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Overview

Interdependence Imperiled? Economic Decoupling in an Era of Strategic Competition

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EXECUTIVE SUMMARY

This chapter assesses changes to the international economic landscape fueled by China's rise and examines how the U.S. is navigating this challenge.

MAIN ARGUMENT

The intensification of globalization in the post–Cold War era has contributed to deep economic integration with China. China's entry into the World Trade Organization made it a linchpin of global trade, and its impressive ensuing growth has enabled it to challenge U.S. hegemony. The rising rivalry with Beijing in recent years has driven Washington to pursue trade diversification, expand domestic manufacturing, and lessen dependency on China. While the Trump administration inchoately sought to decouple from China, the Biden administration has emphasized "de-risking" to protect critical supply chains while vigorously competing with China through various restrictive trade and industrial policies. Driven by this competition and their own problems with Beijing, key Indo-Pacific states are also struggling to diversify from China without cutting off any of the existing linkages that provide them with significant economic and strategic benefits.

POLICY IMPLICATIONS

- Large-scale economic decoupling from China is unlikely for the U.S. and Indo-Pacific nations given the importance of the absolute gains from trade. Consequently, narrow trade diversification may be the only outcome within reach.
- U.S.-China competition threatens globalization, even as China's diminishing trade linkages with the U.S. potentially increase its own strategic autonomy.
- Although U.S. de-risking might limit the dangers posed by Beijing to critical supply chains, China's strong trade ties with U.S. partners and others will advance both its domestic and strategic ambitions, thus undermining U.S. efforts to limit China's rising power.

Overview

Interdependence Imperiled? Economic Decoupling in an Era of Strategic Competition

Ashley J. Tellis

For a few years now, the United States and other nations in the Indo-Pacific region have faced increasing pressures to reconfigure their economic ties with China. The deep commercial linkages that reciprocally bind China and its trading partners have arisen due to globalization, the historical process centered on the growing interconnectedness of national economies because of the vastly increased cross-border exchange of goods and services, finance, technology, people, and data. These expanding ties, which intensified after the Cold War, have undoubtedly benefited all the states involved, at least in the aggregate, even if the resulting gains have not always been symmetrically shared either among or within them. In fact, the history of the last several decades suggests that all the states in the Indo-Pacific seemed willing to live with the differences in gains arising from their trade with China as long as the absolute benefits were positive and Beijing did not pose any significant threat to their security.

Until the advent of Xi Jinping as China's supreme leader, both conditions seemed to obtain—to the advantage of China as well as its trading partners. Unfortunately, the assertiveness that incipiently manifested first under Hu Jintao only intensified under Xi, thus raising the question of whether Beijing's partners, most importantly the United States, could live with the risks of their deepened economic dependence on China if it became a danger to their interests. These risks were seen to emerge from multiple directions.

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China's asymmetric gains from trade, some of which derived from its exploitative trade practices and which previously could be ignored, could not now be disregarded if they contributed toward the enlargement of its already massive and increasingly threatening military capabilities. Furthermore, China's willingness to constrict critical raw materials exports or access to its markets as a form of coercion raised questions about its commitment to mutually beneficial interdependence in the face of various political disputes. Finally, the growing recognition that China had become the locus of excessive concentration in the international economy for everything from electronics to pharmaceuticals—even if for entirely legitimate reasons—accentuated fears that it had come to enjoy unacceptable leverage vis-à-vis the rest of the international system.

None of these issues mattered much when China's international behavior was benign, as was consciously the case when Deng Xiaoping's policy of "hide and bide" guided the country's external conduct. But the rising Chinese forcefulness under Xi has intensified the threats perceived as emanating from China not only in neighboring countries and the United States but increasingly in Europe as well. Those nations most directly threatened by Chinese military power have consequently embarked on increased efforts at internal and external balancing. Internal balancing generally entails mobilizing greater domestic resources for security (usually manifested through larger defense budgets) and improving a nation's military forces to cope with the anticipated threats. External balancing, in contrast, involves doubling down on preexisting alliances where available or forming strategic partnerships of various kinds to parry the emerging dangers posed by China. Even when external balancing is possible, all countries that are unnerved by Chinese power—including the United States, its Asian allies, and various neutral powers in the Indo-Pacific—have concentrated on internal balancing as their primary instrument of defense. Such responses are to be expected whenever new threats surface in the unruly world of international politics.[1]

The resulting competition between China and its rivals, however, is occurring amid novel historical conditions: the deep economic interdependence produced by globalization. Unlike the Cold War, when the competing antagonists—the United States and the Soviet Union, together with their affiliates—had no meaningful commercial linkages with one another, China and its opponents today are bound together by deep economic ties along different dimensions. This new reality poses discomfiting dilemmas

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[1] For a useful overview of balancing and its internal and external facets, see William C. Wohlforth, Stuart J. Kaufman, and Richard Little, "Introduction: Balance and Hierarchy in International Systems," in *The Balance of Power in World History*, ed. Stuart J. Kaufman, Richard Little, and William C. Wohlforth (New York: Palgrave Macmillan, 2007), 1–21.

on all sides and raises the question of whether the states threatened by China will respond by diminishing their economic engagement with Beijing both in order to limit its increases in power and as a form of insurance against excessive dependency on China.

This issue is of interest for both theoretical and policy reasons. The pursuit of strategies focused on limiting economic engagement with China or diversifying away from it despite the higher costs entailed would suggest that the threatened states are willing to limit the absolute gains deriving from trade to concentrate on meeting the dangers to their security. This emphasis on relative over absolute gains would be consistent with the expectations of various realist theories of international politics.[2] The policy implications of such a shift are just as important: any concerted effort to consciously alter the existing patterns of trade, which hitherto were shaped mainly by market forces, creates opportunities for developing new strategic partnerships among states that may not have had tight economic linkages. Such a development not only would test the relative strength of state power over societal forces but also could boost the prospects for creating new "soft balancing" coalitions against China through economic ties as a complement to (or even as a substitute for) strategic affiliations.[3] The United States, in particular, as the hegemonic power most directly affected by China's rise as a new systemic rival, could be expected to display an inordinate interest in such developments, even encouraging them as a means of correcting the evolving shift in the balance of power with China.

This volume in the *Strategic Asia* series, *Reshaping Economic Interdependence in the Indo-Pacific*, examines whether there are fundamental changes occurring in the physical, financial, and virtual realms of the Asian trading system because of intensifying U.S.-China competition and China's rising political problems with many of its neighbors. Through a series of studies focused on key countries and the Southeast Asian subregion, the book investigates whether decoupling from China is underway in merchandise trade, service and investment flows, labor movements, and the digital economy and data governance (to the degree that each of these is significant for the countries in focus). To do so, each chapter describes the political challenges facing the nation (or nations) involved and the composition and direction of trade in order to assess whether any significant shift toward limiting the economic exposure to China is occurring and,

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[2] For a summary overview of the issues involved, see Joseph Grieco, Robert Powell, and Duncan Snidal, "The Relative-Gains Problem for International Cooperation," *American Political Science Review* 87, no. 3 (1993): 729–43.

[3] This concept receives extended discussion in T.V. Paul, *Restraining Great Powers: Soft Balancing from Empires to the Global Era* (New Haven: Yale University Press, 2018).

if so, the prospects for success. The entire volume is thus unified by an interest in examining the evidence for decoupling from China by various Indo-Pacific states and what the consequences of such a development might be for regional and global politics.

The headline conclusion is that, despite the growing dangers posed by Beijing, the regional states still value the gains from trade with China. They are loath to restrict their commercial ties because the absolute gains accruing are desirable both to fulfill domestic political objectives and to effectively support the internal balancing necessary to cope with Chinese assertiveness. To the degree that decoupling is contemplated, it is highly narrow and by no means universal. Most nations prefer to diversify some elements of their trade beyond China, but without cutting off any of the existing linkages with the Chinese production system. This suggests that geopolitical competition under globalization will remain a complicated endeavor: those states that gain a strategic advantage will not be those that restrict ties with their rivals as a rule but rather exploit the economic interdependence that binds them to their competitors, as well as to other bystanders, to buttress their own efforts at internal balancing. That, at any rate, seems to be the first-best strategy. A fallback approach centers on constricting trade with China in the narrowest ways—principally to protect national defense capabilities—while expanding economic links through high-quality agreements with a targeted set of friends and partners.[4]

This chapter sets the context for this conclusion and is divided into three sections. The first section examines how globalization arose and how it created the conditions for China's dominant presence in the global production chains that have propelled its international ascendancy. The second section describes how Washington began to push back against China's rise as a strategic rival by utilizing various instruments of statecraft to reconfigure its post–Cold War commercial ties with Beijing in order to protect U.S. hegemony. The third section summarizes the key insights emerging from the chapters in this volume, which illuminate the larger conclusion that decoupling, even in soft forms, is proving to be difficult in the Indo-Pacific, although many states persist in their efforts to limit their vulnerability to Chinese power. The conclusion summarizes the implications for future great-power competition between the United States and China.

