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Deglobalization does not forcedly mean less multilateralism. This is how Europe should think about the likely coming bipolar world, built on the growing competition between the U.S. and China. Like other countries in a bipolar world, Europe would be hard-pressed to take sides between the two geopolitical behemoths. Much speaks in favor of a tighter transatlantic relationship, but this is easier said than done. The degree of Europe's dependency on global trade is such that a hard-nosed decoupling from Asia would be immensely costly, possibly eroding democratic consensus among European citizens, and would still require many years. Europe has the cultural inclination and economic interest to represent a force for multilateralism between the U.S. and China.

Deep geopolitical tensions are dividing the world between the two largest geopolitical powers along, broadly speaking, the main public policy lines of modern society: security, economy, technology, and culture. All the activities related to those policies are thus subject to geopolitical considerations with direct implications for Europe. They are also key for the green and digital transitions at the core of the EU's priorities. Against the backdrop and the realization of the indivisibility of the world's environment and the undesirability of a divided digital sphere, the European Union has the chance to define its collocation in the US-Chinese balance of powers in a constructive way.

The process underway has been described by ECB President Christine Lagarde as a complex historical intersection of three trend lines: "*From dependence to diversification; from efficiency to security; from globalization to regionalization*". Recently, however, the process of shortening the global supply chains has become dramatically urgent: the war in Ukraine has made it more likely that Europe will be confronted with another long-lasting Cold War scenario, calling on it to develop a comprehensive response to the geopolitical challenges. Issues related to military hard power, energy, trade, finance, infrastructure, artificial intelligence, cybersecurity, education, health, or science were already becoming matters of choice between China and the US. Now they have assumed a fundamental connotation for Europe's very existence.

In this brief, we will identify several reasons why globalization will be more resilient than generally assumed. We will also show that in the case of technological cooperation, the US and Europe are working in the right direction – defending democratic values, through rules-setting, while keeping the door open to like-minded countries. We will also consider the costs of a confrontational scenario, derived from calculations by researchers at the IMF, in which Europe sides more or less unconditionally with the US, accepting the world's bipolarity, instead of trying to assert Europe as a third pole arbitrating between the US and Asia in the name of multilateralism.

To dispel possible misunderstandings, we start with a clear statement of facts: Europeans share the democratic set of values that have connotated the transatlantic cooperation with the US and cannot – and will not – turn their back on the US. In this regard, the attitude of the Europeans, as surveyed by Pew Research in 2021, is not ambiguous. In every country surveyed around half or more of the respondents have a favorable opinion of the US. Around two-thirds or more have positive views of the US in Italy, France, and the UK. These broadly positive views reflect a significant shift since 2020 when ratings of the US were at or near historic lows in most European countries. For example, in Germany, while only about a quarter of those surveyed had favorable views of the US in 2020, in 2021 a 56% majority had that opinion.

When it comes to China, the opposite is true. Among the people surveyed, only in Greece do around half or more have a favorable view. Large majorities in most of the world's advanced economies surveyed have broadly negative views of China – including around three-quarters or more who say this in Japan (88%), Sweden (80%), Australia (78%), South Korea (77%) and the US (76%). In many European countries, these unfavorable views are at or near historic highs, though they are largely unchanged since 2020.

The growing lack of trust in China and its leader, Xi Jinping, reflects the same dynamics that characterized growing distrust for the US and former President Donald Trump before the last presidential elections. These parallel signs of detachment seem to prove that Europeans care for the democratic nature of their partner as well as for their multilateral policies. If this is true, we can safely maintain that the set of values that have connotated the transatlantic cooperation is still the benchmark of Europeans' choices.

