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Containing Crisis

Strategic Concepts for Coercive Economic Statecraft on China

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Executive Summary

As the United States and China seek to manage an increasingly tense relationship, both sides have turned to coercive economic statecraft as a core part of their broader foreign policy, with disruptive impacts on the global economic order. A growing body of research examines the use of coercive economic tools, including prior work by the CNAS Energy, Economics, and Security program. This report adds to that literature by specifically examining the use of coercive economic tools during periods of geopolitical crisis to assess their value in de-escalating tensions or deterring further economic coercion. The researchers developed scenario exercises to examine these dynamics, supported by a literature review and extensive engagement with subject matter experts. The insights from the research informed the development of two overarching strategic concepts intended to guide U.S. policymakers when deploying economic tools as part of a crisis management situation.

Research Insights

From the scenario exercises and further research, the research team identified the following insights into how the United States and China may deploy coercive economic tools in times of crisis:

1. China may be willing to deploy the widest range of economic tools in response to a geopolitical conflict.
2. While both China and the United States may be willing to accept negative economic impacts to pursue geopolitical objectives, both also demonstrate a preference to broadly retain access to the other's market, which may constrain the use of the most extreme forms of economic coercion.
3. Countries other than the United States may be more reticent to take coercive economic actions against China due to fears of possible negative economic and political consequences.
4. The United States may be advantaged by its alliances, and its ability to act jointly with allies may compensate for the narrower set of economic tools the United States is willing to use to manage geopolitical tensions.
5. Persuasive rather than coercive tactics may best improve the United States' negotiating position when it seeks to use economic statecraft to manage geopolitical tensions.

Strategic Concepts

Based on these insights, the research team recommends that the United States use the strategic concepts of **joint pressure** and **bound engagement** to guide its coercive economic statecraft policy.

The United States, coordinating with like-minded countries, should deploy **joint pressure** on China when using economic tools to respond to geopolitical escalation. Rather than acting alone, the United States should coordinate its responses with partner countries to maximize pressure on China, strengthen the ability of the United States to impose costs, and minimize China's ability to retaliate. While certain circumstances may require the United States to act unilaterally or as a first mover, this should be a rare exception to the general posture of joint pressure.

The United States should have a strategy of **bound engagement**, by which it engages in economic escalation in a manner bound by constraints embodied in domestic and international rules and norms. This may include a domestic legal framework for use of economic tools, binding international trade and investment rules, or norms such as the concept of a proportionate response to a provocation. It may include rules by which both the United States and China are bound, such as World Trade Organization obligations, or rules that the United States develops with partners to guide joint coercive economic statecraft and to which China is not a party.

Introduction

The United States has long used its position as the leading military and economic global power to advance its vision of a liberal world order.

However, the People's Republic of China (PRC) has posed a formidable challenge to America's leadership in recent years by offering an alternative model to existing international systems and norms developed and traditionally championed by the United States. As the Chinese Communist Party (CCP) consolidated its political power under Xi Jinping, clashes between the two systems over the future of economic and technological leadership have been increasingly fraught not only for U.S. national security but also that of U.S. allies.

To gain advantage in economic and technological competition, the United States and the PRC have traded blows in coercive economic measures, i.e., restrictions on trade, investment, and financial transactions intended to inflict costs on one another and induce policy change.¹ As both countries possess significant leverage in market power, financial flows, and supply chains, they have employed measures that are increasingly cross-domain, combining the economic, financial, and diplomatic spheres. When these countries impose coercive measures against one another, other states may be impacted by a cycle of economic coercion and retaliation, which complicates the geoeconomic calculus of all actors. Firms may be forced to choose between investing in the Chinese market or investing elsewhere and building redundancy in supply chains. Overall, these and related factors contributed to reduced bilateral foreign direct investment in 2020.²

Amid the increasing number of coercive economic measures imposed in recent years, the 2020 "Phase One" trade deal between the United States and China attempted a brief respite from economic hostilities. It promised expanded Chinese purchases of U.S. goods and

services to improve the U.S. trade balance with China and structural changes that would improve access for American firms that want to operate in the Chinese market. Nevertheless, China's commitment to fully implement its obligations remains uncertain, and the United States and China likely will continue to utilize both threatened and actual coercive economic measures over time.³ Indeed, since the trade deal was signed in January 2020, there has been a series of coercive economic measures between the two countries. Significant actions include targeted multilateral sanctions in reaction to China's treatment of the Uyghurs and significant Chinese counter sanctions, as well as the U.S. passage of the Hong Kong Autonomy Act and related sanctions in August 2020 in response to China's imposition of the National Security Law in Hong Kong.⁴

The use of coercive economic statecraft likely will remain a constant factor in the bilateral relationship for the foreseeable future. Yet, the United States lacks a clear strategy for how and when to deploy coercive economic tools to successfully manage geopolitical crises. Existing literature has not yet defined overarching strategic concepts to guide policymakers in this realm. That is what this report seeks to accomplish. To examine how the United States and the PRC may deploy coercive economic measures against one another in times of geopolitical crisis, the CNAS research team integrated analysis from unique scenario exercises, structured interviews with subject matter experts, and a literature review. This report lays out the design and methodology of the scenario exercises, consolidates insights from the exercises and further research, and concludes with an exposition of strategic concepts and specific recommendations for how U.S. leaders can utilize economic tools to navigate geopolitical competition with the PRC.

Throughout this report, the authors refer to the Chinese government or state as the People's Republic of China (PRC) and the party in power as the Chinese Communist Party (CCP). When discussing Chinese society and civilization at large, the authors will employ the conventional use of "China," e.g. "U.S.-China relations." When discussing the teams who played the role of China in the scenario exercises, the authors have referred to these teams as the "PRC teams."

Methodology and Scenario Design

Current scholarship does not sufficiently examine the economic escalation dynamics between the United States and the PRC, nor does it present principled frameworks that U.S. policymakers should operate by when considering the use of coercive economic measures against the PRC. To address these research questions, the CNAS research team leveraged an extensive literature review, a series of subject-matter expert interviews, and a set of scenario exercises. The literature review and structured interviews informed the development of the scenario exercises and also were used to supplement the insights derived from the exercises.