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[4] This conclusion is based on the insight originally detailed in Duncan Snidal, "Relative Gains and the Pattern of International Cooperation," *American Political Science Review* 85, no. 3 (1991): 701–26. For further discussion, see Ashley J. Tellis, *Balancing Without Containment: An American Strategy for Managing China* (Washington, D.C.: Carnegie Endowment for International Peace, 2014); and Ashley J. Tellis, "The Geopolitics of the TTIP and the TPP," in *Power Shifts and New Blocs in the Global Trading System*, ed. Sanjaya Baru and Suvi Dogra, Adelphi Series 450 (London: International Institute for Strategic Studies, 2015).

The Rise of Globalization and Its Consequences

When viewed over the long arc of modern history, the postwar period has witnessed the most dramatic upsurge in economic interdependence. If the modern era is dated as beginning in 1492, the extent of trade openness—defined as the sum of global exports and imports divided by global GDP—never exceeded 10% before the early nineteenth century.[5] The first wave of globalization that began thereafter saw a dramatic spike, reaching a high of around 30% early in the twentieth century, but this expansion collapsed with the onset of World War I, and the downturn persisted throughout the interwar period and into World War II.[6]

The triumph of American hegemony in the aftermath of that catastrophic conflict breathed fresh life into global trade as the new superpower consciously set about recreating an open trading system that was intended to, *inter alia*, rebuild the war-torn states in order to buttress their stability and thereby strengthen the various U.S.-led alliances in their struggles against global Communism.[7] This new regime, which would launch the second wave of globalization, had to overcome significant domestic and international preferences for protectionism. It was finally institutionalized through the General Agreement on Tariffs and Trade (GATT). The GATT enshrined the United States' postwar conviction that free markets at home, when married to increasingly freer trade abroad, remained the most efficient device not only for accelerating economic growth and expanding national power but also for producing peace and stability—which would inevitably result from the deepened economic interdependence produced by the progressive elimination or reduction of quotas, tariffs, and subsidies among the participating states.

This vision proved eminently successful. By 1995, when the GATT had evolved into its successor entity, the World Trade Organization (WTO), the original 23 signatories had expanded to 125 countries, with their economic interactions covering about 90% of global trade.[8] Not surprisingly, trade openness in the international system had then reached an all-time high at a little over 43%.[9] This outcome was clear evidence of the success of U.S.

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[5] Antoni Estevadeordal, Brian Frantz, and Alan M. Taylor, "The Rise and Fall of World Trade, 1870–1939," *Quarterly Journal of Economics* 118, no. 2 (2003): 359–407.

[6] Mariko J. Klasing and Petros Milionis, "Quantifying the Evolution of World Trade, 1870–1949," *Journal of International Economics* 92, no. 1 (2014): 185–97.

[7] For the history of this effort, see Thomas W. Zeiler, *Free Trade, Free World: The Advent of GATT* (Chapel Hill: University of North Carolina Press, 1999).

[8] "General Agreement on Tariffs and Trade," *Encyclopedia Britannica*, August 1, 2023, https://www.britannica.com/topic/General-Agreement-on-Tariffs-and-Trade.

[9] Drawn from World Bank, "Trade (% of GDP)," World Development Indicators, https://datacatalog.worldbank.org/indicator/f22f8e24-c0ce-eb11-bacc-000d3a596ff0/Trade----of-GDP.

policy. Since the end of World War II, Washington had consistently pushed for expanded international trade through eight rounds of GATT negotiations. Each one built on the achievements of its predecessors to reduce quantitative barriers and institutionalize the idea of trade without discrimination—codified in the "most favored nation" principle—while creating new mechanisms for arbitrating interstate commercial disputes and setting the pattern for complex future multilateral negotiations.

Even as the United States exhibited leadership on trade expansion, its vast military capabilities—despite concurrently competing with Soviet power—provided the systemic guarantees that the physical movement of goods across the commons would proceed unhindered. Simultaneously, U.S. military prowess ensured that the inequalities in relative gains that inevitably arise in all trading relationships would not be exploited by some of the participating states to threaten the security of other key actors within the trading network.[10]

The GATT years (1947–95) thus witnessed the progressive expansion of globalization that had first begun in the nineteenth century, with beneficial effects for international economic growth and the progressive revitalization of those countries destroyed by World War II. While the lowering of trade barriers and the asymmetric opening of the U.S. market to U.S. allies and less-developed countries had an important role to play in producing these outcomes, advancements in technology also made a huge difference. The remarkable transformations in transportation, especially road and rail networks, shipping, and aviation, that had long been underway—when married to the differences in national factor endowments—now permitted the large-scale decoupling of the production and consumption nodes that gradually became visible during the Cold War era. The advanced economies in North America, Europe, and eventually Northeast Asia exploited the fruits of industrialization to create lucrative production clusters in their home regions. This clustering permitted the fabrication of complex commodities by reducing the costs of coordination required to produce these goods. Due also to the diminishing costs of transportation, huge numbers of high-quality finished products could now be delivered easily throughout the developed world and to developing countries.[11]

The emergence of these early global value chains, which defined the character of the postwar economic system prior to the rise of China, created a striking divergence in international incomes between the developed

[10] Michael C. Webb and Stephen D. Krasner, "Hegemonic Stability Theory: An Empirical Assessment," *Review of International Studies* 15, no. 2 (1989): 183–98.

[11] Richard Baldwin, "Global Supply Chains: Why They Emerged, Why They Matter, and Where They Are Going," in *Global Value Chains in a Changing World*, ed. Deborah K. Elms and Patrick Low (Lausanne: WTO Publications, 2013), 13–59.

and developing countries. The former were marked by the capacity for technological innovation, manufacturing specialization, production at scale, and remunerative exports, while the latter—most of which were still poor and recovering from the legacies of colonialism—were unable to compete either in large-scale industrialization or in technological innovation. (The Soviet bloc, which chose to sit out of the economic integration occurring among its rivals, attempted to ape both their industrialization and their innovation but came out a poor second.) As a result, the GATT era was characterized by a striking increase in the wealth accruing to the industrialized economies of the "first world." Although the less industrialized states of the developing "third world" also grew as a result of their connectivity to the open trading system, their income gains were less pronounced. As Lant Pritchett summarized, "The growth rates of [developing] countries have been, on average, slower than the richer countries, producing divergence in relative incomes."[12]

The advent of the WTO era, however, would transform these dynamics dramatically. At the highest level of generalization, the second wave of globalization that began after World War II and gathered steam during the GATT period has been sustained to this day. The level of trade openness, which had grown to over 43% by 1995, has risen even further since: it peaked at almost 61% in 2008, just before the global financial crisis hit, recovering to slightly under 57% in 2021.[13] World trade has undoubtedly grown more slowly than GDP since the financial crisis—a reality that the *Economist* has dubbed "slowbalisation"[14]—but, as one other survey concluded, "the globe [still] remains deeply interconnected, and [trade] flows have proved remarkably resilient [even] during the most recent turbulence."[15] This study, in fact, notes that "trade in manufactured goods reached a record high in 2021 despite [the] new disruptions to supply chains" caused by the U.S.-China trade war and the Covid-19 pandemic, and "the fastest-growing flows are now data, services, intellectual property (IP), and international students."[16] All this data suggests that globalization endures despite countervailing pressures.

The fact that economic connectivity has increased since the WTO came into existence, however, should not obscure the critical changes that have occurred since the end of the GATT era. The earliest phase of postwar globalization brought about by the GATT system was distinguished by the manufacturing dominance enjoyed by the advanced economies and their

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[12] Lant Pritchett, "Divergence, Big Time," *Journal of Economic Perspectives* 11, no. 3 (1997): 3–17.

[13] Drawn from World Bank, "Trade (% of GDP)."

[14] "The Steam Has Gone Out of Globalisation," *Economist*, January 24, 2019.

[15] Janet Bush, ed., "Global Flows: The Ties That Bind in an Interconnected World," McKinsey Global Institute, November 2022, iv.

[16] Ibid., 4.

export gains arising out of the maturing revolutions in transportation. With the steady integration of developing countries into the global trading system (especially China, which joined the WTO in 2001), further shifts were underway. For one thing, the legacies of colonialism had increasingly receded into the past, and most of the third world was now populated by a variety of developmental states. The most capable nations, such as China, had favorable factor and social endowments that positioned them to exploit the emerging technological revolutions that were beginning to unfold. The ensuing transformations in the international economic system would be propelled this time around not by local clustering and lowered transportation costs—the drivers of change during most of the GATT era—but rather by the interaction of labor cost differentials and the emergence of the information and communications technology (ICT) revolution.[17]

These new variables amplified the benefits previously produced by industrial growth, such as urbanization, the upskilling and education of the workforce, and the local production of medium-complexity goods, but also created new effects. The availability of a huge pool of skilled low-cost labor in China (and to a lesser degree in Southeast Asia) induced multinational firms from developed countries to move their manufacturing operations to these locales, where Western technology, management skills, and finance were married to indigenous labor to produce advanced manufactured goods on a large scale for export to the world at large. The arrival of the ICT revolution enabled a radical desegregation of the manufacturing process: it made possible the supervision of "complexity at distance,"[18] such that each component of the finished product could be fabricated in different national locations based on their cost advantages. The persisting gains in lower transportation costs that were first realized during the GATT era, then, permitted these components to be exported and re-exported as necessary across borders before being finally assembled into end products in China prior to their eventual sale to the wider world.

