

## EDITORIAL ESSAY

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### China's Challenge: Geopolitics, De-Globalization, and the Future of Chinese Business

Michael A. Witt

*INSEAD, Singapore*

#### INTRODUCTION

The international context of business has shifted markedly in recent years, with globalization under US hegemony giving way to the twin forces of de-globalization and a growing Sino-American rivalry. Symptoms have become hard to miss, with manifestations such as the trade wars and the recent US ban of Huawei representing just the tip of the iceberg.

Viewed from the perspective of International Relations (IR) theory in political science, de-globalization and Sino-US conflict are no accident. Under current conditions, further exacerbation of conflict would be consistent with theory. Even short of global war – which theory suggests is possible – the implications of these changes for businesses worldwide would be profound.

This essay lays out initial thoughts on the possible impact of these changes on Chinese enterprises. It argues that Chinese firms may face a range of novel challenges as a result of de-globalization and superpower rivalry. For example, in a world that is at least in part increasingly hostile to Chinese business, Chinese firms will need to devise new ways to catch up and keep up with advanced technology, to resolve critical dependencies on foreign suppliers, and to avoid being perceived or treated as enemy firms in host markets. At a minimum, these and other adaptations will provide novel empirical settings for testing existing theories. At the same time, it also seems likely that they may present opportunities for theory extension or new theories of international business and global strategy.

The text following below first describes why IR theory suggests that de-globalization and Sino-American rivalry are not an aberration but to be expected under present conditions. A possible and increasingly likely scenario growing out of these

Corresponding author: Michael A. Witt ([michael.witt@insead.edu](mailto:michael.witt@insead.edu))

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considerations is a renewed cold war, with separate economic spheres of interest around China and the United States. This scenario connects with the possible implications already mentioned – technology, dependencies, as well as political strategies abroad. The essay concludes with thoughts about possible alternative scenarios for Sino-US relations.

## **THEORIES OF INTERNATIONAL POLITICS AND TRIGGERS OF DE-GLOBALIZATION AND CONFLICT**

This essay starts with the premise that de-globalization and Sino-American rivalry are political phenomena. This is probably uncontroversial for the latter. For the former, alternative hypotheses are possible. For instance, de-globalization may be a consequence of new business models that now localize economic activities that in earlier days would have crossed international boundaries.

While this possibility is well worth investigating, prima facie evidence looks inconsistent with it. In particular, not only trade, but many other indicators of economic interdependence have seen declines. This includes foreign direct investment (FDI) flows and stocks (Witt, 2019), which would presumably still appear in the accounts of firms executing localized strategies, unless all activity is outsourced. Downward trends are also visible in revenues and profits generated abroad (*Economist*, 2019b), which should presumably grow if localized strategies were prevalent and successful. Political theory, on the other hand, tells a story that is consistent with the evidence. It also has history on its side, in that the last de-globalization during the Great Depression clearly resulted from political forces (Witt, 2019).

The field of IR in political science has evolved two main theories: liberalism and realism. The remainder of this section provides a high-level overview of the mechanisms envisioned by the two theories, drawing on the foundational works by Moravcsik (1997) for liberalism and Waltz (1979) for realism. More detailed expositions can be found in IR primers (e.g., Matthews & Callaway, 2017) or textbooks (e.g., Pevehouse & Goldstein, 2016).

### **Liberalism**

The term ‘liberalism’ as used in this essay denotes exclusively the IR theory by that name. It does not imply an outcome, nor a political theory of individual freedom, nor socially progressive policies (a usage specific to the United States), nor conservative free-market oriented policies (a usage common elsewhere in the world).

In simple terms, liberalism suggests that international politics is a function of various actors pursuing their respective self-interests using different types and levels of power. While countries represent the main players in international politics, any individual or organization, including firms and international organizations, may co-determine outcomes. Power ranges from soft power, based on cooptation of other countries by presenting an attractive model or outcome, to hard power,

based on economic or military coercion. Outcomes of the interactions among states may be positive sum ('win-win') or zero sum ('win-lose'), and actors are usually (but not always) rational, in that they possess all relevant information, have clear preferences and conceptions of cause and effect, and choose the outcomes that are optimal to them.