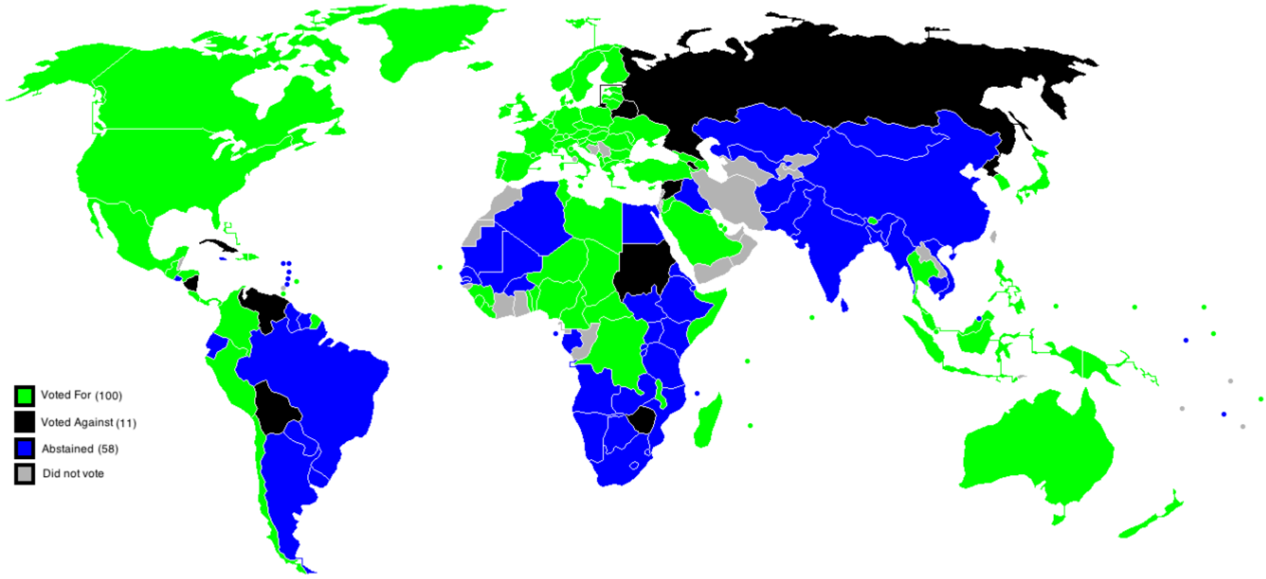
Will it remain so? Multilateralism may be instinctively preferable for Europeans, but this is far from solving the problem of Europe's place in a world of growing spheres of influence. Establishing strategic autonomy, either in the sector of defense or in the industrial domains, requires member states' consensus on the best ends, ways, and means to consolidate an independent yet complementary position between the two other largest political systems. This may only become possible if multilateralism is a more economically convenient way to define Europe's role in the world than bipolarity. It is thus necessary to inquire whether Europe's economic needs can be best absolved with or without the Asian markets.

Conventionally, European leaders tend to frame the issue starting from the political visions of Europe rather than its economic convenience. Strategic autonomy has become a common catchphrase in most European chancelleries as Josep Borrell, the EU High Representative for Foreign Affairs and Security Policy, has repeatedly remarked. Leaders like Emmanuel Macron have advocated "European solutions for European problems", while German Chancellor Olaf Scholz has called for the EU to defend its general interests. It sounds rational to establish a political design before taking any other action. However, unlike the bipolarity of the US-USSR Cold War, the new Asian-US bifurcation is not likely to be built around ideological blocs. "China does not represent the existential threat of mutually assured destruction that drove strategy and diplomacy in the earlier bipolar era. Rather its challenges arise more in the domains of technology and economy."[1] We limit this extremely complex set of questions to the assumption that economic preferences significantly contribute to building the bedrock on which democratic consensus throughout the European Union creates and defines the viability of a common foreign policy stance.

One further preliminary consideration about the relevance of economic interests in the strategic design is due. In Figure 1, the geographical distribution of votes in favor of the UN resolution condemning Russia's aggression on Ukraine has been interpreted as revealing the world's growing political divides.

[1] "Can Europe Help Prevent a Bi-polar World?" by Jean-Christophe Bas & Richard Higgott

Figure 1



One way to decrypt the votes' distribution is to distinguish between democratic and autocratic regimes. A second possible way, however, is to observe three vertical blocks voting in favor of the UN resolution (the Pacific American bloc from Canada to Chile; the Euro-African bloc from Scandinavia to Congo); and the Pacific basin from Japan to Australia). From a different perspective, Figure 2, published in the last CIA Factbook, and Figure 3, published by the World Bank, show the main good or product categories exported by each state. These simple exemplifications have some explanatory power about the causal factors behind the vote of some autocratic countries – Venezuela, Saudi Arabia, or Libya, among others - against Russia, indicating that trade competition may remain a more powerful motivation in determining geopolitical choices than the distinction between democracies and autocracies. India, generally listed among democracies, condemned the invasion of Ukraine in harsh tones at the UN but then refrained from voting in favor of the resolution. Similarly, the levels of specialization may help us understand the common instances of groups of countries. More precisely, the relevance of global supply chains for each country could be a keystone of foreign alliances.