The scenario exercises were designed to focus on exploring economic coercion and potential escalation dynamics in the U.S.-China relationship. The research team ran the scenario exercise four times with participants with experience in government, private industry, and think tanks from the United States, Europe, and Asia, to better understand how the United States and the PRC might levy coercive economic tools against one another during heightened geopolitical tensions. Specifically, the exercises explored whether the PRC may be willing to levy coercive economic measures against the United States and how the United States could respond most effectively to China's arsenal of intensified economic coercion.

Insights from these scenario exercises could serve as a starting point to formulating a cohesive U.S. strategy in responding to the PRC's coercive economic statecraft. Following the scenario exercises, the researchers identified five insights from the scenario exercises and tested the validity of the insights through follow-on discussions with subject matter experts and comparisons with observed real-world behavior of the U.S. and the PRC governments. These insights are discussed in full in the following section.

Scenario Development

To develop the two scenarios used in the exercise, the research team relied on a literature review on economic statecraft to help frame the strategic environment and specific policy developments found in the scenarios. The team leveraged ample writing covering how states generally deploy economic statecraft to understand how states might deploy coercive economic tools to manage a crisis situation.

The scenarios were designed to ensure that the teams would devise either unilateral or joint economic actions to respond to flashpoints in U.S.-China geopolitical friction. David Baldwin's and André Beaufre's analyses find that economic statecraft is a highly salient tool of foreign policy and, when combined with political, diplomatic, and policy tools in other spheres, could become a highly effective means for achieving national objectives.⁵ As such, the scenarios were designed to involve more than simply economic statecraft or coercion, but rather crisis events that involved multiple levers of national power. This, in turn, encouraged the teams to employ economic and broader policy tools to further foreign policy goals in the exercises.

The literature on coercive economic tools, accompanied with real-world examples of countries using such tools, also proved helpful in developing the contours of the two scenarios. Building on the research team's previous publications on U.S. and PRC arsenals of coercive economic tools, the research team integrated additional literature on the those tools used by the two major economies.⁶ For example, Evan Feigenbaum's work, which offers five distinct categories of China's coercive economic measures—passive, active, exclusionary, coercive, and latent—provided the basis for China's activities in the two scenarios.⁷ Jennifer Harris and Robert Blackwill's extensive inventory of geoeconomic policies—trade, investment, economic and financial sanctions, cyber, aid, financial and monetary policy, and energy and commodities—were similarly useful when scripting the actions undertaken by China, the United States, and other countries or country groupings in the scenarios.⁸

The result was two scenarios of U.S.-China geopolitical escalation, and the summaries of these scenarios follow.



ASIA-BASED SCENARIO: PEOPLE'S REPUBLIC OF CHINA'S AGGRESSION ON TAIWAN

This scenario presented a crisis situation involving significant aggression from the PRC against Taiwan. In the scenario, the PRC aggressively implemented its National Security Law in Hong Kong, eroding the limited political and free speech rights under the “one country, two systems” framework. As Taiwanese policymakers and populace watched the developments in Hong Kong with agitation, there was increasing support in Taiwan for a referendum to rename the Republic of China to Taiwan and renegotiate the 1992 Consensus—an agreement reached between the PRC and Taiwan that there is only one China but allows for different interpretations by either side. This proposed referendum touches upon the PRC’s political redline on Taiwan’s status. In response, the PRC announced a range of diplomatic, economic, and military measures against Taiwan and warned American, European, and other multinational companies of severe restrictions or complete expulsion from the Chinese market if they supported Taiwan. To deter the PRC from military action on Taiwan, the U.S. Department of Defense held a press conference disclosing intelligence that the People’s Liberation Army Navy may have been planning to launch a blockade of Taiwanese ports.



EUROPE-BASED SCENARIO: REVIEWING CHINESE ACQUISITION OF SENSITIVE TECHNOLOGY

This scenario presented a crisis situation surrounding a potential Chinese acquisition of dual-use technology from a fictitious Italian company, which manufactured advanced robotics and lithium-ion batteries for use in autonomous vehicles. The company's research and production operations were based in Europe, but its customer base was split evenly between European and Chinese carmakers. European stakeholders argued that as the technology was European, the company did not need a U.S. export license to sell to Chinese carmakers. The U.S. Senate introduced legislation that would require foreign companies owned by U.S. companies to obtain export licenses to sell non-U.S. technology to China. This bill prompted a sharp reaction in China and Europe. As the amendment was being debated in Congress, a U.S. joint venture capital firm closed a 51 percent stake in the Italian firm. The U.S. Departments of Commerce, Energy, and Defense assessed that the firm's advanced robotics technology could have dual uses. Because of the new 51 percent stake by a U.S. company, the export of this technology from the United States to the PRC would require a U.S. export control license, giving the U.S. government jurisdiction to potentially block this export.

Scenario Exercise Design

The literature review also proved essential to the design of the scenario exercises. The research team reviewed the literature distinguishing different types of coercive economic tools to help provide structure for the exercises. Specifically, Henry Farrell, Abraham L. Newman, and Daniel Drezner's work on how countries weaponize their positions in economic networks for coercive ends inspired the research team to vary the objectives of the country teams and to select countries with varied stakes and positions on the global supply chain.⁹ Thomas Schelling's volume, *The Strategy of Conflict*, provided a useful concept of focal points in coordination scenarios, which are areas of common interest where actors could coordinate actions and calibrate expectations of each other's actions.¹⁰ This led the CNAS researchers to ensure there were opportunities for cooperation among the teams represented in the exercises.

The scenario exercise was run four times during the summer and fall of 2020. Each scenario exercise featured four teams. The two main teams across all four exercises were the United States and the PRC. The exercises also featured a Rest of World (RoW) team that varied across the two scenarios. In the Asia-based scenario, the teams included the United States, the PRC, Taiwan, and an RoW team consisting of perspectives from Australia, South Korea, Europe, and Japan. For the Europe-based scenario, the teams included the United States, the PRC, and Europe; the RoW team consisted of perspectives from Japan, South Korea, Australia, and Southeast Asia. The Europe team included countries, such as Italy and Germany, with stakes in the scenario.

