Chapter 12
Rivalry, Expansionism, and the Future of the International System

Abstract  This chapter revisits the main thesis of the book—capitalism is an expansionist system fraught with risks of violent confrontation. History should guide us to manage these conflicts effectively and draw lessons from them. Barring major armed or nuclear conflicts (flashpoints of such incidents are many), the world will perhaps converge towards multipolarity whereby the economic and political powers of the BRICS nations are likely to increase at the expense of Western Europe and the United States. This process will be accelerated by the ongoing public health crisis and the global economic crisis. The international trade and financial systems are also likely to change. Whether this transition will take place in a peaceful and orderly manner is an open question. Given the dangers of a nuclear-armed great power conflict, it is likely that a Thucydides’ Trap would be avoided this time.

‘The Coronavirus pandemic will forever alter the world order. The United States must protect its citizens from disease while starting the urgent work of planning for a new epoch’. Henry A. Kissinger (2020)

Chapters 10 and 11 describe the gradual geopolitical transformation since 1991. In its desire to expand rapidly first into the post-Soviet space and later elsewhere, the American-led Atlantic Alliance overextended itself. Unsuccessful military campaigns in Iraq and Afghanistan coupled with economic malaise following the 2008 financial crisis significantly weakened the Atlantic Alliance. In contrast, the emerging powers within BRICS focused on rebuilding their economies and exploiting scale economies internationally without overextending themselves. As a result, we are now approaching a critical juncture where a switch in geopolitical balance of power appears inevitable. This process is further accelerated by the ongoing SARS-CoV-2 or COVID-19 (commonly known as Coronavirus) pandemic and public health crisis. The sharp economic downturn because of the pandemic is likely to have a profound impact on the geopolitical balance of power. In what follows, I discuss the potential economic consequences of the pandemic. Following which I present a brief assessment of the potential effects of the pandemic on the geopolitical positions of the United States, China, Russia, India, and the EU.

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S. Bhattacharyya, A History of Global Capitalism, Frontiers in Economic History, https://doi.org/10.1007/978-3-030-58736-9_12
12.1  The Economic Consequences of COVID-19: An Initial Assessment

12.1.1  The Genesis and Spread of the Pandemic

The coronavirus pandemic is caused by the highly contagious virus COVID-19. The virus spreads from people to people during close contact and causes lower respiratory tract infection. High temperature, persistent cough, sneezing, and fatigue are some of the common symptoms of this disease. At a later stage among many patients, the virus triggers a severe immune response leading to weakening of the immune system. A weakened immune system also invites bacterial and fungal infections that are not treatable using common antibiotics. It causes untreatable and potentially fatal pneumonia in patients.

First human infection with the virus was identified in the city of Wuhan in China in December 2019. It is identified to be common among certain animals such as bats. However, human infections were not recorded prior to the case in Wuhan. It is believed that the virus was first transmitted to a human from animals in a Wuhan seafood market. The first human-to-human transmission was identified soon after. Due to the highly contagious nature of this virus, it spread rapidly across the city of Wuhan and then to the neighbouring Hubei province. By January 2020, the disease reached an epidemic proportion and started spreading all across China.

Following the initial outbreak in China, the disease was transmitted to other countries through air travel. By mid-January, the disease already spread to other parts of Asia and arrived at the continents of Europe and America. At the time of writing on 20 July 2020, the disease reached every continent of the world except the southernmost continent of Antarctica. Data from the John Hopkins University indicates that there are over 13 million recorded infections around the world with over 600,000 fatalities and around 7.3 million recoveries. Note that these are recorded figures and the actual infections and fatalities are likely to be much higher. Many countries including developed ones do not have a sufficient number of testing kits and therefore many infections stay unrecorded. Furthermore, some countries solely record hospital deaths making it harder to ascertain the actual number of fatalities.

The disease currently has no proven treatment. It causes breathing difficulties in patients and therefore respiratory support is essential for saving lives. If left untreated, fatality rates could be significantly higher. Due to the lack of medication or any proven treatment, it takes very long to treat patients and thereby imposing additional pressure on the public health system.

In order to minimise the rate of spread of this disease, countries around the world have largely followed the World Health Organisation (WHO) guidelines and imposed ‘social distancing’ regimes. ‘Social distancing’ implies limiting people-to-people contact by closing down places of social gathering, transport, air travel and asking citizens mainly to stay home. This strategy is commonly known as ‘lockdowns’. Lockdowns have severely restricted mobility.
12.1.2 Macroeconomic Effects of the Pandemic

12.1.2.1 Public Health to Macro Economy: Identifying the Channels

In order to understand the short- and long-term economic effects of the pandemic and lockdowns we would need to revisit the key principles of a globalised capitalist economic system. Even though we are addressing an empirical question, the discussion below is theoretical in nature. Thus, the actual effect could very well turn out to be different. In the absence of sufficient and reliable data, this is perhaps the best analytical way forward in understanding the macroeconomic effects of the pandemic.

