INVESTING IN TIMES OF THE PANDEMIC: HOW COVID-19 IS RESHAPING GLOBALIZATION

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This report was written by Eurasia Group at IMCO's request to provide perspective on how the Covid-19 pandemic has affected global political and economic trends. It forms part of IMCO's ongoing research and analysis of how shifts in geopolitical dynamics will affect investments and investment strategy.

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PREFACE

The coronavirus pandemic has claimed over 4.7 million lives and infected over 230 million people as of this report's writing. Lockdowns and border closures have slowed—and in some cases stopped—the movement of goods and people as countries attempt to contain the pandemic. The International Monetary Fund (IMF) memorably warned of a "Great Lockdown" last April, and Boeing estimated last month that international air travel may not return to its pre-pandemic levels until late 2023 or early 2024.

It would be premature to pen an obituary for globalization. While global economic output plunged by 3.2% last year, it is forecast to increase by 6% this year and by 4.9% in 2022. The latest update from the UN in May reported that global trade in the first quarter of this year was roughly 3% higher than it was in the first quarter of 2019. And digital connectivity has rapidly expanded as individuals have gotten used to attending school online and working remotely.

Still, after successive waves of infection and nearly two years of living with the virus, the world is even more riven by competition and fragmentation. The world's most important bilateral relationship is deteriorating, even though US President Joe Biden stressed at the UN General Assembly meeting last month that the US and China must cooperate: "[W]e'll all suffer the consequences of our failure," he warned, "if we do not come together to address the urgent threats like Covid-19 and climate change or enduring threats like nuclear proliferation." As countries across the world increasingly seek to mitigate economic risks related to globalization, trade flows and supply chains are being disrupted. And the rise of nationalism and the intensification of great-power frictions make it increasingly difficult to marshal collective action on the most systemic challenge facing our world—climate change. Meanwhile, disparities in economic recoveries and vaccine access are exacerbating inequality among and within countries, further complicating efforts to nurture global cooperation.

US-CHINA RELATIONS

Most analyses of global trends either begin with or soon arrive at the relationship between the world's two most powerful countries. The pandemic has exacerbated strategic competition between the US and China, with most observers arguing that the bilateral relationship is at its lowest point since the normalization of ties between the two in 1979.

Former president Donald Trump's administration fundamentally reset US policy toward China, arguing that engagement had failed, that Washington needed to act more aggressively to protect itself from economic espionage, and that the US needed to prioritize the development of emerging technologies to prevent China from overtaking it as the world's preeminent power. Accordingly, the Trump administration imposed tariffs on Chinese exports and undertook a pressure campaign to curb the expansion of Chinese technology companies such as Huawei, the world's leading provider of 5G mobile technology. In response, China moved to find alternative export markets and accelerate innovation.

The pandemic only heightened the conviction in Washington and Beijing that interdependence was more of a liability than an asset. The US was alarmed to discover how much it relied on China for essential pharmaceuticals—and how dominant a position China had in global supply chains more generally.

Full decoupling is not feasible, but selective disengagement will continue. Pursuant to Executive Order 14017, the White House published a detailed report on the US's supply chain vulnerabilities in June. It features reviews by the Department of Commerce of semiconductor manufacturing and advanced packaging; by the Department of Energy of large capacity batteries; by the Department of Defense of critical minerals and materials; and by the Department of Health and Human Services of pharmaceuticals and active pharmaceutical ingredients.

Also in June, National Economic Council Director Brian Deese announced the Biden administration's plan for "a twenty-first century American industrial strategy," arguing that "the idea of an open, free-market global economy ignores the reality that China and other countries are playing by a different set of rules." The Senate and the House are in negotiations over the Innovation and Competition Act, a piece of legislation aimed at boosting US scientific and technological competitiveness referred to in the media as "the most significant government intervention in industrial policy in decades."

China, meanwhile, is pursuing its "dual circulation" strategy—which stresses the importance of domestic consumption and innovation—and is moving to reduce the reliance of its supply chains on US inputs. It is set to spend 10.6 trillion renminbi ($1.6 trillion) through 2025 on next-generation technology infrastructure. While advanced industrial democracies will not march in lockstep against China, Beijing fears that they will increasingly coordinate to stymie its technological progress.

