

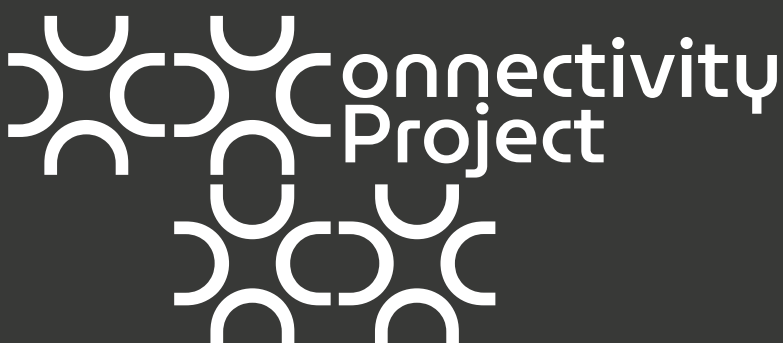


Hungarian Institute  
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# The Risk of Decoupling and De-risking

*by Philip Pilkington*



# The Risk of Decoupling and De-risking

Visions of European political economy have in recent years been dominated by concepts of decoupling and de-risking. According to these concepts, Europe in particular and the West in general should seek to limit their dependency on, and even trade with, perceived global adversaries such as Russia and China. Yet few recent studies have attempted to substantiate the global interdependence of the European economy, and the costs that would be imposed by attempting to limit this global exchange. The future of Western economies will be decided between strategies of decoupling on the one hand—with a potentially enormous economic cost—and a renewed appreciation for connectivity on the other.

The connectivity of the global economy is now such that trying to untangle it through aggressive intervention is impossible and ultimately self-destructive.

If pursued to their logical conclusion, policies based on decoupling and de-risking would leave Europe increasingly vulnerable to deindustrialization and consequent inflation, as today's fragile supply chains become even more delicate in an increasingly multipolar world.

The origins of the trend toward decoupling lie, as we shall see, in a reaction to the “over-globalized” world created in the 1990s and early 2000s—the world in which, many people thought, it would no longer matter where things are made. As the geopolitical assumptions around this form of globalization have failed to materialize, a counter-impulse has set in. But as with most attempts at rapid geo-economic shift, efforts to “decouple” Western economies (and especially Europe) from perceived adversaries have quickly reached their limits.

Since the decoupling trend began over the last seven or eight years, European leaders have begun to reframe the concept. Beginning in June 2023, the European Council announced that the EU “does not intend to decouple or to turn inwards” away from China. But the Council declared that the EU’s policy is to “continue to reduce critical dependencies and vulnerabilities, including in its supply chains”—in other words, a policy to “de-risk and diversify where necessary and appropriate.”<sup>1</sup> Current efforts toward “de-risking” European economies have been focused on attempts to cap or limit the dependency of European manufacturing on raw materials supplied especially by Russia (energy) and China (raw materials). But while increasing Europe’s ability to harvest its own raw materials is a praiseworthy one, political efforts toward de-risking have tended to result in ham-fisted attempts at sanctions and trade wars.

In the following study we want to examine global economic interdependence seriously. We want to try to quantify, at a very abstract level, the basic dependencies that exist in the world economy to see if these have increased in recent decades

1 <https://www.consilium.europa.eu/en/press/press-releases/2023/06/30/european-council-conclusions-on-china-30-june-2023/>

and whether different countries and regions have different levels and types of dependencies. While this abstract overview will not answer every question about global interdependencies, it will at least offer the reader a “mental map” to understand where these dependencies exist, how they have developed through time, and which regions are more or less globally interdependent. This analysis is essential for evaluating how efforts toward decoupling and de-risking would affect regions differently, and therefore for evaluating corresponding policy proposals.

As we will show, the European economy is a functionally open one that benefits from strong global interconnection. Not too long ago, this idea was taken for granted—and formed the basis of a flexible and dynamic European economy. For the European economy to enjoy continued success, it will need to return to this strategy of connectivity.

## Origins of Decoupling and De-risking

The idea of decoupling Western economies from China appears to have arisen in 2015 during Donald Trump’s campaign for the presidential election in 2016. Trump’s concerns about free trade—or “bad trade deals” as he routinely referred to them—were a constant theme in his career as a public businessman who enjoyed courting the press. As early as 1987, for example, Trump appeared on the *Larry King Live* show on CNN to discuss whether he had political ambition.<sup>2</sup> “I am sick of other countries ripping off the United States,” Trump said, and he went on to highlight the American relationship with Japan, which at the time accounted for the majority of America’s growing trade deficit.

When Trump began his campaign for president, he asked his son-in-law Jared Kushner to find him an economic adviser. Kushner reportedly went on Amazon in search of economists dealing with the topic and found Peter Navarro, author of a book called *Death by China* and professor of economics and public policy at the Paul Merage School of Business, University of California.<sup>3</sup> Navarro would later become Assistant to the President and policy coordinator of Trump’s trade policy. The fact that Navarro was plucked from obscurity shows just how reluctant economists were to discuss the fact that the United States was running enormous trade deficits with China.

Just before the election, in late September, Navarro and his coauthor, a private equity investor called Wilbur Ross, published a paper entitled “Scoring the Trump Economic Plan: Trade, Regulatory, and Energy Policy Impacts.”<sup>4</sup> The paper highlighted serious problems in the American economy that were unfashionable to discuss in economic circles.

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2 <https://www.youtube.com/watch?v=A8wjC7vHcTs>

3 <https://thehill.com/homenews/administration/328969-report-kushner-found-trump-economic-advisor-navarro-by-browsing/>

4 [https://web.archive.org/web/20170309013333/https://assets.donaldjtrump.com/Trump\\_Economic\\_Plan.pdf](https://web.archive.org/web/20170309013333/https://assets.donaldjtrump.com/Trump_Economic_Plan.pdf)

Since the era of globalization, manufacturing as a percent of the labor force has steadily fallen from a peak of 22% in 1977 to about 8% today. To those who would blame automation for the decline of manufacturing, one need only look at two of the most technologically advanced economies in the world, those of Germany and Japan, each of which is a worldwide leader in robotics. Despite declines in recent years, Germany still maintains almost 20% of its workforce in manufacturing while Japan has almost 17%. (p. 10)

The paper goes on to state that critics “have attacked Trump as an ‘Isolationist’ and ‘protectionist’ who will start a ‘trade war’” but that “these attacks reveal a more fundamental lack of understanding of the role trade deficits have played in constraining US economic growth” (p. 15). Navarro and Ross then go on to effectively lay out a plan to start a trade war. First, they would identify countries they believed to be “currency manipulators,” most notably China, and “impose defensive and countervailing tariffs if the currency manipulation does not cease” (p. 16). The plan also involved identifying countries that were “cheating” on trade deals and imposing tariffs on them and renegotiating older trade deals, most prominently the NAFTA trade deal signed by President Bill Clinton in 1993. In response 370 economists including 8 Nobel Prize winners signed a letter against the Trump plan, which it said favored “magical thinking and conspiracy theories over sober assessments of feasible economic policy options.”<sup>5</sup> The letter did not contain any serious discussion of the American trade deficit, and it is worth noting that many of the signatories are currently supporting even more aggressive trade war policies being undertaken by the Biden administration.