Figure 2

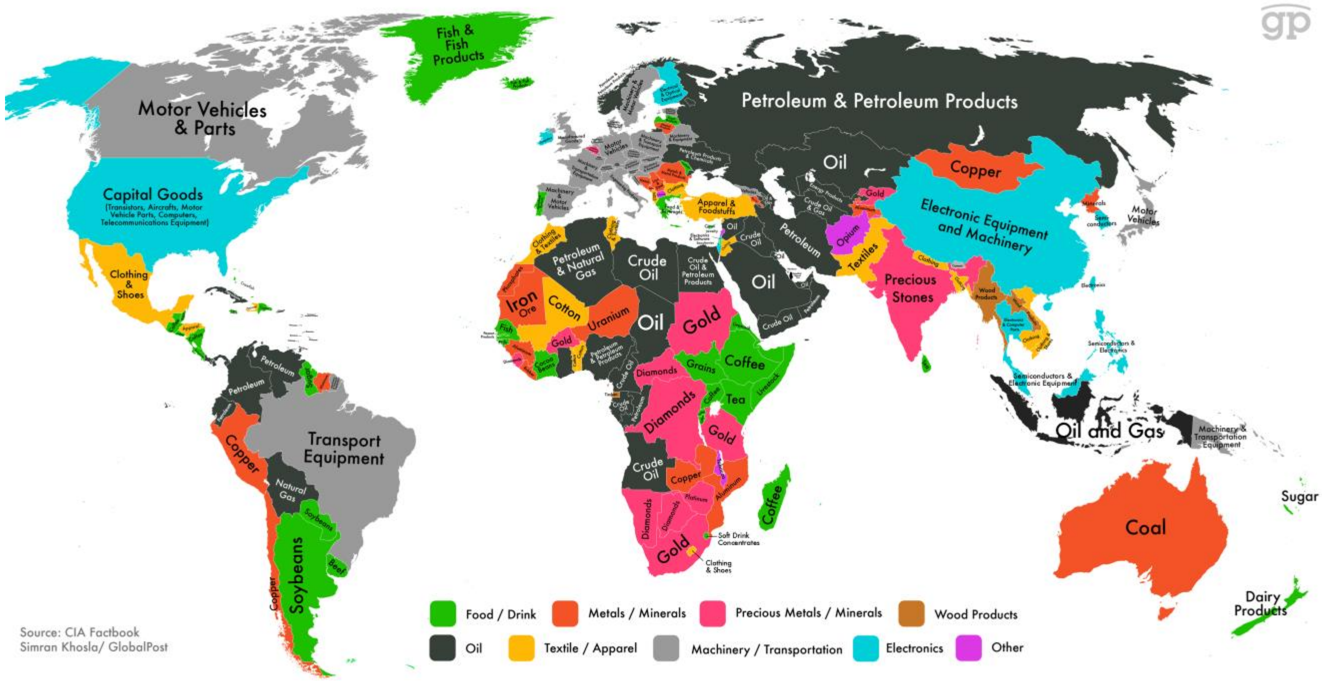
