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DEFINING THE GREAT GLOBAL DECOUPLING

Eighth annual Robert F. Ellsworth Memorial Lecture
by The Honorable Kevin Rudd,
26th Prime Minister of Australia

21ST CENTURY CHINA CENTER
School of Global Policy & Strategy

THE GREAT U.S.-CHINA 'DECOUPLING' DILEMMA

Kevin Rudd Speech for the Robert F. Ellsworth Memorial Lecture

The following is ASPI President Kevin Rudd's full remarks from the Robert F. Ellsworth Memorial Lecture on November 4, 2019, at the University of California San Diego. A portion of the following remarks were originally published in Axios.

The casual, increasingly nonchalant and, for some at least, apparently satisfying deployment of the term "decoupling" to describe the current trajectory of the U.S.-China relationship, reminds us of the classical wisdom that in foreign policy, words are bullets. Indeed, "decoupling" has become the "term du jour" of U.S.-China relations, reflecting for some of the unfolding reality of the relationship. For others, its desired destination.

This is despite the fact that despite the current fetid state of the relationship, neither the United States government nor the Chinese government, at least at this stage, are deploying the "d" word as part of their official vocabulary, despite the fact that the relationship is now in the worst shape it has been for nearly half a century.

Official reluctance, however, has not prevented the term being thrown around with reckless abandon by the academy, think tanks, and the commentariat in both capitals—with varying levels of semi-official enthusiasm, but I fear with greater and greater levels of political contagion.

This has also happened with remarkable speed. It's only 18 months ago that we first became accustomed to the phrase "trade war." But by the end of last year, this had happily morphed onto a "technology war." And by the early months of this year, these had morphed, in turn, into a much wider economic war covering trade, technology, talent, foreign direct investment, capital markets more generally, and as of last week, national currency strategy as well. A year is a long time in global politics. And a year and a half, it now seems, is an eternity.

"Decoupling" began appearing in the academic and think tank literature on U.S.-China economic relations last May. Six months later it had become the battle-cry of none other than President Trump's former Chief Strategist, Steve Bannon. Mr. Bannon, like all good propagandists, can spot a good marketing opportunity at a thousand paces.

This simplistic debate about decoupling reminds us afresh that geopolitical and geo-economic change is now so multidimensional, complex, and rapid that it defies the ability of political and policy elites remaining abreast of what is actually happening out there in the so-called "real world," let alone working out what to do about it, and then to explain it to their various constituencies. It also reminds us that in international relations, language can both reflect realities, just as easily as it can create realities in the real world as well. And it reminds us that sharp language like this, designed to cut through the dense fog of political and foreign policy debate, particularly when used ahead of the curve in advance of the reality which it seeks to describe, often produces unintended consequences.

For example, in the context of the "Great Decoupling" debate that now rages in both countries, it is resulting in the generation of contingency plans in both capitals against a range of economic scenarios in case a capital "D" decoupling actually comes to pass. This, in turn, heightens the danger of these plans actually being activated in response to any evidence, however incomplete, of hostile actions from the other side. Thereby creating a cycle of action and reaction which eventually spirals out of control.

It reminds me a little of the mobilization plans, schedules, and railway timetables of the great powers on the eve of the Great War, albeit today in the less-lethal domains of the international economy. Less lethal perhaps, but comprehensively destructive nonetheless.

My purpose in this lecture is three-fold:

- First, to analyze the domestic and foreign policy context in which this current debate on the "great decoupling" debate has taken off;
- Second, to look carefully at trade, foreign direct investment, technology, capital and currency markets to test whether we are actually witnessing a substantive economic decoupling, or indeed something much more mixed than that.
- And third, to begin reflecting on where all this takes us in the wider world of foreign policy, national security policy, and geopolitical stability for a future that affects us all.

My argument is simple: that those supporting comprehensive decoupling are seeking to create the conditions precedent for a substantive rather than rhetorical Second Cold War; that despite this, the present and prospective economic relationship is much more inter-connected than the increasingly wild use of the term decoupling might suggest; and that policymakers in both capitals would be better advised to define afresh the terms of economic coexistence, within the framework of what the United States has now defined as this new era of strategic competition, rather than indulging in loose and inflammatory language that could well become a self-fulfilling prophecy.

In other words, we should be very careful what we wish for. A fully "decoupled world" would be a deeply destabilizing place, undermining the global economic growth assumptions of the last 40 years, heralding the return of an iron curtain between East and West and the beginning of a new conventional and nuclear arms race with all its attendant strategic instability and risk.

Political and Foreign Policy Context

The current debate on economic decoupling between the U.S. and China occurs within a much wider political context. Much as economists would love to ignore politics, the reality is that it is the evolving nature of the domestic political economy of both the U.S. and China that will be the critical determinant of the relationship's future. This goes to the heart of the so-called decoupling debate.

The reality today is that the U.S.-China relationship plays deeply into the domestic politics of each country. It is no longer a sacred space where only professional diplomats are allowed to operate. Politicians in both capitals, Republicans, and Democrats in Washington, conservatives and reformers in Beijing, now rampage around the public debate on the relationship because it is now legitimately seen as central to everything.

From soybeans to the South China Sea, to climate change. From Huawei to the NBA, to human rights. And almost all points in between.

China in U.S. Domestic Politics

In the United States, the president tries to sit above it all, maintaining his own definition of political and strategic ambiguity, claiming his Chinese counterpart as his best buddy, while in the next breath declaring that China has now become America's public enemy number one. Underneath the president, following the removal of National Security Advisor Bolton, the center of gravity on China policy has now moved to Secretary of State Pompeo who has made it plain, through the first in what he intends to be a series of thematic addresses on China, that "China is truly hostile to the U.S. and [its] values." The Pentagon voice on China under new Secretary of Defense Esper at this stage remains largely unknown. Meanwhile, Treasury Secretary Mnuchin seeks to pour oil on the troubled waters of the trade war wherever he can to try to calm markets, re-energize global growth and sustain the American economy through the election year 2020. While USTR Lighthizer is doing as professional a job as he can, staying carefully within his negotiating remit, to try and bring the trade war to a satisfactory conclusion—one which maximizes Chinese trade and economic policy change, while also minimizing the future bilateral trade deficit; recognizing, reluctantly, that the latter remains his president's principal interest. It is not unusual for such disparate views on China to be present within a single administration. What is unusual is for these differences to be played out so publicly, and for the president to exhibit such personal volatility on a relationship so fundamental to long-term U.S. strategic and economic interests.

Of course in Washington, the Republicans represent the sound of only one hand clapping on China. The Democrats have doubled down just as much. In fact, probably more so. Democrats have always exhibited greater skepticism than Republicans on China, both on trade and human rights. To this, they have now added the intersecting domains of technology and national security. As well as a political determination, mindful of the presidential election campaign that lies ahead, to depict any deal the president may make with Xi Jinping in trade, technology or the rest of the economic relationship, as insufficient and, by definition, therefore, a political sell-out.

