

# A DEMOCRATIC TRADE PARTNERSHIP: Ally Shoring to Counter Coercion and Secure Supply Chains

Ash Jain and Matthew Kroenig, with Marianne Schneider-Petsinger





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This report is a product of the Scowcroft Center's Democratic Order Initiative, which is aimed at reenergizing American global leadership and strengthening cooperation among the world's democracies in support of a rules-based democratic order.

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This is the fifth and final report in a five-part series of Atlantic Council publications, as part of a project on revitalizing the rules-based international system and positioning the United States and its allies to succeed in an era of strategic competition.

The first publication, *Present at the Re-Creation: A Global Strategy for Revitalizing, Adapting, and Defending a Rules-Based International System*, sets forth an overarching global strategy for the United States and its allies to uphold the rules-based system by strengthening cooperation among the world's democracies, while seeking to cooperate with other global powers on areas of common concern.

The second report, *From the G7 to a D-10: Strengthening Democratic Cooperation for Today's Challenges*, proposes the creation of a new D-10 core group of influential democracies across North America, Europe, and the Indo-Pacific, aimed at deepening strategic collaboration on the most pressing challenges facing the rules-based order.

The third report, *An Alliance of Democracies: From Concept to Reality in an Era of Strategic Competition*, suggests that an Alliance of Democracies could foster cooperation among a larger group of nations committed to shared values and goals, potentially as a standing body stemming from the Biden administration's series of democracy summits.

The fourth report, *Toward a Democratic Technology Alliance: An Innovation Edge that Favors Freedom*, calls for a new alliance that would ensure that the free world prevails in the race for advanced technologies by jointly investing in innovation, countering unfair practices, and developing rules and norms consistent with democratic values.

This report contends that a *Democratic Trade and Economic Partnership* could provide an integrated framework for leading democracies and other partners to coordinate on economic challenges posed by revisionist autocracies and foster free, fair, and secure trade. This report draws on relevant sections from these previous publications.

## I. INTRODUCTION AND EXECUTIVE SUMMARY

The post-World War II global economic order is in the midst of a profound transition. The first phase of this order, established by the United States and its allies around the Bretton Woods system of institutions, encouraged free markets and open trade, and focused primarily on economic engagement within the free world. The second phase, which began with the end of the Cold War, expanded the order to include all nations willing to reduce trade barriers. But the era of inclusive globalization now appears to be coming to an end. In the aftermath of the 2008 global financial crisis, the COVID-19 pandemic, and more recently, Russia's invasion of Ukraine, the global economic order is entering a new third phase.

The precise contours of this new phase are still unclear, but a few trends are emerging. As China and Russia act more aggressively to challenge the rules-based order, the United States and other leading democracies have begun imposing new trade barriers, including a widening range of tariffs and sanctions, against them. At the same time, free trade has become less salient, particularly in the United States, where both political parties have begun

to emphasize supply chain resilience and domestic onshoring. While free trade still appears to have resonance in other parts of the world, the question is whether this third phase of the order will be characterized by increasing protectionism, or whether a new model for economic engagement can emerge that fosters secure supply chains and, at the same time, maintains the benefits of an open global trading system.

This report seeks to encourage the latter. It suggests that a new Democratic Trade and Economic Partnership (D-TEP) could provide an integrated framework for the United States and its allies and partners to work together to counter the economic challenges posed by revisionist autocracies, while ensuring that the global economic order remains free and open, as well as stable and secure.

### Challenges to the Global Order

From Russia's invasion of Ukraine to China's increasingly assertive actions to undermine key tenets of the global order, the world is at an inflection point, entering

what President Joe Biden has called a long-term global “struggle between democracy and autocracy.”<sup>1</sup>

In the economic domain, the rules-based order, led by the United States and its democratic allies since the end of World War II, has advanced an interconnected global economy based on free markets and open trade and finance. While its benefits have often been uneven, this order has resulted in dramatic increases in global economic prosperity and improved living standards for people around the world.

Among the biggest beneficiaries of this open economic order have been China and Russia. But rather than liberalizing their political systems as they integrated into the global economy, as many had hoped, the authoritarian leaders in Moscow and Beijing have reaped the benefits of the global trading system while consolidating their repressive regimes. To fuel their economic growth, China, and to some extent Russia, have engaged in intellectual property theft, forced technology transfers, and other unfair trade practices, while taking advantage of unfettered access to global markets.<sup>2</sup>

At the same time, as corporations have relocated production facilities abroad and increased global trade, the United States, its European allies, and other democracies around the world have become dependent on China and Russia across a range of critical economic sectors. In the energy sector, for example, the European Union (EU) was, prior to the start of the latest conflict in Ukraine, reliant on Russia for more than 40 percent of its natural gas imports and over a quarter of its crude-oil imports. Dependency on China is even more dramatic. The United States and other democracies are deeply reliant on Chinese supply chains across a range of industry sectors, from pharmaceutical ingredients to lithium batteries to essential earth minerals.

The concern over supply chain dependencies is not just theoretical. Moscow and Beijing are using their economic clout to coerce democratic nations to accede to their

political demands. In recent months, China has acted to restrict Australian imports after its leaders called for an independent investigation into the origins of COVID-19,<sup>3</sup> and forcefully retaliated against Lithuania for its decision to allow Taiwan to open a representative office in its own name. Many analysts have suggested that China and the United States are in a situation of “mutually assured economic destruction.”<sup>4</sup> Were China to engage in more aggressive actions, such as taking military action against Taiwan, the rapid imposition of sanctions and the increasing decoupling that the West has employed against Russia would be far more difficult to impose against China, given the potential economic consequences.

The COVID-19 pandemic served as a wakeup call for supply chain dependencies, prompting democratic governments to look for alternative sources of supplies as it became clear that China was the dominant source for personal protective equipment (PPE) and other health supplies. With Russia’s invasion of Ukraine, the United States and its allies have moved swiftly to isolate Russia from the global economy, cutting off trade and investment across large swathes of the Russian economy. Recognizing the growing strategic dependencies on autocracies, policymakers have begun to look to ways to promote supply chain resilience by seeking to promote domestic manufacturing in certain industries, such as semiconductors.

Rather than relying strictly on domestic on-shoring, which would be costly and impractical, a growing chorus of voices have suggested that the way to establish more resilient supply chains is through “ally shoring”—sourcing essential goods and services with countries that share democratic values and a commitment to an open, rules-based international order.<sup>5</sup> The White House has called for “work[ing] with America’s allies and partners to strengthen our collective supply chain resilience,”<sup>6</sup> and Treasury Secretary Janet Yellen spoke about the need for “friend shoring” among countries that “have strong adherence to a set of norms and values about how to operate in the global economy.”<sup>7</sup>

1 “Remarks by President Biden to Mark One Year Since the January 6th Deadly Assault on the U.S. Capitol,” White House, January 6, 2022, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/01/06/remarks-by-president-biden-to-mark-one-year-since-the-january-6th-deadly-assault-on-the-u-s-capitol/>; “Remarks by President Biden on the United Efforts of the Free World to Support the People of Ukraine,” White House, March 26, 2022, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/03/26/remarks-by-president-biden-on-the-united-efforts-of-the-free-world-to-support-the-people-of-ukraine/>

2 Karen M. Sutter, “U.S.-China Trade Relations,” *Congressional Research Service*, 2020, updated March 2, 2022, <https://crsreports.congress.gov/product/pdf/IF/IF11284>.

3 Stephen Dziedzic, “Chinese Official Declares Beijing has Targeted Australian Goods as Economic Punishment,” *ABC News*, July 7, 2021, <https://www.abc.net.au/news/2021-07-07/australia-china-trade-tensions-official-economic-punishment/100273964>

4 James Dobbin, et al., “Conflict with China,” RAND, 2011, [https://www.rand.org/content/dam/rand/pubs/occasional\\_papers/2011/RAND\\_OP344.pdf](https://www.rand.org/content/dam/rand/pubs/occasional_papers/2011/RAND_OP344.pdf).

5 Elaine Dezenski and John C. Austin, “Rebuilding America’s Economy and Foreign Policy with ‘Ally-Shoring,’” Brookings, June 8, 2021, <https://www.brookings.edu/blog/the-avenue/2021/06/08/rebuilding-americas-economy-and-foreign-policy-with-ally-shoring/>.

6 “Building Resilient Supply Chains, Revitalizing America Manufacturing, and Fostering Broad-Based Growth,” White House, June 2021, 17, <https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf>; “Remarks by Secretary of the Treasury Janet L. Yellen on Way Forward for the Global Economy,” US Department of the Treasury, press release, April 13, 2022, <https://home.treasury.gov/news/press-releases/jy0714>.

7 Remarks by Janet Yellen, Atlantic Council, April 13, 2022, <https://home.treasury.gov/news/press-releases/jy0714>

Congress has also begun to take steps to promote supply chain resilience among allies and partners.<sup>8</sup>

The Biden administration's launch of the Indo-Pacific Economic Framework (IPEF) is a concrete manifestation of this effort. With its parameters still being developed, the initiative seeks to strengthen economic engagement among US allies and partners in the Indo-Pacific, as a complement to the Quad's ongoing discussion on supply chains. Separately, the US-EU Trade and Technology Council is facilitating an economic dialogue among transatlantic partners, including on supply chains.

While potentially impactful, the current patchwork of multi-lateral supply chain dialogues and initiatives remains too narrow, both in terms of economic and geographic scope. Rather than approaching the challenges systematically, these efforts have tended to focus on a handful of sectors, such as semiconductors, with outcomes that are bifurcated along regional lines. Yet today's supply chains, particularly those involving China, are global, not regional, and the same set of strategic and economic challenges impacting the United States are also impacting America's allies across both Europe and the Indo-Pacific. What is lacking is an integrated framework that would bring together leading democracies to coordinate a free world strategy on these challenges.

## A New Economic Framework

Given the significant vulnerabilities they face, the United States and its democratic allies must adopt a fundamentally new approach to deal with the growing economic challenges to the rules-based order.

The United States and leading democracies in Europe, North America, and the Indo-Pacific should lead the establishment of a new strategic trade and economic framework for the twenty-first century: a **Democratic Trade and Economic Partnership (D-TEP)** that would bring together willing democracies, and potentially other nations that meet certain criteria, to act together under a common economic umbrella. D-TEP would provide a holistic and systematic framework for the United States and its allies and partners to coordinate on the economic challenges posed by revisionist autocracies and help position the free world to succeed in an era of strategic competition.

D-TEP would be focused primarily on achieving the following goals.

**1 Reducing strategic dependence on China and Russia.** D-TEP would aim to reduce vulnerability among democracies to coercion, blackmail, or potential economic disruptions from revisionist autocracies – namely China and Russia – by encouraging the shifting of supply chains in certain areas toward more stable and trusted partners. The goal is not to cut off all trade and investment, particularly with regard to China. Rather, it is to identify critical economic sectors in which the United States and its allies cannot afford to continue allowing unfettered trade and investment flows, and to take impactful steps to reduce strategic dependence in these sectors.

**2 Expanding free, fair, and secure trade among democracies,** by bringing down trade and investment barriers in the industry sectors around which supply chains would be reorchestrated under this framework. The goal is to expand the benefits of free, fair, and secure trade, while pushing back against rising protectionism and encouraging greater openness within the democratic world.

**3 Incentivizing nations on the fence to join the free world** in upholding the rules-based order. With the economic benefits of supply chain shifts accruing to member states, the prospect of D-TEP membership could serve as a powerful inducement for nonaligned democracies and other nations to work more closely with the United States and its allies to advance shared interests and reduce strategic vulnerabilities to autocracies that are challenging the order.

All three of these goals are important and interconnected. Reducing strategic dependence on China and Russia will require shifting supply chains to more reliable and trusted allies and partners. For this to work, the private sector needs meaningful incentives, including the reduction of trade barriers in the affected industry sectors, which could facilitate new opportunities to foster more free and secure trade. Nations that are part of this framework will accrue significant economic benefits, and access to these benefits can be used as an incentive to persuade governments on the fence to join and take meaningful steps toward upholding the rules-based order.

To be clear, D-TEP would not be intended to supplant or undermine the World Trade Organization or the existing bilateral and multilateral trade and investment agreements that D-TEP members have in place among themselves or other states. The United States and its allies

8 United States Innovation and Competition Act of 2021, <https://www.congress.gov/bill/117th-congress/senate-bill/1260/text>.



should continue looking for ways to strengthen the WTO and reinforce its efforts to expand open trade and investment worldwide, even as it builds a more tailored economic framework with democratic allies and partners.

In pursuit of these goals, D-TEP would be organized around four core pillars, each of which would entail commitments by member states and corresponding benefits.