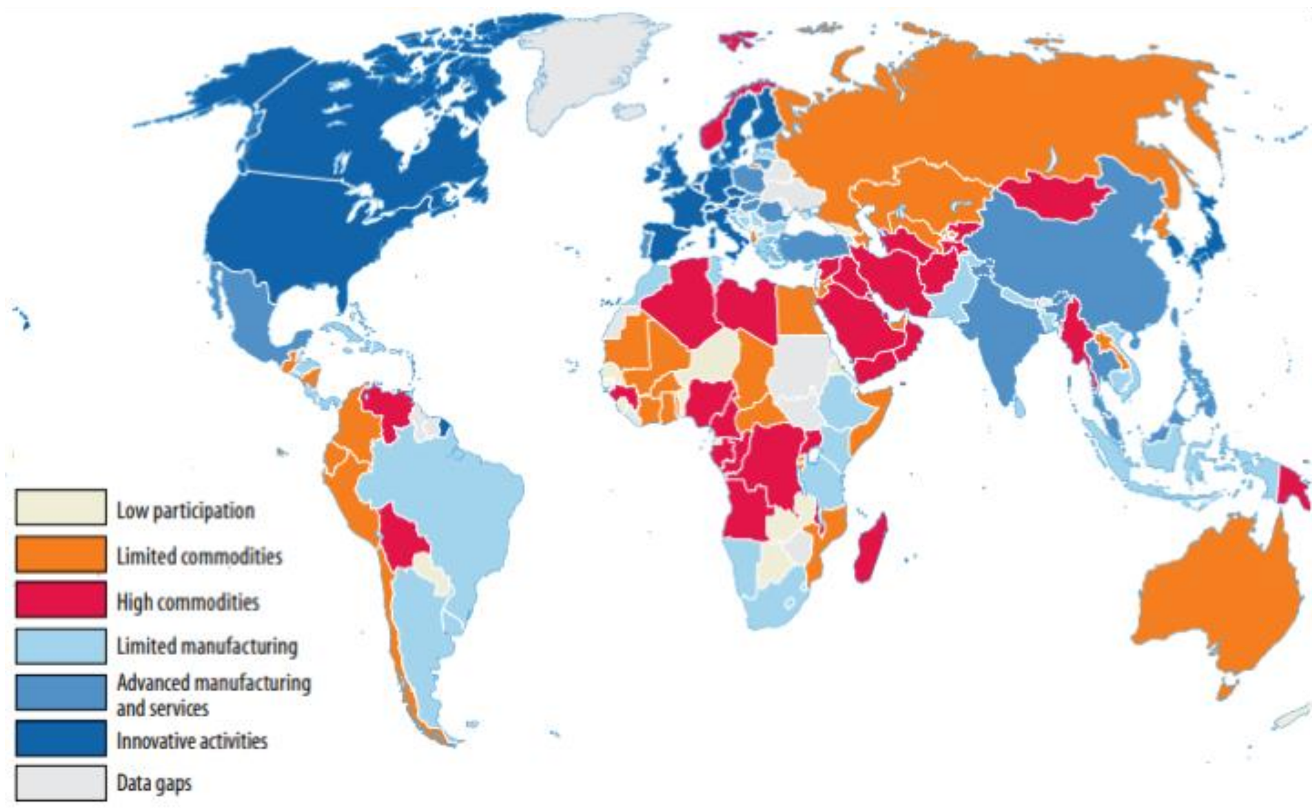
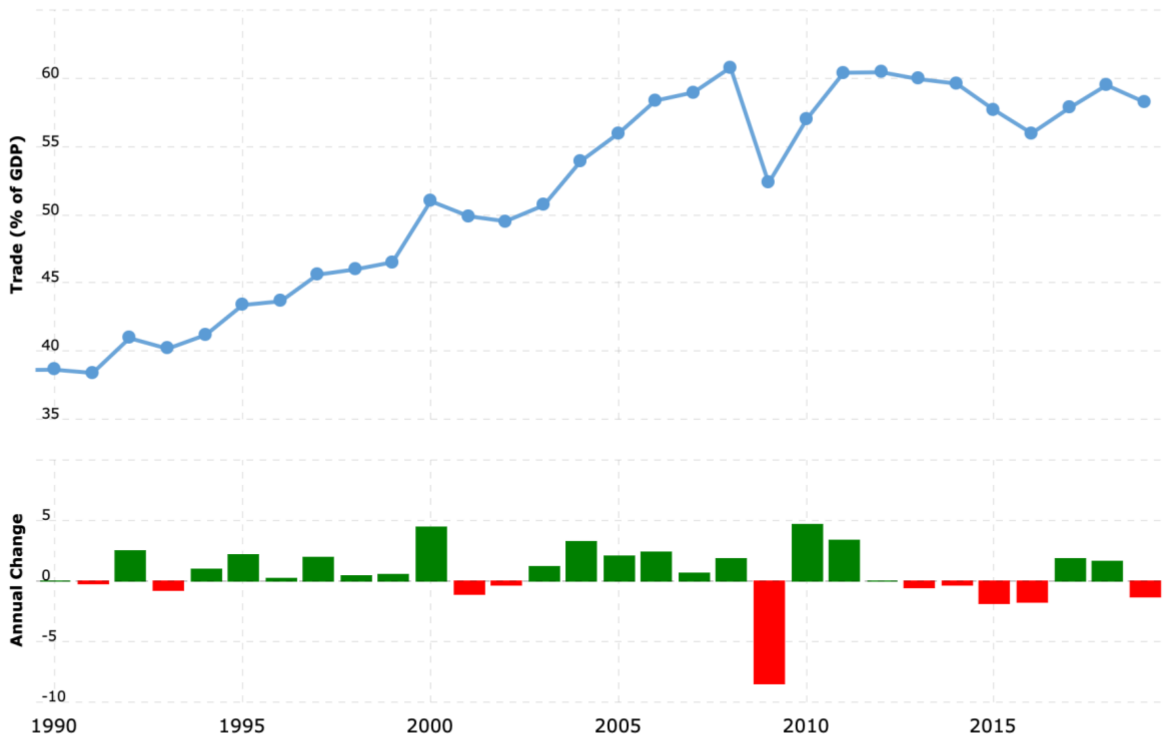