Teams engaged in free play to enhance creativity and were not bound by a complex set of rules or formal adjudication that determined whether a decision was successful. Rather, the teams had to contend with crisis situations set up by the scenarios. However, there were some bounding mechanisms, such as the instruction to all teams that they were precluded from pursuing military action in the exercise in order to focus on economic statecraft and other supporting tools, such as diplomacy.

The teams also were periodically interrupted by "injects," or breaking events determined by the CNAS researchers to complicate decision-making or incentivize the teams to act. An example inject used in the scenario exercises was a news report observing that U.S.-China economic friction has adversely influenced the stock prices of major U.S. and European carmakers. In response to these injects and other events in the exercise, the teams had the opportunity to coordinate policy with other teams via bilateral and multilateral meetings.

The scenario exercises encouraged open-ended discussion and creativity in a loosely structured way. Experts were able to explore a broad range of policy options within their own teams or with other teams. The exercises provided the CNAS team with useful trends in behavior and in the usage of coercive economic tools to interrogate further through additional research and research interviews with subject matter experts.

Insights from Scenario Exercises and Further Research

The objective of this project was to examine the economic escalation dynamics between the United States and the PRC and develop principled frameworks that should guide U.S. policymakers when they consider the use of coercive economic measures against the PRC. Through a series of scenario exercises, subject matter expert interviews, and further research, the research team developed the following insights about potential behavior of the United States, China, and other countries when deploying economic tools to manage geopolitical crises.

INSIGHT



China may be willing to deploy the widest range of economic tools in response to a geopolitical conflict.

In the scenario exercises, the PRC team often levied the broadest range of economic tools in response to an escalation scenario, including official measures (e.g., retaliatory tariffs, economic embargoes, offers of preferential loans) as well as more "off-book" actions (e.g., targeted actions that press on economic interests of specific entities and typically fall outside the realm of official policies, such as boycotts encouraged through state propaganda). It also was generally able to act with greater speed. This may be an artifact of the personalities of the participants on the PRC teams, but it is more likely a representation of real-world dynamics in which the PRC's centralized governance system may entail less coordination with internal stakeholders or international partners and thus enable faster reaction times. In the Asia-based scenario, the PRC team took the off-book action of ceasing chip purchases that are produced by American firms in Taiwan. In the Europe-based scenario, the PRC team incentivized localization by offering preferential land rights and loans to a European company to acquire its dual-use technology.

The U.S. team's policy responses drew from a more limited set of tools, with a strong reliance on sanctions and export controls.

This observed behavior in the scenario exercises is consistent with real world trends. The PRC has strong state control over its economy and can exercise a huge range of punitive market access restrictions on foreign entities (e.g., denial of licenses), while also having considerable leeway to use positive commercial inducements (e.g., tax incentives, purchase commitments) to achieve geopolitical objectives.¹¹ China's significant real-world use of off-book measures is notable. For example, in response to the operationalization of the U.S. Terminal High Altitude Area Defense anti-missile battery in South Korea, the PRC levied an impressive suite of off-book coercive economic measures, such as market denial to the South Korean entertainment industry, restrictions on outgoing and incoming tourism, and embargoes on consumer products.¹² More recently, in 2021, the PRC government targeted Western companies in response to their condemnation of forced labor of the Uyghur people in Xinjiang. The PRC condemned companies participating in the Better Cotton Initiative (including Nike, Adidas, Burberry, and Zara) and mobilized state organizations and the larger Chinese society to economically punish H&M, such as the Communist Youth League denouncing the brand online and the privately owned ride-share app Didi dropping H&M from its search results.¹³

In contrast to the PRC's broad range of policies, U.S. policy reflects a differentiation between the coercive economic tools used to manage crises (mostly sanctions and certain export control authorities) and those more suitable for managing long-term economic and technology competition (e.g., the Committee on Foreign Investment in the United States [CFIUS]; the full range of export controls; information and communications technology; services trade restrictions; and cyber and economic espionage prosecutions). This latter bucket of tools often is tied to specific legal requirements that constrain policymakers from using the tools in a broader manner in response to geopolitical crises. For example, CFIUS action must be based on the assessment of a particular risk arising from a given transaction, and it cannot be used to broadly restrict or prohibit access to the U.S.

Off-book coercive economic actions are targeted actions that press on economic interests of specific entities and typically fall outside the realm of official policies, such as boycotts encouraged through state propaganda.

market. The PRC has developed many parallel regimes to U.S. and EU precedents, such as the PRC Ministry of Commerce's Unreliable Entity List, which parallels the U.S. Department of Commerce's Entity List, and the PRC Blocking Statute, which mirrors the European Union's blocking statute.¹⁴ However, these formal measures do not reflect the limits of state power as they do in U.S. and other rule-of-law based democratic systems. The United States cannot act unless permitted by its law. While the PRC has laws that parallel those of the rule of law-based democracies and establish a basis for coercive economic action, it also can use state control of economy to go beyond what is specifically permitted in law, as demonstrated by its extensive off-book actions.¹⁵

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The use of economic tools by the PRC and the United States during recent geopolitical disagreements related to Hong Kong demonstrates the contrast between the PRC's state control and its more expansive arsenal of coercive economic measures and the United States' law-bound and more limited policy arsenal. In June 2020, the PRC passed the Hong Kong National Security Law, which gives the PRC a basis for the enforcement of its national security laws in Hong Kong.¹⁶ This raised concerns in the United States about the autonomy of Hong Kong and led to U.S. sanctions on PRC officials responsible for the crises in Hong Kong. The PRC mirrored the United States in issuing retaliatory sanctions on U.S. officials but went beyond that proportional measure and pulled from its more expansive coercive policy tool kit to target American business interests, such as its all-of-society mobilization against the National Basketball Association (NBA), in response to one team manager's tweet of support for Hong Kong's protestors.¹⁷ Besides condemning the NBA's capitulation to Chinese coercive economic measures, U.S. lawmakers did not enact any market-based coercive economic measures against the PRC in response.¹⁸

Key Policy Implications: During periods of intensified geopolitical friction, the PRC might have the flexibility to respond either in a proportional manner or in an escalatory manner with its off-book measures. Moreover, the PRC's centralized decision-making process and its demonstrated familiarity and readiness with using economic coercion as part of its policy tool kit also could manifest in faster policy implementation. This poses a direct challenge to the United States, which may struggle to keep up with the speed and intensity of economic warfare and to align interests with its domestic actors and multilateral partners. The United States remains bound by domestic and international law considerations, and it starts with a default of an open economy with limited national security levers, whereas the PRC starts with a default of total state control.

