

## Letter n°59

### **Deglobalisation. The economic aspect, between concern for independence and mutual dependences.**

*"There is a force in democracies that renews itself as opposed to dictatorships exhausting their strength."  
Bergson.*

Politically, as we will see in Letter 60, blocs are forming, oppositions are crystallizing but economically, even if the major economies have little exposure to foreign trade, around 15% of GDP for the United States for example, dependencies are mutual.

Companies talk about possible relocations but fear a division of the world into blocs, worry about protectionist measures and, beyond the objurgations of politicians, are aware of the multiple obstacles to relocations: the difficulty sometimes in finding qualified labour, the costs, the risk of closing attractive markets in China, the lack of visibility for investing in a market that is opened one day but closed another.

To better understand the issues at stake, we will analyse four points: firstly, we will recall that globalisation has been contested for some time. Then, we will discuss China as the pivot of international trade with its strengths and fragilities. We will also evaluate the policies of Western countries to maintain their pre-eminence. Finally, we will show to what extent the dependencies between the blocs and between the different regions of the world are mutual.

**Globalisation has been challenged for a long time:** 4 points stand out.

- Let us remember the failure of the Doha negotiations to strengthen trade liberalisation at the WTO, the World Trade Organisation. Initiated in 2001, the discussions were unsuccessful.
- Since then, we have seen a proliferation of regional agreements. A practice that has been used in particular by the British since Brexit.
- Since the 2008 crisis, there have been intense debates on the costs, in terms of jobs, of industrial relocations carried out by Western countries and let us not ignore the rise of populist movements, the election of Donald Trump, advocate of protective measures against China, or the vote in favour of Brexit.

The call for "deglobalisation" has two causes: one is the rise of populism in democracies, fuelled in part by the criticism that globalisation is worsening inequalities; the other is geopolitical tensions between the United States, China and Russia.

- According to **World Bank** figures, the peak of globalisation has passed, with international trade as a percentage of world GDP rising from 26% in 1986 to 51% in 2008 before falling back to 42% in 2021. In fact, the idea of a peak in 2008 is questionable because trade is largely focused on industrial products and, as a country develops, industry is supplanted by services.

In addition, as a sign of continued globalisation, FDI flows around the world have, according to UNCTAD, reached a high of \$1650 billion in 2021 but are declining in 2022.

## **China, the linchpin of international trade:**

### **- *China is the leading player in international trade:***

90% of world trade by volume is carried out by sea transport and the world's production workshop is in Asia, most often in China. It is no coincidence that 90% of containers are made in China and that 9 out of 10 ships are built in China, Japan or South Korea. Nearly 40% of the world's containers come from or are destined for China, and if we consider East and Southeast Asia, this figure rises to 2/3.

If, since the war in Ukraine, there has been a sharp slowdown in the activity of the Silk Road rail to the EU, it is because insurers refuse to cover the risk and because many buyers do not want to depend on the Russians who are in charge of transport on part of the route. This is an impediment on trade, but it does not prevent the further expansion of international trade.

### **- *China, in search of strategic independence:***

The quest for independence has two aspects: the desire to build up through subsidies, large state-owned corporations in many industrial sectors and the desire to overcome backwardness and dependence in many high-tech sectors.

In terms of subsidies, China spends more than other countries to support its companies, the equivalent of 1.7% of GDP according to the *Center for Strategic and International Studies (CSIS)*. By comparison, the United States spends 0.4% of its GDP.

From a technology angle, China and its system of state capitalism, after having invested heavily in infrastructure in recent years, is banking on the technologies of the future. We remember the ambition displayed in 2021 during the presentation of the 14th five-year plan when investment in semiconductors (global market share of less than 10%), AI and quantum technology had been put forward.

"China 2025" does nothing different. China wants to move upmarket, reduce the percentage of low value-added exports such as textiles, promote technology and reduce its dependence on the Western world in a dozen sectors considered decisive for the country's future.

Thus, China is rapidly developing its semiconductor production and, in five years, has doubled its share in global production to 9% according to the *SIA (Semiconductor Industry Association)*, ahead of Taiwan, which is now quite close to the EU's and Japan's market share but still far from the United States and South Korea.

In addition, a month ago, a \$2.3 trillion infrastructure investment plan was launched with a component aimed at digital autonomy.

China, in response to US measures against Huawei and other Chinese companies, is excluding Dell and HP computers, and indirectly Microsoft, from access to public contracts and is asking Chinese companies to choose local producers like Lenovo.

As an example of deglobalisation, Ping An, a major Chinese insurer and HSBC's largest shareholder, asked the bank to split the group in two and no longer supervise the Asian business from London.

### **- *Mutual dependencies: China's fragility:***

The question of presence in China is on the minds of the major international groups.

It is true that American FDI in China has fallen in recent years from \$30 billion to \$5 billion. Apple, whose main production is carried out in China, wants to diversify its supplies. But Western companies remain attracted to the Chinese middle-class market because it is now more important than the American market. Companies are therefore continuing to invest and, in 2021, FDI, foreign direct investment, in China reached a record level.

