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Contents

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ORIGINAL PAPER

The economy-security conundrum in American grand strategy: foreign economic policy toward China from Obama to Biden

Zeno Leoni[1]

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Abstract
This article argues that in a Janus-faced Liberal International Order, American grand strategy faces an economy-security conundrum. Tensions between transnational economic networks and national security concerns require different administrations to square a balance between important yet competing interests. This conundrum is especially challenging for Washington, D.C., when dealing with China. Indeed, while the Chinese and the American economies are interdependent, China continues to rise, with revisionist demands, and outside of the US-led system of alliances. The economy-security conundrum is managed by different presidents who pursue similar long-term objectives but through different approaches, leading to both strategic continuity and policy changes between one administration and the next. Former US President Barack Obama's Trans-Pacific Partnership, subsequent President Donald Trump's trade war, and President Joe Biden's Build Back Better World (B3W)—most recently rebranded as Partnership for Global Infrastructure and Investment (PGII)—are indeed different policies, but all are aimed at either compelling China to abide the free-market rule of law or to separate from the West, especially regarding strategic and future industries.

Keywords Grand strategy · US–China relations · Biden foreign policy · Decoupling

1 Introduction

This article provides an analysis of the economy-security conundrum in US foreign policy toward China. It advances a twofold argument. The economic interdependence of the United States with a geopolitical rival like China requires effort to strike a balance between the economic interests of private companies and the national

✉ Zeno Leoni
Zeno.j.leoni@kcl.ac.uk

[1] Defence Studies Department, Lau China Institute, King's College London, London, UK

security interests of the state. This balance is addressed by different presidents and administrations who pursue similar long-term, strategic goals but through different policies: while American grand strategy does not change, one can see different ways in which it is operationalized. Former US President Barack Obama's Trans-Pacific Partnership, subsequent former President Donald Trump's trade war, and President Joe Biden's Build Back Better World (B3W)—most recently rebranded as Partnership for Global Infrastructure and Investment (PGII)—and Indo-Pacific Economic Framework (IPEF) are policies that have sought to implement the same long-term goal—compelling China to abide the free-market rule of law. That said, each administration has pursued this goal with a different approach.

This conclusion is achieved by building on recent neorealist contributions to literature on American grand strategy and the flaws of liberal hegemony identified by Barry Posen (2014), Stephen Walt (2018), and John Mearsheimer (2018). These authors agree that American grand strategy since the end of the Cold War has been overly ambitious as it sought to spread and enforce liberal values worldwide at the expense of US national power and international leadership. This article does not disagree with this view, and the flaws of liberal hegemony must be acknowledged. However, rather than blaming the military overstretch and lavish defense expenditures, this article maintains that the problem with China's rise from an American perspective has deeper, structural causes. Contrary to what neorealists have argued, however, liberal hegemony has been highly beneficial to the United States for decades, because it has upheld a world order that once provided a political-economic environment in which the US could prosper.[1] Yet, the American strategy of liberal hegemony tends to cause "blowback[s]" insofar as this strategy requires, encourages, and support other countries—including potential rivals—to develop economically and to actively stimulate and contribute to the global economy by embracing free-market rule of law (Johnson 2000; Leoni 2021, 74; Lee 2020). In the long-term, this strategy can create geopolitical dilemmas by favoring the rise of systemic rivals.[2] A deeply consequential example is that of China's economic and geopolitical rise. Beijing's opening to free-market elements since 1978 has been advocated by US strategy makers in an attempt at building a globalized order, but with the effect of undermining US geopolitical primacy.[3] This overstretch of US-led globalization has led Washington, D.C., to face its greatest geopolitical challenge to date. China's integration within the liberal international order (LIO) requires US strategy makers to maintain a delicate balance between economic and national security interests, and this is a challenging task for the world-leading power whose hegemony has been constructed through the promotion of transnational business. Different presidents and administrations seek to achieve a balance between these two dimensions.

[1] The neorealist critique focuses on the post-Cold War era. However, this article's author does not emphasize this watershed to the extent the US after the Cold War 'adapted its long-standing post-World War II grand strategy to a new era of American dominance' (Brands 2018, 2).

[2] See Lascurettes on 'ordering-to-exclude' (2020, 35).

[3] Such perspective also allows to provide a more analytical explanation of why the US is on a 'collision course' with China (Layne 2017).

Presidents pursue similar grand strategic objectives but do so according to their worldview and/or electoral agendas, displaying competing approaches to the operationalization of US grand strategy (Colucci 2018, 139–140).

The rest of this article is organized in four sections. The first defines the economy-security conundrum while engaging with the literature on the LIO. The LIO, indeed, is riddled with tensions between its two structural pillars, such as an aspatial network of flows of capital, goods, people, ideas, and a territorial order made of sovereign states. The second section continues to reflect on the economy-security conundrum but through the lens of American grand strategy. Here, it is discussed how the US, for the sake of economic interests, has contributed to the rise of a geopolitical rival. Furthermore, it is demonstrated how recent US administrations have struggled to find a balance between economic and security interests. The third section contains a comparison of Obama's, Trump's, and Biden's foreign economic policies toward China. In the fourth section, the conclusion is drawn that, while there was discontinuity in the policies used—possibly caused by differences in their worldviews—the ultimate objectives of the three leaders' strategies were aligned; they all aimed to discipline or isolate China, especially by intervening in supply chains of critical technology and industries (Porter 2018, 11; Waterman and Stokes 2019, 204). The idea of decoupling is the thread that runs through each strategy, although to different extents and in a crescendo from Obama to Biden. Yet, the latter's policy to contain China faces limits.

2 The economy-security conundrum and American grand strategy

The economy-security conundrum concept captures the competing nature of economic and security interests and the challenge of coordinating these in foreign policy. It is particularly useful at a time of deep globalization and rising political systems that are competing with the Western model. While some of the academic literature implicitly acknowledges the existence of such a conundrum, the label "economy-security conundrum" is not used explicitly. The latter represents a more focused interpretation of the concept of "economy-security nexus," applied as a broad umbrella that covers the realist-liberal dichotomy; this concept is defined as "how well or how poorly states interact with one another in geopolitics and how this is (or is not) affected by their economic relations" (Pempel 2013, 17). However, while the economy-security nexus offers a broad spectrum of possibilities, the rise of China within a Liberal International Order makes the economy-security conundrum highly relevant. This is because the LIO is a Janus-faced order (Layne 2017, 261). In it, the International System of States (ISS) intersects—but does not merge into—a global order whose distinguishing feature is the transnational flow of capital, goods, people and ideas. Spanish sociologist Manuel Castells pointed out that there is a tension between the "space of flows" and "national elites" because the former is "a-spatial" and "escape[s] the socio-political control of nations" while the latter strives to "preserve their social cohesion, develop the set of rules and the cultural codes by which they can understand each other and dominate the others, thus establishing the 'in' and 'out' boundaries of their cultural/political community" (2009, 446). This tension has been captured by a variety of scholars who appertain to different theoretical and disciplinary camps. Liberal John Ikenberry explained that the LIO "has been built upon the modern states system and evolving frameworks for managing great power relations" (2011, 21). Marxist David Harvey maintained that while '[t]he capitalist operates in continuous space and time,… the politician operates in a territorialized space', and that the 'relation between these two logics should be seen, therefore, as problematic and often contradictory'' (2003, 27, 30).

The economy-security conundrum can be further deconstructed. First, while one can artificially separate economic and security interests, they are in fact more interdependent than the concept suggests. Colin Flint explained that the state-network dichotomy is not a simple one, because states—or sections of them—have been "active agents in promoting [or shaping] transnational networks" (Ibid, p. 180; Farrell and Newman 2019). Doing so allows states to have a closer command of transnational flows and to find a more convenient balance with respect to their economy-security conundrum (Flint 2017, 179). Second, the economy-security conundrum is often the product of tensions stemming from the distribution of power within liberal democracies. That said, it also has an external dimension. Security interests of the US, for instance, may clash with economic interests within its network of allies. Finally, while the economy-security conundrum affects the foreign policy of any capitalist democracy, it has greater implications for the hegemon and main beneficiary of the LIO than for other states. Indeed, the conundrum has been highlighted by a variety of scholars writing on American grand strategy. Posen and Ross envisioned four different, competing approaches to US grand strategy, which "are not entirely mutually exclusive" but "contain fundamental disagreements about strategic objectives and priorities" (1996, 50; 2014, 6). William Pfaff described American grand strategy after the Cold War as "[a]n implicit alliance [of] … international liberals, … and unilateralist neo-conservatives" (Pfaff 2001, 221). Similarly, Walter Russell Mead advanced a distinction between Hamiltonian, Wilsonian, Jeffersonian and Jacksonian traditions in US foreign policy, choosing Wilsonianism and Hamiltonianism as the driving principles (2001).[4] For Gavin, American grand strategy has sought to "contain, open, and inhibit" simultaneously (2015, 12–19). Such a tension is recognized also by critical scholarship in International Political Economy (IPE), history, and geopolitics. Neil Smith maintained that since the twentieth century in American grand strategy there has been a "contradiction between a spaceless and a spatially constituted American globalism" (2003, 7). Perry Anderson defined it as a special pathway to (global) nationalism, "a *complexio oppositorum* of exceptionalism and universalism" (2013, 6).[5] Similarly, Doug Stokes pointed out that there is in American grand strategy "a dual 'national' and 'transnational' logic" that works in favor of both American power and global capitalism (2005, 218).[6]

[4] See also Martel (2015, 361).

[5] See also Agnew (2003a, 877–880).

[6] Colucci explores additional literature along the realist-idealist divide (2018, 139–140). Departing from the literature so far surveyed, Dombrowski and Reich argued that American grand strategy does not exist because 'the constraints imposed by diverse operational demands' lead to 'a significant gap between … rhetoric and behaviour', or between strategy and operations (Dombrowski and Reich 2017, 1014–1015).

From these accounts of American grand strategists, one can infer two points of both conceptual and historical value. First, the economy-security conundrum is a spectrum, and in different historical periods US administrations will position on different sides of it. During the Cold War, security interests dominated in foreign policy, as compared to the 1990s, when the philosophy of hyperglobalism found many advocates in Washington, D.C. Second, US strategy-makers in the long-term have set the conditions for the US to become entangled in the inner contradictions of its own strategy and, more broadly, of the type of world order that it has designed since the end of WWII. This is especially the case when dealing with a commercial partner that operates through different values and institutions. The challenge for Washington, D.C. is to contain the rise of China while benefiting from its performance as a crucial locomotive of the global economy.

