



Letter n°79

Can we really talk about the decline of the West?

"Shoot for the moon. Even if you miss, you'll land among the stars." Oscar Wilde.

The great strength of the West, of market capitalism, is the ability to undertake the faith in the future, and the optimism expressed by this magnificent advice from Oscar Wilde.

Since 2016, the Chinese economy in terms of purchasing power parity has surpassed that of the United States, and since then, many have talked about the decline of the West. But let's not be led into erroneous conclusions, let's not be deceived by the Cassandras.

Despite China's tremendous growth over the past 30 years, the United States' share of the global economy has remained stable at around a quarter. The US GDP per capita, thanks to GDP growth, working hours, and population growth that trend higher, remains the highest among all major countries, and China's GDP per capita in purchasing power parity represented only 30% of the US GDP by the end of 2022.

In the midst of a new "*Clash of Civilizations*", a nod to *Samuel Huntington's* eponymous book, in the midst of a China eager to unite many countries in the South against Western countries, in the midst of a Russia which, to use *Sébastien Boussois'* expression in his book "Putin's Holy War", "*seeks to crystallize all the frustrations caused by the West*", in the midst of a possible Sino-American confrontation analyzed by Graham Allison in his book "*The Thucydides Trap*", let us remember China's dispatch of over 1.5 million soldiers against American troops in 1950, let us remember the dispatch of 300,000 Chinese soldiers to Vietnam, and let us ask ourselves whether the West is in decline or whether the West will emerge strengthened from this competition, this challenge.

To try to answer the question of a possible decline of the West, we will analyze successively some of the strengths and weaknesses of the two main Western groups, the United States on one hand, and the European Union on the other. At the end of 2021, the US GDP represented 24% of the world's GDP, while the European Union represented over 17%. If we add Japan, Great Britain, Australia, Switzerland, and a few others, the Western camp represents a little over 50% of global wealth, far ahead of China, at 18%, which when combined with Russia (1.8%), is at less than 20%. We can therefore conclude that Western dominance is somewhat enduring.

The United States: a new economic momentum.

According to the IMF, the GDP growth, after 2.1% in 2022, could be 1.6% in 2023. Therefore, we are not facing a recession, as feared by many investors a few months ago.

To reassure ourselves, if necessary, we can successively examine the strengths, weaknesses, financial preeminence, and relations with China.

Economic strengths:

- The past:

Over the past thirty years, there have been over 5 million job losses in the manufacturing industry. But, contrary to beliefs, these job cuts have resulted less from Chinese competition, only 1/6th, than from productivity gains. Not surprisingly, the share of manufacturing in GDP has remained around 12%.

- The present:

For the United States, they represent 4% of the world's population, but nearly a quarter of the world's GDP, abundant natural resources, a quarter of global natural gas production, 12% of oil production, and productive agriculture.

They also hold leading positions in innovation with the GAFAM and in armaments with 40% of global spending, which amounts to a military budget of \$886 billion for 2023.

Compared to the EU, Japan, China, and Russia, the United States has the advantage of population growth, greater flexibility, better worker mobility (although it has decreased), high research budgets at 3.5% of GDP, and is the source of the most patents in the world. In 2022, Americans were able to create 4.5 million jobs without an inflationary spiral, and the unemployment rate is at a record low of 3.5%.

- The future:

Thanks to various plans implemented by Biden totaling \$2 trillion, there is a resurgence of industry in the future sectors of semiconductors and energy transition.

Although Biden was unable to pass the \$3.5 trillion BBB (Build Back Better) plan, he was able to pass three plans: the infrastructure plan amounts to \$1.2 trillion, the Chips Act offers \$50 billion in grants, and while the IRA officially proposes \$370 billion, it is limitless in practice as long as companies invest, and there are already more than \$50 billion in projects.

Overall, this is the most ambitious program initiated by the state since Franklin Roosevelt.

There is so much potential, even if the United States sometimes face labor shortages in these sectors, and even if they are lagging behind Europeans.

Weaknesses of the United States:

- From an economic perspective:

The United States suffers from a monopolistic drift especially in certain sectors of tech (see the work of ***Thomas Philippon*** on this subject).