The globalised economic system depends on the movement of goods, services, labour, capital, and raw materials. Goods and services move from the locations where they are produced to the locations where they are consumed. They could be final goods and services reaching the final consumers or they could be intermediate goods and services moving between producers. Labour moves from its place of residence to the factories or offices to work. Fixed capital (office buildings etc.) could be stationary but capital goods travel long distances between producers to facilitate production. The same applies to raw materials that typically travel around the globe to reach factories where they are transformed into final or intermediate goods.

The movement of goods, services, and factors of production takes place via the supply chain. In the process, they change hands and these transactions take place in markets. Movement requires the use of transport services. Transactions even in an age of electronic communications require significant degree of human contact. All of this is made possible in a modern globalised economy due to relatively low and continually declining transport costs. The pandemic, subsequent lockdowns, and the sharp decline in economic activity have demonstrated to what extent modern economies rely on transport and human contact in order to conclude transactions.

By disrupting transport, limiting contact, and reducing transactions the pandemic and the restrictive measures have partially frozen the lifeblood of the world economy. Given the intensity and geographical expanse of the pandemic, it can now be said that it will leave a profound impact on the world economy. The impact on individual economies would of course vary. I will discuss the individual effects in the next section. Here, I will describe the theoretical demand and supply-side effects of the pandemic.

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1Labour, capital, and raw materials are otherwise known as factors of production.
12.2 Demand Response

As the disease started spreading from China to other parts of the world, the initial demand response was positive. Predictably, large sections of the population panicked on the face of uncertainty. Therefore, consumers in large numbers brought forward their purchases accumulating inventory of essential commodities anticipating a future lockdown. This positive demand shock disrupted supply chains with retailers and distributors struggling to maintain their stock on shop floors due to unusually high demand. This, however, was short lived. After four to five weeks following the panic demand started to fall. As the epidemic intensified, governments imposed lockdowns restricting movement. This undoubtedly restricted the ability of consumers to visit shops. Many switched online. However, online platform and associated delivery infrastructure were not fit for purpose to manage such high volume. It is impossible to add logistical capacity overnight. Vans need to be purchased; drivers need to be appointed etc. Therefore, the supply chain for online purchases also collapsed contributing to the general fall in demand.

The first casualty of the restrictive measures was the airline industry. With the advent of budget air travel, this industry typically operates with a fairly slim margin. National carriers may receive subsidies from the state budget but this cannot be said about a large array of private passenger carriers. In a competitive marketplace such as passenger transport, companies are under continuous pressure to issue cheaper tickets to lure passengers. With relatively high fuel, personnel, and rental costs the profit margins of most carriers are not significant. As a result, following restrictions on air travel many companies are under stress and steadily laying off workers in order to survive the shock.

The second casualty is the hospitality industry. Hotels, restaurants, cafes, bars, and clubs rely on tourists and outdoor life. Restrictions on movement and zero influx of tourists meant they had to shut down. Some of the workers received temporary government assistance. However, as the pandemic perseveres, unemployment in the hospitality industry is likely to be high. The overall negative outlook for the hospitality industry is likely to continue for a long time as government support for the industry is gradually withdrawn.

The third casualty is transport and retail. As demand shrinks and retailers shut down their stores, the demand for transport services would continue to fall. This will also contribute to job losses. This is likely to have a more severe impact in Western nations where a significant proportion of the non-graduate male workforce engage in driving for a living. Truck driving, local removal services, taxis, and couriers are common semiskilled professions in Western developed economies.

Some workers are temporarily compensated by their employers or the government due to the economic hardship imposed by the lockdown. However, as the pandemic perpetuates, many of the short-term unemployed are likely to become long-term unemployed thus significantly aggravating labour market and macroeconomic challenges.
With high unemployment, household income falls over time delivering a second round medium-term contractionary effect from the demand side. The Keynesian multiplier could potentially magnify such contractionary effect as it passes through the economy. The magnitude of the contractionary effect in a country would depend on its initial condition and parameter values. The initial conditions and parameter values vary across countries. Therefore, the contractionary effects would also vary across countries.

12.3 Financial Market Volatility in the Short Run

Predictably, the uncertainty associated with the pandemic caused turmoil in the financial markets. The equity market is spooked by the pandemic and is sceptical about the medium run revenue prospects of the listed companies. The markets suspect that transport, tourism, retail, energy, and airline sectors would encounter a prolonged drop in revenue thereby making it difficult for them to service their current credit obligations. Firms in these sectors are unlikely to churn out profits and pay dividends. Many of them might not survive the pandemic. These effects might spread to other sectors of the economy through the credit channel (derivatives) or supply chain. Therefore, the overall sentiment in the equity market remains negative with large sell-offs not seen since the Great Depression. On average equity markets around the world collapsed by approximately 30 percent during the first four months following the COVID-19 outbreak. Even though the market stabilised after the initial turmoil, the sentiment remains overwhelmingly negative. Likewise, the outlook going forward is also negative and uncertain.

