

DEBATE

Response to Bryan Mercurio's *Caveat Emptor*

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Abstract

Bryan Mercurio's brief accurately describes the inflection point of the global trading system as world governments retreat from free and fair trade. Chief among them is the United States, whose recent reversal is sending shockwaves throughout the rules-based economic world order. The United States' conflation of trade policy vis-à-vis China and national security, as well as the use of trade policy to garner political support from voters disenfranchised by the global trading system, have given way to industrial subsidies and protectionist tendencies. This article aims to build upon Mercurio's points and identify the underlying causes and long-term consequences of the current US direction. In addition, this piece differs from Dr Mercurio's assertions on three critical aspects of today's trade landscape. Firstly, industrial policy and economic security measures were first undertaken by China, and the United States and allied nations only followed suit. Secondly, the current US economic policy regarding China is severely constrained by today's political landscape, and the Biden administration's approach is moderate given these confines. Lastly, despite challenges, low-income countries can gain from the diversification movement as production shifts away from China.

1. Introduction

The post-1945 consensus on trade policy was meant to foster a more liberalized, rules-based order by creating global institutions and frameworks. In the aftermath of World War II's devastation, democratic allies led by the United States concluded that an international system predicated on a set of norms encouraged peaceful and cooperative behaviors among states. Aside from ensuring rules-based trade, this new global system contributed to peaceful interstate relations by building upon the idea, as Robert Schuman put it, that economic linkages make war 'not merely unthinkable, but materially impossible'.¹ Schuman's words referred to a foundational idea behind the EU, but it rings true for the rest of world trade. War ceases to be a viable option when countries gradually build relationships that make conflict ruinously costly. With world trade at an inflection point, as Bryan Mercurio puts it in his *From the Trenches* commentary in this volume, governments must keep in mind the importance of norms and economic linkages to achieve not only prosperity, but also stability.

The last seven years have shown a stark reversal in the trade policy of the US – once the most ardent champion of free trade. Donald Trump's election in 2016 and his presidency's have marked a turn to protectionism and prompted the US to retreat from the international system and burn economic bridges in the process. Under President Biden, the US has adopted a friendlier tone and taken concrete steps to reach out to allies, but it also kept many of the preceding administration's protectionist policies in place, and in some cases, doubled down on the criticism

¹European Union (2023) 'Schuman Declaration May 1950', https://european-union.europa.eu/principles-countries-history/history-eu/1945-59/schuman-declaration-may-1950_en.

of the multilateral that the US had helped establish earlier. When a World Trade Organization (WTO) Panel concluded that the United States broke WTO rules in imposing Section 232 tariffs on steel and aluminum last December 2022, the Office of the US Trade Representative responded that it ‘strongly rejects the flawed interpretation and conclusions’ and argued that ‘the WTO has no authority to second-guess the ability of a WTO Member to respond to a wide-range of threats to its security’.²³ The United States’ significant and arguably WTO-inconsistent subsidy packages have also drawn the ire of trade partners. Several allied governments have protested, for instance, that the Inflation Reduction Act’s domestic assembly and local content provisions violate the rules and unfairly distort the market.

The inflection point in which world trade now finds itself can be attributed to two main causes. The first one is that economic security vis-a-vis China is the new focus of trade policy. Policymakers and companies are shifting focus from time and cost efficiencies towards efforts to diversify supply chains away from the PRC. The second driver for the current shift is that trade policy is now used as a political tool to win over voters who have felt increasingly disenfranchised by the global trading system.

2. Economic Security and China

Importantly, the shift from free trade to managed trade, which Mercurio describes, did not start with the election of President Trump, the pandemic, or the Biden’s administration’s industrial policy splurge. It was China that pioneered this shift to address its own supply chain vulnerabilities across several critical industries, especially high-tech sectors, long before Western nations, through a state-led push to develop independent supply chains. In 2015, the Chinese government unveiled its Made in China 2025 program to make the country a large player in advanced manufacturing.⁴ In 2016, Xi Jinping encouraged the development of technologies in which China already holds a comparative advantage, such as the processing of heavy rare earths, which Beijing could withhold from its partners to assure leverage.⁵ The United States government and other allied nations did not lead the charge in diversification or industrial policy, but rather followed in China’s footsteps.