Figure 3



The idea that the economic factors driving globalization have been withering for years is only partly true. In the graph below, the global trade/GDP ratio shows that after 2009 growth has stopped and even went into reverse.

Figure 4



In February 2020 the Organization for Economic Co-operation and Development (OECD) confirmed that the overall level of integration of international production chains remains high but has weakened. The 2008 global financial crisis negatively impacted trade finance and led to a consolidation of global supply chains. The financial regulation of cross-border transactions has substantively limited the scope and reach of American financial intermediaries, till then a driving force in globalization. This has been accompanied by a slowing down of international trade growth due to issues such as a rise in restrictive measures and weak levels of cross-border investment. In fact, part of the effect is due to the growing income in many emerging countries that has shifted consumption from goods to services, which are more frequently traded at the domestic level. A strong case in point is provided by China, where the trade/GDP ratio has declined by 26 pp since 2008.

Exacerbated by the pandemic crisis, a strong sense of deglobalization has been gaining ground, particularly in the US. A Bank of America Securities survey of analysts conducted in 2020, which covered more than 3,000 companies, found a "tectonic shift in global supply chains": Companies in more than 80% of 12 global sectors, representing $22 trillion of market cap in North America, Europe and Asia-Pacific (excluding China), have "implemented or announced plans to shift *at least* a portion of their supply chains from current locations."

Even before the health crisis, what triggered deglobalization was the tariff war between the US and China. Behind President Trump's political motivation, the structural reason was a reassessment largely based on extensive automation in many sectors and productions, which has made the labor-cost benefit of outsourcing and offshoring less attractive, especially in times of concern about national security and "ESG concerns of high carbon footprints associated with long supply chains and potentially problematic employment practices." Companies in about half of all global sectors in North America declared an intent to "reshore."

After two years, the surprising reality is that almost none of the largest global corporations has significantly "reshored" its production. Rather than the repatriation of production, the process underway seems to be characterized by a re-composition of supply chains along criteria that are generally defined as "near-shoring".

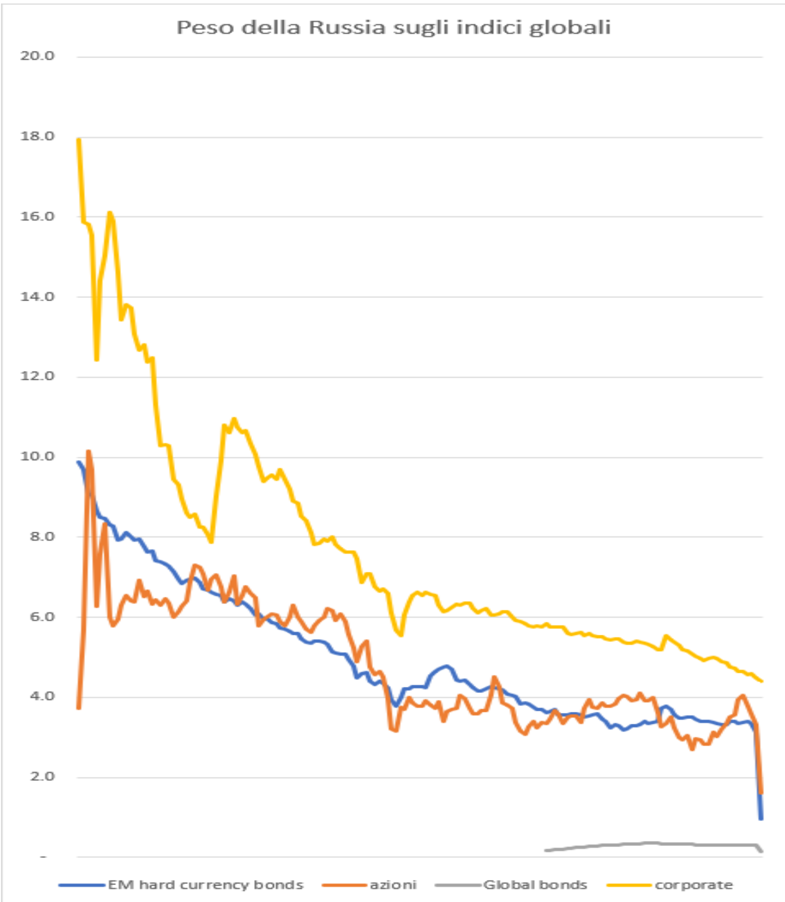
An article recently published in the Harvard Business Review presents a number of examples of strategy changes in the wake of the war in Ukraine boosting interest in local supply chain strategies: "The recent agreement by Électricité de France (EDF) to purchase part of GE's nuclear power business, which GE had bought from Alstom in 2015, exemplifies this swing from globalization to localization". As reported in The New York Times, France is increasing its dependence on nuclear power plants, which already generate 70% of its electricity. It decided that to do so it needed to better control the whole supply chain for such plants. Another example presented by the HBR is semiconductor manufacturing equipment. The US and Dutch governments have blocked ASML, the world's largest producer of lithography equipment used to make computer chips, from selling its most advanced machines to China.

