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## The Great Divide: A Grim Externality of the US-China Split

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The world is again in breakup mode. Pangea, the planet's single large continent was pulled apart 200 million years ago by powerful tectonic pressures deep under the surface. The result: Separate and distinct continents. The world is facing similar tectonic pressures, but very much on the surface. The breakup is multi-faceted. It is most distinctly East-West. And it is correspondingly North-South. But it is also, and most complex, a breakup of Southeast and Southwest. And this last tectonic shift will be important for all developing countries, including Brazil. Let me explain.

The East-West divide is clear to all. It is the western democracies—notably the United States and its closest allies—facing off against the less-well defined group of nations with no allegiance to liberal democracy, rule of law, and free-market, rules-based capitalism. The West is most practically defined by the G-7 and the OECD. These wealthy liberal democracies have sophisticated legal structures supporting well-developed capitalisms nurturing, supporting, and moving ahead rapidly with advance technology economies. That is 20 percent of the world's nations with 18 percent of the planet's population generating 50 percent of global GDP. It is this set of nations that have banded together for the past 75 years to form and support the Bretton Woods System (World Bank, IMF and WTO). It supports the International Court of Justice, the Financial Stability Board and the numerous other infrastructure institutions created to permit a vibrant integrated international economy to prosper. The international rules-based system fostered under Bretton Woods is profoundly complex, adaptable, innovative, and profit-oriented.

On the other side is the East. It is most useful to recognize the East as China and its allies. China's allies are loosely defined as its security allies (North Korea and possibly Laos) and, more importantly, the countries that have become economically dependent on trade

with China and so are under its influence. This group is much larger and more amorphous. It tends to be illiberal democracies and straight-up authoritarian states with less advanced, less sophisticated primary good and manufacture based economies. Many, like China, are trapped as middle-income economies because they do not have the political and legal structures that permit advanced free-market, rules-based capitalism to flourish. They are centrally administered state capitalisms that cannot avoid for long the problems of crony capitalism. Milo Brankovic calls these “political capitalisms,” in which corruption and inefficiency, he argues, are endemic.

The divide grows rapidly. Russia has slid, of necessity, into the Chinese sphere. In part due to the invasion of Ukraine and in part due to Nancy Pelosi's visit to

Taiwan, the divide is quickly getting deeper and wider. The U.S. Trade Representative, America's top trade official, announced in August of this year that under the auspices of the American Institute in Taiwan (AIT) and the Taipei Economic and Cultural

Representative Office in the United States (TECRO), a consensus was reached on the negotiating mandate for the U.S.-Taiwan Initiative on 21st-Century Trade. The negotiating mandate sets out the broad objectives shared by the two sides for the upcoming trade negotiations. The first round of negotiations are planned for early Fall. Both Beijing and Washington—the capitals of East and West—are shifting to war readiness.

The North-South divide is less certain. Brazil and India, the two developing nations large enough to shift the balance, are both straddling the fence between East and West. The rest of the “South” must manage within the tectonic shifts. Developing countries want most of all economic growth. Growth comes from integrating deeply into the global economy, working with as many partners—suppliers and customers—as possible. Nurturing this system has been the goal and result of the Bretton Woods system. However, developing countries increasingly must choose a side: South-East or South-West. United States and friends, or China.

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The first pressure facing developing countries, including Brazil and India, is trade. For 75 years under Bretton Woods, developing countries enjoyed the positive-sum game of joining long supply chains spanning the globe relatively unhampered by political divides. Those supply chains are now in question.

*Made in China 2025*, is a bold industrial strategy to develop cutting edge tech capabilities in China that take on directly the G-7 comparative advantage. It turns the trade war into a hybrid trade-and-technology war. US policy response is energizing domestic high-tech manufacturing, including the bill recently [passed](#) by Congress providing \$52 billion in funding for semiconductors and related manufacturing. It is aimed at enhancing US economic security vis-à-vis China. It includes measures to bring supply chains home, or at least ‘friend-shoring.’ Much is lost, of course, as friend-shoring abandons the efficiency gains from taking full advantage of division of labor and comparative advantage, thereby increasing production costs and consumer prices. While some welcome the [reduced competition](#), most recognize the long-term cost. But, national and economic security comes at a cost. For everyone.

Major suppliers like Taiwan Semiconductor Manufacturing Corporation (Taiwan’s TSMC) and US chipmakers Intel and Micron are under pressure to boost domestic US production, reduce their footprints in China and make it harder for Beijing to obtain advanced technology. The pressure is growing as Washington has recruited Korea, Taiwan and Japan into a so-called “Fab 4 chip alliance” that is designed to co-ordinate policy among these four on research and development, subsidies and supply chains. The growing East-West division is troublesome for global producers like Samsung and SK Hynix, who are heavily tied to China—sales up 26% in 2021. They both have boosted investments in US production facilities even as they remain heavily exposed to the Chinese market.

The Western countries have substantially increased controls of investment coming into their countries. The United States, for example, has greatly expanded the obligations of the Committee on Foreign Investment in the U.S. (CFIUS) by the Foreign Investment Risk Regulation Act (FIRRMA).

Similarly, strategic export controls have intensified in all Western nations. On top of this, Russia’s invasion of Ukraine led Western countries to. The United States and 37 other countries collaborated closely to impose [unprecedented sanctions](#) on the Kremlin, highlighting

strategic technologies like semiconductors, microelectronics, navigation equipment, and aircraft components. In addition, the U.S. and others, are pushing hard to put unprecedented controls in place on outbound investment to ensure that critical technologies (increasingly broadly defined) are not exposed to economic rivals, read China.

The second pressure is less overt and more profound. The West has declared that telecommunications systems—fundamental infrastructure for any developing economy— must be either West or East. Specifically, the Western nations have determined that Huawei and ZTE, China’s major telecom providers, are tied to the State and, consequently, pose a serious security risk. Huawei and ZTE systems have been [barred](#) from most Western telecommunications systems. U.S. firms have been barred from supplying critical technology components to Huawei and ZTE. The East-West telecom divide is virtually complete. The North-South divide is more complicated because so many countries have relied for both Western and Chinese companies for significant elements of their telecommunications systems. Because the Western countries have decided that national security cannot be assured if their systems contain Chinese equipment, Chinese suppliers have been excluded. The Southeast-Southwest divide is just beginning, but it has potential to be deeply problematic for emerging economies because Western countries are requiring countries to choose one system or the other. If the ‘other’ is chosen, then significant components of security and economic connectedness will be blocked. Countries will be increasingly corralled into the West or pushed into the East. The economic costs will be high.

**National and economic security comes at a cost. For everyone.**



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This article is a result of the authors’ ascertainment and analysis, without compulsory reflecting CEST’s opinion.