**Pillar One** would entail an agreement among member states on a common framework for regulating trade and investment flows to China and Russia. The framework would distinguish between three categories: (i) strategic sectors vital to national security, such as arms and advanced technologies that could have security applications, in which trade would be restricted; (ii) critical and sensitive sectors, such as energy and pharmaceuticals, in which incentives would be developed to encourage the shifting of supply chains away from China and Russia; and (iii) other economic sectors, such as furniture and appliances, in which trade would generally be permitted without restrictions (except where subject to sanctions related to other issues).

**Pillar Two** would set forth a commitment by D-TEP member states to take collective action to assist other members if they become the subject of economic coercion. Some have likened this to NATO's Article V, where an attack against one is considered an attack against all.<sup>9</sup> A commitment by democracies to act together under this pillar could serve as a significant deterrent against economic coercion and a channel to coordinate joint assistance to those that are targeted.

**Pillar Three** would outline an agreement between member states to reduce trade barriers among themselves in specific industry sectors. Such an agreement would be structured in a narrow and practical way, beginning with the critical sectors identified in Pillar One, where it is in the interest of D-TEP members to promote the shifting of supply chains away from China and Russia. Over time, D-TEP could also facilitate agreements to reduce trade barriers in other industry sectors, serving as a platform to revitalize discussions among the United States and its allies on fostering more free, fair, and secure trade.

**Pillar Four** would constitute a set of bold economic initiatives in areas where autocratic powers, particularly China, are at risk of outcompeting the democratic world, and

where the United States and its allies have a particularly strong interest in working together to maintain a strategic edge. These initiatives, with a potential focus on global infrastructure, digital commerce, and clean energy technology, as well as other critical technologies, could help limit Beijing and Moscow's attempts to co-opt nations in the global South by making them more economically dependent on China and Russia.

Together, these four pillars would facilitate a series of mutually reinforcing activities and provide an integrated framework to reduce strategic dependence on autocracies and advance the rules-based economic order. D-TEP would pool the economic power and influence of the world's leading democracies based around shared interests and a common willingness to act. At the same time, it would consolidate a meaningful package of economic benefits that many nations around the world—in particular, developing nations—could find compelling and attractive.

Importantly, D-TEP would not force member states to choose between trading at large with China and the West. Rather, it would focus on restricting trade or incentivizing supply chain shifts in specific industry sectors, leaving unchanged the ability to engage in trade and investment across a wide range of other (except, as noted, where targeted sanctions have been imposed) areas. In addition, D-TEP could help rekindle domestic political support for more open global trade.

To achieve its objectives, D-TEP may benefit from a two-tiered membership structure. **DTEP allies**, or full members, would consist of nations that are *free-market democracies*, committed to the rule of law, and willing to embrace the full scope of obligations required under D-TEP. This could include the leading democratic economies of the G7—the United Kingdom, Canada, France, Germany, Italy, Japan, and the United States—and the D-10, which also includes Australia, South Korea, and the European Union.<sup>10</sup> The partnership would aspire to bring in other rising democracies, particularly Mexico and India.

**DTEP associates** would include *free-market economies*, that are willing to commit to most, but not all, of the required obligations. This could provide an avenue for association with nondemocratic, but increasingly significant, economic partners, such as Vietnam. Associates would gain partial access to the supply chain reorchestration and other benefits under this framework.

9 Ivo H. Daalder and Anders Fogh Rasmussen, "Memo on an 'Economic Article 5' to Counter Authoritarian Coercion, The Chicago Council on Global Affairs, June 9, 2022. Jonas Parello-Plesner, "An 'Economic Article 5' to Counter China," *Wall Street Journal*, February 11, 2021, <https://www.wsj.com/articles/an-economic-article-5-to-counter-china-11613084046>.

10 The D-10, as currently organized by the Atlantic Council's D-10 Strategy Forum, includes these ten participants. India was added in Prime Minister Boris Johnson's attempts to formalize a D-10 in 2021.

While seeking to maximize participation, D-TEP's success will not be determined by how many nations end up joining. Rather, it will depend on having the full commitment of the world's largest democratic economies. If it can facilitate agreement among the G7 or D-10 across its four pillars, D-TEP could have a significant impact on reducing strategic dependence on China and Russia and advancing free, fair, and secure trade.

## Key Recommendations

While the rationale for establishing a new trade and investment partnership along the lines of D-TEP is compelling, several obstacles and concerns must be considered, including whether such a framework could further polarize the global order, undermine the WTO, involve significant economic costs, or become too unwieldy or impractical to implement. Moreover, bringing D-TEP to fruition will require determined US leadership and support from key allies. To move this forward in a feasible way, the following recommendations should be considered.

- 1** The United States should establish a senior diplomatic envoy, based at the State Department or National Security Council (NSC), that would be responsible for developing and coordinating strategies to reduce supply chain dependencies, and other leading democracies should follow suit. In addition, Washington should consider establishing a dedicated Office of Strategic Competition that would focus on integrating a wider range of strategies—across the areas of trade, technology, security, disinformation, democracy, and development—that are required to position the United States and its allies to succeed in the long-term systemic competition with rival autocracies.
- 2** The United States should engage a small core group of likeminded allies to discuss the possibility of establishing a new integrated trade and economic partnership. Initially, this core group could include some members of the G7 or D-10, including Germany, Japan, and the United Kingdom, which—together with the United States—constitute the world's four largest democratic economies. If agreement on a basic framework can be reached, discussion could expand to include the remaining G7 and D-10 members.
- 3** Given their economic and political significance, Mexico and India, among other rising democracies, should be approached early on in the consultation process. Bringing these nations into this framework would provide an enormous boost, and the United States and its allies should prioritize efforts to include them – ideally as full members if they are willing to sign on to the required obligations, but at least as associates, with a pathway toward full membership over time.
- 4** The Biden administration should also consult Congress early in the process, as dedicated funding and implementing legislation will be required to make D-TEP a reality. Similarly, lawmakers in other leading democracies should be consulted to help build support among allies and partners. In addition, the private sector should be engaged to ensure that the incentives for supply chain reorchestration are appropriately designed, and to help build a broader base of support for this framework.
- 5** Finally, even as it pursues a new trade and economic partnership among allies and partners, Washington should seek to reinvigorate efforts to strengthen and reform the WTO, and foster efforts to expand greater economic openness. At the same time, it should continue to engage with Beijing to discuss trade and economic issues, while seeking to reassure China that the supply chain reorchestration called for under this proposal would not cut off China from the global economy.



Russian president Vladimir Putin and Chinese president Xi Jinping meet in Beijing and issue a joint manifesto establishing a “no limits” partnership, February 3, 2022. (via REUTERS)

## II. STRATEGIC CONTEXT

### Success of the Rules-Based Order

Over the past seventy-five years, the United States and its democratic allies across North America, Europe, and the Indo-Pacific have established a rules-based order aimed at defending shared security interests, promoting free-market economies, and advancing shared democratic norms. This order has proven highly successful, facilitating unparalleled levels of peace, security, and global prosperity, and fostering freedom for hundreds of millions of people around the world.<sup>11</sup>

In the economic domain, the rules-based order has served to promote an interconnected global economy based on free markets and open trade. The core principle—

enshrined in the Bretton Woods system and its key institutions—is that an open, rules-based economic system, including the free movement of goods and capital, reduces prices and increases standards of living. Since the 1950s and the early days of the General Agreement on Tariffs and Trade (the precursor to the WTO), the volume of global trade has increased by forty times.<sup>12</sup> Over the past seven decades, this order has produced dramatic gains in prosperity, with global gross domestic product (GDP) rising 1,300 percent since 1950.<sup>13</sup> While its benefits have often been uneven, both within and across nations, it helped fuel unprecedented innovations in communications, health, and other areas that have significantly improved living standards for people around the world.

11 Ash Jain and Matthew Kroenig, *Present at the Recreation: A Global Strategy for Revitalizing, Adapting, and Defending a Rules-Based International System*, Atlantic Council, October 30, 2019, <https://www.atlanticcouncil.org/in-depth-research-reports/report/present-at-the-re-creation>.

12 “Evolution of Trade under the WTO: Handy Statistics,” World Trade Organization, [https://www.wto.org/english/res\\_e/statis\\_e/trade\\_evolution\\_e/evolution\\_trade\\_wto\\_e.htm](https://www.wto.org/english/res_e/statis_e/trade_evolution_e/evolution_trade_wto_e.htm).

13 Max Roser, “Economic Growth,” Our World in Data, 2013, <https://ourworldindata.org/economic-growth#:~:text=An%20almost%203%2Dfold%20increase,grown%2013%2Dfold%20since%201950>.

## China and Russia Push Back

China and Russia have been among the biggest beneficiaries of an open economic order. China's integration into the global economy helped to lift four hundred million Chinese out of poverty, and Russia's economy prospered after its embrace of free markets following the collapse of communism.<sup>14</sup> With the end of the Cold War, there was widespread optimism within the West that the benefits of trade and economic engagement would provide China and Russia with a stake in the existing rules-based system. In addition, many believed this would reinforce Russia's nascent transition to democratic rule, and provide the Chinese Communist Party with a strong incentive to promote political liberalization at home.<sup>15</sup>

However, rather than liberalizing their political systems as they integrated into the global economy, the authoritarian leaders in Moscow and Beijing have reaped the benefits of the global trading system while consolidating their repressive regimes and undermining core elements of the rules-based order. Russia and China's rising wealth—largely facilitated by foreign investment and trade—“has emboldened them to challenge Western democracies head on.”<sup>16</sup> The challenges posed by these autocratic powers are evident in several domains.

As underscored by its unprovoked invasion of Ukraine, Russia has emerged as the most aggressive challenger to the rules-based order. Russia's accumulated wealth, facilitated by large-scale energy exports, has provided

the resources to support its military capabilities, which provided Moscow with ambitions to reconstitute, by force, its influence in countries of the former Soviet Union. Russia has also invested in cybersecurity assets to allow it to meddle in foreign elections and engage in coercion—through military intimidation, economic boycotts, energy disruptions, arms sales, and targeting of individuals in Europe with chemical agents— that is inconsistent with norms relating to self-determination and foreign interference.

If Russia seeks to disrupt the order, China may be seeking to displace it. As it has risen, China has frequently violated fundamental principles and norms of the rules-based system. Beijing has engaged in what many now consider a genocide against the Uyghur population in Xinjiang, and is dismantling Hong Kong's liberal institutions despite its international treaty commitments. At the same time, Beijing has engaged in a rapid military build-up as it issues explicit military threats against its neighbors, including Taiwan, and asserts claims of “indisputable sovereignty” over disputed territories that underscore its ambitions to carve out a regional sphere of influence. On the economic front, China's unfair trade and economic policies run contrary to liberal economic norms, and have provided China's state-run economy—and companies within it—unfair commercial advantages, by engaging in forced technology transfer, intellectual-property theft, counterfeiting, espionage, illegal subsidies, and dumping to depress prices and push rivals out of the market.<sup>17</sup>

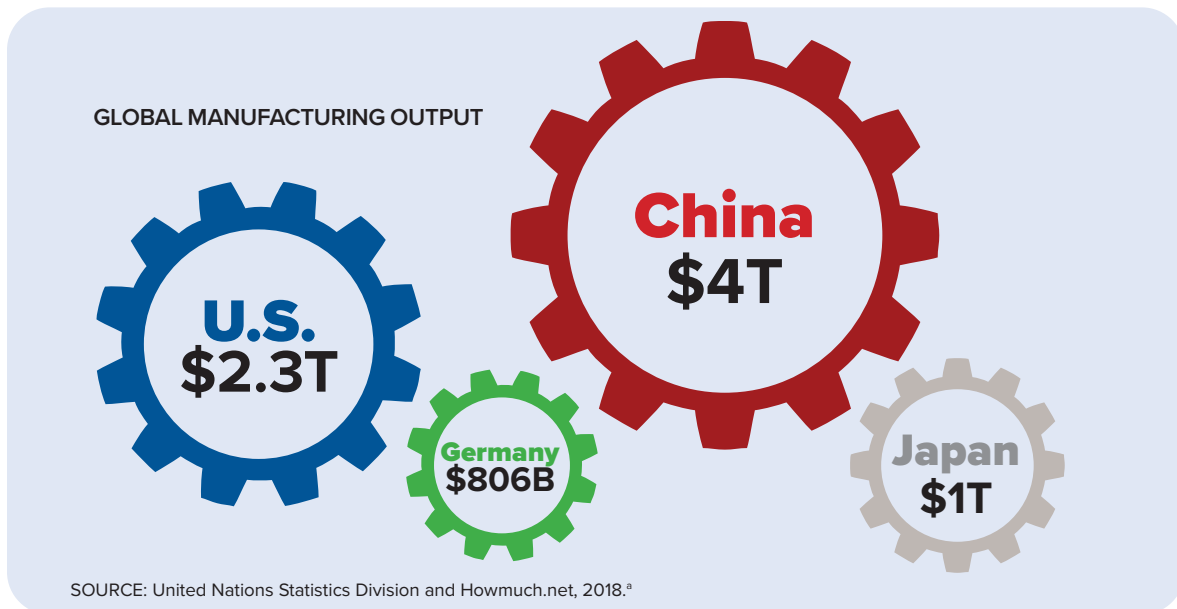
14 Russian per capita GDP rose from \$3,492 in 1990 to \$10,126 in 2020. “GDP per Capita (current US\$)—Russian Federation,” World Bank, <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=RU>.