3 China's rise and the US economy-security conundrum

Observing American grand strategy in a post-unipolar era, prominent neorealist scholars advocated for the US to disengage from global commitments. Stephen Walt stated that a grand strategy of liberal hegemony entails that "the United States must remain much more powerful than any other country," and that "it should use its position of primacy to defend, spread, and deepen liberal values around the world" (2018, 54). Similarly, John Mearsheimer wrote that "liberal hegemony … invariably leads to policies that put a country at odds with nationalism and realism' (2018, viii).[7] It is reasonable to sympathize with neorealist arguments. However, they failed to emphasize the structural flaws of American grand strategy. While liberal hegemony has objectively led the US to become the world's superpower, US efforts to create a global economy have contributed to the rise of potential challengers. This has been the case with regard to former and potential competitors such as Germany, Japan, and above all China, countries which were encourage and even supported to develop technologically by Washington, D.C.

In contrast with Japan and Germany—which remain tied to the US through formal diplomatic agreements—the rise of China has made managing the economy-security conundrum highly challenging, due to the magnitude of the Chinese economy, its depth of integration within the LIO, and the diplomatic-military isolation of the PRC. As China's military power increased after the Cold War, Washington, D.C. was struggling to keep "the world open enough" for American and global business while "prevent[ing] the rise of any grand challenge" to American power (Harvey 2003, 84). Yet, it has been noted that subsequent US administrations "significantly marginalised [geopolitical interests] in favor of the economic calculus that has come to rule a neoliberalism dominated by US power" (Smith 2005, 187).

[7] See also Posen (2014, xi).

Although security interests were prioritized during the Cold War, this was not the case in the long run, with respect to US foreign policy toward China. While the short-term objective of the reproachment with Beijing was to isolate the USSR, Washington, D.C.'s long-term objective was to open the Chinese economy to global capitalism (Kissinger 1971; Kissinger 2011, 235, 243; Nixon 1967, 121). After the Cold War, however, neoliberal ideology had free rein and then-President Bill Clinton convinced, with a passionate speech, the US Congress to support China's membership in the World Trade Organization (Clinton 2000). Hyperglobalist consensus in the US led to a deliberate strategic oversight of China's rise, as military spending grew by more than 15 times between the late 1990s and the end of the 2010s, while US defense expenditures doubled (The World Bank 2019a, 2019b). The implications of this are that China has become both Washington, D.C.'s most important partner—because it performs as an engine of the world economy—and greatest challenge—due to growing competition in strategic technological sectors and revisionist geopolitical aspirations in the South China Sea. Furthermore, this growth has allowed China to act more assertively since the late 2010s (Shambaugh 2020, 16). Meanwhile, many realized that China does "ultimately prove a much more formidable economic and strategic competitor" than the USSR, thanks to its state-managed capitalism (Shambaugh 2020, 16, Posen 2014, 18).

The rise of China and tensions between economic and security interests have been especially felt in the Indo-Pacific—while not so much in the MENA region, for instance. In 2011 the Obama administration announced that it intended to make the Asia–Pacific a geopolitical priority (Clinton 2011). In particular, this entailed shifting from a 50–50% distribution of naval assets between the Atlantic and the Asia–Pacific to a 40–60% one (Alexander 2012). The Pentagon worried that in the Western Pacific Ocean, within the First Island Chain, military primacy enjoyed by the United States during the Cold War could no longer be taken for granted (Townshend et al. 2019, 9–11). Furthermore, the rise of a middle class of hundreds of millions in the Asia–Pacific has made this part of the world a highly appealing geopolitical region. Yet, the Obama administration did not implement the pivot in a confrontational manner. Some argued that it engaged with China through three different approaches, reflecting the views of three different departments—Treasury, State, and Defence (Luttwak 2012, 213–247).

While the economy-security conundrum continued to affect US strategy-makers, the Trump administration was able to pursue rebalancing economic and security interests—also thanks to a bipartisan anti-China mood in Washington, D.C. (Zhao 2019, 372–373). Meanwhile, Secretary of Defense James Mattis made clear that "[i]nter-state strategic competition, not terrorism, is now the primary concern in U.S. national security" (National Defense Strategy 2018, 1). Against this backdrop, Trump called for an increase in the number of US warships and sought to refine the US "pivot to Asia" by changing its name to Free and Open Indo-Pacific (FOIP), a more ideologically-charged strategy, which also sought to gain the support of India (2017; Medcalf 2019, 68). Although Trump's rebalancing of the economy-security conundrum in US-China policy was challenged, the president's actions against China and a spiralling relationship informed President Biden's agenda. On the one hand, the Biden administration has acknowledged that China is "the only competitor potentially capable of combining its economic, diplomatic, military, and technological power" (The White House 2021, 8). On the other hand, it stated in a foundational speech on American foreign policy that US–China policy should be "competitive when it should be, collaborative when it can be, and adversarial when it must be", acknowledging that it is not possible to develop a policy that is satisfactory under all aspects (US Department of State 2021). This approach was further articulated by the recognition that allies play a key role and captured by the phrase "invest, align, compete," three keywords that emphasized the importance of "international coalition building" in Biden's China policy (US Department of State 2022; Li 2021).

4 US foreign economic policy towards China from Obama to Biden

4.1 Obama's regionalism and the Trans-Pacific partnership

The Obama administration's foreign economic policy toward China reflected Obama's commitment to regionalism. The president's policy manifested elements of pragmatism and selective engagement with the world's problems, but the worldview was a Wilsonian one. Obama stated that "power is no longer a zero-sum game;" that "[n]o balance of power among nations will hold;" and that the post-WWII "international order … brought about diplomatic cooperation between the world's major powers" (2009a, 2009b). Considering this, the Obama administration sought to tackle China's economic power through the Trans-Pacific Partnership, which already existed under former president George W. Bush but evolved into a far-reaching project under Obama (Capling and Ravenhill 2011, 558). Obama's TPP was a case of leveraging regionalism as a reaction to the slow performance of multilateral mechanisms and to the inability of the American hegemon to shape the agenda in such institutions. It offered a framework for overcoming China's and other countries' opposition in the WTO that emerged during the Doha Round—similarly, Obama pursued US interests in Europe through the Transatlantic Trade and Investment Partnership (TTIP) (Dian 2017, 589–592). Its rationale was about strengthening US-led regionalism in Asia–Pacific while engaging in a non-confrontational fashion with China. The TPP required stringent rules on transparency for state-owned companies, an attempt to discipline China's state capitalism by stimulating internal reform and bringing Chinese companies onto the terrain of free-market competition, where some strategic sectors of American industries thrive. For this reason, regulating state-owned enterprises (SOEs) served the interests of intellectual property (IP) and information technology (IT) companies of Silicon Valley and other US tech hubs. Above all, obstructing SOEs equated to undermining China's geopolitical power because economic leavers are pivotal to Chinese grand strategy. Obama promised a commitment to: achieve groundbreaking agreements to liberalize … areas where the United States is a global leader in innovation" (NSS 2015, 17). He stated that "it's important for us to be making the rules in this region, and that's exactly what TPP does" (Obama 2016). Obama stressed the relationship between China's geopolitical threat, international standards, and US hegemony when he stated that "if we fail to get the Trans-Pacific Partnership done … then that void will be filled by China … They will make the rules, and those rules will not be to our advantage" (Obama 2015). These words resonated with an equally evident geopolitical vision in an op-ed written by former secretaries John Kerry and Jimmy Carter, in which they wrote that the success of the TPP will have helped the US to support that system that "has served us so well" (Kerry and Carter 2015). With the TPP, the US would have achieved economic security through international standards while encouraging reform in China. Potentially, this would have led to a favorable balance between economic and security interests in the Asia–Pacific.

4.2 Trump's nationalism and the trade war

While Obama's worldview depicted an interconnected global system, former president Trump manifested a Hobbesian, disarticulated worldview where "social and political organization are defined in terms of this or that state" (Agnew 2003b, 98). In his UN speech in 2018, Trump stated that "[w]e reject the ideology of globalism, and we embrace the doctrine of patriotism" (Trump 2018b). Because of his emphasis on "pride" and "fear" for "domination and defeat", scholars labelled Trump a Jacksonian president (Clarke and Ricketts 2017). This worldview stemmed from a foreign economic policy in contrast to that of the Obama administration, although the long-term goals were the same. While withdrawing American participation from the TPP allowed Trump to respect promises made during the electoral campaign, US opposition to China's state-led capitalism, cheap export, growing competition in strategic sectors, and intellectual property theft continued in a more pressing, confrontational, and bilateral manner with the use of trade tariffs. Like Obama, Trump stated that the "United States must marshal the will and capabilities to compete and prevent unfavourable shifts in the Indo-Pacific" (NSS 2017, 45). During his Asian tour, Trump denounced the fact that "other countries used government-run industrial planning and state-owned enterprises" engaged in "predatory industrial practices" that could harm American private enterprises and innovation (Trump 2017). The Silicon Valley system—including other American technological hubs—and the increasingly important infrastructural value of the Internet in the global economy, were not only central to Obama's TPP, but also remained a concern for the Trump administration. US Trade Representative Robert Lighthizer, in fact, stated that there is an "unprecedented threat" posed by China, because "[t]echnology and innovation are America's greatest economic assets … we must … protect American competitiveness" (Office of the US Trade Representative 2018). Indeed, this highlights once again the importance of international standards for American hegemony and how this depends on a certain relationship between economic and geopolitical interests. However, contrary to Obama, Trump operationalized American grand strategy with a nationalist policy. At the end of May 2018, Trump announced an additional 25% duties for a list of products that included about 1102 separate U.S. tariff lines (ibid. 2018) for a total of $50 billion in 2018 trade value. The logic of this list was to hit products from industrial sectors related to the "Made in China 2025" industrial policy, particularly those regarding "aerospace, information and communications technology, robotics, industrial machinery, new materials, and automobiles" (ibid.).

Trade sanctions were published in the Federal Register of June 20, 2018 and became effective July 6 (Federal Register 2018, 28710–28756). On June 18, 2018, the US announced more tariffs worth £200 billion, should have China retaliated against the first round of tariffs (Trump 2018a). These were added to tariffs on US$250 billion worth of Chinese products. Yet, while Trump was determined to mitigate the consequences of the economy-security conundrum, the effectiveness of tariffs was limited by its bilateralism amidst a world economy that moves along multilateral networks—the negotiation between Washington, D.C. and Beijing never reached Phase 2. The problem was addressed by the Biden administration.