While observers debate whether the US and China have entered into "a new Cold War," their relationship is increasingly, if not irreversibly, adversarial. The Biden administration's interim national security strategic guidance, issued in March, calls China "the only competitor potentially capable of combining its economic, diplomatic, military, and technological power to mount a sustained challenge to a stable and open international system."

The administration justified its decision to end the US's nearly 20-year intervention in Afghanistan in part by arguing that Beijing would like to see Washington indefinitely bogged down in "endless wars," and it says that the US's ability to recover steadily from the pandemic and make long-term investments in domestic infrastructure will be key litmus tests of the country's governance. The administration sees US-China competition as embodying a larger, systemic struggle between democracies and autocracies. As it works to “build back better” at home, it is also looking to restore longstanding US alliances and partnerships. Perhaps the most important component of the Biden administration’s envisioned coalition against China is the Quadrilateral Security Dialogue (the Quad), a grouping of the US, Australia, India, and Japan. The leaders of the four countries met in Washington on 24 September for the first-ever Quad Leaders’ Summit, with China looming large in their discussions. Just a little over a week before, Washington, London, and Canberra announced the creation of AUKUS, a trilateral security partnership whereby the US and the UK will help Australia build at least eight nuclear-powered submarines over the coming decades.

China believes that the US is embarking on a new containment campaign and is therefore girding itself for protracted struggle with the world’s lone superpower. But Chinese leaders believe they are in a stronger position than their adversary. China has recovered quickly from the pandemic; the country’s GDP is on course to overtake that of the US within the next decade; and Beijing is joining major trade agreements such as the Regional Comprehensive Economic Partnership at a time when Washington is wary of doing so.

The good news is that the probability of an armed confrontation between the two powers, while increasing, remains low. The most concerning scenario involves Taiwan, which China considers sovereign territory. Beijing has increased its pressure on Taipei and repeatedly avowed that its “national rejuvenation” requires the island’s reunification with the mainland. But China has not shown any urgency to undertake that task, and it understands that the potential consequences of attempting an incursion would be devastating. These could include military retaliation by the US; massive economic sanctions; and interruptions to the operations of Taiwan Semiconductor Manufacturing Company (TSMC), the world’s most important semiconductor company, whose chips are indispensable for China’s technological progress. Still, with frictions rising in the Asia-Pacific, it is concerning that high-level military communication between the US and China remains strained and sporadic.

GLOBAL COMPETITION AND COOPERATION

TRADE AND RESOURCES ARE GROWING AREAS OF COMPETITION

Though Washington and Beijing now take a much dimmer view of trading with each other, they previously regarded these exchanges as a stabilizing force in their relationship. Trade, more generally, was a core driver of globalization for the better part of a half-century, as countries lowered barriers to commerce to promote value-added growth and more efficient supply chains. That movement culminated with the 1995 founding of the World Trade Organization as the arbiter of international trade disputes.

While the US's outlook on trade had already begun to change under the Trump administration, the pandemic strengthened the shift toward a more protectionist approach to trade policy—not only in the US, but in countries around the world.

As this shift continues, countries are also using trade policy more openly as a tool of diplomacy, rather than simply as a means of deepening bilateral and multilateral economic ties. China has been an early adopter of this approach, especially as it has pursued an increasingly assertive foreign policy. Beijing's manufacturing heft has given it a dominant position in global trade, even as the pandemic has compelled countries around the world to consider how they might reduce their reliance on its exports. While there has been a notable slowdown of US-driven trade deals, China has sought to act as a champion of free, multilateral trade to distinguish itself from the US and deepen the dependence of other countries on its market. That China formally submitted its application for membership in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership the day after AUKUS was announced testifies to the premium it places on strengthening its trading position.

China will continue to wield access to its nearly 1.4 billion consumers as leverage to extract concessions from companies and countries alike. After Australia called for an independent inquiry into the origins of the coronavirus, for example, Beijing pushed back forcefully, imposing tariffs on and limiting imports of a range of Australian goods. China also uses the "gravitational pull" of its economy to secure more favorable terms on raw material supplies, not only through increased economic ties with key providers of those goods, but also through investments associated with its principal geoeconomic program: the Belt and Road Initiative.

