Arbitrating in Time of Trade War: Successfully Navigating the Minefields of National Security, Cross-Border Data Restrictions, Sanctions and US- China "Decoupling" to Achieve Fair and Efficient Dispute Resolution

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REALTIME ECONOMICS

Foreign direct investment is exiting China, new data show

Nicholas R. Lardy (PIIE)
November 17, 2023 10:00 AM

Taking time away from his tense meeting with President Joseph R. Biden Jr., President Xi Jinping spoke in San Francisco in mid-November to US corporate and big tech CEOs, assuring them that China is ready to be a partner and friend of the United States and that its modernization offers a "huge opportunity" for the world. Little wonder that he seeks to dial back tensions with the United States: New Chinese data imply that foreign firms operating in China are not only declining to reinvest their earnings but—for the first time ever—they are large net sellers of their existing investments to Chinese companies and repatriating the funds.

These outflows exceeded $100 billion in the first three quarters of 2023 and are likely to grow further based on trends to date. The investment selloffs are contributing to downward pressure on the value of the Chinese currency and, if sustained, will modestly reduce China's potential growth.

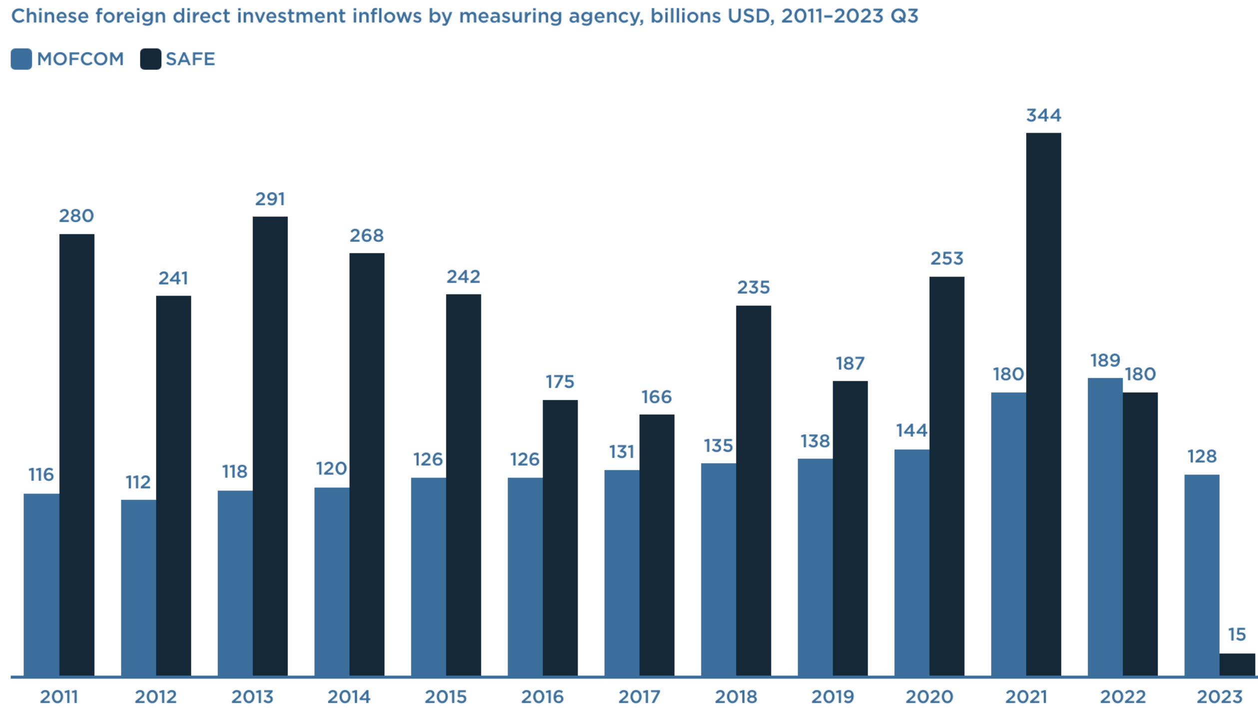
Several factors appear to be influencing the trend, including the spike in US-China tensions, making investors more cautious. In addition, Beijing's closure of foreign consultancy and due diligence firms that are critical to foreign firms' evaluation of potential new investments and its increasingly stringent regulatory environment, including a new national security law and restrictions on cross-border data flows, have led foreign firms to reduce their direct investment or even to disinvest from their existing direct investments.

Time will tell whether President Xi's words will first stem the current large foreign direct investment (FDI) outflows and eventually lead to a resumption of the net FDI inflows that China has enjoyed for more than four decades. A safe assumption is that it will take more than words to accomplish this objective.

