The US Trade and Technology War Against China and the Resulting Geoeconomic Fragmentation: Potential Implications and Risks for the Global Economy

Goran Nikolić¹, Jelena Zvezdanović Lobanova² and Milan Zvezdanović³

¹Institute of European Studies, Belgrade, Serbia
²Institute of Social Sciences, Belgrade, Serbia
³Academy for National Security, Belgrade, Serbia

Article Information

Review Article • UDC: 327(73:510)
Volume: 20, Issue: 3, pages: 195–211
Received: June 02, 2023 • Accepted: October 19, 2023
https://doi.org/10.51738/Kpolisa2023.20.3r.195nzlz

Author Note

Goran Nikolić ID https://orcid.org/0000-0001-9312-2194
Jelena Zvezdanović Lobanova ID https://orcid.org/0000-0003-3159-3331
Milan Zvezdanović ID https://orcid.org/0009-0004-7887-5250
We have no known conflict of interest to disclose.
Corresponding author: Goran Nikolić
E-mail: goranvnikolic@gmail.com

* Cite (APA):

© 2023 by the authors. This article is an open-access article distributed under the terms and conditions of the Creative Commons Attribution (CC BY) license (https://creativecommons.org/licenses/by/4.0/).
Abstract

The aim of the paper is to assess the possible consequences and risks for the global economy due to the increasingly pronounced geo-economic fragmentation, dominantly determined by the trade and technological war of the US against China. Based on benchmark studies’ findings, we reason that decoupling and trade fragmentation could manifest through several main channels. These are, among other things: the slowdown in the growth of global trade, reduced migration, decreased FDI, and bans on the transfer of certain high technologies. In order to achieve the primary goal of the study, we suggested pragmatic ways to preserve as many of the benefits as possible resulting from trade openness, that is, international economic cooperation. First of all, in addition to more intensive communications of the main global economic actors, in which additional efforts would be made for compromise solutions along the lines of argumentation of the academic community and experts in relevant international institutions, the work of leading multilateral organizations should be revitalized, giving greater importance in their leadership to developing countries, especially China. In the end, we argue that, despite all the risks, it is not realistic that geo-economic fragmentation will lead to a significant decline in most types of economic cooperation at the global level since there are no valid (geopolitical) reasons why Western countries would stop importing price- and qualitatively competitive products from China. Instead, collaboration will primarily be reduced to a limited number of high-tech sectors, perceived in Washington, Brussels, and Beijing as strategically important.

Key words: geo-economic fragmentation, decoupling, trade-technological war, China, USA.
The US Trade and Technology War Against China and the Resulting Geoeconomic Fragmentation: Potential Implications and Risks for the Global Economy

The trend of relative economic decline in the West

According to one of the leading contemporary economic thinkers, Martin Wolf, claims, today neither global cooperation (through the G20 – a group of the twenty largest economies in the world) nor Western domination (through the G7) seems feasible, while the risk of global fragmentation or “anarchy” is growing (Wolf, 2023). According to him, both the “unipolar” moment of the US and the economic dominance of the G7 (consisting of: France, Germany, Italy, Britain, Canada, USA, and Japan) has been overcome. Although the G7 is still the most powerful and cohesive economic block in the world, among other things, because G7 members control practically all the world’s leading reserve currencies, the new reality is the substantial rise of the “rest” of the world, primarily China. Namely, between 2000 and 2023, the share of the G7 in GDP by purchasing power parity fell from 44% to 30%, with the portion of all developed countries decreasing to 41% (from 57%). As Wolf sees it, the G7, with 10% of the world’s population, cannot continue its dominance much longer.

At the same time, China, which became an economic superpower, increased its share of global GDP from 7% to 19%. Through the Belt and Road Initiative (“Silk Road”), Beijing has become a major investor (and creditor) of developing countries (now IMF is using something different term - Emerging Market and Developing Economies – to encompass all developing countries, which are defined as ones at a lower level of economic development compared to developed – industrialized – countries). For many developing countries and G20 members, China is a more important economic partner than the G7 (Brazil is an indicative example).

China, which is the leading trading partner for two-thirds of the world’s countries, dominates international trade even more than the US did at its peak after World War II, and this is a fact that the West’s geo-
economic strategy needs to face up to. By eventually displacing Germany from the Global Value Chains (GVC), Beijing would “seal” its dominant strategic position. The tripolar global trade structure appears to be on the way to a unipolar one, with Beijing as the main actor, effectively carrying out a hostile takeover of the existing “trading blocs”.

