ANALYSIS

Can the United States Really Decouple From China?

Probably not—but that doesn't mean it won't try.

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Despite their differences, U.S. President Joe Biden has continued his predecessor's hard line toward Beijing. Biden, like former U.S. President Donald Trump, believes the United States must "decouple" from China by reducing U.S. dependence on Chinese products and supply chains—for both economic and national security reasons. Biden is not alone in this conviction. Much to the disappointment of those who favor more U.S.-Chinese trade and investment, moves to put distance between the two economies are gaining support among Democrats and Republicans alike.

Yet despite bipartisan support, economic decoupling is a tall order. If the Biden administration wants to succeed, the United States will not only have to reorder large parts of its own globalized economy but also ensure the participation of other countries that are big trade partners of—and investors in—China. Both objectives will be harder to achieve than many in Washington expect.

So far, Biden has built on the Trump administration's decoupling efforts—albeit with softer rhetoric. Last June, the White House outlined a comprehensive plan for boosting production at home to reduce Washington's dependence on fragile global supply chains, especially those originating in China. It focused mostly on critical industries like

semiconductors, where the United States has seen a sharp decline in its market share over recent decades, and rare earth minerals, where it depends on China for around 80 percent of its needs. Meanwhile, Biden has retained the tariff hikes Trump imposed on imports from China and taken steps to ban U.S. companies' investments in 59 Chinese firms that have ties to the Chinese military or produce surveillance equipment. Some were already on Trump's blacklist, including telecommunications giant Huawei.

Biden and congressional Democrats are also pushing for big investments to reduce U.S. reliance on critical imports from China. That's the goal of Senate Majority Leader Chuck Schumer's Innovation and Competition Act, a $250 billion mega-plan to fund scientific research and expand manufacturing in cutting-edge technologies. Schumer's bill already passed in the Senate—with support from 19 Republicans—where there's bipartisan agreement that creating new technology hubs across the United States' Rust Belt is essential and urgent.

Meanwhile, critics of economic decoupling, notably the U.S. Chamber of Commerce, warn it will disrupt existing supply chains, exacerbate delays in production, and force companies and consumers to pay more—not least because relocating production can't happen overnight. As a result, Biden is facing urgent calls from U.S. companies to end Trump-era tariffs. Moreover, China has already threatened to cut back on imports from the United States should Schumer's bill become law, potentially hurting U.S. farmers and energy producers.

Decoupling efforts have already affected U.S. consumers. Since Trump acted unilaterally, the consequences of his decoupling strategies were felt by the U.S. economy alone. Indeed, by raising tariffs on imports from China, Trump increased the costs of Chinese-made goods for U.S. consumers—by as much as $80 billion in 2018 alone. Moreover, the number of U.S. jobs gained did not match Trump's typically extravagant promises. To the contrary, there was a net loss of anywhere between 250,000 to 300,000 jobs. The trade deficit with China did fall but only modestly, from $346.8 billion in 2016 to $344.3 billion in 2019—the last year before the data is skewed by the COVID-19 pandemic.

For the decoupling strategy to have any chance at success, Biden needs to abandon his unilateral policies and mobilize collective action with countries that have substantial trade with—and investments in—China.

The Biden administration has taken some steps in this direction, including the agreement at last June's G-7 summit on the Build Back Better World (B3W) partnership—a project seen as an attempt to counter China's Belt and Road Initiative. B3W seeks to shore up cooperation among G-7 countries while making substantial investments in low- and middle-income countries in infrastructure, financial coordination, and economic development. The fewer countries China pulls into its orbit, the easier it will be for the United States to readjust its economic ties—but that will require a more strategic and substantial effort than what the White House has unveiled so far.

More recently, Biden struck a deal to remove Trump-era tariffs on European steel, which had driven European exports to the United States down by 53 percent since 2018. The new agreement, which removes tariffs on roughly $7 billion worth of EU steel and aluminum exports, may improve the prospects for a united front against China. The United States and European Union are already making renewed efforts to curb intellectual property theft—for which China has been widely blamed—in areas such as wind turbine software and technology related to telecommunications and automated vehicles.

