inward foreign investment”.<sup>54</sup> These fears have only grown in intensity in the wake of President Trump’s policies towards China and Chinese companies.<sup>55</sup> In what could amount to awareness of its own “balance of dependence”, China’s government is reportedly trying to wean itself off its reliance on foreign suppliers for “stranglehold technologies”, arguably in preparation for a more hostile world economy.<sup>56</sup> As Hirschman put it, “in general, a country embarking on a power policy will have fixed for the amount of its trade relations with foreign countries a certain

maximum limit which it will think unsafe to exceed”.<sup>57</sup>

In the countries which are now beginning to react to China’s management of interdependence, particularly in the US, debates are increasingly more nuanced and cognizant that solutions are more complex than the simplistic dichotomy between relying on China or reshoring production. It is increasingly acknowledged that some degree of strategic action in the economic domain is required of states,<sup>58</sup> otherwise the asymmetry between China’s selective market economy and the openness of third markets will generate risks for the latter. As France’s President Macron put it, the *naïveté* towards China is over.<sup>59</sup>

In the EU, the European Commission is advancing proposals to bring together a number of initiatives that give concrete expression to “Europe’s strategic autonomy”, a concept which “is about reducing dependence on others for things we need the most: critical materials and technologies, food, infrastructure, security and other strategic areas”.<sup>60</sup>

Ultimately, the balance of dependence is an exercise that takes place in the domestic politics arena, taking into account the locally affected interests – as well as, of course, the international constraints that shape a country’s foreign policy. This means there is no pre-determined result for this exercise. Countries might conclude, all factors weighed, that they are comfortable with the existing level of interdependence.

An interesting example is a recent report by the New Zealand-China Council<sup>61</sup> discussing the risks associated with New Zealand’s reliance on the Chinese market for its exports, especially for agricultural products and services – China absorbed more than 24% of New Zealand’s exports in 2018. The document frames the debate in an interesting light by stating that “[t]here is no obvious right or wrong answer to the question of how much New Zealand should export to or import from China, or any other market for that matter (...)”.<sup>62</sup>

Crucially, the report posits that “asserting that New Zealand is ‘too’ economically reliant on China implies it is possible to define somehow the ‘correct’ size of the trading relationship”.<sup>63</sup>

This seems like a sensible way of portraying the

52 Wright, 2017, p. 153.

53 McKinsey Global Institute, 2019, p. 4.

54 Huang, 2019.

55 Gewirtz, 2020.

56 *Economist*, ‘Xi Jinping is trying to remake the Chinese economy’, 2020.

57 Hirschman, 1945, p. 19.

58 See, for example, Friedberg, 2020; Farrell and Newman, ‘Chained to globalization’, 2020; Gertz, 2020; and Gehrke, 2020.

59 Peel, Mallet and Johnson, 2019.

60 European Commission, ‘Communication on a new industrial strategy for Europe’, 2020, pp. 13–14.

61 New Zealand-China Council, 2020.

62 *Ibid.*, p. 4.

63 *Ibid.*

trade situation vis-à-vis China, but it reveals a bias that privileges the economic perspective of the question of dependence. It overlooks its political (or geoeconomic) angle. In fact, this question goes to the heart of the current re-edition of the “states and markets” debate: some governments know the “correct” level of reliance on China has been exceeded because they see the space for strategic decision-making being affected by domestic economic interests.

### **CORPORATE STATECRAFT: MARKET VIEWS ON NATIONAL SECURITY AND STRATEGIC INTERESTS**

The increasing introduction of geoeconomic measures by states alters the rationale on which economic relations have been based, in the process limiting the market’s leading position in these relations. Under market capitalism, it is in states’ strategic interest that companies are able to pursue their economic goals in an environment with minimal political interference. Instead, strategic capitalism is putting under strain the frequently held convergence between “national interest” (strategic) and “corporate interest” (economic).<sup>64</sup>

Reactions from market players seek to reconcile the economic imperative that has oriented their businesses until now with the emerging strategic logic that gradually encroaches upon market transactions. These reactions could be grouped under what we call *corporate statecraft*: by instinct, companies seek to preserve their businesses but, in a shifting strategic global environment over which they have limited control, this often requires adapting their attitudes in order to achieve that goal.

Traditional accounts of state-market interactions tend to oscillate between a state-centric approach that sees corporations as extensions of government power and the transnational view in which firms are portrayed as autonomous actors that undermine the state’s authority.<sup>65</sup> Corporate statecraft examples show the reality is slightly more nuanced: companies have adopted responses which range from taking sides in the geoeconomic dispute all the way to rejecting states’ geoeconomic measures.

