A Glitch in the Matrix

Why the pivot to Asia has no clothes.

BY BARRY C. LYNN | SEPTEMBER 12, 2012

Economic interdependence among nations, Americans have long believed, is the surest and safest path both to a wide prosperity and a perpetual peace. If all nations jointly depend together on one vast "global" factory for many basic goods, so our thinking holds, no one state will ever dare disrupt the functioning of this "communalized" system.

In recent years, the United States pursued this strategy nowhere more dramatically than with China. The basic idea — as Bill Clinton put it in 1997 — was that further "isolation would encourage the Chinese to become hostile." Conversely, greater interdependence would have a "liberalizing effect."

But nearly two decades after Washington lifted almost all controls on commerce with China, this is not happening. Despite a vast increase in trade between China and the rest of the world, and a vast increase in the wealth and well-being of the average Chinese citizen, the regime has become more autocratic at home and more adventurist abroad. If anything, Beijing is proving highly adept at leveraging interdependent systems for national political advantage, as it did two years ago when it cut off export of rare earth metals to force Japan to back down in a territorial dispute.

So what should a fading hegemon do when its grandest of strategies proves to be flawed?

One extreme option would be to double down on that strategy, hoping that yet greater degrees of industrial interdependence might finally convince our rival to act as a more responsible partner in the world system. Another extreme option, diametrically opposed to the first, would be to abandon interdependence in favor of more traditional approaches such as a military balance of power.

The Obama administration, over the last year, has chosen to pursue both of these extreme — and opposed — options. On the one hand, it has begun to devote real energy to a new generation of trade agreements, like the Trans-Pacific Partnership, which aim to tie the U.S. and Chinese economies together even more closely. On the other, it has begun to meet force with force. As Beijing blusters in the South China Sea and builds up military power, Washington has dispatched Marines to Australia, promised a new missile shield to Japan, and proposed to station a second carrier group in the region.

This is absurd. To tighten the gears of the international production system and, simultaneously, to position more heavy weapons right on the factory floor is a recipe only for catastrophe. Any conflict of any size would almost instantly break many of our most vital systems of supply. Instead, the United States should use its power to force corporations to distribute production capacity more widely. Such a move would reduce China's growing leverage over America — and it would help stabilize the international system, economically and politically.

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To understand our task today, we must first remind ourselves of what American policymakers intended when they set about rebuilding the nations shattered in the Second World War.

One of the most daunting political challenges of the late 1940s and early 1950s was to figure out how to restart German and Japanese industry while preventing either state from using that capacity to support reckless military ventures. In Europe, the result was the Coal and Steel Community, which tied German industry intimately to that of France. In Asia, the result was to cede large sections of the U.S. market for industrial goods to Japanese firms, and thereby to tie Japan's industrial interests intimately to those of America. The idea was to develop the industrial capacities of our allies, then to weave those many distant factories into complex, border-busting networks designed to force a productive cooperation among peoples.

These days, international relations experts often distinguish between "hard" power –namely, military force — and "soft" power like diplomacy. In the years after World War II, policymakers in Washington carefully coordinated the projection of national power across at least four distinct planes. In addition to military force, they manipulated ideology and information, monetary policy and finance, and supply and production.

Sometimes the aim was to coerce a private firm into sharing some industrial art with an ally. In one classic example, Washington forced U.S. companies to transfer both technology and machines to Taiwan's nascent radio industry. Another came when Washington helped to transfer television technologies to Japan.

Other times Washington brought power to bear directly on an allied state. The most dramatic instance was in 1956, when the Eisenhower administration shut down an Anglo-French attempt to seize control of the Suez Canal. It did so not by threatening to intervene militarily, but by threatening to crash the British pound and to cut off the flow of oil to both nations.

During this first era of postwar "globalization" there were, however, still real limits to how much industrial specialization nations would accept or expect. Washington — even while liberally welcoming the exports of Japan, Germany, and other nations — sought to ensure that U.S. firms remained competitive in all vital industrial activities, hence that Americans would continue to understand all basic industrial technologies. Key trading partners, meanwhile, also demanded high degrees of autonomy for certain industries, demands that Washington rarely challenged. As a result, nations mostly continued to produce their own heavy machinery, automobiles, defense materiel, chemicals, and food.