15 Robert Robb, “China Isn't Going to Change. It's Time to Break Some of Our Economic Ties,” *Arizona Republic*, December 3, 2021, <https://www.azcentral.com/story/opinion/op-ed/robertrobb/2021/12/03/china-wont-change-its-time-decouple-our-economies/8838408002/>.

16 Edward Alden, “The West Though Money Could Tame Dictators. Has Putin Proved it Can't?” *Washington Post*, April 11, 2022, <https://www.washingtonpost.com/outlook/2022/04/11/russia-china-peace-capitalism/>.

17 Hans Binnendijk, et al., *The China Plan: A Transatlantic Blueprint for Strategic Competition*, Atlantic Council, March 22, 2021, <https://www.atlanticcouncil.org/in-depth-research-reports/report/china-plan-transatlantic-blueprint/>.

## China's Growing Economic Prowess



## China's Increasing Economic Power

China and Russia have depended on unfettered access to global markets to fuel their economic growth, and to gain access to technology, capital, and critical resources.<sup>18</sup> After China and Russia joined the WTO in 2001 and 2011, respectively, they obtained the full benefits of the global trading system—including reduced trade barriers and nondiscriminatory tariff treatment. Since opening its economy to foreign trade and investment, China has become the world's largest manufacturer of goods, and, according to the World Bank, has had the "fastest sustained expansion by a major economy in history."<sup>19</sup> China has surpassed the United States as the world's largest exporter of goods—and increasing its share of global trade from 1.9 percent in 2000 to 11.4 percent in 2017—and could overtake the United States as the world's largest economy sometime this decade.<sup>20</sup>

To be sure, China and Russia's entry into the World Trade Organization (WTO) has benefitted the global economy in many ways, including by providing reliable sources

for lower-wage manufacturing and access to natural resources. But it has come at a significant cost. Since 2006, Beijing has been implementing policies aimed at appropriating technology from foreign corporations across several critical industries, such as air transportation, power generation, high-speed rail, information technology, and electric automobiles.<sup>21</sup> China is also harnessing civilian technologies for strategic military purposes, such as hypersonics and supercomputers, which it has advanced by utilizing access to US technology.<sup>22</sup> As the *Economist* notes, autocracies, including China and Russia, "are now an especially serious rival to democracies when it comes to investment and innovation."<sup>23</sup> The share of patent applications issued to companies based in autocracies has gone from 5 percent to more than 60 percent since the mid-1990s.<sup>24</sup> Having driven its economy by trading with the world, China appears to be positioning itself to become the world's primary challenger to the rules-based, democratic order.

18 Robert G. Sutter, "U.S.-China Trade Relations: Perilous Past, Uncertain Present," Rowman & Littlefield, 2018.

19 Wayne M. Morrison, "China's Economic Rise: History, Trends, Challenges, and Implications for the United States," Congressional Research Service, June 25, 2019, <https://www.everycrsreport.com/reports/RL33534.html>.

20 Woetzel et. al, "China and the World: Inside the Dynamics of a Changing Relationship," McKinsey Global Institute, July 1, 2019, <https://www.mckinsey.com/featured-insights/china/china-and-the-world-inside-the-dynamics-of-a-changing-relationship>.

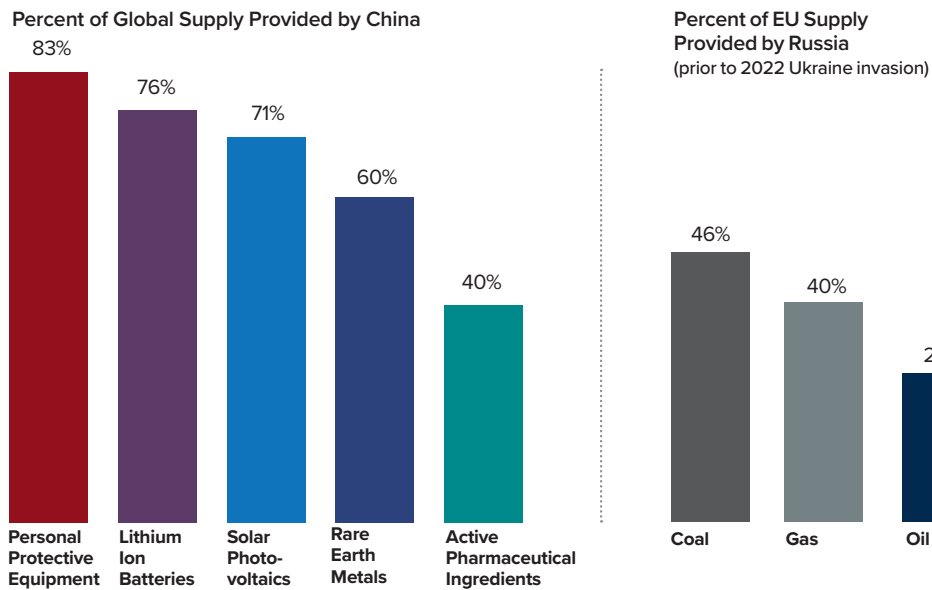
21 Thomas Hout and Pankaj Ghemawat, "China vs the World: Whose Technology Is It?" *Harvard Business Review*, December 2020, <https://hbr.org/2010/12/china-vs-the-world-whose-technology-is-it>.

22 Ellen Nakashima and Gerry Shih, "China Builds Advanced Weapons Systems Using American Chip Technology," *Washington Post*, April 9, 2021, [https://www.washingtonpost.com/national-security/china-hypersonic-missiles-american-technology/2021/04/07/37a6b9be-96fd-11eb-b28d-bfa7bb5cb2a5\\_story.html](https://www.washingtonpost.com/national-security/china-hypersonic-missiles-american-technology/2021/04/07/37a6b9be-96fd-11eb-b28d-bfa7bb5cb2a5_story.html).

23 Ibid.

24 "Globalisation and Autocracy Are Locked Together. For How Much Longer?" *Economist*, March 19, 2022, <https://www.economist.com/finance-and-economics/2022/03/19/globalisation-and-autocracy-are-locked-together-for-how-much-longer>.

## Dependencies on China and Russia



SOURCE: US Geological Service, United Nations, US Department of Energy, Foreign Policy, Financial Times, European Commission<sup>9</sup>

## Supply Chain Dependencies

As multinational firms have relocated production facilities and increased trade and investment abroad, the United States, its European allies, and other democracies around the world have become dependent on China and Russia across a range of critical economic sectors. In the energy sector, for example, the EU was, prior to the start of the latest conflict in Ukraine, reliant on Russia for more than 40 percent of its natural gas imports and over a quarter of its crude oil imports. For certain countries, this dependence is even greater; Poland, Finland, and Slovakia look to Russia for two-thirds of their oil imports.<sup>25</sup> More than 35 percent of US palladium is sourced from Russia, and, as the White House recently warned, Putin has the means to cut off critical minerals and gases needed to sustain the West's supply chain for semiconductor chips.<sup>26</sup> India's

largest military supplier is Russia, on which it depends for more than half of its defense equipment.<sup>27</sup>

Dependency on China is even more dramatic. The United States and other democracies are deeply reliant on Chinese supply chains across a range of industry sectors, from pharmaceutical ingredients to smartphones to essential earth minerals. China dominates the global lithium-battery supply chain, producing 76 percent of the world's lithium-oxide and hydroxide exports.<sup>28</sup> China provides more than 60 percent of the world's rare-earth metals, which are essential for the manufacture of electric car batteries, satellites, weapons, wind turbines, and solar panels.<sup>29</sup> In the health sector, even before the pandemic, China was the largest exporter of PPE, accounting for more than half of the world's facemasks, gowns, and goggles, and its share of the market has grown since then.<sup>30</sup>

25 Thomas Earl, "How Russian Oil Flows to Europe," *Transport & Environment*, March 8, 2022, <https://www.transportenvironment.org/discover/how-russian-oil-flows-to-europe>.

26 Alexandra Alper and Karen Freifeld, "Russia Could Hit U.S. Chip Industry, White House Warns," Reuters, February 11, 2022, <https://www.reuters.com/technology/white-house-tells-chip-industry-brace-russian-supply-disruptions-2022-02-11/>; Ambrose Evans-Pritchard, "Vladimir Putin Controls the Supply Chain of Western Technology, So Who Is Bluffing?" *Telegraph*, February 22, 2022, <https://www.telegraph.co.uk/business/2022/02/22/vladimir-putin-controls-supply-chain-western-technology-bluffing/>; Alper and Freifeld, "Russia Could Hit U.S. Chip Industry, White House Warns," *Reuters*, February 11, 2022, <https://www.reuters.com/technology/white-house-tells-chip-industry-brace-russian-supply-disruptions-2022-02-11/>.

27 Ashok Sharma, "India to Boost Arms Output, Fearing Shortfall from Russia," Associated Press, April 7, 2022, <https://www.defensenews.com/global/asia-pacific/2022/04/07/india-to-boost-arms-output-fearing-shortfall-from-russia>.

28 "Global Lithium Market: China is Unlikely to Tap into Afghanistan's Resources Fast," *GlobeNewsWire*, November 4, 2021, <https://www.globenewswire.com/news-release/2021/11/04/2327800/0/en/Global-Lithium-Market-China-is-Unlikely-to-Tap-into-Afghanistan-s-Resources-Fast-IndexBox.html>.

29 Jevans Nyabiage, "China's Dominance of Rare Earth Supply Is a Growing Concern in the West," *South China Morning Post*, April 25, 2021, <https://www.scmp.com/news/china/diplomacy/article/3130990/chinas-dominance-rare-earths-supply-growing-concern-west>.

30 Patricia Fok, "China Dominates the Pandemic PPE Market. What Does that Mean for U.S. as Virus Surges?" *PBS News*, October 27, 2020, <https://www.pbs.org/newshour/show/china-dominates-the-pandemic-ppe-market-what-does-that-mean-for-u-s-as-virus-surges>.

The global economy is heavily dependent on Chinese manufacturing, as well as on China's growing consumer market. More than 82 percent of mobile phones and 94 percent of laptop computers imported to the United States were assembled in China.<sup>31</sup> China is now the largest trading partner for large parts of the democratic world, including the EU, for which China overtook the United States in 2020, as well as Australia, Japan, South Korea, Brazil, and Indonesia.<sup>32</sup> The US and Chinese economies are also deeply intertwined, US companies have invested more than \$700 billion of assets in China, and China owns as much as a trillion dollars in US sovereign debt.<sup>33</sup>

## Autocratic Coercion

The concern about supply chain dependencies is not just theoretical. Moscow and Beijing are using their economic clout to coerce democratic nations to accede to their political demands. In 2014, for example, Russian state gas company Gazprom cut gas supplies to Slovakia by 50 percent in response to Slovak assistance to Ukraine following Russia's seizure of Crimea.<sup>34</sup> In 2017, Russia's state-controlled rail company restricted freight deliveries through Latvia in retaliation for Latvia's refusal to support the Nord Stream 2 pipeline.<sup>35</sup> And, just last year, Gazprom limited the supply of gas as a way to pressure Moldova into distancing itself from the European Union.<sup>36</sup>

The COVID-19 pandemic highlighted the risks inherent in depending on Chinese supply chains for critical supplies. At the onset of the COVID-19 pandemic, China nationalized production of PPE, and initially withheld exports in order to deal with its own outbreak, as the United States' European allies suffered from severe shortages. While its actions to restrict exports during the early days of the pandemic did not appear aimed at causing deliberate harm, China now regularly engages in coercion against democratic states, by using its economic leverage to

pressure democracies to reverse political decisions that it found objectionable. In 2010, China restricted the export of rare-earth minerals and took other measures against Japan after a collision between a Chinese fishing boat and a Japanese coast-guard ship near the disputed Senkaku/Diaoyu islands.<sup>37</sup> The same year, Beijing imposed restrictions against Norway on imports of salmon after Liu [Xiaobo] won the Nobel Peace Prize, and, in 2016, restricted trade with South Korea after Seoul agreed to deploy a US Terminal High Altitude Area Defense (THAAD) missile-defense system.

