The Pandemic Effect: A New Order for Economics, Geopolitics and Society?

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At the heart of many science fiction films is the morality-tale question of whether, in the face of an alien attack, the world will band together to vanquish its common enemy or revert to an "every-man-for-himself" ethos. In 2020, the SARS-CoV-2 pandemic, the first truly global pandemic in a century, and the related economic crisis, have provided a real-world laboratory experiment, and the results are not pretty. Further, given that the virus has essentially hit the world all at once – albeit in a somewhat rolling impact manner – different approaches to governance, leadership, and crisis management have been put to a simultaneous and collective stress test.

No country has been challenged in the way that the United States has, for in many ways this should have been the crisis the U.S. "trained" for; what seventy-plus years of global leadership and hegemony prepared it for. The failures of the U.S. on this front, in absolute terms, as well as relative to global peers, is well understood and, at this point, not subject to debate.

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Coming on the heels of the U.S.-led "Global Financial Crisis and Great Recession," the renewed exposure of racial and economic inequality, almost two decades of "unending wars" and perceived foreign policy overreach, as well as the rise of China, the question is, as the U.S. heads into one of the most consequential and contentious elections in its history, what will this mean in terms of global leadership and the global operating environment, irrespective of the 2020 electoral outcome. In a world living with a yet-to-be-controlled virus, plus looming demographic and environmental challenges, the answer to that question will be of profound consequence.

Getting Back to Sustainable Growth

Over the last sixty years, rich economies have experienced 5%+ drops in GDP 13 times and on average it has taken four years for GDP to return to pre-crisis levels. It stands to reason that the slower recoveries have rendered countries more vulnerable to additional economic and political shocks.

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As of September 2020, the OECD is forecasting the global economy will shrink by 4.5% in 2020. On the surface, this looks better than the 6% contraction that was forecast as late as June, but this "improvement" is the result of vast injections of public resources and, as this year's book goes to print, the pace of recovery is fading, even as the pandemic is demonstrating signs of the feared "second wave." To put this in perspective, the IMF asserts that there has been only one time that the post-war global economy has contracted for a year, and that was by 0.1% in 2009, during the Financial Crisis. So, while we have seen a modest recovery rebounding from a very steep fall, the question is one of getting back to sustainable growth.

It has been 150 years since so many countries have been in simultaneous recession. Emerging markets have, for the most part – and for reasons still unknown – avoided the worst impacts of the virus itself, but due to a confluence of factors (lack of spare reserves, collapse in tourism, reduction in remittances, plunging demand for natural resources – and the logistics and infrastructure to get them to market, stresses on fragile health care systems), the economic impact has been harder. The actual contraction may be less than in the developed world, but the compromise to growth will be similar. All this before taking into consideration the long-term consequences of the pandemic impact. As students in the developed world fitfully return to school, at the very least, most children have some access to remote learning. In much of the developing world, the technology option is not available, and in the poorest elements of society, children are being sent to work. Meanwhile, 70% of children are seen getting WHO recommended vaccines this year (versus 84% in 2019), a level not seen in a quarter century. So, the developed and the developing world are feeling the effects. However, it is worth noting that China is the only major economy forecast to experience positive year-on-year growth in 2020.

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Looking forward, economists and policymakers are attempting to anticipate the "shape" of economic recovery. Will the shape be V, U, W, L or the newest shape: K? At various points this year, financial markets would seem to have priced in a V-shaped recovery, but in reality there has been a disconnect between what is observable in the real economy, and the investment environment that reflects "free money" from the Federal Reserve and, in an effectively zero or even negative interest rate environment, a dearth of choices. Consumer behavior is much tougher to forecast than monetary policy in a sui generis economic environment, thus creating challenges to business response in terms of investment and employment strategy, as well as uncertainty about trade patterns. So, at the moment, it appears that the K-shaped recovery is what's unfolding – the aforementioned, liquidity-charged market performance, juxtaposed against "permanent" job losses and the unabated rise in inequality that has accelerated since the great recession. All of this points to a deterioration in productivity growth and unemployment not returning to pre-COVID levels.

