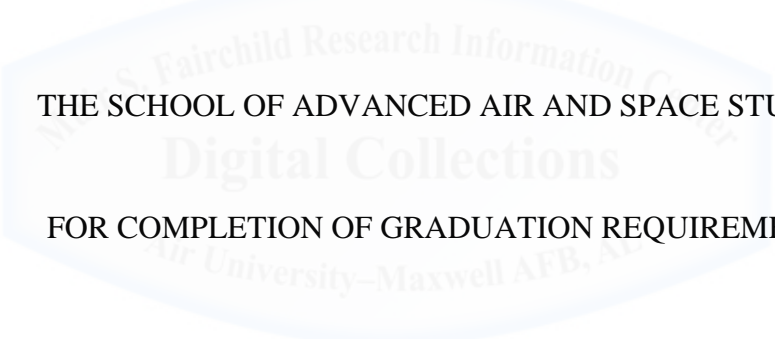


INVESTING IN THE FUTURE WORLD ORDER:
GEOECONOMIC STRATEGY AND FOREIGN DIRECT INVESTMENT

BY

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DISCLAIMER

The conclusions and opinions expressed in this document are those of the author. They do not reflect the official position of the US Government, Department of Defense, the United States Air Force, or Air University.



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ABSTRACT

Preservation of the US-led liberal world order is vital to the national security interests and long-term economic prosperity of the United States, and changes are occurring to the international system which warrant US attention. There has been a resurgence of the use of economic tools in statecraft and a rise of Foreign Direct Investment (FDI) in international commerce. Because of these changes, states are developing geoeconomic strategies to better employ the economic instrument of power in support of economic and geopolitical interests. Leveraging of FDI has become a powerful tool in geoeconomic strategy, and many states are using FDI to further their global influence. The United States, however, does not have a strong geoeconomic component of its grand strategy and is not actively leveraging FDI. This thesis begins by discussing in detail the resurgence of geoeconomics and the rise of FDI. Following that discussion, the thesis provides a framework for analyzing geoeconomic strategies and incorporating FDI into those strategies. The framework is applied to three case studies and examines the geoeconomic strategy and directed-FDI use of three states: Germany, China, and the United States. Germany and China leverage FDI to pursue their national interests. Conversely, the United States primarily subscribes to a *laissez-faire* view of economics, treating economics as an almost apolitical field. This puts the United States in a position of disadvantage in today's geoeconomic-centric world. The final section of this thesis discusses potential geoeconomic strategies for the United State and provides a recommendation for future research to assist in the development of those strategies. The author concludes that the United States needs to reinvigorate its thinking about geoeconomics, develop a strong geoeconomic component of its grand strategy, and consider the leveraging of FDI in the development of its geoeconomic strategy.

Introduction

China wants to write the rules for the world's fastest-growing region. That would put our workers and our businesses at a disadvantage. Why would we let that happen? We should write those rules.

President Barack Obama
State of the Union Address
20 January 2015

The United States has been writing the rules of the world order since 1945 following two devastating world wars, but the ability to continue doing so will require adapting to a changing international environment. The United States, in cooperation with its European allies, led the establishment of a world order founded upon liberal democracy, economic interdependence, and international institutions.¹ This US-led world order, rooted in the Westphalian system of states, was designed to promote human rights and economic development across the globe.² While the economic instrument of power has always been fundamental to the liberal order, the international system has undergone additional changes which have altered the role and nature of states' employment of economic power. Forty years ago trade accounted for 90% of all cross-border flows, but in 2014, 90% of the flows were financial.³ The rise of foreign direct investment (FDI) has altered the means by which states can employ economic power. This rise of FDI combined with a recent resurgence of economics as an instrumental tool in statecraft mark significant changes to the liberal world order.

As a result of these changes to the world order, states are developing and revising their strategies for the employment of the economic instrument of power. China serves as a prime example. In 2010, Vietnam hosted the summit for the Association of Southeast Asian Nations (ASEAN).⁴ During the meeting, Vietnam joined fellow ASEAN nations in criticizing China for its South China Sea aggression.⁵ The next year, Indonesia

¹ G. John Ikenberry, *Liberal Leviathan: The Origins, Crisis, and Transformation of the American World Order*, Princeton Studies in International History and Politics (Princeton, NJ: Princeton Univ. Press, 2011), 64.

² Ikenberry, *Liberal Leviathan*, 66.

³ Robert D. Blackwill and Jennifer M. Harris, *War by Other Means: Geoeconomics and Statecraft* (Cambridge, Massachusetts: The Belknap Press of Harvard University Press, 2016), 53.

⁴ Blackwill and Harris, *War by Other Means*, 114.

⁵ Blackwill and Harris, *War by Other Means*, 114.

served as the chair for the summit and reiterated the condemnation of China's actions.⁶ In 2012, Cambodia was chosen to serve as the chair for the summit. That same year, China provided Cambodia with \$2.7 billion in loans and grants (up from \$1.9 billion the year before), which was more than double the investment from all ASEAN countries combined and ten times more than what the United States provided.⁷ At the conclusion of the summit, Cambodia blocked all efforts of the other states to criticize China.⁸ In 2017, the Philippines hosted the summit and also removed statements criticizing China.⁹ President Duterte stated that improving relations with China was necessary for the Philippines to receive infrastructure funding.¹⁰ In both cases, China used its economic power to influence the behavior of other states.

China uses FDI to support its national interests through infrastructure projects and coercion of developing countries. Many other nations have also revised their national security strategies to account for these changes, but the United States continues to turn primarily to the military instrument of power to achieve geopolitical objectives.¹¹ When the economic instrument of power is considered, it generally takes the form of sanctions, but the use of FDI for influence is largely neglected. Such limited approaches lead one to consider how the United States might employ FDI as a tool of soft power? This study seeks to answer this question.

⁶ Blackwill and Harris, *War by Other Means*, 114.

⁷ Blackwill and Harris, *War by Other Means*, 114.

⁸ Blackwill and Harris, *War by Other Means*, 114.

⁹ Fox News, "Philippines Abruptly Drops South China Sea Mentions from ASEAN Statement," Text.Article, *Associated Press*, April 30, 2017, <http://www.foxnews.com/world/2017/04/30/philippines-abruptly-drops-south-china-sea-mentions-in-asean-statement.html>.

¹⁰ Fox News, "Philippines Abruptly Drops South China Sea Mentions from ASEAN Statement."

¹¹ Contrary arguments put forth that the military instrument of power is merely a more visible form of power projection, but the United States does utilize other instrument of powers. It is accurate that military force is more visible and can often produce quicker, more tangible results, and it is also true that the United States has employed sanctions to a much higher degree in recent years. Whether or not the United States is too dependent on the military instrument of power, the argument here is that the US may underutilize the other instruments of power, specifically the economic one. The recent proposal by the Trump administration to cut State Department funds to support the \$54 billion increase in defense spending is indicative of the tendency of the United States to promote the military instrument of power above others. Leslie H. Gelb, "GDP Now Matters More Than Force," *Foreign Affairs*, October 21, 2010, <https://www.foreignaffairs.com/articles/united-states/2010-10-21/gdp-now-matters-more-force>; The Economist, "Neglecting the State Department Does Real Damage," *The Economist*, accessed May 6, 2017, <http://www.economist.com/news/united-states/21721386-america-has-proud-and-effective-tradition-diplomacy-it-being-traduced-neglecting>.

In doing so, we begin with the concept of geoeconomics, a term less frequently used and understood than its counterpart geopolitics. Geoeconomics is “The use of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results; and the effects of other nations’ economic actions on a country’s geopolitical goals.”¹² When it comes to US foreign policy, the concept of geoeconomics is often limited to the attainment of economic goals. For example, the American people support trade as a means to increase domestic prosperity, but when the financial benefits of trade are unevenly distributed, the people’s support wanes. This limited view of geoeconomics, however, fails to account for the alternative role of economics in achieving *geopolitical* objectives.

Geoeconomics transcends economic power purely for the sake of economics. Domestic prosperity is undoubtedly of vital importance, but the economic instrument of power can be used to promote geopolitical interests. Blackwill and Harris discuss seven geoeconomic instruments: trade policy, investment policy, economic and financial sanctions, cyber, aid, financial and monetary policy, and energy and commodities.¹³ This study focuses on investment policy in order to determine whether or not the United States can better incorporate FDI into its geoeconomic strategy, and if so, to identify the implications of such use.

The growth of FDI over the past several decades has been substantial, and it is altering the nature of commerce between nations. The Wall Street Journal wrote, “Trade is no longer the primary vehicle for global interaction and integration... FDI has become the primary means by which firms compete in markets.”¹⁴ FDI stock grew from \$692.7 billion in 1980 to \$16.2 trillion in 2008, marking a 2,300 percent increase.¹⁵ In 2015, FDI stock amounted to \$25 trillion,¹⁶ and states signed 31 new International Investment Agreements (IIAs).¹⁷ Currently, China is member to 131 Bilateral Investment Treaties

¹² Blackwill and Harris, *War by Other Means*, 20.

¹³ Blackwill and Harris, *War by Other Means*, 49.

¹⁴ Stephen D. Cohen, *Multinational Corporations and Foreign Direct Investment: Avoiding Simplicity, Embracing Complexity* (Oxford ; New York: Oxford University Press, 2007), 206.

¹⁵ Thomas H. Oatley, *International Political Economy*, 5th ed (Boston: Longman, 2012), 161.

¹⁶ OECD, “Foreign Direct Investment (FDI) - FDI Stocks - OECD Data,” *OECD*, accessed April 23, 2017, <http://data.oecd.org/fdi/fdi-stocks.htm>.

¹⁷ UNCTAD, ed., *Investor Nationality: Policy Challenges*, World Investment Report 2016 (New York Geneva: United Nations, 2016), 12.

(BITs) and 150 IIAs, whereas the United States is party to 47 BITs and 113 IIAs.¹⁸ China remains highly regulative of its FDI, both inflow and outflow, and is utilizing FDI to expand its influence and further its national interests. The United States, however, maintains a primarily *laissez-faire* approach regarding FDI, as this is most consistent with current beliefs about the desired operation of the liberal international order. But as the world order evolves and economic tools become a stronger currency for influence, Washington should examine whether or not current policy is sufficient to address these changes.

While no other nation can directly challenge the United States militarily, nations are capable of exerting significant influence through economic means. China's military power is less threatening to other nations than their ability to withhold trade and investment.¹⁹ The United States recently abandoned two trade deals that would have encompassed 60 percent of the world economy. With FDI surpassing trade as the key driver of international commerce and Washington incapable of selling the geopolitical importance of international trade to the American public, perhaps it is time to rethink US investment policy.

This study begins an empirical examination into the changing nature of international relations and the rise of FDI in international commerce. Specifically, I seek to identify correlations between FDI use and state behavior to develop a theory of FDI impact on geopolitical outcomes and FDI incorporation into geoeconomic strategy. To do so, I lay out the remainder of the thesis as follows. First, chapter one outlines the changes that have occurred to the strategic environment that make the use of FDI an attractive geoeconomic tool for states. In particular, I argue that two major changes to the international environment (the resurgence of geoeconomics and increasing levels of FDI) contribute to the potential effects that directed-FDI use can have on states in the international system.

In order to understand how a state can use FDI in support of a geoeconomic strategy, it is important to determine what type of strategy a state is employing. Chapter

¹⁸ UNCTAD, "International Investment Agreements Navigator," *Investment Policy Hub*, accessed April 23, 2017, <http://investmentpolicyhub.unctad.org/IIA>.

¹⁹ Gelb, "GDP Now Matters More Than Force," 4.

two provides a framework for this analysis by utilizing Wigell's typology for assessment of a state's geoeconomic strategy.²⁰ Wigell's typology examines the means and motivations of states' use of economic tools. The means can be cooperative or competitive and can serve economic or geopolitical ends. The assessment of those two criteria lead to the identification of four potential geoeconomic strategies: neo-mercantilism, neo-imperialism, liberal institutionalism, or hegemony. The discussion of framework is followed by a review of the tools available to states for leveraging of FDI, both inwardly and outwardly. Bringing together the discussion of geoeconomic strategy and FDI regulation, I examine how the various tools of FDI correlate to each strategy. With a foundational understanding of how the strategic environment has changed, a framework by which to analyze geoeconomic strategy, and a review of how states can leverage FDI in their strategies, I proceed to look at three case studies. Each study analyzes present FDI policies and geoeconomic strategies for a specific state, and then reviews historical examples of how those states have used FDI in support of their strategies.

Germany is the subject of chapter three. By examining Germany's use of its economic instrument of power through Wigell's framework, we discover that Germany has oscillated between a liberal institutionalist strategy and a neo-mercantilist strategy, but generally tends more towards the latter. Germany uses its economic power to further the economic wealth of Germany, often through means which harm its fellow Eurozone members. The German government supports its large multinational corporations' (MNCs) endeavors to invest overseas, while also taking considerable steps to encourage investment in Germany from outside entities. Germany has developed a geoeconomic strategy that capitalizes on its strengths and utilizes FDI to its benefit, although this often comes at the expense of other nations. We have witnessed more leadership initiatives by Germany in recent events, which suggests it might be leaning more towards a hegemonic strategy for the future, at least from a regional perspective.

²⁰ Mikael Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies: Neo-Imperialism, Neo-Mercantilism, Hegemony, and Liberal Institutionalism," *Asia Eur. J.* 14, no. 2 (June 2016): 1, doi:10.1007/s10308-015-0442-x.

I turn to China in chapter four. The nature of the communist regime in China and the rapidly growing economy afford China a vast amount of resources and tools for its geo-economic strategy. China's economic actions tend to be disruptive to the international system and are regularly employed in pursuit of geopolitical objectives over economic goals. Wigell's framework categorizes China's geo-economic strategy as a neo-imperialist strategy. China uses all available aspects of FDI to augment its strategy. China's mastering of geo-economics is enabling it to challenge the liberal world order, which could present the United States with formidable challenges in the future.

Finally, in chapter five I examine the United States. Historically, the United States used its economic might to promote geopolitical interests in a manner which generally supported the governing institutions of the liberal order. The Marshall Plan and the use of trade agreements for geopolitical interests in the past suggested a US geo-economic strategy of hegemony. In more recent years, the United States has reverted to an extreme view of *laissez faire* economics, neglecting its economic instrument of power. Today, the United States operates under an underdeveloped geo-economic strategy of liberal institutionalism. Sanctions serve as the foundation of the US economic instrument of power, but tools such as trade and FDI are rarely considered. If they are used, it is generally for economic goals vice geopolitical interests.

Building off of the discussion in chapter five, chapter six returns to the strategic landscape and examines the possible geo-economic strategies for the United States and the implications of employing those strategies. Drawing from the studies of Germany and China, if the United States could better incorporate FDI into its geo-economic repertoire, how could it do so and what would be the implications? What are the domestic considerations that the United States should take into account as it develops its geo-economic strategy for the future? This final chapter concludes with a discussion about future research considerations.

The world order created by the United States following World War II has prevented great-power war for over seventy years, but it has undergone changes since its original inception, and it is undergoing changes now. These changes may seem small and cosmetic, but they are affecting the way in which nations exert influence on the world stage. If FDI is to remain a primary driver of international commerce, ignoring its

potential could have negative long-term effects on US power projection and the ability of the United State to shape the future international environment in its favor. Rules are going to be rewritten, and others seem willing to lead this effort if the United States fails to do so.



Chapter 1

Changes to the Strategic Environment

Everyone, it appears, now agrees that the methods of commerce are displacing military methods – with disposable capital in lieu of firepower, civilian innovation in lieu of military-technical advancement, and market penetration in lieu of garrisons and bases.

Edward Luttwak

There have been many changes to the international system since the end of World War II, but two particular and interrelated changes in the past few decades are of particular importance when it comes to international relations and the role of the economic instrument of power. The first change is a resurgence of the economic instrument of power in statecraft, which is not a new concept, but has risen to a new level of influence. This heightened influence drove the coining of a new term to describe economics in statecraft—geoeconomics. The advent of nuclear weapons and more solidified norms of peaceful conflict management have promoted a general decline in conflict between states, thereby leading states to turn toward other aspects of state influence such as economics. The second change is the increase of FDI as a means of commerce. Advances in technology and the post-war capitalist economy fashioned by the United States have enabled foreign investment to rapidly expand across the globe. This growth in FDI affords states with new tools for economic influence. These two changes have altered the relations between states and have led states to develop new strategies and avenues for the application of their economic power.

The first major change to the international system is the resurgence of geoeconomics in statecraft. New solidified norms of peaceful conflict resolution and the potential of nuclear holocaust have reduced the use of the military instrument of power. By comparison to previous historical periods, military force is used more sparingly, and often alongside economic tools.¹ The reduced use of force in combination with changes to the free-market system have increased the attractiveness of the economic instrument of power. In 2009, following the 2008 recession, the Chinese Vice Foreign Minister during

¹ Robert D. Blackwill and Jennifer M. Harris, *War by Other Means: Geoeconomics and Statecraft* (Cambridge, Massachusetts: The Belknap Press of Harvard University Press, 2016), 36.

a meeting at the Chinese Consulate in Manhattan asked the question, “Now that the free market has failed. What do you think is the proper role for the state in the economy?”² Although it is not especially surprising to hear this type of question from a Chinese diplomat, this question undoubtedly loomed in the thoughts of many Western leaders as well following the recession. After the crisis, Western nations recognized the need for state intervention, and the market experienced the largest amount of state intervention since World War II.³ While Western states intervened primarily to encourage economic stabilization, this pattern of intervention created an atmosphere more tolerant of various forms of state capitalism.

Harris and Blackwill attribute the geoeconomic resurgence to three factors. The first factor is that the use of geoeconomics among great and rising powers has gained popularity, possibly due to a lack of other viable options.⁴ Today, there is no state that can challenge the United States militarily, and this forces states to use other means to project influence.⁵ Furthermore, more often than not, military force is poorly suited for solving many of today's disputes. Nye describes military force as “a blunt instrument unsuited to dealing with many situations...and force has little to offer in addressing issues such as climate change, financial stability, or Internet governance.”⁶ The second factor contributing to the revival of geoeconomics is that states have more resources and avenues for economic influence at their disposal.⁷ The increase in FDI has furthered the ability of states to control State Owned Enterprises (SOEs) and create Sovereign Wealth Funds (SWFs), and this presents states with new tools for economic power projection. The third factor for the resurgence of geoeconomics is that the nature of today's markets have changed.⁸ Today's markets are more integrated, deeper, and faster than in previous eras.⁹ The interconnectivity of the markets has caused states to be more reliant on the

² Ian Bremmer, *The End of the Free Market: Who Wins the War between States and Corporations?* (New York, N.Y: Portfolio, 2010), 1.

³ Bremmer, *The End of the Free Market*, 82.

⁴ Blackwill and Harris, *War by Other Means*, 35.

⁵ Blackwill and Harris, *War by Other Means*, 36.

⁶ Joseph S. Nye, “Will the Liberal Order Survive?,” *Foreign Affairs*, December 12, 2016, <https://www.foreignaffairs.com/articles/2016-12-12/will-liberal-order-survive>.

⁷ Blackwill and Harris, *War by Other Means*, 36.

⁸ Blackwill and Harris, *War by Other Means*, 37.

⁹ Blackwill and Harris, *War by Other Means*, 37.

policy choices of others, as well as more critical when disagreements over those policies arise.¹⁰

Current examples of the use of geoeconomics abound, but are especially prevalent from Russia and China. These two states use geoeconomics to strengthen regional ties, coerce neighboring countries, and promote their political agendas. The creation of the Eurasian Economic Union (EAEU), for example, is one of Russian President Putin's attempts at coalition building which requires economic coercion to maintain.¹¹ It is estimated that it costs Russia between \$7-12 billion annually to retain Belarus as a member, and in order to convince Kyrgyzstan to join, Russia had to grant it a \$200 million loan in addition to trade and economic preferences.¹² Furthermore, Russia threatens European Union (EU) states with a reduction in energy supplies if they support US-led sanctions, it provides economic assistance to Crimea to gain favor, and it bans imports from nations who are acting contrary to its interests.¹³ In 2013, in an attempt to dissuade Moldova from signing EU agreements, Russia instituted a ban on Moldovan wine and threatened to cut off its energy supply.

China uses economics heavily to pursue its international goals. The Asia Infrastructure Investment Bank (AIIB) enables China to further its span of control in Asia. China has convinced 57 countries to join, 14 of which are advanced economies of the G20, and China has recruited every major trading ally of the United States except Japan.¹⁴ Projecting its influence, the AIIB provides more loans to Latin American nations than both the World Bank and International Monetary Fund (IMF) combined.¹⁵ Like Russia, China restricts imports of items from nations to express its disapproval of that nation's actions. China gives preference to Taiwanese companies that act in accordance with the mainland's interests and imposes punishment on those who China views as threatening to the one-China policy.¹⁶ China is keenly aware of its ability to use the state's economic might to achieve its objectives and exercises that ability through

¹⁰ Blackwill and Harris, *War by Other Means*, 37.

¹¹ Blackwill and Harris, *War by Other Means*, 36.

¹² Blackwill and Harris, *War by Other Means*, 34.

¹³ Blackwill and Harris, *War by Other Means*, 4–5.

¹⁴ Blackwill and Harris, *War by Other Means*, 115.

¹⁵ Blackwill and Harris, *War by Other Means*, 4.

¹⁶ Blackwill and Harris, *War by Other Means*, 4.

many different means. The discussions today about the rise of China are not in reference to its military might, but rather to its growing economic clout. Today, economic strength is less about its translation to military force, and more about the ability of that economic might to project influence in its own right, an option that was uncommon in previous eras. For this reason, the rise of China creates anxiety amongst those favorable to the current established rules of the liberal world order, because China is increasingly in a position to challenge those rules.

The second change to the international environment is the rapid increase of FDI since the 1980s. The annual inflow and stock value of FDI from 1982 – 2004 increased by more than 10 fold in comparison to a mere 3.5 fold increase in overall world output and a 5 fold increase in world exports.¹⁷ FDI has also far surpassed foreign aid as the primary mechanism for capital flows to the developing world.¹⁸

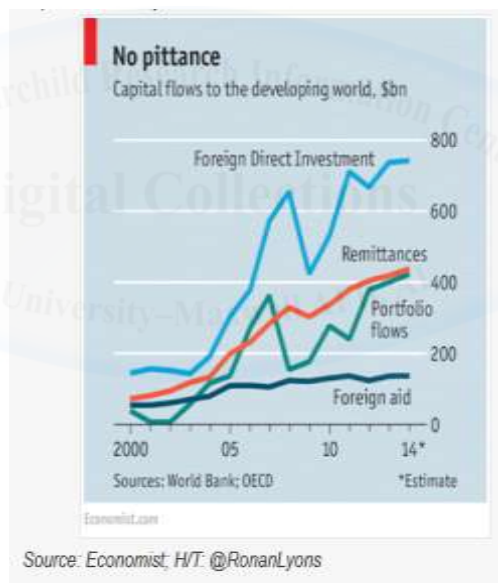


Figure 1 - Capital flows to developing world

Source: <http://trueeconomics.blogspot.com/2015/09/5915-remittances-foreign-aid-other.html>

When multinational corporations (MNCs) first began to expand globally, the international community viewed FDI quite skeptically. Many nations feared MNCs would overtake governments in economic power, and potentially threaten national

¹⁷ Stephen D. Cohen, *Multinational Corporations and Foreign Direct Investment: Avoiding Simplicity, Embracing Complexity* (Oxford; New York: Oxford University Press, 2007), 56.

¹⁸ True Economics, "True Economics: 5/9/15: Remittances, Foreign Aid & Other Capital Flows," *Remittances, Foreign Aid & Other Capital Flows*, accessed April 25, 2017, <http://trueeconomics.blogspot.com/2015/09/5915-remittances-foreign-aid-other.html>.

security and state sovereignty. While some still share this view, the Monterey conference in 2002 marked a significant shift in this way of thinking.¹⁹ This conference expanded the minds of policy makers to see the opportunities for job creation, technological advancement and sharing, and access to international markets.

In 2008, FDI stock had reached \$1.8 trillion, 10 times as much as 20 years earlier. MNCs and their subsidiaries were responsible for about two-thirds of all the world's trade in merchandise, and large firms used FDI more than trade by a factor of 1.5 when selling to foreign markets.²⁰ In 2015, states signed 31 new IIAs, bringing the total number of IIAs to 3,304.²¹ The World Economic Forum Global Council attributes the recent reduction in FDI growth to a slowing world economy and increased protectionism by states.²² Despite the growth slow down, FDI remains a key driver along with trade for economic commerce.

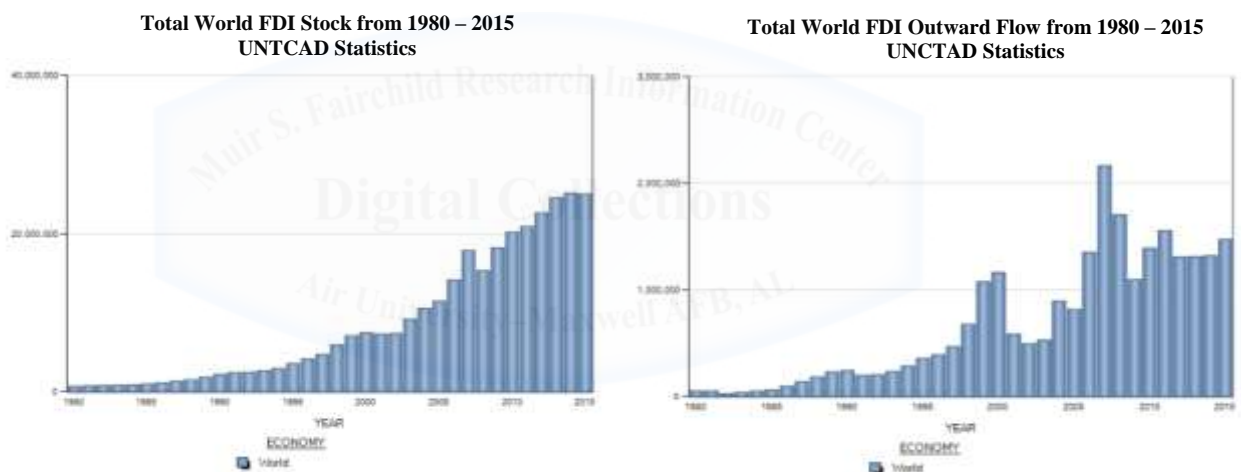


Figure 2 – FDI Stock and Flow Statistics from 1980 - 2015

Source: http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en

In addition to the FDI statistics, the actions of nations and MNCs display the increased role of FDI in international commerce. Countries recognize that investment by foreign companies can bring increased sources of production and training to their

¹⁹ United Nations, *Monterrey Consensus on Finance for Development* (United Nations Department of Economic and Social Affairs, 2003), <http://www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf>.

²⁰ Cohen, *Multinational Corporations and Foreign Direct Investment*, 58.

²¹ UNCTAD, ed., *Investor Nationality: Policy Challenges*, World Investment Report 2016 (New York Geneva: United Nations, 2016).