Beginning in 2020, China imposed hefty tariffs on Australian barley and wine imports, while throwing up barriers to several other products—including timber, lobster, and coal—in retaliation for “smearing China” after Australia called for an independent investigation into the origins of COVID-19.<sup>38</sup> Last year, China banned Lithuanian imports, and began to pressure multinational corporations to reduce investments in Lithuania and stop sourcing supplies from that country, in retaliation for Lithuania's decision to allow Taiwan to open a representative office in its own name. Beijing has used similar tactics against the United States, threatening economic retaliation against the National Basketball Association, Hollywood studios, and universities for allowing free speech critical of China.<sup>39</sup>

As noted in a recent report, the COVID-19 pandemic “has laid bare long-standing vulnerabilities in US and global supply chains, including American reliance on sole-source manufacturing and on Chinese manufacturing, in particular.”<sup>40</sup> Given their intertwined economies, some analysts have suggested that China and the United States are in a situation of “mutually assured economic destruction.”<sup>41</sup> As a result, leading democracies are in a vulnerable position if they choose to stand up to Beijing's coercive threats. Were China to engage in a more aggressive assault against the rules-based order, such as taking military action

31 Kevin Rudd, “To Decouple or Not to Decouple?” Asia Society, <https://asiasociety.org/policy-institute/decouple-or-not-decouple>.

32 Anders Sundell, “Visualizing Countries Grouped by Their Largest Trading Partner,” Visual Capitalist, February 11, 2022, <https://www.visualcapitalist.com/cp/biggest-trade-partner-of-each-country-1960-2020/>.

33 Annabelle Timsit, “How Much Debt Does China Own?” Quartz, September 24, 2020, <https://qz.com/1905559/how-much-us-debt-does-china-own>.

34 “Russia cuts gas supplies to Slovakia by 50% in response to Slovak assistance to Ukraine,” Alliance for Securing Democracy, October 2014, <https://securingdemocracy.gmfus.org/incident/russia-cuts-gas-supplies-to-slovakia-by-50-in-response-to-slovak-assistance-to-ukraine/>.

35 “Russian state-controlled company restricts rail freight deliveries through Latvia in retaliation for Latvia's refusal to support for Nord Stream 2,” Alliance for Securing Democracy, May 23, 2017, <https://securingdemocracy.gmfus.org/incident/russian-state-controlled-company-restricts-rail-freight-deliveries-through-latvia-in-retaliation-for-latvias-refusal-to-support-for-nord-stream-2/>.

36 “Russia Attempts to Use Gas Supply to Gain Concessions from Moldova,” Alliance for Securing Democracy, October 2021, <https://securingdemocracy.gmfus.org/incident/russia-attempts-to-use-gas-supply-to-gain-concessions-from-moldova/>.

37 Binnendijk et al., *The China Plan*.

38 Dziedzic, “Chinese official declares Beijing has targeted Australian goods as economic punishment.”

39 Ash Jain and Dan Fried, “State of the Order: Assessing January 2022,” Atlantic Council, February 8, 2022, <https://www.atlanticcouncil.org/commentary/blog-post/state-of-the-order-assessing-january-2022/>.

40 “Ties That Bind, A Helsinki Commission Staff Report on Secure Supply Chains,” Wilson Center, 2021, [https://www.wilsoncenter.org/sites/default/files/media/uploads/documents/Ties\\_that\\_Bind.pdf](https://www.wilsoncenter.org/sites/default/files/media/uploads/documents/Ties_that_Bind.pdf).

41 Leon Whyte, “US-China: Mutually Assured Economic Destruction?” *The Diplomat*, May 26, 2015, <https://thediplomat.com/2015/05/u-s-china-mutually-assured-economic-destruction/>

against Taiwan, the rapid imposition of sanctions and the increasing decoupling that the West has employed against Russia would be far more costly and challenging to impose against China, given the consequences they would have on the US and global economies.<sup>42</sup>

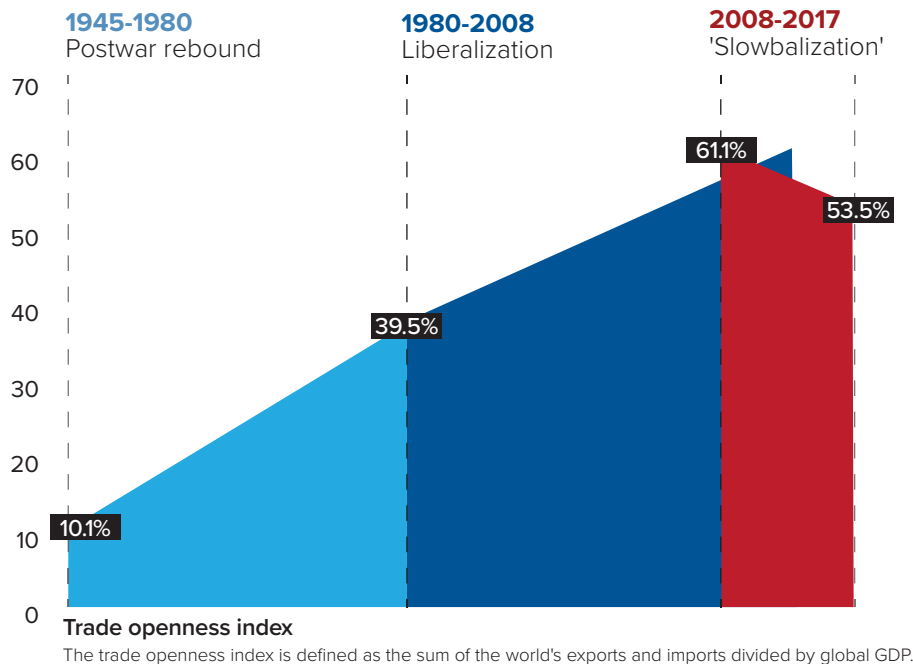
## Deglobalization and Protectionism

Policymakers in the United States and its allies have recognized the problems posed by the growing strategic dependencies on autocracies. The COVID-19 pandemic, followed by Russia’s further invasion of Ukraine, have both served as wakeup calls, prompting democratic governments to look for alternative sources of supply for critical items. As China and Russia act more aggressively to challenge the rules-based order, the United States and other leading democracies have begun imposing new trade barriers, including a widening range of tariffs and sanctions, against

them. However, these calls for shifting supply chains away from China are also fueling pressure toward protectionism. As free trade has become less salient, particularly in the United States, both political parties have begun to emphasize supply chain resilience and domestic onshoring.

This has coincided with a gradual slowing of the process of globalization since the global financial crisis of 2008. According to the *Economist*, between 2008 and 2019, world trade, relative to global GDP, fell by about five percentage points.<sup>43</sup> Recognizing its own economic dependence, particularly on the West, China itself has begun to reduce its reliance on overseas markets.<sup>44</sup> A notable essay in Bloomberg suggests that “geopolitics is definitively moving against globalization—toward a world dominated by two or three great trading blocs.”<sup>45</sup> Globalization has slowed and, according to columnist David Brooks, has “even kicked into reverse.”<sup>46</sup>

### Globalization in Retreat



SOURCE: Peterson Institute for International Economics and Our World in Data\*

42 Dobbin, et al., “Conflict with China.”

43 “Globalisation and autocracy are locked together. For how much longer?”, *The Economist*, May 19, 2022, <https://www.economist.com/finance-and-economics/2022/03/19/globalisation-and-autocracy-are-locked-together-for-how-much-longer>.

44 Kevin Yao, “China pursues economic self-reliance as external risks grow: advisers,” *Reuters*, August 4, 2020, <https://www.reuters.com/article/us-china-economy-strategy/china-pursues-economic-self-reliance-as-external-risks-grow-advisers-idUSKCN25031K>.

45 John Micklethwait and Adrian Wooldridge, “Putin and Xi Exposed the Great Illusion of Capitalism,” Bloomberg, March 24, 2022, <https://www.bloomberg.com/opinion/articles/2022-03-24/ukraine-war-has-russia-s-putin-xi-jinping-exposing-capitalism-s-great-illusion>.

46 David Brooks, “Globalization is Over, The Global Culture Wars Have Begun,” *New York Times*, April 8, 2022, <https://www.nytimes.com/2022/04/08/opinion/globalization-global-culture-war.html>.



The challenges facing the global economic order are significant. But they also offer an opportunity to reshape the order in ways that are more structured and conducive to the interests of the United States and its allies. As the Bloomberg piece notes, “the answer to globalization’s woes isn’t to abandon economic liberalism, but to redesign it.”

## Supply Chain Resiliency and Ally Shoring

As an alternative to protectionism, a growing chorus of voices has called for the United States to establish more resilient supply chains by strengthening cooperation with democratic allies and partners<sup>47</sup>. Elaine Dezenski and John Austin, for example, have called for “ally shoring”—sourcing essential goods and services with countries that share democratic values and a commitment to an open, rules-based international order.<sup>48</sup> A recent report issued by Deloitte suggested the need to “protect critical supply chains by enabling closer supply chain coordination among allies and partners.”<sup>49</sup> In addition, a report issued by Chatham House, based in the United Kingdom, has advocated for greater cooperation among allied democracies to protect “strategic supply chains without sliding into protectionism,” while others have called on the United States to “deepen economic integration among like-minded nations” and pointed to the need for “a tighter free world economic bloc that makes it harder for autocratic regimes to coerce.”<sup>50</sup>

While encouraging domestic reshoring efforts, the Biden administration has also emphasized the need to work with allies and partners on supply chain resiliency. As a presidential candidate, Biden called for new approaches to limit dependence on China and Russia by creating a “strong understanding with our allies on how best ensure supply

## A growing chorus of voices has called for the United States to establish more resilient supply chains by strengthening cooperation with democratic allies and partners

chain security for all of us.”<sup>51</sup> The White House followed with a report that cited the need to “cooperate with our allies and partners to foster and promote collective supply chain resilience.” More recently, Treasury Secretary Janet Yellen affirmed the economic and geostrategic benefits of “friend shoring,” by which the United States can count on countries with “strong adherence to a set of norms and values about how to operate in the global economy.”<sup>52</sup>

Congress is also considering legislation to foster ally-shoring. The Senate last year passed a bipartisan bill, the United States Innovation and Competition Act—co-sponsored by Senators Chuck Schumer (D-NY) and Todd Young (R-IN)—that would establish a program in the Department of Commerce that would “work with governments of countries that are allies or partners of the United States to promote diversified and resilient supply chains,” and call for the United States and European allies, as “close partners...sharing values grounded in democracy... and the rules-based international order,” to work together to diversify reliance on Chinese supply chains.<sup>53</sup> A similar measure in the House of Representatives, co-sponsored by Representatives Ro Khanna (D-CA) and Mike Gallagher (R-WI), passed earlier this year and is currently pending reconciliation.<sup>54</sup> In addition, Representatives Michael McCaul (R-TX) and Doris Matsui (D-CA) co-sponsored

47 A new Atlantic Council report by Frank Kramer also suggests that ally shoring, or friend shoring, is often critical to assuring the key elements of resilient supply chains necessary for national security. Frank Kramer, “Free but Secure Trade: Priorities in Support of National Security,” Atlantic Council, 2022, <https://www.atlanticcouncil.org/wp-content/uploads/2022/06/Free-but-Secure-Trade-Priorities-in-Support-of-National-Security.pdf>

48 Dezenski and Austin, “Rebuilding America’s Economy and Foreign Policy with ‘Ally-Shoring.’”

49 “Boosting Resilience: Working with Like-minded Partners to Orchestrate Critical Supply Chains,” Deloitte Center for Government Insights, 2022, <https://www2.deloitte.com/global/en/pages/public-sector/articles/boosting-resilience-working-with-like-minded-partners-to-orchestrate-critical-supply-chains.html>.

50 Marianne Schneider-Petsinger, “US and European Strategies for Resilient Supply Chains,” Chatham House, September 14, 2022, <https://www.chathamhouse.org/2021/09/us-and-european-strategies-for-resilient-supply-chains/06-conclusions-and-recommendations>; Micklethwait and Wooldridge, “Putin and Xi Exposed the Great Illusion of Capitalism”; Michael Beckley and Hal Brands, “The Return of Pax Americana?” *Foreign Affairs*, March 14, 2022, <https://www.foreignaffairs.com/articles/russia-fsu/2022-03-14/return-pax-americana>; Miyeon Oh, Robert Dohner, and Trey Herr, *Global Value Chains in an Era of Strategic Uncertainty: Prospects for US-ROK Cooperation*, Atlantic Council, November 2020, <https://www.atlanticcouncil.org/wp-content/uploads/2020/11/GLOBAL-VALUE-CHAINS-final-11-19-1.pdf>; Miyeon Oh, James Hildebrand, and *Enhancing US-Japan Cooperation on Global Supply Chains*, Atlantic Council, May 27, 2021, <https://www.atlanticcouncil.org/in-depth-research-reports/enhancing-us-japan-cooperation-on-global-supply-chains/>.

51 “The Biden Plan to Rebuild US Supply Chains and Ensure the US Does Not Face Future Shortages of Critical Equipment,” The Biden-Harris Campaign, <https://joebiden.com/supplychains/>.

52 “Remarks by Secretary of the Treasury Janet L. Yellen on Way Forward for the Global Economy.”

