ECONOMIC DECOUPLING

Our new reality?

The Era of Fragmented Globalization
Assessing the Implications of a Potential US-Chinese Break-Up for Businesses and Policymakers

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Executive summary

Economic decoupling refers to the possibility that the United States and China could adopt very different standards and technologies, and rely on increasingly distinct and separate supply chains in the future. This would lead to an era of fragmented globalization, where two global but relatively independent systems coexist. In this scenario, the turbulences and disruptions we have witnessed since the beginning of the pandemic could become structural rather than temporary. Economic decoupling could ultimately challenge the way businesses grow, strategize, operate, allocate resources and hire across the globe.

The purpose of this White Paper is to define economic decoupling and to discuss its implications for business and for policy. After providing a definition and an overview of economic decoupling today, the paper offers a case study that explores how economic decoupling could challenge the way companies do business in five critical areas: supply chains, tech standards and business models, talent attraction and retention, business solutions and global legal frameworks. It then collects the insights of five experts on the lessons of the case study and the possible implications of economic decoupling for business and policy. The last section of the white paper offers recommendations for businesses and policymakers from the American Chamber of Commerce in France.

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INTRODUCTION: A LOOMING BREAK-UP?

China entered the World Trade Organization (WTO) in 2001. In the run-up to this, Western strategists and political figures, including then-US President Bill Clinton, believed that allowing China to join the organization was the best way to pressure Beijing to implement democratic reforms and to transform the country from within.

Two decades later, China's transformation is undeniable on the economic front, but certainly not on the political front. In addition, China's membership in the WTO has not alleviated tensions with Western countries and with the United States in particular. On the contrary, today, headlines about the possible break-up in the economic relationship between the United States and China are worrisome for business leaders. Many global stakeholders feel that Washington and Beijing are not playing the same game, having both different rules *and* time horizons in mind – making the potential for miscalculation and misunderstanding between the two world powers significant.

Furthermore, whereas technology could have once been a force of cooperation and convergence among great powers, pushing them to rely on a common set of tools and standards, it could now feed new political ambitions of independence and self-reliance. As global economies looking to digitalize and localize some of their activities, technology could become an enabler of the break-up rather than a hurdle.

This white paper explores the consequences that a US-Chinese breakup would have for business and for policy.

A CHANGING PARADIGM?

Over the past three decades, global economic interdependence, global market integration and global trade were considered to be three key features of globalization that allowed businesses to grow and thrive. According to the OECD, just before the beginning of the pandemic, 70% of international trade involved global value chains.[1] In addition, despite trade tensions between China and the United States that started under the Trump administration and that have continued under President Joe Biden, China remained the first non-American market for US exports (only behind Canada and Mexico) and the top exporter to the United States.[2] More generally, the WTO's forecasts suggest global trade has recovered faster from the pandemic dip than initially anticipated. Its growth rate will reach its pre-Covid-19 trend by the end of 2022, with world merchandise trade volume that will exceed its 2015 level by 20 to 25%.[3]

And yet, today, the notion that global economic interdependence and global market integration could generate dividends for a wide range of stakeholders everywhere is not as consensual among policymakers anymore. The pandemic did not create this situation, although it certainly accelerated it. As The Economist puts it, "governments everywhere are switching from the pursuit of efficiency to a new mantra of resilience and self-reliance."

In addition, policymakers are increasingly concerned with the political consequences of rising inequalities at home – especially after missing, for so long, important aspects about the drawbacks of globalization. They increasingly seem to believe that the benefits of globalization are not trickling down to vulnerable populations – and that time to fix the broken promises of globalization is running out. In doing so, they may privilege political options that may be economically costly, but that also fulfill non-financial and more identity-related aspirations – and are thus considered to be politically meaningful. In practice, these policymakers can opt for protectionist measures and economic favoritism over global economic cooperation, potentially undermining business opportunities worldwide. "The drive towards economic integration has now faded," argued a European Central Bank study before the pandemic, noting that after expanding "at approximately twice the rate of global GDP in the years leading up to the global financial crisis, the ratio of average imports to GDP growth (…) has fallen to around 1 since 2011."[4] By 2017, more than half of G20 countries exports were subject to harmful trade measures, compared to 20% in 2009 after the global recession.[5]

What is more, technologies making it easier for some sectors to digitalize, localize and simplify their productions processes could also accelerate worldwide economic break-up, in particular between the US and the Chinese economies. China is no longer interested in being the world's factory – and is not considered as such by the rest of the world. Short-term alternatives may have included outsourcing production to lower-cost economies in Southeast Asia. But these new technologies offer longer-term solutions leading to a complete restructuring of some industries. These technologies could also widen the gap between businesses and industries that have the ability to adapt and those that do not – further destabilizing the business environment of firms, including incumbent ones, that are ill-prepared for digital transformation. These changes have been in the works for some time, and the ongoing Covid-19 related health crisis did not create any new reality, but may have accelerated and exacerbated these transformations to the extent that they become insurmountable for some actors. The political implications of these transformations could, in turn, further feed the political distaste for globalization given its consequences on the home front.

Ultimately, the combination of a growing political preference for protectionism and the development of game-changing technologies that could limit the need for global economic integration could be fatal for globalization – or, at the very least, transform the globalization paradigm in an unprecedented way.

Should global actors decide, for political and strategic reasons (that technology and new societal realities can help rationalize) to willingly rely on distinct technologies and standards and on increasingly independent supply chains, they could dismantle the existing global economic system, foregoing the benefits of integration and synergies. This would lead us into an era of fragmented globalization, to a world dominated by at least two relatively disconnected but coexisting global systems.[6] It may not mean the end of globalization per se, given how entangled countries are, but it may limit the degree of economic interdependence among global powers.[7]

As a result, the bottlenecks and supply chain disruptions we have been witnessing since the beginning of the pandemic could become permanent rather than circumstantial. To this extent, these widely documented global disruptions would amount to a structural change in globalization rather than represent temporary turbulences.

THE ECONOMIC DECOUPLING SCENARIO

This risk of fragmentation that this white paper seeks to document is not meant to be an account of *the* future, but of *one* possible future – one in which economic decoupling, rather than economic integration, becomes our new global reality. This analysis is meant to help global actors hedge against the possibility of such fragmentation.

Economic decoupling as a policy risk for all stakeholders (including Europe)

In fact, this scenario is not predestined, and policymakers could have the ability to contain this risk. But they could also accelerate economic decoupling if they do not act with care.

There are confidence-building measures that Washington and Beijing could implement in order to decrease the likelihood of miscalculation and misunderstanding. For instance, the Biden administration is contemplating the idea of setting up a 'red phone' with Beijing, a move seen as reminiscent of the Cold War era. As the report states, "While the concept is still in its infancy and has yet to be formally raised with the Chinese, the Biden administration wants to develop a rapid communication tool that could be folded into a broader effort to reduce the risk of conflict between the US and China, according to a US official and another source familiar with early conversations about the device."[8]

Such a line of communication would play a key role in exchanging or conveying messages to China, especially when it comes to "urgent information [that] could be shared about sudden military movements or warning messages sent about cyber hacks."[9] Additional reports suggest this practice of semi-informal conversations among high-ranking military officials from both countries likely existed under the Trump administration.[10] All of this suggests that some officials on both sides of the Pacific may still believe in win-win opportunities at the global stage and in the value of compromise, though this may be at odds with the stated attitude of both nations' respective leaders at times. The most recent US-Chinese joint Glasgow declaration in November 2021 on enhancing climate action in the coming decade confirms this.[11]

Similarly, there are plenty of reasons to believe that European partners could seek to better manage their relationships with both the United States and China on terms that could be more equal than major headlines suggest – *if these Europeans partners so desire*. In fact, the relative strength of European nations in terms of trade and regulation may be indispensable to the United States as it seeks to contain the rise of China – making both sides of the Atlantic natural allies in this struggle.[12]

Indeed, there are plenty of opportunities for transatlantic partners to reinforce their relationship, especially when it comes to expanding trade relations and to developing compatible and international standards (especially technological standards), as the June 2021 creation of the EU-US Trade and Technology Council shows.[13] In the same vein, the volume of bilateral EU-Chinese trade points to interdependence rather than EU dependence on China, thereby limiting the harmful potential of aggressive trade policies.[14] In addition, China's investments in European hubs, most notably ports, makes Beijing a key actor on the continent – but one should not forget China's dependence on European partners, particularly given the persisting risk of expropriation.

Europe is also seeking to live up to its ambitions of strategic autonomy. A few weeks after the announcement by the G7 of the 'Build Back Better World' program, Europe announced the launch of its own program, 'A Globally Connected Europe,' which aims to counter the Chinese Belt and Road Initiative by linking Europe to the rest of the world through massive investments overseas.[15] The role of Europe is particularly striking here, as economic decoupling is often pictured in terms of a real struggle between Beijing and Washington, with Brussels a more ambivalent player. One might wonder: has the European Union been sidelined? Should its alignment with the United States be taken for granted, or should it instead be seen as an independent player? Or is it ultimately the referee of the US-Chinese rivalry?

These are difficult questions to answer, as current evidence is inconclusive. But the evidence does show that future policy choices in Washington, Beijing *and* Brussels could play a decisive role in determining if and to what extent economic decoupling becomes a reality. The possibility of economic decoupling presents a risk, but also comes with a wide range of unanswered questions the answers to which policymakers could shape - should they feel empowered to do so.

Economic decoupling as a risk for business

If economic decoupling does become a reality, it is difficult to imagine what firms could do to change its course.

An important reason for the current pandemic feels unprecedented to so many private actors is that the crisis does not result from economic imbalance (as past economic crises have) but rather from a set of politically-mandated lockdowns that were designed to limit mounting pressure on national healthcare systems. The decision to ease these restrictions may be science-based but may also be the result of social and economic pressure emanating from societies that can no longer bear the cost of lockdowns. Firms are economic actors that can lobby for change – but decisions taken in an unprecedented crisis, according to a political logic that may be hard to capture due to a lack of precedent, tend to place businesses in the position of being followers rather than leaders.

The economic consequences of this pandemic could turn out to be a warm-up exercise for economic decoupling, which if it occurs would be driven by political decisions rather than by temporary imbalances and disruptions. The translation of the US-Chinese rivalry in the field of business is, yet again, a powerful illustration of this issue. As the Chinese government cracks down on its tech giants, it is becoming increasingly challenging for these actors to continue to be listed on US stock markets.[16] Chinese tech IPOs may become increasingly rare in the future. Similarly, China's growing influence in Hong Kong is discouraging many global corporations, particularly US tech giants, to develop their activities in the region - especially given the impact of Chinese influence on freedom of speech.[17] Put differently, economic decoupling could first and foremost be about the changing calculus of governments and regulators. These actors may have a very specific political agenda that businesses will need to account for without having the ability to influence them.

Therefore, it is critical that businesses anticipate these potential changes, or, at the very least, consider opportunities to transform the way they do business in this changing landscape.

This white paper seeks to explore these dimensions and to help key actors, including businesses and policymakers, adjust to new global realities. Section 1 defines, documents and provides explanations for economic decoupling. Section 2 is a case study documenting how economic decoupling in challenging business-as-usual for a wide range of companies in a wide range of ways, including changing supply chains, evolving technology standards, new strategies for talent attraction and retention, geopolitical tensions and extraterritorial law, and the development of new business models and solutions. Section 3 concludes by offering policy options and recommendations for businesses and policymakers based on the case study and the expert insights of the previous chapter. This section also offers insights of a wide range of expert commentary on this case study.

SECTION 1:
WHAT IS ECONOMIC DECOUPLING?

Economic decoupling refers to a scenario in which the United States and China opt for divergent technologies and global trade standards, and rely on increasingly independent supply chains. In addition, whereas some may have once hoped that technology and the internet would help great powers and their populations converge towards a limited but common set of beliefs about the world, it is instead likely that growing independence between the United States and China would lead to an increasing divergence in their perspectives on world affairs and business. Economic decoupling, should it materialize, could considerably limit the degree of interdependence among global economies, in particular the United States and China – and thereby transform the very foundations of globalization as we have known it since the fall of the Berlin Wall in 1989.

Changing political strategies and geopolitical aspirations, as well as the emergence of technologies that make the digitalization and the localization of production processes possible, are all drivers of economic decoupling. They challenge global economic interdependence and integration, which were once key features of globalization, by questioning their relevance - especially in a post-pandemic world. They also question the role other major powers may have in this struggle, especially the European Union: will they need to pick sides, try to offer alternatives, or try to act as referees?

While there is nothing preordained about economic decoupling (should it materialize) this scenario would be a game-changing challenge for businesses and policymakers, creating a new global reality that they would need to prepare for, in particular if the turbulences and the disruptions caused by the pandemic were to become structural.

BACK TO NORMAL, SOON?

Investigating the drivers of economic decoupling may be a challenging task when the pandemic is still underway and when the temptation to believe that a return to normal is forthcoming – in particular if and when the imbalances the health crisis created can be solved in the short or medium run.

The evidence of recovery

Moreover, if these imbalances are surmountable, the possibility of economic decoupling could quickly reverse and the pressures on globalization could be short-lived. Evidence regarding economic growth, trade and economic integration prospects suggest that these imbalances are, in fact, surmountable.

The disruptions in global trade were nothing short of spectacular during the pandemic and could have lasting effects, as the current shipping container shortage shows. But the shortage is less the result of too few shipping containers in the world (especially as the three leading manufacturers that produce 80% of the world's vessels and who are all Chinese are boosting their productions) and more the consequence of these containers being in the wrong place. The pandemic therefore created a set of imbalances that disrupted global commerce but could just be temporary in nature as the international situation normalizes.[18] A crisis ending with the correction of the imbalance (that may have caused it) is, after all, a pattern that we are used to in global economics. In other words, the headlines about the Suez Canal being blocked accidentally by a 20,000-container cargo ship for six days may be more spectacular than the actual long-term consequences of disruption.

