

GEOSTRATEGIC DECOUPLING: HOW US-CHINA RIVALRY IS SHAPING A NEW INTERNATIONAL DIVISION OF LABOUR

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Kycocera is a leading Japanese producer of components for semiconductor fabrication machinery. Like many multinationals, much of its production was, until recently, located in China. Since 2017, Kyocera has been systematically moving production from China to Thailand and Vietnam, even reshoring some of its operations to Japan. Kyocera [President Hideo Tanimoto recently stated](#) that “the business model of producing in China and exporting abroad is no longer viable.”

Kyocera is not alone. Many multinationals headquartered in the OECD are responding to the heightened geopolitical risk posed by US-China rivalry by developing [location strategies that are less Sino-centric](#). While not all MNCs are leaving China as hastily as Kyocera, great power rivalry and its concomitant risks are undeniably driving an economic decoupling.

Decoupling seemed like a remote prospect until recently. Even as Trump launched a so-called ‘trade war’ against China in 2018, [many officials in his administration remained skeptical about the possibility of decoupling](#). Their skepticism was due to the fact that contemporary global production is hyper-complex, and sophisticated goods like smartphones are the products of [industrial ecosystems](#) comprising hundreds, if not thousands, of firms. This complexity defies the efforts of any single actor – even the US Government – to meaningfully influence the geography of production. However, the triple shock of the trade war, Covid-19, and the Russian invasion of Ukraine have [exacerbated geopolitical risk](#) to levels not seen in decades. Decoupling

is now driven by both states seeking to prosecute geostrategy and insulate themselves from supply risks and firms as they attempt to reduce their exposure to geopolitical risk by relocating production and resources to jurisdictions deemed less risky. According to the International Monetary Fund (IMF), these efforts are driving “[gloeonomic fragmentation](#).”

Gloeonomic fragmentation is particularly evident in the sectors anticipated to be the source of hegemony and growth in the 21st century, such as semiconductors, biotech, quantum computing, aerospace, artificial intelligence, electric vehicles, energy storage technology, and more. The possibility that the global economy can remain integrated and insulated from great power rivalry now seems remote, or in the words of Kyocera’s President, “no longer viable.” Instead, great power rivalry is shaping the emergence of a new international division of labour.

Building resilient production networks

The [international division of labour as we know it](#) began to take shape in the 1970s. The oil crises and inflation eroded corporate profits, leading many companies to seek lower production costs by offshoring operations to countries with cheap labour proximate to large consumer markets (e.g., Mexico and Turkey). The end of the Cold War and the emergence of a unipolar international order accelerated this trend, and some ‘emerging’ economies – particularly [BRICS](#) – were able to attract significant foreign direct investment (FDI). The [global production network](#) (GPN) became the spatial expression of globalization in the post-Cold War era, as relatively footloose multinational corporations (MNCs) distributed production worldwide in search of low-cost labour and resources, and jurisdictions with low regulatory burdens.

Since the 2008 economic crisis, the world economy has been characterised by sluggish economic growth *and* a [relative decline](#) in trade and FDI. At the same time, China has emerged as a powerful centre of economic growth and a technological superpower. China’s economic clout has allowed Beijing to refuse to fully accede to US security imperatives and ignore norms regarding state involvement in

the economy. These background conditions – secular stagnation, meteoric economic growth in China, and Beijing’s assertive posture – set the stage for Trump to fuse a series of economic and political issues that had weighed down US-China relations into a grand narrative, in which China has become the US’s primary geostrategic competitor. Meanwhile, the Covid-19 pandemic disrupted supply chains and resulted in shortages of everything from computer chips to shipping container space. As pressures began to ease, Russia’s invasion of Ukraine precipitated an economic shock in the form of higher energy and commodity prices worldwide. These events prompted governments to move decisively to secure strategically significant supply chains.

The US has, in practice, largely abandoned its commitment to a liberal and open world economy. Washington has used a series of tools to strengthen strategic global production networks, such as export controls, subsidies for firms to locate production in the US, investment screening mechanisms, and technology-transfer bans. In 2021, the White House outlined this strategy in a document entitled ‘[Building Resilient Supply Chains, Revitalizing American Manufacturing and Fostering Broad-Based Growth](#).’ This policy framework reverses decades of support for free trade. But according to its proponents, this policy shift is necessitated by the so-called [China Challenge](#). Biden’s [National Security Strategy](#) asserts that China is the only “competitor intending to reshape the international order and, increasingly, the economic, diplomatic, military, and technological power to do it.” In other words, Washington has prioritized maintaining its status as the sole global superpower over its commitment to a liberal economic order. In this context, both Washington and [Beijing](#) are competing to define the geography of strategic production networks.