53 United States Innovation and Competition Act of 2021, S. 1260 (2020–2021), <https://www.congress.gov/bill/117th-congress/senate-bill/1260/text>.

54 “America Creating Opportunities, Pre-Eminence in Technology, and Economic Strength Act (COMPETES) Act of 2022,” House Committee on Science, Space, and Technology, <https://science.house.gov/americancompetes>.

legislation that aims to foster more secure semiconductor supply chains and establishes a common funding mechanism with US partners.<sup>55</sup>

In addition, allies have joined these calls for supply chain resiliency. The EU has proposed measures for diversifying and strengthening supply chains, including by enhancing cooperation with the United States and other likeminded countries, focusing on “reshoring or nearshoring.”<sup>56</sup> The Japanese government, which has been concerned about the concentration of its supply chains in China since the dispute over the Senkaku Islands, has offered several rounds of subsidies to encourage firms to relocate production back to Japan or diversify supply chains by moving to a third country, mostly in Southeast Asia.<sup>57</sup>

## Existing Supply Chain Dialogues

The United States and its allies have begun to discuss supply chain cooperation through a number of existing venues. Through the Trade and Technology Council (TTC), launched in September 2021, the United States and the EU established a Secure Supply Chains Working Group, one of ten issue-based working groups within the TTC, to improve resilience and security of supply in key sectors, with an initial focus on semiconductors, clean energy, pharmaceuticals, and critical materials.<sup>58</sup>

The Biden administration’s Indo-Pacific Economic Framework (IPEF) is a concrete manifestation of ally-shoring. While its parameters are still being developed,

the initiative will focus on “supply chain resilience” as one of four pillars for cooperation among regional allies.<sup>59</sup> In addition, through the Quad, the United States is working with Australia, Japan, and India to discuss critical-technology supply chains, and to diversify equipment suppliers and telecommunications—as well as critical medical supply and service supply chains—particularly amid the COVID-19 pandemic, through the Quad Vaccine Partnership.<sup>60</sup> Separately, the Supply Chain Resilience Initiative (SCRI), a trilateral agreement among Japan, Australia, and India, convenes the countries’ trade ministers to locate supply chain vulnerabilities, support investment and trade diversification, and ultimately act as a “supply chain shield against China’s dominance.”<sup>61</sup> The United States, the EU, and Japan have also restarted a trilateral dialogue on trade challenges.<sup>62</sup>

While potentially impactful, the current patchwork of multi-lateral supply chain dialogues and initiatives remains too narrow, both in terms of economic and geographic scope. Rather than approaching the challenges systematically, these efforts have tended to focus on a handful of sectors, such as semiconductors, and are leading to outcomes that are bifurcated along regional lines. Yet today’s supply chains, particularly those involving China, are global, not regional, and the same set of strategic and economic challenges impacting the United States are also impacting America’s allies across both Europe and the Indo-Pacific. What is lacking is an integrated framework that would bring together leading democracies to coordinate a free world strategy on these challenges.

55 See “Analysis for CHIPS Act and BIA Briefing,” Department of Commerce, April 6, 2022, <https://www.commerce.gov/news/press-releases/2022/04/analysis-chips-act-and-bia-briefing>.

56 Marcin Szczepeński, “Resilience of Global Supply Chains,” European Parliamentary Research Service, November 2021, [https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/698815/EPRS\\_BR\(2021\)698815\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/698815/EPRS_BR(2021)698815_EN.pdf).

57 Oh, et al., *Enhancing US-Japan Cooperation on Global Supply Chains*.

58 “EU-US Trade and Technology Council Inaugural Joint Statement,” European Commission, September 29, 2021, [https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT\\_21\\_4951](https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_21_4951).

59 Matthew P. Goodman and Aidan Arasasingham, “Regional Perspectives on the Indo-Pacific Economic Framework,” Center for Strategic and International Studies, April 11, 2022, <https://www.csis.org/analysis/regional-perspectives-indo-pacific-economic-framework>.

60 “Quad Principles on Technology Design, Development, Governance, and Use,” White House, September 24, 2021, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/24/quad-principles-on-technology-design-development-governance-and-use/>.

61 “QUAD Allies India, Australia & Japan Form A ‘Supply Chain Shield’ Against China’s Dominance,” *Eurasian Times*, April 29, 2021, <https://eurasiatimes.com/quad-allies-india-australia-japan-form-a-supply-chain-shield-against-chinas-dominance/>.

62 “2021 Report to Congress on China’s WTO Compliance,” United States Trade Representative, February 2022, <https://ustr.gov/sites/default/files/files/Press/Reports/2021USTR%20ReportCongressChinaWTO.pdf>.



G7 leaders discuss common challenges in Schloss Elmau, Germany, June 2022. (via Council of EU)

### III. D-TEP: STRATEGIC VISION AND GOALS

**G**iven the significant vulnerabilities they face, the United States and its democratic allies must adopt a fundamentally new approach to deal with the growing economic challenges to the rules-based order.

The United States and leading democracies in Europe, North America, and the Indo-Pacific should lead the establishment of a new strategic trade and economic framework for the twenty-first century: a **Democratic Trade and Economic Partnership (D-TEP)** that would bring together willing democracies, and potentially other partners that meet certain criteria, to act together under a common economic umbrella. D-TEP would provide a holistic and systematic framework for the United States and its allies and partners to coordinate on economic challenges posed by revisionist autocracies and help position the free world to succeed in an era of strategic competition.

D-TEP would be focused primarily on achieving the following goals.

- 1 Reducing strategic dependence on China and Russia.** First, D-TEP would aim to reduce democracies' vulnerability to coercion, blackmail, or potential supply chain disruptions from China and Russia. The goal is not to cut off all trade and investment, particularly with regard to China. Rather, it is to identify critical economic sectors

in which the United States and its allies cannot afford to continue allowing unfettered trade and investment flows, and to take impactful steps to reduce strategic dependence in these sectors. D-TEP would also seek to ensure that China and Russia are not able to gain access to military and other national security-related products, services, and technologies.

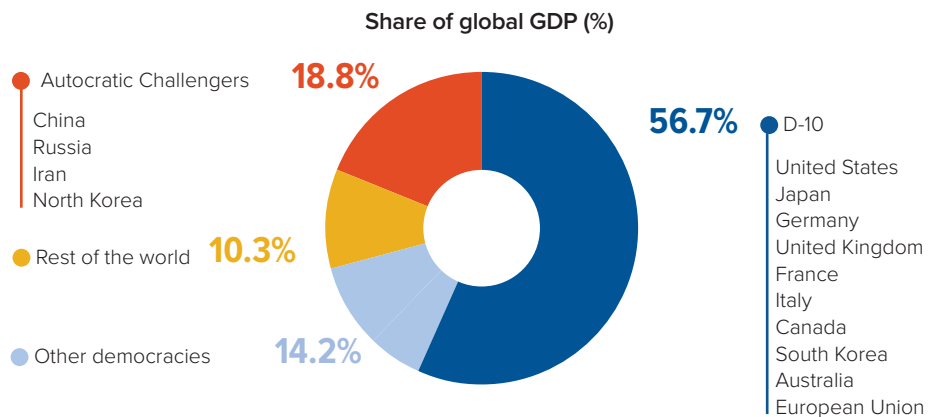
- 2 Expanding free, fair, and secure trade among democracies.** Second, D-TEP would be aimed at fostering free, fair, and secure trade within the democratic world, by bringing down trade and investment barriers in the industry sectors around which supply chains would be reorchestrated under this framework. The goal is

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D-TEP would provide a holistic and systematic framework for the United States and its allies and partners to coordinate on economic challenges posed by revisionist autocracies and help position the free world to succeed in an era of strategic competition.

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## Democracies' Economic Power



SOURCE: WORLD BANK

to expand the benefits of trade, while pushing back against rising protectionism and encouraging greater openness within the democratic world. Over time, D-TEP could help facilitate agreements among democracies on expanding market access in other sectors, while fostering closer economic engagement and cooperation among states committed to upholding the rules-based order.

**3 Incentivizing nations on the fence to join the free world in upholding the rules-based order.** Finally, D-TEP would aim to incentivize nations, particularly those in the global South, to join the United States and its allies in upholding the rules-based order. With the economic benefits of supply chain shifts accruing to member states, the prospect of D-TEP membership could serve as a powerful inducement for nonaligned democracies and other nations to work more closely with the United States and its allies to advance shared interests and reduce strategic vulnerabilities to autocracies that are challenging the order.<sup>63</sup>

All three of these goals are important and interconnected. Reducing strategic dependence on China and Russia will require shifting supply chains to a broad group of reliable and trusted allies that can provide a pool of diverse

sources of goods and services. For this to work, the private sector needs meaningful incentives to shift these supply chains, including the reduction of trade barriers in the affected industry sectors, which could also facilitate new opportunities to foster more free and secure trade among democracies. Nations that are part of this framework will accrue significant economic benefits, and access to these benefits can be used as an incentive to persuade governments on the fence to work more closely with the United States and its allies to reduce vulnerabilities to autocracies that are challenging the order.

To be clear, D-TEP would not be intended to supplant or undermine the World Trade Organization or the existing bilateral and multilateral trade and investment agreements that D-TEP members have in place among themselves or other states. The United States and its allies should continue to look for ways to strengthen the WTO and reinforce its efforts to expand open trade and investment worldwide, even as it builds a more tailored economic framework with democratic allies and partners.<sup>64</sup> Washington should also continue to work through the Group of Twenty (G20) and other more inclusive economic venues, and maintain a bilateral economic dialogue with China to seek to resolve trade disputes and prevent a further breakdown of the global trading system.

63 "To attract allies and partners, it is not enough merely to oppose flagrant violations of territorial sovereignty. The United States also needs to be for something—something that is more appealing to the rest of the world than, say, Russian arms or Chinese cash... You know what would be really appealing? If the United States could offer the promise of greater trade and investment with countries in the global South." Daniel W. Drezner, "The Biden Administration's Zombie Foreign Economic Policy," *Washington Post*, April 12, 2022, <https://www.washingtonpost.com/outlook/2022/04/12/biden-administrations-zombie-foreign-economic-policy/>.

64 See Josh Lipsky, Bretton Woods 2.0



A key goal of D-TEP is to reduce strategic dependency on Russia and China in critical industry sectors, such as the production of lithium ion batteries. (via REUTERS)

## IV. CORE ELEMENTS OF D-TEP

In pursuit of the goals outlined above, D-TEP would be organized around four core pillars, each of which would entail commitments by member states and corresponding benefits.

### Pillar One: Regulating Trade and Investment with China and Russia

Pillar One of D-TEP would facilitate an agreement among member states on a common framework for regulating trade and investment flows with China and Russia. The goal is to reduce vulnerability among democracies to coercion, blackmail, or potential supply chain disruptions from China and Russia, by identifying economic sectors in which the United States and its allies cannot afford to continue allowing unfettered trade and investment flows, and to take steps to reduce strategic dependence in these sectors. It would rely on reshoring and ally shoring—sourcing essential goods and services with likeminded countries that share democratic values—as a means to reduce these risks.

The framework would distinguish between three categories of industry sectors: strategic sectors vital to national

security; sensitive and critical industry sectors; and other economic sectors.<sup>65</sup>

- **For strategic sectors vital to national security**, D-TEP would prohibit member states from engaging in trade and investment with China and Russia. This includes arms and other military equipment, intelligence-related items, and advanced technologies with potential security applications—such as those relating to certain applications of AI, quantum computing, 5G technology, and biotechnology, and related research and development in these areas. Many leading democracies, including the United States and the EU, already have regulations and export controls in place that prohibit the sale of defense articles and certain dual-use technologies to unauthorized states.<sup>66</sup> D-TEP would seek to harmonize regulations on export controls, investment screening, outbound investments, and other measures, and ensure they are adequate to prevent China or Russia from obtaining items that pose significant security risks, and to ensure that D-TEP states are not reliant on Russian or Chinese sources for such items.<sup>67</sup>

<sup>65</sup> Binnendijk, et al., *The China Plan*.

<sup>66</sup> US law contains nine categories of prohibited goods range from depleted uranium, chemicals, toxins, machine tools and parts with particular application, high-performance computers, x-ray components, telecommunications equipment, sensors, lasers, navigation equipment, avionics, underwater equipment, and some aircraft. The Commerce Department's Bureau of Industry and Security (BIS) has also issued a series of new China-related Entity List designations and export control reforms to restrict exports to China in the fields of AI, quantum computing, biotechnology and drones. "China: Economic Sanctions," Congressional Research Service, August 22, 2016, [https://www.everycrsreport.com/files/20160822\\_R44605\\_160c92226c43bf33f590663dd758fe9b4e0b8caa.pdf](https://www.everycrsreport.com/files/20160822_R44605_160c92226c43bf33f590663dd758fe9b4e0b8caa.pdf); Jeffrey I. Kessler, et al., "United States Adopts Wide-Ranging China Restrictions," WilmerHale, December 29, 2021, <https://www.wilmerhale.com/en/insights/client-alerts/20211229-united-states-adopts-wide-ranging-china-restrictions>.

