

THE BROOKINGS INSTITUTION
BROOKINGS CAFETERIA: How might a global China use economic sanctions?
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(Music)

FORD: Hi, I'm Lindsey Ford and you're listening to the Brookings Cafeteria, the podcast about ideas and the experts to have them. I'm a David Rubenstein Fellow in the Foreign Policy program here at Brookings, and this is day two of our 5-day Global China takeover of the Cafeteria podcast.

We're talking to different Brookings scholars each day this week in conjunction with our Global China project, which has just published a new series of papers, looking at various aspects of how China is exercising its growing influence on the global stage.

Yesterday I talked to Tarun Chhabra and Ryan Hass who are co-directing the project along with Rush Doshi. Today, I'm very pleased to be talking to Richard Nephew who's a senior nonresident scholar here at Brookings and also a senior research scholar at the Center on Global Energy Policy at Columbia.

Richard is a well-known expert on sanctions policy. He has literally written the book on the topic. It's called *The Art of Sanctions*. And, he served as the principal deputy coordinator for Sanctions Policy at the Department of State during the Obama administration. So, Richard, welcome.

NEPHEW: Thanks very much for having me.

FORD: We are going to talk today about your paper that you did for this project which looks at sanctions policy as an emerging area of strategic competition between Washington and Beijing. And, I felt the paper was really fascinating and particularly timely.

What interested me is thinking about the fact that the U.S. has traditionally had sanctions policy as sort of a unique tool in our toolkit. And, there's been a lot of discussions about how we deploy sanctions as a policy tool right now. Not just toward Iran but in the

China context, in particular, people have advocated for sanctions over issues like, say, territorial aggression in the South China Sea, human rights abuses in Xinjiang.

So, for me, I think looking at how China might seek to play more in this space in the future on its own is a really important topic to explore. So, jumping right in, you talk in the paper -- you say that China's general opposition to multilateral sanctions, unilateral sanctions, that has been a pretty traditional stance for the Chinese government, has relaxed in recent years.

And, so, you think that, in terms of where they're headed, sanctions policy could become a more competitive aspect of the U.S.-China relationship in the future. Can you talk a bit about what you see as some of the more significant evolutions we've seen in China's rhetoric and its approach to sanctions and where you think they might be headed in thinking about sanctions policy in the future?

NEPHEW: Sure. I mean, I think if we really dial our thinking back and consider Chinese policy ever since the revolution, we can see various different epochs, and I think the initial years were defined by China trying to restructure the economy and trying to actually have a more modern economy.

So, at that time, sanctions were not exactly something that you would want to do, because ultimately they come down to denying access to China for the rest of the world, and I don't think that's something that they thought was in their interest, and, in fact, quite the opposite. They wanted to encourage business activity. And, that was even when you had Chairman Mao. Throughout the sixties, seventies, and eighties, you really still saw this as being the predominant Chinese approach to sanctions, and it matched the noninterventionist foreign policy approach that China had as well.

Over the course of the last 15 years, that's really shifted. It shifted as China itself has started taking on much more of a global leadership role as well as they started to see that there are some advantages to leveraging the Chinese economy. So, now we're seeing the Chinese being prepared to use sanctions and isolation in a variety of contexts, whether dealing with South Korea and the acceptance of the THAAD system, the air defense system, the missile defense system that we installed there in the Philippines, the South China Sea, as you suggested, Taiwan arms sales. You know, we're seeing them start to exert themselves into areas they consider to be foreign policy priorities. We're also seeing them start to be ready to use sanctions affirmatively, not just in retaliation.

In the past, they'd be prepared to use the threat of sanctions or use of sanctions to actually cut off business conduct in response to something that had been done to China. Now, they're looking at it in a much more affirmative way. How can we use our economic policy and economic access as a tool? How do we deny or threaten to deny access to China, and will that actually encourage foreign policy changes? And, this is all being reflected both in the official and in the academic sphere, which is really suggestive that they're thinking through the contours of a much more evolved and settled policy.

FORD: You mentioned some of the things that we've seen China do vis-à-vis maybe private companies and their stance toward Taiwan, in the South Korea case, Lotte, in retaliation for the THAAD deployment. I thought that this was interesting in your paper, was that you sort of pointed out maybe a more expansive definition of sanctions, right, that things like these sort of targeted boycotts that we saw China encouraging, could actually be a form of sanctions policy, and one that China could potentially use quite effectively.