Beyond these political postures, however, three years into this administration, it is still not clear what the actual content of America's China strategy is. America is angry about China because it believes China has cheated in adopting WTO rules in its international trade and wider economic practices. America is frustrated with China because of what it sees as repeated broken promises to reform. And America feels betrayed by China because in Washington's view, the U.S. extended WTO membership to Beijing on trust, only to see that trust in large part dishonored when China decided instead to set out eating America's economic, technological and strategic lunch. But while America clearly has an attitude towards China, it's not clear at this stage that Washington has an agreed strategy for dealing with China.

In thinking through what U.S. strategy might be, it's important to look at the National Security Strategy of December 2017, the National Defense Strategy of 2018 and other recent policy speeches by both Vice President Pence and Secretary Pompeo. The National Defense Strategy defined China for the first time a peer competitor of the United States. The National Security Strategy concluded that 40 years of strategic engagement with China had not caused Beijing to adhere to the global rules-based order, let alone become its effective advocate as a responsible global stakeholder and that therefore a new period of outright strategic competition was the inevitable consequence. In other words, no more "Mister Nice Guy," always giving China the benefit of the doubt. But while both documents represent significant departures from the past, they nonetheless represent the analytical conclusions of the U.S. national security establishment rather than outlining a detailed new policy strategy for the future.

Secretary Pompeo's address to the Hudson Institute on October 30 provides greater insight into the likely direction of such a strategy in the future. It is a remarkably blunt speech. Indeed, various strategic hard heads in Beijing may welcome its bluntness as a clarification of the depth and breadth of the administration's strategic intent. The heart of Pompeo's speech is an explicit American rejection of China's ideological system. Indeed he states that China's Communist Party is a Marxist Leninist Party "focused on the struggle and international domination." This language has not been used by a U.S. administration in relation to China in half a century. The Secretary stops short of calling for regime change, although when he goes on to say that America wants to see a "liberalized China," "regime change" is how it will be read in Beijing. Pompeo says he is not seeking confrontation with China. But he underlines that administration policy is now that Chinese economic practices that contravene competitive neutrality are being confronted; so too must China's efforts through its bilateral and multilateral diplomacy to change the international rules-based system. So too should China's domestic human rights practices now be taken on directly. Secretary Pompeo admits that the administration is still "trying to work out the right strategy and tactics to deliver against these objectives," but that this task will be the central task of the United States "for the next 50-100 years."

This is a hard-hitting speech. Indeed, it embraces much of the language of the Cold War from a previous era. But for the purposes of my topic today, what is important is that Secretary Pompeo does not embrace any form of decoupling of the two economies. Indeed, this is made crystal-clear in Vice President Pence's Malek Memorial Lecture the week before when he stated: "We are asked whether the Trump administration seeks to decouple from China—the answer is a resounding no."

The Chinese may note from all this that economic decoupling is not on the administration's agenda, or at least for now. But the open question, of course, is whether Beijing accepts these assurances at face value given that there has been a complete collapse in political and strategic trust in bilateral undertakings of all hues between the two sides over the last year and a half.

The Chinese Political Context

This brings us to the prevailing political context in China where the Communist Party has just concluded the long-awaited Fourth Plenum of the 19th Central Committee. The only credible way to interpret the Plenum Communique is that Xi Jinping continues to reign supreme. Despite multiple rumors about the possible elevation of would-be replacements for Xi at the 20th Party Congress in 2022, nothing happened at all at the Plenum on this score, thereby conveying a clear message that Xi intends to remain in harness for the long-term. This was reinforced by the fact that the Communique was almost an exclusively political and ideological document, reinforcing Xi's determination to reassert the party's control over everything in China. Indeed, I would not be surprised if we soon see a dramatic resuscitation of the anti-corruption campaign of recent memory in order to remind wavering comrades of what may await them should they be tempted to stray from party discipline and challenge his continued hold in the leadership. There has certainly been grumbling within the party about Xi Jinping overreach—on the concentration of individual power; on the alienation of the Chinese private sector and the resultant slowing of economic growth; on the U.S.-China trade war; on the South China Sea; on China's 2025 strategy for dominating high technology in the decade ahead; on the cost of and reaction to the Belt and Road Initiative; and most of all on the elimination of term limits for the presidency. But none of this has reached critical mass. And Xi, as a political dialectician from central casting, who prides himself in his well-honed ability to anticipate action, reaction and further reaction three steps ahead of anybody else, seems to have anticipated the emerging criticism of his leadership and has begun acting decisively to deal with any difficulties well in advance. While continuing for a third five-year term in 2022 will not be without its difficulties, at this stage, it remains the most probable outcome.

Xi's principal vulnerability remains the economy. Growth is slowing. Private sector business confidence remains low. Private entrepreneurs still see little reason to invest in the future because of uncertain signals on the future of the market economy, how big they will be allowed to grow, their ability to expatriate profits, the continued impact of the deleveraging campaign and an un-level playing field with state-owned enterprises both in market share and in credit allocation. Despite efforts 12 months ago to change course in an important speech to the nation's leading entrepreneurs on November 1, 2018, there is little evidence to date that the tax and credit policies announced since then have flowed through to the private sector to the extent of restoring business confidence, let alone returned to pre-2015 levels. Sustaining 6% national economic growth, therefore, remains a real problem. And Xi's critics will note carefully that the Fourth Plenum document paid scant attention to the real elephant in the national living room—the economy. Indeed, it will be read by some as a triumph of politics over economics at a critical time for the country.

This, then, is the domestic political and economic context in which Xi Jinping now confronts the rhetoric and/or reality of economic decoupling from the U.S. Xi, therefore, faces three broad strategic alternatives for the economy for the future given the current fragility of global, regional, and national growth. First, he could revisit his November 1, 2018 speech encouraging the private sector and double down on policy measures to enhance new private investment and employment. Second, he could make even greater recourse to fiscal and, to a lesser extent, monetary policy stimulus to fill the growing economic growth gap. China has headroom to do so. But not infinite headroom without generating other asset bubbles, financial imbalances, and systemic risks for the economy at large. Third, he could seek to limit his exposure to additional externally-generated threats to the economy by adopting a general strategy of trying to prevent the economic rift with the U.S. from widening further, greater international economic diversification in trade, investment, and technology markets beyond America, together with greater national economic self-reliance. The evidence to-date suggests we are likely to see a combination of the second and third of these approaches above.