The initial movement in the equity market is expectation induced. As investors sold off shares, the demand for bonds and dollar liquidity increased strengthening the dollar against all currencies. Capital inflow into the United States also increased. This is the first sign of financial panic as investors typically flee to the safe haven. Holding US dollar liquidity (cash) or buying government bonds (US Treasury bonds) are considered safe relative to holding equity. Demand for US government bonds increased sharply reducing Treasury bond yields to historic lows. Furthermore, the demand for gold (another safe haven) also increased and continues to increase progressively.

Western governments responded swiftly to the collapse in the equity markets by announcing expansionary fiscal and monetary policies. The market was not convinced by the policy response. The slide continued albeit at a slower pace and then stabilising at a low-level equilibrium. I will discuss policy response separately below.
12.4 The Oil Shock

Amid the pandemic induced equity market chaos in March 2020, the Organisation of the Petroleum Exporting Countries (OPEC) met in Vienna along with the non-OPEC petroleum producing countries led by Russia to review their existing production cut agreement which was due to expire on 31 March 2020. This agreement is commonly referred to as the OPEC+ agreement. Petroleum prices were already sliding amid the pandemic and the financial market turmoil. Saudi Arabia, the de facto leader of OPEC demanded that the non-OPEC countries agree to an additional production cut of 1.5 million barrels a day till the end of 2020. Russia responded to this proposal by suggesting that the existing market conditions are too volatile to merit a firm decision. Therefore, their position was to extend the existing arrangement for another month (till the end of April) to get a clear view of the demand trajectory. This was not acceptable for Saudi Arabia and their representatives withdrew from further negotiations. The Saudi Crown Prince announced that Saudi Arabia would increase production instead and sell its oil at a discount in the European and American markets.

Due to the Saudi posture, crude oil prices collapsed to 20 US dollars a barrel. It was the lowest crude price recorded since the 1990s. This set financial markets into a tailspin. US Crude oil benchmark the West Texas Intermediate (WTI) collapsed even lower and turned negative for a short while threatening the viability of the entire US oil industry. Moreover, the Saudi and other Gulf country overproduction triggered a supply glut not witnessed during the post-war period. The world started rapidly running out of storage space (including offshore storage space such as oil tankers) for crude. Recognising the threat to the US oil industry, which the US government considers to be a strategic asset, the US President Donald Trump lobbied hard with OPEC and non-OPEC countries to arrive at an agreement. More on this later.

12.5 Supply Response

It is expected that the demand side contraction would be coupled with negative supply-side effects. The lockdowns imposed by governments all around the world would automatically cut production. In addition, low demand going forward would force firms to cut production. There will be low demand for consumer durables given declining disposable income. Contraction in the transport sector would limit demand for cars. The supply response facing low demand in these sectors would also be contractionary. A contractionary supply response for final goods would have contractionary knock-on effects on the capital goods, intermediate goods, and raw material sectors. It is likely that the initial contractionary demand effect would be magnified manyfold through the knock-on effects on supply. This undoubtedly would cause mass unemployment and an even weaker demand creating a vicious cycle. All of these sectors, especially in the Western world (what I have referred to as
the Atlantic Alliance throughout the book) have significant credit exposure. Therefore, the risk of mass defaults and a potential transnational banking crisis remains high.

It is not difficult to envisage that there would be problems in the agriculture sector and the food supply chain. Farmers in developed countries have significant credit exposure. Many small and medium-sized farmers typically rent their plot and machinery for farming. They rely on short-term credit from financial institutions to meet their rental cost. A pandemic induced credit crunch would hit them hard. It is likely that financial institutions would charge a higher risk premium on short-term loans making credit expensive and farming unprofitable. Furthermore, fruits and vegetables farms typically use seasonal migrant workers for planting and fruit picking. Widespread travel ban and lockdowns would increase their labour cost and possibly even cause labour shortages. Facing these shocks many and especially small and medium-sized farms focusing on fruits and vegetables could go out of business. This would reduce supply and would be inflationary. Some of these effects are already apparent in food-deficit countries in Europe. The full extent of the effect will be known during the final quarter of 2020 and the first two quarters of 2021.

How about the effect of the pandemic on the grain market. Let us focus on wheat and rice. Farming in large wheat producing countries such as Russia, the United States, Canada, and Australia are capital intensive and therefore their operations are likely to be relatively less affected by the pandemic. The picture in rice could be starkly different. Let us focus on India and Thailand, two large rice producing countries. Rice cultivation in India and Thailand remain labour intensive. Plots are typically small in India and there are numerous near subsistence farmers operating in this sector. Lockdown in India coincides with the crop-planting season. Paddy planting typically relies on seasonal migrant agricultural workers who travel across provinces to work on land. They are unable to travel due to the lockdown. This will adversely affect output. Large-scale default on credit by farmers might follow further exposing financial institutions with exposure to agricultural loans. Challenges for Thailand and Southeast Asia are somewhat different. The entire region is experiencing a drought. This is negatively affecting production. The pandemic will aggravate the negative effects.