But that doesn't mean the EU is rushing toward decoupling from China itself. European trade experts predict doing so would stunt growth and reduce incomes across the continent. EU multinationals operating in China agree. A recent survey by the European Union Chamber of Commerce in China found that European companies continue to value China's lucrative market, reporting no new plans to shift investment elsewhere. Former German Chancellor Angela Merkel recently echoed this belief, stating "total decoupling … would be damaging for us." Indeed, the potential downsides are huge for the EU: Its trade with China totaled $745 billion in 2020, making China—not the United States—the EU's largest trade partner for the first time.

Some analysts have pointed to the EU's Global Gateway project—$340 billion in planned investments by 2027 centered on international infrastructure, digital communications, and green energy—as a bold step to combat China's economic might. However, the *Economist*, in a column aptly titled "Why bullshit rules in Brussels," derided it as "mainly a mixture of existing commitments, loan guarantees and heroic assumptions … rather than actual new spending." They may be right, particularly since $340

billion is small compared to the $1 trillion China committed to foreign infrastructure projects over the same period.

For Biden's decoupling strategy to be effective, Japan must also sign on. But Tokyo also has a lot to lose. The Chinese and Japanese economies are now deeply intertwined. Four decades ago, Japanese trade with China totaled $1 billion; by 2019, it had soared to $304 billion. Japanese foreign direct investment in China has ballooned as well, reaching $11.3 billion in 2020—27 percent of Japan's total investment in Asia.

Even so, Tokyo has been trying to change course, allocating $2.2 billion in 2020 to entice Japanese companies with operations in China to move back to Japan or Southeast Asian countries to diversify Japan's supply chains. So far, 87 Japanese firms have received such support. This reflects a larger trend: At the 2012 high point, 14,394 Japanese firms operated in China; by 2019, more than 700 of those had left.

Still, China remains a big investment venue for Japanese firms, notably those connected to automotive production, which are estimated to account for half of Japan's investments in China. Despite the danger of transferring technology and establishing extensive supply chains in China, thereby creating their own competition, Japanese firms continue to consider that an acceptable risk for gaining access to China's vast market. Indeed, China ranked first in 2020 among the places Japanese firms planned to increase business and exports. This suggests Tokyo has a strong awareness of the economic costs of decoupling.

South Korea's position is even more precarious given its extensive economic ties with China. Although South Korea's exports to the West grew sharply in last few years, China remains its top export market, with sales totaling $133 billion in 2020—around 27 percent of its total exports—versus $74.4 billion to the United States and $25.1 billion to Japan. According to the Korea Institute for Industrial Economics and Trade, one-fifth of South Korea's imports come from China, a higher proportion than from Japan or the United States. Those imports are vulnerable to supply chain disruptions that could, among other things, cause costly production delays and shortages for consumers.

Furthermore, in Asia more generally, the creation of the Regional Comprehensive Economic Partnership, which comprises 15 Asia-Pacific

countries—including China—and accounts for around 30 percent of global GDP, shows that decoupling from China is scarcely the prevailing trend.

Economic constraints aren't the only reasons Asian countries are leery about decoupling from China. Consider South Korea. As the military balance of power in East Asia between China and the United States shifts in Beijing's favor, Seoul will be skittish about making any drastic moves that could anger Beijing. Anti-Chinese sentiment has increased in South Korea, especially among the young: A recent Chicago Council on Global Affairs poll revealed that more than half of respondents consider China a military threat. Still, as the strategic environment in its neighborhood changes, Seoul will be mindful of the risks involved in following a decoupling script written in Washington and may prefer to avoid an economic offensive against China.

Given the difficulties of organizing a cohesive, U.S.-led coalition committed to economic decoupling, the strategy is unlikely to change China's behavior. What's more, Beijing has moved to reduce its own reliance on export-led growth in favor of increased demand from consumers at home. Even if decoupling were to progress, China's government would remain committed to its core priorities, such as reunifying with Taiwan or quashing revolts against its authoritarian political order.

Decoupling—even if it has little direct influence on China—still has an upside. Reducing the United States' reliance on fragile supply chains can help insulate the economy from future disruptions like those seen over the last two years. And investing in domestic capacity is long overdue. If all of this can be done while shoring up partnerships with like-minded allies, then all the better.

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