NEPHEW: Yeah. And, it's a function of -- what are China's advantages? When they actually sit back to think -- what do we have in terms of leverage, what do we have in terms of something that's deniable to other folks, I think what they see is, they've got the Chinese market, first and foremost.

They've got a market that is emerging, that is evolving, that is becoming a much more important source of income for international companies. And, they say, okay, we'll deny access to that. If you would like to invest in China, we won't let you, and we won't let you have that kind of market access.

I think we're seeing them start to have this same approach with regard to the Chinese middle class. If you are going to do things we don't like, then we're not going to allow our tourists to come to your country with all the money that they potentially can spend.

So, I think what this really speaks to is a Chinese approach in which they have identified what are their advantages, what are their strengths, what are things that other people want access to and therefore can be denied? And, in this regard, they're not really approaching things differently than the United States would do.

When you think about how U.S. sanctions policy has evolved over time, we also have targeted things that people want and access they want to the U.S. economy, such as access to the U.S. financial system. And, by denying that, we seek to persuade countries, companies, entities that they ought not engage in conduct that we don't like.

And, so, I think really where the Chinese are at this point is a process of cataloging what are their strengths, what are their opportunities, and then selectively using them where they think there are vulnerabilities to their sanctions target -- again, not unlike the

United States.

FORD: So, you talk about this idea that China thus far has been basically reactive, responding to how we might use sanctions policy affirmatively, but now they are doing this process of cataloging their own strengths and thinking about how those could be used in an affirmative manner. And, those strengths will look different. Where the U.S. has used its financial markets and access to U.S. financial markets as a strength, China may use its own domestic markets and access to the Chinese middle class, like you just said.

So, recognizing that China may be looking to use sanctions policy in a different way than us -- it will bring different economic advantages to the table than the ones that the U.S. has -- what kinds of problems and challenges does that present for policymakers?

NEPHEW: Well, I think there are several challenges that are created. I mean, I think first is that we'll actually have to deal with the actual consequences of any Chinese action. Again, to the extent that they are prepared to use sanctions pressure and sanctions tools against the United States and our companies, individuals, and entities that are important, they're going to be doing damage.

And, if they were to deny access to General Motors to all of China, we're going to have to deal with the consequences, potentially General Motors, both in terms of its actual economic performance as well as its level of competition with the rest of the world. Those are effects that we're going to have to deal with. And, when you consider China as a market, that potentially could be very, very serious.

We also are going to have to deal with the political effects that come from that. And, I think this is a not-yet-fully-realized issue. But, at the point in which China's able to threaten thousands of jobs in the United States, as we're already starting to see with the

tariff, you know, tit-for-tat response that we've had since Trump became President, I think we'll start to see a need for policymakers to have to deal with angry constituents.

And, those constituents can be everyone from soybean farmers all the way up to the heads of global corporations, and those kinds of political effects are going to shape our decision making. They're going to shape our options set. They're going to shape how members of Congress and members of the Executive Branch consider sanctions tools, which, I think, is a pretty important thing to keep in mind.

Because, to the extent that China is able to shape our decision set, by taking certain U.S. interests and putting direct pressure on them, we'll have to start considering whether or not we want to apply sanctions pressure on China and in certain areas, whether it's human rights or whether it's with regard to Taiwan or North Korea, or whether we don't want to do that. Because, we do have our own interests at stake here, which I don't think we've fully internalized how that'll affect U.S. policy and how it'll affect our desire to have to achieve a maximalist foreign policy, instead engage in trade-offs.

And, I think the last thing that will be a fairly major challenge for us is the effects on partners. One of the things that I point out in the paper is that China doesn't just have to put pressure on the United States directly to put pressure on the United States, that we also have got allies and partners that are potentially more exposed to China even than us. Again, look at South Korea and THAAD.

And, to the extent that the Chinese are able to damage their economy or damage their strategic interests, those are interests to the United States as well and they're going to have an effect on what we have to do potentially in terms of defense, in terms of economic security, and certainly in terms of political relationships, so, a lot of challenges

that are going to have both primary and direct effects on the U.S., our economy, and our political decision makers.

FORD: Yeah, this is a great point that I thought you raised in the paper, which is, it's not simply how China might seek to use its sanctions against the United States directly but that in many instances it might be an indirect play. And, that might actually be more difficult for the U.S. to deal with, because some of our closest allies and partners are actually far more economically vulnerable and exposed to China's ability exert economic coercion.