²² World Economic Forum, *WEF_GAC_GlobalTradeFDI_FDIKeyDriver_Report_2013.pdf* (Global Agenda council on Global Trade and FDI, 2013), http://www3.weforum.org/docs/GAC13/WEF_GAC_GlobalTradeFDI_FDIKeyDriver_Report_2013.pdf.

domestic economies.²³ Since the late 1970s, states have increasingly lowered trade barriers in an attempt to attract FDI.²⁴ Between 1991 and 2000, states made 1,074 changes to policies regarding FDI, and 95% of those changes were favorable to attracting more FDI.²⁵ In 2015, 85% of the policy measures taken created a more favorable environment for FDI.²⁶ Similarly, the vast growth of MNCs demonstrates the importance of FDI. There were approximately 7,000 MNCs in 1970, with this number quadrupling to about 30,000 by 1990 and then doubling in 2005 to approximately 77,000.²⁷ FDI rebounded in 2015 and reached its highest levels since the global recession of 2008. The primary factor driving this rebound was an increase in Mergers & Acquisitions (M&As) which rose from \$432B in 2014 to \$721B in 2015.²⁸

The increase in the value of Sovereign Wealth Funds (SWFs) and the number of State Owned Enterprises (SOEs) also shows the growth of FDI in commerce. In 2008, 15% of global M&As were national oil and gas companies and emerging-market-based SWFs, and these accounted for six of the ten largest asset deals.²⁹ Estimates from mid-2013 reported that SWFs owned \$3-5.9 trillion of assets under management as compared to \$2.4 trillion of all hedge funds under management.³⁰ In the spring of 2016, the Sovereign Wealth Fund Institute estimated the total value of SWFs at \$7.2 trillion, which is twice as much as in 2007.³¹ The majority of the equity of the SWFs is concentrated in the top ten funds, which hold 85% of the total assets, and the only democracy on this list is Norway.³² These SWFs provide nations with yet another economic tool for achieving geopolitical objectives. The largest SWF owner, Norway, for example, would not allow investment in Israeli firms with ties to the West Bank settlement dispute.³³ Not only do

²³ Stephen G. Brooks et al., "The Once and Future Superpower," *Foreign Affairs*, April 13, 2016, 39, <https://www.foreignaffairs.com/articles/united-states/2016-04-13/once-and-future-superpower>.

²⁴ Brooks et al., "The Once and Future Superpower," 38.

²⁵ Brooks et al., "The Once and Future Superpower," 41.

²⁶ UNCTAD, *Investor Nationality*, 11.

²⁷ Cohen, *Multinational Corporations and Foreign Direct Investment*, 47.

²⁸ UNCTAD, *Investor Nationality*, 10.

²⁹ Bremmer, *The End of the Free Market*, 178.

³⁰ Blackwill and Harris, *War by Other Means*, 55.

³¹ Itziar Aguirre, "Sovereign Wealth Funds Fun Facts - Business Insider," *Business Insider*, February 1, 2016, <http://www.businessinsider.com/sovereign-wealth-funds-fun-facts-2016-2/#2-most-funds-are-state-owned-2>.

³² Blackwill and Harris, *War by Other Means*, 55.

³³ Blackwill and Harris, *War by Other Means*, 56.

these SWFs enable states to pursue geopolitical objectives through economic means, they have raised concern among Western nations due to their lack of transparency, because they do not fall under the same regulatory framework as funds which are responsible to shareholders.³⁴

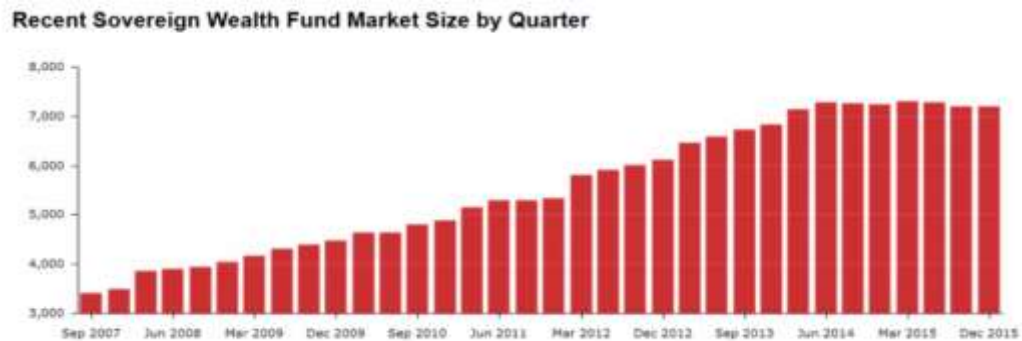


Figure 3 – Growth of Sovereign Wealth Funds

Source: Sovereign Wealth Fund Institute

The rise of SOEs also has been significant over the past few decades. SOEs are now ranked among some of the largest companies in the world and have claimed over half of the top ten Initial Public Offerings (IPOs) in the last six years.³⁵ Between 2004-2009, 120 state-owned companies were added to the Forbes list of the world’s biggest 2000 companies, while 250 private companies were removed.³⁶ In 2016, SOEs supplied over a third of all outbound FDI from emerging markets and ranked among the top listing contributors in the world’s leading stock markets.³⁷ The World Economic Forum Council on Global Trade and FDI conducted a study in 2013 which examined FDI as a key driver for trade and prosperity. One of the observations from this study was that “increased FDI by SOEs and SWFs presents new challenges to ensuring that competition conditions in the global marketplace remain equitable and do not give rise to national security concerns.”³⁸

The resurgence of geoeconomics and the increased use of FDI have altered the strategic landscape on which the United States now finds itself. While the threat or use of military force will always play a role in influencing behavior, there are many situations

³⁴ Thomas H. Oatley, *International Political Economy*, 5th ed (Boston: Longman, 2012), 187.

³⁵ Blackwill and Harris, *War by Other Means*, 54.

³⁶ Blackwill and Harris, *War by Other Means*, 36.

³⁷ Blackwill and Harris, *War by Other Means*, 54.

³⁸ World Economic Forum, *WEF_GAC_GlobalTradeFDI_FDIKeyDriver_Report_2013.pdf*, 9.

to which it is poorly suited, and the United States is increasingly facing these situations in today's economically-focused environment. With geoeconomics gaining popularity among the leading world-powers, states are now exploring new options for exercising its full potential. Technology and globalization have eroded borders and timelines, creating an environment where FDI can thrive. Other nations have recognized these changes and are adapting their national security strategies accordingly. The next chapter discusses these strategies and introduces a framework for analyzing them.



Chapter 2

Geoeconomic Strategies and FDI Regulation

Thus, what is of supreme importance in war is to attack the enemy's strategy.

Sun Tzu

Sun Tzu's infamous advice to "know yourself and know your enemy" is as relevant today as it was centuries ago when he wrote it. In order to be successful in any type of conflict, it is important to understand not only your own strategy, but also your opponent's strategy. Nations develop multiple strategies to guide them in their actions in the game of international relations. The United States publishes a National Security Strategy, a National Defense Strategy, and a National Military Strategy. Although there might not be an official published document, each instrument of power is wielded with some sort of strategy in mind (or at least should be). With the resurgence of geoeconomics, the importance of developing and understanding a strategy for the employment of the economic instrument of power is increasingly important. Largely missing in the literature, however, is a means by which to analyze states' strategies in the employment of economic power. Wigell's proposed typologies of geoeconomics attempt to bridge this gap.¹ This chapter contains three sections. First, I examine Wigell's approach as it will serve as the tool for analyzing and identifying each country's geoeconomic strategy for this study. Second, I review the FDI regulating options available to states. Finally, I discuss how states could employ those regulating mechanisms in support of each strategy.

Wigell's Framework for Geoeconomic Strategy

Wigell's typology identifies a state's geoeconomic strategy from a regional perspective, this study will build upon his framework to analyze nations' strategy from a global perspective.² Wigell proposes four "ideal-typical" geoeconomic strategies: neo-imperialism, neo-mercantilism, hegemony, and liberal institutionalism.³ Wigell's model examines two criteria: 1) how a nation uses economic tools and 2) why a nation uses its

¹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 135.

² Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 135.

³ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 135.

economic tools.⁴ The motivation and the means by which a nation employs its economic instrument of power serve as primary indicators of the country's overall geoeconomic strategy.

The first criteria of Wigell's model assesses how a nation uses its economic power. Specifically, does the state employ its power in a competitive or cooperative manner? Wigell argues that by examining this question, we can determine the willingness of the state to act unilaterally in situations which may negatively affect neighboring countries.⁵ If the goal of the acting state is economic domination or the construction of hierarchical relationships, then the state is considered to be acting competitively.⁶ Examples of competitive actions are coercive policies, threats to cut off market access or commodities, withdrawal of foreign aid, or any other action which attempts to persuade a minor power to act in a manner which suits the greater power.⁷ In sum, a competitive strategy attempts to "write the rules of the game" through exploitation of lesser states.⁸ In contrast to competitive means, a nation which uses its economic power in a cooperative manner will act in ways which benefit the greater region.⁹ In this case, the state is willing to use their economic power for the collective good and is prepared to accept sacrifices to uphold governing institutions and norms.¹⁰ A cooperative state is committed to institutionalism and governing rules, and it will provide economic incentives to lesser states to encourage behavior in accordance with those established norms.¹¹ A cooperative strategy does not suggest that positive economic competition does not occur. The free-market economy relies on competition between entities, but the competition to which Wigell refers takes a more negative form. It is not the inherent competition within a market system, but rather a form of competition which challenges or bends the rules of the system for personal gain.

⁴ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁵ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁶ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁷ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁸ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

¹⁰ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

¹¹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

The second criteria of Wigell's model examines states' motivation for the employment of economic power. While the first criteria asked how the state is using geoeconomics, the second criteria asks why. This part of the model determines whether the economic power is employed in pursuit of geopolitical goals or whether it is primarily employed for economic purposes.¹² Is economic power the means or the ends? If a state is investing considerable economic resources with no clear economic benefit, the state is most likely using economic power for geopolitical purposes.¹³ A nation which is using economic power as a means for geopolitical influence will use its economic power for things such as political coercion or strengthening of alliances.¹⁴ In this case, economics are a means to geopolitical ends. Alternatively, a state can employ a strategy which uses economic power for purely economic goals. These states use economic power to further their commercial interests and state wealth.¹⁵ Motivations for these states are "narrowly economic rather than broadly political."¹⁶ Wigell acknowledges that assessing motivations can be challenging and is not always clear, but by observing state actions we can formulate a reasonable conclusion to help determine their strategy.¹⁷

Wigell combines the results of these two criteria to form a set of typologies for assessing a state's overall geoeconomic strategy. The neo-mercantilist and neo-imperialist strategies consider foreign relations a zero-sum game and adopt a competitive strategy in the employment of their economic power.¹⁸ These two strategies both use economic power to coerce and pressure other nations, but their objective in doing so differs. The goal for the neo-mercantilist state is greater economic power, whereas the objective of the neo-imperialist state is more geopolitical clout.¹⁹ The liberal institutionalist and hegemonic strategies comprise the other half of the model. States employing these strategies cooperate with international institutions and established norms. In general, these states view coercion as detrimental to their long-term interests,

¹² Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

¹³ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

¹⁴ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

¹⁵ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 141.

¹⁶ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 141.

¹⁷ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

¹⁸ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 141.

¹⁹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 141.

and they focus on mutual benefits between states.²⁰ While these strategies might use coercive measures to promote better behavior by a state, the motivation for the coercion is to encourage compliance with international norms and is normally pursued through multilateral means. The difference between these final two strategies lie in the fact that a state operating under a hegemonic strategy is willing to assume the role of a hegemonic power and provider of public goods, even at economic costs to themselves.²¹ In the hegemonic strategy, the state uses economic power not only for economic purposes, but also for geopolitical purposes. Conversely, liberal institutionalist states seek cooperation between nations but are less willing to bear additional economic costs to uphold the system, nor are they willing to accept the burden enforcing system rules.²²

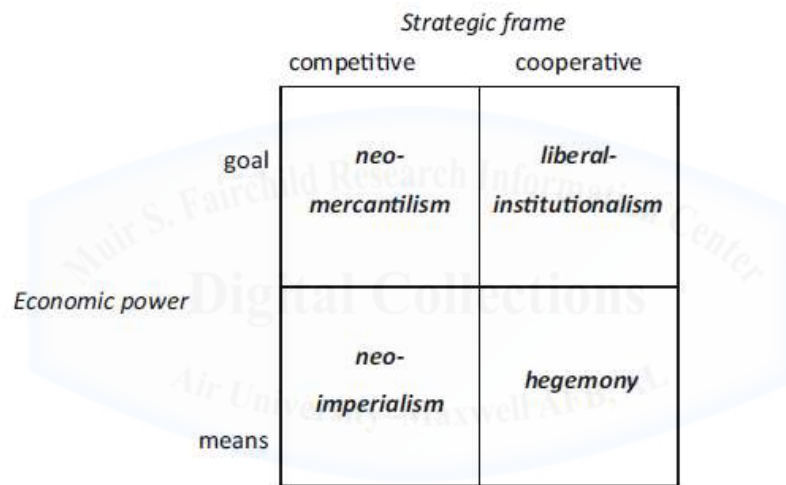


Figure 4– Wigell’s Strategic Frame

Source: Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 140.

Wigell makes two qualifying remarks about his typology which are important to mention. First, Wigell acknowledges that these strategies are ideal-typical, and a state will most likely not always follow one specific strategy.²³ Although they might have a tendency towards a particular strategy, there may be times when they deviate into other quadrants. Recognizing that states are dynamic actors who will respond to various situations in multiple ways, it is conceivable and expected that states may modify their

²⁰ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 141.

²¹ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 141.

²² Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 145.

²³ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 146.

behavior and strategy in response to different events and different states.²⁴ The second qualifying remark is that states may also modify their strategies depending on the area of foreign policy which they are attempting to affect.²⁵ Russia may operate under a different strategy in pursuit of energy objectives than it would when attempting to affect the trade policy of another nation.²⁶ Despite these caveats, Wigell designed his model to provide “a guideline for analysis,”²⁷ and that is how it is applied within this thesis.

Table 1 – Tactics and Policies of Regional Powers’ Geoeconomic Strategies

Source: Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 140.

Strategy	Tactics and policies
Neo-imperialism	Economic force, coercion, imposition, and bribery
Hegemony	Provision of public and private goods
Neo-mercantilism	Protectionism and selective multilateralism
Liberal institutionalism	Economic integration and multilateralism

State Regulation of FDI

Returning to our focus on FDI, in this section I examine the most common FDI regulatory options for states. These are generic options and do not account for the type of governance of the state. As such, some of these options are better suited to authoritarian regimes than to liberal democracies. The purpose of this section is to provide a baseline for regulating options, while the considerations of government structure will be reserved for the final section. This section is divided into three parts. The first part discusses regulation of inward FDI (IFDI), the second part the regulation of outward FDI (OFDI), and the final part the impact of trade policy on both forms of FDI. Each part will provide an example of how states have used these regulations in the past.

IFDI

Countries can attract or dissuade FDI from foreign entities through a variety of regulatory measures. Specifically, states can alter tax policy, offer grants and subsidies, or regulate which sectors are open for foreign investment. Additionally, states can alter

²⁴ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 146.

²⁵ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 146.

²⁶ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 146.

²⁷ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 146.

their administrative processes or shape the investment environment in ways which encourage or discourage investment. Governments can also outright ban FDI in certain economic sectors, which is normally accomplished through constitutional amendment or national legislation.²⁸ The motivation behind these bans can be economic or political. The United States primarily limits investment for national security reasons. For example, the United States passed the Exon-Florio Amendment in 1988 which authorizes the president to investigate and prevent investment in US companies for national security reasons.²⁹ In 2005, the China National Offshore Oil Cooperation (CNOOC) attempted to purchase the US-owned Unocal oil company. Several US policy makers argued that since China's government had funded more than two-thirds of the money for the deal, this put US oil assets at risk and could have compromised national security.³⁰ CNOOC withdrew their offer.

Governments can encourage FDI through financial incentives.³¹ Taxes can be used to either incentivize or discourage investment depending on where the taxes are directed. Other economic influences include preferential treatment to government contracts, telecommunication structures, or subsidized power and water.³² Following the collapse of the Berlin Wall, for instance, Germany sought to build up the former East German economy. In 1996, the German government provided Dow Chemical with a \$6.8 billion subsidy to invest in a plant in the eastern part of the country. While the primary purpose of this transaction was economically motivated, the geopolitical implications of reuniting the country and promoting nation-wide prosperity is evident.

The third way governments can control IFDI is through adjustments to the administrative process of foreign investment. Streamlining the application process for foreign investors encourages investment, while long, regulatory processes discourage it. Regulatory hassles can become so burdensome that they overshadow the economic benefits of doing business in a country. If an MNC faces increased administrative costs,

²⁸ Cohen, *Multinational Corporations and Foreign Direct Investment*, 169.

²⁹ Edward M. Graham and Paul R. Krugman, *Foreign Direct Investment in the United States*, 3rd ed (Washington, D.C: Institute for International Economics, 1995), 34.

³⁰ Ian Bremmer, *The End of the Free Market: Who Wins the War between States and Corporations?* (New York, N.Y: Portfolio, 2010), 192.

³¹ Cohen, *Multinational Corporations and Foreign Direct Investment*, 165.

³² Cohen, *Multinational Corporations and Foreign Direct Investment*, 166.

bureaucratic delays, or regulatory burdens, it will most likely choose to investment elsewhere.³³ In 2004, for example, Sony allegedly closed one of its audio plants in Indonesia because of the extensive regulatory hassle they were facing with the administrative paperwork.³⁴ On the other end of the spectrum, Dell chose to invest in Ireland in the 1990s because of the continuously supportive nature of the government.³⁵ Beyond a burdensome administrative process, governments can create policies which shape the investment environment in their country. Protection of intellectual and private property, technology transfer rights, and dispute settlement mechanisms all play a role in how favorable an environment is to foreign investors.

OFDI

When it comes to regulating OFDI, three primary means are available: SOEs, SWFs, and incentives for MNCs. Because most democratic governments refrain from the use of SOEs and SWFs, they rely primarily on incentives to influence MNCs. Conversely, state-capitalist governments rely heavily on SOEs and SWFs to direct FDI and expand their influence. Oil and gas companies are prevalent among SOEs, and several countries are utilizing these companies to achieve geopolitical goals. As of 2010, national oil companies owned three-quarters of global crude-oil reserves.³⁶ The non-state-owned multinational oil companies produced only 10 percent of the world's oil and gas and owned only 3 percent of its reserves.³⁷ Because state governments control these companies, governments can use them for political as well as economic purposes.

Iran and Venezuela, for example, have enjoyed extensive cooperation through energy transactions with each other, and they have limited potential business from Western multinational oil companies because of their shared disdain for the US, using their energy cooperation as a means to send a political message.³⁸ Additionally, Venezuelan president, Hugo Chavez, directed Citgo Petroleum Corporation, a subsidiary of Petroleos de Venezuela, to reserve 10 percent of its oil for American victims of

³³ Cohen, *Multinational Corporations and Foreign Direct Investment*, 169.

³⁴ Cohen, *Multinational Corporations and Foreign Direct Investment*, 170.

³⁵ Cohen, *Multinational Corporations and Foreign Direct Investment*, 153.

³⁶ Bremmer, *The End of the Free Market*, 56.

³⁷ Bremmer, *The End of the Free Market*, 56.

³⁸ Bremmer, *The End of the Free Market*, 61.

hurricane Katrina.³⁹ His actions received world-wide attention and served as a propaganda tool for political purposes.⁴⁰ China is also using its state-owned oil companies for geoeconomic leverage. China sent three of its national oil companies to Africa to compete against Western MNCs for oil contracts.⁴¹ In 2009, China's trade with Africa was over \$100 billion, ten times higher than in 2001.⁴²

In addition to using SOEs to acquire resources, China uses its SOEs to strengthen political ties with nations. In 2011, the President of Brazil made her first state-visit to Beijing, and China seized the opportunity to strengthen ties between the BRICS nations. Upon President Rousseff's arrival, China welcomed her by announcing an order for thirty Embraer airplanes (all purchased by state-owned Chinese airlines).⁴³ An observer made the comment, "this is not the sort of gift the US government or Japan could or would give." China, conversely, makes it a practice to use its SOEs to shape its political relationships. When it comes to investment in Africa, China requires African nations to recognize its one-China policy. The number of African nations which recognized Taiwan as an independent nation fell from 13 to 4 within five years of China's initial investment on the African continent.⁴⁴

SWFs serve as another avenue through which states can steer their FDI outflow. In 2013, Russia directed one-sixth of its SWF to a bailout package for Kiev in an attempt to further Ukraine's dependence on Russia.⁴⁵ China used its SWF to persuade Costa Rica to cease its recognition of Taiwan as an independent nation by purchasing \$300 million in bonds.⁴⁶ Despite efforts by the International Forum of Sovereign Wealth Funds (IFSFW) to encourage nations to abide by the Santiago Principles for good and transparent conduct, there is no enforcement mechanism as it is a voluntary program. GeoEconomica, a SWF watchdog firm, made the following statement about Qatar's SWF, "Qatar's foreign policy interests have strongly informed Qatari SWF

³⁹ Bremmer, *The End of the Free Market*, 85.

⁴⁰ Bremmer, *The End of the Free Market*, 85.

⁴¹ Bremmer, *The End of the Free Market*, 60.

⁴² Bremmer, *The End of the Free Market*, 60.

⁴³ Blackwill and Harris, *War by Other Means*, 41.

⁴⁴ Blackwill and Harris, *War by Other Means*, 56.

⁴⁵ Blackwill and Harris, *War by Other Means*, 55.

⁴⁶ Blackwill and Harris, *War by Other Means*, 56.

management.”⁴⁷ SWFs provide nations with an extremely flexible avenue by which to control FDI in support of geopolitical interests, and they remain largely unregulated.

The last method by which states can direct OFDI is through influence over MNCs. Because MNCs are privately-owned companies, their goal is to maximize productivity and profit, not to serve geopolitical interests. However, governments can provide incentives to encourage these MNCs to support political goals. There are a number of US and European firms which rely on political support for their investment abroad, and trade policy often plays a large role in MNC decisions to invest overseas. As was discussed with IFDI, MNCs also respond to incentives such as taxes, grants, or subsidies. For example, following World War II, the United States encouraged MNCs to invest in foreign iron and copper resources.⁴⁸ President Truman established a Material Policy Commission which modified tax laws and created more favorable conditions for overseas investment.⁴⁹ Another example is the Marshall Plan, which created a more promising environment for MNCs in Europe and supported the political objectives of rebuilding the European economy and balancing against the Soviet Union.⁵⁰

Many of these regulations for both inward and outward flows can be generalized or tailored for specific countries with BITs or Double-Taxation Treaties (DTTs). Similar to the way Regional Trade Agreements (RTAs) function for trade, BITs establish a legal framework for investment between countries. States generally construct them for the purpose of protecting MNCs and encouraging FDI.⁵¹ One of the features of modern BITs is procedural rights which provide investors with an adjudicatory function to enforce substantive rights.⁵² Having a dispute settlement mechanism in the case of unlawful or unfair treatment affords investors with an increased degree of security over their investment in the host country. Some RTAs contain specific sections outlining regulations of investment between member nations, in which case these agreements are

⁴⁷ Blackwill and Harris, *War by Other Means*, 57.

⁴⁸ Robert Gilpin, *U.S. Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment*, The Political Economy of International Relations Series (New York: Basic Books, 1975), 115.

⁴⁹ Gilpin, *U.S. Power and the Multinational Corporation*, 115.

⁵⁰ Gilpin, *U.S. Power and the Multinational Corporation*, 108.

⁵¹ Lisa E. Sachs and Karl P. Sauvant, “BITs, DTTs, and FDI Flows: An Overview,” *Eff. Treaties Foreign Direct Invest. Bilateral Invest. Treaties Double Tax. Treaties Invest. Flows Oxf. Oxf. Univ. Press Pp XXVIII-LXII*, 2009, 7, <http://ccsi.columbia.edu/files/2014/01/Overview-SachsSauvant-Final.pdf>.

⁵² Sachs and Sauvant, “BITs, DTTs, and FDI Flows,” 10.

then classified as Treaties with Investment Provisions (TIPs), and they are subsequently included in the IIA database.

Trade Policy

The mechanisms so far have addressed methods for direct regulation of FDI, but governments can also indirectly affect FDI through trade policy. Trade agreements can be beneficial or detrimental to FDI between nations. Liberalization of trade between nations enables better vertical flow of FDI, because MNCs can conduct intrafirm trade with the preferential benefits of the trade agreement.⁵³ In some cases MNCs have become a strong lobbying force for further liberalization of trade and RTAs, while in other cases, MNCs have used FDI as a means to circumvent tariffs and trade barriers that were not in their favor.⁵⁴ Governments can also use trade agreements to regulate investment by SOEs. Trade agreements can contain stipulations regarding government intervention in economic affairs. The European Union (EU) serves as a historical example of this. The agreement requires governments to make certain economic and government reforms in order to be considered for acceptance into the union. The desire to join the EU encouraged reform in many former Warsaw Pact countries that might have otherwise resorted to authoritarian rule and state-run economies.⁵⁵ Recently, US-based MNCs have had a difficult time competing with China's SOEs in Asia. A trade deal, such as the previously proposed Transpacific Partnership (TPP), could help US companies better compete in the region by encouraging reform in partner nations.⁵⁶

FDI within Geoeconomic Strategies

In this chapter, we have identified categories of geoeconomic strategies as well as examined ways in which states can affect the economic and geopolitical landscape through FDI regulatory mechanisms. Pairing these two discussions, geoeconomic strategy should provide us with some sense as to *how* and *why* countries regulate FDI. In other words, we should expect a state's position on FDI inflows and outflows to be consistent with their larger geoeconomic strategy. This final section reviews each

⁵³ Cohen, *Multinational Corporations and Foreign Direct Investment*, 209.

⁵⁴ Cohen, *Multinational Corporations and Foreign Direct Investment*, 44, 208.

⁵⁵ Ian Bremmer, *Superpower: Three Choices for America's Role in the World* (New York, New York: Portfolio Penguin, 2015), 115.

⁵⁶ Bremmer, *Superpower*, 115.

geoeconomic strategy, discusses which tools of FDI are most complimentary for each strategy, and concludes with a discussion of how government type might influence strategy.

Neo-Imperialism

Neo-imperialist strategies use economic resources as a means to achieve geopolitical objectives through competitive actions. Nations employing this strategy are less concerned with control of territory, but rather they focus on control of other nation-states' behavior.⁵⁷ Neo-imperialist states seek to shape their regions in ways that force lesser powers to become dependent on the imperialist state.⁵⁸ States employing this strategy look to coercion, imposition, and bribery.⁵⁹ As these states are focused on geopolitical concerns and express little regard for governing institutions, we can expect these states to use all tools of FDI. Because they are more concerned about geopolitical ends than economic ends, these states are likely to exercise tight controls on inward and outward FDI even at economic cost. Furthermore, these states will not be concerned with challenging international norms and institutions and will use SWFs, SOEs, and MNCs to achieve geopolitical ends even if that disrupts healthy market competition. These states will form trade deals and IIAs which may not be optimized for economic growth, but carry with them geopolitical benefits.