China, unlike Putin's Russia, is not indifferent to growth. It is concerned about falling into the middle-income trap if, and is likely, growth falls to 3% by 2030.

At a time when China is struggling to meet its GDP growth target of 5% in 2022, a far cry from the 10% annual growth of recent decades, and at a time when China is facing high youth unemployment and is struggling to create enough jobs to preserve social peace, the key to the continuity of power, exports remain its engine of growth.

Even if overall imports as a percentage of GDP have fallen, China cannot do without the rest of the world as a source of supply of essential components and deprive itself of the West as an outlet for its production. It is unable to manufacture advanced chips and still spends more than 2.5% of its GDP to acquire high-tech goods or components, American microprocessors supplied by AMD, Intel and Nvidia.

China remains the number one industrial production hub in the world and while many Western companies are looking to move their factories to other Asian countries, it is costly.

- ***China's strength in the production of rare earths:***

China is the world's indispensable supplier of rare earths. By 2020, China accounted for nearly 60% of the world's rare earth production, refined more than 80%, and held nearly 40% of reserves. As Deng Xiaoping wryly puts it, "There is oil in Saudi Arabia, there are rare earths in China." China did not hesitate in 2010 to deprive Japan of rare earths for a year following an incident on the Senkaku Islands claimed by both countries. Such an incident prompted Western countries to react and in particular Australia, the main producer outside China, to develop its production and try to emancipate itself from China, its main trading partner.

China has developed an integrated vision from upstream to downstream, developing lithium and cobalt mines, and becoming the world leader in supplying batteries for electric vehicles with companies like CATL, CALB and CETC. Major Chinese mining companies, Tianqi Lithium or Jiangsi Ganfeng, have taken stakes in mines abroad in Congo, the world's largest cobalt producer with a market share of 60%, or in Canada and Australia in lithium.

Indonesia, the world's largest producer of nickel, has relied on China to develop refining capacity for the metal.

**Western countries are giving themselves the means to keep the advantage:**

From an economic point of view, it is true that average GDP growth in the OECD fell from 4% in the 80s to 1.5% in the years before Covid; it is also true that the rise in debts has led to the financialisation of economies; it is true that everywhere there has been a decline in the social elevator and a decline in the welfare state and this has encouraged populist contestation; but according to the **IMF**, the West still represents 57% of world GDP at market prices and 42% of world GDP in PPP, compared with 19% for China.

From a trade point of view, contrary to belief, Western countries mainly trade with each other: 70% of European countries' trade is between countries in the zone, in North America this percentage is 50% and, if we see relocations, these respective percentages will increase.

From a political point of view, the dream of China's convergence towards the Western model has not been realised and today many are worried about the Chinese ideological stiffening. Therefore, prudence, in the name of national security, requires anticipating and diversifying supplies of goods deemed essential, providing for precautionary stocks and fighting against unfair competition that could weaken national companies.

From the industrial point of view, Western countries have become aware of some of the harms of industrial relocation: the decline of medium-sized cities, the closure of shops in these cities, the loss of well-paid blue-collar jobs replaced by precarious jobs in services.

Conjunctively, Trump's measures against China have been ineffective: on imports, taxes have reduced the purchasing power of American consumers, on exports, taxes on certain products such as soybeans have only led to a redirection of Chinese trade flows, and Brazil has replaced the United States as the preferred supplier.

More fundamentally, the US and its Western allies are working to reduce their dependence on China and authoritarian regimes. We are witnessing a growing number of initiatives, from aid for relocation, the desire to promote sectors, the aspiration to create leading companies in sectors of the future such as hydrogen. In the background, in some places, the role of the state is reaffirmed in supporting sectors, development aid, training,

etc. i.e. the creation of an attractive environment. In Europe, there is a strengthening of the union, economically in sectors deemed strategic or financially through a greater mutualisation of debts and in the United States, there is a revival of the "Buy American Act".

The question to be asked is that of a possible counterproductive effect of relocations, namely, in addition to the cost of the operation, in addition to the increased production costs, supply disruptions due to relocations. One can still relocate from China to Vietnam, but the nature of the regime in the two countries differs little and relocations elsewhere in Asia may be met with lower efficiency and higher prices.

But let's look at the United States and then Europe:

- ***The United States:***

At the domestic level, three trends have marked the last forty years: public spending has risen from 32% of GDP in 1980 to 40% in 2019, before a further increase caused by the fight against Covid. At the same time, tax cuts have been financed by increasing public debt to over 1x GDP. Finally, corporate profit rates, thanks in part to globalisation, have reached a record high of 15% of GDP compared with 11% in 1980.

Today, the United States does not want to lose its pre-eminence and intends to take up the challenge of its relative decline, in particular thanks to the help of the infrastructure plan to make up for the underinvestment of the last decades.

