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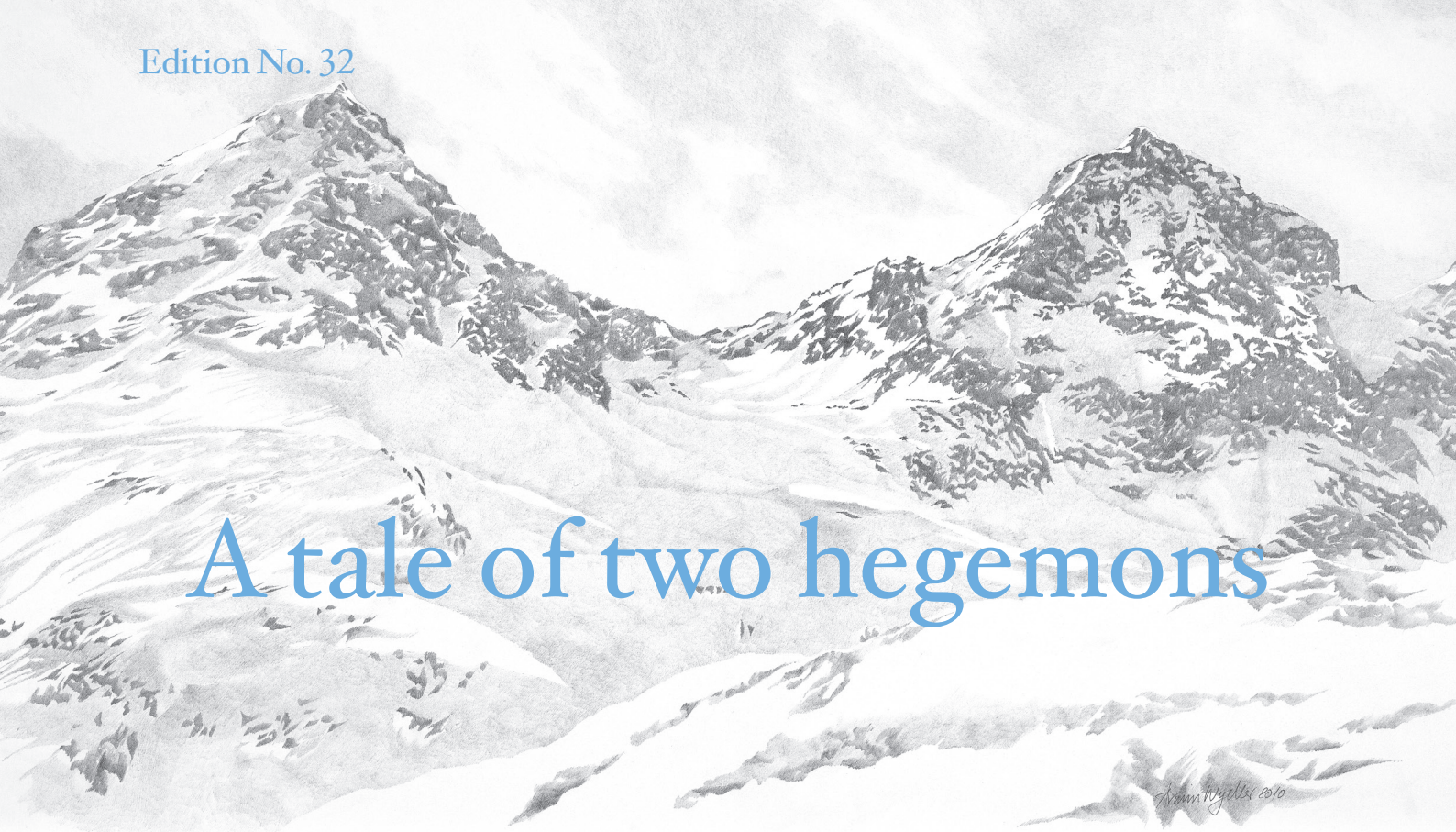

# A tale of two hegemons

bergsicht

CHAPTER 1

## Globalisation in your pocket

Much has been written about trade wars, national interests and splendid isolation of late, and there has been no shortage of warnings about imminent and dire consequences, should the situation escalate. It is hard to escape the impression, however, that the tariff ping-pong begun by US president Donald Trump is being hyperbolised for the benefit of a global public that in turn is being egged on by a media permanently salivating for sensation; the armed conflicts in Syria, Afghanistan and elsewhere are dragging on interminably and no longer provide enough red meat to sate voracious editorial boards, especially as any "moral high ground" once claimed by one side or another has now fallen by the wayside. Against such a backdrop, it is entirely propitious to be able to talk up a match between Trump and Xi Jinping – with a few European ballboys and girls watching from the tramlines – into this year's hot topic.

