

The international system: on Covid and bipolarity

Covid amplifies trends that undermine the international order. The world was already entering a bipolar system prior to the pandemic, and that future is unchanged; but the virus does create a strong inward focus among national elites. This, in turn, stokes deglobalization and nationalism, thereby causing decoupling and strengthening different spheres of influence. While Covid may not usher in a completely new world order, it has certainly unleashed forces with important implications for international relations.

The international system was, is, and will remain one of emerging bipolarity. In brief, the United States and China will be the world's superpowers for the foreseeable future. The global distribution of power determines the nature of any system and these two nations have emerged over the past decade as the clear leaders on the most important indices of power – military and economic. In the military realm, the United States retains a huge advantage over China. According to the Stockholm International Peace

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Research Institute, Chinese nominal defense spending in 2019 was roughly 35% that of the US. The two are much closer in the economic sphere, with the US ahead on nominal GDP and China in purchasing power parity. The two are both well ahead of any other power: the number three country in these metrics ranks far below China.

THE COVID EFFECT IN A BIPOLAR WORLD. There are specific, structural, and enduring reasons behind the US and China rankings that will not change because of Covid-19. The virus and ensuing lockdowns also affect soft power, and while soft power influences outcomes, it does so to a lesser extent than hard power.

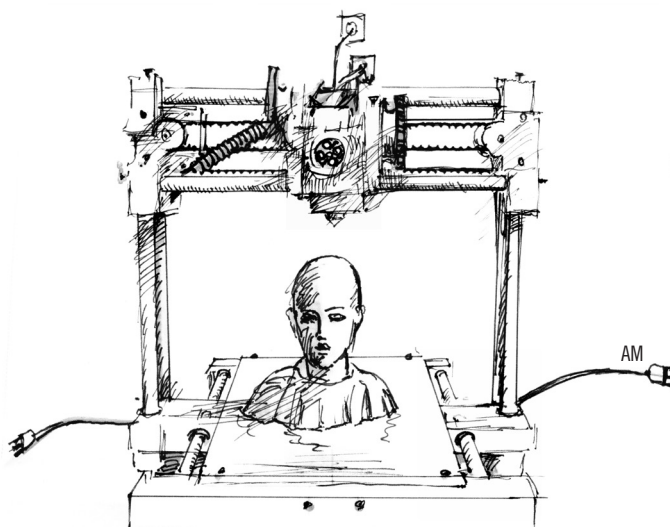
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Soft power means influence through attraction – a squishy concept that is hard to measure. Both the United States and China have bungled policy during the pandemic and taken a hit when it comes to soft power. That said, the US started off with much more soft power before the crisis and the country maintains that lead: Hollywood and free speech still attract. Prior to the outbreak, the Soft Power 30 Index (produced by the Portland consultancy with the University of Southern California) ranked the US at number 5 and China at 27.

Emerging bipolarity currently has several key characteristics. Balancing between the United States and China will occur primarily in the economic realm, where the two are closer to parity. Balancing will be much less intense in the military realm, where China will be deterred by US superiority. Technology, before the pandemic, was the focus of the competition and is likely to remain so.

We are coming off a period of unipolarity, and bipolar systems are inherently less stable than unipolar ones. But according to the same logic, bipolar orders remain more stable than the multipolar future that most observers

foresee. The system, therefore, will be relatively stable (peaceful). Bipolarity increases predictability and transparency in balancing. In the current order, stability will also be amplified by the caution-inducing impact of nuclear weapons and because balancing will primarily occur in the economic realm. Also, the new era will be marked by Realpolitik when it comes to foreign policies and spheres of influence. Finally, the provision of public goods will decline, but not by as much as most observers think.



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WHY IS COVID AN EXPEDITER? Understanding process helps explain outcomes and their impact on markets. It is often asserted that the pandemic is expediting existing global trends. Since early 2020, Covid has observably accelerated the main trends in the international system – deglobalization and nationalism. But it is almost never explained why this pandemic is an expediter.

The answer lies in the sharp inward focus that national elites have adopted in reaction to the crisis. This impulse reinforces the most basic reason that nation-states exist – to protect citizens. Leaders focus on domestic jobs and

have less time and money for foreign affairs. They erect barriers to movement of people and capital. This dynamic means that the relative role of the state will increase at the expense of the system.