China's increasing use of economic initiatives as instruments of its foreign policy has provoked a sharpening reaction from strategic competitors within and well beyond the Asia-Pacific—most prominently the US. Beginning in 2018, Washington abandoned its prior emphasis on trade liberalization, one shared by administrations of both parties, and embarked on a new course of penalizing Beijing for a range of transgressions that included forced technology transfer, intellectual policy theft, commodity dumping, and industrial subsidies. Trump administration officials cited those issues as the primary causes of the decline of America's working class, and they imposed a broad range of retaliatory Section 301 tariffs on more than $380 billion in Chinese products. A phase one agreement between Washington and Beijing temporarily stopped further escalation of the trade war—the administration agreed not to apply additional 301 tariffs in exchange for Chinese commitments to purchase agricultural products, manufactured goods, and energy from the US—but it is set to expire at the end of 2021. The US also renegotiated the North American Free Trade Agreement to form the United States-Mexico-Canada Agreement, which includes greater protections for US labor and industry.

The tariffs imposed by the Trump administration did little to undercut China's dominance of global goods trade. Indeed, even as systemic bilateral competition between Washington and Beijing continues to generate trade uncertainties, the latter is in a much better position to take advantage of them—even in the Asia-

Pacific, where many of its neighbors are increasingly apprehensive of Chinese military modernization and strategic ambitions.

The Biden administration has been cautious about pursuing new trade deals during its first nine months in office, owing to its prioritization of other policy areas, particularly domestic spending programs; an aversion of Biden's core political constituencies to trade liberalization; and a strategic pause, as the administration completes a comprehensive review of foreign policy, especially that related to China. Still, one area of potential progress is on digital trade. Kurt Campbell, the Indo-Pacific Coordinator on the National Security Council, has championed the concept of a digital trade deal for the region, and many countries there, including Australia and New Zealand, have already requested formal engagement on the topic.

Where the Biden administration and like-minded international partners have been more active is in the areas of supply chain analysis and policy development to drive diversification away from China. The administration's aforementioned report on supply chain vulnerabilities focused heavily on domestic investment opportunities to reshore significant parts of the supply chains for semiconductor manufacturing and advanced packaging, large capacity batteries, critical minerals and materials, and pharmaceuticals and active pharmaceutical ingredients. Metrics used to gauge industry vulnerabilities included single-source dependence, the possibility of dual-use applications, and the potential for supply chain disruptions to have an outsized impact on US domestic manufacturing capacity. The report issued recommendations for attracting supply chains to the US and for fighting back against trade-distorting practices abroad. It also led to the creation of a so-called Trade Strike Force, led by the office of US Trade Representative, to marshal existing trade enforcement tools across the US government.

Like the US, the EU is conducting its own supply chain vulnerabilities review; it published a report this March that explored how it could promote reshoring in the fields of pharmaceuticals, medical products, semiconductors, and solar energy.

While the US and EU reviews both call for cooperation with like-minded partners to address supply chain security and resilience concerns, with fora such as the US-EU Trade and Technology Council (TTC) and the Quad actively discussing ways of addressing them, there will be areas in which significant onshoring will prove difficult in the near to medium term. Advanced industrial democracies will find it challenging, for example, to reduce their dependence on China's capacity to process and refine critical minerals and rare earth elements. Development of new capacity comes with significant environmental costs, creating policy conflicts for countries seeking to pursue greener growth. Latin American countries such as Chile and Argentina are potential winners from this push given that they have significant critical mineral deposits and have made less ambitious climate pledges; moreover, the Inter-American Development Bank has made investments in new refining capacity a priority.

THE GLOBAL TECHNOLOGY ECOSYSTEM IS FRAGMENTING

Heightened concern over supply chain vulnerabilities has, unsurprisingly, coincided with growing technological fragmentation. While the pandemic has forced the world to increase its reliance on technology—think of how indispensable platforms such as Zoom, Webex, and Microsoft Teams have become to universities and companies—it has also made apparent to policymakers how much influence they have ceded to major technology companies and, as noted earlier, how vulnerable critical tech supply chains are. National authorities are fighting back, looking to defy a new wave of speculation about the growing irrelevance of the state.

