

How Smart Power Influences Economic Power – A Brief Overview on the Sino-American Tariff War from 2018 to 2021

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Abstract

Today's Transnational Companies (TNCs) have gained an increased role in the diplomatic realm, due to recent globalization developments. International relations focus around trade liberalization and creation of deep interdependencies limiting the use of hard power as a coercive method. The 1990's, Joseph's Nye concept of soft power has gained importance in the political and economic diplomatic negotiations, influencing also the TNCs internationalization decisions, leading to a deeper market globalization. The speed of globalization development and dynamics of international relations brought to the forefront a new type of power: smart power. Today's world is dominated by two major economic actors: USA and China, and their sensitive bilateral relations has brought into light a modern Thucydides' Trap. To avoid a potential war, each country used different smart power strategies: China had a long run-oriented strategy with smaller gains, while the USA aimed for a big impact in a short period of time, obtaining opposite results influencing the global business environment, and the TNCs performances worldwide. The research objective is to analyze the impact of the two opposite smart power strategies on the main TNCs by country, comparing their revenues, profits and changes in profit, of the first top 10 rankings presented in Forbes 500 during a time period starting 2018 (since the "tariff war" began) to 2021 (present). The main results emphasized that economic power is divided among TNCs from the USA and China, despite the existence of tense diplomatic and economic relations.

Keywords: TNCs, tariff war, Sino-American relations, smart power, economic power

JEL Classifications: F10, F19, F50, F53, F63

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Introduction

Globalization development, technological advance, networks and interdependencies allowed TNCs to act as diplomatic actors operating within and outside the traditional diplomatic system (Siracusa, 2015, p. 1), and transnationality enabled the rise of a new subject of international economics: TNCs – as a link between states and economies (Kordos, Vojtovic, 2016, p. 152). Home governments support TNCs with protectionist measures stimulating their development despite negative effects upon interstate trade, and at national level, controlling their magnitude by adjusting the exchange rate and/or the monetary and fiscal policy. Anticipating protectionism, TNCs can operate with (tradable) inventories until they adapt to a new trade policy (Eichengreen, 2020, p. 827). Influencing the international business environment by increasing international competitiveness and internationalizing production, (Bari, 2010, p. 237) TNCs are fundamental components of the world economy system, based on FDIs, asserted primarily in developed countries and gaining a higher level of economic power comparable to nation-states (Bal, 2006, p. 23).

Recently, the sensitivity of the Sino-American relations has been unfoundedly compared to a modern Thucydides' Trap with limited room for maneuver under the UN Charter. Unable to use *hard power*, both countries aimed for *smart power* strategies mixing *soft power* with elements of protectionism, impacting the global business environment, burdening the Sino-American relations and influencing the presence of TNCs originating from the USA and China on the global market. To understand this impact the **research methodology** is focused on quantitative compared analysis of the economic performances of the first 10 TNCs of Forbes 500 (annual data) by country, in terms of revenues, profits, changes in profits from 2018 (beginning of the “tariff war”) to 2021 (present) underlining that the current economic power is divided between USA and China and is influenced by two opposite *smart power* strategies.

Balance of Power

Development of globalization allowed a shift from *hard power* (coercive) to cooperative trade agreements (*soft power*) but the evolution of current international relations emphasized the need for a combined concept – *smart power* (Nye, 1990, p. 167, Nye, 2017, p. 2).

The complexity of defining a TNC is based on dynamic interdependencies of the global business environment. According to UNCTAD (1999, p. 2) TNCs “[...] operate in multiple societies around the world, responding to each country's legal requirements while adjusting to diverse social and economic conditions. Occasionally, TNCs are caught between conflicting requirements or expectations in different countries [...] At the same time, TNCs seek

to maintain their corporate identity and the operating procedures of an integrated global enterprise? – emphasizing the shift of TNCs towards using diplomacy and their growing activities as tools to maintain good relations, therefore tilting the balance towards *smart power* through economic power (sometimes exceeding the power of some developed states) and *soft power*. TNCs became major actors generating contradictory consequences in global economy and states' policy through cheaper production, a decrease of unemployment, an increase of taxes level, access to information and technologies, speeding up the efforts to support free trade through policy changes (Kordos, Vojtovic, 2016, p. 151, p. 153).

