

Economic Deterrence in a China Contingency

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EUROPE



AUSTRALIA



Introduction



What If?

- The United States and allies had months of advance knowledge that Russia was planning to invade Ukraine.
- After the full-scale invasion, they introduced a set of punishing economic measures, including financial sanctions, export controls, and travel restrictions.
- But what if they had introduced those measures *before* the full-scale invasion of February 2022?
- Could they even have agreed to do so?



Applying the Record on Sanctions to the China Case

- We examined how economic measures could serve as pre-emptive deterrence against a potential Chinese invasion of Taiwan.
- Deterring China from launching an attack on Taiwan is a central focus of U.S. and allied security planning.
- Sanctions and other restrictive economic tools are key parts of modern deterrence — but their timing, effectiveness, and desirability are far from clear.
- We looked at how the United States and its allies might act, the ripple across the global economy, and how such actions might shape China's response.



Assumptions and Methods

- This analysis models a Taiwan crisis scenario resembling the lead up to Russia's 2022 invasion of Ukraine.
- It assumes credible intelligence indicates that China is preparing to invade Taiwan within an ensuing 3 to 6 months.
- The invasion scenario is agnostic — it could take the form of a blockade, quarantine, outlying island grab, precision strikes, or an amphibious assault.
- Restrictive economic actions, including investment bans and export controls, are collectively referred to as sanctions for convenience.
- Multi-method research: Literature, interviews, workshops, economic modelling.



Bottom-Line Up Front

- Under certain conditions China could be deterred by economic measures.
- The U.S. would have to take the lead and might need to use both positive and negative inducements to get allies to act.
- A broader sanctioning coalition, especially one that includes the EU, would be more effective.
- Everyone would be economically hurt by sanctions.



How Would the United States and its Allies Respond?



The U.S. Response

- The U.S. has one of the most well-articulated legal regimes on economic restrictions and can institute a wide variety of measures.
- As the world's largest economy and financial hub, it has the most power to exercise restrictions.
- Former senior officials assess that pre-emptive sanctions on China are possible — though not guaranteed — if an invasion of Taiwan appeared imminent.
- In contemplating sanctions, the U.S. would look to allies to join, with Australia and Japan the most important of those in the Pacific area.



The Australian Response

- Australia's economy is deeply intertwined with China's, making policymakers cautious about actions that may harm their economy.
- Economic deterrence would likely remain symbolic, with Australia instead prioritising non-economic tools — especially intelligence.
- Australia would only adopt sanctions if the threat from China was believed to be existential or irreversibly threatened its immediate security interests.
- Absent these conditions, the U.S. would need to exert strong pressure on Australia to have it join meaningful, pre-emptive actions.



The Japanese Response

- Japan could technically impose sanctions on China quickly, but the political decision would be difficult.
- Despite Taiwan's importance to its security, Japan's deep economic interdependence and large presence in China complicate action.
- Japan's response would hinge on sanction effectiveness; the likelihood of Chinese retaliation; the safety of Japanese nationals and assets in China; and U.S.-led international pressure.



The UK Response

- The UK's position regarding a Chinese invasion of Taiwan has remained indiscernible.
- The possible costs to the UK economy of Chinese retaliation are high, and the returns to a strategy of UK sanctions are uncertain.
- Should the UK decide to take economic actions, it would seek to do so multilaterally and try to match the type and severity of allied actions.
- Measures most consistent with current policy practices are targeted and country-agnostic, but no options are off the table, especially if there were a strong consensus and pressure from UK allies, particularly the United States.



How Might China Respond?



China's Calculations

- Under the right conditions, sanctions could help dissuade a top leader from pursuing military aggression if
 - China was planning a limited operation,
 - the Chinese leadership and public were divided,
 - the Chinese government still valued economic growth,
 - the sanctioning coalition was large.
- In a different scenario — with China fully committed to attacking Taiwan — sanctions would be unlikely to deter aggression.
- Their value would instead lie in degrading China's ability to sustain the war and reducing the benefits of its military gains.



How Would These Measures Affect the Global Economy?



Our Modelling Method and Scenarios

We modelled the economic consequences of different combinations of sanctions.

- Multi-region (20), multi-industry (8) DCGE model calibrated to data from Global Trade Analysis Project.
- Sanctions modelled as declines in bilateral trade

Scenario	USA	Taiwan	UK	Japan	Australia	EU 27	Canada	ROK
1	P	P						
2	C	C						
3	P	P	P	P	P			
4	C	C	P	P	P			
5	C	C	C	C	C			
6	P	P	P	P	P	P		
7	C	C	P	P	P	P		
8	C	C	C	C	C	C		
9	P	P	P	P	P		P	P
10	P	P	P	P	P	P	P	P

Multilateral complete: -74.2

Unilateral complete: -71.0

Multilateral partial:-20.6

Unilateral partial: -5.6

NOTE: P = Partial sanctions; C = Complete sanctions.

Aside: Although Simon Kuznets did not work on issues of economic statecraft, his work on national income, economic structure, and distribution provide a foundation for modelling consequences of economic actions.