A key dynamic in liberalism is that domestic-level politics – what happens inside a country – is highly influential on the foreign policy of a country. Foreign policies working toward globalization or de-globalization thus depend on which domestic interests have more power, those in favor of openness or of protection. Foreign policies leading to conflict are similarly the result of domestic interests favoring a confrontational stance having gained the upper hand over interests favoring de-escalation.

In accounting for a wide range of actors with different (self-) interests and power, liberalism presents a fairly realistic depiction of political dynamics. However, this comes at the expense of parsimony: understanding international politics requires taking into account the domestic interest configurations of a multitude of countries as well as the additional influence of international actors such as the United Nations or the World Trade Organization and the international institutions (in the Northian sense of 'rules of the game', see North, 1990) underpinning them.

Liberalist scholars have identified two sets of conditions that are likely to reduce the risk of major conflict: economic interdependence and democracy. The first condition, which is formally known as 'commercial peace', hinges on the notion that nations that are highly *interdependent* economically may find it too expensive to go to war with each other. While this sounds logical, the historical record is contested. For instance, economic interdependence at the beginning of World War I was at a record high. One issue is that relative to individual countries' GDP, the amounts at stake in losing interdependence are usually relatively small. For instance, the volume of China-US trade in 2018 was US\$659 billion (United States Census Bureau, 2019). Given that the United States has a GDP of about \$20 trillion, the entire value of this trade could be replaced in a few weeks.<sup>[1]</sup>

The second condition, known as 'democratic peace', suggests that Western-style democracies do not fight each other. While the empirical record for this condition is extremely strong – no exceptions have been documented – the understanding of the underlying mechanism remains vague. Among the hypothesized drivers of democratic peace are mutual respect among democracies as well as the difficulty of motivating peoples of democratic nations to wage war against another democracy. Importantly, democratic peace does not mean that democracies do not go to war at all. They are more than ready to fight non-democracies, and the countries to have fought most wars in recent history – the United States, the United Kingdom, and France – are all democracies.

For liberalists, globalization requires two main ingredients: agreement of states to cooperate in permitting interdependence (i.e., opening their markets),

and international institutions (i.e., rules) that provide the institutional infrastructure that enables and maintains this cooperation. Accordingly, de-globalization is the result of states losing interest in interdependence, or international institutions failing, or both.

Conflict, including war, is the result of diverging interests, usually about major matters such as ideologies, territories, or international predominance. Economic interdependence reduces the risk of war, and the presence of Western-style democratic governance in all countries involved effectively eliminates the risk of war.

## **Realism**

Realism presents a much more reductionist and thus, despite its name, abstract approach to international politics. By assumption, the only actors in realism are sovereign nation states, all other actors including international organizations and the international rule books they represent are treated as irrelevant. Actors are assumed to be rational. Assumed to be irrelevant is also all domestic politics, including form of government.

Under realism, states all share the same interest: survival in a world that is ultimately anarchic and thus a 'self-help' system. This survival requires states to be able to defend themselves, which in turn is based on hard power in the form of economic and military strength. Importantly, power in realism is always relative to others and thus a zero-sum game: it is better to lose 2% of GDP if this causes a major rival to lose 5% of its GDP, than to grow GDP by 10% if this means letting the rival grow by 12%.

Realists have argued that globalization requires the presence of a hegemon – an overwhelmingly powerful state. The underlying idea is that international institutions that shape economic interdependence, such as WTO rules, are expressions of hegemonic power that forces other states to play by these rules. Accordingly, once a hegemon declines (i.e., it loses power relative to other states) and this decline becomes apparent to other states – for instance, through an economic crisis that reveals the inability of the hegemon to enforce the rules – globalization begins to unravel as countries start to opt out of the rules.

Hegemonic decline and attendant rise of a challenger is also associated with a heightened risk of major conflict and war (Allison, 2017; Gilpin, 1983). Under these conditions, the reigning hegemon will try to keep the challenger at bay. In the last resort, this could involve a preemptive war with the objective of destroying the challenger before it becomes powerful enough to overwhelm the incumbent hegemon.

## **CHINA'S CHALLENGE**

The issue for the future of Chinese business is that all triggers of de-globalization and conflict specified in both theories are present in the current environment.

Indeed, China has played a central role in bringing them about – not necessarily by intent, but certainly in effect. The sections that follow explore these questions with an emphasis on Sino-US relations, but the arguments especially under liberalism also extend, *mutatis mutandis*, to China's relations with other states.

