The novel coronavirus SARS-CoV-2, and the associated disease COVID-19, have provoked policy responses near unprecedented in their scale and in the dual shocks they wreak to both global output and demand. Public health controls, like forced business shutdowns and travel restrictions, significantly disrupt supply chains, including for high-value industries like automobiles, electronics and pharmaceuticals. Related barriers to intermediate goods and services exchange pose exceptional risks to production processes, optimized to reduce inventory costs in exchange for flexibility. Consumer spending largely plummets with the viral spread and the enforcement of social distancing, albeit preceded by sharp spikes in certain industries or products attributable to stock piling behaviour, as with groceries, retail and credit card purchases. The slump in aggregate demand could inhibit stimulus measures, like interest rate cuts, as consumers stay home rather than fully leverage cheap money. In capital markets, rocketing volatility in equities trading and pressures on fixed-income assets combine with plummeting commodity prices. Governments have responded proportionally to the economic challenges of the virus around the world with massive fiscal interventions, and increasing public debt levels have raised new fears of default. The associated oil shock could be especially severe for the sovereign credibility of emerging, petroleum-dependent economies.

Closer to home, Canadian financial institutions are working in tandem with the public-sector to inject critical liquidity for households, small businesses and vulnerable sectors; adjust borrowing terms to ease debt burdens; and manage institutional and systemic risks. The coronavirus tests the competencies and safeguards of the financial industry, driving banks, insurers, investors, Crown corporations, regulators and officials to concentrate their energies on addressing a clear and present danger. The immediacy of the challenge imposes a degree of short-termism. Nevertheless, the pressures of the moment need not come entirely at the expense of longer-term strategic thinking. Financial institutions should consider what the coronavirus portends for future macroeconomic and geopolitical conditions.

Leading scholars and pundits alike have begun to explore future scenarios. Some observers project that COVID-19 will mark a sea change in the course of international affairs. Brookings Senior Fellow Thomas Wright suggests that the geopolitical and economic effects of the virus are ultimately dependent on its timeline. Yet if the crisis lasts for a year or more, as public health experts predict, the repercussions could be dramatic and lasting. Allianz Chief Economic Adviser, Mohamed El-Erian, points to the onset of a “new, new normal” in macroeconomic conditions marked by surging deglobalization, the weaponization of trade and investment policy and a disproportionate intolerance to risk. Richard Haas, President of the Council on Foreign Relations, questions whether COVID-19 is really an historical watershed, but rather suggests that it will accelerate existing global trends like decreased multilateralism, the decline in U.S. leadership and increased tensions between major powers. Some prevailing themes may be drawn from these and other forecasts, a selection of which are particularly salient for Canadian financial services. The coronavirus pandemic illustrates a failure of transnational cooperation when faced with a complex and borderless risk, similar to threats from climate change, financial instability or data governance. It exemplifies the break toward greater economic segmentation, defying notions of a slow but steady convergence around free trade, open investment and shared regulation. And with disparities in the exposure to and underwriting of risk, the outbreak could plant the seeds for political resentment and institutional distrust.
Geopolitics in a Post-Pandemic World

TRANSNATIONAL COOPERATION

Although a product of zoonotic transmission, the novel coronavirus benefits from the interconnectivity created by modern systems and technologies. The pandemic offers a fitting example of what British sociologist Anthony Giddens terms “manufactured risks,” or the unclear, unprecedented and incalculable perils derived from the very process of human development itself rather than external sources. This class of threat characterizes fellow scholar Ulrich Beck’s “World Risk Society” in which global threats “tear down national boundaries and jumble together the native with the foreign.” Beck proposes a new transnational statehood or cosmopolitanism to grapple with the necessarily shared challenges of manufactured risk, but he recognizes that nationalist or xenophobic sentiments are also possible.

The COVID-19 pandemic has incited suboptimal collaboration, particularly between the two largest economies and most significant geopolitical actors. The United States and China have taken largely independent courses through the outbreak, marked by distrust and at times even overt competition. Uncertainty surrounding the origins and properties of the virus have fed mutual suspicions and allowed conspiracy theories to metastasize in both countries, further limiting the avenues for bilateral action. China made efforts to restrict information and misrepresent the outbreak, resisted outside support from the U.S. Centers for Disease Control (CDC) and limited the World Health Organization’s (WHO) travel access to the city of Wuhan. For its part, the “America First” response of the Trump Administration has far from improved its diplomatic relationships with traditional allies. The White House announced restrictions on travel from the EU in March, allegedly without first consulting European officials. A summit of G7 nations failed to produce a joint communiqué following disagreement over appropriate labels, with Secretary of State Mike Pompeo reportedly stipulating the use of “Wuhan virus” over the objections of his peers. More recently, in mid-April, the White House withheld U.S. funding to the WHO on charges of mismanagement in its pandemic response. President Trump also suggested that the organization had supported China in its efforts to suppress information.