4.3 From the B3W to IPEF: Biden's strategy of positive decoupling

Contrary to recent presidents like George W. Bush, Obama, and Trump, whose worldviews were clearcut, President Biden has not yet left an ideological legacy in US foreign policy. Nonetheless, it is evident that two structural factors have influenced his approach. First, in contrast to his two predecessors, Biden has been a member of the political establishment throughout his career; his foreign policy has not derailed from the pillars of American grand strategy—in the way Trump's policy did. But, Biden inherited from Obama and Trump the strategy of "pivot to Asia" and a domestic environment increasingly sceptical of China. Considering this, his foreign economic policy toward China has sought to tackle the economy-security conundrum with features that resembled both Obama's and Trump's approaches. Like in Obama's and Trump's foreign policy, the underlying theme of Biden's policy has been one of growing dissatisfaction with the LIO, and an effort to reform it in a more US-friendly way. While Biden's strategy remains undeveloped, the primary theme is pursuing geo-economic re-engineering of the LIO by leveraging US alliances. From an operational viewpoint, Biden has sought to bridge the gap between supply chains and geopolitical objectives; that is, to make trading networks more resilient *vis-à-vis* diplomatic tensions and disruptions. This objective has been set out in the executive order titled America's Supply Chains, which demanded a review of US supply chains resilience (Biden 2021). The report, submitted by Jake Sullivan and Brian Deese—assistants to the president for National Security and Economic Policy, respectively—stated that "we must reduce our dependence on China and other geopolitical competitors for key products", adding that a "friend-shoring" that keeps supply chains among allies should be pursued (2022, 7). Two initiatives have stemmed from this geoeconomic necessity: the Build Back Better World (B3W) and the Indo-Pacific Economic Framework (IPEF). If the White House's fact sheet emphasized that the B3W focuses on "climate, health and health security, digital technology, and gender equity and equality," the Carbis Bay G7 Summit Communiqué aimed at obtaining greater political alignment around US-sponsored values and standards of the rules-based international order (2021). This was congruent with the advice of Congress, which stated that the Biden administration should "initiate an agenda with G7 and G20 countries on matters relevant to economic and democratic freedoms" on "international infrastructure standards," "security of 5G telecommunications," "[a]nti-competitive behavior," "[p]redatory international sovereign lending," "[i]nternational influence campaigns" among other things (S.1260—117th Congress 2021-2022, 857–858). This policy represents an attempt at creating a new sphere of influence or economic-technological line of defense, a more exclusive club than the post-WWII LIO which seeks to hinder China from accessing parts of the global economy, including next-generation industries and technologies. Its final goal is to build a LIO 2.0. This policy has been described by the Henry Jackson Society as "positive decoupling" (Rogers et al. 2020). This concept means that the US and some of its partners "may not be able to regenerate self-sufficiency across all strategic sectors" and should accept limited dependency on China in some strategic areas (ibid., 34). However, with projects like the B3W the US and its partners commit to "forcing breakthroughs in frontier technologies that China does not yet dominate, rather than chasing after China's production of existing products" (ibid.). During the G7 held in Bavaria (Germany), the B3W was rebranded the Partnership for Global Infrastructure and Investment (PGII), although this represents "a continuation and expansion" of the B3W, which seeks to "catalyze international infrastructure financing and development" (Rahman and Ahmad 2022; The White House 2022a).

A second important move, in keeping with the overarching logic of the B3W, was the launch of IPEF, Biden's attempt at replacing the defunct TPP—which currently the US does not intend to re-join (Barns-Graham 2021). This is a geoeconomic strategy rather than a free trade negotiation—with the specific intent of eroding China's growing influence in the Indo-Pacific. It provides the US with an opportunity to develop a non-traditional free trade agreement (FTA), as countries joining IPEF will not need to lower their custom barriers. This approach seems to consider the more consensus-based procedures used within ASEAN and the diversity of the Asia–Pacific. Concretely, IPEF is seeking to uphold a US-friendly regional and international order by promoting cooperation to make the world economy digital, resilient, cleaner, and fairer (The White House 2022b).

5 The limits to decoupling

Biden's economic policy, aimed at keeping China out of a US-led sphere of influence, represents a development in the commitment to decoupling within US policy circles. That said, for the GPII and IPEF, the road is not without obstacles. Regarding the GPII, at Carbis Bay G7, the communiqué confirmed that members "will cooperate to address the challenge posed by China" but only "where it is in our mutual interest" (Carbis Bay G7 Summit Communiqué 2021, 19). Furthermore, it was reported that while the US was keen to make most of the G7 and of the B3W about China, Britain and other European countries preferred to identify the G7 spirit with a post-COVID-19 reconstruction of the economy; these countries were sceptical of the US's hawkish stance towards China (Leoni 2022; Parker and Cameron-Chileshe 2021). Others, like South Korea—invited as a guest—have continued to apply "strategic ambiguity" between the US and China. Nonetheless, the drama of the war in Ukraine and China's pro-Russia stance might have played in favor of the Biden administration. Due to the fear of a Russian invasion of Europe, US partners have become more lenient toward Washington, D.C.'s demands—at least in the short term. Yet, the concrete operationalization of the GPII remains nebulous and faces several uncertainties, from its reliance on private funding to the political resolve in a broad coalition. IPEF faces challenges that are substantially not different from those of the GPII. Even if IPEF was well received—on the day of the launch, Indo-Pacific countries joined—this framework remains a lame duck. Indeed, the new initiative is causing a degree of "unease" among those regional members that would like to gain access to the American domestic market and take advantage of their competitive production costs (Harris 2022). But for this to happen the US would have to join the Comprehensive Progressive Agreement for Trans-Pacific Partnership (CPTPP). Furthermore, because IPEF is not an FTA, the next president might easily scrap IPEF with an executive order. This flaw, in particular, increases the political charm of China, which could appear as a more politically stable and reliable partner. Meanwhile, this puts the fragility of US grand strategy under the spotlight, with domestic institutions incapable of taking an economic burden for the sake of geopolitical objectives. Overall, it remains unclear what the B3W and IPEF bring to the table, both in terms of resources and opportunities for American allies. In fact, while these frameworks might offer a solution to the economy-security conundrum, US partners will have to be persuaded that they will be able to compensate for the loss of income that any decoupling from China might involve.

Nonetheless, these two frameworks are informed by strategic thinking and represent a sophisticated evolution in US foreign economic policy toward China. More to the point, the comparison between Obama's, Trump's, and Biden's foreign economic policy toward China, provides evidence about two dynamics central to American grand strategy in the post-2008 era. First, tensions between economic and security interests have great influence on US economic policy toward China. In a liberal order made of an international system of states and a spaceless economy, the foreign policy of the hegemon will be in tension with developing a coherent policy toward one of the locomotives of the global economy, namely China. Second, in hindsight and following from the previous point, the trend of US foreign economic policy toward China has been and will continue to be one of decoupling. To balance the economy-security conundrum, it appears logical to assume that this decoupling will be highly selective and is likely to affect only some strategic industries—as in the case of semiconductors—and, above all, next-generation technology, and the green economy.

6 Conclusion

This article sought to advance a contribution to the debate on US foreign policy after 2008 and US–China relations by unpacking the tension between national and global interests endemic to US grand strategy. This intervention was necessary to bring fresh insights into the debate stimulated by arguments laid out by neorealist scholarship. Neorealists such as Posen, Walt, and Mearsheimer pointed out that American grand strategy, especially since the end of the Cold War, has been flawed by its constant attempt at engineering a liberal international order based on international rule of law, liberal democracy, and human rights, among several other principles. They correctly maintained that enforcing such order has undermined American national interests and power. This article, indeed, agreed that the American grand strategy of liberal hegemony has drained the relative power of the hegemon. Yet, it maintained that the main structural flaw of a strategy of liberal hegemony is the intentional integration into the LIO of countries that can become geopolitical rivals of the United States. While American grand strategy represents a synthesis of two self-reinforcing but also contradictory elements—nationalism and globalism—this strategy has contributed to causing the rise of economic competitors, such as Japan and Germany, and systemic rivals, such as China. Managing the economy-security conundrum in a post-American order, furthermore, has become an increasingly challenging task, especially when confronting China. The latter's strategic interlocking between political power and key—state-owned—industries allows China to leverage on whole-of-government cooperation for the sake of geopolitical objectives. The latest developments in American foreign policy, from the B3W and PGII to IPEF and, more broadly, to calls for decoupling and whole-of-government approaches against security challenges, are a testament to the fact that the US, like other Western governments, is taking a page from China's book. Cooperation between government and industries, and between close allies, is a key element for facing a competitor like China that can pull different levers of power at once.

Data availability Data were access through secondary sources available online as open source or through library login details.

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Economics in the new age of national security

The growing geopolitical and economic split between the United States and China should prompt a paradigm shift in economic thinking. In particular, as this Project Syndicate column argues, economists will need to reconsider their approach to topics such as comparative advantage, market integration and how to promote convergence.

Project Syndicate
By Rabah Arezki
September 6, 2022

The global economy has entered a new age of national security. The Covid-19 pandemic highlighted the vulnerability caused by over-reliance on global supply chains and the failure of coordination in tackling global health risks. But what has really ushered in this new era is Russia's unprovoked invasion of Ukraine and sabotage of the global economy.

Beyond its human and economic toll, the war in Ukraine has sharply increased the divisions between the Western and Eastern geopolitical blocs centred around the United States and China, respectively. Russia has weaponised its energy and food exports to divide Europeans and has sought to stoke anti-Western sentiment in developing countries. China has sided with Russia and affirmed its support for the Kremlin's security concerns. Tensions over Taiwan, a leading global semiconductor manufacturer, are another major flash point in US-China relations.

These developments should be seen as aftershocks of the world economy's increasing polarisation, underpinned by the asymmetry of the two superpowers' political systems. It is no coincidence that several frozen conflicts have recently become active, and that many medium-size and regional powers are behaving more assertively.

Unlike the Soviet Union during the Cold War, China is both a strategic and an economic rival to the United States. China's growing trade and financial ties with the Global South help to explain the shift in many poorer countries' allegiances vis-à-vis America. But the decision by many developing countries in March to abstain from voting on United Nations General Assembly resolutions condemning Russia's invasion of Ukraine surprised US and European officials.

The growing geopolitical and economic split between the superpowers should prompt a paradigm shift in economic thinking. Economists have long regarded national security as a separate field of study with little relevance to their analysis of markets – and for good reason: their profession, like the global economy, has flourished amid the relative stability of the post-World War II era.

The Bretton Woods institutions and the World Trade Organization – with the West and specifically the United States providing an implicit backstop – have helped support the global economy's expansion. Since 1960, global GDP has increased about eightfold. And as a result of the Chinese economy's formidable rise in recent decades, China's GDP (measured at market exchange rates) could surpass that of the United States by 2030.