China is actually the “world manufacture”, since it makes up about 30% of the global manufacturing industry, practically supplying the whole world with relatively cheap products in a wide assortment. Therefore, despite the efforts of the West to slow down China’s growth, industrialized countries, and especially the US, continue to supply China with the most important “component” that it cannot create on its own - the demand for the products of its manufacturing industry, where the Chinese surplus exceeded 10% of its GDP in 2022. Even with the rising prices of its products, China’s total merchandise surplus is approaching its peak before the global financial crisis. Expressed in current dollars, that surplus, and especially its dynamics, looks much more impressive (paradoxically, after Trump’s tariffs, the surplus of the manufacturing industry even increased, despite Washington’s intentions). On the other hand, imports of the manufacturing industry, as a share of China’s GDP, have decreased since 2000, by as much as five percentage points (and amounted to about 9% of GDP in 2022), which is a good argument for those who talk about de-globalization (Setser, 2023). When imports used as input in exports are excluded (semi-final, i.e. intermediate products), the (net) export of the processing industry is as much as 14% of its GDP, and the (net) import is below 4% of China’s GDP. It is clear that Beijing could not achieve such surpluses without large American deficits. The sudden appearance of China as a net exporter of cars and, from 2023, the world’s largest exporter of the same, indirectly indicates the growing trade deficit of the EU with that country.

Faced with the resistance of their leading companies, as well as the academic public and international institutions, political elites in the West slowly began to see all the risks of a trade and technological war with China. (although it is desirable to go further in relaxing bilateral relations by transforming “de-risking” into focused and rational policy-making). Namely, it is reasonable to diversify the supply of energy and vital raw materials and components, but to do the same with a supply
of Taiwan’s advanced chips is hardly feasible, as is an attempt to squeeze Chinese competitive industrial products from Western markets.

Bearing in mind the mentioned numbers, that is, the trends, the question that arises is how the global economy should be managed. The IMF and the World Bank, bastions of G7 influence in an increasingly divided world, as it is nowadays, will not be able to do that. It seems that the reality should be recognized and the quotas in the IMF and the World Bank should be adjusted, thus recognizing the huge changes in the global economic power. In addition, the work of the World Trade Organization (WTO) should be revitalized in exchange for China’s renunciation of using its own treatment in the WTO as a developing country (in order to circumvent the anti-state support rules that typically restrict industrialized nations). The key is to find a way of global coordination, and this will mean recognizing the importance of organizations that Beijing and its allies are creating, such as BRICS, which is on its way to becoming globally relevant.

**Overview of related literature**

Studies dedicated to decoupling and trade fragmentation have been very present in academic literature in recent years, even becoming a top topic of leading international organizations. For example, one of the most recent IMF studies (IMF, 2023, 91), published at the institution’s the 2023 spring session, has warned of the downsides of friend-shoring and growing geo-economic fragmentation, which could reshape the locating of foreign direct investments – FDI (the fragmentation of which would negatively impact the world economy in return). It is emphasized that FDI flows have slowed down significantly and that they are increasingly concentrated among geopolitically aligned countries (this is especially true for strategic sectors). It is warned that in the long term, the fragmentation of FDI (which is a consequence of the creation of geopolitical blocs) may generate large losses in income, especially for developing countries. The IMF, as usual, calls for multilateral arrangements and the maintenance of global integration as the best ways to reduce the economic costs associated with the increasingly pronounced geo-economic and FDI fragmentation. By the way, the term “geo-economic fragmentation” was coined by a group of
experts within the IMF to describe the reversal of global economic integration (Aiyar et al., 2023).

A lot of studies deal with the costs of decoupling, that is, the trade, and especially the technological war between Washington and Beijing. The group of authors suggest that the harm to the US caused by tariffs is widespread, significant, and counterproductive to Washington’s goal of ‘disciplining’ Beijing (Manak, Cabanas, & Feinberg 2023). When it comes to costs, they are significant ($48 billion), borne by American consumers and companies (Lee & Smith, 2023). Nobel laureate Michael Spence indicates that global supply chains (GVC), which become less elastic and more expensive with decoupling, will be more susceptible to inflationary pressures, and the task of curbing price growth will fall to a greater extent on central banks (Spence, 2023). This will affect the growth of interest rates and consequently increase fiscal pressures, while population aging and the trend of slowing productivity will further worsen conditions on the supply side.