The Westphalian state was already on the rise before Covid, when those left out began pressuring authorities to reverse the excesses of neoliberalism. The coronavirus and its inward focus create synergies with deglobalization and nationalism; feedback loops strengthen all these trends. Covid has prompted demand for a massive increase in the role of the state. In many places, that will lead to a stronger state; in others, however, it could lead to a failed state.

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Covid created a “centripetal moment” early in the spring, when it combined with deglobalization and nationalism to paralyze international cooperation. The moment was unique. The literature on the impact of the Spanish flu of 1918 is thin, but it does not clearly suggest that the pandemic had a significant effect on the international system. In other words, pandemics do not necessarily speed up existing trends; Covid did so because of preexisting conditions. Understanding this process matters. Investors will face domestic landscapes in which the roles of nation-states and the demands made on them are not only new but are also much greater.

WAR AND PEACE. The pandemic, all else equal, causes peace. This may be stark and perverse, but it is also true. I am drawing on – and hopefully building upon – the work of Barry Posen (professor at MIT) here. I assume that the coronavirus crisis is a relatively long one – that a vaccine will become available in 2021, but that it will act like the current flu vaccine. That means it will help, but that it will not fully prevent infection, and longer-term public health strategy will involve vaccines, symptom management, and transmission mitigation.

Covid will cause elites to be more pessimistic about the all-important question concerning war: “Will I win?”. During a pandemic, the industrial engines of nations that fuel wars slow down.

Soldiers do not fight well when they are sick. Leaders know their country is weaker and do not know how the country will endure a war. They do not know as much, compared to pre-pandemic times, about the extent of their adversary’s strength and how that country would perform in a war. An inability to make well-informed judgements about the outcome does not prevent war but does make it less likely. Whereas Covid does not logically reduce intra-state conflict, wars between states will be less common while its effects are present.

The peace-inducing effects of the coronavirus dovetail with those of emerging bipolarity. Covid, predictability, less military balancing, and the caution-inducing nuclear weapons all work to preserve the peace.

Lastly, and as noted above, the inward focus caused by Covid promises a spike in deglobalization and decoupling; it reduces interdependence. Contrary to the claims of most analysts, less interdependence does not translate into an uptick in the likelihood of war. Common wisdom (outside academia) holds that the webs of interdependence reduce the chances of war. Analysts who identify as realists, however, insist that interdependence means more friction between nations, and more wars. In the end, the truth is indeterminate: the facts do not clearly support either claim. In any case, the evidence does not back the claim that less interdependence means more war.

Countries will make dangerous grabs on the bet that an adversary is distracted, weak, and unlikely to hit back. China apparently made that calculation when it imposed the new national security law in Hong Kong in June. On balance, though, most observers and investors are overly alarmed about military conflict, as both Covid and emerging bipolarity will suppress it.

DECOUPLING 2.0. There is a broad debate out there on this issue. Is the world heading toward severe decoupling, or are the US and China – and nations generally – too tied up with each other to separate drastically? It is a false choice. The real task is to tease out how much decoupling will happen in what sectors, and when.

Covid and the ensuing inward focus puts wind at the back of the sails of decoupling. The current crisis will probably lose some of its grip when a vaccine arrives, but fear of the next pandemic means that any decoupling that happens soon will remain in place for a long time. The coronavirus undoubtedly sped up and deepened the first round of US-China decoupling. Each side scapegoated the other, and relations soured further. High-tech, movement of people, and academia are all arenas in which, during the pandemic, the United States and China decoupled further.

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What's new is decoupling 2.0: the second wave, of which Covid is a key driver. This round will involve global trade as all countries seek to become more independent, though the relationship between the world's two superpowers will be the most important component. Healthcare, data, and tourism are the sectors likely to be most affected. After the pandemic, healthcare will be a strategic sector – ventilators, masks, and pharmaceuticals are goods that nations will stockpile. Countries will seek to reduce reliance on China and India for drugs. Markets and prices will be subject to new forces as the sector realigns.

Data will likely also be part of the second, global wave of decoupling. The digital nature of work will be sticky, so larger data flows will be the new normal. That will play to large companies that monetize data well. Many nations will be wary of this development because of privacy concerns, fear of big American firms, and potential loss of their share of new revenue streams. This logic will drive more countries to pursue data localization.