But today's geopolitical polarisation risks fragmenting the global economy in multiple ways. There are strong indications that this is already happening. Former US President Donald Trump's 'America First' approach and instigation of a tariff war with China dealt a sharp blow to free markets and free trade, and Joe Biden's administration has followed suit. US Treasury Secretary Janet Yellen recently advocated 'friend-shoring' supply chains to trusted allies as part of America's strategic response to the growing Chinese challenge. But deciding who counts as a 'friend' may be difficult; using criteria such as a country's commitment to democracy could result in a rather small group.

In parallel, a growing number of countries have shown interest in joining the BRICS, a group comprising Brazil, Russia, India, China and South Africa. China is promoting a new global governance system supported by new organisations. And China and Russia are looking to develop alternatives to the SWIFT payment system. That, too, will not be easy, not least because payment systems are intertwined with issues related to reserve currencies. A litmus test for China is whether it can find an alternative to US Treasuries in which to invest its sizeable foreign-exchange reserves.

There have been many historical episodes of fragmentation, including trade wars, but perhaps none so pervasive between two economic and strategic superpowers. The trend is evident in stock exchange delistings, sectors such as microchips and telecommunications technology, agricultural land sales, energy, and the defence industry. And the fragmentation of supply chains for both goods and services could increase further as a result of non-tariff barriers such as security, privacy and phytosanitary standards or problems related to the interoperability of electronic and digital equipment.

The trade-offs between economic efficiency and national security are enormous. Deviating from globalised markets will no doubt reduce efficiency, stoke inflation and leave hundreds of millions of people worse off. Economists should therefore rethink their approach to topics such as comparative advantage, market integration and how to promote convergence.

In this new environment where security of supply has become paramount, the design of value chains will have to minimise the risk of weaponisation. And while free markets define efficient pricing better than any other mechanism, fragments of the global economy will likely function independently with autonomous pricing and sourcing.

Tackling increasing economic fragmentation and curbing its costs will undoubtedly require economists to address the underlying sources of division. Building trust and limiting uncertainty between the two superpowers and their allies will thus be vital. But that will require something altogether different from fresh economic thinking.

The Price of Fragmentation

Why the Global Economy Isn't Ready for the Shocks Ahead

KRISTALINA GEORGIEVA

We are living through turbulent times, in a world that has become richer but also more fragile. Russia's war in Ukraine has painfully demonstrated that we cannot take peace for granted. A deadly pandemic and climate disasters remind us how brittle life is against the force of nature. Major technological transformations such as artificial intelligence hold promise for future growth but also carry significant risks.

Collaboration among nations is critical in a more uncertain and shock-prone world. Yet international cooperation is in retreat. In its place, the world is witnessing the rise of fragmentation: a process that begins with increasing barriers to trade and investment and, in its extreme form, ends with countries' breaking into rival economic blocs—an outcome that risks reversing the transformative gains that global economic integration has produced.

KRISTALINA GEORGIEVA is Managing Director of the International Monetary Fund.

A number of powerful forces are driving fragmentation. With deepening geopolitical tensions, national security considerations loom large for policymakers and companies, which tends to make them wary of sharing technology or integrating supply chains. Meanwhile, although the global economic integration that has taken place in the past three decades has helped billions of people become wealthier, healthier, and more productive, it has also led to job losses in some sectors and contributed to rising inequality. That in turn has fueled social tensions, creating fertile ground for protectionism and adding to pressures to shift production back home.

Protectionism and decoupling come at a cost.

Fragmentation is costly even in normal times and makes it nearly impossible to manage the tremendous global challenges that the world now faces: war, climate change, pandemics. But policymakers everywhere are nevertheless pursuing measures that lead to further fragmentation. Although some of these policies can be justified by the need to ensure the resilience of supply chains, other measures are driven more by self-interest and protectionism, which in the long term will put the world economy in a precarious position.

The costs of fragmentation could not be clearer: as trade falls and barriers rise, global growth will take a severe hit. According to the latest International Monetary Fund projections, annual global GDP growth in 2028 will be only three percent—the IMF's lowest five-year-ahead forecast in the past three decades, which spells trouble for poverty reduction and for creating jobs among burgeoning populations of young people in developing countries. Fragmentation risks making this already weak economic picture even worse. As growth falls, opportunities vanish, and tension builds, the world—already divided by geopolitical rivalries—could splinter further into competing economic blocs.

Policymakers everywhere recognize that protectionism and decoupling come at a cost. And high-level engagements between the world's two largest economies, the United States and China, aim to reduce the risks of further disintegration. But broadly speaking, when it comes to trying to turn back the tide of fragmentation, there is a troubling lack of urgency. Another pandemic could once again push the world into global economic crisis. Military conflict, whether in Ukraine or elsewhere, could again exacerbate food insecurity, disrupt energy and commodity markets, and rupture supply chains. Another severe drought or flood could turn millions more people into climate refugees. Nonetheless, despite widespread recognition of these risks, governments and the private sector alike have been unable or unwilling to act.

A more shock-prone world means that economies will need to become much more resilient—not just individually but also collectively. Getting there will require a deliberate approach to cooperation. The international community, supported by institutions such as the IMF, should work together in a systematic and pragmatic manner, pursuing targeted progress where common ground exists and maintaining collaboration in areas where inaction would be devastating. Policymakers need to focus on the issues that matter most not only to the wealth of nations but also to the economic well-being of ordinary people. They must nurture the bonds of trust among countries wherever possible so they can quickly step up cooperation when the next major shock comes. That would benefit poorer and richer economies alike by supporting global growth and reducing the risk that instability will spread across borders. Even for the richest and most powerful countries, a fragmented world will be difficult to navigate, and cooperation will become not only a matter of solidarity but of self-interest, as well.

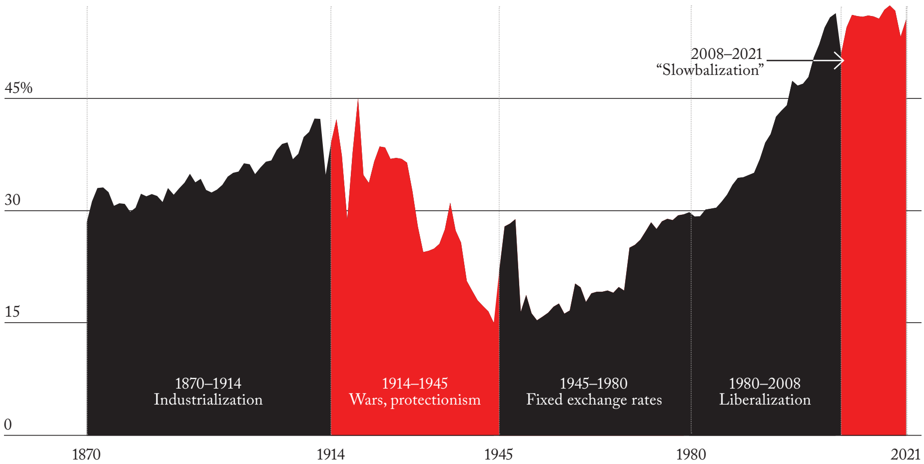
A FRAGILE WORLD

Two world wars in the twentieth century revealed that international cooperation is critical for peace and prosperity and that it requires a sound institutional foundation. Even as World War II was still raging, the Allies came together to create a multilateral architecture that would include the United Nations and the Bretton Woods institutions—the IMF and the World Bank—together with the precursor to the World Trade Organization. Each organization was entrusted with a special mandate to address the problems of the day requiring collective action.

What ultimately followed was an explosion of trade and integration that transformed the world, culminating in what came to be known as globalization. Integration had accelerated in previous historical eras, especially in the wake of the Industrial Revolution. But during the world wars and the interwar period, it had sharply retreated, and in the immediate postwar era, the fragmentation of the Cold War threatened to prevent it from recovering. The international security and financial architecture the Allies built, however, allowed

THE PHASES OF GLOBAL INTEGRATION

Sum of exports and imports as a percentage of GDP



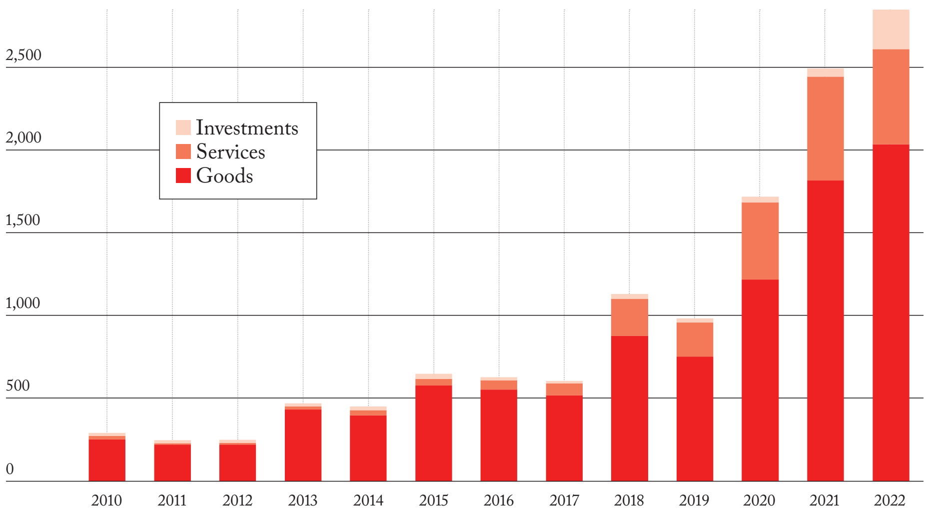
Note: Sample's composition changes over time. *Sources: Peterson Institute for International Economics; Jordà-Schularick-Taylor Macrohistory Database; Penn World Table (10.0); World Bank; IMF staff calculations.*

integration to come roaring back. Since then, that architecture has adapted to massive changes. The number of countries in the world has grown from 99 in 1944 to nearly 200 today. In the same period, the earth's population has more than tripled, from around 2.3 billion to around 8.0 billion, and global GDP has increased more than tenfold. All the while, the expansion of trade in an increasingly integrated global economy has delivered substantial benefits in terms of growth and poverty reduction.

These gains are now at risk. After the 2008 global financial crisis, a period of "slowbalization" began, as growth became uneven and countries began imposing barriers to trade. Convergence in living standards within and across countries has stalled. And since the pandemic began, low-income countries have seen a collapse in their per capita GDP growth rates, which have fallen by more than half, from an average of 3.1 percent annually in the 15 years before the pandemic to 1.4 percent since 2020. The decline has been much more modest in rich countries, where per capita GDP growth rates have fallen from 1.2 percent in the 15 pre-pandemic years to 1.0 percent since 2020. Rising inequality is fostering political instability and undermining the

WALLED OFF

Number of trade restrictions imposed annually worldwide



Sources: Global Trade Alert; IMF staff calculations.

prospects for future growth, especially for vulnerable economies and poorer people. The existential threat of climate change is aggravating existing vulnerabilities and introducing new shocks. Vulnerable countries are running out of buffers, and rising indebtedness is putting economic sustainability at risk.