Xi Jinping has learned not to trust what Donald Trump says. That is likely to mean not believing the recent assurances of his Vice President and Secretary of State that the administration has no interest in pursuing a decoupling strategy with China. Indeed Xi Jinping believes the U.S. has fundamentally changed course toward China since 2017. He reportedly told his politburo colleagues in closed session earlier this year that the party should prepare itself for 30 years of sustained struggle with the United States and that this will involve multiple American provocations over that time. If this analysis is true, where it leads us is a conclusion that Xi Jinping has now embarked on an accelerated strategy seeking to insulate China to the greatest extent possible from possible American coercive action against Beijing across the full breadth of the country's economic armory. As we will explore in the sections that follow we are already beginning to see some evidence of this in trade, FDI, technology, talent, and capital markets. But these are still early days. And the patterns are far from even, particularly when it comes to capital markets and certain technology markets where unscrambling the U.S.-China economic omelet would be no easy feat. Not to mention mutually destructive.

The irony of this thesis is that whereas the Trump administration may indeed be genuine when it says it doesn't want to embark on economic decoupling with China, it may well be Xi Jinping's administration that initiates and accelerates the process in the name of national self-reliance. China has a long and celebrated tradition of what is called "Zili Gengsheng." And those of us who follow China closely have noted with a little alarm the fact that this old slogan from pre-reform and opening days has made a loud reappearance since the first shots were fired in the trade war some 18 months ago. It is a separate question, of course, whether going down the self-reliance road would be in China's national economic interests. Most of us, together with most Chinese economic reformers, would answer with a resounding no. But a sense of vulnerability does strange things to people, just as it does to states. Particularly if China were to combine greater self-sufficiency on the one hand, with a radical new and accommodating international posture towards its non-American friends and partners around the world, as China also sought to offset its vulnerabilities in export, technology, talent, FDI, and where necessary capital markets by seeking new strategic economic alliances in Europe, Japan, Korea, India, Southeast Asia, as well as with some if its more significant BRI partners.

To test the decoupling proposition properly, whether it's being initiated by the United States or by China, or whether there is no substantive decoupling evident at all, it's important to look at what is actually happening in each of the economic domains referred to above. To some extent, this will be a superficial analysis given that each of these domains generates its own formidable complexities. But I believe it's time to draw these disparate threads together to see what aggregate picture, if any, may be emerging—beyond the reflections of the commentariat, and more in the nuts and bolts of the real bilateral economy. It might also give policymakers in both Beijing and Washington pause for thought based on the general principle of "be careful what you wish for." The law of unintended consequences is as much alive in the dismal science as it is political science and international relations.

The Decoupling of U.S.-China Trade?

At this stage of its economic development, China's vulnerability to the United States restricting its markets to Chinese goods and services remains significant. The U.S. has long been China's largest export market—and by a massive margin. By contrast, China is less significant to overall U.S. exports. Whereas the U.S., on average over the last decade, represented 19% of Chinese exports, China represented only 8% of total U.S. exports, consistently coming in as America's third-largest market after Canada and Mexico. Furthermore, China in aggregate is a more trade-exposed economy than the United States. As of 2019, China's exports and imports combined represented 36% of total Chinese GDP. By contrast, the traded sector of the U.S. economy in the same year made up only 26% of U.S. GDP. Therefore, while trade remains important to both economies, it is much more important to China at this point of its economic evolution than to the U.S. For these reasons, China's leadership, in framing its overall policy response to the U.S., is acutely aware that the U.S. can inflict more economic damage on China through trade than China can inflict on the U.S. The U.S. market as of 2019, notwithstanding the trade war, still represented 17% of total Chinese exports significantly contributing to China's overall economic growth. America, therefore, for the time being at least, remains the key.

But because of the declining role of Chinese exports to overall GDP over the previous decade, China is less vulnerable now than it was on the eve of the global financial crisis a decade or so ago. In 2006, Chinese exports to GDP had risen to 36%, whereas by 2019 they had almost halved to 19%. Second, Chinese household domestic consumption has been steadily increasing, replacing exports as the principal driver of economic growth. Boosting household consumption will, therefore, become an even more important part of Xi Jinping's strategy to reduce his country's overall vulnerability to international economic forces. Furthermore, China is acutely aware that the United States is China-dependent for a range of consumer goods that cannot be readily replaced in the near-term without producing an American consumer revolt. For example, the 2018 U.S. Census Bureau data showed that 82% of mobile phones and 94% of laptop computers imported to the U.S. were from China. In other words, America does not have all the cards in this game, and China knows it.

Xi Jinping's challenge, therefore, is to manage the U.S. relationship in a manner that prevents a major collapse in growth from declining exports while seeking to insulate China, to the greatest extent possible, from further punitive American action via the continuing trade war. This will include taking whatever measures may be possible to reduce the impact on Chinese manufacturing as third countries seek to reduce their exposure to growing U.S.-China geopolitical risk by moving their global supply chains offshore.

China's national interest, for at least the decade ahead, is to de-escalate the trade war until such time as China's dependency on the U.S. export market is less critical. This will likely mean yielding to American pressure on intellectual property protection, forced technology transfer, further access to the Chinese market and administratively decreeing a major increase in Chinese imports from the US to reduce the bilateral trade deficit, particularly in agriculture. Xi Jinping is nonetheless unlikely to accept U.S. demands for cutting Chinese state subsidies for Chinese firms active in the global market. This is because in the party's view, the role of the state is inseparable from the general economy without fundamentally changing the entire nature of the Chinese system. For these reasons, a phase one trade deal is highly likely this year. And a phase two deal remains probable for next year. Beyond the immediate effect on the traded sector itself, these agreements would also assist in returning confidence to markets in what is a critical election year for President Trump. As well as an important period for Xi Jinping given the weakened state of Chinese growth caused by non-trade war factors arising from poor domestic economic policy settings.

Xi is also likely to expand Chinese export opportunities in third-country markets in Europe, Japan, Korea, India, Southeast Asia, and BRI countries across Eurasia in order to reduce export dependency on the U.S. over time. This will be implemented in tandem with a new diplomatic offensive in these states as China seeks to widen its penetration of global markets. In the meantime, China will continue to promote the Regional Comprehensive Economic Partnership among APEC economies, with a view to bringing it into force in 2020. Similarly, China is in the process of examining whether it should become a member of the Trans-Pacific Partnership, already agreed to by 11 regional economies from which the U.S. has now withdrawn. Such an approach from Beijing would present the TPP 11, led by U.S. allies Japan and Australia, with a major dilemma, particularly if China did not seek to renegotiate the agreement in order to gain access to this high-quality trade agreement. China is also likely to use its widening political influence in the WTO to prevent any U.S.-led multilateral action in the future, led by a U.S. Democratic administration, against China's global economic and trading practices.