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Importance of Central Banks

It has become abundantly clear that sustainable, comprehensive growth of the economy is not possible absent the "flattening of the curve" via either a safe, effective, scalable vaccine or behavioral change.
An unprecedented supply and demand shock has left monetary and fiscal policymakers scrambling, even as they remain handicapped by political dynamics. As has happened in the past, in the U.S., the Federal Reserve did its part and acted fast, validating yet again the importance of central bank independence.
The policymakers, led by Jerome Powell, still had weapons in the arsenal, despite pleas to deploy them when the economy was in ruder health. In an encouraging early sign, so did the fiscal authorities, (particularly when compared to TARP and the CARES Act), and the result was fairly efficient bi-partisan efforts (particularly on the part of House Speaker Nancy Pelosi and Treasury Secretary Steven Mnuchin), even if the deployment and disbursement was anything but. The unfortunate reality is that leaders must contemplate that the pandemic will last longer, with the corresponding suppression of global demand, than is politically palatable.

The key bills were passed in March and June of 2020, but meanwhile the $20+ trillion U.S. economy has been on "pause" for over half a year. Clearly, institutional and political inertia will have to be overcome, and more will have to be done on the fiscal front. While fiscal hawks will likely whine, it is worth considering that this is a "whatever it takes" moment, and worth remembering that there is no discernable inflation and there are more options available to the country with the global reserve currency. The big question is whether there will be political space to move beyond "survival" bills and design true stimulus bills that have multiplier and accelerator effects, particularly focused on the technologies and jobs of the future. Because here's the sobering reality: U.S. GDP growth in the fourth quarter of 2019 was 2.1% (recall that GDP growth averaged 2.4% in President Obama's second term). When one considers the size of the tax cuts that led to the largest peacetime deficit in history (until the pandemic), the return on that policy design (with so much saved money going into market-boosting buybacks rather than geared toward productivity-led growth) was shockingly poor.

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As we look at policy responses in aggregate, the picture that emerges is of governments claiming powers and spending money as never before in an attempt to combat the pandemic impact. At the same time, central banks are printing as much money as necessary, keeping borrowing costs low and, in the Fed's case, effectively becoming the lender of last resort not only to the financial system, but to the real economy as well. Historically, "temporary" expansion of state power tends to become long lasting, even when a given government paradoxically doesn't "believe" in big government. As spending increases alongside declining tax revenue, so will debt increase. And the phenomenon will raise the question of what the central bank's role should be – if the government can spend like this with rates at zero and no inflationary impact during the pandemic, why not do the same to finance other things ,especially since the Fed's statement at this year's virtual Jackson Hole conference that it would allow the economy to run hotter for longer – dovishness that will be music to the ears of proponents of Modern Monetary Theory.

Big Tech Winners

An additional phenomenon of the pandemic to watch is that the other "bigger" winner (in addition to government) is big tech – as evidenced by the tech platforms' disproportionate stock market performance. However, big tech and big government are still opposed. This battle has been underway and foretold for some time, but the COVID era has proved Google, Facebook, Apple, and the other big platforms 'essential.' Watch this space as the essential can be viewed as a utility, and utilities can be regulated. Big tech needs to get in front of this, otherwise bigger, and now less laissez-faire governments will do it for them.

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The dislocations, shortages, and disruptions caused by the pandemic have led to a lot of talk about the evolution of supply chains. However, supply chain resiliency is about more than just diversifying from China. It's not nearly as simple as that. Eighty percent of trade involves countries with declining political stability scores, and the share of global trade conducted by countries in the bottom half of political stability rankings has doubled this century. So, thinking strategically about a China-plus strategy is key. The rhetoric regarding diversifying supply chains from China has yet to be borne out in fact. Relatively few U.S. companies have indicated an intent as yet to move any of their supply chain out of China, and a very few intend to leave altogether. While the U.S. trade deficit with China has improved from its 2018 peak, in reality it's merely back to pre-Trump administration levels, and the overall trade deficit with the world remains little changed, so the shift has been to other countries. The pandemic itself has notably had the effect of increasing China's share of global exports – 20% in the second quarter of 2020 vs. 13% in FY 2019.