<sup>67</sup> Nearly all corporate transactions with foreign acquirors or investors now merit some level of CFIUS risk analysis to determine whether a deal triggers a mandatory filing or presents a risk of CFIUS attention. Also, China deals, especially those involving the health sector, advanced technology or information about US persons, are increasingly likely to be reviewed by CFIUS before or after closing. Most OECD nations have stepped up their foreign investment screening systems in response to Chinese acquisitions in strategic sectors. "Understanding U.S.-China Decoupling: Macro Trends and Industry Impacts," China Center, US Chamber of Commerce, 2021, [https://www.uschamber.com/assets/archived/images/024001\\_us\\_china\\_decoupling\\_report\\_fin.pdf](https://www.uschamber.com/assets/archived/images/024001_us_china_decoupling_report_fin.pdf).

- **For sensitive and critical industry sectors**, D-TEP states would commit to measures aimed at incentivizing private industry to shift supply chains away from China and Russia, and toward DTEP member states. These include areas in which supply chain disruptions could cause significant vulnerabilities or harm to the security or the economies of the United States and its allies, or the well-being of their citizens. Drawing on a White House policy directive on critical infrastructure, sectors included in this category are those that pertain to energy (e.g., oil, gas, solar), health and medicine (e.g., vaccines, pharmaceutical ingredients, PPE), rare-earth minerals, chemicals, transportation (e.g., commercial aircraft, high-speed trains), water and wastewater systems, telecommunications, internet and computing, financial products (e.g., government bonds), agricultural commodities, other important technology products (e.g., semiconductors), and other critical manufacturing.<sup>68</sup>
- **For other economic sectors**, such as furniture, appliances, electronics, toys, industrial parts, and other broad streams of existing commerce, D-TEP would generally permit open trade and investment, in accordance with the WTO and other existing trade agreements. But this would be subject to two important caveats. First, trade in these sectors (as well as those above) may be restricted by existing, and potentially future, sanctions against China and Russia for violations of international norms. This includes sanctions against Russia for its invasion of Ukraine, and against China for its human rights violations in Xinjiang and Hong Kong, as well as penalties imposed against Beijing for unfair trade practices. Second, democracies should avoid becoming overly dependent on China or Russia in any specific industry sector, or on aggregate imports or exports, in ways that could give these autocratic powers potential coercive leverage. D-TEP could develop guidelines on levels of risk and when supply chain diversification may be beneficial in these sectors.

D-TEP would facilitate agreement on specific sectors and products to include in this category, and on what measures can be taken to encourage the shifting of supply chains in these areas to D-TEP member states. Such measures could include corporate tax and financial incentives to incentivize production in D-TEP states; the removal of tariffs and regulatory hurdles on products in these sectors; the imposition of new tariffs on products in these sectors that originate from China and Russia; and supplier-certification programs, similar to the Blue Dot Network.<sup>69</sup>

Delineating between these sectors and implementing this framework in a practical way may prove challenging. Moreover, regulating the sourcing of critical components for an industry may not be entirely effective by itself, as there may be single sources hidden several layers down in the supply chain that need to be addressed as well. Still, such a framework could provide a rational and constructive starting point to build upon. Moreover, once D-TEP is established, other autocratic challengers to the rules-based order, such as Iran and North Korea, could be considered for similar treatment under Pillar One.

68 Presidential Policy Directive 21 could form the basis of national security sensitive products. Those sectors include chemicals, commercial facilities, communications, critical manufacturing, dams, defense industrial base, emergency services, energy, financial services, food and agriculture, government facilities, healthcare and public health, information technology, nuclear reactors, materials and waste, transportation systems, and water and wastewater systems. These sectors have been extensively analyzed by government and industry, and plans have been drafted which identify risks (including supply chain risks) and propose mitigation strategies.

69 Even so, Tokyo has been trying to change course, allocating \$2.2 billion in 2020 to entice Japanese companies with operations in China to move back to Japan or Southeast Asian countries to diversify Japan's supply chains; Blue Dot Network—a set of countries that will certify infrastructure projects as compliant with global standards—provides a strong base from which to expand US efforts. A resilience plan mandate should require key critical infrastructure companies to have at a minimum non-Chinese companies in their supply chains—a “China-plus one” approach—which would require additional supplier in a democracy/member state.

## Pillar Two: Assisting Democracies Subject to Economic Coercion

Pillar Two would entail a commitment by D-TEP member states to take collective action to assist other members if they become the subject of economic coercion. Some, including former NATO Secretary General Anders Fogh Rasmussen, have likened this to NATO's Article V, in which an attack against one is considered an attack against all.<sup>70</sup> In response to such coercion, member states could seek to locate and coordinate delivery of alternative sources of goods to replace those being cut off, provide financial assistance to target nations that suffer economic damage, and impose sanctions or other retaliatory actions against those engaged in economic coercion.<sup>71</sup> Where private-sector or non-governmental entities are being targeted, member states could also seek to coordinate joint actions to defend these entities and mitigate the potential economic harm.

Whereas Pillar One would be aimed at taking steps to prevent coercion by reducing opportunities available to revisionist autocracies, Pillar Two would be aimed at deterring such coercion through the threat of retaliatory measures and the promise of assistance to potential target nations that would render the use of such coercion ineffectual. If Pillar One is successful, the opportunities available to autocratic powers to engage in such coercion would be limited. But fully implementing Pillar One, including the reorchestration of supply chains, could take years. In the meantime, D-TEP member states need to develop a common understanding as to what types of coercive actions would trigger action under Pillar Two, and what forms of assistance member states would be prepared to provide.

## Pillar Three: Reducing Trade Barriers within the Free World

Pillar Three would outline an agreement between member states to reduce trade barriers among themselves in specific industry sectors. Such an agreement would need to be structured in a narrow and practical way, beginning with the critical sectors identified in Pillar One, where it is in the interest of D-TEP members to promote the shifting of supply chains away from China and Russia, and toward the democratic world. For these sectors, member states would seek agreement on reducing tariff and nontariff

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D-TEP would entail a commitment by member states to take collective action to assist other members if they become the subject of economic coercion.

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barriers; harmonizing standards and regulations to promote greater compatibility; and enacting reciprocal procurement provisions, so that preferential treatment for government purchases of goods and services in these sectors would extend to all D-TEP member states.

The reduction of trade barriers in these sectors could help facilitate greater market access in these sectors to member states, which would provide another meaningful incentive for nations to take on the commitments required under Pillar One. Over time, D-TEP could also facilitate agreements to reduce trade barriers in other industry sectors as well, serving as a platform to revitalize discussions among the United States and its democratic allies—across the Atlantic and Indo-Pacific—on fostering more free, fair, and secure trade, while promoting greater economic integration within the free world.

## Pillar Four: Coordinating Initiatives to Counter Autocratic Influence

Pillar Four would constitute a set of bold economic initiatives in areas in which revisionist autocracies, particularly China, are outcompeting the democratic world, and in which the United States and its allies have a particularly strong interest in working together to maintain a strategic edge. These initiatives could help counter Beijing and Moscow's attempts to co-opt nations in the global South by making them more economically dependent on China and Russia.<sup>72</sup>

- **Global infrastructure initiative.** Through its Belt and Road Initiative, China has invested billions of dollars in physical infrastructure across Asia, Africa, and Latin America, as it aims to become the partner of choice for countries across the global South. In response, the United States and its allies launched the Build Back Better World (B3W) partnership at the G7 summit in June 2021, with the goal of creating “a values-driven,

70 Ivo H. Daalder and Anders Fogh Rasmussen, “Memo on an ‘Economic Article 5’ to Counter Authoritarian Coercion, The Chicago Council on Global Affairs, June 9, 2022. Jonas Parello-Plesner, “An ‘Economic Article 5’ to Counter China,” *Wall Street Journal*, February 11, 2021, <https://www.wsj.com/articles/an-economic-article-5-to-counter-china-11613084046>.

71 Recently, democracies have sought to work together to assist nations that have been the targets of coercion. The EU, for example, filed a claim with the WTO in light of Chinese coercion campaign against Lithuania, and lowered tariffs on imports from Ukraine, after Russia's invasion.

72 Zoe Liu Zongyuan, “What the China-Solomon Islands Pact Means for the US and South Pacific,” *Council on Foreign Relations*, May 4, 2022, <https://www.cfr.org/in-brief/china-solomon-islands-security-pact-us-south-pacific>. Beijing's recently-concluded bilateral security cooperation agreement with the Solomon Islands, for example, reflects China's growing influence in the South Pacific.

high-standard, and transparent infrastructure partnership” to help finance projects in developing countries.<sup>73</sup> D-TEP could serve as the coordinating body for an expanded infrastructure initiative, building on the G7’s recently announced global infrastructure plan, with the aim of drawing increased levels of funding from member states, mobilizing private-sector capital, and coordinating funding from development-finance institutions. Grounded in D-TEP, such an initiative could facilitate priority funding for infrastructure projects in member states, and allow companies based in member states priority access to bid on new projects in third countries.

- **Digital commerce initiative.** Digital commerce represents the future of global economic growth. Seeking to outcompete the democratic world, China’s Digital Silk Road aims to serve as the center of global e-commerce networks by promoting digital free-trade zones, establishing regional logistics centers, and expanding China-centric digital infrastructure in developing countries—including next-generation cellular networks, fiber-optic cables, and data centers.<sup>74</sup> While enhancing digital connectivity, these efforts are also serving to spread authoritarianism and infringe on fundamental human rights. D-TEP could launch a digital-commerce initiative aimed at counteracting the spread of digital authoritarianism and ensuring that international digital connectivity creates a secure, free, and open cyber environment.<sup>75</sup> The initiative would coordinate efforts among democracies to pool financial resources, and provide logistical support for building digital infrastructure in the developing world, while seeking agreement on shaping norms and rules on digital commerce that are consistent with democratic norms and values.<sup>76</sup>

- **Clean energy technology initiative.** China dominates the global supply chain for renewable energy sources, producing the vast majority of the world’s solar panel materials<sup>77</sup> D-TEP would facilitate the launch of a new clean energy technology initiative aimed at ensuring that the democratic world will not become dependent on China or any other autocratic power for its future energy requirements. The core of this initiative will include a dramatic infusion of funding for research and development, production incentives, and other measures to ensure that the free world will lead the future of clean energy manufacturing and innovation, such as geothermal, hydropower, nuclear, solar, and wind.<sup>78</sup> Similar initiatives could be developed to jumpstart cooperation around other critical technologies—from AI to quantum computing to hypersonics—with the goal of accelerating technological innovation among leading democracies and reducing reliance on China.<sup>79</sup>

Together, these four pillars would facilitate a series of mutually reinforcing activities, provide an integrated framework to reduce strategic dependence on autocracies, and advance the rules-based economic order. D-TEP would pool the economic power and influence of the world’s leading democracies based around shared interests and a common willingness to act.

At the same time, it would consolidate a meaningful package of economic benefits that many nations around the world—in particular, developing nations in the global South—could find attractive. Such benefits could potentially accrue across each of D-TEP’s four pillars. First, participating nations could benefit from the potential relocation of manufacturing facilities in critical sectors that would be incentivized under Pillar One, providing increased jobs for their citizens and facilitating access to secure supply

73 “Fact Sheet: President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership,” White House, June 12, 2021, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/12/fact-sheet-president-biden-and-g7-leaders-launch-build-back-better-world-b3w-partnership/>; “DFC Announces Support for New Build Back Better World Initiative, Bolstering Global Infrastructure Investments,” US International Development Finance Corporation, June 12, 2021, <https://www.dfc.gov/media/press-releases/dfc-announces-support-new-build-back-better-world-initiative-bolstering-global>. See also Tal Alexrod, “G-7 rolls out global infrastructure plan,” ABC News, June 26, 2022.

74 Jonathan E. Hillman, “Competing with China’s Digital Silk Road,” Center for Strategic and International Studies, February 9, 2021, <https://www.csis.org/analysis/competing-chinas-digital-silk-road>.

75 Clayton Cheney, “China’s Digital Silk Road: Strategic Technological Competition and Exporting Political Illiberalism,” Council on Foreign Relations, September 26, 2019, <https://www.cfr.org/blog/chinas-digital-silk-road-strategic-technological-competition-and-exporting-political>.

76 Pepijn Bergsen, et al., “Digital Trade and Digital Technical Standards,” Chatham House, January 24, 2022, <https://www.chathamhouse.org/2022/01/digital-trade-and-digital-technical-standards/digital-trade>; Daniel S. Hamilton, “Advancing Supply Chain Resilience and Competitiveness: Recommendations for U.S.-EU Action,” Transatlantic Leadership Network, <https://www.transatlantic.org/wp-content/uploads/2022/03/TTC-Supply-Chains.pdf>.