In summary, Xi Jinping recognizes the significant tactical threat to his economy from the U.S.-China trade war for the coming years. His short-term strategy is to manage the trade war down by offering sufficient concessions to prevent further escalation, while not compromising on what he regards as core national economic and political interests. In the meantime, he is also pursuing a long-term, two-pronged strategy of trying to re-boost domestic private consumption as a major driver of economic growth on the one hand, while rapidly diversifying Chinese export markets in the other. Neither of these strategies are necessarily guaranteed of success. But both are designed to reduce China's long term economic dependence on the United States, reinforced by a Chinese view that by the end of the coming decade, the U.S. will be less significant to both the Chinese economy and the global economy. In Xi Jinping's view, the economic danger for China from the trade war lies in the immediate decade ahead when trade decoupling needs to be avoided at all costs because of the major dislocation this would create for overall Chinese growth.

Foreign Direct Investment

Foreign direct investment flows between China and the United States represent a relatively recent development in the overall bilateral economic relationship, only registering significant numbers over the last twenty years, and in the case of Chinese investment in the U.S., only the last ten. Indeed, it was for these reasons that both sides began negotiating a draft "Bilateral Investment Treaty" (BIT) in 2009 to enhance the overall investment relationship and deal with China's historically restrictive approach to investment in multiple sectors of its economy that it deemed to be sensitive. But amidst the continuing travails of the trade war, these negotiations have stalled. As of 2019, the total stock of U.S. FDI in China had reached $269 billion, with annual flows averaging around $USD 15 billion. Meanwhile, Chinese FDI in the U.S. had reached an accumulated stock of $145 billion, but with annual flows dropping by 80% in 2018, reflecting a number of recent political and regulatory changes, both in Beijing and Washington.

To put this into a wider context, total U.S.-China bilateral FDI flows in 2018 represented approximately 1.4% of the total global FDI flows. By contrast, total U.S.-China trade in the same year represented approximately 3.3% of total global trade. As for total foreign investment coming to the United States, Chinese FDI in 2018 represented 1.4% of the stock of overall global investment into America and 2% of total 2018 flows. As for total foreign direct investment into China, U.S. FDI made up just over 9% of global FDI 2018 flow to the Middle Kingdom. Therefore, unlike trade where U.S.-China trade dictates the overall global trade in goods and services, as well as representing a major component of each countries total trade, the same does not apply to the U.S.-China FDI relationship. The reality is that it represents a much smaller share.

Nonetheless, from China's perspective, foreign direct investment has been an important means of securing access to advanced technology. This has applied both to China's domestic FDI strategy as well as the types of firms it has sought to acquire or invest in abroad, including in the United States. China in the last several years, however, has begun to encounter new and significant resistance to its approach to U.S. investments. Washington has tightened CFIUS (Committee of Foreign Investment Regulations in the United States) procedures, introduced FIRRMA (Foreign Investment Risk Review Modernization Act) and reactivated the Export Control Reform Act (ECRA), all of which have imposed new levels of scrutiny and control on inbound Chinese investments, as well as what U.S. firms may be allowed to collaborate on with Chinese partners in China itself. These new measures have the potential not just to reduce foreign direct investment between the U.S. and China, but also portfolio investments including venture capital activity between the two counties. This is particularly significant given that as of 2019, venture capital investments in both countries had not been affected by the general downturn in bilateral FDI. That may now change as well.

For these reasons, from China's perspective, the investment door to the United States is now closing. Just as Beijing anticipates that U.S. technology firms will face increasing resistance from Washington regulators to continue collaborating with Chinese companies and institutions in China itself. Furthermore, Xi Jinping's administration has limited expectations that the restrictions put in place under the Trump administration will be reduced under a successor Democratic administration. As with trade, China is now seeking to improve its foreign investment environment for other potential investors from third countries, as well as improving reciprocal arrangements for Chinese investors in those countries. This includes the introduction of China's new Foreign Investment Law with new provisions for intellectual property protection, as well as rendering forced technology transfer illegal in China. China has also removed foreign equity caps for investors in the Chinese finance and insurance sectors. Just as China is now seeking to advance its overall investment relationships with Japan, India, and Europe in an effort to offset the prospective loss of American FDI, venture capital and possibly the full range of portfolio investment opportunities as the overall geopolitical climate continues to deteriorate.

In summary, decoupling from each other's FDI markets may be happening more rapidly than we may all think, particularly from the China end, although this has obviously been compounded by capital export controls imposed by the Chinese government for other reasons.

Technology

For Xi Jinping's China, the struggle for technological primacy over the United States has now become a central factor in Beijing's overall relationship with Washington, as well as in China's national security and national economic strategy more generally. China's ambition is to achieve national autonomy in all critical technology categories in the decade ahead and, where possible, to then achieve technological dominance over its economic and geostrategic competitors. This applies, in particular, to the principal drivers of the artificial intelligence revolution, next-generation mobile telecommunications and quantum computing. These ambitions are made clear in the "Made in China 2025" strategy of April 2015 which identified ten core technologies where China would need to prevail. The list is led by ICT but includes all other major technology categories as well. The strategy sets targets for China to be 70% nationally self-sufficient by 2025 and then globally dominant in all by mid-century.

"China 2025" was supplemented in July 2017 with the State Council's "New Generation Artificial Intelligence Development Plan" which states explicitly that AI is a major area of international economic and strategic competition, where China has a "major strategic opportunity," and where Beijing could achieve significant "first-mover advantage." China's leadership believes that collectively these not only represent the principal next-generation technologies that will determine China's future global competitiveness. They also represent the engine-room of a much broader "Fourth Industrial Revolution," following earlier revolutions driven by paradigm-shifting technologies in fossil fuel combustion, electricity generation and most recently digital electronics. This fourth revolution, driven by profoundly disruptive technologies clustered around new breakthroughs in artificial intelligence, the convergence of human and machine capabilities and its multiple potential applications through the "internet of things," is seen by Chinese leaders as fundamentally transforming the structure of the global economy and determining the future distribution of global economic power. It is also seen as deeply instrumental in the ongoing "informationization" of warfare, including the deployment of new forms of autonomous offensive and defensive weaponry in remotely controlled battle-spaces.

Given the revolutionary, game-changing nature of these emerging technologies, China, therefore, sees a combination of threat, opportunity, and urgency. China, having lagged behind the West badly in the first three industrial revolutions, is determined not to do so again. Indeed, Beijing sees an opportunity to dominate and deploy these technologies to leap-frog the U.S. and the rest of the West economically and, if possible, militarily. China has also concluded that the U.S. and its allies are now embarked on a strategy to deny it access to these technologies in the future. From Beijing's perspective, this leaves them with little alternative other than to achieve national self-reliance as quickly as possible. China has therefore embarked on a centrally coordinated strategy embracing an unprecedented national scientific research effort, the large scale acquisition of targeted foreign firms, technology transfer from foreign joint ventures in China, the rapid development of national and global product champions and, according to the U.S. authorities, large-scale technology theft. In this rapidly unfolding technology war, the stakes have become very high indeed, dwarfing the traditional domains of trade, investment, foreign policy and even classical security policy in its overall significance. In many respects, it has become the new, central terrain of the relationship. Therefore for anybody seeking to navigate the already complex domain of U.S.-China relations—past, present, or future—a failure to incorporate the significance of this rapidly developing yet still undeclared technology war will render any conclusions reached on a way forward as radically incomplete.

