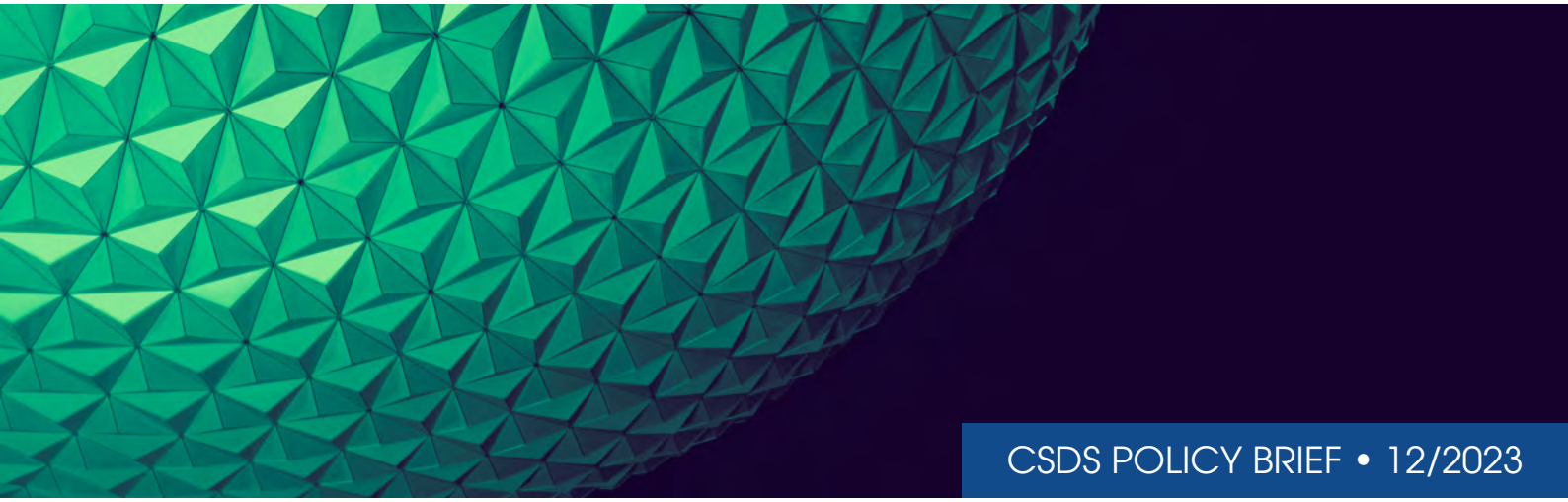
BRUSSELS SCHOOL OF GOVERNANCE
CENTRE FOR SECURITY, DIPLOMACY AND STRATEGY



CSDS POLICY BRIEF • 12/2023

Counter-order: Chinese Power, the West and Geo-economics

J. Alexander Thew, Daniel Fiott, Frank Finelli and Mickey P. Strasser | 26 April 2023

Key Issues

- Western countries need to reflect on their economic statecraft, as they are not sufficiently calibrated for the growing geo-economic aspects of great power competition.
- China is spearheading a counter-order to the American-led economic system that has prevailed for decades. Beijing is using capital, resources and dependencies to accrue power.
- Economic statecraft in the West must focus on maintaining the supremacy of currencies and raw material stocks, while also safeguarding against privately-controlled cryptocurrencies and revitalising its economic diplomacy with developing countries.

Global order over the past three decades has been governed by the rules and institutions set by the United States (US) and West. Globalisation has led to increased trade and this has contributed to a reduction of poverty and higher standards of living across the globe. China has been one of the main beneficiaries of this trend. Yet, rising incomes and integrated markets have become somewhat of a double-edged sword because the wider distribution of resources means any war will result in high economic costs. The idea that globalisation, interdependence and trade will bring world peace has been challenged. If anything, wider access to wealth, industry and capital has led to the military modernisation of states that want to subvert the very order that led to their development.

This Policy Brief looks at how rival powers such as China are using economic statecraft to enhance their relative power and subvert the Western order that has prevailed since at least 1944.