Neo-Mercantilism

Neo-mercantilist strategies seek to further the economic power of the state by using economic tools in a competitive fashion. These states project a foreign policy which is economically oriented, and they view the global political economy as a zero-sum game.⁶⁰ Nations operating under this strategy seek to control markets, technology, and resources and are commonly referred to as "trading states."⁶¹ These states define their national interests foremost in economic terms and believe that economic power is what ultimately affords them political influence.⁶² Neo-mercantilist states will avoid

⁵⁷ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 143.

⁵⁸ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 143.

⁵⁹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 143.

⁶⁰ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 143.

⁶¹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 143.

⁶² Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 143.

costly political commitments or proactive political roles in order to focus their resources and attention on their economic efforts.⁶³

Because neo-mercantilist states strive to enhance their economic power, we can expect them to be more hesitant in the ways which they manipulate FDI. These states are unwilling to suffer economic loss for geopolitical gain, so they will tailor their inward and outward FDI to promote economic growth. The economic burden incurred from oversight of SOEs make these states less likely to use that tool of FDI, but SWFs could serve as a valuable option if the funds can be efficiently managed to generate more state wealth. These states are concerned with upholding the world order only as long as it proves economically beneficial to them. As such, these states can be expected to encourage their MNCs to expand and compete within in the system even if it causes harm to neighboring states. Being “trading states,” these states will aggressively pursue trade deals and IIAs which benefit them economically.

Hegemony

Nations employing hegemonic geoeconomic strategies seek to provide international leadership, and uphold and support international institutions through cooperative means. States utilizing this strategy avoid coercion and tend to use softer forms of power through established norms and governing bodies.⁶⁴ A hegemonic state recognizes that the price of continued leadership may involve some economic costs in the way of the provision of public goods and services.⁶⁵ Despite the potential for “free-riders” and a disproportionate burden of cost bearing between states, the hegemonic power is willing to shoulder these responsibilities because it believes it is in the long-term interest of the state to uphold the established economic order.⁶⁶

Hegemonic states believe in the sanctity of the existing world order, and they are less willing to employ tools of FDI which could degrade the functioning of that order. Because the liberal order is founded upon free-market competition, SOEs are generally viewed as detrimental because they could be motivated by geopolitical goals vice profit. As such, a hegemonic strategy (which *would* be motivated by geopolitical goals) would

⁶³ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 143.

⁶⁴ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 144.

⁶⁵ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 143.

⁶⁶ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 143.

have to employ these tools cautiously as to not significantly hinder free-market competition. If the world order was altered to accept less emphasis on free-market competition, SOEs might be considered. With regard to SWFs, hegemonic strategies could use this tool provided they abide by the established Santiago Principles and operate in a transparent manner (as Norway does).

Given the current liberal system, however, the most valuable FDI tools for a hegemonic strategy will be MNCs, regulation of FDI, and trade and investment deals. Hegemonic states are willing to incur economic costs in pursuit of geopolitical goals, which means they are willing to financially support the investment of their MNCs in regions or areas which prove beneficial geopolitically. Likewise, they are willing to tailor their inward and outward FDI in ways which might be detrimental to the domestic economy if the geopolitical interests are deemed more important. Finally, they will be willing to enter trade deals and IIAs which are not economically ideal, but which strengthen foreign relations with other nations. Again, this analysis describes a hegemonic strategy within the current liberal order, but changes to that order might alter the tools of FDI which a hegemonic power would be willing to use.

Liberal Institutionalism

States which choose to abide by a liberal institutionalist strategy pursue primarily economic objectives within the established norms and institutions of the international order. The foreign policy is idealistic in contrast to the realist nature of neo-mercantilism.⁶⁷ Liberal institutionalist states believe that economic interdependence and integration promote security and prosperity between states.⁶⁸ States employing a liberal institutionalist strategy define their national interest primarily in economic terms, but pursue those interests through established international institutions.⁶⁹

Liberal institutionalist states are the least likely to employ the tools of FDI, because these states subscribe to a *laissez-faire* view of geoeconomics. These states will use regulation of FDI to enhance the domestic economy or encourage wealth abroad which can be repatriated, but they will not do this at the expense of the free-market

⁶⁷ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 145.

⁶⁸ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 145.

⁶⁹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 145.

economy. If they view their actions as potentially harmful to the current world order, they will likely abstain. A liberal institutionalist state could also theoretically employ SOEs for economic goals, but would face the same potential criticism as a hegemonic state. SOEs are often seen as having an unfair advantage due to their allegiance to governments and not shareholders. SWFs could be employed as a means to promote economic growth if utilized with transparency and compliance with Santiago Principles. Liberal institutionalist states will likely only financially support MNCs for economic purposes in ways which do not damage the international system. Finally, liberal institutionalist states would view trade deals and IIAs as means to obtain more favorable economic conditions vice mechanisms for strengthening of international alliances.

Role of Government Type

This final section examines how government structure could impact geoeconomic strategy. Based on the current liberal order, we would expect liberal democracies to generally operate within the cooperative strategies, although economic goals could also lead them to a neo-mercantilist strategy. It would not be uncommon for democracies to use economic power for both geopolitical and economic goals, but it is unlikely that they would employ strategies which significantly degrade the liberal order. Democracies generally subscribe to the liberal beliefs of universal human rights, economic development, and international cooperation. For this reason, we would not expect a democracy to employ a neo-imperialist strategy. Conversely, authoritative regimes that do not adhere to the aforementioned principles would be willing to employ a neo-imperialist strategy. This would, in fact, be anticipated if their desire is to alter the world order. If their aspirations are more limited, we would expect them to employ a neo-mercantilist or liberal institutionalist strategy as long as they continue to benefit from the current system. If the state is able to alter the current world order through a neo-imperialist strategy, we could see them turn to a hegemonic strategy to maintain that new order.

In this discussion of government type there is another important concept that should be addressed, and that is the concept of “sending states” versus “receiving states.” States are generally classified as sending or receiving based on their propensity towards exports or imports, immigrants or emigrants. This thesis does not make that distinction,

but rather proposes that on a strategic level with FDI, states can both send and receive. While government type, cultural considerations, or natural resources could influence the directional tendency of the flow of goods, recent changes to the strategic environment liberate states from restrictions such as “sending” or “receiving.” The globalization of finance and advances in technology enable states to more easily send *and* receive. We will see in this thesis that Germany focuses on outward flow of FDI, but it is also able to utilize the inward flow of FDI for strategic interests. China has previously been viewed as a receiving state, but its economic growth has afforded it the ability to now send capital abroad. The United States is the greatest exporter and recipient of FDI, making it both a sending and receiving state. For these reasons, this thesis will not restrict states to one category or the other, but will assume that states are capable of leveraging both inward and outward flow of FDI to accomplish strategic outcomes.

Conclusion

This chapter has discussed a framework for analyzing a country’s geoeconomic strategy, the regulating mechanisms for FDI, and the integration of these two concepts. As we move forward and analyze the geoeconomic strategies of three states, we expect their regulation of FDI to align with their geoeconomic strategy as proposed by this chapter. Recognizing that the type of government is potentially an intervening variable, influencing the extent to which a state can regulate its FDI, each country chapter will further incorporate that consideration into the analysis. Upon completion of these studies, we hope to gain insight into how the United States can develop its geoeconomic strategy and potentially leverage FDI in support of that strategy.

Chapter 3

German Geoeconomic Strategy and FDI

The discussion on the role of geo-economics in international relations is in its infancy. But one consensus has already been reached: if there is a role model for successful use of geo-economic power, it is Germany.

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Despite Germany's relative reluctance to employ military force as readily as the United States or its fellow European partners, Germany serves as a strong and influential power in Europe and beyond. Germany guides much of EU policy and despite lacking a permanent seat on the UN Security Council, it exerts considerable sway on the direction of world events. Why is this so? In his study on the rise of geo-economics, Edward Luttwak wrote, "even if we leave aside the persistence of armed confrontations in unfortunate parts of the world and wholly disregard what remains of the Cold War—World Politics is still not about to give way to World Business."¹ Luttwak describes geoeconomics as "the admixture of the logic of conflict with the methods of commerce—or as, Clausewitz would have written, the logic of war in the grammar of commerce."² In this sense then, Germany has returned to its Clausewitzian roots, learning to use the grammar of commerce in the logic of conflict.³ This chapter will examine Germany's geoeconomic strategy and its leveraging of FDI to support that strategy.

Government Structure

The Federal Government of Germany is classified as a democratic federal parliamentary republic. There are sixteen states, which are overseen by a three-part government system, similar to the United States.⁴ The legislative branch is a parliament comprised of representatives from the sixteen states. Most politicians will specialize in a specific domestic area, and there is little career benefit from involvement in foreign

¹ Edward N. Luttwak, "From Geopolitics to Geo-Economics: Logic of Conflict, Grammar of Commerce," *Natl. Interest*, no. 20 (1990): 17.

² Luttwak, "From Geopolitics to Geo-Economics: Logic of Conflict, Grammar of Commerce," 17.

³ Hans Kundnani, "Germany as a Geo-Economic Power," *Wash. Q.* 34, no. 3 (August 2011): 41, doi:10.1080/0163660X.2011.587950.

⁴ Central Intelligence Agency, "CIA World Factbook — Germany," accessed April 23, 2017, <https://www.cia.gov/library/publications/the-world-factbook/geos/gm.html>.

policy issues.⁵ The Chief of State (President) heads the executive branch, but the Head of Government (Chancellor) is the primary determinant of government policy.⁶ The Chancellor forms and heads the Federal Cabinet, and maintains the power over the use of the armed forces.⁷ The Federal Cabinet is comprised of Federal Ministers, and these Ministers are responsible for executing the general policy guidelines as prescribed by the Chancellor.⁸

There are three ministries that deal directly with economic policy: the Federal Ministry for Economic Affairs and Energy, the Federal Ministry of Finance, and the Federal Ministry for Economic Cooperation and Development.⁹ The Minister for Foreign Affairs plays a dominant role in foreign relations, similar to the US Secretary of State.¹⁰ German corporations play a large role in the determination of economic policy. Lobbying in Germany is different from in the United States in that corporations can legally contribute large amounts of money directly to campaigns, and the public largely accepts this practice.¹¹ Political candidates are often recruited and selected specifically to represent particular interests in areas such as business and labor.¹² In summary, German foreign policy is primarily determined by the Chancellor and her cabinet, executed by the Ministers, and heavily influenced by the private sector.

Official Policy and Outlook towards FDI

Being an export-driven economy, Germany is highly supportive of both outward and inward FDI. The focal point for trading and investing in Germany lies with the agency, Germany Trade and Invest (GTAI).¹³ This agency serves as the economic development agency for the Federal Republic, and the federal government has tasked it

⁵ Stephen F. Szabo, *Germany, Russia and the Rise of Geo-Economics* (London: Bloomsbury Academic, 2015), 36.

⁶ "Federal Government | Ministries," *Bundesregierung.de*, accessed April 23, 2017, https://www.bundesregierung.de/Webs/Breg/EN/FederalGovernment/Ministries/_node.html.

⁷ "Federal Government | Ministries."

⁸ "Federal Government | Ministries."

⁹ "Federal Government | Ministries."

¹⁰ "Federal Foreign Office Leadership," *Auswärtiges Amt*, accessed April 23, 2017, <http://www.auswaertiges-amt.de/EN/AAmt/Leitung/Uebersicht.html>.

¹¹ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 49.

¹² Szabo, *Germany, Russia and the Rise of Geo-Economics*, 49.

¹³ GTAI, "GTAI - What We Do," *German Trade and Invest*, accessed April 23, 2017, <http://www.gtai.de/GTAI/Navigation/EN/Meta/About-us/what-we-do.html>.

with facilitating direct investment in Germany and supporting German businesses in their international endeavors.¹⁴ GTAI provides education and resources to assist German corporations in expanding internationally, and GTAI advertises the attractiveness of Germany's investment environment in order to entice further investment from foreign corporations.¹⁵ Because of the desire to draw FDI, Germany has fostered an environment which makes investing in Germany extremely attractive.

Regulation of Inward FDI

Restrictions and Screening

The Federal Ministry for Economic Affairs and Energy (BMWi) retains the right to review the acquisition of any domestic company in Germany to avoid national security risks.¹⁶ The law is more restrictive for countries which lie outside of the EU or the European Free Trade Association (EFTA).¹⁷ Financial transactions are subject to review anytime a country outside of these areas seeks to acquire at least 25% of voting rights in a German company.¹⁸ If the purchasing company lies within the EU or EFTA, the acquisition is subject to review only if there are indications of an "abusive approach or a circumvention transaction."¹⁹ Currently, there is no requirement for investors to obtain approval beforehand for any acquisition, but there are mechanisms in place for the investor to seek pre-approval if desired.²⁰ Germany labels certain sectors such as weapons of war and information technology as sensitive for security reasons, and acquisitions in these areas are subject to more stringent review processes.²¹ The sectors and processes are clearly defined, and GTAI provides prospective investors with the education and resources required to begin applications. Before investing in these areas, the buyer must submit written notification with detailed information regarding the acquisition.²² If the Economic Affairs Ministry does not initiate a further review of the

¹⁴ GTAI, "GTAI - What We Do."

¹⁵ GTAI, "GTAI - What We Do."

¹⁶ "BMW - Federal Ministry for Economic Affairs and Energy," *BMW - Federal Ministry for Economic Affairs and Energy*, accessed April 23, 2017, <http://www.bmwi.de/Navigation/EN/Home/home.html>.

¹⁷ "BMW - Federal Ministry for Economic Affairs and Energy."

¹⁸ "BMW - Federal Ministry for Economic Affairs and Energy."

¹⁹ "BMW - Federal Ministry for Economic Affairs and Energy."

²⁰ "BMW - Federal Ministry for Economic Affairs and Energy."

²¹ "BMW - Federal Ministry for Economic Affairs and Energy."

²² "BMW - Federal Ministry for Economic Affairs and Energy."

acquisition within one month of the written notification by the investor, the transaction can be considered approved.²³

Incentives for Investment and Sector Specific Policies

Germany employs a broad range of incentives to encourage investment in Germany. Eligibility for these incentives is generally the same for foreign investors as for domestic investors. Germany offers grants for investments which improve economic activities in assisted regions in Germany, and these grants vary by region, but can cover up to 40% of eligible costs.²⁴ The state-owned KfW Banking Group and other state-owned banks offer promotional loan programs with attractive interest rates, and the Federal Employment Agency offers labor-related incentives for programs which support their recruiting and training efforts.²⁵ Foreign investors are treated equally to German companies with regard to incentives, establishment, and protection of physical and intellectual property.²⁶ While there is no official policy on encouraging or dissuading FDI from specific sectors of the Germany economy, there has been a noted effort to attract FDI in Research and Development (R&D).²⁷ GTAI advertises Germany as a highly attractive location for technology investment, and in 2013 published specific requests for investment in four sectors: Renewable energy and resources, chemicals and health technologies, mechanical and electronic technologies, and services (industrial equipment).²⁸

Administrative Investment Processes and Investment Environment

The administrative process for investment in Germany, while complex with regard to legal, regulatory, and accounting systems, is very transparent and consistent. Agencies such as GTAI provide a vast amount of products, support, and education to assist foreign investors in navigating administrative processes. Oversight of the investment process is well regulated, and foreign investors can rely on an efficient and

²³ "BMW i - Federal Ministry for Economic Affairs and Energy."

²⁴ U.S. Department of State, *Investment Report 2015 Germany* (US Department of State, 2015), 8, <http://www.state.gov/e/eb/rls/othr/ics/2015/241572.htm>.

²⁵ U.S. Department of State, *Investment Report 2015 Germany*, 8.

²⁶ U.S. Department of State, *Investment Report 2015 Germany*, 1.

²⁷ U.S. Department of State, *Investment Report 2015 Germany*, 2.

²⁸ U.S. Department of State, *Investment Report 2015 Germany*, 2.

sophisticated legal system to help protect their investments.²⁹ Germany has taken efforts to make the investment environment as friendly as possible for investors. The predictability and reliability of German laws make dispute settlement and protection of property rights fair and effective, and foreign investors are treated equally to domestic investors.³⁰ German courts are independent, and the government does not intervene in their operations.³¹

Regulation of Outward FDI

Sovereign Wealth Funds

Germany does not have a SWF. After German reunification, the government established a public agency called TLG Immobilien to manage privatization of assets previously owned by East Germany. In 2000, the country shifted its focus from privatization to profit portfolio managing of properties, and in 2012 the federal government sold the agency to private investors.³²

State Owned Enterprises

Germany refers to its SOEs as “public funds, institutions, or companies” and categorizes an entity as an SOE when the government owns more than 50% of capital shares or voting rights, but when the entity’s budget and administration are separate from the government.³³ The oversight of these SOEs is decentralized and falls to the ministry with the most appropriate expertise.³⁴ The purpose of the oversight is to ensure the companies’ actions are in accordance with promoting public interests rather than pursuing profit, and the government is required to relinquish its ownership stake if it is determined that a more effective alternative exists for public good.³⁵ The Federal Finance Ministry publishes an annual detailed report on all SOEs and their activities, and Germany makes a formal annual declaration to the Organization for Economic

²⁹ U.S. Department of State, *Investment Report 2015 Germany*, 1.

³⁰ US Department of State, “Investment Climate Statements for 2016 Germany,” 6, accessed April 22, 2017, <https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2016&dldid=254367#wrapper>.

³¹ US Department of State, “Investment Climate Statements for 2016 Germany,” 6.

³² U.S. Department of State, *Investment Report 2015 Germany*, 15.

³³ U.S. Department of State, *Investment Report 2015 Germany*, 8.

³⁴ U.S. Department of State, *Investment Report 2015 Germany*, 13.

³⁵ U.S. Department of State, *Investment Report 2015 Germany*, 13.

Cooperation and Development (OECD) on its compliance with OECD guidelines for SOEs.³⁶ The major SOEs in Germany are the Deutsche Post, Deutsche Telekom, and Deutsche Bahn. The majority of other government ownership is in areas related to administration efficiency, science, infrastructure, defense, development policy, economic development, and culture.³⁷

Incentives for MNCs

Recognizing the value for its export-driven economy, the German government is highly supportive of its MNCs' endeavors to invest abroad. In 2009, German OFDI stock grew by 7% to \$1.4 billion, ranking Germany among the four largest outward-investing countries in the world.³⁸ As of 2016, Germany ranked second to the United States in OFDI stock with \$1.8 billion.³⁹ The German government continues to support OFDI by expanding its network of IIAs. Currently, Germany has 186 IIAs in force (132 BITs, 54 TIPs), making it number one in the world for the most investment treaties, followed second by China with 128 in force.⁴⁰ The German government also provides some guarantees to safeguard OFDI by German corporations, but generally there is a requirement for an established BIT with the destination country.⁴¹

Table 2 – Investment Treaties by States

Source: UNCTAD, "International Investment Agreements Navigator."

No.	Name	Total BITs *	Total TIPs *
1	Germany	135 (132 in force)	67 (54 in force)
2	China	129 (110 in force)	20 (18 in force)
3	Switzerland	114 (112 in force)	34 (30 in force)
4	United Kingdom	106 (96 in force)	67 (54 in force)
5	France	104 (96 in force)	67 (54 in force)

³⁶ U.S. Department of State, *Investment Report 2015 Germany*, 13.

³⁷ U.S. Department of State, *Investment Report 2015 Germany*, 14.

³⁸ U.S. Department of State, *Investment Report 2015 Germany*, 13.

³⁹ Thomas Jost, *Outward FDI from Germany and Its Policy Context: Update 2011*, Columbia FDI Profile (Vale Columbia Center on Sustainable Investment; Columbia Law School, September 8, 2008), 1, http://ccsi.columbia.edu/files/2014/03/Germany_OFDI_-_8_September_2011_-_FINAL.pdf.

⁴⁰ UNCTAD, "International Investment Agreements Navigator."

⁴¹ Jost, *Outward FDI from Germany and Its Policy Context: Update 2011*, 4.

Geoeconomics in Practice – Analyzing German Geoeconomic Strategy

Germany's geoeconomic outlook is rooted in the concept of *Wandel durch Handel*, "change through trade."⁴² This philosophy encompasses the belief that close economic ties can assist in overcoming adversity between nations and help generate economic reform within nations.⁴³ Germany views recent Russian aggression as a sign of weakness and uncertainty in their government and economy, and thus Germany holds to the belief that true reform within Russia will be best realized through non-threatening interaction and the generation of economic interdependence.⁴⁴ This is not unlike the United States' concept of promoting democracy and free markets to inspire change within oppressive regimes. The difference between the United States and Germany is that Germany does not aspire to be the "shining light of democracy," and it does not seek to *Germanize* other nations in the same manner as the United States seeks to impart its democratic ideals or values to other cultures.⁴⁵ While Germany does believe that some internal reforms in Russia are necessary, it is not against some "light versions of authoritarian systems," nor is it concerned about dealing with a communist China.⁴⁶ Germany employs geoeconomics largely for its own prosperity, because it believes that economic power enables it to be a more influential state, but not necessarily a dominating or hegemonic state.

Following World War II, Germany found its identity in economic power, and its foreign policy has reflected and continues to reflect the belief that the strength of Germany lies in its economic might.⁴⁷ The European debt crisis provided Germany with an increase in economic might which it had not possessed for quite some time.⁴⁸ With an economy that relies heavily on exports for prosperity, Germany's policy toward FDI is extremely favorable, encouraging both inward and outward foreign investment. As a

⁴² Szabo, *Germany, Russia and the Rise of Geo-Economics*, 25.

⁴³ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 25.

⁴⁴ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 25; Stephen F. Szabo, *Connectivity Wars: Why Migration, Finance and Trade Are the Geo-Economic Battlegrounds of the Future*, ed. Mark Leonard, 2016, 130, http://www.ecfr.eu/page/-/Connectivity_Wars.pdf.

⁴⁵ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 32.

⁴⁶ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 32.

⁴⁷ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 146.

⁴⁸ Sanjaya Baru, "Geo-Economics and Strategy," *Survival* 54, no. 3 (June 2012): 52, doi:10.1080/00396338.2012.690978.

result, German foreign policy is largely driven by German businesses who think and operate globally.⁴⁹ German businesses are less concerned about democratic values or human rights in other countries, and thus German foreign policy often yields to the influence of German corporations in these areas.⁵⁰ As political analyst Steven Szabo says it, “The business of Germany is leading, and politics follows behind.”⁵¹ With this general concept of German outlook on geoeconomics, we begin our analysis of German geoeconomic strategy through the lens of Wigell’s framework.

Cooperative or Competitive

Post-World War II Germany has been described as an “economic giant, but a political dwarf.”⁵² Germany is well known for its robust economic power, but has been criticized at times for failing to lead in the political and military realms.⁵³ Over the past several decades, Germany has primarily acted in accordance with international institutions and pursued geopolitical objectives in accordance with multilateral agreement from its allies. Germany is a member of and abides by the guidelines and regulations of the major economic institutions such as the OECD, WTO, IMF, and UNCTAD. Germany’s actions with regard to FDI have historically been viewed as cooperative with international norms. As an example, Germany recently raised concerns about potential security threats from FDI entering the EU. The EU has become the main destination for FDI from China, and the EU as a whole grants the same openness to FDI from China as from any EU member.⁵⁴ Germany worked with the EU commission for development of a screening process for IFDI.⁵⁵ As a result, the EPSC generated a report calling for a screening process similar to the United States’ CFIUS program.⁵⁶ However, despite historical cooperation, Germany has also engaged in actions which highlight a more competitive side of German economic policy.

⁴⁹ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 6.

⁵⁰ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 6.

⁵¹ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 6.

⁵² Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 146.

⁵³ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 146.

⁵⁴ EPSC, *Engaging China at Time of Transition*, Strategic Notes (European Political Strategy Centre, July 15, 2016), 4, https://ec.europa.eu/epsc/publications/strategic-notes/engaging-china-time-transition_en.

⁵⁵ Financial Times, “Politicising Investment Makes the World Poorer,” *Financial Times*, accessed April 22, 2017, <https://www.ft.com/content/792b5784-b884-11e6-ba85-95d1533d9a62>.

⁵⁶ EPSC, *Engaging China at Time of Transition*, 5.

Wigell describes a country's economic framework as competitive when "the goal is to perpetuate economic domination and the cementing of a hierarchical relationship in which neighboring states are made more dependent on the regional power, allowing it to reap national benefits at the expense of mutual benefits."⁵⁷ Germany sees itself not as a superpower, but as a *Gestaltungsmacht*, a shaping power, and it believes that its economic might is the source of its shaping influence.⁵⁸ As such, Germany has somewhat departed from the economic cooperation strategy of the immediate post-World War II environment and turned towards a more competitive strategy, using its economic power to achieve its own objectives. Blackwill and Harris write, "Germany has done more to remake Europe in its likeness in the past four years than it had accomplished in the past century."⁵⁹ The Eurozone has greatly favored and advantaged Germany's manufacturing market, and Germany's role in the EU and its economic might largely enable it to "dictate the terms on which foreign capital into the Eurozone is solicited."⁶⁰

Germany's export economy and trade surpluses are creating dissension with other countries in the Eurozone, and Germany has been criticized for taking depreciation measures to maintain its competitive export market.⁶¹ Conversely, Germans tend to view the Eurozone crises or financial difficulties of states as the result of weakness or poor policy decisions by other states in the Union.⁶² As Hans Kundnani from the European Council on Foreign Relations states:

Of course, Germany is not solely to blame for this shift from cooperation to competition within the Eurozone. Nevertheless, economic cooperation—and the transfer of sovereignty as a pre-condition of this—is a key characteristic of a civilian power or trading state. It appears, however, that Germany is not only increasingly defining its national interest in economic terms, but also increasingly using its economic power to impose its own preferences on others in the context of a perceived zero-sum competition within the Eurozone, rather than to promote greater cooperation in a perceived win-win situation.⁶³

While the accusation that Germany is a currency manipulator is arguably harsh and unfounded (the European Central Bank governs monetary policy), the continued

⁵⁷ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁵⁸ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 143.

⁵⁹ Blackwill and Harris, *War by Other Means*, 82.

⁶⁰ Blackwill and Harris, *War by Other Means*, 82.

⁶¹ Kundnani, "Germany as a Geo-Economic Power," 33.

⁶² Kundnani, "Germany as a Geo-Economic Power," 37.

⁶³ Kundnani, "Germany as a Geo-Economic Power," 37.

accumulation of a current account surplus has strained Germany's fellow Eurozone neighbors.⁶⁴ Germany also went against the desires of the United States, United Kingdom, and other EU members when it signed up as a member to China's Asian Infrastructure Investment Bank (AIIB).⁶⁵ Subsequently, although several other European countries also joined the bank, Germany retains the highest voting rights for non-regional members, and comes in fourth place overall behind China, India, and Russia.⁶⁶ While Germany's overall adherence and participation in the established world economic institutions *imply* a cooperative strategy, these economic policies and actions in the Eurozone suggest Germany is taking more of a competitive than cooperative stance when it comes to its geoeconomic strategy.