Some of the greatest appeals to national self-interest reflect in tensions over the supplies critical to public health workers. Chinese demand for Personal Protective Equipment (PPE) surged at the height of its outbreak in January and February, yet its export capacity for the materials proved less inhibited than originally anticipated. Beijing has since provided aid to other severely affected countries like Iran and Italy; however, some observers characterize the move as part of a larger geopolitical play at American expense. President Donald Trump invoked executive powers under the Defence Production Act (DPA) to limit the foreign sale of products like N-95 respirators, surgical masks and gloves through intermediaries. Minnesota-based producer 3M faced prohibitions on N-95 exports to Canada and Latin America, although a later agreement with the White House exempted the two markets. And in the European Union, Brussels placed export controls on medical equipment only after individual states within the bloc, like Germany, France and the Czech Republic, enforced their own domestic kerbs. As reported in early April, nearly 70 countries in total had imposed restrictions on PPE and/or medicines. Such barriers risk spreading trade protectionism as a cascade of states adopt new controls.

The current bout of non-cooperation may not just be a failing of the pandemic response, but could serve as yet another symptom of the larger breakdown in the rules-based order. Robert Kaplan, Managing Director at the Eurasia Group, considers the virus a manifestation of “Globalization 2.0” whereby nationalist aims, divisions and realist geopolitics reassert themselves at the expense of unity. In this regard, political discord in the COVID-19 crisis could foreshadow similar outcomes when countries tackle other manufactured risks like climate change or financial contagion. Policy successes, like COP-21 or the G20 response to the global financial crisis (GFC), could prove relics of a bygone, more accommodative moment in international relations.

MARKET SEGMENTATION

The COVID-19 pandemic could further stem the progress of economic integration. Since the end of the Cold War, globalization presupposed a degree of ideological and systemic “convergence.” In theory, as the U.S.-led order proliferated throughout the world, countries would steadily liberalize, coalesce around rules of state conduct and align against mutual threats. To some extent, convergence did play out over the succeeding decades. Smithian principles of specialization and divided labour would proliferate across borders and support more productive markets.
Yet the coronavirus illustrates the vulnerabilities of the globalized economy to outside shocks as the push for efficiency discounts the need for resiliency. Modern supply chains resemble complex and dispersed networks for most finished goods, with key components produced in many different locations by highly specialized firms. Assembly plants often keep limited inventories, sufficient for only a few days or even hours at most. These lean manufacturing techniques may generate higher profits in stable economic conditions but also prove highly vulnerable to sudden trade disruptions. Such trade-offs in modern supply chains factor into the current crisis. Global demand overwhelmed the two primary manufacturers of reagents for viral RNA identification, leading to a shortage in available testing kits.

Some observers in Washington have reacted to the exposed trade vulnerabilities with calls for greater protectionism. These proposals extend beyond temporary export controls on PPE, as described previously, to include more dramatic reorientations of the U.S. economy. In the earlier days of the outbreak in China, Commerce Secretary Wilbur Ross suggested that risks from the virus should factor into corporate reassessments of supply chains, and that firms could relocate operations and create new jobs in North America. White House Trade Advisor Peter Navarro has proposed an executive order that would, in part, encourage federal departments to buy only American-made pharmaceuticals and other medical supplies in a larger effort to pull production back onto U.S. soil; the European Commission has rejected similar proposals for reshoring. Shannon K. O’Neil, Vice-President, Deputy Director of Studies and a Senior Fellow at the Council on Foreign Relations, warns that calls to domesticate supply chains after COVID-19 will create net losses, increasing the costs of goods and services and decreasing competitiveness. As an alternative, she argues that greater redundancy is required in production processes, with back-up sources at different locations ready in advance of an external shock. Such preparedness may impose marginal losses in efficiency but are, on net, preferable to an autarkic shift toward domestic production. In other words, contingency in the manufacturing process marks the point of risk optimization.

As of yet it is unclear whether industries and governments will better accommodate for economic contingency while fully reaping the advantages of an open marketplace, or whether the protectionism instigated by COVID-19 will spread to encompass corporate and public policy decisions in other sectors. In its contributions to this dilemma, the virus may only build on existing sources of stress. O’Neil notes that automation, new technologies and recent trade disruptions, including the U.S.-China trade war, have already put pressure on “multi-step, multi-country manufacturing.” Furthermore, the digital economy already trends toward greater partition as states diverge over data governance and the pursuit of emerging technologies, another key topic of study for the Global Risk Institute (GRI).