China's large size, its huge reserves of savings, its low-cost yet skilled manpower, the remarkable industriousness and entrepreneurism of its people, and its purposeful state-controlled economic liberalization thus made it a conspicuous beneficiary of this latest evolution of globalization. In time, the consolidation of this pattern enabled China to develop a vast production system (a "global value chain") centered on itself, integrating thousands of component suppliers (mainly in Northeast and Southeast Asia but also, when necessary, in Europe and the Americas) who produced intermediate goods

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[17] Baldwin, "Global Supply Chains," 16–24.

[18] Ibid., 16.

for the finished products that were finally manufactured in China either for domestic consumption or for export.[19]

Thanks to this progression in globalization, China became the "new workshop of the world,"[20] one that currently produces close to 30% of the world's manufacturing output and dominates the global trading system, with close to a 15% share of global exports (almost double that of the United States in the second spot) and an 11.5% share of global imports (second only to the United States) in 2020.[21] This outcome was a natural product of the success of market capitalism as it crossed national boundaries. Once the overarching framework of economic cooperation was constructed through state action, private actors from the developed world in search of profit moved technological, managerial, and financial resources to China, which were married to its cheap and skilled labor to create allocative efficiency on a scale that was previously beyond reach.[22] This transformation, in turn, produced three critical consequences that would have an important bearing on the future of interdependence.

For starters, the rise of China and the concomitant rise of Asia resulting from the WTO era of globalization undermined the industrial dominance of the developed world that was the distinguishing characteristic of the GATT period. Today, deindustrialization marks the developed West in conspicuous ways as a small number of developing countries—mostly centered on the Chinese production system—have eclipsed the older and previously established centers of mass manufacturing, often creating new economic and political problems in these countries as a result.[23] As this process has unfolded, the income differences between the developed and developing world are also diminishing. While the gap between the two is still significant, the income divergence that marked the GATT era is eroding as

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[19] Alicia Garcia Herrero, "China and the Transformation of Value Chains," Bruegel, November 2019, https://www.bruegel.org/sites/default/files/wp-content/uploads/2019/11/Presentation-by-Alicia-Garcia-Herrero.pdf.

[20] "A New Workshop of the World," *Economist*, October 10, 2002, https://www.economist.com/asia/2002/10/10/a-new-workshop-of-the-world.

[21] "Top 10 Manufacturing Countries in the World," Safeguard Global, December 20, 2022, https://www.safeguardglobal.com/resources/blog/top-10-manufacturing-countries-in-the-world; Alessandro Nicita and Carlos Razo, "China: The Rise of a Trade Titan," UN Conference on Trade and Development, April 27, 2021, https://unctad.org/news/china-rise-trade-titan; and General Administration of Customs of the People's Republic of China, "Review of China's Foreign Trade in 2020," January 14, 2021, http://english.customs.gov.cn/Statics/436edfa3-b30d-45cd-8260-7d5baf34a5a8.html.

[22] For details, see Mona Haddad, "Trade Integration in East Asia: The Role of China and Production Networks," World Bank, Policy Research Working Paper, no. 4160, March 2007, https://documents1.worldbank.org/curated/en/934051468236684868/pdf/wps4160.pdf.

[23] Khuong Vu, Nobuya Haraguchi, and Juergen Amann, "Deindustrialization in Developed Countries amid Accelerated Globalization: Patterns, Influencers, and Policy Insights," *Structural Change and Economic Dynamics* 59 (2021): 454–69.

the share of global GDP produced by the developed world steadily contracts. The International Monetary Fund estimates that when GDP is measured in terms of purchasing power parity, the emerging and developing world already contributes more to global GDP than the advanced economies and has done so since around 2007.[24]

Furthermore, although the power of the advanced economies still lies in their possession of superior technology and scientific knowledge—as embodied in IP—the globalization of production chains has resulted in the diffusion of critical technologies to the new producers of intermediate and final goods in the developing world.[25] Because international production chains require high-quality components from numerous sources, the Western owners of IP invariably seek to nurture long-term business relationships with various manufacturing units, which often take the form of joint ventures with local firms in key emerging economies. This, in turn, often entails capital expenditures to create advanced production facilities, training for the native labor force, the inculcation of managerial expertise, and the transfer of technology to meet the quality standards expected of these products manufactured overseas.[26]

In a country like China, which boasts both a calculating state that is determined to transform its technology base and a highly skilled labor force that can absorb many advanced technologies received from abroad, the diffusion of IP to the progressive disadvantage of its creators is inevitable—even if the more egregious possibilities of coercive transfers and outright theft are disregarded. Given the predictability of this outcome, IP holders from the developed world invariably aim to utilize the profits recovered from overseas manufacturing to fund further advancements in technology so as to ensure their continued dominance. Although risky, the successes of globalization leave them with few better choices, even if the technological leavening of the recipients eventually contributes to expanding the strength of their home countries.

Finally, the growing economic power of the developing world and its increasing technological competency due to the successful globalization witnessed in the WTO era have produced shifts in the geopolitical balance of power, with the rise of China only being the most striking example of

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[24] International Monetary Fund (IMF), "GDP Based on PPP, Share of World," https://www.imf.org/external/datamapper/PPPSH@WEO/OEMDC/ADVEC/WEOWORLD.

[25] For more on this dynamic, see IMF, *World Economic Outlook: Cyclical Upswing, Structural Change* (Washington, D.C.: IMF, 2018), 173–214.

[26] For an insightful overview of the process, see Fukunari Kimura, "How Have Production Networks Changed Development Strategies in East Asia?" in Elms and Low, *Global Value Chains in a Changing World*, 361–83.

this phenomenon.[27] Any shift in the underlying distribution of material capabilities has geopolitical impact, and the history of the postwar period is no exception to this rule. But the two previous alterations that occurred under the aegis of U.S. hegemony had minimal disruptive impact because the early revival of war-torn Europe and the later regeneration of the East Asian economies, such as Japan, South Korea, Taiwan, and Singapore, all involved small nations that had either alliance ties or close affinities with the United States. The rise of China, however, is different for several reasons. China is a large, continental-sized country that rivals the United States in potential power. It has prospered greatly because of its participation in the U.S.-led trading order, yet it increasingly poses a persistent and dangerous military threat to the guardian of that system, the United States, as well as to U.S. allies. Moreover, Beijing has sharp political and ideological differences with Washington, which have made it Washington's most consequential rival since the end of the Cold War marked the demise of the Soviet Union.[28] The deepening antagonisms between the United States and China are thus not surprising: they mirror the problems witnessed endlessly when power distributions threaten to shift in the international system.[29]

What makes the U.S.-China competition in the postwar period unique, however, is that it is deeply embedded within the economic interdependence that has been produced by the very globalization fostered by the United States. The economic linkages between the two countries are so deep that they have been aptly described as in "codependency."[30] Yet the ties that bind have also begun to chafe as Washington and Beijing now struggle to advance their own competitive geopolitical interests. China's assertive behaviors in various parts of the Indo-Pacific have created similar challenges for its other economic partners—Japan, South Korea, Taiwan, the Philippines, and India, to name a few. All these states have strong trade ties with Beijing, but their persistent political problems with

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27 For a rich history that illuminates the past, see George Modelski and William R. Thompson, *Leading Sectors and World Powers: The Coevolution of Global Economics and Politics* (Columbia: University of South Carolina Press, 1996). For a specific application to China, see Michael D. Swaine and Ashley J. Tellis, *Interpreting China's Grand Strategy: Past, Present, and Future* (Santa Monica: RAND Corporation, 2000), 151–229.

28 Ashley J. Tellis, "Power Shift: How the West Can Adapt and Thrive in an Asian Century," German Marshall Fund and Legatum Institute, Asia Paper Series, January 2010.

29 Robert Gilpin, *War and Change in World Politics* (Cambridge: Cambridge University Press, 1981); and Karen A. Rasler and William R. Thompson, *The Great Powers and Global Struggle, 1490–1990* (Lexington: University Press of Kentucky, 1994).

30 Stephen Roach, *Unbalanced: The Codependency of America and China* (New Haven: Yale University Press, 2014).

China have resulted in "hot economics, cold politics" increasingly defining the nature of their overall relationship.[31]

The U.S. Pushback Against China

Given these developments, the United States has attempted to extricate itself from the constraints imposed by economic interdependence with China by toying with the idea of "decoupling"—that is, by limiting economic engagement with Beijing in order to either correct U.S. economic losses or restore Washington's freedom of action in the arena of international politics.[32] Whatever the motivations, the notion of decoupling is aimed at consciously reducing U.S. dependency on China, which, if taken to its limit, would imply the recreation of entirely separate global production chains that have no (or at best minimal) reliance on Chinese materials, technology, or production facilities. If such an outcome could be engineered, it would effectively result in a fragmented globalization, where relatively independent production networks—each incorporating separate supply chains and possibly different technical standards, business models, and legal and regulatory frameworks—would come into being and coexist unhappily.[33]

An evolution of this sort would be extraordinary on multiple counts. Any significant restructuring now between major trading partners such as the United States and China would be distinctive in the first instance because it would have occurred in peacetime. In the past, war has been the main precipitant for radical dislocations in commercial exchanges across national borders.[34] Such a development, to the degree that it was precipitated by U.S. political decisions, would also be ironic in that Washington would finally have mimicked Beijing's "desire for a kind of managed integration that enhances China's development progress, while building national champions and mitigating the risks associated with a full merging with the global economy."[35] This evolution would be enormously consequential as well. Because the

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[31] Ji Siqi and Ralph Jennings, "China, Philippines Cautiously Flip Trade Dip as 'Hot Economics, Cold Politics' Define Relations," *South China Morning Post*, August 9, 2023, https://www.scmp.com/economy/china-economy/article/3230537/china-philippines-cautiously-flip-trade-dip-hot-economics-cold-politics-define-relations.