INSIGHT



While both China and the United States may be willing to accept negative economic impacts to pursue geopolitical objectives, both also demonstrate a preference to broadly retain access to the other's market, which may constrain the use of the most extreme forms of economic coercion.

In both the Asia-based scenario exercise and the Europe-based scenario exercise, the PRC team was aware of the potential economic costs of coercive actions. However, this awareness did not constrain the PRC team from implementing coercive economic measures to maintain its political redlines. The PRC team employed policies such as tariffs and embargoes, which also hurt its own economy, to maintain core national interests. In contrast, the U.S. team preferred de-escalation, but doing so in a way that maintained U.S. principles. For example, the U.S. team wanted to defend the Taiwan team in principle, but also wanted to de-escalate tensions, which may have led the U.S. team to be more hesitant in deploying the full force of its economic arsenal. Because these two goals of de-escalation and principled action can be in tension, this may have watered down the U.S. team's response and allowed the PRC team to marginally gain more than they would otherwise. This preference for de-escalation also sometimes manifested in the U.S. team and other regional partner teams moving relatively slowly on coordination of policies.

Real world developments are consistent with the PRC team's tendency for escalation. When political redlines are crossed, the PRC has been willing to take short-term

economic hits. For example, the PRC has been willing to accept the economic impacts of the U.S. tariffs imposed following the section 301 investigation into Chinese trade practices rather than reforming core aspects of its industrial policy and state-controlled economy. The PRC's proposed tariffs on U.S. crude oil, which would hurt American crude oil producers but also dampen its own refineries, demonstrated that it is not afraid to take on some short-term economic costs.¹⁹ Moreover, it could rely on policy tools such as slashed taxes to cushion the negative economic impact of the tariffs.²⁰

The United States' observed conduct in the real world is more escalatory compared with behaviors of the U.S. team across all of the scenario exercises, possibly due to participants' perceptions of the sustained deterioration of U.S.-China relations over both the last and current administrations. The United States has been willing to absorb short-term economic consequences to deploy coercive economic tools both to manage times of acute geopolitical tension as well as to manage longer-term economic competition with China. For example, the 301 tariffs have negatively impacted American producers and consumers, and the U.S. government provided support to the agriculture sector to cushion the economic blow on this politically sensitive constituency.²¹ Under certain circumstances, however, the United States has practiced restraint while managing escalatory cycles. For example, in response to a massive hack into Microsoft Exchange tied to actors associated with the Chinese state, the Biden administration response was limited to the indictment of specified individuals responsible for the hacks.²² This was decidedly a more subdued policy option compared with more aggressive responses such as sanctions, particularly considering that the named individuals reside outside the United States and may be unlikely to face prosecution.²³

The willingness of the United States and China to accept negative economic repercussions from the use of coercive economic statecraft may differ based on the specific geopolitical circumstances of a conflict. During periods of high tension when no core interests are threatened, both the PRC and U.S. teams deliberated courses of action that would allow them to retain access to each other's economies. During the Europe-based scenario exercise, the PRC team did not have to contend with defending any of its core interests and its actions were correspondingly tempered. The PRC team sometimes deployed similar economic measures to the U.S. team in a tit-for-tat manner rather than taking escalatory measures, perhaps because it was reluctant to completely alienate the U.S. team for fear of losing market access to the United States.

The tendency of the U.S. and PRC teams to exercise restraint if no core interests are threatened is consistent with real-world observations and reflects the considerable integration of the U.S. and Chinese economies. Even though bilateral goods and services trade fell between 2018 to 2020, the PRC is still the largest U.S. goods trading partner, third largest U.S. export market, and largest source of U.S. imports in 2020.²⁴ Financial ties also have grown in recent years in the form of passive holdings in equity and debt by both sides.²⁵ Moreover, many institutional actors in the American stock market have exposure to Chinese bonds and stocks.²⁶ In a September 2021 phone call, President Biden referenced the need to “ensure competition does not veer into conflict,” whereas the PRC Foreign Ministry’s readout described the two leaders’ determination to avoid “letting competition veer into conflict.”²⁷ Perhaps recognizing the degree of interconnections, while the two countries often levy aggressive coercive measures against one another, they stop short of full rupture of economic relations.

Key Policy Implications: Both the PRC and the United States may be willing to escalate and accept economic costs under certain circumstances in order to achieve political objectives. Economic integration may serve as a necessary brake on unchecked escalation, but it is unlikely to prevent the continued use of coercive economic statecraft as an essential part of Chinese and U.S. foreign policy.

INSIGHT



Countries other than the United States may be more reticent to take coercive economic actions against China due to fears of possible negative economic and political consequences.

In the scenario exercises, teams other than the U.S. team and the PRC team were reluctant to use coercive economic measures due to concerns about the negative economic and political consequences from escalation with the PRC team. This reflected participants’ knowledge of the possible real-world economic consequences of reduced market access in China and the relatively larger impacts of this on smaller economies. In some of the scenario exercises, all non-PRC teams made conciliatory moves to the PRC team in attempts to prevent negative impacts on their own economies.