And there is some truth to these assertions, certainly: the tone in dealings between supposedly friendly nations has coarsened, and odd – indeed, sometimes abstruse – mercantilist calculations are being made. Instead of promoting business (and thus the economy), trade ministers are spending their time imposing tariff barriers, and carefully targeted stabs in the back with the stiletto of import duties have already been administered, breaking a taboo on the floodlit stage of international economic relations. What few care to mention is that a fairly dirty and ruthless "war" was already being waged behind the scenes in the less visible (and considerably murkier) world of non-tariff trade barriers; such matters are complex, of course, and impinge on highly sensitive issues in advanced economies, such as often conflicting visions of environmental/development policy, domestic agriculture, "accompanying measures" (in the case of EU-Swiss bilateral agreements), and much more besides.

Although the following remarks describe and discuss the irresistible rise of a new hegemon – China – and we take this as an opportunity to ponder some do's and don'ts in our own backyard, one thing should be made abundantly clear from the outset: the case for increased exchange and trade between countries, a trajectory towards far deeper *globalisation*, is unambiguously borne out by *economic logic*. Or, to put it another way, the protectionist strategies certain politicians are currently cooking up – and indeed have recently implemented – contradict the fundamental and largely undisputed economic principles elaborated by David Ricardo (1772 – 1823). His theory holds that cross-border exchanges of goods between producers with relative (or "comparative") advantages and

disadvantages promotes prosperity *on all sides*, leaving no one holding the short end of the stick – so international specialisation makes sense. Our readers need look no further than the iPhone in their pockets for a practical demonstration of this; it consists of several hundred components sourced from a host of countries. The memory, camera and screen come from Japan, for example, the RAM and processor from South Korea, and the transmission technology, battery and chassis from China; Switzerland – interestingly – supplies the 30-or-so screws that hold the whole thing together. Because the component manufacturers themselves likewise make use of specialised division of labour, however, such stated origins tell only half the story; a portion of their manufacturing processes may well have been outsourced to another country such as Malaysia or Thailand. In other words, in a world of economic specialisation, it is scarcely possible to ascertain what comes from where. While tracking precise provenances matters to statisticians and the guardians of national accounts, it is fairly irrelevant to the rest of us. Component origins are in any case something of a moveable feast, as the manufacturing process is continually being optimised and ever more efficient solutions must constantly be sought – an economic principle more iron-clad even than Ricardo's.

In much the same boat as the smartphone is the first "Chinese" commercial aeroplane, which has become a poster child for economic nationalism in the country. This is nonsense; not even the name of the plane is "national" (Comac stands for "Commercial Aircraft Corporation of China Ltd"). Pretty much all the avionics are from the USA (courtesy of Rockwell, Honeywell and Parker Aerospace), the turbines are from the Franco-American manufacturer CFM, the de-icing technology from Liebherr (Switzerland/Germany) and the tyres are Michelins – from the States(!) as well. Only the hardware for the tailplane and fuselage is genuinely Chinese. Here too, look behind the scenes at the components' manufacturers, and you'll be faced with a bewildering array of companies and countries of origin: this is globalisation, red in tooth and claw, and every politically motivated deviation from its path (e.g. import duties) betokens a loss of economic efficiency – and hence a waste of resources.

There is no reason to doubt the desire for cost optimisation (nor yet the refinement of production techniques or component procurement required to achieve economic success) inherent in all commercial undertakings; the enormous decline in information and transaction costs made possible by IT and communications technology means that the global availability of more or less everything has soared, and anything that is manufactured is produced with this universal availability in mind. Pretty much every region of the world has one or another specific ace up its sleeve: one lot have rare earth elements, the others work at very competitive rates, others again are very precise, or very fast (or both), a fourth group can produce rubber for tyres or steel for screws, and so on...

Now that we have spelled out the powerful economic logic behind *maximising the exchange of goods and services and promoting greater globalisation*, we may begin the analytical portion of this *bergsicht*. In it, we explore the rise of China as a military, economic, political and cultural power, and reflect on how we might relate to this emerging prince of princes, this new hegemon.