[32] Keith Johnson and Robbie Gramer, "The Great Decoupling," *Foreign Policy*, May 14, 2020, https://foreignpolicy.com/2020/05/14/china-us-pandemic-economy-tensions-trump-coronavirus-covid-new-cold-war-economics-the-great-decoupling.

[33] "Economic Decoupling: Our New Reality?" American Chamber of Commerce in France, December 2021, https://amchamfrance.org/wp-content/uploads/2021/12/Economic-Decoupling-Our-New-Reality.pdf.

[34] Johnson and Gramer, "The Great Decoupling."

[35] "Decoupling—Severed Ties and Patchwork Globalisation," European Union Chamber of Commerce and MERICS, 2021, 10, https://merics.org/en/report/decoupling-severed-ties-and-patchwork-globalisation.

United States is the principal underwriter of the open trading system, any major shift by Washington toward protectionism would constitute not a modest erosion but a fundamental rewriting of the rules of the game. Unlike China's parasitic integration into the global trading system—an outcome that, however corrosive, was tolerable because, when all is said and done, Beijing is still more a beneficiary of the regime than its guarantor—U.S. policies on international trade remain the cornerstone on which its continued health, not to mention liberalization, depends.[36] As such, even purely national decisions taken by Washington have extranational effects.

That the structural disruption of trade flows ensuing from the pursuit of decoupling would undermine the postwar U.S. vision of global economic integration goes without saying. But it would also do more. It would subvert the greatest achievements of globalization hitherto: the increases in allocative efficiency and, by extension, the improvements in aggregate growth and welfare, as well as technological innovation, which have increased the overall prosperity of the developed world even as they have raised incomes and lifted millions out of poverty in developing countries. The danger of putting these gains at risk is well understood in the United States, but the pressures to decouple from China nonetheless have deep roots in two sources.

For starters, national security elites fear that the rise of China has diminished the relative power of the United States. This weakening of U.S. hegemony not only erodes its capacity to protect the larger Western international order but also weakens, in the language of Mancur Olson, its standing as a "privileged" actor, meaning its ability to make those supernormal contributions necessary to maintain the open trading system as a collective good.[37] Rectifying the loss in relative power requires the United States to consider, among other things, some sort of decoupling from China that holds the promise of limiting its ascendancy.[38] If the United States can recover its relative advantages as a result, it could—in the most optimistic conception—continue underwriting the open trading system with fewer burdens than might be possible in the face of progressive (relative) decline.

Furthermore, the threats posed to the United States and its partners by Beijing's growing military and technological capabilities often provide sufficient reason for Washington to consider decoupling from China as a means of arresting its growth. Such decoupling is arguably even

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[36] The relationship between trade openness and hegemonic power remains the foundation of hegemonic stability theory, which received its classic formulation in Charles Kindleberger, *The World in Depression, 1929–1939* (Berkeley: University of California Press, 1973). Kindleberger emphasized that open trading systems could survive only if there existed a hegemonic power to bear the costs of upholding them.

[37] Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965), 48–50.

[38] An extreme version of this argument is offered in Robert Lighthizer, *No Trade Is Free: Changing Course, Taking on China, and Helping America's Workers* (New York: Broadside Books, 2023).

more justified because China has already pursued a strategy of targeted disengagement from the global trading system right from the moment when it began opening up to the world. Consequently, a U.S. response that helped limit China's advantages and thereby improve its relative position globally was necessary to sustain the open trading system over the long term while neutralizing the growing political dangers posed by expanding Chinese military and technological capabilities.[39]

Even as concerns about relative gains and their impact on U.S. participation in the international trading system surfaced, Washington initially responded by attempting to correct the problems through further liberalization of global trade. The Doha round of WTO negotiations sought to expand trade in agriculture and services as well as to protect IP (in addition to other efforts at enlarging market access) with the ambition of securing gains for the United States where it had important comparative advantages. The difficulties attending these negotiations eventually pushed Washington to pursue partial free trade agreements involving selected partners as a substitute for universal trade expansion, a strategy that unfortunately met with only partial success.

While these efforts were underway, the impact of the "China shock" began to be increasingly felt in the United States (and other industrialized nations).[40] Between China's comparative advantages and its structurally unfair trade practices, those U.S. states most exposed to competition from China experienced increased unemployment and reduced wages resulting from dramatic deindustrialization. It has been estimated that China's entry into the WTO accounted for 59.3% of all U.S. manufacturing job losses between 2001 and 2019.[41] Such outcomes should not have been surprising. Although classical trade theory predicted that exchange across borders would leave both partners better off, not all individuals within the trading nations

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[39] Charles W. Boustany Jr. and Aaron L. Friedberg, "Partial Disengagement: A New U.S. Strategy for Economic Competition with China," National Bureau of Asian Research, NBR Special Report, no. 82, November 2019, https://www.nbr.org/wp-content/uploads/pdfs/publications/sr82_china-task-force-report-final.pdf. See also Aaron L. Friedberg, *Getting China Wrong* (Medford: Polity Press, 2022), which defends a partial free-trade system as the solution to the problems posed by China's asymmetric gains.

[40] David H. Autor, David Dorn, and Gordon H. Hanson, "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade," National Bureau of Economic Research, NBER Working Paper Series, no. 21906, January 2016, https://www.nber.org/system/files/working_papers/w21906/w21906.pdf.

[41] Autor, Dorn, and Hanson, "The China Shock." The findings of this working paper are summarized in "The China Shock and Its Enduring Effects," Stanford Center on China's Economy and Institutions, SCCEI China Briefs, October 1, 2022, https://fsi9-prod.s3.us-west-1.amazonaws.com/s3fs-public/2022-12/china_shock_enduring_effects_10.1.22.pdf. The longer-term impact of the China shock has been disputed by other studies, which are usefully summarized in Scott Kennedy and Ilaria Mazzocco, "The China Shock: Reevaluating the Debate," Big Data China, October 14, 2022, https://bigdatachina.csis.org/the-china-shock-reevaluating-the-debate.

would benefit equally. Even if the populations at large gained from lowered prices because of trade, groups may be advantaged differently depending on what they consume. Moreover, even if they do benefit where consumption is concerned, these gains might not compensate sufficiently for the employment and wage losses that could come in the wake of expanded trade.[42] When the domestic losers from globalization are concentrated geographically, they can possibly shape political outcomes—using the power of the ballot to correct the losses suffered in the marketplace.

Whether or not this factor was critical to the outcome of the 2016 U.S. presidential election, Donald Trump entered office on a plank aimed at containing China as an economic, and especially as a trading, threat to the United States. In short order, his administration also declared China to be a strategic competitor that was "leveraging military modernization, influence operations, and predatory economics to coerce neighboring countries to reorder the Indo-Pacific region to [its] advantage."[43] This growth in Chinese power, the administration correctly noted, helped underwrite Beijing's massive military modernization, which was aimed at seeking "Indo-Pacific regional hegemony in the near term and displacement of the United States to achieve global preeminence in the future."[44]

Although Trump personally seemed curiously ambiguous about the national security threats posed by China's rise, he nonetheless sought to counter its economic ascendancy. He did so, however, through an erratic and counterproductive campaign of imposing tariffs not only on China but also on many U.S. allies—an approach consistent with his view that the multilateral trade system was disastrous for the United States. Trump's tariffs, unfortunately, proved to be the bigger disaster, costing the U.S. economy dearly in terms of lost wages, jobs, and GDP growth, while doing nothing to correct the structural distortions in China that were the source of its unfair advantages in international trade.[45] In any event, toward the end of Trump's term in office, the disruptions caused by the Covid-19 pandemic only served to remind the world about the dangers of China's domination in global manufacturing and pushed the United States and its partners

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42 For a useful summary of the distributional consequences of trade, see Erhan Artuc, "Distributional Effects of International Trade: Facts and Misconceptions," World Bank, Development Research Group, https://thedocs.worldbank.org/en/doc/621581582658115902-0050022020/original/ErhanArtucPolicyResearchTalkTheDistributionalEffectsofInternationalTrade.pdf.

43 U.S. Department of Defense, "Summary of the 2018 National Defense Strategy of the United States of America," 2018, 2, https://dod.defense.gov/Portals/1/Documents/pubs/2018-National-Defense-Strategy-Summary.pdf.