Citing an IMF study (Aiyar et al., 2023), the executive director of that institution, Kristalina Georgieva, states that the long-term cost of trade fragmentation could range from 0.2% of world GDP to 7% in a pessimistic scenario (Georgieva, 2023).

In the working paper, the authors address the channels of influence of trade and technological fragmentation on global growth (Cerdeiro et al. 2021). It was shown that, among other things, trade flows decrease as countries impose higher non-tariff barriers (which reduces demand for high-tech imports, hindering consumption and investment growth); inadequate sectoral allocation is created (which leads to inefficiencies such as excess capacity); global diffusion of knowledge is prevented (which prevents innovation and domestic productivity).

Since commercial banks are critically important for financing international trade and lending to the real economy, the impact of geopolitically generated shocks to globalization could also have negative repercussions on credit potential. Therefore, a number of authors also dealt with this topic, indicating that the reduced activity of banks can increase the shocks produced by protectionist trade policies (at the domestic and international levels), by transmitting financial stress through lending and liquidity flows (Federico et al. 2020). Namely, if
banks affected by negative trade events were to reduce credit activity, the effects of the initial shock to the real economy could be amplified. Thus, shocks due to trade fragmentation could affect the reduced total offers of loans through banks. Additionally, the decline and redistribution of bank credit supply can reinforce trade fragmentation and potentially slow down firms’ adjustment to trade shocks (Buch, Goldberg & Imbierowicz, 2023).

**Geo-economic fragmentation of the world economy**

Geoeconomic fragmentation refers to disruptions in the flows of trade, capital (FDI), and migration (IMF, 2023, 91). The trade war, and then the attempt to contain China in the domain of high technology by the West, led by Washington, is the most important, but not the only, generator of geo-economic fragmentation. Namely, the trends of slowing down or stagnation of globalization have been present since the 2008-2009 Great Recession.

Just as growing global economic integration has affected the global economy through multiple interconnected channels, so geo-economic fragmentation is likely to have similar effects, but in an inverse way. Namely, for several decades, international trade has acted as a catalyst for reducing income differences between countries, greatly reducing global poverty and lower prices, especially for low-income consumers. Cross-border migration has provided significant benefits to both people and firms, generating an increase in efficiency in the distribution of labor among countries at different levels of income and productivity (e.g. through remittances). Capital flows, especially FDI, provided developing countries with a source of external financing, contributing to greater efficiency of domestic enterprises, as well as technological diffusion, i.e. productivity growth.

Geo-economic fragmentation calls into question all these acquired benefits. Transition costs are likely to be significant, as it takes time and effort to reconfigure supply chains, with short-term costs due to trade fragmentation likely to be much higher. Since they are further from the so-called technological frontiers, developing countries lose disproportionately when access to technology is difficult. Productivity losses due to less diffusion of knowledge could accumulate, increasing
the long-term costs of technological decoupling. In any case, the costs will be higher the deeper the fragmentation.

In addition to trade and FDI fragmentation, there is also a noticeable downward trend in financial globalization measured by global cross-border banking loans. Against these negative trends, trade in services is growing constantly strongly; on average increasing by 4% in the period 2010-2021 (UNCTAD, 2018).

**Signs of slowing down of globalization**

Diversification of supply chains (friend-shoring, reshoring) is already well underway, not only because of US-Chinese competition, but also because of the need to increase resistance due to climate change, pandemics, wars, and the increased use of economic sanctions. The latest forecasts of the WTO (2023) indicate that the trend of slowing globalization is intensifying, as this organization is projecting a slowdown in the growth of world trade volume to a modest 1.7% in 2023, mainly due to a slowdown in global demand. Also, in the report of the International Trade Chamber (ICC, 2023, pp. 11–20), it is indicated that globalization continues to slow down, as trade tensions between the US and China, the pandemic, and the war in Ukraine have led to an increase in protectionist measures (primarily export controls, the scope of subsidies, and investment restrictions).

A particularly worrying dynamic is the growth of investment barriers, a trend that could accelerate in the near future. The process of investment restrictions is linked to the growing “concern” for national security. Countries implementing FDI screening generate as much as 63% of global FDI inflows (UNCTAD, 2022).

Given the growing investment barriers, the strong slowdown in FDI flows is not surprising. Namely, global FDI declined from an average of 3.3% of GDP in the 2000s to 1.3% in the period 2018–2022 (IMF, 2023, pp. 7–11).

