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US. Decoupling from China: Strategic logic, Trend and Measures

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Abstract: *With the expansion of the technological revolution, technology is reshaping the international political landscape and reconstructing the national power structure with unprecedented speed and intensity. Technology has become a key variable affecting a country's domestic and foreign affairs. Throughout the history of the rise of great powers, the first step to gaining hegemony is to cultivate and master the technological power leading the entire world. National strength based on technology has become the core content of the competitive strategy of great powers. The safety of the industrial policy and supply chain has become the new focus of national security. Therefore, the United States accelerates the process of decoupling from China, due to the rapid rise of China's national power. Focusing on the history of American economic, this paper sorts out the policy evolution and theoretical logic of American decoupling from China by sorting out and comparing thinktank reports and policy documents, relying on the mercantilism theory of international political economy and the thoughts of American school. Through case analysis, the article draws lessons from the experience of science and technology competition among great powers to provide corresponding suggestions.*

Keywords: *China-US relations, decoupling, supply chain decoupling, industrial policy*

1. Introduction

The 2019 U.S.-China trade war has sparked a long-term rivalry between China and the U.S. Unlike the Cold War, the competition between China and the U.S. will be more complicated. To contain China's rise, the U.S. government is focusing on economic and technological competition, as well as "decoupling" from China through the supply chain, industrial chain, and value chain. According to Kevin Rudd's, the term "decoupling" first appeared in an international relations discussion of US-China relations in May 2018[1]. In August 2018, Steve Bannon, then-US President Donald Trump's chief strategist, argued that the United States needed to "decouple" from China. And the government should take active measures to eliminate the dependence on China (or a Chinese entity) in the industrial chain. Therefore, the term "decoupling" used in this paper refers to the active reduction of reliance on the other party in specific areas due to security considerations, not the severance of bilateral relations or all interactions, which "decoupling" manifests both as the state or result of China-U.S. competition as well as the process of policy adjustment on both sides in China-U.S. competition.

2. The evolution of U.S. decoupling policy towards China

The U.S.-China relation fell dramatically when Donald Trump became president. The trade war has made the Trump administration's China policy became more aggressive, while the spread of COVID-19 in the U.S. has made the U.S government aware of its shortage of critical medical equipment and dependence on Chinese manufacturing. From then on, "decoupling" has become a high-frequency term to describe U.S.-China relations. The phrase "decouple from China" appeared in three times as many U.S. political articles in the first 10 months of 2020 than in the previous three years combined[2]. In May 2020, the Trump administration decided to prohibit Huawei from using U.S. technology to design or manufacture semiconductor chips, causing a significant breakdown in the China-U.S. technology supply chain, which was recognized as the starting point for the United States' technological decoupling from China. Since then, the Trump administration has announced and implemented initiatives or mechanisms to contain China's technology, including "China Initiative" led by the U.S. Department of Justice, "Clean Network" and "the Multilateral Action on Sensitive Technologies" led by the U.S. Department of State,

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and others. The Trump administration has developed a basic framework for decoupling from China using policy tools including sanctions, export controls on key products, an entity list, and bans on scientific research, education, and personnel exchanges.