In a more fragile world, countries (or blocs of countries) may be tempted to define their interests narrowly and retreat from cooperation. But many countries lack the technology, financial resources, and capacity to successfully contend with economic shocks on their own—and their failure to do so will harm not only the well-being of their own citizens but also that of people elsewhere. And in a less secure world with weaker growth prospects, the risk of fragmentation only grows, potentially creating a vicious downward spiral.

Should this happen, the costs will be prohibitively high. Over the long term, trade fragmentation—that is, increasing restrictions on the trade in goods and services across countries—could reduce global GDP by up to seven percent, or $7.4 trillion in today's dollars, the equivalent of the combined GDPs of France and Germany and more than three times the size of the entire sub-Saharan African economy. That is why policymakers should reconsider their newfound embrace of trade barriers, which have proliferated at a rapid clip in recent years: in 2019, countries imposed fewer than 1,000 restrictions on trade; in 2022, that number skyrocketed to almost 3,000.

As protectionism spreads, the costs of technological decoupling—that is, restrictions on the flow of high-tech goods, services, and knowledge across countries—would only add to the misery, reducing the GDPs of some countries by up to 12 percent over the long term. Fragmentation can also lead to severe disruption in commodity markets and create food and energy insecurity: for example, Russia's blockade of Ukrainian wheat exports was a key driver behind the sudden 37 percent increase in global wheat prices in the spring of 2022. This drove inflation in the prices of other food items and exacerbated food insecurity, notably in low-income countries in North Africa, the Middle East, and South Asia. Finally, the fragmentation of capital flows, which would see investors and countries diverting investments and financial transactions to like-minded countries, would constitute another blow to global growth. The combined losses from all facets of fragmentation may be hard to quantify, but it is clear that they all point to lower growth in productivity and in turn to lower living standards, more poverty, and less investment in health, education, and infrastructure. Global economic resilience and prosperity will depend on the survival of economic integration.

A GLOBAL SAFETY NET

In a world with more frequent and severe shocks, countries have to find ways to cushion the adverse impacts on their economies and people. That will require building economic buffers in good times that can then be deployed in bad times. One such buffer is a country's international reserves—that is, the foreign currency holdings of its central bank, which provide a readily available source of financing for countries when hit by shocks. In the aggregate, reserves have grown tremendously over the past two decades, on par with the expansion of the world economy and in response to financial crises. But those reserves are heavily concentrated in a relatively small group of economically stronger advanced and emerging market economies: just ten countries hold two-thirds of global reserves. In contrast, reserve holdings in most other countries remain modest, especially in sub-Saharan Africa, parts of Latin America, oil-importing states in the Middle East, and small island states—which, taken together, account for less than one percent of global reserves. This uneven distribution of reserves means that many countries remain highly vulnerable.

No country should rely on its reserves alone, of course. Consider how a household, which cannot save enough money for every conceivable shock, purchases insurance for a home, a car, and health care. Similarly, countries are better off if they can complement their own reserves with access to various international insurance mechanisms that are collectively known as "the global financial safety net." At the center of the net is the IMF, which pools the resources of its membership and acts as a cooperative global lender of last resort. The net is buttressed by currency swap lines, through which central banks provide one another with liquidity backstops (typically to reduce financial stability risks), and by financing arrangements that allow countries within specific regions to pool resources that can be deployed if a crisis hits.

In a less secure world with weaker growth prospects, the risk of fragmentation only grows.

Protecting countries and their people against shocks contributes to stability beyond their borders: such protection is a global public good. A global safety net that pools international resources to provide liquidity to individual countries when they are struck by calamities is thus in the interest of individual countries and the world. The COVID-19 crisis provides a good example. With the pooled resources of the IMF, member countries received liquidity injections at an unprecedented speed and scale, helping them finance essential imports such as medicines, food, and energy. Since the pandemic, the IMF has approved over $300 billion in new financing for 96 countries, the broadest support ever over such a short period. Of this, over $140 billion has been provided since Russia's invasion of Ukraine to help the fund's members address financing pressures, including those resulting from the war.

Although the global financial safety net helped manage the fallout from COVID and the effects of Russia's invasion, it is sure to be tested again by the next big shock. With reserves unevenly distributed, there is a pressing need to expand the world's pooled resources to insure vulnerable countries against severe shocks. The IMF's nearly $1 trillion in lending capacity is now only a small part of the overall safety net. Although self-insurance through international reserves has sharply increased for some countries, pooled resources centered on the IMF have increased far less than self-insurance and have shrunk markedly relative to measures of global financial integration. That is why the international community must strengthen the global financial safety net, including by expanding the availability of pooled resources in the IMF.

DEALING WITH DEBT

Even if the global financial safety net is strengthened, some countries might exhaust their buffers in the face of global economic shocks and accumulate economic imbalances over time—notably, higher fiscal deficits and rising debt levels. Although debt is up everywhere, the problem is particularly acute for many vulnerable emerging-market and low-income countries as a result of recent economic jolts, rising interest rates, and, in some cases, policy errors on the part of governments. By the end of 2022, average debt levels in emerging-market countries had reached 58 percent of GDP, a significant increase from a decade earlier, when that figure stood at 42 percent. Average debt levels in low-income countries had increased even more sharply over that period, from 38 percent of GDP to 60 percent. About one-quarter of emerging-market countries' bonds are now trading at spreads indicative of distress. And 25 years after the launch of a broad-based international debt relief initiative for poor countries, about 15 percent of low-income countries are now considered to be in debt distress, with another 40 percent at risk of ending up in that situation.

The costs of a full-blown debt crisis are most keenly felt by people in debtor countries. According to one analysis by the World Bank, on average, poverty levels spike by 30 percent after a country defaults on its external obligations and remain elevated for a decade, during which infant mortality rates rise on average by 13 percent and children face shorter life expectancies. Other countries are affected as well. Savers lose their wealth. Borrowers' access to credit can become more limited.

To ensure debt sustainability in a world of more frequent climate and health calamities, individual countries and international organizations must do everything they can to prevent the unsustainable accumulation of debt in the first place—and failing that, to support the orderly restructuring of debt if it becomes necessary. If debt crises multiply, the gains that low-income countries have made in recent decades could quickly evaporate. To prevent that from happening, international institutions can help countries focus on economic reforms that would

Crate expectations: a container ship in Shanghai, July 2023

COSTFOTO / NURPHOTO / GETTY IMAGES

spur growth, improve the effectiveness of budgetary spending, enhance tax collection, and strengthen debt management.

Reducing the costs of debt crises means resolving them quickly. Doing so is not easy. The creditor landscape has changed significantly over the past several decades, with new official creditors such as China, India, and Saudi Arabia entering the scene and the variety of private creditors expanding dramatically. Quick and coordinated action by creditors requires mutual trust and understanding, but the increase in the number and type of creditors has made that more challenging, especially since some key creditors are divided along geopolitical lines.

Consider the case of Zambia, Africa's second-biggest copper producer. Over the past decade, it ramped up spending on public investment financed by debt, but economic growth failed to follow, and the country ran out of resources to meet its debt repayments, defaulting in 2020. Its official creditors took almost a year to agree to a deal to restructure billions of dollars of loans. This milestone required the mostly high-income group of creditors known as the Paris Club to cooperate with the new creditor countries. But the job will be fully complete only when private creditors also come forward and agree to a comparable deal with Zambia—work that is already underway.

Although reaching an agreement for Zambia took time, official creditors have been learning how to work together, in this case under a Common Framework established by the G-20. The technical discussions taking place through the new Global Sovereign Debt Roundtable—initiated in February 2023 by the IMF, the World Bank, and the G-20 under India's presidency—are also helping build a deeper common understanding across a broader set of stakeholders, including the private sector and debtor countries. This development holds promise for highly indebted countries, such as Sri Lanka and Ghana, that still need the international community to decisively follow through on commitments to provide critical debt relief.

Reducing the costs of debt crises means resolving them quickly.

But creditors and international financial institutions must do more. Debtors should receive a clearer road map of what they can expect from creditors in the timing of key decisions. Creditors also need to find ways to more quickly clear hurdles to reaching consensus. For instance, earlier information sharing can help creditors and debtors resolve debt crises in a more cooperative fashion, with help from institutions such as the IMF. And if private creditors demonstrate that they can do their part and provide debt relief on terms comparable to those offered by official creditors, it will reassure the official creditors and give them the confidence to move faster.

International financial institutions and lenders must also develop mechanisms to insure countries against debt crises in the event of major shocks. Such mechanisms play a crucial role in ensuring that a liquidity crunch does not tip countries into more costly debt distress. One promising idea would be to take a contractual approach to commercial debt. This could involve including clauses in debt contracts that would automatically trigger a deferral of debt repayments if a country experienced a natural disaster such as a flood, drought, or earthquake.

Debtors must do their part, too, starting by being more proactive when it comes to risk mitigation, and better coordinating their debt management strategy with fiscal policy. Governments must also show a willingness to tackle the underlying policy mistakes at the heart of more fundamental debt challenges. For instance, Zambia's strong commitment to undertaking necessary economic reforms, such as removing fuel subsidies that mostly benefited wealthier households, meant that the IMF could move forward with its own financial support and that official creditors were more willing to provide debt relief.

THE FIGHT AGAINST FRAGMENTATION

The IMF has long played a central role in the global economy. It is the only institution empowered by its 190 members to carry out regular and thorough "health checks" of their economies. It is a steward of macroeconomic and financial stability, a source of essential policy advice, and a lender of last resort, poised to help protect countries against crises and instability. In a world of more shocks and divisions, the fund's universal membership and oversight are a tremendous asset.

But the IMF is just one actor in the global economy and just one among many important international financial institutions. And to keep up with the pace of change in a fragmenting world, the fund's financial model and policies need a refresh. An important first step would be completing the 16th General Review of Quotas. The IMF's quota resources—the financial contributions paid by each member—are the primary building blocks of the fund's financial structure, which pools the resources of all its members. Each member of the IMF is assigned a quota based broadly on its relative position in the world economy, and the IMF regularly reviews its quota resources to make sure they are adequate to help its members cope with shocks. An increase in quotas would provide more permanent resources to support emerging and developing economies and reduce the fund's reliance on temporary credit lines. It is essential that the IMF's membership come together to bolster the institution's quota resources by completing the review by the December 2023 deadline.