Economic or Geopolitical Ends

Germany practices a "commercial *realpolitik* that privileges the country's economic well-being above other interests."⁶⁷ Because Germany views economic power as its strength for influence in the political realm, there is little doubt that its economic endeavors have an ultimate political objective—to be a shaping power through economic influence. Wigell writes that "when a regional power is clearly not prepared to assume the costs of regional leadership, but rather uses economic power to further its own commercial interests, it indicates that the driving motivations are narrowly economic rather than more broadly political."⁶⁸ While Germany's geoeconomic actions ultimately endow Germany with further political power, the actions themselves are rarely undertaken solely for geopolitical objectives at the expense of economic costs. German policies are heavily influenced by big export and foreign investment firms, and the German system is designed to support and encourage this.⁶⁹ Germany's use of FDI and foreign policy are intimately related, but primarily rooted in growing Germany's economic power.

⁶⁴ Szabo, *Connectivity Wars*, 148.

⁶⁵ Szabo, *Connectivity Wars*, 146.

⁶⁶ "Members of the Bank - AIIB," *Asian Infrastructure Investment Bank*, accessed April 23, 2017, <https://www.aiib.org/en/about-aiib/governance/members-of-bank/index.html>.

⁶⁷ Andrew Moravcsik, "Germany, Russia, and the Rise of Geo-Economics; The Paradox of German Power," *Foreign Affairs*, August 19, 2015, <https://www.foreignaffairs.com/reviews/2015-08-13/germany-russia-and-rise-geo-economics-paradox-german-power>.

⁶⁸ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 141.

⁶⁹ Moravcsik, "Germany, Russia, and the Rise of Geo-Economics; The Paradox of German Power."

The German relationship with China demonstrates an attempt at *Wandel durch Handel*, but in spite of its poor success at stimulating change in China, commerce with China continues. Economics trump geopolitics. China serves as the second largest export market for Germany after the EU, and economic interests have surpassed political and ideological considerations.⁷⁰ Human rights issues are largely downplayed, and the German relationship with China is pursued in a much more bilateral fashion than the general European approach to relations with China.⁷¹ When Angela Merkel met with the Dalai Lama in 2007, she received heavy criticism from German businesses and subsequently toned down her rhetoric of the situation at the same time Foreign Minister Steinmeier supposedly sent a letter to his Chinese counterpart reaffirming Germany's recognition of Tibet as part of Chinese territory.⁷²

Germany recognizes its dependence on rare earth minerals and has expressed concern over China's expansion into Africa and Central Asia.⁷³ In an attempt to counter Chinese competition in the region, Germany sought better access to these minerals for German companies and signed an accord with Kazakhstan to do so. Despite Angela Merkel's objections to the agreement based on human rights issues, Germany ultimately signed the agreement for its greater long-term economic benefits.⁷⁴ It appears more and more that *Handel* is not producing *Wandel*, and yet *Handel* continues because economic benefits tend to outweigh ideological beliefs or human rights.⁷⁵ Large corporations carry enough clout with German foreign policy to persuade the government to overlook human rights concerns or democratic values. Former Chancellor Schröder referred to Germany's overlook of these values as merely a "more patient" approach to human rights.⁷⁶

If Germany is indeed using a competitive framework to pursue economic ends, which it appears in recent years that it is, this translates to a strategy of neo-mercantilism. Neo-mercantilist states are "trading states...which define their national interests foremost in economic terms, while applying multilateralism selectively with a close view to

⁷⁰ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 143.

⁷¹ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 143.

⁷² Szabo, *Germany, Russia and the Rise of Geo-Economics*, 8, 143.

⁷³ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 91.

⁷⁴ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 92.

⁷⁵ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 33.

⁷⁶ Hans Kundnani, *The Paradox of German Power* (New York: Oxford University Press, 2015), 80.

national economic security concerns.”⁷⁷ Germany has pursued economic power for the sake of prosperity and influence, but not in an imperialistic manner—to the contrary it has received its fair share of criticism for *not* leading. A neo-mercantile strategy dictates “avoiding costly political commitments or proactive regional political role, so as to be able to devote maximum attention to national economic development.”⁷⁸ Germany’s decision to abstain from military action in Libya in 2011 demonstrated its willingness to avoid a costly political role, despite the pressure from its Western allies.⁷⁹ In combination with the abstention from Iraq, Germany made clear its intentions to “apply multilateralism selectively.”⁸⁰ Additionally, Germany’s willingness to overlook *Moralpolitik* in favor of *Realpolitik* when it comes to democratic values and human rights issues demonstrates the emphasis which Germany often places on economic power above traditional Western ideals. As such, Germany’s geoeconomic strategy most closely aligns with neo-mercantilism.

The Role of FDI and Government Structure in German Neo-Mercantilist Strategy

With regard to using FDI for its geoeconomic strategy, Germany relies primarily on MNCs. The lack of a SWF and strict regulations on SOEs makes those poor choices for economic tools of power. Germany’s big businesses, however, are the driving factor behind Germany’s use of FDI as a geoeconomic tool. Edward Luttwak suggests that the interaction between states and private actors will vary, and at times each will influence the other.⁸¹ He describes this as “reciprocal manipulation.”⁸² There is perhaps no better example of such a relationship as that which exists in Germany. German companies consistently lobby the government to enact policies which further their business endeavors. In turn, the economic success bodes well for the careers of the politicians where economic success of the country is a key measure of success in German politics.⁸³

⁷⁷ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 143.

⁷⁸ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 143.

⁷⁹ Kundnani, “Germany as a Geo-Economic Power,” 31.

⁸⁰ Wigell, “Conceptualizing Regional Powers’ Geoeconomic Strategies,” 143.

⁸¹ Kundnani, “Germany as a Geo-Economic Power,” 41.

⁸² Kundnani, “Germany as a Geo-Economic Power,” 41.

⁸³ Kundnani, “Germany as a Geo-Economic Power,” 41.

In 1998, Chancellor Schröder began to take large trade delegations with him on his visits to other nations.⁸⁴ This further increased the role of the chancellery in promoting business opportunities for German corporations abroad.⁸⁵ Germany's relationship with China has steadily grown over the years, and German investment in China now greatly overshadows German investment in Russia.⁸⁶ Chancellor Schröder began the practice of the German Chancellor visiting China once a year, normally accompanied by a large delegation of CEOs from Germany's major firms. When Angela Merkel made her annual trip to China in July 2014, she was accompanied by representatives from Siemens, VW, Airbus, Lufthansa, and Deutsche Bank.⁸⁷ Chancellor Schröder also encouraged the EU to lift an arms embargo against China which had been in place since 1989, following the incident at Tiananmen Square.⁸⁸ The push for removal of the ban was largely driven by Germany in conjunction with France. The removal would have opened a new industry for German submarines, but in order for the ban to be lifted, all EU members must unanimously agree, which to date has not occurred.⁸⁹

Although not successful in lifting the arms embargo against China, Germany was successful in blocking an EU attempt to sanction China over solar panel production and imports.⁹⁰ In 2013, solar panel companies in the EU felt threatened when Chinese companies began installing solar panels in EU member states at a lower cost.⁹¹ The EU imposed a tariff on solar panels from China, to which China retaliated with an anti-dumping case against European wine and further threatened an investigation into luxury car companies, mostly German companies.⁹² Chancellor Angela Merkel promised

⁸⁴ Kundnani, "Germany as a Geo-Economic Power," 36.

⁸⁵ Kundnani, "Germany as a Geo-Economic Power," 36.

⁸⁶ Kundnani, *The Paradox of German Power*, 80.

⁸⁷ Dieter Dettke, *Germany: The Geopolitical Uncertainties of Geo-Economic Power* (American Institute for Contemporary German Studies; John Hopkins University), 5, accessed April 22, 2017, <http://www.aicgs.org/issue/germany-the-geopolitical-uncertainties-of-a-geo-economic-power/>.

⁸⁸ Kundnani, *The Paradox of German Power*, 80.

⁸⁹ Deutsche Welle, "EU Proposes End To China Arms Embargo | Europe | DW.COM | 15.04.2004," *DW.COM*, accessed April 23, 2017, <http://www.dw.com/en/eu-proposes-end-to-china-arms-embargo/a-1170380>; Financial Times, "Japan Fears Brexit Blow to EU Arms Embargo on China," *Financial Times*, accessed April 23, 2017, <https://www.ft.com/content/219af680-41c6-11e6-b22f-79eb4891c97d>.

⁹⁰ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 146.

⁹¹ Yu Chen, *EU-China Solar Panels Trade Dispute: Settlement and Challenges to the EU* (European Institute for Asian Studies, June 2015), <http://www.eias.org/wp-content/uploads/2016/02/EU-Asia-at-a-glance-EU-China-Solar-Panels-Dispute-Yu-Chen.pdf>.

⁹² Chen, *EU-China Solar Panels Trade Dispute: Settlement and Challenges to the EU*.

Premier Li in a meeting over the dispute that “Germany would work to make sure that no permanent import duties would be placed on Chinese solar panels.”⁹³ In the end, the call for a tariff was blocked and a minimum price was set instead.⁹⁴

German GDP growth is heavily dependent on the exports and FDI of large corporations, but because much of those exports go to countries such as China and Russia where the industries are largely state-regulated, the corporations rely on the German government to facilitate the investments.⁹⁵ For example, while the majority of products exported to China are transported via maritime routes, a new “Silk Road” train track now connects Germany to China by rail.⁹⁶ This provides a fast and efficient mode of transportation, but it connects by way of Russia. Recent shaky relations between Europe and Russia over the Ukraine have generated a challenging and delicate geopolitical situation for Germany. How has Germany mitigated the problem? The rail route is controlled by Trans-Eurasia, a joint business endeavor between Russian Railways and Deutsche Bahn (a 100% German SOE).⁹⁷ Any threat by Russia against the railway would alienate it from both Germany and China, which is a risk Russia is not willing to take.

In a recent press release by the Federal Ministry of Economic Affairs and Energy, the German government provided MNCs with export credit guarantees of more than 20 billion Euro and investment guarantees of over 4 billion Euro to assist in their investments abroad.⁹⁸ Despite continuing sanctions on Russia, the federal government provides insurance possibilities for businesses in Russia, and with the lifting of sanctions on Iran, the insurance options have been extended to cover investment there as well.⁹⁹ With regard to government influence on MNCs from abroad, the government sees IFDI

⁹³ Chen, *EU-China Solar Panels Trade Dispute: Settlement and Challenges to the EU*.

⁹⁴ Chen, *EU-China Solar Panels Trade Dispute: Settlement and Challenges to the EU*.

⁹⁵ Kundnani, “Germany as a Geo-Economic Power,” 41.

⁹⁶ Dettke, *Germany: The Geopolitical Uncertainties of Geo-Economic Power*, 5.

⁹⁷ Dettke, *Germany: The Geopolitical Uncertainties of Geo-Economic Power*, 6.

⁹⁸ Federal Ministry for Economics Affairs and Energy, “Promotion of Foreign Trade and Investment: Federal Government Provides Export Credit Guarantees Totalling More than €20 Billion and Investment Guarantees Totalling More than €4 Billion,” accessed April 22, 2017, <https://www.bmwi.de/Redaktion/EN/Pressemitteilungen/2017/20170209-bundesregierung-exportgarantien.html>.

⁹⁹ Energy, “Promotion of Foreign Trade and Investment.”

not as a replacement or threat to domestic companies, but as a supplement to them.¹⁰⁰ As a result, Germany has reduced tariffs in a number of industries, especially R&D, in order to encourage foreign investment in Germany.¹⁰¹ The government has also instituted tax incentives to encourage MNCs to invest in Germany.¹⁰² These examples show the German government's extensive involvement in utilizing the FDI of MNCs both inward and outward to further its economic power.

Possibly more pronounced in German politics than the government's influence on MNCs, is the inverse relationship of the MNCs' influence on the government. The starkest examples of this can be seen with Germany's relationship to Russia. With over six thousand German companies in Russia, German policy has remained fairly business friendly towards Russia. Angela Merkel has shifted this policy somewhat, taking a more multilateral approach with the use of sanctions, but in general, businesses continue to drive German's foreign policy towards Russia.¹⁰³ One example of this is the Petersburg Dialogue. The CEO of Siemens, one of Germany's largest engineering firms, met personally with President Putin and agreed to a long-term investment commitment in Russia at the very same time Angel Merkel was meeting with President Obama to discuss sanctions.¹⁰⁴ The relationship between Russia and Germany is driven largely by business, especially in the energy sector, and Germany has remained especially dependent on Russia for gas and oil. Attempts to liberalize the European gas market to reduce this dependence on Russia were heavily opposed by Germany's big energy companies, E.ON and Ruhrgas.¹⁰⁵ While some German firms are supportive of Merkel's tougher stance towards Russia, the long-term sustainability of her efforts is uncertain.¹⁰⁶

Government structure plays an interesting role in Germany's geoeconomic strategy. Considering the fact that, as a member of the EU, Germany does not directly

¹⁰⁰ Marcel Fratzscher and others, *Increasing Investment in Germany* (Report Prepared by the Expert Commission on Behalf of the Federal Minister for Economic Affairs and Energy, Sigmar Gabriel, 2015), 9, https://berlinoeconomicus.diw.de/en/wp-content/uploads/sites/3/2015/04/Extract_from_the_report_prepared_by_the_expert_commission.pdf.

¹⁰¹ Fratzscher and others, *Increasing Investment in Germany*, 10.

¹⁰² Fratzscher and others, *Increasing Investment in Germany*, 10.

¹⁰³ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 137.

¹⁰⁴ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 138.

¹⁰⁵ Kundnani, *The Paradox of German Power*, 80.

¹⁰⁶ Szabo, *Germany, Russia and the Rise of Geo-Economics*, 138.

control its trade or monetary policy, the German government has more limitations with regard to economic tools than a democracy such as the United States. Although a topic for future study, this could contribute to the fact that Germany places so much emphasis on FDI. That aside, as a liberal democracy which places heavy emphasis on economic prosperity, it is not surprising to see Germany operating under a neo-mercantilist strategy. Although the structure of the German government does not differ substantially from other democracies, the political motivations of being a shaping power through economic strength allow for a degree of domestic acceptance of government intervention in FDI, which may not be common to all democracies.

Conclusion

Germany's geoeconomic strategy predominately resembles a neo-mercantilist strategy with hints of liberal institutionalism and hegemony. Germany cooperates with the governing institutions of the established world order, but it is not afraid to take a more competitive side and use its economic power for its own economic interests at the expense of others. Recent Brexit negotiations and the Greek financial crisis serve as examples where Germany played a more hegemonic role and risked financial costs in order to uphold liberal institutions. While such recent events might suggest a movement away from neo-mercantilism, these are the exceptions rather than the norm and may be more reflective of a German government seeking to maintain its economic advantage over weaker neighbors within an EU structure rather than outside of it. When it comes to leveraging FDI for economic and geopolitical purposes, MNCs serve as the foundation of Germany's geoeconomic strategy. They are the primary instrument through which Germany accumulates economic strength and influence. As with most democratic capitalist states, Germany does not utilize a SWF or its SOEs (Deutsche Bahn as a possible exception) in a contentious fashion to accomplish geopolitical or economic objectives. For Germany, the majority of influence is exerted on the government by the MNCs, but ultimately this serves the political aims of the government's quest of being a shaping power in Europe. The government thus institutes policies which further promote both inward and outward FDI. This reciprocal relationship helps Germany grow in economic power, and in turn, shape EU policy such as it did with the removal of sanctions on solar panels from China. If the geopolitical landscape has truly changed to a

materialistic era where economic tools trump the military use of force, then Germany has positioned itself to a position of utmost influence and advantage for the current environment. In the words of Andrew Moravcsik, Germany “*might be today’s most underrated global power.*”¹⁰⁷



¹⁰⁷ Moravcsik, “Germany, Russia, and the Rise of Geo-Economics; The Paradox of German Power.”

Chapter 4

Chinese Geoeconomic Strategy and FDI

Beijing has been playing the new economic game at the maestro level...staying out of wars and political confrontations and zeroing in on business--its global influence far exceeds its existing economic strength.

Leslie Gelb

President Emeritus for Council of Foreign Relations

China is playing the game of international relations in a way which maximizes its strengths and minimizes its weaknesses. Recognizing that it cannot directly challenge the United States in the military arena, China is turning to its economic power for influence. Never before in history has one government had so much wealth at its disposal.¹ In an age of geoeconomics, this places the Chinese Communist Party (CCP) in a very advantageous position. China has used the Western world-order to its advantage, and it has played within the rules of the system just enough to build its wealth and influence without compromising the CCP's domestic power. This accumulated economic wealth and influential power is enabling China to challenge Western institutions and re-write the rules of the road in ways that benefit its own geopolitical interests. This chapter will examine China's geoeconomic strategy and FDI's role in that strategy.

Government Structure

The CIA World Fact Book classifies the People's Republic of China (PRC) as a communist state.² The chief of state, President Xi Jinping, is the head of the executive branch, and the National People's Congress (NPC) is responsible for electing both the president and vice president. The NPC is comprised of members indirectly elected by municipal, regional, and provincial people's congresses and the People's Liberation Army (PLA).³ In practice, only CCP-approved candidates are elected, and there is no political party which opposes the CCP.⁴ The State Council is the primary executive body

¹ Blackwill and Harris, *War by Other Means*, 93.

² CIA, "CIA World Factbook — China," accessed May 1, 2017, <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html>.

³ CIA, "CIA World Factbook — China."

⁴ CIA, "CIA World Factbook — China."

and is comprised of the premier, vice premier, and state councilors.⁵ The State Council serves as the main administrative authority and includes the heads from every government ministry.⁶ Every five years, the NPC convenes to outlay future policies and guidelines for the country, and during this convention the attendees select the Central Committee which serves as a sort of board of directors for the party.⁷ With regard to financial matters, the Ministry of Commerce for the People's Republic of China (MOFCOM) and the National Development and Reform Commission (NDRC) maintain the Catalogue for the Guidance of Foreign Investment in Industries, which contains detailed information on restrictions, guidelines, and processes for China's prospective investors.⁸ The regulations and regulatory documents are governed and generated by the State Council.⁹

Official Policy and Outlook towards FDI

Publically, China promotes and encourages both inward and outward FDI, and recognizes the benefits that FDI can bring to its economy. In practice, China is extremely restrictive of its IFDI, and the state plays a large role in the direction of its OFDI. President Xi has recently announced reform plans to make Chinese FDI processes more investment-friendly, but little action has been taken. China has also increased negotiations over a US/China BIT, but the government still remains very restrictive and inconsistent with regard to regulation of FDI and little forward progress has been made. In terms of treatment of foreign investors, China claims to provide equal treatment after the investment has been established, but not before or during negotiations. In practice, many companies complain they are never treated equally. The 2015 Report to Congress of the US-China Economic and Security Review Commission reported that China has demonstrated a trend of opening up specific sectors for investment in order to improve local industry and capabilities. Once the domestic industry is adequately developed,

⁵ Gov.cn, "State Structure of the People's Republic of China," accessed May 1, 2017, http://english.gov.cn/archive/china_abc/2014/08/23/content_281474982987300.htm.

⁶ Bremmer, *The End of the Free Market*, 34.

⁷ Council of Foreign Affairs, "The Chinese Communist Party," *Council on Foreign Relations*, accessed May 1, 2017, <http://www.cfr.org/china/chinese-communist-party/p29443>.

⁸ US Department of State, "Investment Climate Statements for 2016 China," accessed April 22, 2017, <https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2016&dliid=254367#wrapper>.

⁹ US Department of State, "Investment Climate Statements for 2016 China."

those markets are closed and unfair treatment drives foreign investors from the country.¹⁰ Despite the restrictions and unfair practice, China's promising emerging economy made it the top destination for FDI in 2015.¹¹

Regulation of Inward FDI

Restrictions and Screening

China's regulations for IFDI are very restrictive, and the government screens inward investment for not only national security, but for economic and geopolitical reasons. Many of China's domestic enterprises are either state owned or state supported, and China attempts to shield these enterprises from external competition by regulating IFDI.¹² There is broad range of sectors that remain closed from foreign investment. In 2015, the MOFOC drafted a new Foreign Investment Law which replaced current regulations and introduced two "negative lists," one for domestic and one for foreign investment.¹³ These negative lists outlay more specifics on which sectors do and do not require approval from the government.¹⁴ Despite this attempt at reform, it is still unclear how China implements these lists, and how these lists conflict with China's current Foreign Investment Catalogue.¹⁵ According to *The Economist*, the EU Chamber of Commerce has dismissed these reforms as "not bold enough."¹⁶

China enacted the National Security Law in July 2015 which allows for further review and screening of foreign investment for a broad range of national security grounds.¹⁷ Foreign countries continue to express concern over selective regulatory screening and approval processes and a lack of transparency in the overall application and approval regulations.¹⁸ Furthermore, investors have raised complaints regarding

¹⁰ U.S.-China Economic and Security Review Commission, *2015 Report to Congress of the U.S.-China Economic and Security Review Commission; Executive Summary and Recommendations*, Annual Report (U.S.-China Economic and Security Review Commission, November 18, 2015), 3, : <http://www.uscc.gov>.

¹¹ US Department of State, "Investment Climate Statements for 2016 China," 1.

¹² US Department of State, "Investment Climate Statements for 2016 China," 1.

¹³ US Department of State, "Investment Climate Statements for 2016 China," 6.

¹⁴ US Department of State, "Investment Climate Statements for 2016 China," 1.

¹⁵ US Department of State, "Investment Climate Statements for 2016 China," 2.

¹⁶ The Economist, "Business in China: Mixed Messages | The Economist," accessed April 22, 2017, <http://www.economist.com/news/business/21707954-missed-opportunity-improve-environment-foreign-companies-china-mixed-messages>.

¹⁷ US Department of State, "Investment Climate Statements for 2016 China," 2.

¹⁸ US Department of State, "Investment Climate Statements for 2016 China," 2.

undefined terms and standards. According to the OECD investment climate review in 2013, foreign firms are growing more weary and anxious of investment protectionist measures by the CCP.¹⁹ In addition to federal FDI laws, local legislatures and governments can further restrict FDI in their regions.²⁰

Incentives for Investment and Sector Specific Policies

The legal framework and approval for foreign investment in China remain largely at the discretion of the government, and in turn, the restrictions are inconsistently applied and tend to favor sectors where the government is seeking development while restricting others for the benefit of SOEs.²¹ The Catalogue for the Guidance of Foreign Investment in Industries was revised in March of 2015, and contains a description of sectors which are “encouraged, restricted, and prohibited.” China’s most recent five-year economic plan stated a desire for further development in energy efficiency and environmental technologies, next generation information technology, biotechnology, advanced equipment manufacturing, and other informational or technological fields.²² This economic plan also included guidelines for restricting FDI in energy and resource-intensive and environmentally damaging industries. On the other hand, China’s policy towards investors who will further domestic growth or provide technology and skills transfers tends to be very favorable.²³

China provides incentives to encourage investment in certain sectors as well as certain regions of the country. Due to the increasingly crowded nature of its coastal cities, China encourages investors to establish regional headquarters and operations in Central, Western, and Northeastern China.²⁴ Potential investors can reference the Catalogue of Priority Industries for Foreign Investment in the Central-Western Regions for more specifics on incentives available for regional investments.²⁵ With regard to sector incentives, China has provided reduced income taxes, resource and land-use fees,

¹⁹ US Department of State, “Investment Climate Statements for 2016 China,” 4.

²⁰ US Department of State, “Investment Climate Statements for 2016 China,” 5.

²¹ US Department of State, “Investment Climate Statements for 2016 China,” 2.

²² US Department of State, “Investment Climate Statements for 2016 China,” 8.

²³ US Department of State, “Investment Climate Statements for 2016 China,” 8.

²⁴ US Department of State, “Investment Climate Statements for 2016 China,” 9.

²⁵ US Department of State, “Investment Climate Statements for 2016 China,” 9.

and import/export duties or priority treatment for domestic services. In some cases the government offers streamlined administrative processes or start-up funding support.²⁶

Administrative Investment Processes and Investment Environment

According to the Department of State (DOS) Investment Report, approximately 77 percent of businesses queried felt that foreign firms were not welcome in China.²⁷ The DOS Investment Report emphasizes the difficulty that businesses face in China. China is ranked 84th of 189 economies for “ease of doing business” by the World Bank. With regard to starting a business, the World Bank ranks China at 136 of 189.²⁸ In an attempt to reduce the red tape and ease the approval process, the State Council has taken some measures to eliminate redundancy and streamline some processes, but in general the process remains extremely burdensome. The MOFCOM’s Department of Foreign Investment Administration is the agency responsible for promoting and attracting FDI, and they established a website in English which provides some clarity and further instructions for launching investment in China.²⁹

Despite publically-stated efforts by the government to improve the investment climate in China, the feedback from investors generally reports a poor and unfair regulatory system. China does not have strong mechanisms for protection of intellectual property or technology transfer. In fact, most companies recognize they will have to sacrifice their intellectual property in order to do business in China. Although China commits itself to abiding by technology transfer rules in accordance with WTO standards, in practice local officials still give preference to investments that further enhance the domestic industries through obtainment of new intellectual property.³⁰ As it pertains to the protection of property rights, Chinese courts are largely inconsistent in their rulings for foreign companies.³¹ Several companies have recently complained about

²⁶ US Department of State, “Investment Climate Statements for 2016 China,” 21.

²⁷ US Department of State, “Investment Climate Statements for 2016 China,” 1.

²⁸ The World Bank, “Ranking of Economies - Doing Business - World Bank Group,” accessed May 1, 2017, <http://www.doingbusiness.org/rankings>.

²⁹ US Department of State, “Investment Climate Statements for 2016 China,” 7.

³⁰ US Department of State, “Investment Climate Statements for 2016 China,” 21.

³¹ US Department of State, “Investment Climate Statements for 2016 China,” 22.

administrative delays in remitting money from China despite having met regulatory requirements.³²

China's dispute settlement mechanism is generally poor for external investors. Chinese officials encourage private resolution of disputes, but if an issue is formalized, the preferred method of handling the dispute is arbitration vice litigation.³³ The primary body in China for oversight of these arbitrations is the China International Economic and Trade Arbitration Commission (CIETAC).³⁴ Some foreign investors have reported favorable treatment by the agency, while others have complained of inconsistent and biased treatment. If a complaint is forwarded for legal action, the lack of judicial independence has not fared well for foreign corporations. Although China's constitution establishes the court as an independent entity, in reality the court system is not independent of the CCP.³⁵ Foreign investors will often face unfair and unequal treatment in court if the CCP intervenes, which frequently occurs.

Regulation of Outward FDI

Sovereign Wealth Funds

The primary SWF of China is the China Investment Corporation (CIC), which the government established in 2007. A board of directors and board of supervisors govern and manage the fund, and they produce an annual report on its performance and structure. Other portions of China's wealth are utilized by government agencies such as the State Administration of Foreign Exchange (SAFE) and China's National Social Security Fund. These agencies are not required to generate reports on their activities which results in a lack of transparency and oversight.³⁶ China established the Silk Road Fund in 2014, which also uses China's sovereign wealth to make investments abroad.

State Owned Enterprises

China currently has approximately 156,000 SOEs, and 54,000 (35%) of these companies are owned by the central government with the remainder being owned by local governments.³⁷ These SOEs account for 30-40% of China's total GDP and

³² US Department of State, "Investment Climate Statements for 2016 China," 15.

³³ US Department of State, "Investment Climate Statements for 2016 China," 17.

³⁴ US Department of State, "Investment Climate Statements for 2016 China," 17.