China has been especially vigorous in cracking down on big tech. It once viewed domestic internet giants such as Alibaba in a mostly favorable light, seeing them as proof that China could innovate as capably as the West, if not more. But Chinese tech titans' adoption of aggressive business practices and expansion into several traditional sectors—including media, transportation, tutoring, and financial services—had mixed social implications. Beijing, meanwhile, decided that too many of these services were insufficiently unregulated and that a lack of government supervision could undermine the ruling Chinese Communist Party's (CCP's) hold on power.

In November 2020, the Chinese government stepped in to prevent the planned initial public offering of Ant, an affiliate of Alibaba that ran China's largest digital payment platform and whose online investing, insurance, and consumer lending businesses held assets of almost $635 billion. Concerned that Ant's shadow lending heightened instability in a Chinese financial system already struggling with excessive debt loads, authorities decided to crack down on the company.

Regulators soon thereafter launched a comprehensive review of the technology sector and took steps that have fundamentally changed the business environment for Chinese platform companies, including revising the country's antitrust regime and data governance framework to target e-commerce sites' anticompetitive behavior, enacting a new law to curb data companies' unfair pricing schemes, and taking minor stakes in platform companies that operate in politically sensitive fields.

The US is also becoming more active on the regulatory front. Biden signed an executive order in July giving the Federal Trade Commission the ability to challenge prior "bad mergers" and limiting noncompete agreements. His administration's willingness to act stems from a shift in the broader US political view of powerful technology companies. Those who believe China poses a critical threat to the future of US leadership—particularly in the realm of frontier technology—argue that the government needs to curb these companies' globalist tendencies and transform them into 21st-century national champions (such as Lockheed Martin). Some in Washington contend that the top issue facing the US is not China but entrenched special interests that have gained massive wealth and power within the US while equality of opportunity and civil society have eroded. They want to tax, regulate, and potentially even break up big technology companies. On at least this one issue, then, there is rare bipartisan agreement: The US needs to rein in big tech.

Europe is increasingly on board with this idea as well. The TTC held its inaugural meeting on 29 September; a joint statement published afterward noted that Washington and Brussels have "identified common issues of concern." The statement said these issues included illegal and harmful content and its algorithmic amplification, transparency, access to platforms' data for researchers, and the democratic responsibility of online intermediaries. Even so, the US and the EU are unlikely to achieve regulatory harmony given that some EU officials maintain that Brussels must uphold its "digital sovereignty" and take care not to align too closely with Washington in challenging China's state capitalist model.

The upshot is that the US, the EU, China, and others will increasingly have their own versions of the online experience and diverging approaches to tech regulation, presenting big tech companies with a labyrinth-like global business environment.

Another trend driving fragmentation is the weakening of technological supply chains, which is pushing governments and companies to reevaluate their access to critical technologies. The pandemic disrupted the supply chain for semiconductors, leading to a chip shortage that is affecting car and medical device manufacturers. As a direct consequence of that shortage, TSMC has announced that it is raising semiconductor prices by as much as 20%.

Geopolitical pressures are adding to the strain on this supply chain. US actions against Huawei in 2019 and 2020, including delaying or denying export licenses, effectively cut the company off from TSMC's chips, leading it and other major Chinese firms to stockpile chips. Beijing is also massively ramping up its internal development capability to skirt US restrictions, and China could ultimately use the chips it develops as strategic weapons, giving them to friendly countries and denying them to unfriendly ones.

Other countries are also seeking a competitive advantage in this industry. White House officials have hosted meetings over the past several months on the chip shortage and have contacted Taiwanese officials to ensure that US firms' needs for specific semiconductors are being addressed. Industry participants in these meetings, which excluded China-based firms, voiced support for working closely with allies and partners to track shortages, expressing unanimous support for ramping up domestic investment in research and manufacturing capacity. The Innovation and Competition Act, a revised version of which Congress will likely pass before the end of the year, would allocate $52 billion to semiconductor research and manufacturing. The EU, for its part, recently confirmed that it will advance a new EU Chips Act, which is intended to shore up the bloc's position in the value chain.