The IMF's better-off members need to make a concerted effort to urgently replenish the financial resources of the Poverty Reduction and Growth Trust. The trust, which is administered by the IMF, has provided almost $30 billion in interest-free financing to 56 low-income countries since the onset of the pandemic, more than quadruple its historical levels. This funding is critical to ensure that the IMF can continue meeting the record demand for support from its poorest member countries. And to address the economic risks created by climate change and pandemics, the fund's better-off members should also scale up their channeling of Special Drawing Rights (an IMF reserve asset, which it allocates to all its members) to more vulnerable countries through the fund's newly created Resilience and Sustainability Trust.

The IMF must also continue working to enhance representation inside the organization. It is important that the fund reflect the economic realities of today's world, not that of the last century. Decision-making at the fund requires a highly collaborative approach and inclusive governance. This would support more agility and adaptability in the IMF's policies and financing instruments to better serve the needs of its members.

Finally, the IMF cannot be truly effective in today's fragmented world unless it continues to deepen its ties with other international organizations, including the World Bank, other multilateral development banks such as the African Development Bank, and institutions such as the Bank for International Settlements and the World Trade Organization. All those international financial institutions must join forces to foster international cooperation on the most pressing challenges facing the world.

In 1944, the 44 men (and zero women) who signed the Bretton Woods agreement sat at one table in a modestly sized room. The small number of players was an advantage, as was the fact that most of the countries represented were allies fighting together in World War II. Today, finding consensus among 190 members is much more difficult, especially as trust among different groups of countries is eroding and faith in the ability to pursue the common good is at an all-time low. Yet the world's people deserve a chance at pursuing peace, prosperity, and life on a livable planet.

For nearly 80 years, the world has responded to major economic challenges through a system of rules, shared principles, and institutions, including those rooted in the Bretton Woods system. Now that the world has entered a new era of increasing fragmentation, international institutions are even more vital for bringing countries together and solving the big global challenges of today. But without enhanced support from higher-income countries and a renewed commitment to collaboration, the IMF and other international institutions will struggle.

The period of rapid globalization and integration has come to an end, and the forces of protectionism are on the rise. Perhaps the only thing certain about this fragile, fragmented new global economy is that it will face shocks. The IMF, other international institutions, creditors, and borrowers must all adapt and prepare. It's going to be a bumpy ride; the international financial system needs to buckle up.

America weaponized the global financial system. Now other countries are fighting back.

We are entering a world of chained globalization.

Washington Post Monkey Cage
By Henry Farrell and Abraham Newman
December 19, 2019

On Monday, the Senate Finance Committee passed the first stage of a bill that would impose sanctions on non-U.S. businesses that were helping build the Nord Stream 2 pipeline from Russia to Western Europe. Like many other sanction measures, the bill relies on U.S. influence over the entire global financial system. A letter from Sens. Ted Cruz (R-Tex.) and Ron Johnson (R-Wis.) threatened that Allseas, a company helping to build the pipeline, would be blocked from any financial transactions with the United States, "destroy[ing] the future financial viability of [the] company."

How can the United States do this? The answer is that since 2001, America has increasingly turned global economic and financial networks into weapons that can be used against adversaries. As we showed in earlier research, financial networks such as the "dollar clearing system" and the SWIFT messaging service, which provide foundations for the global financial system, have been used by the United States to gather intelligence and to isolate entire economies, such as Iran, from the global financial system. Control of these networks allows the United States to issue "secondary sanctions" against countries, businesses or individuals that it wants to target, obliging non-U.S. actors to adhere to the sanctions or risk substantial penalties.

Now, these tools are leading to backlash and reaction. As we discuss in a new article in Foreign Affairs, other countries are beginning to think about how they can best respond: by threatening retaliation, by creating their own networks, or by insulating themselves from U.S. pressure. Here's what is going on.

Other states are unhappy with U.S. tactics

Although German Chancellor Angela Merkel is not threatening retaliation, other German politicians are less sanguine. Key lawmakers responded fiercely to U.S. legislation that would impose sanctions on the Nord Stream 2 pipeline that transports gas from Russia to Europe. German Foreign Minister Heiko Maas said, "We are opposed in principle to interventions from abroad, and to extraterritorial sanctions." German members of parliament are claiming the sanctions are a "hostile act" and are calling for "countermeasures." These calls feed into a wider European debate. A widely read report published this year by the European Council on Foreign Relations described U.S. use of financial networks as a "critical challenge" for Europe and suggested Europe should consider developing tools that could be used to retaliate or to deter the United States from using these sanctions in the future.

Rivals such as China are also worried and angry. This week, a provisional first stage trade deal was reached between the United States and China. However, as Julian Gewirtz reported in Politico, Chinese policy intellectuals don't see any prospect of happy relations between the United States and China. Instead, they see a "financial war" emerging. Gewirtz describes how the liberal economist and former finance minister Lou Jiwei foretells the "next step in the frictions between China and the United States is a financial war. … The U.S. has been hijacked by nationalism and populism, so will do everything in its power to use bullying measures [and] long-arm jurisdiction." Other Chinese policy experts are making similarly dire prophecies. The problem, as they see it, is that U.S. efforts to weaponize the global financial system are undermining Chinese security.

These states are considering their options

Countries that are unhappy with U.S. domination have three major options. First, they can try to develop their own networks. As Gewirtz notes, there is a lot of discussion in China about creating alternatives to SWIFT and dollar clearing, although it is not clear whether China can do this. Russia, too, is trying to build up an alternative international payment system and has gotten interest from other countries, including NATO member Turkey. Both China and Russia are intrigued by the possibilities of blockchain-based systems of financial exchange. Even Europe is trying to build a limited channel to allow economic exchange with Iran. However, building these networks is hard, and getting other states to commit to them, and private actors to use them, is even harder.

A second alternative is retaliation and deterrence. The United States may be less quick to weaponize global networks if it fears others will retaliate against it. The difficulty, however, is that no other country enjoys the same kind of global network control that the United States has. What this means is their economic retaliation is limited to weaponizing their own domestic markets rather than global networks.

China, for example, has often used market access as a means to deter other states; it has just quietly threatened Germany, for example, suggesting it might impose import restrictions on German cars, if Germany discriminates against the Chinese telecommunications provider Huawei. The European Union may consider changing its rules to allow similar measures if the United States targets its relationship with Russia, for example by imposing licensing requirements on U.S. financial firms that want to operate in Europe, and withdrawing their licenses if they cooperate with U.S. sanctions policy.

The difficulty is that this kind of threat is only credible if it comes from countries with big internal markets, which U.S. firms want access to. Other countries may be forced to resort to blunter threats to counter U.S. pressure. It is possible, for example, that Iranian-sponsored attacks on oil refineries and shipping are intended to communicate a threat to the U.S. and its allies.

A third possibility is simply to hunker down and build up defenses. Russia has spent the past couple years building up financial reserves that do not depend on the U.S. dollar and creating internal financial communications systems that limit its reliance on SWIFT. China is building up a domestic semiconductor industry to ensure its firms cannot be attacked through their reliance on U.S.-based technologies. Over the next several years, countries are likely to insulate themselves more from the global financial and technology economies than in the past.

We live in a world of 'chained interdependence'

As our Foreign Affairs article suggests, countries are beginning to wake up to the strategic challenges of global networks. This is creating a backlash against the United States. It is not clear how the United States is going to respond to this backlash, but however it does respond, it is likely to create new dynamics of reaction and counterreaction.

This is not, as some commentators suggest, likely to lead to a new Cold War, in which adversaries' economies are separated by a global wall. What is more likely is a world of "chained interdependence," where countries find themselves bound together by networks and supply chains that combine continued economic benefits with critical security vulnerabilities. Mapping out how security and economic questions intersect in a world of global networks presents a huge research challenge. We don't have the systematic concepts, or the data, to have more than a very rough understanding of what is going on.

Istituto Affari Internazionali

The Weaponisation of Finance and the Risk of Global Economic Fragmentation

by Nicola Bilotta

The decision by the US and Europe to disconnect select Russian banks from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) and to freeze Russia's foreign reserves might have significant, long-term effects on the international monetary system. While transformations in this system have historically been slow to materialise, the range and scope of the recently deployed sanctions will likely catalyse a global push to diversify from the US dollar-centric global financial system.

Whether the US and European countries, as well as their allies, will strengthen or reduce financial sanctions against Russia in the future, the "weaponisation" of finance against a G20 country like Russia sets an historical precedent that will amplify concerns that one day any country could be disconnected from western-dominated financial infrastructure.[1] In the latest G20 meeting of finance ministers, Chinese Minister of Finance Liu Kun strongly criticised the "politicisation" of the global economy, warning that such moves may undermine international economic cooperation.[2]

While it is true that no other contender could challenge the existing US-dominated dollar system in the short-to-medium term, the US and its allies should strategically reflect upon the long-term implications if their leadership in the global monetary system is eroded.

Debates on the US dollar's international dominance are nothing new. Even before the war in Ukraine, it was widely acknowledged that the current global monetary regime provided the US with an extremely efficient bulwark to

[1] Russia is the first G20 country – and formally a G8 country – to be targeted by this set of sanctions. Previously, similar sanctions were deployed against smaller countries such as Iran or North Korea, which are less integrated in the world economy.

[2] "G20 Members Should Cooperate in Providing Stability for a Volatile World: Chinese Finance Minister", in *Global Times*, 21 April 2022, https://www.globaltimes.cn/page/202204/1259921.shtml.

Nicola Bilotta is Senior Fellow at the Istituto Affari Internazionali (IAI).