³⁵ US Department of State, "Investment Climate Statements for 2016 China," 18.

³⁶ US Department of State, "Investment Climate Statements for 2016 China," 27.

³⁷ US Department of State, "Investment Climate Statements for 2016 China," 25.

approximately 20% of total employment.³⁸ The central government established the State-owned Assets Supervision and Administration Commission (SASAC), which directly controls and runs 106 strategic SOEs.³⁹ The Chinese government grants preferential treatment regarding policies and practices to their leading SOEs. These SOEs can expect easier access to credit, tax breaks, and critical infrastructure such as land, telecommunications, or minerals.⁴⁰ Among the larger SOEs run by the SASAC, the senior managing members report to the CCP and despite the fact that the SOE's board of directors may include stockholders or investors, these members have no power over managerial decisions.⁴¹ As a result, these SOEs are considered an extension of the central government and will always win in legal disputes because the CCP cannot be found to be at fault in any sort of court proceedings.⁴²

China has announced planned reforms in SOE policy to include selling shares, improving management structures, and emphasizing economic goals.⁴³ The reforms, however, still state that SOEs will focus their resources in areas that “serve state strategic objectives.”⁴⁴ Other measures such as more transparency and improved corporate governance have been suggested, but as with other reform in China, the timing and implementation plan for these reforms remains in question.⁴⁵ The central government subsidizes investment endeavors which suit the strategic goals and needs of China. This often provides an unfair advantage to SOEs as they compete against Western MNCs. The United States attempted to challenge China's use of SOEs by bringing charges against China with the WTO in 2014, but the WTO ruled against the United States in favor of China stating that due to the narrow definition of what is considered a government entity, the United States “had to prove that Chinese SOEs also performed government functions or exercised government authority.”⁴⁶

³⁸ US Department of State, “Investment Climate Statements for 2016 China,” 25.

³⁹ US Department of State, “Investment Climate Statements for 2016 China,” 25.

⁴⁰ US Department of State, “Investment Climate Statements for 2016 China,” 25.

⁴¹ US Department of State, “Investment Climate Statements for 2016 China,” 26.

⁴² US Department of State, “Investment Climate Statements for 2016 China,” 26.

⁴³ US Department of State, “Investment Climate Statements for 2016 China,” 11.

⁴⁴ US Department of State, “Investment Climate Statements for 2016 China,” 26.

⁴⁵ US Department of State, “Investment Climate Statements for 2016 China,” 11.

⁴⁶ Financial Times, “WTO Rules against US on China State Companies,” accessed April 22, 2017, <https://www.ft.com/content/6ae06806-0bbe-11e4-8693-00144feabdc0>.

Incentives for MNCs

In addition to SOEs, China extends considerable benefits and backing to large private corporations to promote OFDI. In 1999, China developed its “going global” strategy, which aimed at furthering “the international operations of capable Chinese firms with a view to improving resource allocation and enhancing their international competitiveness.”⁴⁷ Despite this new strategy and the rapid growth in OFDI from China, some Chinese firms still complained of stringent approval processes and complicated regulations for outward investment.⁴⁸ Since then, the Chinese government has instituted several reforms to reduce limitations and encourage outward investment. Examples of these reforms include reduced approval times and transfer of approval authority to local MOFCOM offices.⁴⁹

Geeoeconomics in Practice – Analyzing Chinese Geeoeconomic Strategy

Shortly after the 2008 financial crisis, CNN conducted an interview with the Chinese Prime Minister. During this interview the Prime Minister made a statement which succinctly encapsulates Chinese economic strategy:

The complete formulation of our economic policy is to give full play to the basic role of market forces in allocating resources under the macroeconomic guidance and regulation of the government. We have one important piece of experience of the past thirty years, that is to ensure that both the visible and invisible hand are given full play in regulating market forces.⁵⁰

Following the death of Mao Zedong in 1976, Deng Xiaoping overcame extreme political opposition and embarked on a plan to extort the benefits of capitalism, while preserving the communist party.⁵¹ Despite several near-collapses of the CCP over the past three decades, this experiment has played out remarkably well for the economic prosperity of China. When Jiang Zemin was appointed as Deng’s successor, he further reformed China’s economic policy to better incorporate the business world with the political party.⁵² Jiang introduced the concept of “red capitalists,” which helped cement the

⁴⁷ Nargiza Salidjanova, *Going out: An Overview of China’s Outward Foreign Direct Investment* (US-China Economic and Security Review Commission, 2011), 5, <http://www.bioin.or.kr/InnoDS/data/upload/policy/1314079084656.pdf>.

⁴⁸ Salidjanova, *Going out*, 6.

⁴⁹ Salidjanova, *Going out*, 6.

⁵⁰ Bremmer, *The End of the Free Market*, 129.

⁵¹ Bremmer, *The End of the Free Market*, 130.

⁵² Bremmer, *The End of the Free Market*, 132.

relationships and understandings between bureaucracy and business in China.⁵³ In China today, many business operations and leadership positions are directly tied to CCP membership and political connections.⁵⁴

Unlike Russia or North Korea, where the domestic audience is heavily oppressed and more acquiescent of living in poverty, the long-term strategic vision of China is to be a great and prosperous nation. The domestic audience, despite living under an oppressive communist regime, expects the government to work towards these long term objectives. In order for the CCP to retain its legitimacy and prevent domestic upheaval, the CCP must continue to promote prosperity at home, and believes it must produce millions of jobs each year.⁵⁵ In an increasingly growing and aging population, the government focuses on obtaining resources from all over the globe and positioning itself to be a nation of global influence. With this background in mind, we begin our analysis of Chinese geoeconomic strategy.

Cooperative or Competitive

China's decision to venture into the world of free-market capitalism undoubtedly required a certain degree of cooperation, but that cooperation has been overshadowed by China's competitive economic endeavors. Wigell describes a country's economic framework as competitive when "the goal is to perpetuate economic domination and the cementing of a hierarchical relationship in which neighboring states are made more dependent on the regional power, allowing it to reap national benefits at the expense of mutual benefits."⁵⁶ Wigell further suggests that coercive measures such as threatening to cut off market access or commodities may be used to allow the regional power to "write the rules of the game."⁵⁷ Unlike Germany whose actions at time portray both a cooperative and competitive nature, China's actions leave little room for argument as to their competitive nature.

An example of Chinese competition in the economic realm is the establishment of the Asian Infrastructure Bank (AIIB). China created the bank in 2014 with 57

⁵³ Bremmer, *The End of the Free Market*, 132.

⁵⁴ Bremmer, *The End of the Free Market*, 132.

⁵⁵ Bremmer, *The End of the Free Market*, 133.

⁵⁶ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁵⁷ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

prospective members. According to the European Political Strategy Center, “the geopolitical motivation of this initiative must be understood against the backdrop of China’s criticism of alleged Western dominance within the World Bank.”⁵⁸ European countries have expressed concern that China is establishing institutions such as the AIIB to compete with existing international institutions and establish its own standards of operation.⁵⁹ The bank will provide a competitive alternative to the World Bank by providing quick financing for underdeveloped countries.⁶⁰ As China will most likely remain the bank’s largest shareholder, the bank also provides an avenue by which China can strengthen economic ties with participating countries.⁶¹ Mr. Jin, the president of AIIB, made the following statement during an interview, “Now that China has developed, it is our turn to contribute... China needs to do something that can help it be recognized as a responsible leader.”⁶² Arkebe Oqubay, a senior minister in charge of Ethiopia’s industrial policy, said in reference to the new bank, “Being a member of the club would help us access new financial resources... we are looking for alternative financing and this could be a good opportunity for us.”⁶³

In addition to the AIIB, China launched the New Development Bank (NDB) with the BRICS nations, which is also viewed as an alternative to the World Bank. The bank will provide China with a new mechanism for further expansion and influence, especially in Africa.⁶⁴ The headquarters will be based in Shanghai, and the first regional center will be in Johannesburg.⁶⁵ The construction of a bank with no Western nations as members provides China with more tools for establishing an alternative economic order. While the bank has not been completed, the proposed provisions to provide better protection of SOEs and state-supported enterprises were greeted enthusiastically by other members of the BRICS countries.⁶⁶

⁵⁸ EPSC, *Engaging China at Time of Transition*, 7.

⁵⁹ EPSC, *Engaging China at Time of Transition*, 7.

⁶⁰ Blackwill and Harris, *War by Other Means*, 115.

⁶¹ Blackwill and Harris, *War by Other Means*, 115.

⁶² Financial Times, “China-Led Investment Bank Attracts 25 New Members,” accessed April 22, 2017, <https://www.ft.com/content/671d8ac4-e18a-11e6-8405-9e5580d6e5fb>.

⁶³ Financial Times, “China-Led Investment Bank Attracts 25 New Members.”

⁶⁴ Blackwill and Harris, *War by Other Means*, 74.

⁶⁵ New Development Bank, “New Development Bank,” *New Development Bank*, accessed May 1, 2017, <http://www.ndb.int/careers/>.

⁶⁶ Blackwill and Harris, *War by Other Means*, 74.

With regard to the use of coercive measures, China has used its economic power for geopolitical ends in a variety of ways. When the Philippines were challenging China's actions in the South China Sea, China refused a shipment of Philippine bananas and let them rot in the cargo ship in the wharf.⁶⁷ In an attempt to discourage the deployment of the US THAAD system to South Korea, China promised various trade and investment incentives to South Korea.⁶⁸ Recognizing that the incentives were not working, China turned to the threat of economic sanctions against South Korea to discourage the installment of the THAAD system.⁶⁹ Other Asian nations have also suffered from Chinese economic coercion. China limited imports on Japanese cars to express Chinese dissatisfaction with Japan's security policy.⁷⁰ China's withholding of investment predicated on the requirements for countries to refuse meetings with the Dalai Lama and disavow Taiwan as an independent nation further demonstrate the coercive nature of Chinese economic power.

Economic or Geopolitical Ends

With regard to the second aspect of Wigell's framework, whether China uses geoeconomics as a means or an ends, China's actions suggest the former. Wigell acknowledges that it is difficult to determine the motivation behind the employment of economic power, but writes that "when a regional power is prepared to invest considerable economic resources in exchange for political influences and alliances, without any clear prospect of gaining economic returns on the investment," then the motivation for the use of economic power is most likely geopolitical.⁷¹ China's investments in the NDB and AIIB serve as examples of significant financial costs in the pursuit of alliances and relationships. The willingness of China to take economic risks by

⁶⁷ Blackwill and Harris, *War by Other Means*, 4.

⁶⁸ Blackwill and Harris, *War by Other Means*, 4.

⁶⁹ The US THAAD system is now in place and China has responded with harsh criticism. One of several reactions implemented by China was to stop travel agencies from sending groups to South Korea. This brought the daily Chinese visitor count to South Korea from 7,500 daily to only 1,000, marking a blow to local tourist shops in South Korea. Financial Times, "China Wields Power with Boycott Diplomacy," Financial Times, accessed May 13, 2017, <https://www.ft.com/content/c7a2f668-2f4b-11e7-9555-23ef563ecf9a>.

⁷⁰ Blackwill and Harris, *War by Other Means*, 4.

⁷¹ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

investing in unstable regimes such as North Korea or Zimbabwe are other examples of investments in pursuit of other-than-economic goals.

In comparison to five years ago, Chinese OFDI stock has tripled, toppling \$1 trillion in 2015.⁷² In spite of this, not all of its economic endeavors have been lucrative. China has used its geoeconomic influence to further the growth and prosperity of China, but much of the economic endeavors suggest geopolitical interests vice economic. China's SOE actions in unstable countries risk significant economic cost due to corruption and poor investment environments, and yet China continues to invest in these regions, accepting higher possibilities of economic loss.⁷³ China has granted more loans to Latin America than the World Bank and IMF combined, and despite the fragile nature of the Venezuelan economy, China reportedly plans to extend the anti-American regime a loan for \$10 billion.⁷⁴

China's One Belt, One Road initiative is an attempt to address a growing population and increased demands for resources, but is also a geopolitical ambition. Analysts have compared China's One Belt, One Road to the US Marshall Plan.⁷⁵ Proposed in 2013, the large infrastructure plan seeks to connect China to central and Southeast Asia, the Middle East, Europe, Africa, and potentially Latin America.⁷⁶ While the economic benefits of this endeavor are evident, the potential for geopolitical influence is also apparent. Rather than negotiate with the EU as a whole, China is negotiating with regions, cities, private companies, and individual nations to further the One Belt, One Road plan.⁷⁷ The European Political Strategy Center (EPSC) has expressed concern that the endeavor carries with it the potential to divide the EU as states negotiate such large investments in parallel.⁷⁸ Frans-Paul van der Putten, an expert on Europe-Chinese relations with the Netherlands Institute of International Relations made the following statement about the endeavor, "It allows China to strengthen its diplomatic influence in

⁷² EPSC, *Engaging China at Time of Transition*, 4.

⁷³ Bremmer, *The End of the Free Market*, 168.

⁷⁴ Blackwill and Harris, *War by Other Means*, 4.

⁷⁵ Financial Times, "In Charts: China's Belt and Road Initiative," *Financial Times*, accessed May 13, 2017, <https://www.ft.com/content/18db2e80-3571-11e7-bce4-9023f8c0fd2e>.

⁷⁶ Financial Times, "In Charts."

⁷⁷ EPSC, *Engaging China at Time of Transition*, 8.

⁷⁸ EPSC, *Engaging China at Time of Transition*, 8.

Asia, Africa, and Europe...which compensates for the geopolitical pressure it faces in East Asia from the United States and Japan.”⁷⁹ Van der Putten further expressed that the new “Silk Road” might pay more geopolitical dividends than economic.⁸⁰

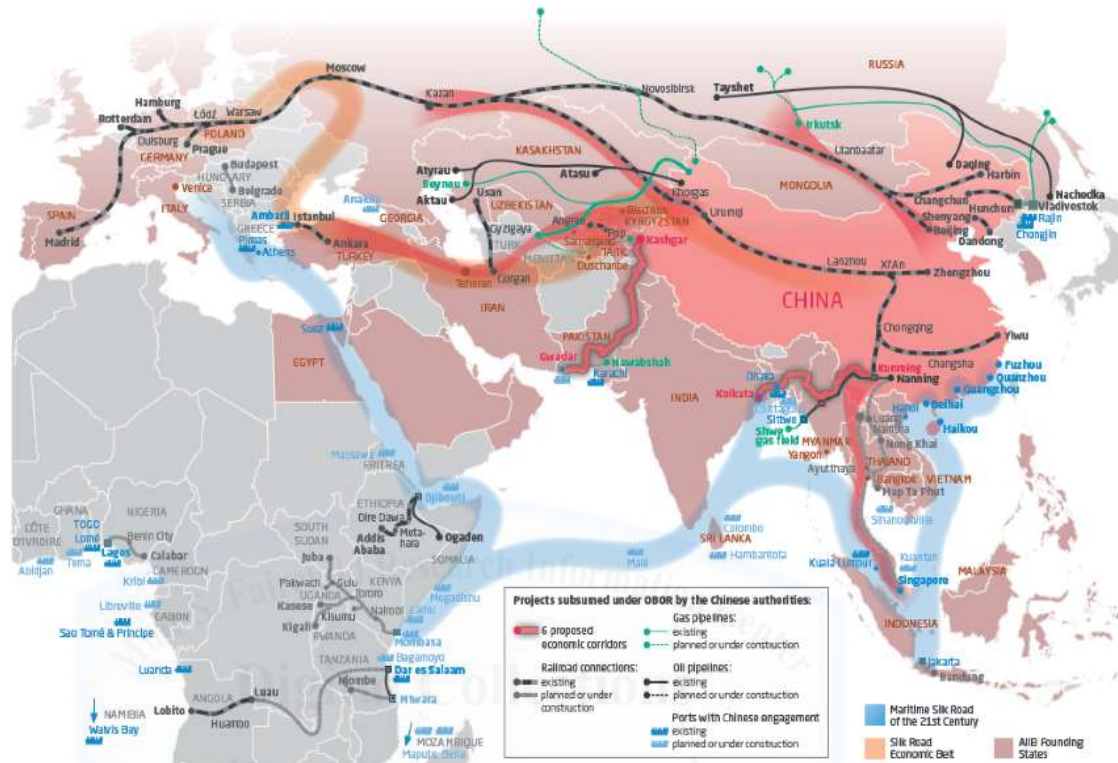


Figure 5 – China’s One Belt, One Road Initiative

Source: Metrics.org

China has also used its economic power to achieve geopolitical objectives with regard to North Korea. North Korea relies on China for 90% of its oil, receiving approximately 500,000 tons annually from China.⁸¹ China has responded to North Korean missile tests by severing the flow of oil on multiple occasions.⁸² Wanting to ensure that this leverage over North Korea is maintained, China has sought to limit the ability of other governments to supply Pyongyang with oil. In 2013, Iran attempted to ship light oil to Pyongyang, but the shipment was halted at a Chinese port, and China

⁷⁹ Foreign Policy.com, “All Aboard China’s ‘New Silk Road’ Express | Foreign Policy,” accessed May 1, 2017, <http://foreignpolicy.com/2017/01/04/all-aboard-chinas-new-silk-road-express-yiwu-to-london-train-geopolitics-one-belt-one-road/>.

⁸⁰ Foreign Policy.com, “All Aboard China’s ‘New Silk Road’ Express | Foreign Policy.”

⁸¹ Blackwill and Harris, *War by Other Means*, 103.

⁸² Blackwill and Harris, *War by Other Means*, 103.

imposed a \$2 million storage expense penalty on the shipment. Since Pyongyang's oil contract with Tehran dictates that the oil must pass through Chinese SOEs for refining, North Korea has little choice but to rely on China as its primary source for oil.⁸³

In 2010, the Norwegian parliament granted the Nobel Peace Prize to a Chinese dissident, Liu Xiaobo. To express its disdain and protest the action, Beijing abandoned BIT negotiations between the Norway and China, and instituted measures which threatened Norway's share of the Chinese salmon market.⁸⁴ Several years later in 2015, after relations had not improved, the Norwegian prime minister refused to meet with the Dalai Lama during his visit to Norway. The Prime minister made the following statement, "The Dalai Lama has visited Norway roughly a dozen times since receiving the prize in 1989—but things are different now... we need to focus on our relationship with China."⁸⁵ The Prime Minister of Denmark also subsequently refused to meet with the Tibetan leader.⁸⁶

These actions suggest that China is using geoeconomics primarily as a means vice an ends, and in combination with a competitive framework, this suggests a geoeconomic strategy of neo-imperialism. Neo-imperialist strategies use geoeconomics not only in pursuit of economic objectives, but also to cement relationships and to create an "informal empire in the neighborhood."⁸⁷ In contrast to a hegemonic strategy, a neo-imperialist state uses "force, coercion, imposition and bribery."⁸⁸ This neo-imperialist strategy appears to most adequately define the nature of China's geoeconomic actions. With that in mind, we turn to how China has used FDI to support this geoeconomic strategy. Due to the nature of the communist regime (a point I return to at the end of the chapter), China has all mechanisms of FDI regulation at its disposal. FDI provides a flexible and powerful tool for China to project and influence nations, whether they be great or small powers.

⁸³ Blackwill and Harris, *War by Other Means*, 103.

⁸⁴ Blackwill and Harris, *War by Other Means*, 129.

⁸⁵ Blackwill and Harris, *War by Other Means*, 129.

⁸⁶ Blackwill and Harris, *War by Other Means*, 129.

⁸⁷ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 142.

⁸⁸ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 142.

The Role of FDI and Government Structure in Chinese Neo-Imperialist Strategy

China's SOEs to date have been the biggest investors in the United States and the global economy.⁸⁹ While Western governments have discouraged investment in Sudan due to its poor human rights practices, China is less deterred by these factors. China has been promoting investment by its oil and energy companies in the region for over a decade, primarily through loans and political influence.⁹⁰ China's use of SOEs in North Korea also is extensive. Since 2003, more than 150 Chinese entities have invested in mineral resources, manufacturing, construction, and other industries.⁹¹ These efforts have not only served China's geopolitical objective of enabling the survival of the Kim regime under US sanctions, but China's efforts here have also sought to encourage economic and political reform.⁹² In 2004, for example, China donated a \$2.4 million glass factory to North Korea in an effort to bring North Korea to the table for six-party talks over the nuclear program.⁹³ In 2012, China utilized its central-government owned China Overseas Investment Company to create a \$490 million fund for investment in North Korea and encourage private investment.⁹⁴

China maintains approximately \$3.5 trillion in foreign exchange reserves, which are managed primarily by the State Asset Foreign Exchange (SAFE) and the Chinese Investment Corporation (CIC).⁹⁵ SAFE has openly announced that a pre-condition for FDI is acknowledgement of the one-China policy.⁹⁶ China uses its SWFs for investment in weak and authoritarian regimes, especially in Africa, to further its influence in these regions. China's relationship with Zimbabwe serves as a good example. The UN Security Council attempted to enact an arms embargo and travel restrictions on

⁸⁹ Lauren Gloudeman and Nargiza Salidjanova, *Policy Considerations for Negotiating a U.S.-China Bilateral Investment Treaty*, Staff Research Report (U.S.-China Economic and Security Review Commission, 1 Aug 16), 6,

https://www.uscc.gov/sites/default/files/Research/Staff%20Report_Policy%20Considerations%20for%20Negotiating%20a%20U.S.-China%20Bilateral%20Investment%20Treaty080116.pdf.

⁹⁰ Bremmer, *The End of the Free Market*, 136.

⁹¹ Blackwill and Harris, *War by Other Means*, 105.

⁹² Blackwill and Harris, *War by Other Means*, 105.

⁹³ Blackwill and Harris, *War by Other Means*, 105.

⁹⁴ Blackwill and Harris, *War by Other Means*, 105.

⁹⁵ Blackwill and Harris, *War by Other Means*, 137.

⁹⁶ Blackwill and Harris, *War by Other Means*, 137.

Zimbabwe's president. In 2011, just prior to Zimbabwe's presidential elections, China provided \$3 million for exclusive access to the country's platinum rights (this contract was estimated to be worth \$40 billion).⁹⁷ A local Zimbabwe paper described Zimbabwe as a "full-fledged Chinese colony" due to the extensive geoeconomic influence that China exercises over it.⁹⁸ Zimbabwe has accumulated over \$7 billion in national debt and is largely isolated from the West due to human rights issues and corruption; thus, President Mugabe relies on the economic assistance from China to remain in power.⁹⁹ In turn, China gains valuable resources at low economic cost and political influence over the African nation.

Utilizing yet another tool of FDI, China uses incentives to steer the investment of MNCs for geopolitical objectives. A good example of this can be seen in China's relationship with Japan. Viewing Japan as a sort of extension of the West in Asia, China seeks to weaken Japanese ties to Washington and strengthen economic interdependence between Tokyo and Beijing. China and Japan have repeatedly engaged in confrontational interactions over territorial sovereignty issues over the Diaoyu/Senkaku island chain.¹⁰⁰ As a result, China's economic pressure on Japan has sought to protect China's claimed sovereignty of these islands as well as weaken Japan's economic relationship with the West.¹⁰¹ In 2010, Japan arrested a Chinese fisherman operating near the contested territorial islands. China immediately responded by stopping shipments of rare earth minerals, which China knew that Japanese firms were heavily dependent on for the manufacture of electronic components used in the United States and Europe. The dependence on these minerals gave Tokyo no choice but to release the Chinese captain. China, however, did not stop there. One year later, China convinced several of the manufacturing companies located in Japan to move their production and technology centers to China by providing low-cost supplies of these minerals in exchange for the move.¹⁰² China's use of geoeconomic influence enhanced its protest over the territorial

⁹⁷ Blackwill and Harris, *War by Other Means*, 137.

⁹⁸ Blackwill and Harris, *War by Other Means*, 137.

⁹⁹ Blackwill and Harris, *War by Other Means*, 138.

¹⁰⁰ Blackwill and Harris, *War by Other Means*, 106.

¹⁰¹ Blackwill and Harris, *War by Other Means*, 107.

¹⁰² Blackwill and Harris, *War by Other Means*, 108.

issues, secured the release of the fishing captain, and strengthened its domestic rare mineral economic capital.¹⁰³

China also used regulation of FDI in its endeavors to monopolize the battery market and out-perform Japan and South Korea. China's state-supported MNC for battery making is CATL.¹⁰⁴ Japan and South Korea have dominated the battery industry for nearly three decades, but China is determined to change that.¹⁰⁵ China is encouraging its companies to invest more overseas and to produce more batteries. Through subsidies of billions of renminbi, China turned its electric carmaker company, BYD, into the world's largest electric car and bus manufacturer.¹⁰⁶ China also regulates IFDI to further dominate the electric battery market. In 2015, two companies from South Korea, LG and Samsung, opened factories in China declaring South Korea would "forge its foothold in the world's biggest new energy vehicle market."¹⁰⁷ One year later, the Chinese government released a list of companies that were permitted to supply batteries in the country, and not one foreign country was on the list.¹⁰⁸ Furthermore, China released new regulations for IFDI that required increased production capacity in order to qualify for subsidies.¹⁰⁹ The only two companies able to meet this requirement were China's BYD and CATL.¹¹⁰

In addition to these regulations on IFDI and subsidies for MNCs, China retains a significant advantage on producing batteries because of its control of essential raw materials. China uses its SOEs and MNCs to invest in mining assets all over the world.¹¹¹ China Molybdenum, owned by a local Chinese government entity, purchased the Tenke mine in the Democratic Republic of Congo last year.¹¹² This mine reportedly contains the world's largest concentrations of cobalt, and offers "security of supply of a

¹⁰³ Financial Times, "Electric Cars: China's Battle for the Battery Market," accessed April 22, 2017, <https://www.ft.com/content/8c94a2f6-fdcd-11e6-8d8e-a5e3738f9ae4>.

¹⁰⁴ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹⁰⁵ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹⁰⁶ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹⁰⁷ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹⁰⁸ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹⁰⁹ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹¹⁰ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹¹¹ Financial Times, "Electric Cars: China's Battle for the Battery Market."

¹¹² Financial Times, "Electric Cars: China's Battle for the Battery Market."

critical battery material for decades to come.”¹¹³ In this single case, China used regulation of IFDI, SOEs, and MNCs to advance its hold on a key, up and coming industry.

China’s autocratic government plays a large role in its ability to leverage FDI for its economic and geopolitical benefit. As the sole party, the CCP exerts direct control over the countries SWF, SOEs, trade policy, and FDI regulations. The government’s political connections to MNCs afford it yet another avenue for controlling FDI. As long as the CCP continues to increase and promote the prosperity of China, it is able to maintain its strongly solidified power. Although China has benefited greatly from the liberal world order, it believes the order is unfairly biased towards Western nations and as such, feels no obligation to uphold that order. Rather, China would like to reshape the order to benefit itself. As an authoritative regime seeking to change the status-quo we would expect China to employ a strategy of neo-imperialism, which is exactly what their actions suggest they are doing.

