STIFEL

CROSSROADS: FOUR WAYS FORWARD

As the U.S. and China remain locked in a decades-long competition for global leadership, this rivalry will shape not only their bilateral relations, but also the global order. With each nation facing a unique set of challenges and opportunities, how they respond to these forces of change will be critical in determining their future trajectories. Using a framework for scenario analysis introduced to us by the Copenhagen Institute for Futures Studies, this article presents four possible versions of the future U.S.-China relationship.

SETTING THE STAGE

The scenarios in this framework are developed by identifying two critical uncertainties and mapping them on a 2x2 grid. Here, the key uncertainties are the future trajectories of the U.S. and China, each with two polar outcomes: leadership or decline. The resulting four quadrants, representing a combination of these outcomes, form the scenarios. The four driving forces that we've identified for each scenario are: Innovation, Global Trade, Domestic Policy, and Foreign Policy.

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(continued)

U.S. REENERGIZED

America experiences a resurgence as China's economic growth slows and its influence wanes. The U.S. leads in transformative technologies, further strengthening its innovation edge, while China struggles to keep pace. The U.S. diversifies its supply chain and trade partners to the detriment of the Chinese economy while China falls short in gaining trust for its high-end products. Domestically, China's efforts to transition to a consumption-based economy falter due to a shrinking workforce and an aging population. Meanwhile, the U.S. prioritizes reducing national debt and enacts growth-stimulating policies that reinforce its leadership, bringing a renewed sense of unity among citizens.

PRODUCTIVE COMPETITION

Both nations pursue economic strength and technological advancement, competing to maximize national wealth while seeking to avoid outright conflict. The U.S. and China recognize and accept their interdependencies, with China relying on the U.S. and allies to sustain growth while the U.S. remains dependent on China's supply chain. Strategic restraint is exercised, as each side accepts that deteriorating relations would bring significant risks. The U.S. and China, though cautious rivals, collaborate on shared global challenges, balancing cooperation with periodic flare-ups of tension.

FRAGMENTED WORLD

Both the U.S. and China face economic and political challenges that erode their global influence and deepen international divisions. China's economy stagnates under the weight of national debt, demographic pressures, and lagging technological innovation. Divisions within the Chinese Communist Party (CCP) emerge as leaders clash over economic and social policies. Meanwhile, the U.S. grapples with deepening polarization, fiscal strain, and uneven growth, weakening its role as a global leader. As both countries turn inward, global trade fractures, with nations prioritizing self-sufficiency and regional alliances. This shift creates opportunities for other countries to aspire for global leadership, creating an unpredictable landscape.

CHINA TAKES THE LEAD

China emerges as the dominant global power while the U.S. contends with challenges that reduce its influence and ability to project power. Successfully executing its plan for "the great rejuvenation of the Chinese nation," China leads in high-end manufacturing, AI, and other technologies, becoming the primary hub for global innovation and trade. Conversely, the U.S. faces economic stagnation, political polarization, and mounting debt, limiting its ability to respond effectively to global shifts. Although the U.S. economy still carries significant weight, nations increasingly view China as a strategic partner and ally, leaving the U.S. more isolated.