77 Ana Swanson and Brad Plumer, “China’s Solar Dominance Presents Biden With an Ugly Dilemma,” *New York Times*, April 20, 2021, <https://www.nytimes.com/2021/04/20/business/economy/china-biden-solar-panels.html>.

78 Such an initiative could build on the Biden administration’s recently released strategy on securing supply chains to ensure a clean energy transition. Tsililile Igogo, “America’s Strategy to Secure the Supply Chain for a Robust Clean Energy Transition,” US Department of Energy, February 24, 2022, [https://www.energy.gov/sites/default/files/2022-02/America%E2%80%99s%20Strategy%20to%20Secure%20the%20Supply%20Chain%20for%20a%20Robust%20Clean%20Energy%20Transition%20FINAL.docx\\_0.pdf](https://www.energy.gov/sites/default/files/2022-02/America%E2%80%99s%20Strategy%20to%20Secure%20the%20Supply%20Chain%20for%20a%20Robust%20Clean%20Energy%20Transition%20FINAL.docx_0.pdf).

79 Ash Jain and Matthew Kroenig, *Toward a Democratic Technology Alliance: An Innovation Edge That Favors Freedom*, Atlantic Council, June 2022, <https://www.atlanticcouncil.org/in-depth-research-reports/report/toward-a-democratic-technology-alliance-an-innovation-edge-that-favors-freedom/>



chains in critical sectors that would allow them to reduce their dependencies on China and Russia. Second, they could benefit from the guarantee of economic support from the United States and other powerful democracies under Pillar Two, which could provide a robust deterrent against economic coercion. Third, they could benefit from the reduction of trade barriers and increased market access to other member states in the industry sectors covered under Pillar Three. Fourth, they could benefit from increased foreign investment, financial assistance, and private-sector participation that could follow from the initiatives described under Pillar Four. More broadly, by joining a coalition of likeminded nations prepared to take meaningful action, member states would become part of a robust network of partners to help protect and defend the rules-based trade and economic order that has been essential to sustaining their own national prosperity.

At the same time, such efforts to limit trade with China and Russia in specific sectors may lead to some economic downsides, as supply chains shift to higher-wage economies with increased production costs. However, the premise of the framework is that the strategic benefits

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**Importantly, D-TEP would not require member states to fully decouple from China or choose between trading with China and the West.**

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of reorchestrating supply chains will outweigh these economic costs in the long-run. Moreover, such costs would be mitigated if some of the impacted supply chains shift toward lower-wage member-states, such as India or Mexico.

Importantly, D-TEP would not require member states to fully decouple from China or choose between trading with China and the West. Rather, it would focus on selective decoupling – restricting trade or incentivizing supply chain shifts in specific industry sectors, leaving unchanged the ability to engage in trade and investment across a wide range of other areas (except, as noted, where targeted sanctions have been imposed).



President Biden launches a new Indo-Pacific Economic Framework in Tokyo, and US officials meet with their European counterparts in the US-EU Trade and Technology Council. (via REUTERS)

## V. PARTICIPATING NATIONS

At the outset, D-TEP would bring together leading democracies that share strategic concerns over the challenges to the rules-based order posed by China and Russia. This could include the advanced industrialized economies of the G7—the United Kingdom, Canada, France, Germany, Italy, Japan, and the United States—and the D-10, which also includes Australia, South Korea, and the European Union.<sup>80</sup> Collectively, these leading democracies constitute nearly 60 percent of the world’s economy, and would represent an influential economic bloc.<sup>81</sup>

In addition, D-TEP would aspire to include India, Mexico, Brazil, South Africa, Indonesia, and other democracies worldwide that are willing to support the goals of this framework. Bringing in these emerging economies could bolster the legitimacy and impact of this framework. With all of the world’s democracies on board, D-TEP’s share of the global economy would rise to about 70 percent.<sup>82</sup> And as noted above, the inclusion of lower-wage economies could also help with the goal of shifting supply chains away from China, as it would provide attractive economic alternatives for firms to relocate manufacturing facilities.

However, many of these nations, with their traditional nonaligned foreign policies, have been reluctant to take sides in what they see as a growing competition among

great powers, and may hesitate to participate in a new framework that requires them to circumscribe existing trade relationships with countries on which they are significantly dependent. India, for example, relies heavily on Russia for military equipment, and China remains Indonesia’s largest trading partner. But the economic benefits of participating in D-TEP may help shift the strategic calculus among many of these nations and incentivize them to reduce such ties.

Also requiring careful consideration is whether D-TEP membership should be extended to nondemocratic, but increasingly significant, economic partners such as Vietnam. On the one hand, it would be beneficial to include all free-market nations—democratic or not—that are willing to join in common efforts to constrain China and/or Russia, as provided by this framework. On the other hand, for D-TEP to succeed, critical supply chains must be relocated to nations that are stable, reliable, and trusted—and the most stable and trusted partners are those that are committed to democracy and the rule of law. If these supply chains simply end up moving from one set of autocracies to another, that may not serve the intended purpose, as it would expose these supply chains to new vulnerabilities stemming from domestic political instability and international human rights sanctions. More broadly,

80 The D-10, in its current manifestation in the form of the Atlantic Council’s D-10 Strategy Forum, includes these ten participants. India was also included in Prime Minister Boris Johnson’s attempts to formalize a D-10 in 2021.

81 Ash Jain and Matthew Kroenig, “From the G7 to a D10: Strengthening Democratic Cooperation for Today’s Challenges,” *Atlantic Council*, June 1, 2021, <https://www.atlanticcouncil.org/wp-content/uploads/2021/06/From-the-G7-to-a-D10-Strengthening-Democratic-Cooperation-for-Todays-Challenges.pdf>.

82 Ash Jain and Matthew Kroenig, “An Alliance of Democracies: From Concept to Reality in an Era of Strategic Competition,” *Atlantic Council*, December 7, 2021, <https://www.atlanticcouncil.org/wp-content/uploads/2021/12/An-Alliance-of-Democracies-From-concept-to-reality-in-an-era-of-strategic-competition.pdf>.

there is a compelling economic and strategic rationale for keeping critical supply chains grounded within democracies that share common interests and values, and are committed to upholding the rules-based order, particularly in the context of the current systemic competition between democracy and autocracy.

Still, completely shutting out nations that are unfree or unwilling to commit to all of the actions required under this framework could prove counterproductive, as it would risk ceding economic influence to China and Russia. These considerations suggest that D-TEP may benefit from a two-tiered membership structure that focuses on committed democracies, but provides an avenue for association with others as well, provided they meet certain criteria:

- **DTEP allies**, or full members, would consist of nations that meet two basic criteria. First, they must be *free-market democracies committed to the rule of law*. This would include nations whose economies are premised on open markets and transparency, and whose governments are democratically elected and committed to protecting human rights and the rule of law.<sup>83</sup> Second, they must be *willing to commit to the full scope of obligations* required under D-TEP, including the measures aimed at regulating trade with both China and Russia. Nations that meet these criteria would be considered full members and would gain the full slate of benefits described above.
- **DTEP associates** would consist of other nations that do not meet both of these criteria, but are broadly supportive of D-TEP's goals. Associates would need to be *free-market economies*, and must be willing to make a *sufficient level of commitment* to regulating trade with China and Russia, though they may not embrace the full scope of this framework. D-TEP associates, which could include democratic and non-democratic partners, would gain partial access to the supply chain reorchestration benefits under Pillar One, as well as a subset of benefits under each of the other pillars.

Such a two-tiered approach could be useful as a means to consolidate support among democracies committed to implementing the full scope of this framework, while providing a docking mechanism to bring in others that are generally supportive, but not yet willing to make all of the required commitments. D-TEP allies would serve as the foundation of an economic alliance of democratic nations united in pursuing common goals, while D-TEP associate status would help create a wider network of partners working to bolster supply chain resiliency.<sup>84</sup>

Maintaining the distinction between these two types of participation is important, because it provides an aspirational pathway for nations not yet fully committed to take the actions necessary to achieve full membership over time. It will also be critical to ensure that the benefits available to D-TEP associates are narrowly tailored, and commensurate with the limited scope of commitments they are willing to take on. For D-TEP to achieve its goals, the benefits of ally status must be significantly more robust than those accorded by associate status, so that they can serve as meaningful inducements toward achieving full membership.

In addition to the leading democracies of the D-10, most of the thirty-eight member states of the Organisation for Economic Co-operation and Development (OECD), including small and middle-power democracies across Europe and parts of Latin America, would likely qualify for membership as D-TEP allies. Taiwan might also be invited as a full member.<sup>85</sup> Every effort should also be made to bring in rising democracies, including India and Mexico, as full or associate members.

At the same time, the success of this partnership will not be determined by how many nations end up joining. Rather, it will depend on having the full commitment of the world's largest democratic economies. If it can facilitate agreement among the G7 or D-10 across its four pillars, D-TEP would go a long way toward achieving its goals, and would have a significant impact on protecting the rules-based economic order.

83 Several credible indices can be relied upon to determine which nations meet this criteria, including, for example, Freedom House's Freedom in the World. "Freedom in the World," Freedom House, <https://freedomhouse.org/report/freedom-world>.

84 See remarks by Liz Truss, suggesting that the democratic world should be open to striking trade deals with countries that do not share its approach to domestic political governance, providing these countries are not trying to undermine liberal democracies, their shared institutions, or international law and order. <https://chathamhouse.soutron.net/Portal/Default/en-GB/RecordView/Index/190734>

85 Taiwan is a full member of Asia-Pacific Economic Cooperation (APEC).



International trade remains vital to global prosperity, and leading democracies should continue to support efforts to advance an open global economy. (via REUTERS)

## VI. CHALLENGES AND OBSTACLES

While the rationale for establishing a new trade and investment partnership along the lines of D-TEP is compelling, several obstacles and concerns must be seriously considered.

- *D-TEP could further polarize the global order.* One significant concern is that, by fostering greater economic decoupling between democracies and China and Russia, D-TEP could further polarize the global order and play into a new Cold War dynamic. While this is an important factor to consider, the reality is that the global order is already polarized. Competition between democratic and autocratic powers is now an established feature of the current system, and the key question is whether democratic nations can find effective ways to organize for success. Still, even as they establish a framework for closer economic alignment, the United States and its allies should continue to engage with China—and Russia, subject to the state of the war in Ukraine—to seek cooperation on issues where they may still have overlapping interests, such as trade and investment

in non-sensitive sectors, global financial stability, and sustainable development, including through the United Nations and the G20.

- *Economic decoupling from China and Russia could prove counterproductive.* A related concern is that, as the Chinese and Russian economies are further disaggregated from the West, Beijing and Moscow will have a freer hand to act more aggressively to challenge the rules-based order. This is also an important argument. Beijing is itself looking for ways to decouple in areas it considers critical, in order to reduce its own economic exposure to the West.<sup>86</sup> And, untethered from the global economy, China and Russia may be able to take greater political and military risks without fear of economic retaliation. D-TEP, however, is not aimed at completely cutting off China and Russia from the global economy. Rather, it is focused on targeted industry sectors where democracies are more vulnerable to coercion. Trade would continue in other sectors (except where sanctions have been imposed), and the United States and its allies would continue to

86 “China Wants to Insulate Itself Against Western Sanctions,” *Economist*, February 26, 2022, <https://www.economist.com/business/china-wants-to-insulate-itself-against-western-sanctions/21807805>.

have economic leverage over Beijing and Moscow in these sectors. With D-TEP in place, the West could have greater economic leverage against Russia and China, as it could threaten to impose sanctions in these sectors without worrying about the potential for retaliatory sanctions against critical supply chains.

- *D-TEP could undermine the WTO.* Another important concern is that D-TEP could undermine the international trading system—in particular, the World Trade Organization, which represents a global consensus in favor of a free and open economy. Critics may suggest that the United States and its allies should concentrate on strengthening and reforming the WTO, rather than building a separate framework with a subset of democratic WTO members. However, the WTO is not designed to address issues such as strategic dependency or economic coercion, and the United States and its allies would need to look elsewhere for action on these issues. Moreover, there is not a binary choice between upholding the WTO or advancing a new economic partnership among democracies. Washington should continue to work at strengthening the WTO, even as it works more closely with democratic partners to reduce supply chain vulnerabilities and advance other shared interests. By fostering closer coordination on economic challenges, D-TEP might also be used as a mechanism to hold accountable those engaging in unfair trade practices, including China.
- *D-TEP would be too unwieldy and impractical to implement.* Another concern is that, by attempting to combine too many elements and a wide range of participants, D-TEP will be difficult or impractical to bring to fruition. It would be more feasible, critics might contend, to treat the four proposed pillars as separate initiatives, and work through smaller regional groupings, such as the Quad and TTC, rather than through a single entity. While this concern merits consideration, in many ways, D-TEP's value stems from the notion that the sum is greater than the parts. The four pillars proposed here are interconnected and mutually reinforcing, and they will have a significantly greater impact if implemented as part of an integrated framework. Moreover, advancing them under a common umbrella

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may actually make it easier to gain traction, as this could help draw support from a wider range of constituencies—from those who support new trade restrictions and a harder line on China, to those who support free trade and strengthening alliances. That said, D-TEP sets ambitious goals, and bringing this partnership to fruition will require strong US leadership and close coordination with a small core group of allies. And if it proves unfeasible to establish in the immediate term, the concepts underpinning D-TEP could still serve as a comprehensive vision for integrating more narrowly-focused dialogues and initiatives over time.