Lastly, international tourism is likely to decouple as well. Many countries are promoting domestic tourism, while fear and restrictions hinder the flow of citizens across borders. Vacation travel patterns will probably shift as worries about virus resurgence and vaccines linger. This trend is more elastic than public health, but sagging demand for several years would probably have a lasting effect.

SPHERES OF INFLUENCE. Given both the inward focus spurred by Covid and balancing from bipolarity, the superpowers and other states will undertake a more hard-nosed pursuit of national interests. Superpower and great power jockeying will increase. Tensions between the United States and China will continue to deepen as both countries endeavor to scapegoat the other to divert their people from policy shortcomings.

The superpowers will also seek to strengthen spheres of influence. This arena of bipolarity is critical to the operation of business. All firms must now look over the horizon and determine whether their investment will lie in the American sphere, the Chinese sphere, or in a more neutral arena.

Covid sinks all boats. As a general hypothesis, the superpowers have such vast capabilities and influence that they have the headroom to absorb a hit and maintain their sway. Large states also have greater leverage during times of crisis. Lastly, these nations can turn to their domestic economies for demand during periods of low growth.

In Southeast Asia – the most entrenched region under emerging bipolarity – China’s influence has grown because of Covid. Beijing is offering many nations assistance in obtaining a future Chinese vaccine; the plan could significantly increase the country’s influence in the region – provided, of course, that the vaccine proves safe, effective, and can be rolled out on a large scale. Recently, Cambodia, Laos, and Myanmar – states already very

close to China – have become even more dependent. Moreover, several of the bigger “neutral” countries have edged toward China. Indonesia recently signed an agreement to produce a potential Chinese vaccine. Both Thailand and Malaysia, meanwhile, were hit hard by Covid and will look even more to China for investment. Yet China has lost ground with the Philippines. President Rodrigo Duterte has reacted to Beijing’s aggressive policy in the South China Sea by inching closer to the United States. Vietnam is always the regional outlier, given its historically antagonistic relations with China. But all told, since the pandemic’s outbreak, Southeast Asia has moved even closer to China.

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In the Middle East and Northeast Asia, American influence will remain paramount after Covid. Transatlantic ties will remain central for EU members, but the coronavirus, Trump’s response to it, and related soft power losses have weakened the US position. If Joe Biden wins November’s election, the US position will recover significantly. If Trump wins, however, the European Union – strengthened by the adoption of the Recovery Fund – will shift more toward a non-aligned position. Covid will have little effect on superpower influence in Latin America. That region will remain aligned with the United States primarily, especially on political culture and security issues. But China is now the largest trade partner for South America.

India fits in as “US-lite,” with modest additional gains by Washington because of Covid. The United States has made significant inroads in the defense sector at Russia’s expense. India’s political culture and soft power inclinations also favor the US. These trends continue to deepen because India-China relations are now tense and at times violent. However, China has significant influence in the economic arena, which bolsters India’s penchant for an independent policy. The US is larger on foreign direct investment into India, while the two countries are about even on total trade turn-

over. Covid-related restrictions by India on trade, though, have reduced Chinese imports and – alongside more general geopolitical friction – will continue to do so.

Africa will remain uncommitted, but the continent is in flux. China is approaching Africa strategically, and its influence there has already increased dramatically. China is far ahead in African tech sectors, for example, but regarding political culture and affinity, many Africans have strong relationships with Americans, in a way that they do not have with Chinese citizens. Also, China's influence on the continent started out extremely low, so its relative increase is hardly surprising; US influence started out very high, but has stagnated because American policy-makers are not focused on Africa.

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PUBLIC GOODS. The provision of public goods will decline because of the pandemic, but probably not by as much as many analysts believe. The inward vector of elite thinking will mean less attention to the global commons. More Realpolitik will yield downward pressure on public goods. The rise of the state, after all, diminishes public space.

Yet both Covid-19 and the bipolar system will also impart some counteracting impulses in favor of public goods. The pandemic imparted an enormous shock, and when leaders believe targeted cooperation can help them and their nations, they act accordingly. In addition, in a bipolar system, both superpowers will make every effort to maintain the order, leading to some cooperation.