CROSSROADS: FOUR WAYS FORWARD *(continued)*

FORCES OF CHANGE

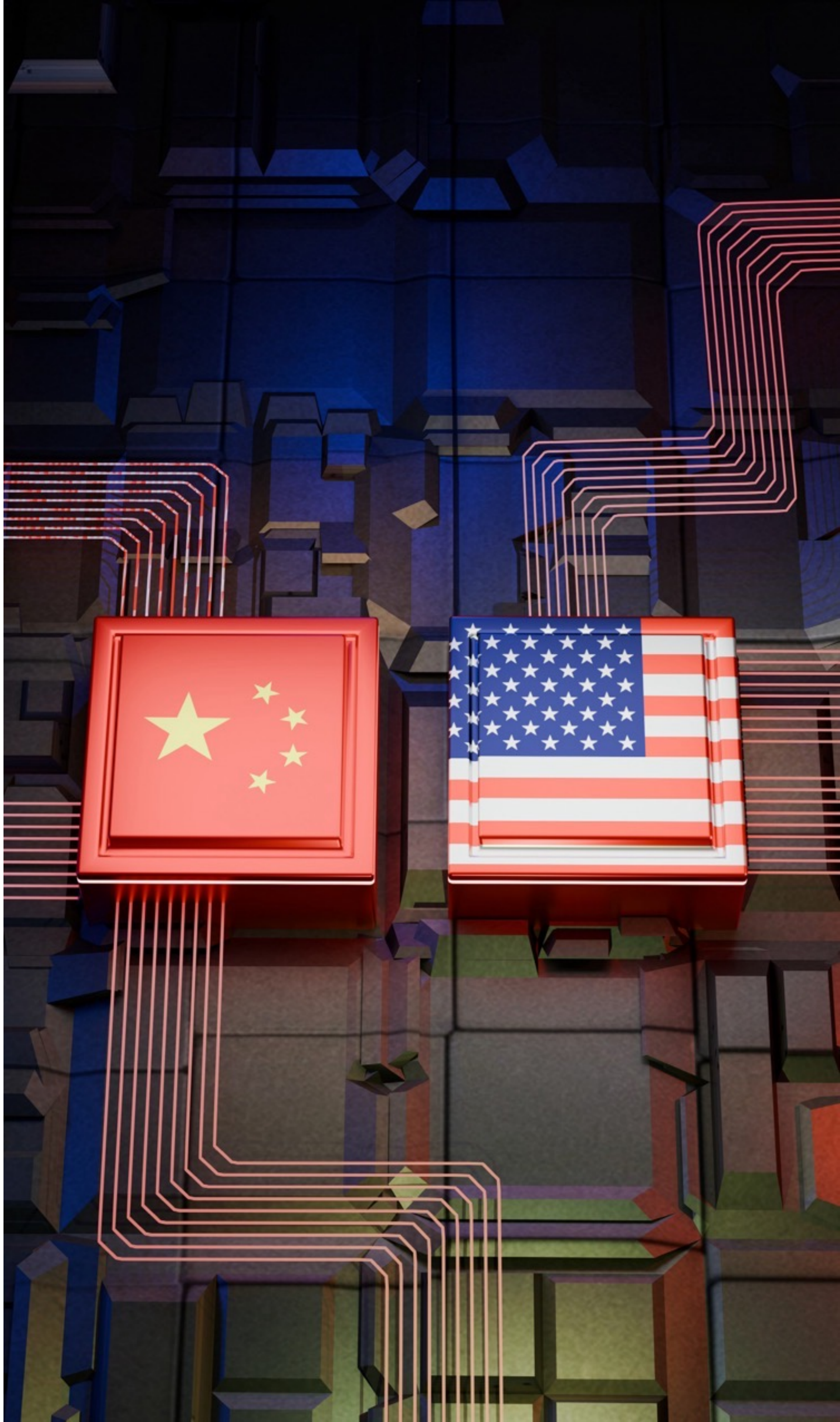
1

INNOVATION: THE GROWTH ENGINE

Innovation fuels economic growth, creates new industries, and improves quality of life. Research shows that up to 85% of America's long-term economic growth stems from advancements in science and technology. In the competition for global power, a central question is whether the U.S. or China will lead the next wave of innovation.

U.S. The U.S. has historically led in innovation, particularly in science and technology. Continued leadership in the next wave of transformative technologies like quantum computing, genetic engineering, and advanced manufacturing is pivotal for the U.S. maintaining its competitive advantage in global trade, security, and influence. Sustained investment in research, quality education, workforce development, and intellectual property protection is essential to achieving this goal.

China Through its "Made in China 2025" initiative, China has strategically prioritized increasing its share of manufactured products from low-cost goods to high-tech, innovative products across 10 key industries including aerospace, medical devices, and power equipment. Its goal is to reduce reliance on foreign technology while becoming an innovation hub with companies that can compete globally. To that end, Chinese leadership is focused on implementing regulatory change and setting policy that promotes innovation.



FORCES OF CHANGE

2

GLOBAL TRADE: THE BARGAINING CHIP

As nations develop transformative technologies, their exports gain global value, offering diplomatic leverage. The U.S. and China's choice on how to engage in trade will redefine the global balance.

U.S. The M7 are a symbol of America's economic power and global influence. Concerns over the cost of free trade — job losses, outsourcing of critical industries, and national security —are prompting a shift in trade policy. Supply chain vulnerabilities, unfair trade practices, and ongoing intellectual property theft by China have intensified bipartisan calls to reshape U.S.-China trade dynamics. Through export controls, sanctions, nearshoring initiatives, and a move to bilateral agreements, the U.S. aims to bolster domestic manufacturing and curb China's technological advancements. However, the U.S. must balance protectionist measures with access to China and other markets, which remain vital for American businesses aiming to compete globally. For many countries, the most attractive aspect of trading with the U.S. is the opportunity to sell their goods. If this dynamic changes, the U.S. could lose significant political leverage.

China Since joining the World Trade Organization in 2001, China has become the world's largest exporter, leveraging both scale and sometimes controversial trade practices. Now, China aims to reduce reliance on foreign markets by boosting domestic demand and shifting from low-cost production to high-value, technology-driven exports. However, much of the demand needed to sustain such exports would still rely on Western and U.S. markets, which are wary of Chinese influence in critical industries. The Belt and Road Initiative has strengthened China's presence in emerging market countries, but many of these nations lack the economic power to support high-value imports. Ultimately, China's trade leadership depends on the success of these initiatives, especially as the West tries to counter them.