In both Beijing and Washington, security considerations are major drivers of that new trade policy. The conflation of national security, industrial policy, and trade provides the intellectual underpinning of instruments deemed unthinkable, unnecessary, or undesirable in the era of free global trade. Funding from the US CHIPS & Science Act, for example, contains ‘guardrails’ against recipients of funding engaging in activities taking place in so-called ‘countries of concern’ or alongside ‘entities of concern’.⁶ In October 2022, the Department of Commerce released new rules tightening export controls on leading-edge semiconductors⁷. In August 2023, the Biden administration unveiled a new outbound investment screening mechanism that requires investors in mainland China, Hong Kong, and Macau to notify the Treasury of investments in

²³World Trade Organization (2018) ‘WTO | Dispute Settlement – DS544: United States Certain Measures on Steel and Aluminium Products’, www.wto.org/english/tratop_e/dispu_e/cases_e/ds544_e.htm.

³A. Hodge (2022) ‘Statement from USTR Spokesperson Adam Hodge’, Office of the United States Trade Representative, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2022/december/statement-ustr-spokesperson-adam-hodge> (accessed 26 October 2023).

⁴Ma Juan (2015) ‘The State Council issued the ‘Made in China 2025’ Notice Machinery Manufacturing and Heavy Industry on the Chinese Government Network, www.gov.cn/zhengce/content/2015-05/19/content_9784.htm.

⁵M. Hui (2023) ‘China Was “De-Risking” Long before the Term Caught on in the West’, Quartz, <https://qz.com/china-was-de-risking-long-before-the-term-caught-on-i-1850828659> (accessed 26 October 2023).

⁶US Senate Committee on Commerce, Science, & Transportation, ‘The CHIPS+ Legislation’, 29 July 2022, www.commerce.senate.gov/2022/8/view-the-chips-legislation.

⁷S. Shivakumar, C. Wessner, and T. Howell (2022) ‘A Seismic Shift: The New US Semiconductor Export Controls and the Implications for US Firms, Allies, and the Innovation Ecosystem’, Csis.org, www.csis.org/analysis/seismic-shift-new-us-semiconductor-export-controls-and-implications-us-firms-allies-and.

semiconductors, quantum technologies, and artificial intelligence – and some transactions, especially in the quantum sector, now face an outright ban.⁸ US authorities have urged businesses to diversify supply chains in sectors where the country is deemed overly dependent on China. The diversification efforts are also evident in the administration's outreach to Indo-Pacific countries to ramp up their own domestic capacity and make up for Chinese production. An apparent goal of the Indo-Pacific Economic Framework for Prosperity (IPEF), the trade agreement meant to cement the Biden administration's economic strategy in the region is to encourage development of resilient supply chains that replace Chinese inputs in critical sectors through its second pillar. President Biden's latest trip to Vietnam, for instance, yielded several promises from the US to assist the Southeast Asian nation's ability to ramp up its semiconductor industry.⁹

US allies and partners are also increasingly viewing trade through a national security lens. De-risking occupies a primordial place in the European Economic Security Strategy, and Europe's proposal to impose export controls on specific technologies is modeled in the US decision from October 2022.¹⁰ At the individual member-state level, Germany released its own National Security Strategy which also argues for 'reducing dependencies in critical areas, keeping geopolitical aspects in mind when taking economic decisions, and increasing our resilience,' and outlines export controls as well as an outbound investment screening mechanism.¹¹ Allied governments, after a significant diplomatic push from Washington, have overtly complemented US controls: the Netherlands and Japan agreed to establish their own curbs on advanced semiconductor equipment last Spring.¹² Nevertheless, more multilateral coordination is needed for the US strategy to work. Some third-country high-tech companies may fill the gaps left by the new controls, rendering them less effective. In the long-term, export controls risk threatening US and allied inputs being designed-out of China-bound supply chains.

Mercurio's piece alludes to the business sector's role in diversification; indeed, though the 'de-risking' movement is incentivized by governments, private industry is contributing to the trend. In recent years, companies including Apple and Mazda have been moving away from Chinese factories to neighboring Asian countries such as Vietnam and Bangladesh.¹³ This trend does not just belong by companies headquartered in the United States and allied countries: Chinese manufacturers are assembling fewer end products at home and are instead shipping processing materials as well as intermediate products for final assembly.¹⁴ Economic factors, such as the ageing Chinese population and growing costs of doing business in China, are reinforcing this trend.

The WTO's Director General, Dr. Ngozi, pointed out in June 2023 that some Low- and Medium-Income Countries (LMICs) will probably profit off this diversification away from

⁸Kim, J.K. (2023) 'US Government Issues Executive Order Restricting US Outbound Investment in Advanced Technologies Involving "Countries of Concern" (China)', Global Sanctions and Export Controls Blog, 11 August 2023, <https://sanctionsnews.bakermckenzie.com/us-government-issues-executive-order-restricting-us-outbound-investment-in-advanced-technologies-involving-countries-of-concern-china/>.