44 Ibid.

45 Erica York, "Tracking the Economic Impact of U.S. Tariffs and Retaliatory Actions," Tax Foundation, July 7, 2023, https://taxfoundation.org/research/all/federal/tariffs-trump-trade-war.

toward contemplating further decoupling from China as a means to increase their national resilience to future shocks. Trump succinctly captured these sentiments when he declared: "We will make America into the manufacturing superpower of the world and will end our reliance on China once and for all. Whether it's decoupling or putting in massive tariffs like I've been doing already, we will end our reliance in China, because we can't rely on China."[46]

The Russian invasion of Ukraine, which began a little over a year after Trump departed office, pushed the European community further in this direction. The costs of being deeply dependent on Russian energy now came to be acutely burdensome, with the result that Europe too finally joined the United States in discovering the merits of decoupling, this time from Russia. The discomfort with globalization, which was manifested early through the United Kingdom's 2016 referendum on Brexit, thus received its final consolidation through the war in Ukraine. The war pushed the United States and Europe—previously the greatest champions of globalization—together on a new course that reflects a marked suspicion of free trade and deeper international integration. This policy shift is striking because it also implicates key Indo-Pacific countries such as Japan and South Korea, which benefited from free trade but are now looking for substitutional solutions because of their own growing problems with China. All told, then, even though globalization itself is not receding, the loss of policy support for its open-ended expansion is a significant change from the optimism that prevailed after the end of the Cold War. As such, this new consensus represents a clear—and potentially dangerous—break from past U.S. trade policy during the postwar era.[47]

Because China, however, has become so central to the global economy, any radical decoupling from it is unlikely to lie within reach during peacetime. Not only would any such effort prove to be utterly chaotic if implemented as a state policy, but it also would result in a striking diminishment of the standards of living, even in the developed world, with disruptive economic and political consequences. The turbulent dislocations would make the disruptions of the Covid-19 pandemic seem trivial in comparison.

Consequently, President Joe Biden's administration has replaced its predecessor's inchoate ambitions about decoupling from China with a more limited goal, now described as "de-risking," which has been defined as "having resilient effective supply chains, and ensuring [that the United

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[46] "Trump Again Raises Idea of Decoupling Economy from China," Reuters, September 15, 2020, https://www.reuters.com/article/usa-trump-china/trump-again-raises-idea-of-decoupling-economy-from-china-iduskbn25z08u.

[47] For an insightful survey of this issue, see Pinelopi K. Goldberg and Tristan Reed, "Is the Global Economy Deglobalizing? And If So, Why? And What Is Next?" Brookings Institution, Brookings Papers on Economic Activity, Spring 2023, https://www.brookings.edu/wp-content/uploads/2023/03/BPEA_Spring2023_Goldberg-Reed_unembargoed.pdf.

States] cannot be subject to the coercion of any other country."[48] If taken at face value, this description suggests that the United States simply seeks to create a redundancy of supply chains—either through unilateral investments or through cooperative actions with its friends—where certain critical technologies are concerned. Yet even a cursory survey of the administration's actions suggests that this explanation of what de-risking entails is all too modest. On the contrary, the diverse actions undertaken, though intended to exemplify targeted disengagement, actually reflect the larger strategic competition with Beijing. They express the administration's conviction that winning the great-power sweepstakes with China requires not merely parrying its emerging military threats in the Indo-Pacific and globally but also, and more fundamentally, dominating the cycles of innovation—by maintaining "as large of a lead as possible" over China—in order to preserve the hegemonic position of the United States in international politics.[49]

Accordingly, Biden's pushback on China thus far has gone beyond just efforts at minimizing the risks to U.S. supply chains. This is clear from at least six distinct policies pursued by his administration.

First, the administration has retained all of Trump's expansive tariffs on China. Although the Trump tariffs were intended to initially correct the U.S. trade deficit with Beijing and eventually rectify China's structural distortions through the planned "phase two" trade negotiations, the bilateral trade deficit has only further ballooned since Biden took office, with few other gains to show in terms of GDP, wage, or employment growth. Since the Biden administration has also not demonstrated any interest in pursuing trade negotiations with China to address its structural distortions, the value of preserving the inherited tariffs is questionable—except for political signaling. In contrast, the administration's approach to sanctions on Chinese apps and companies has been more sensible. The earlier bans on Chinese apps have been revoked, and the Commerce Department is now vested with the authority to monitor and appropriately control any software applications that may prejudice national security. Similarly, the oversight of Chinese military companies has now been transferred from the Department of Defense to the

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48 Eric Martin, "U.S. Wants to 'De-risk,' Not Decouple, from China, Biden Aide Says," Bloomberg, April 27, 2023, https://www.bloomberg.com/news/articles/2023-04-27/us-wants-to-de-risk-not-decouple-from-china-biden-aide-says.

49 "Remarks by National Security Advisor Jake Sullivan at the Special Competitive Studies Project Global Emerging Technologies Summit," White House, September 16, 2022, https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/09/16/remarks-by-national-security-advisor-jake-sullivan-at-the-special-competitive-studies-project-global-emerging-technologies-summit.

Treasury's Office of Foreign Assets Control so that the sanctions on these entities may be administered more effectively.[50]

Second, the administration has promulgated new restrictions on the export of advanced integrated circuits, electronic components containing advanced integrated circuits, semiconductor manufacturing equipment, and related software and technology to China. The expansion of U.S. export controls and the creation of new rules that constrain third-country activities pertaining to China's semiconductor and supercomputing manufacturing capabilities are intended to limit the threat that Beijing could pose to U.S. national security, especially through the development of advanced weapons.[51] Because technology is central to great-power competition today in a way that industrialization was during the twentieth century, the administration's strategy is prima facie reasonable and has been defended as exemplifying the "small yard and high fence"[52] approach that restricts trade only in regard to a small set of foundational capabilities. Yet the gambit is not without risks. Future controls in other arenas such as quantum technologies, artificial intelligence, biotechnology and biomanufacturing, advanced telecommunications, and advanced materials—which have been identified as critical to the evolving U.S.-China competition—could easily expand the "small yard" in ways that disfigure it beyond recognition. If this were to occur through either bureaucratic momentum or leadership indiscipline (which often accompany such policy shifts once they are initiated), the ambition of maintaining "as large of a lead as possible" over China could itself be subverted because sustaining technological supremacy when international knowledge flows of different kinds are constricted could prove to be daunting in an era of deep economic interdependence.[53]

Third, the administration has persisted with its predecessor's policy of intensively scrutinizing Chinese foreign direct investment into the United States. The Committee on Foreign Investment in the United States (CFIUS), whose review authority was expanded in 2018 with an eye to

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[50] Brian J. Egan et al., "China Faces Existing and Expanded U.S. Restrictions on Trade, Investment and Technology," Skadden, January 19, 2022, https://www.skadden.com/insights/publications/2022/01/2022-insights/regulation-enforcement-and-investigations/china-faces-existing-and-expanded-us-restrictions.

[51] For details, see "Biden Administration Restricts U.S. Exports of Advanced Computing and Semiconductor Manufacturing Equipment, Software, and Technology to China," Dorsey, November 28, 2022, https://www.dorsey.com/newsresources/publications/client-alerts/2022/11/us-adds-strict-limits-on-technology-exports.

[52] "Remarks by National Security Advisor Jake Sullivan on Renewing American Economic Leadership at the Brookings Institution," White House, April 27, 2023, https://www.whitehouse.gov/briefing-room/speeches-remarks/2023/04/27/remarks-by-national-security-advisor-jake-sullivan-on-renewing-american-economic-leadership-at-the-brookings-institution.

[53] For insightful analysis of the issues involved, see Hugo Meijer, *Trading with the Enemy: The Making of U.S. Export Control Policy toward the People's Republic of China* (New York: Oxford University Press, 2016).

preventing Beijing from acquiring U.S. firms with advanced technology, including those with military implications, continues to keep "China in the crosshairs."[54] The number of reviews has expanded in comparison with other foreign investments in the United States. This enhanced scrutiny of Chinese investments is appropriate because Beijing has often sought to circumvent U.S. export controls pertaining to advanced technology by instead acquiring the U.S. companies that create them. In a similar vein, CFIUS authority has been expanded to include oversight of China's real estate acquisitions in the United States, especially transactions that involve properties located within a certain proximity of important national security installations.[55] And the U.S. Securities and Exchange Commission has increased the disclosure requirements for foreign holding companies as well.

Fourth, the administration has complemented the scrutiny of inward Chinese direct investment with a striking new innovation, namely, the prohibition of certain outward U.S. investments in semiconductors and microelectronics, quantum information technologies, and artificial intelligence capabilities to China. The diffusion of these technologies, which are relevant to military, intelligence, surveillance, or cyberspace operations, is sought to be controlled through new restrictions on the acquisition of equity interests, the provision of debt financing, greenfield investments, and joint ventures involving Chinese nationals.[56] Although passive investments lie outside the purview of these carefully targeted restrictions, they nonetheless represent a novel effort to prevent U.S. entities from aiding the growth of China's technological capabilities. One observer described this initiative "as a major step in setting up a U.S. system of oversight to screen transactions to countries of concern," which could only be "expected to expand in time."[57]

Fifth, the administration has embarked on a "place-based" industrial policy with multiple facets.[58] Born of the conviction that the free-market solutions that drove globalization in previous years failed American workers,

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[54] Martin Chorzempa, "U.S. Security Scrutiny of Foreign Investment Rises, but So Does Foreign Investment," Peterson Institute for International Economics, September 1, 2022, https://www.piie.com/blogs/realtime-economic-issues-watch/us-security-scrutiny-foreign-investment-rises-so-does-foreign.