Our arguments in this Policy Brief are based on observations made at an international security seminar held at the US Military Academy, West Point, on 9-10 February 2023. During this seminar, the authors were part of panel discussions as moderators, speakers, discussants and rapporteurs and they exchanged views on the evolution of geo-economics and global strategic competition. In this regard, this second piece in a series of three Policy Briefs from the international seminar provides a window into the growing importance of economic forms of power and the weaponisation of economic interdependencies. Needless to say, we write here in our personal capacities and none of the content herein can

be attributed to our respective employers.

Creating the counter-order

China is a major economic power but it is ruled by a single, authoritarian, political entity called the Chinese Communist Party (CCP). In this sense, the Chinese "state-capitalist" economic model is different to those found in the US and Europe. The CCP is in a position to align its economic and geopolitical strategy. For example, China has offered negative real interest rates to subsidise loans to State-Owned Enterprises (SOEs), which has fuelled Chinese firms' global expansion, drowned out fair competition and supercharged China's industrial development. While Russia sits on a vast array of resources and appears today to be closer to the Chinese economic model, the world is steadily bifurcating between the American and Chinese economic models.

However, the US and China are still engaged in an economic relationship of convenience. The West's wealthy consumer base supports China by importing its goods. Only relatively recently have we seen measures to "reshore" or "near-shore" manufacturing capacity back to the West and to protect key industries (e.g. semiconductors). Given the economic interdependencies between the West and China, and in the context of growing strategic rivalry, a greater focus on economic security is to be expected. However, this focus cannot be confined to lowering trade dependencies. To be sure, ensuring that Chinese technologies cannot be used for the purposes of espionage, surveillance and/or sabotage (e.g. 5G) remains an important priority.

The US dominated global financial system is being questioned by China. Should the Chinese yuan effectively challenge the dollar in parts of the global financial system, then capital flows could shift more easily in China's favour. China and its like-minded partners have a vested interest in weakening the dollar, even if they do not want the responsibility and cost of becoming the world's reserve currency. What is more, China has a stake in not weakening state power in global currency markets more generally. Indeed, in 2021 Beijing outlawed crypto trading and mining. Such steps were taken as the rise of bitcoin led to capital outflows from China and a depreciation of the renminbi.

The US dollar will likely maintain its dominance for the foreseeable future, but China is able to erode Western economic power in other ways – not least by deploying infrastructure and aid programmes. China's "Belt and Road Initiative" (BRI) is both infrastructure and aid development because it seeks to increase interdependencies between Beijing and developing countries. China seeks to use the BRI to globally promote its SOEs and norms, and ensure that the developing world sides with Beijing. To this end, China coats its interactions with normative pleas to historical anti-colonial movements, all while pursuing its own national interests.

Although there have been reports about the supposed demise of the BRI, the Chinese state holds to the idea of investing US$1 trillion until 2027 in infrastructure projects such as roads, railways and ports in over 70 countries. The challenge facing China is how to effectively leverage these BRI infrastructure projects when recipient states do not share China's normative view of the world or interests in international fora such as the United Nations. In such cases, China needs more than economic inducements and so it may choose instead to use its diplomatic and military power to coerce BRI partners. China is already opening military bases in Africa.

China's efforts have given rise to US and European Union (EU) alternatives called the Build Back Better World (B3W) and Global Gateway initiatives, respectively. These initiatives offer developing countries an alternative because the sustainability of the BRI could be called into question in the future. Any major economic shock in China or change in the CCP's economic strategy could choke inward investment flows to developing nations, which would be destabilising.

Alternatively, the growing dependency of developing countries on China could benefit the CCP for more than just economic reasons. For example, if these countries default on debt payments, they could become even more dependent on China because these financial agreements are often collateralised with rights to critical infrastructure. This, in turn, could lead developing countries to "hand over" strategic infrastructure assets (e.g. ports and electricity grids) to China in the form of direct ownership or favourable concessions. High profile cases in Ecuador and Sri

Lanka already point to some of the fears associated with the BRI.