Recovering trade data and increasingly optimistic growth projections seem to point in the same direction. The OECD's September 2021 growth projections are more optimistic than those of December 2020 and suggest that G20 advanced economies could return to pre-pandemic output growth trends by the end of 2022.[19] Similarly, the DHL Global Connectedness Index 2020, which examines the state of globalization and the global and regional flows of trade, capital, information, and people, reaches this conclusion: while the pandemic has affected all four of the dimensions covered by the index, the international flow of people was the one hardest hit with a decline of 70% and may not recover before 2023 or 2024. However, when it comes to the state of globalization as a whole, the world's overall level of connectedness has not fallen below the level of the 2008-09 global financial crisis. In fact, the report argues, the disruptions caused by the pandemic notwithstanding, and with the notable exception of international people flows, the fundamental links that connect nations remain resilient, especially as trade and capital flows recover.[20]

In the same vein, the perception of European companies doing business in China is improving and is beating their expectations from the beginning of the pandemic. According to a survey conducted by the European and German Chambers of Commerce in China in February 2020, 50% of respondents expected year-on-year revenue declines and 0.5% expected revenue growth. But as a later report found, "contrary to those expectations, European companies in China found themselves in a resurgent market after production went back online far quicker than had been initially anticipated. Though y-o-y revenue shifts were the worst in a decade, 42% of respondents actually saw revenues increase in 2020."[21] The temptation to believe that actors have weathered the crisis is therefore significant.

Defining a 'new normal'

Nevertheless, the evidence that economic decoupling may become tomorrow's reality is not all circumstantial.

As the very same report on European businesses in China notes, "having successfully navigated those dark times, European companies are (...) preparing to shift strategies to address the coming storms. Contrary to the plans that members spoke about in the first quarter of 2020, to build resilience outside of China and into their global supply chains and to diversify into other markets, many now report that they are building resilience in China to secure their market position."[22]

A similar argument can be made about global trade. Though global trade has recovered faster than the international organization initially expected,[23] there are increasing preoccupations about what sustained trade tensions would do to global trade.[24] Even before the pandemic, the notion that global trade could have reached a hard-to-break plateau at barely more than 60% of global GDP was a source of preoccupations among global experts.[25] More broadly, multilateralism has lost momentum in recent years given the difficulty of the World Trade Organization to function, in particular because the Trump administration refused to name new judges to the organization's appellate body, and given the rise of bilateral agreements to the detriment of the development of global standards.

The evidence suggests that structural transformations that are also changing globalization as we know it and that may challenge the resilience of global flows in the future. This would mean a fundamentally different business environment in the future. Rather than "back to normal", globalization may shift durably and structurally to a new normal as a result of a wide range of forces, most notably economic decoupling.

ECONOMIC DECOUPLING AS A POTENTIAL 'NEW NORMAL'

The combination of a changing geopolitical landscape and technological transformations is shaping this new normal and is making economic decoupling a growing possibility rather than an improbable future.

A changing geopolitical landscape

Economic decoupling could be the result of a very long-term process that may currently unravel in a US-Chinese breakup. The pandemic is, on paper, unrelated to this breakup, but may accelerate its consequences.

From 'Chimerica' to economic decoupling

This process started with a significant degree of integration of the US and Chinese economies and is ending with the break-up that we may be currently witnessing. In fact, the terms of the US-Chinese relationship have profoundly evolved over the past two decades. Until 2008, it was hard to separate the US from China, given the condominium they formed - which British historian Niall Ferguson called Chimerica.[26] China was the global factory while the US was the global tech headquarters of the world.[27]

This global division of labor did not last into the 2010s. Depending on which side of the Pacific you stand; you may have a very different narrative of what happened in the 2010s.

In China, the view is that there was a political choice on the part of the United States in particular to turn nationalist and to resort to protectionist policies. Chimerica was always an unequal relationship that transcended economics and trade.[28] That made it a complex relationship to manage. The election of Donald Trump made Chimerica almost impossible to sustain.[29] The fact that the Biden administration promised Beijing would face "extreme competition" from the United States and its allies,[30] and extended US-Chinese competition to realms beyond trade to include technology (artificial intelligence and quantum computing in particular) and geopolitical influence, put a definitive end to the whole notion of Chimerica.[31] China cannot find a partner in Washington when both sides of the American political aisle increasingly view globalization as a zero-sum game, especially when it comes to dealing with Beijing. In this context, room for compromise in Washington is hard to find.[32]

In the West, the story is somewhat different: as one seminal piece shows, competition from Chinese imported goods affected manufacturing employment, triggered a decline in real wages and caused a decline of household earnings – what is now commonly referred to as the 'China Shock'.[33] The piece concludes: "The consequences of China trade for US employment, household income, and government benefit programs may contribute to public ambivalence toward globalization and specific anxiety about increasing trade with China."[34] In addition, on both sides of the Pacific, the virtues of economic and technological interdependence seem to lose their attraction. An increasing number of countries beyond the United States view their relationship with Beijing through the prism of rivalries that sometimes extend to cyberspace and even outer space.[35]

Regardless of the narrative one opts for to explain the end of Chimerica, the breakdown in the US-Chinese relationship is increasing political tensions and shaping the reactions of the two key stakeholders in profound ways. This is not only about the US blocking semiconductor exports to China and China limiting US access to rare earth minerals. It is about how the two economic superpowers are perceiving the limits of their engagement with one another.

Donald Trump's 2020 electoral loss notwithstanding, the notion that globalization is a zero-sum game is increasingly prevalent in Washington. The once mainstream belief that the dividends of globalization would one day trickle down to the American middle classes, including those who suffered from the most significant effects of economic competition of China, is defunct. Today, the pervasive sense is rather that Washington is out of time and needs to act fast on this front. Observers suggesting that these decisions could prove to be economically costly may be missing part of the point: these calculations are also political in nature and embed the fear of social demotion that middle classes in America and beyond have been expressing since 2016 at the very least – even if it undermines the sense of shared economic destiny that was once so central to the previous paradigm of globalization.

Beijing is also looking to limit its own dependence on the rest of the world. With its 2015 *Made in China* strategy, China is looking to move away from its *world factory* role by upgrading its manufacturing capabilities and betting on a more technology-intensive strategy (as opposed to the previous, a labor-intensive one). Its goal was to reduce independence on foreign producers by increasing the

Chinese-domestic content of core materials to 40 percent by 2020 and 70 percent by 2025 means reducing its dependence on the rest of the world. In 2020, Beijing further detailed this approach by offering the concept of 'internal circulation,' or as one observer put it, "the domestic cycle of production, distribution, and consumption - for its development, supported by innovation and upgrades in the economy."[36]

Economic integration and interdependence are therefore no longer fashionable in any of the narratives about globalization in the US or in China – and may further feed a breakup in the future, by also making it financial. Though there is, for now, no real sign of financial decoupling, since China is still fully integrated in the global financial system, US foreign direct investments to China never recovered their 2008 record and Chinese foreign direct investments to the United States have been declining since 2016.[37] Further tensions could lead on the US side to increasing reliance on bans on certain technologies, on sanctions and on export restrictions, including through extraterritorial laws suggest that politics and technology could play a significant role in the movement of decoupling. The 2020 Chinese export control law also suggests that Beijing is ready to use similar tools as Washington.[38]

This will also have for businesses that may have questions about where to build resilience: at a global scale, or inside China. In fact, a sign of economic decoupling concerns supply chains that may shorten in the future. Prior to the pandemic, a global supply chain was a meaningful way to leverage comparative advantages of each point of the globe (and thereby to reduce costs), and to diversify risk. Today, this logic seems less fashionable among some actors that see in global supply chains a risk of overextension and over-dependence on some countries - China in particular.[39] For example, microchip manufacturer Intel is seeking self-sufficiency by reducing its dependence on China, with the blessing of the ex-Trump administration.[40] More local supply chains may become part of tomorrow's reality, the effects that this has on consumer wallets notwithstanding. Localization would entail more redundancy costs that may affect prices in a way typical consumer-electors may not necessarily anticipate when championing more local production.

Taken together, these elements could serve as the terms of a US-Chinese divorce in a way that would be, if not final, at least durable – thereby making economic decoupling a structural feature of the global business environment.

The COVID-19 health crisis as a (geo)political accelerator

The instigators of this break-up, which results from growing distrust and increasing difficulties to promote cooperation across the Pacific, may have found an additional rationale with the pandemic. By reminding a wide range of global actors that cooperation and trust is more of an exception than a rule in international relations, the pandemic may have accelerated the unraveling of Chimerica as it accelerated the technological transformations we are currently experiencing. The concomitance of these changes may be coincidental in theory, but are all interrelated in practice.

In fact, issues with vaccine rollouts across the globe are a telling example of how rivalries, not cooperation, can get the upper hand in the times of crisis. The decision of the G7 to distribute one billion doses of vaccines worldwide obfuscate the absence of any real coordination among nations beforehand – the efforts of the World Health Organization in this respect being far too modest and lacking the support needed to be meaningful.

Vaccine nationalism was the rule rather than the exception. Developed economies on both sides of the Atlantic failed to find a compromise to suspend patents on Covid-19 vaccines. In addition, many countries favored their own population regardless of the global consequences of a slower vaccine rollout – with all of the costs this entailed.[41] In the US, the vaccine strategy resembled, in many ways, an America First approach. In India and in the European Union, authorities placed restrictions on vaccine exports. The ability of the international community to accelerate the production and the distribution of doses, with the aim of better coordination and of getting ahead of mutations – that is, the ability of the international community to guarantee the OECD's upside scenario – still remains to be proven. The fact that this issue is still an open question at this stage of a global pandemic suggests that current geopolitical tensions are not just circumstantial but rather durable realities of the business environment. Such lack of coordination can further exacerbate economic decoupling.

The pandemic has also underscored the potential for lasting geopolitical tensions and pressure from supply chain choke points to converge and compound the long-term effects of global disruption. Taiwan, and its Taiwan Semiconductor Manufacturing Company (TSMC), is a case in point. The island has always sought to remain neutral in the power struggle opposing the United States and China. Yet, because TSMC plays such a key economic role - it controls more than 50% of the global semiconductor foundry market and as its assets and human resources are, for the large part, based on the island - Taiwan remains a critical link in the global supply chain of microchips. This makes TSMC a critical partner for China, which has stated that an uninterrupted supply of high-end chips is a national security matter for Beijing. It also makes TSMC a critical partner for the United States, whose tech companies, Apple especially, depend on in order to continue their operations. This places Taiwan in a position of bargaining strength to the extent it can balance out the interests of China and the United States. But it also makes the island vulnerable if geopolitical tensions were to continue to escalate, given the ramification any further disruption in the microchip supply chain could have for both powers and the world economy at large.

Whereas one could have legitimately expected global actors to refrain from geopolitical undertakings that could disrupt the global economy – a constraint imposed on actors that political commentator Thomas Friedman once called the 'golden straitjacket'[42] – new geopolitical aspirations and political calculus could challenge the way globalization works in the future. In fact, resurgent geopolitical tensions, as well as increased preferences for protectionism and for economic favoritism, which both offer far more political mileage in domestic contexts that can be very unstable, are also forces shaping the business environment. Lack of coordination – as well as a high potential for miscalculation – can amplify economic decoupling if such central pieces of the global economic puzzle become the target of geopolitical rivalries.

A changing technological landscape

It is not rare for technology to be at odds with geopolitics, as the first often relies on cooperation when the second often leads to rivalry. But in the case of economic decoupling, instead of creating hurdles, technology may accelerate a process initiated by geopolitics.

The Fourth Industrial Revolution comes to age

In fact, structural tech trends are shaping the business environment and are transforming production processes by making them simpler, more local and more digitalized – under the effects of what many business commentators now refer to as the Fourth Industrial Revolution. These trends are important not only because they could accelerate economic decoupling, but also because they suggest that economic decoupling may not only be politically driven. It may also be driven by technological change, a factor that may already be out of the hands of any single actor as it becomes a global reality – unless policymakers wish to say differently, through legislation (and in that case, incentives may differ greatly across countries).

In practice, the underpinning technologies of the Fourth Industrial Revolution, like 3D-printing, smart sensors and the Internet of Things, have allowed for a more effective organization of resources and for more decentralization. This new revolution may limit the need for internationalization of supply chains. It is also likely to accelerate technological change - automation in particular - further weakening ill-adapted industries and low-skilled workers, and further pushing the notion that globalization is a zero-sum game. The pandemic and subsequent health crisis may accelerate the effects of the Fourth Industrial Revolution. It is remarkable, in fact, that they have mainly increased geopolitical tensions between China and the rest of the world and have given a decisive strategic advantage to economic sectors that had already begun their digital transformation. To this extent, the pandemic has been more of an accelerator, favoring sectors that have already adopted technologies of the Fourth Industrial Revolution.

The rise of fragmented internet

Similarly, instead of unifying the internet and making it easier for people to connect, technology has made it easier for the 'splinternet'[43] to emerge. The splinternet is a fragmented internet, and more broadly, a fragmented media ecosystem, in which all global actors do not have access to the same information and networks – like when the UK regulator revoked China Global Television Network's TV license, leading China to ban BBC World News in retaliation,[44] or when the social media company LinkedIn decides to close down its application in China after a censorship controversy and launch a new job boards application as a replacement.

Some studies have also shown how social media can play the role of echo chambers comforting people in what they already think, rather than exposing them to contrarian views. As a result, the internet and social media could be driving people apart, rather than lead to converging views.

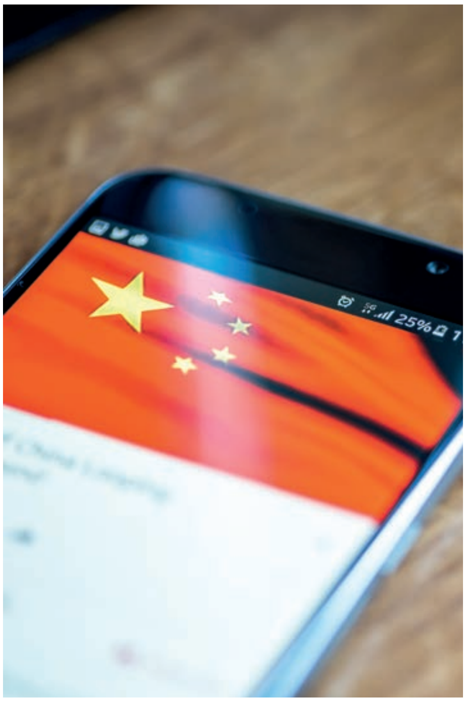
This may have long-term effects on globalization: if economic actors do not have access to, and thus, do not rely on the same information to make decisions, different sets of logic and strategic decision-making processes could emerge as a result. This could, in turn, accelerate the process of economic decoupling.