## Realism

Under realism, the crux of the matter is straightforward: China's rise has challenged US hegemony. Key metrics that matter to realists are military and economic strength. Using military budgets and gross domestic products at purchasing power parity as proxies – which are admittedly subject to a range of measurement issues (Witt, 2019) – US economic strength relative to the next largest economy peaked in 1999, which is also the year in which China became the world's second largest economy (World Bank, 2018). By 2013, China's economy surpassed that of the United States in size, and by 2017, US GDP stood at 83% that of China (World Bank, 2018).

In terms of military budgets, the US reached its most recent high point in 1992, spending more than 9 times as much as France, the next closest contender at that time. By 2017, the US military budget was about 2.6 times the size that of China, whose military spending has grown by about 1,000% since 1990 while that of the US has remained roughly stable (Stockholm International Peace Research Institute, 2018; Witt, 2019). After corrections for purchasing power differences as well as the expenses that the United States incurs for ongoing wars and veterans, the gap shrinks further.

The upshot is that on both measures of power, the United States has been losing ground to China. For a realist, this makes conflict inevitable. In the past, this would probably have led to a global war (Allison, 2017; Gilpin, 1983). The saving grace in our day and age, according to realism, is nuclear weapons. To the extent that both sides can make a credible threat of mutually assured destruction, then under the critical assumption of rationality, a direct military confrontation becomes unlikely.

Other expressions of conflict remain possible. In military terms, one risk is the re-emergence of proxy wars, in which declining hegemon and challenger support different sides in regional conflicts that are safely away from either major power. Likely geographies for future proxy fights include South America, Africa, the Middle East, and parts of Asia.

On the economic front, realists would expect efforts by the declining hegemon to shore up its own economic power and weaken that of the challenger. The current trade wars initiated by the United States, for instance, may be consistent with this expectation. While these may impose an economic loss on all involved, including the United States itself, they may make sense from a realist perspective as long as others lose relatively more than the United States. To the extent this strategy bears fruit, its overall effect is a transfer of relative power to the United

States not only from the challenger, China, but also from other targeted markets including allies such as the European nations, Japan, and South Korea.

Similarly, visa restrictions the United States has begun to impose on Chinese students and scholars (Perlez, 2019; Zhang & Ren, 2019), especially in science, technology, engineering, and mathematics (STEM), may imply some loss to the United States, as it reduces the availability of talent at US research organizations. At the same time, the negative impact on China is likely to be even larger, as these measures impede the acquisition of knowledge that China has relied on to build up STEM industrial and research capacity. An analogous logic applies to restrictions on mergers and acquisitions by Chinese firms in the United States.

## **Liberalism**

Liberalism presents a more complex picture. National security matters, but liberalism offers different prescriptions on how to assure it. In addition, other societal interests co-determine foreign policy.

Liberalism offers two central prescriptions for preventing conflict: commercial and democratic peace. The European Union provides perhaps the clearest example of practical use of these mechanisms. Frequently misunderstood as a glorified free trade zone, the European Union in reality is a construct intended to help maintain peace in Europe (European Union, 2019). Trade and investments reinforce economic interdependence and thus are means towards commercial peace. In addition, prosperity through trade and investments is intended to anchor democracy in EU member states – only democratic countries are permitted to join the EU – which in turn should maintain democratic peace.

Both approaches have also played important roles in past US foreign policy. For instance, the United States encouraged the founding of the European Economic Community (predecessor of the EU) in part to make internecine war in Western Europe less likely. However, liberalism also lay at the heart of misadventures. For instance, democratic peace theory featured prominently in US government attempts to justify the second Iraq War and the attendant notion of forcible regime change (Owen, 2005).