The figure below shows two different official time series for inward FDI: one from the Ministry of Commerce (MOFCOM) and the other from the State Administration of Foreign Exchange (SAFE). There are multiple differences between the two series, but the main one is that SAFE measures FDI on a net basis, i.e., FDI inflows minus FDI outflows, while MOFCOM only measures gross FDI inflows. Both agencies include greenfield investment and mergers and acquisitions (M&A) by foreign firms in their FDI data while SAFE also includes several other items. While these additional items were large a few years ago, as explained below, they are now likely quite small. Most of the $113 billion difference between the two numbers in the first three quarters of 2023 must result from the net sale of direct investment assets by foreign investors.

Foreign investments in China have declined in recent years

Chinese foreign direct investment inflows by measuring agency, billions USD, 2011–2023 Q3



MOFCOM = Ministry of Commerce; SAFE = State Administration of Foreign Exchange

Source: Ministry of Commerce of China and State Administration of Foreign Exchange of China.

As shown in the figure, through 2021 the SAFE measure of FDI inflows was larger than MOFCOM's. There were several reasons for this disparity:

1. Because of the peculiar legal structures involved, SAFE numbers include the value of initial public offerings (IPOs) of some Chinese companies in offshore markets. MOFCOM does not include these inflows.
2. When foreign venture capital and private equity investment leads to a foreign ownership share in a Chinese startup of 10 percent or more, SAFE counts this as FDI. (If it is less than 10 percent, SAFE counts this as a portfolio inflow, per International Monetary Fund conventions.) MOFCOM ignores these transactions.

3. SAFE counts on a real time basis reinvested profits of foreign firms as inflows of FDI and repatriated profits of foreign firms operating in China as FDI outflows. MOFCOM apparently estimates these flows based on data from the prior year. This leads MOFCOM to an underestimate of FDI when reinvestment flows are rising and an overestimate when the repatriation of earnings is increasing.
4. Finally, when foreign financial institutions make direct investments in the financial sector in China, SAFE includes these transactions in its accounting of China's FDI, MOFCOM does not.

In the figure, the four items enumerated above led to a large increase in 2021-22 in the FDI reported by SAFE relative to the MOFCOM data. But in 2022 the numbers reported by SAFE declined dramatically, while those of MOFCOM rose slightly. The result was that the two agencies reported almost identical numbers in 2022.

This pattern cannot be accounted for precisely since SAFE does not publish disaggregated FDI data. Other sources appear to show the main causes.

Proceeds from offshore IPOs in the United States alone peaked at $12.6 billion in 2021. But in late 2021 the Chinese securities regulator tightened the rules for offshore listings. And the US accounting watchdog was threatening to delist Chinese companies from the US market if it could not get access to certain auditing papers of these listed Chinese firms.

As a result of these actions, offshore listings of Chinese companies in US markets plummeted to $468 million in 2022. The US accounting watchdog announced in December 2022 that it had achieved full access to the relevant auditing documents, thus lifting the risk that Chinese firms could be kicked off US stock exchanges. And the Chinese securities regulator in March 2023 announced new regulations designed to revive offshore listings. Nonetheless, new listings in the United States languished at only $405 million in the first three quarters of 2023. Hong Kong also counts as an offshore market, and the value of IPOs there by Chinese firms in 2020 was even larger than in New York and fell by an even larger percentage by 2022.

Foreign capital raising for China-focused venture capital and private equity funds followed a similar pattern, rising from less than $15 billion in 2020 to almost $50 billion in 2021 before falling to $20 billion in 2022 and only about $5 billion in the first three quarters of 2023.

It is likely that reinvested earnings by foreign firms operating in China followed a similar pattern, but the magnitude of this reinvestment is not known. Surveys show attitudes of these companies turned increasingly cautious in recent years as geopolitical tensions with China rose and China appeared to be transitioning to much slower growth, presumably leading to less reinvestment and more repatriation of the earnings of these companies.

Finally, in the Phase One Economic and Trade Agreement China reached with the United States in January 2020, China agreed to lift existing equity limitations on foreign firms engaged in joint ventures providing banking, insurance, securities, and other financial services. This allowed foreign firms to either establish new wholly foreign-owned financial services firms or buy out their Chinese partners in existing joint ventures. In either case these foreign firms had to invest, in the case of establishing new wholly foreign-owned financial firms by purchasing Chinese government bonds, to meet the minimum capital requirements imposed by the relevant Chinese regulators.

Since these bonds can’t be traded but must be held for the life of the foreign firm, SAFE treats these funds as direct investment. SAFE also treats the funds used to buy out the ownership shares of existing local joint venture partners as direct investment. For example, JPMorgan Chase and Goldman Sachs both took over their securities joint ventures in 2021. In July 2021 the China Banking and Insurance Regulatory Commission approved Allianz Insurance Asset Management as a wholly foreign-owned insurance asset management firm. In late 2022 the same regulator approved Chubb’s expansion of its ownership stake in its joint venture insurance group from 47 to 83 percent, giving Chubb majority control.