CHAPTER 2

## From mid-size regional player to global power

Let's begin with the comparatively easily determined figures for military spending, arsenal size and availability of military manpower. With an annual defence budget of some USD 220 billion, China occupies second place on the global league table, trailing only the USA (approximately USD 600 billion). A long way back down the track (on about USD 60 billion) we find Russia, Saudi Arabia and India, while France, the UK, Japan and Germany comprise a fourth group on about USD 50 billion apiece. The Chinese have more than doubled their expenditure over the last ten years, even as the UK and the USA have been reining in their outlays slightly. It is safe to assume that the figures for China have been massaged down, and that a portion of the funds supposedly disbursed for technology ought actually to be allocated to the defence sector; as a percentage of GDP, military spending is probably around 2 to 2.5% (USA: 3%).

Whatever the precise details, this is a considerable sum. And what do they have to show for it? An army in excess of 2 million combatants (with a reserve in the region of 500,000 additional troops) supported by some 10,000 tanks, lightly armoured personnel carriers (approximately 5,000) and artillery *en masse* (10,000 guns), not to mention nigh on 1,000 fighter aircraft and 1,600 helicopters. The USA outguns them by a country mile in every category (apart from ordnance and nominal troop strength), and this superiority extends still further when non-conventional weapons are included: China's 260 atomic warheads are dwarfed by America's 7,200. On the high seas, China has hitherto concentrated on frigates, corvettes and medium-range submarines, but the USA truly rules the waves vaunting an armada of destroyers and aircraft carriers. This superiority is also reflected in the number of military bases; China boasts precisely one (Djibouti) beyond its immediate sovereign sphere of influence, although the Americans, the French and the Japanese also maintain a presence there. The USA has built up a network of 29 naval bases in 17 countries.

Beyond this purely numerical perspective, the assumption has to be that, in making ostensibly economically motivated investments in extraterritorial harbour facilities, China is in fact pursuing a military agenda. Given that the three high-profile ports of Gwadar (Pakistan), Hambantota (Sri Lanka) and Koh Kong (Cambodia), for instance, are haemorrhaging money and are likely to continue doing so, the possibility of dual use cannot be excluded in such cases; a veil of secrecy has certainly been cast over the kind of infrastructure being installed in these sites.

By contrast, China's efforts to extend its borders in the South China Sea, i.e. on its own doorstep off the coast between Vietnam and Taiwan, are as plain as a pikestaff. Strictly speaking, under international law, territorial waters extend no further than 12 nautical miles from a state's coastline, but the Chinese are systematically backfilling artificial islands off Malaysia and the Philippines in open defiance of the edict passed by the Permanent Court of Arbitration in The Hague. Their efforts to acquire an interest in ports up and down the Straits of Malacca – clearly a strategic bottleneck for any naval operations in the Pacific theatre – are also impossible to ignore.

What we think is taking shape here is, on one hand, a highly proactive and realistic power-grab to establish *ascendancy* in the immediate vicinity, and on the other, an armaments programme that is being pursued with great vigour (and no expense spared) to achieve a certain *naval dominance* in the Pacific region, and the *Indian Ocean* in particular. After all, the missing piece in the colonial expansion of the People's Republic along the Silk Road (to which we shall return in subsequent chapters) and in Africa is the option to assert claims to ownership – and to be able to secure them over the long term. Six sister ships are due to roll down domestic slipways over the next few years to join the lone (Soviet-made) aircraft carrier mentioned above, and the appropriate defensive assets required to protect these valuable mobile bases (rockets, support ships and submarines) are also being laid in.

What might come to pass, and with what probability? We believe that the Chinese top brass are proceeding on the assumption that they have already secured their perimeter along the South China Sea, international law be damned; President Putin has already demonstrated how *de facto* situations can be established with his annexation of the Crimea. China knows it would be largely immune to sanctions, and that the price of any such punitive measures would be prohibitive for the industrialised nations. Given the asymmetrical advantages of the Chinese, we doubt that the annexation of the South China Sea would amount to a *casus belli* for the USA. We feel that any attempt to resolve the Taiwan question once and for all is less likely, however, as the danger of direct military confrontation with the USA is far too high for the moment – but the Philippines would seem to us to be in latent danger, not least as internal political disputes look unavoidable. If the Chinese are gathering their strength for a "Big Push" into the Indian Ocean – realistically, they could achieve this only after definitively securing the South China Sea – they would need to find a reliable littoral state in relatively close geographical proximity. The continuing necessity of the difficult *passage obligé* through the Karakorum, with the attendant danger of a direct – and presumably undesirable – confrontation with India, militates against Pakistan. The tactical geography would suggest that the lot falls to Thailand instead, but thoughts of that kind are rather more speculative than realistic.