Until the Trump Presidency, the underlying ideas and mechanisms of liberalism also guided US and Western foreign policy towards China. Rather than contain China at an early stage, as realism would have suggested, the United States from the 1980s through the Obama Presidency encouraged the development of economic interdependence (Pan, 2018). Clearly US business had an interest in trade and investments. However, the long-term aspiration was also to create economic interdependence, and thus commercial peace, as well as to facilitate democratization through growing prosperity (Pan, 2018) (see Moore, 1966), and thus the emergence of democratic peace. Expectations of democratization seemed like a safe bet, as no country without oil resources has become a rich economy in recent history without evolving towards Western-style democracy

(Witt, 2016). However, China under Xi Jinping has confounded these expectations: relatively high levels of GDP growth continue, but the country remains authoritarian in governance (Economic Intelligence Unit, 2019) without any near-term prospect of change. As a result, China is now seen as a liberalism bet gone wrong (Pan, 2018), undermining liberalist prescriptions for engagement and shifting the focus from positive-sum economic interdependence to zero-sum confrontation (Landler, 2018).

Viewed through the new lens of confrontation, some facets of economic interdependence now seem like a risk rather than a peace mechanism. For instance, shifting production to China has arguably had the effect of hollowing out of capabilities in the United States and in other Western economies that may be crucial to defense (Berger, 2013). Additionally, Chinese industrial policies supporting national champions combined with laws requiring Chinese firms to fully cooperate with the Chinese intelligence apparatus (Kharpal, 2019) have given rise to concerns about firms active in strategic industries, such as Huawei.<sup>[2]</sup> Complicating matters further, the announcement of the Made in China 2025 initiative formalized that China is seeking to attain world leadership in key industries. This has prompted a growing number of Western governments to curtail planned acquisitions, especially in high technology, by Chinese firms (Alderman, 2018; Rappeport, 2018). While these examples are hardly exhaustive, they illustrate a general point: business with and from China is increasingly seen as an inimical force that needs to be controlled or even banned. This is most clearly evident in the United States, but it is also visible in public discourse and policies of many other Western nations.

Reinforcing this trend is a growing sense that especially the United States has gained less from commercial engagement than anticipated. The evidence suggests that competition from China, not least that resulting from offshoring by US firms, has been hurting certain US industries and their workers (Acemoglu, Autor, Dorn, Hanson, & Price, 2016; Autor, Dorn, & Hanson, 2013). One of the responses available to displaced workers is to mobilize politically to seek redress through protection (Acemoglu et al., 2016; Frieden, 1991). Trump's election as US President as well as global populism are at least partially the consequences of such mobilization (Rodrik, 2018).

At the same time, China has proved a more difficult market than anticipated. Part of the explanation is that Chinese government policy has worked against establishing a level playing field for foreign firms, despite promises to the contrary. This is especially true in industries viewed as strategic or involving high technology (Ferracane & Lee-Makiyama, 2017). The 2017 OECD FDI Regulatory Restrictiveness Index rates China 67<sup>th</sup> out of 69 countries, ahead only of the Philippines and Saudi Arabia (OECD, 2019b), and China imposes by far the most restrictions on digital trade among the 64 countries included in the Digital Trade Restrictiveness Index (Ferracane, Lee-Makiyama, & van der Mazel, 2018). Western firms routinely complain about obstacles including 'administrative

issues, ambiguous rules and regulations, and an unpredictable legislative environment' (European Union Chamber of Commerce in China, 2018: 9).

Numerous additional points of friction impinge on the relationship as viewed through a liberalist lens, with US intelligence circles concluding that China has become a 'whole-of-society threat' (Perlez, 2019). For example, Chinese and US political ideologies clash, with the former emphasizing authoritarian one-party rule and the latter, individual freedom and democracy. The two countries disagree over China's territorial claims in the South China Sea (*Economist*, 2018b), its border disputes with Japan (Senkaku/Diaoyu Islands) (*Economist*, 2012), and with respect to Taiwan. Differences are also visible with respect to the treatment of the Uighurs in western China, which the Chinese governments defends as necessary for stability and the United States views as human rights violations (Buckley & Mozur, 2019; Buckley, Mozur, & Ramzy, 2019).

In sum, for liberalists, hopes for democratic peace with China have been dashed, economic interdependence seems to have produced fewer benefits than hoped for, and plenty of additional friction points have become salient. At the same time, the Sino-US trade war and more generally restrictions on trade and investments involving China are likely to reduce economic interdependence with China, with adverse consequences for globalization levels and the prospect of commercial peace.

## IMPLICATIONS FOR CHINESE BUSINESSES

These developments have a range of implications for Chinese businesses. The text below highlights three aspects: Chinese firms will need to substitute for advanced knowledge that so far was sourced elsewhere, to resolve critical dependencies on foreign suppliers, and to avoid being perceived or treated as enemy firms in host markets.