Conclusion

China is indeed practicing geoeconomics at a maestro level. China uses every instrument of FDI to accomplish both its economic and political interests in regions all over the world. Despite receiving condemnation from the United States and other western powers, China continues to bend rules and accomplish its objectives. The nature of the authoritative regime allows the government to exert control of economic endeavors through methods which are not available to most Western states. The ability of China to invest abroad through its SOEs and SWFs provides the CCP with a vast array of tools for coercion and bribery. In addition to these tools, China uses incentives to influence the operations of both Chinese and foreign-owned MNCs. The CCP is dedicated to building a strong and prosperous China with sufficient resources for its growing population. China’s neo-imperialist geoeconomic strategy uses FDI to build asymmetric relationships and gather resources all over the globe. Mr. Xi has been vocal about his distaste for current economic institutions, saying that China should “guide international society”

¹¹³ Financial Times, “Electric Cars: China’s Battle for the Battery Market.”

towards a “more just and rational new world order.”¹¹⁴ China wants to rewrite the rules of the road, and FDI is playing a pivotal role in helping it achieve this goal.



¹¹⁴ The Economist, “Tortoise v Hare: Is China Challenging the United States for Global Leadership? | The Economist,” accessed April 21, 2017, <http://www.economist.com/news/china/21719828-xi-jinping-talks-china-solution-without-specifying-what-means-china-challenging>.

Chapter 5

US Geoeconomic Strategy and FDI

Harnessing economic power to foreign policy goals presents formidable obstacles... Yet if war is too important to be left to the generals, surely commerce is, in this context, too salient to be left to bankers and businessmen.

Samuel Huntington
American Political Scientist

The United States boasts the largest GDP in the world, is the number one exporter and recipient of FDI¹, and possesses the world's reserve currency. In spite of its advantageous economic position, the United States has not made a concerted effort towards the development of a geoeconomic strategy. Possessing the strongest military in the world, the United States relies primarily on the military instrument of power to achieve geopolitical objectives. Maintaining a strong military for conventional deterrence is not inherently problematic of course; in fact it is extremely important and necessary. In today's geoeconomic world however, there are situations and challenges which are better resolved through other means. The United States has the means to effectively engage in geoeconomics, but presently it does not have the strategy or the will. This was not always the case. Historically, the United States used economic influence in combination with military power to great avail. This chapter will examine US geoeconomic strategy from both a historical and current perspective to look at the ways in which FDI has contributed to US economic power over time.

Government Structure

The United States government is classified as a constitutional federal republic with three independent branches of government. The President serves as the head of the executive branch and is elected indirectly through an Electoral College process. The President appoints a cabinet to act as his primary advisors, and the cabinet members must be approved by the Senate. The Senate is one of two bodies of the legislative branch. Two individuals from each of the fifty states are elected by the people to represent the

¹ Jonathan Masters, "Foreign Investment and U.S. National Security," Council on Foreign Relations, 1, accessed April 22, 2017, <http://www.cfr.org/foreign-direct-investment/foreign-investment-us-national-security/p31477>. (As of December 2016)

state on the Senate, which results in a Senate comprised of 100 members. The House of Representatives is the second body of the legislative branch and contains 435 members, distributed according to the population of the states. The third branch, the Judicial branch, is an independent branch led by the Supreme Court which consists of nine justices. These justices are appointed by the President and must be approved by the Senate.²

With regard to economic policy, the US Department of Treasury is the executive institution that advises the President on financial issues, and the mission of the department is to maintain a strong economy and promote economic growth and job opportunities.³ The US Department of Commerce contains twelve bureaus, which include the International Trade Administration (ITA). The ITA is charged with strengthening US competitiveness, promoting investment and trade, and ensuring fair trade and compliance with international law.⁴ With regard to FDI, the agency responsible for oversight of foreign investment in the United States is the Committee on Foreign Investment in the United States (CFIUS).

Official Policy and Outlook towards FDI

The United States recognizes that foreign investment has great economic benefits and has publically declared an open investment policy and a commitment to treat all foreign entities in a fair and equal manner.⁵ The Obama administration launched an initiative in 2013 called Select USA which was designed to attract more foreign investment in the United States.⁶ The United States also has traditionally supported US-based companies' endeavors abroad, recognizing that economic interdependence between nations promotes cooperation and increases security and stability. Despite the openness to IFDI, the United States has expressed concern over the national security implications

² CIA, "CIA World Factbook — The USA," accessed May 1, 2017, <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.

³ US Department of Treasury, "Duties & Functions of the U.S. Department of the Treasury," accessed May 1, 2017, <https://www.treasury.gov/about/role-of-treasury/Pages/default.aspx>.

⁴ US Department of Commerce, "International Trade Administration," *Department of Commerce*, accessed May 1, 2017, <https://www.commerce.gov/doc/international-trade-administration>.

⁵ James Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, Congressional Research Service Report (Congressional Research Service, April 6, 2017), Summary, <https://fas.org/sgp/crs/natsec/RL33388.pdf>.

⁶ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, Summary.

of foreign investment in the United States or in US-based MNCs abroad. The rise of SWFs and SOEs over the past few years has increased US concern about IFDI, leading Washington to establish several new laws and procedures to ensure foreign investments do not compromise national security. The openness to both inward and outward FDI has diminished in recent years due to job loss and perceived unfair trade deals.

Regulation of Inward FDI

Restrictions and Screening

The United States has several mechanisms in place for screening and reviewing IFDI. An executive order established CFIUS in 1975 creating the first real mechanism for screening FDI in the United States. Congress introduced an additional screening mechanism in 1988 resulting from concerns over foreign acquisitions of US firms, specifically from Japanese companies.⁷ Congress felt that CFIUS did not adequately review and screen foreign investments.⁸ In response to these concerns, Congress passed the Exon-Florio Provision that details how foreign investments are reviewed. The Exon-Florio Provision grants the President the authority to block any pending or proposed foreign “mergers, acquisitions, or takeovers” of “persons engaged in interstate commerce in the United States ” if the President believes the commerce threatens US national security.⁹ Congress imposed two limitations on this newly granted authority. First, the President must “conclude that other US laws are inadequate or inappropriate to protect the national security,” and second, he must have “credible evidence” that the investment poses a threat to national security.¹⁰

The passing of the Exon-Florio Provision was a part of the Omnibus Trade and Competitiveness Act of 1988 passed by Congress and endorsed by President Reagan. President Reagan delegated his Exon-Florio authority to CFIUS, further legitimizing the committee and transforming it into an important foreign policy tool.¹¹ The heart of the screening of inward foreign investment now lies with CFIUS. The Committee is comprised of nine members from various major departments and agencies within the

⁷ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 3.

⁸ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 3.

⁹ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 3.

¹⁰ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 3.

¹¹ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 4.

executive branch, and the President can appoint additional members to join the committee on a temporary basis.¹² CFIUS operates under the direction and authority of the President, and as a result, the discretion of investment reviews follows the guidance provided to the committee by the President.¹³ After several amendments, CFIUS evolved to serve as the statutory authority on IFDI in the United States, and the committee is now chaired by the Secretary of Treasury. The ultimate authority to suspend or prohibit an investment was returned to the President, but CFIUS conducts the reviews and makes a recommendation to the President.¹⁴

CFIUS is required to review every investment transaction which would result in “foreign control of any person engaged in interstate commerce in the United States.”¹⁵ If the investment is initiated solely for the purpose of economic investment or will not result in the foreign investor “determining or directing the basic business decisions,” then it does not require CFIUS review.¹⁶ Foreign investors are required to notify CFIUS if they are investing in a deal which could potentially have security implications.¹⁷ The foreign investor may informally consult with CFIUS in order to identify and address concerns before filing a formal notification. Once the investor files the formal notification, CFIUS has 30 days to review the investment deal.¹⁸ Most cases will be completed and approved within this 30-day period, but if additional security concerns are identified then an additional 45-day investigation is initiated.¹⁹ Following the investigation, CFIUS makes a recommendation to the President, who then has 15 days to make a determination.²⁰ While several entities have withdrawn their requests during one of the first two phases, only three transactions have ever made it to the President and been subsequently denied.²¹

CFIUS activity dropped in 2009 after the 2008 financial crisis, but started to rise again in 2010. During the six-year period from 2008-2013, foreign investors notified

¹² Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 8.

¹³ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 5.

¹⁴ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 7.

¹⁵ Masters, “Foreign Investment and U.S. National Security,” 5.

¹⁶ Masters, “Foreign Investment and U.S. National Security,” 5.

¹⁷ Masters, “Foreign Investment and U.S. National Security,” 5.

¹⁸ Masters, “Foreign Investment and U.S. National Security,” 5.

¹⁹ Masters, “Foreign Investment and U.S. National Security,” 5.

²⁰ Masters, “Foreign Investment and U.S. National Security,” 5.

²¹ Masters, “Foreign Investment and U.S. National Security,” 6.

CFIUS of 635 investment transactions.²² Of these notices, 6% were withdrawn by the investor during the 30-day review, 31% of them were required to progress to the 45-day investigation, and 7% of the cases were withdrawn during that 45-day investigation.²³ In total, 90% of the transactions were completed, and only one required a decision by the President.²⁴

Incentives for Investment and Sector Specific Policies

US legislation imposes limitations on foreign investment in maritime, aircraft, banking, resources, and power industries.²⁵ The United States along with 33 of the other OECD-member nations signed a non-binding commitment to treat foreign corporations equally to domestic firms. The only provision by which a country can deviate from this commitment is in the area of “critical infrastructure.”²⁶ Each nation defines critical infrastructure somewhat differently. The United States defines critical infrastructure as:

Systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have debilitating impact on security, national economic security, national public health or safety, or any combination of those matters. For investment policy purposes, this definition is narrower: systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on national security.²⁷

In an effort to encourage FDI in specific sectors, the United States created incentives to promote innovation and entrepreneurship. The US Small Business Administration (SBA), assists small businesses in obtaining financial support and educational or technical support.²⁸ The SBA also offers additional funding for businesses willing to abide by new clean and sustainable energy standards.²⁹ The federal government also offers grants for workforce development or energy efficient practices in certain sectors.³⁰

²² Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 25.

²³ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 25.

²⁴ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 25.

²⁵ Jackson, *The Committee on Foreign Investment in the United States (CFIUS)*, 5.

²⁶ Masters, “Foreign Investment and U.S. National Security,” 3.

²⁷ Masters, “Foreign Investment and U.S. National Security,” 3.

²⁸ Taxeem Pasha and Rachel Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, Financial Update Report (International Trade Administration, SelectUSA, December 31, 2013), 12, <https://www.selectusa.gov/servlet/servlet.FileDownload?file=015t0000000LKSj>.

²⁹ Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 12.

³⁰ Select USA, “Programs and Incentives | SelectUSA.gov,” accessed May 1, 2017, <https://www.selectusa.gov/programs-and-incentives>.

Some state governments provide further economic support to assist foreign investors in the startup of their businesses.³¹

Administrative Investment Processes and Investment Environment

The United States consistently ranks among the top nations for ease in establishing and doing business in the United States. In 2013, the United States won the A.T Kearney award for the top nation for FDI Confidence Index. This index assesses the political, economic, and regulatory environment of a country, and this award demonstrated the confidence of foreign investors in the United States.³² The World Economic Forum Global Competitiveness Index also ranks the United States among the top ten nations for foreign investors.³³ The World Bank's doing business report ranked the United States 4th out of 185 for the best "regulatory environment conducive to operating a business."³⁴ The United States is recognized for having a transparent and predictable administrative process, and international firms acknowledge the United States' fair treatment of foreign firms and protection of intellectual property.³⁵ The International Trade Administration (ITA) oversees the Select USA program which seeks and promotes FDI in the United States. The website provides potential investors with resources and assistance for establishing investments in the United States. Once investors have completed the application process and constructed their corporations in the United States, they can expect an extremely favorable environment for their investments. The United States has predictable and fair regulatory measures for protection of property rights and affords national treatment of foreign investors in nearly every sector.³⁶

³¹ Select USA, "Programs and Incentives | SelectUSA.gov."

³² Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 4.

³³ Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 4.

³⁴ Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 5.

³⁵ Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 7.

³⁶ Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 8.

Regulation of Outward FDI

State Owned Enterprises

While the US federal and state governments maintain ownership of certain domestic services and companies, the companies are operated autonomously from government intervention. When the United States has intervened in private companies, as was the case during the 2008 economic crisis, it has been for economic purposes to maintain stability in the economy. The United States does have privately owned entities that receive special benefits from the government in order to “improve the workings of the credit market.”³⁷ Congress passed the Omnibus Reconciliation Act in 1990 which created these entities, officially naming them Government Sponsored Enterprises (GSE). Mortgage companies such as Freddie Mac and Fannie Mae are GSEs, as are several agriculture and loan corporations.³⁸ An important distinction between GSEs and SOEs is that GSEs are not agencies of the government; rather, they are privately owned.³⁹ The government does not manage or direct their operations, but rather supervises them to encourage domestic stability.⁴⁰ As such, SOEs do not play a notable role in US regulation of OFDI.

Incentives for MNCs

As was the case with Germany and most other democratic countries, the United States relies primarily on incentives for MNCs to steer outward FDI from the United States. While there is governmental oversight of MNCs through the US Security and Exchange Commission and the Internal Revenue Service, the internal governance of MNCs in the United States is the responsibility of the board of directors for that corporation, and the government allows those directors autonomy in running their corporations.⁴¹ There is a difference between these governing boards in the United States and those in Germany, however. In the United States, the board of directors directs corporate strategy, sets the salary levels for senior management, and is responsible for

³⁷ Kevin R. Kosar, “Government-Sponsored Enterprises (GSEs): An Institutional Overview,” *Wash. Post*, 2004, 1.

³⁸ Kosar, “Government-Sponsored Enterprises (GSEs),” 3.

³⁹ Kosar, “Government-Sponsored Enterprises (GSEs),” 3.

⁴⁰ Kosar, “Government-Sponsored Enterprises (GSEs),” 3.

⁴¹ Cohen, *Multinational Corporations and Foreign Direct Investment*, 33.

reasonably protecting the interests of the shareholders.⁴² In Germany, law mandates that the board of directors be divided evenly between employee-selected members and shareholder-selected members, which grants an equal voice to both parties.⁴³

The United States influences the FDI of its MNCs primarily through a number of tax policies. The United States currently has the highest corporate tax rate of all OECD developed economies and the third highest in the world.⁴⁴ However, the United States has a number of tax breaks, which when applied, bring the actual amount of taxes paid by corporations back down to a number relatively even with most other OECD countries.⁴⁵ Unlike most developed countries, the United States taxes corporations for their foreign profits, but only when those profits are repatriated into the United States.⁴⁶ This encourages many MNCs to leave earnings overseas rather than return them to the United States. The United States can also impose tariffs or tax breaks on the export and import of goods, or tax breaks for R&D endeavors or clean energy compliance actions. These all influence the decision making of the MNCs when they choose whether or not to invest domestically or overseas.

The other method by which the United States influences the investments of MNCs is with trade and investment deals. Unlike Germany who must negotiate trade deals through the European Union, the United States has unilateral control over its trade policy, making it a powerful tool for influencing FDI. RTAs and BITs influence the locations of MNC subsidiaries because they provide better trading deals for intrafirm trade. RTAs can also help MNCs compete in overseas markets against SOEs. Conversely, sanctions provide the opposite effect, in that they prevent MNCs from investing in sanctioned countries or sectors.

Geeconomics in Practice – Analyzing US Geoeconomic Strategy

Following the close of the Second World War, the United States found itself in a precarious position. Pearl Harbor demonstrated that even with an isolationist foreign policy and the protection of two large oceans, the United States could not be shielded

⁴² Cohen, *Multinational Corporations and Foreign Direct Investment*, 33.

⁴³ Cohen, *Multinational Corporations and Foreign Direct Investment*, 33.

⁴⁴ Masters, "Foreign Investment and U.S. National Security," 2.

⁴⁵ Masters, "Foreign Investment and U.S. National Security," 3.

⁴⁶ Masters, "Foreign Investment and U.S. National Security," 3.

from the perils of Europe and Asia. As the war drew to a close, the United States faced the option of leading the rebuilding efforts of a new world order or leaving that task to the Soviet Union. The United States took on the challenge. Pairing economic statecraft with military might to counter the Soviet Union, the United States successfully established a new world order, which over seven decades later is still standing. In the aftermath of the war, Secretary of State George Marshall said, “the United States should do whatever it is able to do to assist in the return of normal economic health in the world, without which there can be no political stability and no assured peace.”⁴⁷ The Marshall Plan was a critical element of the reconstruction effort, and despite the economic costs to the United States, this plan was enacted to achieve political goals.⁴⁸ Over the course of the next several decades as the Cold War unfolded, the United States remained the leader of the Western world order and relied on military power to balance the Communist bloc. Economic tools were still used but the primary currency of the day was military power. With the fall of the Soviet Union and the fading of the Cold War, the United States serves as the sole military superpower.⁴⁹ Decades of leading through military power resulted in the slow erosion of the economic instrument of power, and despite the resurgence of geoeconomics, the United States still chooses to harness military might as its instrument of choice to underpin a liberal economic order

Subscribing to a *laissez-faire* view of economics, the United States generally intervenes in economic operations only for dire economic purposes and rarely for geopolitical interests. This is not to say that the United States has abandoned the economic instrument of power all together, quite the opposite in-fact. The United States’ use of sanctions has risen sharply over the past several administrations.⁵⁰ The issue with the US approach to geoeconomics is that sanctions are but one tool in the toolbox. Furthermore, the effectiveness of sanctions relies largely on the role of the dollar as the reserve currency and the banking and monetary systems of the Bretton Woods institutions.⁵¹ Sanctions can certainly be effective, but they must be enforced over long

⁴⁷ Blackwill and Harris, *War by Other Means*, 162.

⁴⁸ Blackwill and Harris, *War by Other Means*, 162.

⁴⁹ Argument note here...

⁵⁰ Blackwill and Harris, *War by Other Means*, 196.

⁵¹ Blackwill and Harris, *War by Other Means*, 77–79.

periods of time with cooperation by other economic players. Sanctions are less flexible and more difficult to enforce than FDI regulations. Furthermore, China desires to make the renminbi a reserve currency alongside the dollar.⁵² The combination of another reserve currency and the new banking institutions being built by China could pose challenges to the Western world's ability to effectively impose sanctions in the future.

Cooperative or Competitive

Despite the United States' willingness to act unilaterally in the employment of military force, the United States has operated largely within a cooperative framework when using economic tools; this is unsurprising as the international governing institutions and norms largely favor the United States. As a founder of many of the Bretton Wood institutions, the United States tends to act in accordance with established policies and norms in an attempt to uphold those governing bodies. When the United States has an economic dispute with another nation, the United States generally addresses the issue through the established mechanisms. Wigell describes a cooperative strategic frame as one where the state acts as a "paymaster," willing to act for collective goals.⁵³ Cooperative states provide "positive incentives" and are committed to established norms and rules of governing structures.⁵⁴ These descriptors are characteristic of United States actions.

In recent years, the United States has primarily used sanctions as its sole tool for economic power, and the United States' use of sanctions has been conducted predominantly through multilateral institutions with the support of allies. Many of the sanctions imposed on Iran emanated from the UN Security Council. While the sanctions against Russia did stem not from the Security Council (Russia owns a veto), they were coordinated with EU allies. Wigell's model holds that states acting competitively will resort to "coercive policies, threats to cut off market access or commodities, withdrawal of foreign aid, or any other action which attempts to persuade a minor power to act in a manner which suits the greater power."⁵⁵ The United States' use of sanctions, with the support of allies, has been in response to aggression by authoritative regimes and has

⁵² Blackwill and Harris, *War by Other Means*, 197.

⁵³ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁵⁴ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 140.

⁵⁵ Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies," 7.

been employed in an attempt to discourage disruptive behavior--behavior which US allies agreed needed to be dissuaded.

Possessing the world's reserve currency affords the United States with an opportunity to act competitively with its monetary policy. Despite this advantage, the United States has largely refrained from currency manipulation or aggressive monetary policies which could destabilize the global economy. The design of the US system with an independent Federal Bank (Fed) provides a degree of protection against the misuse of the currency. Interestingly, the Fed and Germany's Deutsche Bundesbank were some of the only independent banks before the early 1990s.⁵⁶ The economists charged with running these banks are the "gatekeepers and beneficiaries of the system."⁵⁷ Furthermore, the Fed is independent from the Treasury Department which holds the responsibility of printing money for the United States. All of these measures help guard against misuse of monetary policy. The US monetary policy in combination with US multilaterally-applied sanctions suggest that the United States is employing its economic power in a cooperative fashion.

Economic or Geopolitical Ends

"For its first 150 years, the American foreign-policy tradition was deeply infused with economic logic. Unfortunately, thinking about international political economy has become a lost art in the United States."⁵⁸ The former World Bank President and US Trade Representative, Robert Zoellick, made this statement.⁵⁹ In the early 1900s and into the Cold War, the United States was extremely willing to flex its economic muscles for geopolitical reasons, but after the collapse of the Soviet Union, the United States began to let these muscles atrophy. Economics became a largely apolitical realm, and economic power became a tool primarily for domestic prosperity vice geopolitical influence. There has been a slight shift in this apolitical attitude with the inauguration of the Trump administration. The new administration appears more willing to engage in geoeconomic behavior, but the aim is economic growth. This shift in motivation from geopolitical to

⁵⁶ Financial Times, "Reform the Economic System Now or the Populists Will Do It," accessed April 22, 2017, <https://www.ft.com/content/72f96588-c38b-11e6-81c2-f57d90f6741a>.

⁵⁷ Financial Times, "Reform the Economic System Now or the Populists Will Do It."

⁵⁸ Blackwill and Harris, *War by Other Means*, 25.

⁵⁹ Blackwill and Harris, *War by Other Means*, 25.

economic goals suggests that the United States has operated under two geoeconomic strategies and merits two separate discussions. The first discussion will look at examples of the United States' historical use of economic power for geopolitical goals. The second will discuss the more recent tendency of the United States to use economic power for economic objectives while shying from opportunities to use geoeconomics for geopolitical goals.

Historical Use – Geopolitical Ends

There is no man who is more interested than I am in carrying the enterprise of American business to every quarter of the globe... [but] if American enterprise in foreign countries, particularly in those foreign countries which are not strong enough to resist us, takes the shape of imposing upon and exploiting the mass of the people of that country, it ought to be checked and not encouraged. I am willing to get anything for an American that money and enterprise can obtain except the suppression of the rights of other men.⁶⁰

This was said by Woodrow Wilson in 1914 during a speech at Independence Hall. Although Wilson was known for his criticism of “dollar diplomacy,” his criticism was over the *misuse* of economic power, not the use of it.⁶¹ In the interwar period, President Roosevelt turned to economic means to prevent German investment in the Western Hemisphere. The United States signed 29 trade agreements with Latin American countries in an attempt to prevent German investment in the region.⁶² In 1944, the United States and its allies signed the Bretton Woods Agreement, believing that economic interdependence was the only hope of preventing war.⁶³ Secretary of State Hull reiterated that economic dissatisfaction was at the heart of war, and if a system could be established which reduced that dissatisfaction, the world might have a shot at preserving peace.⁶⁴

As the United States ventured into the challenges of the Cold War, economic strength became a critical compliment to military power. The United States recognized that in order to counter the Soviet Union and Communist-bloc nations, Europe needed to be strong and interconnected. In order to provide favorable economic benefits to rebuild and strengthen Europe, the United States actually promoted discrimination of US

⁶⁰ Blackwill and Harris, *War by Other Means*, 158.

⁶¹ Blackwill and Harris, *War by Other Means*, 158.

⁶² Blackwill and Harris, *War by Other Means*, 159.

⁶³ Blackwill and Harris, *War by Other Means*, 161.

⁶⁴ Blackwill and Harris, *War by Other Means*, 161.

goods.⁶⁵ In 1950, the United States provided financial assistance to Europe for the creation of the European Payments Union which enabled conversions between European currencies.⁶⁶ This union formed the basis for the European Economic Community, creating a preferential trade area for European countries, thereby reducing trade benefits for the United States.⁶⁷ These examples demonstrate how the United States was willing to accept economic costs for geopolitical gain.

Recent Use – Economic Ends

Despite the United States' historical disposition to use economic power for geopolitical ends, the more recent trend shows an unwillingness to endure economic costs in support of foreign policy goals, leaving economic power as tool for simply economic purposes. The United States had an opportunity to use economic power for geopolitical goals in May of 2011 when President Obama outlined a series of financial initiatives to help build democracy and stability in the Middle East and North Africa during the Arab Spring. The President outlined two initiatives, the Middle East/North Africa Trade and Investment Partnership (MENA-TIP) and the Middle East/North Africa Incentive Fund (MENA/IF). These were designed to provide funding to help “capitalize on the opportunities presented by the Arab Spring, supporting those countries that are moving to undertake the democratic and economic reforms necessary to address citizens’ demands and provide lasting stability to the region.”⁶⁸ Congress felt that the plan did not have enough congressional oversight, and placed too much trust in the administration for how the funds would be spent. Resultantly, Congress did not pass the bill and the United States missed a potential opportunity to advance stability in the region.⁶⁹

The trade agreements, the Transpacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (T-TIP) serve as prime examples of potentially missed geopolitical opportunities, both of which the United States withdrew from for economic purposes. The political benefits from these trade deals were evident to many US officials, but these benefits were not adequately expressed to the American public or to

⁶⁵ Gilpin, *U.S. Power and the Multinational Corporation*, 102.

⁶⁶ Gilpin, *U.S. Power and the Multinational Corporation*, 107.

⁶⁷ Gilpin, *U.S. Power and the Multinational Corporation*, 108.

⁶⁸ Blackwill and Harris, *War by Other Means*, 195.

⁶⁹ Blackwill and Harris, *War by Other Means*, 195.

Congress. When shaping the purpose and substance of these agreements, policy was driven by purely economic considerations over political interests. The origins of TPP grew largely from geopolitical considerations as a solution to the stalled negotiations of the Doha Round at the WTO.⁷⁰ In 2013, a Congressional Research Report noted that just as NAFTA facilitated the agreement of the WTO Uruguay Round, TPP could possibly do the same for the Doha Round.⁷¹ Additionally, TPP would have given the United States preferential access to 40% of global GDP and helped US-based corporations compete with China's SOEs in the region.⁷² TPP could have further strengthened US economic ties with nations in the most economically promising region and promoted liberal trade in a region that is being eclipsed by China's state capitalism.⁷³

T-TIP is a similar story. The members who were party to the T-TIP agreement are responsible for half of the global output and nearly a third of global trade.⁷⁴ Select USA estimates that the would-have-been signatories to T-TIP represent at least 61% of FDI stock in the United States.⁷⁵ When Secretary of State Clinton suggested that T-TIP could serve as an "economic counterpart to what NATO represents on the security side," she was criticized for "unduly geopoliticized trade policy."⁷⁶ Eighteen months later, however, when Russia invaded Ukraine and began using economic coercion to achieve its political goals, many of the same policy makers that had criticized Secretary Clinton were calling for the passing of T-TIP as an "economic NATO."⁷⁷ Despite the geopolitical benefits of both of these trade deals, policymakers failed to adequately express their benefits, and both deals were abandoned.⁷⁸

The Trump administration has revived some government intervention in FDI, but the goals remain economically motivated. The new administration has enacted incentives to encourage MNCs to invest in the United States. The President offered tax breaks to

⁷⁰ Blackwill and Harris, *War by Other Means*, 181.

⁷¹ Blackwill and Harris, *War by Other Means*, 181.

⁷² Bremmer, *Superpower*, 115.

