

# Prospects

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## GEO-ECONOMICS – The new role of second-tier powers

- What is the common denominator between Qatar's LNG contract with China, the cut in Saudi Arabia's oil production against the wishes of the United States, recent Gazprom deliveries to Azerbaijan<sup>1</sup>, Turkish strikes in Syria and Saudi Arabia's likely inclusion in the BRICS economic bloc? **All signs point to the same phenomenon: many powers that are often categorised as second-tier geopolitically are increasingly independent geo-economically.** They are less and less concerned by the demands and threats of countries with the most power. **These stalemates may seem like small potatoes compared to the trade war between China and the US, but they'll have just as great an impact on the global economy.**
- **This autonomy is being displayed not only by countries like India, Turkey, the Gulf countries and Brazil, but Kazakhstan, Azerbaijan, Vietnam and Malaysia, as well.** The list is long! It also includes countries that have military alliances with the US, but sometimes go it alone, bringing to mind German Chancellor Scholz's trip to China or the Arabian Peninsula's relationship with Russia. Biden can eat his words – nothing will change.
- It's worth noting that **this is not merely de facto autonomy, but activism.** Each of these countries wants to take advantage of the opportunities that have arisen from cumulative shocks (war, Covid, etc.) to take a political stance in their periphery, increase trade and draw investment. **Their aim is to boost their power and independence amidst a global imbalance.** This is happening in the blink of an eye, as the climate crisis lends an urgency fuelling the free-for-all approach.
- **There are multiple factors at play giving second-tier powers room for manoeuvre and more bargaining power.** One such factor is economic performance for those that stand to benefit from the current situation, especially in the Gulf countries. Another is the rivalry between the US and China, which is driving up the appeal – trade leverage and investment attractiveness – of some countries like Vietnam. Meanwhile, others like Turkey are experiencing the advantages of a geo-economic status as a "pivotal state". **Value chains are also an unlimited source of power** for countries monopolising a segment – especially as the **climate transition shifts the comparative advantages.** It's rather likely that the resource economy will be **increasingly headed by cartels like OPEC.** Furthermore, the number-one factor motivating countries both large and small to seek more autonomy is the fear of shortages. And more generally fear of a "war on resources" which would be the worst-case scenario of the climate transition story.
- **Does this mean the two-power-bloc geopolitical scenario has serious limitations?** Actually, the situation is not so simple, as countries are gaining independence and also using bloc logic at the same time. Moreover, geo-economic fragmentation attests to what political scientists, like Immanuel Wallerstein, are predicting to be a new balance of power – when a global system structured by relations between the centre and its periphery is weakened, the latter will be the one to determine a new balance of power. This rebalancing process could also be positive as long as it doesn't leave countries vying for survival to fend for themselves, as long as it bolsters mutual resilience, and as long as it doesn't hinder the creation of a new system of production, distribution, and regulation that will be consistent with the new climate scheme and the protection of biodiversity. The final question is: what will the countries who acquire power today do with it tomorrow?

<sup>1</sup> Source: Eurasianet

## The shift in the geopolitical order combined with climate issues will act as a powerful springboard for infrastructure projects

It will take another two to three years to officially confirm the dominant trends in trade and investment flows, but here are a few potential scenarios. **The first is that the hegemonic rivalry between the US and China is boosting the appeal and trade leverage of second-tier powers of all sizes.** One example that speaks volumes is that of the US and the small, insular Pacific island nations, which recently saw their US aid tripled so that they would agree to ratify new partnership agreements. The Solomon islands refused due to a security agreement signed with China.

**As for the largest countries bordering multiple strategic regions, Kazakhstan – and Central Asia in general – is well-positioned to benefit from multi-focal geo-economics as a natural buffer between Europe and Asia.** This is evidenced by the distance it has taken from Russia – since the summer, Kazakhstan has been wooed even more than usual by the EU and China, which will be connected to it via railways by 2025 (container traffic has increased 11% since 2021, but is limited by congested infrastructures). Kazakhstan definitely has an interest in developing its relationship with the West if it doesn't want to be absorbed by China. Smaller countries such as Kyrgyzstan and Tajikistan will have a harder time finding their independence, as illustrated by the latter's recent military cooperation agreement with China. In this region, the shift in the geopolitical order linked to a weakened Russia has caused an increase in regional trade and relations with China, as well as infrastructure projects linking the area to China and Europe, circumventing Russia (Middle Corridor to Azerbaijan).

**In the same vein, intensified relations between Israel and the Gulf countries following the Abraham Accords** paved the way, among other things, for a free-trade agreement between Israel and the UAE in last May and rekindled the project to develop the legendary Hejaz Railway between them. With the wealth of a windfall backed by oil prices, every nation in the Gulf is poised to know what this Near Eastern start-up nation has to offer the race for digitalisation and the transition. But the people don't always agree, as demonstrated by the boycott of Israeli journalists by Arab fans at the World Cup in Qatar.