The wide distribution of industrial capacity and industrial ownership that resulted was buttressed by the fact that the United States and other industrial nations still enforced strong antitrust laws during this period. And it was further boosted by the then-common fashion among "vertically integrated" industrial firms to make their own components rather than rely on outside suppliers.

By the time the Berlin Wall fell in 1989, the achievements of this first generation American imperial system were far greater than almost anyone had imagined when the rules were first established. The nations integrated within this system enjoyed a great and highly democratic prosperity. More important, they enjoyed a wide and deepening peace, most strikingly on the millennia-old battlefields that stretch along the Rhine. And yet these nations were tied together loosely enough to allow for failure. The collapse of a large company or large bank generally threatened only one economy at a time. Problems could be isolated, cleaned out, even fixed.

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After the collapse of the Soviet Union in 1991, groups around the world began to promote the idea of a next phase of international industrial integration. One key goal would be to expand the international system to include nations like China and India. Another would be to deepen integration among the nations already within the system.

The first main step toward such a "second-generation" globalization was the lifting of most trade restrictions on China, beginning in 1993. Even more fundamental was the transfer of much of the power to regulate trade from the state to the corporation, accomplished through such agreements as the 1994 Uruguay Round of the General Agreement on Tariffs and Trade, which established the World Trade Organization.

This era also saw the establishment of a new myth — that "globalization" is less the result of political decisions than of some sort of metaphysical and hence unstoppable "force," powered perhaps by technology or the market itself. And this era saw the establishment of a new set of high rules, the most important being that no state should ever attempt to interfere in the workings of this "natural" process of "globalization," not even the state that imposed the system in the first place.

In the nearly two decades since, this replumbing of the international system has resulted in a truly revolutionary change in how international industrial activity is regulated.

In the 1980s, when Tokyo moved to capture command over the production of computer components like DRAMs, the Reagan administration used a combination of tariffs, quotas, subsidies, and arm-twisting to force the shift of much of that industrial capacity to third-party nations, such as Taiwan, South Korea, and Singapore. The goal was not to bring this vital capacity home, nor to restore manufacturing jobs in America. It was to make the international system itself more competitive, more international, and more stable.

In the 1990s, by contrast, Washington paid little or no attention as Japan and other mercantilist nations — most notably Germany, South Korea, Taiwan, and China — made similar plays to capture control over particular industrial activities. When Taipei used the Taiwan Semiconductor Manufacturing Corporation to build a commanding position in the business of making chips, no one challenged this play. Nor was there any effort to stop Seoul from using Samsung to capture a commanding position in the business of making DRAMS. Or to stop Beijing's highly coordinated efforts to capture command over the assembly of most electronics or the production of vital chemicals like Vitamin C.

This change in international regulation of industry was compounded by the de facto abandonment of antitrust enforcement in the United States and elsewhere, and by industrial "outsourcing," the euphemism of choice for the practice by which industrial corporations jointly pool the operations of their suppliers. Suddenly, after many decades of careful grooming of competition, no authority in government or in the private sector was charged with preventing monopolization of control and the concentration of capacity and power.

The result today is an entirely new level of geographic concentration of industrial capacity. In instance after instance, some nation or another has made itself master of some vital link in the chain of production.

This concentration of capacity poses many, entirely unprecedented problems. One of biggest is that it makes the production system, as a whole, physically unstable. For the first time in history, entire swaths of our international industrial system have become subject to "crashes" much like financial crashes. A good example of such a crash took place after the March 2011 tsunami in Japan. Much of that disruption could be traced to the loss of a single plant, belonging to a semiconductor manufacturer named Renesas, which supplied a single vital component to almost the entire Japanese automotive industry, as well as many car manufacturers abroad.

Indeed, industrial capacity today is so highly concentrated and tightly integrated that any of many natural, financial, epidemiological, or political disasters anywhere in the world would immediately paralyze much if not most of the international system, with perhaps catastrophic results.

A second problem posed by this extreme geographic concentration of capacity is that it appears to be politically destabilizing. High priests of this second generation of globalization — like *New York Times* columnist Thomas Friedman — hold that such extreme industrial interdependence means no rational actor will ever risk disrupting business as usual. After all, for system to work, everyone must show up for work every day.