It is interesting that Navarro used the example of Germany when highlighting American problems with manufacturing and trade. Navarro’s criticisms of American policy were clearly grounded, even if his ideas about launching a trade war were unrealistic and poorly thought through. The response to Navarro by the academic economists was ultimately shallow and political. Yet as interesting as this debate was from an American perspective, it seems obviously out of place from a European perspective. After all, as Navarro highlights: many European countries had, until recently, robust manufacturing sectors and trade surpluses. The imposition of American discussions about these issues immediately feels alien, even before looking at the actual data which, as we shall see, only reinforces this initial impression.

## How the COVID Response Accelerated Decoupling

Trump and his team laid the foundations for the move toward decoupling with China. But even as the Trump administration pursued their protectionist policies, they were by no means mainstream. They were not widely accepted by the public and newspaper headlines regularly criticized the policies. All this changed with the onset of the COVID-19 pandemic in 2020.

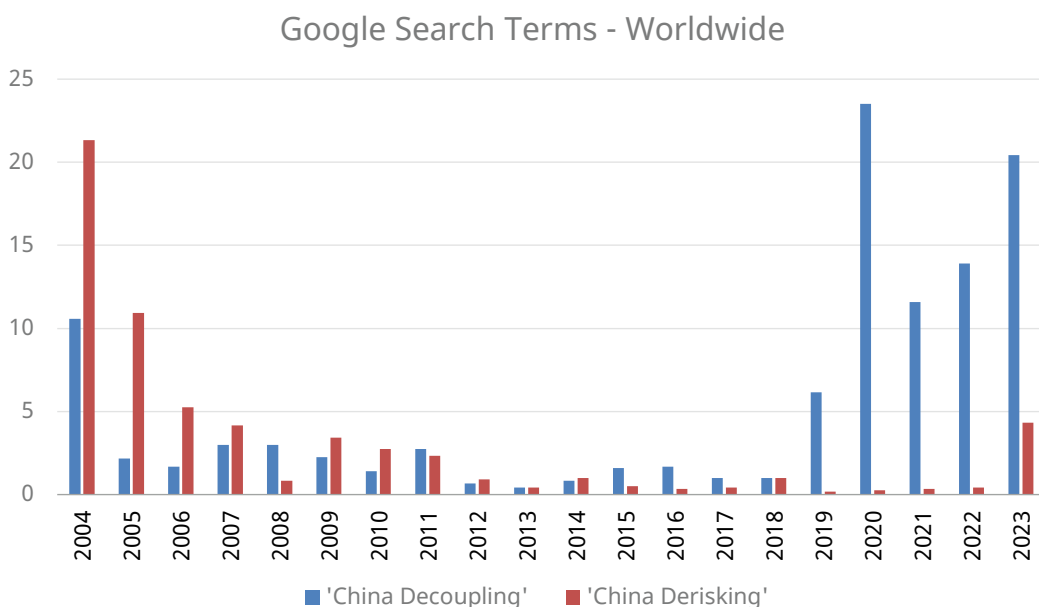
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5 <https://www.timesofisrael.com/hundreds-of-prominent-us-economists-warn-against-voting-trump/>

It appears that the impetus for this development was the immediate experiences of Americans to source masks and other medical equipment, much of which was imported from China.<sup>6</sup> These experiences gave rise to a raft of articles highlighting “supply chain dependencies” and other issues related to globalization. The underlying assumption of many of these articles was that global supply chains themselves were the problem, rather than the interventions in the global economy driven by the response to the pandemic.

In the course of the pandemic response, Western publics and especially the United States came to realize that China was a large producer of N95 masks and were prioritizing domestic consumption of them rather than allowing them to be exported.<sup>7</sup> This led to the onshoring of mask production in many Western countries.

During and after the pandemic, more general discussion around decoupling from China then became widespread, as can be seen from the following chart which shows the relative frequency of Google search terms.



Yet the origins of the debate show why it has become so misleading. The hoarding by China of N95 masks was an unusual event that could, and was, easily overcome by onshoring mask production. After all, N95 masks are extremely easy to produce and, with adequate government support and subsidy, it was easy for domestic companies to start production. Yet the broader supply chain disruptions caused by the pandemic were much more widespread. Every economic sector suffered delays from suppliers. The worst of these were retail trade, construction and manufacturing, with 50–60 percent of these businesses suffering supply delays.<sup>8</sup>

6 <https://hbr.org/2021/05/the-strategic-challenges-of-decoupling>

7 <https://poole.ncsu.edu/thought-leadership/article/need-to-know-supply-chain-impacts-where-are-all-the-n95-masks/>

8 <https://www.whitehouse.gov/cea/written-materials/2021/06/17/why-the-pandemic-has-disrupted-supply-chains/>

These delays had multiple causes, but the main ones were the seizing up of global transport networks in the face of the new restrictions. Yet unlike with N95 masks, these problems could not easily be solved by increasing domestic production. The supply chain issues here were related to products that are by no means simple to produce. Many came from industries that require years or even decades of fixed capital investment to function and require employees with very specific skills and educations.

The fact that the decoupling debate emerged as a reaction to a global event explains why it started out, and thereafter remained, largely undefined. Was the debate purely focused on medical equipment? Did this refer to all medical equipment, or just the specific medical equipment required to counteract the effects of the pandemic? Or were people concerned about supply chain dependencies in general? And in that case, was their preference for total autarky, where the American economy would produce everything from antibiotics to diamonds domestically?

Even after the fear surrounding the pandemic subsided, these questions remained in the air. And as often happens, they made their way from the desks of American policymakers to ones in Brussels and European capitals. Yet they continued to be undefined. We might have hoped that the initial discussion, based as it was on a reaction to events and therefore rather vague, would give rise to economists and policymakers trying to quantify the supply chain dependencies that globalization had introduced into the global economy. But no such quantification was forthcoming. Instead, policymakers—especially American policymakers—started to enact policies that seemed poorly justified and not clear in what they were meant to achieve.

## The Difficulty of “De-Risking”

Even though the debates around decoupling in the pandemic were highly misleading, they succeeded in normalizing the idea. When the Biden administration took power, it became clear that the Trump-era policies would be continued and even expanded. The main advocate for these changes was National Security Advisor Jake Sullivan. But as the initial talk of decoupling was looked upon negatively by America’s allies and seen as overly protectionist, the Biden administration started talking about “de-risking.”