⁹The White House (2023) 'Remarks by President Biden and President Võ Văn Thường of Vietnam at a State Luncheon', The White House, 11 September 2023, www.whitehouse.gov/briefing-room/speeches-remarks/2023/09/11/remarks-by-president-biden-and-president-vo-van-thuong-of-vietnam-at-a-state-luncheon/.

¹⁰European Commission – European Commission (2023) 'An EU approach to enhance economic security', https://ec.europa.eu/commission/presscorner/detail/en/IP_23_3358.

¹¹Federal Ministry of Defence, 'National Security Strategy', 31 October 2022, www.bmvg.de/en/national-security-policy.

¹²G.C. Allen and E. Benson (2023) 'Clues to the US–Dutch–Japanese Semiconductor Export Controls Deal Are Hiding in Plain Sight', Csis.org, 2023, www.csis.org/analysis/clues-us-dutch-japanese-semiconductor-export-controls-deal-are-hiding-plain-sight.

¹³T. Huileng (2023) 'Moving Supply Chains out of China: How Apple, TSMC, Mazda Are Doing It', Business Insider, Insider, 27 June 2023, www.businessinsider.com/companies-leaving-china-diversifying-supply-chains-apple-tsmc-mazda-2023-6#:~:text=China%20has%20been%20the%20factory,supply%20chains%20out%20of%20China.

¹⁴H.L. Tan (2023) 'Supply chains may be moving out of China and into Asia – but they aren't really decoupling from the country', Insider, 2023, www.businessinsider.com/trade-supply-chains-china-separating-southeast-asia-off-shoring-decouple-2023-9 (accessed 26 October 2023).

China as countries turn to them for their manufacturing and processing needs.¹⁵ In that sense, lessening concentration would help ‘reglobalize’ world trade and stimulate economic growth.¹⁶ Despite Dr. Mercurio’s skepticism at this idea, diversification has already shown its potential to bring benefits to LMICs. In the advanced technologies realm, countries have begun to explore alternative locations of chip manufacturing hubs throughout Southeast Asia. President Biden’s latest trip to the region was marked by several announcements of public sector investments and partnerships with private enterprises to build up Southeast Asia’s production capabilities.¹⁷ In the immediate aftermath of recent Chinese export curbs on graphite, a key component of EV batteries for which China is the largest global producer by far, countries began looking to LMICs as a more stable source of supply. South Korea announced that it would begin to look to Tanzanian production.¹⁸ Natural graphite refiners around the world announced they would ramp up operations. However, reality may fall short of the large expectations put on these nations. Take the example of Southeast Asia and semiconductors: Vietnam’s industry is facing several issues. Guaranteeing the necessary power generation to scale-up manufacturing in the country will prove challenging.¹⁹ In addition, Vietnam will face a chronic shortage of skilled workers, around forty-five thousand, in the chip sector alone.²⁰

Washington’s recent economic engagement with China, however, is also driven by significant downgrades in public opinion.²¹ In 2011, 51% of the US public had a ‘favorable’ opinion of China – against 35% for ‘unfavorable’. In 2023, 83% of the US public has an unfavorable opinion of China, and just 14% is ‘favorable’.²² As Mercurio notes, the Biden administration largely followed, with perhaps more rhetorical nuance, former President Trump’s China policy with respect to both trade and security. However, while the Trump campaign and subsequent presidency actively helped to shape US public opinion on China – by, for instance, blaming it for lost jobs and a botched pandemic response – the Biden administration inherited a new political landscape of what is and is not politically feasible regarding engagement with China. Mercurio’s *Caveat Emptor* overlooks the fact that current US policymakers can only work within the confines of these new limits.

The Trump tariffs on Chinese goods are a case in point. They were a topic of controversy when they were put in place and, as Mercurio highlights, the Biden presidential campaign did criticize them.²³ But with the public’s positioning on China, and increasingly hawkish rhetoric from Capitol Hill, removing these tariffs is simply not acceptable. Thus, the administration hides behind the lengthy ‘review’ process, and Ambassador Tai’s office labels them as a legitimate response to compete economically with China.

¹⁵K. Georgieva and N. Okonjo-Iweala (2023) ‘Finance and Development, June 2023: World Trade Can Still Drive Prosperity’, *Finance & Development* 60(002) (June 2023), <https://doi.org/10.5089/9798400240997.022.A003>

¹⁶World Trade Organization (2023) ‘WTO Annual Report 2023’, www.wto.org/english/res_e/publications_e/anrep23_e.htm.