The record of the Cold War shows that superpowers can provide public goods even when they are strong adversaries. The United States and the Soviet Union agreed to many nuclear arms control agreements because both countries found those agreements to be in their national interest. The two countries also established hotlines and broader crisis management proto-

cols. US-China hotlines do exist but, based on public information, they are rarely used, and there is no clear protocol for their use. China does not yet have a formal crisis management apparatus. The US-USSR experience suggests that the two current superpowers have plenty of room for improvement. Also, individual leaders' beliefs matter. Biden, throughout his career, has had an engagement-oriented approach toward China. If elected, he might work to ease US-China confrontation in the belief that Covid is his most important challenge. A Biden administration would likely start a strategic dialogue, work with allies on China, and be less eager to implement tariff hikes or to take other provocative actions. A hard-headed provision of some public goods is likely if Biden wins. Public health, climate, arms control, and crisis management lead the areas of possible cooperation.

However, if Trump is re-elected, more "America First" would mean even fewer public goods than at present. The world will still be bipolar because the distribution of capabilities would not change. But international cooperation and institutions would further weaken.

SHAPING MOMENTS. For all its impact, Covid will not usher in a new order. The world was entering a bipolar system prior to the pandemic, and that future is unchanged. Shaping moments – periods when new orders are established – require two conditions: a coalition of nations and/or one powerful country must possess and implement a vision of a new order; and a geopolitical shock induced by a commonly viewed "evil" must be present. The historical record is demonstrative: new and more cooperative orders evolved at very specific times. In 1815, the Concert of Europe was formed in reaction to the Napoleonic Wars. The United Kingdom led its establishment, in coalition with Prussia, Russia, France, and Austria. The crucible event for the Concert was common revulsion over the death toll from the

wars. Similarly, in 1945, the United Nations and other Bretton Woods institutions were formed in reaction to World War II. The United States led the way, in coalition with the UK, France, and Russia. The shaping events were the horrors of the war and fascism. The liberal order that resulted exists still, albeit in attenuated form.

In the current crisis, there is no nation or coalition with the vision and capability to lead the formation of a new order. Equally important, the shock today is not geopolitical. It is medical. Deductively and based on diplomatic history, there is no basis on which to claim that Covid or any other pandemic did or can lead to a new system. No new order occurred after the Spanish flu of 1918. New political orders can redress political failings but cannot readily redress medical failings.

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IMPLICATIONS FOR INVESTORS. I have focused here on a series of macro impacts of Covid that are underappreciated by investors. But what about implications of these trends for markets?

First, interstate war is now less likely than many believe. Until a vaccine arrives, nations will be very reluctant to risk a war. Afterwards, caution in case of the next pandemic will be prevalent. For firms, this means discounting war scenarios in corporate planning.

Second, firms should establish a new Office of Market Interventions. In the new landscape created by inward-looking countries and the centripetal moment, many types of state intervention in economies will become common. Industrial policy, strategic sectors, state aid, and government spending will all grow and reshape the business environment. Successful business will require top notch navigation of the new environment. That will mean establishing an Office of Market Interventions and hiring experts in the field of political economy.

Third, decoupling 2.0 will necessitate new actions by firms. With most mergers and acquisitions, a company will need to understand the existing and potential requirements of both states involved. Also, any foreign status will entail more risk. On data, firms will need to establish more local storage centers and beware of transfers that fall askance of regulations. In high-tech, given the state of US-China relations, planning for two digital platforms is prudent. Lastly, given the dramatic increase in digital surface area, it is only a matter of time before businesses endure a spike in cyberattacks. Getting out in front of that is key.

Fourth, spheres of influence will significantly affect investment climates once the pandemic ends. The most profoundly affected arena is bound to be Southeast Asian nations, where the pandemic is only reinforcing the Chinese role. To do a meaningful risk assessment, corporate players in the region must consider Chinese goals in Southeast Asia. Undertaking scenarios for every relevant region will likewise be important in the new bipolar world. Finally, investors need not fear the near-term advent of no international system. Both Covid and emerging bipolarity provide drivers for public goods and cooperation. To paraphrase a Broadway hit: “fear less, smile more.”