The meaning of decoupling and de-risking is clear enough: it principally entails cutting ties between the United States and China, with consequent pressure exerted by the United States on Europe to decouple as well. De-risking is more difficult to understand. According to the European Union, it means evaluating European “dependence” on China in critical areas (semiconductors, AI, quantum, biotech), for example by fostering domestic extraction of raw materials that go into making high-technology products and those required by the green transition. From an American perspective, it appears to mean cutting ties with adversarial countries in areas that the United States determines to be strategically important. Overall, talk of de-risking creates an environment in international trade that leaves

businesses in both Europe and China nervous about the future. Official platforms for exchange between Western countries and China have been reduced, as have China's Belt and Road Initiative investments in Europe.

In practice, efforts toward de-risking have mainly been focused on limiting exchange between the Western and Chinese semiconductor industries. While the explicit justification by the United States for the bans on exports of advanced semiconductors to China is that the Chinese might use it to develop military technology, the reality is that the United States wants to keep a technological edge over the Chinese. The strategy appears to be to keep China one step behind in both consumer and military technology by starving them of access to advanced semiconductors. In practice, this is how de-risking is used as an economic strategy by the United States.

Currently, however, China has responded by successfully producing their own advanced semiconductors, and so the strategy appears to be self-undermining. By creating a competitive alternative industry in China, it is simply eroding the West's market share, which had previously maintained a monopoly over advanced semiconductor production.

Much of this was predictable and was highlighted by industry experts. For example, in the summer of 2023, former Samsung executive and South Korean lawmaker Yang Hyang-ja said that: "The more the US sanctions China, the harder China will try to make rapid technological progress. China will provide more national support for the goal. Then it will pose a crisis to South Korea, given China's abundant talent and raw materials."<sup>9</sup> With statements like this, it became increasingly obvious that American trade strategy was not being run by either industry experts or even economists. It increasingly looked like a purely reactive strategy, cobbled together quickly in response to fears raised by the pandemic.

Beyond this, the Chinese response has shown clearly how dangerous even de-risking is as a strategy. In response to the de-risking strategy, China has hinted at putting export restrictions on the rare elements germanium and gallium, which are essential for much of the American and European electronics industries.

The European Union has stated that, by 2030, it "should extract at least 10% of the raw materials it consumes," and that "no country from outside the EU should provide more than 65% of the EU's annual consumption of any strategic raw material."<sup>10</sup> While germanium and gallium are not difficult to manufacture, to produce them in large quantities a country needs a large heavy industry—aluminum/bauxite processing for gallium, zinc for germanium.<sup>11</sup> Creating these large heavy industries would take a decade or more, would require enormous economic restructuring and would raise concerns among Western environmental pressure groups. The gallium-germanium debate shows in microcosm what we hope to highlight in the

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9 <https://www.ft.com/content/26770ab3-f71c-4f39-8569-273a12ffb7b0>

10 <https://www.europarl.europa.eu/news/en/headlines/priorities/circular-economy/20211118S-TO17611/sustainable-supplies-of-critical-raw-materials-crucial-for-eu-industry>

11 <https://www.ing.com/Newsroom/News/China-strikes-back-in-the-tech-war-restricting-exports-of-gallium-and-germanium.htm>

following study: that, praiseworthy as it may be to increase Western domestic output of important commodities and other products, the “decoupling” and “de-risking” framework are implausible and self-destructive. Only a connectivity-based approach, emphasizing mutual benefit for Western countries and their Asian counterparts, can provide economic growth and security.

## Assessing Global Import Dependency

When trying to determine the risks posed by decoupling and de-risking at the most abstract level, we need to understand how the world is connected in terms of imports. The global economy is infinitely complex, but we can use trade statistics to tease out what the basic connections and dependencies are. As we already suggested, most imports are not easily substitutable by domestic production. Not every import is a cloth N95 mask, and the vast majority of imports have a whole domestic supply chain standing behind them in the producing country.

For example, it has become popular for Americans to import mini skid steers (also known as mini track loaders) from China to do lighter construction work. If America were to ban these imports and move to make them domestically, it would raise the issue of where to source components and raw material from. Chinese skid steers, for example, use domestically produced Chinese steel. If America truly moved to produce these goods domestically the country would also have to create the adjacent industries. A fortiori for Europe.

Let us turn first to overall goods imports. We will break these numbers down in a variety of ways, but one of the most important components of our analysis, building on the first paper in this series, will be to try to compare the Western country grouping with the emergent BRICS grouping. The first is what we will call the “Western grouping.” In the Western grouping we include all the major Western economies: Canada, Japan, South Korea, the United States and the European Union.<sup>12</sup>

Next, we have three different baskets to measure both the current BRICS economies and their future potential development. The first of these is simply the original BRICS: Brazil, Russia, India, China and South Africa. The second is the BRICS+, which adds in the countries added to the grouping in August 2023:<sup>13</sup> Saudi Arabia, Iran, Ethiopia, Egypt, Argentina and the United Arab Emirates. Finally, the third is the countries rumored to be on the short list to join the grouping.<sup>14</sup> This includes, on

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12 Note that we do not include the antipodes, Australia and New Zealand. The reason for this is that, although both countries are firmly stitched into the Western cultural and diplomatic bloc, their economies are not. New Zealand mainly exports food and dairy products to China, which absorbs around 29 percent of the country’s exports. Australia famously exports raw commodities to China for processing, with China absorbing 34 percent of its exports. It is not clear that either country could easily move away from this model of economic development, and so we believe that the future of the antipodes is at best uncertain. That said, neither economy is particularly large and leaving them out of the Western bloc makes little difference to our analysis.

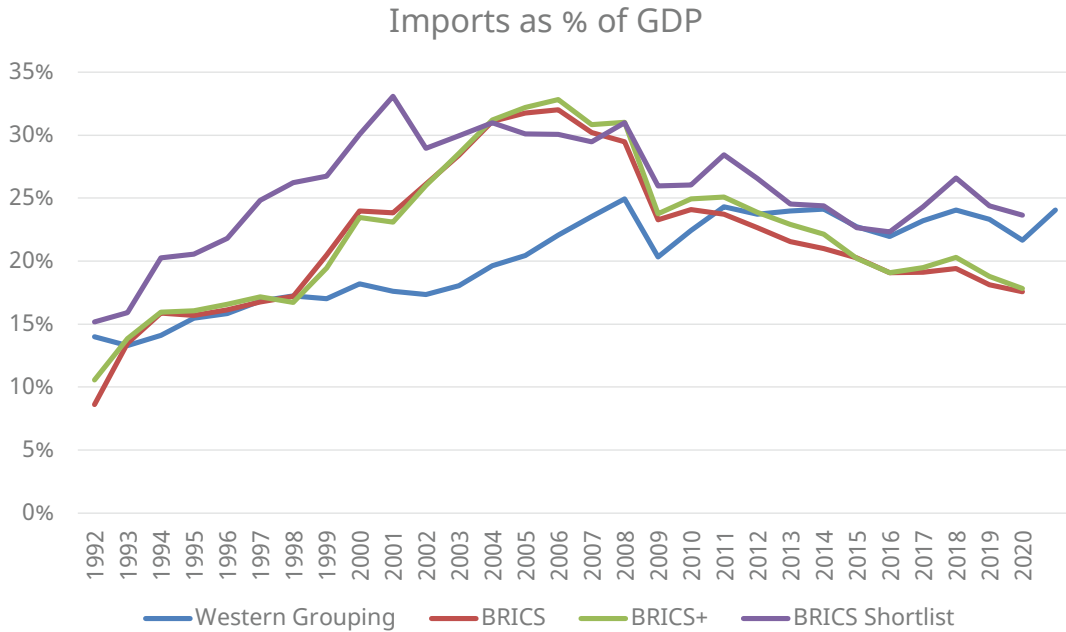
13 <https://www.reuters.com/world/brics-poised-invite-new-members-join-bloc-sources-2023-08-24/>

14 <https://www.reuters.com/world/what-is-brics-who-are-its-members-2023-08-21/>



top of the BRICS+: Indonesia, Turkey, Thailand, Kazakhstan, Afghanistan, Nicaragua, Nigeria and Senegal. We believe that this short list represents the likely expansion of the BRICS+ in the coming years and is worth examining.