In Biden's presidency, his China policy did not change significantly. He inherited the framework of competition with China during Trump's era and regarded science and technology competition as the core of strategic competition between China and the U.S. The decoupling strategy from China became systematic and precise by constructing a "small yard, high fence" strategy. Meanwhile, the Biden administration adopted the Indo-Pacific Economic Framework(IPEF) to include India, ASEAN, Japan, South Korea, Australia, and other countries into a US-led group in order to hedge against China's growing influence in the region and to create "all-area competition," "cross-area competition," and "long-term competition" against China. In June 2021, the Treasury Secretary Janet Yellen said she expects the U.S. to decouple in some areas from China to protect its national security[3]. On May 23, 2022, the IPEF was officially launched in Japan, with the combined economies of the 13 first members accounting for approximately 40% of the world. As the most important pillars of the four, trade and supply chain statements are the most comprehensive. By coordinating intra-regional export controls on China, restricting exports of "sensitive" products to China to improve the transparency, diversity, security, and sustainability of the supply chain, making the supply chain more resilient and well-integrated.[4] The launch of IPEF is a major turning point for the U.S. to join with Indo-Pacific countries to collectively implement decoupling strategy in order to counter China's regional economic influence. In addition, the U.S. has strengthened its cooperation with EU and accelerated the complete decoupling from China in high-tech fields and key industries. The U.S.-EU Technology Trade Council (TTC) was established in September 2021 and held its first meeting to consult on five topics: investment reviews, export controls, artificial intelligence, semiconductor supply chains, and global trade challenges.[5] According to Business Insider Deutschland, the U.S. and EU are seeking united front to confront China's tech ascent. The joint statement published in May 2022 decided that the U.S. and EU plan to reduce their "dependence" on China in areas such as semiconductors, critical minerals, clean energy, and pharmaceuticals. The U.S. and EU will strengthen their cooperation to advance transparency in and diversification of the supply chain[6]. Biden officially signed the *CHIPS and Science Act of 2022* into law in August 2022, providing more than 52 billion US dollars in support for semiconductors' R&D, production, and labor training. The China guardrail provision stipulates that "any company seeking CHIPS Act funding to enter into an agreement…for a 10-year period beginning on the date of a CHIPS Act award not to engage in any significant transaction involving the material expansion of semiconductor manufacturing in China or any other foreign country of concern.[7]" At the same time, the Department of Commerce (DoC) issued a ban on the export of more advanced process production equipment of 14 nm and below to China. On October 7 in 2022, the U.S. announced new measures to restrict the sale of semiconductor technology and equipment to China, including the requirement for U.S. chip manufacturers to apply to the DoC for an export license to export chips used in advanced artificial intelligence computing and supercomputers, as well as the right to prohibit the import of chips that use U.S. technology but not manufactured in the U.S. The US Department of Commerce's Bureau of Industry and Security's Unverified Verification List has added 31 new Chinese companies, limiting their access to certain regulated US semiconductor technology. It is seen as the largest policy shift in U.S. technology exports to China since the 1990s, marking the first time the U.S. has cracked down on Chinese-made storage chips for non-specific military uses through export controls. The U.S. government's systematic crackdown on China has spread from manufacturing to research and development, broadening the scope of the concept of "national security" in competition with China. The U.S. government is using its policy toolkit to squeeze China's high-end manufacturing sector and create a full chain of decoupling from R&D-production-sales to reclaim its lost leadership position in many areas.

3. The Reason for U.S. Decoupling from China

3.1. Realistic Reasons

3.1.1. Domestic Political Changes

In the 1990s, the world entered an era of hyper-globalization. China's Reform and Opening-up and the emergence of many emerging economies provided massive low-cost goods, services, energy, and commodities, resulting in a complex industrial chain and division of labor around the world. After getting over the economic stagflation, the U.S. economy entered great moderation with low inflation. The relative stability of geopolitics allowed production to be effectively allocated to the lowest cost without

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having to concern investment security, and many U.S. companies came to China and other emerging countries to build factories, and the high-cost manufacturing industry flowed out to emerging economies like China and Southeast Asia. Replacing manufacturing with rapid financial development and free circulation of capital, the U.S. has experienced high economic growth. The world manufacturing center began to shift, China and Southeast Asia emerged as the world's manufacturing center. The relative decline of domestic industry poses the risk of losing the status of the U.S. as the "core". In *US Power and the Multinational Corporation: The Political Economy of Direct Investments*, Robert Gilpin proposes four strategies for coping with the relative decline of domestic industry. The fourth one is the "retreat of the core", where the core needs to retreat to protectionism or rebuild some kind of preferential system as the periphery upgrades its economic and industrial structure and moves away from its dependence on the core[8]. The 2008 financial crisis and the COVID-19 pandemic ended the era of low inflation and high growth on which American affluence was based, and entered into wage-price spiral inflation. As of August 2022, the core inflation rate in the U.S. is at a high level of 4.8% and continue to rise[9]. The ongoing recession and rising inflation have created opportunities for protectionism and growing public anger over stark income and wealth inequality, giving rise to more pro-worker and "laggard" policies, including a push to bring manufacturing back to the U.S.

3.1.2. The Sputnik Moment of China and the U.S.

A Sputnik moment refers to a moment that people realize that they are being threatened or challenged and must redouble their efforts to catch up. It comes from the time when the Soviet Union launched the first satellite, the Sputnik 1, and beat the USA into space.