Perhaps the most instinctive corporate attitude is to keep states at a distance, as has been the prevailing approach before the current geoeconomic cycle. Firms

and other market players attempt to keep a lid on state interference over their activities in an attempt to literally maintain business as usual.

The Federation of German Industries (BDI) declared in a 2019 report that “German industry has no interest in a conflict-oriented economic, political and technological containment or decoupling from China”.<sup>66</sup> Similarly, in the US public consultation seeking inputs to define “emerging technologies” to be subject to export controls, a number of responses either sought to discourage the imposition of such controls or argued for a strict definition of which technologies to target. Amazon, for example, contended that “export controls on these [emerging] technologies, unless carefully and narrowly drawn and truly essential to national security interests, would ultimately hurt U.S. companies and competitiveness globally”,<sup>67</sup> while Tesla argued that “controls on the export of technology can be counterproductive to the United States’ technological leadership”.<sup>68</sup>

Tesla is, in fact, one of the companies which is betting on manufacturing in China, despite the escalating US-China geoeconomic tensions. Its Shanghai Giga-factory, which began production in 2019, expects to source 100% of its components from China by the end of 2020.<sup>69</sup> Other companies also appear to be taking a “one company, two systems” approach – certainly with an eye on the promising returns from the Chinese market<sup>70</sup> – in the hope that adapting their activities to the particular demands of each side of the strategic divide will allow them to continue their operations with minimal geoeconomic disruption.<sup>71</sup>

Companies also seek to preserve their businesses by portraying the state-corporate interaction as mutually reinforcing. In this type of corporate reaction, they argue the strategic character of their sectors, in what would amount to a corporate version of the “economic security is national security” argument raised with different formulations by government officials. Thus, for example, during the US government public consultation on “emerging technologies” mentioned above, the US Semiconductor Industry Association (SIA) claimed that “[m]aintaining a strong U.S. semiconductor research, design, manufacturing and

64 Gilpin, 1975, p. 142; Krasner, 1978, p. 89.

65 Babic et al, 2017.

66 Federation of German Industries, BDI, 2019, p. 6.

67 Amazon.com, Inc., 2019.

68 Tesla, Inc., 2019.

69 *Global Times*, 2020.

70 Fang, 2020.

71 Helberg, 2020.

supplier base is, in itself, a national security issue”.<sup>72</sup> It is worth noting that this strategic claim is couched in economic terms (companies in general show deference to the state’s prerogative to determine what is in the national security), with the case being made by showing the negative economic impacts that geoeconomic measures would have on the US privileged position in a given technology.<sup>73</sup> This category of corporate statecraft also includes examples in which a firm more openly takes sides on the geoeconomic dispute, such as Facebook’s case for its importance in supporting the American economy and values – ‘Facebook is a proudly American company’, as Mark Zuckerberg stated during a congressional hearing on antitrust practices by digital platforms.<sup>74</sup>

A different, but related, example of corporate statecraft is observed in companies’ positions pleading for their home governments to adopt geoeconomic measures. These are often presented as necessary to preserve the national leadership in some economic sectors or to level the playing field, all the while supporting these companies’ businesses. In 2020, the US Semiconductor Industry Association released a report in which it took aim at China’s industrial policies designed to support indigenous development of chip manufacturing, which will possibly lead to a loss of US market share in China. It then went on to advocate active state measures, such as tax incentives and investments in this industry “[b]ecause of the importance of semiconductor technology to our economy and national security, and in light of the challenges facing the U.S. in maintaining its leadership in this field”.<sup>75</sup> This stance has been echoed by Google’s former CEO, Eric Schmidt, who advocates a number of public-private initiatives to “renew American leadership” at a moment of competition with China.<sup>76</sup> In its 2019 China paper mentioned above, the German BDI also put forward a number of proposed geoeconomic measures to counter China’s practices, at the same time that it recognized the importance of the Chinese market to its associates.<sup>77</sup>

In addition, there are also instances in which market players have pushed back against geoeconomic measures. Accordingly, US companies Cisco and Oracle rebuffed the Trump administration’s proposal to

develop open source 5G software to compete against Huawei;<sup>78</sup> Germany’s BDI criticized its government’s proposal to fund stakes in national companies – in order to avert foreign acquisitions in strategic sectors – claiming that public resources should be used instead to finance research in new technologies;<sup>79</sup> and Toyota and other Japanese companies are reportedly not taking the subsidies offered by Japan to relocate their supply chains out of China, attracted as they are to the promising returns from the Chinese domestic market.<sup>80</sup>