The FDIs value of goods and services exceed actual exports worldwide, making TNCs the main tool for developing international relations, as a first step in trade liberalization (Bal, 2006, p. 109) and the nature and evolution of global demand and supply. The possibility of internationalization and subcontracting proliferated the networks of non-state actors, i. e. TNCs (Weiss, Seyle, Coolidge, 2013, p. 7, pp. 8 – 9) allowing them to gain economic power over developing countries rather than industrialized ones (main FDI beneficiaries) due to inadequate political system and ineffective institutional apparatus (Uhlin, 1988, p. 235). Determined by economic, social and political factors FDIs emphasize the complexity of internationalization and the emergent relations between TNCs and states (Bari, Zaharia, 2019, p. 26), fearing that nation states may lose influence and power in favor of regions, while ease of cross-border operations facilitate an increased role of TNCs as beneficiaries of protectionist measures from home governments (Uhlin, 1988, pp. 238 – 239). Recent evolution of the developing countries gave an impetus for new TNCs: China's open-trade based system made its business environment appealing for TNCs subsidiaries placements (Kyove, Streltsova, Odibo & Cirella, 2021, p. 218) despite the sensitive legal environment.

Use of *smart power* within the Sino-American Relations

Previously perceived as a “*giant with clay feet*”, China produced poor quality, high quantity, cheap merchandise, despite the switch from the Maoist autarky to the East Asian export-led growth model. Today they register a remarkable economic performance, being the main producer worldwide and an important geopolitical and economic actor (Nye, 2019, p. no page). China's dramatic economic development raised its *hard power* resources, simultaneously understanding the importance of using *soft power* in a smart way, to prevent their neighbors from joining dangerous coalitions. China's new image delivered mixed results: the display of its impressive economic growth reduced the country's poverty levels and promoted its culture worldwide, but did not outperform USA's global image (Nye, 2017, p: 2). China's evolution placed the country in a “Thucydides' Trap” against USA, and according to political scientist Graham Allison, a rapid shift in the balance of power caused a

structural stress, therefore USA, as hegemon, can feel threatened, leading thus to war (Allison, 2015, p. 1). From a modern perspective, Alan Greeley Misenheimer concludes that Allison's concept welcomed the attention on historical Thucydides, but failed to thoroughly analyze the teachings derived from the original trap, which might help USA and China avoid real and contemporary lures (Misenheimer, 2019, pp. 1-2).

The Sino-American "frenemies" relation is long term: China struggled to obtain the Most Favoured Nation (MFN) status during Jimmy Carter's administration. The US-China cooperation was successful in most areas but after the collapse of the communist regime in Europe, USA fearing the possibility of Chinese alliances with the former communist countries, imposed heavy sanctions on China's import of weapons and high technology, and even bombed in 1999 the Chinese embassy in Belgrade – binding Presidents George Bush and Bill Clinton to reevaluate the American policy towards China. President George W. Bush, aware of the increasing international role, supported China's accession to the World Trade Organization (WTO) and the hosting of the 2008 Summer Olympics at Beijing. During President Barack Obama's Administrations – a vivid supporter of *soft power* – there was a cooperative approach towards China that turned into a "potential rivalry" using a "containment strategy" (Arežina, 2019, pp. 293-295).

China's biggest break came during the 2008 economic and financial crisis: the global financial markets' collapse allowed China to massively invest worldwide developing a "*influence via investment*" model, granting a Chinese leverage with geopolitical ramifications exceeding economy and trade. From 2008 to 2018 China's influence grew and successfully combined the model with *soft power* to reach the heart of Europe and facing USA on the fronts of two oceans: the Pacific – with the use of military capability (*hard power*) and the Atlantic through commercial and investment ties (China-EU Comprehensive Strategic Partnership Agreement) (Ishmael, 2019, p. 202; p. 206).

USA fully utilized its hegemonic position investing, internationalizing and maintaining a risky policy due to a high level of indebtedness. According to the Federal Reserve and US Department of the Treasury, several countries own US securities with the value of more than USD 7 trillion in June 2021, as presented in Figure No. 1.