The Global Economy: Unilateral U.S., Taiwan Sanctions

- When only the United States and Taiwan act, the effect on China is modest but negative (scenarios 1 and 2).
- Complete sanctions (scenario 2) deal a much more serious blow to China, but also to the United States and Taiwan.
- A few other countries lose, but many gain.

GDP Effects
Annual Change
by Year and
Scenario

Scenario	Year	USA	China	Taiwan	UK	Australia	Japan	ROK	Canada	EU 27	ASEAN Plus	World
S1	2024	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
	2025	-0.052	-0.096	-0.285	0.016	0.007	0.010	0.019	0.041	0.013	0.026	-0.020
	2026	-0.052	-0.101	-0.307	0.014	0.005	0.007	0.014	0.040	0.011	0.021	-0.023
	2027	-0.052	-0.106	-0.329	0.012	0.003	0.005	0.010	0.039	0.009	0.016	-0.025
	2028	-0.052	-0.110	-0.350	0.010	0.001	0.002	0.005	0.038	0.007	0.011	-0.028
	2029	-0.051	-0.114	-0.372	0.008	-0.001	-0.001	0.001	0.037	0.004	0.007	-0.030
	2030	-0.051	-0.118	-0.379	0.007	-0.003	-0.003	-0.003	0.035	0.002	0.002	-0.033
S2	2024	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
	2025	-0.509	-0.941	-2.536	0.146	0.171	0.004	0.079	0.685	0.100	0.231	-0.189
	2026	-0.510	-0.995	-2.741	0.120	0.132	-0.020	0.021	0.682	0.075	0.160	-0.221
	2027	-0.510	-1.046	-2.941	0.095	0.096	-0.044	-0.033	0.678	0.050	0.094	-0.252
	2028	-0.509	-1.094	-3.137	0.072	0.069	-0.070	-0.086	0.670	0.026	0.037	-0.281
	2029	-0.507	-1.140	-3.329	0.051	0.044	-0.096	-0.136	0.663	0.003	-0.017	-0.308
	2030	-0.499	-1.179	-3.488	0.032	0.030	-0.118	-0.173	0.584	-0.019	-0.059	-0.334

The Global Economy: Multilateral Sanctions

- Full sanctions by the United States, Taiwan, UK, Japan, and Australia (Scenario 5) produce larger losses for China, decrease losses for the United States and Taiwan, but increase losses for other sanctioning countries.
- Including the EU 27 (Scenario 8) results in the largest decline for China, smaller declines for the United States and Taiwan.
- When EU 27 joins, other countries benefit but the EU also has declines.

GDP Effects

Annual Change
by Year and
Scenario

Scenario	Year	USA	China	Taiwan	UK	Australia	Japan	ROK	Canada	EU 27	ASEAN Plus	World
S5	2024	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
	2025	-0.484	-1.761	-2.481	-0.378	-1.226	-1.028	0.271	0.751	0.167	0.499	-0.354
	2026	-0.484	-1.799	-2.701	-0.391	-1.261	-1.064	0.211	0.745	0.145	0.425	-0.382
	2027	-0.484	-1.833	-2.914	-0.404	-1.293	-1.096	0.155	0.740	0.123	0.354	-0.408
	2028	-0.482	-1.864	-3.120	-0.414	-1.322	-1.125	0.102	0.733	0.103	0.287	-0.432
	2029	-0.478	-1.891	-3.313	-0.424	-1.346	-1.149	0.058	0.690	0.084	0.228	-0.454
	2030	-0.470	-1.911	-3.478	-0.430	-1.366	-1.168	0.021	0.608	0.067	0.181	-0.474
S8	2024	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
	2025	-0.454	-2.578	-2.455	-0.303	-1.171	-1.033	0.346	0.791	-0.352	0.674	-0.520
	2026	-0.452	-2.596	-2.665	-0.313	-1.202	-1.064	0.294	0.789	-0.368	0.600	-0.543
	2027	-0.450	-2.612	-2.869	-0.320	-1.231	-1.093	0.247	0.786	-0.381	0.529	-0.565
	2028	-0.448	-2.626	-3.064	-0.325	-1.256	-1.118	0.205	0.783	-0.394	0.462	-0.584
	2029	-0.442	-2.636	-3.247	-0.329	-1.278	-1.138	0.169	0.737	-0.408	0.403	-0.602
	2030	-0.434	-2.642	-3.408	-0.333	-1.295	-1.157	0.139	0.661	-0.421	0.355	-0.618

Conclusion



Conclusion

- Economic measures alone are unlikely to deter but can work in concert with and magnify a credible military response and diplomacy.
- There would be value in planning for such an eventuality, including developing specific courses of actions.
- It would also help to build up analytic capability to have a better understanding of the consequences of any actions.
- We focused on implications for the U.S. but there are also implications for U.S. allies: If the U.S. were to act, it is likely it would want allies to act and could pressure them to do so.
- All of them, including the United States, would face difficult tradeoffs.