This is a dynamic context and it remains challenging to discern a clear path adopted by corporations in trying to preserve their businesses. Traditional geopolitical risk management does not provide companies a sharp compass to navigate this type of transformation. Geoeconomic actions affecting companies’ operations cannot be subsumed under “a coup, state intervention, the actions of local oligarchs, a change in the political fortunes of a key local partner, or a radical shift in public sentiment toward the company”.<sup>81</sup> Rather, it is the very *rationale* of capitalism that is being reshaped as the result of frictions between major economic powers.

### The multilevel geoeconomic context

The current geoeconomic cycle is not only dynamic. It is also playing out at different levels, which all contribute to the shift to strategic capitalism.

The first level is *state to state*. It essentially expresses itself in the dynamic leading to the geoeconomic chain reaction described above. The second level involves *states and their national firms* and takes place within the domestic political arena. The third level describes the interactions between *one state and foreign companies*. In these two levels where states and companies interact, strategic and economic interests will converge or diverge – leading to counterintuitive situations in which strategic interests of a state converge with those of foreign corporations, yet diverge from strategic goals of the host state of the same firm. We look at the two levels of state-firms interaction in turn.

It might be difficult to define *a priori* how far states can go in imposing on their national firms the bill for geoeconomic decisions. But a good barometer for

72 Semiconductor Industry Association, 2019, p. 1.

73 Ibid., p. 4.

74 U.S. House of Representatives Committee on the Judiciary – Subcommittee on Antitrust, Commercial, and Administrative Law, 2020.

75 Semiconductor Industry Association, 2020, p. 3.

76 Schmidt, 2020.

77 Federation of German Industries – BDI, 2019.

78 Waters, 2020.

79 Nienaber, 2019.

80 Ryall, 2020.

81 Luttwak, 1990, p. 128.

assessing the limits of state action should be domestic political debates. This is an aspect highlighted by Luttwak, who underscored that “geo-economic activity of the state will become a focal point of political debate and partisan controversy”.<sup>82</sup>

Decades of free market capitalism have surely given global business enough clout to push back on government decisions,<sup>83</sup> but this power is not without limits, as many of the recent geo-economic measures demonstrate. Similarly, states should not assume they will enjoy free rein in radically subverting economic relations simply by transferring the policy arena to the strategic realm. There are no reasons to expect either states or markets to have the upper hand in determining how much economic relations can depart from market-oriented principles. In fact, the examples above show that the “states and markets” dynamic flows in both directions: companies seek to limit the impact of governments’ geo-economic actions over their businesses; at the same time, however, they also attempt to induce governments to adopt measures – such as industrial policies and tax incentives – that hedge their positions in a geo-economic battle they cannot control.

A key element to observe, then, is how much the state can mobilize resources for geo-economic strategies. Intuitively, state capitalist systems can be assumed to have a comparative advantage over market economies when it comes to mobilizing resources for geo-economics.<sup>84</sup> By comparison, in market democracies, where business–government relations are more distant, policymakers will be constrained in using firms to advance the state’s geo-economic interests. There are also cases, however, where this assumption is not confirmed. Thus, China sometimes finds it difficult to control its corporate actors, even state-controlled ones,<sup>85</sup> while, as shown above, industries in Western countries are lobbying their governments to adopt geo-economic measures designed to reciprocate China’s geo-economic policies.

In an environment in which states and markets have diverging views on the need for geo-economic policies, part of the mobilization efforts involves the narratives deployed to convince the public. As Stephen Krasner argued, “[t]he arena in which an issue is decided is partly a function of its inherent nature and

partly a function of the way in which it is defined”.<sup>86</sup> This seems to be precisely what drove senior US officials, in a series of coordinated speeches delivered in 2020, to lash out at a vast array of American companies – from hotel chains to airlines, from the NBA to big tech and Hollywood – for kowtowing to the demands of the Chinese Communist Party.<sup>87</sup> By taking the unprecedented step of publicly bashing important contributors to the US GDP, American officials seemed intent on reframing the debate on China away from a purely economic discussion. These official statements express the divergence between the government strategic view on China and companies’ economic interest in accessing the Chinese market.