We've seen this in various cases. And, I raised Korea and Lotte, but they're been others. And, I think you mention in the paper that in some cases where the U.S. might be perhaps more resilient, essentially, to this pressure, because of the size of our economy, that smaller countries don't have the same ability to offset that pressure.

So, for the U.S., as we think about wanting allies and partners to stay aligned with us on issues that are in our interest and in support of our values, what do U.S. policymakers actually do? What are the tools that you can use to help some of these smaller countries who might be exposed to Chinese economic coercion be able to actually offset that challenge?

NEPHEW: Yeah, this is a really difficult problem, and it's especially difficult because our solution set for this particular set of challenges is different than what China can bring to the table, and that's on the basis of our market economy and our inability to potentially match dollar for dollar the sort of influence that China is going to bring to bear.

We're not going to be going to Italy anytime soon with a massive aid package or certainly help for their industrial policy the same way that China is able to, for instance, try

and leverage the Belt and Road Initiative. And, to the extent that it's actually being pretty successful in Europe, I think you can see some of the risks and questions that are generated from there.

I do think there are things that we can do. I think, first of all, especially for our most vulnerable partners who are at risk from a security standpoint, we can reinforce them in a direct physical sort of way against any kind of political and economic coercion that might be brought to bear. And, this is probably the most important, in Japan and South Korea, to make sure at a minimum they don't feel insecurity at a physical level, but also reinforce them on a political level, and to underscore that we are partners, we're allies, and that set of interests won't change.

And, I think, frankly, this is one area where the Trump administration has done some damage to the United States. Because, in South Korea and Japan now it's hard to make that case, that it's worse sticking with the U.S. even if there is a short-term problem that might be created with China. But, there are opportunities to rebuild those relationships and reinforce them going into the future, and that would give some confidence and some sense of stability for those partners.

I think we could also keep working with partners on avoiding excessive interdependence with China. And, I think you see a little bit about this with respect to Huawei, you see it with the debates that were 5G, and other such things. But, I think, you know, there are ways in which we can talk and strategize and cooperate with partners to identify areas in which interdependence in trade and business activities are perfectly fine in place where it's more dangerous.

And, if we're thoughtful and if we're considerate about identifying and redlining

those areas, I think we'll be able to assure our partners that we're not just seeking domestic U.S. economic advantage here but rather looking after their baseline security and political independence vis-à-vis China.

I also think that there's some messaging that needs to be done to China itself. And, I think here it's worth us having a serious conversation, both internally and eventually with partners, about whether or not we want to expand our security assurances to include the economic interests of our allies in addition to their physical ones. This is challenging, especially because we are economic competitors with countries like Japan and South Korea.

But, I think, again, within the confines of a stable political relationship, we'll be able to convince them first and then eventually the Chinese that, notwithstanding any economic competition that might exist with our partners and allies, ultimately, if China is going to threaten their stability and threaten their economic security as a result of any kind of sanctions fight that we end up having with the Chinese, that the Chinese will be chastened by that to some extent, or at least will have to bear in mind that there are risks if they take too aggressive a case.

So, I think reassurance is the bottom line. I think some messaging will also need to be engaged. But, I think, more than anything, we need to try and rebuild the relationships, such that they have more of a feeling of trust when we say we have your interests at stake here.

MS. FORD: This is a really interesting idea, thinking about sort of alliance commitments, not only in the security context, but does that extend as well to the economic context if economic coercion is being applied in a way that would impact our

security interest? And, it's intriguing to me, because, as a security person my instinct, and probably of a lot of national security people, will be like, yeah, that makes a lot of sense.

But, I wonder, would the business community see it the same way, right? Would making those kind of reassurances for some folks in the business lane, potentially impact their bottom line, because there are competitive relationships there, and lead folks in the business community be less supportive of that kind of idea. What do you think?

NEPHEW: No, I think that's an issue. And, as I said, I mean, I think when you start thinking outside of physical security issues and starting thinking about economic security issues, I think you can hear people in the business sector start to get a little nervous about - what does that mean? How far would an administration go?

But, look, if we really think about it, though, our interest in our partners does extend to their economic stability, because they're economic partners, because they're markets. When you think about Europe, for instance, it's not just NATO, it's the fact that they're one of our largest trading partners, the fact that we have investments there and they have investments here.