During the Asia-based scenario, the U.S. and RoW teams had strong preferences to de-escalate tensions with the PRC team. The U.S. team was motivated to de-escalate to prevent sustained escalation in both economic and non-economic realms, whereas the RoW team was more concerned with economic ripple effects. This aligns with real-world patterns in the Indo-Pacific, where regional stakeholders are sensitive to the PRC’s economic influence. For example, in 2010, the PRC

limited exports of rare earth elements after a Chinese fishing boat and a Japanese coast guard patrol vessel collided off disputed islands in the East China Sea. At the time, the PRC mined 93 percent of the world’s rare earth minerals.²⁸ Even though this development spurred Japan to enact policies to reduce its rare earths dependence, in the short term, Japan had to make policy concessions to the PRC by releasing the detained captain from the maritime dispute.²⁹ While the United States, the European Union, and Japan eventually were able to successfully litigate a case against the PRC at the World Trade Organization, the incident illustrates why countries may be wary of the significant economic leverage that the PRC enjoys and is willing to deploy for geopolitical reasons.³⁰ Similarly, in 2012, the PRC restricted banana



In October 2019, protestors throw basketballs at a hoop with Hong Kong Chief Executive Carrie Lam’s photo on it in response to a tweet from the Houston Rockets’ General Manager Daryl Morey in support of Hong Kong protest efforts. His tweet incited significant backlash from the People’s Republic of China (Billy H.C. Kwok/Getty Images)

imports as part of a broader political dispute with the Philippines in the Scarborough Shoal and successfully forced a concession from Manila.³¹

During the Europe-based scenario exercise, the Europe team highlighted the fact that EU member states have varied levels of stakes in the Chinese market. This complicated the Europe team's collaboration with the U.S. team and may have contributed to its preference for de-escalation with the PRC team in the scenario exercises. The more hesitant approach of the EU team is consistent with real-world observations, as the economic interests of prominent member states in the Chinese market may make EU-level coordination of a stronger stance on the PRC difficult. For example, Germany accounts for nearly half of EU trade with the PRC. Italy and Greece, along with many other European countries, had signed onto the PRC's Belt and Road Initiative.³² China has looked to amplify these divergences, meeting separately with at least 17 central and eastern European countries.³³ In addition to fluctuation in trade and investment dynamics between European countries and the PRC, sustained U.S.-China economic friction could lead to costly restructuring in global value chains.³⁴

During periods of high tension when no core interests are threatened, both the PRC and U.S. teams deliberated courses of action that would allow them to retain access to each other's economies.

The divergence of interests and preferences between the U.S. team and its partner teams made policy coordination difficult. Across the scenario exercises, the U.S. team and non-PRC teams had vigorous debates with one another over the design and potential impact of coercive economic tools. The U.S. team was determined to organize collective countermeasures, as it recognized joint action could magnify deterrent impact against the PRC team, but was often unsuccessful in its efforts to coordinate joint action with partner teams. This aligns with real-world patterns of behavior, as divergent strategic interests and legal systems have slowed coordination between Washington and allies in Europe and Asia, though recent developments indicate that key allies are becoming more open to increased pushback on the PRC.

In Europe, persuading all EU member states to recognize the threat presented by the PRC has been

difficult, though the EU did take an important step in naming the PRC as a “systemic rival” in a June 2020 white paper.³⁵ The EU and EU member states also have set up new investment screening mechanisms to address concerns with Chinese investments in the EU market.³⁶ Moreover, the EU was willing to stand firm on Xinjiang sanctions with the United States, Canada, and the United Kingdom, even when the Chinese retaliation effectively terminated the years-long process of negotiating the EU-China Comprehensive Agreement on Investment. In other areas, such as export controls, EU action has not advanced as far as the United States may desire though both sides have signaled a need for closer cooperation.³⁷ Notwithstanding these developments, the EU governance structure and divergent economic interests of member states likely will continue to present challenges for holistic and expeditious U.S.-EU cooperation on coercive economic statecraft.

In the Indo-Pacific, key partners express reluctance to choose sides between Washington and Beijing but also are becoming wary of the PRC's economic coercion.³⁸ Australia, for example, historically has tried to balance security ties with the United States and economic interests with China. It has become more wary in recent years to concede to the PRC, especially given the PRC's bans on key Australian goods such as live seafood, beef, barley, and timber in May 2020 after Australia requested an inquiry into the origins of COVID-19.³⁹ Citing trade tensions without naming the PRC's coercive measures over Australian imports, Japan and Australia issued a joint statement after a defense ministerial dialogue in June 2021 that opposed “coercion and destabilizing behavior by economic means” in the international system.⁴⁰



Rare earth magnets are crucial building blocks of almost every electronic gadget. The People's Republic of China has leveraged its dominant position in the rare earths supply chain to economically coerce other nations. (Nelson Ching/Getty Images)

Key Policy Implications: The reluctance of partner nations to employ joint coercive economic measures against the PRC may lead to policy impasse or less effective responses that could embolden PRC coercive economic statecraft. The PRC may be able to leverage this dynamic to provide targeted incentives or retaliation against partner nations or companies to further erode already limited support for U.S.-led joint actions. The United States may need to weigh the impact of retaliation on the U.S. economy, as well as the appetite of possible partners for absorbing negative economic consequences, when determining a strategy for deploying coercive economic measures.

INSIGHT



The United States may be advantaged by its alliances, and its ability to act jointly with allies may compensate for the narrower set of economic tools the United States is willing to use to manage geopolitical tensions.

The U.S. team was aware of the more limited tools it had in its coercive economic tool kit but recognized that it could leverage its relationships with partners to coordinate more effective policy responses to the PRC team's coercive actions. Across the Asia-based and Europe-based scenario exercises, the U.S. team showed a preference to lobby partner teams to take strong joint action, noting that coordinated action would deter the PRC team more than unilateral measures. Moreover, the U.S. team was cognizant that friction likely would arise from unilateral or extraterritorial application of U.S. policies and laws. In parallel, the PRC team's primary concern was to prevent unified action against itself. The PRC team levied economic measures during the exercises to exert pressure on and divide the other non-U.S. teams, though in some instances its overly aggressive posture led to backlash from the other teams. In one instance, the PRC team's aggressive stance prompted collective action from other teams.