In addition, even prior to the 2020 lifting of equity restrictions, foreign banks took ownership stakes exceeding 10 percent in several Chinese banks, which SAFE counts as direct investments. The largest seems to be HSBC's investment in 2004 of $1.7 billion in Bank of Communications, establishing a 19.9 percent ownership position. Following the lifting of equity ownership restriction in 2020, most foreign financial firms that sought to establish new wholly foreign- owned financial firms or assume full ownership of existing joint ventures had completed such transactions in 2021 or early 2022, so these direct investments presumably fell in 2022 and 2023.

This incomplete information only partially accounts for the sharp decline in FDI reported by SAFE for 2022, suggesting that foreign firms began to sell down their FDI that year. The figure above shows that in 2022 FDI reported by SAFE was very close to the greenfield and M&A FDI reported by MOFCOM. The extra contribution to FDI of the four items not counted by MOFCOM but included in the SAFE data on FDI appears to have vanished.[1] In the first three quarters of 2023, data reported by MOFCOM exceeded that reported by SAFE by $113 billion, implying that foreign firms had exited from more than $100 billion in direct investment.

NOTE

1. If these four items were net positive in the first three quarters of 2023, then foreign firms in 2023 must have sold even more than $113 billion of their prior direct investments.

DATA DISCLOSURE

This publication does not include a replication package.

Article · 02 Jan 2024

The U.S.-China Chip War: Who Dares to Win?

Global Insights

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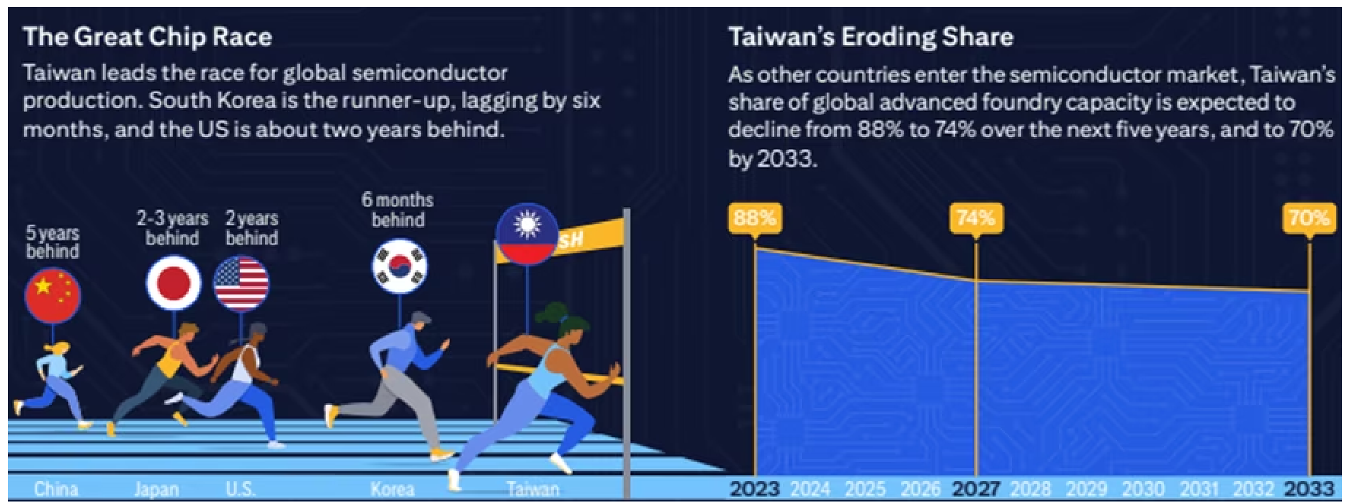
China and the U.S. are increasingly jostling over semiconductor intellectual property and manufacturing, with the U.S. seeking to jump-start its own chip production while using sanctions to blunt China's drive for self-reliance in this critical industry. A new Must C Citi Research report from a team led by Chris Danely looks at the battle for supremacy in semiconductor manufacturing unfolding between the U.S. and China.

playing a crucial role in nations' economic prosperity and national security. Despite accounting for 25% of total semiconductor demand, the U.S.'s total semiconductor manufacturing capacity is just 12%, down from 37% in the 1990s. That has sparked concerns about a threat to national security given China's efforts to gain a significant foothold in this vital industry.



Source: Citi Research, TechInsights, SIA, and Gartner

A key focus of the report is the CHIPS and Science Act, which became U.S. law in 2022. Its aim is to boost domestic chip production, with $52.7 billion earmarked for allocation over five years to develop domestic manufacturing, as well as R&D and workforce programs.