While governments' efforts to develop advanced semiconductor manufacturing in new locations and expand industry capacity may not remedy the current chip shortage, they are another example of growing technological fragmentation. Technology will increasingly comprise multiple systems, not only in terms of regulation, but also in terms of production. Just as the geopolitical order is leaderless and increasingly volatile, so, too, is the technological order.

CLIMATE COOPERATION IS PROVING ELUSIVE

Perhaps nowhere are the consequences of competition and fragmentation more apparent, and concerning, than in the fight against climate change, arguably the foremost test of the post-pandemic order.

The news is not all grim. Indeed, many governments are acting with greater urgency, precisely because the pandemic has placed the current order's inability to address transnational challenges in such sharp relief and made clear that countries cannot wait for or rely on large-scale multilateral action to protect their own vital national interests. The Biden administration has pledged to reduce US greenhouse gas emissions by at least 50% from 2005 levels by 2030, and it would like the US to achieve net-zero emissions by 2050. Biden stated at last month's UN General Assembly meeting that he would seek to double the amount of US aid he had pledged in April to assist developing countries in their efforts against climate change; if he succeeds, Washington would allocate about $11.4 billion annually by 2024. China has committed to achieving peak emissions before 2030 and aims to achieve net-zero emissions by 2060. It has also pledged to stop building coal-fired power plants abroad. The EU, meanwhile, has committed to reducing the bloc's emissions by at least 55% from 1990 levels by 2030.

Unfortunately, though, growing geopolitical tensions are testing the bounds of international cooperation: Even as the urgency of mitigating climate change and its far-reaching consequences grows more apparent, nationalism is increasingly permeating global dialogues and dampening expectations. As the global fight for competitive advantage through and beyond the energy transition intensifies, conflict is outpacing cooperation, with net-zero aspirations increasingly colliding with the realities of G-Zero (the term coined by Eurasia Group founder Ian Bremmer to describe a situation in which no country or bloc of countries has the political and economic leverage to drive an international agenda). As a result, the push to tackle climate change will be defined by unilateral government actions to make the global economy and global markets greener. Developing countries face a dual challenge in trying to develop and decarbonize at the same time amid all-time low levels of economic and political solidarity.

These tensions will be on full display in the run-up to the November climate change conference known as COP26. The Paris Agreement reflects the concept of "common but differentiated responsibilities and respective capabilities," recognizing that while all countries must act on climate concerns, expectations must account for deep differences in levels of economic development. With that recognition came a commitment to transfer $100 billion yearly by 2020 to support the developing world's decarbonization efforts, a target that was missed. Without fundamentally decoupling emissions growth from economic growth in countries such as China and India, the world stands little chance of arriving at a cohesive, globally coordinated approach to addressing climate change. Meanwhile, as they seek to achieve domestic targets and build economic capacity for competitive advantage in an evolving global economy, climate champions such as the US, the EU, and Canada will struggle to mobilize public support fast enough. The energy transition itself, meanwhile, is proving to be deeply disruptive to domestic politics, as fossil fuel industries are increasingly seen to be the home of stranded assets.

Nationalistic sentiment is another impediment to fighting climate change, illustrated perhaps most clearly by the challenge of carbon leakage. As national governments press ahead with emissions-reducing policies, particularly carbon pricing, they run the risk of losing industrial activity to jurisdictions with more lax emission constraints. EU leaders have proposed to address the problem with a carbon border adjustment mechanism that would impose an import levy on trading partners with lower carbon pricing—a proposal some observers have criticized as a form of trade nationalism.

At the same time, trade represents a pathway to drive global efforts to address climate change. Most recently, the EU has used negotiations with Mercosur—a trade bloc comprising Argentina, Brazil, Paraguay, and Uruguay—to drive behavioral change in the developing world. This strategy has paid some dividends, but intensifying geopolitical frictions will likely prompt climate leaders with market power to rely more on sticks than carrots.

