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THOUGHT LEADERSHIP BRIEF

Deglobalisation in the Context of the United States-China Decoupling

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KEY POINTS

- The deceleration in trade, global FDI and technology transfer has been fuelled by a shift from engagement to strategic competition between the US and China.
- COVID-19 is also an important factor driving deglobalisation, largely impacting the movement of people.
- Deglobalisation is much less evident for finance, with the exception of foreign direct investment, although attempts by the US and China to downsize portfolio investment and cross-border lending are emerging.

ISSUE

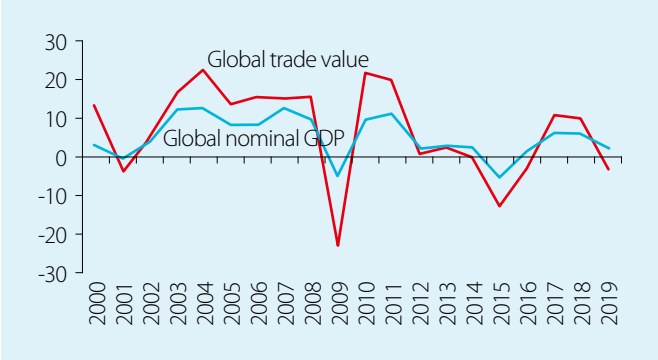
After decades of increasing globalisation, we are now seeing a clear trend of deglobalisation fueled by a decoupling of the United States and China. Deglobalisation is not a new concept but rather a megatrend which has been seen before, most notably just before the First World War. We define deglobalisation as a reduced number of exchanges, whether it is in trade, investment, technology or movement of people. We examine the decoupling taking place between the US and China, given increasing strategic competition in trade, FDI and technology. COVID-19 is another significant catalyst of deglobalisation due to the impact the pandemic has had on the movement of people. This brief will evaluate the speed at which trade and global value chains, technology, movement of people, and financial flows are decelerating.

ASSESSMENT

Trade

Deglobalisation in trade was underway even before the trade war of 2019. Global trade flows declined sharply during the 2008 global financial crisis. There was an expectation that trade would thereafter continue to grow at rates similar to those prior to the crisis, but this has not been the case. Global trade value grew by an average of 2.7% from 2009 to 2018 (Figure 1), a much lower rate than the 12.6% average growth before the global financial crisis (GFC). This decline is also evident in trade volumes, which saw negative growth rates. The global services trade collapsed in 2008 and has not returned to pre-GFC level . The degree of integration of global value chains (GVC) have also declined since the GFC.

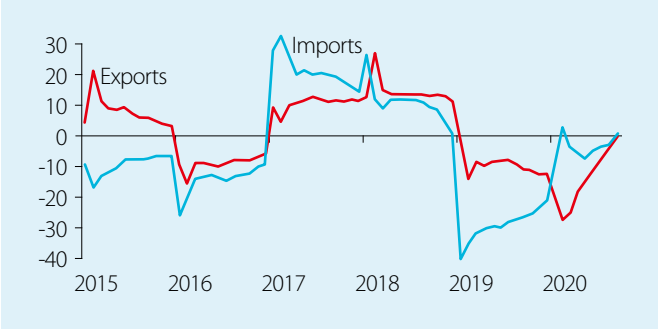
Figure 1. Global GDP and Trade Growth (year-on-year, %)



Source: Bruegel based on UNCTAD.

These changes have weakened the World Trade Organisation's (WTO) ability to facilitate global trade flows effectively. Its appellate body, which arbitrates in disputes, has been functioning poorly as evidenced by increasing confrontations on trade between the US and China. Former President Trump's disdain for multilateralism and China's state-led system are not compatible with the liberal nature of the global trading system. US trade sanctions against China further drives their decoupling in trade, technology and investment flows. In other words, US-China decoupling reinforces the post-GFC deglobalisation trend, at least in terms of trade and global value chains (Figure 2).

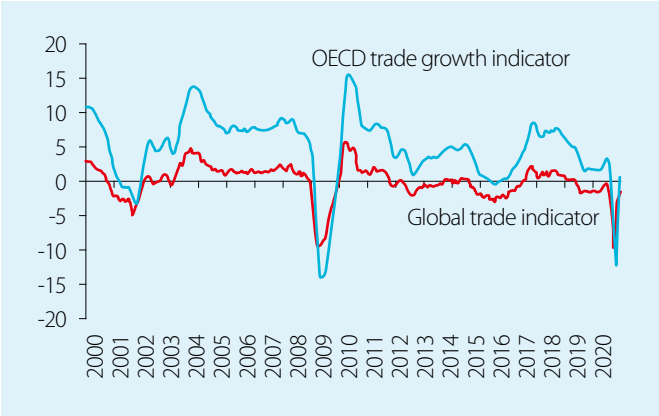
Figure 2. China's Trade in Goods with the US (year-on-year, %)



Source: Bruegel based on www.wind.com.cn/.