As part of the CHIPS Act, semiconductor companies will get 25% investment tax credits for investing in semiconductor manufacturing or specialized tooling equipment. But as the report notes, the CHIPS Act faces challenges in turning its goals into realities. In March, the Commerce Department introduced conditions for companies seeking $150 million or more in funding, including stock buyback limitations, profit sharing, and a preference for union labor. The report warns such conditions could make returning leading-edge semiconductor manufacturing to the U.S. extremely difficult, with companies working to stay below the $150 million threshold.

The former chair and CEO of the Taiwan Semiconductor Manufacturing Company (TSMC), a behemoth that produces 90% of the world's most advanced processor

one of the world's most profitable. That leads the authors to conclude that only less-profitable chip companies may prove more willing to participate in the CHIPS Act in its current form, limiting its industry impact.

Semiconductor companies that choose to manufacture chips in-house are known as Integrated Device Manufacturers (IDMs), with the plants that make such chips called fabs. Another model for the industry is to go "fabless," outsourcing the manufacturing process to a foundry. And some companies have chosen a hybrid model.

The Semiconductor Industry Association estimates that the 10-year cost of a state-of-the-art fab ranges between $10 billion and $40 billion, up from less than $1 billion in 1997. Only four IDMs—Samsung, Intel, Hynix, and Micron—have the scale necessary to support construction of leading-edge fabs. Other semiconductor companies, including Nvidia, AMD, Qualcomm, and Marvel, have outsourced some or all of their manufacturing to TSMC.

Source: Citi Research, TechInsights, SIA, and Gartner

TSMC is the clear leader among the five major foundry companies, with a 58% share of the global market. In 2021, Intel announced it would refocus on the foundry business with an eye on overtaking Samsung as the second-largest

business.

Meanwhile, TSMC is rushing to establish fabs outside Taiwan as a hedge against supply chain disruptions that might arise from the region's geopolitical tensions. The authors think this move will help TSMC hold onto most of the foundry business, although they note it has been having trouble establishing a leading-edge foundry in the United States. Samsung's foundry business, on the other hand, is expected to benefit from the CHIPS Act given its 27 years of foundry experience in the United States.

The CHIPS Act isn't the only tactic deployed in the U.S.–China chips rivalry. The U.S. and its allies are also using sanctions on China. These date to 2017 and U.S. action against ZTE; in October the U.S. Commerce Department's Bureau of Industry and Security further tightened export controls on advanced semiconductor production equipment and high-performance computing chips. Such restrictions have limited China's ability to acquire and make advanced chips, with an emphasis on items or technologies used for supercomputing and AI training. The export restrictions also apply to non-U.S. vendors and exporters, which has led Japan and the Netherlands to limit their semiconductor-making technologies. The authors note their belief that China's advanced semiconductor fabs are still capable of producing chips in limited volumes, which will likely lead to further sanctions.

The European Union has created its own take on the CHIPS Act with the European Chips Act (ECA). As with the U.S., only about 10% of global chip manufacturing is situated in Europe; the EU aims to double that to 20% by 2030. European and international chip makers have already committed to R&D and fab expansion plans in Europe in hopes of accessing funding from the ECA and other sources. Because the ECA lacks the restrictions that come with the CHIPS Act, chip manufacturers seem to have few if any reservations about accessing this funding.

Japan has pursued its own drive to establish semiconductor production facilities, with 2022's Economic Security Promotion Act outlining a framework for combined public and private financing of ¥10 trillion over 10 years. Japan accounts for 12% of global semiconductor consumption, but its share of production capacity is extremely low. Semiconductor industry activity is booming in Japan, a development that has been fueled by expectations for growing demand for

subsidiaries, Taiwan-based PSMC, and U.S.-based Micron.

A redacted public version of the report, first published on 30 November 2023 and including a Q&A with semiconductors expert Chris Miller and a graphical overview of the semiconductor industry, is available here.

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Technology

China raises concerns with US over chip-making export controls, sanctions

By **Joe Cash**

January 11, 2024 11:08 AM EST · Updated a month ago

Chinese Commerce Minister Wang Wentao speaks at a news conference in Beijing, China March 2, 2023. REUTERS/Florence Lo/File Photo *Purchase Licensing Rights*

Feedback

BEIJING, Jan 11 (Reuters) - China's Commerce Minister Wang Wentao expressed concern over U.S. curbs preventing third countries from exporting lithography machines to China during a phone call with U.S. Commerce Secretary Gina Raimondo on Thursday, his ministry said.

Washington has used export controls to cut off China's access to advanced chips and chip-making tools that could fuel breakthroughs in AI and

Netherlands, home to the world's leading chip equipment maker ASML, was one of the countries involved. On Jan. 1, ASML said the Dutch government had revoked an export licence covering the shipment of some of its equipment to China.