[55] Christian C. Davis et al., "CFIUS Expands Jurisdiction Over—and States Restrict Chinese Investment in—Real Estate," Akin, May 19, 2023, https://www.akingump.com/en/insights/alerts/cfius-expands-jurisdiction-overand-states-restrict-chinese-investment-inreal-estate.

[56] Gavin Bade, "Biden Sets New Rules Restricting U.S. Investments in China," *Politico*, August 9, 2023, https://www.politico.com/news/2023/08/09/biden-investment-rules-hits-chinese-chip-ai-computing-00110488.

[57] Karen Freifeld, "Biden Order Curbing Investment to China Expected Next Week—Sources," Reuters, August 4, 2023, https://www.reuters.com/world/us/biden-order-curbing-investment-china-expected-next-week-sources-2023-08-04.

[58] "The Biden Administration Embraces Place-Based Industrial Policy," *Economist*, July 27, 2023, https://www.economist.com/united-states/2023/07/27/the-biden-administration-embraces-place-based-industrial-policy.

accelerated U.S. deindustrialization, enabled China's rise, and strengthened China's ability to mount serious military challenges to the United States, the administration's "21st-century industrial strategy" has embarked, inter alia, on a concerted effort to return manufacturing to the United States through the massive provision of government funds to a wide range of industries from clean energy to semiconductor fabrication.[59] The motivations underlying this effort are simultaneously political, economic, and strategic. The administration seeks to strengthen the U.S. middle class (and thereby win its support for U.S. global leadership and perhaps for the Democratic Party), stimulate the technological recrudescence of the U.S. economy (to, among other things, bolster domestic employment and mitigate climate change), and stay ahead of China (by pushing the technology frontier outward in both the civilian and military realms to the advantage of the United States).

These objectives are understandable given current circumstances, but the dangers are not trivial. They include the inconsistent success of industrial policy in the past, the problems associated with increasing costs when investment decisions are freed from the discipline of the market, the risk of stimulating comparable efforts by other states to the detriment of both the nation and the global system as a whole, and the problems of intensifying fissures not just among states but within U.S. alliances themselves.[60] At the end of the day, the real challenge is that successful industrial policy requires a persistent manipulation of incentives and not simply episodic initiatives at the margin. Absent such a commitment—especially when trying to resuscitate a domestic industry with incumbent international competitors—it will be difficult to create a self-sustaining ecosystem that effectively joins labor, capital, and innovation. Moreover, producing such success might end up being even more dangerous if it leads to the large-scale subversion of markets within the U.S. economy as a result of increased state dominance.

Sixth, and finally, the administration—partly in an effort to mitigate the risks of its industrial policy—has declared its support for "friendshoring," which focuses on shifting existing supply chains (or parts thereof) that are currently anchored in China to countries that are either political allies or strategic partners of the United States.[61] If these shifts are narrowly limited to those items that are essential to national security, the policy of friendshoring

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[59] "Brian Deese on Biden's Vision for 'a Twenty-First-Century American Industrial Strategy,'" Atlantic Council, June 23, 2021, https://www.atlanticcouncil.org/commentary/transcript/brian-deese-on-bidens-vision-for-a-twenty-first-century-american-industrial-strategy.

[60] For an excellent evaluation of Biden's industrial policy, see Robert Kuttner, "Reclaiming U.S. Industry," *American Prospect*, January 24, 2023, https://prospect.org/economy/2023-01-24-biden-american-industrial-policy.

[61] "Remarks by Secretary of the Treasury Janet L. Yellen on Way Forward for the Global Economy," U.S. Department of the Treasury, April 13, 2022, https://home.treasury.gov/news/press-releases/jy0714.

can be defended even if it entails additional costs. But the danger is that if friendshoring gains momentum, various special interests within the United States and elsewhere will find excuses for using state resources to move production across national boundaries without regard for economic viability.[62] At its core, friendshoring essentially involves using state power through either sovereign directives or financial incentives to change the decisions of private actors about where investment and production are located. Unilateral actions by a government toward this end could precipitate emulation by other countries and a destructive race to the bottom.

The success of any friendshoring strategy, accordingly, requires coordination between states—and more. Rarely do exhortations alone—as the Biden administration seems to be invested in—suffice because the costs of moving production against economic logic are often prohibitive. Consequently, financial incentives to private actors are usually necessary, unless these entities choose to move production to less economically attractive locations simply as a response to geopolitical risks. When this is not the case, however, friendshoring could easily run aground because of the unavailability of the requisite subsidies, national competition among states over relocation, increased costs arising from investments shifting to more marginal sites, and, finally, the simple difficulty of moving production because of the limitations associated with many alternative geographies.[63]

This last consideration is not insignificant. Because of differences in factor endowments, there are few alternatives outside China in Asia where manufacturing at comparable scale and quality can be undertaken. Given that private companies have no peers in finding the best settings (and partners) to build their value chains, it would be comical to assume that governments—and the United States is no exception—will be able to induce the relocation of manufacturing activities or the widespread restructuring of global production systems through rhetorical appeals or even through inexpensive selective incentives. Not surprisingly, then, the Biden administration and its international partners thus far have little to show by way of success where friendshoring is concerned.[64]

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62 Raghuram G. Rajan, "Just Say No to "Friend-shoring," Project Syndicate, June 3, 2022, https://www.project-syndicate.org/commentary/friend-shoring-higher-costs-and-more-conflict-without-resilience-by-raghuram-rajan-2022-06.

63 Halit Harput, "The Hidden Costs of Friend-shoring," Hinrich Foundation, November 15, 2022, https://www.hinrichfoundation.com/research/article/trade-and-geopolitics/the-hidden-costs-of-friend-shoring.

64 The difficulties of engineering successful friendshoring are clearly explicated in "Globalization 2.0: Can the U.S. and EU Really 'Friendshore' Away from China?" Allianz, October 5, 2022, https://www.allianz.com/content/dam/onemarketing/azcom/Allianz_com/economic-research/publications/specials/en/2022/october/2022_10_05_Globalization_AZ.pdf.

Irrespective of how successful each of the elements in the administration's de-risking strategy has been thus far—and this survey has not captured those elements that are entirely internal, such as the increased domestic investments in science and technology or the nurturing of science, technology, engineering, and mathematics talent—the challenge of managing economic dependence on China has become a preoccupation of many states in the Indo-Pacific region. The shift in the U.S. attitude toward globalization, and trade ties with China in particular, has already produced demonstration effects as several Indo-Pacific nations, prompted by their own ongoing problems with China, have moved to implement de-risking strategies of their own, often with Washington's express encouragement. Other states find themselves caught in the middle of what is seen as unwelcome U.S.-China competition. But whatever the various regional attitudes may be, the chapters in this volume indicate that the process of decoupling is fraught and its ultimate success is entirely unclear.

Asian "Decoupling" from China

The chapters that follow suggest that how the Indo-Pacific states respond to the possibilities of decoupling from China depends on many variables, such as (1) the character and the intensity of their competition with China, (2) the history of their bilateral relations, (3) the extent of their interdependence with China and the availability of alternatives, (4) the benefits and costs of altering their existing patterns of trade with China, (5) the character of their state-society relations at home, (6) the relative power differential between themselves and China, and (7) the existence of strategic partnerships (especially alliances) with external powers, particularly the United States, and their influence over national decision-making. The interaction of these factors shapes the different behaviors pertaining to loosening economic ties with China.

When viewed synoptically, the contributions to this volume indicate that despite the myriad concerns about China as a potential—or sometimes even as a growing—strategic threat, the value of maintaining strong trade ties with it has not diminished. Even countries like Japan and India, which are intensely fearful of Chinese aggressiveness, cannot cut ties with China, no matter how desirable such independence may seem. For all nations in the Indo-Pacific, China is simply too big and too important, either as a supplier or as a market, to be divested from. Consequently, diversification from China may be the best that can be achieved, but even this solution has inherent limits where merchandise trade is concerned because China "maintains its manufacturing leadership,"[65] remains a vital supplier of many commodities or raw materials for which there are no economical substitutes, and, thanks to its size and growing prosperity, offers huge markets for goods produced by others at a time when there are few comparable alternatives.

Since this volume focuses on the prospects of decoupling from China, it is perhaps appropriate that the first chapter centers on China itself. William J. Norris considers how China has responded to the threats of decoupling by other countries and highlights a series of paradoxes in this connection. To begin with, China's integration with the global system has always been strategic and deliberately uneven in that Beijing wanted to benefit from external integration but without becoming vulnerable to the outside world. In fact, Beijing has always viewed—and shaped—external linkages with an eye to exploiting others' dependencies on China. That China is now the most important hub for many global supply chains gives it enormous leverage, which many countries, including the United States, will be unable to easily escape from without suffering increased costs. Even as these dependencies remain significant, Norris notes that China's own reliance on foreign trade as an engine of growth is steadily diminishing, with domestic consumption already accounting for more than half of its national product. With Xi Jinping's emphasis on "dual circulation," China's trade-to-GDP ratios could further decline. This suggests that even as many countries continue to be dependent on trade with China for their continued prosperity, China itself will be increasingly liberated from trade- and export-driven growth, thus increasing its strategic autonomy. Its other economic problems still remain significant, but the steady shift away from trade as a driver of growth—a sign of China's maturation as an economy—is noteworthy.