### Substituting for Inbound Knowledge Transfer

China has made great strides in academic and applied research. This is most clearly visible in patents granted to Chinese inventors. The most stringent of these metrics, triadic patents (i.e., those granted in all three, the United States, Europe, and Japan), indicates about a seven-fold increase in the global share of Chinese patents from 2006 to 2016 (latest available), from 0.97% to 6.94% (OECD, 2019a). While these measures have various flaws – e.g., some of these patents will have been registered by subsidiaries of Western MNCs in China (Witt & Redding, 2009) and not all knowledge is patented (Witt & Jackson, 2016) – it conveys a sense of how far the Chinese national innovation system has come over the past years.

This progress has benefitted from the openness of US and Western universities and research communities to Chinese students and scholars. In 2017/18, the United States hosted 363,341 Chinese college and university students, an

increase of almost 350 percent over a decade earlier (81,127) (Statista, 2019). Almost half of these pursued studies in fields related to STEM: engineering (19%), math and computer science (17.2%), and physical and life science (8.4%). Another 20.7% studied business and management (Institute of International Education, 2019). At the same time, while earlier generations of Chinese students tended to stay abroad, by now a majority of students return to China (*Economist*, 2018a). The knowledge these graduates acquire about developing and implementing innovation represents a massive knowledge transfer from the United States to China. Returnee students educated elsewhere in the West reinforce this effect.

Both realism and liberalism would expect growing resistance to allowing Chinese students and scholars access to Western universities and knowledge networks. From a realist perspective, the knowledge transfer noted earlier implies a loss of relative power of the United States in particular and the West in general vis-à-vis China.

Liberalists would consider a wider range of questions in addition to national security. For instance, allowing Chinese students and scholars into the country could be viewed as a tool of soft power (which realists consider irrelevant). Soft power requires, however, that these students and scholars return with a positive image of the host country. Part of the challenge with this is that many Chinese students tend to socialize mostly with compatriots (a phenomenon also observed with other Asian students), which reduces points of interaction with the host country (Spencer-Oatey, Dauber, Jing, & Lifei, 2017).

Liberalists would also consider the argument that a US education can be linked to commercial and democratic peace. Commercial peace may result on the basis of greater commercial linkages, which may be enhanced through contacts students and researchers make during their stays and familiarity with the respective other country. To the extent knowledge acquired in the US contributes to economic development, one could also argue that over time, this would ultimately lead to democratization. As noted earlier, at least the latter bet on democratic peace seems to have gone wrong for the case of China, effectively nullifying this point.

Liberalists would further weigh the interests of different constituents inside the country in arriving at a policy. For instance, given concerns noted earlier that US workers have lost out as a result of trade with and offshoring to China, enabling the transfer of technological know-how that may further erode the competitive positions of US firms becomes a problem. On the other hand, an argument can be made that the tuition money Chinese students pay and their intellectual input help reinforce US strengths in research and development.

Overall, the representation based on liberalism is much more complex than that under realism. Given cross-cutting pressures, liberalist policy is likely to be neither black nor white but some shade of grey. At the same time, taking into account the weakening of some of the arguments in favor of permitting access to Chinese students and scholars – soft power and democratic peace, in particular – one would expect a shift towards a more restrictive shade of grey.

Consistent with these expectations and the realist view, the US government has recently moved to reduce access to US universities and knowledge networks for Chinese nationals. For instance, visa rules have been tightened for graduate students in sensitive research areas such as robotics, aeronautics, artificial intelligence, or material sciences (Perlez, 2019; Zhang & Ren, 2019). Many Chinese graduate students in these areas who recently travelled back to China for vacations have been unable to obtain new visas even though they were still in the midst of their programs (Zhang & Ren, 2019). Similarly, a growing number of Chinese scholars has seen visa applications rejected or existing visas revoked (Perlez, 2019).

For Chinese firms, these developments could have important implications. First, the extent of advanced technological knowledge available to these firms is, *ceteris paribus*, likely to shrink. Second, the number of highly qualified researchers and engineers in China is, *ceteris paribus*, likely to be lower than it would otherwise have been. In principle, the Chinese government could work to ameliorate these issues. In practice, this may be easier said than done, given that the country has consistently experienced a skills shortage especially at the high end of the market (Witt & Redding, 2014). Chances therefore are that firms will have to bear part of the burden.