⁷³ Bremmer, *Superpower*, 116.

⁷⁴ Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 8.

⁷⁵ Pasha and Crabtree, *Foreign Direct Investment in the United States: Drivers of U.S. Economic Competitiveness*, 8.

⁷⁶ Blackwill and Harris, *War by Other Means*, 185.

⁷⁷ Blackwill and Harris, *War by Other Means*, 185.

⁷⁸ Blackwill and Harris, *War by Other Means*, 185, 254.

Carrier and Ford to keep jobs in the United States, and both companies agreed.⁷⁹ The current administration also stated intentions to enforce a “border adjustment” which would impose a large tax on imports and exempt exports from taxes. All of these proposals and actions are being made in an attempt to keep jobs and investments at home, and they are driven by motivations to boost the US economy vice any geopolitical endeavors. The willingness of the government to incentivize the FDI of MNCs for domestic economic impact suggests that the United States is operating a strategy that uses economic power for the purpose of economic ends vice a means for geopolitical purposes.

In light of these two uses of economic power, the United States has varied between two of Wigell’s strategies. Historically, the United States operated within a cooperative framework in pursuit of political goals, portraying a hegemonic strategy. More recently, the combination of a cooperative framework and economic goals suggests a strategy of liberal institutionalism. The difference between the liberal institutionalist strategy and the hegemonic strategy is that the hegemonic state is willing to carry some of the burden of provision for public goods and services. The historical willingness of the United States to contribute more funding to institutions such as NATO and the UN demonstrate a willingness to make economic sacrifices and serve as a hegemonic power. The recent actions by the United States demanding other nations pay their “fair share,” the withdrawal from trade deals with are not economically fair, and the efforts to rein in MNCs suggest that the United States is now more closely aligned with liberal institutionalism. Given this dichotomy in strategy, the next section is also divided into two parts. The first looks at how FDI has contributed to the US strategy of hegemony, and the second looks at how FDI has contributed to the more recent tendency of the United States to employ a liberal institutionalist geoeconomic strategy.

⁷⁹ Financial Times, “The Mounting Challenge of Economic Nationalism,” accessed April 22, 2017, <https://www.ft.com/content/c8d3d226-e6e6-11e6-967b-c88452263daf>.

The Role of FDI and Government Structure in US Geoeconomic Strategy

Hegemonic Geoeconomic Strategy

As the United States ventured from the end of the Second World War into the Cold War, it faced a challenging dilemma. Its long-term economic goals did not coincide with short term security issues, specifically the containment of the Soviet Union.⁸⁰ In order to build the liberal world order that would best serve the United States best in the long run, sacrifices were necessary with regard to trade and discrimination of US goods. These sacrifices, however, would strengthen US hegemony. The role of the dollar was instrumental in promoting US influence, and MNCs followed closely behind.⁸¹ Following the establishment of the European Common Union, the United States was at a disadvantage when it came to exports. US-based MNCs, however, could establish multiple subsidiaries in the European market and gain the benefits of those markets while also building an American presence.⁸² As Robert Gilpin writes, “Faced with a deteriorating balance-of-payments situation, the United States government began to regard the multinational corporations and their growing overseas earnings as the means to finance America’s hegemonic world position.”⁸³

Although the United States initially suffered economically, the expansion of FDI began to turn things around. In 1971, the so-called Peterson Report showed that income from FDI had surpassed capital outflows, and the surplus was increasing.⁸⁴ In 1960, the surplus was \$0.7 billion, but by 1970 it was \$1.6 billion.⁸⁵ In a nine-year span from 1961 to 1970, US-based MNCs invested \$28.8 billion overseas and paid \$2.3 billion in interest payments, but earned \$41.8 billion in income. Combining that income with collected royalties and fees, MNCs boasted a net inflow of \$35.3 billion.⁸⁶ By 1980, *Fortune* Magazine reported that “the annual return on foreign investment (dividends, fees, and royalties) will be approximately \$20 billion.”⁸⁷ The income generated from these MNCs

⁸⁰ Gilpin, *U.S. Power and the Multinational Corporation*, 150.

⁸¹ Gilpin, *U.S. Power and the Multinational Corporation*, 152.

⁸² Gilpin, *U.S. Power and the Multinational Corporation*, 152.

⁸³ Gilpin, *U.S. Power and the Multinational Corporation*, 156.

⁸⁴ Gilpin, *U.S. Power and the Multinational Corporation*, 157.

⁸⁵ Gilpin, *U.S. Power and the Multinational Corporation*, 157.

⁸⁶ Gilpin, *U.S. Power and the Multinational Corporation*, 157.

⁸⁷ Gilpin, *U.S. Power and the Multinational Corporation*, 157.

enabled the United States to offset its merchandise imports while funding its political and military expenses overseas. The US Secretary of Treasury during this period claimed, “The United States government has consistently sought, and will continue to seek, to expand and extend the role of the multinational corporations as an essential instrument of strong and healthy economic progress thorough the Free World.”⁸⁸ The United States used FDI to promote both economic growth and geopolitical interests.

Liberal Institutional Geoeconomic Strategy

While the primary strategy during the Cold War was hegemony, there is a good example of the United States’ employment of liberal institutionalism during the same period. The United States poured considerable amounts of resources into World War II and faced major shortages in raw materials such as iron and copper.⁸⁹ The shortage of available resources at home, in combination with the discovery of new resources in South America, Canada, and Africa provided the United States with an opportunity to use its MNCs to replenish the shortage of ores.⁹⁰ In order to accomplish this, the United States altered its tax laws to encourage MNCs to venture abroad.⁹¹ The amended tax laws provided exemptions for MNCs that pursued petroleum, other raw materials, and other energy sources abroad.⁹² These tax provisions created an incredibly profitable opportunity for MNCs and brought much-needed resources to the United States.⁹³

In addition to using OFDI for economic goals, the United States has used IFDI to support its economic interests. In 1981, the Japanese car maker, Toyota, established an extremely lucrative business exporting cars to the United States.⁹⁴ As a result, President Reagan and Congress informed Toyota that the excessive exports had become disruptive.⁹⁵ Not wanting to lose this promising and profitable endeavor, Toyota made the decision to establish a manufacturing plant in the United States. Recognizing the importance of image in selling to the American people, Toyota branded its foreign

⁸⁸ Gilpin, *U.S. Power and the Multinational Corporation*, 161.

⁸⁹ Gilpin, *U.S. Power and the Multinational Corporation*, 114.

⁹⁰ Gilpin, *U.S. Power and the Multinational Corporation*, 114.

⁹¹ Gilpin, *U.S. Power and the Multinational Corporation*, 114.

⁹² Gilpin, *U.S. Power and the Multinational Corporation*, 114.

⁹³ Gilpin, *U.S. Power and the Multinational Corporation*, 114.

⁹⁴ Cohen, *Multinational Corporations and Foreign Direct Investment*, 131.

⁹⁵ Cohen, *Multinational Corporations and Foreign Direct Investment*, 131.

subsidiary as Toyota USA.⁹⁶ By 2005, cumulative investment from Toyota in the United States was nearly \$14 billion, and the company purchased \$25 billion annually in parts, goods, and services.⁹⁷ Toyota placed advertisements in US magazines to emphasize the benefits that it had brought to American workers, claiming that the creation of manufacturing plants and other R&D facilities had provided over 386,000 jobs to the United States.⁹⁸ The President of Toyota Motor Corporation said he would like to continue to expand operations in the US market without causing “trade or political friction.”⁹⁹ In this example, the United States was able to harness the benefits of IFDI to promote economic and job growth in the United States.

A similar example of using IFDI for economic prosperity can be seen with German car manufacturer BMW. In the 1990s, BMW made the decision to start investing in business overseas and spent three years seeking a potential site.¹⁰⁰ Ultimately, BMW chose to build a plant in Spartanburg, South Carolina (SC). Despite researching over 250 different locations, SC was able to lure BMW to its state through a range of incentives and policies.¹⁰¹ Not only did SC provide financial incentives to BMW for starting a plant in its state, the labor market in SC was relatively inexpensive and nonunionized.¹⁰² The state and local government gave BMW an advance of \$40 million for the land purchase, and furthered agreed to lease the land to BMW for only \$1 per year.¹⁰³ The state also spent a substantial amount of money preparing the site for the foreign investor, and then provided BMW with a tax break for a twenty-year period.¹⁰⁴ By the fall of 1992, BMW established an assembly plant that provided 2,000 new jobs and produced 90,000 cars a year.¹⁰⁵ A similar example can be seen between Mercedes-Benz and Alabama during the same time-period.¹⁰⁶

⁹⁶ Cohen, *Multinational Corporations and Foreign Direct Investment*, 131.

⁹⁷ Cohen, *Multinational Corporations and Foreign Direct Investment*, 131.

⁹⁸ Cohen, *Multinational Corporations and Foreign Direct Investment*, 131.

⁹⁹ Cohen, *Multinational Corporations and Foreign Direct Investment*, 131.

¹⁰⁰ Oatley, *International Political Economy*, 191.

¹⁰¹ Oatley, *International Political Economy*, 191.

¹⁰² Oatley, *International Political Economy*, 191.

¹⁰³ Oatley, *International Political Economy*, 191.

¹⁰⁴ Oatley, *International Political Economy*, 192.

¹⁰⁵ Oatley, *International Political Economy*, 191.

¹⁰⁶ Oatley, *International Political Economy*, 192.

The United States' attempts to influence MNCs to garner economic benefits have not always been so successful. In 2004, the United States passed the America Jobs Creation Act (AJCA) which included the Homeland Investment act.¹⁰⁷ This act permitted US-based MNCs to repatriate overseas income at a tax rate of 5.25% rather than the normal 35%.¹⁰⁸ The goal of this act was to encourage MNCs to invest more domestically and create jobs in the United States. The provisions of the act required that corporations spend the repatriated money to fund jobs and R&D, but they were not permitted to use the money for stock buybacks or executive compensations.¹⁰⁹ In 2011, the Senate Permanent Subcommittee on Investigations conducted an investigation to assess the results of the AJCA. The committee determined that the act did not increase American jobs or investment.¹¹⁰ The committee determined that overall jobs were lost rather than created. The top 15 corporations that took advantage of the act reduced their workforces by 20,931 jobs, and of the 840 corporations in the study there was no evidence of job growth.¹¹¹ Furthermore, the investigation found that the top 15 corporations actually decreased their pace of expenditures on R&D and found no evidence of increases in R&D funding of the total 840 corporations.¹¹² The investigation found that a narrow portion of the MNCs benefited from the act; \$150B was repatriated to the Pharmaceuticals and Technology industries, but there was no benefit to the domestic firms that did not engage in offshore investment.¹¹³ The report recommended "against enacting a second corporate repatriation tax break due to the harm associated with a substantial revenue loss, failed jobs stimulus, and added incentive for U.S. corporations to move jobs and investment offshore."¹¹⁴

Government structure plays a large role in the United States' ability to leverage FDI. Like Germany, the executive branch has little control over monetary policy as this has been assigned to the Fed. Trade policy is controlled by Washington, but there is a

¹⁰⁷ Carl Levin, "Repatriating Offshore Funds," *Commun. ACM* 48, no. 10 (2005): 1.

¹⁰⁸ Levin, "Repatriating Offshore Funds," 1.

¹⁰⁹ Levin, "Repatriating Offshore Funds," 3.

¹¹⁰ Levin, "Repatriating Offshore Funds," 1.

¹¹¹ Levin, "Repatriating Offshore Funds," 4.

¹¹² Levin, "Repatriating Offshore Funds," 4.

¹¹³ Levin, "Repatriating Offshore Funds," 4.

¹¹⁴ Levin, "Repatriating Offshore Funds," 5.

prevalent view that trade should be about economic goals vice geopolitical, and the three-branch system of the US government limits the flexibility of trade agreements. Unlike China where the CCP can negotiate trade deals and BITs with autonomy, in the United States the executive branch must also garner the support of Congress. Even an attempt to influence MNCs through tax policy requires the approval of congress, whose members generally have domestic vice geopolitical goals in mind. While such a system of checks and balances certainly carries advantages, when it comes to leveraging FDI, it makes geoeconomics difficult.

Conclusion

The US geoeconomic strategy has changed over time, but FDI has proven beneficial to both strategies. During the interwar and Cold War periods, the United States had clearly defined threats and a distinct policy of containment. A geoeconomic strategy of hegemony fit nicely into this grand strategy, and US-based MNCs greatly supported that strategy. In the years to follow the Cold War, the United States lost its primary threat with the fall of the Soviet Union. Understandably, economic goals and American idealism replaced the perceived need for collective security and economic interdependence. The United States had successfully established a new world order, and the burden of hegemony was somewhat lifted. As a result, the United States turned to a strategy of liberal intuitionism. Operating within the liberal order institutions, the United States used economic power for the sake of economics. Despite the limitations of the three-branch government structure, FDI helped the United States gain resources and wealth abroad while also attracting business and investment at home. The questions moving forward are how should the United States fashion its geoeconomic strategy for the future environment, and how can the United States leverage FDI to support its strategy? The next chapter addresses these questions.

Chapter 6

Considerations for the Future

I would say it is not China rushing to the front... but rather the front runners have stepped back, leaving place to China. If China is required to play a leadership role, it will assume its responsibilities.

Zhang Jun

Chinese Senior Foreign Ministry Official

Preservation of the liberal economic order established at the end of World War II under US leadership is essential to US national security and long term economic interests. The resurgence of geoeconomics and the rise of FDI presents the United States with some important strategic considerations and challenges with regard to the safeguarding of that system. In order to address these challenges and uphold the liberal world order, the United States needs to develop a strong geoeconomic component of US Grand Strategy. Other nations have developed geoeconomic components for their grand strategies as we have seen in this thesis with China and Germany. Despite the extremely advantageous economic endowments of the United States, Washington is hesitant to use any economic tools beyond sanctions. It is time for the United States to develop and leverage its geoeconomic potential and formulate a strategy for its application. In addition to preserving US influence abroad, this strategy must include the promotion of domestic prosperity to reduce the national debt and the development of mechanisms to more evenly distribute wealth at home. The ability of the United States to secure national security interests through economic *or* military means are both contingent upon a strong economy. As the current liberal order has greatly benefited the United States, the United States should seek to formulate its strategy around cooperative means to preserve that order as much as possible. Thus, the United States should adopt a strategy of liberal institutionalism, hegemony, or revised strategy comprised of an amalgamation of the two. This final chapter will examine considerations and implications of those strategies and conclude with a recommendation for the future based on those findings.

Hegemony

If the United States chooses a geoeconomic strategy of hegemony today, it will be because it believes that the world order still benefits from US leadership. This will entail some economic risks; there will likely always be free riders, but an effective hegemonic strategy secures US influence in international affairs. Unlike neo-imperialism, which requires bullying and coercion to solicit cooperation, hegemony earns the respect and followership of partner nations through leading by example. The future holds formidable challenges such as nuclear proliferation, climate change, and resource constraints, and these are issues which require international cooperation with both US allies and adversaries. Loss of international influence will degrade the United States' ability to navigate these challenges to conclusions which are favorable to the United States. The aim of hegemony is not to sacrifice US interests solely for the sake of others, but rather to accept some sacrifices with the expectation that ultimately US leadership and the upholding of the liberal world order is in the long-term best interests of the United States, and the world.

How can FDI contribute to a hegemonic strategy for the United States? Just as China is using its SOEs to project influence world-wide, Washington could develop a strategy to leverage MNCs (US and non-US) toward investment actions that support global development and economic growth and that encourage state behavior consistent with US interests. This is not to suggest some form of "crony capitalism,"¹ but rather to provide incentives for countries to maintain good behavior. This should not be done through bribery or coercion, but through options such as tax credits, management of interest rates from the Federal Reserve, or investment guarantees in a manner similar to Germany. This would be a departure from the United States' traditional *laissez-faire* approach to investment which encourages corporations to invest in locations of their choosing, but this is a necessary component of employing geoeconomics for geopolitical purposes. The current administration is already providing incentives to MNCs to bring jobs back to the United States;² a hegemonic strategy would act similarly, but with

¹ Financial Times, "Politicising Investment Makes the World Poorer," Financial Times, accessed April 22, 2017, <https://www.ft.com/content/792b5784-b884-11e6-ba85-95d1533d9a62>.

² Financial Times, "Politicising Investment Makes the World Poorer."

primarily foreign vice domestic policy goals in mind. The United States has limited its economic relations with countries such as Iran and North Korea for geopolitical purposes, and FDI could compliment US sanctions. If a state chooses to engage in aggressive behavior, rather than undergoing the multi-lateral, time-consuming process of sanctions, the United States could encourage its MNCs to invest elsewhere (as sanctions do now). China has a horrendous track record of poor intellectual property rights protection. Software makers reported that China pirated over 80 percent of all video games used in China.³ Despite these conditions, investors continue to invest in China because of the growing economy and potential profit. Rather than allowing this poor behavior to continue, the United States could provide financial backing to encourage MNCs to invest in other countries.

The United States could also utilize MNCs to discourage human rights abuses and poor working conditions in developing countries. This has already happened in China to some degree, but it could be promoted in places such as Africa as well. When Procter & Gamble (P&G) began its operations in Egypt, it worked hard to ensure its employees received a strong health insurance plan.⁴ This set a standard for future businesses investing in Egypt.⁵ Many MNCs will build one subsidiary in a country with hopes of expanding their investments into other markets in the region, thus they make an effort to establish strong values and standards to garner local populace support.⁶ Unfortunately, many MNCs are hesitant to venture into unstable nations due to the financial risk. China's SOEs are backed by the government and are willing to take on these risks. Germany's MNCs are venturing into Iran with the financial support of their government. If the United States believes that US-based MNCs could contribute to the long-term stability of a country or region, it should be willing to support those endeavors despite the potential economic costs. Supporting MNCs' investments in selected countries could further promote education, skills transfer, and reduction of poverty, all of which promote better stability. China initiated its "going out" strategy in 1999, and is procuring

³ Bremmer, *Superpower*, 196.

⁴ Stephanie Tam, "Earth 2.0: Is Income Inequality Inevitable?," *Freakonomics*, accessed April 21, 2017, <http://freakonomics.com/podcast/earth-2-0-income-inequality/>.

⁵ Tam, "Earth 2.0."

⁶ Tam, "Earth 2.0."

resources and influence all over the globe. In a hegemonic strategy, the United States should be prepared to support the expansion of US-based MNCs just as it did during the Cold War.

Part of employing a hegemonic strategy requires upholding governing institutions. There were many concerns when China first joined the WTO in 2001. Western nations were not sure that China would abide by the established rules, but in fact, China has largely recognized the legitimacy of the institution. The United States has addressed China's poor trade practices and misuses of SOEs through the WTO, and China has mostly honored the determinations of the WTO.⁷ The challenge for the future is that China is attempting to create its own institutions to undermine US-led institutions. If the United States wants to uphold the Bretton Woods system, it cannot turn a blind eye to China's actions.⁸ Nor can it afford to withdraw from trade deals which carry geopolitical significance. Both of these actions place US-based MNCs at a disadvantage. The TPP carried with it enormous potential to address the issue of SOEs in Asia. US-based MNCs are finding it extremely difficult to compete against Chinese-backed SOEs. A trade deal with the region (which excluded China) would have allowed US-based MNCs to better compete and would have secured US influence and presence in a region with significant future security challenges. Instead, the United States withdrew from the deal, and China is proposing an alternative trade deal, the Regional Comprehensive Economic Partnership (RECP). This trade deal would only further alienate US investment in the region. If the United States wants to maintain influence in Asia, FDI is a notable option which also benefits the United States economically, but the United States must be willing to help its MNCs compete in that market.

Globalization has brought billions of people out of poverty across the world, and it is spawning a middle class across the globe. The United States has led that effort, and the liberal order established by the United States has brought enormous domestic economic and political benefit. That order is being challenged by rising economic powers such as China, and if China rewrites the rules to alter the existing order, there is little doubt that the order will remain as favorable to the United States as it has

⁷ Tam, "Earth 2.0."

⁸ Bremmer, *Superpower*, 196.

historically. MNCs enabled the United States to overcome its balance of payment problem following World War II. Today, despite the US trade deficit, the United States is the largest recipient of FDI in the world. The role of the dollar as the world's reserve currency allows the United States to run its excessive debt and trade imbalances. If the United States allows the current system to further degrade, the ability of the United States to maintain its geopolitical influence will also degrade. Employing a hegemonic geoeconomic strategy would enable the United States to preserve the current system and secure its long term interests, and leveraging FDI could serve as an excellent tool to support those efforts.

There are key challenges associated with a hegemonic strategy; the foremost being in the title. The United States has damaged its international prestige with some of its recent military activities, and this has degraded the trust of many of its allies. The term, hegemon, carries with it many negative connotations, especially in light of this tarnished prestige. What this strategy should really promote is leadership, not domination. Another challenge with this strategy is the development of a narrative to garner domestic support. The everyday American is generally more concerned about domestic prosperity and jobs than international influence, as is evident from the current administrations election based on the slogan to "Make America great again." Convincing working-class Americans that economic costs in pursuit of geopolitical aims is worthwhile will not be easy. Finally, if the United State desires to continue leading the world order and to regain some confidence from its allies, it will need to tread carefully in the realm of geoeconomics. We have discussed methods to leverage FDI in ways which support geopolitical interests without becoming competitive or damaging to free-market competition. If the United States chooses a hegemonic strategy, careful consideration should be given to each of these challenges.

Liberal Institutionalism

Despite some blunders along the way, the United States has done a remarkable job of leading the free world and establishing a successful world order. The United States has greatly benefited from the established order, as have its allies, but many believe the time for paying others' way has passed. The United States took on the burden of hegemony following World War II because it was materially and strategically best

suited to do so, and its European allies and the world needed it to lead. But somewhere along the way, the United States lost sight of the ramifications of US developed technology and globalization—especially financial globalization—on US society and the working class at home. Without support from the American people and a robust economy at home, the United States will be unable to maintain its strong military or international economic influence. Unlike the hegemonic strategy, a liberal institutionalist strategy would focus on economic goals, and there are ways which FDI could facilitate the achievement of those goals. The primary benefits derived from a liberal institutionalist strategy would be realized through bolstering the economic health of the US economy.

Globalization and technology have done amazing things for the developed and developing world, but members of the United States economy have suffered. The median household income for Americans without a high school diploma dropped by nearly 20 percent between 1974 and 2015.⁹ Conversely, Americans with a college degree or above saw an increase of 17 percent in their median income.¹⁰ Inequality has created a discouraged population of hard-working Americans who have lost faith in their government and the liberal world order. Following World War II and throughout the Cold War, US political leadership was preoccupied with Soviet containment and failed to appreciate how emerging globalization and technology could degrade the economic health of the middle and lower economic classes. The trend accelerated after the Cold War with the globalization of finance as businesses increasingly outsourced manufacturing and deployed automation technologies. There are winners and losers in globalization, and the United States ended up with too many losers. A writer for *Foreign Affairs* says it well, “today’s crucial foreign policy challenges arise less from problems between countries than from domestic politics within them.”¹¹ When developing a geoeconomic strategy, the United States needs to focus on restoring health and prosperity at home. The ability of the United States to exercise geopolitical leadership is dependent upon a healthy economic system, military power, and most critically domestic stability.

⁹ Jeff D. Colgan et al., “The Liberal Order Is Rigged,” *Foreign Affairs*, April 17, 2017, <https://www.foreignaffairs.com/articles/world/2017-04-17/liberal-order-rigged>.

¹⁰ Colgan et al., “The Liberal Order Is Rigged.”

¹¹ Colgan et al., “The Liberal Order Is Rigged.”

FDI can benefit a liberal institutionalist strategy well, but the key to that happening lies in the first word of that acronym---foreign. While “Made in the USA” sounds great and is a catchy slogan, the US economy has evolved beyond “making things,” unfortunately to the detriment of many US workers. In 2011, President Obama reportedly asked Steve Jobs what the United States would have to do to get Apple to make iPhones in America with American workers.¹² Mr. Jobs replied with, “Those jobs aren’t coming back.”¹³ He went on to inform the President that US companies had “become brilliant at managing across borders,” and the manufacturing environments overseas were so streamlined and cost-productive that the same profits simply were not feasible back in the United States.¹⁴

The US economy is not the manufacturing-based economy that it was immediately following World War II.¹⁵ Advances in technology and higher education have launched the United States to a service-based economy, and it is doubtful there will be any turning back. President Trump’s recent attempt to revive coal mining jobs is unlikely to see the benefits that he and the coal miners hope to achieve.¹⁶ Whereas coal produced 49 percent of US electricity in 2006, in 2015 it generated only 30 percent.¹⁷ Advances in shale and fracking and other sources of energy are replacing coal. Additionally, advances in technology are largely responsible for the job losses, not regulations. The Bureau of Labor Statistics reports that the United States produces 50 percent more coal than it did in 1940, but employs only about 13 percent of the miners.¹⁸ The United States tried to reign in MNCs from abroad in 2004 with the Homeland Investment Act, and it was a dismal failure (see Chapter 5). America’s MNCs are much like Germany’s; they think and operate globally. MNCs have an obligation to act in the

¹² Financial Times, “America Business Is the Master, Not Victim, of Globalisation,” accessed April 21, 2017, <https://www.ft.com/content/9c7bfa42-e479-11e6-9645-c9357a75844a>.

¹³ Financial Times, “America Business Is the Master, Not Victim, of Globalisation.”

¹⁴ Financial Times, “America Business Is the Master, Not Victim, of Globalisation.”

¹⁵ Financial Times, “America Business Is the Master, Not Victim, of Globalisation.”

¹⁶ The Economist, “Coal and Carbon: The President’s Executive Orders Won’t Do Much for Coalminers | The Economist,” accessed April 21, 2017, <https://www.economist.com/news/united-states/21719824-they-could-harm-planet-undermining-co-operation-other-countries>.

¹⁷ The Economist, “Coal and Carbon: The President’s Executive Orders Won’t Do Much for Coalminers | The Economist.”

¹⁸ The Economist, “Coal and Carbon: The President’s Executive Orders Won’t Do Much for Coalminers | The Economist.”

best interests of their shareholders, which may not necessarily be in line with the geopolitical interests of the United States. If the United States wants to benefit economically from FDI, it needs to approach it differently.

The establishment of Toyota USA and the BMW's factory in South Carolina brought thousands of jobs and income to the United States. The challenge is encouraging foreign investors to invest in the United States in ways which benefit our dislocated workers. Just as the United States provides tax breaks and grants for corporations who invest in R&D, the United States could provide incentives to foreign corporations who provide skills transfer and on-the-job training for displaced workers.¹⁹ The United States' infrastructure is in dire need of repair. The United States could encourage foreign companies to assist in that endeavor while employing US workers. This relieves some of the cost burden from the government, while providing jobs for the working class.