The peak of the COVID-19 pandemic also saw a collapse in global trade flows (Figure 3). While the pandemic is an exceptional event and the immediate impact should be temporary, there is no expectation of an upcoming rise in trade flows. Shifts in supply chains as firms re-shore production could affect global trade volumes permanently.

Figure 3. Global Trade and Exports (year-on-year, %)
Note: the red line shows the Natixis Global Trade Indicator of growth in global trade in goods. The OECD indicator = three-month moving average.

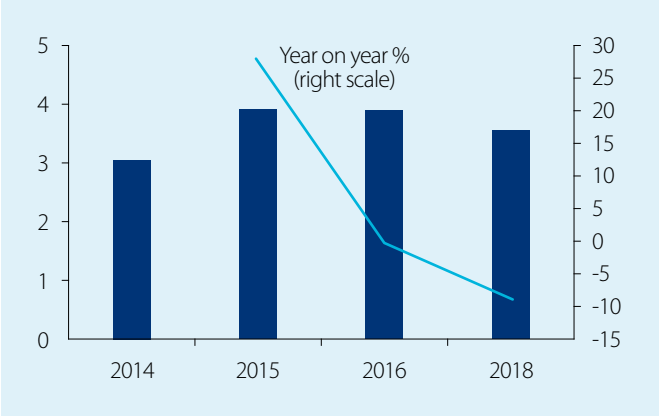


Source: Bruegel based on Natixis and OECD.

Technology

Technology protectionism is embryonic but evolving amid US-China decoupling. Transfer of technology is increasingly restricted as global technology competition intensifies through export controls on high-end technology products. The Trump Administration targeted China, with the number of approvals falling sharply from 27% in 2016 to 9% in 2018 (Figure 4). In retaliation, China introduced export licenses for key technologies such as drones and artificial intelligence in 2020.

Figure 4. Approved US Licenses for Tangible Items, Software and Technology Exports to China (000s)



Source: Bruegel based on US Department of Commerce.

Increased controls on the free flow of technology investment with the intent of blocking Chinese mergers and acquisitions in the US also drive technological decoupling. The EU followed suit in April 2020 and set up its own investment screening process aimed at blocking China's technological progress. Furthermore, the US "*entity list*", which includes Huawei and the largest producer of semiconductors in China (SMIC), forbids US companies from conducting business with those deemed risky to national security. In September 2020, China announced its own list in response. The consequences of being on China's entity list are not sanctions, as is the case with being on the US list, but involve being blocked from all trade and investment with China. As the web of sanctions and prohibitions expands, technology decoupling may eventually reinforce trade decoupling. It goes without saying that trade decoupling between the world's two largest economies will foster deglobalisation of trade and investment.

Another example of US-China decoupling which has global impact is the ban on Huawei from providing 5G platforms in the US. Other countries, including the United Kingdom, have implemented the same ban. In August 2020, the White House published executive orders threatening penalties against US residents or companies that engage in transactions with Chinese-owned social media platforms, TikTok and WeChat. Seen as equivalent to the great firewall set up by China to prevent its internet users accessing services including Google and Facebook, the exchange of information across borders looks increasingly divided.

Beyond hardware and software, the next conflict will, without doubt, involve cloud and data storage. China's restrictions on data storage outside of the country have been in place since 2017. To comply with the law, foreign companies such as Apple must store Chinese user data in China through partnerships with local companies. A potential US-China decoupling in this arena makes the need to upgrade the Chinese technology industry more urgent than ever, and China is prepared to pay the associated financial costs.

Movement of people

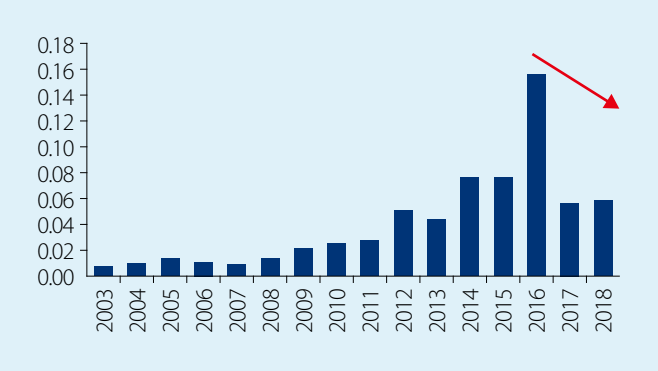
Until 2019, international mobility was growing in the form of longer-term migration. However, a decline in travel services in recent years has been driven by increased restrictions on labour mobility via immigration controls. The denial of visas to enter the US has increased rapidly, particularly for Asian countries. The US is also reported to have revoked visas for a significant number of Chinese students and researchers, citing potential security risks.