Globalization accelerated the diffusion of technology, and economies on the periphery have taken advantage of this to gain access to some of the latest technological developments. As a result, China has made significant advances in a variety of new technologies, including 5G, AI, quantum technology, and so on. The Center for Strategic and International Studies (CSIS) found that over the past 30 years, China has become a global manufacturing center of excellence, the largest source of imports for more than 1/3 of the world's countries in all industries, and the world's largest trading partner in terms of volume of goods[10]. China is dominant in the upper reaches of the supply chain in multiple sectors and surpassed the U.S. in 2010 to become the world's largest value-added manufacturer, accounting for 28% of global production by 2018. And as demonstrated in a survey by Hamilton Center for Industrial Strategy, from 1995 to 2018, China's share of total global advanced industrial output experienced a rapid increase from less than 4% to 21.5%. Though the U.S. has maintained overall growth, it has seen a decline in market share in electrical equipment, machinery and equipment, and motor vehicle production, among others. Over the past 20 years, the relative share of the U.S. in global advanced industrial output has declined by 16 percentage points.[11] The U.S. Special Competitive Studies Program (SCSP) believes that "China is becoming a dominant economy of the future", and China has established a dominant supply chain in new energy design and production, new technologies, and the supply of rare resources that are closely related to military defense. Various changes have forced U.S. policymakers to rethink their industrial policies based on neoclassical economics and free market. A debate has emerged in U.S. public opinion that the Sputnik moment has arrived in China and the U.S.[12]. The change in the international industrial landscape caused by China's rising technological power is the main reason behind the U.S. choice to decouple from China.

3.1.3. The Rise of External Risk and the Uncertainty

The worldwide spread of COVID-19 caused a sudden disruption of the global supply chain. The severe material shortages that occurred during the outbreak made the U.S. government realize that it had become "overly" dependent on China in many areas, relying on China for 97% of the basic personal protective equipment and medical devices needed for the outbreak and more than 80% of the active pharmaceuticals[13]. Therefore, enhancing supply chain resilience has become a consensus among all sectors of U.S. society.

The Russia-Ukraine war and the rising external risks caused by geopolitical instability are also reasons why the U.S. is accelerating the process of decoupling from China. The war has cut off the access to cheap energy, and rising energy prices have caused the global economy to fall further into recession before it can get out of the epidemic dilemma. The conflict has also affected the general decline in expectations of market stability in China in the western world. Dale C. Copeland proposed trade expectations theory, which argues that the impact of economic dependence on state behavior depends on its expectations of the future trade environment. This theory makes a judgment about economic interdependence and the occurrence of war, if a country has positive trade expectations for the future, it tends to pay more attention to the benefits of maintaining the current state of peace and the significant

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costs of conflict with other countries, and therefore will maintain peace. However, if trade expectations for the future are negative, leading the country to believe that future trade with other countries will be interrupted and foreign investment will be terminated, which will prevent it from obtaining the raw materials and investment needed for development and lead to economic decline, which in turn may lead to a pre-emptive war to prevent other countries from growing and threatening it[14]. Constructing new supply chains based on values to hedge external risks to enhance supply chain resilience and diversify supply chains has also become one of the reasons for the U.S. decoupling policy.

3.2. Historical and Theoretical Basis: American School

In early days of capitalist expansion, classical mercantilism emerged as the first theory in the tradition of political economics to achieve rapid accumulation of wealth, initiating the abusive idea of state intervention in the economy. Proposals such as import bans and tariff protection and charters were the main policy features of late mercantilism. German mercantilist economist Friedrich Lister discussed the economic theory of the state, emphasizing the decisive importance of industry as the backbone of a country's economy, and free competition do not give a country that lags industrially an advantage in competition. Therefore, Lister believed that the protection and development of domestic industry was the key to competitive victory, and tariffs were the main measures of establishing and protecting domestic industry[15]. Meanwhile, Lister also pointed out that "although a country's foreign market is extremely prosperous, its domestic market is ten times more important to it than the foreign market ..... While it is important to pursue wealth abroad, there is ten times more important than this is the cultivation and defense of the domestic market".