IMPLICATIONS FOR EMERGING MARKETS

THE PANDEMIC HAS INCREASED INEQUALITY AMONG COUNTRIES

No analysis of the pandemic's consequences, however cursory, would be complete without at least some consideration of the economic damage it has wrought. Thus far, as one would expect, the damage has been distributed unevenly across national economies; similarly, policy responses across countries have varied widely, leading to a K-shaped recovery in which advanced economies progress along the upper prong while many emerging market economies falter along the lower prong.

The unevenness in the recovery has implication for the shape and pace of globalization. Lagging recoveries, challenges in regaining pre-pandemic rates of growth, and heightened vulnerabilities threaten the full participation of emerging markets, which have limited monetary and fiscal space to blunt the pandemic's worst effects. Yet many of them have undertaken more expansive efforts than ever before, often to an extent that markets would have harshly punished in previous times. Emerging market central banks reduced interest rates to historically low levels, and some launched quantitative easing programs, but these efforts have often exacerbated imbalances; government debt in emerging markets is expected to surpass 65% of GDP this year, up from less than 55% just before the pandemic. While market interest rates have remained low, emerging market economies will become vulnerable when advanced ones rein in stimulus and move toward tighter monetary policy. They could confront outflows from both debt and equity markets, with countries borrowing in foreign currencies facing particularly acute risks.

In a move away from coordinated global crisis policies, international and multilateral institutions such as the IMF will become less accommodating. Early in the pandemic, global institutions used their ample lending power to provide assistance to emerging markets, often in the form of light-conditionality rapid financing. More recently, the IMF announced an unprecedented increase in credit lines with a $650 billion special drawing rights allocation. Going forward, though, lending will have more strings attached, meaning it will be more difficult for countries with debt problems to turn to multilateral authorities for relief.

Differential levels of vaccine access are also driving higher inequality among countries. While over 44% of the world's population had received at least one dose of a coronavirus vaccine as of the end of September, the figure for residents of low-income countries was just over 2%. If current trends persist, some countries may not receive any doses until 2023. The longer it takes for widespread vaccination to begin, the greater the impact on health and economic well-being, especially among lower earners.

THE PANDEMIC HAS ALSO INCREASED INEQUALITY WITHIN COUNTRIES

The pandemic's uneven impact on different demographic groups and segments of the labor force has also led to increased inequality within countries, with lockdowns and business closures generally hitting those on the lower end of the income distribution hardest. Low- and middle-wage industries experienced especially severe disruptions. As mobility rates plunged, the blow to the service sector had an outsized impact on women and minority groups, whose employment in many countries tends to be concentrated in services. Women were also disproportionately burdened with childcare responsibilities as schools and daycare facilities shuttered, forcing many to leave the labor force.

Because the pandemic has accelerated technological uptake in many fields, it is likely to lead to more remote work and greater digitalization over time, which are also likely to widen inequalities within societies. Certain sectors can adjust to remote work relatively easily, but other professions are ill-suited to this change; some may even become obsolete. These realities risk “hollowing out the middle” of the labor force, with dislocated middle-skilled workers forced to compete for low-paying, low-skilled work, while jobs requiring higher skills are increasingly performed remotely.

In the early months of 2020, several countries—led by the US and members of the EU—passed record spending programs, eviction moratoriums, and other forms of support. Accompanied by large-scale monetary easing, these extraordinary measures have softened the blow of unemployment for many households. But once the measures run out, many citizens will be worse off, especially in emerging markets, where the space for fiscal stimulus is limited and most policy responses were one-offs.

While most analysis of inequality tends to focus on income, the pandemic is also likely to increase wealth inequality. In developed countries, particularly the US, ultra-accommodative monetary policy has accompanied loose fiscal policy, cushioning the impact of the pandemic on credit and employment while fueling rapid growth in equity markets. These wealth effects have disproportionately benefited rich households, which hold more of their wealth in financial assets.

Rising income and wealth inequality have fueled existing political frictions, especially in emerging markets. The frustration of those who lost their livelihoods during the pandemic will test social stability and could lead to unrest. The pandemic will almost certainly affect voting behavior as well, potentially boosting support for populist leaders. While Black Lives Matter protests and the Capitol riot in the US demonstrate that large-scale protests can occur in wealthy and developing countries alike, destabilizing political events such as coups and terrorist attacks are more likely to take place in the latter. In middle- to high-income countries, the consequences of rising inequality are likely to be stronger populist or anti-government sentiment or other changes in voting behavior, such as widespread abstention or support for protest parties.