¹⁷E.L. Murphy and T. Denamiel (2023) ‘Vietnam: Biden Anoints a New Trusted Tech Partner’, *Csis.org*, 2023, www.csis.org/analysis/vietnam-biden-anoints-new-trusted-tech-partner.

¹⁸Borowiec (2023) ‘China’s Graphite Curbs Send South Korea Searching for Alternatives’, *Nikkei Asia*, 24 October 2023, <https://asia.nikkei.com/Economy/Trade/China-s-graphite-curbs-send-South-Korea-searching-for-alternatives>.

¹⁹K. Vu and F. Guarascio (2023) ‘Heatwave Lays Bare Vietnam’s Structural Electricity Woes’, *Reuters*, 13 June 2023, www.reuters.com/business/energy/heatwave-lays-bare-vietnams-structural-electricity-woes-2023-06-12/.

²⁰F. Guarascio (2023) ‘Engineer Shortage May Harm US Plan to Turn Vietnam into Chips Powerhouse’, *Reuters*, September 2023, www.reuters.com/technology/engineer-shortage-may-harm-us-plan-turn-vietnam-into-chips-powerhouse-2023-08-31/.

²¹L. Silver, C. Huang, L. Clancy, and M. Fagan (2023) ‘Americans Are Critical of China’s Global Role – as Well as Its Relationship with Russia’, *Pew Research Center*, <https://www.pewresearch.org/global/2023/04/12/americans-are-critical-of-chinas-global-role-as-well-as-its-relationship-with-russia/#:~:text=Negative%20views%20of%20China%20continue,American%20Trends%20Panel%20in%202020> (accessed 26 October 2023).

²²*Ibid.*

²³S. Anderson (2020) ‘Biden Says He Will End Trump’s Tariffs on Chinese-Made Goods, Aide Walks Back Statement’, *Forbes*, 7 August 2020, www.forbes.com/sites/stuartanderson/2020/08/06/biden-says-he-will-end-trumps-tariffs-on-chinese-made-goods/?sh=607cf581523a.

The broader movement of de-risking supply chains and diversifying them away from China's manufacturing capabilities are also born out of this renewed consideration of the political ramifications of trade policy. Observers of the G-7 leaders meeting in May 2023 argued that the members used uncharacteristically strong language to endorse de-risking and diversifying supply chains and production in order to moderate excessive dependencies in their respective nations' critical supply chains.²⁴ Mercurio's characterization of 'excess' regarding the leaders' wording may be true relative to the trade landscape in 2015, but it now represents an attempt at moderation.

In the US, policy debates on trade engagement with China often go far beyond de-risking' in critical sectors. The Trump administration's trade chief, Robert Lighthizer, recently published a book in which he argued for no less than complete decoupling from the China²⁵. Lawmakers on Capitol Hill now often consider ways of further limiting bilateral economic ties, from Representative McCaul's advocating to expand restrictions on outbound investment to Representative Gallagher's argument for 'selective decoupling'.^{26,27} From that point of view, the United States' current economic engagement with China is much less 'hawkish' than Mercurio portrays it to be. The Biden administration cannot work political miracles – such as lowering the China tariffs – but it can narrow down decoupling by limiting economic barriers to a small set of national security-critical goods as embodied in Jake Sullivan's 'small yard, high fence' description.²⁸ What complicates that picture is that economic security considerations have become intermingled with policies that seek to reshore manufacturing to create jobs for left-behind workers, straining trade between China and the US in areas far removed from the sectors subject to export controls. Thus, a key exception to the 'small yard, high fence' approach can be found in the Inflation Reduction Act guardrails against sourcing key inputs, such as critical minerals from China, hindering the green transition, which required Congressional approval to pass.

3. Left-Behind Workers

Trade's novel use as a political tool is going beyond the United States' relationship with China. US negotiators have voiced support for a more equality-oriented, worker-centered trade policy – a policy that aims to distribute the gains from trade. Already David Ricardo's model suggested that trade policy can create gains; however, the remit of distributing them lies in other areas – such as tax policy or education policy. Trade policy that aims to distribute gains itself, rather than have its advantages shared by other elements of government, risks decreasing gains altogether.

Nevertheless, trade policymakers are now touting protectionist tendencies aimed in part at courting voters who feel like they have been cheated by the previous trade order emanating from the Washington Consensus, and therefore favor the distorting elements of trade policy such as state subsidies or tariffs. That some of these voters live in areas where elections could reasonably favor either party exacerbates the matter. Michigan, which famously voted red after two decades of supporting Democratic candidates in 2016, only to favor President Biden's candidacy four years later, is set to benefit from the Inflation Reduction Act's domestic content

²⁴The White House (2023) 'G7 Hiroshima Leaders' Communiqué', The White House, 20 May 2023, www.whitehouse.gov/briefing-room/statements-releases/2023/05/20/g7-hiroshima-leaders-communication/.