Overall, there is indeed much to suggest that China is *playing catch-up* like never before with its armaments programme in an attempt to reinvent itself as a global military power. Its sway is being extended concentrically towards Africa and along the sea arm of the Silk Road (China's maritime strategy is known as the "String of Pearls"). China appears to be keeping its considerable terrestrial might on the back burner as a domestic *ultima ratio* for now; we have yet to see compelling evidence of any push along the land-based portion of the Silk Road into the soft Asian underbelly of the former Soviet Union. One final point that should not be forgotten in any summing-up is that China has amassed virtually *no combat experience* since the 1970s – in direct contrast to the USA, which has repeatedly had recourse to its armed forces over the past few decades, albeit with deplorable results. But the tough lessons are often the most educational... Is China "dangerous"? Yes, to the extent that its power is undeniably increasing, and yet at the same time no, given its historic lack of experience in conducting military operations abroad, and given the risk aversion of the country's *nomenklatura*. But the potential danger is growing in lockstep with the country's arsenal of weapons, and generals with time on their hands will eventually be tempted to play with their toys.

CHAPTER 3

## The only real dynamic

That China has managed to leap to the pinnacle of the global economy within a mere two-and-a-half decades is already being treated almost as a matter of course, a historical inevitability; this is of course anything but the case. Without that persevering, intelligent and forward-looking ruler Deng Xiaoping, all this might never have happened – or might only have happened later and on a far more modest scale. Your author still has vivid memories of the tales told by his economics tutor and intellectual mentor Karl Brunner (1916 – 1989) about intensive consultations with Deng; perhaps only Milton Friedman could have been a more liberal-minded and market-orientated interlocutor. There is a strong chance that, rising above all ideology, the notionally Communist Deng knew exactly what his country needed after the Mao

dictatorship and the Cultural Revolution. Yet knowing precisely when to set such fundamental change in motion bespeaks rare statesmanship. To date, China's secular awakening has proceeded systematically and consistently, and Cassandra-like prognoses of any let-up in growth have invariably proven too pessimistic; the collapse of the banking system has been prophesied as routinely as the disintegration of the major state-owned conglomerates, and yet each time, the country has shown itself to be far more elastic and robust than had been assumed.

In 2000, China's GDP was around USD 1,200 billion, or 3.6% of global output. That same country is now number three in the world, with a GDP of USD 12,000 billion, or 15% of global output. Labour productivity, on the other hand, is still comparatively low (about a third of that recorded in the USA or Germany). Consistently low labour costs have meant that the country is still highly competitive, however. Automation levels also remain low; the image of countless industrious worker ants is not entirely fanciful. Capital is often allocated to industrial companies via political old-boy networks rather than according to economic criteria, and there is a dearth of competent executives. Nonetheless, in a world of ongoing specialisation, China has been smart enough to fill the role that the industrialised nations either no longer wanted or were unable to hold on to. "Made in China" has become the rule, rather than the exception, for consumer products of every kind. Part of this specialist division of labour includes the odd – not to mention ominous – situation whereby the Americans, who seem quite incapable of putting money away for a rainy day, are allowing the Chinese (the sellers!) to finance their consumption of Chinese goods. The USA's public debt to the People's Republic is correspondingly high and currently stands at USD 4,700 billion, with a further USD 350 billion being racked up every year, on average. Trade with Europe is less subject to distortions of this kind, as the Old World has hitherto been able to supply the Chinese with expensive capital goods.

China's sustained growth at rates well north of 6% has enabled the most radical reduction of poverty ever witnessed – in an extremely short space of time. Although some in the development aid industry continue to wring their hands over a "widening gulf between rich and poor", this assertion only describes the gap between the poorest and specific top earners/the super-rich; the impressive increases in the income levels of hundreds of millions of the poorest in China is of far greater import. Until recently, hunger, malnutrition, physical deformity, inadequate schooling, etc. were commonplace and accepted as normal; and while such scourges continue to affect broad swathes of the country – poverty is still widespread and the ecological repercussions of the boom are being felt precisely by the poorest – any action that results in a doubling or tripling of the lowest incomes for a population of over a billion is unquestionably a quantum leap in the truest sense of the word. Even more impressively, and in stark contrast to other countries in the formerly Communist East (most notably Russia), something approaching a prosperous middle class has emerged in China over this period. Economists put the size of this demographic at 300 to 400 million people – over half the population of Europe.