Distinct standards and technologies

Finally, technological transformations have also been widely influenced by political decisions, as public authorities have willfully chosen to adopt different technologies and standards across the globe.

Two instances suggest that global powerhouses may not rely on the same technological tools and standards in the future. The first is the so-called Great Firewall in China, which has undermined the ability of non-Chinese tech companies to penetrate the market. The second is the example of 5G technology and the deliberate choice on the part of the United States (and other European governments) to exclude Chinese technology from their network.[45]

The question of the degree of interoperability between standards and technologies is still open, but such interoperability would probably depend on the very political will that deliberately initiated this differentiation of technologies and standards in the first place. As a result, the possibility of the coexistence of at least two independent global systems is real, especially as each global power, including the EU, has ambitions to be a norm setter in a wide range of technological sectors and to impose its own standards to the International Organization for Standardization.



The fact that the pandemic has accelerated the digital transformation of societies and companies is widely accepted. However, the evidence also suggest that technological change could be driving economic decoupling beyond the pandemic, in a way that would have occurred even without a public health crisis.

ASSESSING THE RISK FOR BUSINESS AND POLICY

As of today, organizing decoupling is very challenging, given how interdependent global supply chains are and given the costs this would represent for economies already hard-hit by the recession. But in the longer run, the influence of political, geopolitical and technological factors may shift the cost-benefit analysis of both policymakers and businesses. This shift of calculus and the decisions that may result from it in business and policymaking circles may take some time, but could be a key feature of the coming business environment if these trends persist. However, they may not affect all industries in the same way.

In fact, suggesting that we are at crossroads when it comes to global decoupling can most certainly feel like a cliché in discussions about the state of the world. Yet, the uncertainty surrounding the future of the business environment illustrates the wide range of scenarios that may lie ahead. This uncertainty is particularly telling when it comes to the success of vaccine rollouts, the future of the global economy and its ability to rebound, the ability of leaders to contain global tensions, the ability of policymakers to find meaningful solutions that transcend ideological divides and that reduce inequalities, and finally the ability for business and public investments to build resilience.[46] Similarly, this uncertainty is also compounded by the perception that the two main stakeholders of economic decoupling, Washington and Beijing, may not be playing the global game according to the same rules and with the same time horizon in mind.

There is a window of opportunity to act for both policymakers on both sides. The need to better coordinate policies, especially given the potential for misunderstandings and miscommunication, is critical. The precedent of the international coalition to fight piracy off the coast of Somalia may be an interesting one: the response to a major source of disruption for global commerce involved a very wide range of countries and institutions, including the United States, the European Union and China. This collective response effectively contained the threat and could one day serve as a blueprint to organize an international effort in the wake of a threat to the free circulation of goods in particular – *if*, that is, global policymakers have the political capital and the will to act.

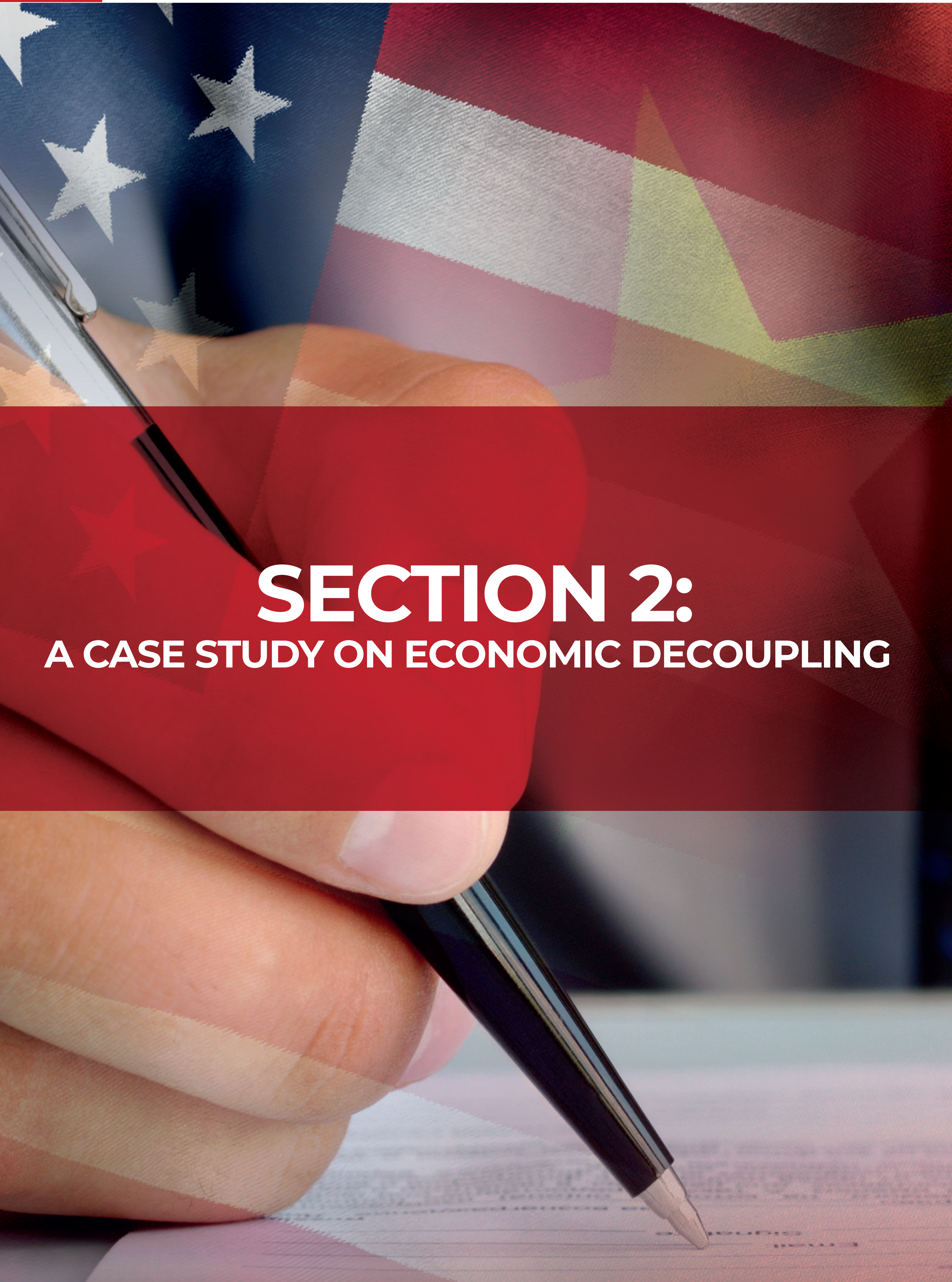
This is why this window of opportunity may be narrow. The response to the pandemic suggests this is an open question and that the hurdles for global cooperation are significant. Yet, there are arguably a number of realms in which the incentives for China and the United States to cooperate are significant, especially when it comes to climate change.

This is also why the corporate world needs to pay particular attention to these developments, as they could shape the future contours of globalization, as well as those of their busine same time, there are a set of tools, business practices and new r can also designate a changing set of opportunities that business

ss environment. There are broad, strategic variables that many businesses may believe they cannot influence. But, at the models that could help them prepare for this changing landscape. Economic decoupling need not be only about risks – it ses will need to seize.

This section has shown how the combination of a possible US-Chinese divorce, renewed geopolitical tensions worldwide in the context of the pandemic in particular and an acceleration of technological change makes economic decoupling a growing possibility rather than an improbable future.

The next section is a case study that explores five aspects of how economic decoupling could affect businesses.



SECTION 2:
A CASE STUDY ON ECONOMIC DECOUPLING

In order to document the evidence that economic decoupling is a plausible scenario for our future, this white book presents a case study that explores five aspects of economic decoupling, namely: 1. *changing supply chains*, 2. *diverging tech standards*, 3. *shifting approaches to talent attraction and retention*, 4. *increasing geopolitical tensions and the continuous reliance on extraterritorial law in global politics*, 5. *the development of new business models and solutions*. In doing so, it documents the potential effects of economic decoupling on business and policy.

THE FIVE DIMENSIONS OF ECONOMIC DECOUPLING:

1. Transforming Supply Chains

The Covid-19 health crisis disrupted global supply chains and challenged their relevance in a way that could accelerate economic decoupling. In June 2021, a McKinsey Global survey of business leaders found that supply-chain disruption had become a top risk for growth, ahead of weak customer demand.[47]

Limiting overextension and overdependence

At the beginning of the pandemic, there were genuine concerns about the effects of a supply-shock recession resulting from broken supply-chains. According to data from Resilinc, a company specialized in supply-chain-mapping and risk-monitoring, the world's largest 1,000 businesses and their suppliers owned 12,000 facilities in quarantined areas.[48]

In addition, the supply chain disruptions caused by the lockdowns showed the degree to which strategic industries like tech, appliance and car manufacturers, and the pharmaceutical industry excessively depended on critical chokepoints (most notably in China) to operate and for critical components and materials. This overdependence could make companies far more vulnerable to any specific disruption (due to a pandemic or any other disruptive event) along their global supply chains.

In practice, it is somewhat difficult to overstate the risk of overdependence on some critical regions in times of disruption. Two experts quoted in the Financial Times suggested this could become a significant problem for a company like Apple. Don Yew, an analyst at Morningstar Singapore, argued that "Since the top provinces in terms of infections include Zhejiang, Guangdong and Henan, which are so important for tech manufacturing, there obviously is a big problem." He added: "This episode is going to make it even clearer to Apple that there is over concentration in China, and they may want to address that." Nick Vyas, an expert on global supply chain management at the University of Southern California Marshall School of Business, also argued that "this outbreak will force them to factor the cost of failure into their calculation, and might well strengthen the case for more onshore or near-shore operations."[49] This overdependence could justify reshoring, or, at the very least, the creation of redundancies that strengthen the resilience and security of supply chains, even if that could mean sacrificing some degree of efficiency and optimization in the short run.

It is worth emphasizing the fact that these risks of overextension and overdependence are not new preoccupations. The combination of political (and protectionist) motivations and technological innovations (including digitalization, 3D printing and other Fourth Industrial Revolution innovations) were already at work before the pandemic, transforming supply chains. In some cases, these transformations were driven by efficiency motivations: even prior to the pandemic, *The Economist* argued that supply chains were becoming shorter, smarter and faster before politicians started taking a hammer to the trading system.[50] Technologies such as artificial intelligence and 3D printing were helping global companies look for new sources of efficiency, leading them to modify and adjust their supply chains to rapidly changing consumer preferences and the rise of e-commerce. It is also worth noting that concerns regarding the environmental impact of global supply chains were also shaping the debate over the risks of overextension before the pandemic even occurred. Finally, during the pandemic, reshoring helped some actors overcome the shortage in semiconductors industry by strengthening regional production capacities.

Global supply chains still work though

> ***Ultimately, decisions on supply chains are made according to fundamentals like production costs and access to large markets like China. Most of those factors haven't changed.***

Alan Beattie, "Coronavirus-Induced 'Reshoring' Is Not Happening,"
Financial Times, September 30, 2020[51]

And yet, the argument in favor of global supply chains remains straightforward and mainstream, despite initial calls for reshoring: Global supply chains help firms lower costs by diversifying risk and by benefiting from the comparative advantages of all of the countries it produces or does business in. This is what guarantees low costs and low prices for consumers who would pay the price of any form of deglobalization, ultimately (including if it comes in the form of a hidden tax). This is also what makes supply chains resilient.[52] To the extent that the current recession resulted from government-imposed lockdowns rather than from poor economic fundamentals or global imbalances, the most recent set of disruptions could just be temporary until public authorities can relax health measures and firms can readjust and reallocate resources.[53]

In fact, during the pandemic, global and diversified supply chains were instrumental in helping some companies quickly adjust and address unforeseen challenges. For example, pharmaceutical giant Johnson & Johnson's global supply chain enabled it to prevent shortages in medicine, the fact that they need to travel through different continents before reaching the final patient notwithstanding. The diversification of manufacturing capacity, combined with global free flow of medical goods and regulatory harmonization, can all contribute to making global supply chains more resilient and allow firms like Johnson & Johnson to operate in spite of shocks like the pandemic. The reverse, namely economic decoupling and reshoring, would affect the efficiency of global supply chains and the dividends of the supply chain internationalization process that has occurred over the past two decades.

Furthermore, reshoring and redundancy are arguably more of a political and media fad than the expression of a need grounded in business reality: By relying on new technologies that could make them more agile instead of sacrificing efficiency for supposedly less risk, firms could readjust their supply chains and look beyond the pandemic by getting geared up for future global challenges including increased digitalization, climate change and geopolitical tensions.[54]

In practice, Ernst & Young, a consulting company, found in a December 2020 survey that while 83 percent of business leaders were considering bringing manufacturing services back to Europe in May 2020, the proportion had dropped to 37 percent by the end of the year.[55]

Making sense of a complex environment

In the end, there are three options for companies: (a) keeping their supply chains global while strengthening them, (b) nearshoring or reshoring in order to limit the risks of overextension and (c) creating redundancies in order to limit the risk of overdependence.

(a) Keeping supply chains global while strengthening them

The first option is arguably the mainstream business option for businesses today: Firms now have plenty of options at their disposal to improve the overall resilience of global supply chains without shortening them and without betting on self-reliance. These include better network mapping and better communication inside the company to identify key gaps and conduct due diligence to shield companies from legal issues that may result from disruptions.[56] Other measures include early warning signals to monitor inventories of critical goods, like food and components. Digitalization tools can help make supply chains more efficient and smarter by increasing predictability and transparency and by helping firms better manage their inventory. In fact, a set of innovations would also help strengthen the resilience of global supply chains. A French startup, Shippeo, offers firms real-time visibility over their global shipments, thereby helping them manage their inventories more effectively and adjust to unexpected delays. More broadly, increasing automation in manufacturing and in warehouses may lessen dependence on manual labor and help firms better manage the effects of disease outbreaks. Similarly, the development of autonomous last-mile delivery options can also lessen the impact of disruptions that forbid people from moving around. In 2019, supply chain technology startups received more than $15 billion in investments.[57] But some firms and some industries may still be very much behind when it comes to these kinds of investments.