- From a social perspective:

The United States is characterized by shortcomings in social protection, a worsening of inequalities at a level unmatched among G7 countries, a relative impoverishment of the middle class, and a decrease in life expectancy.

- From a political perspective:

On the local scene, there is populism, the fracturing of the country into two opposing camps, the possibility of a return of Trump, and on the international scene, an anti-Americanism aggravated since the Iraq war in 2003 and the abrupt withdrawal from Afghanistan.

The indisputable financial preeminence:

- From a stock market perspective:

The United States accounts for nearly 60% of international market capitalization, 1.7x GDP, while China represents less than 4%.

The United States, more than any other country, benefits from highly liquid financial markets capable of supporting numerous start-ups. In 2019, China launched the Star Market in Shanghai, supposed to rival the Nasdaq, but it remains modest.

- From a monetary perspective:

Another advantage of the United States is that the weight of the dollar in international transactions has fallen from 72% in 1999 to 59%, but it has remained stable over the last two years.

China itself, more indebted, is not necessarily an alternative or a threat. According to the IMF, the Yuan represents only 3% of reserves compared to just over 20% for the Euro. The Yuan is used for less than 2% of international payments compared to 45% for the dollar and 34% for the Euro, percentages that have remained stable.

In recent years, China has been trying to develop commodity contracts in Yuan with Russia and more recently Saudi Arabia, but the dollar is not threatened.

The \$ is contested by some countries angry about US sanctions, the high level of US debt, and the US current account deficit, but the recent statements by Brazil, Malaysia, and Bangladesh in favor of the Yuan will hardly change the status quo.

- From a market perspective:

Whether in terms of exchange rates or international bond issuances (\$48% and €38%), the weight of the \$ is at least stable.

Yuan-denominated loans are increasing because interest rates are more attractive than those for the \$, but as long as the Yuan is not convertible, the dollar is unlikely to lose its preeminence. In fact, the threat in the long term could come from digital currencies.

- From a budgetary perspective:

Despite critics of the \$, the United States will be able to continue financing their public debt, which is 122% of GDP in 2022, and their very large external deficit with global savings, therefore investing more than they save.

- From a standards perspective:

The United States has a significant advantage because all the world's largest financial audit firms are Anglo-Saxon, including Ernst & Young, Pricewaterhouse, and others. The same is true for all the large law firms.

The US-China relationship: between political tensions and economic pragmatism.

Let's analyze the 2001 mistake, recent containment efforts tempered by interdependence:

- The 2001 mistake:

In hindsight, the Western mistake was to accept China into the WTO in 2001 without conditions. By failing to ban public subsidies to companies and demand the opening of Chinese public markets, the West offered great advantages to China. Even today, almost 30 sectors remain closed to foreign companies.

- Containment efforts:

Aware of the Chinese threat, President Obama signed the TPP (Trans-Pacific Partnership) with 15 countries in 2016. The agreement was meant to bring together 40% of the world's GDP and 800 million people in Asia. One of Donald Trump's many mistakes was to block the agreement in 2017. China took advantage of this and created the RCEP (Regional Comprehensive Economic Partnership) with the 10 ASEAN countries in November 2020, which includes a reduction in customs duties.

The trade war was initiated by Trump in 2018 with the imposition of 25% tariffs on \$35 billion of Chinese imports. It was worsened in December 2019 with an expansion of the list of sanctioned products. A rare example of continuity, it was maintained and even intensified by Biden with sanctions against telecom operators in 2022.

Joe Biden intends to be even more restrictive and impose restrictions on direct investments by American companies in China in certain sensitive technologies.

- Interdependence:

To simplify and show the interdependence between the two largest economies on the planet, the United States represents the heart of the world's financial markets, while China, despite offshoring, remains the heart of global industrial production. China and the United States share the same desire for independence, but with \$700 billion in mutual trade, they are highly interdependent, and large American companies are dependent on the Chinese market, such as Apple, which generates 20% of its sales there.

Many Chinese companies remain listed in the United States, and many American companies have factories in China. It can be said that China is a spur for the United States.

The United States follows a triptych in its relationship with China: the 3 Cs - economic competition with tariffs averaging, according to the *Peterson Institute*, 19%/20% imposed by each of the two countries, confrontation on human rights and Taiwan, and cooperation on climate issues.