IMPLICATIONS FOR CANADIAN INSTITUTIONAL INVESTORS

As the pandemic continues to shape globalization, what are the main implications for long-term Canadian institutional investors? First, they should assess global trends within a G-Zero context, in which global leaders will struggle to galvanize collective action, whether it be to solidify climate commitments, establish cyber rules of the road, or slow the spread of future pandemics.

The fragmentation that arises in a G-Zero world will create winners and losers, both in terms of industries and geographies, producing new opportunities for investment. On balance, the pandemic has also reduced the tail risk of conflict by undermining all military powers’ confidence in victory. On the other hand, the pandemic’s effect on inequality may increase the allure of populism in some states, leading to dysfunction and erratic policymaking. In the long run, sustained populist sentiment might also raise the risk of miscalculation, potentially increasing the risk of conflict once again.

Second, Canadian investors should examine their portfolios through the lens of US-China strategic competition. Structural factors and hardening attitudes in each country will perpetuate the intense rivalry, leading to more decoupling in the technology sector; selective market access for Western capital in China; and potential benefits for third countries in regions where Washington and Beijing are vying for competitive advantage. Canadian investors should understand that China considers Canada to be a proxy for the US, and it may accordingly take aim at Canadian interests to undermine those of the US. Long-term investors are less prominent targets than Canadian goods exports or iconic brands, but they could become vulnerable if US-China relations continue deteriorating.

Canadian investors also need to reflect on the troubled state of Sino-Canadian relations, despite Canada’s release of Meng Wanzhou and China’s release of Michael Kovrig, a former diplomat and a senior advisor to the International Crisis Group, and Michael Spavor, an entrepreneur who worked to develop international business and cultural ties with North Korea. These considerations imply a series of Canada-specific political risks, distinct from US-China tensions; Canadian firms should not count on US support in the event of Chinese retaliation against them.

A final implication for Canadian institutional investors is that state interventions in markets are likely to increase in frequency and scope. The pandemic has convinced many policymakers that maintaining access to sufficient supplies of essential goods—such as medical equipment and vaccine doses—is imperative to national security. The weaponization of trade has further contributed to the revival of state involvement in the economy; consequently, investors should expect greater forays into industrial policy and other forms of intervention, even in countries with generally pro-market policies.

But more government intervention need not be a net negative. Identifying the industries and firms that stand to receive the greatest degree of state support could allow Canadian institutional investors to readjust their portfolios and improve their returns. Discerning these new areas of opportunity—and avoiding the many sources of downside risk—will require additional investment in foresight, horizon-scanning capabilities, and careful due diligence.

CONCLUSION

Even as vaccination rollouts gain momentum across the world, the pandemic is likely to persist for some time; vaccine access is highly uneven, new mutations of the coronavirus continue to emerge, and epidemiologists are actively debating the necessity of booster shots for fully vaccinated individuals. How the pandemic transforms globalization in the coming months and years remains to be seen.

To date, though, the health crisis has not so much introduced new trends as it has intensified those that already existed on 11 March 2020, when the WHO officially declared Covid-19 a pandemic. The US-China relationship had been trending downward, taking an especially sharp turn for the worse with the arrival of the Trump administration. Observers had been sounding alarm bells about nationalism, technological fragmentation, and insufficient global cooperation for well over a decade, especially since the onset of the 2008 global financial crisis. And they had been lamenting growing inequality, among and within countries, for far longer.

That these trends are not new does not make their intensification less worrisome; on the contrary, it is distressing to consider the possibility that the gravest crisis so far this century is making the world less capable of managing its current challenges and preparing for future ones. Canadian institutional investors should assume that both the G-Zero phenomenon and US-China strategic competition will grow more entrenched. They should further anticipate a sustained increase in state-led market interventions as governments seek to reduce their vulnerabilities to globalization. As challenging as it will be for institutional investors to navigate the emerging post-pandemic world, a careful consideration of geopolitical risk will improve the odds of good performance on behalf of their fiduciaries.

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