As far as the United States is concerned, bilateral trade with China continues to grow, setting new records (to include ever-increasing U.S. imports from China). But, as other studies have pointed out, this fact obscures important emerging cleavages in U.S.-China trade relations. When eleven major types of flows encompassing trade, capital, information, and people have been examined, the share of U.S. flows involving China has declined for eight types of flows, increasing for only one, with two others remaining somewhat stable (that is, falling by less

[65] Yukon Huang and Genevieve Slosberg, "China's Response to the U.S. Trade War," *China Leadership Monitor*, June 1, 2023, 8.

than 5%).[66] Norris confirms this change when he notes that China is increasingly less important as a source of U.S. imports, which are shifting toward other low-cost Asian producers at China's expense. Despite these changes, however, the United States and China still maintain the largest trading relationship between two nations that do not share a common border, but whether this will suffice to restrain a China that will be increasingly less dependent on the United States for its continued growth remains a disquieting question that Norris flags for further consideration.

Kristin Vekasi's chapter on Japan offers critical insights on the viability of decoupling from China because Japan remains, in principle, the best test case for such a possibility due to several factors: Tokyo increasingly views China as its most dangerous security threat; Japan is an advanced industrial nation that depends heavily on foreign trade; and the United States guarantees Japanese security over and above the protection offered by Japan's own formidable military forces. If any nation can dramatically minimize (or transform) its economic dependence on China at least cost, it should be Japan. Yet Vekasi's analysis indicates that despite Tokyo's strong desire to limit economic linkages with Beijing because of the latter's growing assertiveness, Japanese businesses still view China as indispensable to their economic viability. In an era where Japan's ubiquitous industrial presence is manifested not simply through branded products but by myriad internal (and invisible) components, the importance of supply chains that traverse China, among other countries, has only increased.

Vekasi notes that Japan's patterns of trade are shifting. Consistent with the insights offered by gravitational models of trade, Japan today trades more with Asia than with the United States and Europe. But even as Japan has increased its focus on Southeast Asia as a complement to its trade with China—the essence of its diversification strategy for both economic and strategic reasons—its gross trade and investment with both entities has increased. This confirms that even a country as concerned about Chinese assertiveness as Japan simply cannot—and does not seek to—sever commercial ties with China, even though Tokyo has begun to consciously restrict the export of certain types of high technology to China, secure supply chains in critical sectors, and increase Japan's resilience to security and economic risks more generally. In fact, Japan remains a great example of how even a formidable

[66] Steven A. Altman and Caroline R. Bastian, "DHL Global Connectedness Index 2022," New York University, Stern School of Business, Center for the Future of Management and DHL Initiative on Globalization, 2022, 23–29, https://www.dhl.com/content/dam/dhl/global/delivered/documents/pdf/dhl-global-connectedness-index-2022-complete-report.pdf. In contrast, and more significantly from a geopolitical point of view, when the economic relations between the United States and its partners and China and its partners are examined, the evidence suggests "that the fragmentation of flows between rival blocs of countries is much more limited than decoupling between the U.S. and China, both in terms of the types of flows involved and the magnitude of the changes in flow patterns."

state concerned about intensifying Chinese threats cannot dismiss its societal interests in continued trade with China—without which its own national security preparedness would actually suffer.

Even more than Japan, South Korea too finds itself on the horns of a painful dilemma. South Korea's economic success owes deeply to the country's integration in global trade, which has made China its largest export market. This reality, combined with Seoul's historic desire to avoid alienating Beijing, has made South Korea an unfortunate victim of Chinese intimidation in recent years. The deep political divisions in South Korean society—with progressives focused more on seeking reconciliation with North Korea and preserving ties with China, while conservatives emphasize strengthening the security alliance with the United States and reconciling with Japan to cope with the dangers emerging from both Pyongyang and Beijing—have not made matters easier. As Yul Sohn and Hyo-young Lee's chapter emphasizes, South Korea now struggles to manage its intense dependence on China, which has consistently yielded a trade surplus for Seoul over the years, with its tight security dependence on the United States, which is now locked into a deep confrontation with China.

The integration between China and South Korea is particularly pronounced in the production of semiconductors—the latter's single-largest export item to China. Seoul also remains highly dependent on China for raw materials used in the production of other manufactured goods. Thus, extricating from China, whether or not in response to U.S. pressures, is proving to be difficult at a time when South Korean exports to Southeast Asia—which also depend on Chinese intermediate products—are themselves rising. Because the structure of Chinese–South Korean trade is now essentially intra-industry trade, limiting the trading ties between the two countries is proving to be extremely difficult even when they intensely compete for new markets in places such as Southeast Asia. The fact that Chinese–South Korean, U.S.-Chinese, and South Korean–North Korean ties are frayed simultaneously burdens Seoul immensely. While it has sought to limit these dangers by doubling down on the partnership with Washington, improving ties with Tokyo, and increasing its domestic competitiveness and manufacturing autonomy, Sohn and Lee suggest that any consequential decoupling from China is likely to lie beyond reach for some time to come.

Syaru Shirley Lin's chapter on Taiwan highlights a similar predicament of perhaps even greater intensity. If there is any one country that has borne the brunt of Chinese coercion in recent years, it is Taiwan. Yet Taiwan's most significant contribution to the international economy—semiconductor manufacturing—is inextricably dependent on its commercial and technological integration with China. Even as tensions across the

Taiwan Strait have increased and Xi Jinping's drive to "Make in China" gathers steam for both economic and strategic reasons, the imperative for Taiwanese ICT firms—which contribute around 40% of the nation's GDP—to remain ensconced in China has only intensified. The political problems notwithstanding, Taiwan's trade with China constitutes over 40% of its total trade, with both its bilateral trade and its trade surplus increasing to record levels despite the presence of an autonomy-conscious Democratic Progressive Party government in Taipei that stringently regulates all investments involving strategic industries in China.

The dangers of excessive economic dependence on China are well understood in Taiwan. The Taiwanese government has prevented advanced semiconductor manufacturing from moving to China and has acquiesced to U.S. pressure to create new semiconductor manufacturing facilities in the United States. But the survival of the Taiwanese ICT sector, to include advanced semiconductor fabrication facilities on the island, simply depends on its continued presence in China. As Lin notes succinctly, for all its challenges, "for Taiwanese manufacturers who serve large multinational clients, there seems to be no readily available alternative to China." The fruits of globalization have thus made China the vital gateway for Taiwan even when the latter seeks to expand trade with wider global markets. A failure to adequately appreciate this fact, Lin fears, could result in Washington inadvertently instrumentalizing Taipei in its rivalry with Beijing, with grave consequences for both Taiwan's domestic politics and its security vis-à-vis China.

Unlike China, Japan, South Korea, and Taiwan, whose economic ascendancy has been underwritten by their deep knitting into global trading system, India's rise has been driven largely by the progressive expansion of its domestic market. In the aftermath of its 1991 economic reforms, however, India's trading links with the world, and especially with the Asian economies, have expanded impressively. One outcome of this new orientation has been growing Sino-Indian trade, with China catapulting to within the top two spots on the Indian trading roster, even as political relations between the two neighbors have acutely deteriorated in recent years. For all the impressive gains in bilateral trade, however, the imbalances are also striking: China enjoys a huge trade surplus derived from its export of capital and consumer goods and critical intermediates, which India's exports of raw materials and intermediates cannot match in value. This fact, exacerbated by the meltdown in Sino-Indian relations since 2000, has impelled India to pursue decoupling from China—a goal that has only received a fillip as a result of parallel U.S. efforts in the same direction since at least the Trump administration.

As Gulshan Sachdeva's chapter in this volume describes, New Delhi may be the only outlier in the Indo-Pacific region in that it is deliberately attempting to limit economic connectivity with China, partly to punish Beijing for its aggression on the border and partly to limit India's vulnerabilities to future Chinese coercion. To that end, New Delhi has embarked on a diverse set of initiatives ranging from banning Chinese apps to limiting Chinese FDI in critical sectors to doubling down on Indian manufacturing as a substitute for Chinese imports. For all these efforts, however, autonomy from China is nowhere in sight. Many of the heavily promoted "Make in India" projects, including marquee initiatives such as Apple's manufacture of iPhones in India, still rely heavily on imported Chinese components, as does the otherwise successful Indian pharmaceutical industry, which cannot operate without active pharmaceutical ingredients sourced from China. Furthermore, the economics of much of India's import-substituting manufacturing are controversial, and the ambition to entice production exiting from China has not yet borne significant fruit.[67] When this is coupled with India's still strong reluctance to join major trading agreements such as the Regional Comprehensive Economic Partnership or even the trade pillar of the shallow U.S.-led Indo-Pacific Economic Framework, Sachdeva concludes that there is a real danger that India may end up outside major global supply chains and, as a result, find itself trapped in a low-level equilibrium—to its disadvantage in the evolving competition with China.