Furthermore, there is also evidence to suggest that China will weaponise its vast wealth in critical raw materials. China's relations with countries in Asia, Africa and Latin America are partly predicated on the strategy of securing further global supplies of raw materials. Both the US and the EU are taking steps to ensure access to supplies of materials, but the challenge facing Western countries is that resource needs will only increase with the technological demands of the digital economy. We already see how governments in the West are becoming more aware of the importance of critical minerals: in 2018, the US listed 35 minerals that were deemed critical for the economy and national security, but this list was increased to 50 in 2022.

The currency of power

In addition to China's strategy, there is a need to think about the overall health of the global financial system. For example, cryptocurrencies seek to circumvent state authority by verifying transactions and maintaining records with a cryptographically based and decentralised system. Although China and other countries have sought to ban or strictly control cryptocurrencies, there are still high adoption rates in emerging markets and bitcoin even bounced back within months of China's ban. While cryptocurrencies and blockchain technology still fail to substitute traditional government-backed currencies, and are as yet to be tested as a viable alternative on a global scale, they are an issue of growing concern to governments.

In fact, the regulation of cryptocurrencies might be one of the few areas where China and the US currently agree, though China appears to be on a much more aggressive path for implementing a central bank digital currency, which could be quite disruptive. State-backed currencies have allowed governments to both regulate the global economy and exercise state power (e.g. central banks manage prices and inflation). For this very reason, advocates of cryptocurrencies tend to be ideologically opposed to the role of the state in the global financial system, and cryptocurrencies are seen as a way of decentralising financial transactions.

Questioning the role of governments clearly threatens to up-end traditional forms of global financial governance. Here, crypto entrepreneurs seek – but have so far failed - to supplant the state's traditional role of ensuring trust between sellers and buyers. Indeed, the increasing uptake of cryptocurrencies threatens to make it harder for the West to impose sanctions on hostile individuals, firms or states. For example, cryptocurrencies have the potential to skirt the SWIFT banking system entirely – this system handles more than 44 million financial messages per day.

Cryptocurrencies raise serious public policy concerns. For example, there is no agreed international tax system for goods and services traded with cryptocurrencies. Tax avoidance and evasion through cryptocurrencies can undermine state tax-takes and dent public budgets for critical spending areas such as defence. In this respect, cryptocurrencies could overlap with the creation of new tax havens and expanded illicit activity, which could be instrumentalised by state rivals and/or criminal organisations.

Relying on cryptocurrencies implies a greater need to enhance cybersecurity protocols and the protection of the electronic information network. It is questionable whether a decentralised currency has the resources or political authority to provide such security and assurances. The US and its partners have a vested interest in not seeing cryptocurrencies finance illicit economic activities. With this decentralised currency system in place, it would be certainly harder to trace and punish illegal activities – some research already claims that 23% of all cryptocurrency transactions are associated with criminal activities.

The challenge facing the West and China in the coming years is how to benefit from digitalised banking, while still being able to control the negative effects of this evolution in financial markets including greater control of these currencies by private actors. Both the US and EU are exploring the benefits and possibilities of introducing a "digital dollar" or "digital euro", but both have taken a rather cautious approach to the issue. China, for its part, has been more adventurous in the pursuit of a "digital yuan" and the government sees it as a way to boost domestic equality and economic growth. Thus,

while China, the US and Europe all want to maintain political control over innovative currencies, the full geo-economic implications of the introduction of digital currencies are unknown but some features are becoming clearer. This includes how China could utilise a "digital yuan" to facilitate cross-border payments to reduce the impact of U.S. sanctions.

The demands of dominance

In this second Policy Brief in a three-part series, we have discussed some of the geo-economic undercurrents at play in the rivalry between the US and China. Clearly, strategic rivals like China have a vested interest in challenging – while not fully replacing – the dominance of the US dollar, but we have also touched upon the interplay between finances and infrastructure, aid and currencies. The logic that has guided us in this Policy Brief is a belief that state planners in Western countries are still behind the curve in developing strategies of economic statecraft. While it is true that the US, the EU, Australia, Japan and others are rapidly developing their economic security strategies, we have tried to show how capital flows, debt and economic dependencies form an intricate web of vulnerabilities for Western countries. It is unclear how digital currencies will develop in the future, but we see significant risks in this unconventional currency, which could give rise to decentralised financial flows and more organised crime.