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ASML's most sophisticated machines - extreme ultraviolet "EUV" lithography machines - are already restricted and have never been shipped to China.

New U.S. export bans in October then stopped ASML from even sending older models of its DUV semiconductor equipment to China.

China was ASML's biggest market in the third quarter of 2023, and responsible for 46% of the company's sales.

"We are deeply concerned by the direct involvement of the United States in interfering with the export of lithography machines by Dutch companies to China," Shu Jueting, a commerce ministry spokesperson, said at a press conference on Thursday.

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"China firmly opposes the U.S. instrumentalising and weaponising export control issues, and even wantonly interfering in normal trade... we urge the Dutch side to respect the spirit of the contract," she added.

Commerce Minister Wang's discussion with Raimondo also highlights Beijing's concern at a U.S. Department of Commerce survey into how U.S. companies are sourcing so-called legacy chips - current-generation and mature-node semiconductors - as the department moves to award nearly $40 billion in subsidies for semiconductor chips manufacturing.

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Feedback

The department said the survey aims to reduce national security risks posed by China and will focus on the use and sourcing of Chinese-manufactured legacy chips in the supply chains of critical U.S. industries.

Wang and Raimondo also discussed the boundary between national security concerns and trade and economic cooperation, China's commerce ministry said.

Additional reporting by Eduardo Baptista and Liz Lee; Editing by Muralikumar Anantharaman and Angus MacSwan

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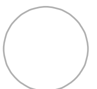

Joe Cash
Thomson Reuters

Joe Cash reports on China's economic affairs, covering domestic fiscal and monetary policy, key economic indicators, trade relations, and China's growing engagement with developing countries. Before joining Reuters, he worked on UK and EU trade policy across the Asia-Pacific region. Joe studied Chinese at the University of Oxford and is a Mandarin speaker.

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TRADE AND GEOPOLITICS

Supply chains are moving away from China. The reasons are more complex than you think.

Association of Foreign Press Correspondents in the United States

Henry Storey

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Published 12 December 2023

The displacement of China from US supply chains is a perceptible and growing phenomenon, but this shift is in no way evidence of direct decoupling. Instead, a reconfiguration of global supply chains is taking place, says Hinrich Foundation contributor Henry Storey in this interview with the Association of Foreign Press Correspondents-USA.

Evolving global trade and supply chains have made the movement of supply chains away from China to countries like Vietnam and Mexico a topic of growing significance. This shift is influenced by a complex interplay of factors, ranging from economic considerations to geopolitical tensions. To delve deeper into the

intricacies of this transformation, we turn to insights provided by **Henry Storey**, a senior analyst at Dragoman, a Melbourne-based political risk consultancy.

According to Storey, it is essential to understand that this shift is not a wholesale displacement of China but a dynamic reconfiguration of global supply chains. The reconfiguration is driven by a combination of economic and geopolitical factors, offering companies diverse options to optimize their supply chains. The initial driving force behind supply chains moving out of China was China's rising labor costs, particularly in labor-intensive and cost-sensitive industries like textiles. However, geopolitical factors started to play a more explicit role from 2018, with the imposition of tariffs on Chinese exports by former US President Trump and growing concerns about geopolitical conflicts.

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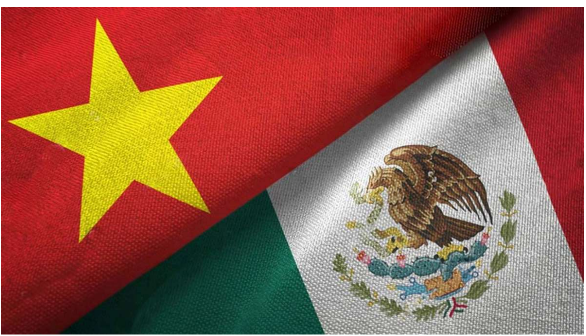

Mexico and Vietnam's role in global supply chain reshuffle

Henry Storey
26 September 2023

While the reconfiguration is significant, it doesn't signify direct "decoupling." Instead, China's role in global supply chains is evolving, enabling this reconfiguration. This process has been facilitated by an increase in Chinese exports and investment. Importantly, Storey notes that Chinese businesses are adapting by relocating and optimizing their operations, reducing costs in the process.

This conversation has been condensed and edited for clarity.

Can you elaborate on the key factors driving supply chains out of China and towards countries like Vietnam and Mexico? How much of this shift is due to geopolitical tensions, and how much is motivated by economic factors?

Supply chains for some of the most labor-intensive and cost sensitive industries like textiles have already been moving out of China since the mid-2010s. This shift

was almost purely driven by China's rising wages, which have eclipsed worker remuneration in Southeast Asia and countries like Bangladesh.

