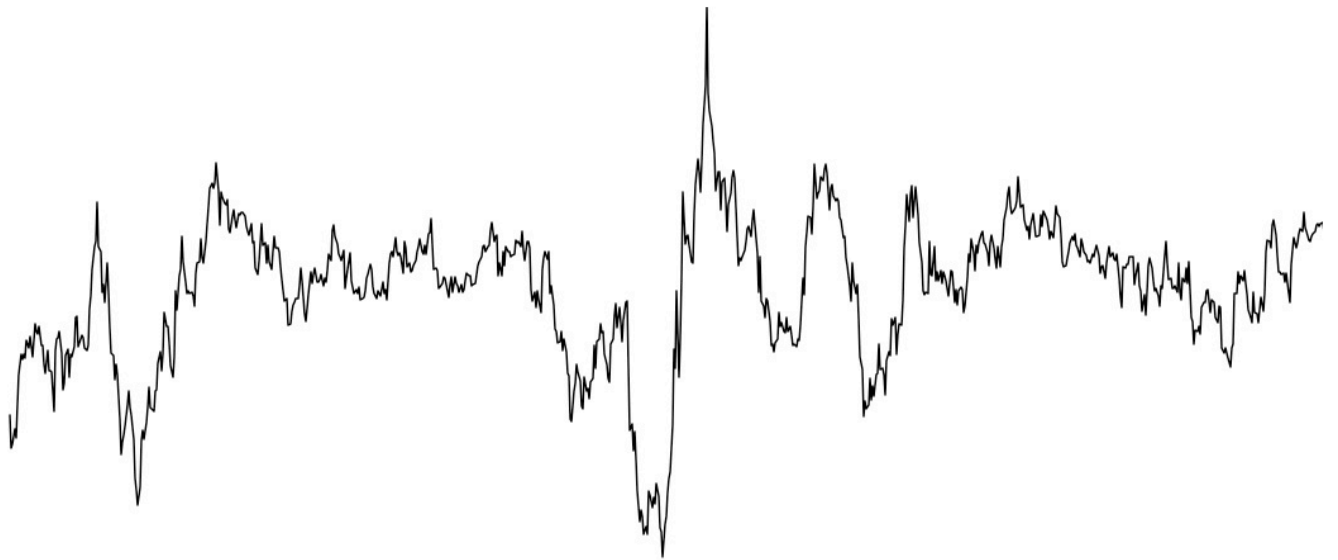


ALPHA SOURCES

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TO WAR?

It's little over a year ago that that I almost choked on my coffee when I read in the FT that Blackrock, one of the world's largest asset managers, was [recommending investors to increase their allocation to Chinese equities and bonds](#). This wasn't because I thought this was a bad investment, per se, The comment by Wei Li, chief investment strategist at Blackrock, that Chinese assets are

under-represented in portfolios given the relative size of China's financial market is probably true. More interestingly, in a world where (some) economists are worried about the imbalanced trade relationship between the US and China—due mainly to subdued Chinese domestic demand and excessive savings—a reversal in capital flows between the world's major economies is

** This piece has been slightly amended from its original version, but none of the main points have been altered.*



exactly what the doctor ordered. This is especially the case if, as is customarily hoped, it coincides with a liberalisation of and the opening of China's capital account, and more freely floating CNY.

CAN YOU INVEST IN CHINA?

The reason I almost choked on my coffee is because it is difficult to come up with a more jarring contradiction than the one between the proposal by Blackrock and the increasingly adversarial relationship between the US and China in both the economic and political realm.

A few months before the FT article, [I had pondered a similar concrete contradiction](#) between the robust unhedged returns on display in Chinese government bonds, for USD-based investors, and

the political economy implications of such flows. I made the following point at the time, which still stands;

“lending money to China's government to fund domestic investment, some of which invariably will go to defence, probably doesn't get you on the White House's Christmas list. (...) I think the mismatch between the increasingly tense geopolitical relationship between China and the U.S., and the fact that capital and goods still flow more or less freely—with the exception of direct outflows from China's mainland—between them represent an enormous tail risk for markets.”

Fast forward to today; US speaker of the house Nancy Pelosi has just completed a controversial visit to Taiwan, dialling up tensions with China to a hitherto unseen



level, and raising [some eyebrows among US allies](#).

This happened only a month after the FT reported that US and European investors have [just piled in a record amount of money into Chinese stock ETFs](#) as zero-Covid restrictions have faded, and the prospect of easier macro policy is now a bit clearer.

At some point, the contradiction between an increasingly cold geopolitical relationship between the US and China, and the idea of Chinese financial assets as a great investment opportunity, as well as the free flow of capital between the US/ Europe and China, will hit home. [When it does](#), the world will change.