The maintenance of the US dollar as the world's reserve currency has been a fundamental element of US power and the foundation for the growth of democracies around the world, but the risks associated with the rise of rival currencies such as the renminbi are clear. Today, the US dollar is faced with growing competition in currency markets. China is seeking to use the renminbi to lure states around the world into its own economic orbit. The major challenge for the Western world today is how China can combine its currency ambitions with other tools of economic statecraft including infrastructure projects through the BRI, the instrumentalisation of debt in developing countries and using its relative wealth in critical raw materials to control global supply chains.

The solution to these growing challenges is far from simple. As Western countries continue to use sanctions, tariffs and technology controls to challenge rivals, states caught in the cross-hairs of such measures may be tempted to align with China in acts of self-preservation. This observation is not a call to lower the sanctions imposed on Russia, but it is an invitation for the West to think about all its other diplomatic relationships around the world in places such as Latin America, Africa and Asia. China today finds it far too easy to pull out the "colonialism" card against the West, but the world should be reminded that China is in many respects engaged in a form of ""neo-colonialism" in many parts of the world. So far, Western countries have not come up with a compelling narrative and strategy that can rival China.

ABOUT THE AUTHORS

J. Alexander Thew

J. Alexander Thew is a U.S. Army Major and assistant professor of economics at West Point's Department of Social Sciences. He has served as an infantry officer in operational units including 2d Cavalry and the 82d Airborne. He earned an MBA at the Yale School of Management. Professor Thew's research interests include economic statecraft and nuclear enterprise and strategy. @jalexanderThew

Daniel Fiott

Dr Daniel Fiott is Assistant Professor and Head of the Defence and Statecraft programme at CSDS, Brussels School of Governance, Vrije Universiteit Brussel. He is a Non-Resident Fellow at the Real Elcano Institute. @DanielFiott

Francis A. Finelli

Francis A. Finelli, CFA, is an investment professional, who currently serves on the Board of Directors of Business Executives for National Security (BENS) in Washington. He is a retired Army Lieutenant Colonel and former Assistant Professor of Economics at the U.S. Military Academy and legislative assistant with the Senate Armed Services Committee.
frankfinelli@alum.mit.edu

Mickey P. Strasser

Mickey P. Strasser is a Finance Senior Fellow in the Department of Social Sciences at the US Military Academy. A career finance professional, Mickey is a Managing Director with more than 30 years of experience in global institutional financial services and is an active leader in a variety of initiatives that impact and support military veterans.
mickey.strasser@westpoint.edu

The **Centre for Security, Diplomacy and Strategy (CSDS)** seeks to contribute to a better understanding of the key contemporary security and diplomatic challenges of the 21st century – and their impact on Europe – while reaching out to the policy community that will ultimately need to handle such challenges. Our expertise in security studies will seek to establish comprehensive theoretical and policy coverage of strategic competition and its impact on Europe, whilst paying particular attention to the Transatlantic relationship and the wider Indo-Pacific region. Diplomacy as a field of study will be treated broadly and comparatively to encompass traditional statecraft and foreign policy analysis, as well as public, economic and cultural diplomacy.

The **CSDS Policy Brief** offers a peer-reviewed, interdisciplinary platform for critical analysis, information and interaction. In providing concise and to the point information, it serves as a reference point for policy makers in discussing geo-political, geo-economic and security issues of relevance for Europe. Subscribe here. In each CSDS Policy Brief, authors express their own views and the content does not reflect the views of CSDS. For more information, contact the editor Dr. Daniel Fiott: daniel.fiott@vub.be.

(Print ISSN: 2983-4651 / Online ISSN: 2983-466X)

Follow us at:
Twitter @CSDS_Brussels LinkedIn CSDS Brussels Youtube CSDS
https://csds.vub.be

BRUSSELS SCHOOL OF GOVERNANCE

The Brussels School of Governance is an alliance between the Institute for European Studies (Vrije Universiteit Brussel) and Vesalius College.

Visitor's address:
Pleinlaan 5, 1050 Brussels, Belgium
Mailing address:
Pleinlaan 2, 1050 Brussels, Belgium

info_bsog@vub.be

www.brussels-school.be