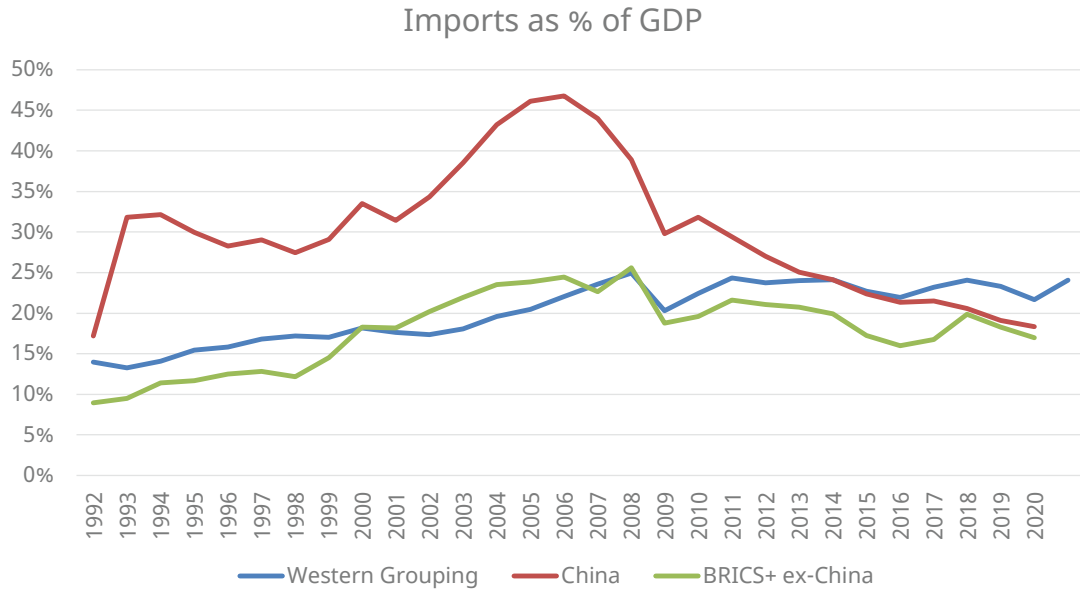
**While the BRICS increased imports to speed industrial development, the West has been increasing imports due to industrial decline**



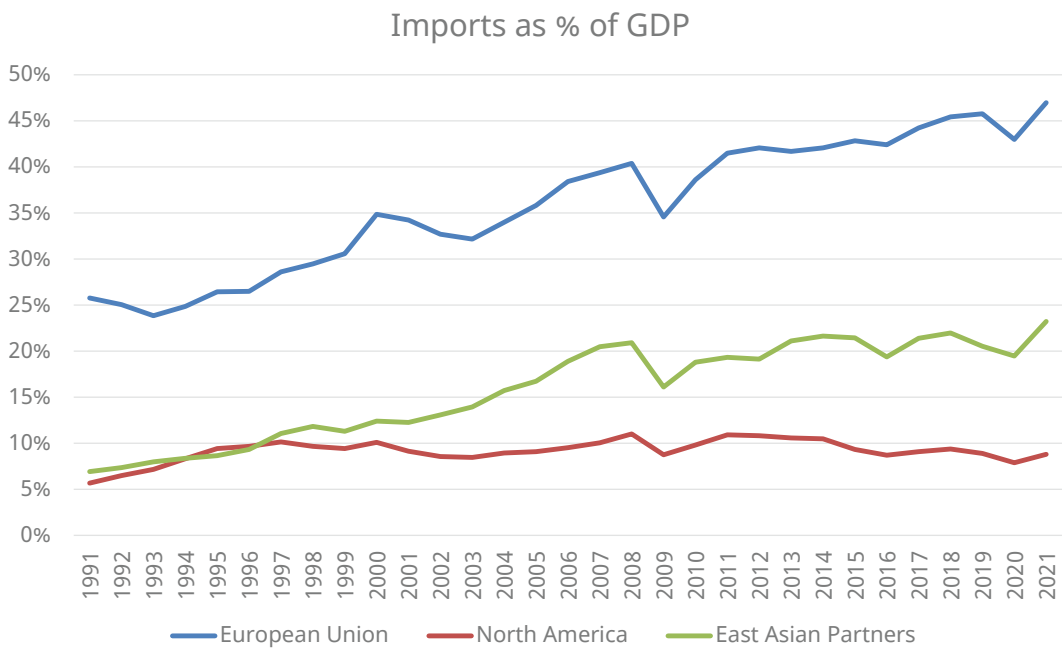
Here we see that, on most measures, the BRICS grouping is slightly less dependent on imports than the Western grouping. If we include the short-listed countries this changes slightly. The reason for this is that the short-listed countries tend to be less economically developed than the others, and economically underdeveloped countries often require larger amounts of imports for domestic production and consumption. This phenomenon also explains the interesting changes that we see in the BRICS grouping. In the early 2000s, at the height of their emergence, the BRICS countries became highly import dependent. We might think of this as the BRICS economies accumulating their capital base. In this decade, the BRICS countries utilized imported Western imports to supplement consumption and build up the structure of their capital base. Once the domestic capital and consumer base was built up, import dependence waned. We might refer to this as a “development hump.”

It is instructive here to remove China from the grouping to see how much of this was a story of Chinese development. As we can see from the following chart, the rest of the BRICS+ grouping did see something of a development hump, but it was by no means as dramatic as what we saw in China.

In contrast to the development hump experienced by the BRICS grouping, the Western grouping has seen a secular rise in import dependency, most likely the result of ongoing deindustrialization.