The intensifying ‘[chip war](#)’ exemplifies this trend. [Alarmed by rapid Chinese progress in semiconductor manufacturing](#) and the [concentration of design and advanced production capacity in nearby Taiwan](#), the US enacted the \$53bn [Chips and Science Act](#) to stimulate domestic production. Shortly thereafter, [the Bureau of Industry and Security cut off China’s access to technology](#) for producing some of the most advanced chips.

While the global economy remains deeply integrated, attempts by Washington and Beijing (as well as the EU and Japan) to strengthen strategic production networks are dramatically impacting the global geography of production. As governments embrace the ‘resilience agenda,’ firms are forced to respond to heightened geopolitical risk. Global production networks are being reconfigured, resulting in a process we refer to as *geostrategic decoupling*.

Geostrategic decoupling and the geopolitics of connectivity

Many leaders worldwide have stated they do not want to be drawn into the US-China rivalry and forced to choose sides. It is entirely rational for national governments to try to maintain access to the world’s two largest economies, both as export markets and sources of inward FDI. Malaysia, for example, is a [recipient of significant investment from US chipmakers](#). However, at the same time, its firms operate far from the technological frontier and remain [deeply integrated within Chinese semiconductor production networks](#).

It remains to be seen how long Malaysia, or any other country, can remain non-aligned. The IMF’s most recent [World Economic Outlook](#) points out that if geopolitical rivalry continues, non-alignment may prove costly:

Rather than having their nonaligned status accepted, these economies may need to walk a narrow path amid pressures from both sides, with the attendant risk of falling out with one bloc or the other. This type of policy uncertainty, in which investors perceive a risk that current policy stances toward that economy could shift radically in the future, can act as an economically meaningful barrier to trade and investment.

In other words, by remaining non-aligned, countries may unwittingly discourage investment and find themselves outside the 21st century’s most dynamic sectors. This has led some countries – particularly those most dependent on the US or China security guarantees – to [reject](#)

[non-alignment and pursue proactive efforts to decouple and diversify strategically significant production networks.](#)

Some countries are responding to geostrategic decoupling by struggling to remain non-aligned, while others are hurriedly signaling their allegiance with one side or another. However, no government can remain aloof from the intense [geopolitics of connectivity](#), and a country's alignment strategy sends a clear signal to MNCs.

In response, MNCs adapt their location strategies and intra-firm relations to mitigate geopolitical risk. They face stark choices, and generally speaking, two paths are possible. The first is to avoid alignment for as long as possible by hedging between the US and China. In practice, this means maintaining activities in both countries. Apple exemplifies this strategy. It has [expansive production networks in China](#), built up over two decades of outsourcing. While it has recently made some moves to [diversify production](#), its factories in 'alt-Asia' remain deeply interconnected with its Chinese production base. Barring unforeseen events, Apple will presumably remain rooted in China. Building production capacity in India and Vietnam would be extremely [slow and costly](#), taking years to replicate its current assembly capacity in China.

By contrast, other firms are prepared to align more closely with one side or the other. [South Korean biotech](#) firms, for example, are collectively divesting from China because they anticipate that the sector is in the crosshairs of US regulators. While this may dent their market share, it may also afford them opportunities to receive political patronage and subsidies. Chip maker Intel planned to ramp up investment in China until 2021, when [it abandoned plans to invest in Chengdu](#) following talks with the Chinese Ministry of Commerce. Since then, it has begun to invest [more heavily in its home US market](#) and allied states. It apparently expects to receive subsidies and support in exchange – it recently promised to build a chip factory in Magdeburg. However, it is [demanding significantly more than the 6.8bn EUR in subsidies already promised](#) by the Federal Ministry for Economic Affairs and Climate Action.

Geostrategic decoupling will likely intensify the global economy's fragmentation in the coming years. In this context, footloose profit-seeking MNCs will be further displaced as the key shapers of the geography of production. Rather than responding simply to market signals, MNCs will be forced to adapt to the demands of a plethora of political actors. The governments of the US and China are at the apex of this emergent political economic order. Still, less powerful states, regional governments, and even municipalities will develop regulatory regimes that reshape global production networks and the spatial division of labour. In some cases, these regulatory orders will be in conflict across sectors. A country may adhere to the US export ban on semiconductor technology while its telecommunications hardware remains underpinned by Huawei hardware. The [IMF refers](#) to this as 'coordination frictions.' These frictions prevent the world from splitting into two somewhat insular blocs, but they will not forestall the emergence of a new international division of labour. A Second Cold War, then, is already being waged – in economic ministries, boardrooms, and on factory floors.

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