THE WAR ECONOMY

Noah Smith has recently put a lot of thought into how a new world of geopolitical competition will look like, invoking the [war economy](#), predicting [a video-game like contest](#) between the West, and possibly India, against China and Russia. As an aside, I wonder where Turkey falls along this spectrum?

He explains why this new struggle for power will, in the economic sphere, be determined [primarily in the space of chips and semiconductors](#). Finally, he asks [whether we could sanction China](#), presumably in the same way that we have sanctioned Russia, after its attempt to invade Ukraine.

Noah isn't the first who have thought along those lines, but he is certainly one of the



first to flesh it out in such detail. The main thrust of his story goes as follows.

The western world needs to orient around a new major political and economic narrative, or at least a significantly altered one, compared to the post-1989 liberalisation, economic integration and globalisation story that has dominated the past three decades.

The West has two choices, broadly speaking. It can organise around a neo-Malthusian Marxist de-growth narrative to reverse climate change, or it can converge on the idea of a power struggle, and an external enemy attempting to topple the west as the centre of global economic and military power.

I agree with Noah that the first is a non-starter—scaring people to care about the climate won't work—even if this particular kind of fervent climate change call-for-action won't go away anytime soon.

This leaves an existential contest between the west and Russia/China as the most obvious new organising principle. Between the war in Ukraine and the now sub-zero geopolitical relationship between the US and China, it is difficult to escape the conclusion that this contest is now in full swing.

This new political economy of war, and geopolitical contest, has two central elements.

1 – A new post-globalisation industrial economy

In this economy, the disinflationary and aggregate output



enhancing effects of globalisation are sacrificed on the altar of self-sufficiency, and fierce economic and political competition. It is also an economy where government intervention rises substantially, in a dirigiste-like manner. Writ large, it means a global economy with reduced capital and goods mobility, higher domestic inflation, and a dramatic shift in product and labour markets benefiting from the status quo of the liberal/globalised world order; I am looking at you international finance, technology, consumer goods, and international trade.

Zoltan Pozsar, a strategist at Credit Suisse, offers an interesting economic perspective on this in his latest missive; [war and interest rates](#). He offers the following premise, which is a plausible flip side

of the coin that Noah Smith is describing.

“Russia and China have been the main “guarantors of macro peace”, providing all the cheap stuff that was the source of deflation fears in the West, which, in turn, gave central banks the license for years of money printing (QE). But now that the pillars of the low inflation world are changing... ...central banks are done with fighting deflation with asset price inflation, and are now fighting inflation with asset price deflation. Central banks are adapting”

This is somewhat hyperbolic, but I think it makes sense if we consider the argument in reverse. **The macro- and political peace will be up-ended if the West enters an existential adversarial contest with China and Russia.**



Zoltan continues with the following important point on inflation in this new world;

“the unfolding economic war between great powers is stochastic and not linear, and what inflation will do in the future does not only depend on the shocks that occurred in the recent past, but also on the many shocks that can happen still. These include more sanctions and the further weaponization of commodities, and more technology sanctions and further supply chain issues for cheap goods.”

2 – Us vs Them

The second element of a new economic and political order in which we’re in an existential fight with China and Russia is that there is no room for nuance. If you thought the current version of identity politics is toxic, you need to

steel yourself for a world with no fences. In an existential conflict, there is only one side, and being on the wrong one means forfeiting your income, assets, and maybe even your life. Indeed, even being on the right side means that you might need to forfeit any combination of these, for the greater good.

GULLIBE OR GUILF?

As far as an overall narrative it is difficult to fault Noah for putting his finger on the themes that he does, invoking a new world order in the process. After all, it is staring us in the face, isn’t?

I can see why a in US-centric world—and let’s be honest, this is Noah’s perspective—it makes sense to articulate the world in this way. The US has the tech, money, military



power, and geographical position to take on a Russia/China axis. It can so with the confidence that success is a high-probability outcome, and that the balance of power within the west is going to shift even more decidedly towards the US, even if was always balanced in this way.

More generally, the US is the hegemon. Why should it stand by idly as the world become multi-polar? Even if that is where we are headed, it makes little sense for the US to just take such a transition on the chin.

There are two major issues with this story, however, or more aptly; two themes that are missing. The first is generic, and the second is specific to Europe.

Noah's description of the joust with China/Russia, and

whoever else decides to join their side, is riddled with pathos and optimism. I sense the same emotion in the way that the west's support for the Ukraine's heroic defence of its country is being described. To be clear, such support is warranted, and Ukraine's efforts are indeed heroic, just as much as Russia's project is unjust, callous and an overreach.