The car industry is also taking a hard look at the risks associated with international suppliers. According to "Autonews", Volkswagen and BMW have been closing assembly lines in Germany due to the shortage of wiring harnesses manufactured in Ukraine by the German company Leoni. Tire manufacturer Michelin has recently announced it could close some plants in Europe due to logistics issues created by Russia's invasion of Ukraine.

Ukrainian companies, Ingas and Cryoin, account for about half of the world's neon production, which is critical for lasers used in chipmaking. Both Ingas, based in the beleaguered town of Mariupol, and Cryoin, based in the port town of Odesa, have shuttered operations due to the conflict. Moreover, Russia produces about a third of the global palladium supply.

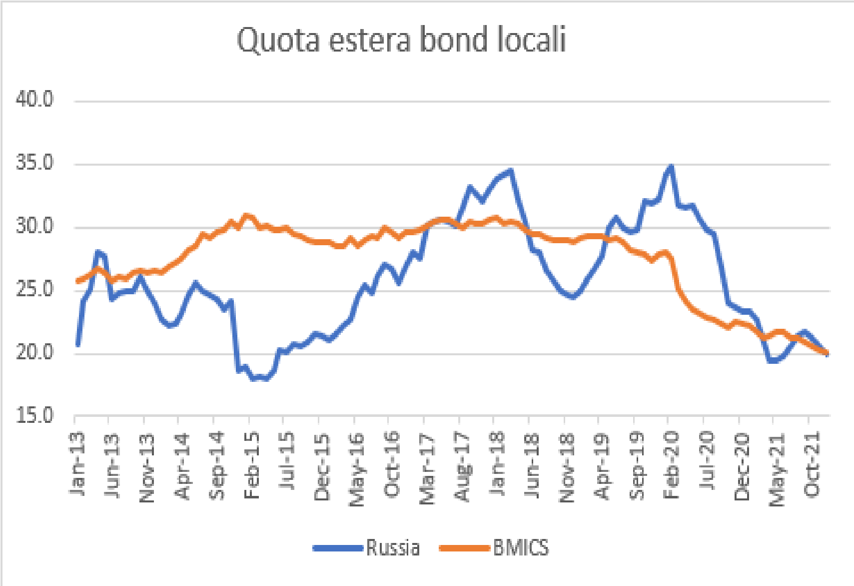
Part of the delay in Europe's reaction is due to the assumption that the driving force of globalization is finance. In the figure below, based on data from the IMF (Global Stability Financial Report), we show how the weight of Russian assets in several global indexes has been regularly declining over the last two decades. From a financial perspective, Russia is little more than a dwarf, and its detachment from the global financial markets is negligible.

Figure 5: Russia's weight in global indexes



The figure below shows how the share of foreign investors in Russian bonds (compared with the bonds of other "emerged" economies – Brazil, Mexico, India, China, and South Africa) is more volatile because it is exposed to political crises. The 2014 annexation of Crimea is a case in point, but it also shows how quickly investors can step back into the markets after the storm. This helps us consider that “deglobalization” has been a variable and dynamic process so far, whose interaction with political considerations has been changing and even reversing over time.

Figure 6: Foreign share of Russian bonds



The invasion of Ukraine, though, is considered an unprecedented event that has changed the pattern of the past decades. A “cold-war scenario” is considered the most likely, in which Russia can hardly find its way back into the trade relationships with the community of advanced economies. Russia’s inevitable drive toward China may represent a historical step in establishing an alliance outside the western community, de facto sanctioning the world’s bipolarity.

A “bipolar world” scenario has huge implications for Europe, which will be forced to reconsider its whole economic structure. Current trade statistics reveal Europe’s dependency on trade partners in specific sectors (Table 1) and products (Table 2).

Table 1

Product group	*Import/export ratio*	*Net imports*	*Main import partner*	*Exposure to the Ukraine?*
Motorcycles	1.4	EUR 2.4bn	Japan, China	Indirect
(Electronic) circuits and diodes	1.4	EUR 19.1bn	China	Direct
Batteries	1.7	EUR 9.7bn	China, Japan	Direct
Electronics and electrical machines	1.7	EUR 95.0bn	China	Indirect
Chemical wood pulp	1.3	EUR 1.9bn	Brazil	Negligible
Biodiesel	1.4	EUR 3.3bn	Argentina	Negligible
Antibiotics and pharmaceutical ingredients	1.3	EUR 17.0bn	Switzerland, US	Negligible
Zinc ores and concentrates	2.1	EUR 1.7bn	Peru, US	Negligible