The main ideas of classical mercantilism deeply influenced the United States, and from the Civil War to the middle of the 20th century, the national economics dominated the national macroeconomic policy of the U.S., which later developed into the American School. Jia Genliang believes that "the economics of the American School was used by the Whig Party and the Republican Party after 1854 as a platform for campaigning and governance, and dominated American political life after the Civil War until the rise of the United States in 1894"[16].

The American school is founded on the three pillars of industrial policy: trade protectionism, massive government investment in infrastructure, and government-led establishment of financial infrastructure. As the founder of the American school and the first Secretary of the Treasury, Hamilton believed that "not only the wealth of the nation, but also its independence and security are materially bound up with the prosperity of manufacturing". It was under the guidance of this idea that early policymakers introduced *the Tariff Act of 1789*, *the Tariff Act of 1816*, *the Morrill Act*, and other laws to protect the development of domestic industry and agriculture in the form of tariff barriers. In 1817, the U.S. Congress imposed a monopoly on U.S. ships in the shipping industry and continued this restriction until World War I[17]. This was the prototype of the U.S. government's policy to manipulate the industrial chain. In 1824, Henry Clay proposed an "American system" centered on protective tariffs, internal improvements, and a national bank. Hamilton's ideas were then formalized into a formal national strategy to guide the U.S. out of dependency and into a fast economic development. In *America's Protectionist Takeoff: Economic Theory and Politics (1815-1914)*, Michael Hudson writes: "In 19th Century, the American school believed the U.S. could remain truly independent relative to Britain and other European countries only if its economy was isolated from Britain and other developed industrial nations; because the growth of domestic demand could finance its economic expansion, the U.S. did not need to rely on external markets, a theory that guided the economic policy making of the U.S. as it emerged as the world's industrial and agricultural power at the turn of the 19th and 20th century"[18]. Affected by the American School, in the Great Depression, President Roosevelt adopted the method of government intervention in the economy and massive investment in infrastructure, which enabled the U.S. to survive the economic crisis without breeding Fascism, and did not fall into a long-term recession, but instead entered rapid development, and became the most powerful country at that time through two world wars. It can be found that the theoretical origin of "decoupling" can be traced back to the American school that the U.S. followed in the early days of its founding. It was through economic decoupling from Britain and diplomatic isolationism that the U.S. was able to break away from its dependence on Britain and achieve national economic independence, and eventually emerge as a great power. Under the guidance of the American school and through protective industrial policies, the U.S. emerged from the Third Industrial Revolution and created a complete manufacturing system and a capital-intensive industrial pattern to increase productivity, and creating a technological and financial empire. Recently, the U.S. has turned the trade protectionism into an informal, non-transparent policy and legal tool, greatly increasing informal trade barriers, unilateralism, and administrative decisions, with covert and unrecognizable

ISSN 2616-7433 Vol. 4, Issue 12: 47-54, DOI: 10.25236/FSST.2022.041206

methods. This phenomenon of protectionism under the banner of liberalism has intensified along with the decline of U.S. comparative advantage and the strengthening of multipolarity.

3.3. Neoconservative ideology

Neoconservatism dominated the U.S. foreign policy-making in the ideological sphere, plunging China and the U.S. into a higher intensity of competition and causing the absolutization of conflict. Neoconservatism emerged in the 1960s as a backlash against the radical liberalism then prevalent in the U.S., represented by the Reagan administration, and was highly hawkish in its foreign policy, advocating toughness against the Soviet Union and vigorous arms development. In 1997, William Kristol launched a neo-conservative thinktank called the Project for the New American Century (PNAC), with four ideas that would become the neoconservative foreign agenda. The second one, consolidate the "democratic coalition" and challenge the "regimes hostile to our interests and values" [19], is evident in the current shift in U.S. policy toward China. In the 2018 U.S. National Defense Strategy, China and Russia are listed as institutional challengers to the United States. The competition between China and the U.S. shifts from economic and trade interests to ideology. In Biden's Indo-Pacific Strategy, liberal democracy is bundled with the dissemination of key technologies, seeking to establish a new supply chain of liberal democratic states in the Indo-Pacific region, contrary to the market choice theory of liberal economic advocacy. Under the influence of neoconservative ideology, decoupling from China has become an inevitable option for U.S. foreign policy.