This comports with recent real-world developments in which the United States increasingly has leveraged its relationships with partners to deploy coercive economic tools against the PRC, an effort that has been reinvigorated under the Biden administration. Recently, there has been increasing transatlantic cooperation on countering the PRC's coercive practices.⁴¹ For example, the United States and the EU recently launched the U.S.-EU Trade and Technology Council, which includes outcomes

related to investment screening and export controls, in an increased effort to coordinate efforts for these specific coercive economic tools.⁴² Similarly, the United States has refreshed efforts to coordinate with Indo-Pacific partners, though efforts to coordinate specifically on coercive economic statecraft are less advanced than those with Europe. In March 2021, the U.S. and Japanese foreign and defense ministers issued a joint statement voicing concerns over the PRC's generally combative behavior that contributes to "political, economic, military, and technological challenges."⁴³ Nations in the Indo-Pacific have also started discussing realignment recently among themselves. In May 2021, Australia and New Zealand announced "support for open rules-based trade that is based on market principles" and pushed back on "hardball trade diplomacy."⁴⁴ In June 2021, Japan backed Australia's response against Chinese economic coercion.⁴⁵

Key Policy Implications: The United States may be more capable of successfully using economic tools to manage geopolitical tensions by acting in concert with economic partners. Joint action with partners may allow the United States to gain increased leverage vis-à-vis the PRC, even if the joint action is based on a narrower set of policy tools than are available to the PRC. Noting the potentially limited appetite of partners to take coercive actions against China, the United States may need to remain flexible on the exact configuration and objectives of particular partnerships dependent on the circumstances of a given escalation situation. It also may be forced to consider whether the United States should act either unilaterally or as a first-mover, and the potential undermining effect that this may have on the U.S. advantage of alliances.

INSIGHT



Persuasive rather than coercive tactics may best improve the United States' negotiating position when it seeks to use economic statecraft to manage geopolitical tensions.

In the Europe-based scenario exercise, the Europe team was broadly aligned with the U.S. team on certain objectives, such as limiting technology transfer to China. However, the Europe team was reluctant to sign onto overly aggressive coercive economic measures and objected to measures that infringed upon their own sovereignty, particularly if they had not been consulted in advance. When the U.S. team used a more persuasive rather than coercive approach to policy coordination with its partner teams, it was successful in leveraging the crisis to achieve longer-term aims. This in-scenario

dynamic seems consistent with real-world developments. With persistent persuasion, the United States has coordinated successfully with allies in the real world. For example, the United States has been able to promote the establishment and strengthening of investment screening mechanisms in key partner countries through a multiyear diplomatic and technical assistance effort.⁴⁶ The United States has had successful negotiations with the EU and the United Kingdom to develop joint approaches to addressing concerns related to China's aerospace industry, including an unprecedented commitment to cooperate on screening investments from U.S., EU, and UK firms into the Chinese market.⁴⁷ The budding U.S.-EU Trade and Technology Council with the European Union may yield promising results, although success is hard to measure given early stages of this cooperation.⁴⁸

In contrast, the United States has struggled to achieve its aims when leaning more heavily on coercive tactics that negatively impact its partners. For example, national security-related tariffs imposed on steel and aluminum imports primarily served to alienate the EU, Canada, Japan, and other partners while having minimal impact on overcapacity of global steel and aluminum production driven by the PRC.⁴⁹ Similarly, efforts to undermine the commercial viability of Huawei through listing the company on the entity list, essentially barring them from receiving critical U.S. technology, did not inspire partner countries to similarly embargo Huawei equipment for their domestic telecommunications infrastructure. Moreover, the United States was coercive in its campaign to get partners to ban Huawei hardware. It threatened to withhold intelligence sharing, and partner nations such as New Zealand, Britain, and Germany responded with resistance.⁵⁰ Many countries ultimately banned Huawei equipment or have initiated review processes to evaluate Huawei hardware's implications for national security, but the U.S. government's coercive approach may have eroded the basis of trust between allies.⁵¹ For example, although the United Kingdom did eventually prohibit use of Huawei equipment in November 2020, which went into effect in September 2021, the U.S. government's coercive campaign may have added unnecessary friction with this transatlantic partner.⁵²

Key Policy Implications: If the United States levies unilateral or extraterritorial measures that impact its partners, it could erode the strength of its historical alliances with key partners. The United States may be more successful if it leverages its asset of historical alliances, refrains from use of unilateral tools, and develops a persuasion-first framework when seeking to coordinate economic action with its partners. While coercion is a necessary element of managing the relationship with China, it undercuts the U.S. negotiating position when used against allies.

Joint Pressure & Bound Engagement: Strategic Concepts for U.S.-China Economic Escalation

This report seeks to develop strategic concepts that the United States may use to guide its actions during times of economic escalation with China. A strategic concept encapsulates a strategy or set of ideas for how national power ought to be deployed. A strategic concept is not tactical, operational, or doctrinal.⁵³ It is not tactical, as it does not entail a series of actions planned to achieve a specific end. It is not operational, as it does not plan and conduct campaigns. It is not a doctrine, as it does not provide official guidance on a country's conduct in foreign policy. A strategic concept is not as high-level as a doctrine but is more all-encompassing than operational and tactical processes. It provides an overall framework under which operational principles and tactical plans are developed. For example, NATO's 2010 strategic concept—"Active Engagement, Modern Defence"—guides the member states of the alliance to respond to national security challenges.⁵⁴ Domestically, the Department of Defense is incorporating the strategic concept "integrated deterrence" into the 2022 National Defense Strategy, which means the United States will integrate with allies and partners and take advantage of multiple instruments of power to respond to adversaries.⁵⁵

Drawing on the insights from the scenario exercises and further research conducted, we propose that the United States adopt the strategic concepts of joint pressure and bound engagement to manage economic escalation with China. When developing the strategic concepts, the research team focused on the use of coercive economic tools to manage situations of geopolitical escalation short of an active shooting war between the United States and China. Within an escalation dynamic, the research team assumed that the overarching policy objectives are to defend U.S. principles and interests, prevent economic conflict from causing escalation in other domains, and preserve stability in the global economic order. The strategic concepts are best employed to manage short-term geopolitical crises. They were not designed to guide the United States as it manages the broader bilateral economic competition or if it were forced to manage an active shooting war, though there may be elements of the strategic concepts that could apply in those contexts as well.

Strategic Concept #1: Joint Pressure

The United States, coordinating with like-minded countries, should deploy joint pressure on China when using economic tools to respond to geopolitical tension. Rather than acting alone, the United States should coordinate its responses with partner countries to maximize pressure on China, strengthen the ability of the United States to impose costs, and minimize China's ability to retaliate.