Table 2

Product	*Combined share in EU import*	*World market share*	*Net import*
Gas*	37%	19%	EUR 30.0bn
Solid fossil fuels	34%	11%	EUR 4.6bn
Chemicals	28%	9%	EUR 1.0bn
Oilseeds	22%	33%	EUR 2.9bn
Oil	21%	8%	EUR 68.2bn
Fertilizers	18%	19%	EUR 1.5bn
Iron (products) and steel	17%	20%	EUR 6.9bn
Grains	16%	22%	EUR 2.1bn
Platinum, palladium...	16%	17%	EUR 1.2bn
Wood	16%	13%	EUR 3.1bn
Nickel and aluminium	13%	10%	EUR 2.7bn

Technology decoupling, broadly defined as the undoing of cross-border trade in high-tech goods and services, might be the most interesting scenario. A special cause for concern is that three-quarters of the world's production capacity of chips are concentrated in East Asia, with China and Taiwan projected to have the world's largest share in production by 2030. As researchers have observed, the localization approach is no panacea. Since China is now a dominant, if not sole, source of thousands of components, reducing dependence on it in many instances will take considerable investment and time. A case in point is Intel's recently announced plan to spend $20 billion to build two semiconductor factories in Ohio. The first plant won't begin production until 2025. Similarly, researchers have pointed out that the European effort to reduce its dependency on the rest of the world may require years: "The European Chips Act promises investments in Europe to increase its global capacity share from 9 percent to 20 percent. These solutions do not address the short-term shortages, with any added capacity going online no earlier than 2026. To give a sense of the European level of dependency, the Apple 2020 supplier list comprises 204 foreign firms spread over 43 countries and 6 continents. But only 13 of those firms are European and only one Italian."

Building on the unity shown in response to the Russian invasion, the US and the European Union have understandably decided to intensify their cooperation on the technological front. The US-EU Trade and Technology Council (TTC) held its second ministerial meeting in Saclay – Paris, France on May 15-16, 2022. In the final communique, the delegations observed that, "the United States and the European Union, home to 780 million people who share democratic values and the largest economic relationship in the world, will advance the TTC agenda on a number of critical economic and technology policies and initiatives designed to strengthen our bilateral economies, meet current geopolitical challenges and update the rules of the global economy." The US and the EU will collaborate closely on emerging technology standards, climate and clean tech objectives, data governance and technology platforms, information, and communication technology services' (ICTS) security and competitiveness, and the misuse of technology threatening security and human rights. The TTC working groups are also coordinating on export controls, investment screening and security risks, and a range of global trade challenges, including countering the harmful impact of non-market, trade-distortive policies and practices on technological development and competitiveness in sectors of shared priority. To ensure that the government dialogues are informed by the broad perspectives of the US and EU communities, the TTC working groups are continuing robust engagement with a diverse range of stakeholders, including those in industry, labor organizations, think tanks, non-profit organizations, environmental constituencies, academics, and other civil society members.

The initiative has great political relevance, not only for the importance of the technological sectors in the economy but because it intends to set standards valid for the rest of the world without – at least in principle - precluding third countries' access to their market. It is a sign that security concerns cannot forcedly coincide with fragmentation or outright deglobalization. On the contrary, it may indicate that globalization requires stronger rules. The fact that Europe and the US work on those rules together is a step in the right direction and could be a footprint in other sectors of global interaction, first of all, in the all-important environmental policies.

The TTC has also initiated a new Cooperation Framework on issues related to information integrity in crises, particularly on digital platforms, with a focus on ongoing issues related to Russian aggression, including Russia's actions to manipulate and censor information. This is a clear signal about the defense of the prerogatives of liberal democracies and an invitation for other countries to adopt it if they want to do business with the US and Europe.