Overall, it is expected that the pandemic would push grain prices in the upward direction. Low production and supply chain disruption are the likely causes. Grain importing developing countries are the most vulnerable. The poor would suffer most from food price inflation. However, given the overall magnitude of the negative shock worldwide, developed countries are also not immune to food price inflation and shortages.

A demand and supply-side contraction of this magnitude is likely to trigger banking crisis, especially in countries where the financial system is extremely overleveraged. All the Anglophone countries (Australia, Canada, Britain, and the United States) and the EU are places to watch for a potential banking crisis, which could complicate the macroeconomic challenges even further. The risk of contagion is also high given cross-border interlinkages in banking through financial derivatives.
12.6 Policy Response and Hyperinflation Risks

Appreciating the sheer magnitude of the economic challenges, governments around the world have announced numerous stimulus packages to protect the economy from the pandemic. Here I will discuss the economic merit of these measures and the underlying risks.

So far, the measures have included monetary policy and fiscal policy. The former is primarily to ensure financial and price stability while the latter is to mitigate the negative effects of the pandemic on the labour market and businesses. In all the advanced economies of the Atlantic Alliance (the United States, Britain, and the European Union), central banks have committed themselves to unlimited asset purchases. This implies that central banks would continue to purchase all the assets including equity not absorbed by the other agents indefinitely. Where would the central bank get resources to conduct such operations? All the central banks who have committed to unlimited Quantitative Easing (QE) also reduced their target interest rate to either zero or near zero. Note that QE is electronic money printing where the central bank creates electronic money for the commercial banks encouraging them to lend. The current QE is intended to provide unlimited liquidity to the interbank lending market. Furthermore, it is intended to support the central bank’s asset purchase programmes. This level of market intervention and extension of central bank balance sheets is unprecedented in post-war history. The monetary policy operations can be summed up as a ginormous corporate debt monetisation programme not seen in recent economic history.

On the fiscal side, countries have announced a wide array of policies ranging from helicopter money, direct payments to the temporary unemployed to loan guarantees. The Trump Administration in the United States instituted helicopter money by offering 1000 US dollars payment to all households. They have also instituted waiver of student loans and loan guarantee for small and medium-sized businesses. Britain instituted loan guarantees for small businesses and direct time-limited payments (up to 80 percent of income) to the temporarily unemployed and the self-employed. I will not discuss the details of these policies here. Instead, I will focus on the macroeconomic consequences of these policies.

Fiscal policies instituted by the governments undoubtedly eased short-term pain in the labour market. It has also stabilised demand up to an extent in the short term. However, longer the pandemic persists and longer the lockdowns are kept in place, these measures are likely to be insufficient to support demand. Moreover, they would jeopardise fiscal sustainability of the individual governments. Some governments do have more fiscal space than others. For example, the United States government have more borrowing capacity than Britain because the dollar is the world reserve currency while the pound sterling clearly is not. Nevertheless, all the sovereigns within the Atlantic Alliance (with the exception of Germany) remain heavily indebted. Therefore, their borrowing capacity is not unlimited.

Another source of macroeconomic and financial instability is the energy market. After several weeks of turmoil following the failure of OPEC+ to reach an agreement
in early March, some stability appears to have been restored. OPEC+ agreed on a new deal to gradually cut production by 9.7 million barrels starting 1 May 2020 for two months following which the cuts will decline to eight million barrels and would stay so till the end of 2020. OPEC+ expects other non-OPEC large oil exporters such as the United States, Canada, and Norway to voluntarily cut production by additional ten million barrels to stabilise price. Canada and Norway oil ministers have already confirmed that they will comply. The United States indicated that the market realities would force a drop in their production, especially in the shale patch.

As I have identified above, the source of inflation could be from the supply side and therefore traditional monetary policy through the interest rate channel may not be effective. Moreover, the monetary policy measures and especially debt monetisation could significantly magnify the risk of hyperinflation which I discuss next.

Under normal circumstances, governments finance their expenditure by collecting taxes. If the expenditure exceeds tax revenue then the government runs a budget deficit and borrows from the credit market by issuing bonds. The realities of the ongoing economic crisis and the promised fiscal response would force governments to drift beyond the usual. The scale of debt creation in already heavily indebted Atlantic Alliance economies would necessitate debt monetisation. Debt monetisation or seignorage is a practice where the central bank prints money to buy government bonds through the asset purchase programme to finance government expenditure. This happens when there are not enough buyers of government bonds.