Historically, however, a dark shadow hangs over [such enthusiasm for war](#), which, when practiced by both sides of a stand-off, leads humanity down a path of death and destruction. The German national socialist Carl Schmitt's famous diagnosis of liberalist democracy is as simple as it is devastating. Liberalism is boring. Real unity, pathos and purpose comes from mobilising the national polity



against a common, external, enemy.

Addis Goldman, a US academic, notes in [a piece for the Hedgehog Review](#) that;

It's clear that we are experiencing a Carl Schmitt moment. Simply put, Schmitt has fresh appeal in a time of authoritarian populism and reactionary conservatism. As Roland Paris has pointed out, it is no surprise within this context that intellectuals are interested in the ascent of "extralegal" and "organic" sovereignty—that is, modes of governing rooted in hostility to liberal norms that embrace civilizational notions of political legitimacy. From Recep Tayyip Erdogan's Turkic-Islamic identity politics to Vladimir Putin's Russo-Christian nationalism (see Aleksandr Dugin's essay "Carl Schmitt's Five Lessons for

Russia"), and the chauvinistic demagoguery of Donald Trump, Rodrigo Duterte, and Jair Bolsonaro, "illiberalism" is on the rise—in this familiar story, as a response to unfettered globalism.

It is no surprise that China is now, according to Goldman, organising its national story around these principles.

Seen from the point of view of a Western discourse, the coming, if not escalating, conflict with Russia and China is something that the West is being forced into. I have some sympathy for this argument, especially in relation to the war in Ukraine. After all, it was Russia who decided to invade Ukraine.

Setting aside the desire in Moscow for a restoration of bygone greatness, Russia's



special operation in Ukraine first and foremost seems like an epic strategic blunder by Mr. Putin. We shouldn't downplay the fact that this is a miscalculation by a leader, that really shouldn't be making this kind of errors.

I have little time for the idea that NATO drove Russia into a corner, forcing Mr. Putin's hand. The counterfactual is that Russia would have been able to pull significant parts of Eastern Europe within its sphere of influence. This is exactly what the West is now being blamed for, by acting *opposite* to what would likely have led to such an outcome in the first place.

Nevermind the fact that populations in the vast majority of Eastern Europe want to move west, not east. The difference for an Eastern Euro-

pean country between being in the proverbial west, compared to the east, is the difference between Slovenia and Belarus. It is easy to see why populations in Eastern Europe prefer the former.

I am more sceptical about China's desire to annex Taiwan and the decision by the US to draw a red line in the sand by pledging support for Taiwan independence. This is not because I think China's claim is legitimate in any internationally recognised sense. But the South China Sea is far away from the US, and Europe. It is difficult to escape the idea that the US is looking for a fight with China over something, which while unjust isn't really its business, in the first place.

This brings us neatly back to the narrative around the



cooling relationship between the West and China/Russia; namely, that that the West is being dragged kicking and screaming into a conflict by belligerent and international rule-flouting actions by China and Russia.

Perhaps, but this requires rewriting at least 20 years of economic development and history in which Western governments, corporations and consumers have been absolutely fine reaping the economic rewards from the free flow of capital and goods between the east and the west.

The eagerness with which some politicians and commentators are driving at an economic and military confrontation with China and Russia seems like writing a cheque that the political economy isn't able to cash.

The proponents of an existential clash with Russia and China are either gullible about the economic and political consequences of such a project, or they're guilefully presenting it by not being honest about the end game. Both of these strategies will run into significant problems once the true cost of such a project dawns on people.

TALES FROM EUROPE

You shouldn't interpret the reservations voiced above as evidence of softness on my part, or reluctance to leverage hard power, if needed. As a European, I am painfully aware of the loss of agency that comes from not being able to wield hard power. **Europe's, or perhaps more aptly Germany's mistake, was not the purchase of Russian energy, but the**



failure to build up a credible autonomous military capability in the 2000s. Imagine the additional degrees of freedom that Germany would have with a strong military not to mention an independent nuclear deterrent.

First, it would offer Berlin a more autonomous foreign policy, especially with respect to its dependence on a US policy line. Second, it would allow Germany, and Europe, to stare down Mr. Putin. This is because regardless of the economic relationship he enjoys with his counterpart, Mr. Putin only respects one thing; hard power. You will find no stronger proponent of an independent and strong European military than me.

Up until recently, no one wanted this to happen. Russia

and China are fine with a militarily timid Europe, but so, I'd argue, is the US. Only the most naïve of observers interpret the occasional moaning in Washington about European NATO members failing to live up to the 2% commitment as a sign that the US is unable or unwilling to pull the weight itself, if it has to.