The two other options are at odds with business and economic orthodoxy, but have gained traction in recent years - and in particular in the aftermath of the pandemic, as shown by US President Biden's executive order on supply chains.[58]

(b) Nearshoring or reshoring

In practice, decoupling from China and reshoring manufacturing, or outsourcing production to more reliable allies, can help reduce the vulnerabilities that result from overextension, even if it would potentially increase production costs. This would require substantial efforts on the part of universities to train and retain talents in critical commercial-sector technologies like AI, robotics and quantum computing, and on the part of public authorities to help industries decouple from China through tax incentives.[59] In addition, it is striking that the cost of global supply chains may also be underestimated if they do not embed the price of carbon, which companies may need to account for in the future. By domesticating supply chains, this argument goes, companies will be able to better contain the risks of overextension and overdependence, and the risk of increasing carbon prices – risks that we may have otherwise underestimated.

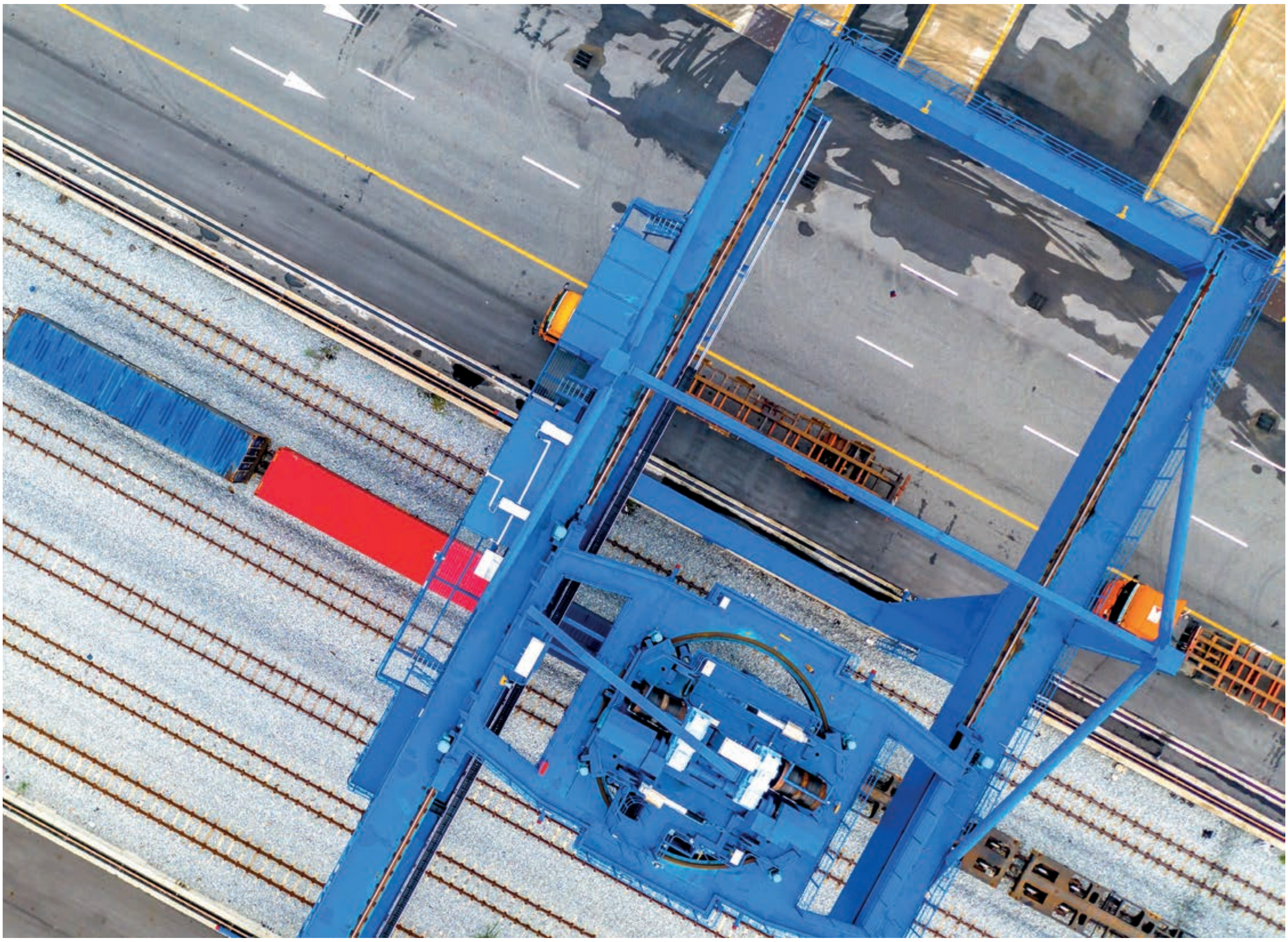
(c) Creating redundancies

An approach based on creating redundancies underscores the limits of just-in-time supply chains that were previously very popular in business circles but failed to avoid the types of shortages that continue to affect industries like computing and cars.[60] Creating redundancies may seem less extreme and closer to mainstream business arguments, but it may entail trading off efficiency for security. When a firm's supplier is hit by a natural disaster, its sales growth can drop on average by two to three percentage points. This shock can spillover to other suppliers and substantially increase the effects of the initial shock.[61] This is why relying on one supplier is usually considered extremely risky, but managers rely on this practice in order to secure supply or meet their cost targets. However, they sometimes depend on suppliers that they don't deal with directly, creating risks that are not necessarily visible before disruptions.[62] Increasing the number of suppliers and the size of inventories may lead to less efficiency but will also improve the overall resilience and reliability of global supply chains by limiting the impact of significant events that would have otherwise crippled global manufacturing processes.

Redundancy would require companies to rely on multiple production facilities and suppliers and to have back-up options and larger inventories in case a country they depend on suffers a natural disaster or is hit with tariffs.[63] Upstream companies that rely on China are a good example. J. Stewart Black of INSEAD and Allen J. Morrison of Arizona State University's Thunderbird School of Global Management have labeled this approach the 'China +1' strategy. They provide the example of F-tech, a company that had "a brake pedal factory in Wuhan that supplied Honda's final assembly operations in both China and Japan, also had a sister plant in the Philippines that primarily supplied Honda production facilities in Canada and the United States. When the coronavirus hit Wuhan and F-tech had to shut down the factory, its China + 1 strategy allowed it to increase output in the Philippines to partially supply Honda's demand in Japan until the factory in Wuhan could get up and running again."[64]

Redundancy would also require public authorities to further develop strategic stockpiles of a wider array of goods, such as protective equipment, pharmaceuticals,[65] minerals for advanced technologies and key components for everyday appliances and vehicles.[66] If relying on more suppliers is not possible, it may also help to increase sources of data to monitor inventories and to identify risks that may not be initially visible.[67]

The first option seems to remain consensual in business circles, while the last two options were especially popular in political circles and in front page headlines. Where companies place the cursor in a post-pandemic world depends on both political and business forces. This question is likely to be a critical one: A 2020 McKinsey report finds that on average, "companies can now expect supply chain disruptions lasting a month or longer to occur every 3.7 years, and the most severe events take a major financial toll." The effects on supply chains of exogenous events will not be limited to Covid-19.[68]



2. Adapting to Different Standards, Business Models and Technologies

Technological convergence has arguably been one of the most significant drivers of globalization, allowing for market and supply chain integration through the adoption of common tools and common standards.[69] Yet, under political pressure of regulators, countries are starting to adopt different technological standards when it comes to health or telecommunications. They may also adopt different standards when it comes to vaccine passports in the future, limiting the extent to which travelers and workers can freely circulate. This requires businesses to adapt their business models to the specificities of each theater or region of operations, which can not only be costly, but also hard to achieve when politics interferes and ultimately picks (domestic) winners and (foreign) losers. As a result, technological divergence is a driver of economic decoupling.

The emergence of different tech standards

The recent battle over the equipment provider that developed economies will choose for 5G technology is an illustration of how far technological divergence can take us. Huawei, a Chinese firm that is a leader in this market, drew heavy criticism from US officials because of its alleged ties with the Chinese government. The 2017 National Intelligence Law in China states that Chinese citizens have the duty to help China's intelligence efforts, potentially blurring the line between the state and private companies like Huawei.[70] More so, cyber experts and authorities have flagged safety concerns related to granting a foreign firm potentially unchecked access to core networks.[71] There has also been speculation about Huawei and other Chinese equipment producers inserting backdoors into their products, potentially making it easier for them to have access to sensitive data.[72] This battle has sparked, at times, surprising reactions, including on the part of the United States. The Trump administration reportedly explored options for the US government to buy a major telecom provider in order to compete with Huawei – or, at the very least, to push an American telecom provider or private equity firm to bid for Nokia or Ericsson.[73] These ideas have obvious diplomatic ramifications for transatlantic relations, as EU members have adopted different stances on their relationship to Huawei, some of which did not follow the US's recommendation to reject the Chinese firm's services.[74] There have also been legal accusations leading Meng Wanzhou, the chief financial officer of the firm, to be arrested in Canada for a potential extradition to the United States – a move that prompted Chinese officials to arrest two Canadians in apparent retaliation.

Ultimately, this technological battle is obviously not happening in a political vacuum – and it may be as (or more) political in nature than it is technical. It may also feed itself by creating precedents in the mind of business leaders and by giving them incentives to avoid doing business in 'the other region' given the regulatory and political risks this can entail. This process could also accelerate under the pressure of the US government banning American investors from investing in Chinese tech and surveillance companies because of security concerns. This process started under the Trump administration and continued with the Biden administration who arguably adopted an even more hawkish stance on the topic, contrary to what some may have expected.[75] If this process continued, it could accelerate the split between the US-dominated and the Chinese-dominated systems.

It would be wrong to assume that the issue of technological divergence is merely an illustration of geopolitical tensions between China and the United States. European governments have often been keen on reminding the rest of the world, including the United States, that they reserve the right to block hostile take-overs of any of their national companies that they deem strategic.[76] Moreover, there is evidence of misalignment between US and EU tech strategies that could be the source of additional technological divergence: While the US has adopted a more privatized and hands-off approach to the internet, for instance,[77] EU members have put more emphasis on the need to protect their sovereignty – their ability to make their own choices and respect their own rules, the toxic US-Chinese rivalry on this issue in particular notwithstanding. This has led Europe to set rules and regulations such as the GDPR in key areas like privacy, and eye the regulation of other tech fields, such as artificial intelligence, for the future. EU rules are meant to influence how tech giants behave inside European borders. However, they will not make the Internet more open and interoperable. The EU's penchant for tech regulation will make it more challenging for the EU and the US to align their approach to the internet. This key policy making area will require the reconciliation of the American market-based and the European institutional-oriented approach – a syncing effort that politicians across the Atlantic may not be ready to make.[78] As two observers of this issue put it, this schism may be the "biggest obstacle for collaboration" and "will be difficult to bridge because it is part of the countries' historical and cultural backgrounds."[79] Aligning approaches could represent an opportunity in the wake of Russian and Chinese activism, but could prove hard in the current political environment and in the age of the splinternet.

This divergence can also affect other sectors, like health, in which countries are adopting very different standards and are making different choices when it comes to healthcare. In the healthcare equipment sector, manufacturers experienced (1) a strong overall increase in demand that was particularly driven by (2) a massive increase in demand for equipment related to the pandemic while (3) demand for other equipment, like large medical imaging equipment stagnated or declined. China is a particularly interesting theater from this standpoint. The 2009 reform of the Chinese healthcare system has led to increased public investment in infrastructure. At the same time, Chinese-specific standards have made it difficult for foreign companies to understand national requirements and to remain competitive in an environment in which regulators have not shied away from giving domestic companies an edge. The health crisis has only accelerated this trend: The overall increase in demand for equipment reached 12.5% in 2020, compared to 3% per year before the health crisis according to one industry actor.[80] This increase was driven by a sharp rise in public demand (as private demand fell), which mostly benefited Chinese companies that were more competitive than foreign ones in contract biddings. In this case, again, diverging standards are both a technical and a political question.

In some cases, the relationship is even more obvious: when regulators and governments decide to set standards that are overtly driven by political considerations. This was the case when the US crack downed on Xinjiang Production and Construction Corps, a major Chinese cotton producer, in response to alleged crimes in Xinjiang. This decision disrupted the supply chains of many apparel retailers in the United States, thereby illustrating how standard-setting can push companies out of a country and accelerate the process of decoupling.[81]

Implications for business models

The coexistence of different standards and norms require businesses to adapt their business models to regional and at times domestic markets in order to remain relevant.

To some extent, economic decoupling has always been part of the reality of some industries like consumer goods and luxury. The example of L'Oréal is illustrative. In the company's two biggest markets, namely China and the United States, consumer expectations of beauty products and services vary enormously and depend on specific geographical, climate and socio-cultural characteristics, as well as on the different types of skin and hair. The USA and China also have very distinct economic models, governance models, as well as regulations and distribution channels. This meant that the company's approach to both markets needed to be tailor-made. In fact, as early as 1997, the company created a corporate headquarters in China, based out of Shanghai, and developed its own Chinese-based centers for distribution, research and innovation. This made it possible for some product innovations to be designed locally. In skincare, L'Oréal Paris has launched products specially designed, manufactured and distributed in China for Chinese consumers. These have been distributed through Chinese channels like the e-commerce website Tmall and by leveraging new technologies like 3D augmented reality makeup trials via the social network WeChat. Similarly, in the United States, L'Oréal USA manages a portfolio of local, homegrown brands to meet the diverse beauty expectations of a multicultural country. Such customization could become more significant in a world of economic decoupling and expand to a wide range of industries and services.

More generally, there are wide disparities between the Chinese e-commerce ecosystem and the rest of the world's ecosystem. The Chinese digital actors are limited in number and therefore impossible to bypass. For instance, digital sales massively come from three marketplaces, namely Alibaba, JD.com and Pinduoduo, whereas in the rest of the world, the channels of distribution are more diverse, Amazon's dominance in several Western markets notwithstanding. Advention Business Partners, an independent strategy consulting group, has noticed that these wide disparities between the two ecosystems has required digital actors to live and strategize in two very distinct worlds — one that is Chinese, and another that includes the rest of the world. It is fairly complicated to duplicate what one does in China in the rest of the world given how particular the Chinese market has become — and the resources one allocates to the Chinese market are, as a result, more difficult to reuse elsewhere. As one partner at Advention Business Partners puts it, an expert in the Chinese market is likely to feel particularly uncomfortable tackling issues in another market given how different Chinese and non-Chinese realities have grown. The coexistence of these two distinct e-commerce ecosystems is another illustration of economic decoupling which requires maintaining two very different mindsets to be able to do well in both inside and outside of China. Beijing's recently stated intention to ban Chinese tech companies (Internet companies that handle large amounts of sensitive consumer data) from listing in the United States may further accelerate this trend.[82]

International professional services network providers are another illustrative example here. Even if these actors used to be local on local, their methodologies, tools and training were designed at a global scale. Today, on the other hand, the emergence of different and competing standards, as well as the existence of distinct regulators and accreditors in different regions of operation require them to adapt their business model. These differences create distinct impacts on the model of service delivery for instance. In addition, it is becoming increasingly challenging to roll out a single united team spirit across the globe and to combine local presence and global expertise. Nevertheless, these challenges could still be manageable for professional services firms if the regional level-playing fields which operate according to the same standards are large enough and if they still require sizeable investments and innovation in order to boost technical excellence and service quality. This seems to be the case for sustainability services, where the European Union has the ambition of becoming a leading region in the field of clean production.