Artificial intelligence has many definitions, but fundamentally it describes systems that interpret information, make decisions based on that information, and adapt and learn from the outcome of these decisions. In recent years, advances in artificial intelligence have accelerated with the ability to process big data through improvements in semiconductors and interconnected computing power. China now sees itself as being in a highly competitive race with the United States across the full spectrum of artificial intelligence. Within this field, China has a range of strengths and weaknesses. First, there is the availability of pure data itself. China, at least at this stage, has great advantages over the collective West given the vast size of its population, the volume of collectible data from the existing Chinese network of digital communication, economic and social transactions and other personal information where there are few privacy restrictions inhibiting effective access. Because this access to data represents a major potential first-mover advantage over competitors, China has limited the cross-border flow of its own data-banks to other countries. It has mandated under their own Cyber-Security Law that foreign firms like Apple must build data storage facilities within China itself rather than using any offshore facilities. Nonetheless, there is a real debate as to whether China's current data advantage will be permanent as digital governance regimes in the U.S., the UK, and Europe become more settled and greater access to individual data becomes more feasible at scale. For the time being, however, China's raw data advantage is real.

Second, in the race to produce the most effective and efficient semiconductors and computer chips, a significant advantage is still held by the U.S. and a limited number of other non-Chinese firms. On semi-conductors, as of 2018 China was only manufacturing 5% of total global supply, while the U.S. provided 45%, primarily through its major corporate leader in the field, Intel. The other two global leaders in semi-conductor technology are Taiwan's TSMC (China's largest supplier) and Korea's Samsung. Indeed, as of 2019, the U.S. semiconductor industry collectively represented about 50% of total U.S. exports to China. China's vulnerability to U.S. domination of the field was demonstrated by the 2018 decision by the Trump administration to ban all U.S. semi-conductor sales to the Chinese national AI champion ZTE (subsequently temporarily lifted) which came close to collapsing ZTE altogether. This followed a 2017 decision by the administration to block the purchase of a U.S. semiconductor firm to a Chinese SOE on CFIUS grounds. Taiwanese law also does not allow any Chinese equity in TSMC. Similar provisions apply to Samsung's semiconductor operations. Part of the reason why China has remained vulnerable in this sector, despite massive efforts to buy technology, talent or just copy, is because the microscopic size of semiconductors has made classical reverse engineering approaches a near technical impossibility. As a result, the U.S. industry believes that China as of 2019 was at least five years behind the most recent advances in semiconductor technology. This has been reinforced by some Chinese industry analysts who argue the gap to be even greater. While Chinese efforts to close this critical gap will continue, the degree of difficulty should not be underestimated.

Third, on the technology that integrates semiconductors or integrated circuits into a single computer chip, a more complex and competitive picture is emerging. China has made more rapid progress in the development of specialist computer chips, particularly focusing on 3D images, voice, and text recognition. This is in contrast to more generic computer chips targeted on the general computing market, but which are re-purposed for AI-algorithmic purposes, which have been the long-standing strength of the American industry. China's own significant indigenous AI state research and development effort has focused on high-powered specialist chips where the gap with the U.S. and the rest is narrower than for generalized chips and semiconductors.

What China is seeking to do is to overcome its natural deficiencies in specific AI technologies and systems by directing a massive state research effort across the industry at large. For example, as of 2019, 48% of all AI start-ups globally were listed as Chinese, while 38% were American. It remains to be seen the extent to which these Chinese startups represent effective individual claims to new, free-standing technologies, or whether their numbers have been inflated because many are dealing with almost identical patents. The truth, however, is that from a near-zero base only a decade ago, Chinese firms have become, at minimum, significant big data and AI innovators. They have also become the leading adapters of emerging technologies developed elsewhere (for example in digital payments systems), thereby providing massive cash-flow for reinvestment back into primary research. Indeed, in the commercial adaption of AI technologies, China on an economy-wide basis now leads the U.S. in many fields.

Parallel to this debate on the nature of the Chinese challenge on artificial intelligence is the escalating dispute between China and the United States on next-generation mobile telecommunications. Fifth-generation, or 5G, data networks can transmit data at twenty times the speed of current 4G networks, drawing on the combination of mid-band and high-band radio frequencies used by those networks. The macro-significance of 5G is that it becomes a major new enabling platform for the deployment of future AI applications globally. China has become the undisputed leader in 5G technologies, infrastructure, and systems, both within China and in a growing number of countries around the world. The Chinese state is estimated to have invested some $180 billion between 2014-15 in the development of 5G technologies. This was based on a specific state plan agreed in 2013 aimed at making China a global 5G leader—including the generous allocation of high-band spectrum, the building of 350,000 mobile towers across the country, as well as the direct support of national champions such as Huawei. China's plan is to launch its global 5G network in 2020. Domestically, the roll-out is already underway, with their three major telecom firms unveiling 5G packages on November 1. Ten million users were already pre-registered prior to its launch.

As the U.S. Defense Innovation Board has stated: "China is on track to repeat in 5G what the United States did with 4G." China's subsidy of its domestic 5G program also extends offshore through the rolling out of the "Digital Silk Road" across a growing number of Belt and Road participating states. These 5G networks, including mobile telephone, internet, and other digital services, are also likely to be subject to Chinese digital governance frameworks, including the potential accessibility of local data holdings to China's security and intelligence services.

China's leadership resents the U.S. campaign against the rollout of Huawei's global 5G network. China has argued, credibly, that neither the United States nor its allies have developed an alternative 5G technology to Huawei's. Nor do they have the intention or the capability of laying out a global system of undersea cables and mobile terrestrial towers necessary for supporting such a network. China, however, has a more limited response to the American counterargument that Beijing, for similar national security reasons, has never allowed foreign providers into the Chinese domestic telecommunications market. Similarly, China is unable to provide assurances that U.S. global military, security, or intelligence communications would remain sacrosanct as a result of China owning, operating and regulating a 5G network relied on by them, particularly at a time of crisis. The American decision in May 2019 to formally "list" Huawei as an entity whose activities were contrary to U.S. national security interests meant that in the absence of specific, case by case approvals by the Commerce Secretary, U.S. firms were banned from selling microprocessors to Huawei—essential for the further roll-out of its global network. Other Chinese entities have also been listed. The Huawei listing has also complicated China's ability to set the global industry standard for 5G, despite the fact that Huawei is the market leader in what remains a limited field of only two Chinese, two Nordic, and zero American firms. In many respects, the May 2019 Entity List represented the formal commencement of hostilities between China and the United States in the new technology war.