4. Trends and Characteristics of U.S. Decoupling from China

4.1. Decoupling of High-tech Sectors and Re-coupling of Low Value-added Industries

In the future, the U.S. decoupling from China will present a "half-coupling" state, which means decoupling from China in key areas, such as chips and semiconductor manufacturing, 5G and other high-tech fields, and re-coupling or partial decoupling from China in economic and trade areas, such as trade in goods and services or some low value-added industries.

In September 2020, the China Taskforce released a report: *Meeting the China Challenge: A New American Strategy for Technology Competition*, which advocates competition with China in four areas, including basic research, 5G, AI, biotechnology, and suggested that "it will be necessary to impose some restrictions on openness"[20]. However, prudent decision-making is required to avoid harm to the global knowledge economy and US leadership. Former chair of the U.S.-China Business Council Evan Greenberg called "decoupling" an "economic impossibility", he said "decoupling" will only "feed China's worst instincts" and at the same time undercut U.S. global competitiveness[21]. Details of the Biden administration's trade policy toward China, announced by U.S. Trade Representative Katherine Tai in October 2021, reveal a continuation of the Trump administration's tariffs on China, but emphasize that the U.S. does not intend to inflame trade tensions with China. Also, she proposed a new narrative of "re-coupling" and "durable coexistence". In the future, more multinational companies will choose the "China+1" strategy, which will have a huge impact on many small and medium-sized manufacturing companies in China.

4.2. Soft Decoupling Instead of Hard Decoupling

"Soft decoupling" refers to a method of gradually isolating China from core technologies and supply chains. The bottom line for continued U.S.-China trade should be profit, and the U.S. will seek an orderly and gradual decoupling. The U.S. will prefer to use the policy toolbox to establish a clear, targeted, and comprehensive decoupling strategy in the future. As Jon Bateman concludes in his study, "Without a clear strategy...Washington may accidentally set in motion a chaotic, runaway decoupling that it cannot predict or control.[22]" Therefore, the decoupling will happen slowly but naturally. The Center for Strategic and International Studies, sees "decoupling" in an interview as an acceleration of at least a decade-long trend.

4.3. Defensive and Offensive Strategies Simultaneously

A report released by the Carnegie Endowment for International Peace shows that early decoupling actions against China were mainly defensive policies, including export and import controls, investment restrictions, licensing regimes, visa bans, financial sanctions, technology transaction rules, federal

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spending limits, and law enforcement actions, aimed at containing China's technology rise. In the future, the U.S. decoupling strategy will become more offensive to nurture its own technological strength [23]. In the context of seeing China as a systemic competitor, the U.S. will combine defensive and offensive actions in its policy of decoupling from China to achieve the effect of extreme pressure on China in the technological field.

4.4. A Whole-of-government Strategy of Decoupling from China

The U.S. will develop a whole-of-government system to counter China. A report by the Office of Senator Tom Cotton argues that early the U.S. competitive performance against China was barely satisfactory, mainly because the federal bureaucracy did not fully mobilize all resources to develop an efficient competitive system and targeted policy plan[24]. On June 8, 2021, at the same time the White House released its assessment of *Building Resilient Supply Chain, Revitalizing American Manufacturing, and Fostering Broad-based Growth*, it established the Supply Chain Disruptions Task Force (SCDTF). The USTR established Supply Chain Trade Strike Force, the Department of Public Health Services established the public-private partnerships(PPPs). The Special Competitive Studies Program writes in its report: "The U.S. must marshal public, private, and public-private resources to put the appropriate focus behind bold technology goals".

4.5. From offshoring to friend-shoring

The global division of labor means moving all manufacturing back home is no longer an economically rational choice, rebuilding supply chain resilience becomes the best option for the U.S. to decouple from China and rebuild competitiveness. In May 2020, USAID officials introduced the concept of "ally-shoring", and in White House's *100-day supply chain report*, the concept of "friend-shoring" was formally adopted, particularly in relation to the supply chain components of critical minerals and rare earths. The decision on supply chains in the Indo-Pacific economic framework is an even better way of thinking about "friend-shoring". In July 2022, during a visit to South Korea, U.S. Treasury Secretary Yellen mentioned that "friend-shoring is about deepening relationships with trusted partners and diversifying supply chains to reduce economic risk"[25]. Friend-shoring would make it possible for the U.S. to arbitrarily expand decoupling from China on security grounds. However, there will be different degrees of divergence within the West concerning China's decoupling, which needs to be discussed separately. In general, the degree of decoupling needs to be judged by the degree of interdependence of the economies. The more dependent a country is, the more motivated it may "decouple" from China, but the more costly and difficult it is to "decouple" because its economic and trade relations are more complex.