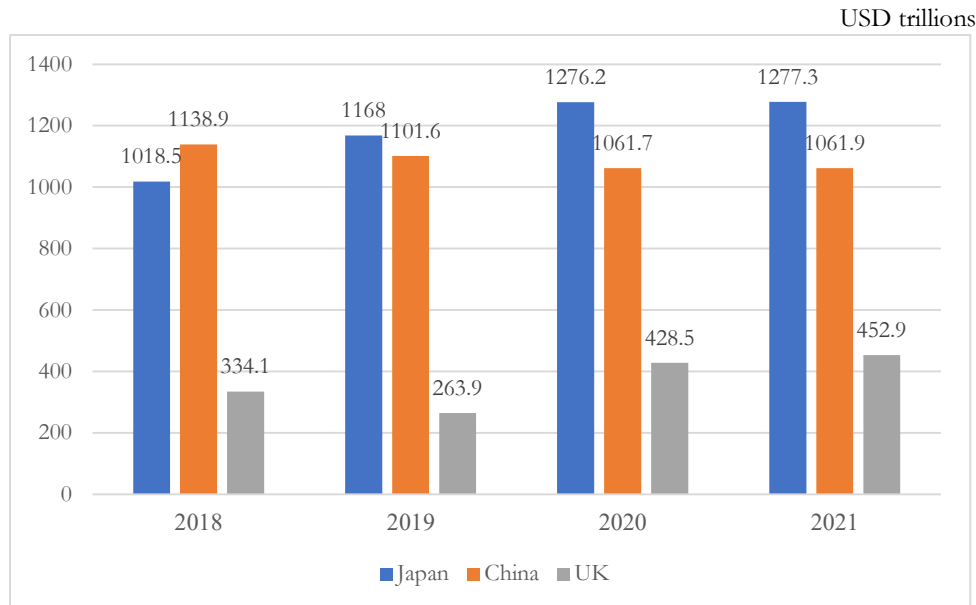


Figure 1. Foreign holders of US treasury securities – 2018 – 2021

Source: Duffin, E. (2021). 'Major foreign holders of U.S. treasury securities 2021', available at: <https://www.statista.com/statistics/246420/major-foreign-holders-of-us-treasury-debt/> and *****(2021) Department of the Treasury/Federal Reserve Board, November 16th, available at: <https://ticdata.treasury.gov/Publish/mfh.txt>.

Figure 1 displays the ranking of US Treasury securities owners from 2018 – 2021: Japan – 4740 USD trillion, China – 4364.1 USD trillion and UK third with a 1479.4 USD trillion (Duffin. 2021, p. no page, Department of Treasury/Federal Reserve Board, 2021, p. no page) raising awareness of the globally frail US position, simultaneously providing Chinese leverage through the possibility of influencing USA's decision-making process by potentially threatening to liquidate its share of assets, thus depreciating of the US Dollar, reducing the value of China's American holdings (Schwarzenberg, Sutter, 2021, p. 2) having no gain on the long term.

Based on the Obama Administration's inheritance, President Donald Trump considered China a potential threat (military and economically) due to "illegal activities, including its theft of American trade secrets" (Brown, 2021, p. 805), deepening this modern Thucydides' Trap. By blaming migrants and other countries' "unfair" practices, rather than considering the national economic and technological changes, he restricted imports to support a higher level of employment and increased wages, by reducing bilateral trade deficits he impacting the multilateral one (Stiglitz, 2018, p. 515), intentionally breaking the rules of free trade and starting a "tariff war" against China, after several public accusations (Steinbock, 2018, p. 518 – 520 & BBC, 2020). Fearing China's rapid economic development, he based his

smart power strategy in using all existing instruments to avoid potential military war, but hid behind *soft power* tools (especially Twiplomacy, which granted him public support) to tilt the scale in USA’s favor and influencing the global business environment.

Smart Power affects TNC’s economic power

Theoretically, the highly indebted USA relied on protectionist measures triggering former President Trump’s objective to “make America great again” by supporting US TNCs. The economic reality proved him wrong, as most TNCs have Chinese commercial partners and the “rise of price – lowering quantity policy” affected US employment and highlighted USA’s fear of Chinese development as [...] “US President Donald Trump’s unilateralist posture has reduced America’s soft power and influence” Joseph Nye (2019, p. no page), causing US *smart power* strategy to fail, the Covid-19 pandemic and President’s Trump public attitude towards China adding pressure. The “Phase One” trade agreement (January 15th, 2020) was the effort to reduce bilateral trade tensions (an expression of *soft power*) but committed China to several burdening provisions (Bisio, Horne, Listerud, Malden, Nelson, Salidjanova & Stephens, 2020, p. 1).

To understand how the two opposite *smart power* strategies impacted the global business environment, a comparative qualitative analysis of the first 10 TNCs ranked in Forbes 500 by country from 2018 – 2021 is presented in Figure 2.

(by number)