**Given its import dependency, the EU is at the highest risk from trends toward decoupling and de-risking**



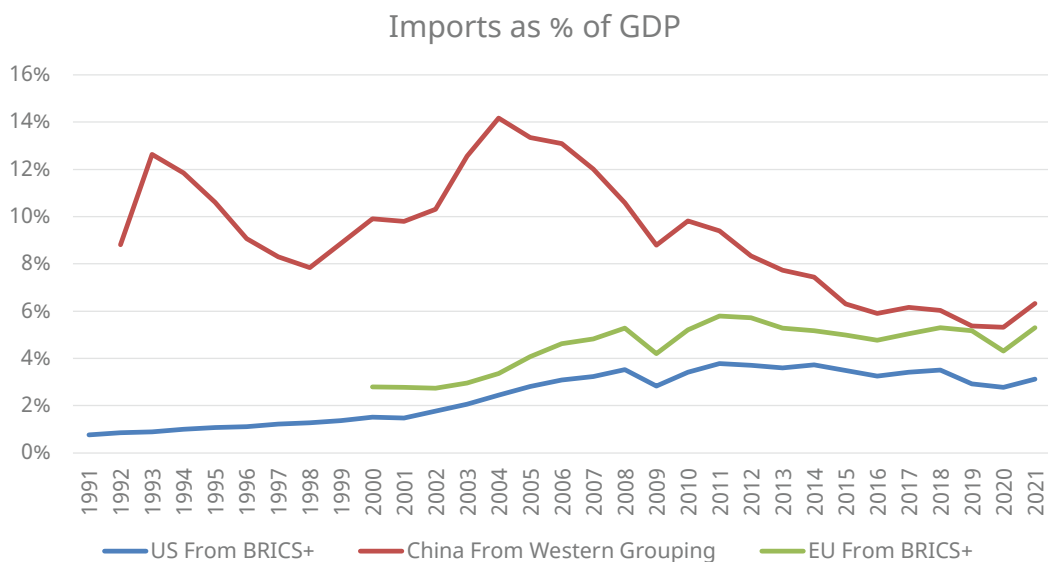
Breaking the Western grouping down into its components, we see that

rising import dependence since 1990 has been a story for all the regions. But it has been much more pronounced in the European Union and amongst East Asian partners than it has been in North America. The extent to which the European Union is a trade-based economy is very striking, and highlights the unique risks that decoupling and de-risking pose to Europe.

The same is true, albeit it to a lesser extent, with the East Asian partner countries. Overall, the story looks like one in which the United States encouraged its allies to aggressively embrace free trade in the 1990s and 2000s while it embraced a form of free trade that was much less aggressive. Now that the United States is encouraging its partners to move in the other direction it is unsurprising that this imperative is met with confusion: after exporting a globalist ideology in the 1990s while proceeding cautiously itself, now the U.S. exports a decoupling ideology while being less exposed to the consequences.

Finally, it is instructive to look at trade dependencies between the groupings themselves. This touches on the question of so-called friendshoring that has recently become a popular trope in Western policymaking circles. The idea of “friendshoring” is that trade dependencies should be limited only to allies. By looking at inter-group trade dependencies, we get some sense of the potential viability of this strategy.

**All major global economic groups are interdependent, but the West’s dependence has grown while China’s dependence has declined**



This chart tells a very interesting story. First, as China developed it became far less dependent on the Western bloc. As late as 2005, an economic “containment” of China would have had the Chinese at an enormous disadvantage. But today China is no more dependent on the Western grouping than the European Union is on the BRICS grouping. It should be noted that while Chinese dependence on the Western grouping has been in secular decline since around 2005, the Western grouping has become increasingly dependent on the BRICS grouping.

We also see here that while the European Union is more reliant on the BRICS grouping than the United States is, the differential is much less than with total import dependency.

We might conclude this analysis by stating that all the groupings are basically equally dependent on each other, but that the

dependence of the Western grouping on the BRICS grouping is growing, while the Chinese dependence on the Western grouping is shrinking.

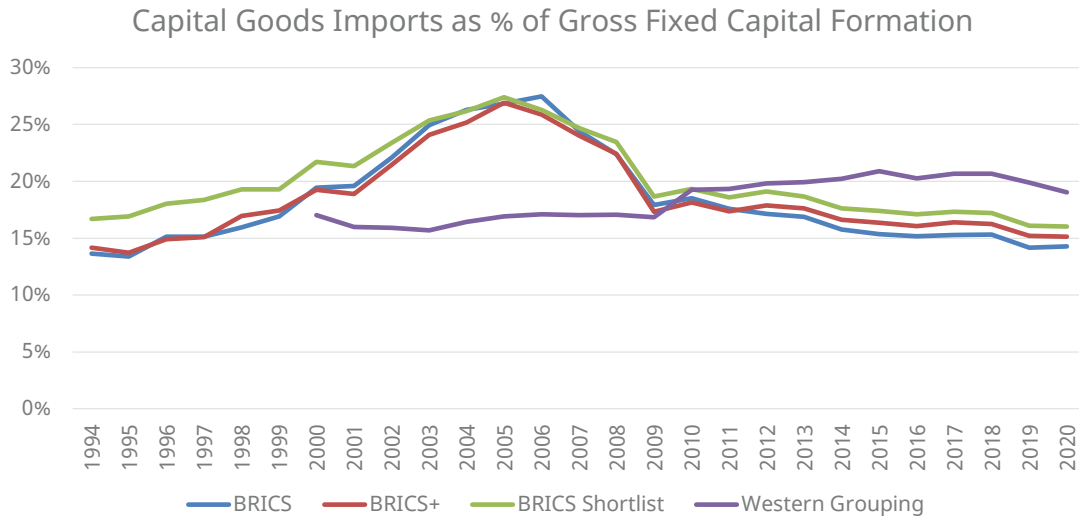
## Supply-Side Dependency I: Capital Goods

It is useful to break down imports further. Broadly speaking, there are three types of imports: consumer goods, capital goods and intermediate goods. *Consumer goods* are those that are sent straight to the shelves when they arrive in a country. Consumer goods are the easiest to either wean a country off or substitute. If, for example, imports of Chinese laptops are diminished, consumers can switch to a domestically produced laptop, a laptop from another trade partner country, or they might continue to use their present laptop until the Chinese laptops come back onto the market. Market pricing can facilitate this transition.

*Intermediate goods* are goods that are used up in the production process. For example, the domestic cutlery industry might rely on imports of foreign steel to produce cutlery. But the domestic cutlery industry may not be the only domestic industry reliant on foreign steel. Other industries may be similarly reliant—for example, the domestic automotive industry and the domestic industry for construction equipment. If the economy is starved of steel imports in this scenario, it is obvious that this would be much harder to adjust to than if a single consumer good ceases being imported. For this reason, we must understand that intermediary goods imports are far more fundamental for the economy than consumer goods imports.

Finally, there are *capital goods* imports. Capital goods are goods used to produce other goods. This typically means machinery imports. For example, one country might be reliant on imports of machine-tooling equipment. Machine-tooling is fundamental to produce other goods—even other capital goods. Capital goods imports also include the parts needed to repair the current capital goods stock. Capital goods sit right at the top of the supply chain hierarchy. If a country is reliant on capital goods imports and these imports are cut off, the impact on the economy could be profound. Starved of intermediary goods, production may slow down. Starved of capital goods, the supply-side of the economy could start to rot and the country may have a hard time ever getting its productive sector up and running again. Let us start then by examining capital goods import dependencies.