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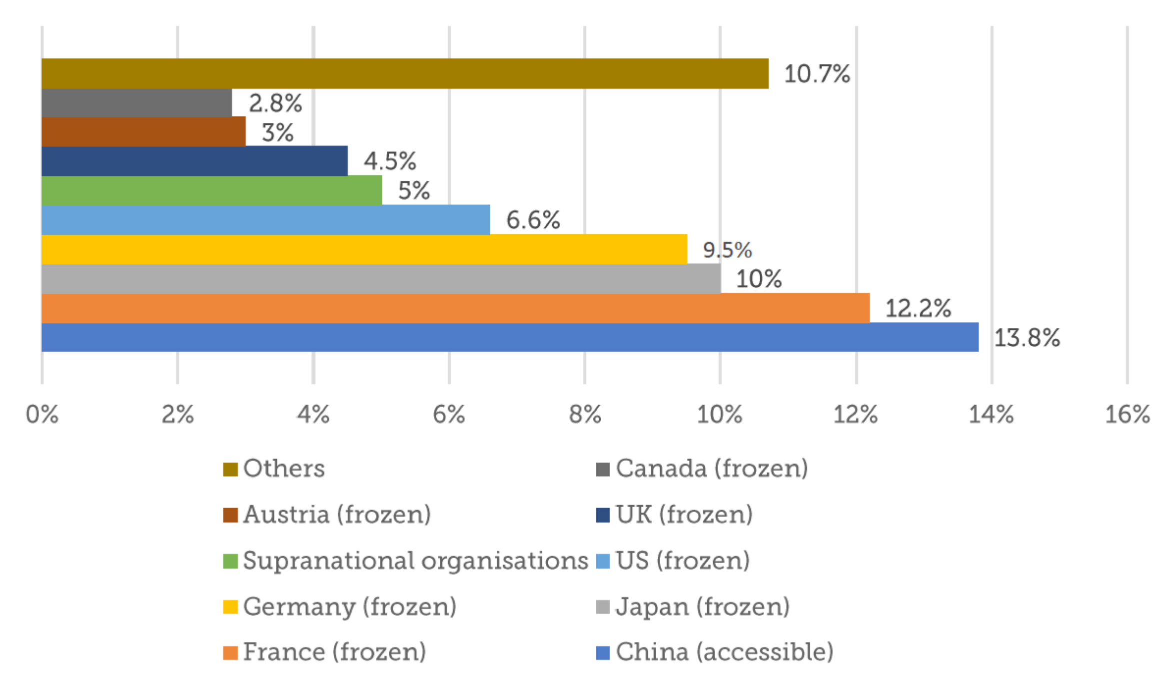
Figure 1 | Location of Bank of Russia foreign exchange reserves and gold assets in June 2021



Source: author's elaboration from *Bank of Russia Foreign Exchange and Gold Asset Management Report*, No. 1/2022, http://cbr.ru/Collection/Collection/File/39685/2022-01_res_en.pdf.

leverage and enforce its foreign policy internationally. As the global economy relies on the US dollar as the primary medium for cross-border transactions and foreign reserves, the US derives significant economic and national security benefits from its central role in the global financial system.[3]

Over the past twenty years, several countries have been attempting to make their currency an attractive alternative to the US dollar. China has implemented significant efforts to globalise its national currency as, compared to its economic power, the yuan significantly underperforms as an international currency, making Beijing highly depended and vulnerable to the US dollar.[4] Also the European Union, one of the US's closest allies, has set the goal of increasing the internationalisation of the euro as a key dimension of its ambitions for a strategic autonomy.[5]

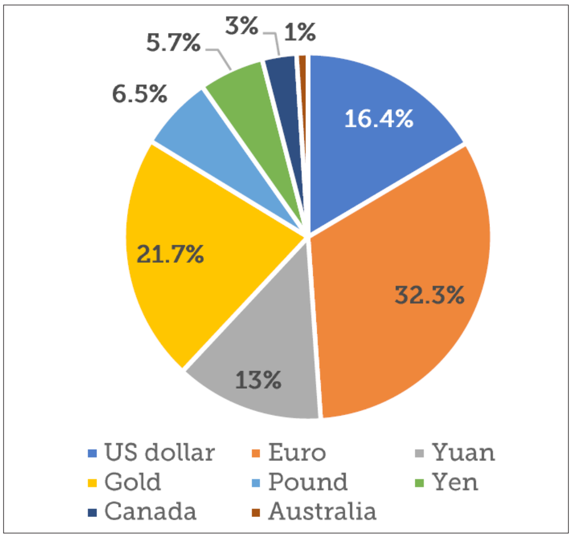
Countries have moreover tried to reduce their dependency on the US-controlled global payment infrastructure. For

[3] White House, *Executive Order on Ensuring Responsible Development of Digital Assets, Presidential Actions*, 9 March 2022, https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets.

[4] "Chinese Banks Urged to Switch Away from SWIFT as U.S. Sanctions Loom", in *Reuters*, 29 July 2020, https://reut.rs/309S59u.

[5] Fabio Panetta, *A Digital Euro for the Digital Era*, Introductory statement at the ECON Committee of the European Parliament, Frankfurt am Main, 12 October 2020, https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp201012_1~1d14637163.en.html.

Figure 2 | Composition of Bank of Russia's assets in foreign currency and gold as of June 2021



Source: author's elaboration from *Bank of Russia Foreign Exchange and Gold Asset Management Report*, No. 1/2022, cit.

example, China, Russia and India have repeatedly expressed their interest to jointly explore an independent alternative to SWIFT[6] while the EU launched (a rather unsuccessful) EU-Iran payment vehicle INSTEX in 2019 to get around US sanctions re-imposed on Tehran by the Trump administration.

Attempts to significantly erode the US dollar's dominance have failed thus far, yet there are – small but still relevant – signals of potential trends of fragmentation which could be accelerated by the war in Ukraine. The International Monetary Fund (IMF), for example, has already reported that some countries are renegotiating the currency used to settle their trade agreements in light of the sanctions applied to Russia.

Indeed, foreign reserves in US dollars decreased globally from around 70 per cent at the beginning of the 2000s to 59 per cent in the third quarter of 2021 (Figure 3). According to a recent IMF study, a quarter of this shift was allocated to the yuan while three quarters into the currencies of smaller countries.[7] Thus, central banks have been implementing a portfolio diversification strategy driven by market forces. In this context, the recent weaponisation of the US dollar could accelerate this ongoing diversification process, a trend that may be further incentivised by a "de-risking management" strategy.

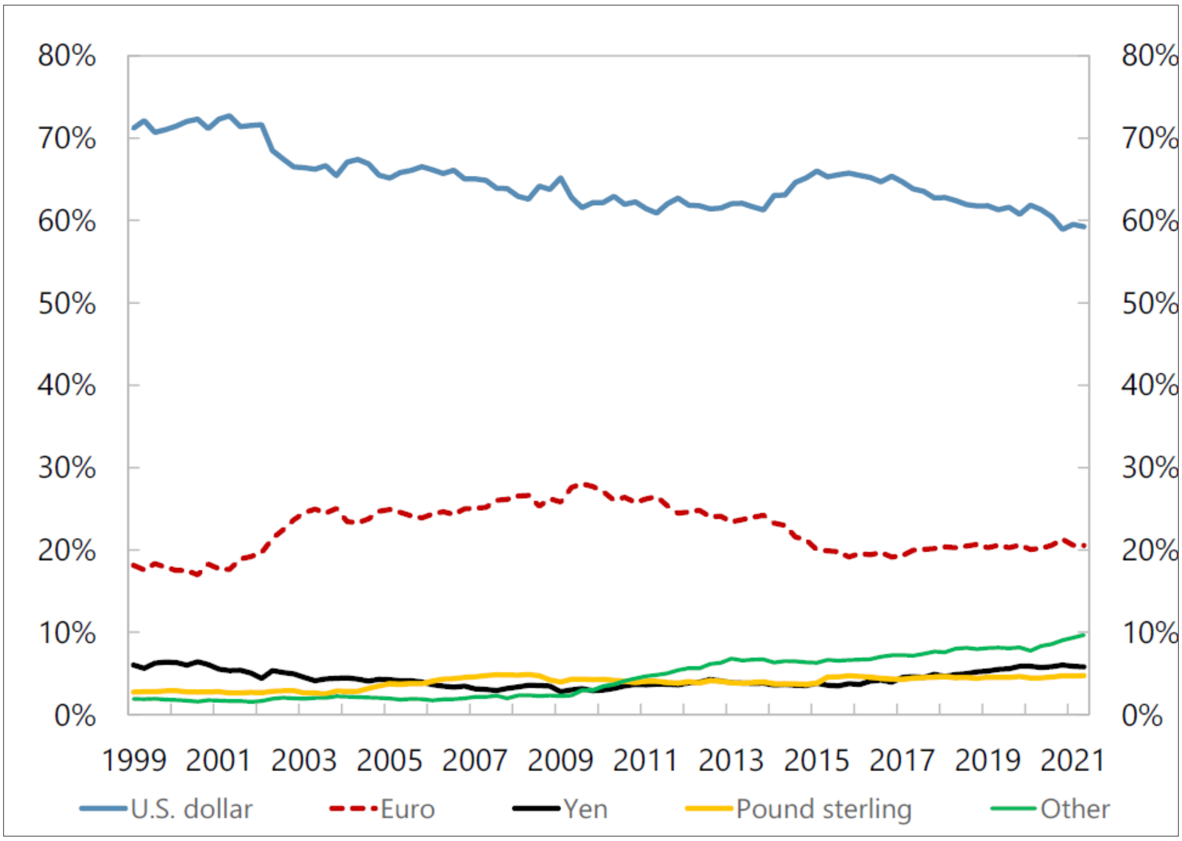
The key question, however, is where this shift could be diverted to, given that a credible alternative to the US dollar is currently lacking. The yuan does not seem to have the underlying characteristics to replace the US dollar. The yuan's internationalisation is weighted down by policy and institutional factors (like capital account controls or limited convertibility) which cannot be mitigated by geostrategic driven motivations. Furthermore, current trends of growing diversification in the composition of foreign reserves appears to be directed towards other western countries and allies– such as the Canadian dollar,

[6] Zongyuan Zoe Liu, "Besides China, Putin Has another Potential De-dollarization Partner in Asia", in *CFR Blog*, 11 March 2022, https://www.cfr.org/node/240063.

[7] Serkan Arslanalp, Barry J. Eichengreen and Chima Simpson-Bell, "The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies", in *IMF Working Papers*, No. 22/58 (March 2022), https://www.imf.org/en/Publications/WP/Issues/2022/03/24/The-Stealth-Erosion-of-Dollar-Dominance-Active-Diversifiers-and-the-Rise-of-Nontraditional-515150.

IAI COMMENTARIES 22 | 19 - APRIL 2022 ISSN 2532-6570

Figure 3 | Currency composition of global foreign exchange reserves 1999–2021 (in percent)



Source: Serkan Arslanalp, Barry J. Eichengreen and Chima Simpson-Bell, "The Stealth Erosion of Dollar Dominance, cit., p. 6.

the Australian dollar and South Korean won – states that tend to align with the US foreign policy priorities (Figure 4).