The research insights suggest that alliances strengthen the ability of the United States to successfully deploy economic tools to manage geopolitical tensions and that unified action may compensate for the more limited set of economic tools that the United States is willing or legally able to deploy. Taking unilateral actions in the economic realm forces the United States to engage with China as a peer competitor. Leveraging the combined

weight of the U.S. market with that of other significant economies places the United States—and its partners—in a comparatively stronger position to coerce, deter, or negotiate with China. Joint pressure with the European Union, as the world's third largest economy after the United States and China, will be critical to maximizing pressure on China. Joint pressure also minimizes the risk that China can blunt the impact of U.S. actions through trade diversion tactics or substitution of alternate sources of capital, goods, or services.

The research insights also suggest that other countries are more reticent to take coercive economic actions due to negative economic or political repercussions. A strategy of joint pressure may mitigate this concern by diffusing the ability of China to retaliate against specific actors.



The U.S. government has launched an assertive campaign against Huawei technology domestically and internationally. Domestically, policy efforts cut across the Federal Communications Commission and the Departments of State and Commerce, among others. Internationally, the United States has appealed to other nations to exclude Huawei equipment in their national 5G infrastructures. Pictured here are production line workers at Huawei's campus in Dongguan, China. (Sean Gallup/Getty Images)

RECOMMENDATIONS TO IMPLEMENT JOINT PRESSURE

Develop U.S. strategy and operational plans for using economic tools to manage geopolitical tensions.

The United States first must mature its own strategy for using coercive economic statecraft before it can develop joint plans with potential partner countries. The strategic concepts laid out in this report are a necessary first step in that effort, but they must be followed by more detailed and comprehensive strategic planning. Progress has been made in coordinating the use of certain economic tools to manage longer-term economic and technology competition with China, such as the closer linkages between export controls and CFIUS resulting from 2018 legislative reforms. However, the United States does not have an overarching strategy on how to respond to malign economic actions from competitor nations. Because it does not have a strategy, it naturally does not have supporting operational plans for deploying and coordinating all of its economic tools to manage geopolitical crises. It must develop a strategy that will guide future economic operational plans if economic tools will continue to be a part of broader efforts to manage the geopolitical relationship with China. The United States also should consider how economic tools can be used in tandem with the Department of Defense's integrated deterrence concept, which envisions using multiple tools of national power.

Initiate joint strategic planning with allies based on U.S. strategy.

To apply joint pressure, the United States and partner countries should initiate joint strategic planning for deploying coercive economic tools in times of geopolitical tension. The research insights demonstrate that the United States and its allies tend to be slower to react than China and that they have significant difficulties coordinating policy due to divergent economic and strategic interests. To mitigate these potential vulnerabilities, the United States can engage in strategic planning efforts prior to the start of an escalation. This can facilitate faster, more cohesive responses among like-minded countries. Importantly, it also can uncover areas of policy disagreement, friction between different legal regimes, and divergent risk tolerance and threat perception in advance of a geopolitical crisis. The United States and partners can work to resolve these tensions during times of calm, including through the implementation of changes to their respective legal regimes as needed.

Conduct joint economic exercises with partners.

Given the novelty of attempting to develop and implement joint economic strategic planning, the United States and its partners should conduct economic exercises to pressure-test their joint strategy. Similar to the scenario exercises conducted during the research for this report, economic exercises can enable the United States and partners to have a frank dialogue about threats and thresholds, more readily identify gaps in their strategy to refine and strengthen it, and identify areas of cooperation or complementarity. Joint economic exercises also can build the necessary institutional and personal relationships that will be critical to enable smooth, rapid responses in a crisis scenario.

Be prepared to act alone or as a first-mover, if circumstances warrant.

While this recommendation appears to undercut the concept of joint pressure, a realistic U.S. strategy will recognize that joint action may not be possible in all circumstances. The policy divergences between the United States and allies that emerged during the scenario exercises reflect genuine differences in strategic interests and interpretation of the threat posed by China. The United States should endeavor to persuade partners to join it when it contemplates coercive economic action, including through high-level political engagements and the sharing of intelligence that supports a case for action, as joint pressure significantly increases the odds of prevailing in a crisis scenario. While several of our recommendations, such as the development of a joint strategy and conducting economic exercises, seek to build consensus to enable joint or multilateral action, the United States also must be pragmatic about the likelihood that joint pressure will be possible in every instance in which it seeks to engage. To avoid undermining joint pressure through the use of unilateral actions, the United States should consult proactively with partners to minimize collateral damage on partners' economies as well as to maintain a general posture of joint pressure. Doing so also might reduce the risk of other unintended consequences such as trade diversion. Unilateral actions should remain an exception to the general rule of joint pressure.

Strategic Concept #2: Bound Engagement

The United States should have a strategy of bound engagement in which it engages in economic escalation in a manner that is bound by constraints embodied in domestic and international rules and norms. This may include a domestic legal framework for use of economic tools, binding international trade and investment rules, and norms such as the concept of a proportionate response to a provocation. It may include rules to which both the United States and China are bound, such as World Trade Organization (WTO) obligations, or rules that the United States develops with partners to guide joint coercive economic statecraft and to which China is not a party.

The research insights suggest that China may have an asymmetric advantage in economic conflict due to the wider range of economic tools available under a state-controlled system. The U.S. objective, however, should not be to match Chinese tools in a tit-for-tat fashion. While wide-ranging economic retaliation may be effective in imposing costs in the context of a short-term crisis, extensive use of unchecked economic retaliation over the long term can undermine the predictability of the global economy and the attractiveness of a domestic market. Economically and strategically, the United States benefits from a global economy that operates under predictable rules and norms. By engaging in economic escalation that is within the bounds of rules and norms, the United States can reinforce the need for rules-bound engagement by all actors and support the sustainability of the rules-based system as a whole. Bound engagement also may reduce the risk that use of economic tools will lead to retaliation in other domains, such as cyber, by virtue of the inherent constraints of this approach.

Extensive use of unchecked economic retaliation over the long term can undermine the predictability of the global economy and the attractiveness of a domestic market.

Critically, bound engagement should not be taken to mean passivity. A strategy of bound engagement means that the range of U.S. actions that may be taken is understood by all actors, which promotes predictability and stability. To the extent that existing rules are insufficient to

provide the basis for an effective response against Chinese economic coercion, the United States likely will need to develop an enhanced set of rules. Those rules could enable wider-ranging, more aggressive actions against China that are still within the concept of bound engagement.