So, to some extent, we're already invested in the economic security of Europe, the economic security of Japan and South Korea. And, I think this is where you just need to have a fairly healthy understanding of -- competition is one thing, and fighting over individual margins, and having competition over your company versus my company, and getting a contract, those are all par-for-the-course aspects of business competitiveness. But, our lines need to be -- while we're all prepared to rock the boat a little bit, we're not going to tip it over. And, the concern that we'd be registering back with the Chinese is, we are not going to allow you to tip the boat over as well.

And, so, if you want to use your tools of economic coercion in order to leverage political decision making, that's a potential line that is dangerous to us and something that we'll take an interest in. If a Chinese company wants to compete with a South Korean, American, Canadian company over who can deliver the best widget for a car, that's a different type of activity.

And, so, I think there are ways, as we've demonstrated for the last 70 years, at the WTO and other trade formats, in which we can have a baseline level of acceptable economic competitiveness, but ensure that the overall situation for our partners is going to remain stable and assured. And, I think it's that kind of agreement that we'll help protect the common space and that we'll do so in a tight, cooperative, and engaged relationship. That, to me, is the level of assurance that is both acceptable from a business context and desirable from a security context.

FORD: That's a great point. I think recently, as folks are wrestling with this idea of "strategic competition" with China and what that looks like, how you reconcile the U.S. economic interests, U.S. security interests, where they intersect, where they may be different, and folks in the economic world and the security world may think about U.S. interests in different ways, has been something really challenging for experts to wrestle with lately.

And, there's been a lot of discussion in particular about this idea of weaponized interdependence, which essentially is saying that, where perhaps in the past folks who really supported liberal internationalism believed that this idea of great institutionalization and bringing China into sort of all of the global institutions and economic networks would create a degree of interdependence that would help us avoid conflict, create incentives

against coercion and unhealthy forms of competition, that maybe that's not true, and that maybe because of the way that international networks develop, that China actually is able to use that interdependence for coercive purposes.

And, so, that's led to a pretty robust debate here in the United States about what folks are calling the idea of "decoupling." And, this has been something that's been talked about a lot lately. Some people talk about that in a very broad sense of simply just trying to decouple the U.S. and Chinese economies to a much greater degree in order to avoid weaponized interdependence.

Some people talk about it perhaps in a more narrow sense, specifically associated with maybe key technologies or things like this. What do you think about this debate? What makes sense in terms of thinking about how to avoid vulnerabilities in the U.S. economy to Chinese coercion?

NEPHEW: I think it's an important debate to be had, in part because of this sense of sanctions competition, if nothing else, that we're starting to sense from the Chinese. I mean, I think, first of all, there is a little bit of an irony here about being overly pearl-clutching about weaponized interdependence, because you can make a good argument the United States did a first in terms of our leveraging the U.S. financial system for foreign policy gate. The difference, of course, is that when we do it it's for truth and justice, and when the Chinese do it it's for nefarious ends, right.

So, I mean, I think ultimately how you look at the use of interdependence and business relationships for foreign policy aims really depends on kind of how you enter the conversation and on what side you sit. I think it's, to me, intuitively obvious that the Chinese would be able to take advantage of an interdependent relationship for foreign

policy interests.

And, if we didn't think they were going to do that, it's because we always assumed that we would be on top in all circumstances, which I think is a fairly short-sighted sort of view. To some extent it goes back to that old saying about, you know, if you owe the bank a million dollars, you've got some leverage over the bank just as much as it does over you.

I do think that there is something to the idea about having more robust protections for intellectual property, for defending our technological edge, for reinforcing our domestic manufacturing sectors. So, there is a lot that we both can and should do to ensure that this interdependence with China doesn't become deleterious to the U.S. overall economic and security interests.

I think that reforming CFIUS was a good idea. It is a good idea in that we need to be much more careful about how we look at Chinese investment in the United States, how we look at supply chains, and really be careful about becoming so dependent that China becomes a single source of failure for the U.S., and the same way you wouldn't want them, or any country, really, to be the same, for a variety of reasons, just because of risks of economic problems or some sort of disruption.

But, I do think that trying to decouple from China just for the sake of doing so is a bad idea. I don't think there's any reason why we can't trade with China, invest in China, and receive investments in turn. And, I think, actually, some degree of interdependence is useful and especially if we're entering a period of hegemonic competition. A world in which we don't need each other may be an especially violent place.