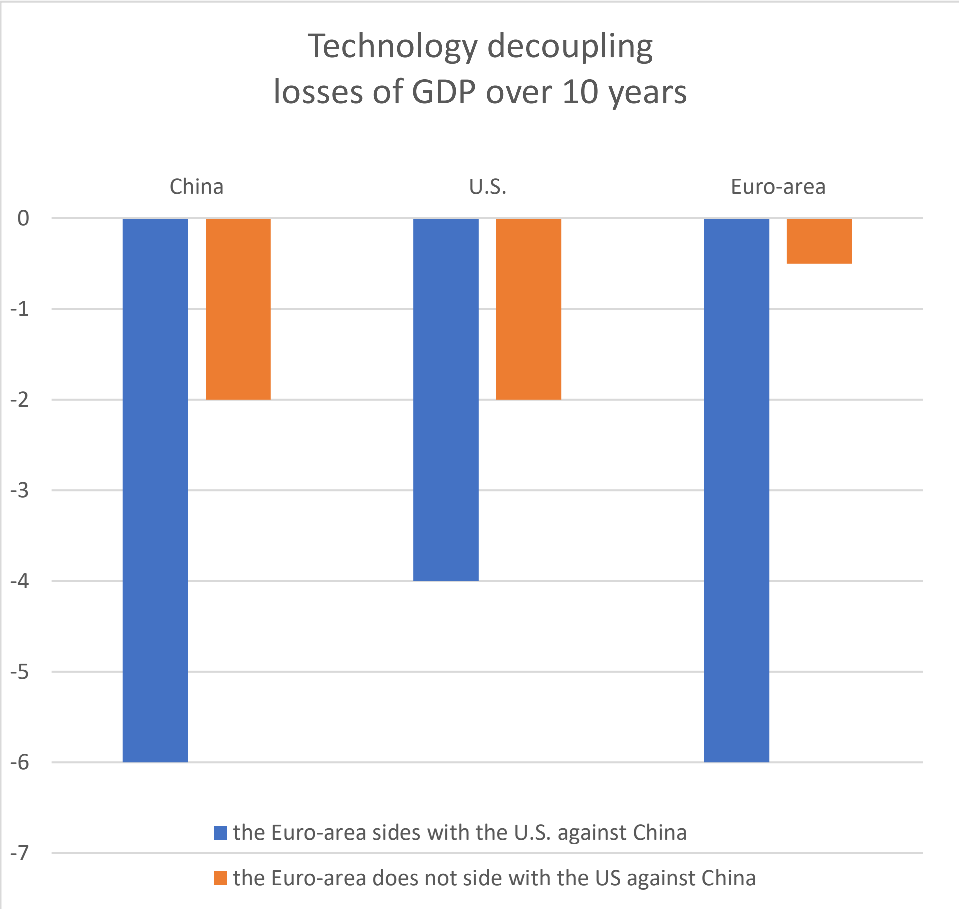
As Rogoff observed soon after Russia's invasion, "Russia, of course, looks set to be isolated for an extended period, but the real hit to globalization will happen if trade between advanced economies and China also drops, which is unfortunately possible in some scenarios. A major realignment of the global economy can hardly be good for geopolitical stability." In a recent enlightening lecture held on May 25 at the School of European Political Economy, former president of the EU Commission Romano Prodi explained why China – representing 25% of the world's population but 5-6% of agricultural lands and an even lower share of natural resources – will need to maintain open economic relationships with the rest of the world. This is a critical argument for those who believe that Western democracies should not write off future cooperation with Asia.

Although Russia and Ukraine only accounted for about 4 percent of global GDP in 2021, the interconnectedness of the global supply chains has caused this conflict to have rippling effects on industrial supply chains. The EU had recognized its strategic dependence on some foreign inputs even before the pandemic and had started to seek ways to increase its autonomy – a quest that has been accelerated by the impact of the coronavirus. To improve the resilience of supply chains, the EU is applying a policy mix that aims to increase domestic capacity, diversify suppliers and support the multilateral rules-based trade environment; it has also enhanced its cooperation with the US on supply chains.

A staff document for the EU Commission has identified 137 products as dependencies in the most sensitive ecosystems. 34 (representing 0.6% of extra-EU import value of goods) could be considered as potentially more vulnerable given their possibly low potential for further diversification as well as substitution with EU production. At the same time, the EU can also be a source of dependency vis-à-vis important trading partners. The analysis provides examples of products where the US is highly dependent on the EU ("reverse dependencies") and vice-versa. Furthermore, "common dependencies" that the EU and the US share vis-à-vis China and the world can also be identified.

The figure below elaborates on the results of an interesting simulation conducted by IMF researchers, who reveal a marked worsening of GDP growth in the case of "technological decoupling" for China and Europe but relatively minor consequences for the US in the case of trade conflicts between China, the US, and Europe once the latter's choices are restrained by the strict adhesion to the transatlantic trade partnership. From this perspective it is clear how different the US and the European vulnerability is in case of trade conflicts and hard-nosed political confrontation between China and the West.

Figure 7



It is of great importance for Europe that transatlantic cooperation is developed in the defense of democratic values but without ideological prejudice against other countries. A bipolar world might represent a severe blow to the European economy with potential consequences on popular consensus for the transatlantic alliance and even national democracies. Dividing the world, prejudicially, between democracies and autocracies could result in a self-defeating exercise.