²⁵R.E. Lighthizer (2023) *No Trade Is Free: Changing Course, Taking on China, and Helping America's Workers*. Broadside Books.

²⁶Leading the Charge: A Conversation with Rep. Mike Gallagher', 27th issue, George W. Bush Institute, 2023.

²⁷McCaul on Executive Order Curbing US Tech Investment in China', Foreign Affairs Committee – Chairman McCaul, 2023, <https://foreignaffairs.house.gov/press-release/mccaul-on-executive-order-curbing-us-tech-investment-in-china/> (accessed on 13 October 2023).

²⁸The White House (2023) 'Remarks by National Security Advisor Jake Sullivan on Renewing American Economic Leadership at the Brookings Institution', The White House, 27 April 2023, www.whitehouse.gov/briefing-room/speeches-remarks/2023/04/27/remarks-by-national-security-advisor-jake-sullivan-on-renewing-american-economic-leadership-at-the-brookings-institution/.

requirements in the automotive industry.²⁹ Arizona, a key, close win for President Biden's campaign, is set to see its semiconductor ecosystem expand through the CHIPS & Science Act's significant funding.³⁰

The general direction of US trade policy aims to now take care of the domestic 'losers' of the liberalized trade order. These individuals and communities were critical to Donald Trump's rise in 2016, as he gave a voice to their discontent. Democrats' team around President Biden has sought to capture these votes back, and policies have followed. These involve showing tepid interest in restoring the WTO's system of dispute resolution. They also involve focusing on the workers from sectors – chief among them manufacturing – where jobs have gone overseas through large public investment. That the recent subsidy packages strain the rules and relationships formed under the Washington Consensus is no longer the primary concern of Washington's trade authorities.

Government-led investments will not solve countries' labor woes, but simply change their nature. Chronic worker shortages are likely to become the norm as nations embark on large subsidy programs. The United States is already facing acute labor gaps in critical sectors of its economy, which will only be made worse by state-led investments in sectors with large manufacturing and construction needs. In the year of peak labor demand from the Bipartisan Infrastructure Law, there could be a shortfall of 160,000 workers in the contractor and subcontractor sector, 145,000 workers in the materials sector, and 40,000 workers in the engineering and technical services sector.³¹ These gaps are also plaguing sectors with supply chains critical to national security, where efforts to de-risk, friend-shore, and re-shore are deemed most important: TSMC's plans to build a fab in Arizona are lagging as the company struggles to find workers.

4. Conclusion

Evidently, a frustrating aspect of President Biden's policy is that more liberalized trade would facilitate many of his administration's goals. The climate transition would benefit from tariff reductions and fewer domestic content requirements on green goods and services such as critical minerals refining or EV battery assembly. In addition, opening market access to other countries would encourage partners to agree to better protect worker rights, undertake anti-corruption initiatives, and adopt US rules for digital technologies. Trade agreements under negotiation such as IPEF lack the necessary market access incentives present in CPTPP to see nations accept higher standards. Their lack of economic integration also hurt the United States' strategic interests vis-à-vis China, which has the opportunity to make more inroads with world economies as the American presence is perceived as retreating. President Biden's economic engagement with the Indo-Pacific has so far failed to make up for the strategic blunder of Trump's TPP withdrawal.

Lastly, the trading system's greatest achievement – stability – is still being eroded. As countries back away from economic interdependence, they give up on the best long-term mechanism for security. When nations depend on each other's inputs in key sectors necessary to life, from agriculture to advanced technologies, they also provide each other with the best guarantee that conflicts will be solved peacefully. As war becomes less materially impossible, it will undoubtedly grow less unthinkable.

²⁹Michigan Primary (2020) 'Michigan Presidential Election Voting History – 270toWin', www.270towin.com/states/Michigan.

³⁰*The New York Times* (2023) 'How Arizona Is Positioning Itself for \$52 Billion to the Chips Industry', www.nytimes.com/2023/02/22/technology/arizona-chips-act-semiconductor.html.

³¹G. Hovnanian, A. Kumar, and R. Luby (2023) 'Will a Labor Crunch Derail Plans to Upgrade US Infrastructure?', McKinsey & Company, www.mckinsey.com/industries/public-sector/our-insights/will-a-labor-crunch-derail-plans-to-upgrade-us-infrastructure (accessed on 10 October 2023).