That sacrifices have had to be made for such exponential development will come as no surprise to the sceptical observer. Acquired rights (property rights in the strictest sense do not apply) are frequently trampled underfoot should the national interest so require; we would remind readers of the collateral damage inflicted by the Three Gorges Dam, and of the city of Datong, which was virtually obliterated to make way for a project intended to create a new and improved cultural city. Hundreds of thousands lost their homes over night; China is incredibly elastic, as we have mentioned.

After welcoming Western foreign direct investment with more or less open arms for many years, the Chinese are themselves now going on shopping sprees abroad with their accumulated riches. The largest such deal to date came in 2016 with ChemChina's takeover of Syngenta, a listed company headquartered in Switzerland, for USD 43 billion. Pirelli, the Italian tyre manufacturer, had gone the same way in 2015 for close to USD 8 billion. HNA, a Chinese air carrier that has attracted its fair share of controversy, acquired the flight logistics groups Swissport and Gategroup during the same period, while Volvo, the once-proud Swedish car manufacturer, has likewise been firmly in Chinese hands since 2017.

Such increased activity by the Chinese on our – open – capital markets has led to discussion of how to deal with state or quasi-state investors from the People's Republic; the turbulence surrounding the HNA Group will presumably only stoke this concern. For the moment, suffice it to say that there is no question of a systematic imbalance between direct investment in China and the latter's direct investment in our economy. Put crudely, the most you could say is that the Chinese have been mirroring what the West has been attempting – and indeed accomplishing – in China since the 1990s. Incidentally, the former National Development and Reform Commission (NDRC)'s "negative list" was recently updated; sectors such as shipbuilding, the car and aviation industries, and considerable portions of the financial sector are now (at least nominally) accessible without let or hindrance to foreign investors. Petrol station operators have similarly flung open their doors and even the electricity market has been partially liberalised.

Such moves are hardly prompted by altruism; the Chinese leadership have never had any illusions about the deficits in their economy and are assuming that foreign competition will galvanise sluggish domestic manufacturers. Under its "Made in China 2025" programme, ten key sectors have recently been

defined in which China wishes to turbo-charge growth, viz. aircraft manufacture, the car industry, agricultural plant production, robotics, maritime technology(!), railways, energy-saving vehicles, medical technology, IT and the power sector. It is certainly no coincidence that the sectors dropped from the negative list mentioned above match the list of priority growth sectors almost exactly; they also correspond, in part at least, to World Trade Association (WTO) requirements.

In short, the momentum of the world economy lies unambiguously in China's court, and this will remain the case for the foreseeable future. Moreover, it is increasingly difficult to accuse China of non-reciprocity as the country is seeking to boost the quality of its domestic economy through greater openness. These qualitative measures will result in more balanced manufacturing conditions, and marked improvements in productivity will, in turn, be accompanied by a pivot towards greater value added and enhanced services. This is both good and bad news for Western industrial nations whose relationship with China has hitherto been distinctly one-sided: while Germany, the global export champion, will probably have to cede some of its dominance (because China will itself wish to manufacture the equipment previously produced by Germany, and will be in a position to do so, especially in the car industry), the trade deficit between China and the USA will inevitably narrow – whatever Donald Trump might have to say on the matter – simply because Chinese consumers are beginning to purchase what the Americans have previously been buying on tick. If this proves to be the case, the Americans will have to start saving and investing for the first time in decades – who says economics is "the dismal science"!?

CHAPTER 4

## Not just a colossus

Where does the People's Republic of China stand politically? Given that the reign of the Communist Party has lasted for some seventy years now, we may safely compare it to the Song or Ming dynasties that helped China to achieve wealth and power. While the regime might accurately be described as undemocratic or dictatorial, it would be wrong to assume a monolithic set-up, with an oligarchic leadership clique free to take heed of naught but its own wishes; the situation is not that simple. The ruling cadre's hold on power is certainly based on a sophisticated and brutal regime of repression of anyone brave enough to kick against the pricks, as is betrayed by the summary justice it metes out (death sentences are regularly handed down for "crimes" in circumstances that are opaque at best). The arbitrary application of power ensures that a certain level of fear is maintained in the population; the "rule of law" in the Western sense is simply not a reality in China today.