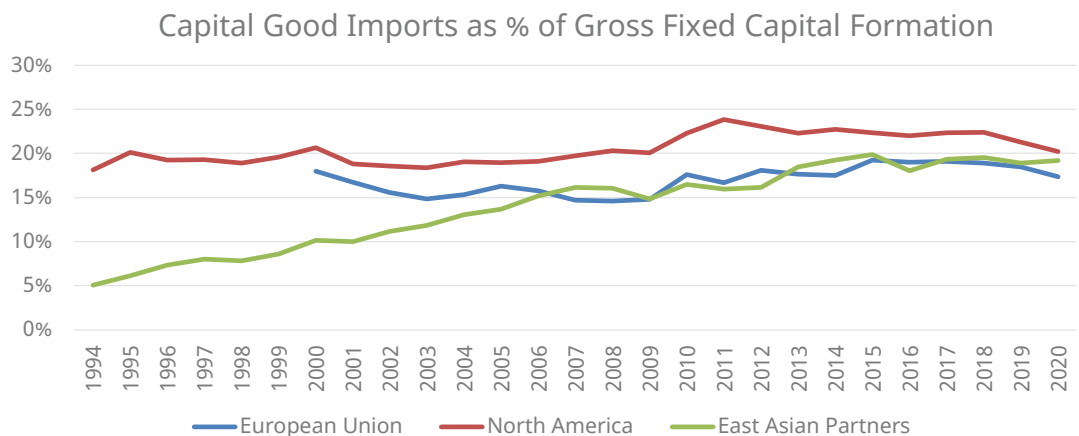
Whereas we measured overall imports as a percent of GDP, we measure capital goods imports as a percent of Gross Fixed Capital Formation. This is the overall addition to the capital stock that an economy undertakes each year.



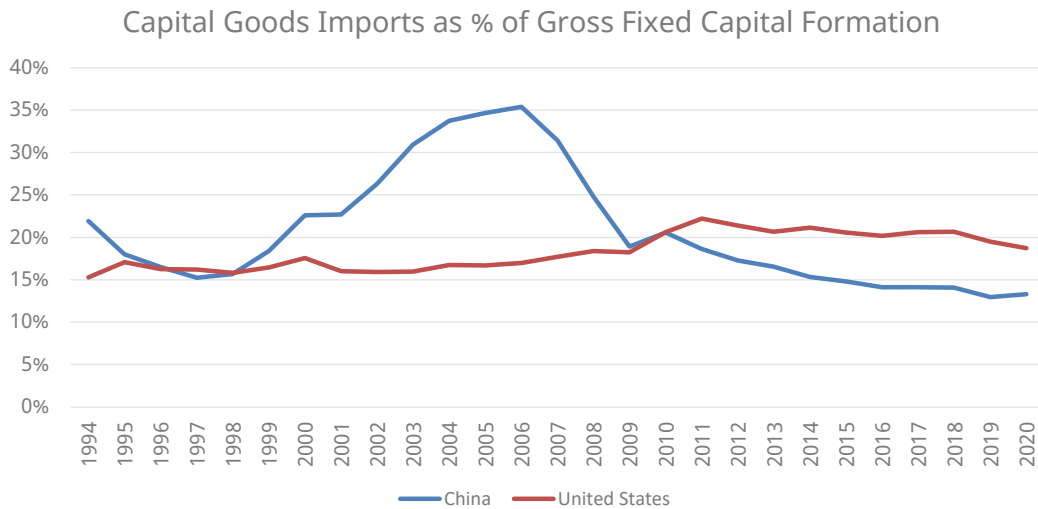
When looking at the grouping taxonomy that we laid out earlier, we see a similar dynamic to what we saw in overall imports. We see a “development hump” in capital goods. This makes sense, as a country that is rapidly developing and building up its own capital stock will start by importing capital goods from countries that already produce them.

But in contrast to what we see in overall imports, the BRICS groupings are now substantially less dependent on capital goods imports as the Western grouping. We also see the same uptrend in reliance on capital goods imports in the Western grouping.

What seems to have happened here is that the BRICS grouping underwent a period of rapid development that sucked in capital goods imports to build up their capital stock. Meanwhile, the Western grouping is becoming more and more reliant on foreign-produced capital goods as its own capacity to produce them wanes. Once more we see the discrepancy in why these two groupings are importing certain types of goods—with the BRICS grouping investing in their future while the Western grouping are losing their previously developed capacity to produce for themselves.



Breaking down the Western grouping into its components, we see a very different picture than we did when we looked at total imports. All the Western regions have similar dependencies on capital goods imports. Indeed, here we find that North America is the most dependent on foreign capital goods of any of the other regions—the opposite of what we saw when we looked at overall imports. The rise in dependence on capital goods imports amongst the East Asian partners is also very striking. Once again, it appears that these countries were encouraged to partake in globalization which likely explains their negative reaction to being told that they now needed to deglobalize.



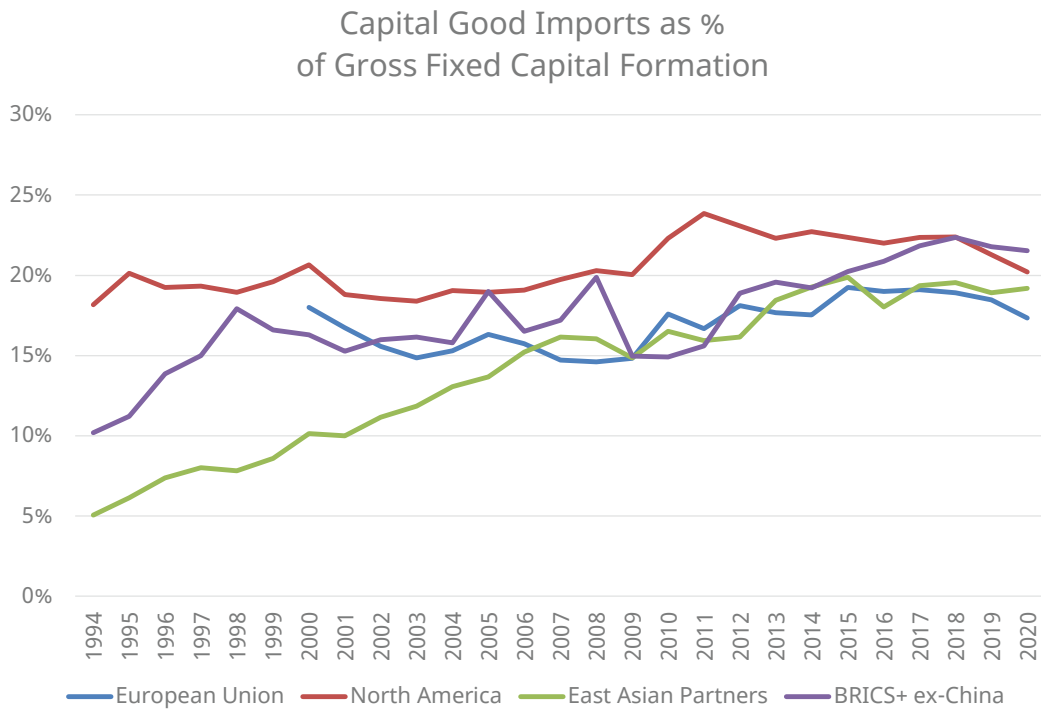
Breaking out China and the United States from the overall group is also instructive. Once again, we see the “development hump” in the 2000s.