5. Case

The U.S.-Japan technology war can help us understand the current situation in a more focused way. During the 30-year-long competition from the mid-1950s to early 1990s, the U.S.-Japan technology war escalated from economic and trade frictions to the containment of Japan's high-tech development, ultimately leading to Japan's "the lost decade". The U.S. share of global semiconductor production remained steady at 60 percent through much of the 1960s and 1970s, but by the end of the 1980s it had fallen to below 40 percent[26]. This led the U.S. government to see a threat to its national competitive advantage and the need for more direct intervention in key areas to ensure that its position of comparative advantage was not compromised. The U.S. government partnered with a newly formed consortium of 14 U.S. semiconductor companies called SEMATECH in 1987. SEMATECH received over $800 million in support funding from the federal government to help the U.S. semiconductor industry rebound. In addition, the U.S. has used many policy tools to sanction and suppress Japan's semiconductor industry; the IBM spy case and the Toshiba-Kongsberg scandal gave the U.S. government a pretext to impose sanctions on Japanese companies in the U.S., and while negotiating with Japan, the U.S. used Section 301 of *the Trade Act of 1974* to investigate Japan. According to statistics, from 1985 to 1995, the USTR conducted 301 investigations into Japanese semiconductors, artificial satellites, supercomputers and auto spare parts. The U.S. and Japan eventually signed the *Plaza Accord* in 1985 and *the 1986 U.S.-Japan semiconductor agreement*, etc., which quickly thwarted the export advantages of Japanese high-tech industries and greatly reduced the overseas share of Japanese companies in a short period of time. In the 1990s, South Korean and Taiwan companies gained market dominance in DRAM and wafer foundry respectively, and Japan could only transform the upstream materials and equipment field after losing the

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advantage. Through both the supply and demand sides at the same time, the U.S. successfully compressed the living space of the Japanese semiconductor industry, making it a link in the U.S. global industrial chain.

6. Conclusion

In future competition, scientific and technological strength is the key. However, China still faces strangling difficulties in several key technologies. In this regard, China needs to recognize the seriousness and urgency of the situation, and formulate effective industrial policies around decoupling from China to reasonably manage the conflict.

The "decoupling" will be a protracted economic war with clear objectives, and China is at a critical period when it needs to rapidly upgrade its industrial structure to cope with the decoupling. Therefore, it is important to realize that relying on free trade and comparative advantage dividends is unrealistic, an internal-oriented industrial policy is inevitabl. In *The Political Economy of International Relations*, Robert Gilpin states that "Some economic sacrifice is necessary for the sake of military defense, but also in the interest of long-term economic prosperity"[27]. The outflow of low-value-added manufacturing is a trend of industrial upgrading, requiring us to seize the time to form a complete high-tech industrial pattern and prevent the hollowing out of the manufacturing industry from causing an economic recession. We need to take initiatives actions, fully develop domestic potential, elevate the large internal unified market to national security, and build a large domestic economic cycle of high efficiency and quality.

Second, more investment should be made to rapidly cultivate technological advantages. We need to strengthen the supervision of research-based enterprises and increase investment in R&D. We also need to increase the cultivation of talents, mastering intellectual resources is the key to victory, high investment in professional talents is a long-term return.

Third, a new system concentrating nationwide effort and resources on key national undertakings has great advantages in rapidly nurturing advanced industries and enhancing the resilience of supply chains to respond effectively to competition. Karl Theodor Helfferich, the German finance minister during World War I, mentioned that "the core of the German economy to remain relatively functional under the blockade was to mobilize all resources to maintain and maximize domestic production capacity."[28].

Finally, industrial policies can help achieve industrial autonomy to a certain extent. The competitiveness of the Chinese economy ultimately relies on the strength of high-tech enterprises. Moderate protection of the industrial sector in its growth phase is not a resistance to globalization; the two are not antagonistic. On the contrary, moderate protection of the domestic market can hedge against the risks associated with changes in international markets.

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