These negative aspects are but one side of the coin, however. There is a flip side, as many experts on the subject will confirm. Certain structures have been put in place to curb the worst excesses of despotism and empire-building. While the dissatisfaction of the people – or of certain classes/cohorts – is undeniable, it is mitigated by three factors: first, by the economic boom that has been under way for more than 20 years, along with the increased prosperity it generates; secondly, by the fact that this generation is the first to enjoy ever-expanding latitude for personal development; and thirdly, by levels of public security, stability and consistency that are second to none. Ultimately, people are prepared to put up with the darker facets of the regime, which sees itself as a technocracy, as long as "it" continues to uphold these standards. This is a system in which performance pressure acts as a kind of corrective and it is thus not entirely far-fetched to draw parallels between the *Chinese system of government* and the management mechanisms of *large, publicly owned* companies under Western capitalism (diverse shareholder base, governance in line with shareholders' voting rights). Indeed, in a purely structural sense at least, there are striking similarities between the National People's Congress and corporate annual general meetings. Seen in the cold light of day, there are comparable oligarchic coteries within companies that, rather like China's Communist party, "fix" questions of strategy and succession before allowing the official decision-making bodies to rubberstamp their choice(s) *nemine contradicente*.

It is also worth noting that China's leaders project the same professional, sovereign, well-informed and consistent image to both their domestic and non-domestic audiences. Anyone glancing through the Chinese government's 13th Five-Year Plan will immediately be reminded of similar strategy documents from the world of Western capitalist commerce. The plan distinguishes between quantitative and qualitative objectives: on the quantitative score, they wish to continue growing at an annual rate of 6.5% (investing 2.5% in research and development); to house 60% of their population in cities by 2025; to reduce environmentally harmful emissions by 40% (to 45% of 2005 levels) and increase the share of non-fossil fuels to 15%; to lift a further 77 million Chinese out of poverty; to replace the one-child policy with a two-child policy (and thus guarantee their pensions); and finally to turn 106 state-owned enterprises into 40 world-class companies. A far from unreasonable set of ambitions! And the same is true of its qualitative objectives, which include transitioning from investment-led expansion to innovation-led growth, deleveraging the banking system and state-owned enterprises, and opening up markets by making them more attractive to foreign direct investment.

It is clear that all of these explicit – and, on the face of it, perfectly reasonable – objectives serve one overarching purpose: to keep the Communist "dynasty" in power. In Xi Jinping, the Party now also has a figurehead who is likely to maintain his hold on power beyond the formally ratified period of office (two five-year terms) and who has real personal influence both at home and abroad. Who can forget his appearance at Davos in 2017, when Xi – of all people – proclaimed himself the saviour of the WTO; this performance was opportunistic statecraft of the highest order.

And yet, even the smartest heads and strongest leadership elites occasionally drop the ball. Even the largest organisations – indeed, these in particular – cannot escape the fact that real-world decisions always involve a certain amount of residual uncertainty. This is just as true for capitalist companies as it is for the grand viziers of the Chinese regime. This uncertainty is in one respect baked in, as future events (and, as such, unknown quantities) are necessarily hostages to fortune, but in another it is specifically home-baked, as strongly hierarchical structures suffer from an information deficit arising from "systemic euphemism". Good news tends to travel fast on its way upstairs to the boardroom; less fortunate tidings are hushed up or glossed over.

China enthusiasts – and we know a few – should be reminded of these conclusions at regular intervals. Even China *can't work miracles*, and much of what looks so promising today may well have quietly withered on the vine in a few years. And there is a further point: it pays to take a look behind the veil of grandiose strategic branding. We too find the notion of the Belt and Road Initiative (the Silk Road with its two arms, terrestrial and maritime) fascinating; but anyone even vaguely cognisant of the small print will be aware of the colonialist subtext of this mammoth undertaking. Unlike the Marshall Plan, which is invariably mentioned in the same breath, the Silk Road project is not about helping temporarily floundering, but fundamentally healthy, economies to find their way back to the sunlit uplands of autonomy, it is about snagging mega-contracts for Chinese construction conglomerates while chalking up even more on the tab of countries that are already mired in debt. If the projects then fail to deliver on their promises, the result will be a new political dependency or "satellite" status for such benighted lands. For all the hype, it is (as ever) worth retaining some critical distance.

CHAPTER 5

## Nudge culture

Managing a population of well over a billion souls is an extremely challenging undertaking. That the system in China has, with a few serious exceptions, been working successfully since the demise of the Cultural Revolution is little short of miraculous – and a situation for which we cannot be thankful enough. Imagine if the chaos in the Middle East (which has not been brought about entirely without Western connivance and contribution) had also spread to Chinese soil: the upshot would have been an inconceivable decline in prosperity, both there and in our own back yards. In this respect, the question of how such an immense population is to be kept docile and – to the extent that this is possible – satisfied with its lot is of paramount interest, indeed of existential global significance.