However, these adaptations can be useless or infeasible at times, in particular for political reasons when local regulators pick winners and losers. These political reasons are a major driver of decoupling when it comes to standards and norms. The potential for two different worlds, governed by a separate set of norms, is quite high. After two decades of globalization, these political and geopolitical factors may transform the way we think about the internationalization of firms and lead some to wonder whether the process might be entering into a reverse mode.

3. Integrating Economic Decoupling in Geographic Expansion Strategies

Geopolitical rivalries between the US and China are pushing both powers to preserve and extend their zones of influence across the globe. Traditionally, the US has relied on extraterritorial laws to exert political, economic and legal influence beyond its borders, including on operations in US dollars involving *non*-American actors. Extraterritorial laws are now also part of the Chinese arsenal: The most recent Chinese national security law makes it illegal for *anyone* to promote democratic reforms in Hong Kong. This division of the world into zones of influence is not just based on differences in business standards and norms, but also on long-term geopolitical rivalries and aspirations that the pandemic may have propelled. This division is another factor intensifying economic decoupling.

Extraterritorial laws: the 'new normal'?

The United States has a long tradition of using extraterritorial laws as means of not only preserving its interests but also to promote them in cases where the US may not even be a direct stakeholder. Article I of the US Constitution gives Congress the power to "regulate commerce with foreign nations," and to "define and punish piracy and felonies on the high seas and offenses against the law of nations." The definition of this power is far-reaching and gives the US legislator the ability to punish acts that can take place beyond American borders. It had allowed the US to sanction companies that did business with Fidel Castro's Cuba and operations that involved US assets which the former Cuban dictator confiscated. It has also allowed Washington to block American goods from being re-exported to countries, like Cuba, by threatening sanctions. Today, the mere use of the US dollar in transactions between two non-American actors can be sufficient for the US Department of Justice to initiate legal proceedings against stakeholders engaging in operations Washington considers unlawful, such as the violation of an embargo. Several banks have been prosecuted in the United States because of this.[83]

The new Chinese national security law is also extraterritorial in nature. It has made it illegal for anyone, including Chinese citizens abroad and non-Chinese citizens, to promote democratic reforms in Hong Kong. As Article 38 of the law states, "This Law shall apply to offences under this Law committed against the Hong Kong Special Administrative Region from outside the Region by a person who is not a permanent resident of the Region." With such wording, the law does not target operations or violent acts of terrorism, as in the case of US anti-terrorist extraterritorial laws, but limits freedom of speech outside of China. It has forced some countries, like Canada, to suspend its extradition treaty with Hong Kong, amid fears that China's judicial system is now taking over in Hong Kong. The new law also states it applies aboard all aircrafts that are registered in Hong Kong, like Cathay Pacific. It is therefore far-reaching and has potential global consequences.

Doing business in a world of extraterritorial laws

Competing extraterritorial laws, particularly in the context of significant political and geopolitical tensions, can therefore accelerate economic decoupling. They exacerbate divisions in a world in which it becomes costly, or potentially impossible, to respect a wide range of often contradictory standards. They can make cross-border transactions extremely hard to carry out given their far-reaching definitions. They can also encourage businesses to pull out of regions or activities to shield themselves from liability in a given part of the world. For instance, in the aftermath of the new security law, Chinese-owned social media company TikTok withdrew from stores in Hong Kong and subsequently became inoperable to Hong Kong users. As one report explained, "the company has said that managers outside China call the shots on key aspects of its business, including rules about data."[84] Similarly, Facebook, WhatsApp, and Telegram have stopped complying with Hong Kong government data requests because of fears that China has subverted Hong Kong's judicial system. In 2020, Facebook refused all 202 Hong Kong government requests since the implementation of the law. The social media company also restricted content in Hong Kong on 13 occasions in the second half of 2020 due to alleged violations of Hong Kong law. The number of requests form the Hong Kong government dropped from 199 cases in the first half of the year, though the number of actual requests is unknown. Beijing could decide to terminate the operations of these firms inside Hong Kong if they continued not to comply with this law, though the immediate consequences of these refusals are not clear.

There are also legitimate concerns about economic decoupling becoming a self-fulfilling prophecy in a world of competing extraterritorial laws. In fact, the growing influence of Beijing worldwide may feed China's, the United States', and potentially the EU's ambitions to contain the rise of the new giant. To this extent, competing extraterritorial laws are the expression of exacerbated geopolitical rivalries and can accelerate the regulatory and technological divergence across the globe in a lasting way. The ability of tech giants to sustain, let alone emerge in the case of Europe, in this business environment is critical, but all but guaranteed given the inclination of politics to meddle with these issues. Tech giants usually rely on vast home markets, deep capital markets, networks of venture capitalists, a solid university system, and political power in support of creative destruction to thrive. Many critics of the EU point to the fact that the its business environment lacks several of these key components. In the United States, the temptation to resort to protectionism and higher taxes on capital may undermine the the efficiency of its business environment. Beijing sees private firms as a threat to the influence of the Communist Party and seeks to regulate private corporations accordingly.[86]

The story of extraterritorial laws may be the sign of the deeper involvement of politics in key economic activities – an involvement that creates barriers and makes it harder for firms to grow.

4. Recruiting and Retaining Talents in this New Environment

A global team used to be an asset. Will it become a necessity in a decoupled world? In fact, the possibility of economic decoupling usually spells the end of market integration at a global scale. And yet, the development of remote work and hybrid offices could lead to the paradoxical emergence of a global labor market for skilled people in the developed world (and digitally-trained workers in developing economies), economic decoupling notwithstanding. Such a labor market could represent a huge opportunity for companies looking to hire and retain talents. But they should not overlook the fact that four generations of workers are coexisting on this labor market – and should not underestimate the effects of this.

Are remote work and the hybrid offices the future?

The expectation that a global village could emerge from the pandemic and a socially-distanced world can seem paradoxical on the surface, but stems from the development of a whole new set of professional interactions. Protracted periods of lockdowns led workers to move away from big cities and to question the need to be in the office every day. Social distancing led companies and decision makers to adapt the way they connected and shared information with a wide range of stakeholders, including employees and customers, but also suppliers and other partners.

The adaptations that led to hybrid work setups were meant to help businesses and executives better manage teams and better serve customers. They achieved both goals: Productivity and customer satisfaction have increased during the pandemic according to a McKinsey survey.[87] They also made businesses more agile – and they are unlikely to go away as a result, even in world in which total remote work will not be part of our future. According to one study in the United States, workers spent, on average, 15 hours of time and $560 to adapt and enhance their workspace at home – which represents 0.7% of US GDP. This comes in addition to company investments in cloud technologies to allow their employees to work from home.[88] (Other technologies, such as AI and robotics could accelerate this trend in the future). The study also finds that between January and September 2020, "The number of patents for technological innovations to accommodate a home-based workforce more than doubled."[89] In addition, these trends could accelerate as regulators are increasingly implementing policies that could allow some health workers to work remotely. Finally, nearly a third of those surveyed would like to work from home all week long, and nearly 80% say they would like to work at least a day from home.[90]

This is not to say that offices are destined to disappear. While the share of CEOs of global companies intending to downsize their office space reached 69% in August 2020, it fell to 17% by March 2021 according to a KPMG survey.[91] In fact, while office space may be a costly real estate investment, it remains incredibly important for creating synergies between workers. Interactions between colleagues and office rituals add intangible but most probably critical value to a company's productivity. There is also anecdotal evidence which suggests that the physical distance between the office and home may be important to help workers get time to explore new ideas, create boundaries, disconnect and avoid being overworked.[92] And perhaps more troubling for companies and workers alike, a workplace that becomes 'too hybrid' may create divides among employees who are physically present and those who are working remotely.

Managing human resources will not be a task of the past, and a hybrid future cannot just mean a combination of remote and physical work (a combination that would likely increase pressure on managers). Instead, it will require a complete overhaul of management responsibilities and logistics to guarantee that the right people are in the right place at the right time.[93] The challenge may lie in rethinking the very definition of the 'office concept' as some companies are doing. This entails reimagining the workplace in a way that empowers employees by giving them more physical space to be safe, helping them thrive in their roles, inspiring them and spurring innovation in a more efficient way than in a traditional office. Some companies are exploring new venues for their employees to work, such as museums, sports venues, restaurants and warehouses, as well as venues that may be closer to their home than the company's main office.[94] These ideas revolve around the possibility of a third workplace, besides the office and the home.

Ultimately, economic decoupling is unlikely to kill notions of company culture or the sense of belonging, quite to the contrary. But the physical proximity we thought we needed to make a team work in a professional setting may not be required in the future and may not be understood by a new generation of workers who completed part of their higher education online. The war for talent may become global as a result, especially as firms need to find the best talent where it is and where it is needed. This global war on talent may also lead, in turn, to more diverse teams that are able to generate innovative ideas and challenge the current state of business in ways traditional teams may not be able to. In the words of Emily Nelson, the deputy chief flight director at NASA's Johnson Space Center in Houston, who worked for more than 20 years on International Space Station operations: "It's always of value to be exposed to different trains of thought. You don't have to agree with a different train of thought to allow it to spur you on to having different creative solutions to the problems that are facing you."[95]

The new state of mind of the worker?

These workplace transformations are not happening in a social or political vacuum. Several fault lines may shape the business environment in which these transformations are accelerating. The rise of nationalism, including in Western democracies, suggests that all countries do not value the benefits of globalization in the way they did over the past two decades. Similarly, the rise of populism, from which Western democracies are no longer immune, also suggests that social divides within countries are deep and represent a challenge to the free-market and politically open system paradigm that emerged after the end of the Cold War.

These social and political divides could shape the mindset of employees, including members of the young generations that are now arriving on labor markets. These youngest workers on the labor market may have expectations regarding the firm's approach to the business environment on key topics such as diversity and climate change, as well as regarding its values, that may be higher and more ambitious than workers from older generations. Questions such as the company's business in regions like Xinjiang, or the relationships it maintains with stakeholders like NGOs, may matter more to this generation that may put higher emphasis on its values than on its financial aspirations.

In addition, it is striking that companies that enjoyed the greatest productivity boost during the pandemic are the ones which supported coaching, mentorship, idea sharing, and coworking.[96] It is also noteworthy that the quality of the workplace, and the ability of workers to choose to work from home during some days, may attract them to companies offering the most attractive work setup, probably involving a form of hybrid work. More than ever, companies that are able to better welcome new generations of workers inside the company – a physical and virtual space that the future may redefine – may thrive compared to their peer competitors.

It is tempting to associate economic decoupling with fragmentation and the end of globalization. On many issues, economic decoupling is likely to lead to fragmentation. In the case of human resources, the opposite could happen. Martha Maznevski, a professor of organizational behavior at Ivey Business School in Ontario, summarizes this point of view by arguing that while "some people are saying this is the end of globalization," this may "just the next wave of globalization."[97] Global teams could become a critical differentiator among companies as a result.

5. Improving Services for Customers

Few headlines are more hackneyed than those focusing on the constant changes occurring in the business environment. Yet, the combination of the trade war and the geopolitical tensions between Washington and Beijing, the pandemic and its effects on work and the office, and new technologies that are digitalizing classic business approaches, gives the undeniable impression that the changes transpiring in the business environment are now accelerating in a way that feels increasingly irreversible. To the extent that trade wars and geopolitical tensions, the pandemic and digitalization could all contribute to economic decoupling, it is worth exploring how companies are trying to adapt to these new realities by developing new solutions for their clients and customers.

The impact of structural changes of globalization

The structural transformations underpinning globalization did not start with the pandemic, which hardly initiated any of them, though it may accelerate some. One set of such transformations relates to how China sees itself in the global market. In 2015, the country designed a strategic plan, called *Made in China 2025*, that aims at upgrading its manufacturing capabilities and at moving away from a labor-intensive strategy to a more technology-intensive strategy. *Made in China 2025*'s goal is to reduce dependence on foreign producers by increasing the Chinese-domestic content of core materials to 40 percent by 2020 and 70 percent by 2025. In a nutshell, China does not want to remain the world's factory.

Made in China 2025 has obvious implications for businesses which relied on China's relatively lower labor costs and supply chain advantages. As J. Stewart Black of INSEAD and Allen J. Morrison of Arizona State University's Thunderbird School of Global Management have pointed out, some companies have opted for an '*in* China *for* China' strategy that aims at "decoupling their entire value chains in China from those outside." As they note, "For that strategy to work, two conditions must be satisfied: significant potential for revenue growth in China for the foreign player, and reasonable production bases outside China to meet the company's global needs."[98]

An '*in* China *for* China' is fully compatible with supply chains migrating out of China, under the effects of rising production costs, the US-China trade war and the Covid-19 outbreak. In fact, as companies try to reduce reliance by moving some of their production facilities in neighboring countries where labor costs are lower and production value propositions are complementary for global exports, they have also adopted an '*in* China, *for* China' approach as China continues to be a significant if not the largest market for multinationals. Financial partners like Citi have to fully leverage their global network to support these multinationals and offer them local solutions and local talents for corporate headquarters that are global in nature. This means providing expertise to cover end-to-end solutions across supply chains and deliver innovative, risk-mitigating solutions in multiple markets. But these solutions must also be replicable and cover multiple markets, by leveraging the same framework and platform to optimize efficiency for multinationals. Digital capabilities combined with the local know-how, access and knowledge are key in effectively supporting companies that may undergo exogenous shocks resulting in supply chain shifts and requiring them to adapt to a new normal.