Then from 2018 more explicitly geopolitical factors started coming into play. The prime example here is former President Trump's imposition of tariffs on almost all Chinese exports. In the intervening years, COVID and escalating concerns over the possibility of conflict in the Taiwan Strait have catalysed a further imperative to "de-risk" supply chains.

The analysis mentions that while supply chains are shifting, it's not necessarily a wholesale displacement of China. Could you explain the nature of this reconfiguration and how it impacts the global supply chain network?

The displacement of China from US supply chains is undoubtedly a perceptible and growing phenomenon. China's share of US imports peaked at 21.6% in 2017, dropping to 16.7% by 2022, and to around 14.6% in the 12 months to July 2023. Concurrently, alternative production bases like Mexico, Vietnam and India have appreciably increased their shares of the US export market. This trend has been facilitated by growing US investment, particularly in Mexico.

However, this shift is in no way evidence of direct "decoupling". This supply chain reconfiguration has been enabled by growing volumes of Chinese exports and investment. Laura Alfaro and David Chor's August 2023 study shows a direct correlation between exports of Chinese goods and inputs to Mexico and Vietnam in categories where China has ostensibly lost US market share.

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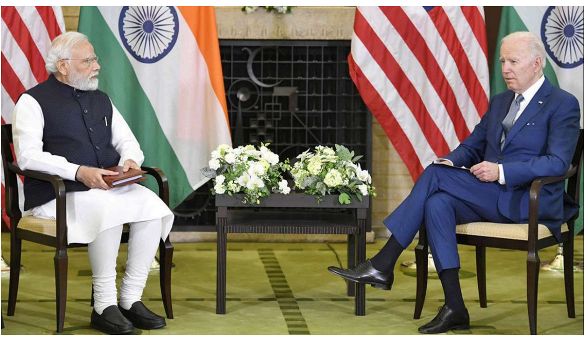

"A smaller planet": Friendshoring's poorer and less secure world

Shiro Armstrong
31 October 2023

Chinese businesses have also been able to reduce costs by relocating internally. Recent data released by research consultancy CEIC shows that since 2018, China's inland provinces have actually increased their global exports (though

not necessarily to the US) at a faster rate than Vietnam and Mexico.

Of course, for some goods related to the energy transition, especially those involving processed rare earths, the US has so far largely failed to even create an illusion of reduced reliance on China.

What impact have tariffs and sanctions, particularly those imposed by the United States, had on the movement of supply chains? How do these trade barriers influence the decision-making process for businesses?

When tariffs were first imposed and Trump's presidency looked to be on the ropes, many US businesses adopted a wait and see approach. President Biden's decision last year to retain tariffs on Chinese goods confirmed a more durable shift in Washington's economic zeitgeist.

When individual businesses decided that the tariffs were likely to be enduring, their effect was to considerably amplify China's already growing cost pressures, making the decision to relocate production easier. For businesses using China as an export base as well as selling to its vast domestic market, the decision was always going to be more complicated.

China's logistics network, dense clusters of suppliers, integration into global supply chains, and growing strengths in innovation and unparalleled pools of skilled labor, are other enduring advantages for export-orientated companies. Another factor is the huge range of direct and indirect subsidies e.g., preferential access to energy, land and utilities provided by local governments. These factors have helped to offset rising wage costs and tariffs.

The article mentions China's enduring reliance on the US consumer market. Could you provide insights into how this reliance affects China's economic strategy and trade relationships with other countries?

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The energy transition is a useful case study here to add to the Mexico and Vietnam examples. Tariffs on Chinese solar panels pre-dating the Trump presidency have long made direct

exports of Chinese solar panels to the US prohibitively expensive. Still, the US solar market has been too lucrative for Chinese companies to ignore. To bypass tariffs, Chinese solar manufacturers have built factories in Southeast Asia. There have also been more cynical instances of trans-shipment, with little if any value-add taking place in third-party countries.

When combined with tariffs, certain conditions of the Inflation Reduction Act (IRA) will greatly disadvantage the import of Chinese EVs and batteries. Chinese companies are thus targeting production in third countries which will benefit from the IRA through free trade agreements with the US, like Mexico and South Korea.

Impact of US labor laws on Vietnam's textile industry

Giang NT Nguyen
04 July 2023

In light of the supply chain reconfiguration, how is this affecting job markets and economies in Mexico, Vietnam, and China? Are there discernible winners and losers among these countries?

There are obviously many factors affecting manufacturing job markets in these countries, not least the worsening prevailing global macroeconomic conditions. Evidence is somewhat anecdotal.

With these caveats in mind, job markets in Mexican border cities like Tijuana, Juarez, and Monterrey do appear to be faring well. Skyrocketing demand for finite labor and land will hopefully also facilitate investment in areas further away from the US border.