CROSSROADS: FOUR WAYS FORWARD *(continued)*

FORCES OF CHANGE

3

DOMESTIC POLICY: STRENGTH STARTS AT HOME

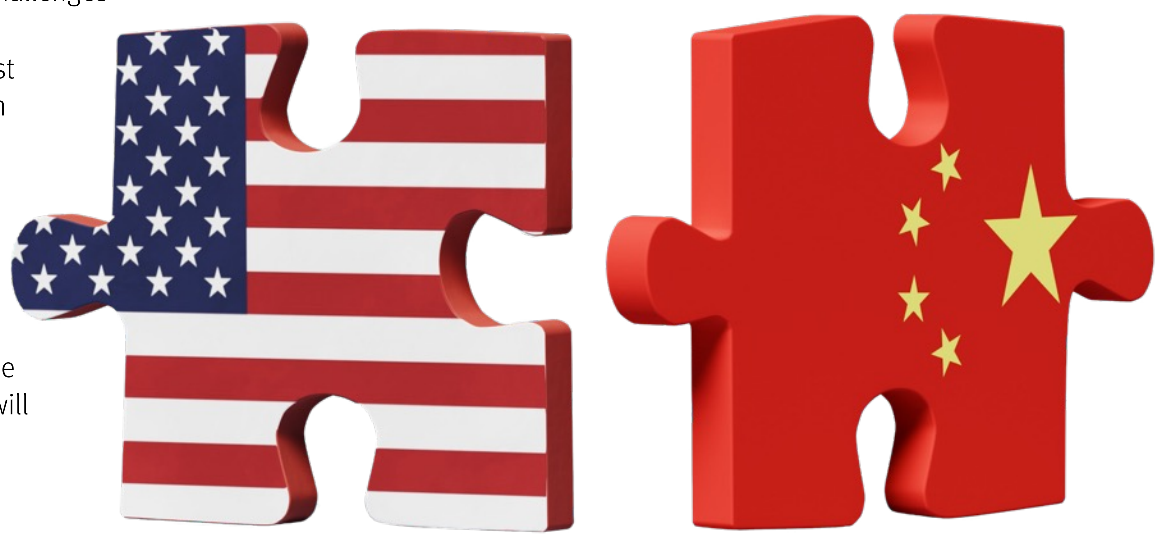
Effective domestic policy will promote economic stability and determine the capacity of each nation to engage globally. Strength at home sets a model that other nations will want to emulate. The economic success achieved by China's authoritarian regime is creating a clash of ideologies.

U.S.

The U.S. faces domestic challenges that could impact its ability to engage effectively on the global stage, including elevated debt levels, political polarization, and demographic shifts. Failure to address the debt problem could restrict funding for innovation and defense, key areas that uphold its global leadership position. Poor fiscal management may cause investors to question U.S. Treasuries as a perceived safe investment, lowering demand, causing interest rates to rise, and eroding investor confidence in our capital markets. Strengthening the middle class through strategic investments and reform in areas like education, healthcare, and immigration is important for reducing polarization in the country. Addressing an aging population, a shrinking workforce, and a skills gap through workforce development policies will also be important. A prosperous America with a strong economy and well-functioning society not only reinforces its own stability but also enhances its influence globally.

China

China's domestic policy focuses on transitioning to a consumption-based economy while managing systemic risks from rapid credit expansion, particularly in the property sector. Its debt is concentrated in local governments and state-owned enterprises, which could impact economic stability if growth slows. Its shrinking workforce and aging population pose significant challenges to productivity and economic stability. To remain competitive, China must invest in workforce development, pivoting from manufacturing-heavy industries to technology and services. However, its authoritarian regime may limit true innovation. In addition, regulatory unpredictability and political controls create challenges for foreign investors, affecting confidence in China's capital markets. The country will have to balance economic reform with political stability as it navigates its own set of domestic challenges.



CROSSROADS: FOUR WAYS FORWARD *(continued)*

4

FORCES OF CHANGE

FOREIGN POLICY: THE STRATEGIC COMPASS

Global divisions are deepening. How each nation chooses to engage with the world and project power will shape alliances, and determine which values and systems dominate the international order.

U.S. Following the collapse of the Soviet Union, the U.S. emerged as the sole superpower, shaping the global order by promoting democracy and open markets, and intervening in conflicts to uphold stability and its strategic interests. As domestic attitudes are shifting to an "America First" approach, U.S. officials are contending with several pressing questions. Should the U.S. scale back military commitments or maintain a strong presence worldwide? What role should the U.S. play in global conflicts, transnational challenges, and economic aid? And, as China expands its influence and becomes more assertive, how should the U.S. counter its influence?

China China has been increasingly assertive in its foreign diplomacy, focusing on mediating conflicts like the war in Ukraine and brokering a Saudi Arabia-Iran deal, while also investing heavily in Latin America, Asia, and Africa. By successfully doing so, China creates allies that align with its interests on geopolitical issues and allow it to establish a military presence in those countries in the future. When it comes to disputes such as Taiwan and the border with India, China faces critical decisions. It can choose to intimidate and escalate militarily, destabilize, or engage in diplomatic negotiations. Each approach carries significant implications.

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