Another option would be tax incentives for US-based MNCs to repatriate funds. This would have to be different from the efforts in 2004, which failed to deliver the desired results. The Homeland Investment Act restricted where MNCs could invest their repatriated funds. Specifically, they could not reinvest their money into stock buybacks or executive compensations. This is understandable because the goal was to create jobs for American workers and encourage R&D, so the United States wanted to direct the money from the repatriation to specific sectors. The problem is that the two sectors which were restricted are the most attractive options for MNCs. By restricting them, MNCs are less motivated to repatriate their money. As a result, MNCs leave the majority of their money overseas, and the United States never reaps the benefits of the inordinate amount of income the MNCs are generating. A one-time tax incentive, which allows MNCs to repatriate money where they see fit, could bring back a valuable sum. Although a tax incentive without restrictions would not direct the *income* where the government desires, it would generate some government funding through the taxes. Five percent of *something* is better than 35 percent of *nothing*. Washington could use those funds for education and training for the working class to assist in increasing their social mobility.

¹⁹ Colgan et al., "The Liberal Order Is Rigged."

The United States faces an arduous challenge with domestic inequality. Transitioning the left-behind members of the manufacturing economy to a service-based economy will not be easy, but the United States must find a way to accomplish it. Currently, US funding for science and R&D is at the lowest point it has been in over 40 years.²⁰ In 2015, the United States spent less on education at the federal level and most state levels than it did before the 2008 recession.²¹ The University of Maryland conducted a study which found that “a targeted and long-term increase in public infrastructure investments from all public and private sources over the next 15 years would increase jobs by almost 1.3 million at the onset of an initial boost, and grow real GDP 1.3% by 2020 and 2.9% by 2030.”²² Investments in education, R&D, and infrastructure, while costly in the short term, are critical to the United States’ long-term economic growth. While utilizing foreign companies to help in these endeavors would reduce the overall number of jobs generated, it will still provide thousands of jobs, promote R&D, and reduce some of the financial burden on the US government. The Congressional Budget Office assesses that infrastructure spending is only at 60 percent of the required level to maintain current economic growth rates.²³ The United States has one of the most attractive investments environments in the world. It should leverage that potential to attract FDI to the areas where it needs it most.

A liberal institutionalist strategy does not stray far from current US activities in the realm of geoeconomics, but it would provide focus for the development and application of economic tools. This geoeconomic strategy would continue to promote the free-market economy and seek to leverage the now-dominant tool of commerce, FDI, for economic growth. As with the hegemonic strategy, a liberal institutionalist strategy would also come with challenges. Because states employing this strategy are unwilling to suffer economic loss for geopolitical gain, the United States would need to find other means to ensure continued influence in today’s geoeconomically-charged environment. As with the hegemonic strategy, the United States would need to be cautious in its influencing of FDI. A liberal institutionalist strategy is focused on economic goals, and

²⁰ Blackwill and Harris, *War by Other Means*, 227.

²¹ Blackwill and Harris, *War by Other Means*, 227.

²² Blackwill and Harris, *War by Other Means*, 227.

²³ Blackwill and Harris, *War by Other Means*, 227.

damaging the free-market economy through manipulation of FDI could damage the world order that the United States seeks to protect.

A Revised US Geoeconomic Strategy

Ultimately, US geoeconomic strategy should be fashioned to support US grand strategy, but because some of the most prominent challenges currently facing the United States are rooted in economics, the geoeconomic strategy will to a large degree also fashion grand strategy. The purpose of this thesis is not to promote a grand strategy for United States, but rather to emphasize the importance of geoeconomics and to encourage the integration of geoeconomics into whatever grand strategy Washington chooses to pursue. Neither the hegemonic nor liberal institutionalist strategies fully address the domestic and international concerns of the United States today. Domestically, the inability of the United States to distribute the benefits of globalization across the population is creating a growing chasm between the working class and the elites. The division within the American people and the polarization of the political parties has resulted in a dysfunctional national government. Washington needs to formulate a strategy which allows the working class to enjoy the benefits of globalization and technology, and preserves support of the elite. The voters ultimately determine geopolitical maneuvering authority provided to the elite.

In addition to this domestic economic challenge, the United States faces an international economic challenge. The United States projects considerable influence because of its military and economic power, but these two things are intricately related. If the United States declines economically, military power and social-economic stability also decline resulting in reduced geopolitical influence. The ability of the United States to maintain its economic and military advantages are predicated on the endurance of the liberal order which so greatly benefits the United States. If the United States does not lead the effort to uphold that world order, it is likely to degrade at increased risks to US interests. At the very least, it will be restructured to better benefit China to the detriment of the United States. Thus, the United States needs a geoeconomic strategy which will support domestic interests, while securing international influence. Neither a liberal institutionalism strategy nor a purely hegemonic strategy will suffice for addressing these hurdles. A revised geoeconomic strategy which draws from both of these strategies is

needed. The challenge is to “craft a [foreign] policy that connects our national security and our economic interests,” and in order to accomplish this we must “[think] outside the bounds of...deeply established disciplinary conventions.”²⁴

A revised geoeconomic strategy can easily incorporate the majority of the suggestions of the liberal institutionalist strategy for promoting domestic growth. Washington should seek ways to encourage repatriation of funds from MNCs and then use those funds to benefit the working class. Furthermore, Washington should provide incentives to foreign investors to contribute to areas of the economy which benefit dislocated workers. The hegemonic side of the geoeconomic strategy will require some economic sacrifice when it comes to trade deals and BITs. Reinvigorating the TPP and TTIP trade deals are paramount to ensuring US influence and long-term prosperity. This will be a hard sell domestically, but is crucial for ensuring the United States’ access to the most promising economically developing region in the world. The United States should also double down its efforts on BIT negotiations with China. These efforts will provide the United States with a valuable opportunity to encourage China to establish better working environments for its workers, better protection of intellectual property, and better regulation of its SOEs.

A revised geoeconomic strategy for the United States is not about dominance; it is about leadership. It is about upholding the institutions and norms of the liberal world order, it is about curbing the exploitation of the system by aggressive states, and it is about projecting liberal ideals and values through economic means. China is using its economic power to gain world-wide influence. Germany is using its power for economic growth. As the leader of the free world, the United States needs a combination of both. There are three challenging but crucial steps which must occur for the United States to be successful in its geoeconomic strategy. First, the United States needs to reinvigorate its thinking about geoeconomics and be willing to consider new tools of economic power, such as leveraging FDI to support US interests, whether they be economic or geopolitical. Second, Washington needs to develop its geoeconomic strategy which uses all applicable tools of economic power and addresses both domestic and international challenges. Third, and perhaps the most challenging, Washington will need to compose a narrative

²⁴ Blackwill and Harris, *War by Other Means*, 178.

which highlights to the American people, both the working-class and elites, the importance of a revised US geoeconomic strategy. As Blackwill and Harris write, “To recall Mao, international power and the influence needed to flourish and to shape the balance of power in America’s favor must derive not only from the barrel of a gun but also from the strength and geopolitical applications of the U.S. economy.”²⁵ Without a revised US geoeconomic strategy, the United States permits China to re-write the rules of the game. If that happens, it is unlikely those rules will be “America First;” it is much more likely they will be “America Follows.”



²⁵ Blackwill and Harris, *War by Other Means*, 257.

Conclusion

We can thus only say that the aims a belligerent adopts, and the resources he employs, must be governed by the particular characteristics of his own position; but they will also conform to the spirit of the age and to its general character.

Carl von Clausewitz

On 11 May 2017, China and the United States announced that they had agreed upon an initial trade agreement between the two nations.¹ The trade agreement provides new economic opportunity for China with the United States, but primarily only requires China to keep commitments that it *had already* made to previous administrations and international institutions.² Despite rhetoric by the current US administration during campaigning about China being a “currency manipulator” or “unfair trade partner,” the signing of this trade deal signifies a softer stance.³ In addition to the trade agreement, the United States recently acknowledged the importance of China’s One Belt, One Road initiative and agreed to send a representative to its upcoming summit.⁴ China’s proposed communique for this summit contains diplomatic provisions which appeal to partners to respect China’s claims over parts of the South China Sea and Taiwan.⁵ China has embraced the spirit of today’s geoeconomic age, and it is leveraging its economic power to influence the actions and behavior of other nations, to include the United States.

The character of the age in which the United States now finds itself has changed from the days of the post-war period and the Cold War. While the US military prides itself in being able to fight and win its nations wars, the most admirable achievement is that the unmatched strength of the military deters even the advent of war. Conflict is inevitable; war is not. Fear, honor, and interests still drive state behavior, but the spirit of

¹ Eurasia Group, “Eurasia Group China/US Geopolitics; Initial Agreement on Trade Actions Does Not Eliminate Risk,” 12 May 17.

² Eurasia Group, “Eurasia Group China/US Geopolitics; Initial Agreement on Trade Actions Does Not Eliminate Risk.”

³ BBC News, “US and China Sign Trade Agreement,” *BBC News*, May 12, 2017, sec. Business, <http://www.bbc.com/news/business-39894119>.

⁴ BBC News, “US and China Sign Trade Agreement.”

⁵ Bloomberg Politics, “Xi’s New Silk Road Forum Sets Chinese Tone for Globalization 2.0 - Bloomberg,” accessed May 15, 2017, <https://www.bloomberg.com/politics/articles/2017-05-09/xi-s-new-silk-road-forum-sets-chinese-tone-for-globalization-2-0>.

the age in which we now find ourselves is conflict resolution absent massive bloodshed. The United States' military might plays a large deterrent role in making such conflict resolution possible, and the goal of this paper is not to advocate for a disbandment of the United States' military instrument of power. The goal is, rather, to encourage strategic thinking about the United States' ability to project meaningful influence devoid of military force. The new age is being characterized by the resurgence of geoeconomics and a rise in FDI. Having recognized the altered strategic landscape, China is employing "the particular characteristics of its own position." China is not in a position to challenge the United States militarily on a global scale, but it is in the economic position to challenge the US-established world order. The United States needs to take advantage of its economic position and develop a geoeconomic strategy to ensure it remains in a position of influence for the future.

This study examined the resurgence of economics as a dominant tool in statecraft. Other countries are actively engaging in geoeconomics for both economic and geopolitical goals. Furthermore, the rise of FDI as a dominant tool for economic commerce is providing a new mechanism which states can leverage in their geoeconomic strategies. In light of those two changes to the international system, this study examined a framework for geoeconomic strategy and discussed ways which states can incorporate FDI into their strategies. Wigell's geoeconomic typology assesses states' means and motivations for employment of economic tools. States can use economic tools in a cooperative or competitive fashion, and they can use them for geopolitical or economic ends. Based on those two criteria, states operate under one of the following geoeconomic strategies: neo-mercantilism, neo-imperialism, hegemony, or liberal institutionalism. Based on the nature of each strategy, we determined which tools of FDI we would expect nations to use within each strategy. With that conceptual foundation established, we looked at the geoeconomic strategies of three nations.

The first state examined was Germany. Germany has built its economy around its MNCs, and the government is heavily involved in supporting both inward and outward FDI. Germany's neo-mercantilist geoeconomic strategy pursues economic prosperity for Germany, and this competitive pursuit often comes at the expense of neighboring nations in the EU. As the economic powerhouse of the EU, Germany has maneuvered itself to a

position of influence to direct the Eurozone in ways which further benefit Germany. There has been some shifts to the strategy over the last year as Germany faces the challenges of Brexit, terrorism, and large influxes of refugees. Germany has demonstrated a willingness, at least in rhetoric, to put the needs of the EU above the needs of its MNCs.⁶ Germany has a strong vested economic, as well as political, interest in maintaining the integrity of the EU. It is possible that we will see Germany pursue more of a regional hegemonic strategy in the days to come.

The second state which was discussed is China. China is using its rapidly growing economy to further its geopolitical goals and world influence, and it does this frequently through bribery and coercion. China's neo-imperialist geoeconomic strategy utilizes its vast numbers of SOEs and its great state wealth to gather resources and guide other states' behavior towards actions which benefit China. Despite a successful verdict at the Hague over the South China Sea dispute with China, the Philippines essentially disavowed their victory, choosing instead to accept China's offer of a large financial investment in the Philippines. Malaysia came to a similar agreement with China in order to resolve their dispute. Rather than relying on Western-established institutions, both nations succumbed to Chinese geoeconomic sway. The CCP is using its power and wealth to expand its influence and reshape the world order because it believes the current order is biased towards the West. By establishing new banks, new trade deals, and new BITs, China is generating its own sphere of influence which could eventually rival the United States' sphere.

Germany and China have honed their geoeconomic strategies and have been putting those strategies to practice, and it is time that the United States developed its own geoeconomic strategy. Because of the United States' unique leadership position, it will need its own geoeconomic strategy. Mirroring the strategies of other nations will not suffice. The United States could employ measures similar to Germany when it comes to supporting its MNCs. Washington could provide more investment guarantees and incentive for MNCs to invest in regions which the United States views as geopolitically important. Washington could also examine Germany's tax structure and look for ways to

⁶ Financial Times, "Merkel Warns German Business EU Freedoms to Take Priority in Brexit Talks," *Financial Times*, accessed April 23, 2017, <https://www.ft.com/content/c947edd2-1e56-3874-ad68-84c3eebd7412>.

use FDI to benefit the US working class. The United States should also consider negotiating more BITs as Germany has done in order to protect and encourage US investments abroad. China's competitive and controversial geoeconomic strategy offers less for the United States to mimic, but it does nonetheless provide some topics for thought. China sends its SOEs to economically fragile countries in order to obtain influence and resources. Rather than just sending aid to countries in need, the United States could consider backing its MNCs, which establishes a forward presence. The key to this task is to avoid the "dollar diplomacy" which "suppresses the rights of other men." The United States should provide backing to the MNCs such as P&G which are improving the conditions of the environments they enter and setting the standards for future businesses.

Renewing the idea of geoeconomics in the United States will be a controversial subject, and it is a challenging strategy to construct. The United States does not want to challenge the free-market spirit by exerting undue pressure on its MNCs. This sort of "crony capitalism" carries with it the potential for civilian-political corruption such as is present in China. The aim of the US strategy should be to uphold the established institutions, not undermine them. The goal is for Washington to work *with* the MNCs in ways which benefit both parties as well as the international community. China is using its SOEs and SWFs in competitive ways which hurt free-market competition, and the United States should not respond in kind. The United States should continue to challenge China's belligerent actions through the mechanisms of the established institutions. The second challenging aspect of the United States' geoeconomic strategy will be the domestic side. Germany has found a way to use both inward and outward FDI to bring great economic wealth to Germany without falling prey to the surge of populism that is sweeping the rest of the Western world. Washington needs to address the concerns of the working class at home. Closing the door on investment and trade is not the answer. Washington needs to enable MNCs to invest in deals which profit both the elites of the corporations and working-class Americans.

This paper has just brushed the surface of a study into geoeconomic strategy and incorporation of FDI, and areas for future research abound. First, part of incorporating FDI into geoeconomic strategy requires determining how FDI could compliment the

various geoeconomic strategies. This thesis paired tools of FDI with strategies and sought to determine whether or not three states operated in accordance with those pairings. The case studies for this thesis generally supported the expectations, but further research is required to fully validate the concept. Second, a more in-depth study into the US geoeconomic strategy, past and present, is needed in order to better assess the need for change and potential areas for change. Further study into the ability of the United States to successfully wield a SWF would be beneficial. Norway is the primary democratic nation which makes extensive use of its SWF, and there could be some interesting insights gleaned from examining their use of it. Third, future research should evaluate the effectiveness of leveraging FDI for economic or geopolitical interests. Finally, the United States will need to address China's misuse of geoeconomics. The United States should not fear the economic rise of China, because even with a smaller GDP the United States could still potentially project considerable influence within the established world order. The goal is to engage with China in a constructive way which encourages it to operate within the current Bretton Woods system, or to co-op with China to revise the system in such a way as to preserve healthy economic competition for the world.

It is time for the United States to "recognize the particular characteristics of its own position." The United States' position of influence has been somewhat degraded due to its instinctive application of military force over the past few decades. The United States needs to regain some prestige and legitimacy in its leadership, and this will entail operating within the norms and institutions of the world order which the United States designed. Economic tools are playing an increased role in statecraft, and the United States has the economic power to play that game very well, but as Leslie Gelb writes, "Nations around the world already see China as the future No. 1 economic power, even though it still lags behind the US substantially in most categories. It's the perception of [China] going up and [the United States] going down. And upon such perception power is based."⁷ With power comes influence. If the United States does not reinvigorate its thinking about geoeconomics and develop a strong geoeconomic component for its grand strategy, it risks jeopardizing its current position of influence. Relinquishment of that

⁷ Blackwill and Harris, *War by Other Means*, 180.

position will hinder the ability of the United States to either preserve the current world order, or if necessary, re-write the rules of the future world order.



Appendix 1

FDI Fundamentals

The goal of this appendix is to provide readers without a background in economics with a foundational understanding of trade, FDI, and MNCs. This discussion does not aim to cover all aspects of FDI, but only to provide enough knowledge to adequately understand the issue which this study seeks to address. This appendix looks at some of the basic definitions, institutions, and regulations regarding FDI and trade. Although the focus of this study is on investment policy, FDI is so intricately linked to trade and MNCs that it is counterproductive to isolate it entirely. Trade policy and MNCs are discussed only to the extent to which they serve as tools for FDI. We begin by looking at institutions and regulations regarding trade.

The World Trade Organization (WTO), originally called the General Agreement on Tariffs and Trade (GATT), is the international system that deals with the global rules of trade. The WTO provides a mechanism by which nations can establish, negotiate, and enforce international trade regulations, and its main function is to ensure a smooth and predictable flow of trade. Currently, 164 nations are members of the WTO which accounts for about 95% of all world trade.¹ While the goal of the WTO is to reduce barriers to trade, national governments are still responsible for managing their domestic economies, and domestic demands often conflict with a fully liberalized trade policy. In order to alter the flow of exports or imports, governments can impose tariffs or nontariff barriers. Tariffs are taxes which a government places on foreign goods, which enable domestic goods of the same kind to be more competitive in the domestic market.² Nontariff barriers include health regulations, government purchasing practices, and other government regulations which may limit the flow of external goods.³ The WTO provides the forum by which governments can negotiate and establish regulations regarding issues such as tariffs.

¹ "WTO | The WTO in Brief - 2," accessed May 21, 2017, https://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr02_e.htm.

² Oatley, *International Political Economy*, 24.

³ Oatley, *International Political Economy*, 24.

One of the core principles of the WTO is nondiscrimination, which requires all WTO members to treat each other equally with regard to their trading policies.⁴ The only exceptions to this rule are permitted by the Generalized System of Preferences (GSP) and Regional Trade Agreements (RTAs).⁵ The GSP allows for lower tariffs on imports from developing countries to advanced industrialized countries.⁶ RTAs, such as the North American Free Trade Agreement (NAFTA), enable nations to give preferential trade treatment to other nations who are party to the agreement. There are two types of RTAs. Free-trade areas allow nations to eliminate tariffs on the member nations, but retain individual tariffs on nonmember nations at each government's discretion.⁷ NAFTA is an example of a free-trade area. Customs Unions are the second type of RTA, the European Union being one example. In a Customs Union, there are no tariffs between member nations, but governments do not have the option of imposing individual tariffs on nonmembers.⁸ Instead, there is one common tariff that is applied on all nonmember goods entering the union.⁹ There are currently 460 RTAs, of which 267 are in force.¹⁰ Every member of the WTO is party to at least one RTA.¹¹

While trade is the process of exchanging goods or services, FDI is a financial exchange between entities. The nearly universal definition of FDI is, "ownership of at least 10% of the common (voting) stocks of a business enterprise operating in a country other than the one in which the investing company is headquartered."¹² It generally implies a long-term relationship and a desire for the investing entity to exert some sort of managerial influence over the receiving entity.¹³ The United Nations Conference on Trade and Development (UNCTAD) defines FDI as, "an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. Further, in cases of FDI, the investor's purpose is to gain an effective voice in the management of

⁴ Oatley, *International Political Economy*, 23.

⁵ Oatley, *International Political Economy*, 23.

⁶ Oatley, *International Political Economy*, 23.

⁷ Oatley, *International Political Economy*, 37.

⁸ Oatley, *International Political Economy*, 37.

⁹ Oatley, *International Political Economy*, 37.

¹⁰ "WTO | Regional Trade Agreements Gateway," accessed May 21, 2017, https://www.wto.org/english/tratop_e/region_e/region_e.htm.

¹¹ "WTO | Regional Trade Agreements Gateway."

¹² Cohen, *Multinational Corporations and Foreign Direct Investment*, 38.

¹³ Cohen, *Multinational Corporations and Foreign Direct Investment*, 38.

the enterprise.”¹⁴ The investor is termed the “direct investor,” and the receiver is referred to as the “direct investment enterprise.”¹⁵ These entities are often called the parent and subsidiary, respectively. For the purposes of this study, we will look at investment made from three types of direct investors: MNCs, SOEs, and SWFs.

An MNC is defined as a firm that, “controls and manages production establishments—plants—in at least two countries.”¹⁶ MNCs are often referred to as Multinational Enterprises (MNEs). An SOE is a company that is owned by and operated on behalf of a state government. Both SOEs and MNCs use FDI similarly in that they are companies investing in foreign entities (although often with different motivations). SWFs are funds which governments manage and use to purchase private assets in other countries.¹⁷ These funds are prevalent in the Middle East, and many of them are funded by state-owned oil companies.¹⁸ When SWFs began to rapidly grow in 2007, there was some concern among Western nations because of a lack of transparency and regulatory framework for SWFs.¹⁹ There was concern that nations would use these SWFs to invest for geopolitical purposes rather than economic reasons. In 2008, a working group of 23 of the leading state-owned investors developed a set of generally accepted principles and practices, known as the Santiago Principles.²⁰ In 2009, these state-owned investors established the International Forum of Sovereign Wealth Funds (IFSWF), an organization committed to helping states abide by the Santiago Principles while providing structure and transparency by encouraging states to report on their SWF activity.²¹ Ultimately however, the IFSWF is only a code of conduct sharing mechanism, and it not a rule-based institution whereby states are required to disclose SWF information.²²

FDI can be divided into two different categories based on production activity. Horizontal FDI is the most common, and this refers to FDI that occurs as a result of a

¹⁴ “Unctad.org | Foreign Direct Investment (FDI),” accessed May 21, 2017, [http://unctad.org/en/Pages/DIAE/Foreign-Direct-Investment-\(FDI\).aspx](http://unctad.org/en/Pages/DIAE/Foreign-Direct-Investment-(FDI).aspx).

¹⁵ “Unctad.org | Foreign Direct Investment (FDI).”

¹⁶ Oatley, *International Political Economy*, 159.

¹⁷ Oatley, *International Political Economy*, 186.

¹⁸ Oatley, *International Political Economy*, 186.

¹⁹ Oatley, *International Political Economy*, 187.

²⁰ “About Us | International Forum of Sovereign Wealth Funds,” accessed May 21, 2017, <http://www.ifswf.org/about-us>.

²¹ “About Us | International Forum of Sovereign Wealth Funds.”

²² Bremmer, *The End of the Free Market*, 167.

corporation transferring a part of its manufacturing to an overseas subsidiary. In this case, it is investing in the same type of business abroad that it is operating domestically. Conversely, vertical FDI is when a company invests in a different part of its manufacturing process, often a supplier or distributor. Vertical FDI takes advantage of the advances in technology and draws upon the geographical specialization and cost advantages of companies in different countries.²³ The methods by which companies invest in their subsidiaries are classified as greenfield investments or brownfield. Greenfield investment occurs when a company builds a new facility from scratch, whereas brownfield is the term used to describe Mergers and Acquisitions (M&As). There is one other method by which a company can acquire a foreign subsidiary, and that is through privatization. In this case, the buyer is a civilian firm purchasing a government-owned entity.²⁴ Once this transaction is complete, further selling of the entity would be considered a M&A deal, unless the entity was at some point subsequently renationalized.²⁵

There are two aspects of FDI which are measured and tracked, FDI stock and FDI flow. FDI stock refers to the total value of direct investment which the parent company owns in the subsidiary at a given point in time and is measured in US dollars (USD) as a share of Gross Domestic Product (GDP).²⁶ FDI flow measures the value of cross-border flow between the enterprises over a period of time and is divided into Inward FDI (IFDI) and Outward FDI (OFDI); flow is also reported in USD as a share of GDP.²⁷ Regulation of FDI is primarily done by individual governments, and many governments formalize their FDI policies through International Investment Agreements (IIAs). IIAs encompass two types of agreements: Bilateral Investment Treaties (BITs) and Treaties with Investment Provisions (TIPs).²⁸ BITs are agreements between two countries which determine how investor enterprises will be established, and how they will be treated in the other nation's territory.²⁹ TIPs include any other treaty signed between nations, such

²³ Cohen, *Multinational Corporations and Foreign Direct Investment*, 72.

²⁴ Cohen, *Multinational Corporations and Foreign Direct Investment*, 73.

²⁵ Cohen, *Multinational Corporations and Foreign Direct Investment*, 73.

²⁶ OECD, "Foreign Direct Investment (FDI) - FDI Stocks - OECD Data."

²⁷ OECD, "Foreign Direct Investment (FDI) - FDI Stocks - OECD Data."

²⁸ UNCTAD, "International Investment Agreements Navigator."

²⁹ UNCTAD, "International Investment Agreements Navigator."

as a RTAs, which includes some form of investment provision.³⁰ There are currently 3352 IIAs in affect, of which 2958 are BITs.³¹

While the WTO primarily focuses on regulation related to trade versus investment, because of the intricate nature of the two, the WTO has taken some actions which directly relate to investment. One of those actions was the Trade-Related Investment Measures (TRIMs) Agreement established in 1994.³² This agreement prohibited governments from increasing domestic production and jobs through the regulation of subsidiary outputs.³³ These regulations typically required subsidiaries to produce a certain percentage of the final value of their products locally.³⁴ This agreement also banned the practice of requiring the annual value of exports to equal the subsidiary's total imports.³⁵ The concern was that both of these actions would impose upon trade flows.

While TRIMs imposes legal restrictions on governments, MNCs' FDI activity is largely based on an international voluntary code of conduct system. Nonbinding codes are similar to the Santiago Principles for SWFs, and MNCs can voluntarily subscribe to nonbinding codes of conduct. Some of these codes include human rights and labor principles, environmental protections, disclosure of business activity, or ethical behavior.³⁶ MNCs will normally agree to abide by these nonbinding codes in an attempt to enhance their image or ease the administrative process for investment in new countries.³⁷ The two most prominent agencies which administer voluntary codes of conduct are the Organization for Economic Co-operation and Development (OECD) and the United Nations.³⁸ While these codes are not international law and there is no enforcement mechanism, they do provide an avenue for encouraging responsible business conduct from MNCs.³⁹

³⁰ UNCTAD, "International Investment Agreements Navigator."

³¹ UNCTAD, "International Investment Agreements Navigator."

³² Cohen, *Multinational Corporations and Foreign Direct Investment*, 170.

³³ Cohen, *Multinational Corporations and Foreign Direct Investment*, 170.

³⁴ Cohen, *Multinational Corporations and Foreign Direct Investment*, 170.

³⁵ Cohen, *Multinational Corporations and Foreign Direct Investment*, 170.

³⁶ Cohen, *Multinational Corporations and Foreign Direct Investment*, 261.

³⁷ Cohen, *Multinational Corporations and Foreign Direct Investment*, 262.

³⁸ Cohen, *Multinational Corporations and Foreign Direct Investment*, 262.

³⁹ Cohen, *Multinational Corporations and Foreign Direct Investment*, 262.

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