Yet, despite their noteworthy operative constraints, alternatives to SWIFT are slowly emerging. China has launched the Cross-Border Interbank Payments System (CIPS) in 2015 while Russia has developed the System for Transfer of Financial Messages (SPFS) in 2014. The volume of transactions processed by the CIPS system grew by 83 per cent in 2021 while SPFS doubled the number of processed messages.[8] However, today CIPS and SPFS together process less than 1 per cent of SWIFT's volume of transactions. SWIFT is reported to carry around 140 trillion US dollars of transactions – of which 40 per cent in US dollars, 37 per cent in euro and 6 per cent in UK pounds.[9]

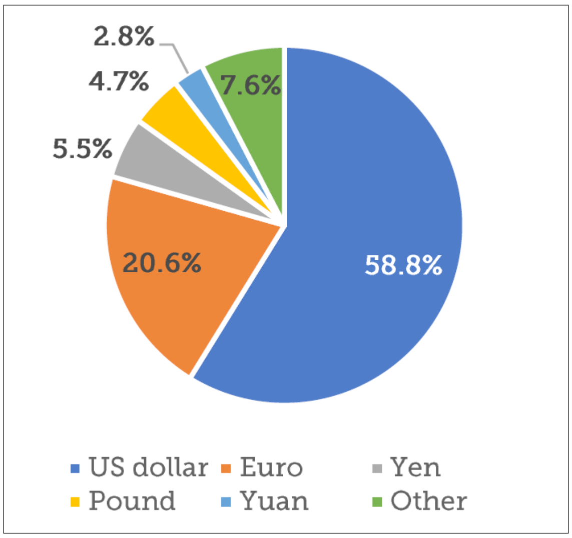
In the medium term, CIPS could be a more realistic and attractive

[8] Maria Shagina, "How Disastrous Would Disconnection from SWIFT Be for Russia?", in *Carnegie Commentaries*, 28 April 2021, https://carnegieendowment.org/publications/84634.

[9] "The Geopolitics of Money Is Shifting Up a Gear", in *The Economist*, 23 October 2021, https://www.economist.com/leaders/2021/10/23/the-geopolitics-of-money-is-shifting-up-a-gear.

IAI COMMENTARIES 22 | 19 - APRIL 2022 ISSN 2532-6570

Figure 4 | World allocated reserves by currency for 2021 fourth quarter



Source: author's elaboration from: IMF Data, *Currency Composition of Official Foreign Exchange Reserve*, https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4.

option as the yuan has a stronger international status than the Russian rouble. Moreover, China could potentially foster CIPS' adoption through its extensive global trade links. Nevertheless, CIPS is constrained by the low internationalisation of the yuan – which today is used for only 3.2 per cent of global payments.[10] Moreover, the CIPS system is directly linked with SWIFT as it can enable the transmission of information related to a transaction through either CIPS or SWIFT channels. Currently, CIPS and SWIFT are cooperating more than competing.[11]

What seems more plausible in the medium term is that new alternatives, like CIPS, could consolidate regionally and along trade links, ultimately leading to the establishment of different multilateral payment systems which cooperate and compete among each other.

Inertia and frictions are key forces that tend to consolidate the hegemony of the US dollar but, in this context of a growing politicisation of money, the process of financial digitalisation can be a crucial force of change in pushing diversification in both the composition of foreign reserves and cross-border payment systems. In the former area, with the advent of automated and electronic trading platforms which significantly lower transaction costs, central banks have gained a much easier and cheaper access to foreign currencies, incentivising reserve diversification.

Furthermore, the possible introduction of central bank digital currencies (CBDCs) around the world has the potential to lower the costs of cross-border transactions.[12] In a future scenario in which several national CBDCs are developed, bilateral and multilateral CBDC-arrangements can promote the establishment of a new payment system network based on multi-CBDCs arrangements in which exchange risks are drastically reduced and nodes are more independent from the US dollar.

[10] Hirsh Chitkara, "Fearing Crypto and China, the US Hesitates to Pull Russia's SWIFT Access", in *Protocol*, 22 February 2022, https://www.protocol.com/policy/russia-swift-sanctions-ukraine.

[11] SWIFT, *SWIFT Offers Secure Financial Messaging Services to CIPS*, 25 March 2016, https://www.swift.com/de/node/21786.

[12] BIS et al., *Central Bank Digital Currencies for Cross-Border Payments. Report to the G20*, July 2021, https://www.bis.org/publ/othp38.htm.

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However, to enable this potential, there is the need of some degree of cooperation on shared standards and protocols which design interoperability between CBDC systems. As China is the frontrunner in the global race for CBDC's issuance, Beijing is levering its first-mover advantage to globally influence the development of CBDCs. The People's Bank of China has already proposed a set of global rules to empower basic interoperability between CBDCs issued by different jurisdictions and has been promoting experiments in cross-border transactions among CBDCs systems.

Global economic power has been shifting over the last forty years, leading to (slight) trends of fragmentation in the international monetary system. While the war in Ukraine might incentivise countries to seek new ways to reduce their vulnerability to the US-led global financial system, the US dollar is likely to maintain its primary role in the global monetary system.

However, the battleground will be in the long-run when digitalisation could empower decentralisation while undermining the unipolarity of the current system. In this scenario, the US risks losing its leadership in the international monetary system if it fails to embrace and shape a new vision for a digitalised (and increasingly politicised) global monetary system. The US cannot however pursue its sole strategic interests when shaping the new system. Washington should coordinate and cooperate with other western nations on equal ground. Otherwise, the US risks fostering further fragmentation.

While still in the early stages of CBDC development,[13] G7 countries could propose and influence widespread preparations for the introduction of a globally interoperable system for CBDCs.[14] The document *Public Policy Principles for Retail Central Bank Digital Currencies (CBDCs)* endorsed by G7 members under the UK Presidency in 2021 should only be the first step of a much more articulated exercise.[15] Otherwise, the risk is to experience a consolidation of non-complementary systems with China paving the ways towards multilateral standards and infrastructure.

Ultimately, the "weaponisation" of finance might have accelerated existing trends of fragmentation and of the US dollar's erosion in the international system. If ignored and not properly counterbalanced in the long-run, the US risks not only to lose this unique form of financial leverage but also its ability to shape and influence the global financial order.

28 April 2022

[13] The EU has recently launched the investigation phase of a digital euro project while the Biden's administration released in March an executive order to investigate on the issuance of a digital dollar.

[14] John Beirne et al., "Central Bank Digital Currencies: Governance, Interoperability, and Inclusive Growth", in *Think7 Policy Briefs*, 21 March 2022, https://www.think7.org/?p=3031.

[15] G7, *Public Policy Principles for Retail Central Bank Digital Currencies (CBDCs)*, 13 October 2021, http://www.g7.utoronto.ca/finance/211014-documents.html.

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Via dei Montecatini, 17
I-00186 Rome, Italy
Tel. +39 066976831
iai@iai.it
www.iai.it

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Director: Andrea Dessì (a.dessi@iai.it)

An agenda for regional economic and security cooperation

East Asia Forum
By Yose Rizal Damuri
January 12, 2023

The connection between economic integration and political security has long attracted attention. Integration through intensive trade and investment relations has led to greater interdependence and made conflict more costly, helping states to maintain peace and stability. But interdependence can also increase the risk that geopolitical tensions might turn into open conflict.

The situation in East Asia and the Pacific resembles the first case. The last open conflict in Southeast Asia took place in 1979 with China's invasion of Vietnam. Despite its deep security and geopolitical fissures, Northeast Asia has been free of open conflict since the Korean armistice was signed in 1953. This peace has been built through greater trade and investment relations among economies throughout the region.

Trade among countries in Southeast Asia has been growing at an average of 11 per cent per year in the past three decades — higher than GDP growth in the region over the same period. The emergence of regional value chains in the 1980s has given rise to an investment relationship between economies in Northeast Asia, and the formation of the so-called 'Factory Asia'. This too has contributed to regional stability and security.

Two major developments in East Asia and the Pacific in the last three decades underline the dynamic of economic integration and geopolitics — the rise of China and the proliferation of regional trade agreements (RTAs). China's rapid economic and technological development has changed the power balance in the region. The integration of China into the global economy in the late 1990s served as an effective engine for regional growth but also increased geoeconomic tension as China gained competitiveness over other countries. China's demands for greater recognition and power sharing in global agendas have also brought a sense of unease to the established order.

While the rise of China has increased tensions among countries in East Asia and the Pacific, the proliferation of trade agreements has reduced the risks that stem from increasing economic interdependence. The region began its formal integration with the ASEAN Free Trade Agreement in 1993. This was followed by a series of bilateral and regional agreements with partners such as Japan, China and Australia.

These RTAs filled the gap in rulemaking and liberalisation efforts at the multilateral level. The agreements created rules for trade and investment relations and provided platforms to settle disputes. Although trade agreements do not necessarily eliminate the risks of conflict, they can insulate economic disputes from security issues.

But trade agreements in the region are limited to ASEAN countries and some of their partners. Agreements between other countries in the region — such as China and Japan, or China and Korea — were non-existent, making economic relations between them prone to greater tension.

As geopolitical and economic environments have evolved, the nexus between economic integration and security has become more complex. East Asia and the Pacific remains free from interstate conflict, but tensions are growing.

The consequence is that countries have turned to using economic and trade policies for geopolitical and security purposes. Australia, for example, is involved in trade disputes with China that started as security concerns over the activities of technology company Huawei in 2018 and intensified over prosecuting investigation into the origins of COVID-19. In Japan and South Korea, mutual export and import bans have continued to escalate since 2019 over historical disagreements stemming from the Japanese occupation of Korea more than 80 years ago.

Countries in East Asia and the Pacific need to do more to prevent economic tensions emerging from greater interdependence and refrain from using trade and investment policy for security purposes. Region-wide agreements, such as the Regional Comprehensive Economic Partnership (RCEP), offer platforms to improve policies on trade and deal with economic tensions. But these agreements need to include rules that cover a range of new issues like cross-border digital investment and intellectual property and technology acquisition. These are issues that will potentially lead to more disputes and need stronger disciplines.

Trade and economic agreements are only effective in reducing tensions that originate from economic relations. Countries also need to continue talks on political and security issues that have taken place under existing regional initiatives, such as the ASEAN Political Security Community or South China Sea code of conduct talks between ASEAN and China.

These talks should be extended to the broader East Asia and Pacific region to include other issues such as tensions over the East China Sea. Just like trade agreements, these would be managed better under a regional framework, not bilaterally. They should not aim to settle the issues, but rather to seek a common understanding on how countries in the region should refrain from flexing military power.

In the meantime, the region cannot shy away from common regional and global challenges, such as energy transition and mitigating climate change. Those require massive resource allocations that are too burdensome for individual countries to manage. Asia-Pacific countries could start to look at specific projects to undertake together. With specific common projects, greater trust will be developed to facilitate conversation on more difficult issues.

ASEAN has a potentially central role to play in these initiatives. It is the only institution with the mechanisms in place to deal with regional and global issues in both the economic and security spheres. ASEAN plus three and RCEP could be expanded to deal more purposefully with tensions arising from economic relations. Incorporating the agreements of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership into RCEP might be a starting point, but that would require more inclusive implementation.

The biggest problem is the absence of leadership in ASEAN that is committed to directing the regional agenda. Indonesia needs to fulfil this role more actively. After its successful leadership of the G20 and in getting the global agenda back on track, Indonesia has an important responsibility to develop this regional agenda. Indonesia has both the moral authority and convening power to lead the discussion and come up with a concrete agenda as the Chair of ASEAN next year.