Despite all the above-mentioned challenges, globalization in a broader sense remains resilient. However, US-China trade relations are showing signs of separation. Namely, the share of US imports from China fell to 16.6% in 2022 from 21.6% in 2017, while exports to China
decreased to 7.3%, from 8.4% of total exports in 2017 (although the increased dollar amounts create the wrong picture). Altman & Bastian (2022) show that the share of almost all bilateral flows (FDI, migration, scientific cooperation) between the US and China has declined since 2016. However, there are no reliable signs of decoupling in non-high-tech industries, implying that ‘decoupling’ ‘takes place in GVCs related to “strategic” (high-tech) sectors.

The cost of geo-economic fragmentation

Economic losses from fragmentation can be considerable. The global cost of fragmentation increases with the degree of fragmentation, that is, with the number of affected sectors and countries. Costs include higher import prices, segmented markets, and reduced access to technology. According to several studies, if the loss due to technological decoupling is calculated, global costs could reach up to 12% of the world GDP, which is equivalent to the combined GDP of Germany and Japan. Countries from the Asia-Pacific region would be most affected by fragmentation because they have a high level of international trade (ICC, 2023, pp. 11–20).

Increasing geo-economic fragmentation requires businesses to adapt quickly, as reconfiguring supply chains takes time. This implies that the short-term costs of trade fragmentation may be much higher than the long-term costs.

Analysts, such as William Pesek, believe that the trade war between Washington and Beijing is MAD – mutually assured destruction, in the economic sense (Pesek, 2023). But perhaps the worst is yet to come – the so-called investment war. Explicitly restricting American investments in Chinese stocks would strongly reduce the market valuation of companies from the US, while significantly reducing the technological diffusion that predominantly goes from America to China.

What is not realistic is that geo-economic fragmentation will lead to the complete disintegration of the world market (or its strict division into blocs), since there are no valid (geopolitical) reasons why Western countries stopped importing the vast majority of consumer goods from China (Shearing, 2023). Instead, the trade will be reduced in areas
perceived in Washington, Brussels, and Beijing as strategically important (batteries, biotechnology, high-tech). Additionally, while some types of capital flow between the US and China will be reduced, this will not mean a complete halt in FDI, portfolio investment, or lending between the two economies.

Discussion – Washington’s new economic paradigm on the horizon?

Washington’s drive to contain China’s technological growth carries the risk of a new Cold War and the division of the world into two or more global trading blocs. The White House is also trying to preserve global hegemony by changing the paradigm. Also, Washington is slowly moving towards transforming the paralyzed WTO.

The Biden administration wants to turn away from the so-called neoliberal economic ideas — free trade abroad and austerity at home — that have driven economic policy since the late 1970s. If neoliberalism supported the interests of the global elite — the core idea of Biden’s new policy is internationalist because it would be based on supporting workers regardless of nationality. All this remains overly optimistic, especially since the key and the most difficult question remains: how to reform a global economic system that is essentially designed to privilege the interests of capital over labor (Bade, 2023).

For decades, global trade has been a “race to the bottom”: corporations sought higher profits by moving to countries with lower wages and fewer regulations, which contributed to inequality, environmental degradation, and populist rebellion. Realizing the new reality, policymakers in Washington (both left, right, and center) came to the conclusion that they should moderate their desires for free trade and provide greater support to domestic industry in order to respond to national security risks (Bade, 2023).

Conclusions

It is clear that the leaderships of the world’s two largest economies have prioritized national security, willingly forgoing the benefits of open trade and investment. Underlying their parallel positions is the logic of
economic exhaustion: Beijing and Washington estimate that they can maintain their policies longer. Xi believes that the predicted economic growth trends are still favorable and that China can close the GDP gap with the US in the next decade. Of course, he surely knows that a more security-focused economic strategy will reduce domestic growth due to the loss of access to Western markets and technology. But the US and its allies are playing a similar game and will bear high costs, as economic growth rates in the West will also decline. Since productivity in China is still much lower than in the US, this means there is more room for productivity growth, which will make China’s growth rates higher than America’s. The Congressional Budget Office (CBO) predicts that the US economy will grow at an average rate of 2.4% in 2024–2027 and 1.8% in 2028-2033. A research team from the Chinese Academy of Social Sciences optimistically estimates that China’s growth will average between 5% and 5.5% this decade and around 4%–4.5% in the 2030s. However, the costs of a security-oriented development strategy are likely to be much higher for China than for the US (Pei, 2023).