Inevitably, international travel and tourism collapsed in 2020 due to COVID-19-related travel restrictions, but the number of short-term visitor arrivals actually started to decline from 2017. Concerns about the impact of travel on health and the environment are likely to redefine the tourism industry going forwards. Travel beyond the pandemic will unlikely see international mobility return to previous levels.

Financial flows

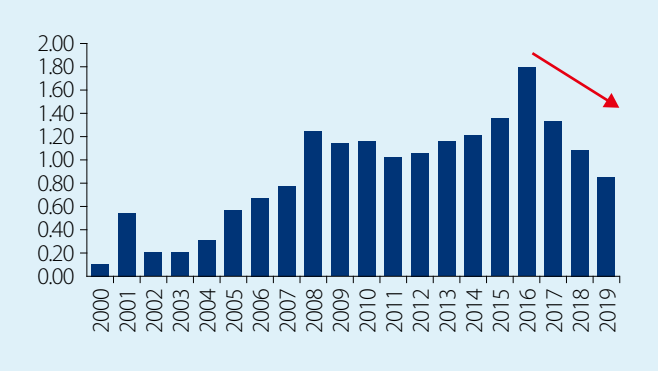
Financial deglobalisation is more pronounced as the US-China conflict moves beyond trade into the arena of foreign direct investment (FDI), portfolio investment and cross-border lending. Both inward and outward FDI flows as a share of global nominal GDP have been declining since the global financial crisis. This is especially true for outward FDI, which halved from 2.7% in 2008 to only 1.2% in 2018. This follows the negative trend in global trade, the fragmentation of global value chains, and is potentially a consequence of those. US FDI flows into China peaked in 2002 after China's entry into the WTO (Figure 5). Chinese FDI into the US continued to grow until 2016 (Figure 6). A subsequent drop since 2017 is likely the result of US constraints imposed by the Committee on Foreign Investment, or increased costs of doing business because of the worsening US-China relationship.

Figure 5. US FDI flow to China (% of GDP)



Source: Bruegel based on UNCTAD and www.wind.com.cn/.

Figure 6. Chinese FDI flow to the US (% of GDP)



Source: Bruegel based on UNCTAD and www.wind.com.cn/.

Portfolio flows into emerging markets have also slowed globally since the European sovereign crisis in 2010. The rebound of portfolio inflows after the initial shock from COVID-19 has been moderate compared to recovery after the GFC (Fig. 14). While we cannot conclusively say that financial deglobalisation is taking place for portfolio flows, when we examine the US-China case, we find that they are slowly but steadily downsizing holdings of each other's financial assets. The US State Department has also asked

universities to divest holdings of Chinese assets related to Xinjiang or China's military. These moves are so far bilateral and have not been replicated by other countries. In fact, foreign holdings of both Chinese bonds and US treasuries are increasing, which is understandable given the economic significance of both economies.

There has also been a shift in cross-border bank lending from developed markets to emerging markets. It is therefore hard to argue for deglobalisation in this domain, but rather, a change in the nature of lending due to an increase in emerging market flows. In the US-China context, Chinese technology firms listed in the US have opted for secondary listings to avoid the risk of delisting from the US stock market. Alibaba Group, JD.com and NetEase Inc etc, have opted for secondary listings in Hong Kong. Meanwhile, the Chinese government has adopted policies to encourage domestic funding of technology companies, including the launch of the Science and Technology Innovation Board (SSE STAR Market) in 2019, which supports technology start-ups with equity financing and with avoiding US equity markets. China is also increasingly selective in its choice of foreign banks in the arrangement of its sovereign issuance overseas.

CONCLUSIONS

After decades of globalisation in every aspect, from trade to technology, movement of people and investment, it seems the trend has turned towards deglobalisation, or at least slower globalisation. And the deceleration in trade and FDI has been fuelled by strategic competition between the US and China, which is pushing them to decouple. COVID-19 is also an important factor driving deglobalisation, largely impacting the movement of people.

In global trade, there are signs of a reduction in the exchange of intermediate goods between countries as a way to exploit comparative advantage and specialisation gains. These trends should not surprise us given the protectionist policies of a number of governments and the reduced role of multilateral institutions, as exemplified by the weakening of the WTO. Beyond trade, technology decoupling between the US and China is seen in reduced approvals for export licenses, limits on use of hardware, and outright bans on software.

Financial decoupling between the US and China is increasingly evident and not only limited to FDI. Rising pressure to de-list Chinese companies from US stock exchanges and the increase of sanctions for transactions with Chinese companies further sustains the deglobalisation trend. Should the world return to capital controls, there will be greater dislocation of global savings and, ultimately, lower potential growth.

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Reference:
García-Herrero, A. and J. Tan (2020) 'Deglobalisation in the context of United States-China decoupling', Policy Contribution 2020/21, Bruegel