Xi Jinping is aware of the significance of all this. He has chaired two politburo committees with overlapping responsibilities in this area: the Central Commission on Internet Affairs and the Leading Group on Internet Security and Informationization. China's ICT, AI, and overall high technology strategy washes across the full spectrum of the party's priorities: iris, facial, and gait recognition technologies in support of the party's domestic political surveillance efforts; social credit scores to underpin political compliance; combined AI and ICT capabilities enabling the party to better communicate its propaganda to its members and the people with more tailored messaging; enhanced cyber capabilities for offensive and defensive security operations; supporting greater economic growth through new market applications of AI; potential improvements in education, health, aged care delivery and the general effectiveness of Chinese governance; reinforcing the Belt and Road Initiative; enhancing China's military capabilities; and using China's new technological leadership to underpin China's role in the future determination of industry and international governance arrangements. Xi Jinping's China sees the battle for technological primacy as the single greatest determinant of the country's and the party's future competitiveness. Overall, Xi Jinping would be pleased with the pace of China's progress so far. In 2019, a report was prepared by the U.S. Information Technology and Innovation Foundation examining 36 different measures of China's progress in catching up with the U.S. in cutting edge technologies. It concluded that "China has made progress in all indicators, and in some areas now leads the United States."

The reality, therefore, is that a significant degree of technological decoupling between the United States and China is already underway. Of course, this began nearly two decades ago when China decided to embark on internet sovereignty to restrict the free flow of information to its citizens. It is now likely to occur with 5G because of U.S. and allied national security reasons. And on AI, a combination of U.S. national security requirements, as well as China's pre-existing strategy of achieving national self-reliance, also places this sector on a decoupling trajectory. This is to the great despair of the U.S. semiconductor industry for whom China is the single largest market and whose profits are redeployed into next-generation research to guarantee continued U.S. technological leadership in the field. It does not mean that future sales of American semiconductors and chips to China are likely to be totally banned. It does mean, however, that the regulatory restrictions on the trade will become greater. While U.S.-China collaboration in other fields of emerging technology may well continue (for example in biotechnology) for some time to come, new restrictions are beginning to emerge in this sector as well. Decoupling will also have a profound impact on future global industry standards, regulation, and governance arrangements as a range of unilateral, plurilateral or multilateral regulatory worlds begin to emerge.

Capital Markets

The prospects for decoupling the two countries' capital markets, however, are considerably less likely. The reason is that the current degree of mutual interests and exposure is simply too great. The current U.S.-China bilateral financial relationship stands at just over $USD 5 trillion. This includes Chinese listings on U.S. stock exchanges ($USD 1.9 trillion); $USD 1.5 trillion in Chinese stocks and bond holdings on Chinese and Hong Kong exchanges intermediated by U.S. firms; $USD 200 billion in Chinese holdings of U.S. corporate stocks and bonds; $100 billion in U.S. cross-border lending to Chinese firms; as well as $USD 1.1 trillion in Chinese official holdings of U.S. Treasuries; and a further $200 billion in other U.S. government bond holdings. The bottom line is these are very large numbers indeed.

By and large, whatever strategic difficulties these two governments may have with each other, it continues to be in each countries' interests to maintain these arrangements. From China's perspective, there is no ready alternative to the diversity, depth, and liquidity of U.S. capital markets. Second, China as of 2019 will, for the first time in a quarter of a century, run a modest current account deficit. This is likely to become a long-term structural deficit, consistent with China's overall economic development, and not inconsistent with other countries' experience at this point of their economic history. China will, therefore, face a net financing requirement, which means that continuing access to global capital markets will be necessary to balance the current account. Of course, China could look to European and other financial markets to meet these needs. Just as it could look to these markets, or its own domestic capital markets if suddenly Chinese firms no longer were able to list in the U.S. Indeed China has contingency plans for both scenarios should the decoupling contagion begin to infect capital markets. But at present, because for the large-scale mutual interests at stake in keeping capital markets open, the prospects of that happening still seem remote.

There are, however, two proposals currently before the U.S. Congress at present which could potentially change this equations. The first is the so-called Equitable Act which threatens to delist from U.S. exchanges any firm which fails to provide regular audited reports to the Public Company Accounting Oversight Board. This directly affects Chinese listings in that many are state-owned enterprises which have routinely failed to comply. There are around 230 Chinese firms currently listed on U.S. exchanges. If the Equitable Act was to pass the House and the Senate, failure to comply would result in their delisting. However, because of the impact of such a significant measure on U.S. firms benefiting from these listing arrangements, not to mention the NYSE itself, it still seems unlikely that the proposed legislation would become law. Those who oppose the legislation further argue that a failure to provide the exchange with full audit reports will generate its own penalties, through lower share prices as investors mark these stocks down. This, it is argued is a more effective means of dealing with non-compliant firms than the drastic step of compulsory delisting.

A second legislative proposal is being introduced by both Republican and Democrat lawmakers seeking to restrict U.S. public pension funds, particularly the Federal Retirement Thrift Investment Board (FRTIB) from investing in certain Chinese firms which are alleged to be complicit in human rights offenses. At least three Chinese firms are under particular scrutiny by the initiating Senators: AviChina Industry and Technology which is alleged to be associated with the Chinese PLA; Hikvision which has supplied surveillance equipment to China for use in the crackdown against Uighurs in Xinjiang; and China Mobile because of its alleged relationship with Chinese security services and which is already banned from operating in the United States. The Board currently manages a total fund of $USD 600 billion. Were this to be given effect, it would have a significant effect on the investment decisions of U.S. portfolio managers. It would also generate an inevitable Chinese reaction.

While U.S. legislators consider imposing these new restrictions on Chinese access to U.S. listing opportunities and portfolio investments, China for the last twelve months has been moving in the reverse direction by opening up its own capital markets more. In September 2019, China removed all quotas on Qualified Foreign Institutional Investors to purchase domestic A-shares on the Shanghai and Shenzhen exchanges. At present, foreigners only hold about 2% of Chinese equities. This is now likely to rise (industry predictions suggest rising to 10% by later this decade) as institutional investors seek to increase their China exposure as part of a balanced global portfolio. These developments have been enhanced by recent decisions to include Chinese equities in MSCI and Barclay's indexes – the very indexes that are drawing the attention of U.S. lawmakers and FRTIB. Similar liberalizations are occurring in Chinese bond markets where at present foreigners hold about 8% of total bonds issued by Chinese firms. That percentage is likely to rise as well. Changes allowing fully owned foreign companies to become majority participants in the Chinese domestic insurance, brokerage, and other financial service industries also point in a liberalizing direction.