## Taking advantage of investments from the US and China at the same time

**In Asia, certain countries are also taking advantage of this geopolitical environment to draw investors from the US and China at the same time, and are benefiting from a carryover effect.** Western investors are less interested in China, whose geopolitical and regulatory risks are mounting up, and which has also had a higher increase in wages than some countries in the region (average monthly wages in China rose 118% from 2011 to 2020 versus 49% in Vietnam and 18% in Malaysia<sup>2</sup>). According to *Investment monitor*, Malaysia – which, alongside Vietnam, is one of the Asia-Pacific countries with the highest increase in investment projects in 2022 – will be hosting three new major projects with China (USD 10 billion for a solar farm), the US (USD 7 billion by Intel) and Austria. Following a drop in the number of projects in 2020 and 2021, investments in Vietnam rose 82% from January to October 2022 in tourism, the IT sector and electronics, in that order, and the top three investors in terms of the number of projects are the US, Singapore and... China.

## The economic advantage for countries experiencing a geopolitical status of “pivot state”

Turkey is one of the countries that benefits the most from a geopolitical status which is broadening its political and economic possibilities. It has managed the balancing act of speaking out against the war while refraining from sanctions, helping Ukraine militarily while benefiting from Russia's tourists and market, threatening Greece while attacking the Kurds in Syria, etc. to the extent that it begs the question: Do the West, Russia and NATO have any cards left to play to influence Turkey? Even the financial markets are now “geo-politicised”, as they have clearly integrated Turkey's status as a pivot country into their tolerance for the short-term debt refinancing of a country that is defying the laws of gravity, monetarily speaking. Then there are Turkey's blooming business endeavours in Azerbaijan, including building an airport in Karabakh. Turkey is the prime example of a country that stands to benefit from the geopolitical situation, especially since its president has been leveraging it. We shall see if he is re-elected in 2023.

**India and Saudi Arabia are headed down a similar path, relying on their economic performances despite being largely “thanks to” the war in Ukraine.** The fact that the war has forced countries to take a side (e.g. Sweden and Finland going from neutral to NATO) has paradoxically also enabled certain second-tier powers to speak up

<sup>2</sup> International Labour Organization

more about their economic and political non-alignment. **In fact, US pressure towards alignment is actually also driving some non-alignment.** Furthermore, shortages have forced countries to find new partners, leading to new neighbourly agreements such as Morocco's deal with Saudi Arabia to buy ammonium in replacement of Russian deliveries. Israel also just authorised Qatar to drill natural gas in the Kana-Sidon field in Lebanon instead of Russia.

**Grain-producing countries in Latin America have also taken the opportunity to rearrange their exports,** and it's likely that some of these contracts will last. In 1914, meat production in Argentina benefited from WWI in the same way. **India has been particularly active in the ramp-up of South-South flows by racking up new free-trade agreements,** such as the one signed in May with the UAE and more recently with Australia. It is obvious that countries like India, Turkey and Israel will be more welcome than a number of western countries, or even China, in certain African markets that are key to supplying many strategic resources. The glory days of the Silk Road are clearly over.

### A new pre-requisite for power: value chains

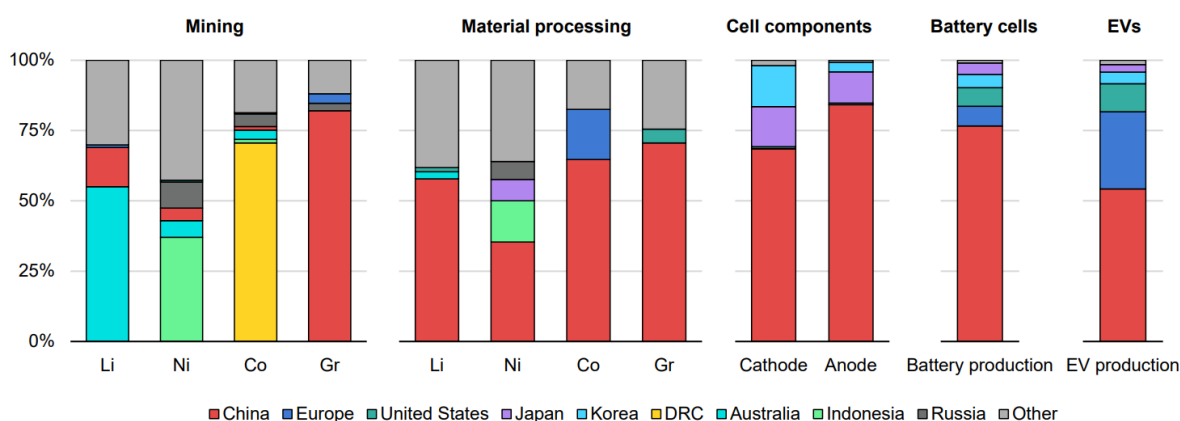
The globalisation of value chains which defies "big country/little country" logic also promotes the trade leverage of second-tier powers and

**their ability to become autonomous.** To be powerful, you just need to control part of an essential value chain. This is Taiwan's life-insurance policy, which will expire once the US builds enough semi-conductor factories of its own. There are also other countries whose trade leverage hasn't been tapped into, such as the Democratic Republic of Congo, which supplies 70% of the world's cobalt for batteries while China handles manufacturing (and also large shares of the Congolese production !).