Whether such an approach will pay off by embarrassing companies out of doing business with China remains an open question. But resorting to this type of strategy is telling inasmuch as it suggests that the government’s arsenal for strong-arming such companies might not be much more diversified. In the current context of deep economic interdependence, if countries force companies to take sides, they might oblige, but not necessarily in the direction expected.<sup>88</sup>

This is where it becomes important to focus on the third level of the geo-economic dynamic, which involves states and foreign companies. In particular, it is relevant to pay attention to certain interactions between China and market actors in the US, as well as between the US government and some Chinese companies. As the US and China take different approaches to the management of interdependence, this level of state–market interaction shows varied patterns of divergence and convergence of security and economic interests.

Tesla’s Shanghai Gigafactory is a case in point regarding China’s strategic approach to interdependence: unlike many other foreign businesses, the electric vehicle manufacturer built its plant in record time, thanks to expedited bureaucratic procedures; it benefited from Chinese state-sponsored financing and subsidies; and it is also China’s first car plant wholly owned by a foreign company.<sup>89</sup> Another example of managed openings is seen in China’s overtures to Wall Street.<sup>90</sup> Despite the US administration’s attempts to

82 Luttwak, 1990, p. 128.

83 Strange, 1996, p. 29.

84 Gertz and Evers, 2020, p. 117.

85 Kärkkäinen, 2016.

86 Krasner, 1978, pp. 89–90.

87 See Barr, 2020; Pompeo, ‘Communist China and the Free World’s Future’, 2020; and O’Brien, 2020.

88 Swanson and McCabe, 2020.

89 Mc Morrow, 2019.

90 *Economist*, ‘Is Wall Street winning in China? As America tries to cut links, China is opening its door to foreign capital and firms’, 2020.