POLITICAL BACKLASH

Much has been said about the indiscriminate nature of the coronavirus. In their pleas for compliance with social distancing rules, public health authorities have repeatedly warned that all individuals and communities remain susceptible to contagion. The rapid global spread of the virus has certainly shattered illusions that geography offers sufficient defence. It may serve as a kind of epidemiological equalizer, but COVID-19 is proving more selective in the economic domain. The disparities inflicted by the illness are already apparent in the labour markets of developed economies, to say nothing of the deprivations in emerging markets. Affluent white-collar workers with broadband connections and video conferencing can safely work from home with only minor inconvenience. By contrast, lower-skilled workers are left unemployed when their offices and factories shut down. Where employees manage to keep their jobs, they are usually in essential services like grocery, pharmacy or retail, earning lower wages in conditions under which social distancing is more difficult to achieve. Thus, exposure to contagion and economic vulnerability both concentrate in the lower half of the income distribution. To paraphrase George Orwell, everyone is equally at risk of the virus but some are more equal than others.

Looking back a decade or more, the 2008 financial crisis created similar imbalances in the distribution of risk. As argued by Philip Stephens of The Financial Times, shareholders and the state absorbed the brunt of the damage instead of the more culpable decision-makers in private and central banks, regulators and governments. Contrary to the solidarity of which officials spoke, “The cost of the crash fell largely on the shoulders of those least able to bear it.” The crisis also revealed the political consequences of this inequitable risk transfer, whether real or perceived.
Backlash against the status quo shaped elections in both the United States and Europe when populists leveraged voter resentment. As Stephens describes, the most harmed constituencies responded emotionally to the unfairness of the financial collapse and recovery. Political leaders channelled this sentiment to push back against globalization, exemplified in Brexit and the Trump presidency.\(^9\) If the COVID-19 pandemic inflicts even greater economic dislocation than the last recession, and public policies once again allot disproportionate costs and benefits, the political ramifications could prove equally, if not more, disruptive in many countries.

THE VIEW FROM CANADA

Barriers to cooperative action in light of manufactured risks are of concern to Canadian financial services. The increasing centrality of climate change in assessment and governance is a case in point. Commensurate with the global dimensions of the problem, effective climate policies, physical and transition risk management and sustainable finance schemes depend upon some measure of coordination across the major economies. Initiatives like the Intergovernmental Panel on Climate Change (IPCC) and the Task Force on Climate-Related Financial Disclosures (TCFD) are designed to facilitate interoperable information, standards and best practices. In other fields, like digital privacy governance, anti-money laundering or international taxation, financial services benefit from some measure of directional alignment across jurisdictions. When the bandwidth for political consensus narrows, emerging threats may be left to intensify and impose costs that financial institutions have only a limited capacity to manage alone.

Furthermore, supply chain failures in crisis scenarios like COVID-19 create immediate challenges for financial services with third-party outsourcing, as GRI has explored elsewhere. Systemic shocks can create new market and credit exposures to the extent that other industries are disrupted. But when the answers to these vulnerabilities are protectionism or retrenchment, the long-term risks to financial institutions can mount. A world of increased segmentation is a difficult one for a smaller economy dependent on trade. Canada relies on imports and exports more than other developed countries: trade represents 66.2% of national GDP, compared to 61.8% for the United Kingdom, 43.2% for Australia, 36.6% for Japan and only 27.5% for the United States (2018 figures).\(^17\) Canadian banks are among the beneficiaries of foreign markets, with 34% of their net income deriving from international sources (2017 figures).\(^38\) If COVID-19 exacerbates geopolitical and economic divides, risk managers may need to adjust their strategic mindsets accordingly. Canada benefits from the opportunities and certainties that come with global integration as the successful renegotiation of NAFTA or new agreements with Europe and the Asia-Pacific can attest. Nevertheless, when regional blocs diverge over time, institutions may face difficult choices and trade-offs in their sales and investment.

The structural inequities of the coronavirus, and the prospect that emergency measures might unintentionally reshape or intensify these imbalances, are also critical factors to monitor. The Canadian financial and regulatory systems earned global admiration, post-2008, for their efficacy and prudent risk management. Major institutions did not go bust and the public did not absorb the same downside risks of financial mismanagement as in other countries. However, COVID-19 may even surpass the GFC in the depth and breadth of its damage, and the federal and provincial governments have taken measures above and beyond historical precedent to stem the economic collapse. In their ongoing efforts, risk managers should remain attuned to the distributional effects of the crisis response and its socioeconomic and political dimensions.
ENDNOTES


3. As noted by Rosen: Refer to Dan Rosen, moderated by Kevin Rudd, “The Economic Impact of Coronavirus,” Asia Society, 1:24:07, March 9, 2020, https://www.youtube.com/watch?v=blkh-FZ9xIM.


Refer to Campbell and Doshi, “The Coronavirus Could Reshape Global Order: China Is Maneuvering For International Leadership As The United States Falters,” *Foreign Affairs*.


Farrell and Newman, “Will the Coronavirus End Globalization As We Know It? The Pandemic Is Exposing Market Vulnerabilities No One Knew Existed,” *Foreign Affairs*.


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