So, I think ultimately what it comes down to is nuance. It comes down to being careful about what sectors we open up, what economic activities we're prepared to allow

Chinese companies to operate in, which ones we're not, being much more thoughtful about how we look at investments, how we study them for their national security impact, for companies not becoming single-source dependent on China, and for ensuring that on the diplomatic front we've got a real conversation going about what our acceptable forms of economic competition and the kinds of intellectual property protections we would expect, and those sorts of things.

And, as long as we're doing this in a fairly straightforward way, I see no reason why we can't have some degree of interdependence but at the same time protect those interests.

FORD: And, you say in the paper that U.S. policymakers need to think much more seriously about some of these tools and the things that they need to do, if we're walking into an era in which we are no longer the only one in the sanction scheme. And, one thing I thought was interesting in what you said is, yes, there are things we perhaps need to be thinking about. Are there opportunities to shape China's nascent sanctions policies? But, also, maybe there aren't, in which case we need to be developing policies to protect ourselves against that possibility.

But, you flag in particular, in one section, that one thing the U.S. has to think about is, some of the vulnerabilities we have that have to do with our own domestic economic policies and thinking about how that makes us vulnerable to China in some cases. And, I thought this was a really interesting argument, that some of the things you said the U.S. needs to be doing to get more serious about protecting itself in a world where China may be able to leverage sanctions policy isn't simply about what we do vis-à-vis China, it's actually what we need to do domestically to get our own house in order.

So, can you tell me a little bit about what you see as vulnerabilities in the U.S. economy that U.S. policymakers need to be more serious about addressing?

NEPHEW: Absolutely. And, I think, this, to me, is a fundamental part of any kind of economic security argument. It's not just about what other people can do to you but what you allow them to do to you if you are leaving yourself open. And, look, it's nothing that I don't think isn't being discussed on a daily basis, but we've got a problem with income inequality in the United States.

It creates a situation in which disruptions to trade patterns that potentially affect some of our big corporates or affect our farming sector, and so forth can have a major impact on millions of Americans. And, again, we're already seeing this to some degree with what's happening with response to the tariffs, the damage that's being done to average folks, and certainly will be done to average folks if the tariff wars continue much longer are, in part, a function of income inequality. If there was more resilience on a family level, we wouldn't have the same kind of political vulnerability that we have potentially now.

You could scale it up to a corporate level as well. The IMF has noted the degree to which our corporate sector is overleveraged and the degree to which the U.S. government is overleveraged, to the extent that that kind of debt dependence, in which China's a prominent figure, creates some exposure to Chinese decision making. Well, that's because we let them in. If we weren't so heavily debt dependent, if we weren't so heavily debt dependent on China, we would not have some of those same vulnerabilities.

So, I think, frankly, we should be trying to sort out these problems for our own sake. I think it would improve the U.S. economy and its resilience more generally. But, I think that if you were to address these problems, then they would not be vulnerabilities

that China would be able to exploit. And, it's less of an issue of closing the door on China in these areas and more simply reducing the degree of our exposure.

It's also worth noting in this context, of course, that the Chinese also have vulnerabilities to the United States, too. Saying I was just talking about it -- about if you owe the bank a million dollars, you know, you've got some leverage. Well, the same thing applies to it with respect to the Chinese. And, I think the degree to which we're having an active conversation with China about our vulnerabilities, and theirs, might actually also lead us away from a path of competition and one in which we can negotiate and engage more seriously in an adult and sober conversation about what we want to see come as a result of U.S. policy decisions and Chinese.

FORD: Great. Richard, thanks. This has been a fascinating conversation. I would encourage everyone to go online to the Brookings website where you can see all of the Global China papers and check out Richard's full paper on U.S. and China sanctions policy, a lot of really interesting lessons in there. I really appreciate you joining us today.

NEPHEW: Thanks very much for having me.

FORD: And, this has been the Brookings Cafeteria. I hope you will all join us tomorrow for day three of our Global China takeover of the Cafeteria podcast. Thanks so much.

DEWS: The Brookings Cafeteria Podcast is the product of an amazing team of colleagues, starting with audio engineer Gaston Reboredo and producer Chris McKenna. Bill Finan, Director of the Brookings Institution Press does the book interviews, and Lisette Baylor and Eric Abalahin provide design and web support. Our intern this Fall is Eowyn Fane. Finally, my thanks to Camilo Ramirez and Emily Horne for their guidance and support.

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