Therefore, despite certain proposed legislative activity in the United States (where the prospects of passage remain unclear because of major opposition from the U.S. financial services industry) the sheer scale of the mutual interests at stake linking U.S. and Chinese capital markets, combined with China's domestically-driven decisions to internationalize its own domestic financial services sector to help service its emerging current account deficit, means that the prospects of any significant decoupling of capital markets is a long way away.

Currency Markets

As for the future of currency markets, three sets of issues arise. The first is the long-standing debate between the U.S. and China on the proper valuation of the yuan. The second concerns the yuan's role as a future global reserve currency. And the third is China's recently announced determination to launch its own international digital currency, in part to reduce its future exposure to the risk of dollar weaponization against Beijing if the bilateral political relationship progressively collapses. Of these, the latter is the most recent, and potentially the most controversial.

On the first of these, despite episodic rhetorical fusillades between the two countries, including President Trump's recent declaration that China was a currency manipulator, China is likely to maintain its current "managed float" whereby the yuan is allowed to move within a defined band each trading today. Trump has indicated phase one of the proposed trade deal between the two countries is to conclude a new currency agreement. It is unclear what this is likely to include, although the yuan has depreciated by 10% since the beginning of the tariff war 18 months ago. If the trade war were to deteriorate further, economic decoupling to gather pace and the political relationship to grind into the dust, then a further round of exchange rate wars would be possible. China might be attracted to using the exchange rate to mitigate against the impact of future tariff increases. However, the problem is that it would result in an exchange rate war between China and all its trading partners, generating political frictions on every front. This represents a significant political disincentive for Beijing.

Second, the internationalization of the yuan has long been a project for the People's Bank of China. Yet, China's political leadership, mindful of the lessons of the Asian Financial Crisis, has long resisted floating the currency and opening the country's capital account. China's long-standing fear has been its potential exposure to international hedge funds and the possible political manipulation of currency markets to destabilize China's political system. These decisions, both on the yuan and the Chinese capital account, have long constrained China's ability to turn its currency into a significant international reserve currency, thereby lessening China's dependency on the dollar intermediation of its global financial transactions.

China has succeeded in having the yuan accepted as part of the IMF's SDR reserve basket of currencies. China has initiated some 36 separate bilateral currency swaps with its trading partners, although the proportion of global trade settlements concluded outside the dollar-denominated system remains small. China has even initiated with Russia an alternative to SWIFT, the dollar-based international financial settlement system. But as of 2019, the dollar remains dominant. The yuan is still at best a marginal player in the international currency system, with 62% of global reserves held in U.S. dollars, 20% in Euro, 5% in Japanese Yen, 4% in Sterling, whereas less than 2% are in yuan, about the same as global reserve holdings of the Australian dollar. Furthermore, the U.S. dollar is used in 88% of all foreign exchange transactions, compared with 4% for the yuan. Because of the long-standing depth, liquidity, and reliability of U.S. global debt markets, in contrast to China's continued reluctance open its capital accounts and float its currency, China has limited options to reduce its own global dollar dependency, despite its paranoia that China will one day become victim to the weaponization of the dollar against it, as it has witnessed with other U.S. geopolitical adversaries including Russia, Iran, Venezuela, and Iran.

China, however, has begun to look at more unconventional ways in which it can deal with its continuing strategic concern over the country's dollar exposure, as well as expand its overall global financial footprint. Chinese commercial platforms Alipay and WeChat Pay are already two of the world's largest digital payment platforms, generating some $USD 8.4 trillion in payment transactions in the first quarter of this year alone. China wants to build on this strength by developing its own international digital currency. It also wants to prevent other potential international competitors, like Facebook's "Libra," from securing serious first-mover advantage in the international marketplace. Indeed Mark Zuckerberg warned Congress in his recent testimony that unless the U.S. backed commercial efforts like Libra, America risks ceding the global ground to China in this new, rapidly unfolding global domain. China does not want its own international digital customers becoming tethered to a digitized currency still within the regulatory control of the United States. China's new cryptography law was just passed by the NPC, coming into effect on January 1, 2020, which will support the release of the new digital RMB. This latest development has some potential to challenge the dollar over time as the global payments system becomes progressively digitized. These are very early days. The precise impact on the dollar remains uncertain. But China clearly senses a serious opportunity to reduce its global dollar dependency by leapfrogging the United States as an early adapter of international digital currency innovation.

Education, Research, and Talent

One final area to examine is what is happening with education, research and the free flow of talent between the two countries. This is perhaps what concerns me most of all. I fear we are slowly entering a new McCarthyism where increasingly Chinese Americans in general, not just Chinese students studying in America, are under a veil of suspicion. And I begin to sense the same may be emerging in China itself where Americans may increasingly become the targets of the Chinese security agencies. The refusal rate for Chinese Government-sponsored visas went from 3% in the first quarter last year, to 13.5% in the same period this year. For the 2017-2018 academic year, there was a 6.6% decline in the number of new international enrolments in general at American universities. This followed a 3.3% decline from the year before. This is the first time there have been year-on-year declines.

This follows a decision announced in the U.S. National Security Strategy in 2017 to review visa arrangements for foreign science, engineering, technology, and mathematics students from certain designated countries. It also follows a statement from the State Department from June this year that State would begin reviewing the visas of existing Chinese students in these areas. Visa renewal times for Chinese students have also now been considerably lengthened. These changes also impact the perceptions of Chinese students themselves. According to a 2019 survey conducted by the Beijing Overseas Study Abroad Association, for the first time, the UK has now passed the U.S. as the preferred destination for Chinese students.

Meanwhile, on the Chinese side, Beijing has shut down more than 200 higher education programs run in conjunction with foreign, including American, universities. China will have its own security-related reasons for doing this. Although it would be analytically flawed to claim this was just in response to these most recent American actions. Beyond all the above, there are also now many reports of visiting American and Chinese scholars, think tankers, and even officials across multiple fields increasingly experiencing visa restrictions, delays, and outright rejections.

So has the great decoupling begun in the field of human talent? The early data is not encouraging. It's possible we are now in an adjustment period as new visa-related administrative arrangements are put in place. The numbers may then re-stabilize. But we would be foolish to ignore the early trends. If these trends become sustained, then this would become the greatest decoupling of all.

National security concerns in both countries are real. Let us not pretend they are not. But there is a danger that the normal operation of our security and intelligence operations in safeguarding the integrity of national research, scientific and technological institutions triggers a tidal wave of exits from both countries as personal safety concerns rise to the fore.

We seem to have lost sight of how far we have come over the last 40 years. Back then, at the beginning of the period of reform and opening, Chinese students in America, and American students in China were relatively rare, almost exotic. We have come a long way since then to the extent that extensive travel, engagement, and personal experience of each other's countries has become normal. Are we on the cusp of reverting to an earlier, atavistic age?