These solutions are not necessarily leading to full decoupling, but they are certainly undermining the notion of a single, globally-integrated market.

COVID for business?

Finding new solutions can also require some industries to completely restructure themselves to be able to offer meaningful solutions.

The surge in business creation that occurred during the pandemic throughout OECD economies is a striking illustration that the Covid-19 crisis was first and foremost a shock on supply – and that it forced a reorganization, a restructuring and, perhaps even a reinvention of supply. In the United States, a recent analysis has found that applications for new businesses experienced a substantial downfall at the beginning of the health crisis before surging from the second half of 2020 through May 2021.

Furthermore, the pace of applications was the highest ever in the United States since 2004, when the US Census Bureau began to record these numbers. In addition, the surge applies to both likely new employers and non-employers, drawing a sharp contrast with what happened during the 2008 Great Recession, "when applications for likely new employer businesses and in turn actual startups of employer businesses declined sharply and persistently." The analysis also finds that the surge in new business applications did not benefit all sectors equally. Non-store retail alone accounts for 33% of the increase. The other industries that benefited from the surge include sectors that were particularly hard affected by the pandemic, including accommodation and food services, suggesting that the pandemic had led these industries to restructure.[99]

These patterns also offer insights into what entrepreneurs, both seasoned and new, may be thinking and seeing when it comes to new opportunities, new business solutions and new services emerging post-pandemic. This is also consistent with talks about the "new Roaring 20s," that is, a decade of prosperity and in boom in services. Paul Donovan, Chief Economist of UBS Global Wealth Management, notes that this development is not unrelated to the future of globalization: when Chinese President Xi states that globalization is irreversible, there may be a definition issue. In Donovan's own words, "global trade in goods is reversing, and the efficiencies of the fourth industrial revolution (simplification, digitalization, globalization) will accelerate that reversal. There are no longer container ships full of compact disks on the world's sea lanes."[100]

Technologies coming to age

In fact, it is noteworthy that this surge in business creation, which suggests that major industries are restructuring, is not happening in a technological vacuum. Some economists are also expecting a surge in productivity in the coming decade as new technologies, that have been on our radar-screens for quite some time, become adopted by businesses. The lag existing between an invention and its adoption by the business sector is widely documented in human history: Stanford Professor Erik Brynjolfsson reminds us that it took a generation for electricity to be used in factories.[101] Today, the pace at which digitalization and artificial intelligence are changing the workplace may be seen as disappointing given our initial expectations of revolutionary change. However, as this pace picks up, the rate of change may be greater than our expectations we revised because of the initial disappointment. Those not paying attention to change in the short run may be surprised and overwhelmed in the medium run by the nature of the transformation leading businesses will go through.

These efficiencies of the fourth industrial revolution, that are driving the reorganization and, to some extent, the reinvention of businesses, could also be a major factor in global decoupling.

SECTION 3:
DEALING WITH DECOUPLING: WHAT POLICY EXPERTS FORESEE

FEEDBACK FROM EXPERTS

Martin Wolf

Chief Economics Commentator
Financial Times

"Something is needed on the future of international rules, even if it is to declare them moribund."

As I understand it, the overall argument is that globalisation is not so much disappearing as changing. I largely agree with this, though this may underestimate the cumulative effects of the geopolitical breakdown we are witnessing.

I find it startling that the paper has no reference to the WTO (so far as I can see). It shows that international rules are deemed to be dead. Yet the paper also says almost nothing about regional trading arrangements. Surely, something is needed on the future of international rules, even if it is to declare them moribund.

My general view is that globalisation (including the integration of supply chains) is driven by two fundamental forces: technology and policy. Technology has been driving globalisation forward... Policy is more complex. It tends to oscillate between pro- and anti-openness phases. It is currently clearly operating against the globalisation of things. But it is not clear how policy is going to impact digital globalisation. Here there are three big factors: regulatory divergence; the difficulty of blocking digital globalisation (though the Chinese are trying hard to do so); and the obstacles created by national cultures etc. (So, it is clearly easier to globalise the virtual labour supply if you operate in English than if you operate in Chinese or German!) Overall, however, policy is clearly becoming more nationalistic and inward-looking.

Elvire Fabry

Senior Research Fellow, Jacques Delors Institute
In charge of trade policy, EU in globalisation and Brexit

"Can decoupling be sustainable?"

Jeremy Ghez makes a relevant mapping of deep trends of fragmentation slowing down the process of global economic integration. The coincidence of a politicization of trade and investment policies with more identity economics fuelling protectionism, and of diverse technological innovations allowing for more customised goods produced close to consumers, is driving to a partial relocation of production. Now that the big three - US, China and the EU – have joined in a green race, the price of carbon needs to be even more seriously factored in the localisation of production.

In addition, businesses are now challenged by the unpredictability of new regulatory initiatives adopted by big economies turning inward to become self-sufficient. The capacity of the Chinese economy to recover quicker than others from the disruptions caused by the pandemic is boosting Washington's decoupling strategy to limit China's economic powerhouse.

Yet, adapting business strategies to this new geopolitical framework and the risk of arbitrary sanctions calls to consider a diversity of decoupling scenarios which would have a different impact upon who is considering the decoupling. As recently underlined by Peter Eppinger, Gabriel Felbermayr and alt (July 2021, Vox-EU CEPR) it is not the same if the US decides to isolate itself, if the US unilaterally decouples from China, if the US and China bilaterally decouple, if the US and the EU decouple from China, or finally if a broad range of countries decouple.

In line with the Trump Administration, President Biden considers decoupling as a strategy to reverse the economic interdependence and limit Chinese competitiveness in the technological sector and beyond. Yet, decoupling may be more sustainable for China than for the US or any other country. It's about the demography, stupid! Decoupling is not only about disentangling the US manufacturing system from the world factory but about giving up on access to a remote strategic market. An aggressive decoupling from Chinese value chains, forced by exports bans, blacklisting of Chinese entities, etc., would also lead to less access to the Chinese consumers. While currently more exports of Chinese goods to the US continue to increase the dependence of China on the US economy, the explosion of its domestic middle class would make any decoupling more sustainable for China than for the US. The Communist Party's dual circulation strategy focused on leveraging China's domestic added value and appetite for consumption demonstrate a good anticipation of the new 'sowbalization' reality, or as the slowdown in global integration.

But it may not be sustainable for others to give up on accessing the Chinese middle class, which by 2030 should represent a quarter of the global middle class. The EU made it clear that China remains a partner, and not only a competitor and a systemic rival. Autonomous instruments currently put in place by the European Commission aim at ensuring more fair competition to enable EU businesses to develop in the Single market and engage in the Chinese market. The alignment of partners on Washington's strategy will be challenged by the increasing use of extraterritoriality measures on the US side as on the Chinese side, as well as the preparation of an anti-coercion instrument on the EU side. In addition, in any decoupling scenario, many small countries which today benefit from the global economic integration, might first try to take advantage of trade diversion caused by the US decoupling, rather than themselves decouple.

Finally, while any decoupling scenario will generate new inequalities and much instability for business, the structural cause of the political backlash against globalisation, namely, the unequal distribution of the benefits of open markets, will most probably continue to be neglected. In addition to increasing the resilience of supply chains and anticipating different decoupling scenarios, businesses should pay attention to this growing opposition of citizens, in the EU as much as in the US, to the ratification of new trade agreements, while China is intensifying negotiations with regional and more remote partners. China may adapt its strategy to sustain a US decoupling but continues to support globalisation and to engage with other partners. The domestic decoupling of economics and politics is therefore as much a challenge for businesses than any US-China decoupling.

Gregory F. Treverton

Professor of the Practice of International Relations and Spatial Sciences, University of Southern California
Former Chairman, US National Intelligence Council

"Geopolitics and Decoupling from China"

The word 'decoupling' has a lineage in international politics that is both venerable and strange. During the Cold War, it was used most often to describe the risk that the security of America's allies, especially in Europe, might become separated from that of the United States itself – for instance, if Mr. Reagan's vaunted 'Star Wars' program had actually produced the equivalent of a dome protecting the United States from nuclear attack.[1] Now, the domain is economics and the connotation of decoupling is generally positive, not negative. Decoupling typically refers to reversing globalization, in particular with regard to China, reducing reliance on supply chains in China, even reshoring them.

Plainly, the world of geopolitics is moving toward more intense competition between the United States and China. Just as plainly, it is a mistake to call this default future a new cold war – though it is already being labeled that – for China and the United States will remain much more interconnected, especially economically, than were the United States and the Soviet Union. And even those Cold War adversaries managed enough arms control to avoid

1 To be sure, there was always considerable theology to these discussions. A sharp-eyed reader, for instance, might notice that instead of shared U.S. and European nuclear vulnerability, if the United States homeland were less vulnerable to nuclear attack, it could be argued that should have made it *more*, not less, credible that Washington would carry out NATO strategy by threatening a nuclear response to a conventional Red Army attack on western Europe.

blowing up the planet, so it shouldn't be beyond the wit of America and China to cooperate to save the planet from pandemics in the short run and climate change in the long.

In the short run at least, the pandemic amplified both the Sino-American competition and the urge to decouple. From the beginning the pandemic was a geopolitical free for all, with open borders closing, and European Union partners denying each other critical medical supplies. The sad state of international cooperation was driven home by an estimate done by the International Monetary Fund in July 2021: a $50 billion program of vaccination and other virus control efforts would generate $9 trillion in additional global output by 2025 – a return of 180 to one.[1] Yet there were no takers, none, and billions of people in poor countries will wait until 2023 to get vaccinated.

Whether China's Covid-19 performance confers long-lasting international benefits also remains to be seen. After setting loose the scourge on the world, it managed the nifty sleight of hand to wind up appearing as both the model and the leader in responding to it. On the negative side of the ledger, its 'wolf warrior diplomacy' clearly overplayed its hand, and its broader Covid-19 diplomacy was tarnished when some of the medical supplies it provided poor countries turned out to be shoddy. It continued to stonewall the World Health Organization (WHO) efforts to dig deeper into the origins of Covid-19, especially to investigate whether it might have leaked from the Wuhan laboratory where 'gain of function' (or genetically altering an organism in a way that may enhance biological functions) experiments were being performed on viruses.

A good deal of the urge to decouple was visceral, images of dependence on China for critical medical supplies. In fact, the 'hyperglobalization' that brought trade to twice the share of global GDP it had ever been had plateaued by the time of the 2008 recession. It recovered but only to pre-recession levels. And much of the supply chain disruption, like the shipping container crunch during the pandemic, was the crunch of success: unlike usual recessions, when trade falls faster than GDP, that was not the case during the pandemic. Shipping containers were not a disease vector as opposed, perhaps, to ports. Consumers, denied the chance to spend money on travel, entertainment and other services, bought things – a reminder that globalized trade remains mostly in goods; the outsourcing of professional services that was such a concern a decade ago has mostly not occurred.

Still, there remains the question of what it means for decoupling if the future we are moving toward is one of tag teams in which countries fall, sometimes awkwardly, into an American-led or China-led grouping, though with some switching of sides and more hedging? Of that, the wrangling over Huawei and 5G has provided a foretaste. The Europeans, in particular, are caught between economic self-interest, on the one hand, and, on the other, security concerns, ones loudly advertised by Washington but without offering much of an alternative to Huawei. Taiwan, and its Taiwan Semiconductor Manufacturing Company (TSMC), is a second case in point. Because it controls more than 50% of the global semiconductor market, it is economically critical to both China and the United States, which dramatically complicates its effort to remain politically neutral between them.

Companies will make their own decisions about whether in chasing pennies of cost savings in efficiency, they have put pounds at risk in security of supply lines.[2] The concern that globalization had gone too far was only sharpened by the pandemic.[3] And it remains an open question, given the importance of the Chinese economy, whether companies will seek more resilient supply lines *inside* China or by moving them *outside* China. In the end, though, companies cannot avoid being affected by the 'choose sides' imperative of a more divided world, and China has taken the lead in putting more direct pressure on private companies. It punished the Ant Group, which owns China's largest digital payment platform, and other tech companies recently for putting out new products without government approval, and it has launched investigations, blocked initial public offerings, especially on U.S. stock markets, forced restructurings, and issued fresh regulations.[4] The United States seems poised to follow suit, with proposals in the air to require government permission to merge or acquire companies, to separate companies structurally, or to move away from the consumer welfare standard that has been the venerable guide to antitrust: are consumers hurt by the merger, a proposition often hard to prove in the informational technology world when so much on the web is cheap or free?

Surely, globalization is, structurally, a long way from the days of Chimerica, the coinage of Niall Ferguson.[5] China is the usual and convenient villain, but the six million manufacturing jobs the United States lost between 2000

1 As cited in Adam Tooze, "Our Era of Incompetence," *New York Times*, September 5, 2021, Week in Review, p. 4.

2 "Has Covid-19 Killed Globalisation?," *The Economist*, May 14, 2020, available at http://www.economist.com/leaders/2020/05/14/has-covid-19-killed-globalisation.

3 Vanessa Gunnella and Lucia Quaglietti, "The Economic Implications of Rising Protectionism: A Euro Area and Global Perspective," European Central Bank, April 24, 2019, available at https://www.ecb.europa.eu/pub/economic-bulletin/articles/2019/html/ecb.ebart201903_01~e589a502e5.en.html.

4 Asheesh Agarwal, Willl the U.S. Emulate China's Tech Take-Down, *The Hill*, September 11, 2021, available at https://thehill.com/opinion/technology/571821-will-the-us-emulate-chinas-tech-takedown.

5 Niall Ferguson and Moritz Schularick, "'Chimerica' and the Global Asset Market Boom," *International Finance* 10, no. 3 (2007): 215–39, https://doi.org/10.1111/j.1468-2362.2007.00210.x.

and 2010, resulted from a combination of production moving to China and other low-wage countries, automation continuing apace, and companies scaling back production in the 2008 recession. Still, the predictions of mainstream economists in the 1990s were too sanguine about globalization, in particular about the extent to which *hyperglobalization* of trade would drive increasing inequality. Until the 1980s trade liberalization mostly lowered barriers erected before World War II.[1] Indeed, trade as a share of global product was only slightly larger than it had been in 1913.