Most in both Washington and Beijing know that separation is a highly suboptimal and dangerous course. However, in both the US and China, voices of dissent are either ignored or stifled, as policymakers in both countries have fully embraced the logic of economic decoupling. As the position of developing countries is weak and the EU is disunited to have a strong voice, there is no one to make a detour from the current path of decoupling and fragmentation (Spence, 2023). Hopes are pinned on de-risking, which has at least in the discourse replaced the more aggressive approach of decoupling, and which rests on three broad pillars: reducing dependence on China, limiting technology exports to China, and encouraging Western companies to trade in the huge Chinese market. It is a coherent policy, but it will be failure, if the risk is an actual war between the US and China, possibly over Taiwan (Rachman, 2023). In that catastrophic event, it will matter less that Western corporations will have to leave China (and that for many of them such as Apple or Volkswagen it could mean bankruptcy), but the fate of the world as we know will take priority.

Washington, along with its allies, is at the beginning of a new type of strategic competition, one with few precedents in contemporary
international relations. Since the leadership in Beijing believes that their
country is practically locked in a long-term geopolitical and ideological
competition with the “global west”, which it sees as the main threat to
internal and external security, the White House should remove any
possible misperception of American intentions, and clarify the US policy,
especially concerning Taiwan (Medeiros, 2023). As Francesco Sisci
observes, although they are at a dangerous crossroads between war and
peace in a world still ruled by Washington, it is not too late to mitigate
the considerable risks with a better understanding of competition and war
(Sisci, 2023).

References

Aiyar, S., Chen, J., Ebeke, C., Garcia-Saltos, R., Gudmundsson, T., Ilyina,
A., Kangur, A., Rodriguez, S., Ruta, M., Schulze, T., Trevino, J.,

IMF. https://www.imf.org/en/Publications/Staff-Discussion-
Notes/Issues/2023/01/11/Geo-Economic-Fragmentation-and-the-
Future-of-Multilateralism-527266


IMF (2023, April 11). World Economic Outlook: A rocky recovery; Chapter 4, Geoeconomic Fragmentation and Foreign Direct Investment. IMF. https://www.elibrary.imf.org/display/book/9798400224119/CH004.xml


Medeiros, E. (2023, May 26). The US must grasp the opportunity to stabilise relations with China. Financial Times. https://www.ft.com/content/d8d1dfd7-eb8d-4ccf-a6d2-4ee6766d5f65


Rachman, G. (2023, May 29). De-risking trade with China is a risky business. *Financial Times*. https://www.ft.com/content/1caf3dd9-1097-4de2-9b57-80b70e465154

Setser, B. (2022, April 26). China trade in manufactures as share of China’s GDP. *Twitter*. https://twitter.com/Brad_Setser/status/1651258097908719620

Shearing, N. (2023, April 24). The key to navigating a fragmented world is understanding the forces driving it. *Capital Economics*. https://www.capitaleconomics.com/blog/key-navigating-fragmented-world-understanding-forces-driving-it


Song, J. (2023, May 24). South Korea warns US could ‘overburden’ its chipmakers with China limits. *Financial Times*. https://www.ft.com/content/5602cb1e-0dcd-4c7f-bed4-d6a9a5887d00


Wolf, M. (2023, May 23). The G7 must accept that it cannot run the world. *Financial Times*. https://www.ft.com/content/c8cf024d-87b7-4e18-8fa2-1b8a3f3fbba1

WTO (2023, April 5). Trade growth to slow to 1.7% in 2023 following 2.7% expansion in 2022. WTO. https://www.wto.org/english/news_e/news23_e/tfore_05apr23_e.htm

Figure 1.

Merchandise exports in 2022 of selected G20 countries to China and G7 (as % of their GDP)

Note: The figure was taken from the website of the Financial Times (https://www.ft.com/content/c8cf024d-87b7-4e18-8fa2-1b8a3f3fbb1)
Figure 2.

China’s trade and manufacturing surplus as a share of the country’s GDP 2000-2022.

Note: The figure was taken from the private Twitter account (https://twitter.com/Brad_Setser/status/1651254166323445762/photo/1)
Trgovinsko-tehnološki rat Vašingtona protiv Pekinga i posledična geoekonomska fragmentacija: potencijalne posledice i rizici za globalnu ekonomiju

Goran Nikolić, Jelena Zvezdanović Lobanova i Milan Zvezdanović

1Institut za evropske studije, Beograd, Srbija
2Institut društvenih nauka, Beograd, Srbija
3Akademija za nacionalnu bezbednost, Beograd, Srbija

Sažetak


Kljucne reči: geoekonomska fragmentacija, decoupling, trgovinsko-tehnološki rat, Kina, SAD.