Competing States, Not Systems

The thinking behind the welcoming of China into the WTO in 2001 was that a richer and more integrated China would lead to greater democratization in the country. The arrival of the internet would only help drive the demand for greater freedoms within the country. This has not happened. China now boasts the world's second largest economy, while the Chinese Communist Party's grip on power is arguably as great as ever. The so-called "Great Firewall of China" has effectively closed off the country's internet, and yet China is highly involved in the global internet – as evidenced in 2020 battles over TikTok and WeChat. China also has an industrial policy, as evidenced by the Made-in-China 2025 and Belt-and-Road initiatives. For its part, the United States now spends less on Research & Development – as a percentage of GDP – than it did in 1955. Indeed, at the height of the Cold War, the U.S. government spent more on R&D than the rest of the world's private and public sectors combined.

Clearly the simple prospect of a rising China raises concerns in Washington, even notwithstanding the genuine need to counter China's illegal or unsavory tactics. And herein lies the challenge for western governments and institutions, which have generally been focused on less multi-dimensional competitors. A China that is ruled by the Chinese Communist Party can be a partner on many issues. The assumption that the Chinese people are oppressed is somewhat belied by the evidence that most citizens may not actually view the CCP as oppressive. In fact, the most recent Edelman Trust Barometer suggests that support for the Chinese government is among the highest in the world. Is it fair to suggest that the average Chinese has a higher opinion of their government than the average American does about theirs? Even those democracies that are in its neighborhood and, in theory, most "at risk," are not calling for any regime change in Beijing. Indeed, stability and predictability provide a counterweight to some of China's more assertive regional behavior. It is a flawed assumption that a "democratic" China would automatically adopt the norms and practices of the West. Turkey and India are good examples of democracies that have not. Many countries' populations harbor anti-Western sentiment, and China is certainly no exception. The paradoxical reality is that, in pursuit of its overarching objectives, the Chinese Communist Party actually keeps a check on Chinese popular nationalism.

Much commentary on U.S. – China relations has characterized the relationship in Cold War terms, and while the shorthand is understandable, it's misleading. This is about competing states, not competing systems, as such. China is neither trying to contain or defeat capitalism, nor is it trying to spread Communism. Indeed there is a sense of Chinese exceptionalism in its unique brand of Communism. While it is transforming its economy, China is still highly dependent on export markets, and its lack of natural resources renders it reliant on imports. For the last 70 years, it has been effectively dependent on the U.S. Navy to protect those supply chains. As the country grows and its strategic competition with the U.S. grows in lockstep, it makes logical sense that it wants its own brand of regional hegemony and the U.S. naval presence in the western Pacific attenuated. The bottom line – China is not looking for global hegemony, but neither does it want to be at the mercy of those who might have an interest in compromising its rise.

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On the one hand, the strategy for the U.S. ought to be simple – it should be striving to ensure the competitive advantages (which are legion) and attractiveness of its own system. The U.S. doesn't seem quite sure how to deal with a superpower with a different values system, but that also represents an enormous opportunity and has many mutual interests. Globalization is shorthand for the system designed and perpetuated by the U.S. in the post-war period. One of the byproducts of interconnected global supply chains and markets was the network effect, which in turn created certain exploitable chokepoints. A clear example of this is the SWIFT system, which ultimately allows the United States to exercise enormous power over the global payments system and therefore global finance and trade. This is only exacerbated by the U.S. being the source of the global reserve currency. To some extent this explains the furious attempts by the U.S. to stymie the efforts of Huawei (meaning, at the end of the day, China) to spread globally – to deprive them of control of the 5G, and therefore Internet-of-Things chokepoint.