We seem to have lost sight of the fact that over 3 million Chinese students over the last 20 years have been educated at American universities. Many more if we add the UK, Canada, and Australia. They also constitute the biggest voice of moderation and understanding of the U.S. and the West across China's vast political and economic system. It would be deeply counterproductive to our interests for this to be decoupled as well.

Conclusion

As we can see from this survey, the emerging picture across these various domains of economic engagement and/or decoupling is mixed.

- In trade, there will be new restrictions in technology exports, but China's overwhelming interest for the decade ahead is to maintain its export markets in America. American industry, from semiconductors to agriculture, albeit for different reasons, shares many of these interests.
- Foreign direct investment represents a different story where some level of decoupling of sorts has begun in Chinese investment flows to the U.S., although these have driven by a range of other Chinese policy considerations as well, not just U.S. regulatory changes.
- Decoupling is likely to become more acute in technology markets, product regulation, and industry standards, in part because of American national security concerns, in part because of China's desire to maximize its own national self-reliance.
- The story is quite different in capital markets where the sheer magnitude of mutual self-interests appear to be militating against any significant decoupling.
- Where a more complex form of decoupling may emerge is with the currency itself where the full implications of China's recent announcements concerning its proposed new international digital RMB are yet to be seen, but where we would be prudent to watch developments very carefully indeed.
- And then there is talent where the early signs are not encouraging at all.

After an 18 month-long trade war, it appears that both sides have stopped, stared into the abyss, concluded that it's a very long way done there and a lot of people on both sides could get seriously hurt —and without any real lasting benefit to anybody. That's why I have argued for the last 12 months that mutual economic interest would eventually kick in and that we would see an imperfect, negotiated outcome by year's end. Given that both presidents have an interest in strengthening their respective economies in the year ahead (President Trump for re-election, and President Xi to reduce the self-induced economic headwinds he currently faces in China), we will see a phase one deal by the end of 2019, probably involving a deferral or cancellation of the proposed December 15 new tariffs, and possibly some reduction in existing tariffs. As for a phase two deal, it is more probable than not that it will be agreed next year. If so, it would need to be accompanied by the elimination of all tariffs as this is China's bottom line for any concessions it will make on outstanding policy disagreements. Removing all tariffs may to be difficult in a presidential election year, in which case negotiations may also continue through until the end of 2020. But the bottom line is there seems to be limited appetite to do further damage to the trading relationship, an interest in repairing it somewhat, as well as sustaining a process for resolving the rest over time.

Resolving or reducing the scope of the trade war is one thing. But that will not of itself mean the end of the technology war, the "talent" war, the declining flows of foreign direct investment or the new, emerging uncertainties on currency. These "wars" are likely to continue in response to political and regulatory toughening in both countries. The danger of a negative spiral remains. Some decoupling is now unavoidable. But full-scale decoupling does not at this stage seem probable. Although China's contingency plans for such an eventuality are being developed, with self-reliance and global diversification beyond America being the key.

Beyond the economic relationship, foreign and security policy tensions will continue to grow between Beijing and Washington. Military competition in East Asia and the West Pacific will intensify. Taiwan tensions will grow both in the lead-up to and in the aftermath of the 2020 Taiwanese presidential elections. Hong Kong will be unlikely to resolve itself in the near term, although skillful management from Beijing may assist in reducing tensions over the next year or two, particularly as China has no interest in militarily intervening. The South China Sea is likely to see sharper incidents between China, the U.S., and its allies although these are also likely to fall short of direct confrontation or conflict. Strategic competition between China and the U.S. will expand in the Indian Ocean, the Gulf, Africa, and Latin America. Europe will become increasingly contested ground in trade, investment, and technology between Beijing and Washington. And across the multilateral system including the UN, the WTO, the UNFCCC and other institutions, China will continue to make inroads at America's expense as the current U.S. administration continues to walk away.

We are unlikely to witness a complete collapse in the U.S.-China relationship. Instead, we are likely to muddle through the remainder of 2020. But the long-term trend line is heading south given that the structural nature of the geopolitical rivalry between the two counties will only intensify. What happens under a re-elected Trump presidency on U.S.-China relations is uncertain. China fears that without the discipline of a subsequent re-elect to contain him, Trump will let loose those within his administration who have yearned for real decoupling but have so far been kept on a short leash during the trade war. How this would play out remains after a Trump win is unclear. Furthermore, what a President Biden or President Warren may do on China remains an equally open question. Their administrations would likely be staffed by a coterie of serious China hands. They are likely to develop a systematic, hard-line strategy on China. But they are unlikely to see any real policy benefit or leverage in fueling a wide-spread economic decoupling in the overall relationship.

In the midst of all this uncertainty, both in Washington and Beijing, it would be wise for both governments to look afresh at how they might navigate the difficult decades ahead. Full-scale strategic competition, without any effective rules of the road, can be a dangerous and destabilizing thing. The alternative, which I advocate, is a form of "managed strategic competition." This would mean a mutually agreed framework which defined areas of fundamental strategic disagreement (which might be managed according to agreed protocols to prevent unnecessary escalation); areas of major disagreement where strategic dialogue is possible, both to manage and narrow such areas of potential escalation; as well as areas where collaboration and cooperation are not only possible by mutually desirable. This is difficult work. But it is more productive than simply standing idly by, watching, waiting and in some cases hoping for one form or another of economic or strategic decoupling to unfold, all as a product of political and diplomatic inertia. And then just hoping for the best. Hope is not a strategy. Nor is anger.

Managed strategic competition might also provide a framework for third countries to work with. If decoupling unfolds over time, and an increasingly binary international system unfolds, third countries will come under increasing pressure to make strategic choices. The Huawei matter may indeed be the first of many such choices to come, and not all in technology. It's often assumed that a bipolar world is primarily a problem for third countries. That is not necessarily so. It may also be as big a problem for China and the U.S. themselves because if choices are forced on the world, Beijing and Washington may not be entirely delighted by the choices which are then made. Which is why some of us have been life-long advocates of multilateral orders because they reduce the conscious or subconscious binary imperative.

Beyond U.S.-China, we may also have already passed "peak globalization" as we move to the third decade of the current century. Not just because of the unfolding strategic competition between the two great powers of the 21st century. Not just because of the steady emergence of competing regulatory systems between them in the internet, mobile telephony and artificial intelligence. But also because of the new forces of protectionism, populism, and nationalism now at work across the world. These forces have become increasingly legitimized over the last several years. They have moved from the margins to the center of the politics of many countries in the developed world, and elsewhere as well. Rather than the "great decoupling," therefore, perhaps we are seeing something more approximating the "great unravelling" of the global rules-based order so painstakingly constructed in the decades following the last world war. And that would be a tragedy for us all as we entered a new era of the law of the jungle.

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