The idea that Mr. Trump kicked up a fuss in NATO because he wanted more burden-sharing via the creation of a stronger European military is laughable. The US president came to Europe like a mafia asking for protection money, and with a deal; don't buy Russian energy, buy ours. If you don't, you might find that our commitment to your security will fade. So far, so good.



Finally, until recently, it seemed as if Europe didn't want a strong military either, but this has now changed with the war in Ukraine. Europe is going to spend a significant amount of resources to build up its military power in the next decade. It will be interesting to see whether this comes with a corresponding political doctrine, nevermind a military one.

In the meantime, the elephant in the room is that it is absolutely not in Europe's interest to enter an existential contest with Russia and China, at this time. It is in fact possible that Europe would be fine in a multipolar world with the power shifting to the East, even if its long-time ally and protector across the Atlantic pond would not.

The cost of a reversal in the international economic order would hit Europe disproportionately hard, compared to the US. If Europeans are unlucky, they will also end up hosting significant military action on their continent, something which history suggests is devastating.

The war in Ukraine is a grim glimpse to what such a situation could look like, if writ large. Europe's relationship with Russia is now reduced to daily briefs on the successful engagement of the US produced HIMARS rocket system which, for the moment, seems to have offered Ukrainian ground forces a key tool to answer Russian artillery barrages in kind.

By contrast, all diplomatic and economic contact with Russia has been severed,



with talks now underway to refuse Russians entry to Europe altogether. At some point, someone in Europe has to ask whether this is a stable equilibrium? And if it isn't, at what point will attempts be made to restore some semblance? The only alternative is that Europe is now all-in on breaking Russia militarily, politically and economically, potentially leaving Mr. Putin isolated in his dacha with nothing to do but caress the red button. [Is this a stable equilibrium](#), for Europe, for Ukraine, for the world?

All the while, Europe is already incurring enormous economic cost from having to rethink its energy infrastructure overnight. This, in turn, is happening in the context of a tsunami of revisionist claims that buying Russian energy was always a hope-

fully naïve economic strategy. If only Europeans had listened to its Anglo-Saxon allies, everything would have been so much better.

THE CENTRE AS AN IDEAL

The story above is one in which the gloves have come off, and in which a centrist and multipolar compromise is dismissed as either soft or, in the parlance of Carl Schmitt, an expression of cowardice.

The question is; can the centre respond to such an indictment? I think it can. Antón Barba-Kay, a US associate professor of philosophy, [eloquently presents the importance and legitimacy of the political centre](#):

“The political myth of the center consisted in the recogni-



tion that disagreement, pluralism, and multilateralism were valuable to democratic politics—not for their own sake, but as expressions of a single underlying civic care. It was this situated care that afforded us the conviction that disagreement was meaningful, that negotiation and deliberation served a common good, that having it all our way was not for the best. The center was therefore a commitment to a good that was notionally distinct from the vindication of one’s own political views, a second political eye lending us political depth-perception. It was the implicit hub through which the different spokes of liberalism came together to realize common, practical ends.”

(...)

“The center’s greatest virtue

was also its greatest liability: It was an insipid notion, not uplifting in itself. Yet, precisely by virtue of being preferred by no one in particular, it also moderated all positions by resolving them into a form in which they could communicate with each other. Only to the extent that there was a center could there be a principled difference between right and left at all. (It no more makes sense to think of Stalin as a figure of “the left” than Hitler as of “the right.”) Absent the center, there can be no two “sides” to any argument, only splintered confrontations between friend and enemy. The center’s critics, from Carl Schmitt to Robin DiAngelo, will assert that it was never anything more than that—an atmosphere of hypocritical hot air promoting only certain interests.”



TO WAR

In a domestic US political context, in which Antón Barba-Kay is writing, the search for a centre is an attempt to avoid the extremes represented by Hilary Clinton's deplorables and the January 6th riots. In a geopolitical context, the centre is the difference between bi- and multilateral negotiations and nuclear war, in the extreme. You would think that we'd be more careful jettisoning it.

Whatever merit a geopolitical centre has, readers should be under no illusion of my personal stance. If the proverbial fence becomes untenable, I, and my fellow Europeans, have no choice but to side with the US as we face off a China/Russia axis. In doing

so, however, we should be neither naïve nor dishonest.

This is a contest in which furnishing Ukraine with modern weaponry and committing resources to [the basic training of Ukrainian cannon fodder](#) will not be enough.

Breaking China and Russia, economically, militarily and politically, will require a significant up-front cost in terms economic prosperity and lives. It is only by realising the political compromise and solution that such a path forfeits that we can openly admit to what inevitably must come next. The West is not yet ready to see this, but the conclusion, if we continue on this path, is inevitable; to war.