What economists did not predict – and perhaps could not have given the data they had – was the coming trade boom, especially in manufactured exports from developing countries, which are now five times the share of global product they were in the mid-1980s. In that sense, China's boom was 'made in America' to the extent it was the primary destination of all those inexpensive consumer goods. In 1991, manufactured goods from low-income countries accounted for just 9 percent of U.S. imports, a number that rose to 15 percent by 2000 and 28 percent by 2007, with China accounting for almost nine-tenths of this growth.[2] American goods imports from China jumped by a staggering 1,156 percent from 1991 to 2007.[3] While manufacturing had been declining as a share of total employment in the United States, in absolute numbers it was relatively stable – until 2000, when it fell off the cliff. As the trade deficit surged, manufacturing in the United States declined, and the surge accounts for more than half the 20 percent decline in manufacturing employment between 1997 and 2005. Small wonder that globalization became a dirty word in the Rust Belt, Northeastern and Midwestern states that have been experiencing industrial decline starting around 1980.

In that sense, the *win-win* sense of the early days of China's boom is long past, and the economic dimension of Sino-American relations is seen as competitive by both. It was noteworthy that the one international venture the President Joe Biden administration did *not* quickly re-enter was the Trans-Pacific Partnership, from which ex-President Trump had withdrawn the United States in January 2017. Nor did the administration move quickly to lift the tariffs the Trump administration had imposed on China. A range of Chinese measures – from the 2015 *Made in China* strategy to the 2020 export control law – bespeak a similar impulse toward competition and self-reliance. These political choices may be undergirded by technological change to the extent that the advances in the Fourth Industrial Revolution, like 3D printing or the Internet of Things, both permits more decentralization, hence limit the need for long, global supplies, and, through automation, hurts low-skilled labor, thus sharpening the sense that globalization is a zero-sum game.

Are there factors that might mitigate this turn from globalization to global competition? This white paper nicely outlines a number of steps companies can take to adapt to and protect themselves from a world of decoupling. Whatever the state of their political relations, the United States and China will remain enormously important to each other economically, and, ultimately, it is in the interest of neither to see the world fall into a mish-mash of competing standards and rules. Not all the supply chains raise the same issues of decoupling: despite all the attention to India, supply chains in pharma mostly link rich countries, with intermediate products valuable enough to be moved by air, not shipping container – one of the reasons that producing vaccines quickly was the singular success of the pandemic. And in the end the two countries might decide that geopolitics should not rule over cooperation to save the human race from pandemics and climate change.

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1 See Paul Krugman in Luís Catão and Maurice Obstfeld (eds.), *Meeting Globalization's Challenges: Policies to Make Trade Work for All*, Princeton University Press, 2019. A summary version is available at https://www.bloomberg.com/opinion/articles/2019-10-10/inequality-globalization-and-the-missteps-of-1990s-economics.

2 David H. Autor, David Dorn, and Gordon H. Hanson, "The China Syndrome: Local Labor Market Effects of Import Competition in the United States," *American Economic Review* 2013, 103(6): 2121–2168, available at http://dx.doi.org/10.1257/aer.103.6.2121, pp. 2121-2.

3 *Ibid.* p. 2158.

Alastair Newton
Co-founder & Director
Alavan Business Advisory Ltd

"Ideology Trumps Economics."

In presentations and papers dating back to 2008, I have readily acknowledged that, as Ronald Findlay and Kevin O'Rourke explored in Power and Plenty (2007), historically the end of a period of hegemony — as we were then entering — had, without exception, been accompanied by the erection of barriers to trade and a sharp uptick in what, today, we would call nationalist sentiment. In other words, we were then, and currently remain, at a point in the geopolitical cycle where one should expect globalisation to be in retreat.

Nevertheless, as recently as January 2020 I was making presentations to investors in Asia in which, without dismissing growing anti-globalisation sentiment, I argued against getting carried away by the perceived (in some quarters) threat of wholesale decoupling. Rather, I promoted the 'chained globalisation' thesis put forward by Henry Farrell and Abraham L Newman in the January/February edition of Foreign Affairs, which can be summed up as follows:

"Globalization, in short, has proved to be not a force for liberation but a new source of vulnerability, competition, and control; networks have proved to be less paths to freedom than new sets of chains.... Governments and societies, however, have come to understand this reality far too late to reverse it. ...China and the US are too deeply entwined to be 'decoupled' without causing chaos. States have little or no ability to become economically self-reliant." However, even then my colleague Richard Windsor (RadioFreeMobile) and I were flagging the risk that the then still nascent 'tech war' between China and the US would, to quote a 3 August 2020 Financial Times editorial, lead to a "carve-up of the internet — and hence the global tech industry — into a series of walled gardens". And more recently, although I have by no means given up on chained globalisation, two things have caused me to broaden out this concern.

The first — and less important to my mind — is Covid-19 and the related shifts in thinking on supply chains and 'just-in-time' delivery which have been mantra from heaven for the anti-globalisation movement.

The second is the shift in thinking in the White House which owes a good deal to the growing belief in Washington in the second half of 2019 (as reported by, for example, David Grossman of BBC News) that China's technological advances increasingly pose an 'existential threat' to the US.

To give Covid-19 a little more 'credit', it was the Trump Administration's mis-handling of the pandemic which allowed the 'China hawks' to lodge this view firmly in the Oval Office (instead of a single-minded obsession with bilateral trade imbalances which had prevailed since January 2017). Nevertheless, it was not until Joe Biden was sworn into office in January 2021 that it metamorphosed into overt recognition in the US Administration that the West is engaged in an ideological struggle with China. As the FT's Gideon Rachman wrote on 21 June 2021:

"As an authoritarian country, which is increasingly open about its ambition to challenge US..., China has belatedly provoked a backlash in Washington. The Trump administration focused largely on the national trade deficit with China. Under Joe Biden, however, the backlash has become more explicitly ideological."

The key word here is 'backlash'. For it is the CPC, driven by what the then head of Australia's diplomatic service Frances Adamson described in June 2021 as a "deeply defensive mindset" rooted in its own 'insecurities', which is primarily responsible for turning a strategic rivalry into an ideological struggle in order to try to justify — and ensure — Party rule in China in perpetuity. If this means, notably, decoupling China's private sector completely from US financial markets so be it. And we should already be in no doubt that China's leaders are not only willing but perfectly able to force even the most powerful of the country's corporates to toe the Party line on not only this but pretty much any count, which is not to say that China can decouple completely. Even to try to do so would undoubtedly trigger the kind of 'chaos' to which Messrs Farrell and Newman refer and risk the sort of collapse in economic growth which the CPC has long feared would lead to its ousting.

As for the US, the combination of a bipartisan consensus on China, widespread protectionist sentiment among Democrats and the Republican Party's shift away from 'big business' is already visibly undermining the corporate sector's lobbying powers when it comes to doing business with and in China.

In sum, although some of the 'chains' still seem unlikely to be broken, the shift in China/US relations from 'strategic rivalry' to ideological struggle seems sure to drive us significantly further down the path of decoupling than had previously seemed economically plausible.

Arnaud Van Waeyenberge

Associate Professor of Tax & Law
HEC Paris

"In this global struggle for the law within the framework of economic decoupling, the European Union certainly has arguments to make."

Economic decoupling, as a scenario in which countries such as the United States and China opt for increasingly different technologies and standards and rely on progressively independent supply chains, is a plausible hypothesis, one in line with the dynamics observed at the global level over the last twenty years. In hindsight, and from a legal standpoint, we can see that globalization has produced, among other things, the following effects[1].

Firstly, the international model based on coordination between public international law (which is subject to contractual agreements) and private international law (which distributes competences between the States) is undermined by the effects of globalization. It also leads to an abundant use of "*law and forum shopping*," which subverts the logic underpinning international law and contributes to the creation of a *global market of national rights* in which States find themselves placed in a situation of competition. Thus, the growing regulatory competition between China and the US is clearly in line with this perspective.

Secondly, globalization has also led to a change in the *nature* of standards. For example, we can see that emerging global standards only occasionally adopt the classical form of our 'good old rules' of law, with everything happening as if globalization has created a fertile ground for the proliferation of instruments which mobilize norms that are sometimes foreign to legal rules. While these have certainly always existed, it has been in a manner in which they have been dormant when it comes to the foundations of law yet are becoming predominant today. Technical standards, indicators, ratings, benchmarks, rankings[2], codes of conduct[3], even computer programs and protocols[4], can thus be counted among the normative instruments which have proliferated on a global scale in an attempt to ensure—with highly variable success—the regulation of certain sectors of activity[5]. This report is therefore right to identify technical standardization, the scope of which is constantly growing, given it has been one of the major challenges posed by this confrontation. Indeed, these standards constitute the real rules of the game of economic globalization.

From the point of view of companies, we observe that - when the system was put in place by the States is not satisfactory from their perspective - one of the strategies adopted was to establish standards themselves or to encourage the creation of standards better suited to their interests. We can thus witness on a global scale the proliferation of standards cobbled together and directly put into service by the actors who venture, by choice or under duress, into normative engineering. These standards sometimes result from the cooperative search for rules by the actors interested in carrying out certain operations, as can be observed, for example, in the case of standard financial contracts[6], and actual global institutions resulting from the practice. More often, these rules result from a fight for the law in which those actors interested or affected in one way or another by the regulation of a certain behavior that is being put under pressure, attempt to capture or make accountable 'points of control'; that is to say, those actors identified as in fact having the means to influence it. What is illustrative of this dynamic is the empowerment of internet-based technical intermediaries, or even search engines, so that they take charge of the filtering of online content or the placement of pressure on the head network companies ("*sociétés tête de reseau*") so that they ensure control of the work conditions of their subcontractors under the auspices of corporate social responsibility[7]. In the context of future economic decoupling, companies will not fail to adopt a similar strategy by identifying 'points of control' able to regulate the sector of activity and placing greater pressure on it so

1 For a more in-depth description of the consequences, see B. Frydman, G. Lewkowicz and A. Van Waeyenberge "De la recherche à l'enseignement du droit global", in P. Ancel and L. Heuschling (eds.), *La transnationalisation de l'enseignement du droit*, Brussels, Bruylant, 2016, p. 241-254.

2 On the technical standards and indicators, see. spec. B. Frydman and A. Van Waeyenberge (ed.), Gouverner par les standards et les indicateurs. *De Hume au ranking*, Bruxelles, Bruylant, 2014. See also K. Davis et al. (ed.), *Governance by Indicators: Global Power through Classification and Rankings*, Oxford, Oxford University Press, 2012.

3 See B. Frymdan and G. Lewkowicz, "Les codes de conduite: source du droit global?" in I. Hachez et al. (ed.), *Les sources du droit revisitées: normativités concurrentes*, Brussels, Anthemis, 2012, pp. 179-210.

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5 B. Frydman, G. Lewkowicz and A. Van Waeyenberge, op. cit.

6 This is the case with the ISDA Master Agreement for the OTC derivatives market.

7 B. Frydman, G. Lewkowicz and A. Van Waeyenberge, op. cit.

that they take better account of their interest.

In this global struggle for the law within the framework of economic decoupling, the *European Union* certainly has arguments to make. The European Union is first of all integrated into the globalization phenomenon by means of a *discourse* through which it projects itself into the global sphere and offers, to this end, a set of tools that it considers useful for world governance[1]. In addition, the construction of Europe has been shaped by the characteristic phenomena of globalization: it is an *integrated economic space*, *a pluralistic space by nature and the control of States over the economy has been severely limited*. Finally, the economic importance of the internal market makes the Union a global player that is difficult to ignore.

André Chieng

Vice-President, France-China committee
President, AEC

"I don't believe in decoupling."

I would like to start by giving some statistics:

(Billions USD)	*2019 S1*	*2020 S1*	*2021 S1*
Chinese exports to US	199	177	253
US exports to China	59	56	88

(source: French Embassy in Beijing, economic research department

In spite of all efforts by Trump, continued by Biden, to tax imports from China and decoupling both economies, exports from China to the US have increased by 43% between 2020 S1 and 2021 S1 and even by 27% if we compare with 2019! Why?

According to me, the reason is very simple: China will still be the workshop of the world for a very long time because there is no alternative.

A supply chain is very complex and sometimes, if one link is missing, the whole chain collapses. Of course 3D printing can solve some of those problems, but not all of them.

Why has Foxconn become the exclusive manufacturer for Apple? The main reason is that to assemble smartphones efficiently, you need a combination of:

- massive trained and disciplined workforce
- important resources of technicians and engineers to supervise the workforce and solve technical problems
- efficient logistics and transportation for supplies and expeditions of finished products
- efficient ecosystem of suppliers close to the assembly factory

If you want to leave China, you can find countries where some of those resources are available, but only in China you can find all of them. Neighboring countries like Vietnam, India, the Philippines, Indonesia are eligible candidates, but it took China 20 years to become the workshop of the world. Those new emerging countries will take at least the same amount of time!

Samsung has started relocalizing factories in Vietnam to be less dependent on China. But what is happening now? Vietnam is presently severely disrupted by the Covid-19 because finally China is also more efficient in fighting Covid!