This opens up a range of research opportunities. A good starting point would be to undertake empirical work elucidating more precisely what role foreign-trained scientists and engineers have played in knowledge transfer to Chinese companies. We have some evidence that ‘returnees’ facilitate technology transfer to China (Li, Zhang, Li, Zhou, & Zhang, 2012; Liu, Lu, Filatotchev, Buck, & Wright, 2010; Luo, Lovely, & Popp, 2017). However, it is not clear from these studies whether the positive contribution comes from overseas education or from employment abroad. In addition, extant business and management studies tends to focus on high-technology clusters such as Zhongguancun in Beijing, which raises the question of how the findings generalize to the population of returnees more generally. Deeper insights in this area could extend the existing International Business (IB) literature on knowledge transfers, not least by elaborating contingencies. These findings would also potentially be policy relevant both for China and other countries, in that they could shed light on how significant these knowledge transfers can be under what circumstances.

Further potential for research lies in the responses of firms to this deterioration in the availability of knowledge and talent. How do firms adjust their internal processes for developing competitive capabilities? How do they adapt their strategic positioning in the market? And how do they interface with the institutional environment to solve these problems and prevent free-rider problems inherent in firm-level responses, such as the temptation to poach from other firms rather than train or develop internally? Given the exogenous nature of technology scarcity – the United States tightening of visa restrictions – and the differential impact on different fields of study, the current context may offer a natural experiment.

## Resolving Critical Dependencies on Foreign Suppliers

Not only has China become an important player in international value chains, China also sources many of the inputs for its own industries from abroad. This is particularly true for high-tech inputs such as advanced electronic components.

Following the same logic as laid out in the previous section, this implies a risk of being cut off from these high-tech supplies. The ongoing case of Huawei, a leading Chinese electronics firm, illustrates this point. In May 2019, the US government added Huawei to its 'entity list', barring US firms from selling software and components to the firm. Among others, this will deprive Huawei of licenses for the operating system for most of its mobile phones (Android, by Alphabet) and for the architecture of its mobile phone processors (by ARM). It remains to be seen whether and how Huawei will be able to adapt. In 2018, a similar case involving ZTE, another leading Chinese electronics manufacturer, was resolved quickly when US President Trump lifted the ban after consultations with Chinese Communist Party Chairman Xi Jinping. A similar reversal seems unlikely for Huawei, and other companies such as Hikvision, a leading supplier of surveillance equipment, may join the entity list soon (Swanson & Wong, 2019).

In addition, wider export restrictions are a distinct possibility. In November 2018, the US Department of Commerce invited comments on possible export controls for 'certain emerging technologies' (US Department of Commerce–Bureau of Industry and Security, 2018). The included list of representative technology categories runs the gamut of leading technologies, including biotechnology, artificial intelligence, semiconductors, advanced computing and quantum systems, logistics, advanced manufacturing, robotics, neural interfaces, aeronautics, materials, and surveillance techniques. While preparations are still ongoing (Behsudi, 2019) and no action has been taken as yet, the publication of this request was bound to set off alarms in China.

Exciting research opportunities grow out of these developments. In China, we are likely to see a redoubling of efforts at localizing the supply of critical components. While localization may well have been the plan anyway, growing US pressure and demonstrated vulnerability will have added urgency to it. For business and management research, this provides a potentially unique opportunity to mine new knowledge about the co-evolution of government industrial policy with the development of firm-level capabilities. It may also offer a fast track to understanding organizational processes in the context of de-globalization of supply chains. While these processes are likely to occur everywhere if the current trend towards de-globalization continues (Witt, 2019), they are likely to proceed much more quickly in Chinese industries currently dependent on high-tech imports. This could be a unique opportunity for building initial theory about these processes that may then be tested and extended as experience accumulates elsewhere.

## Managing Hostility Abroad

Few topics have received as much attention in the recent IB literature as Chinese outward FDI (OFDI). The above discussion suggests that we may see substantial changes in this area in the coming years.