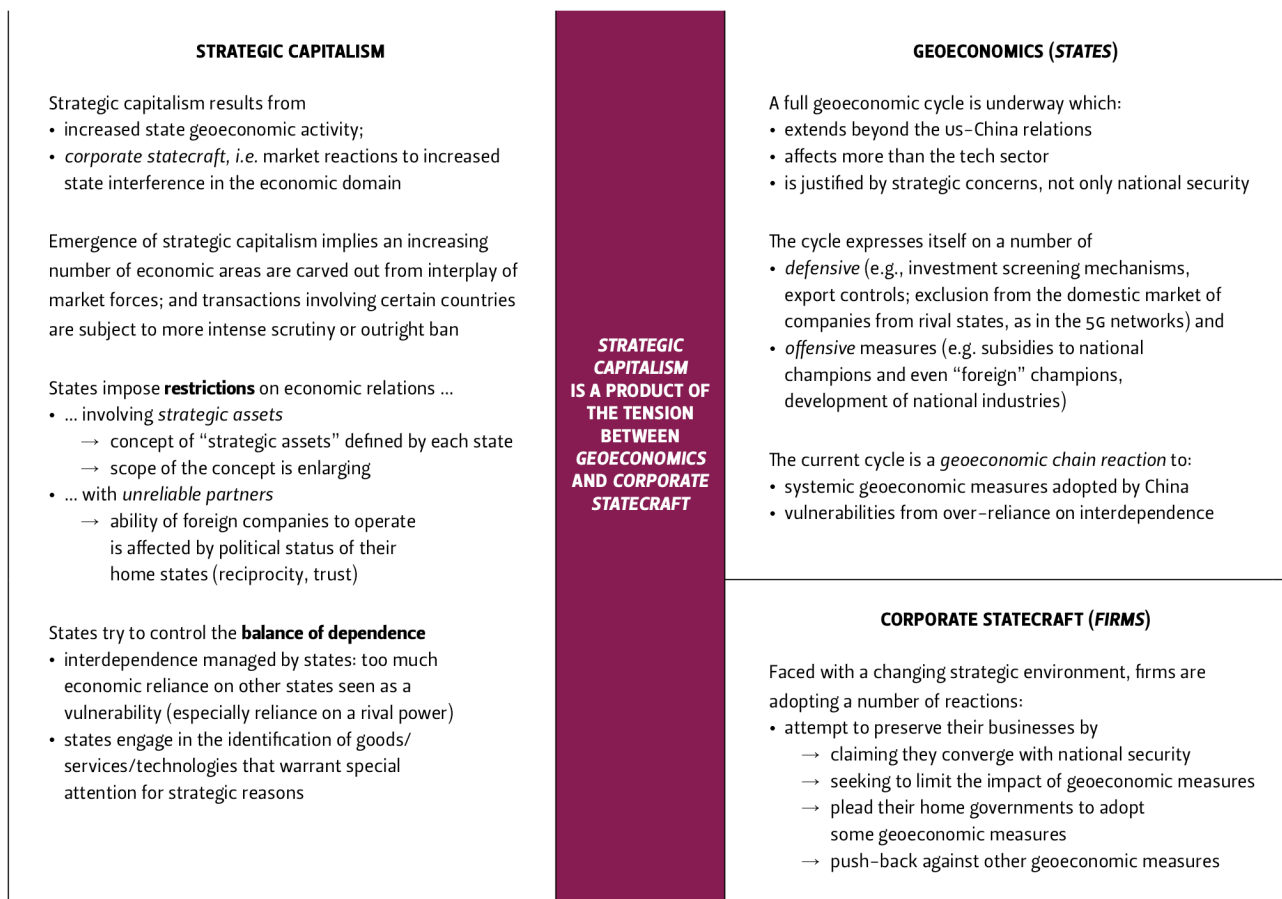


Figure 1. Strategic capitalism in a nutshell.

spook investors from the Chinese financial market, China’s government has been recently luring American financial firms into its market by a series of market access decisions.<sup>91</sup> These cases show an interesting convergence between the strategic interests of the Chinese regime and the economic goals of these market actors in accessing China’s promising domestic market – a pattern of convergence also seen in those sectors of the US economy subject to the fury of senior American officials, as described earlier.

The US seems to be taking a less selective approach to managing interdependence with China. The cases of Huawei, WeChat and Tiktok, virtually excluded from the US market, as well as the companies which risk being delisted from the US stock market, show the US government’s willingness to sever ties with China. These movements signal a divergence between the strategic views of the US government and the economic interests of those companies. This, in turn, reflects the prevailing perception, in the US, that there is significant convergence between the economic interests

of Chinese companies with the strategies of the government of China.

The point being made, of course, is not that China is more of a pro–market capitalist whereas the US is not. Both sets of actions follow a strategic (non–market–oriented) logic: by selectively opening its market, China seeks access to assets it has prioritized while the US is working to prevent China from enjoying such access, which it sees as a stepping stone in China’s ascent as a major rival power.

Instead, what is relevant is that by increasing interdependence with strategic sectors of the US economy (at the level of *state–foreign companies*), China puts to test the US government’s capacity to mobilize resources to deploy geoeconomic measures. It affects the US ability to balance the dependence with China given that influential economic sectors in the US policy–making become stakeholders of the Chinese economy.

The geoeconomic dynamic at this level (state–foreign companies) is not limited to the US domestic

91 Weinland, 2020.



context, of course. It plays out also elsewhere, involving domestic sectors in other countries that have developed economic links with China – these domestic actors are expected to advocate a market-oriented approach to China and oppose a geoeconomic one, which might affect their businesses. As mentioned earlier, national debates opposing economic to strategic interests will reflect the characteristics of each bilateral economic relations with China – and the points where balance will be struck may vary across the world. This process will, in turn, influence how far the global economy will drift toward strategic capitalism.

### **CONCLUSIONS – SHIFTING TO STRATEGIC CAPITALISM, BUT HOW MUCH?**

Branko Milanovic recently warned about the rise of a “clash of capitalisms”, pitting liberal, meritocratic capitalism (epitomized by the Western countries) against a state-led, political model, of which China represents the main example.<sup>92</sup> Drawing on this characterization, we would argue that strategic capitalism stands at the friction points of these two

clashing models.

Strategic capitalism is increasingly the prevailing approach to regulating economic interactions between actors on the two sides of the strategic divide. Whether strategic capitalism will also end up disciplining economic transactions *within* each strategic camp is still undefined. In fact, it could be argued that the state-led model of capitalism is already in many ways ruled by this approach. The pressing question remains about the evolution of the liberal capitalist model – the model which has shaped the globalized economy in past decades.

Much of the evolution of these trends will depend on the domestic debates taking place in different countries, particularly in the US and China. Everywhere, including in these two major powers, domestic actors and external constraints will play a key role in determining the extent to which the economic order will drift away from the prevailing market orientation – in many ways, this is a struggle to define the proper place of policymaking<sup>93</sup> and some level of public-private collaboration is warranted.<sup>94</sup> What seems evident is that capitalism will become more strategic, and less market-driven, in the coming years. /

92 Milanovic, 2020.

93 Cohen, 2020.

94 Borchert, 2020.

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