Let me explain why the risk of a bond market collapse (i.e. a drastic decline in bond price due to lack of demand) now is real. Within the Euro-Atlantic economic space (I am also including Japan here) all sovereigns are heavily indebted. Germany has a relatively cleaner balance sheet but Germany would need to finance its own expenditure following the contractionary shock. The same applies to the corporate sector, which is also highly leveraged. Countries that have the cleanest sovereign and corporate balance sheets are Russia and China. They are geopolitical rivals of the Atlantic Alliance and therefore unlikely to buy sovereign bonds issued by the latter unless major concessions are offered. Therefore, the existing financial system would be unable to absorb such a massive excess supply of bonds. Debt monetisation would be the only viable option.

The economics of what I described above is straightforward. A country’s current account is defined as net payments received from abroad due to exports or ownership of foreign assets. Therefore, it is a measure of the country’s external financial balance. A current account deficit implies foreigners have more claims on the country’s economy. Similarly, a current account surplus implies locals have more claims on the foreign economy. The laws of macroeconomics dictate that a country’s external financial balance (or current account) should equate to its internal financial balance. Internal financial balance is the sum of government financial balance and
the private sector financial balance. In other words, current account should be equal
to the sum of net government saving and private sector saving.  

Now consider the typical Atlantic Alliance country with current account deficit,
large budget deficit and sovereign debt, and large private sector deficit (a highly
leveraged private sector). Any attempt to borrow further can only take place either by
increasing private sector savings (i.e. selling bonds to the private sector—corporates,
pension funds) or by reducing the current account deficit. A highly leveraged and
exposed private sector cannot buy more bonds without triggering a sharp recession.
Central bank led QE and asset purchase programmes are trying to encourage more
private sector borrowing which is exactly opposite of private sector buying govern-
ment bonds (i.e. saving or deleveraging). Reducing the current account deficit for
countries with large trade deficits imply reducing net foreign asset positions. In other
words, encouraging foreigners to buy bonds. However, as I have illustrated above all
other members of the Atlantic Alliance are already saturated with debt and are trying
to sell their bonds at the same time. Countries (Russia and China) with strong
sovereign balance sheets are unlikely to be interested. Therefore, the risk of a
bond market crisis is relatively high. The risk could be minimised through interna-
tional policy coordination, but international cooperation and goodwill are in short
supply in the current environment.

Failure to sell bonds implies there is only seignorage or debt monetisation left as
an option to finance the deficit. Seignorage is directly increasing in money growth.
However, it is also indirectly decreasing in money growth through its relationship
with inflation expectations and money demand. This is demonstrated by the equation
\[ S = \frac{\Delta M}{M} \bar{Y} L(\bar{r} + \frac{\Delta M}{M}) \] where \( S, M, Y, r, L(\cdot) \) are seignorage, money supply, output, real
interest rate, and money demand, respectively. A stagnant or falling output and
potentially high inflation expectation working from the supply side could increase
the need for debt monetisation beyond the optimal level. If tax revenue collapses
then more and more seignorage would be necessary fuelling inflation expectations
even further. A negative real interest rate would not be able to outweigh the money
demand collapse due to persistent high inflation expectation. Open capital account
and free movement of capital would complicate the challenges even further. In an
open economy, \[ \bar{r} + \frac{\Delta M}{M} = i * - \Delta E_{t+1}^e \] where \( i *, \Delta E_{t+1}^e \) are the world interest rate
and the expected appreciation in nominal exchange rate, respectively. Seignorage
and high inflation expectation would mean high money growth which could lead to
rapid depreciation of the national currency triggering a currency crisis. A currency
crisis would invariably trigger hyperinflation and end badly. Even though hard to
imagine under normal circumstances, the risks are now real and should be given due
consideration.

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\(^2\)For the more mathematically minded \((S_p - I) + S_g - CA = 0, CA = NFA_t - NFA_t - 1,\) and
\( CA_t = NX_t + rNFA_t, \) where \( S_p, I, S_g, CA, NX, NFA_t \) are private saving, investment, government
saving, current account, net exports, and net foreign assets, respectively.
12.7 Asset Markets and the Macro Economy: Long-Run Effects

The long-term outlook for the developed country asset market is negative. The global economy has not witnessed twin contractionary demand and supply-side shocks since the Second World War. Indeed, we are in uncharted territory and predicting the future is not easy. Nevertheless, the risk of a financial crisis is real.

The pandemic is already causing mass unemployment. The labour market challenges would intensify over time. If the pandemic persists and governments have to impose lockdowns in order to contain it then the current short-term unemployed risk becoming long-term unemployed. Search costs and other labour market frictions would not make it easy for the long-term unemployed to return to the workforce. High unemployment is correlated with mortgage defaults. Households in advanced economies of the Atlantic Alliance have very high exposure to mortgage debt. It is difficult to measure the magnitude of the problem at this stage. If indeed defaults are widespread then banks and mortgage lenders would be unlikely to absorb all the losses. Some of them might fold. If the other surviving financial institutions are exposed to the bad assets through financial derivatives then the contagion would be large. We would be experiencing a serious financial crisis.

12.8 The United States, China, Russia, India, and the EU: Key Powers in a Future System?

The transition towards a multipolar international system that was already set in motion after the dissolution of the USSR will only accelerate going forward. In what follows, I analyse what effect this transition will have on each of the major powers.