Conversely, recent reports suggest Chinese labor hirers experiencing unusually quiet conditions, which have been partially attributed to supply chain reorientations.

Regarding the "friend-shoring" policy, what incentives or disincentives are governments offering to attract companies to relocate their operations? How effective has this policy been in practice?

Tariffs are evidently quite a potent disincentive which can induce companies to shift operations in more price sensitive and consumer-orientated sectors. Obviously this strategy is not without costs to consumers and also manufacturers e.g., through higher input costs. For the former, Alfaro and Chor estimate a 10% increase in Vietnam's unit price of imports associated with a 5% decrease in China's share of the US market.

Governments including Tokyo and Washington (the CHIPS Act makes US$500 million available for companies building facilities to support friendshoring) have offered direct incentives for relocating operations from China. These initiatives are probably too limited to have much of an effect.

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Friend-shoring battery supply chains

Akhil Ramesh
20 June 2023

Although not an incentive as such, the changing tenor of government conversations around economic security, deindustrialization, supply chains and industrial policy can no longer be ignored by boardrooms. Particularly when these concerns are echoed by suppliers and customers.

Defining success or effectiveness depends on the exact metric. Is the objective to increase economic security (a somewhat nebulous and subjective term), decouple, re-industrialize, build up alternative manufacturing hubs – or a combination of the above? The answer will vary at the company and sectoral level.

The analysis mentions that Mexico and Vietnam may need to develop greater indigenous value-adding capacity to remain competitive. How are these countries planning to enhance their value-added capabilities?

I can't speak to Mexico, but the Vietnamese leadership is acutely aware of the limits of its current growth model, which so far has mostly focused on final assembly with limited value-add. The fear is that market share will be eroded by other emerging economies. Operations may also be re-shored to Western countries and automated. The paradigmatic example of Vietnam's failure to develop greater indigenous value-added capacity is the fact that despite the Apple ecosystem's much vaunted investments in the country, not one Apple supplier is Vietnamese.

To evolve up the value chain, Vietnam has emphasized vocational and STEM education, and technology transfer in its economic planning. Hanoi has also lent on major investors like Samsung to cultivate local suppliers and promote local leadership. Efforts to get Samsung to invest in a semiconductor manufacturing plant have so far been unsuccessful.

Vietnam will face challenges that earlier export-orientated industrializers like Taiwan and South Korea did not. These include growing Western scepticism of offshoring, fierce mercantilist competition from China and greater difficulties in protecting local industry because of generally lower tariff rates compared to earlier eras.

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Darren Anderson
14 February 2023

Regarding the potential for future policy shifts, what are the risks for businesses that have already made substantial investments in relocating their supply chains?

An obvious risk is policy continuity. It is not inconceivable that the US will remove some tariffs on China. There were powerful voices in the Biden administration calling this to help reduce inflation and put a floor under bilateral relations.

There are also risks more specific to the IRA. Battery components and critical minerals sourced from a "foreign entity of concern" will eventually be ineligible for tax credits. The US has yet to define what exactly is meant by this. The eventual definition will have implications for Ford (among other companies), which has partnered with Chinese companies to source nickel from Indonesia.

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Why Prospect of US-China 'Decoupling' Is Getting Serious

Analysis by Brendan Murray and Ramsey Al-Rikabi | Bloomberg
June 22, 2023 at 4:47 a.m. EDT

For companies weighing a presence in China, concern about not being in the game has tended to eclipse the risk of being caught up in the country's geopolitical rivalry with the US. The benefits of access to China's vast, skilled workforce, modern logistics and low manufacturing costs helped to drive US-China trade to a record last year, even as the pandemic continued to disrupt industrial supply chains. Now, there are nascent signs that a "decoupling" of the world's economic superpowers, predicted during much of the past decade, is starting to happen. While US officials prefer to say they're "derisking" trade with China, the term describes a more targeted approach to the same phenomenon.

1. What's 'decoupling?'

The obvious analogy is to personal relationships — decoupling being the opposite of pairing up. But trading partners can break up, too. The UK did that with the European Union through Brexit. And sanctions on Moscow forced many countries to ditch Russian exports. With China and the US, decoupling isn't seen as an all-or-nothing proposition that ends in an abrupt divorce. Most experts say it will be a slow, steady reduction in their economic inter-dependence — China traditionally serving as the world's factory floor, the US its biggest consumption engine. Decoupling is seen as one reason why Chinese President Xi Jinping courted French President Emmanuel Macron in April, or why the US struck a deal with Japan for minerals needed to make electric vehicles.