Unlike the chapters surveyed thus far—which focus on countries that have approached (or have been compelled to approach) decoupling because of strategic imperatives—Vikram Nehru's chapter on Southeast Asia is distinctive not only because it assesses an entire region rather than just a single country but, more significantly, because this region still remains an unabashed champion of globalization. Because Southeast Asia's success during the past few decades—the fruit of the second wave of U.S.-led globalization in Asia during the postwar period—has been intimately linked to growing international interdependence, all the regional states are determined to protect their extant structure of trade. This structure has witnessed the region's progressive integration into the China-centered production system, while being equally nourished by U.S. and Japanese investment in a virtuous symbiosis that has made Southeast Asia's trade-to-GDP ratio the highest for any region in the world, including the European Union. The prosperity

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[67] Rahul Chauhan, Rohit Lamba, and Raghuram Rajan, "The PLI Scheme: Sense and Nonsense in the Debate," January 2023, available at https://studylib.net/doc/26054867/the-pli-scheme--sense-and-nonsense-in-the-debate; Rajiv Kumar, "Can We Please Not Judge PLIs by Value Added," *Times of India*, August 29, 2023, https://timesofindia.indiatimes.com/blogs/toi-edit-page/can-we-please-not-judge-plis-by-value-added; Irene Yuan Sun, "The World's Next Factory Won't Be in South Asia," Bloomberg, October 5, 2019, https://www.bloomberg.com/view/articles/2019-10-06/why-factories-leaving-china-aren-t-going-to-india?embedded-checkout=true; and Viswanathan Rajendran and Patrick Van den Bossche, "The Make in India Moment Is Here," *Times of India*, May 5, 2020, https://timesofindia.indiatimes.com/blogs/voices/the-make-in-india-moment-is-here.

that has accrued as a result has made Southeast Asia a vociferous defender of free trade. Not surprisingly, the region is deeply alarmed by the threat of any U.S.-China conflict that threatens to force diverse forms of decoupling, which could destroy the productive regional integration that has benefited all its constituent states.

The geopolitical threats posed by China in Southeast Asia are undoubtedly unsettling, and most of the resident nations hope that U.S. military power will suffice to preserve the peace that has allowed them to prosper. But they fear that the threat of decoupling from China, however labeled, would tear asunder the bonds that could help avert conflict while also destroying the prosperity that has been built up over decades. Consequently, even though the region has actually benefited from the decoupling that has occurred in U.S.-China trade—since most reshoring has resulted in greater investment in Southeast Asia—the dangers of further tariff wars, fragmenting standards, and technological cleavages are viewed as forcing unpalatable choices upon the regional states. Because these nations are minnows in a sea of whales, their ability to shape the outcome of U.S.-China rivalry is admittedly limited. To the degree that they can, however, they have sought to moderate this competition by refusing to become party to any policies aimed at eroding integration while seeking to keep both the United States and China productively enmeshed in Southeast Asia and enticing other major extraregional states such as Japan, South Korea, India, and Taiwan to remain engaged.

The last chapter, Darren Lim, Benjamin Herscovitch, and Victor Ferguson's study of Australia, once again confirms the larger theme running through the volume: that economic engagement with China is critical to national prosperity and that even capitals allied with Washington seek to avert the worst downside of deepening U.S.-China rivalry, even if they have no illusions about the dangers posed by Beijing's ambitions. For many years, Australia invested deeply in its economic ties with China. This was a natural outcome for an open economy that relied heavily on trade—especially exports of agricultural goods, minerals, and energy—for its growth. China's demand for exactly these inputs made the country an important partner for Australia. Accordingly, Canberra sought to protect commercial ties with China, which had become Australia's largest two-way trading partner and an important source of foreign investment. The deindustrialization of the Australian economy, which occurred as a result of domestic market liberalization, made Australia even more dependent on trade in primary goods, especially with the fast-growing economies in Asia.

Chinese aggressiveness during the last decade, however, involving attempts at manipulating Australian domestic politics coupled with a blatant economic coercion campaign, set the stage for Canberra's re-evaluation of its previous conviction that trade relations could be detached from international competition—something the supply vulnerabilities created by the Covid-19 pandemic only reinforced. Recognizing the emergent Chinese threat, Australia soon doubled down on its traditional security alliance with the United States. This involved acquiring new military capabilities through the AUKUS agreement with the United States and the United Kingdom and supporting an enhanced U.S. military presence in Australia and regionally, while strengthening national security by imposing new restrictions on Chinese ICT firms and initiating screening of Chinese investments in sensitive sectors. Canberra simultaneously embarked on its own de-risking strategy by seeking new markets beyond China. Despite all these initiatives—and the loss of optimism about China as an economic partner—Australia still remains intertwined with China. As Lim, Herscovitch, and Ferguson succinctly explain, "the economic opportunities presented by China's internal market in terms of size and price premiums remain unparalleled. Even many of those businesses directly in the firing line of Beijing's sanctions appear to have calculated that the potential risk of politically motivated disruption recurring in the future does not justify the economic costs of a permanent exit from the trading relationship."

Conclusion: Dilemmas Ahoy!

It is indeed tragic that globalization, which has been a vital legacy of the United States' postwar hegemony, has now collided with the exigencies of U.S.-China competition. Yet such an outcome is not surprising because the pressures of geopolitical rivalry inevitably make states sensitive to the problem of relative gains. Consequently, China's economic ascendancy, which derives from the country's integration into the open trading system and was once viewed as a positive benefit for all, is now perceived through more jaundiced eyes as Beijing continues to challenge Washington in the Indo-Pacific and even globally. It is not surprising, then, that the United States seeks to limit the continued rise of Chinese power in a variety of ways.

In the aftermath of recognizing China as a strategic competitor, the United States—and the Biden administration, in particular—has sought to pursue a policy of "de-risking." This policy has been advertised as seeking to limit the vulnerabilities posed by manufacturing concentration in China and its accompanying dominance in those critical supply chains that are vital to the health of all national economies. This more conservative aim, however, intersects with the larger imperatives of U.S.-China competition, which have taken Washington in the direction of not simply reducing overreliance on China for critical goods but attacking its capacity to dominate the "leading sectors" of the emerging global economy and thereby arresting its rise as a genuine peer of the United States.[68]

This objective is understandable—even defensible, from the viewpoint of U.S. interests—but it brings multiple dangers in its trail.[69] Any effort at slowing China's growth through initiatives such as strategic denial and industrial policy will inevitably degrade economic efficiency globally, which will also increase costs and reduce U.S. competitiveness, potentially diminishing U.S. growth as well. These disadvantages may be accepted as tolerable penalties if they burden China more than the United States. This is, after all, the essence of competition involving relative gains. But there is no assurance that Washington will in fact come out enduringly ahead if China can productively sustain its other trade partnerships, as it seems to be doing, at a time when the United States, for domestic political reasons, remains reluctant to join the very agreements, such as the Trans-Pacific Partnership, that it had previously championed.[70] Expanding market access to the successful Asian economies by cementing high-standard trade agreements offers the United States a beneficial way to correct its relative losses vis-à-vis China and is an indispensable complement to the technology controls and state-led industrialization now being implemented.[71]

The Biden administration's Indo-Pacific Economic Framework is, unfortunately, an all-too-poor substitute in this context. Strengthening the multilateral trading system, which the United States itself constructed, is also necessary, at the very least by making a new push for WTO reform to include resuscitating its Appellate Body. Although the United States relies less on trade for its own economic growth than its many partners do, securing their cooperation vis-à-vis China will require greater attentiveness by Washington to the multilateral trading regime, which matters greatly to them. Admittedly, the United States must also do better on several other counts, such as repairing its public finances, reforming its immigration policies, expanding investments in education, and increasing public funding for research and development.[72]

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[68] An extended discussion of the notion of "leading sectors" can be found in Modelski and Thompson, *Leading Sectors and World Powers*.

[69] For a wider perspective on the risks beyond U.S.-China competition, see Robert B. Zoellick, "Team Biden Wants a Revolution," *Washington Post*, August 15, 2023.

[70] The domestic constraints—including the divisions within the Biden administration—with respect to developing a sensible U.S. trade policy are described in Bob Davis, "Biden Promised to Confront China. First He Has to Confront America's Bizarre Trade Politics," *Politico*, January 31, 2022, https://www.politico.com/news/magazine/2022/01/31/biden-china-trade-politics-00003379.

[71] Tellis, "The Geopolitics of the TTIP and the TPP," 93–112.

[72] For more on the challenges of revitalizing the U.S. economy, see Tellis, *Balancing Without Containment*, 67–84.

These challenges become especially problematic because, as the analyses in this volume suggest, even U.S. allies and partners that are otherwise troubled by Chinese assertiveness have not found any satisfactory way of decoupling from China as a means of limiting its growth in power. Other than doing what is minimally required to buy insurance against overdependence on China in certain narrow areas, they seem intent on sustaining—perhaps even expanding—their trading relationships with China because of the absolute gains they enjoy. Since China already seems intent on further limiting its dependence on the United States for its own reasons, Washington could face the problem of confronting a Beijing that is far more autonomous—because of thinner Sino-U.S. economic linkages—even as strong Chinese trade connectivity with other states (including U.S. allies and partners) pushes them deeper into the crossfire of U.S.-China rivalry.

The challenges of security competition under conditions of economic interdependence are not well understood in regard to their empirical consequences. Consequently, Washington will have to muster extraordinary discipline to ensure that its new attitude toward interdependence with Beijing does not end up undermining U.S. interests—economic and political—more than it does China's ambitions.