The problem with this line of thinking is that it is simply not true. Indeed, it is all too easy to imagine scenarios in which a high degree of interdependence actually *tempts* some rational actor to disrupt the normal flow of goods, to achieve some political end. This includes, most obviously, enemies of the system, like terrorists. But it also includes factions within a state making a play for power. And it includes existing state leaders, perhaps seeking to exploit some particular dependency in our interdependent world for national gain, just as Beijing itself did in the fall of 2010 when it cut off the flow of rare earths elements to Japan.

This same power can be turned on America.

In recent years there has been a lot of talk about how China has become America's main banker, hence how Beijing can cut off our credit. The far more real and immediate threat is posed by the fact that China has also become our main provisioner of innumerable vital goods, including some of our most important pharmaceuticals, chemicals, and electronics, as well as our clothing, shoes, hand tools, lightbulbs, and batteries.

The threat is beautifully simple — to stop us from getting what we need.

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The time has come to recognize that America's decision to renounce our traditional role as the ultimate arbiter and enforcer of the postwar international economic system has left the world a far more dangerous place, politically and economically.

First off, doing so unleashed a dangerous scramble for power, by all but forcing second-tier regimes to adopt reckless, nationalistic behaviors to promote their industrial exports, if only to protect themselves from the tactics of the other mercantilists in the room. Along the way, one of these regimes, Beijing, managed to consolidate sufficient industrial and financial power — and a sufficiently sophisticated understanding of how to exercise such power — to do what no other nation has managed since the war, which is to establish itself as de facto co-hegemon alongside the United States.

Worse, America's decision in the 1990s to dismantle both the intellectual framework and the state institutions necessary to understand how the global industrial system really works means that the United States — due to our blindness – is itself fast emerging as one of main threats to the peace, prosperity, and stability of today's world.

Nowhere is this more evident than in our present attempt to combine further industrial appeasement of Beijing with a provocative show of military force, in our increasingly panicky effort to keep China productively engaged in our world system. Obama officials clearly view their "Asia pivot" — and new proposals to further liberalize trade — as a smart hedging strategy, a bit more carrot backed by a bit more stick. Yet given that neither element of this "strategy" makes any sense on its own, it is highly unlikely that the two elements will be effective when combined together.

On the contrary, this "strategy" — by simultaneously further empowering and further provoking China — may well only lay the groundwork for some sort of grand and dangerous national humiliation, not unlike that imposed by the Eisenhower regime on Britain and France in 1956.

In the event of some sort of actual showdown in the South China Sea, Beijing already knows, first of all, that the United States is extremely unlikely to use military power. One of the prime rules of warfare, after all, is to keep your supply lines behind you, and the first shot in the South China Sea would immediately sever many of the most vital systems of supply that serve not only the U.S. military but the civilian population stateside. Second, Beijing already knows that it enjoys the ability to project significant real power directly into the United States by disrupting the normal flow of goods.

Officials there do not even need to impose some sort of across-the-board trade embargo to achieve their ends. Far more effective would be to put the squeeze on one industrial system or other, or one company or other, day after day, in a systematic fashion, until Washington cried uncle. The Pentagon has sketched out complex plans for how to respond to any use of force by China. Far more useful would be to know how the United States as a nation would respond when, suddenly, grandma can't get her medicine. Or when, suddenly, the store shelves empty of batteries and lightbulbs. What does the president do when he has General Electric and Wal-Mart both on the phone, demanding the restoration of normal trade? Or when Apple's stock plummets because the company can't move any of its iPhones through Chinese ports?

The only real option is to embrace the logic of industrial interdependence, hence to recognize that the only way for the United States to achieve its most vital national aims — indeed, to be taken seriously by China — is no longer to reposition its aircraft carriers, but to force its industrial and trading corporations to reposition the machines on which it depends. The United States does not need to bring all or even any of these systems of production home. But it can no longer continue to live in a world in which many activities remain in one location, under the control of one state, especially a strategic rival.

The task won't be easy. More than half a century has passed since the United States had sufficient power simply to dictate policy to its industrial partners. But if there is any doubt that a large nation today can compose a strategic vision and then put it into effect, we need but consider China. From a position of near impoverishment China has, over the last two decades, leveraged itself into a position as co-sovereign over today's international system.

Washington will also likely soon discover that it has real allies in this effort. When a system is built to crash, the only rational action is to fix it, and rational actors in other states will therefore support any reasonable effort. The goal, after all, is a third generation global system, one built to last for the 21st century.