Falling levels of FDI are, by definition, to be expected in a de-globalizing world. In addition, Chinese OFDI will be affected by geostrategic concerns about China's rise. Much of Chinese OFDI in advanced industrialized countries such as the United States and its allies has been strategic-asset-seeking. The underlying motivation for many of these cases seems to be to use foreign acquisitions as a 'springboard' to achieve quicker development, not least through technology transfers (Luo & Tung, 2018). *Mutatis mutandis*, similar concerns as for Chinese international students apply.

This has prompted Western societies to strengthen regulatory tools for preventing foreign acquisitions of local firms, with an eye especially towards thwarting Chinese investors (Alderman, 2018; Rappeport, 2018). For instance, the United States has rejected a series of Chinese attempts to buy semiconductor manufacturers in the United States and in allied nations (Mozur, 2016; Swanson, 2017). Similarly, the US government worked with Japan to prevent a possible Chinese acquisition of nuclear power company Westinghouse Electric (Soble, 2017).

Additional concerns arise where foreign direct investments may give Chinese firms access to key areas of the economy or to sensitive information. For instance, Alibaba's Ant Financial failed to obtain approval for purchasing MoneyGram in 2018, a deal that would have given it a larger role in the US financial system (Swanson & Mozur, 2018). In 2019, the US government forced Beijing Kunlun Tech to sell its controlling stake in Grindr, a gay dating app, to reduce the potential for the Chinese government to use the information gained through the app to blackmail US officials (Sanger, 2019).

This has contributed to a sharp decline in Chinese OFDI to advanced industrialized countries, possibly by as much as 73% in 2018 alone (Baker McKenzie, 2019). While other factors were also at play, including tighter control of outbound transactions by the Chinese government, controls on inbound investments did play a role. Some 21 planned investments in Europe and the United States did not pass regulatory review in 2018, and the tightened screening seems to have deterred at least some Chinese investors from even trying (Baker McKenzie, 2019). Reinforcing this trend further are growing restrictions on some Chinese products in overseas markets, such as drones and security cameras (*Economist*, 2019a).

A major implication of these developments is that a springboard strategy is becoming much more difficult to execute for Chinese firms. This leads to multiple different sets of research opportunities. The first of these dovetails with the research agenda growing out of the curtailment of knowledge transfers: how will Chinese firms and the Chinese government work towards substituting for external knowledge that is becoming less accessible?

A second set of research opportunities relates to those Chinese firms that do have an established overseas presence, especially in high-tech industries. As the example of Grindr illustrates, successful acquisition of a company in the past does not guarantee continued possession into the future. One possible response could be to transfer as much technology or information as quickly as possible and then to sell.

More interesting from a research perspective would be attempts to make continued Chinese ownership palatable to the host country. One question here is how to gain sufficient legitimacy in the host market. Existing research would suggest various avenues, such as increased efforts at local stakeholder engagement that include corporate social responsibility (CSR) activities (e.g., Henisz, 2017; Henisz, Dorobantu, & Narthey, 2014; Rathert, 2016; Yang & Rivers, 2009). But there may also be room for novel responses, with concomitant opportunities for theory extension. For instance, we may see organizational changes, such as a loosening of direct ownership ties, or new organizational forms, such as compartmentalized business groups (see Witt, 2019). At the extreme end of the spectrum of possible responses, we may even see firms that move all activities related to a given, sensitive business area out of China and to an overseas subsidiary. Ownership patterns – state or private – of Chinese firms may emerge as an important contingency governing the specific approaches chosen (Cui, Hu, Li, & Meyer, 2018).

A third set of research opportunities relates to how Chinese firms can devise effective strategies for the Chinese government to offer them political protection abroad. For some firms, this protection may come automatically, while others may have to work to obtain it. An expectation with face validity would be that the state will have an inherent interest in protecting the investments of state-owned enterprises (SOEs), especially of its 'central SOEs' administered by the State-owned Assets Supervision and Administration Commission (SASAC) (see Witt & Redding, 2014). The less ownership stake the state has in a given firm, and the less relevant that firm is deemed to be for further economic development or national security, the weaker the inherent tendency to provide protection is likely to be. If a firm under these latter conditions wants meaningful protection, it will probably have to work for it. Elucidating the mechanisms for gaining protection could help elaborate and extend theories related to the interplay of business and politics, for instance, in the area of non-market strategies.