- *Europe will not support trade restrictions on China.* Another key obstacle relates to whether Europe will be prepared to take on new economic commitments that could significantly reduce trade with China. Given the significant trade and investment ties they have with China, many European nations have been reticent about the prospect of restricting trade and investment. However, the strategic context with regard to Europe's views on China has changed significantly, even in just the past year. EU-China relations have sharply deteriorated in light of China's human rights crackdown in Xinjiang and Hong Kong, its aggressive gambit to sanction members of the European Parliament, and its coercive pressure campaign against Lithuania.<sup>87</sup> In response, the EU parliament indefinitely postponed plans to adopt a new Comprehensive Agreement on Investment with China, and EU strategy documents now recognize China as a "systemic rival."<sup>88</sup> Following Russia's invasion of Ukraine, many European governments have also expressed concern over supply chain dependencies with China, which could make it more difficult to hold Beijing accountable if it were to provide

87 Alan Crawford, Colum Murphy, and Alberto Nardelli, "Alarmed by Russia's Invasion, Europe Rethinks Its China Ties," *Bloomberg*, April 28, 2022, <https://www.bloomberg.com/news/articles/2022-04-28/alarmed-by-russia-s-aggression-europe-rethinks-its-china-ties>; Binnendijk, et al., *The China Plan*.

88 Alexander Chipman Koty, "European Parliament Votes to Freeze the EU-China Comprehensive Agreement on Investment," *China Briefing*, May 27, 2021, <https://www.china-briefing.com/news/european-parliament-votes-to-freeze-the-eu-china-comprehensive-agreement-on-investment/>; Phillippe Le Corre, "Europe's Tightrope Diplomacy on China," *Carnegie Endowment for International Peace*, March 2021, <https://carnegieendowment.org/2021/03/24/europe-s-tightrope-diplomacy-on-china-pub-84159>.

direct support to Russia.<sup>89</sup> These factors could make it easier for Europe to support the supply chain decoupling activities provided under D-TEP.

- *The private sector will lobby hard to preserve open trade with China.* Another concern is that the private sector may seek to scuttle any effort that could accelerate economic decoupling with China. Multinational companies in the United States, Europe, and other democracies have made significant investments in existing supply chains, particularly manufacturing facilities in China, and it will certainly entail higher costs to dismantle these facilities and relocate them. However, driven partly by supply chain challenges caused by the COVID-19 pandemic, many companies have already begun to recognize that exclusive reliance on Chinese manufacturing is risky, and have started to shift production lines elsewhere. In addition, many business executives increasingly understand the national security concerns regarding China, and are adjusting to the new strategic context. According to the US Chamber of Commerce, companies are anticipating that “some form of decoupling will be likely... to prepare for or hedge against such an outcome.”<sup>90</sup> Because D-TEP would allow companies to continue doing business

across a wide range of industry sectors, the private sector may actually support a framework that focuses on providing greater incentives to shift supply chains in the specific sectors identified in Pillar One.

- 7 *Using D-TEP to reduce trade barriers is politically unfeasible.* Finally, some have suggested that Congress will not support attempts to reduce trade barriers, as Pillar Two would entail. While free-trade agreements have become politically unpopular in the United States, there is growing support in Congress for shifting supply chains away from China, and toward allies and partners, as evidenced by passage of bills in both the House and Senate, with bipartisan support, that call for ally shoring. The politics around trade in the United States and other democracies are shifting. China is perceived as a significant economic threat, and Congress may be willing to support the reduction of trade barriers and greater market access in specific sectors if it is part of an overall package, such as D-TEP, that would help reduce strategic dependencies, while creating new jobs in the United States. The notion of supporting free, fair, *and* secure trade may have growing political resonance in the context of the growing challenges from Russia and China.<sup>91</sup>

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89 FT piece: “I don’t want us to be facing a similar situation with China in 10 years,” Lars Klingbeil, co-chair of the Social Democratic party, told Der Spiegel at the weekend. “We have to drastically reduce our dependence on authoritarian states. We can see that with Russia in terms of our energy supply. With China, we can start now.” Relatedly, there is renewed interest in free Germany’s Finance Minister recently called for renewing discussions on a transatlantic free trade agreement. We should resume negotiations on a transatlantic free trade agreement. Especially now in the (Ukraine) crisis, it is becoming clear how important free trade is with partners around the world who share our values,” Christian Lindner, the finance minister of Europe’s largest economy, told Handelsblatt. Reuters. <https://www.nasdaq.com/articles/germany-calls-for-new-talks-on-transatlantic-trade-deal>

90 “Understanding US-China Decoupling,” US Chamber of Commerce, 2021, [https://www.uschamber.com/assets/archived/images/024001\\_us\\_china\\_decoupling\\_report\\_fin.pdf](https://www.uschamber.com/assets/archived/images/024001_us_china_decoupling_report_fin.pdf)

91 Franklin D. Kramer, “Managed Competition: Meeting China’s Challenge in a Multi-vector World,” December 2019, <https://www.atlanticcouncil.org/wp-content/uploads/2019/12/Meeting-Chinas-Challenges-Report-WEB.pdf>



Congressional legislation and dedicated funding will be required to make D-TEP a reality. (via REUTERS)

## VI. RECOMMENDATIONS FOR ACTION

**B**ringing D-TEP to fruition will require determined US leadership, and support from key allies. To move this forward in a feasible way, several practical steps should be considered.

**1** The United States should establish a senior diplomatic envoy, based at the State Department or National Security Council, that would be responsible for developing and coordinating efforts to reduce supply chain dependencies on China and Russia. In close coordination with the Commerce Department and US Trade Representative, such an envoy could take the lead in engaging allies and partners on such efforts, including the potential for a new trade and economic partnership, as proposed here. In addition, the administration should consider establishing a dedicated Office of Strategic Competition that would focus on integrating a wider range of strategies—including across the areas of trade, technology, security, disinformation, democracy, and development—that are required to position the United States and its allies to succeed in the long-term systemic competition with rival autocracies. Similar offices should be established by other leading democracies to serve as counterparts for more effective strategic coordination.

**2** The United States should engage a small core group of likeminded allies to discuss the possibility of establishing a new integrated trade and economic partnership. Initially, this core group could include some members of the G7 or D-10, including Germany, Japan, and the United Kingdom, which, together with the United States, constitute the world's four largest democratic economies. If agreement on a basic framework can be reached, discussion could expand to include the remaining G7 and D-10 members, as well as other key allies and partners.

**3** Given their economic and political significance, Mexico and India, among other rising democracies, should be approached early on in the consultation process. Bringing these nations into this framework

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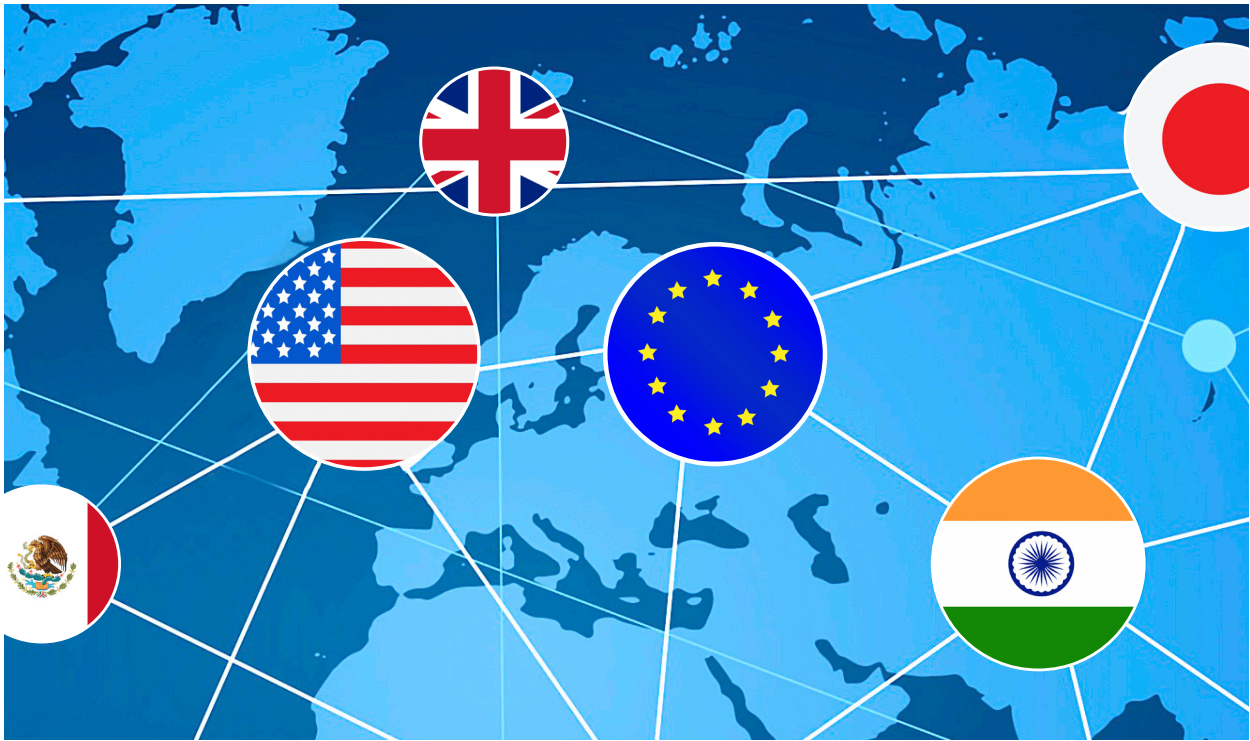
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would provide an enormous boost, and the United States and others should prioritize efforts to include them – ideally as full members if they are willing to sign on to the required obligations, but at least as associates, with a pathway toward full membership over time. Once a sufficient set of allies and partners have expressed their support for this framework, the administration could then proceed with formalizing an agreement and inviting a broader group of nations to participate.

**4**The Biden administration should also consult Congress early in the process, as dedicated funding and legislation will be required to make D-TEP a reality. Several members of Congress, across both sides of the aisle, have expressed support for supply chain resilience and ally shoring. These and other members should be engaged as this framework is being developed. Similarly, lawmakers in other leading democracies should be consulted to help build support among allies and partners. In addition, the private sector should be engaged to ensure that the incentives for supply chain reorchestration are appropriately designed, and to help build a broader base of support for this framework.

**5**Finally, even as it pursues a new trade and economic partnership among allies and partners, Washington should seek to reinvigorate efforts to strengthen and reform the WTO and foster efforts to expand greater economic openness. At the same time, it should continue to engage with Beijing to discuss trade and economic issues, including on areas where greater cooperation may be possible, and where disagreements need to be resolved. The administration should also reassure China that the supply chain reorchestration called for under D-TEP is not intended to cut off China from the global economy. Rather, the United States and its allies will continue to allow trade and economic engagement in non-strategic and non-critical industry sectors (subject to existing sanctions), while seeking a resolution to the ongoing trade disputes and pressing Beijing to take meaningful steps to end its unfair trade practices.





(via Shutterstock)

## VII. CONCLUSION

Meeting in the United Kingdom in 2021, the leaders of the G7 affirmed their commitment to “championing freer, fairer trade within a reformed trading system” and “a more resilient global economy,” while “upholding our values as open societies.”<sup>92</sup> In the aftermath of the Covid-19 supply chain disruptions and Putin’s further invasion of Ukraine, leading democracies have begun to take meaningful actions toward these goals. But there is much more to be done. Leading democracies must now work to build a more systematic and sustainable framework to selectively decouple from revisionist autocracies, and advance a free, fair, and secure trading system.

The United States and its democratic allies and partners retain a preponderance of global power in the world, and if they stand united behind a shared vision, they can have an enormous impact in shaping the future of the global economic order. Utilizing their combined economic influence, they can work to ensure that the new third phase of the global economic order that will define much of the 21<sup>st</sup> century is characterized not by protectionism and fragmentation, but rather by openness and resilience that leads to a more secure, prosperous, and democratic world.

92 Carbis Bay G7 Communique, June 2021, <https://www.g7uk.org/wp-content/uploads/2021/06/Carbis-Bay-G7-Summit-Communique-PDF-430KB-25-pages-3.pdf>

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