China's success is not, however, pre-ordained. It is doubtful that Xi Jinping sleeps well at night, and given the millions of people entering the workforce each year; spare industrial capacity; a looming mid-century demographic cliff that makes Japan's look like junior varsity in comparison. So, while much is made of Xi's ambitions, his actions also reflect the need to act now, and the window of opportunity has been made more attractive by a more distracted and isolationist U.S. In the competition for global support (or at least relative global neutrality between China and the U.S.), China is embracing multilateral organizations and institutions, to be more of a rule-maker. China's lending to the developing world has made it a bigger lender than the IMF or World Bank. And last year, China overtook the U.S. in terms of how many embassies and consulates it maintains around the world.

America's Most Formidable Rival

China is likely to prove the most formidable rival the U.S. has ever faced. But a number of countries' ambitions are growing as they perceive a less hegemonic U.S. Russia, as an example, may be far from a peer, but its projection of asymmetric power wasn't anticipated when the Soviet Union collapsed. It continues to drive the crisis (in Europe, in the Middle East, in the U.S. electoral system), but the net impact is to damage Western credibility and the true net winner of Russian disruption is actually China, which is ultimately better positioned to capitalize.

The most recent Pew Research survey of 13 countries shows that only 34% of respondents have a favorable view, in 2020, of the U.S.: 15% say the U.S. has done a good job on COVID, 16% have confidence in President Trump (in contrast to 76% for Chancellor Merkel and even 23% for Putin), and only 34% believe the U.S. is the world's leading economy (versus the 48% saying China is). It's a reminder that in a certain sense, the alliance system is as much a popularity contest as it is a group of countries holding similar values and that there is nothing inevitable to countries staying "on board." The U.S.' rivals need to sell the idea that there is less to be gained by latching on to U.S. leadership.

Results of Pew Research Survey of 13 Countries

Views on the U.S.

34%
Have a **favorable view,** in 2020, of the U.S.

15%
say the **U.S.** has done a **good job** on COVID

Leadership Confidence

16%
Have confidence in **President Trump**

76%
Have confidence in **Chancellor Merkel**

23%
Have confidence in **Vladimir Putin**

Who is the world's leading economy?

34%
Believe that **U.S.** is the world's leading economy

48%
Believe that **China** is the world's leading economy

The upshot is that we have seen retrenchment before, generally in the aftermath of war or intense and focused geopolitics. And while the periods of retrenchment have tended to be shorter following perceived "successes," these periods do share characteristics such as: The U.S. can't be the world's policeman and a refocus on domestic priorities. What's important to note is that historians suggest there has never been four consecutive presidential terms of retrenchment – and we're coming up on the end of the third.

The U.S. has followed these periods with greater activism. As we consider the tectonic issues of the 21st century: the rise of China; the role of the U.S.-built post-war system; technological disruption of not only the workplace, but the very relationship between populations and their leaders (and institutions of state); and, the most existential of all, climate change, each is crying out for global leadership. Take climate change – ultimately countries will have to adapt. It can be argued that there is no such thing as a "natural disaster." Earthquakes, fires, and pandemics are all naturally occurring events, but the "disaster" part is social and political – in other words, manmade. But without leadership, the process will be messy, both in terms of science and politics – hydrocarbons producers will fight over share of their declining markets, while others will fight to dominate the key renewable energy technologies.

While support for democracy may be in decline around the world (even within democracies), and while the U.S. continues its epic struggle to reconcile a political and economic system that promises equality and promotes inequality respectively, and while the biggest autocracy is extending its influence and increasing its prosperity, the biggest challenges facing the evolving global population require leadership within the context of a global commons.
The world is looking less cooperative than it did pre-COVID. But nationalism in the past has not produced a stable balance of power, but led rather to catastrophe. The institutionalized, global world that the U.S. built and (even as it did more for the world than any other system in history) benefited from more than anyone – was born of just such a catastrophe.
However, unlike the world of the 1940s, there are no greater powers than the U.S. and China to save them from themselves. They will have to manage. And therein may lie the silver lining from the pandemic – for it has shown us that humans can change and adapt their behavior expeditiously when survival depends on it.

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