12.8.1 The United States

The surreal atmosphere of the Covid-19 pandemic calls to mind how I felt as a young man in the 84th Infantry Division during the Battle of the Bulge. Now, as in late 1944, there is a sense of inchoate danger, aimed not at any particular person, but striking randomly and with devastation. But there is an important difference between that faraway time and ours. American endurance then was fortified by an ultimate national purpose. Now, in a divided country, efficient and farsighted government is necessary to overcome obstacles unprecedented in magnitude and global scope. Henry A. Kissinger (2020)

The United States overextended itself since the conclusion of the cold war in 1991. Some of its major weaknesses going forward would be its highly leveraged economy, near unsustainable sovereign debt-to-GDP ratio, erosion of its industrial
base, extremely high military spending, expensive social entitlement programmes, and overreliance on the service sector. In addition to sovereign debt, the United States has very high exposure to household and corporate debts. Its budget and trade deficits continue to grow and it relies heavily on capital inflow from abroad. In other words, it maintains a large current account deficit which is growing over time. Its net foreign asset position is negative and growing over time.

So far, this has been manageable due to the global reserve currency status of the dollar. There is significant external demand for the dollar as it is widely used in international trade-related transactions, especially in the market for raw materials (petroleum, industrial metals etc.). However, an unprecedented pandemic induced demand and supply shock is likely to put immense pressure on the dollar. The US macroeconomic balance sheet is weak thus increasing the risk of a currency crisis and hyperinflation. The policy response following the pandemic and lockdown relies heavily on increasing leverage even further. Furthermore, it also offers an unprecedented fiscal stimulus (2 trillion dollars) effectively doubling the US Federal budget in a month. Such policy framework assumes that the pandemic induced lockdown is not going to last beyond 8–12 weeks. Therefore, the recession that would follow a lockdown is functional and not structural. Following the relaxation of lockdown, recovery from a functional recession would be swift and thus expanding leverage is not a risky strategy.

There are two major downsides to this strategy which is worth noting here. First, the United States economy has deep structural problems. As I have discussed above, its economy is highly leveraged. Therefore, the recession following a lockdown is unlikely to be functional if the pandemic lasts for 12 weeks or more. Job lost in the service sector, an important sector for the United States economy, would be difficult to regain within a short span of time. The pandemic would unleash unpredictable political forces, which could alter the current model of globalisation. It is highly likely that the rules of engagement in international trade and finance would change. These changes may not be favourable to the reserve currency status of the dollar. A highly leveraged economy would not work in favour of the dollar.

Due to the reasons outlined above, the impending structural recession in the United States would be deep and protracted. Undoubtedly, the effect of this economic contraction would not be uniform across society. This would likely unleash bitter distributional conflicts within the American polity. The sharp division in American politics following the election of Donald J. Trump is not a favourable starting point. Failure to unite the country could make distributional conflicts sharp and debilitating. The litmus test for national unity would be period after the presidential election in November.

Nevertheless, being a continental economy America has vast reserves of resources. Therefore, in the medium to long run it is likely to recover. However, its global military footprint would decline. The economic necessities would force

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3See the previous section for a discussion on the economics of hyperinflation.
4See discussion on unlimited asset purchase in the previous section.
America to retreat. Its aggressive military and foreign policy posture would wane. In spite of the weaknesses and challenges, it will remain a great power in the future.

12.8.2 China

China has vast amount of resources. It has massive financial reserves and low sovereign debt. It did increase private sector leverage following the 2008 financial crisis, but it is sustainable. China has strong macroeconomic balance sheet with large and persistent trade surplus and current account surplus. It has a large internal market of over a billion people. The economy mainly relies on manufacturing and it has a relatively low exposure to services. China definitely has policy space to grow its economy by boosting internal consumption. The OBR initiative and its close coordination with the Russian led EAEU would work in favour of the Chinese economy. These projects encompass economies with unutilised capacity. Therefore, realisation of the common infrastructure projects and market integration within the OBR-EAEU space would deliver scale economies to China sustaining its economic expansion.

Chinese foreign policy stance is less militaristic compared to the United States or the Atlantic Alliance. China’s military spending is approximately 10 times less than the United States and miniscule compared to the entire Atlantic Alliance. This would work in China’s favour going forward.

China is the only country so far to have successfully contained the COVID-19 epidemic. Therefore, it can start operating its economy at near capacity. It would suffer knock-on effects from the ongoing global recession but it is likely to be mild and brief. China has policy space. It will focus on domestic demand to ride the short-term negative demand induced shock. It will recover fast once the world reaches a permanent solution to the COVID-19 induced public health crisis.