### Will cartels run the world?

It is very possible that we are headed towards a world run by cartels as countries start to become aware of their new power plays, just like Indonesia did in its proposal to Canada at the G20 summit to form a nickel production bloc. To try to make ourselves feel better, we will say it is merely a way to regulate commodity prices, but make no mistake: **a world run by cartels will be far more influenced by second-tier powers than by superpowers/major importers. As for the climate transition, it is clearly accelerating this growth in cartels by shifting comparative advantages to new commodities, new expertise and new regions.**

The electric-battery value chain



Source : EIA

### From a shortage economy to a fear economy?

**The last driver for the activism of second-tier powers: superpowers are selfish.** Did we really think that we could fight each other on airport tarmacs over masks without leaving a lasting effect? Did we think that pressure from the West as a result of the war in Ukraine would erase the message that it isn't a team player in the event of a critical emergency? **What's more, the war reinforced the idea that shortages are very likely to be the new normal,** meaning a macroeconomic environment in which supply shortages will move from one sector to the next, constantly creating not global shortages but sporadic supply issues, and above all, relatively unstable prices.

**The shortage economy is a concept invented in the 80s by seminal Hungarian economist Janos Kornai about Eastern European economies, in which shortages indicated the dysfunctional nature of planned economies where demand exceeded supply.** The chronic shortage was also an economy of anticipation and fear, one of the symptoms of which was the plastic bag Soviet citizens always carried in case they happened upon a delivery, always ready to queue up.

Karl Polanyi reminds us in *The Great Transformation* that the memory of shortage goes beyond the time in which it occurs, spanning multiple generations. The *“war experience (...) confronted them with the perils of interdependence. In vain was trade resumed, in vain did swarms of international conferences display the idylls of peace, and dozens of governments declare for the principle of freedom of trade—no people could forget that unless they owned their food and raw material sources themselves or were certain of military access to them, neither sound currency nor unassailable credit would rescue them from helplessness. Nothing could be more logical than the consistency with which this fundamental consideration shaped the policy of communities. The source of the peril was not removed. Why then expect fear to subside?”* **In today's world, the impact of the memory (and hysteresis) of Covid and of the war on consumption and saving behaviours, as well as on the choices of nations, will be all the more significant as it is coupled with more acute awareness of climate change and a more dangerous form of globalisation.**

**Geopolitical unrest paired with climate emergencies ultimately manifest in the form of fear over a war on resources, driving many**

**countries to adopt protective measures and establish reserves.** Companies are also in the process of changing their reserve policies, as security and resilience criteria are now just as important as costs. **The geo-economic activism of second-tier powers therefore goes to show, if that was necessary to begin with, that we may not exactly be in a war economy, but we are entering a shortage economy.**

### Fragmentation and opportunities

**Does this mean the two-power-bloc scenario – autocracies versus democracies – will have economic limitations? A simple yes or no won't suffice.** In fact, the trend towards autonomy for second-tier powers is taking place *at the same time* that production chains in strategic sectors (semiconductors, quantum technologies, AI, etc.) are being rebuilt according to bloc logic. Because military technology has such a strong spillover into civil applications, no country or company is immune to national security concerns. Countries most aligned with the US will not be able to avoid restructuring their trade and investments as part of the “globalisation among friends”. But for many countries it won't be as simple as that – it'll involve geopolitical alignment in strategic sectors and non-alignment in others.

Lastly, the fragmentation scenario is scary from this perspective because it reveals an upheaval in globalisation that is a far cry from Friedman's “flat” world for the taking in his book published in 2005. That said, there is another way to look at this fragmentation by examining the opportunities it creates. While we have our hands full with the US/China trade war and the war in Ukraine, is globalisation reinventing itself without us playing a leading role? Is it reinventing itself from the periphery inwards? Paradoxically, this kind of scenario would be in keeping with the tune political scientists have been singing – that once a global system breaks down which has long been based on circular relations between a hegemonic centre and its periphery, the periphery determines the new balance. This tune is one of global systems, where Fernand Braudel and Immanuel Wallerstein meet the lessons of history.

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