We have already mentioned the element of brutal and arbitrary suppression, but in the next section, we wish to examine a second, more subtle method of *social engineering* that revolves around the notion of *nudging*. And what is that, you may ask? It is well-known that living beings react to incentives, be they of a positive or negative nature; we know all about sticks and carrots from donkey rides. In a nutshell, nudge theory postulates that, given a comprehensive system of incentives affecting the lifestyle of each individual (not to mention entire cities and companies), such individuals, groups and entire cohorts of the population will always do the "right thing". The system of incentives should naturally accommodate fine gradations, tolerate certain "mistakes", allow for redemption and even hold out the possibility of forgiveness; by the same token, enticing rewards should beckon for the productive and the principled.

To this end, a system of "social credit" has been developed in China for individuals and firms alike. Good behaviour is rewarded with plus-points, while straying from the path of righteousness attracts black marks. Depending on their points tally, citizens are permitted to travel to certain areas or even to venture abroad, while layabouts and malcontents have to stay at home (they aren't even allowed to buy public transport tickets, let alone hire a vehicle). Consumer behaviour is also to play a part in individual ratings, as are one's dealings with others: those consorting with low-rated, "bad" people will be marked down accordingly.

Under the aegis of a specialised authority, the Central Leading Group for Comprehensively Deepening Reforms, eight private providers have been licensed to create algorithms for this incentive scheme. Interestingly, these include the Sesame Credit Group, the entity responsible for credit card business and private loans within Alibaba's subsidiary Ant Financial. This will mean – over the medium-term, at least – that

China's money and credit card infrastructure and its incentive scheme will be living under one roof; in practice, both private and corporate financing will be contingent on relevant social ratings.

The prototype that Sesame Credit has created for individual ratings includes the following sliding scale for evaluating good behaviour: 1. Payment habits (how punctually are electricity and telephone bills settled?), 2. Contractual compliance (timekeeping, fulfilment of work contracts and the like), 3. Truthfulness in respect of personal details (home address, telephone numbers used, etc.) 4. Online and consumer behaviour (choice of videos, leisure and gambling, number of Pampers per child/per unit of time, etc.), 5. Interpersonal relationships (who is fraternising with whom?). The list of positive incentives encompasses the granting of consumer credit, the option to hire a car and a fast-track route to procuring a Schengen visa. On the flip side, a poor rating may result in exclusion from a particular profession or in being unable to send your children to certain schools. Thanks to Big Data, the technical prerequisites for the comprehensive implementation of such an incentive scheme are already in place. A pilot scheme is currently underway in the region of Xinjiang in northwestern China, an area inhabited by Uyghurs of Turkic descent that has encountered social and political unrest; some 800,000 separatists have been consigned to re-education camps and facial recognition CCTV cameras have been erected at every road junction.

We share the fears that the prospect of such a system elicited in George Orwell – the fact that every aspect of one's life is to be captured and documented is especially disquieting. This is no time for Western condescension, however – much the same is also happening in our purportedly freer society, with the simple difference that data capture is (still?) being carried out secretly (NSA) or surreptitiously (Google, social media, insurance companies) and is not (yet?) being consolidated; whether that is really any better than an overt system designed to nudge citizens and manage an entire society is open to debate.

CHAPTER 6

## Side by side

We have all long since accustomed ourselves to the presence of an ever more important actor on the global economic stage, and we are all also well aware of China's increasing political leverage. And yet, while China-watchers are generally well informed about issues like the country's rearmament programme, the socio-cultural ramifications of its comprehensive, Big Data-powered social engineering drive remain largely off their radar. And we feel there is a genuine *blind spot* in apprehending quite how *methodically* China has gone about cementing its power (e.g. through the systematic deployment of highly coordinated processes, not only in economic, military and political affairs, but also within the socio-cultural arena). Unlike the Soviet Union's attempts back in the day to keep up with the USA by means of the Warsaw Pact and Comecon, China's efforts to achieve the same goal have every chance of success. Indeed, we may yet see the Chinese moving into pole position on every front, thanks to the consistency mentioned above and the all-too-apparent weakness of traditional industrialised nations (i.e. their fragmentation, and the vulnerability of their ruling political cadres to the vagaries of democratic whim). From a historical perspective, this should come as no surprise: fragmentation has been the ultimate fate of ascendant power structures for millennia.