In Asia, Biden, after Trump's withdrawal from the TPP in 2017, is working to strengthen ties with a few key countries and is setting up the IPEF, an agreement on common standards involving Japan, Australia, India, South Korea, Indonesia, Malaysia, New Zealand, the Philippines, Singapore, Thailand and Vietnam in four areas: digital, green energy, the fight against corruption and supply chains.

Notwithstanding this agreement, Indonesia continues to buy Russian oil and South Korea is sometimes reluctant to align itself with the US diplomatic line.

- ***Europe:*** 5 points to remember.

From a trade point of view, the European Parliament has passed a motion calling for a halt to imports of products manufactured through forced labour in Xinjiang, China.

From an ecological point of view, the EU has decided to tax imports of products whose production has caused significant greenhouse gas emissions from 2026 onwards, and this will affect Turkey and Indonesia in particular i.e. countries that have benefited from industrial relocations until now.

From an economic point of view, the EU has decided to close European public procurement to foreign public companies that have been improperly subsidised.

From a political point of view, the EU has decided to tighten the Schengen Agreement, i.e. to facilitate the return of illegal foreigners and to increase border control.

From a fiscal point of view, on the other hand, while 150 countries have agreed to a minimum corporate tax rate of 15%, in Europe the implementation of the agreement is suspended by Hungary's blockage.

**Awareness of mutual dependencies:**

Between democracies and autocracies, economic ties are often close and would be difficult to untie.

- From a trade point of view, out of China's \$700 billion in trade surpluses, \$500 billion is with Western countries and China, struggling with its domestic problems, cannot do without it.
- From a financial point of view, 1/3 of FDI (foreign direct investment) in authoritarian regimes belongs to Western companies. Selling these stakes would be difficult, as evidenced by the difficulties faced by Western companies in withdrawing from Russia.

- From an economic point of view, democracies need raw materials and these are often produced in countries with authoritarian regimes. At the same time, autocracies need outlets in democracies because, for a long time, democracies will remain the main consumer markets, the richest countries.

As **Alain Frachon** reminds us, "At the peak of the Cold War, trade between Americans and Soviets did not exceed \$2 billion/year. Today, between China and the United States, trade amounts to \$2 billion/day."

- From a monetary point of view, the links would also not be easy to undo either: if of the \$12 trillion of foreign exchange reserves in the world at the end of 2021, 60% were in \$, 20% in €, the autocracies have \$7 trillion in foreign exchange reserves often denominated in Western currencies. China with \$3.2 trillion in foreign exchange reserves holds almost half of this total and therefore cannot be isolated.

### **Conclusion:**

For the moment, contrary to what is being said, there is no evidence for deglobalisation and, since the invasion of Ukraine, there has been no decrease in the use of the \$ but rather an increase and appreciation. But let's remember 5 points:

- ***The economic crisis is perceptible in many autocracies:*** among the autocracies, many are facing major difficulties. Turkey comes to mind, with its middle classes impoverished by official inflation of over 73% as a result of Erdogan's obstinacy in lowering interest rates. One thinks of Russia facing, among other things, an increase in the emigration of graduates and demographic stagnation. We think of Brazil with Bolsonaro on the verge of losing the autumn election after having made a number of mistakes...
- ***The temptations to withdraw are diverse:*** more than thirty countries, notably Russia for cereals destined for certain countries, India for wheat, Malaysia for poultry, Argentina for soybean oil, are blocking exports of certain products. The idea is to protect local populations, but the risk is to aggravate the tensions on the prices of these products.
- ***The interweaving of trade is an inescapable reality:*** faced with supply disruptions during the COVID crisis, companies, especially in sectors deemed strategic, want to abandon the organization of just-in-time production, the zero stock. But large multinational companies often depend on chains of subcontractors located around the world.
- ***The major challenges are international and require cooperation:*** "***Progress has never been more than a consoling prospect,***" said Kant, but if life expectancy in the world has risen from 50 years in 1960 to 75 years, it is thanks to medical cooperation. Today, there is a reason for optimism in the wake of the Covid epidemic, never has a vaccine been quicker to launch. Global collaboration is just as necessary in the fight against global warming, because inaction on the climate results in a disengagement of young people from the democratic and capitalist model and to impatience.
- ***We must avoid protectionism:*** globalisation has made it possible to diversify supply and great progress has been achieved in the fight against poverty: in 1984, nearly 40% of the world's population lived on less than \$1.90/day, today 10% do. The worsening of inequalities is not a result of globalisation but comes from the monetary and fiscal policies carried out by many countries. Today, it is too early to assess the cost of relocations in the recent surge in inflation. Undeniably, a return to protectionism would structurally worsen inflation. In other words, halfway between globalisation and protectionism, diversification of supplier is undoubtedly the way forward and the IMF is moving in this direction. If deglobalisation were to gain influence, countries that are very open to the outside world, such as Germany, would be affected.

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