**But today China is substantially less reliant on capital goods imports than the United States.**

A very interesting trend emerges if we look at American dependency on Chinese-produced capital goods. In the early 1990s, Chinese-made capital goods accounted for almost none of America’s newly formed capital stock. Today they account for 5–6 percent.

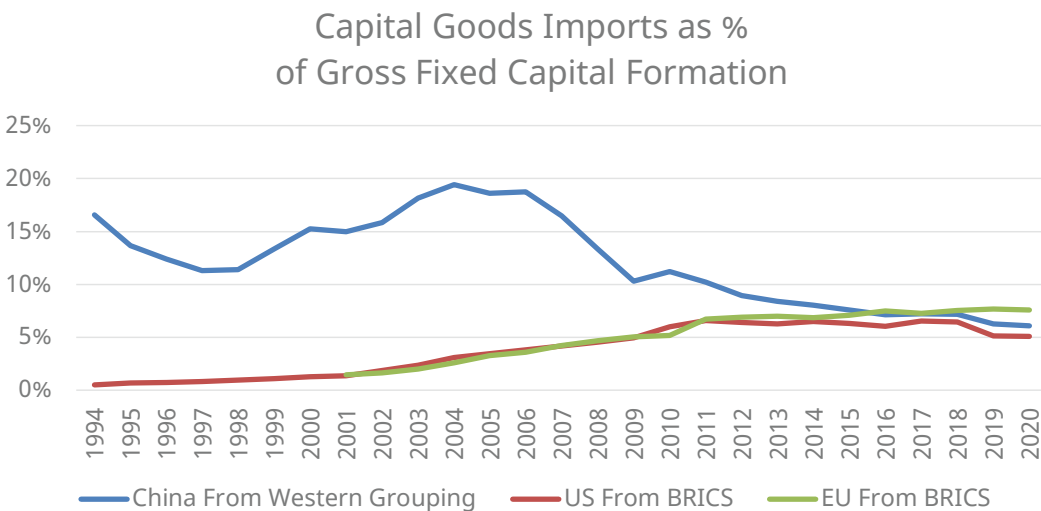


Removing China from the BRICS grouping shows once again that dependence on foreign capital goods imports is fairly uniform across all the regions.



Finally, we turn to the question of how dependent the groupings are on each other. Here we see a similar picture emerge as we do in overall imports. In the 1990s, China was heavily dependent on the Western grouping for their capital goods stock. But over time this has diminished substantially, and now the various groupings are roughly equally reliant on each other. Once again, we see an upward trend in the Western grouping of reliance on the BRICS grouping for their capital goods.

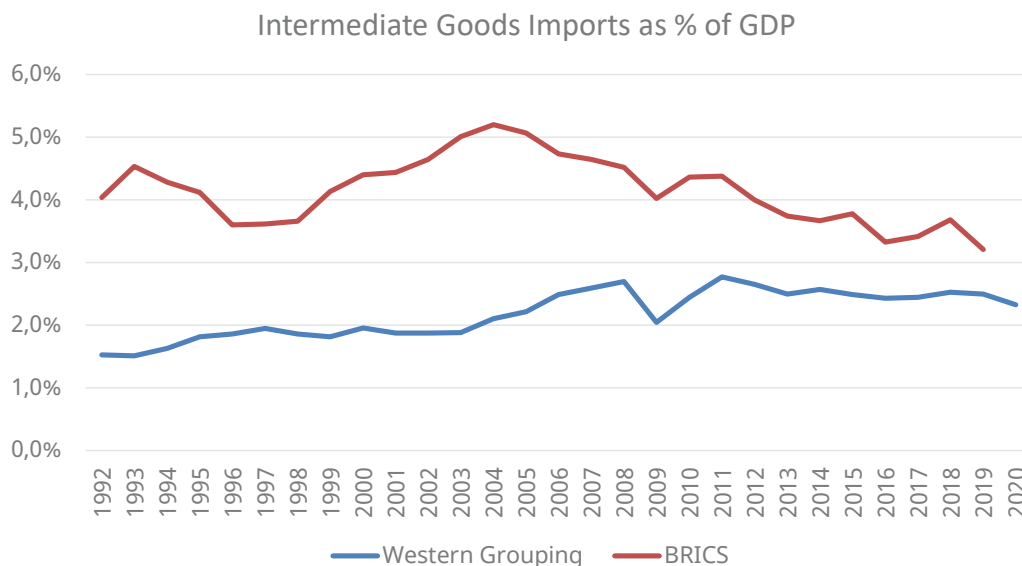
As the Chinese become less dependent on the West for their capital goods, the West becomes more reliant on China for their capital goods.



## Supply-Side Dependency II: Intermediate Goods

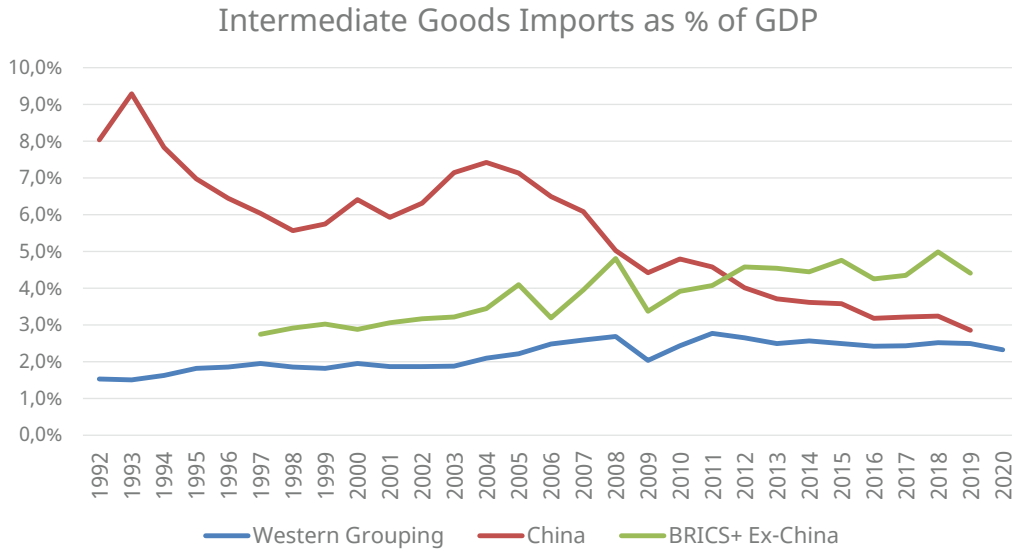
Next, we will examine dependencies of various regions and groupings in terms of intermediate goods. Capital goods imports are arguably more important than intermediate goods imports since, if they are cut off, this would give rise to a degradation of a country's capital stock over time. While a cessation of intermediate goods imports would not do this, it would have a much more immediate impact on the economy in that it would bring the production process in industries that relied on the intermediate goods to an immediate halt. This would create shortages, inflationary pressure in the economy and falling living standards.