Relocalizing to the west? The main problem is not that the workforce is too expensive. On the one hand, automation,

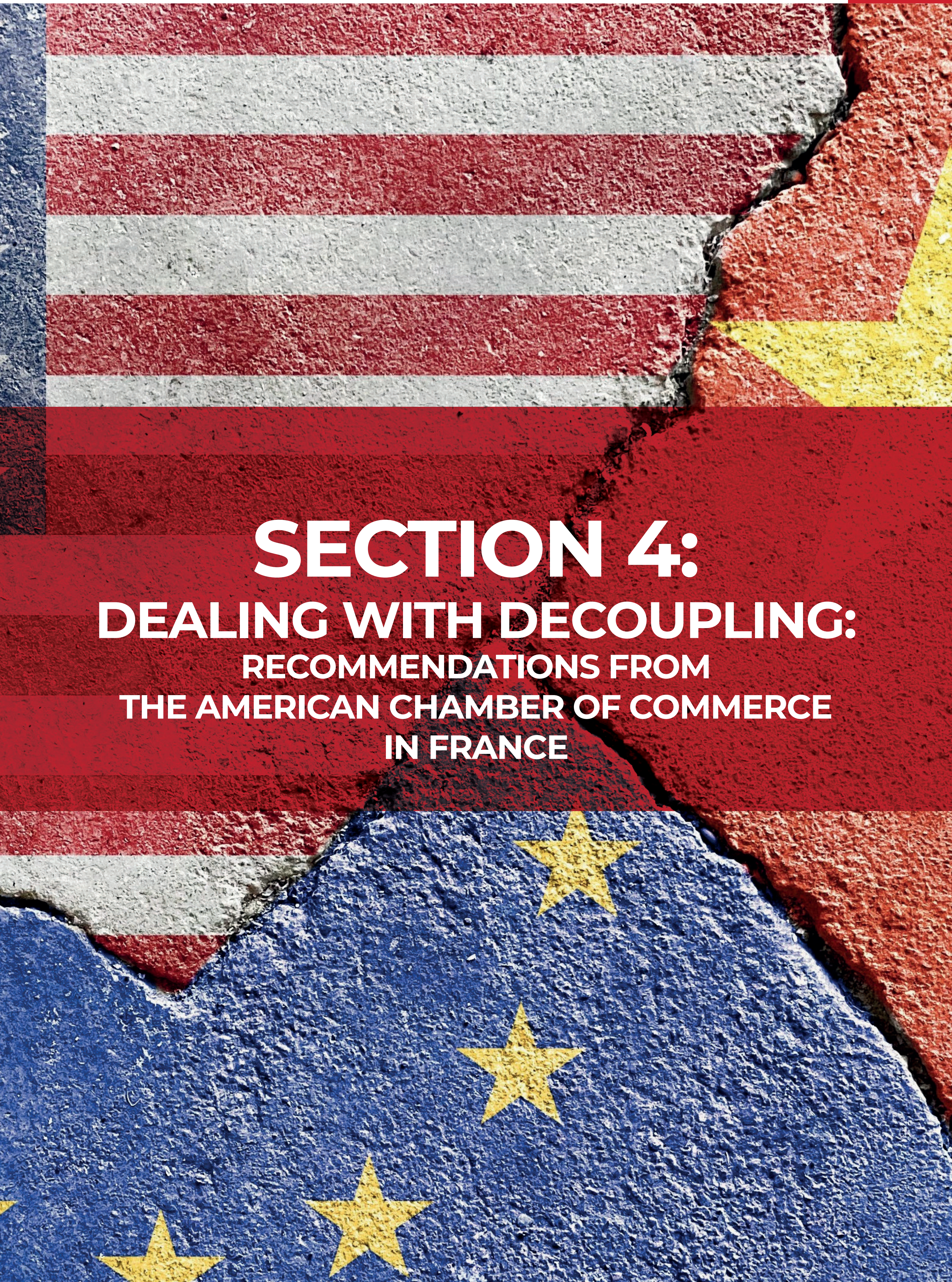
1 On this point, see Anu Bradford, *The Brussels Effect - How the European Union Rules the World*, Oxford, Oxford University Press, 2020.

3D printing and demand for flexible and short series can solve many problems. On the other hand, Chinese salaries have increased and China is no more the low-cost manufacturing base it used to be. The problem is the shortage of mid-level engineers! I am not sure of my figures but I believe that China produces more engineers than the United States and Europe combined. The quality of those engineers is not the highest, but for industry you need a lot of mid-level engineers and technicians. The United States has the most Nobel Prizes but not enough trained technicians and engineers!

China has another advantage: the size of its market which is present in Ghez's study. He rightly notices that *in* China *for* China is a new priority of many multinationals. But he doesn't emphasize enough that often to be present in China is a necessity. The case of l'Oréal is described, but the study misses one important fact: for l'Oréal, the distribution of the future is created now in China. L'Oréal sells today 55% of its products online in China. It is twice the percentage of the United States! New marketing methods, new consumption habits all come from China.

China has its weak points that are pinpointed by Made in China 2025. The lack of microchips made in China is the most obvious one. China spends more money importing micriochips than petroleum, despite the fact that China is the biggest oil importer in the world. But there are others, and Made in China 2025 gives a good idea of them. China is far from being self-sufficient!

As a conclusion: interdependence is much stronger than decoupling forces. A reversal of this situation could only happen if there was a real war between China and United States, which no one hopes would happen!



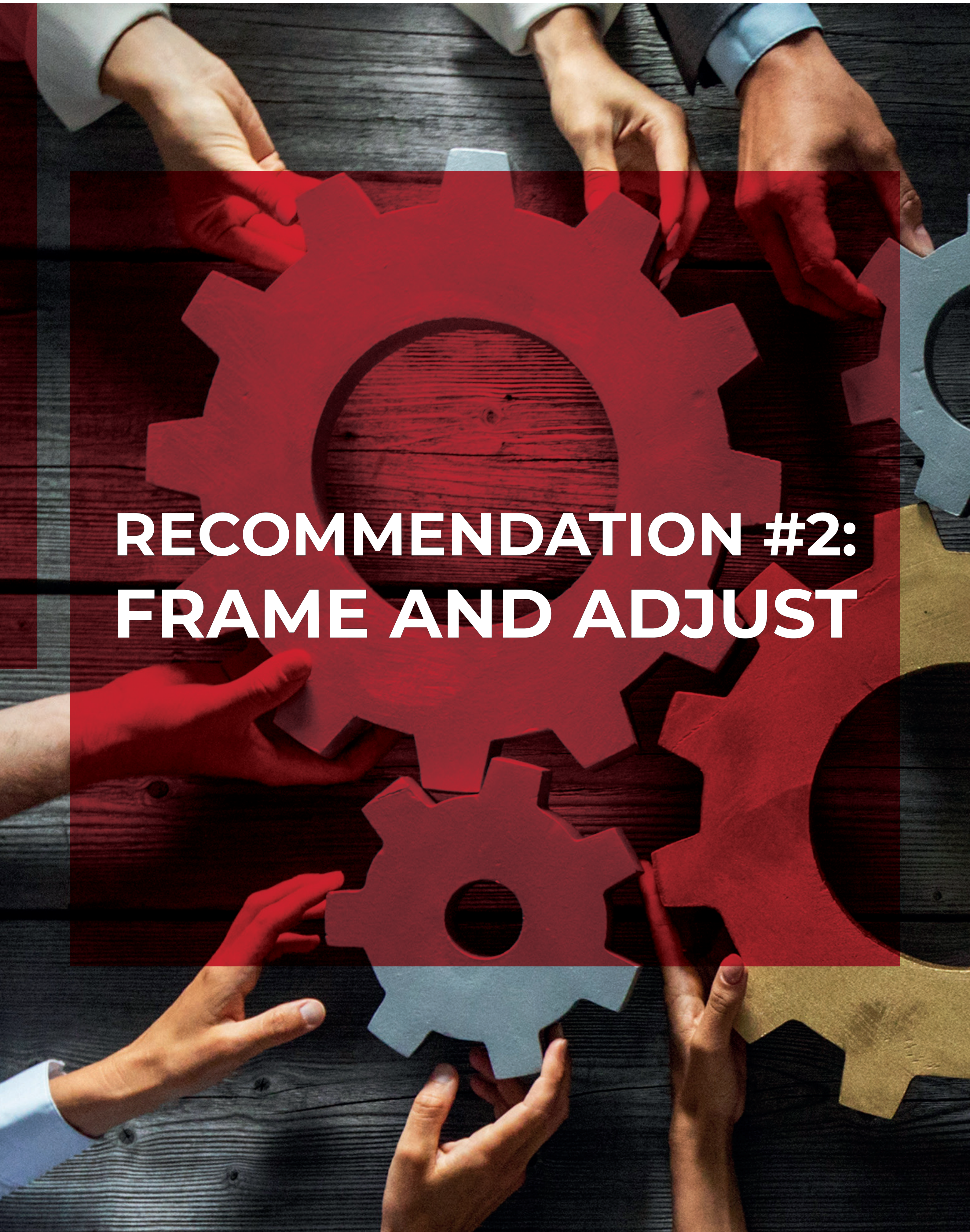
SECTION 4:
DEALING WITH DECOUPLING:
RECOMMENDATIONS FROM THE AMERICAN CHAMBER OF COMMERCE IN FRANCE

RECOMMENDATION #1: TURN THE STRESS TEST INTO A RESILIENCE TEST

Stress tests, which are typically used to evaluate the potential effects on an institution's financial condition, are a useful tool for anticipating and mitigating potential supply chain disruptions. However, they are often limited. In the future, **resilience tests should consider more complex scenarios** in which changes are not linear but instead occur in a quick, disruptive and exponential way. Such an approach could shed light on new forms of possible crises and global threats. It could help companies avoid both underestimating exponential changes in its initial stages and overstating its effects in the longer run.

Global supply chains provide a useful case study here. The pandemic highlighted the fact that they were not as resilient as was previously thought. Indeed, **the threats to supply chains are numerous and multifaceted**. Some are known: rising protectionism, pandemics, climate change... While others are unknown and thus difficult to anticipate. In order to be prepared to react to these known and unknown disruptions, **companies could universalize the use of resilience tests that account for more complex scenarios to evaluate the strength of their supply chains**. In the world of finance, stress-tests are typically conducted using computer simulation techniques used to test the resilience of institutions and investment portfolios against potential macro and micro economic scenarios. Such testing is used to determine investment risk and help evaluate internal processes and controls.

AmCham France suggests adapting this approach to offer companies from all sectors a tool to evaluate potential supply chain risks and weaknesses. Based on the results of these, companies would be able to develop tailored measures to mitigate risk and increase resilience. The measures that could be used may depend on many factors, such as the nature and probability of the threat to the supply chain, the size of the company, the type of industry, the location of their main markets, etc. We believe companies should consider communicating on these resilience tests and on how they may have impacted their corporate strategies and business models. Those that do may develop a strategic edge by improving their credibility and transparency to markets and by reassuring clients, shareholders or business partners - particularly in places with less stable economic and political conditions. However, the disclosure of stress tests results should not be mandatory.



RECOMMENDATION #2: FRAME AND ADJUST

We do not know if economic decoupling will occur and, if it does, what impact it will have on the global economic order. Yet, there is evidence to support that even moderate levels of decoupling could lead to an increased **divergence of norms and standards**. To a certain extent, this is already the case: while in non-strategic areas Chinese standards tend to be aligned with those of the rest of the world, there is an increased divergence in norms and standards when it comes to strategic areas.

This would naturally make technical requirements for products difficult to satisfy, constituting a significant obstacle to global trade flows. In order to safeguard international trade and reduce the impact of diverging standards on companies' internal supply chains, **companies should make it a priority to design products that can be compatible with different global standards**. Such modus operandi is already common practice in the automobile industry, where most parts of a product are standardized and a select few are tweaked depending on the market the car is being sold in. Thanks to this practice, companies are able to keep the core of a product unchanged, simplifying production systems and reducing costs.

AmCham France suggests a wider implementation of such practice, in order for companies to be competitive in the global economy and overcome the hurdles presented by differing technical requirements. In this regard, a company should **identify common denominators** for each product, which would constitute its core standards, and customize only those parts that cannot be standardized, adapting them to the regulatory requirements of the importing state. Consequently, compatibility should be central to production strategies, with the objective of manufacturing a product that can ultimately be adapted to every market while still retaining its core features.

In practice, a company's main task would be to frame and adjust: first, frame those elements of a product that can be standardized and then adjust the remaining ones to distinctive national standards. One possible effective strategy to achieve this goal would be for a company to start following the strictest regulatory rules out of their major markets when developing the core of one product, and then customize it during the final stages of production based on local regulations.

RECOMMENDATION #3: STRENGTHEN EUROPE AND PRIORITIZE A DIVERSIFIED EXPORT STRATEGY

A more fragmented world calls for a stronger Europe. The European Union was built on an underpinning logic of global economic integration. For it to thrive in a context of resurfacing protectionism from global superpowers, such as China or the United States, there is a growing necessity for the EU to strengthen its internal market in order to encourage and facilitate inter-European trade. This could be done through the further harmonization of rules of the Single Market.

The importance of **diversifying the export structure** should also be viewed as central for European countries, in order to be less exposed to political and economic shocks coming from Beijing. Some European countries are far too dependent on China for their exports, putting them in a situation where a potential divestment from their Chinese trading partners could have dire economic consequences.

Ultimately, the EU must embrace a more **homogeneous approach and strategy vis-à-vis China and the US**. What is the EU's political and economic relationship with China? What is its strategy? As things currently stand, different countries maintain very different relationships with China. The approach of European countries must be homogenous, which in turn will help businesses better define their strategies.

RECOMMENDATION #4: RETAINING TALENTS - HOPE FOR THE BEST, PLAN FOR THE WORST

Information and communication technologies facilitate access to the talent pool. Simultaneously, this talent pool is threatened by geopolitical tensions. One should need to look no further than at Britain's labor market woes to see that **less economic integration has a negative effect on the supply of labor**. Indeed, access to talent could become more challenging in a decoupled world. If countries were to move to limit the mobility of their labor forces, the implications for companies could be severe. Indeed, major companies around the world heavily rely on foreign talent. Thus, it is critical for countries to work towards developing legal frameworks that protect the mobility of talents in the event of rising protectionism.

Fortunately, **digitalization and artificial intelligence have been a countervailing force to this would-be resurgence of labor protectionism**. Information and communication technologies have created an avenue for companies to maintain their operations while having employees work remotely. The pandemic has exacerbated this trend and created conditions for an even more globalized labor market.

These evolutions are promising, but the risk of economic decoupling to labor markets should not be underestimated. Technology only affects the working conditions of those members of the labor force that have jobs that allow them to work from home (40% of workers in the US). As a result, while nations and companies should remain optimistic that the positive evolutions in global labor markets brought forward by technology will endure, they should also plan for serious disruptions by investing more in adapting their national educational systems to the types of jobs that are in demand in their countries. Further investment should also go towards vocational and skills training for employees. Finally efforts to diversify the workforce in key sectors of the economy should be accelerated as there is a large supply of skilled workers to be found in underrepresented groups.

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AmCham

AMERICAN CHAMBER
OF COMMERCE IN FRANCE

Zahira BENABDALLAH
Membership and Communications Manager, AmCham France
E-mail: zahira.benabdallah@amchamfrance.org

Zachary PASCAUD
Public Affairs & External Relations Manager, AmCham France
E-mail: zachary.pascaud@amchamfrance.org

Jeremy GHEZ
Associate Professor of Economics and International Affairs, HEC Paris
Board Member, AmCham France
E-mail: ghez@hec.fr

77 rue de Miromesnil
75008 Paris, France

www.amchamfrance.org

+33 (0) 1 56 43 45 63