Unlike the United States or Russia, China is not a continental economy. It is labour abundant but resource poor. However, it has strong neighbourhood advantages. The combined resources of a Russia–China alliance surpass any other alliance. Chinese authorities appear to be acutely aware of this fact and invest heavily in maintaining good relations with Russia. With the realisation of integration projects within OBR and EAEU, the China–Russia alliance will gain strength. Therefore, overall China is likely to have significantly more influence in international affairs barring a repeat of the Sino-Soviet split of the 1960s. Such split looks unlikely in the near future.

12.8.3 Russia

Russia enters the COVID-19-induced economic crisis with the strongest macroeconomic balance sheet of all the major economies. It has massive reserves relative to
the size of its economy and extremely low sovereign debt. Its corporate external debt is also very low. Its banks are well capitalised as it underwent banking reforms following the 2015 sanctions and oil price induced negative shock. Banks have very little exposure to external debt, as they cannot borrow on the Western financial markets due to sanctions. Russia leads a large market of 170 million people within the EAEU. The economy relies on agriculture and industry including raw materials and manufacturing. It has a service sector footprint mainly in urban areas but it is not as large as other advanced Western economies. It has high per capita income measured using the purchasing power parity (PPP) exchange rate.

Being a continental economy, it has all the resources required for economic expansion. It is labour scarce but resource and skill abundant. Following the EU and American imposed sanctions regime in 2015, it has successfully pursued import substitution policy rapidly diversifying its economy. It is self-sufficient in food and the largest exporter of grains (wheat and wheat-based products) in the world. It has a highly competitive raw materials sector. It also operates R&D intensive high-tech manufacturing industries such as aviation, space, automobiles, nuclear energy, and petrochemicals. It also has a vibrant information technology (IT) industry that is growing at a rapid pace.

Russia also has strong neighbourhood advantages. It is rapidly integrating its economy with the fast-growing economies of Asia and especially China. As I have mentioned earlier, the combined resources of a Russia–China alliance surpass any other alliance. Russian authorities like the Chinese authorities also appear to be acutely aware of this fact. Multi-level integration is currently underway using the EAEU, OBR, and SCO platforms.

Being the third largest exporter of crude following the United States and Saudi Arabia, Russia has significant influence on the market for this strategic resource. It has influences on a significant number of key market participants within OPEC and beyond. Therefore, in spite of the relatively moderate size of its economy, Russia’s economic influence around the world cannot be underestimated.

As the successor of a superpower such as the USSR, Russia’s diplomatic influence around the globe cannot be underestimated either. Russia is a permanent member of the United Nations Security Council. It has a strong conventional military force and a very competitive military industrial complex. It is the second largest exporter of armaments only next to the United States. It has strong military defence relationships with large countries such as India, Algeria, and Egypt. Its trade relationships with these countries are growing. The Syrian and Ukrainian conflicts are a testament to the military and diplomatic powers of Russia. It has successfully lured NATO power Turkey into acquiring Russian anti-aircraft missile system such as the S-400.

Undoubtedly, Russia will suffer from the negative consequences of the pandemic. The pandemic reached Russia late and remains largely contained. The human losses so far are less significant relative to the rest of the world. It has one of the lowest fatality rates from the pandemic. Russia is self-sufficient in medicine to tackle the pandemic. It has sufficient stocks of the locally produced drug Avifavir to treat the virus. It is also the first country in the world to complete clinical testing of its
coronavirus vaccine. Nevertheless, the pandemic drained Russian government resources. It caused high unemployment mainly in the urban services sector. However, the negative effects are small relative to other major economies. Given Russia’s strong macroeconomic fundamentals and its proximity to the Chinese and Asian markets, the ongoing recession is unlikely to be structural. Therefore, it is likely that the Russian economy will bounce back fast.

The long-term economic outlook also appears to be positive given the scale economy opportunities that the EAEU and OBR integration projects will unleash. The Russian government is currently investing heavily into infrastructure (hospital, roads, housing). It is also digitising the economy and modernising public services at a rapid pace. These are likely to deliver significant productivity dividends in the medium to long term. Overall, it is expected that the Russian influence in international affairs would only grow.

### 12.8.4 India

India’s macroeconomic balance sheet is stable. However, it would face major challenges in the short run. It has a relatively high stock of corporate debt. Bank balance sheets in India are not strong as most banks carry a large burden of non-performing assets (or loans). Many loans issued by the banks are unlikely to be repaid even though they remain on the bank’s ledger as assets.

India also has high exposure to FDI-dependent service sector jobs. India specialises in the offshoring economy and especially the back office functions of large multinational corporations. These formal sector jobs are related to the health of the parent company. Therefore, India is particularly vulnerable to external financial market volatility. If there are losses in the value of the parent company in the global financial markets, then local job losses will follow. These losses could very well be structural if there are policy changes in the home country of the multinational corporation.

Job losses in the formal sector could have adverse knock-on effects on the large informal sector. In spite of India’s recent economic success, it still remains one of the poorest in the world. In fact, World Bank estimates that the total number of absolute poor residing in India is far greater than the same in Africa. A crisis in the formal sector would present significant challenges for the Indian informal sector.