First let us compare the overall Western grouping and BRICS grouping in terms of intermediate goods imports. What we see is that the BRICS grouping is still more dependent on intermediate goods than the Western grouping, but this is falling through time. Meanwhile, it has risen in the Western grouping but may have stabilized since around 2010.



When it comes to intermediate goods it seems likely that China, due to its rapid development of its internal industry, may have a vastly different profile to the rest of the BRICS. When we remove China from the rest of the grouping a very different picture emerges. Here we see that the BRICS grouping has a larger dependence on intermediate goods imports than the Western grouping and that it is rising through time. China, on the other hand, started out with extremely high dependency on intermediary goods but this has fallen dramatically. As of today, China is roughly the same in terms of intermediary goods dependence as the Western grouping and still appears to be falling.



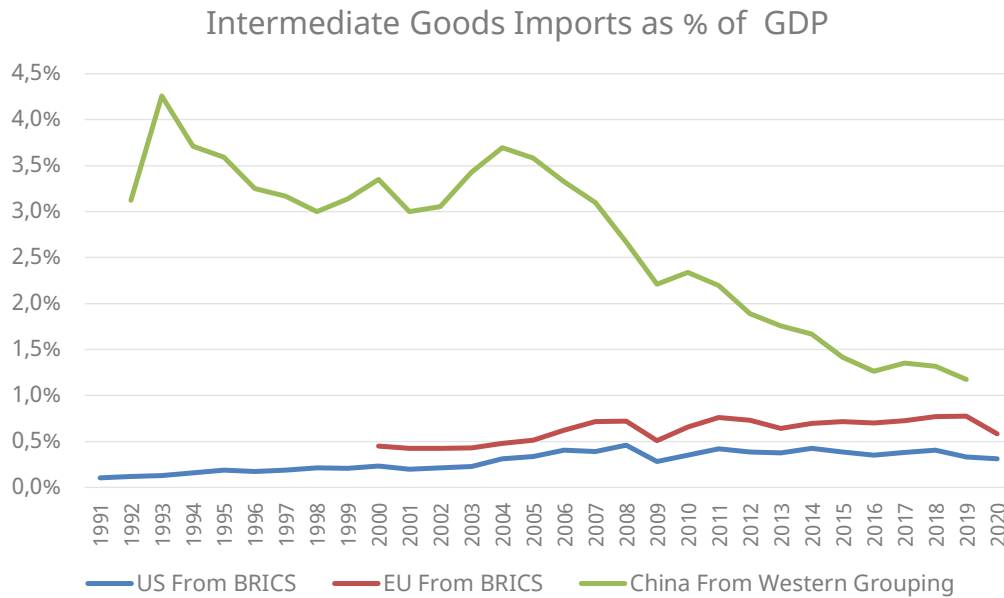


The Western grouping itself is relatively homogenous in terms of intermediary goods imports. In all the regions we see a secular increase through time. We also see that North America is somewhat less dependent on intermediary goods than Europe or the East Asian partners.

While the discrepancy is not as large as in the case of total imports, Europe is somewhat more dependent on intermediary goods imports than the United States. Once again this raises serious questions about Europe adopting a “one-size-fits-all” trade policy that is being formulated in Washington, D.C.



When it comes to reliance on other regions for intermediary goods, the main story is once again the rise of China. When China was developing it was extremely dependent on the Western grouping for intermediate goods imports. But over time this has fallen to levels that are similar to the Western grouping's reliance on the BRICS.



## Conclusion

Examining the data on import dependency, we see that the world has become much more connected since the 1990s. This is hardly surprising given the decision in that period to pursue aggressive globalization.

Europe has become extremely dependent on imports. In contrast to the BRICS and North America, Europe appears to operate as something resembling a midsize island economy not unlike the United Kingdom. This means that any attempt to decouple or de-risk will disproportionately impact Europe.

Indeed, looking at even the most basic of statistics, discussions of decoupling and de-risking appear to be policies conceived with the economy of the United States in mind. Whether they would work for the United States is doubtful, but it is obvious from even a cursory examination of the data that they would not work for Europe. Europe is a truly open economy completely based on trade while the United States, despite years of free trade rhetoric, is only partly open.

It is striking how dependent all the Western countries are on the import of capital goods. Here the United States is as dependent as both Europe and its East Asian partners. A growing share of capital goods dependence is reliant on the BRICS, and China in particular.

This should strongly highlight to policymakers the dangers of decoupling and de-risking.

Capital goods are essential for the development of any economy. Without them a country is left consuming its seed corn. It appears that China has become an extremely important producer of capital goods in the past two or three decades. This means that if trade barriers were rapidly raised, the Western countries would be starved of access to key capital goods. This would likely destroy the capacity of their economies to grow and develop. It would also, through lack of access to spare parts, lead to a rotting of the existing capital stock. It is hard to overstate how dangerous this would be to Western power and living standards.

Overall, when the data is examined, it becomes clear just how connected the world now is. Globalization cannot simply be reversed, and anyone who proposes otherwise is engaged in fantasy. There is certainly an opening for a debate on industrial policies that could rebalance dependencies, in both the Western grouping and in the BRICS grouping, but this would be a long-term gradualist process and would have to be undertaken in a framework of mutual understanding and cooperation. This is where a connectivity strategy could prove key. A connectivity strategy is not akin to open free trade. Rather it seeks to try to achieve national economic goals through trade connections with other countries. For countries that have issues with their domestic industrial base or their trade balance, pursuing this strategy may involve a domestic industrial policy that utilizes capital goods imports from other countries to rebuild a robust domestic capital structure.

Taking zero-sum actions and engaging in aggressive trade wars, on the other hand, will only result in heavy inflation, economic shortages, collapsing living standards, and perhaps even societal and political breakdown. Put simply, the current decoupling/de-risking strategy is not viable. When we look at the actual economic data it becomes clear that those who are promoting it do not have a realistic assessment of the global economy in mind and are operating based on vague and ultimately false premises.

When it comes to the connectedness generated by decades of globalization, there is no rewind button. The only way out is through.

Countries simply have no choice but to embrace the new globalized world and address their economic problems and imbalances within it. A strategy of retreat is neither viable nor desirable. The only realistic option on the table is to pursue national economic goals in an overall framework of global cooperation.<sup>15</sup>

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15 The source of all data is World Bank.