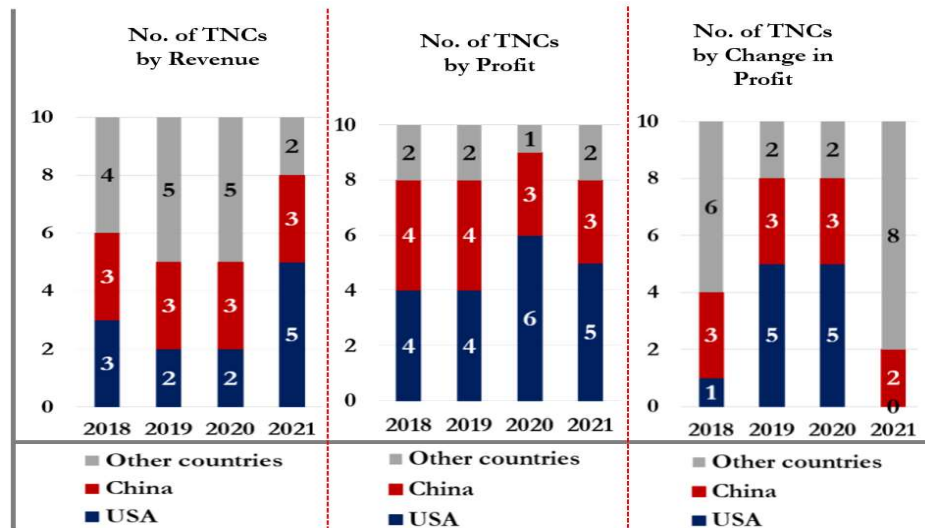


Figure 2. Evolution of top 10 TNCs by revenue, profit and change in profit 2018-2021

Source: Author’s calculations based on data retrieved from Fortune 500 reports, available at: <https://fortune.com/global500/>

During the past four years and in terms of evolution by revenue, both USA (fluctuating) and China (constant) had an average of 3 TNCs present in Forbes' top 10, reiterating that the main players worldwide are USA's and China's TNCs.

With an average of 4.75, USA has 9 companies present in Forbes top 10's ranking by profit, while China, with an average of 3.5 had 4 TNCs. While US TNC come from different sectors, China relies exclusively on the financial sector - namely banks, underlining China's aggressive investment policy at global level, since 2008, bringing them close to Europe's heart and breathing in USA's neck, adopting a tenacious approach to changing the world order and consolidating their influence by mixing *soft power* measures with *hard power* leading to *smart power* strategies (Pecheritsa, Boyarkina, 2017, p. 7).

Regarding the profit changes, Figure No. 2 displays a descending sinusoidal evolution of American TNCs (no presence in 2021) in the top 10, while China was rather constant and included 2 TNCs in 2021. While US TNCs activate in tertiary sectors, the Chinese operate in industrial ones or sectors receiving governmental subsidies. In terms of economic power of the TNCs and despite the "tariff war", the Covid-19 pandemic and the opposite *smart power* strategies, it is visible that China displays better performances proving a small economic impact of the diplomatic pressure.

Current evolution of TNCs have helped USA and China to reduce the power gap in political, economic, social and cultural areas maintaining differences in terms of economic size, military power and R&D, making it difficult for China to challenge USA – an influential actor of the international decision-making power in most international organizations and hegemon (Shengli, Huiyi, 2019, p. 506), highlighting scientific concerns regarding the "China Effect". Significant growth of Chinese exports to the USA and the shift of Chinese trade policy (including China's WTO accession and the use *smart power* strategies) had little negative impact on USA's labor market due to mass competition in manufacturing sectors, but not in the tertiary sector where USA is leader (Gasiorek, Magntorn Garrett & Serwicka, 2019, p. 8).

Linking his decisions strictly to USA's welfare, former President Trump omitted the implications for the global business environment and diplomacy, generating effects visible in the future.

The undertaken analysis provided a general overview regarding the influence of new diplomatic trends on TNCs performances originating from two major geopolitical actors – USA and China, and a detailed radiograph is base for future research.

Conclusions

Globalization has generated an unprecedented technological advance while the speed of information and a shorter geographical distance led to liberalization of global trade alongside the need for regulatory frameworks in the trade policy realm, to support these developments. Parallel to state activities, TNCs have gained higher importance in the world economy system, through FDI and internationalization strategies, networks and interdependencies and recently acting like diplomatic actors, negotiating with states and even successfully intervening in the states' balance of power. In turn, national governments support their own TNCs through trade policy measures, influencing the balance of power and global trade relations. US-China sensitive bilateral trade relations have been burdened through President Trump's actions from 2018 focused on protecting national TNCs interests and business environment making full use of diplomatic tools available, negatively impacting global free trade and diminishing US power and influence. The results were opposite to the expectations, his actions affecting national jobs and profits. The outbreak of the Covid-19 pandemic in 2020 made it difficult to resume diplomatic negotiations especially since former President Trump publicly accused the Chinese government of spreading the virus.

TNCs originating from USA and China maintained the business dynamics, as shown by the conducted analysis based on data provided by top 10 rankings of Forbes 500. The findings illustrated that most US TNCs were active in retailing, finance and also healthcare – considering the pandemic. On the other hand, most Chinese companies activate in strategic areas: energy, mining and financial sector, basing their advance on support from the national totalitarian government, alongside investment decisions taken during the economic and financial crisis of 2008. Present with FDIs on all continents, China has secured itself a major role in the world economy system, demonstrating their understanding of *smart power* is more effective than President Trump's. China is currently the world's largest trading partner, which has not been undermined by the Covid-19 pandemic. In response, developed countries are forced to look for solutions, because they depend on Chinese supply, and currently, the global investment space is very limited

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