Europe: strengthening integration.

- Endemic pessimism:

When talking about the European Union, one often confronts the prevailing pessimism among Europeans. After the invasion of Ukraine, the EU was expected to fall into recession, lose all industrial competitiveness due to rising energy prices, and be exposed to offshoring.

- Avoided recession:

The latest figures show resistance, with expected GDP growth of 0.8% this year, and even reindustrialization in sectors related to the energy transition. The composite PMI confidence indicator has just reached its highest level in 11 months.

Between the EU and the United States, there is political convergence and economic competition:

- Political convergence with the United States:

In the face of the threat, aggressiveness, and revisionism of autocracies. This convergence was undermined by Donald Trump, but Joe Biden, for example, rejoined the Paris Climate Agreement in 2021 and strengthened cooperation within NATO.

- Economic competition with the United States:

As evidenced by the discussions around the beneficiaries of the American IRA, the EU is right to advocate for balanced access to the American market. Europeans would like, like the Japanese, to obtain from the Americans the possibility for their manufacturers to benefit from the IRA and the \$7500 tax credit.

To date, only one European electric model, a VW, meets the dual requirement of half of battery components made in the United States and 40% of the value of battery raw materials coming from American mines, and is eligible for the aid provided by the IRA. VW will invest \$5 billion in a battery cell factory in Canada by 2027, the largest in the world for these products. This is in addition to \$2 billion in investments in South Carolina for electric vehicles and a battery factory in Ontario, with a subsidy of \$9.5 billion over ten years. At the same time, the group has put a freeze on an investment project in the Czech Republic.

- Recent progress:

Let us not be too pessimistic. While projects are on hold in Europe, such as Tesla's \$3.6 billion investment in Berlin and VW's \$5 billion battery factory investment in Eastern Europe in favor of a plant in Canada.

But the €100 billion plan adopted by France until 2030 or the €200 billion plan adopted by Germany exceeds the IRA as a percentage of GDP. The IRA is spread over ten years and represents only 0.2% of GDP each year.

The European Net Zero Industry Act intends to offer an answer, simplifying aid for the development of green technologies. The agreement aims to double the share of renewable energy in European consumption to at least 42% by 2030.

For semiconductors, an agreement equivalent to the American "Chips Act" has just been reached and by 2030, a doubling of the global market share in semiconductors to 20% is hoped for through a €43 billion plan.

Europe has fallen behind in digital, 5G, and artificial intelligence.

European financial markets do not have the same attractiveness as the American market, and since 2000, 220 European companies, many in tech, according to Dealogic, have chosen to list in the United States because capital raising can be much higher there.

Conclusion, the absence of Western decline.

"Men behave wisely when they have exhausted all other resources." Churchill.

In conclusion, let us hope with Churchill for the return of reason, the end of the dream represented by autocratic models or state capitalism without individual freedoms.

- *From a political perspective:*

Given the attractiveness of democracies, no one dreams of emigrating to China, Iran, North Korea, Venezuela, and a few others. At the same time, the United States, like Europe, will remain a welcoming place.

- *From an economic perspective:*

Proof of the superiority of political and economic liberalism, while liberal democracies represent only 15% of the world's population, their average standard of living is 6 times higher than the average of other countries.

- *From a commercial perspective:*

"Deglobalization", meaning the relocation or reindustrialization in developed countries, will harm emerging countries and thus aggravate wealth gaps in favor of the West.

- *From the perspective of companies and the stock market: persistent interdependence.*

While politically the world sees two powers opposing each other, economically the reality is different as Western companies are still investing in China and signing contracts: recent examples include Airbus' new contract providing for a second assembly line in China, Tesla producing half of its vehicles in China, European automakers who, before Covid, sold 500,000 cars to China and produced nearly 5 million locally, and Chinese companies always on the lookout for opportunities in Europe or the United States, as well as examples of mutual dependencies, the West for Chinese rare earths and China for Western semiconductors.

The IMF, Yellen at the helm of the US Treasury, have understood this well and emphasize the disastrous costs of a potential economic decoupling.

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