Moreover, the pace of the COVID-19 epidemic in India appears to be rapid. There are question marks concerning testing and reliability of the published data on infections and fatalities. Therefore, the actual extent of the pandemic could be even more severe. Eventually, India like all other countries will recover from this crisis even though the losses would be far greater than comparable economies. India’s success would depend on reorienting its economy towards the rapidly growing Southeast Asia and the strengthening of its vast internal market. Indeed, India has strong neighbourhood advantages. It also has untapped potential, a seemingly unlimited supply of young workforce (demographic dividend), and a very
large internal market. The degree of Indian engagement into the integration projects of EAEU and OBR would define India’s destiny going forward.

12.8.5 The European Union

What’s at stake is the survival of the European project. The risk we are facing is the death of Schengen. Emmanuel Macron, President of France, 26 March 2020, Source: Reuters

The European Union entered the pandemic-induced economic crisis ill prepared. The public health crisis rapidly escalated in Italy, Spain, France, and elsewhere. The European Union member countries have extremely weak macroeconomic balance sheet. Almost all the major EU economies have unsustainable sovereign debt. They are also locked into a common currency that makes their economy uncompetitive. The corporate balance sheets are not sustainable either. Sovereign debts in Italy, Spain, France, and Portugal are extremely high. Major European banks have very high exposure to this debt. The sovereign debt position is likely to worsen even further with the COVID-19 induced public health crisis and lockdowns. The ongoing recession is likely to be deep and protracted.

Even though the Euro is the second most used currency in the world, it does not have the same privileges as the dollar. Therefore, it is much more fragile and essentially relies on the macroeconomic balance sheet of Germany.

The public health crisis exposed weakness of the European projects as the member states had to fend for themselves. No meaningful help arrived from Brussels. It became very apparent that national governments are more effective in tackling public health challenges than supranational structures.

On economic issues, the heavily indebted nations of Greece, France, Italy, and Spain pushed for debt mutualisation. Their joint position during the recent EU Commission meeting was fiscal consolidation and the issuance of joint Eurobonds. If adopted, such proposal would imply a common tax system and more taxes in the future for the surplus countries of Germany, the Netherlands, Denmark, Austria, Finland, and Slovakia. In other words, taxpayers in the surplus countries would have to pay for the debt of the deficit countries. The joint French, Spanish, Italian, and Greek position in support of debt mutualisation was flatly rejected by the surplus countries. There is no realistic prospect of such proposal passing a German veto as this is against a ruling by the German Constitutional Court, which deems European debt mutualisation ‘unconstitutional’. As an alternative, Germany proposed strengthening the European Stability Mechanism (ESM) from the current 500 billion Euro to a trillion Euro. It is questionable whether this will ward off an impending sovereign debt crisis. Even if it does, the ESM would impose more austerity on the deficit countries weakening their economies even further. It remains to be seen whether the indebted countries would accept such a debt trap.

Regardless of the outcome of current round of negotiations on the ESM, the Euro remains unsustainable. It is likely that the deficit countries would have to eventually
exit the Euro. The pandemic-induced economic crisis and another round of austerity imposed by the creditors behind the new ESM would unleash unpredictable political forces that could permanently change the European political landscape. The already battered European Union may not survive such a political earthquake.

12.9 Final Word

We are standing on the threshold of a multipolar world order. This new order was long time in the making but the pace of transformation accelerated following the ongoing coronavirus pandemic. As it appears so far, the pandemic is disproportionately affecting the Western Alliance, especially the United States and the EU. However, the risk of a second wave elsewhere remains significant. It is beyond doubt that the pandemic will leave indelible impact on the international system. In the emerging multipolar world order, China, Russia, and perhaps India are likely to have leading roles. Given the resource endowments and mutual compatibility, the combined economic power of China and Russia is likely to surpass that of any other competing alliances. So far India has maintained a safe distance from any potential alliance but the post-pandemic economic realities may very well change this position. It is likely that India will increasingly align with Russia and China on economic issues and with the United States on security issues. The United States is likely to remain a significant player in a multipolar order but its overleveraged and fragile economy will force it to retreat. It is unlikely to remain a hyper power. The future of the European Union appears to be uncertain. It may or may not survive the existential challenge thrown its way by the pandemic. The pandemic has exposed inherent weaknesses of its overleveraged economy and institutions. It does not possess military power of any significance. The outcome of the existential challenge will decide whether the European Union will have a seat on the high table.

We are witnessing a critical juncture in economic history where the future is likely to be significantly different from the past. The international economic system, especially since 1991 has relied on three fundamental principles namely free movement of goods and factors of production, financial leverage, and greed. The pandemic-induced public health crisis has rudely exposed weakness of that system. The impending economic crisis would force many countries to rethink the three fundamental principles of global engagement. I suspect many would choose a system based on need, less leverage, and factor movement restrictions. This undoubtedly would shape elite feuds and imperial expansions of the future.

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