The research insights also suggest that the United States is most successful in managing crisis scenarios when it relies on persuasive rather than coercive methods when building coalitions. Bound engagement necessarily constrains the use of the most coercive methods, as actions would be limited by agreed rules and norms and aggressive unilateral actions outside these rules and norms would not be pursued. While certain actions (e.g., sanctions) are inherently coercive in nature, bound engagement would constrain a more aggressive or unpredictable use of coercive tools, particularly in peacetime scenarios or situations where such actions could have negative repercussions for allies.

RECOMMENDATIONS TO IMPLEMENT BOUND ENGAGEMENT

Communicate clearly to partner and competitor nations about the domestic U.S. legal and policy framework for the use of economic tools to manage crisis scenarios.

The United States has an established set of economic tools that may be deployed in response to an escalation scenario. The United States, however, has not effectively communicated the conditions under which each tool would be deployed, how such deployment would further specific U.S. foreign policy objectives, and the conditions under which a restriction may be eased. This has led to confusion over which economic tools are suitable for use in crisis management and which are more suited for the management of long-term economic and technology competition. This problem is particularly acute when the same tool could be used for multiple objectives. For example, entity list designations and the accompanying trade restrictions have been used to address concerns as varied as intellectual property theft, human rights concerns, and technology competition. To be effective at using economic tools to coerce actors to behave in a certain way, the United States must be clear about the specific behavior it seeks to address and the conditions under which it will deem the coerced entity to have complied. The Treasury's 2021 Sanctions Review is an important step in the right direction, as it emphasizes similar themes regarding clarity of policy objectives and assessing unintended consequences of sanctions.⁵⁶

Enforce international and bilateral economic rules.

Bound engagement requires that existing rules be seen as credible constraints on state behavior, highlighting the importance of enforcing China's existing trade and investment obligations. In instances in which China violates commitments it has made under the WTO, the Phase One agreement, or other international trade agreements, the United States should avail itself of all available options to enforce its legal rights and hold China accountable for violations of its commitments. Enforcement of China's international trade and investment obligations will not be sufficient in and of itself to deter future coercive behavior, particularly given that some of China's coercive economic actions may be difficult to litigate under existing trade and investment rules. However, enforcement is an important piece of an overall approach to raising the political cost for China when it does violate rules or norms. Consistent with the joint pressure concept, enforcement actions that can be taken in coordination with partner countries may be most effective in imposing political costs on China.

Consider new plurilateral mechanisms to develop international rules for use of coercive economic tools.

No existing international institution has the mandate to set broad rules for the use of coercive economic statecraft or coordinate implementation among its members. While the WTO clearly binds its members to trade liberalization commitments, it does not lay out a framework for how states might use economic tools appropriately for coercive purposes, as such policies would fall largely under the WTO's essential security exceptions and remain in the exclusive competency of the member economies. Efforts in the Group of 7 to coordinate certain aspects of coercive economic statecraft are helpful for the purposes of aligning political objectives and setting loose norms, but those efforts are insufficient to operationalize the agreed-upon abstract concepts. The Financial Action Task Force, a multilateral effort to enhance sanctions, has a mission to counter the threats of the abuse of the financial system by criminals and terrorists and likely would not be a forum in which the United States could coordinate coercive sanction actions with partner countries. Multilateral export control regimes, including the Wassenaar Arrangement, focus on preventing harmful technology transfer as opposed to the use of technology controls as a means of coercive economic statecraft.

The lack of agreed-upon norms or rules heightens the challenges of implementing the first recommended strategic concept (joint pressure), as like-minded countries are left to navigate complex legal and policy matters on the fly during an escalation scenario. Building on the recommendations of that section, the United States should examine the viability of plurilateral arrangements with its closest partners to develop specific rules that would more closely align the legal regimes underpinning the coercive economic tool kits of each partner country. A plurilateral agreement on export controls, for example, could strengthen the ability of the United States and partners to use technology controls to respond to Chinese provocations. Cooperation with allies is currently limited by a narrow conception of what constitutes a national security risk under Wassenaar and correspondingly narrow sets of legal authorities in partner countries to impose new export controls for broader foreign policy purposes. A new plurilateral export control agreement could mitigate these limitations.⁵⁷

Do not rule out the possibility of direct negotiations with China.

Strengthening the rulebook for the United States and partners is an important part of a broader strategy and will yield important benefits for the stability of the global economy. Yet, these efforts are necessarily indirect, as they do not require a commitment from China nor do they create binding rules with which China must comply. The United States should not rule out the possibility of negotiating directly with China to address concerns with its coercive economic practices and to pursue binding commitments from China. Both countries have an interest in ensuring that economic tensions do not spill over into conflict. As the research insights highlight, both nations have a long-term interest in maintaining access to each other's markets.

While leaving the door open to direct talks, the United States should approach any such discussions with appropriate skepticism and calibrated expectations. Neither side is likely willing to forgo the use of coercive economic statecraft, which is wholly integrated into the foreign policy of both countries. It is equally unlikely that China and the United States would agree to broad limitations on the use of specific coercive economic tools. A more realistic objective would be for the United States to engage directly with Chinese counterparts in instances of specific escalation, to ensure that economic conflict remains contained to the economic realm and to

establish clear conditions for the removal of economic restraints. Should improved political conditions permit a broader trade negotiation with China, disciplines on China's off-book measures should be included as a negotiating priority, again with pragmatic expectations on how much progress could be achieved in constraining Chinese behavior.

Conclusion

Coercive economic statecraft is likely to remain a prominent feature of the U.S.-China relationship. Economic tools increasingly will be part of each side's response to geopolitical escalation, with significant potential to disrupt trade and investment flows and undermine the stability of the global economic order. As it engages in coercive economic statecraft, the United States must pursue its near-term policy objectives while not undercutting its long-term strategic interest in a stable global economy. The strategic concepts of joint pressure and bound engagement—and the accompanying recommendations of this report—can guide policymakers as they seek to strike this delicate balance in a complex, multipolar geopolitical dynamic.

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