2. What are the roots of 'decoupling?'

China joined the World Trade Organization in 2001, the heyday of enthusiasm for free markets. The US-China trading partnership, covering about $690 billion of goods last year, proved hugely beneficial to both sides and it has supercharged the global economy over the past two decades. But confidence in globalization started to subside with the shock of the 2008 financial crisis and the ascension in 2012 of Xi, who pushed to assert China as a top global power. Then Donald Trump rode his "Make America Great Again" slogan to the White House in 2017. He accused Beijing of unfair economic policies and launched a trade war, seeking to rebalance the US trade deficit with China with tariffs on Chinese products.

3. How have the tensions evolved?

Trump's successor, Joe Biden, has maintained a hard line on Beijing. His administration has attached urgency to cracking down on intellectual property theft by Chinese entities and shoring up national security with measures such as China-focused export controls and investment restrictions and by boosting access to critical minerals. A big objective of the US's Inflation Reduction Act, for instance, is to reel in China's market power over raw materials such as lithium, cobalt, nickel and magnesium — key ingredients for electric motors and batteries and other essential drivers of the green-energy transition. Biden's $50 billion CHIPS and Science Act aims to do something similar to reshore production of high-tech equipment, such as semiconductors, and includes new rules that restrict China's access to it. In an attempt to cool tensions, Biden's White House, echoing the language of the European Union, has taken to calling its strategy "derisking," rather than decoupling, a distinction that hasn't eased concern in Beijing. US Treasury Secretary Janet Yellen in April warned "a full separation of our economies would be disastrous for both countries."

4. What transactions are being affected?

The short answer: those on which tariffs and export controls are imposed. The Trump administration's tariffs on about two-thirds of imports from China are still in place, while Biden has targeted sales of advanced semiconductors and the tools to make them. The impacts of such moves can be unpredictable, rippling across industries beyond those targeted by the measures. For example, measures to curb Chinese access to military technology could hit production of washing machines as they contain chips also used in missiles. Chad Bown, a trade expert at the Peterson Institute for International Economics in Washington, recently spiced up the decoupling debate with new research showing how some US imports can decouple from China while others reach new highs. Chinese imports that were still subjected to 25% tariffs in 2022 — goods like semiconductors, IT hardware and some consumer electronics — were almost 25% lower than their pre-trade war levels, his research showed. On the flip side, goods without any Trump-era tariffs were 42% higher.

5. Is decoupling showing up in overall trade data?

It's hard to see tectonic shifts yet, but another dive into the weeds did unearth some evidence. According to a March report by the New York University Stern School of Business and parcel-delivery giant DHL, the US-China trade relationship is starting to show a "general pattern" of decoupling. This research said that in 2022, the share of imported Chinese goods as a percentage of total US imports fell to 16.6%, down from 21.6% in 2017 — the last year before Trump launched the trade war. The value of US goods exported to China in 2022 as a percentage of total US exports fell to 7.3% from 8.4% in 2017. The report concluded, though, that it's too soon to announce the end of globalization and a split of the world economy into rival blocs. It's more that globalization's myriad relationships are changing as some of the biggest economies move on to find other partners or invest in themselves.

6. What is driving the fragmentation, apart from US-China tensions?

Part of the trend is a reaction to the Covid-19 pandemic, and the way supplies of a single component could be disrupted, throwing into disarray lean supply chains spanning the globe and jamming up production of a host of finished products across multiple regions for months. As a result, companies are seeking more resilient supply chains — padded with more inventories or outfitted with better visibility — as well as a diversification of sources. For some big companies, that means making sure China isn't their only factory, or pulling out entirely, and setting up production in countries such as Vietnam, Mexico and Turkey. However, companies will find it difficult to replace the immense production capacity and relatively low costs that China offers.

7. Why is that?

For a company like Apple Inc., which has moved some assembly of its iPhones to India, China's workforce and production ecosystem are virtually irreplaceable. The country has hundreds of smaller suppliers feeding into mammoth assembly plants, giving Apple the scale and flexibility to respond to demand. Also consider a recent Financial Times article that laid out China's push to become an ocean shipping juggernaut, with an investment of at least $40 billion between 2016 and 2021 in coastal port infrastructure alone. China has 76 port terminals able to service ships carrying more than 14,000 20-foot containers, while potential rivals across South Asia have a combined 31, the paper said. So moving manufacturing away from China ultimately means higher costs for merchandise importers. "No country has built port infrastructure ahead of demand like China has, and thus the cost of re-sourcing — irrespective of where — will involve a transportation premium owing to comparable inefficiency of other countries' transport networks," Peter Tirschwell, vice president of maritime and trade at S&P Global Market Intelligence, wrote on Twitter. In other words, decoupling from China likely comes with costs for companies and, ultimately, consumers. The International Monetary Fund estimates the long-term cost to global output from economic fragmentation could be as high as 7%, an assessment that considers shocks including Brexit and Russia's invasion of Ukraine.

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