An attendant point is how to best provide this political protection. The Chinese government is fully aware of its coercive power and has not hesitated to use it, especially against less powerful countries. The problem is that even if this approach secures short-term victory, it also tends to generate ill will towards China and its firms abroad, thus reducing their legitimacy.

An example is China's reaction to the arrest of Wanzhou Meng, CFO of Huawei, in Canada on the basis of a US warrant. The Chinese government has responded, not by acting against the United States as the originator of the

warrant, but by arresting Canadian citizens. Canadian exports to China have likewise suffered. China seems to consider these to be appropriate responses for defending a Chinese citizen and the interests of a leading Chinese firm. However, even if these efforts pay off and Meng is released, they will have come at a high price by reinforcing the impression of China as a threat. And since the IR literature indicates that countries tend to form alliances to balance against perceived threats (Walt, 1987), there is a distinct chance that these policies contribute to the formation and strengthening of an anti-China alliance.

The challenge for Chinese firms invested abroad is thus how to leverage the power of the Chinese government without falling into what might be termed the 'bully trap'. This seems to be new territory for the IB literature. Recent works have started to elucidate the impact of diplomatic relations between countries on aspects such as location decisions (Li, Meyer, Zhang, & Ding, 2018). But we have neither theoretical nor empirical treatment of the ways in which home governments attempt to protect the interests of 'their' firms. Characteristics of home country governance are likely to emerge as major contingencies in these approaches. For instance, China's response to the Meng case is clearly conditioned by the absence of rule of law – the notion that the justice system serves the law, and only the law – in China. In exploring these questions, for China but also other countries, lies a major opportunity to expand our understanding of IB.

## CONCLUSION

This essay began with an exposition of why IR theory suggests that de-globalization and Sino-American rivalry are not an aberration but to be expected under present conditions. A possible and increasingly likely scenario growing out of these considerations is a renewed cold war, with separate economic spheres of interest around China and the United States. These developments could open up exciting research opportunities, including questions of how Chinese firms will devise new ways to catch up and keep up with advanced technology, how they will resolve critical dependencies on foreign suppliers, and how they will avoid being perceived or treated as enemy firms in host markets.

While a cold war scenario is a likely outcome that is consistent with theory, other scenarios remain possible. For example, under realism, peaceful coexistence of China and the United States would become easier if China fell into the middle-income trap. Realism would suggest that a China that does not gain economically on the United States, and by extension does not have the funds to challenge US military superiority, would be much less likely to trigger a hostile response from the United States.

Conversely, under liberalism, democratic peace might prevail if an increasingly prosperous China moved toward Western-style democracy. A successful resolution of the current conflict over trade and market access could prompt further growth in economic interdependence, which would reinforce commercial peace.

And China might find a way to make a credible argument to the United States that it is not a threat, ideological or otherwise.

Of these, the most likely scenario is probably that of the middle income trap (Redding, 2016; Witt, 2016). That said, if any country could prove an exception to existing patterns, China would be a leading candidate. The country is currently experimenting with a 'social credit system', which uses comprehensive surveillance paired with artificial intelligence to score individuals based on their behavior and social connections (*Economist*, 2016; Mozur, 2018). Among others, this system may enable China to overcome its current lack of institutionalized trust: A functioning social credit system observing and sanctioning everyone would make deviant behavior close to impossible, thus potentially obviating the need for Western-style rule of law.

The other scenarios seem much less likely. Western-style democratization is clearly not the preference of the Chinese Communist Party. Trade and investment issues defy quick resolution because they have become associated with larger security issues. And it is unclear how a large and powerful country can make a credible argument that it is not a threat to anyone, perhaps with the exception of turning isolationist and inward-oriented.

A deepening cold war thus remains a likely trajectory from here. While this means we will live in interesting times, at least from a research perspective, there will be no shortage of exciting new opportunities.

## NOTES

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- [1] The precise impact is difficult to determine, mostly because of multiplier effects on other parts of the economy. Some of the trade, such as US agricultural exports, would also be likely to move to other destinations if China were no longer available as a destination, which in turn could reduce the negative impact.
- [2] It bears remembering that subsequent to the Snowden reports, China drew very much the same conclusion about Western telecommunications equipment and removed foreign equipment from its IT stack.

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