Renaissance, Enlightenment, the Modern period and thus Western superiority *per se* as a relatively ephemeral excursus within a much longer tale: this may well be the way the wind is blowing. Broken down to the scale of individual or corporate lives – i.e. with respect to the next five, maybe ten years – this means we must start coming to terms with the fact that we will have a second, ever more powerful and increasingly influential, hegemon to deal with. The US-dominated Atlantic Age has not gone away and it continues to shape much in our daily lives – think of the ubiquity of the USD as the only genuinely global currency, for example. But the reality of China is waxing increasingly large. A *tale of two hegemons*, standing side by side, with a good part of the world (Africa, half of Asia, Europe) lying between them: this is the challenge ahead.

This is in no way to suggest that military confrontation is inevitable (we have expressed our views on the precarious security situation in the South China Sea in chapter 2). Nonetheless, it is hard to imagine that China will be able to pursue its interests in this corner of the world without resorting to force – the situation *is* dangerous (although the itchy trigger finger of the USA, the old hegemon on the block, must be considered equally threatening, all things considered, and the Americans may become more bellicose as their power inexorably wanes). Equally, they may revert to focusing on issues closer to home, preferring to pursue a Monroe Doctrine-style policy of non-interventionism. One thing is certain: history teaches us that a phase in which one hegemon declines as another rises is typically fraught with conflict.

One of the non-cooperative options open to the old hegemon is a long-underestimated instrument of power: the mighty dollar, the *de facto* global currency. As every USD-denominated transaction has to pass through US sovereign territory and the American banking system is thus always involved in global trading activity, the US government has at its disposal a handy big stick with which to further its political ends. It need not even be applied directly; its *principal force* is felt as an *anticipatory effect* – the mere threat of cutting off an institution's access to the US financial

system is more than enough to make the international banking system fall into line. These days, no bank would dare to work with an insubordinate institution (one doing business with "unmentionables" like Vekselberg, a citizen of a "rogue state", for example). This is how sanctions and other measures are applied; the cost of such action is enormous destabilisation of international trade, however.

We believe that China will soon set about overcoming this Achilles heel (its lack of autonomy in processing international payment transactions) – and it will be all the quicker about its business the less restraint the old hegemon displays in applying the kind of pressure described above. Much like his predecessor, the current US president seems to derive a good deal of pleasure from the extraterritorial application of his country's laws; hegemons will be hegemons... China will attempt to elevate its currency to the status of a global trading currency, not least emboldened by the realisation that the EUR will never be able to fulfil this role. While we doubt that this will have been accomplished by 2020, as some have suggested, the great transformation in the global currency system is coming.

Two hegemons, side by side. What strategic options might present themselves to the rest of the world caught somewhere in the middle? We see five:

1. A consciously intensified *rapprochement* by certain countries – perhaps even certain companies – to one side or the other. Let's call this option "Cozying Up".
2. Resolute, proud non-alignment – without taking on all the trouble involved in wanting to become a hegemon yourself. To achieve this, you have to be big and independent enough, and also fairly powerful – like India. We'll call this option "Indian Pride".
3. An attempt to rise to the rank of hegemon yourself. Europe might indulge itself in the illusion of this option, in the worst case even making common cause with Russia or Turkey. We dub this option "Three's a Crowd".
4. Agile and (wherever possible) neutral exploitation of opportunities as they arise. We'll call this option "La Suisse Existe Toujours"...
5. Resolute and unflagging attempts by the rest of the world to rope the two co-existing hegemons into the multilateral system (IMF, WTO, UN, etc.). We have christened this option "One World 2.0".

The appeal of these strategic options is that they are they are not mutually exclusive – they can be pursued simultaneously. The challenge for all those who – given the exhortation to greater global exchange in our introduction – must continue to bet on globalisation lies in the *enforced multipolarity* imposed by all these options, with the exception of the first. *One hub is not enough*, seems to be the message, and this is as true for industrial firms manufacturing around the globe as it is for investors seeking reasonable geographical diversification for their assets. What should be produced where in future? Will efficiency criteria have to be complemented by strategic considerations – pertaining to autonomy and supply security, for instance? Where ought the financing of large companies to take place – centrally, in the most liquid financial centre, or in a decentralised fashion, at the relevant location? Will there have to be pre-set breaking points in future organigrams? And how far should investors take geographical diversification? Will a US-denominated certificate on the MSCI World be enough, or should they snap up property rights in a range of jurisdictions? Will they need pre-set breaking points in their portfolios? What bank could offer such a service?

In other words, coping with the new world order is going to require strategic responses and an appropriate toolkit. Planning for these changes will certainly keep us on our toes.

KH, in July 2018

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